

SPECIAL REPORT

Public Benefits and Matrimonial Settlements

CASE STUDY 1: Disabled spouse - no public benefits

Bill and Linda are in their mid-30s and have decided to divorce. Linda has Multiple Sclerosis and is unable to work because of her disability. She wants alimony and equitable distribution. Linda's attorney succeeds in having Bill pay Linda a \$500,000 lump sum as equitable distribution and proposes \$2,500 a month in alimony. Linda requires a home health aide for approximately 20 hours a week at a cost of \$1,540 a month and has other medical bills totaling approximately \$3,000 a month. She will soon lose her medical coverage under Bill's policy. Linda is concerned that her medical bills will consume her share of the equitable distribution. Linda demands \$7,000 a month alimony. The case drags on at increasing cost and bitterness for both sides.

CASE STUDY 2: Disabled spouse - public benefits

Harry and Sally are in their mid-30s and have decided to divorce. Sally has Multiple Sclerosis and is unable to work because of her disability. She wants alimony and equitable distribution. Sally's attorney succeeds in having Harry pay Sally a \$500,000 lump sum as equitable distribution and Harry's attorney proposes \$2,500 a month in alimony. Sally requires approximately 20 hours a week of home care at a cost of \$1,540 a month and has other medical bills totaling approximately \$3,000 a month. She will soon lose her medical coverage under Harry's policy.

Harry's attorney brings in a consulting elder and disability law attorney, who is a member of the Special Needs Alliance and an expert on Special Needs Trusts. The consulting attorney arranges for the court to establish a Self-Settled Special Needs Trust through the divorce decree and to direct payment of the equitable distribution and alimony to the trust. As a result of establishing the trust, Sally becomes entitled to SSI payments of approximately \$600 a month and Medicaid coverage of all her medical bills as well as a home health aide for the required 20 hours a week. The trustee of the Special Needs Trust uses the funds in the trust to pay for monthly expenses that exceed the amount of Sally's SSI payment. The trustee makes payments directly to the providers of goods and services rather than to Sally.

Because the equitable distribution is paid directly to the trustee of the Self-Settled Special Needs Trust, the assets in the trust are not countable to Sally for purposes of determining her public benefits eligibility. Similarly, because the alimony is paid into the Self-Settled Special Needs Trust, it is not considered income to Sally for purposes of determining her public benefits eligibility.

USING SPECIAL NEEDS TRUSTS IN MATRIMONIAL SETTLEMENTS

If you are divorcing and either you or your spouse is disabled and eligible for means-tested public benefits such as Supplemental Security Income (SSI) and Medicaid, you both may benefit from the establishment of a Self-Settled Special Needs Trust. This type of trust can allow for public benefits to be employed in your matrimonial settlement, potentially increasing the funds available to the disabled spouse while reducing the financial burden on the non-disabled spouse.

WHEN IS A SELF-SETTLED SPECIAL NEEDS TRUST REQUIRED?

A Self-Settled Special Needs Trust is required if a person with disabilities currently receives - or is likely to receive in the future - SSI, Medicaid, Section 8 housing, certain types of state disability benefits or benefits under any other means-tested program, and is about to receive a settlement or other monies that will bring the person's "countable assets" to more than \$2,000. Countable assets are those taken into consideration by the Social Security Administration when determining whether a person meets the asset limit for SSI eligibility. That limit currently is \$2,000.

IN WHAT TYPES OF MATRIMONIAL SETTLEMENT SITUATIONS SHOULD A SPECIAL NEEDS TRUST BE UTILIZED?

Special Needs Trusts should be considered in matrimonial settlements when one spouse is disabled and eligible for public benefits. Because the establishment of a Special Needs Trust can enable the disabled spouse to qualify for public benefits, the trust can help reduce the amount of money required from the non-disabled spouse for support while increasing the overall benefit to the disabled spouse. When public benefits are used to help fill some of the financial need of the disabled spouse, matrimonial cases can be easier to settle.

Special Needs Trusts can be used in the following ways:

- ◆ For equitable distribution. Equitable distribution is a division of marital assets. If one of the divorcing spouses is disabled, payment of the equitable distribution directly to that spouse will cause him or her to lose - or become ineligible for - public

benefits. The solution is to have the equitable distribution paid into a Self-Settled Special Needs Trust for the benefit of the disabled spouse.

- ◆ For alimony. Payment from a non-disabled spouse to a disabled spouse for maintenance and support during legal separation and/or after a divorce is finalized results in the alimony payments being counted as income to the disabled spouse for SSI eligibility purposes. The alimony reduces the SSI payment dollar for dollar and, if large enough to completely eliminate SSI, also results in the loss of Medicaid. The solution is to establish a Self-Settled Special Needs Trust and have the court direct payments to the trustee of the trust rather than directly to the disabled spouse.
- ◆ For child support. Payment of child support is considered income to the child recipient. If the child has disabilities and receives SSI, one-third of the support payment will be excluded from the child's countable income for purposes of determining SSI eligibility. But the remaining two-thirds of the support payment will reduce the child's SSI payment dollar for dollar. If the SSI payment is reduced to \$0, the child also will lose Medicaid. When the child support is paid directly to a Self-Settled Special Needs Trust, however, the income is not counted to the child and public benefits can be maintained. Note that, nationally, Social Security claims officers have been inconsistent as to whether a Self-Settled Special Needs Trust can be used for child support.

The converse issue is whether assets in the Self-Settled Special Needs Trust of a person with disabilities can be reached to enforce a child support order. Assets in the Self-Settled Special Needs Trust must be for the sole benefit of the person with disabilities. While there are no court rulings, there are a number of cases in which it has been argued that payment of a child support order is a proper distribution from a Self-Settled Special Needs Trust. The reasoning is that the distribution meets the standard of being for the *sole benefit of the person with disabilities* because it enables the person to avoid being held in contempt of court and possibly being sentenced to jail. A Self-Settled Special Needs Trust is not exempt from claims of creditors unless it is established in a state with legislation authorizing what is called a "domestic asset protection trust."¹

A third issue arising when a Self-Settled Special Needs Trust is used for child support is whether the trust

¹Alaska, Delaware, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota and Utah.

assets are available when determining the parent's obligation of support. A Missouri case has held that the assets are not available and that the court determining the level of child support should not take the assets into consideration when deciding on the parent's obligation of support.² This reasoning may be applied by judges in other states.

WHAT ARE THE REQUIREMENTS OF A SELF-SETTLED SPECIAL NEEDS TRUST?

Self-Settled Special Needs Trusts must meet several requirements.

- ◆ Assets of the individual. The trust must be funded with assets owned by the individual with disabilities, such as litigation proceeds.
- ◆ Age. The individual must be under 65 years of age at the time the trust is funded.
- ◆ Disability. The individual must be disabled as defined in the Social Security Act.
- ◆ Benefit. The trust must be for the sole benefit of the individual with disabilities.
- ◆ Establishment. The trust must be established by a parent, grandparent, guardian or the court.
- ◆ Payback. The state Medicaid agency must be reimbursed upon the death of the person with disabilities.

Additionally, the trust must be irrevocable - that is, it must be permanent - and give the trustee discretionary authority to make distributions.

WHAT PUBLIC BENEFITS ARE PROTECTED BY THE TRUST?

The purpose of a Special Needs Trust is to preserve public benefits for the person with disabilities. Typically these benefits include:

- ◆ SSI. A monthly income of approximately \$600.
- ◆ Medicaid. A medical payment program.
- ◆ Section 8 housing. A low-income housing program.
- ◆ State disability programs. These include group homes, vocational training, etc.

WHAT CAN THE TRUST PAY FOR?

The trust can pay for a very broad range of goods and services as long as payment is made directly to the provider rather than to the person with disabilities.

Examples include personal effects such as furniture, appliances, computers and automobiles, rent, home improvements, pools, utilities, medical insurance, newspaper subscriptions, services of a care manager, federal and state taxes, and funeral and legal fees. Payments for food and shelter are likely to reduce the SSI payment by one-third or one-third plus \$20, depending on living arrangements.

Trusts can purchase homes and vehicles. While these are non-countable assets, they are considered special assets. If the trust will be used to purchase these items, there are several options that must be considered in consultation with the elder and disability law attorney assisting in the case to ensure that the assets are titled properly.

Generally, funds in the Self-Settled Special Needs Trust can only be used for the benefit of the person with disabilities. Other family members or friends benefiting from the trust are usually required to pay a *pro rata* share for their benefit. For example, if a parent lives with a disabled child in a house paid for by funds from the trust, the parent must pay his or her share of expenses. As noted above, trust assets usually cannot be used to meet a parent's legal obligation of support.

HOW IS A STRUCTURED SETTLEMENT USED IN A DIVORCE SITUATION?

Using a structured settlement in a divorce situation is a creative method that often leads to an excellent result. Structured settlements have several features that need to be understood:

- ◆ Present value. When a non-disabled spouse purchases a structured settlement annuity for the benefit of a spouse with disabilities, he or she pays for the annuity based on its present (i.e., current) value. The insurance company is responsible for investing the money and making future payments.
- ◆ Rated age. In many cases, an individual with disabilities may have a rated age. This means an insurance company believes that, as a result of disability, the person is physically much older than his or her actual age and has a shorter life expectancy. Consequently, a lifetime annuity can be purchased for the disabled person based on the shorter life expectancy associated with the rated age. That significantly increases the monthly payment the

²Louis v. Dept. of Soc. Servs. 61 S.W. 3d 248 (Mo. 2001).

person with disabilities receives while making the cost of purchasing the annuity much lower than it would be for a lump sum payment of an equitable distribution. It also is much less expensive to purchase the structured settlement with a lump sum than with alimony. Again, the payment is based on the rated age rather than the actual age and the insurance company assumes the risk that the person with disabilities will outlive the life expectancy associated with the rated age.

- ◆ Preservation. The average divorce settlement, like the average lottery winning, lasts five years. What the spouse with disabilities usually needs most is an income and medical benefits. By having the non-disabled spouse buy a structured settlement for the disabled spouse, with payments directed to the Self-Settled Special Needs Trust, the disabled spouse is able to maintain public benefits and often increase monthly income. The structured settlement guarantees the disabled spouse a monthly income for life with a fixed period guaranteed.

Structured settlements can work well when used for the following purposes:

- ◆ Equitable distribution. A non-disabled spouse may use a structured settlement to fund his or her obligation of an equitable distribution, in whole or in part. If the spouse with disabilities has a rated age, the use of a structured settlement will allow the non-disabled spouse to save money while providing the disabled spouse with a guarantee that the money will last his or her lifetime.
- ◆ Alimony. A structured settlement is perfect for alimony payments. Again, the spouse paying the alimony saves money by purchasing a structured settlement annuity — especially if the disabled spouse has a rated age — while the person with disabilities is guaranteed a steady income stream for life, paid directly by an insurance company rather than a resentful ex-spouse. In fact, the spouse with disabilities may receive a larger monthly payment under the structure at no additional cost to the spouse paying the alimony.
- ◆ Child support. Typically, the obligation for child support ends at 18. But when a child is disabled, it may be possible to have the court extend the order for the life of the child. In some situations, life insurance is used to fund the needs of the disabled child

after the parent's death. A structured settlement may provide a better option because it can fund the child's needs both during the parent's lifetime and after their death. Again, the magic of the rated age may result in a discounted cost.

WHAT ADDITIONAL FEATURES SHOULD BE CONSIDERED IN A STRUCTURE?

- ◆ Cost of living. Over time, cost-of-living increases reduce the purchasing power of a dollar. Structures can be designed to include a cost-of-living adjustment (COLA) feature. Since, historically, the cost of living has increased 3% a year, a structure with a 3% COLA, compounded, makes sense.
- ◆ POPs. POPs establish that additional lump sums will be paid out at certain stages of a disabled person's life. For example, if the individual is likely to go to college, a significant lump sum could be paid to cover college tuition when he or she turns 18.
- ◆ Commutation rider. If a settlement is large, there may be federal and/or state estate tax due after the person with disabilities dies. A commutation rider in the structure ensures that monies will be available to pay these taxes, if necessary.

HOW IS THE TRUST ESTABLISHED AND FUNDED?

Federal law requires that the trust be established by a parent, grandparent, guardian or the court. The trust cannot be established by the person with disabilities. The trust is funded by having the court order the non-disabled spouse to pay the lump sum by check directly to the trustee of the Self-Settled Special Needs Trust. If a structured settlement is involved, the court also must order that the monthly payments from the structure be paid by check directly to the trustee of the Self-Settled Special Needs Trust. Payments should not be made to the matrimonial attorney, as that constitutes "constructive receipt." This means that public benefits agencies will consider the money in the attorney's trust account to be available to the person with disabilities, disqualifying him or her from benefits.

HOW SHOULD THE MONEY BE INVESTED?

Any money placed in the Self-Settled Special Needs Trust, other than the structure, should be invested in accordance with the Uniform Prudent Investor Act. Because the assets

need to last throughout the lifetime of the person with disabilities, they should be invested conservatively, with the objective of preserving principal while providing the growth necessary to outpace inflation and taxes. There should be a written Investment Policy Statement in place that specifies the acceptable level of investment risk to be taken and outlines the trust's investment strategy.

HOW IS A TRUSTEE SELECTED?

Family members often want to serve as trustees of Special Needs Trusts. But, to ensure that a trust will be administered properly and continue to protect the public benefits of the person with disabilities, a trustee must have experience and expertise in the following areas, at a minimum:

- ◆ The Uniform Prudent Investor Act.
- ◆ The Principal and Income Accounting Act.
- ◆ Public benefits laws.

Since family members rarely have this expertise, a better solution is to select a professional trustee. Family members can remain involved by serving as co-trustees or trust protectors or by having a trust advisory committee appointed. The trust advisory committee, which can include a parent, a lawyer, an accountant, a social worker and even a sibling, advises the trustee with respect to distributions.

WHAT CAN A COUNSELING SESSION ACCOMPLISH?

When establishing a Self-Settled Special Needs Trust, it is wise to have a counseling session with the elder and disability law attorney, the person with disabilities, the trustee and other interested family members. The person with disabilities and/or family should prepare a budget. The family and the trustee should then agree on which budget items will be paid by the trustee, which by the disabled person, and which items, if any, can be purchased through use of a credit card that ultimately will be paid by the trustee.

It also is important to run a Monte Carlo Simulation. This is a financial tool that helps determine how long trust assets will last assuming certain conditions, such as different levels of expenses and varying investment returns. Once everyone understands that the trust should last the lifetime of the person with disabilities and a Monte Carlo Simulation has shown how long the trust is likely to last under various scenarios, the person with disabilities

and/or family may agree to reduce expenditures to a more appropriate level.

Finally, the counseling session is an opportunity for the elder and disability law attorney to review with the trustee, the family and the person with disabilities the state law requirements pertaining to the administration of a Self-Settled Special Needs Trust. At the end of the session, everyone should understand the rules and a game plan should have been adopted that will enable the person with disabilities to receive maximum benefits from the trust during his or her lifetime.

WHAT AGENCY APPROVALS ARE REQUIRED?

- ◆ SSA. If the person with disabilities is receiving SSI, the Self-Settled Special Needs Trust will require review by the Social Security Administration.
- ◆ Medicaid. If the person with disabilities is receiving Medicaid, the trust will require review by the state Medicaid agency.
- ◆ Filing. It is very important to file notices and copies of the trust document with the Social Security Administration and/or state Medicaid agency. The elder and disability law attorney generally is responsible for this. It also is important to submit a separate cover letter that shows SSA and the state Medicaid agency exactly how the trust document complies with their requirements. The agencies seldom respond with specific approval of the trust, but if they do not approve it, they will respond with specific reasons.

WHAT ESTATE PLANNING DOCUMENTS DOES THE PERSON WITH DISABILITIES NEED?

If the person with disabilities is a competent adult and has such non-countable assets as a home, a vehicle or personal effects, he or she should consider executing a will. The individual also should execute an Advance Medical Directive/Living Will and a Durable Power of Attorney. These documents are extremely helpful in the event that an individual becomes incapacitated and is no longer able to take certain actions on his or her own behalf.

WHAT ESTATE PLANNING DOCUMENTS DO FAMILY MEMBERS NEED?

If the family members of an individual with disabilities intend to leave money to him or her — or for his or her benefit — they should execute a will, an Advance Medical

Directive/Living Will, a Durable Power of Attorney and a Third-Party Special Needs Trust (sometimes called a Supplemental Needs Trust). Leaving money directly to a person with disabilities will jeopardize public benefits, while leaving it to a Self-Settled Special Needs Trust will trigger a Medicaid payback requirement. Placing the funds in a Third-Party Special Needs Trust can allow a family to supplement the lifestyle of the person with disabilities without loss of public benefits. Third-Party Special Needs Trusts operate in much the same way as Self-Settled Special Needs Trusts except that there is no Medicaid payback and there are no Medicaid accounting requirements.

A family that wishes to establish a Third-Party Special Needs Trust should consult with an elder and disability law attorney. It also is important that the family's beneficiary designations be reviewed to ensure that the Third-Party Special Needs Trust is the beneficiary of any funds intended for the person with disabilities.

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