

# SPECIAL REPORT

## Using Public Benefits to Pay for Matrimonial Settlements

### CASE STUDY 1:

#### Disabled spouse - no public benefits

Bill and Linda are in their mid-30s. Linda has been diagnosed with Multiple Sclerosis and is unable to work. Bill and Linda have decided to divorce and Linda 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 her other medical bills are 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. Sally has been diagnosed with Multiple Sclerosis and is unable to work. Harry and Sally have decided to divorce. Sally 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 her other medical bills are approximately \$3,000 a month. She will soon lose her medical coverage under Harry's policy.

Harry's attorney, working with a consulting special needs attorney, arranges for the equitable distribution and alimony to be paid into a Special Needs Trust (SNT). The lawyer drafting the trust was an expert on special needs trusts. As a result of establishing the SNT, Sally became eligible for SSI payments of approximately \$600 a month and Medicaid coverage of all her medical bills as well as a home health aide for 20 hours a week. The trustee of the Special Needs Trust uses the alimony to pay for living 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. The equitable distribution does not have to be used for Sally's medical bills.

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

# THE APPLICATION OF SPECIAL NEEDS TRUSTS IN MATRIMONIAL SETTLEMENTS

If you have matrimonial cases in which one spouse is disabled and eligible for means-tested public benefits, it is important to understand how Self-Settled Special Needs Trusts can allow for public benefits to be employed in the matrimonial settlement.

## 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.

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

Special Needs Trusts should be utilized 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 while increasing the benefit to the disabled spouse. When public benefits are used to help fill some of the financial need, 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 the marital assets. If one of the divorcing spouses is disabled, the existence of the equitable distribution will prevent that person from accessing public benefits and will cause a loss of any existing 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 the divorce is finalized results in the alimony payments being counted as income to the disabled spouse for SSI eligibility purposes. The alimony will reduce the SSI payment dollar for dollar; if the alimony is large enough to completely eliminate SSI, the individual with disabilities also will lose Medicaid. The solution is to establish a Self-Settled Special Needs

Trust and have the court direct payments to the trustee of the Special Needs Trust rather than directly to the disabled spouse.

**FOR CHILD SUPPORT.** Payment of child support is considered income to the child recipient. For SSI purposes, one-third of the support payment is excluded from the child's countable income. But the remaining two-thirds of the support payment reduce the child's SSI payment dollar for dollar. If the payment is reduced to \$0, the child will lose both SSI and the accompanying Medicaid. When the child support is paid directly to a Self-Settled Special Needs Trust, the income is not counted to the child and public benefits can be maintained. Note, however, that 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 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 facing jail time. Self-Settled Special Needs Trusts are not exempt from claims of creditors unless they are established in a state with legislation authorizing domestic asset protection trusts.<sup>1</sup>

A third issue arising in situations where there is a Self-Settled Special Needs Trust used for child support is whether the trust assets are available for the support of the child when determining the parent's obligation of support. A Missouri case has held that the assets are not available for purposes of child support and that the court deciding on the level of child support should not take those assets into consideration when determining the parent's obligation of support.<sup>2</sup> This reasoning may be applied by judges in other states.

<sup>1</sup>Alaska, Delaware, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota and Utah.

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

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

**ASSETS OF THE INDIVIDUAL.** The trust must be funded with assets owned by the individual, 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 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 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 programs for the person with disabilities. Typically these benefits include:

**SSI.** A monthly income.

**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, automobiles, rent, home improvements, pools, utilities, medical insurance, newspaper subscriptions, services of a care manager, federal and state taxes, 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 special needs attorney assisting in the case to ensure that the assets are properly titled.

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. As noted above, trust assets usually are not permitted to be used to discharge a parent's legal obligation of support.

## HOW IS A STRUCTURED SETTLEMENT USED IN A MATRIMONIAL SITUATION?

Utilizing a structured settlement in a divorce situation is a creative method that often leads to an excellent result. There are several features of structured settlements that should be understood:

**PRESENT VALUE.** The divorcing spouse purchasing a structured settlement annuity for the benefit of the disabled spouse pays for the annuity based on its present value. The insurance company is responsible for investing the money and making future payments.

**RATED AGE.** Many individuals with disabilities have a rated age. This means that 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 life-time annuity can be purchased based on a shorter life expectancy, thereby significantly increasing the monthly payment. Because of the rated age, the cost to purchase the annuity is much lower than it would be for a lump sum for equitable distribution. It also is much less expensive to purchase the structure with a lump sum rather than with alimony. Again, the payment would be 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 based on the rated age.

**PRESERVATION.** The average divorce settlement, like the average lottery winning, lasts five years. What the disabled spouse 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 plaintiff a monthly income for life with a fixed period guaranteed even if he or she dies prematurely.

There are several situations in which a structured settlement makes sense:

**EQUITABLE DISTRIBUTION.** If the disabled spouse has a rated age and the non-disabled spouse funds the obligation of equitable distribution in whole or in part with a structured settlement, the non-disabled spouse saves money while the disabled spouse has a guarantee that the money will last his or her lifetime.

**ALIMONY.** A structured settlement is perfect for alimony payments. Again, the person paying the alimony saves money by purchasing a structured annuity, especially if the disabled spouse has a rated age, while the person with disabilities is guaranteed a steady stream of income for life paid directly from an insurance company rather than a resentful ex-spouse. In fact, the person 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 the 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 death. Again, the magic of the rated age may result in a discounted cost.

## WHAT 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. Because, historically, the cost of living has increased 3% a year, a structure with a 3% COLA, compounded, makes sense.

**POPs.** It is usually possible to anticipate that certain events will occur during the lifetime of the person with disabilities that will require lump sums of money. The structured settlement contract can be designed to take these into consideration. POPs establish that additional lump sums will be paid out at certain stages of the 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 made to the matrimonial attorney constitute "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 those 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 the 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 INVESTMENT 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 special needs 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, which provides a way to determine how long the trust will last assuming certain conditions, such as different levels of expenses and investment returns. Once it is understood 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 disabled person and/or family may agree to reduce expenditures to a more appropriate level.

Finally, the counseling session is an opportunity for the special needs 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 should be filed with the Social Security Administration.

**MEDICAID.** If the person with disabilities is receiving Medicaid, the trust should be filed with 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 special needs 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, they will respond with specific reasons.

### WHAT ESTATE PLANNING DOCUMENTS DOES THE PERSON WITH DISABILITIES NEED?

If the individual 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. Advance Medical Directives/ Living Wills are important for anyone wishing to avoid a Terri Schiavo-type situation. A Durable Power of Attorney is 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 no Medicaid accounting requirements.

Families that wish to establish Third-Party Special Needs Trusts should consult with a special needs 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 individual with disabilities.

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