PLAN and PRESERVE

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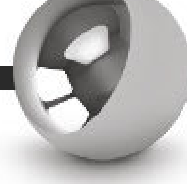
To help ensure the financial security of clients with disabilities, you need to evaluate how a litigation recovery will impact their public benefits and how to protect those resources.

For plaintiffs with disabilities, receiving and managing a litigation recovery[1] can raise unique challenges. Being aware of which plaintiffs may require special planning, the issues that arise for these clients, and how to select the appropriate tools can ensure they receive the full benefit of the litigation recovery.

As defined by the Social Security Administration (SSA), a "disability" is the inability to engage in any "substantial gainful activity" due to a medically determinable physical or mental impairment, or combination of impairments, that has lasted or can be expected to last for a continuous period of at least 12 months or to result in death.[2]

In this context, the term "disabled" applies only to people who have a significant and long-lasting disability that prevents them from working and earning more than $1,260 per month.[3] This population generally consists of those with developmental disabilities such as Down syndrome, cerebral palsy, and autism;



serious mental illnesses such as schizophrenia; or serious physical disabilities such as quadriplegia. Someone in a wheelchair who works a full-time job would not meet the federal government's definition of disability.

Moreover, only certain types of public benefits require a plan to preserve them. When working with plaintiffs with disabilities, be mindful that they (and their families) often don't know what benefits they receive or may provide incorrect information. It is easy to confuse the types of benefits because they are similarly named and administered by the same agencies. Early in the litigation process, take time to identify the benefits involved. If you are not an expert in this field, consult a special needs planner because this information is critical to preparing the client for planning options and creating an appropriate plan.

Not every person with a disability requires a special plan: The type of disability, the type of public benefits received, and the net amount of the litigation recovery determine what will be required to meet the client's needs. Usually, this plan involves transferring the litigation recovery to a first-party special needs trust (SNT), which preserves public benefits eligibility, but there are alternatives that may make more sense in different situations.[4] Federal, state, and local rules and regulations are typically at issue, increasing the complexity of this analysis.

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Protecting Needs-Based Public Benefits

Public benefits are divided into two main categories: entitlement benefits (Social Security Disability Insurance (SSDI) and Medicare) and needs-based benefits (Supplemental Security Income (SSI) and Medicaid). Special planning is not necessary if the plaintiff receives entitlement benefits only because those programs do not have a "resource test" (discussed below), so anyone who meets their definition of "disability" qualifies. Note, however, that if a portion of the settlement is to cover future medical care that could be paid by Medicare, then a Medicare set-aside arrangement should be discussed.[5]

Planning should also be considered if the plaintiff will need to preserve future eligibility for Medicaid-funded services not covered by Medicare, such as skilled nursing care; in-home caregiving; and Medicare premiums, deductibles, and copayments.

Preserving needs-based benefits requires special planning because to become or remain eligible for SSI and Medicaid, people must be below certain income levels and have no more than $2,000 in countable assets.[6] This is often called the "resource test."

Needs-based public benefits recipients who directly receive litigation proceeds or structured settlement annuity payments that put them above the applicable limits will lose those benefits. This can be devastating. They will need to apply for private health insurance, which may not include certain items that Medicaid covers, such as in-home caregiving, skilled nursing care, or many types of mental health services. Plus, their recovery will be spent on expenses that public benefits typically would cover—such as food, shelter, prescriptions, or skilled nursing care—so the funds will be depleted much more quickly, possibly leaving them in worse shape than before the settlement.

Sometimes the question arises whether preserving public benefits is necessary. Plaintiffs likely to reenter the workforce may be able to forgo them, but for people with profound disabilities, remaining eligible for public benefits often is the only way they can meet their lifetime needs for housing, transportation, food, goods and services to enhance their quality of life, caregivers, therapies, treatments, and medical care. Combining a litigation recovery with public benefits generally offers the safest and best way to provide for the plaintiff's lifetime care.

Placing assets into a qualifying SNT means that the assets and any income derived from the assets will not be counted against the plaintiff, which preserves eligibility for needs-based benefits.[7] It also may be prudent to prepare and fund SNTs or other types of trusts if, for example, plaintiffs lack capacity to manage their own affairs, may be susceptible to the undue influence of others, or may not be able to manage their own litigation recovery. If the plaintiff requires that level of protection, an SNT is a fully discretionary spendthrift trust in which assets are managed by others.[8]

First-Party SNTs

First-party SNTs are statutorily created "safe harbor" trusts authorized by Congress to protect people with disabilities so that the assets held in

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trust for public-benefits recipients are not counted against them.[9] The two primary types of first-party SNTs are:

- (d)(4)(A) SNTs or "payback SNTs," which are established by the individual, a parent, a grandparent, a legal guardian, or the court for individuals with disabilities who are under 65. Medicaid will receive all amounts remaining in the trust on the beneficiary's death up to the amount of Medicaid benefits paid.[10]
- (d)(4)(C) SNTs or "pooled SNTs," which are established and managed by a nonprofit association that maintains separate accounts of pooled assets for the benefit of multiple beneficiaries. The accounts are established by a parent, a grandparent, a legal guardian, the individual beneficiary, or the court. The state will, on the beneficiary's death, receive all amounts remaining in the account (to the extent assets are not retained by the nonprofit) up to the amount of Medicaid benefits paid over the lifetime of the individual.[11]

First-party SNTs must strictly comply with various federal, state, administrative, and judicial rules and regulations. For example, the first-party SNT must not require mandatory disbursements to a beneficiary, must be for the "sole benefit" of the beneficiary, must have a spendthrift provision, and must have a provision that on either early termination (before death) or on termination because of death, any state Medicaid agency that has provided services will be paid back from the trust assets before they can be distributed to heirs.[12]

Even small changes in plaintiffs' fact patterns (for example, their age, legal capacity, or amount of recovery) can lead to very different planning solutions. The SSA has been active in denying SNTs not established under its specific set of policy guidelines. For example, after the SSA claimed the beneficiary's parents had not set up a first-party SNT correctly, the Eighth Circuit, in a controversial decision, upheld the agency's denial of the trust funded with litigation proceeds—meaning the recovery was countable under the SSA's resource test, costing the person with a disability her SSI eligibility.[13]

Payback SNTs. Under the 2016 Special Needs Trust Fairness Act, plaintiffs who have legal capacity can now establish their own payback SNT.[14] If the plaintiff is a minor or an incapacitated adult, and therefore lacks legal capacity, then it generally takes a court order to establish the SNT. In many states, the court then supervises that SNT for the remainder of the plaintiff's life.[15] Plaintiffs who are 65 or older may not establish or fund payback SNTs.[16] For them, a pooled SNT or other planning alternatives can be considered.

Pooled SNTs. A pooled SNT works well for some people who do not have a large enough litigation recovery to establish a separate payback SNT, are 65 or older, or lack someone in their life trustworthy enough to be the trustee.[17]

There is not a benchmark on the amount of money that triggers a move from a separate payback SNT to a pooled SNT. The plaintiff will make this determination: Some plaintiffs want to select their own trustee even when the recovery is modest (which we would characterize as less than $60,000), and some plaintiffs want to use a pooled SNT for a very large trust. It's important that they understand the differences and make an educated decision when selecting the appropriate type of trust.

Typically, a person with a disability will join an existing pooled SNT

by executing its joinder agreement and transferring assets to the trust. Protecting a client's settlement using this type of trust usually can be done quickly because no drafting is involved.

As long as all of the SSA, state Medicaid agency, and state trust rules are strictly followed, such a transfer can be made without causing any public-benefits disqualification. Although each person has a separate account maintained on his or her behalf, the funds of all beneficiaries are pooled together for investment purposes to provide aggregate investment fee discounts. By law, the pooled SNT must be "established and managed" by a nonprofit organization,[18] though the actual investment and distribution tasks can be, and often are, delegated to specialists.

Unlike a payback SNT, a pooled SNT does not exclude those over 65. But some state Medicaid agencies will penalize funding a pooled SNT by withholding Medicaid benefits for up to five years.[19] Other states will not.[20] Depending on the settlement amount, it still may be prudent to fund the pooled SNT, wait out the penalty period, and then use the funds while preserving benefits.

SNT Alternatives

Generally, alternatives to first-party SNTs are considered only when the litigation recovery is a modest amount. For example, if the recovery is $10,000, it may not be prudent to create and fund an SNT. But even plaintiffs with larger settlements will sometimes use alternatives under the right circumstances.[21]

Achieving a Better Life Experience (ABLE) accounts.[22] These are a relatively new tool in which assets held in the ABLE account are exempt up to $100,000 for SSI eligibility.[23] For people eligible for Medicaid, the account can grow up to the applicable state's 529-plan funding limits (for example, $529,000 in California) before suspending public benefits eligibility.[24] The money in the ABLE account grows income tax free and remains tax free if used for the plaintiff's "Qualified Disability Expenses," which are broadly defined to mean almost everything a person would need.[25] A big benefit for plaintiffs who have capacity is that they manage their ABLE accounts, a level of control they cannot have with an SNT.

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Limitations include that the plaintiff must have been disabled before turning 26, can have only one account, and can only fund the account with up to $15,000 annually from all sources.[26] An ABLE account makes sense for someone with a disability who meets the rules for use, has capacity, and receives a net settlement of less than $15,000. It is also often used as part of spend down plans.

Spend down plans. These involve spending the litigation recovery on exempt assets (for example, the primary residence or one automobile) or other qualified expenditures (such as paying off existing debt or funding an ABLE account) until the plaintiff's countable assets are below $2,000.[27] The difficulty is that the spend down must be finished so that the plaintiff has less than $2,000 of countable assets on the first day of the next calendar month. In other words, if the plaintiff receives the litigation funds on Jan. 20, the spend down must be complete by Jan. 31 to be effective, just 11 days later.

When doing a spend down plan, have the plaintiff decide in advance how the money will be spent, and provide the check as early as possible in the month. A report documenting each expenditure with proof, such as receipts, must then be made to the government agency showing that the litigation recovery was withdrawn from the plaintiff's account before the first day of the next month.[28]

A spend down plan generally makes sense when the litigation recovery is for a smaller amount, and the plaintiff has immediate, demonstrated needs. For example, if the plaintiff receives $50,000 on Feb. 5, spends $25,000 on a car (his only one), pays off his credit card debt of $10,000, and funds an ABLE account with the remaining $15,000 before Feb. 28, then he will preserve SSI and Medicaid eligibility for March.

Many other alternatives to SNTs are available, such as prepaying for shelter, goods, or services;[29] preparing and funding a "Personal Services Contract;"[30] or even gifting funds (if the plaintiff can handle the loss of benefits for a period of time). We commonly combine and use these different tools in addition to funding a first-party SNT. If you have a firm grasp of what is allowed by the SSA and the state Medicaid agencies, there are many ways to maximize the recovery for the plaintiff.

Before finalizing recoveries for plaintiffs with disabilities, carefully consider whether they have any special planning needs. Creating a tailored

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plan protects your clients and gives them long-term access to the care and resources they deserve. ▣

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Notes

1. Litigation recovery refers to a settlement, judgment, or verdict.
2. 20 C.F.R. §416.905 (2012).
3. *See* 20 C.F.R. §§416.971–416.976; *Substantial Gainful Activity*, Soc. Security Admin., https://www.ssa.gov/oact/cola/sga.html.
4. This article discusses only first-party SNTs, not third-party SNTs. A first-party SNT is funded with the assets of the person with a disability, while a third-party SNT can be funded with the assets of anyone else. The third-party SNT is traditionally used when a parent plans to leave an inheritance to a child with a disability. There is a substantial difference between the laws governing the two types of trusts, so the planner must understand these differences or risk accidentally funding a litigation recovery into a third-party SNT and causing disqualification for benefits.
5. The Centers for Medicare and Medicaid Services has yet to promulgate regulations or content on Medicare set-aside arrangements for litigation proceeds, but failure to establish a provision for them may pose a risk to future Medicare eligibility.
6. 20 C.F.R. §416.1205(c).
7. 42 U.S.C. §1396p(d)(4) (2018).
8. A spendthrift trust is created when the trust instrument provides that the beneficiary may not assign his or her interest and the trust is not subject to the claims of creditors. *See* Restatement (Second) of Trusts §152 (1959). A discretionary trust directs the trustee to pay whatever amount the trustee sees fit. *See id.* §155. Thus, a fully discretionary spendthrift trust gives the trustee full discretion to use (or not use) the funds in the trust for the benefit of the beneficiary, and the beneficiaries cannot assign their interest in the trust to any third party. It protects beneficiaries from their own reckless spending and the undue influence of others.
9. The Medicaid program allows SNTs under the Omnibus Budget Reconciliation Act of 1993 (*see* 42 U.S.C. §1396p(d)(4)), and the SSI program allows the same SNTs under the Foster Care Independence Act of 1999 (*see* 42 U.S.C. §1382b (1999)), which incorporates the Medicaid safe harbor provisions into SSI law.
10. 42 U.S.C. §1396p(d)(4)(A).
11. 42 U.S.C. §1396p(d)(4)(C).
12. 42 U.S.C. §1396p(d)(4)(A); *Program Operations Manual System (POMS), SI 01120.203 Exceptions to Counting Trusts Established on or After January 1, 2000* SI 01120.203.I.2, Soc. Security Admin. (July 26, 2018), https://secure.ssa.gov/poms.nsf/lnx/0501120203.
13. *Draper v. Colvin*, 779 F. 3d 556 (8th Cir. 2015). The court stated: "In reaching this conclusion, we recognize that we draw a hard line. However, we are not persuaded that we must find in favor of [Plaintiff] because her parents came 'close enough' to meeting the requirements laid out in the POMS. Only by enforcing compliance with the letter of the POMS can the agency oversee the vast SSI program, effectively administer the Act, and consistently distribute benefits to disabled individuals." *Id.* at 564.
14. The Special Needs Trust Fairness Act was part of the 21st Century Cures Act (P.L. 114-255). Section 5007 passed into law on Dec. 13, 2016.
15. For example, in California there is a well-defined and robust procedure for court supervision over the management of SNTs for those who lack capacity. *See* Cal. Prob. Code §§3600–3613 (West 2016); Cal. R. Ct. 7.903. In contrast, Michigan has no specific statute covering court oversight of an SNT. Whether the court supervises the SNT is within the judge's discretion and varies widely among jurisdictions.
16. 42 U.S.C. §1396p(d)(4)(A).
17. A directory of national and statewide pooled trusts is available at *Directory of Pooled Trusts*, Special Needs Answers, https://specialneedsanswers.com/pooled-trust.
18. 42 U.S.C. §1396p(d)(4)(C)(i).
19. *Ctr. for SNT Administration v. Olson* (676 F. 3d 688 (8th Cir. 2011)) held that there is a penalty for a person 65 or older funding a pooled SNT in North Dakota.
20. In California, there is no penalty for the initial funding for a person 65 or older funding a pooled SNT. *See* Cal. Code Regs. tit. 22, §50489.9(a)(4), (c).
21. Gifting or transferring a litigation recovery to another person will not preserve eligibility and will result in the loss of SSI for up to 36 months and Medicaid for up to 60 months. 42 U.S.C. §1382b(c)(1)(A)(iv); 42 U.S.C. §1396p(c)(1)(B)(i). As a result, this is generally an unacceptable option unless the plaintiff has planned for the loss of public benefits.
22. 26 U.S.C. §529A (2018).
23. *Program Operations Manual System (POMS): SI 01130.740 Achieving a Better Life Experience (ABLE) Accounts*, Soc. Security Admin. (Apr. 30, 2019), https://secure.ssa.gov/apps10/poms.nsf/lnx/0501130740.
24. 26 C.F.R. §1.529A-2(g)(3). Although 26 C.F.R. §1.529A has not been finalized, the IRS has stated it can be relied on. *See, e.g., Guidance Under Section 529A: Qualified ABLE Programs: A Proposed Rule by the Internal Revenue Service on 6/22/2015*, Fed. Register, https://tinyurl.com/s43dzft.
25. 26 U.S.C. §§529A(a), 529A(e)(5); 26 C.F.R. §1-529A-3(a); *see also* 26 U.S.C. §529A(c)(1)(B).
26. 26 U.S.C. §§529A(b)(1)(B) & (b)(2)(B); 26 CFR §§1.529A-1(a)(4) & 1.529A-2(g)(2).
27. *Program Operations Manual System (POMS), SI 01150.007 Transfer of Resources by Spend-Down* SI 01150.007.A.1, Soc. Security Admin. (Feb. 24, 2012), https://secure.ssa.gov/apps10/poms.nsf/lnx/0501150007.
28. The agency to which the report must be submitted will vary depending on the public benefits the plaintiff is receiving and the state he or she is located in. Primarily, it will be the SSA, but it could be the state's Medicaid agency as well.
29. *Program Operations Manual System (POMS), SI 01150.005 Determining Fair Market Value* SI 01150.005.C.3.b., Soc. Security Admin. (Feb. 18, 2014), https://secure.ssa.gov/apps10/poms.nsf/lnx/0501150005.
30. *Id.* at D.3.c.