

Court-Ordered Trusts for Management of Assets Received by Disabled Persons

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Introduction

Many persons with disabilities experience those disabilities as a result of accidents, which give rise to legal claims resulting in settlements or judgments. Receipt of these assets, in excess of the very limited exempt levels, will disqualify even the most severely disabled person from a wide variety of government assistance programs and services provided through those programs. Many of those services are difficult, if not impossible, to purchase outside of the government assistance programs. For that reason, Special Needs Trusts (SNTs) are often used to receive and manage negotiated settlements and judgment awards for those with disabilities. The same federal statute that authorizes courts to direct settlements and judgments to SNTs also allows courts to direct bequests, inheritances, and assets already owned by a person who becomes disabled, to SNTs.

Two "control" options are generally available for managing assets of an incapacitated individual: 1. guardianship (including conservatorship) or 2. trust. When the guardianship option is chosen, ownership of guardianship assets remains with the ward even though the assets are subject to court control and management by the guardian. Regular financial reports must be made to the court, generating attorneys' fees and costs and, in many cases, accountant's and other fees. Court authority must be obtained for all expenditures and investment changes. Courts may restrict investment activity to only the most conservative options. After investments are allowed by the court, they may be made through a broker. Delays incurred in obtaining court approval may allow that "immediate" investment opportunity to slip away. When guardianship assets exceed statutorily prescribed levels, the guardian is required to post a bond, at the expense of the guardianship estate. It can be expected that investment commissions and accountant's fees will be incurred in managing a guardianship estate which includes substantial assets.

Assets held in a guardianship belong to the ward, and thus by definition are "available" to him or her for purposes of benefit eligibility determinations. Assets held in certain trusts belong to the trust, not to the beneficiary. To avoid having trust assets counted as "available" to the beneficiary as an asset or resource, a discretionary spendthrift trust model is used. The trust is structured such that the beneficiary has no ownership interest in, and is not entitled to demand payments from, the trust. This also provides an often critical protection from the creditors of clients who do not have the requisite capacity to control impulsive spending patterns.

A trust arrangement will result in some ongoing Trustee's fees and initial startup costs, but will not normally require extensive resort to a court for investment and disbursement authority. Advantageous interest rates and stock prices can be realized immediately without the expense and delay (often weeks) needed to obtain court approval. Annual court reports may also be avoided or at least the costs of reporting may be minimized. The financial reports required of a Trustee under most state laws will be generated through normal bookkeeping techniques. The Trustee will generally have authority to make all investment decisions, subject to state trust law, without the expense of seeking court approval. The Trustee will be able to make all decisions on trust spending, again without the expense of seeking advance court approval of individual expenditures.

Ownership of assets passes to the trust subject to the management and control of the Trustee. It is our experience that the cost of regular petitions and reports in guardianship proceedings, together with fees paid to guardians and attorneys, investment commissions, and other charges, may often be equal to or greater than fees charged by professional Trustees. Fees charged by professional Trustees generally include all money management charges including any stock/bond brokerage fees or commissions. In addition, if a guardian's investment authority is restricted to certain areas, the rate of return realized on guardianship investments may be substantially less than that realized from trust investments.

Trust Use for Settlements and Judgments

While most attorneys who represent severely injured clients do an excellent job in the preparation and presentation of the liability/personal injury case, both in settlement discussions and in litigation, the same attorneys often lack the knowledge of the critical impact that funds received through settlement or judgment can have on the disabled client. Issues involving competency to sign attorney-client agreements and releases and to properly hold and manage the proceeds of litigation must be considered. The attorney should also be aware of implications for eligibility for collateral source benefits from local, state or federal programs currently or potentially available to the client as a result of the client's disability.

The plaintiff has experienced permanent and severe disabilities, and requires assistance and supervision for most of his daily living needs. Through the efforts of counsel, a reasonable settlement has been reached. However, the settlement is a result of negotiation and compromise. Although possibly substantial in value, there is still a significant possibility that the plaintiff's future disability related needs could exceed the amounts received under the terms of the settlement achieved on his behalf.

Sometimes concern is expressed about preserving government benefit eligibility when substantial settlement sums are received. However, unless a disabled plaintiff has been fully and completely compensated through settlement or judgment with no risk that future medical and ongoing living needs will exceed his underlying settlement/judgment, the preservation of eligibility for potential future collateral source benefits is critical.

In the past, the ability to use SNTs for receipt and management of settlements or judgments while permitting ongoing eligibility for SSI, Medicaid, and other needs-tested disability related programs and benefits was premised on the Social Security Administration's regulations and as set forth in its Programs Operations Manual System (POMS). The POMS controlled not only eligibility for benefits through the Social Security Administration, but also was used to establish criteria in most states for federally funded, state administered assistance programs, including the Medicaid program.

The 1993 Omnibus Budget Reconciliation Act (OBRA), signed into law on August 10, 1993, eliminated the inherent problems with POMS and validated the use of SNTs for disabled persons in combination with their continuing eligibility for needs-tested, disability related federal programs. The relevant portion of the Act provides that assets held in such trusts shall be disregarded when determining the eligibility of beneficiaries of those trusts for federally funded disability related benefit programs. Certain criteria must be met for a trust to qualify under that portion of the Act, codified at 42 U.S.C. § 1396p(d) et seq. Among other provisions, the Act grants states a lien against assets remaining in such trusts at the beneficiary's death to the extent of Medicaid benefits rendered to that beneficiary. Each state was required to develop its own statutes and regulations to implement the federal law.

Though less important now as a result of the 1993 OBRA amendments to Medicaid eligibility rules, constructive receipt of settlement proceeds by the client should still be avoided. State and federal court rules applicable to clients under disability should be utilized to establish jurisdiction to allow the court to direct settlement or judgment proceeds to properly drafted trust instruments. This allows the court to protect the best interests of the disabled client.

Careful planning by the plaintiff's attorney can avoid pitfalls for the client that would cause severe and lifelong negative consequences. Failure to plan harms not only the client, but also exposes plaintiff's counsel to long term potential malpractice liability to the client or a subsequently appointed guardian or conservator acting on the client's behalf.

When an SNT is used to protect the acquired assets of a disabled person, a court of competent jurisdiction must approve it. Significantly greater restrictions and safeguards must be built into the trust instrument to satisfy the court than are needed in a trust created by a competent individual with his or her own assets. Except where settlement sums are nominal, the courts have almost universally required the use of a professional bonded or insured fiduciary, such as a bank or trust company, to serve as Trustee.

The primary purpose of the trust is to provide a secure and economical yet highly responsive vehicle for receipt, management, and disbursement of proceeds for the benefit of a disabled, incompetent, or minor beneficiary. A professional Trustee carries responsibility for disbursement decisions. Financial security is assured. Beyond regular and ongoing needs, the discretion granted in the Trustee permits it to respond to emergency situations much more quickly and appropriately than could a guardian or conservator who must first obtain court authority. The flexibility granted in the trust instrument allows response to both ongoing and emergent needs without the delay and inherent restrictions of advance court approval.

The trust cannot be held responsible for expenses incurred other than at the discretion of the Trustee. This is an integral protection to prevent trust assets from being considered "available" to the beneficiary or for payment of his or her expenses in general. Therefore, provision for payment of pre-trust debts, including liens, subrogated interests, litigation costs and plaintiff's attorneys' fees, should be made in counsel's Petition and Order directing establishment of the trust. Those items should be paid from the gross settlement prior to funding the trust.

Court ordered SNTs might require the Trustee to file annual accountings with the court. Mandatory court accountings are not included in the federal legislation concerning SNTs. However, local court rules or state law often governs court approval of this type of trust arrangement. Even when court rules and statutes do not demand accountings, the courts have jurisdiction to demand accountings. Fortunately, this requirement should not result in delays in trust activities or responsiveness, since advance court approval of trust investments or disbursements is not obligatory.

Income Tax Implications

Even if a parent, grandparent, guardian or court establishes an SNT, the disabled beneficiary is the Grantor, for income tax purposes, of the trust because the beneficiary is the actual owner of the assets that are funding the trust. Revenue Ruling 83-25, 1983-1 CB 116 held that a disabled beneficiary, as the owner of the damages award, is considered the Grantor of the trust to which the damages were transferred. Since the disabled beneficiary is considered the Grantor of a court ordered SNT and the income may be distributed to, or for the benefit of, the beneficiary at the discretion of

The Trustee may pay the income tax liability directly to the Internal Revenue Service on behalf of the disabled beneficiary as a distribution for the special needs of the beneficiary.

Although the disabled beneficiary is considered the owner of the SNT for income tax purposes, the beneficiary is not considered the owner of the income for purposes of meeting eligibility requirements for government assistance programs. For eligibility purposes, income is defined in 20 C.F.R. Section 416.1102 as anything received by the beneficiary in cash or kind that can be used to meet the needs for food, clothing, and shelter. Under the Grantor trust rules, the disabled beneficiary never actually receives the income but is only taxed on it.

General Considerations

Whenever a professional fiduciary will be used to manage a trust, the factors such as fee structure, investment performance, continuity and flexibility should be considered. It is not essential for all parties to sign the trust prior to presentation at Court, since there is no trust until the court orders it. However, as to any signors who have not executed the trust before hearing, it is vital that they have had the opportunity to review the trust format (draft or final form) and advise counsel they will abide by the trust's terms and provisions. The parties need not attend the hearing, unless otherwise directed by the court or required in that jurisdiction. If a professional fiduciary is not designated as Trustee, the court may require bonding for the Trustee.

Care must be taken when presenting an SNT to a court for approval to avoid any appearance of continued control or ownership of the proceeds by the beneficiary. If the beneficiary or beneficiary's guardian/conservator requests creation of the trust, the beneficiary may be considered as having voluntarily placed the proceeds in the trust, thereby having had "control" over the trust and assets. To avoid these complications, the court is asked to make an independent determination on the appropriateness of the trust. The court's jurisdiction to do this is premised on the beneficiary's disability. Depending on state law, total "incompetency" may not be required, merely that the client meet the disability criteria established for eligibility for SSI benefits.

It is important to use counsel who is familiar not only with the requirements within the jurisdiction where trust approval is sought, but with trust law and special needs planning.