

**RAYMON B. HARVEY, P.A.**

# SPECIAL NEEDS TRUSTS FOR LITIGATION PURPOSES

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# GETTING STARTED

During the course of a personal injury lawsuit, little attention is given to planning for how the settlement or judgment proceeds will be managed. This booklet is intended to explain how Litigation Special Needs Trusts can provide both reliable asset management and continued eligibility for government benefits such as Supplemental Security Income (SSI) and Medicaid. The creation of a special needs trust to hold proceeds from a lawsuit is essential if:

If a Litigation Special Needs Trust preserves litigation proceeds to provide for the plaintiff's wellbeing as well as provide reliable asset management and advocacy for the trust plaintiff, the Trust may be an appropriate option.

- Sudden availability of lump sum litigation awards will prevent a disabled individual from qualifying for essential public benefits.
- Holding the litigation funds in a conservatorship or guardianship account will cause loss of eligibility for essential public benefits.
- The award will be exhausted quickly in order to meet medical expenses which would otherwise be payable by Medicaid, and the recipient has no other means of support to meet his or her needs.

## WHAT IS A SPECIAL NEEDS TRUST?

A properly designed and administered Special Needs Trust will supplement a disabled person's government benefits, without jeopardizing eligibility for government aid, particularly SSI and Medicaid.

### Is a Litigation Special Needs Trust appropriate in my situation?

Litigation Special Needs Trusts are an effective management tool for litigation proceeds when preservation of benefits is, or in the future may be, essential to the wellbeing of the settling party. Funds held in a properly drafted Special Needs Trust will not count as a resource for purposes of qualifying for SSI or Medicaid, it is very important to strike a balance between the need to maintain public benefits and the burden of the restrictions inherent in Special Needs Trusts.

The chief restriction of a Special Needs Trust is that the disabled person (the "beneficiary" of the trust) loses control of the funds. Moreover, cash cannot be given directly to the beneficiary. Instead the Trustee must pay for services and goods directly. The burdensomeness of these restrictions can be minimized with the use of trustees and advisors who are trained and experienced in managing Special Needs Trusts.

If a Litigation Special Needs Trust will serve to protect the litigation proceeds to provide for the beneficiary's well-being, as well as provide reliable asset management and advocacy for the trust beneficiary, a Litigation Special Needs Trust may be an appropriate option.

# SPECIAL NEEDS TRUST BASICS

## LITIGATION SPECIAL NEEDS TRUSTS AND ESTATE PLANNING SPECIAL NEEDS TRUSTS

There are two types of Special Needs Trusts, the distinction is dependent upon the source of the funds held by the trust.

### SPECIAL NEEDS TRUSTS FOR ESTATE PLANNING

A Special Needs Trust funded through an estate plan is referred to by the Social Security Administration as a "third party trust." These trusts are established to allow family and friends to make gifts for the benefit of a SSI or Medicaid recipient without triggering a disqualification for benefits. A 3rd Party Special Needs Trust has fewer restrictions than a Litigation Special Needs Trust, the most important of which is that the State Medicaid agency does not have a right to be reimbursed when the beneficiary dies.

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A 3rd Party Special Needs Trust allows family and friends to make gifts for the benefit of a SSI or Medicaid recipient with no requirement that the government be reimbursed upon the disabled beneficiary's death.

### SPECIAL NEEDS TRUSTS FOR LITIGATION PROCEEDS

The law authorizes Litigation Special Needs Trusts and it restricts who can establish the trust and requires that, upon the death of the beneficiary, Medicaid must be reimbursed for any expenditures paid on behalf of the beneficiary. Unlike trusts used for estate planning purposes, Litigation Special Needs Trust assets must be used solely for the disabled beneficiary and gifts to third parties are prohibited. These trusts are most commonly used to preserve personal injury settlements of disabled persons, but can also be funded by inheritances left directly to a beneficiary. These trusts have been used for many years, but Litigation Special Needs Trusts established as of January 2001 must comply with the Foster Care Independence Act of 1999.

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A Litigation Special Needs Trust requires that upon the death of the beneficiary, Medicaid must be reimbursed for any expenditures Medicaid has made on the beneficiary's behalf.

# FEDERAL AND STATE LAW

## FEDERAL LAW

Litigation Special Needs Trusts are authorized by Federal law, at 42 USC §1396p (d)(4)(A). The statute requires that in order to maintain eligibility for SSI and Medicaid, a trust containing the assets of a disabled beneficiary under the age of 65 must be established by a parent, grandparent, legal guardian or a court. In addition, the trust must have a provision that upon the death of the beneficiary, Medicaid will be reimbursed for any benefits received by the beneficiary.

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**Federal Law:** A Litigation Special Needs Trust must

1. Be established by a parent, grandparent, legal guardian or the court,
2. Have a provision that upon the death of the beneficiary, Medicaid must be reimbursed for any benefits received by the beneficiary, and
3. Have a beneficiary under the age of 65



# MEDICAID AND MEDICARE LIENS

## LIENS STEMMING FROM THE INJURY

Under both Federal and State law, any payments made by Medicaid or Medicare to treat the injury which gave rise to the lawsuit, must be reimbursed to the state before the funds can be paid to a trust, or to the plaintiff directly. Under current law, Medicaid will accept less than the full amount of its lien. The amount of the reduction will often depend on the circumstances of the particular case.

Under both Federal and State Law, any payments made by Medicaid or Medicare to treat the injury which gave rise to the lawsuit, must be reimbursed to the state before the funds can be paid to a trust, or to the plaintiff directly.

## POST-DEATH LIENS ON THE TRUST ASSETS

The State also has a right to reimbursement from the Litigation Special Needs Trust, but only after the beneficiary's death. The amount of the lien is dependent on how much Medicaid the beneficiary has received during his or her lifetime. Essentially, the beneficiary makes a bargain with the government that will continue benefits during his or her lifetime in return for the promise to repay Medicaid from the remaining trust assets upon death. Despite the imposition of this lien, a Litigation Special Needs Trust provides significant asset protection for beneficiaries because

Both Federal and State law require the Medicaid Payback Trust be subject to a second lien, upon the death of the beneficiary, for any Medicaid used by the beneficiary.

- Medicaid generally pays less for medical services than what an individual would be charged in the open market.
- Medicaid does not charge interest on the lien. Therefore the amount subject to the lien is, in essence, an interest free loan.

If all of the trust assets are spent prior to the death of the beneficiary, the State cannot recover on its lien from the trust. If the beneficiary has other assets outside of the trust they may be subject to the lien. This risk may be minimized with advice from an attorney familiar with Medicaid recovery laws.



# TAXES, Structured Settlement Annuities and Special Needs

## TAXATION OF A PERSONAL INJURY AWARD

Under current IRS law, most payments received as the result of a personal injury suit are not counted as gross income. This exclusion applies to both one-time payments and payments made over a period of time. However, any portion of the award that is attributable to lost wages, or punitive damages is subject to taxation.

Most payments received as the result of a personal injury suit are not counted as taxable income, but any portion of the award that is attributable to lost wages, or punitive damages is subject to taxation.

## What is a Structured Settlement Annuity?

A structured settlement is the payment of money for a personal injury claim where all or part of the settlement is paid out over a period of time. These "periodic payments" are funded through an annuity purchased from a life insurance company or Treasury Bond Trusts.

## Taxation of Annuity payments

A properly designed structured settlement of personal injury claims will produce tax-free income to the recipient. Certain guidelines must be met. Annuity payments made to an estate (after the beneficiary's death) are also income tax-free, but may be subject to the estate tax.

## Problems with structured settlement annuities

**Taxes** The benefit of income tax-free payments from the annuity is illusory in many cases since most Special Needs Trust expenditures are tax deductible. For example, if all the trust income is used to pay for attendant care and medical supplies for the beneficiary, the trust has no taxable income.

**Flexibility** If the litigation proceeds are used to purchase an annuity, there are no funds available to pay for the unexpected expense of a change in circumstance.

**Limited Management Options** Most banks and trust departments have a minimum amount of trust assets that they will agree to manage before they will accept a LSNT account. Typically, this amount has to be greater than \$250,000, although some trust departments have a much higher minimum.

## HOW CAN YOU SELECT THE RIGHT OPTION?

It is often helpful to have a Life Care Plan created in order to make an informed decision on whether a structured annuity is appropriate in your case.

# Selection of the Trustee

Under Federal law, a Special Needs Trust is not considered an available resource for benefits purposes if the Trustee has complete discretion as to time, place, purpose and amount of all distributions from the trust. Always keep in mind that the Special Needs Trust beneficiary can have no control over the funds. Therefore, selection of a Trustee is crucial to successful administration of the trust.

The best-managed trusts are usually managed by a team of family and friends, private and corporate fiduciaries, tax and financial advisors, and care managers.

The ideal Trustee should:

- Understand public benefits
- Use his or her discretion for the best interests of the beneficiary
- Conform all investments to all statutory fiduciary requirements
- Understands taxes
- Keep perfect books
- Carry insurance, be bondable or have deep pockets
- Be able to identify second rate services or abuse
- Be immortal

The fact is that no single person meets all the requirements of the perfect Trustee. Trustee duties should be divided between several entities or persons. A system of checks and balances can be built into the trust administration by dividing the duties into three categories.

- Financial (investment, management and disbursement of assets)
- Personal (including advocacy, care management, benefits)
- Accountability

The Raymon B. Harvey Law Firm can assist you in designing the best management system for you and can help you locate professionals to fill those roles.

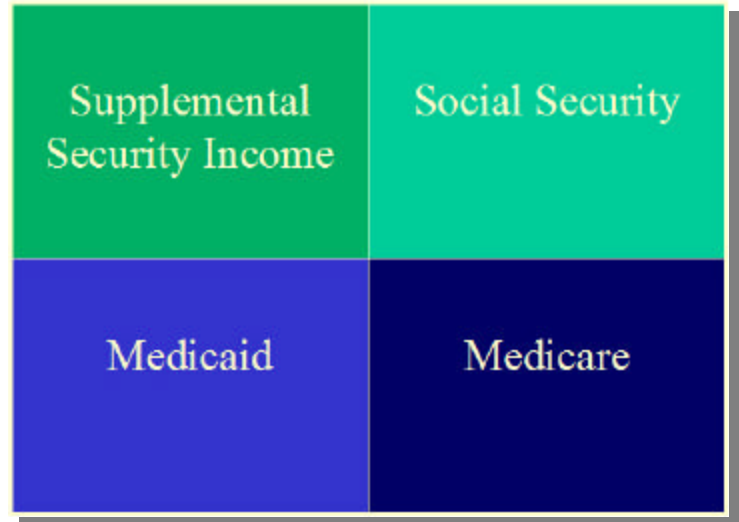
Well-managed trusts use a team approach, combining the respective skills of family and friends, private and corporate fiduciaries, tax and financial advisors and care managers. The Raymon B. Harvey Law Firm can assist you in designing the best management system for you and can help you locate professionals to fill those roles.

# BENEFIT BASICS

## Public Benefits in General

Public benefit programs can be divided into two categories, programs based upon need (or needs based programs) and programs based upon entitlements.

The most common needs based programs are Supplemental Security Income (SSI), which is a cash assistance program, and Medicaid, which is a medical assistance program. Eligibility for needs-based benefits is dependent upon showing sufficient evidence of a disability and limited income and resources.



The most common entitlement programs are Social Security Disability, which is a cash assistance program and Medicare, which is a medical assistance program. The entitlement programs have no income or resource requirements. Eligibility is based on adequate evidence of a disability and sufficient contribution into the system.

## Supplemental Security Income (SSI)

SSI is a federal program administered by the States and is intended to pay for the beneficiary's food, clothing and shelter. In Arkansas, so long as the beneficiary is receiving at least one dollar of SSI eligibility, Medicaid is automatic. SSI is a needs-based program that has income and resource limitations. To remain eligible for SSI, the recipient can have no more than \$2,000 in cash in his or her own name at the beginning of any calendar month. In addition, the SSI recipient can also own the following assets and remain eligible.

- A residence of any value that the beneficiary lives in
- \$2,000 in household goods
- One automobile of any value
- Any item related to the beneficiary's disability
- A term life insurance policy or burial plot worth any amount

Any distributions of cash made directly to a SSI beneficiary will cause a dollar for dollar reduction in benefits. If the trust pays directly for services or exempt resources there will be no reduction in SSI benefits. A Special Needs Trust is specifically drafted so that the assets of the trust are not counted for SSI or Medicaid, but a skilled trustee is necessary so that distributions from the trust do not cause a loss of eligibility.

## Medicaid

Eligibility for Medicaid is often the most important benefits program. This is because in many cases the beneficiary will not qualify for private medical insurance or the coverage under Medicare is inadequate. Medicaid provides

- “medically necessary” durable medical equipment,
- medication,
- medical services and treatments,
- hospitalization including nursing care,
- psychiatric care, dental care, and
- long term nursing care.

Medicaid is often the most important benefits program if the beneficiary will not qualify for private medical insurance or coverage under Medicare is inadequate

Medicaid eligibility is either met by qualifying for SSI, or by meeting income and resource restrictions similar to the SSI program.

## SOCIAL SECURITY DISABILITY

Social Security Disability is an entitlement program that employers and employees pay for with Social Security taxes. Eligibility is based on work history and the amount of benefits is based on earnings. The beneficiary's resources do not reduce benefits. Income the beneficiary receives from investments and gifts from others do not affect eligibility, but if the beneficiary's earnings exceed more than \$700 gross per month, the beneficiary is presumed to no longer be disabled.

## Medicare

Medicare is a federal health insurance program for people over 65 and people under 65 who have been receiving Social Security based on disability for two or more years. Persons can be eligible for both Medicare and Medicaid. Medicare does not cover medications, dental care or long-term hospitalization.



# COMMON QUESTIONS ABOUT SPECIAL NEEDS TRUSTS



## General Questions

### **Should Every Disabled Person Have A Litigation Special Needs Trust?**

No. While a trust of this sort can enhance the quality of life of a person with disabilities, all other options should be considered. The Raymon B. Harvey Law Firm can work with you to explore the options and select the right plan for your situation.

### **Must the Beneficiary Always Remain on Benefits?**

No. Ideally, the trust will assist a disabled person to become independent. The trust provides that the Trustee may terminate the trust. In this event, Medicaid may require repayment from any remaining trust assets for services provided while the trust was in effect.

## Trustee

### **Can The Disabled Person Serve As Trustee?**

No. The premise of a Special Needs Trust is that the disabled beneficiary does not have access to trust assets. The assets of the trust are for the disabled person's benefit, however he or she has no power or authority to direct trust disbursements.

### **Who Can Serve As Trustee?**

The choice of a Trustee is crucial when establishing a Special Needs Trust. Technically, the only restriction is that neither the beneficiary nor the beneficiary's agent may serve as Trustee. For practical purposes, it is almost always preferable that the Trustee be a professional who is familiar with the administration of Special Needs Trusts.

## Distributions

### **What Can The Trust Pay For?**

Distributions should be made for needs such as transportation, education, telephone, medications and treatment not paid for by Medicaid, as well as attendant, and any other items to enhance the quality of life of the disabled person. If distributions are made for food, clothing, shelter or medical care or services provided by Medicaid this would trigger a slight reduction in benefits.

### **I Read Somewhere That A Special Needs Trust Can Never Pay For Food, Clothing, or Shelter. Is That True?**

The Special Needs Trust can pay for food, clothing, or shelter. If trust funds are used to pay for these items, the beneficiary's SSI will be reduced.

### **Can The Trust Make Gifts To Someone Other Than The Beneficiary?**

No. Federal and State laws require that all distributions from a Litigation Special Needs Trusts be for the sole benefit of the beneficiary.

## Residential

### Can the Trust Own a House?

The trust may own a residence. Home ownership should be discussed and planned for early in the process. However, in some circumstances it is preferable not to have the home in the trust because it may subject the home to a lien upon the beneficiary's death. If the beneficiary is competent, then it may be preferable for the beneficiary to own the home in their own name or in a living trust.

### May The Trust Pay The Beneficiary's Rent?

In order to allow the trustee the authority to pay rent from the special needs trust, the trustee must be given authority to make distributions to the landlord even if there is a slight reduction in benefits. Many trusts written by inexperienced attorneys are overly restrictive and never allow a distribution that could cause even a slight reduction in benefits.

**For example**, if the beneficiary of a Special Needs Trust has an apartment with rent of \$1,500 a month and the trustee pays the landlord directly, the beneficiary's SSI would be reduced by \$201.66.

## Caregivers

### Can Payments Be Made To Family Caregivers?

In many circumstances, family members continue to provide care for the disabled beneficiary. It is not unusual for the Special Needs Trust to pay the family caregiver for their services. Care must be given though when paying family members. Any salary to the family member should not be greater than what would be paid to a non-family member with similar qualifications.

## The Medicaid Lien

### Is There Interest on the Lien Upon the Beneficiary's Death?

No. Even though Medicaid must be repaid for services provided to the beneficiary, there is no interest on the lien amount. This amounts to an interest free loan. Additionally, Medicaid pays less for services compared to services paid privately.

### Are SSI Payments Subject to the Lien Upon the Beneficiary's Death?

No. Only Medicaid must be repaid by the trust. Payments made by SSI, Social Security payments or Medicare are not required to be repaid upon the death or earlier termination of the trust..



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