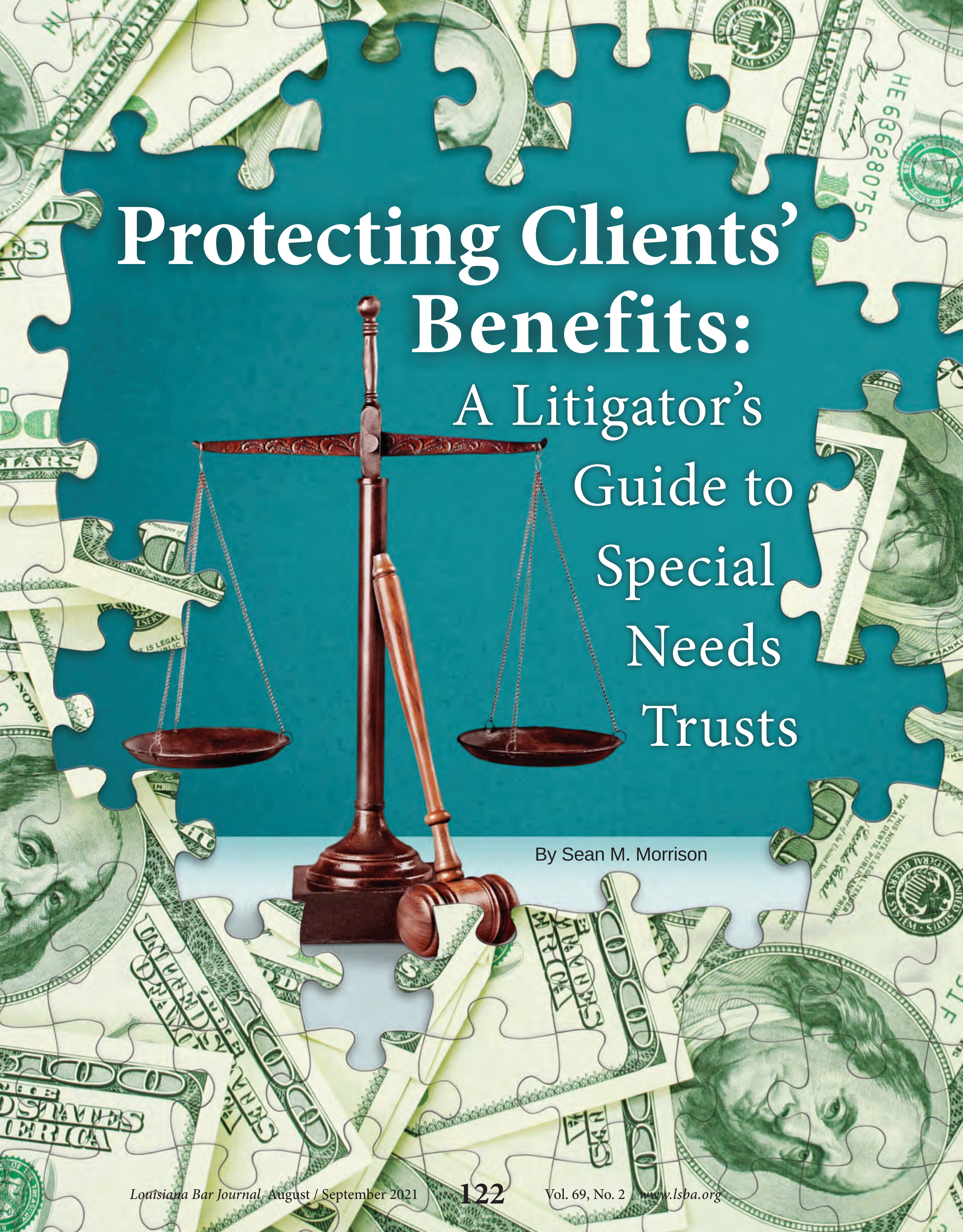
Protecting Clients' Benefits:

A Litigator's Guide to Special Needs Trusts



By Sean M. Morrison

Clients are complex. It's one thing to navigate the legal system. It's another to understand the complexities of your clients' lives. But as attorneys, we have an ethical obligation to work in their best interests. Clients with special needs or disabilities are particularly vulnerable and often introduce litigators to the complexities of government benefits laws. This article explores the pitfalls of managing a client's reliance on government benefits in the context of litigation, and offers some tools for litigators in planning for their settlements and judgments.

The Terrible Tragedy of Tom Pettiette

Tom Pettiette was a seasoned trial attorney in Texas. He recognized a good case when he saw one. Christina Grillo and her mother brought him a good case. Christina had been born with severe brain damage, quadriplegia, blindness and seizures allegedly due to the doctor's negligence at her birth. Tom helped Christina and her mother sue the hospital.

Christina's lifecare plan said she would need about $20 million in medical care over the course of her life. Tom used that to secure a $1.2 million structured settlement offer from the hospital. But Tom knew he could do better for the family. He pushed and eventually the hospital agreed to a $2.5 million lump-sum settlement — more than double the original offer. It was a big win.

However, as personal injury attorneys know, clients spend their settlements quickly. A study of accident victims receiving settlements showed that 25-30% completely spent their settlements within two months, and 90% are fully spent within five years.[1]

The Grillos were no different. Tom's settlement disqualified Christina for Medicaid. Instead, the family had to pay medical costs out-of-pocket at the highest billing rate (called "fee-for-service") rather than the negotiated or free rates offered by Medicaid. The money Tom had won for his client was gone in just a few years and his win became a liability.

Christina's family sued Tom for malpractice, claiming he did not properly advise them about how structured settlements and special needs trusts could be used to help them. Ultimately, Tom settled the case for $4.1 million.[2]

This is not a hypothetical and these cases continue to happen. Your malpractice insurance carrier is certainly aware of these risks. Winning a great settlement for your client is no longer enough. It is vital to be knowledgeable about settlement methods that can protect your client, especially if they receive government benefits.

The Pitfalls of Means-Tested Benefits

For many people with special needs or disabilities, government assistance is crucial. Often, housing, medical care and specialized education is only available with assistance. While there are myriad government benefit programs, both at the state and federal level, litigation proceeds tend to impact "means-tested" benefits.

Eligibility for various benefits programs varies greatly, but these programs can generally be broken down into two categories: means-tested and universal benefits. Means-tested programs are those which stipulate income or asset limits to those who are eligible. Examples of means-tested programs include Medicaid, Supplemental Security Income (SSI), SNAP (food stamps) and Federally Assisted Housing (Section 8). Universal programs are all the rest, such as Social Security retirement, SSDI and Medicare.

The two programs of most consequence for litigators are Medicaid and SSI. For clients with special needs or disabilities, losing Medicaid essentially means they lose their healthcare. SSI benefits are modest, but the program is very important because a person eligible for SSI is automatically eligible for most other means-tested benefits, including Medicaid. Conversely, losing SSI eligibility can mean clients also lose their healthcare, Section 8 housing, food stamps, and so on.

SSI is administered by the Social Security Administration (but is not the same thing as Social Security retirement or SSDI). To be eligible for SSI, the person must be disabled (using the same criteria as Social Security disability), have assets less than $2,000 (with some exceptions, including a house and car)[3] and a low monthly income.[4] SSI provides only relatively minor benefits. Currently, in Louisiana, it only pays a maximum of $794 per month for a single individual.[5]

Due to the asset limits, windfalls can be particularly dangerous. A sudden influx of income that pushes assets above the $2,000 limit can eliminate many benefits. This is common when a person receives an inheritance or gift or wins a judgment or settlement. Fortunately, we have legal tools to protect clients from losing their benefits due to windfalls such as these.

Special Needs Trust Overview

Of the tools attorneys can use to protect their clients' benefits, the most common and most powerful is the special needs trust. Assets placed in a special needs trust do not count as available assets for purposes of means-tested benefits programs like SSI and Medicaid. Special needs trusts were created in 42 U.S.C. § 1396p(d)(4) to provide protections for individuals with special needs so that their healthcare needs did not force them to be either independently wealthy or stuck in poverty.

Like all trusts, special needs trusts have a settlor, a trustee and a beneficiary. Special needs trusts must be irrevocable, for the sole benefit of the beneficiary, and the beneficiary cannot be the trustee. Typically, the trustee is institutional, or somebody trained in managing special needs trusts due to their unique requirements.

Special needs trusts can pay only for certain expenses. While the list is quite extensive, they are generally barred from paying for food, housing or medical expenses already covered by Medicaid — basically anything that the government benefits are already providing.

There are three types of special needs trusts — first-party, third-party and pooled trusts. A first-party special needs trust is created by the beneficiary's assets and he or she must be under 65 years old when the trust is created. This is the most common in the context of litigation because a settlement or judgment is considered the client's funds.

A third-party trust is funded by someone other than the beneficiary. This is common in estate planning, where a parent or grandparent bequeaths to the trust rather than to the child. The primary difference between the first- and third-party is that in a first-party trust, on the beneficiary's death, the remainder of the trust assets must first reimburse Medicaid for any healthcare expenses from the beneficiary's life. If the beneficiary had significant medical needs, there is usually nothing left for the contingent beneficiaries.

Finally, a pooled trust is managed by a special nonprofit organization which manages many of these trusts at the same time. The remainder of the trust at the child's death is left to the organization's pooled fund to help others.

Where Special Needs Trusts Fit in Litigation

Special needs trusts should be created during litigation to avoid interruptions in benefits. Even funds sitting in your IOLTA account are considered to be in the client's "constructive receipt" and will count against their eligibility. That is why planning must begin before the settlement agreement or judgment is in place.

Plaintiffs' attorneys should ensure that the settlement agreement states that the proceeds be paid to the trustee of the special needs trust rather than to the client directly. In the case of a judgment, the court must be aware of the need for a special needs trust so that the damages can be awarded accordingly. While it is no longer required that the court establish the trust, it is beneficial to do so. It adds legitimacy to the trust, and this may help satisfy SSA or Medicaid scrutiny.

Early planning is better. Medicaid may place a lien on lawsuits which takes before attorney fees, but this lien affects only injuries that Medicaid has paid for. There is often room for negotiation if discussions are begun early.

Even late planning is not too late. Once the client is in actual or constructive possession of the settlement funds, his/her benefits will be impacted. But a trust can still be established. In those situations, it is best to contact a special needs planning attorney right away to help mitigate the impacts.

Other Planning Tools

Special needs trusts are not always appropriate. The cost of establishing a special needs trust and the expenses of management may not make sense for smaller settlements. There is no specific dollar amount that would act as a cutoff, though anything under $15,000 might be put in an ABLE Account (see below). Conversely, a settlement large enough to cover both medical expenses and a satisfying lifestyle may not warrant the restrictions of a special needs trust.

While special needs trusts are the most powerful and useful of the tools, they are not the only protection for benefits. By understanding the myriad regulations involving the individual benefits, combined with financial planning and other legal tools, it's possible to create spending and savings plans that meet your clients' goals without jeopardizing their benefits.

Spend-Down Options

One option is to simply spend the money before it impacts benefits. SSI is based on the client's assets at a particular time each month. But there can be variation within the month. If a client gains a windfall, it is possible to spend down the money on qualified expenses before the review date. However, the spend-down technique requires planning because there are limits on how the money can be used. A common misstep is to gift the money to family members, which causes a penalty period that counts against the benefits.

Wheelchair-accessible vehicles, ramps for the house or accessible bathrooms have high price tags and can spend down funds very quickly. Other permissible expenditures include prepaid funeral expenses, paying off debt and mortgages, education and entertainment expenses, vacations and best of all — attorney fees.

ABLE Accounts

The pseudo-alternative to special needs trusts are ABLE accounts. These relatively new tools were introduced in 2014 through the Achieving a Better Life Experience Act. They operate similarly to 529 college savings accounts (they are 529A accounts). In Louisiana, they are managed by the Louisiana Office of Student Financial Assistance.[6] Originally, they were designed as an alternative to special needs trusts. However, the restrictions on the accounts have led them to be far less utilized than originally intended.

Like a special needs trust, funds in ABLE accounts do not count as assets for purposes of SSI and Medicaid eligibility and have similar spending restrictions. But there is no trustee, so the beneficiary can manage his/her own account. This is very important to those who have the capacity to manage their money, but still rely on benefits.

The downside is the ABLE account restrictions. First, the disability must have occurred before the client turned 26 years old to qualify. Second, the contribution limit is just $15,000 per year, and the account can hold a maximum of only $100,000. Finally, like the first-party special needs trust, any funds left over after the beneficiary's death are subject to Medicaid reimbursement.

Pooled Trusts

As described above, pooled special needs trusts are another tool that can be used. Because pooled trusts are already established, they have significantly decreased set-up costs. Some examples of organizations that manage pooled special needs trusts in Louisiana are the Commonwealth Community Trust, Louisiana Pooled Trust and the National Foundation for Special Needs Integrity.

For smaller settlements, or clients who are over 65 years old when the trust is created, pooled trusts provide a great alternative to the legal and trustee fees associated with other types of special needs trusts.

Hypotheticals

Clients are complex, and unique. A client without cognitive disabilities may want more control. A client with high up-front needs may utilize more spend-downs. A client with a shorter life expectancy may have more concern over what happens to the assets on his/her passing. Proper planning often uses a combination of tools to fit a client's needs. A few hypotheticals may illustrate how planning can meet various needs.

Hypothetical 1

A 45-year-old man with Down syndrome is involved in a slip-and-fall case. He already receives SSI, Medicaid and other means-tested government benefits because Down syndrome is automatically classified a disability by the Social Security Administration. You settle the case for $150,000.

Analysis: The client is already categorized as disabled and receives means-tested benefits. Without planning, he would be forced to spend the entire settlement on ongoing medical expenses, whether due to the injury or his underlying condition. After a couple of years paying out-of-pocket for medical care, the settlement money is gone. Ultimately, the whole case was a wash as it left the client no better than before.

This is a prime case for a structured settlement paying directly into a special needs trust. The client would continue to enjoy Medicaid and SSI, but he could now use the assets in the special needs trust for vacations, education or debt payments. Your work with the client improved his lifestyle.

Hypothetical 2

A 17-year-old man with autism is injured such that his legs no longer work. His family does not receive SSI at the moment because his parents' income is too high to qualify. The settlement is $100,000.

Analysis: Even though the client does not currently receive SSI, he may be eligible when he turns 18. His disability — both autism and his new physical disability — must first be accepted by the Social Security Administration. Assuming he qualifies, a special needs trust would make sense financially. However, there may be other planning options.

Since his injuries require a wheelchair, he may want to purchase a wheelchair van, a ramp for his house and build an accessible bathroom. These may cost $55,000 up front. His disability occurred before he was 26, so he could open an ABLE account. A structured settlement could make annual contributions up to the $15,000 limit for the next three years. This would avoid a special needs trust completely. Alternatively, the remaining funds not otherwise spent down could be placed in a pooled trust to avoid the expenses of creating and managing a first-party special needs trust.

Hypothetical 3

Your client is on both Medicaid and Medicare (called dual eligibility). You help her obtain a recovery in a worker's compensation case. The Department of Health and Human Services determines that a Medicare Set Aside (MSA) account is appropriate.

Analysis: The funds put into the MSA must be spent down before the client will receive future Medicare benefits. However, the MSA account is considered an available asset that counts against the client for her Medicaid benefits. In this situation, the MSA account can actually be placed in a special needs trust to protect the Medicaid benefits.

Conclusion

Financial planning for clients with special needs or disabilities is usually the last thing a litigator wants to deal with. However, proper planning can have a significant impact on your clients and protect you from a costly malpractice claim. It is no good to fight and win for your client, only to have the settlement burned up with medical costs when it could easily be protected.

When you have a client on means-tested benefits, you should present them with the benefits of a special needs trust or other planning measures. If they decline to use these planning tools, then you should outline the risks in a letter reiterating your recommendation and seeking their waiver of the options. These waivers are aptly called *Grillo* letters.

FOOTNOTES

1. William F. Flahaven et al., California Practice Guide: Personal Injury (The Rutter Group ©1992), Ch. 4.

2. Josephine Grillo, As Guardian and As Next Friend for Christina Grillo, A Minor v. Tom L. Pettiette, T.E. Swate, and Hardy Milutin & Johns, 96th District Court, Tarrant County, TX, No. 96-145090-92. Settlement amounts as reported in Lawyers Weekly, 8/2/2001.

3. These are the 2021 numbers for a single individual. The asset limit for a married couple is $3,000. As income or assets increase, there is an offset to SSI benefits, which can get complicated. There are income exclusions, forms of income that do not count against benefits, and dollar-for-dollar decreases in benefits. This article is not the place to dig into the complexities of SSI benefits. Suffice it to say that if that decrease in benefits reaches $0 for the month, all other benefits programs attached to SSI eligibility are also suspended.

4. Determining the income limit is more complicated than the assets. It includes income from various sources, but also accounts for a number of exclusions. SSI income limits are beyond the scope of this article.

5. As of 2021. The amount is $1,191 for a couple.

6. *https://www.able.osfa.la.gov/*.

Sean M. Morrison is an attorney in Slidell practicing business and estate planning. He helps families of individuals with special needs create special needs trusts and manage disability benefits so they can rest assured their child is cared for. (sean@seanllc.com; Ste. 305, 155 Robert St., Slidell, LA 70458)