

Memorandum 91-55

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

Attached is a staff draft of a *Tentative Recommendation Relating to Special Needs Trust for Disabled Minor or Incompetent Person*. The Commission discussed special needs trusts at the last meeting. As the Commission wanted, the draft provides that if the trust has been immune from claims by public entities for reimbursement, when the trust terminates, trust assets are subject to Welfare and Institutions Code provisions governing reimbursement.

Terry Ross objects to the reimbursement provision. He says it is unnecessary because of Probate Code Section 15306(b). He says the effect of that subdivision is that, if the beneficiary is ineligible for Medi-Cal and is being cared for in a state hospital, hospital expenses are paid out of the trust on a current basis, so there will be no later claim for reimbursement.

If, on the other hand, the beneficiary is eligible for Medi-Cal, state hospital expenses are reimbursed by the federal government. State reimbursement claims for Medi-Cal may not be made if the beneficiary was under 65 when services were received, or where there is a surviving spouse, surviving child under 21, or a surviving child who is blind or permanently and totally disabled. Welf. & Inst. Code § 14009.5.

Because of these limitations, Terry says reimbursement claims on termination of special needs trusts are rare. He will write to us to elaborate his views.

Respectfully submitted,

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California Law Revision Commission

Staff Draft

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 21, 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
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9/6/91

RECOMMENDATION

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.¹ 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.²

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.³ If the minor or incompetent person has severe permanent

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 effectively forbid such trusts. See Merced County Probate Rules, Rule 1712; Solano County Probate Rules, Rule 7.69 (assets greater than

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.⁴ 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.⁵ 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.⁶

\$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 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.

~~(d)~~ (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).