Customizing 1301 Trusts—The Next Big Thing

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I. INTRODUCTION

The 1301 Trust offers an attractive mechanism for the management of assets belonging to minor children, incapacitated adults, and persons with only a physical disability. Statutory probate courts overwhelmingly prefer the use of the management trust as an alternative to opening a guardianship estate. However, attorneys, courts, and trustees understandably are more comfortable using familiar forms for the 1301 Trust, as such forms have withstood the test of time, are easy to replicate, and are less complicated to administer by the trustee.

This paper makes the argument that attorneys, trustees, and courts might better serve clients if they approach the drafting of a 1301 Trust as an opportunity to solve a variety of challenges associated with protecting the best interests of the beneficiary—not just provide professional management of assets under the supervision of the courts. These authors suggest how the 1301 Trust agreement may be drafted to creatively address a variety of complicated objectives including:

- Protecting beneficiary's rights to governmental benefits (special needs provisions);
- Protecting trust from creditors of the beneficiary (spendthrift provisions);
- Optimizing income tax deferral of qualified asset passing to trust ("see through" or "stretch" provisions);
- Prolonging the existence of the trust created for a minor beneficiary beyond the beneficiary's 25th birthday;
- Respecting the existing estate plan of the incapacitated person when assets have beneficiary designations, pay on death provisions, or are held as joint tenant with rights of survivorship, yet need to be consolidated with the trustee;
- Settle a contested guardianship and inevitable litigation after the incapacitated person's death, resulting from contradictory estate planning documents signed when such person's capacity was in question;
- Protect the trustee when the trustee agrees to take on the management of liability prone assets (exculpatory clause); and
- Create a mechanism for the settlement of disagreements as to distributions from the trust (Advisory Committee to the Trustee).

II. HISTORY OF THE 1301 TRUST

The 1301 Trust began as a Section 867 Management Trust, named after Section 867 of the Texas Probate Code. Enacted in 1993, Section 867 gave courts the power to create a trust for the benefit of a minor child or incapacitated adult as an alternative to guardianship of the such person's estate.

Since 1993, the 1301 Trust has undergone many revisions to help serve people more efficiently and expand its functionality. The first major change to the court created trust came in 1997. Prior to 1997 a guardianship was needed in order to create a management trust, but the revisions to Section 867 of the Texas Probate Code in 1997 made it possible to create a management trust independent of a guardianship for a minor child or incapacitated adult.

Then, in 2011, persons with only physical disabilities scored a win when Section 867 was amended to enable such persons to become beneficiaries of management trusts. Later in 2013, Section 867 was amended again to allow persons with only a physical disability to apply for the creation of a management trust without the need of a guardian or attorney ad litem.

Before the changes to Section 867 of the Texas Probate Code in 2013, those persons having only a physical disability faced important limitations with respect to the management trust. The legislative changes to Section 867 of the Texas Probate Code in 2013 enabled persons suffering only a physical disability to: 1) file for the creation of a management trust; 2) enjoy more discretion regarding the terms and trusteeship of such trust; 3) avoid the expense of an attorney ad litem; and 4) sidestep court protections normally afforded to incapacitated persons and minor children, like court audits of annual accountings and the bonding of fiduciaries.

III. BASIC PROVISIONS OF THE 1301 TRUST

Other than including the required terms, there is no statutorily sanctioned form for the 1301 Trust. Some trust companies have developed preferred language and preferred forms for attorneys to use in preparing the terms of the 1301 Trust. These authors ran across a basic form for the 1301 Trust in an article written by Keith V. Novick and Ryan M. Moore entitled, "An Overview of Chapter 1301 Trusts and Reflections on Certain Unanswered Questions About Management Trusts," published by the Dallas Bar Association.

A. Who May Apply for the Creation of a 1301 Trust?

The following persons may apply for the creation of a 1301 Trust:

- The guardian of a ward;
- An attorney ad litem or guardian ad litem appointed to represent a ward or a ward's interests;
- A person interested in the welfare of an alleged incapacitated person who does not have a guardian;
- An attorney ad litem or guardian ad litem appointed to represent an alleged incapacitated person who does not have a guardian; or
- A person who has only a physical disability.

See Tex. Est. Code §1301.002.

Importantly, in 2011, the Texas Legislature extended the list of applicants to include persons having only a physical disability. Then, in 2013, the Texas Legislature made forming a 1301 Trust for a person having only a physical disability much more efficient by removing the requirements that: 1) the court appoint an attorney ad litem; 2) a bank or trust company serves as trustee; and 3) the fiduciary be bonded and file annual accountings. Such amendments to Chapter 1301 of the Texas Estates Code paved the way for the formation of court created, self-settled special needs trusts.

B. Who May Serve as Trustee of a 1301 Trust?

The court may appoint an individual, including someone who is a private professional guardian, a nonprofit corporation qualified to serve as a guardian, or a guardianship program as the Trustee of a 1301 Trust provided the court finds that the appointment is: 1) in the best interests of the ward or incapacitated person for whom the trust is created; and 2) the value of the trust's principal is either less than $150,000 or more than $150,000 but the applicant has been unable to find a financial institution in the geographic area willing to serve as trustee. In all other cases where the beneficiary is a minor child or an incapacitated person, the trustee must be a financial institution. *See* Tex. Est. Code §1301.057. If the 1301 Trust is formed for the benefit of a person having only a physical disability, the court is not required to appoint a financial institution to serve as trustee. *See id.*

C. Required Terms of the 1301 Trust

A 1301 Trust created for a minor child or incapacitated person must provide that:

- The minor child or incapacitated person is the sole beneficiary;
- The trustee may distribute income and/or principal as necessary for the health, education, maintenance, or support of the beneficiary;
- Any trust income that is not distributed to the beneficiary is added to the trust principal;
- If the trustee is a corporate fiduciary, they serve without having to give bond;
- Subject to the court's approval, the trustee is entitled to receive reasonable compensation payable from the income and/or principal of the trust for the services the trustee provides to the beneficiary in the same manner as compensation of a guardian is determined and paid.

See Tex. Est. Code §1301.101. If the 1301 Trust is created for the benefit of a person with only a physical disability, the trustee need not be bonded and the court need not approve reasonable compensation paid to the trustee. *See id.*

D. Optional Terms of the 1301 Trust

The trustee of a 1301 Trust created for a ward or incapacitated person may make distributions to a person whom the beneficiary is obligated to support as necessary for such person's health, education, maintenance, and support. Such distributions may be made without the intervention of the ward's guardian or representative of an incapacitated person. *See* Tex. Est. Code §1301.102. Further the court may include additional provisions in a management trust on the trust's creation or modification if the court determines the addition does not conflict with a required term. *See id*.

IV. MODIFICATIONS OF THE 1301 TRUST TO CONSIDER

In an effort to fully reveal how the various objectives outlined below were achieved with thoughtful drafting, "Sample Language" has been included. No pride of authorship is associated with the sample language presented in this paper and it was included reluctantly, as the entire thrust of the paper is to encourage individuality, creativity, and problem solving when drafting the 1301 Trust.

A. Statutory Authority to Modify Required Terms

Interestingly, the Court creating or modifying a management trust may omit or modify otherwise applicable, required terms if the court is creating a trust for a person who has only a physical disability, or if the court determines that the omission or modification is:

- Necessary and appropriate for the person for whom the trust is created to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the person; *or*
- In the best interests of the person for whom the trust is being created.

See Tex. Est. Code §1301.101(c).

The portion of Chapter 1301 set out above appears to open the door to a broad range of planning options with respect to the 1301 Trust. Consequently, drafters should consider customizing or adding to the standard 1301 Trust form to address the individual needs of the beneficiary. The remainder of this outline is devoted to setting out specific examples where making modifications to the standard language of the 1301 Trust resulted in significant benefits to the beneficiary.

B. Special Needs Language

1. Introduction. For beneficiaries receiving Supplemental Security Income or Medicaid, or those who may at some point need to avail themselves of such benefits, consider creating the 1301 trust as a supplemental needs trust. This will ensure that the trust property is not considered an asset of the beneficiary for purposes of determining eligibility for these means-tested benefits.

"Supplemental Needs Trust" ("SNT") is a broad term encompassing self-settled and third-party created trusts. It provides a mechanism for preservation of assets and distributions for the beneficiary while giving the beneficiary the option of maintaining eligibility for certain governmental "need-based" benefits.

The operative words describing these trusts are "supplemental needs," thereby distinguishing such trusts from "support" or other types of trusts. SNTs may have very strict distribution restrictions, prohibiting certain distributions, or they may be drafted more broadly. A trust with broad distribution standards may give the trustee full discretion to make distributions, even to the extent of causing the beneficiary to forfeit governmental benefits, if it is determined that such strategy is in the best interest of the beneficiary.

2. Defining a Self-Settled Supplemental Needs Trust. A trust funded with assets belonging to the beneficiary or the beneficiary's spouse is a self-settled trust. *See* 42 U.S.C.§ 1396(e)(1). The federal statute extends the definition of such assets to include those assets arising from a personal injury recovery or a legacy or inheritance. *Id. See also*, POMS SI 01120.200 et seq. (THHSC adopting POMS).

The creation and funding of a self-settled SNT is allowed by the Social Security Administration and Medicaid in light of the self-settled trust exceptions created in the Omnibus Budget Reconciliation Act of 1993. The two exceptions are found at 42 U.S.C. §1396p(d)(4)(A) (for individual trusts) and 42 U.S.C. §1396p(d)(4)(C) (for pooled trusts). Both provisions provide that the trust can be created by the beneficiary, a court, or the beneficiary's parent, grandparent, or guardian. *See* 42 U.S.C.§1396p(d)(4)(A) and 42 U.S.C.§1396p(d)(4)(C). While only 42 U.S.C. §1396p(d)(4)(A) is expressly limited to beneficiaries who are under the age of 65, the age limit is applied by Texas Medicaid to both (d)(4)(A) and (d)(4)(C) trusts, in that Texas Medicaid penalizes for a transfer made to either type of trust after the beneficiary has reached age 65. *See* MEPD F-6713 Transfer of Assets (pertaining to (d)(4)(A) trusts) and MEPD F-6723 Transfer of Assets (pertaining to (d)(4)(C) trusts).

It is critical to understand that there is no one good form for an SNT, since the purpose of an SNT is to serve the needs of a particular beneficiary and protect that beneficiary's specific government benefits. The SNT should be drafted to fit the beneficiary's specific current or potential circumstances and eligibility needs. As a result, when drafting and administering a self-settled SNT, one must have a grasp of the eligibility criteria that the trust intends to protect. For example, it may be unwise to make distributions of cash to a person receiving Supplemental Security Income ("SSI") because the SSI recipient loses $1 of SSI benefit for every $1 of cash received. However, if the trust beneficiary is, instead, eligible for the Community Living and Support Services Medicaid program benefit ("CLASS"), the trustee can make distributions of cash up to a gross monthly income of $2,313 (in 2019).

Under the SSI program, if an SSI recipient is willing to lose as much as $277 of the SSI income each month, then the trustee could make distributions for food and shelter. But some SSI recipients receive less than $277 per month, so a distribution for food and shelter would be unwise. Under the CLASS program, a trustee can make unlimited distributions for food and shelter. An SNT cannot be drafted without an understanding of the government benefits the beneficiary is currently receiving and will likely pursue in the future.

Originally, SNTs were strictly construed, with the trustee making distributions ONLY for goods and services that were supplemental in nature. If the distribution could *theoretically* result in disqualifying income in the month of receipt or create a subsequent disqualifying resource, then the distribution could not be made. Fortunately, SNTs have evolved to allow for distributions for almost any need, depending on the beneficiary's circumstances and the eligibility requirements of the governmental benefit sought to be preserved.

3. Supplemental Needs Trust Provisions. Before drafting a court-created supplemental needs trust, it is helpful to review the relevant Social Security Administration Program Operations Manual System (POMS) provisions dictating the review and treatment of trusts. POMS SI 01120.202 "Development and Documentation of Trusts Established on or After 01/01/00" is a good place to start, but here are some key points to address in a 1301 Trust with supplemental needs provisions:

a. Essential Provisions

i. Sole Benefit of the Individual. It is critical that the trust be drafted to provide for the sole benefit of the individual for whom the trust is created by the court. *See* POMS SI 01120.201F.2. The sole benefit issue is often as much a matter of training the trustee as including the relevant language within the trust itself. Fortunately, recent Social Security Administration policies have been clarified to provide that the agency "should not read this so strictly as to prevent any collateral benefit to anyone else." *See* POMS SI 01120.201F.3. The Social Security Administration considers a trust to be established for the sole benefit of an individual if the trust benefits no one but that individual, whether at the time the trust is established or at any time for the remainder of the individual's life. *See* POMS SI 01120.201F.1. As long as expenditures are made for the primary benefit of the trust beneficiary, distributions should be considered for the sole benefit of the beneficiary. *See* POMS SI 01120.201F.3.a.

SAMPLE LANGUAGE:

This declaration of trust creates an irrevocable management trust and special needs trust (the "Trust") for the benefit of [BENEFICIARY'S FULL NAME] (sometimes referred to as the "Beneficiary"), a beneficiary as provided in Chapter 1301 of the Texas Estates Code, with [TRUSTEE] or its affiliates as Trustee.

ii. Requirement of a Disability. To qualify for the special needs trust exception, the individual whose assets were used to establish the trust must be disabled for SSI purposes under section 1614(a)(3) of the Social Security Act at the time the trust was established. *See* POMS SI 01120.203B.4.

iii. State Payback Provision. All self-settled supplemental needs trusts, including those created by a court for a person with a disability, must include a state payback provision. More specifically, 42 U.S.C. §1396p(d)(4)(A), provides that "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 subchapter." *See* 42 U.S.C. §1396p(d)(4)(A). Social Security Administration policies permit the payment of limited administrative expenses prior to repayment of the State, but they specifically do not include payment of debts owed to third parties and funeral expenses. *See* POMS SI 01120.203E. It is only after the State has been repaid for required medical expenses, that any remaining funds can go to residual beneficiaries or the beneficiary's estate.

SAMPLE LANGUAGE:

Unless terminated by exhaustion of all of the assets of the Trust or earlier order of the Court, this Trust shall cease and terminate upon Beneficiary's death. Upon termination, the Trustee shall distribute and deliver the remaining principal and undistributed income, free of Trust, as follows: (1) pursuant to instructions contained in POMS §SI 1120.203.E, the Trustee is authorized to pay allowable administrative expenses; then, (2) pursuant to 42 U.S.C.A. §1396p(d)(4)(A), every State that has made expenditures on Beneficiary's behalf shall receive all amounts remaining in the Trust up to an amount equal to the total medical assistance paid on Beneficiary's behalf under the State's plan administered pursuant to 42 U.S.C. Subchapter XIX, paid in a prorated manner; then, (3) after taxes have been paid and, after the State(s) has been reimbursed for the above noted expenditures, the Trustee shall distribute and deliver the remaining principal and undistributed income, free of Trust, to the personal representative of the probate estate of Beneficiary. Provided, however, *that the Court may enter an order directing the Trustee to pay remaining proceeds (after the satisfaction of any Medicaid reimbursement obligation) directly to the heirs at law of Beneficiary if Beneficiary dies without a will and the Court is satisfied that there is no necessity for the administration of a probate estate.*

iv. Established by the Court. In the case of a trust established through the actions of a court, the creation of the trust must be required by a court order. *See* POMS SI 01120.203B.8. The court must specifically either establish the trust or order the establishment of the trust. An individual is permitted to petition a court for the establishment of a trust or may use an agent to do so. Petitioning a court to establish a trust is not establishment by an individual. The court order establishes the trust, not the individual's petition. Mere approval by the court of an already created special needs trust is not sufficient for the trust to qualify for the exception. Remember that a beneficiary with only physical disabilities or the beneficiary's parent, grandparent or guardian may also create the trust. *See* 42 U.S.C.§1396p(d)(4)(A); 42 U.S.C.§1396p(d)(4)(C).

SAMPLE LANGUAGE:

This trust agreement is established this [DATE OF CREATION], pursuant to the Decree of the [COURT] (the "Court") under Cause Number [CAUSE NUMBER], in a case styled [STYLE] (the "Case") pursuant to the Court's equitable and common law jurisdiction, 42 U.S.C. §1396p(d)(4)(A) and Chapter 1301 of the Texas Estates Code.

v. Accountings. The trustee of a management trust created for a ward must file an annual accounting of trust transactions in the same manner and form required of a guardian of the estate. *See* Tex. Est. Code §1301.154. The court may waive the requirement of an annual accounting for a trust created for a person who has only a physical disability. *See id.* Some courts are known by the authors to also waive the requirement of an annual accounting by a corporate trustee which issues regular statements of trust activity.

SAMPLE LANGUAGE:

The Trustee shall 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 of the estate under the Texas Estates Code. The Trustee shall provide a copy of the annual account to the Guardian of Beneficiary's Person and Estate. These accountings shall set forth all receipts and distributions made during the reporting period and assets held in Trust at the end of the period.

vi. Beneficiary Cannot Serve as Trustee. A beneficiary may not serve as the trustee of his or her own self-settled SNT. Under Supplemental Security Income regulations and Medicaid program benefit regulations, if the beneficiary can control the distribution of the funds, then the assets subject to the beneficiary's control will be deemed to be accessible to the beneficiary and will cause the beneficiary to lose eligibility for benefits. *See* MEPD §F-6300; POMS SI 01120.200D.1.a.

b. Other Important Considerations

i. Early Termination Provision. An early termination provision allows a trust to terminate before the death of the beneficiary, such as if the beneficiary is no longer disabled, the beneficiary becomes ineligible for means-tested benefits, or the trust fund no longer contains enough assets to justify its continued administration. In the case of a 1301 trust, early termination would no doubt be a result of court action, but if a trust has an early termination clause, it must meet certain requirements in order to maintain SSI and Medicaid qualification:

- The State would receive all amounts remaining in the trust at the time of termination up to an amount equal to the total amount of medical assistance paid on behalf of the individual under the State Medicaid plan(s); and
- Other than payment for designated administrative expenses and the State, no entity other than the trust beneficiary may benefit from the early termination; and
- The Beneficiary does not have the power to terminate.

See POMS SI 01120.199.

ii. Facility of Payment Clause. Including a facility of payment clause in the trust adds clear language that the trustee can pay directly to providers of goods and services. Rarely, if ever, are distributions from a supplemental needs trust made directly to the beneficiary. The rationale is two-fold: in many cases the beneficiary would not be able to administer funds if they were received directly from the trust, and direct distributions from the trust to the beneficiary would be income to the beneficiary, which might reduce or eliminate qualification for government benefits.

SAMPLE LANGUAGE:

Subject to the terms and conditions of this trust, it is not necessary that Beneficiary or Beneficiary's legal representative, if any, actually pay an allowable expense prior to requesting payment from the Trustee. Beneficiary or Beneficiary's legal representative may direct suppliers of allowable goods and services to apply directly to the Trustee for payment. The Trustee is authorized to make payments from the Trust directly to the providers only to the extent that the distribution is authorized by the terms of this Trust.

iii. Avoid Explosion Clauses. Avoid the use of an explosion clause such as: "If the Trustee finds that the mere existence of this Trust will disqualify the beneficiary for *any* government benefit, then this trust shall terminate." The inclusion of such a provision could result in the unintended early termination of a supplemental needs trust, triggering a state payback provision prior to the beneficiary's passing. A supplemental needs trust is intended to protect Supplemental Security Income and Medicaid benefits. It is not intended to protect benefits such as SNAP, HUD housing, or state mental health benefits. In fact, under three provisions of the Texas Health & Safety Code, a trust funded in excess of $250,000 could disqualify an individual for certain mental health benefits. *See* Tex. Health & Safety Code §§ 534.0175, 552.018 & 593.081. The termination of a trust due to the loss of a government benefit which the trust was not intended to protect would surely not be the intent of the court or the beneficiary.

iv. Particular Expenditures: Care Coordinators and Life Insurance on Parent or Caregiver's Life. A care coordinator or case manager may be recommended in order to advise the trustee on the special needs of the beneficiary and assist in the care management. A supplemental needs trust is just that—for supplemental needs. But how would a trustee know, over a beneficiary's lifetime, just what the beneficiary's supplemental needs are? One might include a provision in the trust document that encourages or requires the engagement of a care coordinator or the preparation of an annual care report issued by a licensed therapist, or social worker. Corporate trustees are well familiar with the advantages of utilizing the services of a care coordinator, so the inclusion of such a provision is probably unnecessary when a corporate trustee will be used, but the inclusion of such a provision can be instructive to an individual trustee.

Including a provision that allows the trustee to purchase a term life policy on the parent or caregiver's life would provide additional funds in the event of an untimely death.

SAMPLE LANGUAGE:

The Trustee is hereby authorized, but has no obligation, to purchase and/or maintain one or more life insurance policies on the life of the Beneficiary's parent, grandparent, or other relatives. The Trust estate hereunder or the Trustee shall be named as the direct beneficiary of such policies. The purpose of this provision is to allow the Trustee to obtain emergency funds to replace caregiver services when a caregiver dies. As soon as possible after the Trustee receives actual notice of the death of the insured under any such policy, the Trustee shall take appropriate action to collect (by whatever means necessary, including the prosecution and maintenance of litigation) the sums of money or other properties as shall be due the Trustee under the terms of any such policies of insurance (including multiple indemnity benefits). No insurance company shall be under any responsibility to see to the performance of the Trust. In the event an insured becomes totally and permanently disabled, upon receiving notice of such fact, the Trustee shall promptly notify all insurance companies which to the knowledge of the Trustee have issued to the Trust estate a policy that contains a waiver of premium provision in the event of such disability, and the Trustee shall take any and all steps necessary to make such waiver of premium provision effective.

v. Doctrine of Worthier Title. Remember the Doctrine of Worthier Title? How long has it been since this issue has arisen? Many of us have not thought of this Doctrine since law school. Recall that the Doctrine of Worthier Title provides that if the grantor is the sole beneficiary of a trust, then the trust is revocable. Under common law, leaving an estate to heirs would not be a remainder but actually a reversion to the grantor and his progeny. Texas has abolished the doctrine by statute in Texas Property Code §5.043, leaving it as a rule of construction—that is to say, the court will look at the intent of the Grantor.

That said, the Social Security Administration relies on state law to determine if, under state law, a provision naming heirs or the grantor's estate as the taker on the grantor's death results in a reversion as opposed to a remainder. If there is no remainder beneficiary, then the grantor is the sole beneficiary and the trust is revocable, regardless of the wording of the trust. Texas Estates Code §1301 et seq. requires that, at the death of the grantor, the trust proceeds be paid to the grantor's estate representative. *See* Tex. Est. Code §1301.204.

SAMPLE LANGUAGE:

This Trust is created pursuant to the requirements of Texas Estates Code Chapter 1301 and 42 U.S.C. §1396p(d)(4)(A), and the Doctrine of Worthier Title does not apply as a rule of construction.

vi. Specific State Authority. For ease of reference for SSI review, it is best to include in the order creating the trust, a specific reference to Chapter 1301 of the Texas Estates Code, as the statutory authority for the for the court to establish the trust.

SAMPLE LANGUAGE:

This trust agreement is established this [DATE OF CREATION], pursuant to the Decree of the [COURT] (the "Court") under Cause Number [CAUSE NUMBER], in a case styled [STYLE] (the "Case") pursuant to the Court's equitable and common law jurisdiction, 42 U.S.C. §1396p(d)(4)(A) and Chapter 1301 of the Texas Estates Code.

vii. Less is More. It is not unusual for a trustee to request specific language in the trust to allow for large distributions such as authority to pay for vacations for the beneficiary and the family or expenditures for countable assets such as a house. However, these provisions have subsequently resulted in disqualification of some trusts by the Social Security Administration. Less specific language is usually more desirable.

SAMPLE LANGUAGE:

This Trust is explicitly intended to be a discretionary trust and not a basic support trust, and the Trust assets are intended to be used in a manner consistent with this premise. The Court has not imposed any specific standards, guidelines, or instructions as to the distributions of income or principal to or for the benefit of Beneficiary in keeping with the intent that this Trust be a wholly discretionary trust and that neither the Trust principal nor income should be considered a financial resource that is available to Beneficiary or Beneficiary's legal representative, if any, or over which Beneficiary or Beneficiary's legal representative, other than the Trustee, have any power, including the rights to withdraw income or principal or to compel a distribution of any of the Trust estate. Beneficiary shall not have any interest in or access to the Trust estate, except as determined by the Trustee according to the standards and limitations contained in this Trust.

C. Spend Thrift Provisions

To maximize the asset protection features of a 1301 Trust, consider adding spendthrift language clarifying that the beneficiary's interest in the trust income and principal is not subject to the claims of creditors. In fairness, this kind of addition to the statutorily required terms and optional terms set out in Sections 1301.101 and 1301.102 of the Texas Estates Code, respectively, has been incorporated into the standard 1301 Trust forms used by trust departments and attorneys for many years.

The language set out below was taken from a paper entitled "An Overview of Chapter 1301 Trusts and Reflections on certain Unanswered Questions about Management Trusts," written by Keith V. Novick and Ryan M. Moore and presented to the Probate, Trusts & Estates Section of the Dallas Bar Association on January 22, 2019 with Judge Ingrid M. Warren, Judge of Dallas County Probate Court No. 2 and James W. Holliday:

SAMPLE LANGUAGE:

Before the actual receipt of any distribution of any portion of the trust estate by Beneficiary, no property (whether income or principal) of the trust will be subject to anticipation or assignment by Beneficiary or to attachment by or the interference or control of any creditor or assignee of Beneficiary or be taken or reached by any legal or equitable process in satisfaction of any debt or liability of Beneficiary. Any attempted transfer or encumbrance of any interest in the trust estate by Beneficiary before its actual distribution will be void. In addition to being applicable to Beneficiary, this paragraph also applies to anyone other than Beneficiary who may be entitled to any portion of the trust estate on termination of the trust.

D. "See Through" or "Stretch" Language for IRA

1. Introduction. If the 1301 Trust is the beneficiary of a qualified retirement plan, then generally the plan must be distributed within five years of the plan participant's death instead of over the 1301 Trust beneficiary's remaining life expectancy. However, if the 1301 Trust contains "accumulation trust" or "conduit trust"

language, then the plan may be distributed over the beneficiary's remaining life expectancy. Such modification to the standard 1301 Trust language could be especially beneficial when the beneficiary is a minor child or relatively young.

2. Caroline's Story. A few years ago, the father of a six-year-old girl died unexpectedly. He worked as an engineer for a large energy company in Houston. He was a single father and was raising Caroline with the help of his mother. When he died intestate at the age of forty-one, his estate, life insurance, and qualified plan passed entirely to Caroline outright.

Caroline's grandmother properly obtained conservatorship in the family courts and sought the formation of a 1301 Trust through the probate courts. When it was determined that the qualified plan had a value of almost $1,000,000, the court recommended that consideration be given to adding special provisions to the standard 1301 Trust language so that the qualified plan could be distributed over the life expectancy of Caroline and avoid the requirement that the plan proceeds be distributed within five years of Caroline's father's death.

The grandmother and the court enlisted the assistance of Karen Gerstner who helped draft the terms of the 1301 Trust so that distributions from the qualified plan could be made over the next seventy-seven years, rather than within the short five-year window that would otherwise be required. The required minimum distribution (RMD) payable through the 1301 Trust and to Caroline's grandmother for her care totaled just over $13,000 the first year and increased each year so that when Caroline turns eighteen, the RMD will be just over $17,000. If Caroline takes only RMDs for seventy-seven years, she will receive distributions totaling $6,723,170, and such distributions have a present value of $2,363,183 as of the date the first RMD is made.

An example of the Application, Order, and Terms of the 1301 Trust structured as a conduit trust is included as Appendix A herein.

3. Key Requirements. For the 1301 Trust to be treated as a "see through" or "stretch" trust so that the RMDs after the death of a participant are calculated over the life expectancy of the primary beneficiary of such trust, four very specific requirements must be met:

- The trust must be valid under state law;
- The trust must be irrevocable, or by its terms become irrevocable on the death of the original IRA owner;
- The trust's underlying beneficiary must be identifiable as being eligible to be the designated beneficiary themselves;
- A copy of the trust document must be provided to the IRA custodian by October 31st of the year following the IRA owner's death.

In addition, the Trustee should not withdraw all the assets held in the qualified plan in order to "fund" the Beneficiary's trust. Instead, the Trustee shall establish an "inherited IRA" for the benefit of the primary beneficiary and shall make a "trustee to trustee transfer" of the beneficiary's interest in the qualified plan to the inherited IRA pursuant to the provisions of the Pension Protection Act.

4. The Accumulation Trust. As the name suggests, the trustee accumulates distributions from the plan in the trust instead of automatically distributing plan distributions to the beneficiary. If the beneficiary has creditors, is not a good steward of funds, is a minor child, or has special needs, an accumulation trust often makes sense.

However, some practitioners shy away from using accumulation trusts because their provisions are more complicated to draft and the trusts are slightly more complicated to administer. For example, the accumulation trust must contain language clarifying that it will not make distributions to any beneficiary older than the beneficiary named in the 1301 Trust or to any entity that would require the plan to be distributed within five years of the participant's death. Without this language, the IRS may deem the 1301 Trust a non-designated beneficiary and require that the plan be distributed within five years of the participant's death because the trust could accumulate plan distributions after the primary beneficiary's death and therefore could potentially make distributions to other beneficiaries named or referred to in the 1301 Trust.

Recall that Section 1301.204 of the Texas Estates Code sets out that upon termination of the 1301 Trust after the death of the primary beneficiary, the remaining principal and undistributed income of the trust shall pass to the representative of the deceased ward's, incapacitated person's, or physically disabled person's estate upon the death of such beneficiary. Such distribution plan on the death of the trust's primary beneficiary would have to be changed to enable the 1301 Trust to enjoy status as an accumulation trust.

For example, the remainder beneficiaries of the 1301 Trust could be the heirs at law of the primary beneficiary, provided that, if any persons who would otherwise be an heir-at-law of the primary beneficiary but were born before the primary beneficiary, such heir-at-law who is older than the primary beneficiary would be deemed to have predeceased the primary beneficiary.

In addition to the difficulties associated with harmonizing the statutory requirements of the 1301 Trust with the federal income tax rules for a conduit trusts, accumulation trusts are more difficult to administer and are likely less tax efficient as compared to the conduit trust. For any given year, unless the trustee pays out to the beneficiary plan distributions within sixty-five days of the close of the year, the plan distributions will be taxed according to the trust's compressed income tax brackets, likely resulting in more tax due as compared to if plan distributions had been distributed immediately to the beneficiary.

5. <u>The Conduit Trust</u>. Conduit trust provisions require plan distributions made to a 1301 Trust to be immediately distributed to the beneficiary. The trust acts as a mere conduit for the distributions from the plan to the trust beneficiary. Provisions for these trusts are simpler to draft, as the primary beneficiary's estate may be named as the remainder beneficiary of the 1301 Trust, in accordance with Section 1301.204 of the Texas Estates Code.

However, automatic distributions of income from the qualified plan to the 1301 Trust could be problematic, especially when the primary beneficiary of the 1301 Trust is a minor child and has the full support of a parent, or when the primary beneficiary has special needs and is receiving governmental benefits.

6. <u>Tax Benefits</u>. At least the RMD must be withdrawn from the inherited IRA each year. If the trust is an accumulation trust, the 1301 Trust would receive the RMD and any portion of the RMD which is not distributed to the beneficiary would be taxable to the 1301 Trust and subject to the compressed income tax rates for trusts. The portion of the RMD distributed to the beneficiary or for the benefit of the beneficiary would be taxable to the beneficiary and subject to individual income tax rates.

If the trust is a conduit trust, that RMD must also be distributed out of the 1301 Trust each year to the beneficiary or for the benefit of the beneficiary. This is a requirement under the federal income tax rules for a conduit trust. Any additional amounts (beyond the RMD) that are withdrawn from the inherited IRA that belong to the 1301 Trust must also be distributed out of the trust to or for the benefit of the beneficiary in the same year as the withdrawal. Again, these are the "conduit trust" rules under the federal Treasury Regulations.

With both the accumulation trust and conduit trust, the beneficiary's life expectancy is used, per the IRS's single life table, to calculate the RMD from the inherited IRA. In other words, the divisor for the beneficiary's age as of the beneficiary's birthday in the year following the death of the participant is taken from the single life table and applied to the plan balance as of December 31st of the year of the participant's death. Such amount equals the RMD for the year following the participant's death.

In subsequent years, to calculate the RMD, the whole number one (1) is subtracted from the prior year's divisor and applied to the value of the balance of the inherited IRA as of December 31st of the prior year. The Trustee may not return to the single life table each year to obtain a new divisor unless the beneficiary of the 1301 Trust is the participant's surviving spouse. The minimum that must be taken each year is the RMD. More can always be taken; but if less is taken, there is a 50% penalty. All amounts withdrawn from the IRA will be taxable as ordinary income for federal income tax purposes in the year taken.

Example:

Year of death	2018
Year of first RMD (year following death)	2019
Age of beneficiary in 2019	6
Fair market value of Inherited IRA on 12/31/2018	$1,000,000
2019 life expectancy factor (based on the IRS Single Life Expectancy Table)	76.7
2019 RMD amount	$13,038 ($1,000,000 / 76.7)
2020 life expectancy factor (revised annually based on the IRS Single Life Expectancy Table)	75.7 (76.7 – 1.0)
2020 RMD amount	(12/31/2019 Fair Market Value / 75.7)

In the example set out above, over the course of almost seventy-seven years, the beneficiary IRA would grow tax deferred and spin off seventy-seven distributions totaling $6,723,170. Assuming a 4% steady growth rate over the course of that seventy-seven years and a discount rate of 2%, the present value of the seventy-seven distributions equals $2,363,183. What is more, considering that, for the first thirty-seven years, the distributions are less than $55,000 annually, the distributions are small enough each year to keep the beneficiary of a conduit trust in a modest income tax bracket.

7. Notes of Caution. Not all IRA custodians offer non-spousal beneficiaries the option to take RMDs based upon their own life expectancy. What is more, such option may be limited due to the age of the account owner at the time of the participant's death.

E. Extending the Term of the Trust

1. Introduction. If the person for whom a 1301 Trust is created is a minor child, Section 1301.203 of the Texas Estates Code requires the trust to terminate on the earlier of the following:

- The person's death;
- The person's 18th birthday; or
- The date provided in the court order which may not be later than the person's 25th birthday.

However, if the person for whom a management trust is created is not a minor, the trust terminates:

- According to the terms of the trust;
- On the date the court determines that continuing the trust is no longer in the person's best interest; or
- The person's death.

See Tex. Est. Code §1301.203.

Considering the provisions set out in Section 1301.203 regarding termination, would it be possible for the adult beneficiary of a 1301 Trust formed when the beneficiary was a minor child to seek court modification of the trust in order to extend the term of the trust beyond the date provided in the original provisions of the trust? In these authors' opinion, the answer is yes, so long as continuing the trust is in the best interest of the beneficiary.

When the beneficiary of a 1301 Trust becomes an adult, Section 1301.203(b) governs the termination of the trust. Consequently, the requirement that the trust terminate no later than the beneficiary's 25th birthday may be lifted and the termination date extended by the court though a modification of the trust when doing so is in the beneficiary's best interest. The court may modify a 1301 Trust at any time before the date of the trust's termination. *See* Tex. Est. Code §1301.201.

2. Brandon's Story. Brandon's parents won a sizeable medical malpractice settlement for Brandon after he suffered complications during his birth which resulted in life-long physical impairments and likely led to mental health challenges which cropped up later during his adolescent years. The settlement was placed in an 867 Management Trust when he was a baby and now Brandon is an extremely bright young adult, attending college, and looking forward to launching his career. His parents avoided tapping into the trust during his childhood and now the trust contains investments worth a great deal.

Brandon still struggles with physical and mental health challenges, and though he is far from incapacitated, he appreciates the fact that the 867 Management Trust has the following benefits:

- Professional management by a corporate trustee;
- Court oversight of distributions, investments, and fees;
- Professionally prepared annual accountings;
- Is protected from his creditors and future failed marriages;
- Enables him to qualify for valuable need-based governmental programs

The trust is scheduled to terminate when Brandon reaches the age of twenty-five. However, given the benefits of the trust he has enjoyed for almost his entire life, he desires that the trust continue for many more years.

3. Modification of Existing 1301 Trust to Extend Term. Section 1301.203 of the Texas Estates Code provides that, "[i]f the person for whom a management trust is created is a minor, the trust terminates on . . . the date provided by court order which may not be later than the person's 25th birthday. . . . If the person for whom a management trust is created is not a minor, the trust terminates . . . on the date the court determines that continuing the trust is no longer in the person's best interests." In Brandon's case, Brandon was a minor when the 1301 Trust was created. However, now as an adult beneficiary of such trust, he should be able to ask

the court to modify such trust to extend the trust's term beyond his 25th birthday and make a case that extending the term of the trust is in his best interest.

Even if the court declined to extend the term of the trust beyond Brandon's 25th birthday based upon Section 1301.203 of the Texas Estates Code, Brandon could make application to extend the trust term based upon Section 1301.051 of the Texas Estates Code which provides that a person who has only a physical disability may apply for the creation (and presumably a modification to extend the term of) a 1301 Trust. If Brandon sought an extension of the trust's term as a person with only a physical disability, he might consider asking the court to do more than extend the trust term. For example, he might ask the court to alleviate the trustee of the duty to file annual accountings pursuant to Section 1301.154 of the Texas Estates Code which provides that, "the court may not require a trustee of a trust created for a person who has only a physical disability to prepare and file with the court the annual accounting . . ." Doing so would enable the trust to save the expenses associated with the preparation and filing of the annual accountings and would enable Brandon to retain more privacy with respect to the assets and distributions associated with the trust.

F. Coordinating Investments and Distributions with Estate Plan

1. Introduction. Most 1301 Trusts address the investment authority of the Trustee and contain language similar to the following:

> The Trustee shall invest the trust estate in accordance with the standards now or hereafter set forth in Chapter 113 of the Texas Trust code, as amended. The Trustee may also invest all or any part of the trust estate in one or more common trust funds or mutual funds now or hereafter established by the Trustee or an institution affiliated with the Trustee when it is found by the Trustee to be prudent. To the extent allowed by law, the Trustee's investment authority shall not be limited by any provisions of the Texas Estates Code.

Often, little consideration is given to preserving the estate plan of the incapacitated beneficiary when the estate plan involves beneficiary designations, pay on death provisions, or accounts held with others as joint tenants with rights of survivorship.

2. Hazel's Story. Hazel worked for many years as a librarian and had accumulated a sizable estate which, with good management, could support her through her sunset years. She had three children and one grandchild. Though her Will left her estate to her children in equal shares, some assets passed outside of probate. For example, she named a longtime housekeeper as the pay on death beneficiary of a credit union account, presumably to provide a severance upon Hazel's death. She named her church as the beneficiary of her 401(k) and one of her grandchildren as a joint tenant with rights of survivorship on a sizable savings account.

When Hazel became incapacitated, a 1301 Trust was established and one of her children was appointed as the guardian of her person. In drafting the 1301 Trust and selecting a trustee, care was taken to respect Hazel's estate planning wishes and sidestep, to the extent possible, potential claims from the housekeeper, church, and grandchild against the trustee after Hazel's death.

3. Preserving the Estate Plan of a 1301 Trust Beneficiary. Often, when a 1301 Trust is formed for an incapacitated person, the trustee gathers the assets and manages the assets under the trustee's institutional canopy, paying little mind to existing beneficiary designations, pay on death designations, and rights of survivorship. Properly, the trustee's primary focus is on the best interests of the incapacitated beneficiary. However, respecting the estate plan of the incapacitated beneficiary should factor into the discussion about the best interests of the beneficiary.

a. Managing and Distributing Assets. Intent on protecting Hazel's existing estate plan, the attorney who drafted the 1301 Trust asked the court to order the trustee of the 1301 Trust to maintain Hazel's church as the beneficiary of her 401(k) plan and to designate the church as the beneficiary of a subsequent IRA rollover account resulting if the trustee was unable to maintain the 401(k) account with the plan administrator. In addition, he included language like the following to guide the trustee with respect to retention of assets, investments, distribution, and apportionment of income, expenses, gains, and losses.

SAMPLE LANGUAGE

The trust will be funded with the following assets and such assets will constitute the initial principal of the trust estate.

Asset	*Value*	*Beneficary/POD Beneficiary/JTWROS*
Publicly traded stock	*$400,000*	*None*
Credit Union Account	*$100,000*	*Housekeeper*
Savings Account	*$100,000*	*Grandchild*
401(k)	*$300,000*	*Church*
Total	*$900,000*	

It is anticipated that the trustee will combine the assets described above, save an except the 401(k) account, and invest such assets as one trust account. The trustee shall consider making distributions to the beneficiary so that the trust account and 401(k) account are proportionately reduced by such distributions such that the trust account makes 2/3 of each distribution and the 401(k) makes 1/3 of each distribution, unless making such distributions proportionately is not in the best interest of the beneficiary. Any income, expenses, gains, or losses, attributable to the trust account shall accrue to or be charged against such trust account. Any income, expenses, gains, or losses attributable to the 401(k) account shall accrue to or be charged against such 401(k) account.

b. Distribution of 1301 Trust on Death of Incapacitated Beneficiary. Section 1301.204 of the Texas Estates Code provides that, "[u]nless otherwise provided by the court . . . the trustee of a management trust shall . . . . distribute the principal and any undistributed income of the trust to: the representative of the deceased ward's or incapacitated person's estate on the ward's or incapacitated person's death." When an incapacitated beneficiary of a 1301 Trust properly establishes an estate plan, as in Hazel's case, consider including a more tailored distribution on death provision within the trust document.

SAMPLE LANGUAGE

The trust will terminate when the court determines the beneficiary is no longer incapacitated or on the death of the beneficiary. On termination, the trustee shall pay all of the remaining trust estate of the trust to the beneficiary, free of any further trust. Or, if the trust terminates as a result of the beneficiary's death, then the remaining trust estate shall be distributed as follows, in the following proportions, except that any accrued but undistributed income shall be distributed along with the trust asset generating such income:

Asset	*Value*	*Proportion*	*Distributee*
Trust Account	*$600,000*	*2/3*	*Personal Representative of Estate of Beneficiary*
		1/6	*Housekeeper*
		1/6	*Grandchild*
401(k)	*$300,000*	*All*	*Church*

c. Important Considerations. Naturally, drafting a 1301 Trust agreement with an eye toward protecting potential successors in interest to an incapacitated person's assets requires many considerations:

- Are the beneficiary designations/pay on death provisions/joint tenant with right of survivorship agreements valid?
- Should those having an expectancy interest in the assets or estate of the incapacitated person receive notice of the Application for the Creation of a 1301 Trust?
- Should those having an expectancy interest in the assets or estate of the incapacitated person join in a settlement agreement wherein they approve of the distribution provisions of the 1301 Trust upon the death of the incapacitated beneficiary?
- What are the tax implications associated with proportionate distributions from non-qualified and qualified assets?
- Is a trustee willing to serve when the trust contains more complicated management and distribution provisions?

In this author's experience, trustees generally appreciate more instructive trust terms that help the trustee manage and distribute the assets earmarked for potential successors in interest so as to minimize the risk of claims against the trustee down the road.

G. Provisions to Aid in Settlement

1. <u>Exculpatory Language</u>

a. Introduction. In response to a case involving a court created trust wherein the Supreme Court of Texas upheld an exculpatory clause, the Texas Legislature added the language set out in Section 1301.103 to the Texas Estates Code. *See Texas Commerce Bank v. Grizzle*, 96 S.W.3d 240 (Tex. 2002). Section 1301.103 provides that, "[a] provision in a management trust created for a ward or incapacitated person that relieves a trustee from a duty or liability imposed by this chapter or Subtitle B, Title 9, Property Code, is enforceable only if: (1) the provision is limited to specific facts and circumstances unique to the property of that trust and is not applicable generally to the trust; and (2) the court creating or modifying the trust makes a specific finding that there is clear and convincing evidence that the inclusion of the provision is in the best interests of the trust beneficiary.

b. Willie's Story. Prior to Willie's incapacity, she and her son operated a local chain of successful restaurants and food trucks. The business was structured as a Texas corporation and it enjoyed flow-through taxation as an s-corporation. Much of the business revenues took the form of cash and many of the workers were paid in cash. Though Willie and her son owned the bulk of the stock in the family business, Willie's daughters also owned shares. Though the daughters did not work in the business, they questioned the integrity with which the books were being maintained.

When Willie became incapacitated, Willie's son sought to become the guardian of his mother's estate and the daughters contested his application, in a power play to gain control of the family business. The contest threatened to deplete Willie's estate and disrupt the business. Though Willie was incapacitated, she had enough snap to inform the court that her son was the only person in the family capable of running the business and she wanted any squabbles among her children to continue, if they must, without her involvement. She believed that the continuation of the business would be threatened if her son was required to buy her out of the family business.

c. A 1301 Trust was Formed to Hold Willie's Assets Including the Stock of the Family Business. Naturally, the intended trustee of the 1301 Trust declined to serve and manage the stock in the family business without some sort of exculpatory language relieving the trustee of the duties and liabilities associated with managing the closely-held stock of the family business. So, the 1301 Trust was drafted to contain the following exculpatory language applicable only to the stock in the family business.

SAMPLE LANGUAGE

With respect to [the Family Business], the trustee of the trust shall be saved harmless from any liability, loss, or injury for any action such fiduciary may take, or failure to take any action, or the exercise of any of the powers and discretions granted to the trustee herein or under law, if done in good faith and without gross negligence. The following provisions are set out as examples and shall in no way be considered limitations on the exculpatory provision set out at the beginning of this paragraph. The trustee may retain the trust's investment in the closely-held stock of [the Family Business] despite risk of loss for failure to diversify. In addition, the trustee shall not be required to join in any action instituted by other shareholders of [the Family Business] as such action relates to [the Family Business] even though inaction on the part of the trustee could result in a reduction of the value, however significant, of the trust's interest in [the Family Business]. Further, the trustee shall be under no duty to exercise, on the part of the trust beneficiary, any option, however profitable or attractive, to sell an interest in [the Family Business]. Finally, the trustee shall not be liable or responsible in any manner whatsoever on account of anything done or omitted by those persons controlling or purporting to control [the Family Business] and the trustee shall have the right to conclusively presume that anything done or omitted by such persons was proper and correct in all respects. The trustee is further authorized to accept without question reports of income, expenses, gains, or losses delivered to the trustee by those persons controlling or purporting to control [the Family Business].

2. <u>Avoiding Final Distribution to Estate</u>

a. Introduction. Often, a contested guardianship results when a person having compromised mental capacity begins signing estate planning documents, especially when the terms of such estate planning documents deviate significantly from such person's previous estate plan or if such documents stray from what many consider to be a natural distribution. Sometimes, resolving the contested guardianship requires pre-settling the distribution plan to take effect upon the death of the proposed ward. Naturally, pre-settling the distribution plan would require a finding that the possibility of proposed ward's mental capacity improving is extremely remote.

b. Robert's story. Robert was an elderly man and had been married several times. He had four children from his first marriage and enjoyed a very close relationship with his children and grandchildren. Late in life, Robert married Tina. As Robert's mental capacity began to decline, he became susceptible to the influence of others. Despite the fact that Robert had a long-time relationship with his estate planning attorney, Tina brought him to another attorney, hired by her, to prepare estate planning documents leaving his entire estate to Tina.

An estate plan leaving Robert's entire estate to Tina represented a significant departure from the estate plan Robert had maintained for many years, as Robert had consistently provided that his children were to receive one-half of his estate. The children got wind of these changes and arranged for Robert to meet with his long-time attorney. Robert's attorney refused to take instruction from Robert or the children, as the attorney questioned Robert's capacity. The children then filed for guardianship of their father and Tina contested the guardianship.

After a long, bitter guardianship dispute the parties met for mediation. One of the sticking points preventing settlement of the guardianship dispute was Robert's latest estate planning changes naming Tina as the sole beneficiary. The parties all agreed that a 1301 Trust was preferred to the creation of a guardianship estate and no party wanted to litigate the estate plan after Robert's death. They were all willing to agree that Robert's estate should be distributed according to the terms of a minimally funded revocable trust he had formed years before his mental capacity began to decline.

Section 1301.204 of the Texas Estates Code provides that, "Unless otherwise provided by the court . . . the Trustee of a management trust shall: . . . . distribute the principal or any undistributed income of the trust to: . . . . the representative of the deceased ward's or incapacitated person's estate on the ward's or incapacitated person's death." Given the family's willingness to agree in a mediated settlement agreement that the revocable trust should govern the final distribution of Robert's estate, the court approved a modification to the standard language of the 1301 Trust that enabled the trustee to distribute the principal and undistributed income remaining in the management trust to the trustee of the revocable trust upon Robert's death.

The court's willingness to allow such trustee to trustee transfer upon Robert's death enabled the family to resolve the contested guardianship, preserve assets for the care of Robert, and wire around the possibility of a will contest upon Robert's death.

3. Advisory Committee to Trustee

a. Introduction. Sometimes, parents of an incapacitated or minor child who is the beneficiary of a 1301 Trust do not agree on appropriateness of distributions for such child. In those situations, the trustee can get caught between a rock and a hard place when trying to determine whether a distribution is in the best interest of a beneficiary. When parents or other interested persons with authority over the beneficiary's person have a history of acrimony with one another, creating a protocol for handling disagreements within the trust document will aid those whose objective it is to provide for the best interests of the beneficiary to reach an efficient, peaceful resolution.

b. Sandra's Story. Sandra was born with cerebral palsy due to medical negligence and a 1301 Trust was created for her when she was a baby and funded with proceeds from a lawsuit. She has led an active life and achieved many milestones her doctors believed would be impossible. After Sandra became an adult, the relationship between her parents began to falter and they divorced.

Sandra's mother loves to travel with Sandra, buys Sandra beautiful clothes, enrolls Sandra in expensive physical therapy sessions, and wants to build a pool in her backyard for Sandra, as the buoyancy of the water creates the ideal conditions for Sandra to exercise her muscles and extend her joints. Sandra's father fervently opposes the use of trust funds for such expenses and is worried Sandra's trust will be depleted. After several dustups between the parents, the trustee of the 1301 Trust made a motion for instruction with the court, and the parents each hired an attorney. The exercise was costly and time consuming. Sandra's 1301 Trust could have contained a mechanism for resolving conflicts between Sandra's parents, thereby sparing her trust from costly litigation.

SAMPLE LANGUAGE

It is expressly understood that [Mother] and [Father] may each request distributions from the Trust on behalf of [Beneficiary]. Both [Mother] and [Father] want to have the opportunity to object to the other's Trust distribution requests. To effectuate that process, [Mother] and [Father] agree to the following process for distributions: all requests for distributions shall be made by email to the Trustee, with a copy to the other parent. The non-requesting party shall have seven (7) days to object to the other party's request and state the reasons for such objection. In the event the non-requesting parent does not object to the requested distribution, the request shall be deemed as having no objection.

In the event of an objection to the distribution request, it shall be in the sole discretion of the Trustee to approve or disapprove of the distribution.

OR

In the event of an objection to the distribution request, the Trustee may, but is not required, to ask for a recommendation from the Advisory Committee to the Trustee ("Advisory Committee"). If the Trustee seeks such recommendation, the Trustee shall deliver to the Advisory Committee a copy of the distribution request, the objection to such request, and the reply to such objection, if any, within a reasonable time after receipt of the objection. After reviewing such documents and having the opportunity to question the [Mother] and [Father], the Advisory Committee shall make a recommendation to the Trustee which may or may not conform to the request, objection, or wishes of either the [Mother] or [Father]. Such recommendation shall be made within a reasonable time after the date the Trustee delivers the distribution request, objection, and reply to such objection, if any. The initial members of the Advisory Committee shall be [Member 1], [Member 2], and [Member 3]. The Advisory Committee shall have no fewer than three members and no more than five members. Additional members may be added to the Advisory Committee based upon the majority vote of the existing members of the Advisory Committee. In the event a vacancy occurs in the membership of the Advisory Committee such that the Advisory Committee contains fewer than three members, the remaining members of the Advisory Committee shall appoint a new member to fill such vacancy by majority vote.

V. HURDLES TO MODIFYING 1301 TRUST

Thinking outside the box and finding solutions to challenges that are as unique as the life stories giving rise to such challenges inserts an element of risk that some practitioners may find unacceptable. However, such risk may be minimized when the 1301 Trust is used to address challenges in a way that enhances or protects the best interests of the beneficiary and the due process rights of interested persons are observed.

A. Due Process Considerations

Many of the modifications suggested in this paper require the buy-in of interested persons or at least notice to persons whose interests are at stake. For example, if the terms of the 1301 Trust direct the distribution of the trust upon the death of the beneficiary to someone other than the personal representative of the estate of the beneficiary, in contravention of Section 1301.204 of the Texas Estates Code, due process concerns arise as to the interests of those having an expectancy interest in the beneficiary's estate. Naturally, due process concerns may be put to rest if such deviations from the traditional 1301 Trust provisions are supported by a settlement agreement signed by all interested persons.

B. Institutional Resistance

Importantly, many courts in Texas face budgetary constraints and lack the resources required to properly oversee guardianship cases. In January of 2019, the Office of Court administration released findings on its initiative to enhance protections of incapacitated persons by implementing the Guardianship Abuse, Fraud and Exploitation Deterrence Program. The findings support such Program for reasons including:

- Over 21,000 of the state's approximately 51,250 active guardianships reside in counties that lack resources to closely monitor these important cases;
- Review of 29,606 guardianship files found 41% out of compliance; and
- In the 244 counties in Texas without a statutory probate judge, the county judge or county court at law judge presides over guardianship cases without sufficient resources to monitor cases.

Facing scarcity of resources and attempting to standardize the review and audit of 1301 Trust Accountings, some courts resist approving 1301 Trust terms which look unfamiliar. This resistance is not misplaced, as approving such terms requires the court to make a finding that such terms are in the best interests of the beneficiary. Further, the court must take a more circumspect approach and determine whether all parties in interest are before the court. Moreover, the court must insure that due process concerns are addressed.

Finally, once the 1301 Trust is operational, the court must revisit the terms of the 1301 Trust each year as the annual accountings are being audited if the distinctive language of the 1301 Trust impacts the management or distribution of assets.

VI. CONCLUSION

Einstein said, "[i]t is the supreme art of the teacher to awaken joy in creative expression and knowledge." Hopefully, this paper inspires attorneys, courts, and trustees to look at the 1301 Trust less as a one-size-fits-all and more like a bespoke bit of handiwork designed to carefully address the unique challenges associated with protecting the best interests of each unique beneficiary.

APPENDIX A—1301 TRUST AS CONDUIT TRUST FOR QUALIFIED ASSETS