

COURT-CREATED TRUSTS IN TEXAS

**Revised to Include Amendments Made
through 76th Texas Legislature (1999)**

Glenn M. Karisch
Barnes & Karisch, P. C.
2901-D Bee Caves Road
Austin, Texas 78746
(512) 328-8355/ FAX (512) 328-8413
karisch@texasprobate.com
www.texasprobate.com

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Glenn M. Karisch
Barnes & Karisch, P. C.
2901 Bee Caves Road, Suite D
Austin, Texas 78746
(512) 328-8355 Fax: (512) 328-8413
karisch@texasprobate.com
www.texasprobate.com

Education

The University of Texas School of Law, Austin, Texas
Juris Doctor with Honors, 1980

The University of Texas at Austin, Austin, Texas
Bachelor of Journalism with Highest Honors, 1977

Professional Experience

Barnes & Karisch, P. C., Austin, Texas, 1998 - Present
Ikard & Golden, P. C., Austin, Texas, 1992 - 8
Hoffman & Stephens, P. C., Austin, Texas, 1991-2
The Texas Methodist Foundation, Austin, Texas, Vice President and General Counsel, 1989-1991
Coats, Yale, Holm & Lee, Houston, Texas, 1980-1989

Professional Activities

Board Certified, Estate Planning and Probate Law, Texas Board of Legal Specialization
Fellow, American College of Trust and Estate Counsel
Member, Real Estate, Probate and Trust Law Council, State Bar of Texas, 1999-
Chair, Estate Planning and Probate Section, Travis County Bar Association, 1996-97

Legal Articles and Papers

Author and Editor, Texas Probate Web Site [www.texasprobate.com] and email mailing list [probate@io.com] (1995-99).

Modifying and Terminating Irrevocable Trusts, State Bar of Texas Advanced Estate Planning and Probate Law Course (1999).

Legal Research on the Internet, (with Joseph G. Hodges, Jr., Denver, Colorado), American College of Trust and Estate Counsel 1999 Annual Meeting.

Using the Internet in an Estate Planning Practice, State Bar of Texas Advanced Estate Planning and Probate Law Course (1998).

Sleeping With the Enemy: How to Sleep At Night While Making a Living With an Estate Planning Practice, Travis County Bar Association Estate Planning and Probate Seminar (1998).

Are the Winds of Change Blowing for Texas Probate Courts?, Or . . . 5B, or Not 5B, That Is the Question, Docket Call in Probate Court Seminar, San Antonio (1998).

"Court-Created Trusts in Texas," State Bar of Texas Advanced Drafting: Estate Planning and Probate Law Course (1995), updated to reflect legislative changes through 1999.

Table of Contents

1. INTRODUCTION, SCOPE AND ACKNOWLEDGMENTS	6
1.1. Introduction.	6
1.2. Scope.	6
1.3. Acknowledgments.	6
1.4. 1999 Legislative Changes.	6
2. HISTORY OF COURT-CREATED TRUSTS	6
2.1. History of Equitable Creation of Trusts.	6
2.2. History of Statutory Trusts in Texas.	7
3. 142 TRUSTS	8
3.1. Statutory Requirements.	8
3.1.1. Basis for Creation.	8
A. Suit Required.	8
1) Interpleader.	8
2) Declaratory Judgment.	8
3) Probate Proceedings.	8
4) Federal Lawsuit.	8
B. Beneficiary Must Be Minor or Incapacitated Person.	9
C. Next Friend/Guardian Ad Litem/No Legal Guardian Requirement	9
1) Can a 142 Trust Be Created For a Non-minor Who Is Subject to a Guardianship?	9
2) What About Attorney Ad Litem?	9
3) Parents Are Natural Guardians, Not Legal Guardians.	10
4) What About Temporary Guardians And Guardians of The Person?	10
D. Application by Next Friend or Guardian Ad Litem.	10
E. Best Interests Finding.	10
F. Judgment Required.	10
3.1.2. Mandatory Provisions.	10
A. Must Use Corporate Trustee.	10
B. Sole Beneficiary Requirement.	11
C. Mandatory Distribution Provisions.	11
1) Agreed Order May Be Different.	11
2) Expanding Standard May Be Different.	12
D. Mandatory Trust Termination Provisions.	12
E. Trustee Compensation.	12
F. Distributions on Termination.	12
3.1.3. Optional Provisions.	13
A. Dribble Distributions.	13
B. Facility of Payment	13
C. Termination at Age Other Than 25.	13
D. Other Optional Provisions.	13
3.1.4. 1997 Change Permitting Supplemental Needs Trusts.	13
A. 142 Trusts Created After Effective Date of SB 912.	14
B. Problems with the Effective Date of SB 912.	14
3.2. Miscellaneous Issues Regarding 142 Trusts.	15
3.2.1. Revocation And Modification.	15
3.2.2. Effect of a Guardianship Proceeding.	15
3.2.3. Funding 142 Trust With Only Part of Judgment.	15
3.2.4. Conflicts Between Tex. Prop. Code § 142.005 And The Texas Trust Code.	15
A. Are 142 Trusts Subject to the Texas Trust Code?	15
B. Jurisdictional Issues.	16

3.2.5.	Can a 142 Trust Be a Spendthrift Trust?	16
3.2.6.	Trustee's Duty to Account.	17
3.2.7.	Distributions For Minor's Support, Education or Maintenance.	17
3.2.8.	Duties And Liabilities of Next Friend or Guardian Ad Litem.	18
3.2.9.	Potential Liability of Trustee For Administering Nonstandard 142 Trusts.	19
3.3.	Drafting 142 Trusts.	19
4.	867 TRUSTS	20
4.1.	Statutory Requirements.	20
4.1.1.	Basis For Creation.	20
A.	Application by a Guardian.	20
1)	What Type of Guardian Is Required?	20
2)	Must Guardian Qualify Before Applying for Trust?	20
B.	Application by an Attorney Ad Litem.	21
C.	Best Interests Finding.	22
4.1.2.	Mandatory Provisions.	22
A.	Must Use Corporate Trustee.	22
B.	Sole Beneficiary Requirement.	22
C.	Mandatory Distribution Provisions.	22
D.	Trustee Compensation.	23
4.1.3.	Optional Provisions.	23
A.	1997 Change Clarifies That 867 Trusts May Contain Extra Provisions.	23
B.	867 Trusts as Supplemental Needs Trusts.	24
C.	Distributions to or for the Benefit of the Ward or Another Person Whom the Ward Is Legally Obligated to Support.	25
D.	Paying Guardian's Compensation.	25
E.	Trust Termination Age.	25
F.	Distribution on Trust Termination.	26
4.2.	Miscellaneous Issues Regarding 867 Trusts.	26
4.2.1.	Transferring Property Into an 867 Trust.	26
4.2.2.	Trust Amendment, Modification or Revocation.	26
4.2.3.	Can and Should Guardian Resign When Trust Is Created?	27
A.	Parents as the Natural Guardian of the Person.	27
B.	Minors Attaining Their Majority.	27
C.	When a Guardian of the Estate is Needed.	27
4.2.4.	Texas Trust Code Applies to 867 Trusts.	28
4.2.5.	Jurisdiction of Courts Supervising 867 Trusts.	28
4.2.6.	Can an 867 Trust Be a Spendthrift Trust?	28
4.2.7.	Trustee's Duty to Account.	29
4.2.8.	Investments in Texas Tomorrow Fund.	29
4.2.9.	Distributions For Minor's Support, Education or Maintenance.	29
4.2.10.	Duties And Liabilities of Guardian And Attorney Ad Litem.	30
4.2.11.	Potential Liability of Trustee For Administering Nonstandard 867 Trusts.	31
4.3.	Drafting 867 Trusts.	31
5.	MEDICAID (D)(4)(A) SUPPLEMENTAL NEEDS TRUSTS	31
5.1.	Statutory Requirements.	32
5.1.1.	Assets of an Individual.	32
5.1.2.	Under Age 65.	32
5.1.3.	Disabled.	32
5.1.4.	Established by a Parent, Grandparent, Legal Guardian or Court.	33
5.1.5.	State Repayment.	33
5.2.	Basis for Creation of Supplemental Needs Trusts in Texas.	33
5.2.1.	142 Trust.	33

5.2.2.	867 Trust.	34
5.2.3.	Parent-Created Trust/Court-Authorized Transfer.	34
5.2.4.	Court-Created Trust Without Reference to Sections 142.005 or 867.	34
5.3.	Drafting Supplemental Needs Trusts.	34
6.	TAXATION OF COURT-CREATED TRUSTS	35
6.1.	Taxation as Grantor Trust.	35
6.2.	I. R. C. § 468B Qualified Settlement Funds.	35
6.2.1.	Historical Background.	35
6.2.2.	Statute.	36
6.2.3.	Regulations.	36
6.2.4.	Avoiding QSF Status.	37
A.	Use a Guardianship And/or 867 Trust.	37
B.	Use a Trust Created by a Relative or Other Third Party.	37
C.	Rely on Rev. Rul. 83-25.	37
7.	CONCLUSION	37
APPENDIX A	-- Comparison of 142 Trusts, 867 Trusts and Guardianships	40
APPENDIX B	-- Tex. Prob. Code Ann. §§ 867 – 873	43
APPENDIX C	-- Tex. Prop. Code § 142.005	46
APPENDIX D	-- Application to Create 142 Trust	48
APPENDIX E	-- Trustee s Application For Approval of Compensation (142 Trust)	50
APPENDIX F	-- Order Creating 142 Trust	51
APPENDIX G	-- Order Approving Trustee s Compensation	53
APPENDIX H	-- Application to Modify Trust Regarding 1997 Legislation	54
APPENDIX I	-- Order Modifying Trust Regarding 1997 Legislation	55
APPENDIX J	Form of 142 Trust	56
APPENDIX K	Combined Application For Guardianship And Creation of 867 Trust Where No Guardianship Exists	59
APPENDIX L	Attorney Ad Litem s Application to Create 867 Trust Where No Guardianship Exists	62
APPENDIX M	Order Creating 867 Trust Where No Guardianship Exists	64
APPENDIX N	Application to Create 867 Trust From Existing Guardianship	66
APPENDIX O	Order Creating 867 Trust From Existing Guardianship	68
APPENDIX P	-- Form of 867 Trust	70
APPENDIX Q	Supplemental Needs Trust Created by Third Party	73

COURT-CREATED TRUSTS IN TEXAS

1. INTRODUCTION, SCOPE AND ACKNOWLEDGMENTS

1.1. Introduction. This paper examines the history of court-created trusts, explores the statutory and nonstatutory bases for court-created trusts, offers drafting suggestions and includes forms for creation of the various types of trusts discussed. The purposes of the paper are to offer a perspective on the growing use of court-created trusts, to explore specific problems in drafting court-created trusts, to offer solutions to some of the drafting problems and to provide forms for use in Texas courts.

1.2. Scope. This paper covers trusts created pursuant to Section 142.005 of the Texas Property Code (142 Trusts), trusts created pursuant to Sections 867 – 873 of the Texas Probate Code (867 Trusts), trusts created pursuant to 42 U.S.C.A. § 1396(d)(4)(a) ((d)(4)(A) trusts or Medicaid supplemental needs trusts), and trusts created by courts pursuant to their equitable power to do so.

The forms attached to this paper are provided as basic examples. The author does not warrant that the forms meet all legal requirements.

1.3. Acknowledgments. The author gratefully acknowledges the assistance of practitioners and judges around the state for their help in preparing this paper, including Judge Guy Herman of Austin, Pi-Yi Mayo of Baytown, Bernard Jones of Houston, Thomas Baird of Temple, Kathleen Ford Bay, Clyde Farrell, Deborah Green and Christine Larson of Austin, and Janice Torgeson of Bank One, Texas, N. A. in Dallas. In addition to the articles cited elsewhere in this paper, other excellent sources of information in this area are Bernard Jones's article, *Estate Planning for Incapacitated Individuals*, 33 Real Estate, Probate & Trust Law Reporter, No. 4, p. 27 (July 1995), and Robert H. Kroney's paper entitled "Court Created Trusts and Related Topics" presented to the State Bar of Texas's 20th Annual Advanced Estate Planning and Probate Course in June, 1996.

1.4. 1999 Legislative Changes. Only one bill changed the law regarding 867 Trusts during the 76th Texas Legislature (1999), and no bills changed the law regarding 142 Trusts. SB 112, effective May 17, 1999, added subparagraph (f) to Section 868 of the Texas Probate Code to provide that, if the trustee determines that it is in the best interest of the ward, it can invest trust property in the Texas Tomorrow Fund (Subchapter F, Chapter 54, Texas Education Code). This amendment probably was unnecessary – the trustee probably had the authority to do this without express statutory authority – but it makes clear that the trustee need not seek court approval for such an investment.

Other bills were introduced in 1999 that would have effected 867 Trusts and 142 Trusts, but they failed to pass. Governor Bush vetoed one bill – HB 1851 – which would have permitted noncorporate trustees of 867 Trusts with less than \$50,000 in trust property upon a showing that no corporate trustee was willing to serve and that creation of the trust would be in the best interest of the ward. (The governor's veto message makes clear that he vetoed the bill for reasons other than this proposed change to 867 Trusts.) Proponents of HB 1851 believed that noncorporate trustees of small trusts would permit more persons to avail themselves of (d)(4)(A) trusts for Medicaid purposes.

2. HISTORY OF COURT-CREATED TRUSTS

2.1. History of Equitable Creation of Trusts. In early Anglo-American jurisprudence, trusts were not recognized by the common law courts. Trusts were first enforced by the court of chancery in England in the early fifteenth century. Bogert, *Trusts and Trustees*, Rev. 2nd Ed. § 3 (1984). Thus, trusts have their roots in equity, and courts sitting in equity have traditionally enforced trusts. Of course, *creating* trusts and *enforcing* trusts are not the same thing.

The most common type of trust created by courts sitting in equity (and without specific statutory authority) is the constructive trust. A constructive trust is a device used by a court sitting in equity to compel one who unfairly holds a property interest to convey that interest to another to whom it justly belongs. Bogert, *Trusts and Trustees*, Rev. 2nd Ed. § 471 (1984). The Texas Supreme Court has stated that constructive trusts, being remedial in character, have the very broad function of redressing wrong or unjust enrichment in keeping with the basic principles of equity and justice, and that a transaction may, depending on the circumstances, provide the basis for a constructive trust where one party to that transaction holds funds which in equity and good conscience should be possessed by another. *Meadows v. Bierschwale*, 516 S. W. 2d 125, 131 (Tex. 1974).

Despite its name, a constructive trust typically has few of the characteristics of express trusts. A constructive trust is a means to convey title to property from one person to another. Thus, while there is a res, a trustee (albeit an involuntary one) holding legal title and a beneficiary holding equitable title, there is essentially no trust administration and, from the perspective of this paper, there is no trust instrument to draft and construe.

Another type of trust which arises in equity is the resulting trust. In resulting trusts, the intent of the party creating the trust is presumed or inferred. Resulting trusts include purchase-money trusts (where one party pays the purchase price to a seller and directs the seller to place title in the name of a third party, the party paying the purchase price is presumed to be a beneficiary of a trust), instances where an express trust does not exhaust the res, and cases of express trusts which fail in whole or in part. Bogert, *Trusts and Trustees*, Rev. 2nd Ed. § 451 (1984).

For purposes of this paper, resulting trusts hardly qualify as court-created trusts. Rather than creating the trust, a court merely presumes or infers the intent of a party to create a trust. Nonetheless, resulting trusts come into existence because of court action and involve drafting and administrative considerations similar to the other types of court-created trusts discussed in this paper.

2.2. History of Statutory Trusts in Texas. Prior to 1979, there was no statutory authority for a Texas court to create a trust. In that year, the Legislature amended Article 1994 of the *Texas Revised Civil Statutes* (the predecessor to Chapter 142 of the Texas Property Code) to permit courts to place the proceeds of a judgment accruing to a minor in a trust.

Since 1893, Texas statutes have permitted minors without guardians to be represented in lawsuits by next friends and for the judgment proceeds payable to the minor to be administered outside of the guardianship system in certain cases. In 1893, the court could permit management of up to \$500 on behalf of a minor without the need for a guardianship, provided the person managing the funds posted a bond of double the amount to be managed. Acts 1893, 23rd Leg., p. 3. Between 1893 and 1979, this statute was amended to permit suits by next friends on behalf of incapacitated persons (in addition to minors), to permit bonded, nonguardianship management of up to \$1,500 (the precursor to Tex. Prop. Code § 142.002), to permit investment of the judgment proceeds in general investments approved by the court (the precursor to Tex. Prop. Code § 142.001), and to permit investment in federally insured accounts (the precursor to Tex. Prop. Code § 142.004). Each of these alternatives to guardianship had drawbacks. The \$1,500 limit on bonded administration obviously had limited usefulness, and trial courts were reluctant to take on long-term court supervision of investments and disbursements, preferring instead to let the probate courts to perform this function in the guardianship process. See Bob Burleson and Tom Normand, *Money Judgments for Minors*, Texas Bar Journal, May 1981, p. 485; see also Michael J. Cenatiempo, *The Article 1994 Trust for Minors -- A New Solution to An Old Problem*, The Houston Lawyer, May 1981, p. 38.

In 1979, the Legislature addressed these problems in two ways. First, it eliminated the \$1,500 ceiling on bonded, nonguardianship management. Second, it permitted the court to create a trust benefitting a minor, so long as a corporate fiduciary was used and so long as the trust contained certain provisions. The authority to create a trust was recodified to Tex. Prop. Code § 142.005 when the Property Code was enacted in 1983. A 1984 amendment permitted 142 Trusts for incapacitated persons (in addition to minors).

There are two significant limitations to the availability of 142 Trusts. First, 142 Trusts can be created only from litigation proceeds -- it is difficult or impossible to get other types of property, such as life insurance proceeds paid directly to a minor, into a 142 Trust. Second, 142 Trusts can be created only if there is no legal guardian for the minor -- once the guardianship is in place, the option of creating a 142 Trust for the litigation proceeds disappears. These limitations, together with a general frustration with the expense and inflexibility of traditional guardianships, were the impetus for adoption of Sections 867 -- 873 of the Texas Probate Code. These provisions, adopted in 1993 as part of the bill recodifying Texas's guardianship laws, permit the creation of 867 Trusts on application of a guardian. The Legislature made a few technical corrections and changes to the provisions regarding 867 Trusts in 1995.

In 1997, the 75th Texas Legislature amended both Tex. Prop. Code § 142.005 and Tex. Prob. Code Ann. §§ 867 -- 873. These amendments, which became effective September 1, 1997, make it clear that the court creating either a 142 Trust or an 867 Trust may vary the terms of the trust from those which would otherwise be required by Texas law in order to make the trust qualify as a Medicaid (d)(4)(A) trust. The text of Tex. Prob. Code Ann. §§ 867 -- 873 and Tex. Prop. Code § 142.005 as amended in 1997 are attached as Appendix B (page 43) and Appendix C (page 46), respectively. In addition, the 1997 changes are discussed throughout this paper.

A table comparing 142 Trusts, 867 Trusts and guardianships of the estate is attached as Appendix A on page 40.

3. 142 TRUSTS

3.1. Statutory Requirements. There are specific statutory requirements for the creation and terms of 142 Trusts.

3.1.1. Basis for Creation. Tex. Prop. Code § 142.005(a) provides:

In a suit in which a minor who has no legal guardian or an incapacitated person is represented by a next friend or an appointed guardian ad litem, the court may, on application by the next friend or the guardian ad litem and on a finding that the creation of a trust would be in the best interests of the minor or incapacitated person, enter a decree in the record directing the clerk to deliver any funds accruing to the minor or incapacitated person under the judgment to a trust company or a state or national bank having trust powers in this state.

This provision places six prerequisites to the creation of a 142 Trust: (1) a suit is required; (2) the suit must involve a minor or an incapacitated person; (3) a minor who has no legal guardian or an incapacitated person must be represented in the suit by a next friend or an appointed guardian ad litem; (4) the next friend or guardian ad litem must apply for creation of the 142 Trust; (5) the court must find that creation of the 142 Trust would be in the best interests of the minor or incapacitated person; and (6) a judgment must be entered. Only if all six prerequisites are met can a 142 Trust be created.

A. Suit Required. A suit must exist in order for a 142 Trust to be created. Typically, the suit is a personal injury or other tort action in which damages are sought and recovered, either by trial or settlement. However, Tex. Prop. Code § 142.005 is not limited to tort suits. This presents a possible planning opportunity -- how far can the term suit be stretched? While creative use of the suit requirement may seem inappropriate at first glance, remember that 142 Trusts can only be created with the approval of the court, and courts retain the right to modify or terminate 142 Trusts.

1) Interpleader. An interpleader seems clearly to be a suit. If a party (such as an insurance company holding the proceeds of a life insurance policy payable to a minor) can be persuaded to interplead the funds rather than waiting for the appointment of a guardian, the court hearing the interpleader action should be able to create a 142 Trust out of the proceeds. (A custodian under the new Uniform Transfer to Minors Act could demand that the insurance proceeds be paid to the custodian. If the insurance company so paid the proceeds, a guardianship would be avoided. If the insurance company did not, the custodian's claim could form the basis for the interpleader.)

2) Declaratory Judgment. Is a declaratory judgment action sufficient to meet the suit requirement of Tex. Prop. Code § 142.005(a)? Any court of record within its jurisdiction has the power to declare rights, status, and other legal relations whether or not further relief is or could be claimed. Tex. Civ. Prac. & Rem. Code § 37.003(a). The Declaratory Judgment Act is remedial in nature and is to be liberally construed and administered. Tex. Civ. Prac. & Rem. Code § 37.002(b). Declarations related to any question arising in the administration of a trust or estate are permitted. Tex. Civ. Prac. & Rem. Code § 37.005. Further relief based on a declaratory judgment or decree may be granted whenever necessary or proper. Tex. Civ. Prac. & Rem. Code § 37.011. Perhaps a declaratory judgment action may be brought by a next friend on behalf of a minor or other incapacitated person who is either holding title to property or is entitled to hold title to property seeking a declaration of the minor's or incapacitated person's rights in the property and seeking creation of a 142 Trust.

3) Probate Proceedings. Is a probate proceeding a suit for these purposes? Probate proceedings include a matter or proceeding relating to the estate of a decedent. Tex. Prob. Code Ann. § 3 (bb). Could someone appear as next friend (or could the court appoint a guardian ad litem) of a minor in a dependent administration and ask for the creation of a 142 Trust rather than a guardianship? A dependent administration presents a easier case than an independent administration, where there is no court supervision of the administration and no court approval of distributions from the estate.

4) Federal Lawsuit. The suit requirement in Tex. Prop. Code § 142.005 is not limited to state court actions. Therefore, there seems no reason why a federal court could not create a 142 Trust for a Texas litigant in a federal proceeding.

B. Beneficiary Must Be Minor or Incapacitated Person. A 142 Trust is available only if the suit involves a minor with no legal guardian or an incapacitated person. For 142 Trust purposes, incapacitated person means:

a person who is impaired because of mental illness, mental deficiency, physical illness or disability, advanced age, chronic use of drugs, chronic intoxication, or any other cause except status as a minor to the extent that the person lacks sufficient understanding or capacity to make or communicate responsible decisions concerning his person.

Tex. Prop. Code § 142.007. This differs from the definition of incapacitated person for purposes of creating a guardianship. Section 601 (13) of the Texas Probate Code provides that incapacitated person means a minor, a missing person, a person who must have a guardian appointed to receive funds due the person from a governmental source, or an adult individual who, because of a physical or mental condition, is substantially unable to provide food, clothing, or shelter for himself or herself, to care for the individual's own physical health, or to manage the individual's own financial affairs.

In many cases where a 142 Trust is sought, this requirement is likely to present no practical impediment to creation of the trust. A party's status as a minor should be easy to prove, and a party's status as an incapacitated person is likely to have been resolved as a practical matter when the suit is brought by the next friend or when the guardian ad litem is appointed -- long before creation of the 142 Trust is sought. However, the next friend, the guardian ad litem and their attorneys may face liability for their actions and inactions in connection with settling the lawsuit and creating the 142 Trust. See *Byrd v. Woodruff*, 891 S. W. 2d 689 (Tex. App. -- Dallas 1994, writ denied). The procedural safeguards built into Texas's guardianship laws are not present in the case of a 142 Trust -- there are no requirements for personal service on and personal appearance of the allegedly incapacitated person, trial by jury on the issue of incapacity, and proof of incapacity by clear and convincing evidence. Compare Tex. Prob. Code Ann. §§ 633, 684 and 685 with Tex. Prop. Code § 142.001 *et seq.* All persons involved in the creation of a 142 Trust should take care that the rights of the minor or incapacitated person are considered and protected and that the terms of the trust are not adverse to the beneficiary's interests -- especially those terms relating to the term and termination of the trust.

C. Next Friend/Guardian Ad Litem/No Legal Guardian Requirement. A 142 Trust is permitted only in a suit in which a minor who has no legal guardian or an incapacitated person is represented by a next friend or an appointed guardian ad litem. Rule 44 of the Texas Rules of Civil Procedure provides that minors and other incapacitated persons who have no legal guardian may sue and be represented by next friend. Rule 173 provides that a court shall appoint a guardian ad litem when a minor or other incapacitated person is a defendant to a suit and has no Texas guardian or where a minor or incapacitated person is a party to a suit either as plaintiff, defendant or intervenor and is represented by a next friend or a guardian who appears to the court to have an interest adverse to such minor or incapacitated person. Other statutes permit the appointment of guardian ad litem in other cases. See, e.g., Tex. Prob. Code Ann. § 683.

There must be no legal guardian for a minor when the 142 Trust is created -- if a guardian of the estate is appointed during the pendency of the suit or even after judgment is entered but before the trust is created, the guardian is entitled to the judgment proceeds and no 142 Trust can be created. *Rodriguez v. Gonzalez*, 830 S. W. 2d 799, 800-1 (Tex. App. -- Corpus Christi 1992, no writ).

1) Can a 142 Trust Be Created For a Non-minor Who Is Subject to a Guardianship? Since the phrase who has no legal guardian in Tex. Prop. Code § 142.005 (a) apparently applies only to minors and not to other incapacitated persons, can a 142 Trust be established for a non-minor who is an incapacitated person who is the subject of a pending guardianship? The answer is apparently yes, although there are no reported cases on the subject.

The author attempted to have this point clarified in the 1997 amendment to Tex. Prop. Code § 142.005. However, the bill enacted by the Legislature does not address this issue.

2) What About Attorney Ad Litem? Tex. Prob. Code Ann. § 34A permits the judge of a probate court to appoint an attorney ad litem to represent the interests of a person having a legal disability, a nonresident, an unborn or unascertained person, or an unknown heir in any probate proceeding. Can an attorney ad litem apply for the creation of a 142 Trust? One can certainly argue that an attorney ad litem under Tex. Prob. Code Ann. § 34A is, in essence, a Rule 173 guardian ad litem and that there is no reason why an attorney ad litem should

not be able to apply for creation of a 142 Trust. A safer solution is for the attorney ad litem to ask the court to also appoint him or her guardian ad litem pursuant to Rule 173 prior to applying for creation of the 142 Trust.

3) Parents Are Natural Guardians, Not Legal Guardians. Parents are the natural guardians of their minor children, but are not legal guardians for purposes of Tex. Prop. Code § 142.005 (a) unless formally appointed legal guardian in a guardianship proceeding. See Tex. Prob. Code Ann. § 676 (b). It is common for a 142 Trust to be created when a minor has a living parent who has not been appointed legal guardian. See, e.g., *Aguilar v. Garcia*, 880 S. W. 2d 279 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.).

4) What About Temporary Guardians And Guardians of The Person? There are no reported cases on whether a minor with a temporary guardian or a guardian of the person with no guardian of the estate may have a 142 Trust created for him or her. Having a guardian of the person in place with no guardian of the estate should not prevent the creation of a 142 Trust, since a guardian of the person has no authority to manage property or represent a minor's interests in litigation. See Tex. Prob. Code Ann. § 767. Read literally, the appointment of a temporary guardian for a minor may not preclude creation of a 142 Trust for the minor, although one might argue that a temporary guardian with the powers of a guardian of the estate is, in effect, a legal guardian. See Tex. Prob. Code Ann. § 601 (10) (definition of "guardian" for Probate Code purposes includes a guardian of the person and a temporary guardian).

D. Application by Next Friend or Guardian Ad Litem. A 142 Trust can be created only if the next friend or guardian ad litem applies for it. A 142 Trust cannot be created based on the application of another party to the suit or by the court's unilateral action. See *McGough v. First Court of Appeals*, 842 S. W. 2d 637, 639 (Tex. 1992).

E. Best Interests Finding. A 142 Trust may be created only if the Court finds that creation of the trust would be in the best interests of the minor or incapacitated person. Tex. Prop. Code § 142.005 (a).

F. Judgment Required. Even though 142 Trusts are a common settlement solution, a judgment with funds accruing to the minor or incapacitated person thereunder is required for creation of the trust. Therefore, as part of the settlement, the case cannot be dismissed with prejudice or otherwise settled short of a judgment in favor of the minor or incapacitated person if a 142 Trust will be used.

3.1.2. Mandatory Provisions. Once the basis for creating a 142 Trust is established, the 142 Trust must meet mandatory requirements regarding choice of a trustee and terms of the trust. Note, however, that the 1997 amendment to Tex. Prop. Code § 142.005 permits variance from these mandatory provisions to create a (d)(4)(A) supplemental needs trust for Medicaid purposes. See "1997 Change Permitting Supplemental Needs Trusts" on page 13 below.

A. Must Use Corporate Trustee. To create a 142 Trust, the court must enter a decree in the record directing the clerk to deliver any funds accruing to the minor or incapacitated person under the judgment to a trust company or a state or national bank having trust powers in this state. Tex. Prop. Code § 142.005 (a). Individuals may not be trustees of 142 Trusts. The trust must provide that the trustee serves without bond. Tex. Prop. Code § 142.005 (b) (5).

One recent trend in at least some courts is to appoint a bank or trust company and an individual as co-trustees. In the author's opinion, this is not permitted by Tex. Prop. Code Ann. § 142.005. There is nothing wrong with making an individual or group of individuals advisory trustees and permitting them to advise the corporate trustee. Giving an individual co-equal authority with a corporate trustee appears to be contrary to the statute.

Since most 142 Trusts are established at the time a lawsuit is settled, and since often the court is presented with an agreed order and agreed form of trust, judges often do not focus on the terms of the trust to determine if the trust terms meet the statutory requirements. Thus, it is likely that some courts will create 142 Trusts with individual co-trustees notwithstanding the statute.

What should a bank or trust company do if asked to be co-trustee with an individual trustee? There appear to be two possibilities regarding liability for future breaches of such a trust that are attributable to acts of the individual co-trustee:¹ (1) It may be that, since the court ordered the co-trustee arrangement and the bank or trust company is administering the trust as drafted (i.e., as it would administer any other trust with co-trustees), the bank may not be liable for the actions of the individual co-trustee unless the bank itself breached its duties; or (2) It may be that the bank is, in effect, the guarantor of the actions of the individual co-trustee, since the individual is serving as trustee

without statutory authority. Certainly the corporate trustee, if faced with a potential liability because of the malfeasance or negligence of the individual co-trustee, can make a forceful argument that the first possibility stated above should apply. However, when one considers that (a) the individual co-trustee is likely to be gone or judgment-proof when this issue arises, (b) there is no bond assuring the performance of the individual co-trustee (see Tex. Prop. Code § 142.005(b)(5)), and (c) the court deciding the case is likely to be the same court who created the trust with the co-trustee arrangement, the judge of which is likely to be looking for some way to make things right, the corporate co-trustee may be in a difficult position.

Therefore, if asked in advance if it is willing to be co-trustee with one or more individuals, a bank or trust company should (a) first try to talk the parties into making the individuals advisory trustees only (there is a good chance that this is what the parties intend in the first place), (b) insist on holding the tie-breaking vote or, at the very least, a veto power, (c) ask for exculpatory and indemnity language to be included in the trust instrument, and (d) plan on administering the trust as if it is solely responsible for the actions of all co-trustees.

Legislation was proposed in 1999 to permit noncorporate trustees of 142 Trusts with less than \$50,000 in trust property upon a showing that no corporate trustee was willing to serve. This legislation failed to pass, however.

B. Sole Beneficiary Requirement. Tex. Prop. Code § 142.005 (b) (1) requires that the minor or incapacitated person be the sole beneficiary of the trust. It is sometimes tempting to create one 142 Trust for multiple plaintiffs in order to minimize trustee's fees and other administrative expenses. This temptation should be avoided for at least two reasons. First, Tex. Prop. Code § 142.005 (b) (1) appears to prohibit 142 Trusts with multiple beneficiaries. Second, a trust with multiple beneficiaries is more likely to be taxed unfavorably under Internal Revenue Code 468B (discussed below). Perhaps a more favorable fee arrangement may be negotiated with the potential trustee of multiple 142 Trusts and drafted into the trusts.

C. Mandatory Distribution Provisions. The trust must provide that (1) the trustee may disburse amounts of the trust's principal, income, or both as the trustee in his sole discretion determines to be reasonably necessary for the health, education, support or maintenance of the beneficiary (Tex. Prop. Code § 142.005 (b) (2)) and (2) the income of the trust not disbursed under Section 142.005 (b) (2) is added to the principal of the trust (Tex. Prop. Code § 142.005 (b) (3)).

Except in the case of a (d)(4)(A) supplemental needs trust (see below), these provisions cannot be modified or abrogated by the court. In one of the few reported cases on 142 Trusts, the Fourteenth Court of Appeals held that the trial judge could not add a provision limiting withdrawals from a 142 Trust to use for medical purposes in situations where the parents have no other means to pay for the required medical care. In *Aguilar v. Garcia*, 880 S. W. 2d 279, 281 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.), the court held:

The clear language of the statute requires that the trustee have the sole discretion to determine what is in the best interest of the beneficiary and make distributions for the health, education, support, or maintenance of the beneficiary. Tex. Prop. Code Ann. 142.005 (b)(2) (Vernon 1984). The statute also clearly states that this provision is mandatory. Even though the trial judge's motives were laudable, she did not have discretion to limit the mandatory powers given to the trustee. We hold that the express terms in section 142.005 (b) (2) are mandatory and the trial court abused its discretion by requiring conflicting modifications to the trust instrument.

[footnote omitted]. If correct, the holding in *Aguilar* could severely limit the ability of a court to design a 142 Trust to meet the specific needs of the trust beneficiary. However, when considering the effect of *Aguilar*, one must consider the following:

1) Agreed Order May Be Different. In *Aguilar*, the trial court sought to impose the modifications to the mandatory statutory distribution standard over the objection of the guardian ad litem. Since only a guardian ad litem (or next friend) can apply for the trust, perhaps *Aguilar* can be read as restricting the ability of the trial court to force modifications of the statutory provisions onto the guardian ad litem and the beneficiaries. See *McGough v. First Court of Appeals*, 842 S. W. 2d 637, 639 (Tex. 1992) (trial court could not force an annuity arrangement over the objection of the guardian ad litem). Thus, in the typical case where the guardian ad litem has requested that a trust have nonstandard provisions and where all parties have agreed to the terms of the proposed trust, the trial court would not be requiring conflicting modifications to the trust instrument as it did in the *Aguilar* case.

2) Expanding Standard May Be Different. In *Aguilar*, the court sought to contract or reduce the distribution standard, restricting the discretion of the trustee required by the statute. Perhaps *Aguilar* does not apply in a case where the distribution standard (or other mandatory terms) are being expanded. For example, if, in addition to giving the trustee the statutorily required health, education, maintenance and support standard, the trust also mandated that a specific amount per month be paid to the beneficiary, *Aguilar* may not apply, since the court would not be limit[ing] the mandatory powers given to the trustee.

D. Mandatory Trust Termination Provisions. The trust must provide that, if the beneficiary is a minor, the trust terminates on the death of the beneficiary, on the beneficiary's attaining the age stated in the trust, or on the 25th birthday of the beneficiary, whichever occurs first, or if the beneficiary is an incapacitated person, the trust terminates on the death of the beneficiary or when the beneficiary regains capacity. Tex. Prop. Code § 142.005 (b) (4). For minors' trusts, the ability to extend the date of trust termination beyond age 18 has been seen as one of its principal advantages over guardianships, which must terminate at age 18 unless the 18-year-old is otherwise incapacitated.

Note that Tex. Prop. Code § 142.005 (b) (4) is somewhat unclear on when a 142 Trust benefitting a minor who also is an incapacitated person must terminate. Does the trust have to terminate at age 25, or can it continue until the beneficiary regains capacity or dies? In many cases it may be difficult to predict the level of capacity an incapacitated minor will have at age 25, while in others it may be clear that the minor is unlikely to ever have capacity to manage the trust assets. If the trust for the minor is set to terminate at age 25, and if the minor appears to be incapacitated at that time, the trust may be amended or modified to continue until the beneficiary regains capacity. Tex. Prop. Code § 142.005 (d).

Section 142.005 (g), enacted in 1997, permits the trust to contain provisions determined by the court to be necessary to establish a special needs trust. This should permit a court to continue a (d)(4)(A) trust beyond age 25. If a minor who does not meet the definition of incapacity in Section 142.007 of the Texas Property Code is the beneficiary of a (d)(4)(A) trust, and if the (d)(4)(A) trust must terminate at age 25, the trust beneficiary would be deprived of the benefits afforded by (d)(4)(A) trusts because at age 25 (1) the government reimbursement provision would kick in and (2) if more than \$2,000 was left in the trust, the trust beneficiary would cease to be qualified for Medicaid and SSI benefits. Therefore, it is necessary under Tex. Prop. Code § 142.005 (g) for the trust to provide that it continues beyond age 25 until the death of the beneficiary or it is otherwise terminated by order of the court.

E. Trustee Compensation. Tex. Prop. Code § 142.005 (b) (6) provides that the trust must provide that the trustee receives reasonable compensation paid from trust's income, principal, or both on application to and approval of the court. The statute does not define reasonable compensation, nor does it provide whether such compensation is paid monthly or quarterly as it accrues (as is the case with most express trusts administered by corporate fiduciaries) or in arrears (as is the case with 867 Trusts and guardianships). The statute also is silent on whether one application and approval is required or whether periodic applications and approvals are required.

In most cases, trustees of 142 Trusts are paid currently as fees accrue (*i.e.*, not in arrears) for serving as trustee of 142 Trusts at their usual and customary rates. Also, in most cases, trustees make one application for payment at the commencement of their service as trustee and obtain court approval just once (unless changed facts or circumstances require as subsequent application). This makes 142 Trusts much more attractive for corporate trustees than 867 Trusts, which limit compensation to the statutory formula for guardianship compensation (unless the court otherwise orders) and which provide for payment in arrears upon the annual filing and approval of a guardianship-type accounting.

Trustees should not forget to apply for approval of their compensation. This may seem obvious, but in the typical case the creation of the trust may be handled by the guardian ad litem and counsel for the plaintiff. Since Tex. Prop. Code § 142.005 (b) (6) requires application to and approval of the court, it is a good idea for the trustee to submit a separate application for compensation and related order for the judge to sign at the time of trust creation so that the requirement is clearly met. Appendix E is an example of such an application.

F. Distributions on Termination. In a 142 Trust which is not a (d)(4)(A) supplemental needs trust, on the termination of the trust under its terms or on the death of the beneficiary, the trust principal and any undistributed income must be paid to the beneficiary or to the representative of the estate of a deceased beneficiary. Tex. Prop. Code § 142.005 (e). 867 Trusts offer more flexibility regarding distributions on trust termination.

A (d)(4)(A) supplemental needs trust created under Section 142.005 (g) enacted in 1997 presumably is permitted to have a different distribution scheme, since (d)(4)(A) trusts must provide for the reimbursement to the state of some

benefits upon termination of the trust. This may present a planning opportunity for (d)(4)(A) trusts which is not there for other 142 Trusts -- in addition to including the government reimbursement provision, perhaps the trust instrument may provide for a tax-planned distribution scheme.

3.1.3. Optional Provisions. Tex. Prop. Code § 142.005 (b) and (c) permit the trust to contain provisions other than the mandatory provisions described above.

A. Dribble Distributions. The trust may provide that distributions from trust principal before the termination of the trust may be made from time to time as the beneficiary attains designated ages and at designated percentages of the principal. Tex. Prop. Code § 142.005 (c) (1). Thus, the trust could provide for one-third of the trust principal to be distributed to the beneficiary at age 21, one-third at age 23 and the remainder at trust termination at age 25.

B. Facility of Payment. The trust may permit payments to the natural or legal guardian of the beneficiary or to the person having custody of the beneficiary or directly to or expended for the benefit, support, or maintenance of the beneficiary without the intervention of any legal guardian or other legal representative of the beneficiary. Tex. Prop. Code § 142.005 (c) (2). This is not as broad as the facility of payment clauses typically used in an express trust. Can the drafter go beyond the optional statutory language to permit distributions to a custodian under the Texas Uniform Transfers to Minors Act, or to the parent of an adult beneficiary? Since 142 Trusts often are created for minors but last beyond the beneficiary's minority, trustees often find themselves faced with the problem of having to determine if payments to the beneficiary's parent may continue after his or her eighteenth birthday. Since Tex. Prop. Code § 142.005 (c) (2) is an *optional* provision, a more universal facility of payment clause which gives the trustee more flexibility in making distributions should fall within the court's power to impose terms of the trust that are not in conflict with the *mandatory* provisions. See Tex. Prop. Code § 142.005 (b).

C. Termination at Age Other Than 25. The trust may provide that it will terminate upon the minor beneficiary's attainment of an age of less than 25. For example, the trust may provide that it terminates when the minor beneficiary attains the age of 21 years. The trust cannot be extended beyond age 25 unless the beneficiary is incapacitated.

D. Other Optional Provisions. The court is authorized to determine the terms, conditions, and limitations of the trust that are not in conflict with the mandatory statutory provisions. Most 142 Trusts go well beyond the minimal statutory requirements. For example, many trusts expressly make the provisions of the Texas Trust Code applicable to the trust. Trusts limiting the liability of the trustee have been approved. Many trusts provide that distributions for the health, education, support, and maintenance of the beneficiary may include enhancements to the family life of the beneficiary, such as the purchase of a new family car or van or the purchase of a new house. These optional provisions can go too far, however. See *Aguilar v. Garcia*, 880 S. W. 2d 279 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.).

3.1.4. 1997 Change Permitting Supplemental Needs Trusts. SB 912 (Acts, 75th Legislature, Regular Session, Chapter 128), effective September 1, 1997, adds subsection (g) to Tex. Prop. Code § 142.005, which reads as follows:

(g) Notwithstanding any other provision of this chapter, if the court finds that it would be in the best interests of the minor or incapacitated person for whom a trust is created under this section, the trust may contain provisions determined by the court to be necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

This new provision provides a means for creating (d)(4)(A) "supplemental needs" trusts for Medicaid purposes under Tex. Prop. Code § 142.005. Prior to the enactment of SB 912, there was an apparent conflict between the mandatory trust terms required by Section 142.005 and the terms needed to meet the requirements of 42 U.S.C. § 1396(d)(4)(a). Despite this apparent conflict, the policy reasons for setting up supplemental needs trusts was so strong that many courts created 142 Trusts with supplemental needs language anyway.

Tex. Prop. Code § 142.005(g) refers specifically to 42 U. S. C. § 1396(d)(4)(A). It does not address the other two types of trusts permitted by the Omnibus Budget Reconciliation Act of 1993 (OBRA 93) -- trusts designed to capture excess income established pursuant to 42 U.S.C. § 1396p(d)(4)(B), commonly called Miller Trusts, and trusts established by a non-profit corporation pursuant to 42 U.S.C. § 1396p(d)(4)(C). On the other hand, the 1997 change to Tex. Prob. Code Ann. § 868 regarding 867 Trusts (discussed below) permits deviation from the statutory

distribution standard if it is necessary and appropriate for the ward *to be eligible to receive public benefits or assistance under a state or federal program* that is not otherwise available to the ward. Thus, while there is no statutory basis for creation of a Miller Trust or a (d)(4)(C) trust² under Tex. Prop. Code §142.005, an 867 Trust may be used for this purpose.

A. 142 Trusts Created After Effective Date of SB 912. New subsection (g) makes it clear that, in order to establish a new 142 Trust with supplemental needs provisions after SB 912 becomes effective, the applicant (in addition to the other requirements for establishing a 142 Trust described above) need only obtain a court finding that such provisions "would be in the best interests of the minor or incapacitated person" for whom the trust is to be created. This finding permits the court creating the trust to include whatever provisions the court determines are "necessary to establish a special needs trust" under 42 U.S.C. Section 1396p(d)(4)(A).

A proposed form of application for creating a new 142 Trust with supplemental needs language under SB 912, together with a proposed order creating the trust and the proposed trust itself, are attached as Appendices D, F and J.

B. Problems with the Effective Date of SB 912. Sadly, SB 912 gives no guidance about its effect on 142 Trusts in existence on its effective date (September 1, 1997), or litigation proceedings under way on its effective date. The author suggested changes to SB 912 which would have made it clear that new subsection (g) applied to 142 Trusts regardless of whether they were created before, on or after SB 912's effective date, but the version that was enacted is silent on this point. (Compare HB 1314, discussed below, which made a similar change for 867 Trusts and which provides that the new amendment applies to existing 867 Trusts.)

How should SB 912 be construed? There are three possibilities:

1. SB 912 could apply only to 142 Trusts created out of litigation proceedings commenced on or after September 1, 1997.
2. SB 912 could apply only to 142 Trusts created on or after September 1, 1997 (even if the litigation proceeding itself commenced prior to September 1, 1997).
3. SB 912 could apply to all 142 Trusts regardless of whether they were created before, on or after September 1, 1997.

Of these alternatives, the most logical is the second: that SB 912 applies to 142 Trusts created on or after September 1, 1997. The construction which would be most beneficial to trustees and attorneys who work in this area is the third: that SB 912 applies to all 142 Trusts -- even those created before September 1, 1997. However, it is difficult to see how one gets to that construction unless the legislative history of SB 912 strongly indicates that intent. (The author has not studied the legislative history of SB 912.)

Other problems have to do with modifying existing 142 Trusts. If SB 912 is construed to apply only to 142 Trusts created on or after September 1, 1997: (1) Can existing 142 Trusts be modified to fall within the provisions of SB 912? (2) If so, how does one go about modifying an existing 142 Trust to gain the protection of SB 912? (3) Who should apply for the modification order? (4) Is the court required to appoint a guardian ad litem or attorney ad litem for the minor?

While the author would like to think that SB 912 applies to existing 142 Trusts without the need for modification, the most logical construction is (1) the new provision applies only to trusts created on or after September 1, 1997; (2) any 142 Trusts existing prior to September 1, 1997, can be modified to fall within the new law; (3) any interested party (including the trustee or a next friend for the minor) is entitled to apply for a modification order; and (4) if the modification is a non-substantive change (in other words, if the 142 Trust being modified already had supplemental needs language in it) then no guardian ad litem or attorney ad litem should be required, but if the supplemental needs language is being added to an existing 142 Trust, then a guardian ad litem or attorney ad litem should be appointed.

Therefore, the author suggests that supplemental needs trusts established prior to the effective date of SB 912 should be modified to make SB 912 applicable. This may be unnecessary, but the cost of doing so is relatively small, and the consequences of failing to make SB 912 applicable to existing trusts if modification is required are great. A proposed form of application and order to accomplish this purpose is attached as Appendix H (page 54) and Appendix I (page 55), respectively.

3.2. Miscellaneous Issues Regarding 142 Trusts.

3.2.1. Revocation And Modification. A 142 Trust may be amended, modified or revoked by the court creating it at any time before its termination, but it cannot be revoked by the beneficiary or a guardian of the beneficiary's estate. Tex. Prop. Code § 142.005 (d). A beneficiary, his or her guardian, or another representative of the beneficiary can ask the court to amend or revoke the trust. If the court revokes the trust before the beneficiary is 18 years old, it can make other arrangements for the investment of the trust property under Chapter 142 of the Texas Property Code (and, therefore, keep the property out of the beneficiary's guardianship estate). If the minor has attained age 18 when the court revokes the trust, the trust property must be paid to the beneficiary after the payment of all proper and necessary expenses. Tex. Prop. Code § 142.005 (d).

3.2.2. Effect of a Guardianship Proceeding. As noted above, a 142 Trust cannot be created for a minor with a legal guardian. If the 142 Trust is established before the guardian is appointed, however, the trust continues in force and effect until terminated or revoked, notwithstanding the appointment a guardian or the estate of the trust beneficiary and notwithstanding the beneficiary's attainment of the age of majority. Tex. Prop. Code § 142.005 (f).

In *Rodriguez v. Gonzalez*, 830 S. W. 2d 799 (Tex. App. Corpus Christi 1992, no writ), a grandmother of four minor children brought a tort suit on behalf of the children (apparently as next friend). The parties settled and entered into an agreed judgment whereby the recovered funds were placed into the district court's registry. At that time, there was no guardian of the children's estates. The grandmother then instituted guardianship proceedings, was appointed guardian of the children's estates, and filed an application for possession of the minors' funds held in the court registry. The attorney ad litem in the tort suit then filed a motion with the district court for creation of a 142 Trust. The district court granted the motion to create a 142 trust and the guardian appealed. The court of appeals held for the guardian, stating:

The provision for the creation of such a trust applies only in those cases in which the minor has no legal guardian. . . . However, once the legal guardian has been appointed and qualified, she is entitled to custody and control of the minors' estates.

830 S. W. 2d at 800-1. Thus, in a dispute between a guardian of the estate and the trustee of a 142 Trust over possession of funds, the relevant date is the date of creation of the 142 Trust. If the guardian qualifies before the trust is created, Tex. Prop. Code § 142.005(f) is not a bar to recovery of the funds by the guardian. If, on the other hand, the trust is created before the guardian qualifies, Section 142.005(f) prevents the guardian from recovering the funds from the trustee.

3.2.3. Funding 142 Trust With Only Part of Judgment. In many (if not most) cases, the court orders only a portion of the judgment proceeds due to be paid to a minor or incapacitated person to be held in a 142 Trust. A portion of the judgment is kept out of the trust to pay attorneys' fees. Tex. Prop. Code § 142.005 (a) requires the court to enter a decree in the record directing the clerk to deliver any funds accruing to the minor or incapacitated person under the judgment to the trustee of the 142 Trust. It is unclear if this means that all funds accruing to the minor or incapacitated person under the judgment must be placed in the trust. If possible, the judgment should be structured so that attorneys' fees and other items are paid out of the portion of the judgment accruing to another party (such as the parents of the injured minor or incapacitated person) so that all of the judgment accruing to the minor or incapacitated person can be transferred into the trust. Another alternative would be to have the court order the trustee to pay the attorneys' fees out of the trust upon creation of the trust. As a practical matter, however, the practice of placing only a portion of the judgment in the 142 Trust is so widespread that it is doubtful that an appellate court would construe Tex. Prop. Code § 142.005 (a) to prohibit such practice. *But see Aguilar v. Garcia*, 880 S. W. 2d 279 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.).

3.2.4. Conflicts Between Tex. Prop. Code § 142.005 And The Texas Trust Code. Although the statute authorizing 142 Trusts is in the Texas Property Code, it is not part of Title 9 of the Texas Property Code, also known as the Texas Trust Code. Potential conflicts exist between the provisions of Tex. Prop. Code § 142.005 and the Texas Trust Code. Unfortunately, there are no reported cases addressing these conflict issues.

A. Are 142 Trusts Subject to the Texas Trust Code? Section 111.003 of the Texas Property Code says that a trust for Texas Trust Code purposes is an express trust only and does not include a resulting trust, a constructive trust, a business trust or a security instrument such as a deed of trust. The methods for creating a trust enumerated in Tex. Prop. Code § 112.001 do not include court-created trusts such as 142 Trusts. Nothing in Chapter 142 expressly makes the Texas Trust Code applicable to 142 Trusts. Therefore, a strong argument can be made that the Texas Trust Code does not apply to 142 Trusts.

Except for the potential jurisdictional conflicts described below, there seems to be no reason that the provisions of the Texas Trust Code should not apply to 142 Trusts except to the extent that such provisions conflict with the terms of Tex. Prop. Code § 142.005 or the terms of the particular 142 Trust. As is the case with express trusts, the Texas Trust Code can fill in the gaps of a simply-drafted trust, addressing issues which may not be specifically addressed in the trust instrument. For example, the Texas Trust Code provides a fairly comprehensive scheme for allocating receipts and expenses to income or corpus. It is unlikely that the typical instrument creating a 142 Trust will go into the same level of detail about allocation of receipts and expenses. Therefore, when drafting 142 Trusts, care should be taken to enumerate the powers of the trustee and, unless there are unique facts which make this unnecessary, the provisions of the Texas Trust Code should be incorporated by reference, except to the extent they may conflict with Tex. Prop. Code § 142.005 or with other provisions of the trust.

B. Jurisdictional Issues. Section 142.005 of the Texas Property Code does not specify which courts may create and supervise a 142 Trust. Rather, it just states that the court may create, amend, modify, revoke or approve trustee compensation from a 142 Trust. Does this mean that *any* type of court can create, amend, modify, revoke or approve trustee compensation from a 142 Trust?

Under the Texas Trust Code, exclusive jurisdiction over proceedings concerning trusts is granted to the district court and statutory probate courts. Tex. Prop. Code § 115.001; *see also* Tex. Prob. Code Ann. § 5A(c). Thus, under the Trust Code, constitutional county courts, county courts at law and justice courts have no jurisdiction concerning trusts. Does this mean that a minor who recovers in a personal injury case in a county court at law cannot benefit from a 142 Trust? As a practical matter, the jurisdictional limits of a constitutional county court or a county court at law may make it impractical to utilize 142 Trusts in many cases, but there are other cases (notably probate or guardianship cases) where county courts -- in particular, county courts at law -- hear issues involving substantial sums. The author is not aware of any cases on this issue.

This statutory construction problem could be resolved in any of the following ways:

1. The statutes could be construed to mean that only district courts and statutory probate courts may create, amend, modify, revoke or approve trustee compensation from 142 Trusts. Under this reasoning, the use of the word court in Tex. Prop. Code § 142.005 without further definition must mean a court with proper jurisdiction, and since only district courts and statutory probate courts have jurisdiction over proceedings concerning trusts, these are the only types of courts which can avail themselves of 142 Trusts.
2. The statutes could be construed to mean that any type of court may create, amend, modify, revoke or approve trustee compensation from a 142 Trust, but only district courts or statutory probate courts may hear any other matters concerning the 142 Trust. Under this reasoning, there is specific statutory authority (and, hence, jurisdiction) for any type of court to take the actions specifically enumerated in Tex. Prop. Code § 142.005, but there is no jurisdiction for courts other than district courts and statutory probate courts to take other actions concerning 142 Trusts. Thus, while a county court at law may create, amend, modify, revoke and approve trustee compensation from a 142 Trust, it could not hear a lawsuit involving breach of fiduciary duty by the trustee of such trust.
3. The statutes could be construed to mean that any type of court may create, amend, modify, revoke, approve trustee compensation from or take any other action with respect to a 142 Trust. Under this reasoning, the specific statutory authority given to courts in Tex. Prop. Code § 142.005 should be read to give that court adequate jurisdiction to fully supervise administration of that trust. Also, 142 Trusts may not even be subject to the Texas Trust Code; therefore, the jurisdictional provisions of the Texas Trust Code do not apply.

Of these possibilities, it is the author's opinion that the second possibility listed is the most reasonable construction. There is no reason to think that the legislature intended to limit the availability of 142 Trusts to cases in the district courts and statutory probate courts. Thus, other types of courts should be able to take the actions specifically enumerated in Tex. Prop. Code § 142.005 (creating, amending, modifying, revoking or approving trustee compensation from a trust). However, there is nothing in Tex. Prop. Code § 142.005 which would appear to authorize a county court or county court at law that creates a 142 Trust to hear other, more complex issues (issues such as breach of fiduciary duty claims) which may arise during the term of the trust. The district courts and statutory probate courts should have the exclusive jurisdiction over these more complex issues by reason of Tex. Prop. Code § 115.001.

3.2.5. Can a 142 Trust Be a Spendthrift Trust? Should a spendthrift clause be added to a 142 Trust? Tex. Prop. Code § 112.035 (d) provides that, if the settlor is also a beneficiary of the trust, a provision restraining the

voluntary or involuntary transfer of the settlor's beneficial interest does not prevent the settlor's creditors from satisfying claims from the settlor's interest in the trust estate. Settlor is defined as the person who creates the trust. Tex. Prop. Code § 111.004 (14). Chances are, the beneficiary of a 142 Trust will be considered by the Court to be the settlor of the trust, and it is doubtful that a spendthrift provision will protect the trust estate from the beneficiary's creditors. However, one can certainly argue that the court, not the beneficiary, creates the trust, and the beneficiary has no right to the trust assets until they are distributed to the beneficiary. Even if the spendthrift clause does not protect the trust assets from the beneficiary's creditors, it may prohibit the beneficiary from voluntarily alienating his or her interest in the trust. Therefore, it is probably a good idea to include a spendthrift provision in the trust.

3.2.6. Trustee's Duty to Account. Section 142.005 of the Texas Property Code provides no special duty of the trustee to account. The court may impose such a duty by including a requirement to account in the trust. If the trust is silent on the trustee's duty to account, then perhaps the trustee must meet the requirements of the Texas Trust Code. In all cases, the trustee is a fiduciary and has the same fiduciary duties that other fiduciaries have. Also, as a practical matter, it probably has a duty to account to the court on request, since the trustee's compensation must be approved by the court and since the court retains the right to terminate or modify the trust.

3.2.7. Distributions For Minor's Support, Education or Maintenance. Tex. Prob. Code Ann. § 777 provides that, absent a court finding of undue hardship, a parent who is the guardian of the person of a ward who is 17 years of age or younger may not use the income or the corpus from the ward's estate for the ward's support, education, and maintenance [emphasis added]. This provision was added to the probate code in 1993 as part of the recodification bill; there is no corresponding provision in pre-1993 statutory probate law. It is consistent with the Family Code (see Tex. Fam. Code § 151.003(a)(3) -- a parent has the duty to support the child, including providing the child with clothing, food, shelter, medical and dental care, and education) and prior case law (see *Tharp v. Blackwell*, 570 S. W. 2d 154, 159 [Tex. Civ. App. -- Texarkana 1978, no writ] -- Texas law imposes upon a parent, who has resources of his own sufficient to maintain his children, and who is also guardian of their estates, to support them out of his own means and he may not have recourse to the estates of the wards.).

Does Texas law (Tex. Prob. Code Ann. § 777 or otherwise) permit or require the trustee of a 142 Trust to withhold payments for the support, education and maintenance of a trust beneficiary under age 18 if the beneficiary's parent or parents have the resources to support the beneficiary? If *Aguilar v. Garcia*, 880 S. W. 2d 279 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.) is decided correctly, then the trust instrument cannot require a trustee to withhold trust distributions which would pay for expenses that fall within a parent's legal duty to support the child. In *Aguilar*, the following provision was included in the trust instrument approved by the trial court:

The Trustee shall pay to or apply for the benefit of the Beneficiary such amounts out of the net income and principal (if income is sufficient) of the Trust as are reasonably necessary in the sole discretion of the Trustee to provide for the health needs of the Beneficiary when it is demonstrated that the parents have no resources available, such as insurance, or other means to provide for the medical needs of the child

880 S. W. 2d at 280 [emphasis added]. The court of appeals said that, while the trial court's motives in including this restriction regarding the parent's means were laudable, the court did not have the discretion to limit the mandatory powers given to the trustee under Tex. Prop. Code § 142.005(b)(2). Thus, requiring the trustee of a 142 Trust to consider parent's resources is prohibited under *Aguilar*.

If the trust instrument merely permits the trustee to consider other sources of support in deciding whether to make distributions, or if the trust instrument is silent regarding other sources of support and the trustee considers such sources in exercising its fiduciary duties under the mandatory health, education, maintenance and support standard, then the *Aguilar* rationale seems inapplicable -- the court is not limiting the mandatory powers given to the trustee by Tex. Prop. Code § 142.005. Thus, the trustee probably is justified (and may in fact breach fiduciary duties owed to the trust beneficiary if the trustee fails to do so) in withholding distributions that can be paid, and in fact are paid, by the parents pursuant to their support obligations.

What can a trustee do if it withholds distributions because of the parents' support obligation and the parents refuse or fail to satisfy their support obligations? First, and foremost, the trustee probably must assure that the support obligations are met by making distributions from the trust. Second, unlike a guardian, the trustee of a 142 Trust has no direct authority to pursue payment of support obligations by the parents. However, the trustee probably is an interested person under Tex. Prob. Code Ann. § 601(14) which is entitled to apply for appointment of a guardian for the trust beneficiary. If a guardian is appointed for the trust beneficiary, that guardian is empowered (and is probably required) to pursue satisfaction of the parent's support obligations on the trust beneficiary's behalf.

If the trust instrument provides that the trustee of a 142 Trust is not required to consider (or is prohibited from considering) other sources of support available to the trust beneficiary in determining whether or not to make distributions, can the trustee (i) ignore the parents' ability to support the trust beneficiary, (ii) make support distributions from the trust and (iii) still avoid liability? Such a trust provision does not limit the mandatory health, education, maintenance and support standard; thus, the court's reasoning in *Aguilar* seems not to apply. It is hard to see how such a provision would be in the trust beneficiary's best interests (thus presenting potential liability for the guardian ad litem or next friend who consents to such a provision), but this may be the best way (from the trustee's perspective) to simplify trust administration and protect the trustee from liability -- the trustee simply follows the trust instrument and makes the support distributions without considering other possible sources of support.

Note that Tex. Prob. Code Ann. § 777 and *Tharp v. Blackwell*, 570 S. W. 2d 154, 159 (Tex. Civ. App. – Texarkana 1978, no writ) both address the situation where the *parent* is the guardian (although Section 777 applies when the parent is the guardian *of the person* and *Tharp* applies where the parent is the guardian *of the estate*). Obviously, in the case of a 142 Trust, a corporate fiduciary, not the parent, will be trustee, although one or both parents may be the guardian of the person of the trust beneficiary. Tex. Prop. Code § 142.005(c)(2) provides that a 142 Trust may provide that distributions, payments, uses, and applications of all trust funds may be made *to the legal or natural guardian* of the beneficiary or to the person having custody of the beneficiary or may be made directly to or expended for the benefit, support, or maintenance of the beneficiary *without the intervention of any legal guardian or other legal representative of the beneficiary* [emphasis added]. Could the situation arise where, under Tex. Prop. Code § 142.005(c)(2), the trustee of a 142 Trust may make support distributions to the guardian of the person of the trust beneficiary, but under Tex. Prob. Code Ann. § 777 the parent/guardian may not expend the trust distributions? This situation probably cannot occur because (i) the prohibition against spending money in Tex. Prob. Code Ann. § 777 applies only to the ward's estate and the trust distributions should not be considered part of the ward's estate (*see* Tex. Prob. Code Ann. § 601(8)) and (ii) Tex. Prop. Code § 142.005(f) trumps the Probate Code, providing that a 142 Trust prevails over any other law concerning minors, incapacitated persons, or their property. Of course, the trustee of the 142 Trust can avoid this scenario by directly applying distributions for the benefit of the trust beneficiary instead of making distributions through the parent as legal guardian, but as a practical matter distributions through the parents will be used in many, if not most, cases.

3.2.8. Duties And Liabilities of Next Friend or Guardian Ad Litem. A 142 Trust can be created only if the next friend or guardian ad litem of the minor or incapacitated person applies for its creation. Tex. Prop. Code § 142.005 (a). What duties does the next friend or guardian ad litem owe to the beneficiary in connection with requesting and drafting a 142 Trust? What potential liabilities does the next friend or guardian ad litem face as a result of actions taken in connection with the 142 Trust?

It is clear that a next friend or a guardian ad litem is a fiduciary of the proposed trust beneficiary who owes that beneficiary the same duties that other fiduciaries owe, including the duty of loyalty. In *Byrd v. Woodruff*, 891 S. W. 2d 689 (Tex. App. -- Dallas 1994, writ denied), the court of appeals found that a guardian ad litem for a minor is a fiduciary, and that:

As a fiduciary, the guardian ad litem shall: (i) use the skill and prudence that an ordinary, capable, and careful person would use in the conduct of his own affairs, (ii) use diligence and discretion in representing the minor's interests, and (iii) be loyal to his fiduciary. *Cf. Interfirst Bank Dallas, N.A. v. Risser*, 739 S. W. 2d 882, 888 (Tex. App.--Texarkana 1987, no writ) (duty of trustee to manage trust property). The fiduciary duty is one of integrity, loyalty, and the utmost good faith. *Coble Wall Trust Co. v. Palmer*, 859 S. W. 2d 475, 481-82 (Tex. App.--San Antonio 1993, writ denied). The guardian ad litem appointed under rule 173 in a settlement hearing is bound to serve the interests of his principal, placing the interests of the minor before his own. *See Crim. Truck & Tractor Co. v. Navistar Int'l Transp.*, 823 S. W. 2d 591, 592 (Tex. 1992).

891 S. W. 2d at 706-707.

In *Byrd*, a 142 Trust was not created. Rather, a portion of the settlement proceeds were held in the registry of the court and/or in the plaintiff attorney's trust account until the minor turned 18, at which point the former minor agreed to the creation of an irrevocable trust to last until age 40. The guardian ad litem participated in the settlement negotiations and recommended the settlement; he did not participate in the irrevocable trust arrangement. The court of appeals refused to let the guardian ad litem out on summary judgment, holding that he owed the minor fiduciary duties and that he was not entitled to judicial immunity.

While *Byrd v. Woodruff* is not a 142 Trust case, one of the minor's allegations was that the guardian ad litem failed to ensure compliance with Tex. Prop. Code § 142.005 in establishing the trust. 891 S. W. 2d at 697. Also, while the *Byrd* court did not expressly hold that a next friend is a fiduciary, the minor in *Byrd* also sued her parents as next

friends, and that part of the case was severed so that the summary judgment in favor of the guardian ad litem was an appealable final judgment. 891 S. W. 2d at 698. Thus, unlike the guardian ad litem, the parents as next friends were unable to win a summary judgment at the trial level (which summary judgment was reversed by the decision in *Byrd*). The Texas Supreme Court denied writ in *Byrd* in 1995.

Since it is clear from the *Byrd* case that next friends and guardians ad litem contemplating applying for 142 Trusts owe fiduciary duties to the minor or incapacitated person they represent, how can they fulfill those duties without fear of liability to the beneficiary? On the one hand, the age of majority in Texas is 18. How can they justify making the beneficiary wait until age 25 to own his or her settlement proceeds outright? On the other hand, if the guardian ad litem or next friend fails to seek a 142 Trust and the minor spends his or her settlement proceeds immaturely between ages 18 and 25, does the guardian ad litem or next friend face liability for not properly safeguarding the minor's funds?

Similarly, what liability does a next friend or guardian ad litem face if he or she asks for the creation of a 142 Trust for a person believed to be incapacitated but who later asserts that he was not and is not incapacitated? Tex. Prop. Code § 142.005 is intended to be a procedure which happens totally outside the guardianship system. Indeed, Tex. Prop. Code § 142.007 provides a special definition of incapacity for 142 Trust purposes, and a 142 Trust cannot be applied for if a guardianship exists. Nevertheless, creation of the 142 Trust is a denial of property rights to the incapacitated person without following the due process safeguards in place under Texas guardianship law.

Byrd v. Woodruff teaches a lesson that we should have known all along -- that next friends and guardians ad litem must take their duties to their minor or incapacitated person seriously. If a 142 Trust is sought, the applicant should make a record of why it is appropriate in that particular case. In some cases, the next friend or guardian ad litem should consider applying for creation of the trust and stating to the court his or her ambivalence about the creation of the trust and the proposed age of trust termination, leaving it to the court to decide. Also, the next friend or guardian ad litem should consider insisting on a form of trust that closely follows the statutory requirements for 142 Trusts.

Another way in which a guardian ad litem can limit his or her liability is to insist on being discharged by the court upon creation of the trust. The guardian ad litem should be dismissed after entry of final judgment, and the guardian ad litem may not recover fees for services rendered after resolution of the conflict for which he or she was appointed. *Brownsville-Valley Regional Medical Center v. Gamez*, 894 S. W. 2d 753 (Tex. 1995). It is the trustee's responsibility to administer the 142 Trust; the guardian ad litem is not responsible for supervising the trustee, nor will the guardian ad litem be compensated if he or she supervises the trustee. Therefore, the guardian ad litem should assure that the final judgment clearly discharges him or her. The guardian ad litem remains liable for his or her actions prior to that time, but he or she should be able to avoid liability for the actions or inactions of the trustee after that time.

3.2.9. Potential Liability of Trustee For Administering Nonstandard 142 Trusts. Does a trustee face potential liability administering a 142 Trust which deviates from the mandatory statutory provisions? There are no cases on this issue, but *Byrd v. Woodruff*, 891 S. W. 2d 689 (Tex. App. -- Dallas 1994, writ denied), and the growing number of fiduciary liability cases involving trustees should signal the need for caution. Trustees should not blindly follow a trust instrument which the trustee knows or suspects is in conflict with the statute. The trustee should consider an application for instructions under Tex. Prop. Code § 115.001 in the event of such a conflict. The availability of this procedure may depend on whether or not the trust instrument specifically makes the Texas Trust Code applicable to the trust. See *Are 142 Trusts Subject to the Texas Trust Code?* on page 15 above.

3.3. Drafting 142 Trusts. When drafting a 142 Trust, the drafter must decide how far from the bare-bones statutory provisions he or she wishes to go. The trustee usually is interested in more specificity, fleshing out the distribution standard with advice to the trustee regarding what factors to consider in making distributions, whom to consult in making distributions, permissible facilities of payment, etc. The parents or other family members of the beneficiary often are interested in assuring that lifestyle-enhancing distributions, such as distributions to pay for a new or improved house for the beneficiary's family or a new car or van for the family, are permitted by the trust. The drafter may be tempted by his or her own expertise in drafting private trusts to build in greater flexibility.

This usually places the drafter in the dilemma of choosing between making the trust as bare-bones and statute-oriented as possible, which is usually the safest course, or making the trust as client-pleasing as possible, which may raise the problems addressed in *Aguilar v. Garcia*, 880 S. W. 2d 279 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.), or *Byrd v. Woodruff*, 891 S.W.2d 689 (Tex. App. -- Dallas 1994, writ denied).

Attached are the following basic forms to consider for use in drafting 142 Trusts:

- * ☐ Application to Create 142 Trust, Appendix D, Page 48
- * ☐ Trustee's Application for Approval of Compensation (142 Trust), Appendix E, Page 50
- * ☐ Order Creating 142 Trust, Appendix F, Page 51
- * ☐ Order Approving Trustee's Compensation, Appendix G, Page 53
- * ☐ Application to Modify Trust Regarding 1997 Legislation, Appendix H, Page 54
- * ☐ Order Modifying Trust Regarding 1997 Legislation, Appendix I, Page 55
- * ☐ Form of 142 Trust, Appendix J, Page 56

4. 867 TRUSTS

4.1. Statutory Requirements. Like 142 Trusts, 867 Trusts have certain statutory requirements regarding trust creation and trust provisions which must be met. HB 1314, enacted into law by the 75th Texas Legislature (effective September 1, 1997), changed some of these requirements. The following reflects those changes.

4.1.1. Basis For Creation. Texas Probate Code 867 provides (with 1997 changes highlighted):

On application by the guardian of a ward or by a ward's attorney ad litem at any time after the date of the attorney's appointment under Section 646 of this code, the court in which the guardianship proceeding is pending may enter an order that creates for the ward's benefit a trust for the management of guardianship funds if the court finds that the creation of the trust is in the ward's best interests. The order shall direct the guardian or another person to deliver all or part of the assets of the guardianship to a trust company or a state or national bank that has trust powers in this state. The order shall include terms, conditions, and limitations placed on the trust. The court shall maintain the trust under the same cause number as the guardianship proceeding.

Thus, in order to create an 867 Trust, there must be (1) an application by the guardian or an attorney ad litem after appointment under Section 646 and (2) a court finding that creation of the trust is in the ward's best interests.

A. Application by a Guardian. One party who may apply for the creation of an 867 Trust is a guardian.

1) What Type of Guardian Is Required? Does Tex. Prob. Code Ann. § 867 require a guardian of the estate, or may a temporary guardian or a guardian of the person apply for creation of an 867 Trust? Prior to September 1, 1995, the answer was unclear. Since September 1, 1995, any type of guardian should suffice. The following definition of guardian was added to the Probate Code effective September 1, 1995:

Guardian means a person who is appointed guardian under Section 693 of this Code, or a temporary or successor guardian. Except as expressly provided otherwise, guardian includes the guardian of the estate and the guardian of the person of an incapacitated person.

Tex. Prob. Code Ann. § 601 (10). Therefore, a guardianship of the estate, a guardianship of the person, and a temporary guardianship should meet the requirement in Section 867 that a guardian of the ward may apply for creation of an 867 Trust.

2) Must Guardian Qualify Before Applying for Trust? If creation of the 867 Trust is based on the application of a guardian, must the guardian be appointed and qualify as guardian before applying for creation of the trust? The answer appears to be yes -- the guardian must qualify before formally applying for creation of an 867 Trust. Thankfully, however, most courts permit the applicant to ask for creation of the guardianship and creation of the 867 Trust at the same time. If the guardian is not appointed, or if he or she fails to qualify as guardian, the 867 Trust cannot be created. However, the combined application permits the court to hear the entire matter at one hearing, cutting down on the time and expense associated with creation of the 867 Trust. If a combined application is used, it is a good idea for the guardian, upon qualification, to file another, formal application for creation of the trust so that the literal terms of Section 867 are met.

If it would be difficult or expensive to bond the guardian for the short time between his qualification as guardian and the creation of the 867 Trust, the guardian can request that his powers as guardian over the property which will pass into the 867 Trust be limited to directing the third parties holding such property to deliver such property to the trustee of the 867 Trust once it is created. The guardian also should obtain an order from the court directing the holders of the ward's property to transfer it directly to the trustee. See "Transferring Property Into an 867 Trust" on page 26 below.

B. Application by an Attorney Ad Litem. Prior to the 1997 amendment to Section 867, for an 867 Trust to be created when no guardianship existed, the "Texas two-step" was required: First, a guardian had to be appointed and qualify (since only a guardian could apply for the creation of a management trust). Second, the guardian then would have to apply for the creation of the trust. As a practical matter, most judges would allow applicants to prove up the guardianship and the trust in one hearing, but it was impossible to get an 867 Trust unless a guardian was appointed and qualified. This was always inconvenient and often a problem, since a non-corporate trustee had to post a bond in order to qualify as guardian. Often this problem was solved by appointing the soon-to-be-named corporate trustee as guardian of the estate (since corporate guardians are not required to post a bond), but this was a cumbersome process which arguably required the filing of an inventory, etc.

In 1997, Section 867 was amended to read as follows [language added by amendment is underscored; author's emphasis is ***boldfaced and italicized***]:

On application by the guardian of a ward or by a ward's attorney ad litem ***at any time*** after the date of the attorney's appointment under Section 646 of this code, the court ***in which the guardianship proceeding is pending*** may enter an order that creates for the ward's benefit a trust for the management of ***guardianship funds*** if the court finds that the creation of the trust is in the ward's best interests. The order shall direct the guardian or other person to deliver all or part of the assets ***of the guardianship*** to [the trustee of the 867 Trust]. . . .

The 1997 amendment eliminated the need for the Texas two-step, so long as the attorney ad litem appointed under Section 646 of the Probate Code thinks the 867 Trust is a good idea and is willing to apply for it. If the attorney ad litem asks for the creation of the trust, then the court can create the trust without waiting for the guardian of the estate to qualify.

This should mean that an 867 Trust may be created without there ever being a guardian of the estate. In order to have an 867 Trust created without a guardian under the amended Section 867, the following must occur:

1. There must be a pending guardianship proceeding. A guardianship proceeding includes a matter or proceeding relating to a guardianship ***or any other matter addressed by this chapter***. Thus, a proceeding to create an 867 Trust is a guardianship proceeding.
2. There must be an attorney ad litem appointed under Section 646. Section 646 requires the court to appoint an attorney ad litem to represent the interests of the proposed ward in a proceeding for the appointment of a guardian.
3. The attorney ad litem must apply for creation of the 867 Trust.
4. The court must find that creation of the trust is in the ward's best interests.

If these four things are present, Section 867 permits creation of the 867 Trust, and nowhere in Section 867 is the appointment of a guardian required. In fact, the amendment to Section 867 apparently anticipates that no guardian may be appointed by permitting the court's transfer order to be addressed to persons other than the guardian. There is no policy reason why a guardian should be required if all of the assets are being transferred to an 867 Trust. (There may be times when it is desirable to have both an 867 Trust and a guardian of the estate, such as when a guardian is needed to prosecute claims on behalf of the ward, but there is no reason to require that a guardian be appointed in every case.)³

The forms attached to this paper as Appendix K (page 59), Appendix L (page 62) and Appendix M (page 64) are, respectively, a combined application for appointment of a guardian and creation of an 867 Trust (normally a prerequisite to the appointment of an attorney ad litem under Section 646), an application by the attorney ad litem for creation of an 867 Trust, and an order creating the 867 Trust without the need for a guardian to be appointed.

If a guardian of the estate is appointed prior to creation of the 867 Trust, it is possible to have the guardian discharged, but it may be necessary for a guardian of the person of the ward to continue to serve. The 1997 amendment added new Section 868A, which reads as follows:

On or at any time after the creation of a trust under this subpart, the court may discharge the guardian of the ward's estate only if a guardian of the ward's person remains and the court determines that the discharge is in the ward's best interests.

This provision was included at the request of some of the statutory probate judges, who wished to assure that there was someone to keep an eye on the trustee and to act on behalf of the beneficiary of the trust should the need arise. See "Can and Should Guardian Resign When Trust Is Created?" on page 27 below for more discussion of the effects of new Section 868A.

C. Best Interests Finding. An 867 Trust may be created only if the court finds that creation of the trust would be in the ward's best interests. Tex. Prob. Code Ann. § 867.

4.1.2. Mandatory Provisions. Like 142 Trusts, 867 Trusts must meet mandatory requirements regarding choice of a trustee and terms of the trust. Many of the mandatory provisions are based on the requirements for 142 Trusts and, therefore, are similar or identical to the requirements of Tex. Prob. Code § 142.005. Some of these mandatory provisions may be varied by the court in order to create a supplemental needs trust. See "867 Trusts as Supplemental Needs Trusts" on page 24 below.

A. Must Use Corporate Trustee. The order creating an 867 Trust must direct the guardian or another person to deliver all or part of the assets of the guardianship to a trust company or a state or national bank that has trust powers in this state. Tex. Prob. Code Ann. § 867. Individuals may not be trustees of 867 Trusts. The trust must provide that the trustee serves without bond. Tex. Prob. Code Ann. § 868 (a) (4).

As noted above, some courts are creating 142 Trusts with individuals serving as co-trustee with a bank or trust company. The author is not aware of any 867 Trusts with individual co-trustees. Given the guardianship orientation of 867 Trusts, it seems unlikely that a probate court would agree to a co-trustee arrangement. Individual co-trustees clearly are not permitted by the statute.

Legislation was proposed in 1999 to permit noncorporate trustees of 867 Trusts with less than \$50,000 in trust property upon a showing that no corporate trustee was willing to serve. This legislation failed to pass, however.

B. Sole Beneficiary Requirement. Tex. Prob. Code Ann. § 868 (a) (1) requires that the ward be the sole beneficiary of the trust (except in the case of supplemental needs trusts -- see "867 Trusts as Supplemental Needs Trusts" below). Notwithstanding the mandatory sole beneficiary requirement, Section 868(b) permits distributions "for the health, education, support, or maintenance of the ward or of another person whom the ward is legally obligated to support." (emphasis added). Presumably this possible conflict can be reconciled by recognizing that, if the ward/beneficiary is legally obligated to support someone, payment for that person's needs benefits the ward/beneficiary.

C. Mandatory Distribution Provisions. Except in the case of supplemental needs trusts (see "867 Trusts as Supplemental Needs Trusts" below), the trust must provide that the trustee may disburse an amount of the trust's principal or income as the trustee determines is necessary to expend for the health, education, support or maintenance of the beneficiary. Tex. Prob. Code Ann. § 868 (a) (2). The trust also must provide that the income of the trust that the trustee does not disburse under Section 868 (a) (2) must be added to the principal of the trust. Tex. Prob. Code Ann. § 868 (a) (3). This distribution standard is virtually identical to the one required in 142 Trusts. Does this mean that the reasoning of the court of appeals in *Aguilar v. Garcia*, 880 S.W.2d 279, 281 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.), which was a 142 Trust case, applies with equal force to 867 Trusts? Obviously, the same bases for distinguishing *Aguilar* in the case of 142 Trusts apply as well in the case of 867 Trusts. In addition, one may argue that *Aguilar* does not apply directly to 867 Trusts and, at most, applies only by analogy, so that until a similar appellate decision is reached with respect to an 867 Trust, practitioners and courts are free to structure 867 Trusts as if *Aguilar* did not exist. Finally, one may argue that Tex. Prob. Code Ann. § 867 imposes a less stringent requirement on the trial court regarding varying from the mandatory provisions -- while Tex. Prob. Code § 142.005 provides that the court may provide for the terms, conditions and limitations of the trust that are not in conflict with the mandatory provisions in the statute, Tex. Prob. Code Ann. § 867 contains no such statement restricting the court's ability to include conflicting provisions in the trust.

The requirement of Section 868 (a) (3) that income not distributed under Section 868 (a) (2) must be added to principal presents a potential problem for 867 Trusts, since distributions from the trust may be made under Section 868 (b) as well as under Section 868 (a) (2). Section 868 (b), which is discussed in more detail below, permits distributions benefitting those persons who the ward is legally obligated to support (such as the ward's spouse and minor children). Does Section 868 (a) (3) prohibit a distribution of *income* to benefit the ward's spouse or minor child, since that distribution cannot be made under Section 868 (a) (2)? Perhaps. Section 868 (a) (3) is an unnecessary provision that should be deleted from the statute. However, until that happens, the best solution probably is: (a) continue to include the Section 868 (a) (3) provision in the trust, since the statute says it is

mandatory and since the court in *Aguilar* suggests that the mandatory requirements must be taken seriously; (b) include the optional provision permitting distributions benefitting the spouse and minor children if desired; and (c) assure that any distributions benefitting the spouse or children are made from the *principal* of the trust.

Ironically, the inclusion of the useless and apparently contradictory requirement about adding income to principal in Tex. Prob. Code Ann. § 868 (a) (2) may actually bolster arguments that more flexible distribution standards are permitted in an 867 Trust. Notwithstanding *Aguilar* and the mandatory statutory provisions, it is not uncommon to see 142 Trusts and 867 Trusts with additional distribution provisions. One may argue that these additional distribution provisions are permitted by the general terms of Tex. Prop. Code § 142.005 (b) and Tex. Prob. Code Ann. § 867, so long as they do not conflict with the mandatory statutory provisions. However, if these additional distribution provisions permit *income* distributions, they may conflict with Tex. Prop. Code § 142.005 (b)(3) and Tex. Prob. Code Ann. § 868 (a) (3), which require income not distributed in accordance with the *mandatory* provisions to be added to principal. In the case of 867 Trusts, one may argue that the legislature must have anticipated that distributions that go beyond the mandatory distribution standard are permitted since the statute expressly permits other, optional distributions pursuant to Tex. Prob. Code Ann. § 868 (b). Therefore, other custom-drafted distribution provisions should not be considered inconsistent with the mandatory provisions and should be permitted in an 867 Trust. (The same argument is unavailable in the case of a 142 Trust, since Tex. Prop. Code § 142.005 does not permit distributions to persons whom the beneficiary is legally obligated to support.)

D. Trustee Compensation. One of the most controversial statutory provisions regarding 867 Trusts is the mandatory trustee compensation provision. The trust instrument must provide that:

the trustee, on annual application to the court and subject to the court's approval, is entitled to receive reasonable compensation for services that the trustee provided to the ward as the ward's trustee that is:

(A) to be paid from the trust's income, principal, or both; and

(B) determined in the same manner as compensation of a guardian of an estate under Section 665 of [the Probate Code].

Tex. Prob. Code Ann. § 868 (a) (5).

Corporate trustees who administer 142 Trusts are used to getting their compensation approved when the trust is created and being paid reasonable compensation, which is usually based on their fee schedules and is paid currently (in other words, as services are rendered and not in arrears at the end of the year). Section 868 (a) (5) requires them to use the 5% in, 5% out formula that guardians use (unless they can convince the court that such formula produces an unreasonably low fee). In addition, Section 868 (a) (5) and Section 871 require them to file an annual guardianship-style accounting with the court and obtain the court's approval thereof before being compensated.

A bill backed by the Texas Bankers Association in the 1995 legislative session would have allowed corporate trustees of 867 Trusts to charge their fee schedules and to use its trust accounting statements as the statutory accounting requirement unless the court otherwise ordered. This bill received strong opposition from statutory probate judges and did not pass. No similar bill was introduced in 1997. Therefore, the current scheme for compensating trustees of 867 Trusts appears likely to stay.

While the trustee compensation provisions have caused some corporate trustees to be reluctant to take on 867 Trusts, there clearly are trustees who are willing to serve, especially on larger trusts. Even in the case of small guardianship estates, it may be possible to use 867 Trusts if the drafter, the trustee and the ward's family are willing to be creative. The author participated in one proceeding in which the trust provided that the trustee's fees were to be paid by a family member of the ward. This enabled the trust to be created, which in turn kept the trust principal out of the soon-to-be-18-year-old ward's hands until the ward was a little older.

4.1.3. Optional Provisions. Like 142 Trusts, 867 Trusts may include certain optional provisions in addition to the mandatory provisions discussed above.

A. 1997 Change Clarifies That 867 Trusts May Contain Extra Provisions. Many practitioners incorporate additional provisions in 867 Trusts which address issues which are not addressed by the statute. Prior to September 1, 1997, the only bases for including these provisions were (1) common sense and (2) two cryptic provisions in the statutes -- first, a provision in Section 867 stating that the court's order creating an 867 Trust "shall

include terms, conditions, and limitations placed on the trust," and, second, a provision in Section 869 (a) stating that the court may amend or modify the trust.

HB 1314, effective September 1, 1997, but applying to trusts existing on that date by its own terms, adds subsection (e) to Section 868, which reads as follows:

The court may include additional provisions in a trust created or modified under this section if the court determines an addition does not conflict with Subsection (a) and, if appropriate, Subsection (d) of this section.

Subsection (a) contains the mandatory provisions of an 867 Trust and subsection (d) contains the new exception for supplemental needs trusts. This new subsection goes a long way toward justifying the additional provisions which are often routinely included in an 867 Trust.

Does subsection (e) require a finding that the additional provisions do not conflict with Tex. Prob. Code Ann. § 868 (a) or (d)? Prudence dictates that the order creating the trust should include such a finding. For example, routinely including the following phrase among the findings in the order should do the trick:

that the additional provisions of the trust do not conflict with Tex. Prob. Code Ann. § 868 (a) or (d);

In light of the *Aguilar* case, *supra*, subsection (e) of Section 868 gives 867 Trusts an advantage over 142 Trusts as a flexible tool to be used in unusual situations. The trial court's determination that the additional provisions do not conflict with the mandatory provisions, coupled with new subsection (e), should go a long way toward avoiding an *Aguilar*-type problem with 867 Trusts.

The provisions of HB 1314 and its legislative history make it clear that the changes made by HB 1314 apply to 867 Trusts created before September 1, 1997, without the need for modifying the trusts. However, the order creating existing trusts may or may not include a determination that the additional provisions are not in conflict with the mandatory provisions. Can one assume that there was an implied finding that the additional provisions were not in conflict? Perhaps it is a good idea for trustees to review the orders creating 867 Trusts to see if the determination of no conflict is implicitly or explicitly stated. While the author suggests that it should be unnecessary to go back and obtain such a determination for existing 867 Trusts with nonstandard language, it would be a simple matter to include a request for clarification from the court that such a determination was made in the order approving a future annual account.

B. 867 Trusts as Supplemental Needs Trusts. Perhaps the most notable change in 1997 to the statutes governing 867 Trusts is the addition of subsection (d) to Section 868, which reads as follows:

When creating or modifying a trust, the court may omit or modify terms required by Subsection (a)(1) or (2) of this section only if the court determines that the omission or modification:

(1) is necessary and appropriate for the ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the ward; and

(2) is in the ward's best interests.

This provision was added to make it clear that 867 Trusts may be established as supplemental needs trusts under 42 U.S.C.A. § 1396(d)(4)(a). All that is required is a court determination that (1) omission or modification of a mandatory term is "necessary or appropriate" for the beneficiary to qualify for government benefits and (2) the omission or modification is in the ward's best interests.

The 1997 amendment, HB 1314, is effective September 1, 1997, and expressly applies to "all trusts created under Section 867, Texas Probate Code, as amended by this Act, regardless of the date on which the trusts were created." The legislative history of HB 1314 makes clear that the legislature intended that existing supplemental needs trusts created under Section 867 prior to the effective date of HB 1314 need not be modified for the terms of HB 1314 to apply. Nevertheless, since trustees must submit annual accounts each year anyway, counsel for trustees should consider obtaining in the order approving the annual account a clarification that HB 1314 applies to the pre-existing 867 Trust and that all required determinations have been made.

C. Distributions to or for the Benefit of the Ward or Another Person Whom the Ward Is Legally Obligated to Support. In addition to the mandatory distributions provided for in Section 868 (a) (2), the trust instrument may provide that a trustee may:

make a distribution, payment, use, or application of trust funds for the health, education, support, or maintenance of the ward or of another person whom the ward is legally obligated to support, as necessary and without the intervention of a guardian or other representative of the ward, to:

- (1) the ward's guardian;
- (2) a person who has physical custody of the ward or another person whom the ward is legally obligated to support; or
- (3) a person providing a good or service to the ward or another person whom the ward is legally obligated to support.

Tex. Prob. Code Ann. § 868 (b).

In the 1993 version of Section 868 (b), distributions were permitted only for the benefit of the ward or for the support, maintenance and education of the ward's children if the ward was an incapacitated adult.

In 1995, this section was amended to permit distributions for the health, education, support and maintenance of persons whom the ward (regardless of age) is legally obligated to support. Presumably the persons whom the ward is legally obligated to support include the ward's spouse and the ward's minor children. Thus, it is clear that the legislature intended to enlarge the pool of potential recipients of trust benefits beyond the ward and an adult ward's minor children. Unfortunately, this clear intent nonetheless left a confusing statute to construe and a confusing trust provision to administer.

In 1997 the legislature made further repairs to this section. As a result, the statute is much clearer. The 1997 changes make it clear that "facility of payment" distributions for the benefit of a ward (or a person the ward is legally obligated to support) may be made directly to persons providing goods and services -- it is not necessary for the payment to go through the hands of the guardian or the person having physical custody of the ward. While this 1997 change makes it less important to include an additional facility of payment provision in the trust, a broad facility of payment provision seems to be permitted by the statute and is probably a good idea.

D. Paying Guardian's Compensation. Consider including a provision in the trust instrument requiring the trustee to pay court-approved fees of the guardian of the person and/or guardian of the estate of the ward. Since most, if not all, of the guardianship assets will be in the trust, this prevents later conflicts between the trustee and the guardians regarding how they are to be paid.

E. Trust Termination Age. Tex. Prob. Code Ann. § 870 (a) permits the court to provide for a trust for a minor to terminate as late as the ward's twenty-fifth birthday. If the court does not otherwise provide in its order, the trust for a minor will terminate on the earlier of the minor's death or the minor's eighteenth birthday. Thus, while the court may order the trust to continue beyond the minor's eighteenth birthday, the trust will terminate at age 18 if the trust instrument is silent. This is different from 142 Trusts, where the statute provides that the trust will terminate at age 25 unless the court otherwise orders. Tex. Prob. Code § 142.005 (b) (4).

Should a court routinely extend the trust termination age to age 25? Many practitioners would argue that it should, since the statute permits it and since most 18-year-olds are too immature and uneducated to handle large sums of money. However, some judges are reluctant to set the trust termination age at age 25 when the ward is young, preferring instead to wait until close to the ward's eighteenth birthday before deciding whether to continue the trust. The statute does not require the court order creating the trust to be the court order that extends the trust beyond age 18; therefore, an order amending or modifying the trust to extend it beyond age 18 can be entered after the trust is created.

As discussed above with respect to 142 Trusts, in order for a (d)(4)(A) trust established for a minor who does not meet the Tex. Prob. Code Ann. §601(13) definition of "incapacitated person" (other than because of his or her minority) to properly benefit that minor, it must not terminate at age 25. If the trust terminates at age 25, the trust beneficiary would be deprived of the benefits afforded by (d)(4)(A) trusts because at age 25 (1) the government reimbursement provision would kick in and (2) if more than \$2,000 was left in the trust, the trust beneficiary would cease to be qualified for Medicaid and SSI benefits. Therefore, it is necessary for the trust to provide that it continues

beyond age 25 until the death of the beneficiary or it is otherwise terminated by order of the court. However, the wording of Section 868(d), enacted in 1997 to permit 867 Trusts to be (d)(4)(A) trusts, arguably only permits the distribution standard of an 867 Trust to be modified (found in Section 868(a)(2)), not the trust termination provisions (found in Section 870). (The author of this paper suggested a broader provision enabling (d)(4)(A) trusts that would have covered the termination issue, but the bill that was introduced was more restrictive.)⁴ Since altering the termination age is necessary for the (d)(4)(A) trust to accomplish its purpose, and since the legislature clearly indicated its intent that 867 Trusts be adaptable to be (d)(4)(A) trusts, the statute should be construed to permit trusts to last beyond age 25.

F. Distribution on Trust Termination. Unlike Tex. Prop. Code § 142.005, which requires the trust on termination to be distributed to the beneficiary or to the personal representative of the beneficiary's estate, Tex. Prob. Code Ann. § 873 permits greater flexibility. As amended in 1995, Section 873 provides:

Unless otherwise provided by the court, the trustee shall:

- (1) Prepare a final account in the same form and manner that is required of a guardian under Section 749 of this Code; and
- (2) On court approval, distribute the principal or any undistributed income of the trust:
 - (A) To the ward when the trust terminates on its own terms;
 - (B) To the successor trustee on appointment of a successor trustee; or
 - (C) To the representative of the deceased ward's estate on the ward's death.

The magic words that every draftsman loves, of course, are: unless otherwise provided by the court. (Wouldn't life be a lot simpler if that modifier was placed on all of the requirements for 142 Trusts and 867 Trusts?) This permits a number of creative dispositive possibilities, so long as the court can be convinced to approve them. For example, this could permit basic bypass or generation-skipping planning.

Of course, if the 867 Trust also is a (d)(4)(A) supplemental needs trust, it must include a provision reimbursing the government for certain costs on trust termination.

4.2. Miscellaneous Issues Regarding 867 Trusts.

4.2.1. Transferring Property Into an 867 Trust. Prior to September 1, 1997, Tex. Prob. Code Ann. § 867 provided that the order creating the 867 Trust shall direct the guardian to deliver all or part of the assets of the guardianship to the trustee of the 867 Trust. Arguably, this provision could be read to require the guardian to receive all property passing into an 867 Trust from third parties and then transfer the property to the trustee. This indirect process presented at least three problems. First, it often presented problems if the guardian of the estate was an individual who could not post a sufficiently high bond. This problem could be dealt with by safekeeping arrangements or orders directing the third party to transfer property directly to the trustee (notwithstanding the language of Section 867), but it was a problem nonetheless. Second, although a guardian of the person should be able to apply for the creation of an 867 Trust, a guardian of the person is not empowered to receive property and transfer it to the trustee. Third, the receipt and disbursement of property may have given rise to a claim for guardianship compensation under Section 665 of the Probate Code.

To address these concerns, Section 867 was amended in 1997 to provide that the court may direct the guardian "or another person" to transfer assets to the trustee. This clearly permits orders directed to third parties holding assets to transfer property directly to the trustee without the need for those assets to pass through the hands of the guardian. In most cases, direct transfers from third parties to the trustee will be preferable to transfers involving the guardian.

4.2.2. Trust Amendment, Modification or Revocation. An 867 Trust may be amended, modified or revoked by the court creating it at any time before the date of its termination, but it cannot be revoked by the ward or by the guardian of the ward's estate. Tex. Prob. Code Ann. § 869. While the ward or the ward's guardian cannot unilaterally revoke the trust, they may of course ask the court to amend or revoke the trust.

It should not be necessary to modify a trust in order for the changes made by HB 1314 (effective September 1, 1997) to apply. Nevertheless, trustees should consider obtaining an order clarifying that HB 1314 applies to the trust and that all determinations required by HB 1314 have been made in the order approving an annual account of the trust.

4.2.3. Can and Should Guardian Resign When Trust Is Created? Prior to 1997, only a guardian could apply for creation of an 867 Trust, and the statute was silent as to whether the guardian could resign after creation of the trust. Many practitioners and courts took this silence as an indication that the guardian could resign, leaving only the trust and the trustee.

The author, an incurable tinkerer, tried to include a provision in the 1997 amendments to Tex. Prob. Code Ann. §§ 867 et seq. that would make it clear that a trust could exist without a guardianship. Alas, some of the statutory probate judges thought this was a bad idea and caused HB 1314 to include new Section 868A, which reads as follows:

On or at any time after the creation of a trust under this subpart, the court may discharge the guardian of the ward's estate only if a guardian of the ward's person remains and the court determines that the discharge is in the ward's best interests.

The rationale for permitting the discharge of the guardian of the estate only if a guardian of the person remains is that the beneficiary of an 867 Trust will benefit from having someone other than the trustee accountable to the court and looking out for the beneficiary's interests. In an analogous situation, the Texas Supreme Court has ruled that no watchdog is needed for the trustee of a 142 Trust. *See Brownsville-Valley Regional Medical Center v. Gamez*, 894 S. W. 2d 753 (Tex. 1995). Remember, though, that 867 Trusts were cut out of the fabric of guardianship law, while 142 Trusts were fashioned out of prior statutes providing alternatives to guardianship. This becomes just one of several distinctions between 142 Trusts and 867 Trusts which can be traced back to the respective statute's origins.

A. Parents as the Natural Guardian of the Person. Section 676 (b) of the Probate Code provides that, if the parents live together, both parents are the natural guardians of the person of their minor child and, if one parent is dead, the surviving parent is the natural guardian of the person of his or her minor child. A minor's parents can reasonably be expected to play the watchdog role envisioned by Section 868A; however, they are not required to file annual reports with the court. A parent as natural guardian of the person should fulfill the "guardian of the person" requirement of Section 868A, especially since most courts will not appoint a guardian of the person for a minor with living parents.

What about minors whose parents do not live together? Section 676 (b) provides: "The rights of parents who do not live together are equal, and the guardianship of their minor children shall be assigned to one or the other, considering only the best interests of the children." Since neither parent is designated as natural guardian of the person, then presumably a court-appointed guardian of the person would be required by Section 868A in order for the guardian of the estate to be discharged. Similarly, a court-appointed guardian of the person of a minor orphan would be required.

What about a minor with a managing conservator appointed under the Family Code? Managing conservators are not guardians of the person, so they apparently would not meet the requirements of Section 868A.

B. Minors Attaining Their Majority. When a minor who is not otherwise incapacitated reaches age 18, both the guardian of the estate and the guardian of the person cease to have authority to act and, presumably, are entitled to be discharged. The 867 Trust for the former minor, on the other hand, may extend to age 25. Obviously, during this seven-year period, there will be an 867 Trust in existence without a concurrent guardianship, notwithstanding the provisions of Section 868A.

C. When a Guardian of the Estate is Needed. In some cases it is advantageous for a guardian of the estate to serve concurrently with the existence of an 867 Trust. For example, if one of the ward's assets is a claim which must be pursued in litigation, it usually will make more sense for a guardian to pursue that claim, rather than transferring the claim into the trust and having the trustee pursue the claim. Similarly, a guardian of the estate may be necessary if tax-motivated gifts are to be made pursuant to Tex. Prob. Code Ann. § 865, since Section 865 provides for the guardian, not the trustee, to make such gifts.

In most cases, however, it is wise for the guardian of the estate to ask to be discharged. This eliminates the bond requirement and saves the ward's estate money (although if the same corporate fiduciary that is trustee of the 867 trust also is guardian of the estate, no bond would be required). It also eliminates the requirement for the guardian to

file an annual account (although the trustee must file such accounts). Finally, it eliminates the possibility of liability for the person serving as guardian.

If a guardian of the estate is needed, it should be possible to minimize the amount of the guardian's bond by transferring all (or substantially all) of the liquid assets into the trust and limiting the powers of the guardian with respect to those assets requiring the guardian's care and attention.

4.2.4. Texas Trust Code Applies to 867 Trusts. Prior to 1997 it was unclear if the Texas Trust Code applied to 867 Trusts. That uncertainty was resolved by HB 1314, effective September 1, 1997, which added new Section 869B to the Probate Code, which reads as follows:

Sec. 869B. APPLICABILITY OF TEXAS TRUST CODE.

- (a) A trust created under Section 867 of this code is subject to Subtitle B, Title 9, Property Code.
- (b) To the extent of a conflict between Subtitle B, Title 9, Property Code, and a provision of this subpart or of the trust, the provision of the subpart or trust controls.

This change made it possible to repeal subsection (c) of Section 868, which permitted the trust instrument governing an 867 Trust to give the trustee the powers of a trustee under the Trust Code. Obviously, now that it is clear that the Trust Code applies to 867 Trusts, trustees of such trusts have the powers of trustees under the Trust Code, unless the trust instrument or Tex. Prob. Code Ann. §§ 867 et seq. provide otherwise.

4.2.5. Jurisdiction of Courts Supervising 867 Trusts. Prior to the enactment of HB 1314, effective September 1, 1997, some courts creating 867 Trusts faced jurisdictional problems in supervising those trusts. Under the Texas Trust Code, exclusive jurisdiction over proceedings concerning trusts was granted to the district court and statutory probate courts. Tex. Prop. Code § 115.001; *see also* Tex. Prob. Code Ann. § 5A(c). Thus, under the Trust Code, constitutional county courts and county courts at law arguably had no (or at least limited) jurisdiction over 867 Trusts.

HB 1314 solved that problem. First, it added Section 869C to the Probate Code, which reads as follows:

Sec. 869C. JURISDICTION OVER TRUST MATTERS. A court that creates a trust under Section 867 of this code has the same jurisdiction to hear matters relating to the trust as the court has with respect to the guardianship and other matters covered by this chapter.

Second, it amended Section 115.001 (d) of the Texas Trust Code to provide as follows:

- (d) The jurisdiction of the district court over proceedings concerning trusts is exclusive except for jurisdiction conferred by law on a statutory probate court or a court that creates a trust under Section 867, Texas Probate Code. [Emphasis added]

These changes make it clear that courts creating 867 Trusts have the same jurisdiction over those trust that they had over the guardianship out of which they were created. For statutory probate courts, this represents no change – they already had jurisdiction over trusts. For county courts at law exercising probate jurisdiction, this means that 867 Trusts may be created without the fear of losing jurisdiction should it become necessary to litigate an issue regarding the trust, such as the malfeasance of the trustee. For constitutional county courts, the rule regarding contested proceedings applies. *See* Tex. Prob. Code Ann. § 606 (b).

4.2.6. Can an 867 Trust Be a Spendthrift Trust? Should a spendthrift clause be added to an 867 Trust? Tex. Prop. Code § 112.035 (d) provides that, if the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of the settlor's beneficial interest does not prevent the settlor's creditors from satisfying claims from the settlor's interest in the trust estate. Settlor is defined as the person who creates the trust. Tex. Prop. Code § 111.004 (14). Chances are, the beneficiary of an 867 Trust will be considered by the Court to be the settlor of the trust, and it is doubtful that a spendthrift provision will protect the trust estate from the beneficiary's creditors. It is even less likely that a spendthrift provision will protect trust assets from the beneficiary's creditors in an 867 Trust than in a 142 Trust, since the property placed in the 867 Trust is the beneficiary's -- it is not going directly from a third party to the trust as is the case with a 142 Trust. However, one can certainly argue that the court, not the beneficiary, creates the trust, and the beneficiary has no right to the trust assets until they are distributed to the beneficiary. Even if the spendthrift clause does not protect the trust assets

from the beneficiary's creditors, it may prohibit the beneficiary from voluntarily alienating his or her interest in the trust. Therefore, it is probably a good idea to include a spendthrift provision in the trust.

One way to, in effect, strengthen the spendthrift argument is for the order creating the guardianship and/or 867 Trust to provide that the court expressly finds that the ward/beneficiary does not have the power to contract.⁵ This is not appropriate in every case and probably does nothing to protect against tort liabilities, but it should make it easier to protect the trust corpus from claims of the would-be contract creditors of the ward/beneficiary.

4.2.7. Trustee's Duty to Account. Tex. Prob. Code Ann. § 871 requires the trustee to prepare and file with the court an annual accounting of the transactions in the trust in the same manner and form that is required of a guardian under the Texas Probate Code. A copy of the annual account must be provided to the guardian of the ward's estate or person (the statute says *estate or person*, but the safe practice would be to send a copy to both the guardian of the estate and the guardian of the person if they are not the same person). The annual account is subject to court review and approval in the same manner that is required of the annual account prepared by a guardian. Tex. Prob. Code Ann. § 871 (c). The annual account forms the basis for determining the trustee's compensation under Tex. Prob. Code Ann. § 868 (a) (5).

If the trustee of an 867 Trust is required to file an annual account which is subject to court review and approval in the same manner that is required of an annual account prepared by a guardian, should the trustee seek pre-approval of extraordinary expenditures much like a guardian might be expected to seek in a guardianship? The safe answer (from the trustee's perspective) is yes. However, the trustee is likely to make fewer trips to the courthouse for preapproval of expenditures than a guardian for the following reasons:

- " The mandatory provisions of an 867 Trust permit income and principal distributions, so no further order of the court is needed to authorize corpus distributions for maintenance and education of the ward. *Compare* Tex. Prob. Code Ann. § 776 (guardian not allowed to expend corpus for maintenance and education without court authority).
- " If the trustee anticipates the need for extraordinary expenditures, it can obtain court approval of such expenditures when the trust is created, either by specifically authorizing such expenditures in the terms of the trust or by separate order approving such expenditures as proper trust distributions.

The Texas Bankers Association backed a bill in 1995 that would have permitted bank-trust-department-type accountings unless the court otherwise ordered. This bill failed to pass, so guardianship-type accountings are required.

In addition to annual accounts, the trustee is required to file a final account. Tex. Prob. Code Ann. § 873 (1).

4.2.8. Investments in Texas Tomorrow Fund. Subparagraph (f) was added to Section 868 by the 76th Texas Legislature, effective May 17, 1999, providing that the trustee may invest trust property in the Texas Tomorrow Fund (Subchapter F, Chapter 54, Texas Education Code) if the trustee determined that doing so was in the best interests of the ward. Presumably this means that the trustee may make this investment without court approval. The 1999 amendment does not necessitate an addition to the trust instrument – the trustee has this authority pursuant to statute regardless of whether or not a Texas Tomorrow Fund investment is specifically authorized by the trust instrument.

4.2.9. Distributions For Minor's Support, Education or Maintenance. Tex. Prob. Code Ann. § 777 provides that, absent a court finding of undue hardship, a *parent* who is the *guardian of the person* of a ward who is 17 years of age or younger may not use the income or the corpus from the ward's estate for the ward's support, education, and maintenance [emphasis added]. This provision was added to the probate code in 1993 as part of the recodification bill; there is no corresponding provision in pre-1993 statutory probate law. It is consistent with the Family Code (*see* Tex. Fam. Code § 151.003(a)(3) -- a parent has the duty to support the child, including providing the child with clothing, food, shelter, medical and dental care, and education) and prior case law (*see Tharp v. Blackwell*, 570 S. W. 2d 154, 159 (Tex. Civ. App. – Texarkana 1978, no writ) -- The law of this state imposes upon a parent, who has resources of his own sufficient to maintain his children, and who is also guardian of their estates, to support them out of his own means and he may not have recourse to the estates of the wards.).

Does Texas law (Tex. Prob. Code Ann. § 777 or otherwise) permit or require the trustee of an 867 Trust to withhold payments for the support, education and maintenance of a trust beneficiary under age 18 if the beneficiary's parent or parents have the resources to themselves support the beneficiary? As discussed above with respect to 142 Trusts,

Aguilar v. Garcia, 880 S.W.2d 279 (Tex. App. -- Houston [14th Dist.] 1994, orig. proc.) would seem to prohibit requiring a trustee of an 867 Trust to withhold trust distributions which would pay for expenses that fall within a parent's legal duty to support the child. *Aguilar* involved a 142 Trust, not an 867 Trust, but the distribution standard in Tex. Prob. Code Ann. § 868 is very similar to the one in Tex. Prop. Code § 142.005. However, for practical reasons, the *Aguilar* result may not hold with an 867 Trust.

It is a longstanding rule (albeit a rule found only in case law until 1993) in Texas that guardians should not make distributions for support of a minor ward if the ward's parents can support the child. See *Tharp v. Blackwell*, 570 S.W.2d 154, 159 (Tex. Civ. App. -- Texarkana 1978, no writ), and the cases therein cited. Since 867 Trusts are outgrowths of guardianship proceedings and are essentially an alternative means of managing guardianship assets, it is hard to believe that a trust requiring consideration of parents' ability to support the trust beneficiary would be held to contravene the statute. Also, if the 867 Trust was established in a statutory probate court, it is likely that the judge will be familiar with the *Tharp* rule and will be supportive of a trustee's desire to withhold support payments in cases where the parents are able to support the minor child. Since 867 Trusts are subject to the continuing jurisdiction of the probate court, an application for instructions regarding withholding such payments should quickly clear up the issue for the trustee.

If the trust instrument merely *permits* the trustee to consider other sources of support in deciding whether to make distributions, or if the trust instrument is silent regarding other sources of support and the trustee considers such sources in exercising its fiduciary duties under the mandatory health, education, maintenance and support standard, then the *Aguilar* rationale clearly seems inapplicable – the court is not limiting the mandatory powers given to the trustee by Tex. Prob. Code Ann. § 868. Thus, the trustee probably is justified (and may in fact breach fiduciary duties owed to the trust beneficiary if the trustee fails to do so) in withholding distributions that can be paid, *and in fact are paid*, by the parents pursuant to their support obligations.

What can a trustee do if it withholds distributions because of the parents' support obligation and the parents refuse or fail to make the corresponding payments? The trustee can file an application for instructions with the probate court and follow the court's instructions regarding what to do.

If the trust instrument provides that the trustee of an 867 Trust is not required to consider (or is prohibited from considering) other sources of support available to the trust beneficiary in determining whether or not to make distributions, can the trustee (i) ignore the parents' ability to support the trust beneficiary, (ii) make support distributions from the trust and (iii) still avoid liability? It seems highly unlikely that a statutory probate judge would approve such a trust, but if he or she did (of if another court exercising probate jurisdiction approved such a trust), then this may be the best way (from the trustee's perspective) to simplify trust administration and protect the trustee from liability -- the trustee simply follows the trust instrument and makes the support distributions without considering other possible sources of support.

Note that Tex. Prob. Code Ann. § 777 and *Tharp v. Blackwell*, 570 S.W.2d 154, 159 (Tex. Civ. App. -- Texarkana 1978, no writ) both address the situation where the *parent* is the guardian (although Section 777 applies when the parent is the guardian *of the person* and *Tharp* applies where the parent is the guardian *of the estate*). Obviously, in the case of an 867 Trust, a corporate fiduciary, not the parent, will be trustee, although one or both parents may be the guardian of the person of the trust beneficiary. Even though Section 777 only specifically applies in cases where the parent is the guardian of the person, it is the author's experience that, regardless of who the guardian of the person is, the probate court will not approve distributions by a guardian of the estate for a minor child with a parent absent some evidence of the parent's inability to support the child.

4.2.10. Duties And Liabilities of Guardian And Attorney Ad Litem. An 867 Trust can be created only if a guardian or an attorney ad litem applies for its creation. What duties do guardians and attorneys ad litem owe to wards with respect to creation of 867 Trusts?

A guardian clearly is a fiduciary of the ward and owes the ward the same duties that other fiduciaries owe, including the duty of loyalty. Similarly, an attorney ad litem probably is a fiduciary and owes the ward similar duties. See *Byrd v. Woodruff*, 891 S.W.2d 689 (Tex. App. -- Dallas 1994, writ denied). Therefore, the duties owed and the matters to be considered by guardians and attorneys ad litem are similar to those discussed above with respect to next friends and guardians ad litem in connection with creation of 142 Trusts.

Tex. Prob. Code Ann. § 872 provides that neither the guardian of person or the estate of the ward nor the surety on the guardian's bond is liable for an act or omission of the trustee. This statute does not protect the guardian for actions taken or not taken in connection with creation of the 867 Trust.

Tex. Prob. Code Ann. § 646 provides that, in a proceeding for the appointment of a guardian, an attorney ad litem shall be appointed to represent the interests of the proposed ward. The attorney ad litem must interview the proposed ward before the hearing and, to the greatest extent possible, discuss with the proposed ward the law and facts of the case, the proposed ward's legal options regarding disposition of the case, and the grounds on which the guardianship is sought. Tex. Prob. Code Ann. § 647. None of this directly applies to creation of an 867 Trust.

To be safe, should the attorney ad litem ask for the creation of an 867 Trust in every case where a guardianship of the estate is sought? After all, there is always a corporate fiduciary where there is an 867 Trust, and the ultimate decision regarding creation of the trust falls upon the court. Why not ask for creation of an 867 Trust in every case and let the court decide? The fear that this might happen prevented the 1995 amendments from including a provision allowing an attorney ad litem to apply for creation of an 867 Trust. Hopefully, attorneys ad litem will exercise good judgment and ask for 867 Trusts only when appropriate.

4.2.11. Potential Liability of Trustee For Administering Nonstandard 867 Trusts. As with nonstandard 142 Trusts, trustees should be careful when administering an 867 Trust which ventures far from the statutory norm. Trustees should seek instructions from the court pursuant to Tex. Prop. Code § 115.001 to avoid liability. Additional comfort can be gained from new subsection (e) of Section 868, discussed above, which expressly permits courts to include additional terms in the trust upon a determination that they additional terms are not in conflict with the mandatory provisions of Section 868.

4.3. Drafting 867 Trusts. The drafting considerations for 867 Trusts are similar to those for 142 Trusts. There remains the friction between closely following the statute and drafting creatively to meet the needs of the trustee, the ward and the guardian.

One difference between drafting 867 Trusts and 142 Trusts is that the court is likely to be more familiar with the statutory requirements in the case of 867 Trusts, especially in counties with statutory probate judges. Statutory probate judges have occasion to be very familiar with guardianships generally and are more likely to have their own opinions about straying too far from the statutory requirements for 867 Trusts. They also are necessarily more involved with the ongoing administration of 867 Trusts since they must approve annual accountings and trustee's fees.

Attached are the following basic forms which may be useful in drafting 867 Trusts:

- * ☐ Combined Application for Guardianship and Creation of 867 Trust Where No Guardianship Exists, Appendix K, Page 59
- * ☐ Attorney Ad Litem's Application to Create 867 Trust Where No Guardianship Exists, Appendix L, Page 62
- * ☐ Order Creating 867 Trust Where No Guardianship Exists, Appendix M, Page 64
- * ☐ Application to Create 867 Trust From Existing Guardianship, Appendix N, Page 66
- * ☐ Order Creating 867 Trust From Existing Guardianship, Appendix O, Page 68
- * ☐ Form of 867 Trust, Appendix P, Page 70

Another excellent source of forms for 867 Trusts and the pleadings related thereto is Bernard Jones, *Estate Planning for Incapacitated Individuals*, 33 Real Estate, Probate & Trust Law Reporter, No. 4, at p. 54 (July 1995).

5. MEDICAID (D)(4)(A) SUPPLEMENTAL NEEDS TRUSTS

In Texas, an individual whose resources or income exceed certain limits cannot qualify for Medicaid benefits. A detailed discussion of the resource and income limits is beyond the scope of this paper. There are certain resources, or assets, which do not count toward the resource limit for Medicaid eligibility purposes. For example, in most cases an individual's homestead does not count as a resource.

The general rule is that any trust created with an individual's own assets will count against the resource limit for that individual for Medicaid purposes. However, the Omnibus Budget Reconciliation Act of 1993 ("OBRA 93") recognized three types of trusts which could be established with an individual's own assets which would not be deemed available for purposes of determining Medicaid eligibility. These are: (1) trusts for disabled persons under age 65 established pursuant to 42 U.S.C. § 1396p(d)(4)(A), commonly called (d)(4)(A) trusts or supplemental needs trusts; (2) trusts designed to capture excess income established pursuant to 42 U.S.C. § 1396p(d)(4)(B), commonly called Miller Trusts; and (3) trusts established by a non-profit corporation pursuant to 42 U.S.C. § 1396p(d)(4)(C).⁶

Of these three types of trusts, the one which typically involves issues of court creation is the (d)(4)(A) trust or supplemental needs trust. For an excellent discussion of supplemental needs trusts generally, see Clifton B. Kruse, Jr., *Medicaid Trusts: Estate Planning Using Non-Medicaid Disqualifying Self-Settled and Third Party Created Trusts*, 19th Annual Advanced Estate Planning and Probate Course, State Bar of Texas, June 1995. For a detailed discussion of eligibility issues in Texas generally and (d)(4)(A) trusts in particular, see H. Clyde Farrell, *Financing Long-Term Care in Texas*, published by the Texas Chapter of the National Association of Elder Law Attorneys.⁷ This paper will focus on the issues associated with supplemental needs trusts which are unique to Texas in light of our statutory scheme for court-created trusts.

5.1. Statutory Requirements. OBRA 93 provides that the following type of trust shall not be deemed available (in other words, count against the resource limit) for Medicaid eligibility purposes:

A trust containing the assets of an individual under age 65 who is disabled (as defined in section 1614(a)(3)) [42 U. S. C. § 1382c(a)(3)] and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this title.

42 U.S.C. § 1396p(d)(4)(A).

Thus, there are five statutory requirements for a (d)(4)(A) trust: (1) the trust must contain the assets of an individual; (2) the individual must be under age 65 when the trust is created; (3) the individual must be disabled; (4) the trust must be established by a parent, grandparent, legal guardian or court; and (5) the trust must provide for repayment of the state upon termination.

Note that (d)(4)(A) does not require supplemental needs language. A (d)(4)(A) trust may contain any distribution standard under which the trustee may *not* be compelled to provide the beneficiary's support needs (*i.e.*, food, clothing, shelter or cash).⁸ This may be accomplished either by giving the trustee absolute discretion to make distributions for the benefit of the beneficiary, or by limiting distributions to supplemental needs (defined, generally, as distributions supplementing but not supplanting public benefits). If the trust requires furnishing of food, clothing and shelter of the beneficiary, or cash distributions to the beneficiary, the Social Security Administration⁹ may count the corpus of the trust as a resource, thus denying eligibility until the corpus is less than \$2,000.¹⁰ Thus, drafters routinely include supplemental needs or absolute discretion distribution standards in (d)(4)(A) trusts so that trust funds may be used for luxuries while SSI and Medicaid pay for basic services.¹¹ See Clifton B. Kruse, Jr., *Medicaid Trusts: Estate Planning Using Non-Medicaid Disqualifying Self-Settled and Third Party Created Trusts*, 19th Annual Advanced Estate Planning and Probate Course, State Bar of Texas, p. K-4, June 1995.

5.1.1. Assets of an Individual. A (d)(4)(A) trust is a trust established with assets of the individual applying for Medicaid. Thus, any property of the individual, whether it originated from earnings, savings, inheritance or otherwise, may be used to fund a (d)(4)(A) trust. One common use of (d)(4)(A) trusts is to hold property received by judgment or in settlement of a personal injury claim or other legal claim on behalf of the individual.

There are different, more lenient rules, for trusts benefitting a Medicaid-eligible person which are created by someone else using someone else's property. For example, parents can establish supplemental needs trusts for their children using the parents' funds without providing for state reimbursement. This type of supplemental needs trust is not within the scope of this paper. Practitioners should be careful not to discourage outright devises or other Medicaid-disqualifying devises to Medicaid-eligible persons. Also, practitioners should not plan on using disclaimers as a way to prevent disqualifying assets from passing to a Medicaid-eligible person. OBRA 93 defines assets to include property that would have been received by the individual but for a disclaimer. 42 U.S.C. § 1396p(e)(1). While there is some debate on this point, most commentators appear to believe that a disclaimer will be treated as a transfer without consideration, which will create a penalty period and, if a Medicaid application is filed within the penalty period, possible criminal liability.¹²

5.1.2. Under Age 65. The individual must be under age 65 when the trust is established.

5.1.3. Disabled. Only persons who are disabled for purposes of the Social Security Act may benefit from creation of one of these trusts. An individual is considered disabled for these purposes if he or she:

is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months (or, in the case of a child under the age of 18, if he suffers from any medically determinable physical or mental impairment of comparable severity).

42 U. S. C. § 1382c(3)(A).

Note that this is a very different definition than the definitions of incapacity in Tex. Prop. Code § 142.007 and Tex. Prob. Code Ann. § 601. It should be much easier to reach this definition of disability than to reach the Probate Code's or Property Code's definition of incapacitated person for purposes of creating a guardianship, 867 Trust or 142 Trust. It is easy to imagine a situation where a (d)(4)(A) trust is called for but the statutory requirements for a 142 Trust or an 867 Trust cannot be met.

5.1.4. Established by a Parent, Grandparent, Legal Guardian or Court. The trust must be established by a parent, grandparent, legal guardian or the court. Noticeably absent from this list of persons who may create a (d)(4)(A) trust is the individual himself or herself. Presumably, since the individual must be disabled to qualify, Congress assumed that he or she would not be able to create the trust. This is not a serious problem, so long as a parent or grandparent is surviving, since the trust may be established by the parent or grandparent and the disabled person can transfer his or her property into the trust. Estate planners can make it easier to establish supplemental needs trusts in the future if they routinely include a provision in durable powers of attorney which expressly authorize the agent to transfer funds into a supplemental needs trust created by a court or third party.

Of course, the disabled person does not always have the capacity to transfer assets into the trust, nor has he or she always properly appointed an agent to transfer the assets under a power of attorney. In an attempt to get around the problems of court-created (d)(4)(A) trusts (discussed below), many practitioners have sought and obtained court-ordered transfers of funds into trusts established by a parent or grandparent. While this gets around the questionable authority of a court to create a trust with the required (d)(4)(A) provisions, but it does not address where the court gets the authority to transfer the disabled person's property into a trust created by the parent or grandparent. Presumably, the court is exercising its general equitable powers when ordering such a transfer.

5.1.5. State Repayment. In order for the trust to qualify, the trust instrument must provide that the State will receive all amounts remaining in the trust upon the death of such individual up to an amount of Medicaid benefits the individual received. This is why a (d)(4)(A) trust works as a supplemental needs trust but not as a family wealth-transfer device. The property left in the trust must go to repay the state for the Medicaid benefits it paid out. However, while the trust is in existence, it can pay for extras – for those lifestyle-enhancing things that go beyond food, clothing and shelter.

5.2. Basis for Creation of Supplemental Needs Trusts in Texas. If the disabled individual has a living parent or grandparent and if the disabled individual either has the mental capacity to transfer his or her property or has appointed an agent with authority to transfer his or her property, then clearly the best way to establish a (d)(4)(A) trust is for the parent or grandparent to establish the trust and for the disabled individual or his or her agent to transfer the desired property into the trust. This assures the greatest flexibility in the terms of the trust and least involvement of courts and other third parties in the process.

Of course, it is not always possible for the disabled person or his or her family to establish the trust in this way. If the disabled person is incapacitated and has not appointed an agent prior to incapacity, another means of getting the property into the trust must be found. Here are four possible ways, all of which have been used in Texas:

5.2.1. 142 Trust. One way to create a (d)(4)(A) trust is to ask a court to create a 142 Trust with special provisions intended to meet the Medicaid requirements. The principal special provisions which must be included are: (1) a different distribution standard that permits distributions only for supplemental needs; and (2) a different trust termination provision so that the State is repaid for Medicaid expenses.

Prior to the enactment of SB 912 in 1997, an apparent conflict existed between Tex. Prop. Code § 142.005 and (d)(4)(A). This resulted in much consternation and nail-biting by attorneys, but in the end many courts created (d)(4)(A) trusts under Tex. Prop. Code § 142.005, modifying the trust to meet the supplemental needs requirements.

SB 912, effective September 1, 1997, eliminates the concern that 142 Trusts cannot be modified to be supplemental needs trusts. New subsection (e) of Section 142.005 permits the court create trusts containing provisions determined

by the court to be necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A) upon a finding by the court that such provisions are in the best interests of the trust beneficiary.

One drawback that remains in using a 142 Trust as a (d)(4)(A) trust is that a lawsuit is required for trust creation. This is not a problem if the assets for the supplemental needs trust are coming from a personal injury or other settlement, but it may be a problem if other assets of the disabled person are to be used.

5.2.2. 867 Trust. Another way to create a supplemental needs trust in Texas is to apply for creation of a guardianship (or use an existing guardianship) and ask the probate court to create an 867 Trust with special Medicaid provisions. Again, the principal provisions to be included are a different distribution standard (a supplemental needs standard) and a different dispositive plan on death.

As with 142 Trusts, 1997 legislative changes make it clear that an 867 Trust can be used to create a supplemental needs trusts if the court finds that this is in the best interests of the ward/beneficiary.

5.2.3. Parent-Created Trust/Court-Authorized Transfer. Another solution is to have a parent or grandparent establish a trust and to have a court order the transfer of property into the trust. This gets around the potential problem caused by I.R.C. § 468B discussed below. However, it assumes that a court has the authority to (and is willing to) order the transfer of one person's property into a trust established by another person. As a practical matter, this may work, since in virtually every case all parties will agree to the transfer.

5.2.4. Court-Created Trust Without Reference to Sections 142.005 or 867. Prior to the enactment of SB 912 and HB 1314, some Texas courts created supplemental needs trusts by referring to the federal statute and not mentioning Tex. Prop. Code § 142.005 or Tex. Prob. Code Ann. § 867, either using its general equitable powers to create a trust or based on the theory that OBRA 93 pre-empted Texas law regarding court-created trusts to the extent they are inconsistent with OBRA 93.

Happily, now that there are two ways to establish supplemental needs trusts under the Texas statutes, courts may rely on a statutorily-authorized trust (either a 142 Trust or an 867 Trust) when creating (d)(4)(A) supplemental needs trusts and need no longer rely on equitable or pre-emption theories.

5.3. Drafting Supplemental Needs Trusts. Courts were willing to create (d)(4)(A) trusts in the appropriate cases without clear authority to do so in Texas statutes. Now that the statutes governing 142 Trusts and 867 Trusts both expressly permit supplemental needs trusts, there appears no impediment to drafting trusts to meet the (d)(4)(A) requirements and seeking their creation under Tex. Prop. Code § 142.005 or Tex. Prob. Code Ann. § 867 as appropriate.

In August, 1996, Congress passed and President Clinton signed the Health Insurance Portability and Accountability Act of 1996 (H. R. 3103, Public Law 104-191, became law August 21, 1996). This act criminalizes transfers of assets for Medicaid purposes. It imposes fines of up to \$10,000 and jail sentences of up to one year for a person who knowingly and willfully disposes of assets (including by any transfer in trust) in order for an individual to become eligible for . . . [Medicaid]. . . if disposing of the assets results in the imposition of a period of ineligibility for such assistance under section 1917(c). It seems clear that this statute is directed at covert transfers of assets, not overt ones such as a (d)(4)(A) trust. If properly done, a transfer of assets to a (d)(4)(A) trust does not result in a period of ineligibility for Medicaid. However, a transfer to a defective (d)(4)(A) trust may create a problem, since the transfer would be a knowing and willful disposition of assets in order to become eligible for Medicaid and since, because of the defective nature of the trust, the transfer may result in the imposition of a period of Medicaid ineligibility. For this reason, it may be prudent to include a savings clause in all trusts intended to be (d)(4)(A) trusts similar to the following: In creating this trust, the parties hereto do not intend to violate any provisions of federal or state law, including but not limited to the Health Insurance Portability and Accountability Act of 1996, and this trust shall be construed and, if necessary, reformed accordingly.

There are optional provisions for supplemental needs trusts in most of the forms attached as appendices to this paper. Other good sources of forms are H. Clyde Farrell, *Financing Long-Term Care in Texas*, published by the Texas Chapter of the National Association of Elder Law Attorneys, and Clifton B. Kruse, Jr., *Medicaid Trusts: Estate Planning Using Non-Medicaid Disqualifying Self-Settled and Third Party Created Trusts*, 19th Annual Advanced Estate Planning and Probate Course, State Bar of Texas, June 1995.

The requirements of (d)(4)(A), including the government reimbursement on termination requirement, apply to trusts which are created with the beneficiary's own money. If a parent or other family member wishes to create a trust

benefitting someone who also receives SSI and/or Medicaid, and if the family member does not wish for the trust to disqualify the beneficiary from such government assistance, he or she can set up a supplemental needs trust for the benefit of such person by trust agreement or by will. This type of supplemental needs trust must contain a distribution standard similar to (d)(4)(A) trusts making it clear that the beneficiary is not entitled to receive distributions for food, clothing, shelter or cash but it is not required to include a provision providing for the reimbursement of the government upon termination. Given this flexibility, it obviously is a good idea to deal with property passing to or for the benefit of a Medicaid recipient **before the Medicaid recipient actually has a right to the property**. Parents of disabled children and children with parents confined to nursing homes should be counseled not to make outright distributions to, or distributions in trust subject to a health, education, maintenance and support standard for the benefit of, such persons without first considering creation of a supplemental needs trust. It is very easy to confuse the (d)(4)(A) variety of supplemental needs trusts (trusts created with the beneficiary's own money) with the third party variety of supplemental needs trusts (trusts created with a third party's money), but there are important distinctions between the two. An example of an inter vivos supplemental needs trust created by a third party is attached as Appendix Q on page 73.

6. TAXATION OF COURT-CREATED TRUSTS

6.1. Taxation as Grantor Trust. In virtually every case, the trustee of a court-created trust should seek to have it taxed for income tax purposes as a grantor trust under Internal Revenue Code §§ 671-679. This avoids the problem caused by the truncated tax brackets applicable to complex trusts. It also may help to avoid the potential problem caused by Internal Revenue Code § 468B described below.

In the typical case, if the beneficiary of the court-created trust can be considered the grantor, the trust will be taxed as a grantor trust, since the income from the trust may be distributed to the grantor or held or accumulated for future distribution to the grantor without the consent of an adverse party. Internal Revenue Code §§ 672(a) and 677(a).

A 1983 revenue ruling directly addresses lawsuit settlement trusts like 142 Trusts. In Rev. Rul. 83-25, 1983-1 C. B. 116, a minor's damage award in a personal injury suit was placed into a court-created trust with a corporate trustee. The trustee had discretion to make distributions for the minor's health, education, maintenance and support. If the minor died before age 21, the trust corpus was paid to his estate. If the beneficiary lived until age 21, he was to receive the property remaining in the trust. The Internal Revenue Service concluded that the beneficiary of the trust was the owner/grantor of the trust for grantor trust purposes. *See also* PLR 8942083.

The Internal Revenue Service also has given grantor trust status to a guardianship-type trust similar to an 867 Trust. *See* PLRs 9502019, 9502024, 9502029 and 9502031 (all of which cite Rev. Rul. 83-25 with approval).

If the person creating and funding the trust are the same, then it is easy to identify that person as the grantor for purposes of the grantor trust rules. This clearly is the case with an 867 Trust, where the beneficiary's court-appointed legal representative caused the trust to be created and funded. Even if the trust is created by a third party, as in the case of a parent or grandparent creating a (d)(4)(A) supplemental needs trust, the trust still may be a grantor trust with respect to the beneficiary if virtually all of the property placed in the trust is the beneficiary's. *See Bixby v. Comr.*, 58 T. C. 757 (1972) *acq.*, 1975-2 C. B. 1, and *Whiteley v. Comr.*, 42 B. T. A. 402 (1940), *aff'd* 120 F. 2d 782 (3rd Cir. 1941), *cert. denied*, 314 U. S. 657 (1941).

While the author is aware of trustees who have treated 142 Trusts as complex trusts in the past, he is unaware of any case where a trustee of a 142 Trust has sought grantor trust treatment and been denied it.

6.2. I. R. C. § 468B Qualified Settlement Funds. A recent blip on the radar screen in the court-created trust area is Internal Revenue Code § 468B. This section, and the regulations promulgated thereunder, provide a punitive tax scheme for trusts and trust beneficiaries that fall within its provisions.

6.2.1. Historical Background. Section 468B relates to the deductibility of liabilities by accrual-basis taxpayers. Historically, an accrual basis taxpayer was able to deduct a liability to be paid in the future if all events had occurred that establish the fact of a liability and if the amount of the liability could be determined with reasonable accuracy. In 1984, Congress, concerned that a current deduction was available for future payments, enacted Internal Revenue Code § 461(h), which imposed the additional requirement that economic performance (in general terms, actual payment or delivery of the amount due to the person entitled to receive it) must occur before an accrual-basis taxpayer may deduct the liability. This called into question the deductibility of a court-ordered settlement payment into a trust or other deferred arrangement, since the person entitled to receive the liability may not receive the payment in the year in which the accrual-basis taxpayer makes the payment. Understandably, the

accrual-basis taxpayer wants to be able to deduct the payment into a settlement trust or other arrangement in the year it makes the payment rather than in the year the trustee chooses to distribute the payment to the trust beneficiary. To further complicate matters, sometimes the accrual-basis taxpayer paid money into a settlement fund whose beneficiaries had not yet been ascertained, as might be the case where a class action lawsuit settles before class members have come forward to share in the proceeds. This gave rise to the so-called homeless income problem, where no one was taxable on the income of the fund until it was actually distributed. Rev. Rul. 71-119, 1974 CB 163.

6.2.2. Statute. To address the settlement fund issue, Congress adopted I. R. C. § 468B in 1986. Under this statute, a designated settlement fund (DSF) may be established. The general scheme is this: Accrual-basis taxpayers are entitled to a current deduction for payments into a DSF, but the tradeoff is that the DSF is taxed on all of its modified gross income at the highest marginal rate applicable to trusts (currently 39.4%). This addresses both the deductibility of the payment by the accrual-basis taxpayer and the homeless income problem, although it resolves the homeless income problem in a punitive manner by not permitting a run-up through the brackets before reaching the highest marginal rate.

6.2.3. Regulations. Under I. R. C. § 468B, DSF status was elective, not mandatory. Therefore, unless DSF status was elected, the homeless income problem still could exist. Congress clearly intended to eliminate the homeless income problem when it adopted § 468B(g):

Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

The Internal Revenue Service utilized this rulemaking authority to adopt Reg. § 1.468B-1, which introduced a concept not found in the statute, a qualified settlement fund (QSF). Unlike DSFs, which are elective, QSFs are mandatory and automatic. A QSF exists if: (1) the fund, account or trust is established by court order or other governmental authority and is subject to the continuing jurisdiction of that court or authority; (2) the fund, account or trust is established to resolve or satisfy one or more contested or uncontested claims arising under the Comprehensive Environmental Response, Compensation and Liability Act of 1990 (CERCLA) or arising out of a tort, breach of contract or violation of law; and (3) the fund, account or trust is a trust under applicable state law or its assets are otherwise segregated from other assets of the transferor (defendant) and related persons.

It seems clear from the historical perspective that I. R. C. § 468B's taxation of settlement funds was intended to catch the multi-beneficiary homeless income problem and was not intended to catch 142 Trusts, where the beneficiary is identifiable at the time the payment is made and the grantor trust rules operate to provide a fair and effective means of taxation. I. R. C. § 468B(g) even mentions grantor trust treatment as an acceptable means to assure that a settlement trust is subject to current income taxation. All of the private letter rulings to date where QSFs are recognized involve class actions or other multi-party litigation where the homeless income problem might otherwise exist. See PLRs 9416032, 9340055, 9338032, 9317006 and 9309030.

However, on its face the typical 142 Trust would seem to run afoul of Reg. § 1.468B-1: (1) it is established by court order and is subject to the court's continuing jurisdiction; (2) it usually is established to satisfy claims arising out of a tort, breach of contract or violation of law; and (3) it is either a trust under Texas law (*but see* Are 142 Trusts Subject to the Texas Trust Code? on page 15 above) or is segregated from the defendant's other assets.

Rev. Rul. 83-25, 1983-1 C. B. 116, which expressly provides for grantor trust treatment of court-created trusts like 142 Trusts, has not been superseded or withdrawn. In fact, it was recently cited with approval in private letter rulings. See PLRs 9502019, 9502024, 9502029 and 9502031. However, no private letter rulings have been issued reiterating Rev. Rul. 83-25's applicability to 142-type trusts since the adoption of Reg. § 1.468B-1.

How does the trustee or beneficiary know if it is dealing with a DSF or QSF? It is easy to determine if the trust is a DSF because an election of DSF treatment must be filed with the Internal Revenue Service. QSFs, on the other hand, purportedly exist automatically if the conditions to their creation exist, so the trustee and beneficiary may not know. The transferor (defendant) is required to notify the trustee no later than February 15 of the year following each calendar year in which the transferor (or an insurer or other person on behalf of the transferor) makes a transfer to the trust. Reg. § 1.468B-3(e). However, the transferor's failure to give the notice does not appear to keep the QSF from existing.

The new punitive rules apply to any DSF or QSF established after 1992. For pre-1992 DSFs and QSFs, transitional rules apply through 1995. All DSFs and QSFs must follow the new rules beginning in 1996. Reg. § 1.468B-5.

A discussion of the mechanics of taxation of DSFs and QSFs is beyond the scope of this paper. For an excellent discussion of this topic, see Theodore B. Atlass, *Income Tax Consequences of Designated and Qualified Settlement Funds*, 1995 ACTEC Annual Meeting. It is sufficient for purposes of this paper to say that, from the perspective of trustees and beneficiaries of court-created trusts, QSF status should be avoided if at all possible.

6.2.4. Avoiding QSF Status. Consider the following to avoid QSF status:

A. Use a Guardianship And/or 867 Trust. If the settlement proceeds are transferred to the plaintiff/beneficiary (or to the guardian of his or her estate), the beneficiary (or his or her guardian) may then create an 867 Trust with the beneficiary's own funds and not with settlement proceeds transferred directly to the trust by the transferor/defendant. This would appear to fall outside of the second requirement for a QSF -- that the trust be established to satisfy claims arising out of a tort, breach of contract or violation of law.

B. Use a Trust Created by a Relative or Other Third Party. As discussed above, many practitioners are utilizing (d)(4)(A) supplemental needs trusts in which a parent or grandparent establishes the trust and the beneficiary's property is transferred into the trust, whether by court order or otherwise. This method may fall outside of the first QSF requirement -- that the trust be established or approved by a court and be subject to the court's continuing jurisdiction.

C. Rely on Rev. Rul. 83-25. Rev. Rul. 83-25, which seems to require grantor trust treatment of 142 Trusts, has not been superseded or withdrawn. Trustees may choose to continue to administer 142 Trusts in reliance on Rev. Rul. 83-25 until otherwise notified by the Internal Revenue Service, or the trustee or a guardian ad litem considering a new 142 Trust may seek a private letter ruling on the subject.

7. CONCLUSION

Court-created trusts are increasingly common in Texas. The 1997 changes to Tex. Prop. Code § 142.005 and Tex. Prob. Code Ann. § 867 *et seq.* should make court-created trusts easier and more flexible to use.

[illegible]

2. The Arc of Texas has a Master Pooled Trust which appears to qualify under 42 U. S. C. §1396p(d)(4)(C). As of January 20, 1998, the pooled trust had approximately 15 account-holders. At least as of January 20, 1998, the probate court has permitted a guardian to invest probate court has permitted a guardian to invest probate court has permitted a guardian to invest although apparently it did not rely on Tex. Prob. Code Ann. §867 *et seq.* to do so.

(1) The section (1) The section refers to a ward, which is defined in Section 601(31) to mean a person who has been appointed guardian ***has been appointed.*** [author's emphasis] However [author's emphasis] How include include a proposed ward since the section permits include a proposed ward since the section permits a trust at any time after the attorney's appointment construing trust at any time after the attorney's appointment mean only a person who already has a guardian would make the at any time phrase meaningless.

(2)(2) The section refers to guardianship funds (2) The section refers to guardianship funds and assets of the guardian areare no guardiansare no guardianship fuare no guardianship funds or assets unless there is a guardianship. However, defineddefined in Section 601 of the Probate Code;the defined term having to dodefined in Section 601 of the Probate Code; is guardianship estate. Asis guardianship estate. As used in Section 867, guardianship funds and guardianship assets are reasonablyreasonably construed asreasonably construed as assets related to a guardianship proceeding, which includes any Chapter XIII (including a proceeding to create an 867 Trust). *See* Tex. Prob. Code Ann. §601.

5. If the outright prohibition of the power to contract is inappropriate, then perhaps the ward/beneficiary does not have the power to enter into a contract for the purchase of goods or services exceeding a certain amount, e.g., \$500.00.

6. This paper does not discuss (d)(4)(B) Miller Trusts or (d)(4)(C) trusts. However, Ann. §867 *et seq.* appears to be the best statutory basis for creation of these types of trusts if no other authority is required. The 1997 amendment to Tex. Prop. Code §142.005(g) is limited to (d)(4)(A) trusts, and the 1997 change to Tex. Prob. Code Ann. §868(d) requires that the trust be created by a state or federal program without referring specifically to (d)(4)(A). The 1997 change to Tex. Prob. Code Ann. §868(d) also states that the trust must be a Trust which apparently is intended to qualify as a (d)(4)(C) Trust. The age-65 limitation on (d)(4)(A) trusts, but that is far from clear.

8. It is true that (d)(4)(A) has no requirement regarding distribution standards, but as it is true that (d)(4)(A) has no requirement that a trustee be under-65, under-65 Medicaid recipients must have SSI to receive Medicaid. For many years, the Supreme Court's Security policy have held that if a trustee can be a trustee, the whole corpus is available and the beneficiary is disqualified. Thus, the whole corpus is available and the beneficiary is disqualified.

in one of these trusts could preclude SSI eligibility and thereby disqualify one of these trusts could preclude SSI eligibility and Medicaid as well.

9. The Social Security Administration determines eligibility for SSI benefits automatically, under current practice, with no substantive part of the Services (DHS). Because of the under-65 requirement, the vast majority are SSI beneficiaries. DHS makes the determination regarding effectiveness of the trust in the minority of (d)(4)(A) cases involving Medical Assistance Only (MAO) benefits, either community waiver (home care) programs.

10. ByBy this mechanism, the agency in effect requires payments from the trustee of a support trust, but it does this by denying eligibility, not by demanding the trustee to make payments.

11. Clifton Kruse argues in some of his articles that supplemental discretion language, is safer in SSI cases because some state courts have construed discretion language to allow the beneficiary to prefer the absolute discretion language because it eliminates the need to make distributions that disqualify the beneficiary for public benefits, if that is to make distributions that disqualify the beneficiary's interests. Farrell says **he has asked the Social Security Administration to use absolute discretion language in the last couple of years and has been told that this language is fine.**

12. This issue is particularly complex. For example, there is no SSI, nor for the community care program, but tSSI, nor for the community based alternatives program. A detailed analysis of this subject is beyond the scope of this paper. Anyone considering the use of research this entire subject thoroughly before proceeding.

APPENDIX A -- Comparison of 142 Trusts, 867 Trusts and Guardianships

#		<i>142 Trust</i>	<i>867 Trust</i>	<i>Guardianship/ Estate</i>
1.	Can be created if lawsuit is pending	Yes	Yes	Yes
2.	Can be created if lawsuit is not pending	No	Yes	Yes
3.	Can be created if a guardianship is pending	No (except possibly for incapacitated persons -- <i>see</i> p. 9)	Yes	Yes
4.	Can be funded with litigation proceeds	Yes	Yes	Yes
5.	Can be funded with property other than litigation proceeds	No	Yes	Yes
6.	Can be requested by guardian ad litem or next friend	Yes	No	Yes
7.	Can be requested by guardian	No	Yes	Yes
8.	Can be requested by attorney ad litem	No	Yes	Yes
9.	Can be requested by any interested person or created on court's own initiative	No	No	Yes
10.	Can exist while guardianship is in existence	Yes, if it was created when guardianship did not exist	Yes	n/a
11.	Can exist while guardianship of the estate is not in existence	Yes	Yes, but guardian of the person may be required	No
12.	Tex. Prop. Code § 142.007 definition of incapacitated person applies	Yes	No	No
13.	Tex. Prob. Code Ann. § 601(13) definition of incapacitated person applies	No	Yes	Yes
14.	Physician's certificate regarding incapacity required	No	Yes	Yes
15.	Incapacity must be proven by clear and convincing evidence at a hearing where an attorney ad litem represents the proposed ward/beneficiary	No	Yes	Yes
16.	Corporate trustee/guardian required	Yes	Yes	No
17.	Health, education, maintenance and support distribution standard mandatory	Yes, except for (d)(4)(A) trusts	Yes, except for (d)(4)(A) trusts	No
18.	Trustee/guardian can be ordered not to make support distributions to minors if minor's parents have the ability to support minor	Probably no	Probably yes	Yes
19.	Principal distributions for health, education, maintenance and support authorized without further court order	Yes	Yes	No (<i>see</i> Tex. Prob. Code Ann. § 776)

#		<i>142 Trust</i>	<i>867 Trust</i>	<i>Guardianship/ Estate</i>
20.	Distributions permitted to person whom the ward/beneficiary is legally obligated to support	Probably not	Yes	Yes
21.	Spendthrift provision may protect the estate or trust from the creditors of the ward/beneficiary	Maybe	Maybe	No, but ward may not have the power to contract
22.	Trust-type investments (securities, etc.) permitted without prior court approval	Yes	Yes	No
23.	Investments limited to Tex. Prob. Code Ann. §855-approved investments (U. S. bonds, FDIC-insured accounts, etc.) without prior court approval	No	No	Yes
24.	Trustee/guardian may make tax-motivated gifts	No	Yes, with the help of a guardian and with court approval	Yes, with court approval
25.	Must terminate when minor ward/beneficiary attains age 18 (if minority is his or her only incapacity)	No	No	Yes
26.	Terminates when minor ward/beneficiary attains age 18 unless extended by court order (not to exceed age 25)	No	Yes	No
27.	Terminates when minor ward/beneficiary attains age 25 unless shortened by the terms of the trust	Yes	No	No
28.	Terminating distributions may be made to someone other than the ward/beneficiary or the ward/beneficiary's estate	No, except for (d)(4)(A) trusts	Yes	No
29.	Trustee compensation based on Tex. Prob. Code Ann. § 665 (5% of income plus 5% of disbursements)	No	Yes	Yes
30.	Annual application and approval of trustee compensation required	No	Yes	Yes
31.	Filing and approval of annual account required	No	Yes	Yes
32.	Filing and approval of final account required	No	Yes	Yes
33.	Guardianship-style accountings required	No	Yes	Yes
34.	Bank-trust-department-style accountings permitted	Yes	No	No
35.	Trustee/guardian has powers of trustee under the Texas Trust Code	Probably	Yes	No
36.	Texas Trust Code applies (to the extent not in conflict)	Maybe (<i>see</i> p. 15)	Yes	No
37.	Court creating trust/guardianship may modify or terminate trust/guardianship	Yes	Yes	Yes

#		<i>142 Trust</i>	<i>867 Trust</i>	<i>Guardianship/ Estate</i>
38.	Court creating trust/guardianship may remove trustee/guardian	District court and statutory probate court: Yes; county court: Maybe (<i>see p. 16</i>)	Yes	Yes
39.	Court creating trust/guardianship may hold trustee/guardian liable for breach of fiduciary duty	District court and statutory probate court: Yes; county court: Maybe (<i>see p. 16</i>)	Yes	Yes
40.	Court creating trust/guardianship may hear trustee/guardian's motion for instructions	District court and statutory probate court: Yes; county court: Maybe (<i>see p. 16</i>)	Yes	Yes
41.	Can be used as a (d)(4)(A) Medicaid supplemental needs trust	Yes	Yes	No
42.	Can be used as a (d)(4)(B) Miller Trust	Probably No	Yes	No
43.	Can be used as a (d)(4)(C) nonprofit pooled trust	Probably No	Probably Yes	No
44.	Can invest in Texas Tomorrow Fund	Probably Yes, though no specific statutory authority	Yes [§868(f)]	Yes [§856]

APPENDIX B -- Tex. Prob. Code Ann. §§ 867 -- 873**GUARDIANSHIP MANAGEMENT TRUSTS**Reflecting Changes Through the Regular Session, 76th Legislature (1999)Changes made by HB 1314 (effective 9/1/97) are shown as follows: *additions*/[*deletions*]

Sec. 867. CREATION OF MANAGEMENT TRUST. On application by the guardian of a ward or by a ward's attorney ad litem at any time after the date of the attorney's appointment under Section 646 of this code, the court in which the guardianship proceeding is pending may enter an order that creates for the ward's benefit a trust for the management of guardianship funds if the court finds that the creation of the trust is in the ward's best interests. The order shall direct the guardian or another person to deliver all or part of the assets of the guardianship to a trust company or a state or national bank that has trust powers in this state. The order shall include terms, conditions, and limitations placed on the trust. The court shall maintain the trust under the same cause number as the guardianship proceeding.

Sec. 868. TERMS OF MANAGEMENT TRUST.

(a) Except as provided by Subsection (d) of this section, a [A] trust created under Section 867 of this code must provide that:

- (1) the ward is the sole beneficiary of the trust;
- (2) the trustee may disburse an amount of the trust's principal or income as the trustee determines is necessary to expend for the health, education, support, or maintenance of the ward;
- (3) the income of the trust that the trustee does not disburse under Subdivision (2) of this subsection must be added to the principal of the trust;
- (4) the trustee serves without giving a bond; and
- (5) the trustee, on annual application to the court and subject to the court's approval, is entitled to receive reasonable compensation for services that the trustee provided to the ward as the ward's trustee that is:
 - (A) to be paid from the trust's income, principal, or both; and
 - (B) determined in the same manner as compensation of a guardian of an estate under Section 665 of this code.

(b) The trust may provide that a trustee make a distribution, payment, use, or application of trust funds for the health, education, support, or maintenance of the ward or of another person whom the ward is legally obligated to support, as necessary and without the intervention of a guardian or other representative of the ward, to:

- (1) the ward's guardian; [or to]
- (2) a person who has physical custody of the ward [for the health, education, support, or maintenance of the ward] or [of] another person whom the ward is legally obligated to support; or
- (3) a person providing a good or service to the ward or another person whom the ward is legally obligated to support.

[~~(c) The trust may provide that a trustee has the powers of a trustee under Subtitle B, Title 9, Property Code.~~]

(d) When creating or modifying a trust, the court may omit or modify terms required by Subsection (a)(1) or (2) of this section only if the court determines that the omission or modification:

- (1) is necessary and appropriate for the ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the ward; and
- (2) is in the ward's best interests.

(e) The court may include additional provisions in a trust created or modified under this section if the court determines an addition does not conflict with Subsection (a) and, if appropriate, Subsection (d) of this section.

[Subsection (f) was added by SB 112, 76th Texas Legislature, effective May 17, 1999:]

(f) If the trustee determines that it is in the best interest of the ward, the trustee may invest funds of the trust in the Texas tomorrow fund established by Subchapter F, Chapter 54, Education Code.

Sec. 868A. DISCHARGE OF GUARDIAN OF ESTATE AND CONTINUATION OF TRUST. On or at any time after the creation of a trust under this subpart, the court may discharge the guardian of the ward's estate only if a guardian of the ward's person remains and the court determines that the discharge is in the ward's best interests.

Sec. 869. TRUST AMENDMENT, MODIFICATION, OR REVOCATION.

(a) The court may amend, modify, or revoke the trust at any time before the date of the trust's termination.

(b) The ward or guardian of the ward's estate may not revoke the trust.

Sec. 869A. SUCCESSOR TRUSTEE. The court may appoint a corporate fiduciary as successor trustee if the trustee resigns, becomes ineligible, or is removed.

Sec. 869B. APPLICABILITY OF TEXAS TRUST CODE.

(a) A trust created under Section 867 of this code is subject to Subtitle B, Title 9, Property Code.

(b) To the extent of a conflict between Subtitle B, Title 9, Property Code, and a provision of this subpart or of the trust, the provision of the subpart or trust controls.

Sec. 869C. JURISDICTION OVER TRUST MATTERS. A court that creates a trust under Section 867 of this code has the same jurisdiction to hear matters relating to the trust as the court has with respect to the guardianship and other matters covered by this chapter.

Sec. 870. TERMINATION OF TRUST.

(a) If the ward is a minor, the trust terminates:

(1) on the death of the ward or the ward's 18th birthday, whichever is earlier; or

(2) on the date provided by court order which may not be later than the ward's 25th birthday.

(b) If the ward is an incapacitated person other than a minor, the trust terminates on the date the court determines that continuing the trust [a guardianship] is no longer in the ward's best interests [necessary for the ward] or on the death of the ward.

Sec. 871. ANNUAL ACCOUNTING.

(a) The trustee shall prepare and file with the court an annual accounting of transactions in the trust in the same manner and form that is required of a guardian under this chapter.

(b) The trustee shall provide a copy of the annual account to the guardian of the ward's estate or person.

(c) The annual account is subject to court review and approval in the same manner that is required of an annual account prepared by a guardian under this chapter.

Sec. 872. LIABILITY. The guardian of the person or of the estate of the ward or the surety on the bond of the guardian is not liable for an act or omission of the trustee.

Sec. 873. DISTRIBUTION OF TRUST PROPERTY. Unless otherwise provided by the court, the trustee shall:

(1) prepare a final account in the same form and manner that is required of a guardian under Section 749 of this code; and

(2) on court approval, distribute the principal or any undistributed income of the trust:

(A) to the ward when the trust terminates on its own terms;

(B) to the successor trustee on appointment of a successor trustee; or

(C) to the representative of the deceased ward's estate on the ward's death.

APPENDIX C -- Tex. Prop. Code § 142.005
TRUSTS FOR MINORS AND INCAPACITATED PERSONS
Reflecting Changes Through the Regular Session, 76th Legislature (1999)

Changes made by SB 912 (effective 9/1/97) are shown as follows: additions/[deletions]

Sec. 142.005. TRUST FOR PROPERTY

(a) In a suit in which a minor who has no legal guardian or an incapacitated person is represented by a next friend or an appointed guardian ad litem, the court may, on application by the next friend or the guardian ad litem and on a finding that the creation of a trust would be in the best interests of the minor or incapacitated person, enter a decree in the record directing the clerk to deliver any funds accruing to the minor or incapacitated person under the judgment to a trust company or a state or national bank having trust powers in this state.

(b) The decree shall provide for the creation of a trust for the management of the funds for the benefit of the minor or incapacitated person and for terms, conditions, and limitations of the trust, as determined by the court, that are not in conflict with the following mandatory provisions:

(1) the minor or incapacitated person is the sole beneficiary of the trust;

(2) the trustee may disburse amounts of the trust's principal, income, or both as the trustee in his sole discretion determines to be reasonably necessary for the health, education, support, or maintenance of the beneficiary;

(3) the income of the trust not disbursed under Subdivision (2) is added to the principal of the trust;

(4) if the beneficiary is a minor, the trust terminates on the death of the beneficiary, on the beneficiary's attaining an age stated in the trust, or on the 25th birthday of the beneficiary, whichever occurs first, or if the beneficiary is an incapacitated person, the trust terminates on the death of the beneficiary or when the beneficiary regains capacity;

(5) the trustee serves without bond; and

(6) the trustee receives reasonable compensation paid from trust's income, principal, or both on application to and approval of the court.

(c) A trust established under this section may provide that:

(1) distributions of the trust principal before the termination of the trust may be made from time to time as the beneficiary attains designated ages and at designated percentages of the principal; and

(2) distributions, payments, uses, and applications of all trust funds may be made to the legal or natural guardian of the beneficiary or to the person having custody of the beneficiary or may be made directly to or expended for the benefit, support, or maintenance of the beneficiary without the intervention of any legal guardian or other legal representative of the beneficiary.

(d) A trust created under this section may be amended, modified, or revoked by the court at any time before its termination, but is not subject to revocation by the beneficiary or a guardian of the beneficiary's estate. If the trust is revoked by the court before the beneficiary is 18 years old, the court may provide for the management of the trust principal and any undistributed income as authorized by this chapter. **If the trust is revoked by the court after the beneficiary is 18 years old, the trust principal and any undistributed income shall be delivered to the beneficiary after the payment of all proper and necessary expenses.**

(e) On the termination of the trust under its terms or on the death of the beneficiary, the trust principal and any undistributed income shall be paid to the beneficiary or to the representative of the estate of the deceased beneficiary.

(f) A trust established under this section prevails over any other law concerning minors, incapacitated persons, or their property, and the trust continues in force and effect until terminated or revoked, notwithstanding the appointment of a guardian of the estate of the minor or incapacitated person, or the attainment of the age of majority by the minor.

(g) Notwithstanding any other provision of this chapter, if the court finds that it would be in the best interests of the minor or incapacitated person for whom a trust is created under this section, the trust may contain provisions determined by the court to be necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

APPENDIX D -- Application to Create 142 Trust

<p>_____, AS GUARDIAN AD LITEM FOR _____, [A MINOR] [AN INCAPACITATED PERSON], Plaintiff,</p> <p>v.</p> <p>_____, Defendant</p>	NO. _____ § § § § § § § § § §	<p>IN THE DISTRICT COURT OF</p> <p>_____ COUNTY, TEXAS,</p> <p>_____ JUDICIAL DISTRICT</p>
--	---	---

APPLICATION TO CREATE TRUST
UNDER SECTION 142.005 OF THE TEXAS PROPERTY CODE

_____ ("Guardian Ad Litem"), guardian ad litem for _____ ("Plaintiff"), a [minor] [incapacitated person under Tex. Prop. Code §142.007], files this Application to Create Trust Under Section 142.005 of the Texas Property Code (the "Application"). In support of this Application, Guardian Ad Litem would show the Court as follows:

1. Plaintiff is entitled to judgment in the above entitled and numbered cause. *[Describe other parties, nature of judgment, etc., if desired].*

2. Plaintiff is [a minor] [a person who is impaired because of mental illness, mental deficiency, physical illness or disability, advanced age, chronic use of drugs, chronic intoxication, or other cause to the extent that Plaintiff lacks sufficient understanding or capacity to make or communicate responsible decisions concerning Plaintiff's person].

3. Plaintiff has no legal guardian.

4. Creation of a trust pursuant to Tex. Prop. Code §142.005 containing the terms and provisions of the trust instrument attached hereto as Exhibit "A" and incorporated herein would be in the best interests of Plaintiff.

OPTIONAL SUPPLEMENTAL NEEDS TRUST PROVISION:

5. It would be in the best interests of the Ward for the trust to be a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

6. The terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

5.[7.] _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the trust for Plaintiff's benefit.

6.[8.] Section 142.005 (b) (6) of the Texas Property Code provides that the trustee of a trust created pursuant to Tex. Prop. Code § 142.005 shall receive reasonable compensation paid from the trust's income, principal, or both on application to and approval of the Court. Guardian Ad Litem asks the Court to approve the fees and compensation that are payable to Trustee under the terms of the trust instrument approved by the Court.

7.[9.] Upon entry of judgment and creation of the trust, the clerk of this court and/or all parties to this proceeding holding funds which are payable to or for the benefit of Plaintiff should be ordered to pay and deliver such funds to Trustee as part of the trust estate of such trust. *[Modify as needed to fit settlement/judgment terms.]*

8.[10.] Upon entry of judgment and creation of the trust, Guardian Ad Litem should be paid a reasonable fee for services rendered, should be reimbursed for expenses, and should be discharged as guardian ad litem for Plaintiff.

PRAYER

Guardian Ad Litem prays that the Court will make the findings and determinations described above, that the Court will create a trust for the benefit of Plaintiff under Tex. Prop. Code § 142.005 with those terms and provisions set forth in Exhibit "A" attached hereto and incorporated herein; that the Court will name Trustee as trustee of such trust; *[that the trust shall be a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A);]* that the clerk of this Court and/or any party to this proceeding holding funds which are payable to or for the benefit of Plaintiff shall be ordered to pay and deliver such funds to Trustee as part of the trust estate of such trust; that the Court shall order that the fees and compensation authorized to be paid to Trustee by the terms of the trust instrument are reasonable; that the Court will order that the Trustee is authorized to pay itself such fees and compensation and reimburse itself for expenses as provided in the trust instrument without further application to or order from this Court; that the Court will award Guardian Ad Litem a reasonable fee, to be paid by Trustee upon funding of the trust (if not sooner paid); that the Court will discharge Guardian Ad Litem; and that the Court will grant such other and further relief to which Plaintiff may be entitled.

Respectfully submitted,

GUARDIAN AD LITEM

APPENDIX E -- Trustee s Application For Approval of Compensation (142 T Trust)

Note that Tex. Prop. Code §142.005(b)(6) provides that the trust must provide that the trustee receives reasonable compensation paid from the trust s income, principal or both **on application to and approval of the court.** Rather than relying on the guardian ad litem s application for creation of the trust to approve trustee compensation, trustees can assure that they meet the statutory requirements by filing their own application seeking approval of compensation. The trustee s application can be approved as part of the order creating the trustee (see optional language (*italicized and bracketed*) in Appendix F) or by separate order (see Appendix G).

<p style="text-align: center;">NO. _____</p> <p>_____, AS GUARDIAN AD LITEM FOR _____, <i>[A MINOR] [AN INCAPACITATED PERSON],</i> Plaintiff,</p> <p>v.</p> <p>_____, Defendant</p>	§ § § § § § § § §	<p>IN THE DISTRICT COURT OF</p> <p>_____ COUNTY, TEXAS,</p> <p>_____ JUDICIAL DISTRICT</p>
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TRUSTEE S APPLICATION FOR APPROVAL OF COMPENSATION

_____ (Trustee), a *[national banking association with trust powers][a state banking association with trust powers][a Texas trust company]*, which has agreed to serve as trustee of a trust benefitting _____ (Plaintiff) which this court is creating pursuant to Section 142.005 of the Texas Property Code, makes this application to the court for approval of its compensation as trustee pursuant to Tex. Prop. Code § 142.005 (b) (6). In support of this application, Trustee would show the Court as follows:

Section 142.005 (b) (6) of the Texas Property Code provides that the trustee of a trust created pursuant to Tex. Prop. Code § 142.005 shall receive reasonable compensation paid from the trust s income, principal, or both on application to and approval of the Court. Trustee makes this application in accordance therewith and asks the Court to approve the fees and compensation that are payable to Trustee under the terms of the trust instrument approved by the Court.

PRAYER

Trustee prays that the Court will approve this application and approve the fees and compensation to be paid to Trustee under the terms of the trust instrument approved by the Court.

Respectfully submitted,

ATTORNEYS FOR TRUSTEE

APPENDIX F -- Order Creating 142 Trust

_____, AS GUARDIAN AD LITEM FOR _____, <i>[A MINOR] [AN INCAPACITATED PERSON],</i> Plaintiff, v. _____, Defendant	NO. _____ § § § § § § § § §	IN THE DISTRICT COURT OF _____ COUNTY, TEXAS, _____ JUDICIAL DISTRICT
--	--	--

ORDER CREATING TRUST
UNDER SECTION 142.005 OF THE TEXAS PROPERTY CODE

On this day the Court considered the Application to Create Trust Under Section 142.005 of the Texas Property Code (the "Application") filed in this proceeding by _____ ("Guardian Ad Litem"), guardian ad litem for _____ ("Plaintiff"), a *[minor] [incapacitated person under Tex. Prop. Code §142.007]*. Based upon the Application, the pleadings of the parties in this proceeding, the evidence presented and the argument of counsel, the Court finds that:

1. Plaintiff is entitled to judgment in the above entitled and numbered cause.
2. Plaintiff is *[a minor] [a person who is impaired because of mental illness, mental deficiency, physical illness or disability, advanced age, chronic use of drugs, chronic intoxication, or other cause to the extent that Plaintiff lacks sufficient understanding or capacity to make or communicate responsible decisions concerning Plaintiff's person]*.
3. Plaintiff has no legal guardian.
4. Creation of a trust pursuant to Tex. Prop. Code §142.005 containing the terms and provisions of the trust instrument attached hereto as Exhibit "A" and incorporated herein would be in the best interests of Plaintiff.

OPTIONAL SUPPLEMENTAL NEEDS TRUST PROVISION:

5. It would be in the best interests of Plaintiff for the trust to be a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

6. The terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

5.[7.] _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the trust for Plaintiff's benefit.

6.[8.] *[Trustee has filed an application with this court for approval of its fees and compensation. The court finds that the Trustee's application should be granted.]* The fees and compensation that are payable to Trustee under the terms of the trust instrument are reasonable and should be approved by the Court.

7.[9.] That the clerk of this Court and/or all parties to this proceeding holding funds which are payable to or for the benefit of Plaintiff should be ordered to pay and deliver such funds to Trustee as part of the trust estate of such trust. *[Modify as needed to fit settlement/judgment terms.]*

7.[10.] Upon entry of judgment and creation of the trust, Guardian Ad Litem should be paid a reasonable fee for services rendered, should be reimbursed for expenses, and should be discharged as guardian ad litem for Plaintiff.

IT IS, THEREFORE, ORDERED that a trust for the benefit of Plaintiff under Tex. Prop. Code § 142.005 is hereby created with those terms and provisions set forth in Exhibit "A" attached hereto and incorporated herein; that Trustee shall be trustee of such trust; *[that the trust shall be a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A);]* that the clerk of this Court and/or any party to this proceeding holding funds which are payable to or for the benefit of Plaintiff are ordered to pay and deliver such funds to Trustee as part of the trust estate of such trust; that the fees and compensation authorized to be paid to Trustee by the terms of the trust instrument are reasonable and are approved by the Court, and the Trustee is authorized to pay itself such fees and compensation and reimburse itself for expenses as provided in the trust instrument without further application to or order from this Court; that Guardian Ad Litem is awarded a fee of \$_____, to be paid by Trustee upon funding of the trust (if not sooner paid); and that Guardian Ad Litem is hereby discharged, will be paid a reasonable fee, be reimbursed for costs, and be discharged.

Signed this ____ day of _____, 199__.

Judge Presiding

APPENDIX G -- Order Approving Trustee s Compensation

Note: Use this Order only if the trustee s application for compensation was not approved in the order creating the trust (see Appendix F and note to Appendix E).

NO. _____

_____, AS
GUARDIAN AD LITEM FOR

_____,
[A MINOR] [AN INCAPACITATED PERSON],
Plaintiff,

v.

_____,
Defendant

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§
§

IN THE DISTRICT COURT OF

_____ COUNTY, TEXAS,

_____ JUDICIAL DISTRICT

ORDER APPROVING TRUSTEE S COMPENSATION

On this day the Court considered the Trustee s Application for Approval of Compensation filed by _____ (Trustee), trustee of the trust benefitting _____ (Plaintiff) being created by this Court pursuant to Tex. Prop. Code § 142.005. The Court finds that the compensation to be paid to Trustee under the trust instrument being approved by the Court is reasonable.

IT IS, THEREFORE, ORDERED that application filed by Trustee is approved and that the Court approves the payment of fees and compensation to Trustee as provided in the trust instrument being approved by the Court.

SIGNED this ____ day of _____, ____.

Judge Presiding

APPENDIX H -- Application to Modify Trust Regarding 1997 Legislation

NO. _____

IN RE COURT-CREATED TRUST
FOR THE BENEFIT OF_____,
[A MINOR]
[AN INCAPACITATED PERSON]§
§
§
§
§IN THE DISTRICT COURT OF

COUNTY, TEXAS,
____ JUDICIAL DISTRICT

APPLICATION TO MODIFY TRUST REGARDING 1997 LEGISLATION

_____ ("Trustee"), trustee of the court-created trust ("the Trust") described below for the benefit of _____ ("Beneficiary"), [a minor] [an incapacitated person], pursuant to Section 142.005 of the Texas Property Code, files this Application to Modify Trust Regarding 1997 Legislation (the "Application"). In support of this Application, Trustee would show the Court as follows:

1. By order dated _____, 19__ (the "Creation Order"), this Court created a trust (the "Trust") for the benefit of Beneficiary pursuant to Section 142.005 of the Texas Property Code. Trustee is trustee of the Trust. The Trust is governed by the terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein.
2. At the time of creation of the Trust, this Court determined that it was in the best interests of Beneficiary for the Trust to qualify as a "special needs trust" under 42 U.S.C. Section 1396p(d)(4)(A), and the Court ordered that the trust instrument governing the Trust should contain provisions which the Court determined were necessary to qualify the Trust as a "special needs trust" under 42 U.S.C. Section 1396p(d)(4)(A).
3. 1997, the Texas Legislature enacted SB 912 (Acts, 75th Legislature, Regular Session, Chapter 128), which added subparagraph (g) to Section 142.004 of the Texas Property Code, which reads as follows:

(g) Notwithstanding any other provision of this chapter, if the court finds that it would be in the best interests of the minor or incapacitated person for whom a trust is created under this section, the trust may contain provisions determined by the court to be necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).
4. While the Court clearly found when it created the Trust that it would be in the best interests of Beneficiary to be a special needs trust and that the provisions of the trust instrument governing the Trust were necessary for the Trust to be a special needs trust, Trustee is unclear whether or not subparagraph (g) applies to the Trust since the Trust was created prior to September 1, 1997, which is the effective date of SB 912.
5. So that there is no confusion or question regarding the terms and conditions of the Trust and the applicability of Tex. Prop. Code § 142.005(g) to the Trust, Trustee asks the Court to modify the Trust so that Tex. Prop. Code § 142.005(g), as added by SB 912, clearly applies to the Trust.

PRAYER

Trustee prays that this Application will be granted; that the Court will modify the Trust so that Tex. Prop. Code § 142.005(g), as added by SB 912, applies to the Trust; that the Court reaffirm its findings that it is in the best interests of Beneficiary for the Trust to be a special needs trust as specified in 42 U.S.C. Section 1396p(d)(4)(A), and that the provisions of the trust instrument governing the Trust are necessary for the Trust to be a special needs trust as specified in 42 U.S.C. Section 1396p(d)(4)(A); and that the Court award such other and further relief to which Trustee may be entitled.

Respectfully submitted,

ATTORNEY FOR TRUSTEE

APPENDIX I -- Order Modifying Trust Regarding 1997 Legislation

NO. _____

IN RE COURT-CREATED TRUST
FOR THE BENEFIT OF_____,
[A MINOR]
[AN INCAPACITATED PERSON]§
§
§
§
§IN THE DISTRICT COURT OF

COUNTY, TEXAS,
____ JUDICIAL DISTRICT

ORDER MODIFYING TRUST REGARDING 1997 LEGISLATION

On this day the Court considered the Application to Modify Trust Regarding 1997 Legislation (the "Application") filed in this proceeding by _____ ("Trustee"). Based upon the Application, the evidence presented and the argument of counsel, the Court finds that:

1. By order dated _____, 19__ (the "Creation Order"), this Court created a trust (the "Trust") for the benefit of _____ ("Beneficiary") pursuant to Section 142.005 of the Texas Property Code.
2. Trustee is trustee of the Trust.
3. The Trust is governed by the terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein.
4. At the time of creation of the Trust, this Court determined that it was in the best interests of Beneficiary for the Trust to qualify as a "special needs trust" under 42 U.S.C. Section 1396p(d)(4)(A), and the Court ordered that the trust instrument governing the Trust should contain provisions which the Court determined were necessary to qualify the Trust as a "special needs trust" under 42 U.S.C. Section 1396p(d)(4)(A).
5. In 1997, the Texas Legislature enacted SB 912 (Acts, 75th Legislature, Regular Session, Chapter 128), which added subparagraph (g) to Section 142.004 of the Texas Property Code, which reads as follows:

(g) Notwithstanding any other provision of this chapter, if the court finds that it would be in the best interests of the minor or incapacitated person for whom a trust is created under this section, the trust may contain provisions determined by the court to be necessary to establish a special needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).
6. The Trust should be modified so that there is no confusion or question that Tex. Prop. Code § 142.005(g), as added by SB 912, clearly applies to the Trust.

IT IS, THEREFORE, ORDERED that the Trust is hereby modified so that Tex. Prop. Code § 142.005(g), as added by SB 912, applies to the Trust; and that the Court reaffirm its findings that it is in the best interests of Beneficiary for the Trust to be a special needs trust as specified in 42 U.S.C. Section 1396p(d)(4)(A), and that the provisions of the trust instrument governing the Trust as attached hereto as Exhibit "A" and incorporated herein are necessary for the Trust to be a special needs trust as specified in 42 U.S.C. Section 1396p(d)(4)(A).

Signed this ____ day of _____, 199__.

Judge Presiding

APPENDIX J Form of 142 Trust

NO. _____

_____, AS
GUARDIAN AD LITEM FOR_____,
[A MINOR] [AN INCAPACITATED PERSON],
Plaintiff,

v.

_____,
Defendant§
§
§
§
§
§
§
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IN THE DISTRICT COURT OF

_____ COUNTY, TEXAS,

_____ JUDICIAL DISTRICT

COURT-CREATED TRUST FOR _____

This declaration of trust creates a trust (the "Trust") for the benefit of _____ (the "Beneficiary"), [a minor] [an incapacitated person (within the meaning of Tex. Prop. Code §142.007)] with _____ (the "Trustee") as trustee.

a. **Authority for Creation.** This Trust is created by the order of the District Court of _____ County, Texas, _____ Judicial District (the "Court") in Cause No. _____, styled _____, as Guardian Ad Litem for _____, [a Minor] [an Incapacitated Person], v. _____, pursuant to Tex. Prop. Code § 142.005.

b. **Transfer to Trust.** The initial trust estate of the Trust shall be the property described on Schedule "A" attached hereto. Additional property acceptable to the Trustee may be transferred to the Trust from time to time and added to the trust estate.

c. **Distributions During Term of Trust.** The Beneficiary shall be the sole beneficiary of the Trust. Prior to termination of the Trust, the Trustee may disburse that amount of the Trust's principal, income, or both as the Trustee in its sole discretion determines to be reasonably necessary for the health, education, support, or maintenance of the Beneficiary. Distributions, payments, uses, and applications of all trust funds may be made to the legal or natural guardian of the Beneficiary or to the person having custody of the Beneficiary or may be made directly to or expended for the benefit, support, or maintenance of the Beneficiary without the intervention of any legal guardian or other legal representative of the Beneficiary. The income of the Trust that the Trustee does not disburse or under this section must be added to the principal of the Trust.

d. **Termination of Trust.** The Trust will terminate on the earlier of: (a) the death of the Beneficiary; or (b) [on the Beneficiary's twenty-fifth (25th) birthday] [when the Beneficiary regains capacity (within the meaning of Tex. Prop. Code §142.007)]. The Trust also may be terminated in whole or in part at any time by order of the Court.

e. **Distribution Upon Termination of Trust.** Upon termination of the Trust, the trustee shall distribute the principal and any undistributed income of the Trust to the Beneficiary, outright and free of trust, or, if the Beneficiary is then deceased, to the representative of the deceased Beneficiary's estate.

If This is a (d)(4)(A) trust, use the following alternative paragraphs c., d. and e. instead

c. **Distributions During Term of Trust.** The following provisions shall govern distributions from the Trust during the term of this Trust:

1. **Purpose and Intent.** This Trust is created pursuant to 42 U. S. C. §1396p(d)(4)(A). It is intended to be construed and administered as a supplemental needs trust under 42 U. S. C. §1396p(d)(4)(A). Without limiting the foregoing, neither the corpus of the Trust nor distributions from the Trust shall ever cause the Beneficiary to be disqualified to receive those public benefits or assistance under a state or federal program to which the Beneficiary then may be entitled but for the existence of this Trust or but for the distributions from this Trust.

2. **Distribution Standard.** During the term of this Trust, the Trustee shall apply for the benefit of the Beneficiary those amounts of the principal and/or income of the Trust for the satisfaction of the Beneficiary's supplemental needs (defined below), as the Trustee, in the Trustee's sole and absolute discretion, may from time to time deem appropriate, subject to the strict limitations set out in this instrument. Any income of the trust not distributed shall be added to the principal. Distributions, payments, uses, and applications of all trust funds may be made to the legal or natural guardian of the Beneficiary or to the person having custody of the Beneficiary or may be expended directly for the benefit of the Beneficiary without the intervention of any legal guardian or other legal representative of the Beneficiary.

3. **Supplemental Needs.** As used in this instrument, "supplemental needs" refers to the requisites, as allowed for in 42 U. S. C. §1396p(d)(4)(A), for maintaining the Beneficiary's health, safety, and welfare when the Trustee determines, in its discretion, that such needs are not being provided for by any public or private agency, including any state, the United States, or any insurance carrier with insurance policies covering the Beneficiary. The Trustee is prohibited from expending any of the trust principal or income for any property, services, benefits, or medical care which are being received by, or which are otherwise available to, the Beneficiary from any governmental source or from any insurance carrier required to cover the Beneficiary. Further, the Trustee is prohibited from expending any of the trust principal or income for any such property, services, benefits, or medical care if that restriction is necessary in order to qualify the Beneficiary for such governmental or insurance carrier benefits because an application for such property, services, benefits, or medical care has been filed with an applicable governmental agency or insurance carrier on the Beneficiary's behalf. The Trustee may pay any deductible amounts for the Beneficiary on any insurance policies covering the Beneficiary so long as that payment does not disqualify the Beneficiary from receipt of benefits. The Trustee shall cooperate with the Beneficiary's conservator, guardian, or legal representative to seek support and maintenance for the Beneficiary from all available resources, including but not limited to, the Supplemental Social Security Income Program (SSI), Supplemental Income Program (SIP) of Texas, the Old Age Survivor and Disability Insurance Program (OASDI), the Medicaid Program, and any additional similar or successor programs, and from any private sources. To the extent required by 42 U. S. C. §1396p(d)(4)(A) and other applicable laws and regulations regarding trusts of this type, the Trustee may supplement, but shall not supplant services, benefits, and medical care received or requested by or on behalf of the Beneficiary that are available through any governmental or private resource.

4. **Payment of Income Taxes.** The Trustee shall pay any income tax liability of the Beneficiary which results from income received by the Trust but reported on the income tax return of the Beneficiary. The funds used to pay this income tax liability shall be paid directly to the appropriate taxing authority and shall not be available to the Beneficiary. The Beneficiary shall not have any right to or interest in any of these funds paid by the Trustee. Further, these funds are not a resource of the Beneficiary and shall not be treated as a distribution of cash for purposes of Medicaid qualification.

d. **Termination of Trust.** The Trust will terminate on the death of the Beneficiary. The Trust also may be terminated in whole or in part at any time by order of the Court.

e. **Distribution Upon Termination of Trust.** Upon termination of the Trust, the trustee shall distribute the principal and any undistributed income of the Trust as follows:

1. First, the Trustee shall pay all amounts required to be reimbursed pursuant to 42 U. S. C. §1396p(d)(4)(A). The Trustee shall reimburse those states where the Beneficiary has received Medical Assistance payments from the state, based upon the state's proportionate share of the total amount of Medicaid benefits paid by all of the states on the Beneficiary's behalf, the smallest amount (if any) as applicable law then requires the Trust to pay. The Trustee's duty to reimburse the state upon termination shall apply to the extent there are remaining assets in this trust and shall apply irrespective of any other provision of this instrument. The Trustee shall reimburse the state only for those benefits provided to the Beneficiary which are subject to such reimbursement claim.

2. After the satisfaction of these obligations, the Trustee shall distribute the remaining property, if any, to the Beneficiary, outright and free of trust, or, if the Beneficiary is then deceased, to the representative of the deceased Beneficiary's estate.

f. **Compensation of the Trustee.** The Trustee is entitled to reasonable compensation paid from the Trust's income, principal, or both on application to and approval of the Court. Unless otherwise ordered by the Court, the fees and other charges described on the Trustee's then-current fee schedule are hereby approved by the Court as

reasonable compensation to the Trustee, and the Trustee is entitled to pay itself such fees and other charges without further application to or approval of the Court. In addition, the Trustee may be reimbursed from the trust estate for expenses it reasonably incurs in connection with the Trust.

g. **Powers of Trustee.** The Trustee shall have all of the powers of trustees under the Texas Trust Code. The terms and provisions of the Texas Trust Code shall apply to this Trust, to the extent they are not in conflict with Tex. Prop. Code § 142.005 or with the terms of this instrument.

h. **No Bond Required.** The Trustee shall serve without giving a bond.

i. **Successor Trustees.** In the event of the corporate reorganization, merger or acquisition of the Trustee, the resulting successor organization shall automatically become the successor trustee. The Trustee may resign with the approval of the Court and may be removed by order of the Court. Upon the resignation or removal of the Trustee, the Court shall appoint a successor trustee. Each successor trustee shall have all of the rights, powers and duties of the Trustee.

j. **Spendthrift Trust.** To the extent permitted by law, the interest of the Beneficiary shall be held subject to a spendthrift trust as provided in Section 112.035 of the Texas Property Code.

k. **Amendment, Modification or Revocation.** The Court may amend, modify, or revoke the Trust at any time before the date of the Trust's termination. Neither the Beneficiary nor the guardian of the Beneficiary's estate may revoke the Trust.

l. **Effective Date.** This Trust shall be effective upon the last to occur of (A) the entry of an order creating the Trust by the Court, (B) the execution of this Declaration of Trust by the Trustee indicating its acceptance of the Trust; and (C) the receipt by the Trustee of the initial trust estate.

TRUSTEE'S ACCEPTANCE:

By: _____
Name: _____
Title: _____

APPENDIX K Combined Application For Guardianship And Creation of 867 Trust Where No Guardianship Exists

Often the need for an 867 Trust is apparent before a guardianship is in place. In these cases, it makes more sense to proceed directly with creation of an 867 Trust without the appointment and qualification of a guardian. However, prior to 1997 only a guardian could apply for creation of an 867 Trust. Since one does not become a guardian until one is appointed and qualifies, appointment of a guardian was a prerequisite to creation of an 867 Trust. In 1997 Section 867 was amended to permit a ward's attorney ad litem *at any time after the date of the attorney's appointment* to apply for creation of an 867 Trust and to permit the court to order third parties to transfer funds directly to the trustee of an 867 Trust without the need for the property to pass through the hands of a guardian of the estate. Thus, now an applicant can try to convince an attorney ad litem to apply for creation of an 867 Trust before a guardian is appointed, obviating the need for a guardianship. This application anticipates that an attorney ad litem will be appointed who can be convinced to file a related application (see Appendix L) for creation of an 867 Trust.

NO. _____

GUARDIANSHIP OF

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IN THE PROBATE COURT

OF

_____,
[A MINOR][AN INCAPACITATED PERSON]

_____ COUNTY, TEXAS

APPLICATION FOR GUARDIANSHIP AND/OR CREATION OF GUARDIANSHIP MANAGEMENT TRUST

_____ (Applicant) files this application for the appointment of a guardian and/or for creation of a guardianship management trust for the benefit of _____ (the Proposed Ward), [a minor][an incapacitated person], pursuant to Tex. Prob. Code Ann. §867. In support of this application, Applicant would show the Court as follows:

1. The Proposed Ward is [a minor][an incapacitated person]. The Proposed Ward's name, sex, date of birth and address are as follows: _____.
2. Applicant's name, address and relationship to the Proposed Ward are as follows: _____.
3. Applicant is seeking the creation of a guardianship management trust pursuant to Tex. Prob. Code Ann. §867. Only if required by the Court for creation of a guardianship management trust, or, alternatively, only if the Court refuses to create a guardianship management trust, Applicant seeks the appointment of a guardian of the estate and person of the Proposed Ward.
4. The nature and degree of the Proposed Ward's incapacity, the specific areas of protection and assistance requested, and the limitation of rights requested to be included in the Court's order are as follows: _____.
5. The facts requiring the guardianship management trust to be created and the interest of Applicant in such creation are as follows: The Proposed Ward needs the assistance of a trustee in managing the Proposed Ward's estate. Creation of a guardianship management trust, rather than a guardianship of the estate, is in the best interests of the Proposed Ward. Applicant believes that creation of a guardianship management trust is in the Proposed Ward's best interests. [Add more facts as desired or appropriate.]
6. No guardianship exists for the Proposed Ward, to the knowledge of Applicant.
7. The name and address of any person or institution having the care and custody of the Proposed Ward is as follows: _____.
8. The approximate value and description of the Proposed Ward's property, including any compensation, pension, insurance, or allowance to which the Proposed Ward may be entitled, to the knowledge of Applicant, is as follows: _____.

9. The requested term of the guardianship management trust is as stated in the proposed form of the trust attached hereto as Exhibit A and incorporated herein.

10. The name and address of any person whom the applicant knows to hold a power of attorney signed by the Proposed Ward and a description of the type of power of attorney is as follows: _____.

11. *[If the Proposed Ward is a minor, include the names of the parents and next of kin of the Proposed Ward and a statement as to whether either or both of the parents are deceased.]*

12. *[If the Proposed Ward is a minor, include a statement as to whether the minor was the subject of a legal or conservatorship proceeding within the preceding two-year period and, if so, the court involved, the nature of the proceeding, and the final disposition, if any, of the proceeding.]*

13. *[If the Proposed Ward is 60 years of age or older, include the names and addresses, to the best of Applicant's knowledge, of the Proposed Ward's spouse, siblings, and children, or, if there is no spouse, sibling, or child, the names and addresses of the Proposed Ward's next of kin.]*

14. This Court has venue over this proceeding because the Proposed Ward is a resident of and is domiciled in _____ County, Texas.

15. Creation of a guardianship management trust pursuant to Tex. Prob. Code Ann. §867 containing the terms and provisions of the trust instrument attached hereto as Exhibit "A" and incorporated herein would be in the best interests of the Proposed Ward. *[If desired, state the reasons for creation of the 867 Trust.]*

OPTIONAL SUPPLEMENTAL NEEDS TRUST PROVISIONS:

16. It would be in the best interests of the Proposed Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

17. The terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Proposed Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Proposed Ward.

18. _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the guardianship management trust for the Proposed Ward's benefit.

19. The Court should direct that, upon creation of the guardianship management trust, each person holding property of the Proposed Ward *[including, but not limited to, _____ (specifically identify third parties holding the Proposed Ward's funds)]* shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust.

20. No guardianship of the Proposed Ward's person or estate is necessary, and the Court should order that none be created. However, if the Court refuses to create a guardianship management trust for the Ward, or, alternatively, if the Court requires the appointment of a guardian of the estate and/or guardian of the person of the Proposed Ward as a condition to the creation of the guardianship management trust, Applicant asks that _____ (the Proposed Guardian) be appointed the guardian of the estate and/or guardian of the person of the Proposed Ward. The Proposed Guardian is qualified and is not disqualified to serve as guardian of the person and/or estate of the Proposed Ward.

PRAYER

Applicant prays that, after proper notice and service of citation, the Court will appoint an attorney ad litem for the Proposed Ward; that the Court will make the findings and determinations described above and necessary for the creation of a guardianship management trust for the benefit of the Proposed Ward; that the Court will create a guardianship management trust for the benefit of the Proposed Ward pursuant to Tex. Prob. Code Ann. § 867 with those terms and provisions set forth in Exhibit "A" attached hereto and incorporated herein; that the Court will name Trustee as trustee of such trust; *[that the trust shall be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A);]* that the Court will order each person holding property of the Proposed Ward to deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust; that the Court will find that no guardianship of the estate and/or person of the Proposed Ward is necessary, or, alternatively, that the Court will

appoint the Proposed Guardian as guardian of the person and/or estate of the Proposed Ward; and that the Court will grant such other and further relief to which Plaintiff may be entitled.

Respectfully submitted,

ATTORNEY FOR APPLICANT

APPENDIX L Attorney Ad Litem s Application to Create 867 Trust Where No Guardianship Exists

This form may be used by an attorney ad litem to apply for creation of an 867 Trust before a guardian is appointed. It may be used in conjunction with Appendix K, in cases where the applicant for the guardianship also wants an 867 Trust to be created, or it may be used by itself in cases where the applicant did not seek creation of an 867 Trust.

NO. _____

GUARDIANSHIP OF

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IN THE PROBATE COURT

OF

_____,
[A MINOR][AN INCAPACITATED PERSON]

_____ COUNTY, TEXAS

APPLICATION FOR CREATION OF GUARDIANSHIP MANAGEMENT TRUST

_____ (Applicant), attorney ad litem for _____ (the Proposed Ward), [a minor][an incapacitated person], files this application for the creation of a guardianship management trust for the benefit of the Proposed Ward pursuant to Tex. Prob. Code Ann. §867. In support of this application, Applicant would show the Court as follows:

1. The Proposed Ward is [a minor][an incapacitated person]. The Proposed Ward s name, sex, date of birth and address are as follows:_____.

2. Applicant is the court-appointed attorney ad litem for the Proposed Ward. Applicant s name and address are as follows:_____.

3. Applicant seeks neither a guardianship of the person or estate of the Proposed Ward; rather, Applicant seeks the creation of a guardianship management trust pursuant to Tex. Prob. Code Ann. §867.

4. The nature and degree of the Proposed Ward s incapacity, the specific areas of protection and assistance requested, and the limitation of rights requested to be included in the Court s order are as follows:_____.

5. The facts requiring the guardianship management trust to be created and the interest of Applicant in such creation are as follows: The Proposed Ward needs the assistance of a trustee in managing the Proposed Ward s estate. Creation of a guardianship management trust, rather than a guardianship of the estate, is in the best interests of the Proposed Ward. Applicant is the court-appointed attorney ad litem for the Proposed Ward and believes that creation of a guardianship management trust is in the Proposed Ward s best interests. *[Add more facts as desired or appropriate.]*

6. No guardianship exists for the Proposed Ward, to the knowledge of Applicant. _____ has filed an application for appointment of a guardian, and that application is pending in this Court under this cause number. *[If accurate: _____ consents to the creation of a guardianship management trust in lieu of a guardianship of the estate pursuant to Tex. Prob. Code Ann. §867.]*

7. The name and address of any person or institution having the care and custody of the Proposed Ward is as follows:_____.

8. The approximate value and description of the Proposed Ward s property, including any compensation, pension, insurance, or allowance to which the Proposed Ward may be entitled, to the knowledge of Applicant, is as follows:_____.

9. The requested term of the guardianship management trust is as stated in the proposed form of the trust attached hereto as Exhibit A and incorporated herein.

10. The name and address of any person whom the applicant knows to hold a power of attorney signed by the Proposed Ward and a description of the type of power of attorney is as follows:_____.

11. *[If the Proposed Ward is a minor, include the names of the parents and next of kin of the Proposed Ward and a statement as to whether either or both of the parents are deceased.]*

12. *[If the Proposed Ward is a minor, include a statement as to whether the minor was the subject of a legal or conservatorship proceeding within the preceding two-year period and, if so, the court involved, the nature of the proceeding, and the final disposition, if any, of the proceeding.]*

13. *[If the Proposed Ward is 60 years of age or older, include the names and addresses, to the best of Applicant's knowledge, of the Proposed Ward's spouse, siblings, and children, or, if there is no spouse, sibling, or child, the names and addresses of the Proposed Ward's next of kin.]*

14. This Court has venue over this proceeding because the Proposed Ward is a resident of and is domiciled in _____ County, Texas.

15. Creation of a guardianship management trust pursuant to Tex. Prob. Code Ann. §867 containing the terms and provisions of the trust instrument attached hereto as Exhibit "A" and incorporated herein would be in the best interests of the Proposed Ward. *[If desired, state the reasons for creation of the 867 Trust.]*

OPTIONAL SUPPLEMENTAL NEEDS TRUST PROVISIONS:

16. It would be in the best interests of the Proposed Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

17. The terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Proposed Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Proposed Ward.

18. _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the guardianship management trust for the Proposed Ward's benefit.

19. The Court should direct that, upon creation of the guardianship management trust, each person holding property of the Proposed Ward *[including, but not limited to, _____ (specifically identify third parties holding the Proposed Ward's funds)]* shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust.

20. No guardianship of the Proposed Ward's estate is necessary.

21. *[If desired: No guardianship of the Proposed Ward's person is necessary.]*

22. Upon entry of the Court's order creating the guardianship management trust, Applicant, attorney ad litem for the Proposed Ward, should be paid a reasonable fee from the trust and should be discharged.

PRAYER

Applicant prays that the Court will make the findings and determinations described above and necessary for the creation of a guardianship management trust for the benefit of the Proposed Ward; that the Court will create a guardianship management trust for the benefit of the Proposed Ward pursuant to Tex. Prob. Code Ann. §867 with those terms and provisions set forth in Exhibit "A" attached hereto and incorporated herein; that the Court will name Trustee as trustee of such trust; *[that the trust shall be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A);]* that the Court will order each person holding property of the Proposed Ward to deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust; that the Court will award Applicant a reasonable fee as attorney ad litem, to be paid by Trustee upon funding of the trust (if not sooner paid); that the Court will discharge Applicant as attorney ad litem; and that the Court will grant such other and further relief to which Plaintiff may be entitled.

Respectfully submitted,

ATTORNEY AD LITEM

APPENDIX M Order Creating 867 Trust Where No Guardianship Exists

This form may be used in cases where the Court agrees that an 867 Trust should be created and where the Court sees no need for a guardianship of the estate (see notes to Appendix K and Appendix L).

NO. _____

GUARDIANSHIP OF

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IN THE PROBATE COURT

OF

_____,
[A MINOR][AN INCAPACITATED PERSON]

_____, COUNTY, TEXAS

ORDER CREATING GUARDIANSHIP MANAGEMENT TRUST

On this day the Court considered the Application for Guardianship And/Or Creation of Guardianship Management Trust filed by _____ (Applicant) and the Application for Creation of Guardianship Management Trust filed by _____ (Attorney Ad Litem), attorney ad litem, regarding _____ (the Ward), [a minor][an incapacitated person]. [The Ward attended the hearing on the above applications.][The Court finds that the Ward's attendance at the hearing on the above applications is not necessary.] After considering the above applications, the evidence presented, and the arguments of counsel, the Court finds by clear and convincing evidence that the Ward is an incapacitated person; that it is in the best interest of the Ward for the court to create a guardianship management trust for the Ward pursuant to Tex. Prob. Code Ann. §867; that the rights of the Ward or the Ward's property will be protected by the creation of a guardianship management trust; and that, if a guardianship management trust is created for the Ward, no guardianship of the estate and/or person of the Ward is necessary. The Court further finds by a preponderance of the evidence that the Court has venue of this matter because the Ward resides in this county; [that the Ward is a minor][that the Ward is totally without capacity as provided by the Texas Probate Code to care for himself or herself and to manage the Ward's property][that the Ward lacks the capacity to do some, but not all, of the tasks necessary to care for himself or herself or to manage the Ward's property]; that the Ward's incapacity is evidenced by recurring acts or occurrences within the preceding six-month period and not by isolated instances of negligence or bad judgment; that creation of a guardianship management trust pursuant to Tex. Prob. Code Ann. §867 containing the terms and provisions of the trust instrument attached hereto as Exhibit "A" and incorporated herein would be in the best interests of the Proposed Ward; [that it would be in the best interests of the Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A); that the terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Ward;] that _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the guardianship management trust for the Ward's benefit; that the Court should direct that, upon creation of the guardianship management trust, each person holding property of the Ward [including, but not limited to, _____ (specifically identify third parties holding the Ward's funds)] shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust; and that upon entry of the Court's order creating the guardianship management trust, Attorney Ad Litem, should be paid the amount stated below from the trust as a reasonable fee for serving in such capacity and should be discharged.

IT IS, THEREFORE, ORDERED that:

1. The Ward is an incapacitated person;
2. A guardianship management trust for the benefit of the Ward is established pursuant to Tex. Prob. Code Ann. §867 with the terms and provisions set forth on Exhibit A attached hereto and incorporated herein;
3. No guardianship of the estate and/or person of the Ward is necessary;
4. [The Ward is a minor][The Ward is totally without capacity as provided by the Texas Probate Code to care for himself or herself and to manage the Ward's property][The Ward lacks the capacity to do the following actions: _____];

5. *[It is in the best interests of the Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A), and the terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Ward;]*

6. _____ ("Trustee"), a trust company or a state or national bank having trust powers in Texas, is appointed as trustee of the guardianship management trust and is ordered to administer such trust in accordance with applicable law and in accordance with the terms and provisions of the trust instrument attached hereto as Exhibit A;

7. Upon creation of the guardianship management trust, each person holding property of the Ward *[including, but not limited to, _____ (specifically identify third parties holding the Ward's funds)]* shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust; and

8. Attorney Ad Litem is awarded a fee in the amount of \$_____ from the trust as a reasonable fee for serving in such capacity and is hereby discharged.

SIGNED this ____ day of _____, _____.

Judge Presiding

APPENDIX N Application to Create 867 Trust From Existing Guardianship

This form may be used by the guardian or the attorney ad litem to apply for creation of an 867 Trust where a guardianship of the estate already exists.

NO. _____

GUARDIANSHIP OF

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IN THE PROBATE COURT

OF

_____,
[A MINOR][AN INCAPACITATED PERSON]

_____ COUNTY, TEXAS

APPLICATION FOR CREATION OF GUARDIANSHIP MANAGEMENT TRUST

_____ (Applicant), [guardian of the estate of][attorney ad litem for]
_____ (the Ward), [a minor][an incapacitated person], files this application for the creation of a guardianship management trust for the benefit of the Ward pursuant to Tex. Prob. Code Ann. §867. In support of this application, Applicant would show the Court as follows:

1. The Ward is [a minor][an incapacitated person]. A guardianship of the estate of the Ward exists in this Court.
2. Creation of a guardianship management trust pursuant to Tex. Prob. Code Ann. §867 containing the terms and provisions of the trust instrument attached hereto as Exhibit "A" and incorporated herein would be in the best interests of Plaintiff. *[If desired, state the reasons for creation of the 867 Trust.]*

OPTIONAL SUPPLEMENTAL NEEDS TRUST PROVISIONS:

3. It would be in the best interests of the Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A).

4. The terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Ward.

3./5.] _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the guardianship management trust for the Ward s benefit.

4./6.] The Court should direct that, upon creation of the guardianship management trust, the guardian of the estate of the Ward and any other person holding property of the Ward *[including, but not limited to, _____ (specifically identify third parties holding the Ward s funds)]* shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust.

5./7.] Upon creation of the guardianship management trust and upon the transfer of all assets in the possession or control of the guardian of the estate of the Ward to Trustee, the Court should discharge the guardian of the ward s estate pursuant to Tex. Prob. Code Ann. §868A.

6./8.] *[If desired or appropriate:]* Upon entry of the Court s order creating the guardianship management trust, _____, attorney ad litem for the Ward, should be paid a reasonable fee from the guardianship estate or the trust and should be discharged.

PRAYER

Applicant prays that the Court will make the findings and determinations described above, that the Court will create a guardianship management trust for the benefit of the Ward pursuant to Tex. Prob. Code Ann. §867 with those terms and provisions set forth in Exhibit "A" attached hereto and incorporated herein; that the Court will name Trustee as trustee of such trust; *[that the trust shall be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A);]* that the Court will order the guardian of the estate of the Ward and any other

person holding property of the Ward to deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust; that upon creation of the guardianship management trust and upon the transfer of all assets in the possession or control of the guardian of the estate of the Ward to Trustee, the guardian of the Ward's estate shall be discharged pursuant to Tex. Prob. Code Ann. §868A; *[that the Court will award _____, attorney ad litem, a reasonable fee, to be paid by the guardian of the estate of the Ward or by Trustee upon funding of the trust (if not sooner paid)]*; that the Court will discharge said attorney ad litem; and that the Court will grant such other and further relief to which Plaintiff may be entitled.

Respectfully submitted,

ATTORNEY FOR APPLICANT

APPENDIX O Order Creating 867 Trust From Existing Guardianship

NO. _____

GUARDIANSHIP OF

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IN THE PROBATE COURT

OF

_____,
[A MINOR][AN INCAPACITATED PERSON]

_____ COUNTY, TEXAS

ORDER CREATING GUARDIANSHIP MANAGEMENT TRUST

On this day the Court considered the Application for Creation of Guardianship Management Trust filed by _____, [attorney ad litem for _____ (the Ward)][guardian of the estate of _____ (the Ward)], [a minor][an incapacitated person]. After considering the above applications, the evidence presented, and the arguments of counsel, the Court finds that the Ward is an incapacitated person; that it is in the best interest of the Ward for the Court to create a guardianship management trust for the Ward pursuant to Tex. Prob. Code Ann. §867 containing the terms and provisions of the trust instrument attached hereto as Exhibit A and incorporated herein; *[that it would be in the best interests of the Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A); that the terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Ward;]* that _____ ("Trustee") is a trust company or a state or national bank having trust powers in Texas and is willing to serve as trustee of the guardianship management trust for the Ward's benefit; that the Court should direct that, upon creation of the guardianship management trust, the guardian of the estate of the Ward and each person holding property of the Ward *[including, but not limited to, _____ (specifically identify third parties holding the Ward's funds)]* shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust; that, upon creation of the guardianship management trust and the transfer of all assets in the possession and control of the guardian of the estate of the Ward to the Trustee, no guardianship of the estate of the Ward is necessary and _____ should be discharged as guardian of the estate; and that upon entry of the Court's order creating the guardianship management trust, _____, attorney ad litem, should be paid the amount stated below from the trust as a reasonable fee for serving in such capacity and should be discharged.

IT IS, THEREFORE, ORDERED that:

1. A guardianship management trust for the benefit of the Ward is established pursuant to Tex. Prob. Code Ann. §867 with the terms and provisions set forth on Exhibit A attached hereto and incorporated herein;

2. *[It is in the best interests of the Ward for the trust to be a supplemental needs trust as specified under 42 U.S.C. Section 1396p(d)(4)(A), and the terms of the trust instrument attached hereto as Exhibit "A" and incorporated herein are necessary and appropriate for the Ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the Ward;]*

3. _____ ("Trustee"), a trust company or a state or national bank having trust powers in Texas, is appointed as trustee of the guardianship management trust and is ordered to administer such trust in accordance with applicable law and in accordance with the terms and provisions of the trust instrument attached hereto as Exhibit A;

4. The guardian of the estate of the Ward and each person holding property of the Ward *[including, but not limited to, _____ (specifically identify third parties holding the Ward's funds)]* shall deliver all of such assets to Trustee, to be held by Trustee as the trust estate of the trust;

5. Upon creation of the guardianship management trust and the transfer of all assets in the possession and control of the guardian of the estate of the Ward to the Trustee, no guardianship of the estate of the Ward is necessary and _____ should be discharged as guardian of the estate; and

6. _____, attorney ad litem, is awarded a fee in the amount of \$ _____ from the trust as a reasonable fee for serving in such capacity and is hereby discharged.]

SIGNED this ____ day of _____, ____.

Judge Presiding

APPENDIX P -- Form of 867 Trust

NO. _____

GUARDIANSHIP OF THE ESTATE

§

IN THE PROBATE COURT

OF _____,

§

OF

[A MINOR]/[AN INCAPACITATED PERSON]

§

_____ COUNTY, TEXAS

GUARDIANSHIP MANAGEMENT TRUST FOR _____

This declaration of trust creates a management trust (the "Trust") for the benefit of _____ (the "Beneficiary") with _____ (the "Trustee") as trustee.

13. **Authority for Creation.** This Trust is created by the order of the Probate Court of _____ County, Texas (the "Court") in Cause No. _____, Guardianship of the Estate of the Beneficiary, pursuant to Sections 867 -- 873 of the Texas Probate Code.

14. **Transfer to Trust.** The initial trust estate of the Trust shall be the property described on Schedule "A" attached hereto. Additional property acceptable to the Trustee may be transferred to the Trust from time to time and added to the trust estate.

15. **Distributions During Term of Trust.** The Beneficiary shall be the sole beneficiary of the Trust. Prior to termination of the Trust, the Trustee may disburse that amount of the Trust's principal or income as the Trustee determines is necessary to expend for the health, education, support, or maintenance of the Beneficiary. In addition, the Trustee may make a distribution, payment, use, or application of trust funds for the health, education, support, or maintenance of the Beneficiary or of another person whom the Beneficiary is legally obligated to support, as necessary and without the intervention of a guardian or other representative of the Beneficiary, to: (A) the Beneficiary's guardian; (B) a person who has physical custody of the Beneficiary or another person whom the Beneficiary is legally obligated to support; or (C) a person providing a good or service to the Beneficiary or another person whom the Beneficiary is legally obligated to support. The income of the Trust that the Trustee does not disburse under this section must be added to the principal of the Trust.

16. **Termination of Trust.** The Trust will terminate on the earlier of: (a) the death of the Beneficiary; or (b) *[on the Beneficiary's eighteenth (18th) birthday, unless the Court orders that the trust shall terminate on a date later than the Beneficiary's eighteenth (18th) birthday, which date may not be later than the Beneficiary's twenty-fifth (25th) birthday]* *[on the date the Court determines that continuing the trust is no longer in the Beneficiary's best interests]*. The Trust also may be terminated in whole or in part at any time by order of the Court.

17. **Distribution Upon Termination of Trust.** Upon termination of the Trust, the trustee shall prepare and file the final account required by Tex. Prob. Code Ann. § 873 and, upon approval of the Court and unless otherwise provided by the Court, shall distribute the principal and any undistributed income of the Trust to the Beneficiary, outright and free of trust, or, if the Beneficiary is then deceased, to the representative of the deceased Beneficiary's estate.

If This is a (d)(4)(A) trust, use the following alternative paragraphs 3., 4. and 5. instead

3. **Distributions During Term of Trust.** The following provisions shall govern distributions from the Trust during the term of this Trust:

A. **Purpose and Intent.** This Trust is created pursuant to 42 U. S. C. § 1396p(d)(4)(A). It is intended to be construed and administered as a supplemental needs trust under 42 U. S. C. § 1396p(d)(4)(A). Without limiting the foregoing, neither the corpus of the Trust nor distributions from the Trust shall ever cause the Beneficiary to be disqualified to receive those public benefits or assistance under a state or federal program to which the Beneficiary then may be entitled but for the existence of this Trust or but for the distributions from this Trust.

B. **Distribution Standard.** During the term of this Trust, the Trustee shall apply for the benefit of the Beneficiary those amounts of the principal and/or income of the Trust for the satisfaction of the Beneficiary's

supplemental needs (defined below), as the Trustee, in the Trustee's sole and absolute discretion, may from time to time deem appropriate, subject to the strict limitations set out in this instrument. Any income of the trust not distributed shall be added to the principal. The Trustee may apply such trust funds for the benefit of the Beneficiary, as necessary and without the intervention of a guardian or other representative of the Beneficiary, to: (A) the Beneficiary's guardian; (B) a person who has physical custody of the Beneficiary; or (C) a person providing a good or service to the Beneficiary.

C. Supplemental Needs. As used in this instrument, "supplemental needs" refers to the requisites, as allowed for in 42 U. S. C. §1396p(d)(4)(A), for maintaining the Beneficiary's health, safety, and welfare when the Trustee determines, in its discretion, that such needs are not being provided for by any public or private agency, including any state, the United States, or any insurance carrier with insurance policies covering the Beneficiary. The Trustee is prohibited from expending any of the trust principal or income for any property, services, benefits, or medical care which are being received by, or which are otherwise available to, the Beneficiary from any governmental source or from any insurance carrier required to cover the Beneficiary. Further, the Trustee is prohibited from expending any of the trust principal or income for any such property, services, benefits, or medical care if that restriction is necessary in order to qualify the Beneficiary for such governmental or insurance carrier benefits because an application for such property, services, benefits, or medical care has been filed with an applicable governmental agency or insurance carrier on the Beneficiary's behalf. The Trustee may pay any deductible amounts for the Beneficiary on any insurance policies covering the Beneficiary so long as that payment does not disqualify the Beneficiary from receipt of benefits. The Trustee shall cooperate with the Beneficiary's conservator, guardian, or legal representative to seek support and maintenance for the Beneficiary from all available resources, including but not limited to, the Supplemental Social Security Income Program (SSI), Supplemental Income Program (SIP) of Texas, the Old Age Survivor and Disability Insurance Program (OASDI), the Medicaid Program, and any additional similar or successor programs, and from any private sources. To the extent required by 42 U. S. C. §1396p(d)(4)(A) and other applicable laws and regulations regarding trusts of this type, the Trustee may supplement, but shall not supplant, services, benefits, and medical care received or requested by or on behalf of the Beneficiary that are available through any governmental or private resource.

D. Payment of Income Taxes. The Trustee shall pay any income tax liability of the Beneficiary which results from income received by the Trust but reported on the income tax return of the Beneficiary. The funds used to pay this income tax liability shall be paid directly to the appropriate taxing authority and shall not be available to the Beneficiary. The Beneficiary shall not have any right to or interest in any of these funds paid by the Trustee. Further, these funds are not a resource of the Beneficiary and shall not be treated as a distribution of cash for purposes of Medicaid qualification.

4. Termination of Trust. The Trust will terminate on the death of the Beneficiary. The Trust also may be terminated in whole or in part at any time by order of the Court.

5. Distribution Upon Termination of Trust. Upon termination of the Trust, the trustee shall distribute the principal and any undistributed income of the Trust as follows:

A. First, the Trustee shall pay all amounts required to be reimbursed pursuant to 42 U. S. C. §1396p(d)(4)(A). The Trustee shall reimburse those states where the Beneficiary has received Medical Assistance payments from the state, based upon the state's proportionate share of the total amount of Medicaid benefits paid by all of the states on the Beneficiary's behalf, the smallest amount (if any) as applicable law then requires the Trust to pay. The Trustee's duty to reimburse the state upon termination shall apply to the extent there are remaining assets in this trust and shall apply irrespective of any other provision of this instrument. The Trustee shall reimburse the state only for those benefits provided to the Beneficiary which are subject to such reimbursement claim.

B. After the satisfaction of these obligations, the Trustee shall distribute the remaining property, if any, to the Beneficiary, outright and free of trust, or, if the Beneficiary is then deceased, to the representative of the deceased Beneficiary's estate.

18. Annual Accountings. The Trustee shall prepare and file with the court an annual accounting of transactions in the Trust in the same manner and form that is required of a guardian of the estate under the Texas Probate Code. The Trustee shall provide a copy of the annual account to the Guardian of the Beneficiary's Estate and Person. The annual account is subject to review and approval by the Court in the same manner that is required of an annual account prepared by a guardian of the estate under the Texas Probate Code.

19. **Compensation of the Trustee.** The Trustee, on annual application to the Court and subject to the Court's approval, is entitled to receive reasonable compensation for services that the Trustee provided to the Beneficiary as the Beneficiary's Trustee that is (A) to be paid from the Trust's income, principal, or both and (B) determined in the same manner as compensation of a guardian of the estate under Section 665 of the Texas Probate Code; provided, however, that the Trustee shall not be entitled to compensation based on distributions to the Guardian of the Estate of the Beneficiary for purposes of making gifts pursuant to Section 865 of the Texas Probate Code. The Trustee may be reimbursed from the trust estate for expenses it reasonably incurs with the approval of the Court.

20. **Powers of Trustee.** The Trustee shall have all of the powers of trustees under the Texas Trust Code. The Trustee may invest the trust estate in investments permitted under the Texas Trust Code without further order of the Court and is not required to invest the trust estate in investments permitted by Section 855 of the Texas Probate Code. The terms and provisions of the Texas Trust Code shall apply to this Trust, to the extent they are not in conflict with Tex. Prob. Code Ann. §§ 867-873 or with the terms of this instrument.

21. **No Bond Required.** The Trustee shall serve without giving a bond. Neither the Guardian of the Estate of the Beneficiary nor the surety on the Guardian's bond (if any) shall be liable for an act or omission of the Trustee.

22. **Successor Trustees.** In the event of the corporate reorganization, merger or acquisition of the Trustee, the resulting successor organization shall automatically become the successor trustee. The Trustee may resign with the approval of the Court and may be removed by order of the Court. Upon the resignation or removal of the Trustee, the Court shall appoint a successor trustee. Each successor trustee shall have all of the rights, powers and duties of the Trustee.

23. **Spendthrift Trust.** To the extent permitted by law, the interest of the Beneficiary shall be held subject to a spendthrift trust as provided in Section 112.035 of the Texas Property Code.

24. **Amendment, Modification or Revocation.** The Court may amend, modify, or revoke the Trust at any time before the date of the Trust's termination. Neither the Beneficiary nor the guardian of the Beneficiary's estate may revoke the Trust.

25. **Effective Date.** This Trust shall be effective upon the last to occur of (A) the entry of an order creating the Trust by the Court, (B) the execution of this Declaration of Trust by the Trustee indicating its acceptance of the Trust; and (C) the receipt by the Trustee of the initial trust estate.

TRUSTEE'S ACCEPTANCE:

By: _____
Name: _____
Title: _____

APPENDIX Q Supplemental Needs Trust Created by Third Party

This is not a court-created trust, nor does it meet the requirements of 42 U. S. C. §1396p(d)(4)(A). Rather, this is a form of trust which may be used by a parent or other relative as a means of transferring property from the parent or relative for the benefit of a person receiving governmental assistance without disqualifying that person from receiving such assistance. The most significant distinction between this trust and a (d)(4)(A) trust is that this trust contains no provision for reimbursing the state upon the death of the beneficiary, since reimbursement is not required for a trust holding a third party's funds (rather than the beneficiary's funds).

SUPPLEMENTAL NEEDS TRUST FOR _____

This trust agreement is made by and between _____ (Settlor) as settlor and _____ (Trustee) as trustee in order to create a trust (the Trust) for the primary benefit of _____ (Beneficiary).

26. Transfer to Trust. Settlor transfers to Trustee the property described on Schedule "A" attached hereto as the initial trust estate of the Trust. The Trustee accepts such property. Additional property acceptable to the Trustee may be transferred to the Trust from time to time by anyone and added to the trust estate.

*[2. **Trust Irrevocable.** This trust is irrevocable.][2. **Trust Revocable.** This trust may be revoked or amended in whole or in part by Settlor during Settlor's lifetime. After Settlor's death, this Trust shall become irrevocable.]*

3. Distributions During Term of Trust. The following provisions shall govern distributions from the Trust during the term of this Trust:

A. Purpose and Intent. This Trust is intended to be construed and administered as a supplemental needs trust. Without limiting the foregoing, neither the corpus of the Trust nor distributions from the Trust shall ever cause the Beneficiary to be disqualified to receive those public benefits or assistance under a state or federal program to which the Beneficiary then may be entitled but for the existence of this Trust or but for the distributions from this Trust.

B. Distribution Standard. During the term of this Trust, the Trustee shall apply for the benefit of the Beneficiary those amounts of the principal and/or income of the Trust for the satisfaction of the Beneficiary's supplemental needs (defined below), as the Trustee, in the Trustee's sole and absolute discretion, may from time to time deem appropriate, subject to the strict limitations set out in this instrument. Any income of the trust not distributed shall be added to the principal.

C. Supplemental Needs. As used in this instrument, "supplemental needs" refers to the requisites for maintaining the Beneficiary's health, safety, and welfare when the Trustee determines, in its discretion, that such needs are not being provided for by any public or private agency, including any state, the United States, or any insurance carrier with insurance policies covering the Beneficiary. The Trustee is prohibited from expending any of the trust principal or income for any property, services, benefits, or medical care which are being received by, or which are otherwise available to, the Beneficiary from any governmental source or from any insurance carrier required to cover the Beneficiary. Further, the Trustee is prohibited from expending any of the trust principal or income for any such property, services, benefits, or medical care if that restriction is necessary in order to qualify the Beneficiary for such governmental or insurance carrier benefits because an application for such property, services, benefits, or medical care has been filed with an applicable governmental agency or insurance carrier on the Beneficiary's behalf. The Trustee may pay any deductible amounts for the Beneficiary on any insurance policies covering the Beneficiary so long as that payment does not disqualify the Beneficiary from receipt of benefits. The Trustee shall cooperate with the Beneficiary's conservator, guardian, or legal representative to seek support and maintenance for the Beneficiary from all available resources, including but not limited to, the Supplemental Social Security Income Program (SSI), Supplemental Income Program (SIP) of Texas, the Old Age Survivor and Disability Insurance Program (OASDI), the Medicaid Program, and any additional similar or successor programs, and from any private sources. The Trustee may supplement, but shall not supplant services, benefits, and medical care received or requested by or on behalf of the Beneficiary that are available through any governmental or private resource.

D. Payment of Income Taxes. The Trustee shall pay any income tax liability of the Beneficiary which results from income received by the Trust but reported on the income tax return of the Beneficiary. The funds used to pay this income tax liability shall be paid directly to the appropriate taxing authority and shall not be available to

the Beneficiary. The Beneficiary shall not have any right to or interest in any of these funds paid by the Trustee. Further, these funds are not a resource of the Beneficiary and shall not be treated as a distribution of cash for purposes of Medicaid qualification.

4. **Facility of Payment.** Notwithstanding anything to the contrary in this instrument, the Trustee, in its sole discretion, may make any distribution required or permitted to be made under this instrument in any of the following ways (regardless of whether or not the Beneficiary is a minor or is incapacitated): (a) To the Beneficiary directly; (b) To the guardian of the Beneficiary's person or estate; (c) By reimbursing the person who is actually taking care of the Beneficiary, even though the person is not the legal guardian, for expenditures made by the person for the benefit of the Beneficiary; or (d) By paying for a good or service directly to the provider of that good or service.

5. **Termination of Trust.** The Trust will terminate on the death of the Beneficiary.

6. **Distribution Upon Termination of Trust.** Upon termination of the Trust, the trustee shall distribute the principal and any undistributed income of the Trust to the Beneficiary's descendants, per stirpes, and if the Beneficiary has no descendants who are then living, to Settlor's descendants, per stirpes, and if none of such persons is then living, to Settlor's heirs at law.

7. **Compensation of the Trustee.** The Trustee shall be entitled to reasonable compensation, which compensation shall not exceed that customarily charged by corporate fiduciaries in _____, Texas. In addition, the Trustee may be reimbursed from the trust estate for expenses it reasonably incurs.

8. **Powers of Trustee.** The Trustee shall have all of the powers of trustees under the Texas Trust Code. The terms and provisions of the Texas Trust Code shall apply to this Trust, to the extent they are not in conflict with the terms of this instrument.

9. **No Bond Required.** The Trustee shall serve without giving a bond.

10. **Successor Trustees.** If the Trustee resigns, _____ shall become successor Trustee. Each successor trustee shall have all of the rights, powers and duties of the Trustee.

11. **Spendthrift Trust.** To the extent permitted by law, the interest of the Beneficiary shall be held subject to a spendthrift trust as provided in Section 112.035 of the Texas Property Code.

Signed this ____ day of _____, ____.

Settlor

Trustee