Special Needs Trusts

There are some common misunderstandings when it comes to the complicated area of special needs trusts. However, a special needs trust can help a disabled person preserve their wealth and maximize their care and support. Join Ringler Radio host, Larry Cohen and co-host, Kenneth R. Klapacz, Esq., Ringler settlement annuity specialist from Chicago, as they turn to Attorney Michael J. Durkin partner at the firm, Pedersen & Houpt in Chicago, to clear up these misunderstandings, talk about his experience dealing in special needs trusts, discuss how special needs trusts are funded and highlight the importance of putting the disabled person and their family first.

Host: Larry Cohen
Co-Host: Kenneth R. Klapacz, Esq.,
Guest: Attorney Michael J. Durkin
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Now, join Ringler Radio host, Larry Cohen.

COHEN: Welcome to Ringler Radio. I'm your host, Larry Cohen, from Ringler's Northeast Operations and I'm awfully glad you could join us again today. Now this edition of Ringler Radio is coming to you from the 2007 Annual Meeting of the American Association for Justice being held right here in beautiful downtown Chicago, Illinois. And for all of you who have not been to Chicago lately, I recommend you come because they've really spruced it up. It's the best I've seen it in a long, long time. I have to give my kudos to Mayor Daley.

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Well, with me today is my co-host. He's a familiar person to you if you've been listening to some of these shows. It's Ken Klapacz from our Chicago office. Ken's a settlement annuity specialist and prior to joining Ringler, he's practiced law in the

Chicago area for over 19 years. For the past seven years he was a partner in the law firm of McArdle, Frost & Klapacz, specializing in representing plaintiffs in wrongful death and catastrophic injury cases.

You're becoming a real regular pro on this show here, Ken.

KLAPACZ: That's because you're my mentor, Larry. I just wish my White Sox were doing as well as your Red Sox right now.

COHEN: Well, I think that's only a dream for you, OK.

KLAPACZ: This year.

COHEN: I'll say. Well today, Ken, we're going to tackle a real interesting subject here and it's somewhat confusing to a lot of folks, but I think we're going to straighten it out for them. It's the area of special needs trust. And our expert guest is Michael Durkin. Mike's a partner in and a member of Pedersen & Houpt Wealth Preservation Practice Group right here in Chicago. He's been practicing law since 1983, focuses his practice in the areas of estate planning, probate and taxation. And as an estate planning attorney for many successful entrepreneurs, professionals, executives and their families, Michael's had an opportunity to represent clients in a wide variety of probate, trust and taxation issues.

That sounds really interesting to me, Mike, but boy, I'm glad I'm not doing it. (laughter) Mike, thanks. Welcome to Ringler Radio.

DURKIN: Larry, thank you for having me here and thank you for giving me the opportunity to talk about one of my favorite topics and that's special needs trusts, because while helping wealthy people preserve their wealth is rewarding, there's nothing more rewarding to me than helping a disabled person preserve their wealth and maximize their care and support.

COHEN: Well, that's interesting and I'm happy you said that. And in that light, why don't you give our audience an overview of just what is a special needs trust. Give a little primer on that.

DURKIN: Sure, Larry. Special needs trusts, sometimes called supplemental needs trusts, are trusts that are structured to provide benefits for a beneficiary that are in addition to or supplement benefits provided by government programs like Medicaid or Supplemental Security Income. Those government programs provide for the basic support and maintenance of the beneficiary recipient and are based on need.

To be eligible for the resources, the recipient must stay below the threshold amount set by the program. So the problem is, if a disabled person has resources, money available to them and we'll talk about the different situations that might come up when they do, how do they keep these vital government programs.

COHEN: So in other words, if they get a claim settlement for example, and that claim settlement, the funds from that would disqualify them typically from these governmental programs, your job is to help through the special needs trust, help preserve those benefits.

DURKIN: Initially, the job is to create the trust and plan for the situation where there's no cessation of benefits. So if there's a judgment or an inheritance, then the child or disabled adult doesn't immediately lose their benefits and they're essentially removed from the nursing home or the care support in the home leaves because the government agencies that provide cut the benefits off.

COHEN: Cut the benefits off.

KLAPACZ: Are there different types of special needs trusts, Mike?

DURKIN: Well, sure. There's two broad categories of special needs trusts and then there's subcategories within it. There's third party special needs trusts and then there's self-settled special needs trusts.

Third party special needs trusts typically are trusts that are created by family members or close friends where the money that is going to be devised or gifted to the disabled person are put in a trust. And then self-settled special needs trusts are trusts that are created to hold the assets of the disabled person. And the structure and the terms of those trusts are very different and as we proceed in this discussion, I want to emphasize to you the importance of knowing which type of situation you have because it can significantly affect how much of the funds are left down the road.

COHEN: Interesting. Well, what qualifies someone for the special needs trust treatment? I know the government has a lot of qualifications. There are rules that need to be followed, aren't there, to have a special needs trust? In other words, one of the ones I remember is that you have to be under 65 years old –

DURKIN: Correct.

COHEN: -- and there needs to be, there are other rules. Give us a list of the, maybe the two or three more important things to consider.

DURKIN: Maybe we should take a step back.

COHEN: Sure.

DURKIN: And what we're trying to do here is preserve benefits, OK. And so let's talk about the benefits we're trying to preserve and the situations that arise that we need to plan for to keep those benefits flowing to our disabled person.

The two major benefit programs that we typically plan for maintaining while creating a special needs trust are Medicaid and Supplemental Security Income. These are needs based, meaning the recipients must have limited income and resources. Obviously, if Ken, when he was practicing or some of the other fine trial lawyers that have been on your program, when they get a big judgment for malpractice or a vehicle collision, once that money comes in the needs based ends and the family is concerned that the judgment award may not be sufficient to provide for the disabled person's care throughout his or her lifetime.

The other major programs are Social Security Disability Insurance and Medicare. Neither Social Security Disability Insurance, referred to as SSDI, neither SSDI nor Medicare are needs based, but are important to consider because that's part of the total benefit package that need to be assessed as to whether a special needs trust is appropriate or not.

COHEN: So what you're really saying then is that when someone receives a settlement in a, let's say, a personal injury case which is what we're really talking about here in this context, they may also be receiving Medicare, which is not needs based –

DURKIN: Correct.

COHEN: -- and they may be receiving SSDI, which is also not needs based, and they may be able to continue with those benefits coupled with the settlement funds. You're using that to evaluate if you do need to then create a trust to protect the governmental benefits that are out there.

DURKIN: Perfect. That's it.

KLAPACZ: Mike, under that setting, ideally when should you get involved in the case? Prior to it being settled, as the settlement discussions are going on? When is the perfect time and the perfect setting?

DURKIN: I'm viewed as the group of attorneys called the probate lawyers. And the probate lawyers typically get involved after a judgment or on a settlement. And the engagement typically begins with consultations with the family, sometimes the disabled person if they can direct their affairs, and the trial attorney. And discussions are entered into regarding whether a special needs trust is appropriate, where it should be created, whether it's through the courts or it can be done by a private arrangement. If the person is not legally disabled, it can be created by private arrangement. If the person is legally disabled, it has to be done in County Illinois through a court order.

COHEN: Who typically becomes the trustee? Are there rules and regulations as to who should or can be the trustee and who cannot be the trustee?

DURKIN: OK. For a private, let's discuss the two types of special needs trusts that are used when we're using a self-settled special needs trust, meaning the assets of the disabled person. So this would be in the context of a judgment or award and the disabled person's own assets are available to him or her.

KLAPACZ: Is that also called the OBRA trust?

DURKIN: Correct. Right. And special needs planning prior to 1993 was done through private trusts and expectations that the trust terms would keep the beneficiary eligible for benefits going forward but there was no certainty. And many of those trusts were challenged over the years by the government agencies saying that they were resources or assets of the disabled person and benefits would be denied. There was a growing concern by the disabled care community, the trial lawyers, that this was not an adequate solution, that there had to be some form of a program to allow these awards and allow other situations to be created to supplement the government programs.

In 1993, legislation was passed that created statutory authorization for special needs trusts for self-settled trusts and the key provision in the self-settled trust legislation is that at the beneficiary's death, the Department of Public Aid must be repaid for all of the disbursements they have made over the beneficiary's lifetime. And that's the key difference between a self-settled trust and a third party trust. Third party trusts, so that's when mom or dad creates a trust for their son's or daughter's benefit. On the beneficiary's passing, the Department of Public Aid or any other government agency doesn't have to be reimbursed. But with the person's own self-settled trust and assets, the reimbursement has to occur.

COHEN: We're talking in this context of mostly personal injury litigation of the self-centered trust.

DURKIN: Self-settled trust.

COHEN: Self-settled trust because it's the settlement funds from the case that the individual is pursuing that's going to be, that are going to be used to fund this trust.

DURKIN: Right. And to continue on with that thought and I'll get back to who should be the trustee, but it was important to lay that background, when you create a self-settled trust to assist a beneficiary in creating a self-settled trust, we always counsel the family in revising their estate plan to create the third party trusts. So then when mom or dad or brother or sister pass away and they leave an inheritance for their family member who's a disabled person, they should leave it in the form of a third party trust. So good planning involves a third party trust from family resources and a self-settled trust from the judgment or award.

COHEN: Because you don't want the inheritance to flow into that self-settled trust to then to be taken by the governmental entity on death.

DURKIN: Correct. Or go directly to the beneficiary, disabled person and then the benefits cease.

COHEN: Because of the disqualification aspect of getting those funds.

DURKIN: Right.

COHEN: It's kind of a Rubik's Cube that you have to figure out.

DURKIN: Correct. Correct. Now, so we have two types of statutory trusts. There's the individual OBRA trusts that are the typical arrangement when there's a large judgment or award. There is no law or requirement as to who can be the trustee, so you have to look at Illinois law and Illinois law or the state where the person resides provisions regarding trustees, and it can be an individual or corporation or non-for-profit organization.

COHEN: Can it be a relative?

DURKIN: It can be a relative. Now, there's a lot of risk in being a trustee because if the trustee does not properly reimburse the Department of Public Aid and the other government agencies, they're personally liable. So if an individual is the trustee of the OBRA special needs trusts and makes disbursements that are unauthorized, maybe to a third party other than the beneficiary, that person could be personally liable for that disbursement.

COHEN: Exactly.

DURKIN: If the Department of Public Aid is not fully reimbursed at the beneficiary's passing.

KLAPACZ: I would assume then, most of the times, it's not an individual that you would recommend being appointed the trustee.

DURKIN: In my opinion, it's almost always in the best interests of the beneficiary and the family to have a corporate trustee act. If the family wants to participate in investment and distribution decisions, they can be a co-trustee.

COHEN: OK. So some professional trustee makes a lot of sense.

DURKIN: Correct.

COHEN: Now there's, I'm sure in each special needs trusts there's language that needs to be put into the trust that provides and protects all these issues and these assets. The language that I recall is the language that speaks about what the funds can be used for.

DURKIN: Correct.

COHEN: In other words, the so-called special needs of the individual and not the food, clothing and shelter normal needs.

DURKIN: Correct.

COHEN: I've always felt that that gets a little hazy at times because the trustee is then being asked to come down on what side of the benefit is it that it's being asked for. Is it a special need or a normal need and how does that work? Is that an issue?

DURKIN: It is an issue and the way we plan for it because Larry, you hit the nail on the head -- it's a gray issue – is we notify the Attorney General for the State of Illinois or the other state, we let them review the trust and we get their approval for the trust and the continuation of benefits. So the starting point is getting the state regulators to approve the trust and agree that this trust conforms to the statutory requirements and that benefits won't be terminated. OK.

And then the other issue is the application of the trust terms to the particular circumstances and what we in Cook County do and in the surrounding counties of Illinois but the practices may be different in other jurisdictions, is we treat these trust estates like they're guardianship estates and we provide accountings to the court and the state regulatory authorities. They see the accountings. They have an opportunity to object and then any exposure to whether these disbursements are being made improperly are on a very short-term basis. They're within a year's time period.

COHEN: So you have an annual accounting essentially that gets looked at.

DURKIN: That gets looked at by the court and that in Illinois, the Illinois Attorney General is a party to the proceeding and can object as to whether the application of the funds is inappropriate.

COHEN; I think our audience would be interested to know, have you in your experience, have you seen during that objection period, have things been knocked out? Have things been denied because they thought it was overreaching the line of what is permissible?

DURKIN: I've never had it go that far but I have had the Attorney General question whether the disbursements exceeded the authority in the trust and we have worked out going forward with the Attorney General policies on certain specific situations. And typically, it involves housing for the ward where the other family members have indirect benefits from it. It involves compensation to the family members for services they provide to the ward. It involves training programs for family members and the guardian of the person. Many times we send family members to different specific programs across the country to learn how to care for their relative and sometimes those disbursements are called into question by the Attorney General.

COHEN: Sure.

KLAPACZ: I just want to back up for a minute, Mike. Maybe it's my lawyer's hat. Typically, how long does it take to get that Attorney General approval of the special needs trust?

DURKIN: Typically, we give them five days' notice to the hearing. And that's it.

KLAPACZ: OK. That quickly?

DURKIN: Yeah. They look at it pretty quickly. If they need time to look at it, they will either call me or appear in court and ask for a continuance but they tend to very responsive and very thoughtful in their comments.

KLAPACZ: I'm going to change directions a little bit, Mike, seeing how we're at Ringler Radio. I have a question as to how are special needs trusts funded? I know one way at least, but if you could elaborate on that.

DURKIN: OK. Well, we're going to, we're again back in the genre of the self-settled trust.

COHEN: Yes. So stay in that (multiple conversations; inaudible)

DURKIN: So if the beneficiary, if the disabled person has any other assets, in other words we're going to try to create eligibility for Medicaid, we need to transfer their existing assets into a OBRA-qualified special needs trust.

COHEN: Right.

DURKIN: OK. If there is a guardianship proceeding, we would go in, petition the court, ask for authority to create the special needs trust and state our reasons as to why we think it's in the best interests of the disabled person to create the trust. Once the court grants us that authority and we create the trust, then we have an irrevocable assignment of all of the assets of the beneficiary into the trust.

Then, let's say in that same situation that beneficiary receives an award from a personal injury accident that's gone on for six, eight years, which I have had a number of times. Then we have, we work with the trial lawyer to have the award sent directly to the OBRA trust and not to the beneficiary.

COHEN: Well, that's critical.

DURKIN: That is, it's critical. Otherwise, the benefits will be terminated.

COHEN: Exactly. One of the things we see though in our, and Ken was alluding to it, is that when the settlement is about to get disbursed, obviously one of the ways it can get disbursed is in pure cash. The cash gets put into the special needs trust to protect those government benefits. But in our world of structured settlements, obviously a lot of these cases get structured and the annuity company actually is directed to send the annuity checks, the monthly checks for example, directly to the special needs trust. So that also works as well.

One of the questions often comes up, Mike, that if a big hunk of cash is sitting in that trust, of course that trust is then taxed –

DURKIN: Correct.

COHEN: On the benefits that are earned so that tax can be somewhat interesting in large, that's why a lot of the times these annuities, because they're in pieces, come in and fund as the pieces get used, the corpus sitting there is not as large so that the taxes become smaller and also the remainder in that trust, theoretically, would not be as great in the event of death. Is that what you found?

DURKIN: Correct. Well, the tax benefits are numerous because the structured settlement provides for an –

COHEN: (multiple conversations; inaudible)

DURKIN: – internal tax rebuild up. Now, the OBRA self-settled trusts are structured as grantor trusts so the income earned by the OBRA trust is income of the disabled person and we have provisions in our trusts that direct the trustees to pay the individual's income tax liabilities and that doesn't create a termination of benefits.

COHEN: OK. That's cool.

DURKIN: So that's how that works, but I agree with you that the lay of the receipt of the income, of the funds through a structure and the tax rebuild up can enhance the ultimate value of the amount of funds available for the disabled person over his or her lifetime.

COHEN: Well, that's music to our ears, isn't it? Well, let's talk about when to establish this trust. You've got the case, the case is about to get settled. Someone's going to approach you, Mike, and say, Mike, there's a need here for a special needs trust because of the individual's currently on Medicaid. One of the issues you just raised is that by creating a special needs trusts, there is an independent trustee appointed so that the family members kind of lose control, to some extent, over those dollars that are being used for the settlement. Of course, it's a good thing for the continuation of the governmental benefits but have you ever seen a situation where there was so much money in the settlement itself that the fact that the governmental benefits might get knocked out isn't as big a concern for the family. And therefore, they don't need the special needs trust and they keep control of the funds.

DURKIN: Correct. I've had a number of those cases and in, I would say, the majority of them and you can't put a dollar number on it because each situation is unique in terms of how much care is needed, we have for the most part not created a special needs trust but there are circumstances where we've had very large estates and awards where we have created the special needs trust. In Illinois, there's no dollar limit on the size of the special needs trust. I have created them for disabled persons where the value of the trust with present value of structured settlement payments and of future awards exceeds $10 million.

COHEN: Sure. Sure. Have you seen that, Ken, in some of those cases you've had?

KLAPACZ: A few, but, now I'll direct this a little later, but it's my experience as an attorney and a structured settlement broker that not a lot of plaintiffs' attorneys actually understand a special needs trust and avoid them. I don't know if that's the right word.

COHEN: Well, we're going to get into that because I think that's an important issue, right after we take a short break so we can hear from some of the folks that make Ringler Radio possible. So let's do that. Let's take a short hiatus here and we'll be back in just about a minute with more from Ken and Mike on the issue of special needs trusts. See you in a minute.

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COHEN: Welcome back to Ringler Radio. I'm your host, Larry Cohen, along with my colleague today, Ken Klapacz. Ken's the settlement annuity specialist in our Chicago office and does a great job. And also joining us is our special guest, Mike Durkin. Mike's a partner and member of Pedersen & Houpt's Wealth Preservation Practice Group here in Chicago and our topic has been special needs trusts and it's quite an extensive topic and we could probably talk for days on it. But it's an important topic to talk about.

KLAPACZ: Yeah, Mike. When we left for the commercial break I was saying it was my experience as an annuity broker and even as a personal injury attorney that there's some common misunderstandings when it comes to special needs trust. What has been your experience?

DURKIN: One of the misunderstandings is that the funds are so restricted that the family and the ward never really has access to them during the ward's lifetime and that the benefits of the trust may be outweighed by the burdens. In my experience, there is certainly enough flexibility in the administration of the trusts where funds can be put to use consistent with the family's objectives in the care of the child and not disqualify the child from benefits that those concerns can be overcome and the family can agree that the special needs trust is in the best interests of the ward. OK.

The one think you can't do is estate and gift tax plan. And with large estates when it's clear there are sufficient funds, one of the reasons why people do not pursue OBRA special needs trust is that they want to employ estate planning and gift planning in the guardianship estate to minimize estate taxes, but that's in a situation where everyone is confident that the assets are sufficient. I don't know if I'm ever confident that the assets are sufficient to provide for a disabled ward.

COHEN: Well, would that concern be because that assets that are sitting in the special needs trust need to be repaid to Medicaid and therefore you can't really do estate planning at that point.

DURKIN: And that's a statutory requirement. That in an OBRA special needs trust, only the disabled person can be a beneficiary. So we can't make annual gifts to family members. We can't buy homes for other family members to live in, unless they provide for market rent.

COHEN: Right. Although from those funds, the existing home the disabled person lives in can be enhanced. That in reality benefits everybody in the family.

DURKIN: Correct. There's an indirect benefit and then the family would have to create an arrangement through the trust as to their occupancy rights.

COHEN: Interesting. Interesting.

KLAPACZ: Mike, you were talking about some of the larger estates that you've handled with the special needs trust. Is there a range that's too low for a special needs trust?

DURKIN: It's market based. And it's market based on who will act as the trustee and at a certain dollar level in a certain region corporate trustees will not want to take on the job of being the OBRA trustee because it's not a sufficient amount of assets to justify their business, to fall within their business plan. When you have that, then your decision tree goes to whether you have a individual trust with a family member as trustee, but there's risks as we talked about in doing that and there's continuity issues. What if the trustee doesn't outlive the beneficiary, have to provide for replacement and very few individuals are skilled in being trustees because you have to know trust law, tax law, and in this case, all the myriad of laws regarding eligibility of benefits. So it's difficult to find an individual that really understands all of the responsibilities of being a trustee.

COHEN: Mike, before we leave our discussion today, I want to give you an opportunity to talk a little bit about pool special needs trust. What are they and how are they different?

DURKIN: Well, that is the alternative when a trust is or an estate is too small to have a private trust with a corporate trustee. And a pool trust is another statutory arrangement where you can become a member of a pool trust arrangement and the pool trusts are administered by a non-for-profit organization and typically in conjunction with a corporate trustee and it's in many ways similar to being a part of a mutual fund. You buy into the pooled fund as an account. You join into the pooled fund arrangement. You are not acting as trustee. You have no control over the investments. You receive an investment return that is determined by the trustees of the pooled fund but you do have the right to participate through recommendations as to disbursements, but the trustee ultimately makes the disbursements.

We find this to be very popular for modest size awards and I won't give a dollar number because it varies from community to community as to when it's appropriate to use it, but I think that the approach is to go to the corporate trustees, see if they will take on the trust arrangement. If they will not, then you go to the local organizations that sponsor the pooled trusts and see if they will take you on. And then that might be your solution to the problem.

Another benefit of a pool trust is that getting away from personal injury awards, one of the other situations where someone wants to be part of an OBRA trust is when they become aged and near disability and they want to take their hard-earned earned assets and put them into an OBRA trust to get on public aid for nursing home care and other benefits. And there's an age restriction under the OBRA laws for that and it's age 65. But that age restriction does not apply to pooled trust arrangements. So if you have an elderly person who needs to be on public benefits because they're rapidly losing all of their resources and the resources that they have are vital to supplementing the care the government agencies will provide, a pooled, being a member of a pooled trust account arrangement under OBRA can be very satisfactory to reaching all their objectives.

COHEN: Well, I think that's a, what you just raised at the end here is a subject for a whole other show. This whole concept of the elderly, nothing to do with let's say, settlement issues, but how you protect elderly folks getting into nursing homes and yet not dissipating an entire asset base that they built up over the years, so –

DURKIN: Correct.

COHEN: –- very, very interesting stuff. And I think if anybody has any questions about the OBRA trust, the special needs trust, the pool trusts, the aged, estate planning, I think you'd be the guy to call. So how would people get in touch with you, Mike, if they wanted to do that?

DURKIN: You can reach me on my, my contact information's on our Web site, PedersenHoupt.com. My phone number is 312-261-2130 or mdurkin @ pedersenhoupt.com.

COHEN: And for all of you who are spelling challenged, Houpt is, how do you spell that again?

DURKIN: H as in Harry, O-U-P-T. And Pedersen's all Es.

COHEN: Ken, how does somebody reach you?

KLAPACZ: I can be reached at kklapacz@RinglerAssociates.com. 1-800-332-0427.

COHEN: Remember, you can reach all Ringler Associates at RinglerAssociates.com. All of their pictures and bios. It's fun to go there and take a look. I'm Larry Cohen. You can reach me at 978-974-9922. And I want to thank all of you for listening today. It's been a very enlightening discussion with Mike and I'd encourage you to contact him if you need more information. In the meantime, why don't you all go out now and have a great day.

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