

## Memorandum 92-5

Subject: Study L-708 - Special Needs Trust (Draft of Recommendation)

Attached is a *Recommendation: Special Needs Trust for Disabled Minor or Incompetent Person*. The Commission considered a *Tentative Recommendation* at the last meeting that had been circulated for comment, and revised the draft. After the meeting, the staff sent the revised draft to the Department of Health Services and Department of Developmental Services and to Terry Ross and Edmond Davis. We received comments from Mr. Davis which are reflected in the attached draft.

We also received a letter from the Department of Developmental Services, attached as Exhibit 1. The Department expressed reservations about the proposal because it

inappropriately shifts the responsibility for care from individuals who have the financial resources to meet their own needs to the public. Allowing individuals who receive settlement proceeds or a judgment to receive public assistance at taxpayer's expense is at odds with basic principles of equity and the intent to provide public assistance to those truly in financial need. We therefore urge the Commission to reconsider . . . .

The Department made suggestions for use if the Commission elects to proceed. We included all the department's suggestions in the draft, except that we modified its suggestion on the statute of limitations, and declined to make a few minor changes of taste.

The tolling provision is in subdivision (e) of Section 3605. It allows three months for the department to bring an action against the trust if its claim is rejected. This corresponds to the provision for decedents' estates. Prob. Code § 9353. The department wanted to say the statute of limitations is tolled from the time the special needs trust is created until it terminates. The problem with this is that when the trust terminates and the statute begins to run again, the limitation period remaining may be several years. The staff thinks subdivision (e) of Section 3605 is a better solution.

The staff recommends the Commission approve this *Recommendation* for printing and submission to the 1992 session of the Legislature.

Respectfully submitted,

Robert J. Murphy III  
Staff Counsel

#L-708

STATE OF CALIFORNIA

California Law Revision Commission

Staff Draft

RECOMMENDATION

SPECIAL NEEDS TRUST FOR DISABLED  
MINOR OR INCOMPETENT PERSON

January 1992

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

January 23, 1992

To: The Honorable Pete Wilson  
*Governor of California*, and  
The Legislature of California

This recommendation codifies the existing practice of courts giving judgment or approving settlement for a disabled minor or incompetent person to order that the proceeds be paid to a special needs trust that will preserve the disabled person's eligibility for public benefits such as social security and Medi-Cal. This will enable a minor or incompetent person who is disabled from an accident to have the same benefit from a special needs trust as a disabled child whose parents have the means to establish a private trust for this purpose.

This recommendation provides that public entities be reimbursed from trust assets for benefits provided to the beneficiary on the beneficiary's death or on termination of the trust by the court.

This recommendation is submitted pursuant to Resolution Chapter 37 of the Statutes of 1980, continued in Resolution Chapter 33 of the Statutes of 1991.

Respectfully submitted,

Edwin K. Marzec  
*Chairperson*

rml72  
1/9/92

#### SPECIAL NEEDS TRUST FOR DISABLED 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. Examples of special needs not normally provided by social security or Medi-Cal that the trust may provide include dental care, special equipment such as a wheelchair, ramp access, vehicle modification for the disabled, and programs for the handicapped such as independence training and recreational programs. 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 special needs trust.<sup>3</sup> If the minor or incompetent person has severe permanent

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1. Prensky & 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. Prensky & 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 that 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

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 disabled minor or incompetent person under the judgment or order be paid to a trustee of a special needs trust under terms approved by the court. This will put a disabled minor or incompetent person who is entitled to personal injury damages or settlement proceeds on an equal footing with a disabled child whose parents have the means to establish such a trust. The trust should be subject to continuing supervision by the court to the extent determined by the court. Public agencies with claims for reimbursement should be authorized to petition the court to terminate the trust on a showing that the beneficiary is no longer disabled or no longer has special needs.

Under existing law, if the minor or incompetent person has substantial disability, the trust is not subject to claims of public

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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 \$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 Prensky & Ross, *supra* note 1, at 42-50.

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 otherwise be authorized under federal or state law.<sup>6</sup>

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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., 42 U.S.C. § 1396p(b)(1)(B) (Medicaid); Welf. & Inst. Code §§ 7513-7513.2 (state hospital costs), 14009.5 (Medi-Cal). See also Welf. & Inst. Code §§ 7277.1, 7278, 7279 (mentally disordered).

RECOMMENDED LEGISLATION

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~~ subdivisions (c) and (d), 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 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) 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) Upon petition of the guardian, conservator, or 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 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 a trust established under Section 3604 for the benefit of the minor or incompetent person.

~~(d)~~ (e) 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. Notice of the time and place of hearing on a petition under subdivision (d), and a copy of the petition, shall be mailed to the Director of Health Services, the Director of Mental Health, and the Director of Developmental Services at the office of each director in Sacramento at least 15 days before the hearing.

Comment. Section 3602 is amended to add authority for the court to order that money of a minor or incompetent person be paid to a trust established under Section 3604. This permits personal injury damages or settlement proceeds for a disabled minor or incompetent person to be paid to a special needs trust.

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.

Prob. Code § 3604 (added). Special needs trust

3604. (a) When a court makes an order under Section 3602 or 3611 that money of a minor or incompetent person be paid to a trust established under this section, the terms of the trust shall be reviewed and approved by the court and shall satisfy the requirements of this section. The trust is subject to continuing jurisdiction of the court, and is subject to court supervision to the extent determined by the court.

(b) A trust may be established and continued under this section only if the court determines all of the following:

(1) The minor or incompetent person has a disability that substantially impairs the individual's ability to provide for the individual's own care or custody and constitutes a substantial handicap.

(2) The minor or incompetent person will have special needs that



are not likely to be met without the trust.

(3) That money to be paid to the trust does not exceed the amount needed to meet the special needs of the minor or incompetent person.

(c) If at any time it appears that (1) any of the requirements of subdivision (b) are not satisfied or the trustee is not making payments from the trust for the special needs of the minor or incompetent person, and (2) the Department of Health Services, Department of Mental Health, or Department of Developmental Services has a claim against trust property, the director of that department may petition the court for an order terminating the trust.

(d) The court's order under Section 3602 or 3611 for payment of money to a trust established under this section shall include a provision that all statutory liens in favor of the Department of Health Services, Department of Mental Health, and Department of Developmental Services shall first be satisfied.

Comment. Section 3604 is new. The section 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. In approving the terms of the trust, the court may, for example, require periodic accountings, court approval for certain kinds of investments, and the giving of a surety bond.

Prob. Code § 3605 (added). Claim of Department of Health Services, Department of Mental Health, or Department of Developmental Services

3605. (a) This section applies only to a trust established on or after January 1, 1993, that satisfies one of the following requirements:

(1) The trust is established under Section 3604.

(2) The trust is established under Article 10 (commencing with Section 2580) of Chapter 6 of Part 4 to receive money paid pursuant to a compromise or judgment for the conservatee.

(b) Notwithstanding any provision in the trust instrument to the contrary, trust property is subject to claims of the Department of Health Services, Department of Mental Health, and Department of Developmental Services to the extent authorized by law on the occurrence of either of the following:

(1) Death of the minor, incompetent person, or conservatee who is the beneficiary of the trust.

(2) A court order under Section 3604 terminating the trust because

any of the requirements of subdivision (b) of Section 3604 are not satisfied, or because the trustee is not making payments from the trust for the special needs of the minor or incompetent person.

(c) If the trustee knows or has reason to believe the decedent received services or benefits from the Department of Health Services, Department of Mental Health, or Department of Developmental Services, the trustee shall give notice of the decedent's death as provided in Section 1215, addressed to the director of that department at the Sacramento office of the director. Failure to give the notice prevents the running of the statute of limitations against that department's claim.

(d) The director has four months after notice is given in which to make the claim. The claim shall be paid as a preferred claim prior to any other distribution. If trust property is distributed before expiration of four months after notice is given, the director has a claim against the distributees to the full extent of the claim, or each distributee's share of trust property, whichever is less. The claim against distributees includes interest at a rate equal to that earned in the Pooled Money Investment Account, Article 4.5 (commencing with Section 16480) of Chapter 3 of Part 2 of Division 4 of Title 2 of the Government Code, from the date of distribution or the date of filing the claim, whichever is later, plus other accruing costs as in the case of enforcement of a money judgment.

(e) If a claim made pursuant to subdivision (d) is rejected, the director of the department making the claim may bring an action against the trust. The action shall be commenced within three months after the notice of rejection is given.

Comment. Section 3605 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 federal or state law. See, e.g., 42 U.S.C. § 1396p(b)(1)(B) (Medicaid); Welf. & Inst. Code §§ 7276, 7513-7513.2 (state hospital costs), 14009.5 (Medi-Cal).

Subdivisions (c) and (d) are drawn from Sections 215, 9202, and 9203. Subdivision (e) is drawn from Sections 9252(c) and 9353(a)(1).

Section 3605 permits reimbursement from trusts established under Section 3604 or under the substituted judgment provisions of conservatorship law (Sections 2580-2586). Section 3605 does not affect

reimbursement rights with respect to other trusts, including special needs trusts established before the operative date of the section.

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 be paid to a trust established under Section 3604 for the benefit of the minor or incompetent person.

~~(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 Section 3604. This permits personal injury damages or settlement proceeds for a disabled minor or incompetent person to be paid to a special needs trust. Before payment or delivery to the trust, all statutory liens in favor of the Department of Health Services, Department of Mental Health, and Department of Developmental Services must first be satisfied. See Section 3604(d); Welf. & Inst. Code §§ 7282.1, 14124.71-14124.76.

## DEPARTMENT OF DEVELOPMENTAL SERVICES

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Law Revision Commission  
RECEIVED

January 2, 1992

File: \_\_\_\_\_  
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California Law Revision Commission  
400 Middlefield Road, Suite D-2  
Palo Alto, CA 94303-4739

Dear Commission Members:

LAW REVISION COMMISSION RECOMMENDATION REGARDING SPECIAL  
NEEDS TRUSTS

The Department of Developmental Services appreciates the opportunity to comment on the November 14, 1991, redraft of the above recommendation. As noted in our previous comment, the recommendation inappropriately shifts the responsibility for care from individuals who have the financial resources to meet their own needs to the public. Allowing individuals who receive settlement proceeds or a judgment to receive public assistance at taxpayer's expense is at odds with basic principles of equity and the intent to provide public assistance to those truly in financial need. We therefore urge the Commission to reconsider its tentative recommendation. Should you elect to proceed, we offer the following amendments.

Probate Code section 3602 subdivisions (a) and (b) authorize payment to a special needs trust under section 3604 without notice to the Directors of the Departments of Developmental Services and Mental Health as provided in section 1460 et seq. if the petition is made by a guardian or conservator. These provisions should be amended to provide for notice and the opportunity to object to establishment of a special needs trust in all cases. The Departments are uniquely qualified to advise the court with respect to whether the individual has special needs which can not be provided by public programs.

Section 3604(b)(1) should be revised to parallel the language of section 15306(b) as follows:

The minor of incompetent person has a disability that substantially impairs the individual's ability to provide for his or her own care . . . .

Section 3604(c) should be revised to make it clear that the court should authorize payment to the trustee only to the extent

necessary to fund special needs. Payment of a substantial settlement or judgment is unjustified where there are limited special needs. We propose the following:

Any money paid to the trustee shall be limited to that necessary to meet the individual's special needs. A trust established . . . .

Section 3604(d) should be revised to add reference to the Department of Mental Health which also has a statutory right to payment for the cost of hospital care and to clarify when the Departments may petition for termination. We propose the following:

If either of the requirements of subdivision (b) are not satisfied or no longer exist or payments for special needs are not made by the trustee and the Department of Health Services, Developmental Services or Mental Health has a claim . . . .

Section 3605 should be revised to include reference to the Department of Mental Health in addition to the Departments of Health and Developmental Services.

We propose the following to further clarify 3605(b):

(b) Notwithstanding any provision in the trust instrument to the contrary, trust property . . . .

(1) The minor, incompetent person, ward or conservatee . . . .

(2) The court makes an order under section 3604 terminating the trust because either of the requirements of subdivision (b) are not satisfied or no longer exist or payments are not made by the trustee.

Section 3605(c) should be revised to provide that the establishment of a special needs trust tolls the statute of limitations on the underlying claim. Should a trustee reject a timely claim, he or she might assert a statute of limitations defense in a subsequent recovery action. We propose the following in lieu of the last sentence of (c):

The establishment of a trust referenced in subdivision (a) shall toll the statute of limitations applicable to actions brought by public entities to recover public assistance or support provided to the beneficiary.

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Section 3605(d) should be revised to establish the Director's claim as preferred and entitled to priority over any remainderman. We propose the following:

(d) The director has four months after notice is given in which to make the claim which shall be paid as a preferred claim prior to any other distribution. If trust . . . .

The comment to section 3605 should include a reference to Welf. and Inst. Code section 7276 in addition to sections 7513-7513.2. Given that this section applies only to trusts established on or after January 1, 1993, the comment should clarify that it does not preclude claims against special needs trusts established prior thereto. In this regard, it would be appropriate to incorporate footnote 3 from the introduction which discusses the questionable authority for special needs trusts.

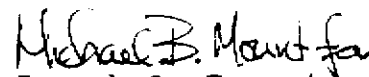
Section 3611 should be revised to indicate that statutory liens must be satisfied before payment to the trustee. We propose the following:

In any case described in section 3610, the court making the order or giving the judgment referred to in section 3600 shall, after ordering satisfaction of all applicable statutory liens, order any one of the following: . . . .

In addition to the above proposal amendments, we agree with the comments and proposals made by the Department of Health Services.

Please do not hesitate to contact me at (916) 654-3405 for any additional information.

Very truly yours,

  
Joseph O. Egan  
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Office of Legal Affairs

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