

**PRESENTED AT**

19<sup>th</sup> Annual Changes and Trends Affecting Special Needs Trusts

February 9-10, 2023

Austin, TX

**A Road Map for Court-Created Trusts In Texas**

**Beth Hearn Owens**

Beth Hearn Owen  
American National Bank & Trust  
Houston, TX

[betho@amnat.com](mailto:betho@amnat.com)

713.385.2771

## Table of Contents

I.	Introduction.....	1
II.	History of Management Trusts .....	1
	A. Texas Property Code Section 142.....	1
	B. Texas Estates Code Section 1301 .....	2
III.	When is a Management Trust Necessary?.....	2
	A. Definition of Incapacity .....	2
	B. Texas Estates Code Section 1301 Situation.....	3
	1. Least Restrictive Alternative.....	3
	2. Family Dynamics .....	3
	3. Guardian Unable to Post Bond .....	4
	4. Complicated Investments.....	4
	5. Cost Effective.....	4
	C. Texas Property Code Section 142 Situation .....	4
	1. No Legal Guardian .....	4
	2. Needs of Beneficiary.....	4
	3. Sophistication of Beneficiary.....	4
	4. Minor.....	5
IV.	Application for Management Trust .....	5
	A. Who Can Apply?.....	5
	B. Appointment of Attorney Ad Litem .....	6
	C. Appointment of Guardian Ad Litem.....	6
	D. Who Can Be Trustee? .....	7
	1. Section 142 Trusts.....	7
	2. Section 1301 Trusts.....	7
	3. Considerations When Selecting a Trustee .....	8
	a. Nationally Chartered vs. State Chartered.....	8
	b. Capital Surplus vs. Assets Under Management.....	9
	c. Other Items to Consider .....	9
	i. Specialty Assets .....	9
	ii. Experience in Court-Created Trusts.....	9
	iii. Account Load and Average Size.....	9
	iv. Distribution Process .....	9
	E. Contents of Application .....	10
	F. Contents of Order.....	10
V.	Trust Agreement .....	11
	A. Required Language .....	11
	B. H.E.M.S. ....	12
	C. Additional Suggested Provisions .....	12
	1. Funeral Expenses .....	12
	2. Income Taxes and CPA Fees .....	12

	3. Attorney Fees .....	13
	4. Authority to Sign Beneficiary's 1040 .....	13
	5. Ability to Collect Additional Funds.....	13
	6. Legal Obligation of Parents .....	13
	7. Retirement Accounts .....	13
VI.	Opening a Management Trust.....	14
	A. Client Identification Procedures .....	14
	1. Photo ID.....	14
	2. W-9 .....	14
	B. Anti-Money Laundering Act.....	14
VII.	Funding of Management Trusts .....	15
	A. Investment Accounts.....	15
	B. Deposit Accounts .....	16
	C. Annuities .....	16
	D. Life Insurance .....	16
	E. Real Estate .....	16
	F. Minerals .....	17
	G. Closely Held Assets .....	17
	H. Unclaimed Property .....	17
	I. Initial Account .....	18
VIII.	Administration of Management Trusts .....	18
	A. Grantor Trust.....	18
	B. Discretionary Distributions.....	18
	1.Monthly Expenses.....	18
	C. Sale of Assets.....	19
	D. Trustee Compensation .....	19
	E. Annual Accounting .....	20
IX.	Termination of Management Trusts.....	21
	A. When to Terminate .....	21
	B. Final Tax Return and Account Closing .....	21
	C. Final Account.....	22
	D. Final Attorney Fees.....	22
	E. Beneficiary's 1040 .....	22
	F. Distribution of Assets .....	22
	G. Receipts.....	23
	H. Application to Discharge .....	23
	I. Order to Discharge .....	23
X.	Conclusion .....	23

## **A Road Map for Court-Created Trusts in Texas**

### **I. Introduction**

The development of court ordered management trusts has become increasingly popular as an alternative to guardianships. The Section 1301 Trust alternative is still considered new law and unchartered territory since it was only enacted in 1993, and even though the Section 1301 Trust counterpart, the Section 142 Trust, was initially created in 1979, there is still a lack of case law for management trusts. Most of the development has been through legislative changes. After several discussions with multiple trust officers and attorneys at various institutions across the state, this road map started to develop. The authors would like to thank their fellow colleagues for their candor, which hopefully can help us fully understand the possible road blocks and speed bumps down the road of management trusts.

### **II. History of Management Trusts**

#### **A. Texas Property Code Section 142**

The initial court-created management trust statute was created in 1979. A few years later, this statute was re-codified to what is now known as Texas Property Code Section 142.005. This section was enacted basically to expand the scope of the statute that allowed property to be managed outside of a guardianship for a minor. Since 1893, property could be managed outside of a guardianship for a minor, if its value was under \$500, an amount eventually increased to \$1,500. All the next friend would need to do is post double the bond amount and get the court to approve the investments. Obviously these two significant limits, along with the district courts' reluctance to approve investments, spurred the creation of the initial court-created trust statute.

Section 142 expanded the original 1893 statute by allowing courts to place into a trust the property received by a minor from a litigated lawsuit. This new statute removed the \$1,500 limit and the investment limitations as long as investment language was incorporated into the terms of the trust and a corporate trustee was appointed. Five years later, the statute was amended to allow the creation of a management trust for incapacitated persons. Legislative history is

unclear as to why the inclusion of incapacitated persons was delayed 5 years. It quite possibly could have been an oversight, or the bill was unable to pass the first time with the addition of incapacitated individuals.

Section 142 (unlike Section 1301 of the Texas Estates Code) can only be created for litigation proceeds. Section 142.005 (a) states:

“Any court of record with jurisdiction to hear a suit involving a beneficiary may, on application and on a finding that the creation of a trust would be in the best interests of the beneficiary, enter a decree in the record directing the clerk to deliver any funds accruing to the beneficiary under the judgment to a financial institution, except as provided by Subsections (m) and (n).”

A trustee of a 142 trust cannot collect funds like a trustee of a Section 1301 management trust. For example, first, a wrongful death suit is settled and the judgement orders that the minor gets a lump sum from the defendant. Then, the minor is also named as the designated beneficiary on the decedent's insurance policy. In this situation, the 142 trustee could not collect the life insurance proceeds. A 142 trustee could only receive the settlement proceeds, but a 1301 trustee, could collect both the settlement proceeds and the life insurance. In addition to the limitation to collect assets, a 142 cannot be created if there is a guardian in place. Section 142.005 (o)(1) states:

"Beneficiary" means:

- (A) a minor or incapacitated person who:
  - (i) has no legal guardian; and
  - (ii) is represented by a next friend or an appointed guardian ad litem; or
- (B) a person with a physical disability.

This beneficiary definition can be problematic if you have a personal injury attorney that calls you to open a guardianship for a proposed ward/client in order to get a settlement approved. Once a guardian is appointed, you no longer have the ability to create a 142 trust. A conversation needs to take place prior to formal guardianship proceedings to determine if a legal guardianship is truly needed, since there may advantages to 142 trust over a Section 1301 trust, such as reduced attorney fees because there is no annual accounting requirement. Sometimes a guardian is

necessary, but sometimes it can be a knee jerk reaction. Guardian ad litem in a district court proceeding can usually approve the settlement on behalf of the beneficiary without a legal guardian being appointed.

I believe the limitations on collection of assets along with the complexities involved with a guardianship administration spurred the development of Section 1301 trusts.

## **B. Texas Estates Code Section 1301**

In 1993, the Texas legislature enacted Section 867 of the Texas Probate Code, as part of the recodification of the guardianship law. Section 867 was eventually re-codified with the 1301 section number when the Texas Probate Code was re-codified as the Texas Estates Code. Upon the application of a guardian, a management trust similar to that of a 142 trust could be created by the court. The original Section 867 stated:

“On application by the guardian of a ward, 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 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.”

This simply-stated section may not seem like much in comparison to Section 1301 with which we are now familiar but it was a huge step forward for Texas guardianships. The original section limited the application to only be made by a guardian and the guardian transferred the funds to the trustee. Now, just about anyone interested in the beneficiary can make an application, and the trustee is authorized to collect assets. The initial changes to Section 867 took place in 1995 with some technical corrections, and then significant changes were made in 1997. The 1997 changes were necessary in order for management trusts to be a good alternative to guardianship. Prior to these changes, there was not

the necessary statutes in place to give attorneys and trustees the necessary guidelines needed to administer such trusts. Examples of the substantial changes include:

- a. language allowing an ad litem to apply to create the trust in addition to the guardian;
- b. inclusion of the HEMS standard to the distribution language;
- c. authorization for the court to modify the terms of the trust if necessary for the beneficiary to be eligible for governmental benefits; and
- d. incorporation of the Texas Trust Code.

These changes and the ongoing changes to court created trusts have expanded the guidelines making court created trusts more user friendly.

## **III. When Is a Management Trust Necessary?**

There are several reasons to create a management trust. The top two reasons are for a minor or incapacitated person.

### **A. Definition of Incapacity**

Several differences between Section 142 trusts and Section 1301 trusts have already been mentioned, and will be addressed throughout this paper. One difference between the two that is of significant importance is the definition of incapacity that applies to each section. Section 142.007 defines an incapacitated person as:

“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 ANN. § 142.007 (West).

This definition loosely defines incapacity and greatly differs from the definition of incapacity according to the Texas Estates Code, which narrowly defines an incapacitated person as:

- (1) a minor;

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](https://utcle.org/elibrary)

Title search: A Road Map for Court-Created Trusts in Texas

Also available as part of the eCourse

[2023 Special Needs Trusts eConference](#)

First appeared as part of the conference materials for the  
19<sup>th</sup> Annual Changes and Trends Affecting Special Needs Trusts session  
"Texas Guardianship (1301 & 1302) and Trial Court-Created (142) Trusts"