

Settlement Compliance Strategies for Closing Cases

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Ethical Issues at Settlement

Suffering even a moderate personal physical injury can create difficult challenges both financially and emotionally for even the strongest among us. However, what happens when someone suffers a serious or catastrophic personal physical injury? Do they get the proper counsel regarding the form of the settlement to protect their current assets, preserve public benefits and safeguard the physical injury recovery? Will the recovery be enough to pay for all the victim's future medical needs without public assistance? Can they recover physically? Can they recover emotionally? All these issues can be very difficult to face for someone who is seriously injured. Personal injury practitioners who represent disabled clients should be aware of their obligations to advise these clients properly and understand the hurdles faced by the injury population in terms of recovery both financially and physically. This white paper addresses issues of major importance when dealing with the form of settlement for a personal injury matter involving a disabled client.

Ethical Concerns & Malpractice Liability

The ABA Model Rules and Ethical Obligations to Advise the Personal Injury Client

Personal injury lawyers are excellent at consulting with clients on the value of their case and obtaining significant monetary results in the litigation, however the practitioner sometimes fails to properly advise/protect their client financially post-settlement.¹ For personal injury

¹ This statement is based on the author's personal experience and observations in countless cases. However, the author acknowledges that practices do vary considerably in this area. Some trial lawyers may simply refer a client to a financial advisor or a local bank. Others may employ a settlement planner with expertise in structured

victims there is usually a focus on the dollar amount of the recovery rather than how the recovery can be structured to provide protection to the disabled injury victim.² The concentration of substance over form by the lawyer handling the physical injury suit can have devastating consequences for an injury victim. A disabled injury victim can mismanage their personal injury recovery and lose the public benefit eligibility they desperately need.³ Therefore questions arise: Does a lawyer have an ethical obligation to advise a disabled client regarding the form of their recovery? Does the lawyer have an ethical duty to explain the impact of a personal injury recovery on public benefits and techniques to protect eligibility? Below I examine the ethical rules, statutes and case law to shed some light on potential answers to these questions.

There are four provisions within the ABA Model Rules of Professional Conduct that are particularly relevant to the personal injury lawyer's advisement obligations when it comes to consulting on the form or structure of disabled injury victim's recovery. Rule 1.4 (b) provides: "A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions"⁴ Rule 1.3 states: "A lawyer shall act with reasonable diligence and promptness in representing a client."⁵ The commentary warns: "A client's interests can be adversely affected by the passage of time."⁶ 1.2 (a) admonishes that: "A lawyer shall abide by the client's decisions concerning the objectives of representation . . . and shall consult with the client as to the means by which they are to be pursued."⁷ Rule 1.2 also says "a lawyer shall

settlements and public benefit preservation techniques. *See also* Ellen S. Pryor, *Liability for Inchoate and Future Loss After Judgment*, VA. L. REV., 1758, 1813 – 1827 (2002) (concluding that practices vary considerably in terms of advisement by the trial lawyer regarding financial obligations at settlement).

² *Id.*

³ *See Generally* Marcus L. Plant, *Periodic Payment of Damages for Personal Injury*, LA. L. REV., 1327, 1331 – 1332 (discussing numerous studies on dissipation of settlements and the resulting dependence on public assistance programs).

⁴ Model Rules of Professional Conduct Rule 1.4(b) (2007).

⁵ Model Rules of Professional Conduct Rule 1.3 (2007).

⁶ Model Rules of Professional Conduct Rule 1.3 (2007).

⁷ Model Rules of Professional Conduct Rule 1.2(a) (2007).

abide by the client's decision whether to settle a matter."⁸ Finally, Rule 2.1 indicates: "In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."⁹

Many personal injury practitioners seem to believe that advice regarding financial matters and techniques to preserve public benefit eligibility crosses the line between legal and "financial" advice. However, as I will discuss more thoroughly below, these issues touch on the law and do create an obligation on the part of the personal injury practitioner to properly advise the client regarding their implication as to the form or structure of the recovery. If you take the Model Rules together with the legal malpractice case law discussed below, it is this author's opinion that the personal injury lawyer must address the financial implications of the settlement and impact on public benefit eligibility with the injured client to enable the client to make an informed decision about the form of the settlement. Allowing a disabled client to take the personal injury recovery in a single lump sum without any advice on the impact of that decision would set up a situation where the client could be adversely impacted by the passage of time.

Malpractice Liability for Failing to Advise Injury Victim Clients

The *Grillo*¹⁰ case from Texas is the most widely publicized legal malpractice settlement involving liability for failing to counsel a minor client on the form of a personal injury settlement. Christina Grillo was born with Cerebral Palsy, cortical blindness and quite a few other medical problems.¹¹ Her parents instituted a medical malpractice action alleging her

⁸ Model Rules of Professional Conduct Rule 1.2 (2007).

⁹ Model Rules of Professional Conduct Rule 2.1 (2007).

¹⁰ Grillo was a confidential legal malpractice settlement that became public due to a filing error on the part of the court approving the malpractice action. See Amy Johnson Conner, *Is Plaintiffs' Lawyer Liable for Not Offering Structured Settlement?*, LAWYERS WEEKLY USA (August 6 2001).

¹¹ *Id.*

medical problems were due to negligent medical care during delivery in a Texas Hospital. The medical malpractice case was settled for \$2.5 million.¹² The settlement was placed into the court registry.¹³ The interest earned from the investments in the trust was taxable and the child lost her Medicaid eligibility since no special needs trust was established.¹⁴

The personal injury lawyers who handled the case were later sued for legal malpractice for their handling of the settlement. In the legal malpractice action, Grillo's legal counsel, Kevin Isern, alleged that her personal injury lawyer "didn't offer a structured settlement to the child and "[t]hey had the money deposited into the registry of the court . . . and she lost Medicaid."¹⁵ Having the money placed in the court registry meant Christina Grillo could not have a tax-free structured settlement and all of the accrued interest was taxable. Isern pointed out that "[i]n a structured settlement, that does not occur."¹⁶ He also pointed to the fact that the lawyers also failed to set up a special needs trust which would have preserved her Medicaid eligibility.¹⁷ Finally, Isern pointed out that in the *Grillo* case "[y]ou have a child who has all these needs, requires 24-hour care and has no government assistance to help pay for it. She got taxed on all the money she gained."¹⁸

The *Grillo* legal malpractice case was settled by the personal injury firm that handled the medical malpractice action on behalf of the minor and by the guardian ad litem ("GAL") who had represented the minor's interests when the settlement was approved.¹⁹ The personal injury

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Amy Johnson Conner, *Is Plaintiffs' Lawyer Liable for Not Offering Structured Settlement?*, LAWYERS WEEKLY USA (August, 6 2001).

firm settled the legal malpractice action for its handling of the medical malpractice settlement for \$1,600,000. Interestingly, the suit against the GAL was settled for \$2,500,000. For attorneys that serve as guardian ad litem with any frequency, it is attention grabbing that the GAL wound up with the largest share of the liability in terms of the gross settlement amount. However, it sends a clear warning message to personal injury lawyers as well as guardian ad litem about their obligations to properly advise a client about the financial options they have and preservation of public benefits.

The only other reported decision regarding suit over failing to give advice about the form of settlement is the *French v. Glorioso* decision.²⁰ In *French*, the injury victim, Karen French, was shot during a robbery attempt at a parking garage in New Orleans and was rendered a quadriplegic.²¹ She brought suit against the owners of the parking garage for providing insufficient security.²² At the time of the shooting, she was covered by a group health care plan but subsequently lost the coverage and was dependent on Medicaid. The case was settled in November of 1998.²³ In July of 1999, French consulted an attorney about setting up an SNT. The attorney advised her that she would lose her Medicaid eligibility since the settlement was deposited into the plaintiff attorney's trust account.²⁴ Following this discovery, French sued the personal injury lawyer for legal malpractice, negligent misrepresentation, breach of contract and breach of fiduciary duty.²⁵

²⁰ *French v. Glorioso*, 94 S.W.3d 739 (Tex. Ct. App. 2002).

²¹ *Id.* at 743.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

Ultimately, the *French* case was not decided upon the merits of her claim against her personal injury attorney but instead on a personal jurisdiction issue.²⁶ Ms. French hired a Texas lawyer to handle the claim, who in turn associated with local Louisiana counsel since the suit needed to be filed in Louisiana.²⁷ The legal malpractice action was brought in Texas against the Louisiana attorney, which raised personal jurisdiction issues.²⁸ There appeared to be some factual dispute between French and her personal injury attorney over what had been recommended in terms of setting up an SNT, but this case again demonstrates the potential malpractice liability for failing to properly and fully advise clients about the impact of the settlement on their financial situation and public benefit eligibility.²⁹

Finally, the American Bar Association released its report on the *Profile of Legal Malpractice Claims* in 2003 and personal injury lawyers made up the largest percentage of malpractice claims, twenty percent.³⁰ Advice and settlement/negotiation made up over twenty three percent of the claims overall.³¹ When those two categories are combined they are tied for first in terms of the highest claims by type of activity in the study.³² While the report does not specify, it is logical to conclude that claims of failing to give advice about financial options, taxation of damages and preservation of public benefits would squarely fall within the purview of advice as well as settlement/negotiation malpractice claims.

²⁶ *Id.* at 747.

²⁷ *Id.* at 743.

²⁸ *Id.*

²⁹ *Id.* at 747.

³⁰ *American Bar Association Standing Committee on Lawyers' Professional Liability*, PROFILE OF LEGAL MALPRACTICE CLAIMS (2003).

³¹ *Id.*

³² Preparation, filing, and transmittal of documents made up 23.08% of claims. The next highest claim by type of activity, after the combination of advice and settlement/negotiation, was pre-trial and pre-hearing at 19.47%. *American Bar Association Standing Committee on Lawyers' Professional Liability*, PROFILE OF LEGAL MALPRACTICE CLAIMS (2003).

Ethical and Legal Duties to the Plaintiff at Settlement

The fact that all the issues relating to the form of the recovery touches the law drives home the fact that it is the personal injury lawyer's obligation to at least raise these issues as part of their discussions with the disabled client. As discussed above, there are provisions in the United States Code along with the Internal Revenue Code that impact the form of the recovery. These provisions, if not explained to the injury victim client, can result in the client's inability to avail themselves of options available under the law. If the injury victim's lawyer does not explain these issues to them, who will?

If the disabled client is not given advice about how to structure their recovery, they could suffer quantifiable damages that can be proven in a legal malpractice case. There are many experts that can be hired to make sure clients are properly advised of all their options for their recovery. To avoid future liability, the personal injury lawyer should hire such experts to protect their clients and themselves. If clients refuse counseling or refuse methods to protect their recovery, a good course of action is to have them sign a waiver or acknowledgement that they have been advised of their options and understand what they are giving up. If the personal injury practitioner gives clients all their options regarding how to structure their recovery, and has them sign a waiver/acknowledgement if they decline the options presented to them, the lawyer has at least documented the file so if there is a subsequent legal malpractice claim they can offer evidence of the advice they gave.

Pursuant to the *Grillo* decision and the Model Rules, a lawyer must counsel clients regarding their financial options and techniques to preserve public benefits to avoid causing a potential loss to the client. *Grillo's* message to plaintiff lawyers is to employ or consult competent experts in taxation, trusts and structured settlements prior to distributing any funds to

the injury victim. If a lawyer fails to discuss the financial options a client has and then the client sues for legal malpractice, there are demonstrable damages as *Grillo* so aptly demonstrated.

Without knowledge of the tax law, the client can lose the power of a significant tax exemption offered for structured settlement recipients. He or she can lose out on the opportunity for a safe investment with competitive rates of return. Finally, and potentially the most damaging, the client can lose public assistance eligibility.

The problem is that plaintiff counsel typically has a very short time period within which to counsel the client in between settlement/verdict and disbursement of the funds. The biggest mistake a personal injury lawyer can make is triggering constructive receipt³³ by placing the settlement proceeds in his or her trust account. One solution to the settlement time crunch is to use a qualified settlement fund (QSF). A QSF is a temporary settlement related trust that can be created pursuant to Treasury Regulations to receive personal injury settlement proceeds.³⁴ A court with jurisdiction over the matter must issue an order creating the trust and the trust must meet the definition of a trust under state law.³⁵ Once created, it allows for an immediate cash

³³ Constructive receipt is a tax doctrine that says even though a taxpayer might not have actual possession of money, they have constructively received the money if it has been set aside, credited to an account or otherwise is available without limitation to the taxpayer. Money held in a plaintiff attorney's trust account that belongs to the personal injury victim is constructively received for tax purposes. This concept is important because once triggered; the plaintiff forever loses the ability to structure his or her settlement and could lose public benefits.

³⁴ Treas. Reg. § 1.468B-1 (2007). There are three requirements for creation of a QSF: (1) It is established pursuant to an order of . . . a court of law . . .; (2) It is established to resolve or satisfy one or more contested or uncontested claims . . . and that has given rise to at least one claim asserting liability (i) Under CERCLA (ii) Arising out of a tort, breach of contract, or violation of law; or (iii) Designated by the Commissioner in a revenue ruling or revenue procedure; and (3) The fund, account, or trust is a trust under applicable state law . . .

³⁵ Treas. Reg. § 1.468B-1 (2007). The mechanical steps involved in utilizing a QSF are as follows: 1. Settle with Defendant for cash and execute a cash release which includes the agreement that Defendant will pay the settlement proceeds into the QSF. 2. Petition a court with jurisdiction for creation of Qualified Settlement Fund and obtain order creating QSF. 3. Defendant writes a check for the net proceeds to the Plaintiff to the Qualified Settlement Fund. 4. Funds remain in Qualified Settlement Fund, without violating constructive receipt doctrine, until: a. Allocation decisions are made; b. Liens are satisfied; c. Special needs trust is created or deemed not necessary. Amount to be structured and the plan are decided upon. 5. QSF automatically terminates when all funds have been dispersed.

settlement with the defendant and removes the defendant from the process. The QSF acts as a holding tank for the settlement proceeds and gives plaintiff counsel time to employ experts while preserving the ability to structure the settlement as well as create public benefit preservation trusts without violating the tax doctrine of constructive receipt. A financial plan can be developed, and the client's needs addressed.

A personal injury practitioner must discuss with disabled clients the form of their personal injury recovery or hire an expert to do so. There are many different options when it comes to the form of the financial recovery. While there certainly is no clear-cut answer as to the amount of the recovery that would trigger the counseling obligation, if a physical injury recovery could result in loss of public benefits it is prudent for the lawyer give advice to that client about the options or have an expert do so. Every client, no matter age, sex or level of sophistication, should be given their options regarding the form of the recovery which are available under the law. Disabled clients especially need counseling given the likelihood they will be receiving some type of public benefits. To prevent being exposed to a malpractice cause of action, the personal injury practitioner should understand the types of public benefits that a disabled client may be eligible for and techniques that are available to preserve those benefits. Having this knowledge will help the lawyer identify disabled clients they may want to refer for further consultation with other experts.

Overview of Public Assistance Programs & Laws That Impact Settlement

Because most of a lawyer's malpractice exposure at settlement is related to public benefit preservation, it is important to understand the basics of these benefits. Ethically, a lawyer must be able to explain these matters to the extent that the client is informed sufficiently to make educated decisions. There are two primary public benefit programs available to those who are injured and disabled. The first is the Medicaid program and the intertwined Supplemental Security Income benefit ("SSI"). The second is the Medicare program and the related Social Security Disability Income/Retirement benefit ("SSDI"). Both programs can be adversely impacted by an injury victim's receipt of a personal injury recovery. Understanding the basics of these programs and their differences is imperative to protecting the client's eligibility for these benefits.

Medicaid and Supplemental Security Income (hereinafter SSI) are income and asset sensitive public benefits which require special planning to preserve. In many states, one dollar of SSI benefits automatically provides Medicaid coverage. This is very important, as it is imperative in most situations to preserve some level of SSI benefits if Medicaid coverage is needed in the future. SSI is a cash assistance program administered by the Social Security Administration. It provides financial assistance to needy, aged, blind, or disabled individuals. To receive SSI, the individual must be aged (sixty-five or older), blind or disabled³⁶ and be a U.S. citizen. The recipient must also meet the financial eligibility requirements.³⁷ Medicaid

³⁶ Disability is defined the same way as for Social Security Disability benefits which is that the disability must prevent any gainful activity (e.g. employment), last longer than 12 months, or be expected to result in death. If someone receives disability benefits from Social Security, they automatically qualify as being disabled for purposes of SSI eligibility.

³⁷ An individual can only receive up to \$552.00 per month (\$829.00 for couples) and no more than \$2,000 in countable resources.

provides basic health care coverage for those who cannot afford it. It is a state and federally funded program run differently in each state. Eligibility requirements and services available vary by state. Medicaid can be used to supplement Medicare coverage if the client is eligible for both programs³⁸. For example, Medicaid can pay for prescription drugs as well as Medicare co-payments or deductibles. Medicaid and SSI are income and asset sensitive, therefore, creation of a special needs trust may be necessary which is described in greater detail below.

Medicare and Social Security Disability Income (hereinafter SSDI) benefits are an entitlement and are not income or asset sensitive. Clients who meet Social Security's definition of disability and have paid enough quarters into the system can receive disability benefits regardless of their financial situation.³⁹ The SSDI benefit program is funded by the workforce's contribution into FICA (social security) or self-employment taxes. Workers earn credits based on their work history and a worker must have enough credits to get SSDI benefits should they become disabled. Medicare is a federal health insurance program. Medicare entitlement commences at age sixty-five or two years after becoming disabled under Social Security's definition of disability.⁴⁰ Medicare coverage is available again without regard to the injury

³⁸ This is commonly referred to as "dual eligibility". For those who are dual eligible, Medicaid will pay Medicare premiums, co-payments and deductibles within prescribed limits. There are two different programs. First, is Qualified Medicare Beneficiaries ("QMB"). The QMB program pays for the recipients Medicare premiums (Parts A and B), Medicare deductibles and Medicare coinsurance within the prescribed limits. QMB recipients also automatically qualify for extra help with the Medicare Part D prescription drug plan costs. The income and asset caps are higher than the normal SSI/Medicaid qualification limits. Second is Special Low-Income Medicare Beneficiary ("SLMB"). The SLMB program pays for Medicare premiums for Part B Medicare benefits. SLMB recipients automatically qualify for extra help with Medicare Part D prescription drug plan costs. Again, the income and asset caps are higher than the normal SSI/Medicaid qualification limits.

³⁹ While most often we deal with someone who has a disability, Social Security Disability also provides death benefits. Additionally, a child who became disabled before age 22 and has remained continuously disabled since age 18 may receive disability benefits based on the work history of a disabled, deceased or retired parent as long as the child is disabled and unmarried.

⁴⁰ SSDI beneficiaries receive Part A Medicare benefits which covers inpatient hospital services, home health and hospice benefits. Part B benefits cover physician's charges and SSDI beneficiaries may obtain coverage by paying a monthly premium. Part D provides coverage for most prescription drugs, but it is a complicated system with a large co-pay called the donut hole.

victim's financial situation. A special needs trust is not necessary to protect eligibility for these benefits. However, the Medicare Secondary Payer Act (MSP) may necessitate the use of a Medicare Set Aside discussed in greater detail below.

Laws that Impact Settlement

In order to properly advise personal injury victims about their legal options at settlement, an attorney first must know and understand the laws that impact settlement. There are important federal laws that can impact a client's eligibility for public benefits post settlement that must be explained. There are also financial options provided for under the Internal Revenue Code that should be explored. These issues are laid out in more detail with a focus on the ethical and malpractice issues raised in discussing the form of a personal injury settlement.

Public Assistance

The Medicare Secondary Payer Act: §1862(b) of the Social Security Act

A client who is a current Medicare beneficiary or reasonably expected to become one within 30 months should concern every trial lawyer because of the implications of the MSP. The Medicare Secondary Payer Act ("MSP") is a series of statutory provisions⁴¹ enacted in 1980 as part of the Omnibus Reconciliation Act⁴² with the goal of reducing federal health care costs. The MSP provides that if a primary payer exists, Medicare only pays for medical treatment relating to an injury to the extent that the primary payer does not pay.⁴³ The regulations that implement the MSP provide "[s]ection 1862(b)(2)(A)(ii) of the Act precludes Medicare payments for services

⁴¹ The provisions of the MSP can be found at Section 1862(b) of the Social Security Act. 42 U.S.C. § 1395y(b)(6) (2007).

⁴² Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499 (Dec. 5, 1980).

⁴³ 42 CFR § 411.20(2) Part 411, Subpart B, (2007).

to the extent that payment has been made or can reasonably be expected to be made promptly under any of the following” (i) Workers’ compensation; (ii) Liability insurance; (iii) No-fault insurance.”⁴⁴

There are two issues that arise when dealing with the application of the MSP: (1) Medicare payments made prior to the date of settlement (conditional payments) and (2) future Medicare payments for covered services (Medicare set asides). Since Medicare isn’t supposed to pay for future medical expenses covered by a liability or Workers’ Compensation settlement, or a judgment or award, Centers for Medicare & Medicaid Services (CMS) recommends that injury victims set aside a sufficient amount to cover future medical expenses that are Medicare covered. CMS’ recommended way to protect an injury victim’s future Medicare benefit eligibility is establishment of a Medicare Set Aside (“MSA”) to pay for injury related care until exhaustion.

In certain cases, a Medicare Set Aside may be advisable in order to preserve future eligibility for Medicare coverage. A Medicare set aside allows an injury victim to preserve Medicare benefits by setting aside a portion of the settlement money in a segregated account to pay for future Medicare covered healthcare. The funds in the set aside can only be used for Medicare covered expenses for the client’s injury related care. Once the set aside account is exhausted, the client gets full Medicare coverage without Medicare looking to their remaining settlement dollars to provide for any Medicare covered health care. In certain circumstances, Medicare approves the amount to be set aside in writing and agrees to be responsible for all future expenses once the set aside funds are depleted.

⁴⁴ *Id.*

The problem is that MSAs are not required by a federal statute even in Workers' Compensation cases where they are commonplace. There are no regulations, at this time, related to MSAs either. Instead, CMS has intricate "guidelines" and "FAQs" on their website for nearly every aspect of set asides from submission to administration. There are only limited guidelines for liability settlements involving Medicare beneficiaries. Without codification of set asides, there are no clear-cut appellate procedures from arbitrary CMS decisions and no definitive rules one can count on as it relates to Medicare set asides. While there is no legal requirement that an MSA be created, the failure to do so may result in Medicare refusing to pay for future medical expenses related to the injury until the entire settlement is exhausted. There has been a slow progression towards a CMS policy of creating set asides in liability settlements over the last seven years as a result of the Medicare Medicaid SCHIP Extension Act's passage⁴⁵. This creates a difficult situation for Medicare beneficiary-injury victims and contingent liability for legal practitioners as well as other parties involved in litigation involving physical injuries to Medicare beneficiaries given the uncertainty surrounding the need to create a set aside. There appear to be regulations on the horizon for set asides based upon a Notice of Proposed Rulemaking from CMS entitled "Medicare Secondary Payer and Future Medicals".⁴⁶

Special Needs Trusts: 42 U.S.C. §1396p(d)(4)

⁴⁵ The MMSEA created a mandatory insurer reporting requirement which tasks defendants/insurers with reporting settlements involving Medicare beneficiaries to Medicare. The reporting requirement requires settlements of \$2,000 or greater to be reported as of 10/1/13. Medicare, Medicaid, and SCHIP Extension Act of 2007 (P.L. 110-173). This Act was passed by the House on December 19, 2007, and by a voice vote in the Senate on December 18, 2007.

⁴⁶ See OMB Website at http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201304&RIN=0938-AR43&utm_source=hs_email&utm_medium=email&utm_content=9802088&_hsenc=p2ANqtz-euylttJVQH6n2LezrHHgA7PMzVcdcZQAsDlnCG1ebSm8BHxtM5Ar222rNomoh-yQIo5y49aJC-7LqU-KfmwSRwyL2xmKNhbg9vTUcuUjT1mNfif4&_hsmi=9802088

The receipt of personal injury proceeds by someone seriously injured can cause ineligibility for means based tested government benefit programs. Medicaid⁴⁷ and SSI⁴⁸ are two such programs. However, there are planning devices that can be utilized to preserve eligibility for disabled injury victims. A special needs trust (SNT) can be created to hold the recovery and preserve public benefit eligibility since assets held within a special needs trust are not countable resources for purposes of Medicaid or SSI eligibility. The creation of special needs trusts is authorized by the federal law.⁴⁹ Trusts commonly referred to as (d)(4)(a) special needs trusts, named after the federal code section that authorizes their creation, are for those under the age of sixty five.⁵⁰ However, another type of trust is authorized under the federal law with no age restriction and it is called a pooled trust, commonly referred to as a (d)(4)(c) trust.⁵¹ These trusts are described fully below.

A personal injury recovery can be placed into a SNT so that the victim can continue to qualify for SSI and Medicaid. Federal law authorizes and regulates the creation of a SNT. The 1396p⁵² provisions in the United States code govern the creation and requirements for such trusts. First and foremost, a client must be disabled in order to create a SNT.⁵³ There are three

⁴⁷ Medicaid is a needs based public benefit that provides basic health care coverage for those who are financially eligible. The Medicaid program is federally, and state funded but administered on the state level. Services and eligibility requirements vary from state to state. The asset limit is \$2,000 for most Medicaid programs but the income limits vary by state.

⁴⁸ SSI or Supplemental Security Income, administered by the Social Security Administration, provides financial assistance to U.S. citizens who are sixty-five or older, blind or disabled. The recipient must also meet the financial eligibility requirements. 42 U.S.C. § 1382 (2007).

⁴⁹ 42 U.S.C. § 1396p (d)(4) (2007).

⁵⁰ 42 U.S.C. § 1396p (d)(4)(A) (2007).

⁵¹ 42 U.S.C. § 1396p (d)(4)(C) (2007).

⁵² 42 U.S.C. § 1396p (2007)

⁵³ To be considered disabled for purposes of creating an SNT, the SNT beneficiary must meet the definition of disability for SSDI found at 42 U.S.C. § 1382c. 42 U.S.C. § 1382(c)(a)(3) states that “[A]n individual shall be considered to be disabled for purposes of this title ... if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or ... last for a continuous period of not less than twelve months (or in the case of a child under the age of 18, if that individual has a medically determinable physical or mental impairment, which results in marked and severe

primary types of trusts that may be created to hold a personal injury recovery each with its own requirements and restrictions. First is the (d)(4)(A)⁵⁴ special needs trust which can be established only for those who are disabled and are under age sixty-five. This trust is established with the personal injury victim's recovery and is established for the victim's own benefit. It can only be established by a parent, grandparent, guardian or court order. The injury victim can't create it on his or her own. Second is a (d)(4)(C)⁵⁵ trust, typically called a pooled trust that may be established with the disabled victim's funds regardless of age. A pooled trust can be established by the injury victim unlike a (d)(4)(A). Third and last is a third party⁵⁶ SNT which is funded and established by someone other than the personal injury victim (i.e., parent, grandparent, charity, etc. . .) for the benefit of the personal injury victim. The victim still must meet the definition of disability.

Dual Eligibility: The Intersection of Medicare and Medicaid – SNT/MSA

If you have a client who is a Medicaid and Medicare recipient, extra planning may be in order. If it is determined that a Medicare Set Aside is appropriate, it raises some issues with

functional limitations, and which can be expected to result in death or ... last for a continuous period of not less than 12 months).”

⁵⁴ 42 U.S.C. § 1396p (d)(4)(A) provides that a trust's assets are not countable if it is “[a] trust containing the assets of an individual under age 65 who is disabled (as defined in section 1382c(a)(3) of this title) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this subchapter.”

⁵⁵ 42 U.S.C. § 1396p (d)(4)(C) provides that a trust's assets are not countable if it is “[a] trust containing the assets of an individual who is disabled (as defined in Section 1382(a)(3) of this title) that meets the following conditions: **(i)** The trust is established and managed by a non-profit association. **(ii)** A separate account is maintained for each beneficiary of the trust, but, for purposes of investment and management of funds, the trust pools these accounts. **(iii)** Accounts in the trust are established solely for the benefit of individuals who are disabled (by the parent, grandparent, or legal guardian of such individuals, by such individuals, or by a court. **(iv)** To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this subchapter.”

⁵⁶ Third party special needs trusts are creatures of the common law. Federal law does not provide requirements or regulations for these trusts.

continued Medicaid eligibility. A Medicare Set Aside account is considered an available resource for purposes of needs-based benefits such as SSI/Medicaid. If the Medicare Set Aside account is not set up inside a SNT, the client will lose Medicaid/SSI eligibility. Therefore, in order for someone with dual eligibility to maintain their Medicaid/SSI benefits the MSA must be put inside a special needs trust. In this instance you would have a hybrid trust which addresses both Medicaid and Medicare. It is a complicated planning tool but one that is essential when you have a client with dual eligibility.

Financial Considerations

Periodic Payments: §104(a)(2) of the Internal Revenue Code

When any physical injury victim recovers money either by settlement or by verdict, the question of the tax treatment of said recovery arises. As long as it is compensation for personal physical injuries it is tax-free under Section 104(a)(2) of the Internal Revenue Code.⁵⁷ Section 104(a)(2) of the Internal Revenue Code states that “gross income does not include . . . the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.”⁵⁸ Section 104(a)(2) gives the personal injury victim two different financial options for their recovery, lump sum or periodic payments.⁵⁹

The first option is to take all of the personal injury recovery in a single lump sum. If this option is selected, the lump sum is not taxable, but once invested, the gains become taxable and

⁵⁷ I.R.C. § 104(a)(2) (2007).

⁵⁸ *Id.*

⁵⁹ *Id.*

the receipt of the money will impact his or her ability to receive public assistance.⁶⁰ A lump sum recovery does not provide any spendthrift protection and leaves the recovery at risk for creditor claims, judgments and potential rapid dissipation.⁶¹ The personal injury victim has the burden of managing the money to provide for their future needs be it wage loss or future medical. The second option is receiving “periodic payments” known as a structured settlement⁶² instead of a single lump sum payment. A structured settlement’s investment gains are never taxed⁶³, it offers spendthrift protection⁶⁴ and the money has enhanced protection against creditor claims as well as judgments.⁶⁵ A structured settlement recipient can avoid disqualification from public assistance when a structured settlement is used in conjunction with the appropriate public benefit preservation trust.

If a structured settlement is to be used for someone eligible for needs based public benefits such as Medicaid and/or SSI, it is vitally important that a plan be properly constructed to avoid disqualification. A structured settlement alone will never preserve public benefit eligibility and may in fact cause permanent disqualification when lifetime benefits are involved.

⁶⁰ *Id.*

⁶¹ Unlike a structured settlement, simply receiving a lump sum does not provide any spendthrift protection as the money can be dissipated rapidly. Similarly, there is no protection from creditor claims like a structured settlement enjoys.

⁶² A structured settlement is a single premium fixed annuity used to provide future periodic payments to personal physical injury victims. The interest earned is not taxable under Section 104(a)(2) and a series of revenue rulings that provide the basis for structured settlements.

⁶³ *See* I.R.C. § 104(a)(2) (2007). *See also* Rev. Rul. 79-220 (1979) (holding recipient may exclude the full amount of the single premium annuity payments received as part of a personal injury settlement from gross income under section 104(a)(2) of the code).

⁶⁴ Structured settlements can’t be accelerated, deferred, anticipated or encumbered. The payments are made pursuant to the terms of the contract with the life insurance company. Thus, a personal injury victim is protected from spending the money too quickly. However, there are “factoring” companies that will purchase structured settlement annuities and provide a lump sum payment. These transactions are now regulated by IRC 5891 and many states have enacted provisions to protect structured settlement recipients from unfair transactions. IRC 5891 requires a finding that the sale is in the best interest of the annuitant and requires judicial approval. IRC 5891

⁶⁵ Many states offer protection by statute for annuities. For example, in Florida, the Florida Statutes provide annuities immunity from legal process as long as they are not set up to defraud creditors. *See generally* § 222.14 Fla. Stat. (2007).

For example, in *Sams v. DPW*⁶⁶, a Pennsylvania court found that the purchase of a structured settlement as part of a personal injury settlement was a transfer of assets for less than fair market value, causing disqualification from needs-based benefits for the recipient. To avoid this sort of outcome, it is necessary that a structured settlement's payments be irrevocably assigned to a properly created special needs trust. According to a 2006 Social Security Administration letter, "if the beneficiary of a trust which is not a resource for SSI has no right to anticipate, sell or transfer the annuity payments, the payments from a structured settlement annuity that are irrevocably assigned to an SNT, are not income to the trust beneficiary when paid into the trust."⁶⁷ In addition, under the *Sams* decision, payments should begin immediately into the trust. They cannot be deferred, and the death beneficiary of future payments should be the special needs trust so as not to frustrate federal payback requirements.

⁶⁶ *Sams v. Department of Public Welfare*, 2013 Pa. Commw. LEXIS 337 (August 21, 2013).

⁶⁷ Letter from Nancy Veillon, Associate Commissioner for Income Security Programs to Roger M. Bernstein dated January 1, 2006.