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NEW JERSEY ATTORNEY GENERAL SPEAKS ON STRUCTURED SETTLEMENTS AND SPECIAL NEEDS TRUSTS

By Thomas D. Begley, Jr., Esquire



Structured settlements have long been used in connection with special needs trusts for persons with disabilities who receive personal injury settlements. There are less often used in cases involving matrimonial settlements and in cases involving inheritances.

A structured settlement is essentially an annuity that pays an injured plaintiff over time, rather than in a single lump sum. The annuity is purchased from a highly-rated insurance company. The defendant, or its

insurer, agree to make future payments to the injured party or directly to a special needs trust. Payments are typically made for the life of the injured party with a guarantee of payments for a minimum term of years, usually closely correlated with the actual life expectancy of the injured party. The actual life expectancy of the injured party may differ significantly from that person's actuarial life expectancy. If the injured person dies prematurely, the guaranteed portion of the settlement is paid to a named beneficiary.

The structures offer a number of benefits to all parties. Advantages to the injured plaintiff include the following:

- *Taxation.* The income component of the structured settlement payment is tax-free, as opposed to a lump sum payment where the income component is taxable income.
- *Creditor Protection.* The structured settlement offer is creditor protection. The special needs trust is a self-settled trust, which in most states is exposed to the claims of creditors. However, the income stream under a structured settlement is not subject to creditor's claims.
- *Protection from Plaintiff.* It is more difficult for the injured plaintiff to squander a structured settlement than it is a lump sum payment.
- *Investment Risk.* The structured settlement eliminates investment risk, because the insurance company is responsible for management of the funds and the periodic payment stream is guaranteed. Essentially, there is a fixed immediate annuity.
- *Rated Age.* Because the actual life expectancy of the injured person is often significantly shorter than the actuarial life expectancy, the insurance company issuing the structure basis the income stream on the higher rated age. This significantly increases the monthly payments during the plaintiff's lifetime. In determining rated age, the insurance company looks at the injured person's medical records. Because of the medical condition, the injured person often does not have a normal life expectancy. The insurance company determines how long they expect that person to live given the medical condition and assigns an age to the injured person. The monthly payments are then based on the life expectancy of a person with that rated age.

Because of the guarantee period, if the annuity is sizable, provision must be made for federal or state estate taxes. Essentially, the present value of the annuity is includable in the injured plaintiff's estate, if he dies prematurely. Insurance companies issuing the structured settlement offer a commutation rider. The commutation rider can be for all or part of the annuity. This means that upon the death of the injured plaintiff, the insurance company will pay a discounted lump sum. The obligation of the insurance company to make future payments is, thereby, terminated. If it is anticipated that the disabled plaintiff will have a taxable estate on death, a commutation rider should be considered.

There have always been two issues with respect to structured settlements and special needs trusts. One is whether the trust must be named as beneficiary of the structured settlement or whether the beneficiary can be a family member. The second issue is whether there must be a commutation of the entire structured settlement annuity on the death of the trust beneficiary.

In a recent letter, the New Jersey Attorney General has answered both questions. It is the position of the Attorney General that the special needs trust must be named as the beneficiary of the structured settlement

annuity, so that if the disabled beneficiary dies, the payments are made to the trust rather than to other family members. The same letter from the Deputy Attorney General to Thomas D. Begley, Jr. indicated that there must be a 100% commutation rider on the annuity, so that if the beneficiary dies there is a 100% commutation of the balance of the payments and that lump sum is paid immediately into the special needs trust.



From everyone here at *Begley & Bookbinder*, we would like to say Happy Holidays and a Happy, Healthy, and Prosperous New Year to all. We are pleased to have worked with you over the years and glad to be able to bring you this newsletter of information. We hope you find it informative during the year.

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