



“Special Needs Trusts—Addressing Some Common Misconceptions”

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As more practitioners become aware of the value of Special Needs Trusts authorized under the Social Security Act and Department of Welfare regulations, some pieces of misinformation have also been spread about the legal community regarding such Trusts which sometimes discourage the proper use of Special Needs Trust planning. A few of these misconceptions and the accurate response to them follow.

1. "My client has already signed a release to resolve the case, and therefore it is too late to create a Special Needs Trust."

The signing of a release authorizing the resolution of a case does not preclude the creation of a Special Needs Trust on behalf of the disabled plaintiff, and will not affect the validity of a Trust when created. However, as discussed below, the personal injury attorney should be careful in managing the receipt and distribution of settlement monies in a manner which does not jeopardize the public benefits (most typically Medical Assistance and Supplemental Security Income) of the disabled plaintiff.

2. "Once the settlement monies are in the personal injury attorney's escrow account, it is too late to create a Special Needs Trust."

The receipt of monies by the personal injury attorney does not, in and of itself, disqualify a disabled beneficiary from receiving the benefits of a Special Needs Trust. Unless the personal injury attorney holds the monies in escrow for an inordinate length of time (more than a few months) the relevant public agencies (the Department of Public Welfare for Medical Assistance, and the Social Security Administration for SSI) will not impute receipt of the money to the disabled plaintiff, but rather generally focus on actual receipt of the money by the disabled individual as the trigger point for recalculating eligibility for public benefits. However, if the personal injury attorney holds the settlement monies for more than a few months, the risk increases that the relevant public agencies could claim that the disabled individual has constructive receipt of the settlement proceeds. In such circumstances, it is important to promptly create a Special Needs Trust to receive the money or to undertake a rapid "spend-down" of the settlement monies in order to reduce or eliminate disqualification for public benefits. (See discussion below).

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3. "Once the personal injury monies have been distributed to the client, it is too late to create a Special Needs Trust, especially if the client has been disqualified for public benefits."

Even where the client has received the personal injury proceeds and has been disqualified for public benefits, a Special Needs Trust can nonetheless be created to receive the monies and allow the client to become re-eligible for these benefits. Once again, however, speed is critical, as the longer the client waits to create the Special Needs Trust, the longer the period of ineligibility will last. However, unlike transfers to other types of Trusts, there is no "look-back" period which would create future ineligibility where the monies are properly placed into a Special Needs Trust. Where a Special Needs Trust is used to receive settlement proceeds on behalf of a disabled plaintiff, re-eligibility for Medical Assistance and SSI is immediate, although bureaucratic processing of the application can take several months. Consequently, it is always highly preferable to create a Special Needs Trust prior to distributing settlement proceeds to a disabled client.

4. "A structured settlement cannot be used in conjunction with a Special Needs Trust."

To the contrary, structured settlements are routinely used in resolving personal injury claims on behalf of individuals who receive public benefits. However, it is essential the structured settlement identify the Special Needs Trust as the recipient of each future payment, and not the individual disabled plaintiff.

5. "Where a Special Needs Trust is used, it is best to put most of the settlement proceeds into a structured settlement which will flow into the Special Needs Trust."

While structured settlements can, and often are, be used to fund a Special Needs Trust, it is important for three reasons that at least some significant portion of the settlement be included as a lump sum to initially fund the Special Needs Trust. First, if the personal injury settlement or verdict is large, federal estate tax could be due at the death of the beneficiary on the entire personal injury settlement proceeds. If the substantial majority of the structured settlement proceeds have not yet been received by the Trust (e.g. where the disabled beneficiary dies soon after the creation of the structured settlement with future payments guaranteed), the Special Needs Trust may not have enough liquid assets to pay the federal estate tax within nine months after the date of death.

Second, many of the best corporate fiduciaries are unwilling to handle a Special Needs Trust unless the Trust is funded with a substantial lump sum (often at least \$250,000.00 to \$500,000.00) at the outset.

Third, if the disabled beneficiary is a minor or incapacitated person, principal of the trust can only be used with court approval, and therefore adequate funding is necessary to generate sufficient income to meet the special needs of the beneficiary.

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6. "Where a settlement is small (less than \$50,000.00), the client should not use a Special Needs Trust or other planning technique, but should simply allow himself (herself) to become disqualified until the settlement money is gone."

This perspective is virtually always incorrect. First, it may be possible to undertake an immediate (i.e., within the month of receipt of the settlement monies) "spend-down" whereby the disabled beneficiary expends all of the settlement monies for goods or services at fair market value (it is never advisable to give the money away). If the disabled beneficiary can spend all of the settlement monies for fair market value during the month of receipt of the settlement, there should be no disqualification for public benefits beyond the month of receipt, and public agencies usually do not disqualify even for that month. For example, if the disabled beneficiary can spend the settlement proceeds on the purchase of a home, car, furniture, electronic equipment, clothing, prepaid funeral expense, prepaid taxes, utility bills, or any other purchase for fair market value, no penalty is exacted by the Social Security Administration or the Department of Public Welfare. Moreover, for valid, documented debts, these agencies will generally permit repayment of these debts which validly existed prior to the receipt of the settlement monies without penalty.

Moreover, if a rapid "spend-down" is not feasible due to the circumstances of the disabled plaintiff, a Special Needs Trust still can be used, as many drafters of such Trusts (the author included) will draft such Trusts at reduced fees for smaller settlements; I have even created Special Needs Trusts for a small fee in unique circumstances for settlements under \$10,000.00 where no reasonable alternative existed.

Finally, some local disability organizations maintain "Pooled" Trusts which will accept smaller settlements; the only disadvantages to such Pooled Trusts are (1) the "one-size-fits-all" Master Trust Agreements which are used by such organizations and (2) the inability to identify a contingent beneficiary for any residuary left after the death of the beneficiary, as Pooled Trusts generally require any remaining proceeds to remain in the Trust for the benefit of other disabled beneficiaries.

We never recommend to individuals to allow themselves to be disqualified for public benefits and to simply reapply in the future. Such individuals almost never are able to purchase health insurance in the open market, and therefore would be left without health insurance until they spent the money down below the \$2,000.00 limit for public benefits. The requalification process can be burdensome and time-consuming. It is simply never necessary to disqualify disabled individuals for the public benefits of Medical Assistance and SSI.

7. "Rather than continuing to accept Medical Assistance, the client will pay for health insurance or for health services out of pocket from the settlement proceeds."

Most individuals who have received Medical Assistance in the past are disabled to the point that no private health insurer will cover that individual. Most Medical Assistance recipients are also unable to access any group plan due to an inability to work, age or other disqualifying circumstance. Moreover, the costs of "private pay" health services are generally astronomical—

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four to ten times the rates paid by private insurers or the Medical Assistance program. Only the most highly funded Special Needs Trust can withstand private payment of health costs on any extended or regular basis.

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