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**SPECIAL NEEDS TRUSTS – INCLUDING
SPECIAL NEEDS – WHAT ARE THEY?
WHEN ARE THEY NEEDED, OR NOT?**

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**SPECIAL NEEDS TRUSTS – INCLUDING SPECIAL NEEDS – WHAT ARE THEY?
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I. SPECIAL NEEDS TRUSTS (“SNT”) – WHAT ARE THEY; WHEN ARE THEY NEEDED, OR NOT?

A. SNTS – WHAT ARE THEY?

**1. FIRST – CONVENTIONAL STANDARDS OF TRUST LAW -
TRIANGULAR LEGAL PROTECTIVE SHELTER**

a. Standard Trust Protections

A trust...a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or one or more other persons, at least one of whom is not the sole trustee.²

A trust may also be described as a fiduciary relationship in which one person is the holder of the title to property, subject to an equitable obligation to keep or use the property for the benefit of another.³

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² See Restatement Third, Trusts § 2, at 17 (Cum. Supp. 2006); Charles E. Rounds, Jr., *Loring A Trustee’s Handbook*, 1 (2007 ed.).

³ See George G. Bogert, *Handbook of the Law of Trusts*, 1 (1963); see also Black’s Law Dictionary, 1047 (abg 6th ed. 1991).

b. Third Party and Others As Fiduciary – Trustee.

A trustee is a person, persons or legal entity or entities with legal capacity to receive, hold and manage property in trust. In certain instances, the settler and/or the beneficiary of the trust may be a co-trustee.⁴

c. Spend Thrift Protection

A spend thrift trust is a trust that restrains voluntary and involuntary alienation of all or any of the beneficiary's interests.⁵ The spendthrift [provision] trust protects the income and principal interests of its beneficiary from the claims of creditors as long as the income and or principal in question is properly held in the trust.⁶

d. Shield Against Undue Influence

A trust generally protects the beneficiary from those attempting to gain access to the income or principal of the trust by exacting undue influence on the beneficiary. However, the protections of the trust usually do not extend to distributions made from the trust corpus to the beneficiary.

2. SECOND - SNTs – AN EXPANDED SHELTER FOR GAINING GOVERNMENTAL BENEFITS ELIGIBILITY UNDER STATE AND FEDERAL LAWS.

a. What Is a Special Needs Trust? Historically the special needs trust (“SNT”) is a hybrid of the irrevocable discretionary trust. In the 1970s, parents of children with severe, chronic disabilities (primarily mental retardation) worked with trust and estates counsel to develop legal

⁴ See Restatement Third, Trusts, *supra* note 2, § 3, at 36; *Loring A Trustee's Handbook*, *supra* note 2, at 47, North Carolina Uniform Trust Code 36C-1-103 (22) (Hereafter “NCUTC”).

⁵ See Restatement Third, Trusts, *supra* note 2, § 58, at 355; NCUTC 36C-5-502, and accompanying general comment.

⁶ *Id.*, § 58, comment d, at 361.

vehicles that would not only provide for the transfer of funds for the benefit of their children with severe disabilities, but more importantly mandate to the trustees detailed instructions that addressed the quality of care and the quality of life of the children to be served by the trustee.

- b. SNT History.** With more than twenty years of SNT development, consumer driven organizations, including the ARC of America, and all affiliated organizations in every state, the National Alliance for the Mentally Ill and the National Autistic Society, and its affiliates across the states, just to mention a few, have been advising their members, numbering in the millions, to utilize the SNT for estate planning purposes.
- c. SNT Politics.** In the early nineties, Congress became concerned with escalating Medicaid costs. With the shift in control to the Republicans in 1992, a concerted effort was made to stiffen the regulations by which persons become Medicaid eligible.

As various committees rewrote legislation focused on so-called “Medicaid planning loop-holes”, repeal of the Medicaid Qualifying Trust became a primary target. However, the consumer groups identified above teamed with the AARP and other organizations in the aging network, including the National Academy of Elder Law Attorneys, to negotiate the exemption of several trusts that if designed to allow for a “pay-back” or reimbursement of the state for Medicaid expenditures on behalf of the trust beneficiary at the end of the trust beneficiary’s life would be exempt and not counted under Medicaid eligibility requirements.

d. New Life for SNTs. New life was breathed into SNTs and in addition, testamentary SNTs were continued as exempt under the statutory and regulatory revisions to Medicaid that became law in 1993.

(1) Primary SNTs. There are several statutorily exempt SNTs.

However, the three created under the Revenue Reconciliation Act of 1993, better known as OBRA '93,⁷ require a “pay-back” provision.

(2) The d4A Individual SNT. The d4A, individual SNT is created by court order, a guardian, parents or grandparents of the trust beneficiary, irrevocable, and for the sole benefit of the trust beneficiary if under the age of 65 and disabled as defined under federal law.

(3) The d4B Individual Income Only SNT. The d4B individual SNT, is the so-called “Miller” or “income only” trust with the same criteria as the d4A. Income is diverted to the trust, with a mandatory amount just under the income cap calculated for distribution by the trustee to pay the patient monthly liability. Funds remaining in the trust must be used for the sole benefit of the beneficiary to supplement his or her quality of life. At the end of the beneficiary’s life, if there is remaining corpus, then it must be used to payback the state.

(4) The d4C Pooled SNT. During the early ‘90s, the federal government and many states, including North Carolina, created statutory

⁷ See 42 U.S.C. § 1396p(d)(4).

initiatives to privately fund organized nonprofit organizations to care for Medicaid recipients through the use of pooled trusts.⁸ Pooled trusts are special needs trusts comprised of the assets of elder citizens and people with disabilities and consolidated under an umbrella nonprofit organization, serving as trustee and responsible for the care of the trust beneficiaries. The concept originated in a more narrow focus where families wanting to leave portions of their estates to care for their family members with developmental disabilities would leave funds in special needs trusts. The focus has expanded to include vulnerable elderly persons who either need asset preservation of their estates to sustain the quality of their lives, or need individualized care giving because they have out-lived their families or never had a family. Since pooled trusts are exempt under Medicaid, each beneficiary of the pooled trust would be an eligible Medicaid recipient.

The assets of the special needs trusts are pooled for management and cost efficiency, with accumulating interest credited to each individual. The supplemental or special needs of each individual are funded with the assets ascribed categorically to the individual during the individual's lifetime, or until the individual's funds are exhausted.

⁸ See N. C. Gen. Stat. § 36D-1 *et seq.* North Carolina Community Trust for Persons with Severe Chronic Disabilities (2007).

A nonprofit organization providing direct care and advocacy for the individual must be the trustee of the pooled trust. Rather than repaying Medicaid for all of the expenses that the client accumulated in long term care, the nonprofit organization would retain the assets remaining in the trust in order to serve other Medicaid recipients of similar need.

The importance of the concept deserves restatement. If Medicaid recipients have no one to care for them, and no families available to advocate their interests, then the nonprofit organization, as trustee of the pooled trust for the benefit of the Medicaid recipients, would supplement the Medicaid needs of the beneficiaries of the pooled trust in order to sustain the quality of their lives. Any assets remaining in the pooled trust beyond the lives of the beneficiaries would be retained by the nonprofit organization to be used for its purposes and mission in serving similarly situated vulnerable elder citizens or persons with disabilities.

It is important to note that the d4C pooled trust is available for persons over the age of 65.

(5) Non-payback SNTs.⁹ Non-payback SNTs under these statutory provisions allow parents and grandparents to transfer their assets to a trust without penalty if established solely for the benefit of the

⁹ See 42 U.S.C. § 1396p(c)(2)(B)(iii).

transferor's child with disability. Neither the parent, grandparent transferor, nor the child beneficiary are disqualified if certain conditions are met. The conditions¹⁰ require that the child beneficiary be blind or disabled as defined under federal law.¹¹ For those states eligible under different criteria, the child must be blind or permanently and totally disabled, without reference to any additional definition.¹² There is no statutory requirement that the trust payback Medicaid after the death of the trust beneficiary if all qualifications are met.

(6) Management and Distribution of SNT. Insurance and other security products should be creatively merged to provide the cash needed by the trustee to supplement the needs of the trust beneficiary while at the same time addressing the declining balance nature of the trust and building as much growth as possible under the circumstances.

(7) Benefit to Clients. The benefit to the client being served by the development and administration of the SNT is that it makes Medicaid immediately available to the elderly or disabled beneficiary, while at the same time stretching the assets in the trust in such a way as to provide additional years of increased quality of life through the trustee's purchase of supplemental quality services for the trust

¹⁰ See 42 U.S.C. § 1396p(c)(2)(A)(ii)(II).

¹¹ See § 1382c of the same title.

¹² See Clifton B. Kruse, Jr., *Third-Party and Self-Created Trusts – Planning for the Elderly and Disabled Client* (3rd ed. ABA 2002).

beneficiary. Additionally, the SNT is the vehicle often incorporated into personal injury awards or settlements in order to stretch funds to cover the life of the disabled plaintiff.¹³

b. Standard Discretionary Trust Language Versus Support Trust Language

1. Discretionary Trust Language

A discretionary trust is a trust wherein the trustee is given the discretion to determine whether and to what extent to pay or apply trust income or principal to or for the benefit of a beneficiary. [N.C. Gen. Stat. § 36C-5-504]. Under a true discretionary trust, the trustee may withhold the trust income and principal altogether from the beneficiary and the beneficiary, as well as the creditors and assignees of the beneficiary, cannot compel the trustee to pay over any part of the trust funds. A trust wherein the trustee has discretion only as to the time or method of making payments to or for the benefit of the beneficiary is not a true discretionary trust.¹⁴ (Reference to NCUTC Chp. 36C by author)

2. Support Trust Language

A trust that has mandatory provisions for the trustee to provide for the health, welfare, maintenance, food, clothing, shelter and education of

¹³ A. Frank Johns, *The Civil Litigator's Expanded Advocacy: Preserving Disabled Client Damage Awards with the Supplemental Needs Trust*, Trial Magazine (November, 1998).

¹⁴ *Lineback by Hutchins v. Stout*, 79 N.C. App. 292; 339 S.E.2d 103; 1986 N.C. App. LEXIS 1976; *Fortune v. First Union*, 323 N.C. 146; 371 S.E.2d 483; 1988 N.C. LEXIS 518. By definition, under a discretionary trust the trustee has discretion whether, and to what extent, to apply trust income or principal to, or for the benefit of, the beneficiaries. *Id.*, 371 S.E.2d at 489 (dissent); NCUTC 36A-5-504, 8-814.

the beneficiary that may not be ignored by the trustee in an exercise of discretion.

c. Supplemental Security Income (“SSI”)

Supplemental Security Income and Medicaid have merged for determining eligibility for benefits.

d. Special Assistance

e. Medicaid

f. Other Means Tested Federal or State Programs or Services

B. SNTs – WHEN NEEDED AND WHEN NOT

1. When Needed.

a. How is the SNT Attorney Engaged?

(1) Through the Personal Injury Lawyer

(2) Through the Plaintiff, or Plaintiff GAL or Guardian

(a) Guardian of the Person. Actually, the guardian of the person carries the power for hiring an attorney for the ward, not the guardian of the estate.

The guardian of the person may give any consent or approval that may be necessary to enable the ward to receive medical, legal, psychological, or other professional care, counsel, treatment, or service.¹⁵

(b) Guardian of the Estate. However, for the purpose of assuring that any settlement is acceptable within the jurisdiction of 35A guardians, the guardian of the estate should be involved in all aspects of the settlement process, including the timing of the SNT

¹⁵ See N.C. Gen. Stat. § 35A-1241 (a)(3) (2007).

setup and the distributions into the SNT rather than into the guardianship estate.

(14) To employ persons, including attorneys, auditors, investment advisors, appraisers, or agents to advise or assist him in the performance of his duties as guardian...¹⁶

(3) Through the Defendant

(4) Through Insurance Defense.

b. Disabled

(1) Defined by Social Security Act (“SSA”). If a beneficiary has been determined to be disabled under the SSA, then the beneficiary is considered disabled for Medicaid qualification and eligibility.¹⁷

(2) Per Se Disabled. The federal government has also identified in its rules those disabilities and medical impairments that are considered per se disabling.¹⁸

(3) Defined by OBRA ’93. The enabling federal legislation that created special needs trusts acknowledges other governmental designations of disability.¹⁹

c. The Need for Supplemental Support

Generally, there are more funds available than would ordinarily be spent down with purchases for the benefit of the plaintiff/victim, but

¹⁶ See N.C. Gen. Stat. § 35A-1251 (14) (2007).

¹⁷ 42 U.S.C. § 1382(c)(a)(3).

¹⁸ See Dana Shilling, *Legal Issues of Dependent and Incapacitated People*, § 12.5, n. 20, citing 20 C.F.R. pt. 404, subpt. P, appx. 1. (2007).

¹⁹ See 42 U.S.C. § 1614 (a)(3) (SSI); OBRA ’93, HCFA Transmittal 64, § 3259.7 (A) (1994).

insufficient funds to meet the total life plan needs of the plaintiff/victim.

See further analysis below.

d. Standard Shelter Protections

- (1) Circumvent Probate
- (2) Spendthrift Protection
- (3) Undue Influence

2. When Not

a. No Disability to Qualify for Benefits

- (1) Special Assistance, but not skilled level of care
- (2) SSD denial of disability claim
- (3) TBI person regaining ability and cognitive function

b. No Need for Standard Trust Shelter

c. Too Little Money Funding SNT (Net Proceeds Going into the SNT)

- (1) Is there a number under which the creation of the SNT is not cost efficient or beneficial?
- (2) Under \$10, 20, 30, 50 or 80,000 ?
- (3) Is it just the number, or do other elements and qualifiers come into play?

d. Too Much Money Funding SNT (Net Proceeds Going into the SNT)

- (1) Is there a number over which the creation of the SNT of not real value?
- (2) Over \$10, 20 30,000,000 ?
- (3) Is it just the number, or do other elements and qualifiers come into play?

II. PRIMARY COMPONENTS OF SPECIAL NEEDS TRUSTS RELATED TO STRUCTURED SETTLEMENTS AND PERSONAL INJURY LITIGATION

A. GRANTOR FUNDED

1. Statutory Limitations. Depending upon the kind of SNT being developed, the federal law limits who may create the SNT if the assets are the assets of the beneficiary and therefore a grantor trust:

a. (d)(4)(A). A (d)(4)(A) trust may only be created by a parent, grandparent, legal guardian or a court. Note that the individual may not create the trust.

b. (d)(4)(C). A (d)(4)(C) trust may be created by a parent, grandparent, legal guardian, the individual or a court. Note that the individual may create the trust. However, the individual must be over the age of 65.

2. Grantor Trusts Require Payback or Retention.

B. IRREVOCABILITY

C. SOLE BENEFIT

D. SUPPLEMENTAL STRUCTURE

E. CONTROLLED DISTRIBUTIONS

F. AMENDMENT

G. TERMINATION AND GOVERNMENTAL PAY-BACK

III. OPTIONAL COMPONENTS OF THE SPECIAL NEEDS TRUST

A. CORPORATE TRUSTEE

Corporations, Banks and Trust Companies whose charters specifically empower the entities to engage in trust services and the entities have all necessary licenses and state authorizations.

B. NONPROFIT TRUSTEE

1. Not for profit corporations, banks and trust companies whose charters specifically empowers the entities to engage in trust services, and the entities have all necessary licenses and state authorizations.
2. Additional requirement that the nonprofit serve clients with disabilities similar to that of the beneficiary named in the pooled trust, or have a formal relationship with such an entity.

C. FAMILY MEMBER TRUSTEE

1. Not favored – often creates problems with “Sole Benefit” mandate and the way in which the family member makes distributions; often little or no over-sight.
2. More difficult when beneficiary in the home of the family member trustee.
3. May be required by the Clerk of Superior Court to file an inventory, do annual accountings and post a bond.

D. TRUST ADVISORY COMMITTEE

1. Always a good component of the SNT
2. Naming members of the TAC
 - a. Parent(s)
 - b. Siblings
 - c. Other Family members
 - d. Medical, Health care or Therapeutic Professionals
 - e. Financial, accounting, securities or insurance professionals
 - f. Legal or Advocacy Professionals
4. Duties and Responsibilities of the TAC

E. TRUST PROTECTOR

- 1. Trust Protector Defined.** A trust protector is a person or entity with a special power over the trust or over the Trustee. Usually holding no day to day fiduciary responsibilities, the trust protector may be an individual an entity or even a committee of several people serving as a kind of board of directors overseeing fundamental aspects of the management of the Trust.
- 2. Varying Powers.** At the recent national conference of the Academy of Special Needs Planners, nationally recognized expert, Ira Wiesner wrote:

Trust Protectors are given a wide variety of powers, including but not limited to the power to remove, add and replace trustees; to veto or direct trust distributions; to add or delete beneficiaries; to change the situs and governing law of the trust; to veto or direct investment decisions; to consent to the exercise of a power of appointment; to determine whether an event of duress has occurred; to amend the trust as to administrative provisions as well as to amend the trust for changes in the law and to bring the trust into compliance with changing government rules and practice; to approve Trustee accounts; and to terminate the trust. In addition, the Protector may hold (1) the right to remove the Trustee; (2) to appoint successor Trustees; (3) to transition oversight between a Trustee and its successor; (4) the right and responsibility to bring matters to the attention of a judge; and (5) the right to control investments.²⁰

- 3. Applying the NCUTC.** If the trust protector has powers of direction, and if the state in which the SNT is created and is the situs of law, then the provisions of the UTC must be taken into consideration. Consider the following sections of North Carolina's recent enactment of the UTC:

(b) If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee must act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust, or the trustee knows the attempted exercise would constitute

²⁰ See Ira S. Wiesner, *The Special Needs Trust: The Trustee, The Beneficiary and Who are all Those Other Folks?* 1 Academy of Special Needs Planners National Conference, Section 2 (2007).

a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

(c) The terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust.

(d) A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.²¹

4. When to Use or Not. Conventional texts on trusts do not index the term trust protector for reference or analysis. However, the consensus of opinion among the special needs planning bar is that the greater sophistication in the development of special needs trusts makes not having a trust protector the exception rather than the rule.²² While there are those that do not make any reference to the inclusion of a trust protector in the special needs trust²³, many others provide ample discourse on the use and import of the trust protector.²⁴

F. BOND

While the imposition of the expense of a bond on special needs trusts has often driven the decision to require a bond, the protection should be considered necessary in view of the greater complexity of SNT administration and distribution. If left to the plaintiff beneficiary or the family member trustee, the expense is always the primary factor. Of course, when the initial amount that funds the SNT is modest (\$50,000 to \$150,000), the

²¹ N. C. Gen. Stat. §§ 36C-8-808 and 809 (2007).

²² See Michael Gilfix, *New Developments in the Evolution of an SNT Practice*, 1 Academy of Special Needs Planners National Conference, Section 5 (2007).

²³ See Stephen Elias, *Special Needs Trusts: Protect Your Child's Financial Future*, Chp. 8 (2005).

²⁴ See Michael T. Palermo, *AARP Crash Course in Estate Planning: The Essential Guide to Wills, Trusts and Your Personal Legacy*, Chp. 6 Using a Trust Protector, 125-136 (2005); see Estate Street Partners LLC, *What is a Trust Protector? Powers of a Trust Protector Differences from a Trustee*, <http://ultratruster.com/trust-protector.html> (author last accessed the website on May 1, 2007).

expense seems unjustified. The larger the corpus of the trust, the greater the need for bonding, and also the greater expense.

G. ACCOUNTINGS FILED WITH CLERK OF SUPERIOR COURT

1. Clerk's Preference. Clerks of superior court across North Carolina are becoming increasingly concerned with the way SNTs are set up and funded when there is also a guardianship estate in existence ready to receive and to control the proceeds of personal injury settlements. The powers granted guardians of the estate make specific reference to exempt trusts:

(23)To create a trust for the benefit of the ward pursuant to 42 United States Code § 1396p(d)(4), provided that all amounts remaining in the trust upon the death of the ward, other than those amounts which must be paid to a state government and those amounts retained by a nonprofit association as set forth in 42 United States Code § 1396p(d)(4)(C), are to be paid to the estate of the ward.²⁵

2. Options to Consider.

- a. **Do Nothing.** Proceed on the assumption that the superior court order for settlement and the creation and funding of the SNT trumps the jurisdiction of the Clerk over guardianships.
- b. **Direct Funds to the Guardianship Estate.** Have the Superior Court's order direct all funds to the guardianship estate, relying on the guardian of the estate to create and fund the SNT under the power granted under 35A-1251 (23). This is a quick and easy way out, but the personal injury attorney, the plaintiff/ward and the family lose significant control and are subjected to probable periods of ineligibility for Medicaid or other means-tested benefits because the receipt of

²⁵ See N. C. Gen. Stat. § 35A-1251 (23) (2007).

funds by the guardian of the estate has no way to shelter the estate assets from being countable.

H. TRUSTEE'S WAIVER OF LIABILITY

Many corporate trustees with ancillary non-profit entities take a position that a hybrid like the SNT requires some form of waiver of liability. Personal injury lawyers and SNT specialists representing plaintiff/beneficiaries should ask hard questions about the need for such protection. It raises the assumption that the corporate trustees know so little of the special needs area that they have greater expectations of error and therefore greater risk.

IV. THE SPECIAL NEEDS OF THE PLAINTIFF/BENEFICIARY

A. DEFINED DISABLED OR QUALIFYING DISABILITY

B. REHABILITATION OF DISABILITY OR RESTORATION OF CAPACITY

C. CYCLES OF DISABILITY

D. LIFE PLAN COMPONENTS

V. CONCLUSION

This outline provided a summary of points to weigh when considering whether or not an SNT is needed in a personal injury case. It first set out the basics of standard trust protection, and then set out the history and unique characteristics of SNTs. The outline moved through when SNTs are needed and when they are not, what the primary components of the SNT are and consideration of optional provisions that may enhance the operation of the SNT. The outline ends with a brief review of the special needs of SNT plaintiff/beneficiaries.