

Memorandum 91-64

Subject: Study L-708 - Special Needs Trust for Disabled Minor or Incompetent Person

Attached is the Commission's Tentative Recommendation Relating to Special Needs Trust for Disabled Minor or Incompetent Person. We circulated it for comment and received three letters, discussed below:

- Exhibit 1: Department of Health Services
- Exhibit 2: Department of Developmental Services
- Exhibit 3: Attorney James Palmer of Redwood City

CHANGES RECOMMENDED BY STAFF

Reimbursement at Death Under Section 3604

The commentators suggest the following revisions to Section 3604:

(1) Make clear that the reimbursement-at-death rule overrides any provision in the trust instrument. (Exhibit 2, p. 3).

(2) Broaden the reference to "public support," which might exclude reimbursement for Medi-Cal and care and treatment in a state hospital. (Exhibit 1, pp. 2-3; Exhibit 2, p. 3).

(3) Delete the limiting reference, "if the property were in the beneficiary's estate, which is "confusing and unnecessary." (Exhibit 2, p. 3).

(4) Require notice of the beneficiary's death to all affected agencies, and toll the running of the statute of limitations if notice is not given. (Exhibit 2, p. 3).

(5) Provide that the reimbursement-at-death rule applies only to trusts created after the operative date. (Exhibit 3, p. 2.)

(6) Delete subdivision (b) requiring a public entity to accept the amount collected from the trust in full satisfaction. This deletion will permit reimbursement from the estate of the deceased beneficiary as under existing law. (Exhibit 1, pp. 3-4; Exhibit 2, p. 3).

The staff would implement these six suggestions by revising Section 3604 as follows:

Prob. Code § 3604 (added). Reimbursement from trust for public support  
3604. If a trust is established under Section 3602 or 3611 on or after January 1, 1993;

(a) ~~On~~ Notwithstanding any provision in the trust instrument, on the death of a minor or incompetent person who is the beneficiary of a the trust established under Section 3602 or 3611, trust property is subject to a claim for public support provided to the beneficiary claims of public entities for reimbursement to the extent reimbursement would be authorized under the Welfare and Institutions Code if the property were in the beneficiary's estate.

(b) ~~A public entity asserting a claim under this section shall accept the amount collected from the trust in full satisfaction of its claim for reimbursement for public support provided to the beneficiary, and shall release all liens for the purpose of enforcing the claim. The trustee shall give written notice of the beneficiary's death to all public entities having a potential claim against trust property pursuant to subdivision (a). Failure to give notice to a public entity as required by this subdivision prevents the running of the statute of limitations on that entity's claim against trust property.~~

Comment. Section 3604 is new. ~~If the trust beneficiary has a substantial disability and the existence of the trust does not disqualify the beneficiary from receiving Medi-Cal benefits, while the trust is in existence it is not subject to claims of public entities for reimbursement for social services provided. See Prob. Code § 15306(b). On the death of the beneficiary, trust property becomes subject to such claims under Section 3604. It permits public entities to obtain reimbursement from trust assets at death of the beneficiary to the extent reimbursement is authorized by the Welfare and Institutions Code. See also, e.g., Welf. & Inst. Code §§ 7513-7513.2 (reimbursement for state hospital costs), 14009.5 (reimbursement for Medi-Cal benefits).~~

#### Comments to Sections 3602 and 3611

When a personal injury case is settled and benefits were furnished under the Welfare and Institutions Code, the interested department must ordinarily be given notice and an opportunity to obtain reimbursement. See, e.g., Welf. & Inst. Code §§ 7282.1, 14124.71-14124.76. The Department of Health Services and Department of Developmental Services urge us to make clear that any liens must be satisfied before the court orders payment of proceeds of settlement or judgment to a special needs trust. (Exhibit 1, pp. 1-2; Exhibit 2, pp. 2-3). This is existing law, and the staff recommends adding the following to the Comments to Sections 3602 and 3611:

Before payment to the trustee, liens authorized by the Welfare and Institutions Code must first be satisfied. See, e.g., Welf. & Inst. Code §§ 7282.1, 14124.71-14124.76.

The Department of Health Services says the second sentence of the Comments to Sections 3602 and 3611 gives the mistaken impression that all special needs trusts, regardless of how drawn, will prevent the beneficiary from being disqualified for public benefits. (Exhibit 1, pp. 4-5). We should not try to state the legal effect of a special needs trust in the Comments to Sections 3602 and 3611. Accordingly, the staff would revise this sentence as follows:

This permits personal injury damages or settlement proceeds for a disabled minor or incompetent person to be delivered to a trustee of a special needs trust ~~designed to supplement public support without disqualifying the minor or incompetent person from receiving such support.~~

#### OTHER POINTS

##### Protection of Trust From Reimbursement During Beneficiary's Lifetime

The Department of Developmental Services objects to allowing proceeds of settlement or judgment to be shielded in a trust while the beneficiary receives public benefits. (Exhibit 2, p. 2). But this TR does not deal with the question of whether trust assets are shielded from creditors' claims during the beneficiary's lifetime. The proposed legislation is quite limited. It does essentially two things:

(1) It permits the court to order payment to a trust (not limited to a special needs trust) and to approve trust terms. Under existing law, the court may order payment to a guardian, conservator, or court-controlled account. For a minor, the court may order payment to a custodian under the Uniform Transfers to Minors Act or, if less than \$5,000, to the minor's parent. Adding authority for payment to a trust, not limited to a special needs trust, provides a useful option to the other arrangements permitted under existing law.

(2) It provides that when the trust beneficiary dies, a trust created under Section 3602 or 3611 is subject to payment of otherwise valid reimbursement claims before proceeds go to other beneficiaries.

The question of whether trust assets may be reached during the beneficiary's lifetime is determined under Probate Code Section 15306. This section provides that, notwithstanding a provision in the trust instrument, the court may order reimbursement from the trust in an equitable and reasonable amount under the circumstances, except that the trust instrument may insulate trust assets from liability if the

beneficiary has a substantial disability and is eligible for public social services notwithstanding the trust. The proposed legislation does not change this rule.

Title of Recommendation

Although the main purpose of the proposed legislation is to authorize special needs trusts, as noted above it is broader than that: It permits the court to authorize payment to a trust, whether or not it is a special needs trust, and whether or not the minor or incompetent person is disabled. Should the title be revised as follows?

**SPECIAL-NEEDS COURT-ORDERED TRUST FOR  
DISABLED MINOR OR INCOMPETENT PERSON**

Reimbursement at Death Under Section 3604

The Commission thought that, if a special needs trust for damages or settlement proceeds for a minor or incompetent person is insulated from reimbursement claims during the beneficiary's lifetime, the trust should be subject to such claims at death of the beneficiary. This is what subdivision (a) of Section 3604 in the TR provides.

The Commission thought it would be an unjustifiable windfall to takers of trust assets on death of the beneficiary if not subject to claims of public entities. The Commission was more concerned with making sure public agencies are reimbursed than with achieving symmetry by treating these trusts the same as a private discretionary trust established, for example, by the beneficiary's parents.

Attorney James Palmer (Exhibit 3) asks what the justification is for treating these trusts differently from private discretionary trusts. There are two reasons for this difference:

(1) The injured party is entitled to his or her damages or settlement proceeds. There is no disincentive for the court to award damages or approve a settlement because the proceeds may be subject to reimbursement. A parent, however, is not obliged to create a private trust for an injured child, so it may be desirable to limit the extent to which the trust may be reached for reimbursement so as not to discourage creation of such trusts.

(2) The Commission wanted a sound rule in this proposal, without regard to what the rule might be for other trusts. Perhaps Section 15306 should be conformed to establish one generally applicable rule.

But this would go beyond the purpose of this recommendation, and might unduly complicate it.

Mr. Palmer also thinks the reimbursement-at-death rule of Section 3604 can be easily evaded by having the court approve payment of damages or settlement proceeds to a court-controlled account, and then having the court approve withdrawal of the proceeds and payment to a trustee. But there is no present statutory authority for payment to a trustee. That is why this legislation is needed.

Mr. Palmer says that alternatively the proceeds can be ordered paid to a conservator, who can then use the substituted judgment provisions to create a special needs trust for the conservatee. Under the substituted judgment provisions, the conservator may, with court approval, create "for the benefit of the conservatee or others, revocable or irrevocable trusts of the property of the estate . . . ." Prob. Code § 2580. This may be a viable alternative as Mr. Palmer suggests, albeit a costly and inconvenient one. The staff thinks this should not prevent the Commission from recommending a reimbursement-at-death rule for damages or settlement proceeds in a trust created under Section 3602 or 3611.

Mr. Palmer asks whether the reimbursement provisions of Section 3604 are intended to override the 50% cap on Medi-Cal recoveries. Section 14124.78 of the Welfare and Institutions Code provides that "in no event shall the director's [Medi-Cal] claim exceed one-half of the beneficiary's recovery after deducting for attorney's fees, litigation costs, and medical expenses relating to the injury paid for by the beneficiary." This cap is not affected by Section 3604, because the section provides that on death of the beneficiary, trust property is subject to a claim for public support to the extent authorized under the Welfare and Institutions Code.

Respectfully submitted,

Robert J. Murphy III  
Staff Counsel

## DEPARTMENT OF HEALTH SERVICES

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COMMENTS ON SPECIAL NEEDS TRUST FOR DISABLED MINOR OR INCOMPETENT PERSON

Dear Mr. Murphy:

We welcome the opportunity to comment upon the tentative recommendation relating to special needs trusts for a disabled minor or incompetent person. We would like to provide some information on its effect on the Medi-Cal program and discuss some requirements that distinguish the Medi-Cal program from other public assistance programs. Medi-Cal is the needs-based California Medicaid program, which provides health care services to eligible recipients. These comments are directed at a special needs trust created for a disabled minor or incompetent person that is funded with the proceeds from a judgment or settlement in a third party liability setting; they do not necessarily apply to a special needs trust created by a person who had no legal obligation to support or compensate the beneficiary.

Probate Code Sections 3602 and 3611

We agree that authority for a court to permit money of a disabled minor or incompetent person to be paid to the trustee of a trust established under terms approved by the court is needed and beneficial to the disabled minor or incompetent person.

However, an increasing number of trusts are being funded by settlements from liable third parties, without first satisfying the Medi-Cal lien authorized by Welfare and Institutions Code section 14124.71. Welfare and Institutions Code section 14124.76 specifies that no judgment, award, or settlement in any claim by a Medi-Cal beneficiary shall be satisfied without first giving notice and an opportunity to satisfy the Medi-Cal lien. To help prevent any payment to a trustee prior to satisfaction of the Medi-Cal lien, we propose amending sections 3602(c)(2) and 3611(c) by adding:

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"Any Medi-Cal lien authorized by the Welfare and Institutions Code shall be satisfied prior to payment to the trustee."

The comments on these sections might also add:

"The personal injury proceeds are not exempt from a Medi-Cal lien pursuant to Welfare and Institutions Code section 14124.71 et seq."

#### Probate Code Section 3604

The intent of this section, to reimburse public entities from the trust property on the death of the beneficiary, for public social services provided, is one the Department of Health Services strongly supports. However, by using the term "public support", rather than "public assistance", in section 3604, the Medi-Cal program is excluded from its scope. The distinction has a significant legal effect.

In the context of the Probate Code, "public support" generally means the provision of food, shelter, and clothing. Examples in the Probate Code include section 15302, (trusts for support); section 15305, (child or spousal support); and section 2420 et seq., (support of a conservatee). These sections clearly characterize support as providing for the basic necessities of life, such as food, shelter, and clothing.

For example, Probate Code section 15306 authorizes the court, in specific circumstances, to order a trustee to satisfy the liability for public support from a trust. The legislative intent for section 15306 was "to remove barriers which prevent state hospital and developmental center clients from qualifying for federally assisted public benefits and assist the state to recover amounts owing for the services provided in these facilities." (Ch. 748, Stats. of 1989, § 1(b).) Each developmentally disabled person and his or her estate are liable for the cost of care and treatment provided in a state developmental center. (Welf. & Inst. Code, § 7513.) Mentally disordered persons and specified relatives are liable for services received in a state mental hospital. (Welf. & Inst. Code, § 7275.)

The Medi-Cal program does not provide public support; it provides health care services, which are also referred to as public social services or public assistance. (Welf. & Inst. Code, §§ 10051, 10061, 14001, and 14009.5.) Reimbursement to Medi-Cal for health care services provided is limited. Medi-Cal beneficiaries are liable for the cost of health care services only when provided

after the beneficiary was 65, and then only from the estate of a deceased Medi-Cal beneficiary, if there is no surviving spouse or minor or disabled child. (Welf. & Inst. Code, § 14009.5.) Medi-Cal can also recover from a third party who is liable for injuries to a Medi-Cal beneficiary. (Welf. & Inst. Code, § 14124.71.) The recovery is made at the time the third party liability claim is settled, and is limited to no more than half of the beneficiary's recovery after deducting attorney's fees, costs, and medical expenses paid by the beneficiary. (Welf. & Inst. Code, §§ 14124.74, 14124.78.)

However, there may be substantial continuing costs of medical care. Without authority for Medi-Cal to be reimbursed for these continuing costs of medical care, the public is bearing the cost, while resources which came from the liable third party and which are generally determined in part by the anticipated future costs of that medical care, are unavailable. For instance, if a minor who was severely disabled by injuries caused by a third party dies before reaching the age of 65, Medi-Cal will not be reimbursed for any of the costs of continuing medical care, despite the existence of trust assets which could cover the costs.

The resources of the State are not unlimited. Thus, the State has a real and definite interest in being reimbursed, if at all possible, by those to whom it provides benefits. Public assistance, such as Medi-Cal, is intended for those who are in need. (Welf. & Inst. Code, § 10051.) Allowing individuals who are beneficiaries of trusts with substantial resources which were provided by liable third parties, to receive public assistance at taxpayer expense is at odds with basic principles of equity and the intent to provide public assistance to those in need. This is particularly apt in the State's current fiscal circumstances, where the rapidly increasing need for public assistance exceeds the funds available.

For these reasons, in Probate Code section 3604(a), "or public assistance" should be inserted after "public support" to allow Medi-Cal to be reimbursed from the trust property on the death of the beneficiary.

Subdivision (b) of section 3604 limits collection of a claim for public support to the amount in the trust on the death of the beneficiary. If applied to Medi-Cal, this could limit Medi-Cal's existing authority to collect from the estate of a deceased beneficiary for care provided after the beneficiary was 65. An illustration of this detrimental impact on Medi-Cal recovery might be a 70-year-old Medi-Cal beneficiary who was injured by a liable third party and placed the proceeds from the claim into a special



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needs trust. On the beneficiary's death, if the trust assets were insufficient to cover the cost of health care services provided to that beneficiary after the age of 65, Medi-Cal would be prohibited from recovering from the beneficiary's estate. Assets in the estate would otherwise have been available to Medi-Cal for recovery, if the requirements of Welfare and Institutions Code section 14009.5 were met.

Consequently, the Department does not propose adding "public assistance" to Probate Code section 3604(b). Instead, we propose a new subdivision (c) to read:

"(c) This section shall not limit recovery from the estate of a Medi-Cal beneficiary pursuant to Welfare and Institutions Code section 14009.5."

This would preserve Medi-Cal's existing authority for estate recovery for health care services provided after the beneficiary was 65.

#### Supplemental Security Income (SSI)

Another important consideration in the special needs trust area is the variation in eligibility requirements for different public assistance programs. For example, SSI is a program which provides public support to the aged, blind, and disabled, in the form of monthly support payments, as authorized in 42 United States Code, section 1382. Trust property is not counted as an available resource to the SSI recipient if the beneficiary's access to the trust principal is restricted, e.g., only the trustee or court can invade the principal. (Program Operations Manual SI 01120.105.A2.) SSI recipients are categorically eligible for Medi-Cal benefits, which means that an SSI recipient is automatically eligible for Medi-Cal. However, if an SSI recipient enters a nursing facility, SSI benefits cease, and the recipient must apply for Medi-Cal to cover the cost of that nursing facility care. A trust which did not make the beneficiary ineligible for SSI could then make the beneficiary ineligible for Medi-Cal.

Failure to consider these differences in public assistance programs can have disastrous results for the beneficiaries, by making them ineligible for Medi-Cal when they enter long term care in a nursing facility.

The comments on sections 3602 and 3611 state that:

"This permits personal injury damages or settlement proceeds for a disabled minor or incompetent person to be

delivered to a trustee of a special needs trust designed to supplement public support without disqualifying the minor or incompetent person from receiving such support."

We recommend that this sentence be amended, possibly by ending it after "special needs trust", so that it does not give a mistaken impression that any special needs trust will not disqualify the beneficiary from receiving public support or public assistance. We note that the excerpt you cited from the Prenskey and Ross article on Public Benefit Planning for the Elderly and Disabled discussed only SSI requirements; it did not consider any other public assistance program's requirements. It might also be helpful to add a caveat that the requirements of public assistance programs vary, and that the terms of the special needs trust must be drafted carefully to avoid disqualifying the beneficiary.

#### Medicaid Qualifying Trusts

When a trust beneficiary applies for Medi-Cal, if the trust is determined to be a Medicaid Qualifying Trust pursuant to 42 United States Code, section 1396a(k), the trust assets are available to meet the needs of the beneficiary, to the extent of the trustee's discretion. (Medi-Cal is the California Medicaid program.)

A Medicaid Qualifying Trust is a trust or similar legal device established by an individual (or spouse) under which the individual is the beneficiary of all or part of the payments from the trust, and the amount of distribution is determined by one or more trustees who are permitted to exercise any discretion with respect to the amount to be distributed to the individual. A trust that is established by an individual's guardian or legal representative, acting on the individual's behalf, falls under the definition of a Medicaid Qualifying Trust. (State Medicaid Manual § 3215.1)

If a special needs trust created with the proceeds of a third party liability claim were determined to be a Medicaid Qualifying Trust, established on the beneficiary's behalf, it would be available for Medi-Cal eligibility purposes, and could make the beneficiary ineligible for Medi-Cal.

#### Transfer of Assets

Trusts may present another eligibility issue, that of whether there was a transfer of assets which would make the individual ineligible for Medi-Cal for a period of time determined by the amount of property transferred without consideration. (Welf. & Inst. Code, § 14015.) This requirement is intended to discourage individuals from transferring their assets without adequate consideration in

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order to establish eligibility for Medi-Cal. A similar SSI transfer of assets requirement was eliminated in 1988 and replaced by a requirement that applicants for SSI and those whose SSI eligibility is being redetermined be informed that transferring assets may affect their Medicaid eligibility. (42 U.S.C. § 1382b(c)); currently there is no period of SSI ineligibility based on a transfer of assets without consideration. However, as discussed above, if a recipient of SSI enters a nursing facility, Medi-Cal eligibility may be affected by the transfer of assets during the 30-month period prior to application for Medi-Cal or entering long term care.

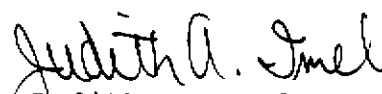
This brief comparison of some of the differences between Medi-Cal and SSI requirements is just one example of the complexity of the law governing public assistance programs. Each program has its own requirements, which may be quite different from other public assistance programs. It is critical that legislative proposals take into consideration the potential effects on other public assistance programs, so that trust beneficiaries don't incur unintended consequences.

We realize that disabled minors and incompetent persons may have special needs that Medi-Cal does not cover. Special needs trusts may be one way to provide for those needs, but it is essential to consider the sweeping repercussions produced by changes in this area of the law. We would be happy to provide assistance as needed as you consider this issue.

Thank you for the opportunity to comment on your proposed legislation. If you have questions regarding this, please contact Judith A. Imel, Staff Attorney, at (916) 657-3089. She plans to attend the Law Review Commission meeting in Sacramento on November 1 when you consider this issue.

Very truly yours,

Elisabeth C. Brandt  
Deputy Director and  
Chief Counsel

  
Judith A. Imel  
Staff Attorney

cc: See next page.

**DEPARTMENT OF DEVELOPMENTAL SERVICES**

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October 21, 1991 Key: \_\_\_\_\_

California Law Revision Commission  
400 Middlefield Rd., Suite D-2  
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RE: CALIFORNIA LAW REVISION COMMISSION TENTATIVE RECOMMENDATION  
RELATED TO SPECIAL NEEDS TRUST

Dear Members of the Commission:

The Department of Developmental Services appreciates the opportunity to comment on the Commission's tentative recommendation. The Department is mandated to collect the cost of developmentally disabled persons care and treatment while in state hospitals (Welf. & Inst. Code § 7513.2). The Department of Mental Health is under a similar mandate with respect to mentally disordered persons (Welf. & Inst. Code § 7277). Both departments have lien rights for the costs of care in third party actions (Welf. & Inst. Code § 7282.1).

While we share the Commission's concerns for the disabled, we believe the tentative recommendation runs counter to case law and the rationale for existing statutory limitations on the right of the state to reach a beneficiary's interest in a special needs trust. As noted in the draft recommendation, Probate Code section 15306(b) currently limits the right of the state to reach a beneficiary's interest. The Law Revision Commission comment regarding Probate Code section 15306 indicates that:

"Subdivision (a) is generally consistent with prior California law which permitted a state institution in which the beneficiary of a spendthrift trust was an inmate to reach the beneficiary's interest. See Estate of Lackmann, 156 Cal.App.2d 674, 678-83, 320 P.2d 186 (1958) (citing Restatement of Trusts § 157).

Subdivision (b) limits the right of the state or a local agency to reach the beneficiary's interest in welfare cases where the trust was established to provide for the care of a disabled beneficiary who is unable to provide for his or her own care or custody.

This limitation is intended to encourage potential settlors to provide in a trust for the care or support of a disabled person without the risk that the benefits of the trust will be taken to reimburse a public agency for a minimal level of support provided by the public agency. However, this rule is subject to the exception provided in the last sentence of subdivision (b)."  
(Emphasis added.)

The rationale for subdivision (b) does not apply in cases where a minor or incompetent receives damages or settlement proceeds. That is, no incentive to provide is necessary given the individuals "entitlement" to damages.

The tentative recommendation inappropriately shifts the responsibility for care from a financially responsible individual to the public. The issue is not whether a disabled minor or incompetent person entitled to damages has a "need for public medical and other benefits . . ." (Staff Draft page 2), but whether the individual has the financial resources to meet his own needs. We concur with the October 8, 1991 comments from the Department of Health Services that allowing trust beneficiaries with substantial resources provided by liable third parties to receive public assistance at taxpayer expense is at odds with basic principles of equity and the intent to provide public assistance to those in need.

Should the Commission elect to adopt the tentative recommendation, it should be modified: to limit special needs trusts to those cases where it is clearly demonstrated that the individual will have special needs not met by public assistance; to limit the amount paid into the trust to that necessary to satisfy such special needs and to provide for payment of trust funds to public entities providing assistance in the event that payments are not being made by the trustee to meet special needs. In this regard, we note an inconsistency between the proposed statutory language and the rationale for the recommendation as expressed in the discussion and proposed comments. While the statutory language in Sections 3602(c)(2) and 3611(c) refers to a "minor", the discussion and comments refer to a "disabled minor." Moreover, given that the stated purpose of the recommendation is to put disabled minors entitled to damages on equal footing with disabled children whose parents have the means to establish a private trust not subject to public claims by virtue of Probate Code section 15306(b), the language here should parallel that of Section 15306(b). That is, a trust should be permitted only for a minor "who has a disability that substantially impairs the individual's ability to provide for his or her own care or custody and constitutes a substantial handicap".

We also share the Department of Health Services' concern regarding payments to a trust prior to satisfaction of statutorily authorized liens. We recommend, however, that the proposed statutory language and comments be revised to refer to

all liens, including that authorized by Welfare and Institutions Code section 7282.1, in addition to the Medi-Cal lien authorized by Welfare and Institutions Code 14124.71 et seq. In addition we agree with the Department of Health Services' concern regarding use of the term "public support." The language utilized should make it abundantly clear that trust property is subject to a claim for the cost of care and treatment in state hospitals.

We support in general that part of the recommendation which adds Probate Code section 3604 to provide for payment of public claims upon the death of the beneficiary. We do not, however, see any justification for the requirement in Section 3604(b) that a public entity accept the amount collected from the trust in full satisfaction of its claim. There could be substantial assets in the estate subject to claims by public entities. (See Prob. Code § 9208 et seq. and Welf. & Inst. Code §§ 7513.1 and 7276). It is unfair to require that the public entity accept collection pursuant to Probate Code section 3604 in full satisfaction of its claim.

Finally, proposed section 3604(a) does not adequately protect the state's interest in securing reimbursement. Specifically, language should be added which requires the trustee to notify the appropriate public entity of the beneficiary's death and which specifies that the claim should not be barred by the statute of limitations. (The statute should, however, specify a reasonable period for presentation of claims after notice of death.) We believe the language in section 3604(a) which provides for reimbursement "if the property were in the beneficiaries estate" is confusing and unnecessary. We offer the following language: "On the death of the beneficiary of a trust established under sections 3602 or 3611, notwithstanding any provision of the trust to the contrary, trust property is first subject to claims for public assistance and the cost of care in state hospitals to the extent reimbursement is authorized under the Welfare and Institutions Code."

Recognizing that this issue presents difficult and complex matters of policy and law, we are willing to work with all interested parties. If I can provide any additional information or assistance, please do not hesitate to contact me at (916) 654-3405.

Very truly yours,



Joseph O. Egan  
Chief Counsel  
Office of Legal Affairs

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October 14, 1991

California Law Revision Commission  
 4000 Middlefield Road, Suite D-2  
 Palo Alto, CA 94303-4739

Re: Special Needs Trust Tentative Recommendation

Gentlemen:

I have the following questions and concern in regard to the proposed tentative recommendation relating to special needs trusts for disabled minor or incompetent persons:

1. The proposed language of Probate Code section 3604 would treat trust property "as if the property were" in the beneficiary's estate at the death of the beneficiary. This appears contrary to present federal Medicaid law limiting a state's right to recovery to a recipient's "estate", which has been interpreted by the Ninth Circuit in Citizens Action League v. Kizer, 887 F.2d 1003, cert denied 3/27/90 to mean only the "probate estate" of the decedent. See 42 U.S.C. 1396p(b)(1)(B).

My question is: Does the Commission seek to challenge the pre-emption of federal law on this question as interpreted in Kizer, or to change the law of trusts as to the nature of the property of an irrevocable trust upon the death of its lifetime beneficiary?

2. The proposal purports to treat property placed in an irrevocable discretionary trust established in a compromise of claim proceeding for disabled minors and incompetents as being subject to the creditors claims of public entities of its lifetime beneficiary, while Probate Code section 15306(b) does not.

My question is: How does the Commission reconcile the disparity between the proposal and the different treatment for disabled persons under a discretionary trust which is not created in a compromise of claim proceeding?

3. It would appear that in actual practice, the effect of the proposal can be sidestepped merely by not using the compromise of claim order procedure to fund a trust subject to the 3604 lien. For instance, the compromise of claim can be made to a blocked account established under 3611(b), and then ordered withdrawn, under present authority, to be paid to a third party trustee, or ordered paid to a conservator, who could then obtain separate authority under substituted judgment to transfer the proceeds to a

15306(b) trust unrelated to the compromise of claim proceedings. (It is incorrect that such a transfer automatically disqualifies the disabled person for public support benefits - at the most it would make the person ineligible for 30 months if the person is institutionalized at the time of the transfer.) I believe several other alternative procedures exist.

My question is: Why does the Commission seek to enact a proposal that is not likely to have any practical effect because it can be avoided by other procedures?

4. The proposal makes no mention as to whether it would become operative as to existing trusts, or only as to trusts executed, approved and/or funded until after the statute's operative date. The reference in 3604 to trusts established under 3602 or 3611 can be interpreted to include previously established trusts, since 3611 is not being amended in the proposal (unless the reference in 3602 to the methods of disposition under 3610 et seq. would be so interpreted.)

My questions are: Why does the Commission seek to enact a proposal that omits to provide for its operative effect? If the proposal attempts to alter the terms and provisions of existing trusts established by final court judgment and settlement contracts with vested rights, should the Commission approve it?

5. The proposal is uncertain and confusing as to whether the limitation presently imposed in Welfare and Institutions Code section 14124.78 on the DHS Director as to a Medi-Cal lien "cap" of 50% of the plaintiff's net recovery would apply against the claim of the public entity at the death of the plaintiff. Section (a) of 3604 refers to reimbursement of public support "authorized under the Welfare and Institutions Code if the property were in the beneficiary's estate". Section (b) of 3604 merely states that the public entity would release "all liens for the purposes of enforcing its claim".

My questions are: Does this mean Medi-Cal would no longer be able to enforce its lien for pre-judgment benefits at the time of settlement if it wished to exercise any claim in the future for post-mortem collection? Does this mean that if it did exercise any claim for post-mortem collection it would not be limited to the 50% cap? Does this mean that all remaining assets in the trust, including investment income and regardless of size of the initial recovery, would be subject to post-mortem collection?

In conclusion, my concern is that I see here an attempt to erode the philosophy that led to section 15306(b) after extensive study by your commission in 1985. Consider again that if you



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require tort recoveries to replace, instead of allowing them to supplement, public benefits, these recoveries will eventually go away and the state will be back supplying the support anyway, (see the discussion in your Memorandum 85-87, p. 8, fn. 20 and the conclusions in the cited article by Mr. Frolik). The fact that public support reimbursement is delayed until the death of the beneficiary, and is limited by the W&I provisions, may ease the concern in situations where it is not likely there will be a surviving member of the family of the plaintiff. But this fact is normally impossible to know at the time of settlement. Therefore the parties will still be influenced, at the time of tort recovery settlement, to select the alternative best suited to supplementing, instead of replacing, available public support after experiencing an event which frequently significantly affects the future life of the entire family.

Very truly yours,

  
James D. Palmer, Jr.

STATE OF CALIFORNIA  
California Law Revision Commission

TENTATIVE RECOMMENDATION

*relating to*

SPECIAL NEEDS TRUST FOR DISABLED  
MINOR OR INCOMPETENT PERSON

September 1991

*This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Comments sent to the Commission will be a public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation it plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.*

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN October 18, 1991.

*The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.*

CALIFORNIA LAW REVISION COMMISSION  
4000 Middlefield Road, Suite D-2  
Palo Alto, CA 94303-4739

TENTATIVE RECOMMENDATION  
*relating to*  
SPECIAL NEEDS TRUST FOR MINOR OR INCOMPETENT PERSON

If a child has a disability that makes the child eligible to receive public benefits, parents of the child who have the means to do so may create a "special needs trust" for the child to supplement public benefits.<sup>1</sup> A special needs trust is a form of discretionary spendthrift trust designed to preserve public assistance benefits of a disabled beneficiary. The trust instrument typically provides that the trust is an emergency backup fund secondary to public resources, and directs the trustee to seek out and obtain available public benefits, particularly social security benefits and Medi-Cal. If these benefits are unavailable or insufficient, the trust instrument authorizes the trustee to supplement the benefits for the beneficiary's health, safety, and welfare. If the trust instrument is properly drawn, the existence of trust assets will not disqualify the beneficiary from receiving public benefits.<sup>2</sup>

But if a minor or incompetent person receives damages or settlement proceeds under a judgment or court order, there is no authority for the court to direct the proceeds to be paid to a trustee.<sup>3</sup> If the minor or incompetent person has severe permanent

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1. H. Prensky & S. Ross, *Public Benefit Planning for the Elderly and Disabled*, in Sixteenth Annual USC Probate and Trust Conference at 40 (U.S.C. Law Center, Oct. 26, 1990).

2. H. Prensky & S. Ross, *supra* note 1, at 40-50.

3. Before July 1, 1991, some lawyers were creating, and courts were approving, special needs trusts for proceeds of personal injury settlements or damages payable to a disabled minor or incompetent person. Letter from Edmond R. Davis to Arthur K. Marshall (June 13, 1991) (copy on file in office of California Law Revision Commission); letter from Sterling L. Ross, Jr., to Valerie J. Merritt (July 22, 1991) (copy on file in office of California Law Revision Commission). This was done under former statutory language which authorized the court to direct that the proceeds be deposited in a "trust company authorized to transact a trust business in this state." Former Prob. Code §§ 3602, 3611 (repealed July 1, 1991). This language was not continued in the new Probate Code. See Prob. Code §§ 3602, 3611 (operative July 1, 1991). It is not clear that the "trust company" language of former law was sufficient to authorize special needs trusts for damages or settlement proceeds. Some local court rules may

disability resulting from an accident, payment of the judgment or settlement to a guardian or conservator or to an account in the disabled person's name will disqualify the person from receiving public benefits, such as Medi-Cal.<sup>4</sup> A disabled minor or incompetent person entitled to damages has just as urgent a need for public medical and other benefits as does a disabled child whose parents have the means to establish a special needs trust that preserves the child's eligibility for benefits.

The Commission recommends authorizing the court giving judgment or approving the settlement to direct that money payable to a minor or incompetent person under the judgment or order be paid to a trustee of a trust under terms approved by the court. This will permit the court to authorize a special needs trust for personal injury damages or settlement proceeds for a disabled minor or incompetent person, putting such a person on an equal footing with a disabled child whose parents have the means to establish a private trust.

Under existing law, if the minor or incompetent person has substantial disability, the trust is not subject to claims of public entities for reimbursement for benefits provided.<sup>5</sup> The Commission recommends that, on death of the beneficiary, trust property should be subject to claims of public entities for public support provided to the beneficiary to the extent reimbursement would be authorized under the Welfare and Institutions Code if the property were in the beneficiary's estate.<sup>6</sup>

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effectively forbid such trusts. See Merced County Probate Rules, Rule 1712; Solano County Probate Rules, Rule 7.69 (assets greater than \$20,000); Stanislaus County Probate Policy Manual, Rule 1901. These rules are reprinted in California Local Probate Rules (12th ed., Cal. Cont. Ed. Bar 1991).

4. See H. Prensky & S. Ross, *supra* note 1, at 42-50.

5. Prob. Code § 15306(b) ("disability that substantially impairs the individual's ability to provide for his or her own care or custody and constitutes a substantial handicap").

6. See, e.g., Welf. & Inst. Code §§ 7513-7513.2 (state hospital costs), 14009.5 (Medi-Cal). See also Welf. & Inst. §§ 7277.1, 7278, 7279 (mentally disordered).

## PROPOSED LEGISLATION

The Commission's recommendation would be effectuated by enactment of the following amendments and addition:

### Prob. Code § 3602 (amended). Disposition of remaining balance

3602. (a) If there is no guardianship of the estate of the minor or conservatorship of the estate of the incompetent person, the remaining balance of the money and other property (after payment of all expenses, costs, and fees as approved and allowed by the court under Section 3601) shall be paid, delivered, deposited, or invested as provided in Article 2 (commencing with Section 3610).

(b) Except as provided in subdivision (c), if there is a guardianship of the estate of the minor or conservatorship of the estate of the incompetent person, the remaining balance of the money and other property (after payment of all expenses, costs, and fees as approved and allowed by the court under Section 3601) shall be paid or delivered to the guardian or conservator of the estate. Upon application of the guardian or conservator, the court making the order or giving the judgment referred to in Section 3600 or the court in which the guardianship or conservatorship proceeding is pending may, with or without notice, make an order that all or part of the money paid or to be paid to the guardian or conservator under this subdivision be deposited or invested as provided in Section 2456.

(c) Upon ex parte petition of the guardian or conservator or upon petition of any person interested in the guardianship or conservatorship estate, the court making the order or giving the judgment referred to in Section 3600 may for good cause shown order ~~either-or-both~~ any one or more of the following:

(1) That all or part of the remaining balance of money not become a part of the guardianship or conservatorship estate and instead be deposited in an insured account in a financial institution in this state, or in a single-premium deferred annuity, subject to withdrawal only upon authorization of the court.

(2) That all or part of the remaining balance of money not become a part of the guardianship or conservatorship estate and instead be

paid to the trustee of a trust established for the benefit of the minor or incompetent person under terms approved by the court.

(2) (3) If there is a guardianship of the estate of the minor, that all or part of the remaining balance of money and other property not become a part of the guardianship estate and instead be transferred to a custodian for the benefit of the minor under the California Uniform Transfers to Minors Act, Part 9 (commencing with Section 3900).

(d) If the petition is by a person other than the guardian or conservator, notice of hearing on a petition under subdivision (c) shall be given for the period and in the manner provided in Chapter 3 (commencing with Section 1460) of Part 1.

Comment. Section 3602 is amended to add paragraph (2) to subdivision (c) to permit money of a minor or incompetent person to be paid to the trustee of a trust established under terms approved by the court. This permits personal injury damages or settlement proceeds for a disabled minor or incompetent person to be delivered to a trustee of a special needs trust designed to supplement public support without disqualifying the minor or incompetent person from receiving such support. See also Section 3604 (public reimbursement on death of beneficiary).

Prob. Code § 3604 (added). Reimbursement from trust for public support

3604. (a) On the death of a minor or incompetent person who is the beneficiary of a trust established under Section 3602 or 3611, trust property is subject to a claim for public support provided to the beneficiary to the extent reimbursement would be authorized under the Welfare and Institutions Code if the property were in the beneficiary's estate.

(b) A public entity asserting a claim under this section shall accept the amount collected in full satisfaction of its claim for reimbursement for public support provided to the beneficiary, and shall release all liens for the purpose of enforcing the claim.

Comment. Section 3604 is new. If the trust beneficiary has a substantial disability and the existence of the trust does not disqualify the beneficiary from receiving Medi-Cal benefits, while the trust is in existence it is not subject to claims of public entities for reimbursement for social services provided. See Prob. Code § 15306(b). On the death of the beneficiary, trust property becomes subject to such claims under Section 3604. See also Welf. & Inst. Code §§ 7513-7513.2 (reimbursement for state hospital costs), 14009.5 (reimbursement for Medi-Cal benefits).

Prob. Code § 3611 (amended). Order of court

3611. In any case described in Section 3610, the court making the order or giving the judgment referred to in Section 3600 shall order any one or more of the following:

(a) That a guardian of the estate or conservator of the estate be appointed and that the remaining balance of the money and other property be paid or delivered to the person so appointed.

(b) That the remaining balance of any money paid or to be paid be deposited in an insured account in a financial institution in this state, or in a single-premium deferred annuity, subject to withdrawal only upon the authorization of the court, and that the remaining balance of any other property delivered or to be delivered be held on such conditions as the court determines to be in the best interest of the minor or incompetent person.

(c) That the remaining balance of any money paid or to be paid be paid to the trustee of a trust established for the benefit of the minor or incompetent person under terms approved by the court.

~~(e)~~ (d) If the remaining balance of the money and other property to be paid or delivered does not exceed twenty thousand dollars (\$20,000) in value, that all or any part of the money and other property be held on such other conditions as the court in its discretion determines to be in the best interest of the minor or incompetent person.

~~(e)~~ (e) If the remaining balance of the money and other property to be paid or delivered does not exceed five thousand dollars (\$5,000) in value and is to be paid or delivered for the benefit of a minor, that all or any part of the money and the other property be paid or delivered to a parent of the minor, without bond, upon the terms and under the conditions specified in Article 1 (commencing with Section 3400) of Chapter 2.

~~(e)~~ (f) If the remaining balance of the money or other property to be paid or delivered is to be paid or delivered for the benefit of the minor, that all or any part of the money and other property be transferred to a custodian for the benefit of the minor under the California Uniform Transfers to Minors Act, Part 9 (commencing with Section 3900).

Comment. Section 3611 is amended to add subdivision (c) to permit money of a minor or incompetent person to be paid to the trustee of a trust established under terms approved by the court. This permits personal injury damages or settlement proceeds for a disabled minor or incompetent person to be delivered to a trustee of a special needs trust designed to supplement public support without disqualifying the minor or incompetent person from receiving such support. See also Section 3604 (public reimbursement on death of beneficiary).