

USING MANAGEMENT TRUSTS IN LIEU OF OR WITH A GUARDIANSHIP OF THE ESTATE

*by Laura Upchurch**

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I. INTRODUCTION

A management trust established under Chapter 1301 of the Texas Estates Code (TEC) is a court-ordered trust created for a ward or an incapacitated person.¹ Placing the assets of a ward's estate into a trust can alleviate the need for a guardian and allows the ward's property to be managed without the costs of applying "to the court for approval of discretionary distributions, payment of expenses, and other day-to-day administrative actions."² Utilizing an independent third party to handle a ward's finances may also reduce contention and strain among parties competing for appointment as guardian, helping to improve relations among those persons with a true interest in the ward's well-being.³ There are, however, significant legal and practical differences between meeting a ward's needs through a trust structure or a guardianship; and attorneys representing clients or serving as guardian *ad litem*s must understand those differences to fulfill their duties to clients and the court.⁴

The purpose of this paper is to explain the technical requirements for management trusts, as set forth in TEC Chapter 1301 and provisions of the

1. TEX. EST. CODE ANN. §§ 1301.053–.054 (Supp.).

2. SARAH PATEL PACHECO ET AL., GUARDIANSHIP ALTERNATIVES § 28, Westlaw (2016).

3. *Id.*

4. *Id.*

Texas Trust Code, found in Chapter 111 of the Texas Property Code, to point out the ways in which such trusts may be used in lieu of or in addition to appointment of a guardian for the ward's estate.⁵ For the most part, the paper will follow the organizational outline of Chapter 1301, with references to and excerpts from the specific TEC sections, while also including tips on practical ways to approach factors and issues presented in various circumstances affecting a ward's needs and protection.⁶

II. ACKNOWLEDGMENTS

Gratitude and acknowledgment are given to the State Bar of Texas for allowing the inclusion in this paper material from the new TexasBarBooks publication, *Guardianship Alternatives*, which is a valuable resource to avoid unnecessary guardianships. In particular, Forms 23 through 42 included in that book can be adapted for various situations involving management trusts. Another good source of information pertaining to management trusts is the *2016 Texas Guardianship Manual*, 4th Edition, a project of the Texas State Bar Guardianship Manual Committee, chaired by Sarah Patel Pacheco, which provides practice notes and forms, organized by the sequence of events occurring during the administration of a guardianship.

III. LEGISLATIVE HISTORY, DEFINITION, AND GOVERNING LAW

A. Legislative History

Before 2014, section 867 of the Texas Probate Code laid out the mechanism for creating a trust by which a trust company could hold and manage a ward's assets.⁷ Such a trust was commonly referred to as an "867 Trust," referring to the statutory provision that created it.⁸ Since the former Probate Code was recodified as the Texas Estates Code, effective January 1, 2014, the provisions controlling management trusts are now found in Chapter 1301 of the Estates Code, under Subtitle H, Court-Authorized Trusts & Accounts.⁹ Even so, many existing trusts are still referred to by courts, practitioners, and trust officers, as "867 Trusts," and the terms of those trusts may differ slightly from a trust created under the new TEC Chapter 1301.¹⁰ An attorney handling a management trust should closely review the terms of

5. See *infra* Parts III–IX.

6. See *infra* Parts III–IX.

7. TEX. EST. CODE ANN. §§ 1301.051–.052 (Supp.).

8. *Id.*

9. *Id.*

10. *Id.*

that document to determine the requirements for management of a ward's estate.¹¹

B. Definition

A management trust established under Chapter 1301 of the Estates Code is a court-ordered trust created for a ward or an incapacitated person.¹² Specifically, TEC Section 1301.001 defines a "management trust" as a trust created under TEC Section 1301.053 (in connection with a guardianship proceeding) or under section 1301.054 (for an incapacitated person without a guardian).¹³

C. Applicability of Texas Trust Code

A management trust is subject to the Texas Trust Code.¹⁴ In the event of a conflict between the Texas Trust Code and a provision of TEC Chapter 1301 or a management trust instrument, Chapter 1301 or the instrument controls over the Texas Trust Code.¹⁵ To fully understand the trustee's powers, duties, and obligations for holding and administering the assets of a management trust, one must look to the applicable provisions of both the Estates Code and the Trust Code.¹⁶

IV. STANDING, VENUE, AND JURISDICTION

A. Eligibility to Apply for Creation of a Trust

Persons who may apply to the court to create a management trust are:

1. the guardian of a ward;
2. an attorney *ad litem* or guardian *ad litem* appointed to represent the ward or the ward's interests;
3. a person interested in the welfare of an alleged incapacitated person who does not have a guardian;
4. an attorney *ad litem* or guardian *ad litem* appointed to represent an alleged incapacitated person who does not have a guardian; or
5. a person with a physical disability.¹⁷

Note, the standing provided to an "interested person" in section 1301.051 matches the right given in section 1055.001 to "any person" to commence a

11. *Id.*

12. *Id.* § 1301.001.

13. *Id.*

14. *Id.* § 1301.002(a).

15. *Id.* § 1301.002(b).

16. *Id.* § 1301.001.

17. *Id.* § 1301.051.

guardianship proceeding.¹⁸ Therefore, the issue of standing does not propel a choice between an application for guardianship or a management trust.¹⁹

B. Venue for Proceeding Involving Trust

An application for the creation of a management trust for an alleged incapacitated person under TEC Section 1301.054 must be filed in the same court in which a proceeding for appointment of a guardian for that person is pending, if any.²⁰ If there is no pending guardianship proceeding on the date the application for creation of the management trust is filed, venue for the action must be determined in the same manner as venue for a suit for appointment of a guardian, pursuant to TEC Section 1023.001.²¹

Thus, a proceeding for creation of a management trust would be initiated in the county in which an adult proposed ward resides or is located on the date the application is filed, or in the county in which the principal estate of the proposed ward is located.²² Venue for a suit to create a trust for a minor would be determined by the county in which the minor's parents or managing conservators reside or, if the parents are deceased, in the county in which they resided prior to their deaths.²³

C. Jurisdiction Over Trust Matters

A court creating a management trust has the same jurisdiction to hear matters relating to the trust as the court has for guardianships.²⁴

V. CREATION OF TRUST

On application by one of the persons described in TEC Section 1301.051 (subject to TEC Section 1301.054(a), if applicable), the court with jurisdiction over the proceeding may enter an order creating a management trust, if the court finds that creation of the trust is in the best interests of the person for whom the application is filed.²⁵ The court may maintain a trust created under section 1301.053 under the same cause number as the guardianship proceeding, if the person for whom the trust is created is a ward or proposed ward.²⁶ Forms for the application and order to create a

18. *Id.* § 1055.001(a).

19. *Id.*

20. *Id.* § 1301.052(a).

21. *Id.* § 1301.052(b).

22. *Id.* § 1023.001(a).

23. *Id.* § 1023.001(b).

24. *Id.* § 1301.151.

25. *Id.* § 1301.053(a).

26. *Id.* § 1301.053(b).

guardianship management trust may be found in the State Bar's *Texas Guardianship Manual*, 4th Edition (2016), Forms 11-1 and 11-4.²⁷

Practice Tip #1: TEC Section 1301.053(a) makes clear that the court may create a management trust only if it makes a finding that the trust is in the ward's best interests; however, Chapter 1301 does not define the term "best interests."²⁸ Chapter 1301 also does not address the factors the court may consider to determine what is in the ward's best interests.²⁹ Thus, the attorney for the applicant seeking to establish a management trust should include in the application the reason that a trust would be beneficial for the ward.³⁰ For instance, if the goal is to create a special needs trust under Chapter 1301, the application should explain that the ward's best interests will be served by preserving the ward's eligibility for government benefits.³¹ If the trust is not a special needs trust, it is presumptively in the ward's best interests to save the court costs and legal fees associated with a regular guardianship and take advantage of the professional management and broader investment options available to a corporate trustee.

A. *Creation of Trust for Incapacitated Person Without a Guardian*

Regardless whether an application for guardianship has previously been filed, on application by a person authorized under TEC Section 1301.051, a proper court exercising probate jurisdiction may enter an order to create a trust for management of the estate of an alleged incapacitated person who does not have a guardian. After a hearing, the court must find that (a) the person is an incapacitated person, and (b) the creation of the trust is in that person's best interest.³² In other words, the court has the right to sidestep a pending application for appointment of a guardian of the estate and instead create a management trust.³³ Particularly, in instances when there is a pending contest and plenty of contention between parties seeking appointment as guardian of an incapacitated person's estate, the court may likely view a management trust as an attractive alternative to guardianship.³⁴ It would curb litigation costs and reduce the strain on the ward caused by constant strife and uncertain circumstances.³⁵

27. PACHECO ET AL., *supra* note 2; see SARAH PATEL PACHECO ET AL., TEXAS GUARDIANSHIP MANUAL (4th ed., 2018).

28. TEX. EST. CODE ANN. § 1301.053(a) (Supp.).

29. See TEX. EST. CODE ANN. ch. 1301.

30. See generally *id.* § 1301.053 (The statute does not define "best interest," so the attorney should do so).

31. *Id.*

32. *Id.* § 1301.054(a).

33. *Id.*

34. *Id.*

35. *Id.*

B. Procedural and Evidentiary Standards; *Ad Litem*s

The hearing to create a management trust pursuant to TEC Section 1301.054(a) must be conducted using the same procedures and evidentiary standards as are required to appoint a guardian for a proposed ward.³⁶ Unless the application for creation of a management trust is filed by a person with only a physical disability, the court must appoint an attorney *ad litem* to represent the alleged incapacitated person in the hearing to determine incapacity under TEC Section 1301.054(a).³⁷ In its discretion, the court, may also appoint a guardian *ad litem* to represent the interests of the alleged incapacitated person.³⁸ Likewise, the court may, but is not required to, appoint an attorney *ad litem* or guardian *ad litem* in a proceeding to create a management trust filed by a person with only a physical disability.³⁹ The court may maintain a trust created under TEC Section 1301.053 with the same cause number as the guardianship proceeding if the person for whom the trust is created is a ward or proposed ward.⁴⁰

Practice Tip #2: If the attorney for the applicant seeking to create a management trust or guardianship has reason to believe that there may be a pending action involving the potential ward or incapacitated person, he should check with the clerk's office in the county in which the application will be filed to determine whether the new application should be filed under the existing cause number, or be assigned a new number.⁴¹ This will prevent confusion, delay, and cost for the client, and likely engender goodwill with the clerk's office, which is always a worthwhile goal.⁴²

C. Authority of Court to Appoint Guardian Instead of Creating a Trust

After a hearing on an application for creation of a management trust, pursuant to TEC Section 1301.054, if the court rules that the person for whom the trust is sought to be created is incapacitated, but a management trust would not be in the person's best interests, the court may appoint a guardian, without commencing a separate guardianship proceeding.⁴³ Note, the court has broad discretion to determine whether to avoid a guardianship and establish a management trust under section 1301.054(a), or to reject the trust application and appoint a guardian under section 1301.055.⁴⁴ This is likely

36. *Id.* § 1301.054(b).

37. *Id.* § 1301.054(c).

38. *Id.*

39. *Id.* § 1301.054(c-1).

40. *Id.* § 1301.054(d).

41. *See id.* § 1301.054(c-1), (d).

42. *See id.* § 1301.054(c-1), (d).

43. *Id.* § 1301.055.

44. *Id.*

the main reason why a dearth of reported cases involve issues directly related to creating management trust.⁴⁵

D. Contents of Order Creating a Trust

An order creating a management trust must include terms and limitations to be associated with the trust.⁴⁶ It must direct any person or entity holding assets belonging to the trust beneficiary, or assets to which that person is entitled, to deliver all or part of that property to the appointed trustee.⁴⁷ If the court agrees to waive the hearing, the order should state that the court is creating a Chapter 1301 management trust for the ward and direct any guardian of the estate to file the final account.⁴⁸

E. Required Terms of a Trust Instrument

TEC Section 1301.101 sets out the terms that must be included in a management trust for a ward or incapacitated person:

- (1) the ward or incapacitated person 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 spend for the health, education, maintenance, or support of the person for whom the trust is created;
- (3) the trust income that the trustee does not disburse under Subdivision (2) must be added to the trust principal;
- (4) a trustee that is a corporate fiduciary serves without giving a bond; and
- (5) subject to the court's approval and Subsection (b), a trustee is entitled to receive reasonable compensation for services the trustee provides to the person for whom the trust is created as the person's trustee.⁴⁹

Forms 11.2 and 11.3 in the State Bar's *Texas Guardianship Manual*, 4th Edition (2016), include these required provisions, as well as optional special needs trust terms.⁵⁰

F. Optional Terms of Trust

When a management trust is created for a ward or incapacitated person, the trust may provide that the trustee may make distributions for the health, education, maintenance, or support of another person whom the trust

45. *Id.*

46. *Id.* § 1301.056.

47. *Id.*

48. *Id.*

49. *Id.* § 1301.101(a).

50. See TEXAS GUARDIANSHIP MANUAL, *supra* note 27.

beneficiary is legally obligated to support.⁵¹ The “other person” may include (1) the ward’s guardian; (2) a person with physical custody of the trust beneficiary or someone whom the trust beneficiary is obligated to support; or (3) a person providing goods or services to the ward or a person that the ward is legally obligated to support.⁵² The court may also include other provisions in the trust instrument, upon creation or modification of the trust if the court determines that the addition does not conflict with section 1301.101.⁵³ The statute also allows for distribution “for the health, education, maintenance or support of . . . another person whom the [ward] . . . is legally obligated to support.”⁵⁴

Practice Tip #3: Exceptions exist to the mandatory health, education, support, and maintenance standard for Chapter 1301 management trusts.⁵⁵ If an attorney wants the trust to qualify as a special needs trust to preserve the ward’s eligibility for government benefits, the trust must not permit distributions for the ward’s basic health, education, maintenance, and support, but only for the ward’s special needs not covered by a government benefits program.⁵⁶ For all other Chapter 1301 trusts, no distributions should be permitted for the benefit of others who have a legal obligation to support the ward.⁵⁷ In particular, such a provision should not be included in a trust for a minor beneficiary.⁵⁸ The parents have a legal obligation to support the minor ward; the minor ward does not have a legal obligation to support the parents.⁵⁹

G. Pay-Back Provision in Special Needs Trust

If the management trust qualifies as a special needs trust, the ward may have access to government benefits programs.⁶⁰ If the trust seeks to qualify as a special needs trust, special care must be given to ensure that the trust conforms to the provisions of 42 U.S.C. § 1396p(d)(4)(A), including a pay-back provision in the trust document.⁶¹ A pay-back provision requires that on the termination of the trust upon the death of the beneficiary, the trust will reimburse the state Medicaid agency for all medical expenses paid on

51. TEX. EST. CODE ANN. § 1301.102(a) (Supp.).

52. *Id.*

53. *Id.*

54. *Id.* § 1301.102(b).

55. *Id.* § 1301.101(c).

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. 42 U.S.C. § 1396p(d)(4) (2010).

behalf of the ward.⁶² Failure to include this pay-back provision will result in the loss of the government benefit.⁶³

H. Termination of Guardianship

While or after a management trust is created under Chapter 1301, the court may discharge the guardian of the estate if the guardian of the ward's person remains and the court determines that the discharge is in the ward's best interests.⁶⁴ If the assets of the guardianship estate are transferred to a Chapter 1301 trust, the guardian of the estate terminates the guardianship the same way it would terminate at the death of the ward or on the removal of the ward's disabilities.⁶⁵ The guardian would file a final account, an application and order to discharge the guardian and terminate the guardianship, a waiver of notice of the final account, a receipt from the recipient of assets, and other appropriate documents.⁶⁶

VI. TRUSTEE

A. Appointment of a Trustee

The court must appoint a "financial institution" to serve as trustee of a management trust, except in limited circumstances.⁶⁷ Those circumstances include: a trust created for a person who has only a physical disability (see TEC Section 1301.057(b)); or the court finds it is in the best interests of the ward or incapacitated person that a financial institution not serve as trustee.⁶⁸

In the latter instance, if the trust principal is greater than \$150,000, the court must also find that the applicant for creation of the trust has been unable, after exercising due diligence, to find a financial institution in the geographic area willing to serve as trustee.⁶⁹ If that is the case, under section 1301.057(d), the court may appoint as trustee, instead of a financial institution, either an individual (including a certified private professional guardian), a non-profit corporation qualified to serve as a guardian, or a guardianship program.⁷⁰ To confirm whether any financial institution is willing to serve as a trustee, the attorney seeking creation of the trust should

62. *Id.* § 1396p(d)(4)(B).

63. *Id.* § 1396p(d)(4)(A).

64. TEX. EST. CODE ANN. § 1301.152 (Supp.).

65. *Id.* § 1301.204.

66. *Id.*

67. *Id.* § 1301.057(b).

68. *Id.* § 1301.057(b)–(c).

69. *Id.* § 1301.057(c).

70. *Id.* § 1301.057(c)–(d).

check lists of corporate fiduciaries located at the office of the statutory probate judge or at the principal office of the Texas Bankers Association.⁷¹

For purposes of section 1301.057, “financial institution” is defined as an institution that has trust powers and is authorized to conduct business in Texas, another state, or the United States, pursuant to section 201.101 of the Texas Finance Code.⁷²

Note, one of the primary reasons why most courts will favor a management trust over a guardianship of the estate is the opportunity to have professional oversight and experienced financial management of the ward’s assets, while simultaneously reducing the possibility of harm to the ward’s estate from acts or omissions of an individual guardian.⁷³ Also, the appointment of a financial institution relieves the judge of liability on the judge’s bond for damages or losses resulting from the judge’s failure to exercise diligence in examining a guardian’s acts and accounting.⁷⁴ Similarly, unless the value of the ward’s assets is too low to make a trust financially feasible, or the nature of the assets is so unique (e.g., real property in need of environmental reclamation) that finding a corporate trustee is virtually impossible, the court will usually be reluctant to appoint an individual trustee.⁷⁵

B. Bond Requirements for Trustees

A corporate fiduciary trustee, or any trustee of a management trust for a person with only a physical disability, may serve without posting a bond.⁷⁶ Otherwise, the court requires a person serving as trustee of a management trust to file a bond with the county clerk in an amount equal to the value of the trust’s principal and projected annual income and meet any additional conditions the court deems necessary.⁷⁷

Practice Tip #4: If an individual seeks to serve as trustee, the applicant client should be advised to begin communications early with insurance agents or bonding companies to issue a bond prior to the hearing on the application for creation of the trust.⁷⁸ Although the bond cannot be approved until after the court’s order is entered, the client may complete the bond application

71. *Id.*

72. *Id.* § 1301.057(a).

73. Glenn M. Karisch, *Court-Created Trusts in Texas* (July 30, 1999), texasprobate.net/articles.court.pdf [perma.cc/Z5Q8-48F5].

74. See TEX. EST. CODE ANN. § 1201.003 (Supp.); *James v. Underwood*, 438 S.W.3d 704, 714 (Tex. App.—Houston [1st Dist.] 2014, no pet.) (finding the judge cannot fail to fulfill statutory duties if no guardian has been appointed).

75. Karisch, *supra* note 73.

76. TEX. EST. CODE ANN. § 1301.058(a) (Supp.).

77. *Id.* § 1301.058(b).

78. See generally J. Robert Smith, *Fiduciary Bonds – Who Needs Them?*, HOLLAND & HART (Aug. 3, 2015), <https://www.fiduciarylawblog.com/2015/08/fiduciary-bonds-who-needs-them.html> [perma.cc/7R23-K38J] (describing the function and form of fiduciary bonds).

beforehand and obtain a preliminary indication of approval or rejection, much like a pre-qualification for a mortgage loan.⁷⁹ Important factors in the bond approval process will be the client's employment record, credit history, and FICO score.⁸⁰ If the client has a poor employment or credit history, it is better to determine that the client is not bondable before time and fees are incurred for naught.⁸¹

C. Trustee's Compensation

Subject to the court's approval, the trustee of a Chapter 1301 trust may receive reasonable compensation from the trust estate, calculated and paid in the same manner as compensation of a guardian, pursuant to TEC Chapter 1155.⁸² Chapter 1155 permits the guardian to charge a fee of 5% of the estate's gross income and 5% of all money paid out, contingent on a finding that the guardian has prudently managed the estate.⁸³ Note that "gross income" does not include Social Security benefits, and "money paid out" does not include compensation to the guardian or "money loaned, invested or paid over on the settlement of a guardianship."⁸⁴

Exceptions to the 5% rule include allowing for the trustee's compensation to be either increased or reduced.⁸⁵ In many instances, courts will permit a corporate trustee to be compensated according to the trustee's regular fee schedule.⁸⁶ The usual corporate trustee's fee schedule is based on a percentage of the market value of assets under management, with the percentage gradually declining as the value of the assets increases.⁸⁷ In addition, the trustee may charge additional fees for services (e.g., stop payment orders, wire transfers, etc.) or for dealing with assets requiring special handling or storage, such as artwork or jewelry.⁸⁸

Practice Tip #5: To determine what compensation standard will be in the best interests of the trust beneficiary, while still allowing a sufficient fee for the trustee's services, the attorney representing the guardian or trustee should calculate the total fee that would result based on the anticipated income to and disbursements from the trust in the first year of the trust's existence. The applicable fee structure for compensating an institutional

79. *Id.*

80. *Id.*

81. *Id.*

82. TEX. EST. CODE ANN. § 1301.101(a)(5), (b) (Supp.).

83. *Id.* § 1155.003.

84. *Id.* § 1155.001; 3 TEX. PRAC. GUIDE PROBATE *Compensation of Guardian* § 18:55, Westlaw (November 2018 update).

85. See TEX. EST. CODE ANN. §§ 1155.002(b), 1155.003, 1155.005-.008 (Supp.).

86. See generally Amy Feldman, *Trust Costs Go Up; Get Ready to Negotiate*, PENTA (Feb. 28, 2015), <https://www.barrons.com/articles/trust-costs-go-up-get-ready-to-negotiate-1425094199> [perma.cc/8UDP-WZRR] (noting the difficulty of determining fee schedules).

87. *Id.*

88. *Id.*

trustee should then be confirmed with the trustee in writing prior to obtaining the court's approval of the trust terms.⁸⁹ If the court authorizes compensation in accordance with the trustee's fee schedule, that schedule should be attached to the trust application, and the order approving the trust should include language approving the trustee's compensation based on the regular fee schedule, which may be amended with the court's approval.⁹⁰ Regardless of the manner in which the fee is calculated, a trustee's compensation authorized under section 1301.101(a)(5) will be paid from the trust's income, principal, or both.⁹¹

D. Successor Trustee

If the trustee of a management trust resigns, becomes ineligible, or is removed, the court may appoint a successor trustee.⁹² For instance, once the assets of the management trust fall below a minimum level, an institutional trustee may determine that the fee structure for compensation of the trustee is no longer advantageous to the beneficiary, or financially feasible for the services being provided by the trustee.⁹³ In that case, the trustee files a motion to resign as trustee with a request to appoint a successor trustee.⁹⁴ If the trustee becomes ineligible or unable to serve, the guardian or another interested person may file an application to appoint a successor trustee, and provide the court reasons why the successor should serve.⁹⁵ The court order approving the appointment of the successor trustee would order the prior trustee to file a final account of its actions.⁹⁶

E. Liability for a Trustee

Neither the guardian of the person or estate nor a surety on the guardian's bond is liable for the acts or omissions of a Chapter 1301 trustee.⁹⁷ A provision of the trust that relieves a trustee from a duty, responsibility, or liability 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

89. TEX. EST. CODE ANN. § 1301.101(a)(5) (Supp.).

90. *Id.*

91. TEX. EST. CODE ANN. §§ 1301.154(c), 1301.055 (Supp.).

92. TEX. EST. CODE ANN. § 1301.155 (Supp.).

93. *Id.*

94. See SARAH PATEL PACHECO ET AL., *Form 20 Application for Leave to Resign as Trustee and for Appointment of Successor Trustee*, GUARDIANSHIP ALTERNATIVES, Westlaw (2016).

95. *Id.*

96. See PACHECO ET AL., *supra* note 2, at *Form 31 Order Appointing Successor Trustee of Management Trust*.

97. TEX. EST. CODE ANN. § 1301.156 (Supp.).

2. the court . . . makes a specific finding that there is clear and convincing evidence that . . . the provision is in the best interests of the trust beneficiary.⁹⁸

VII. TRUST ADMINISTRATION

A. Investments: Comparison to Guardianships

Perhaps the best reason to use a management trust over a guardianship to oversee a ward's finances is the greater variety of investment options available to a trustee, without the increased cost of seeking the court's approval.⁹⁹ TEC Chapter 1161 controls the requirements for retaining and investing a ward's assets under guardianship, and sets out the applicable standards that a guardian must meet.¹⁰⁰ For instance, a guardian has a duty to keep the ward's estate invested, other than those funds immediately necessary for the education, support, and maintenance of the ward or persons the ward supports.¹⁰¹ The guardian must exercise the discretion of a person of "ordinary prudence, discretion, and intelligence," considering various factors, including: probable income and increase in value of the assets; safety of capital; anticipated costs of supporting the ward; the ward's age, education, current income, net worth, liabilities, and ability to earn additional income; the nature of the ward's estate; and any other resources reasonably available to the ward.¹⁰²

Chapter 1161 sets out very specifically the types of investments that will meet the "prudent investor" standard required under TEC Section 1161.002.¹⁰³ For instance, the guardian is considered to have exercised appropriate discretion if he or she invests in United States bonds, tax-supported bonds of the state of Texas, or FDIC-insured share accounts held at a state or federal savings and loan association or savings bank with its main office in Texas.¹⁰⁴ The court may modify or eliminate the guardian's duty only upon a showing "by clear and convincing evidence that the action is in the best interests of the ward."¹⁰⁵ A guardian who fails to invest or lend estate assets in accordance with Chapter 1161 may be held "liable for the principal and the greater of the highest legal rate of interest on the principal" or "the overall return that would have been made on the principal" if it had been properly invested under the statutory standard.¹⁰⁶ Unfortunately, absent

98. *Id.* § 1301.103.

99. *Id.* § 1301.156.

100. TEX. EST. CODE ANN. ch. 1161 (Supp.).

101. *Id.* § 1161.001.

102. *Id.* § 1161.002(a).

103. *Id.*

104. *Id.*

105. *Id.* § 1161.005.

106. *Id.* § 1161.008.

the time and cost of filing an application, setting a hearing, and obtaining a court order, a guardian of the estate often cannot generate enough income from permitted investments to meet the monthly obligations of the ward without invading the principal of the estate.¹⁰⁷

By comparison, the Texas Estates Code provides direction for one particular investment that may be made by the trustee of a management trust: the Texas Tomorrow Fund operated by the State of Texas, if the trustee decides that the investment would be in the trust beneficiary's best interest.¹⁰⁸ Otherwise, investment of the assets of a management trust are generally governed by the provisions of the Texas Trust Code, which allows for greater flexibility and creativity to obtain the best returns for the ward's estate.¹⁰⁹ In addition, trustees can invest trust assets without requiring prior approval from the court in which the guardianship is pending.¹¹⁰ The broader discretion and investment power afforded under the Texas Trust Code can often save significant time and expense and result in increased income and value from the ward's estate.¹¹¹

B. Significant Texas Trust Code Provisions

For an attorney representing a guardian, ward, or the trustee of a management trust, there are some important Texas Trust Code (TTC) provisions to consider regarding trust administration.¹¹²

1. General Principles

The trustee, when allocating receipts and disbursements (a) must administer the trust "in accordance with the terms of the trust" instrument; (b) may exercise the discretion given by the trust instrument, even when the result is outside the parameters provided by the Trust Code; (c) must follow the Trust Code if the trust is silent or does not give the trustee discretionary power of administration; and (d) must allocate a "receipt or charge a disbursement to principal" if the trust instrument or the Trust Code does not otherwise provide.¹¹³

107. *Id.* § 1161.003.

108. *Id.* § 1301.151.

109. *Id.* § 117.003(b).

110. *Id.* § 1161.006.

111. *Id.*

112. *See infra* Sections VII.B.1–10.

113. TEX. PROP. CODE ANN. § 116.004(a) (Supp.).

2. Business Activities

A trustee who conducts a business or other activity may maintain separate accounting records for the business, rather than including the business transactions as a part of the general trust accounting.¹¹⁴ If the trustee maintains a separate accounting, the trustee may determine the extent to which the business's net cash receipts must be retained for working capital, replacing fixed assets or other reasonably foreseeable business needs.¹¹⁵ A trustee can maintain separate accounting records for a retail business, farming, livestock operations, management of rental properties, and others.¹¹⁶

3. Receipts from Entities

A trustee must allocate certain receipts from an "entity" to principal, including (a) property other than money; (b) money received in one distribution or a series of related distributions in exchange for part or all of a trust's interest in the entity; (c) money received in total or partial liquidation of the entity; and (d) money received from an entity that is a regulated investment company or a real estate investment trust, if the money distributed is a capital gain dividend for federal income tax purposes.¹¹⁷ The trustee must allocate to income all other receipts from an entity.¹¹⁸ An "entity" generally includes a regulated investment company, real estate investment trust, common trust fund, or other organization in which a trustee has an interest.¹¹⁹

4. Other Principal Receipts

A trustee must allocate to principal:

- "An amount received as a distribution of principal from a trust or an estate in which the trust or the ward has an interest"¹²⁰;
- "Money received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit," subject to provisions of TTC Chapter 116, Subchapter D¹²¹;
- "Amounts recovered from third parties to reimburse the trust because of disbursements [for environmental matters], or for other reasons to the extent not based on the loss of income"¹²²;

114. *Id.* § 116.153(a).

115. *Id.* § 116.153(b).

116. *Id.* § 116.153(c).

117. *Id.* § 116.151(c).

118. *Id.*

119. *Id.* § 116.151(a).

120. *Id.* § 116.152.

121. *Id.* §§ 116.002(4), 116.161(2).

122. *Id.* § 116.161(3).

- “Proceeds of property taken by eminent domain,” except for awards for the loss of income associated with that property¹²³;
- “An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods . . . held subject to the terms of the lease,” not to be distributed to “the beneficiary until the contractual obligations of the lease have been satisfied with respect to that amount”¹²⁴;
- “An amount received from the sale, redemption or other disposition of an obligation to pay money to the trustee more than one year after [the obligation is acquired]”¹²⁵; and
- “The proceeds of a life insurance policy or other contract in which the trustee or [the ward] is named as a beneficiary, including a contract that insures the trustee or trust against loss for damage to, destruction of, or loss of title to . . . a trust asset.”¹²⁶

5. *Other Receipts of Income*

The trustee must allocate to income:

- “An amount received as a distribution of income from a trust or an estate in which the trust [or the ward] has an interest”¹²⁷;
- “An amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease”¹²⁸;
- “An amount received as interest . . . on an obligation to pay money to the trustee . . . without any provision for amortization”¹²⁹; and
- “Proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or . . . loss of profits from a business.”¹³⁰

6. *Apportionment of Receipts Between Principal and Income*

The trustee must apportion receipts between principal and income as follows:

- Payments that a trustee receives from a “private or commercial annuity, an individual retirement account, or a pension or

123. *Id.* § 116.161(4).

124. *Id.* § 116.162.

125. *Id.* § 116.163.

126. *Id.* § 116.164.

127. *Id.* § 116.152.

128. *Id.* § 116.162.

129. *Id.* § 116.163(a).

130. *Id.* § 116.164(b).

profit-sharing plan.”¹³¹ The trustee must allocate “to income the portion of the payment which the payer identifies as being from interest” a dividend or an equivalent payment, and must “allocate the balance to principal”¹³²;

- “Receipts from an interest in minerals,” including a production payment, royalty, shut-in well payment, take-or-pay payment or bonus¹³³;
- Proceeds from “the sale of timber and related products”¹³⁴; and
- Payments in exchange for the trust’s interest in an asset-backed security, “whose value is based upon the owner’s right to receive distributions from the proceeds of financial assets that provide collateral for the security.”¹³⁵

7. Allocations of Disbursements from Principal

A trustee must make the following disbursements from principal:

- “One-half of the disbursements [paid for compensation of the trustee and of any person providing investment advisory or custodial services to the trustee] unless, consistent with the trustee’s fiduciary duties, the trustee determines that a different portion . . . shall be allocated to principal”¹³⁶;
- “The remaining one-half of all expenses for [accountings, judicial proceedings, or other matters that involve both the income and remainder interests]”¹³⁷;
- “All of the trustee’s compensation calculated on a principal as a fee for acceptance, distribution, or termination [of the trust], and disbursements made to prepare property for sale”¹³⁸;
- “Payments on the principal of trust debt”¹³⁹;
- Expenses of a proceeding to construct the trust, “to protect the trust or its property”, or otherwise concerning the trust principal¹⁴⁰;
- “Premiums paid on a policy of insurance . . . of which the trust is an owner and beneficiary,” other insurance covering loss of a principal asset or the loss of income from or use of the asset¹⁴¹;

131. *See id.* § 116.172(a)(3).

132. *See id.* § 116.178(b).

133. *Id.* § 116.174(a).

134. *Id.* § 116.175(a).

135. *Id.* § 116.178(a).

136. *Id.* § 116.202(a)(1).

137. *Id.* § 116.202(a)(1-a).

138. *Id.* § 116.202(a)(2).

139. *Id.* § 116.202(a)(3).

140. *See id.* § 116.202(a)(4).

141. *See id.* § 116.202(a)(5).

- “Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust”¹⁴²; and
- Disbursements related to environmental matters.¹⁴³

If a principal asset of the trust is encumbered with an obligation that requires income from that asset to be paid directly to the creditor, the trustee must transfer from principal to income an amount equal to the income paid to the creditor in reduction of the principal balance of the debt.¹⁴⁴

8. Allocations of Disbursements from Income

The trustee of a Chapter 1301 trust must make the following disbursements from income:

- “One-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee unless, consistent with the trustee’s fiduciary duties, the trustee determines that a different portion . . . should be allocated to income”¹⁴⁵;
- “One-half of all expenses for accountings, judicial proceedings, or other matters that involve both income and remainder interests”¹⁴⁶;
- All other “ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income . . . and expenses of a proceeding or other matter that concerns primarily income interest”¹⁴⁷; and
- “Recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.”¹⁴⁸

9. Transfers Between Principal and Income

In general, a trustee may make transfers to principal the net cash receipts from a principal asset that is subject to depreciation, to account for the reduction in value due to wear, tear, and decay.¹⁴⁹ The trustee may also transfer income to principal to reimburse for certain extraordinary repairs or capital improvements to a principal asset, expenses to prepare property for rental, or to pay for environmental matters.¹⁵⁰

142. *Id.* § 116.202(a)(6).

143. *Id.* § 116.202(a)(7).

144. *Id.* § 116.202(b).

145. *Id.* § 116.201(1).

146. *Id.* § 116.201(2).

147. *Id.* § 116.201(3).

148. *Id.* § 116.201(4).

149. *Id.* § 116.203.

150. *Id.* § 116.204.

10. Income Taxes

A tax required to be paid by a trustee based on receipts allocated to income must be paid from income; a tax based on receipts allocated to principal must be paid from principal, even if the tax is called an income tax.¹⁵¹ Chapter 1301 trusts are considered grantor trusts under Internal Revenue Code Sections 671–678.¹⁵² Income from trust assets is taxable to the beneficiary.¹⁵³ The costs of preparing tax returns may come out of trust proceeds.¹⁵⁴ The trustee should be certain the appropriate tax returns are filed.¹⁵⁵

C. Annual Accountings

The trustee of a Chapter 1301 trust must prepare an annual account and file it with the court.¹⁵⁶ The requirements for a trustee's accounting are the same as those for a guardian of the estate under TEC Section 1163.001, et seq., and the annual account is subject to court review in the same manner as an annual account prepared by a guardian.¹⁵⁷ The trustee must provide a copy of the annual account to the guardian of the ward's estate or person.¹⁵⁸ However, the court may not require a trustee of a trust created for a person with only a physical disability to prepare and file an annual accounting.¹⁵⁹

VIII. TRUST MODIFICATION

The court may amend, modify, or revoke a Chapter 1301 trust at any time before the trust terminates.¹⁶⁰ The trust may not be modified or revoked by the trust beneficiary or the guardian of the ward's estate.¹⁶¹ When creating or modifying a Chapter 1301 trust, the court may omit or modify terms required by TEC Section 1301.101(a), (a-1), or (b), which mandates distributions for the ward's health, education, maintenance, and support, only if the court determines that modification or omission is necessary and appropriate for the ward to receive public benefits or assistance under a state or federal program not otherwise available to the ward and in his or her best

151. *Id.* § 116.204(a)–(b).

152. *See* I.R.C. §§ 671–678 (2000).

153. *Id.* § 677.

154. TEX. PROP. CODE ANN. § 116.205 (Supp.).

155. *See* I.R.C. §§ 671–678.

156. TEX. EST. CODE ANN. § 1301.154 (Supp.).

157. TEX. EST. CODE ANN. § 1301.154(a) (Supp.).

158. *Id.* § 1301.154(b).

159. *Id.* § 1301.154(d).

160. *Id.* § 1301.201(a).

161. *Id.* § 1301.201(b).

interests.¹⁶² Form 33 in the State Bar's *Texas Guardianship Manual*, 4th Edition (2016) may be used to modify a management trust.¹⁶³

IX. TERMINATION OF TRUST

A. Termination

A management trust for a minor terminates on the death of the ward or on the ward's eighteenth birthday, whichever is earlier, or on a date selected by the court that is not later than the ward's twenty-fifth birthday.¹⁶⁴ Some courts will not permit a Chapter 1301 trust to extend beyond the ward's eighteenth birthday, assuming the ward is not otherwise incapacitated.¹⁶⁵ If the applicant wants the trust to extend past the beneficiary's eighteenth birthday, the applicant should check with the court in which the guardianship is pending.¹⁶⁶

If the minor beneficiary also suffers from a disability that would require the beneficiary to access government benefits, the management trust may be established as a special needs trust.¹⁶⁷ However, some courts still require that the management trust terminate at the age of twenty-five, even though the ward is likely never to regain capacity.¹⁶⁸ In this situation, the trust must be modified prior to the ward reaching the age of twenty-five to ensure that the ward's government benefits will not be reduced or terminated.¹⁶⁹

If the trust beneficiary 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 ward's best interests, subject to TEC Section 1301.202(c), or on the death of the trust beneficiary.¹⁷⁰

B. Final Account

On termination of a Chapter 1301 trust, the trustee must prepare a final account in the same manner as a guardian, pursuant to TEC Sections 1204.101 and 1204.102.¹⁷¹ After the court approves the accounting, the trustee must distribute the remaining trust assets to the ward or incapacitated person when the trust terminates on its own terms; to the successor trustee, if

162. *Id.* § 1301.101(c).

163. *See* TEXAS GUARDIANSHIP MANUAL, *supra* note 27.

164. TEX. EST. CODE ANN. § 1301.203(a) (Supp.).

165. 3 TEX. PRAC. GUIDE PROBATE *Termination of Trust* § 20:91, Westlaw (database updated November 2018).

166. *Id.*

167. *Id.* § 20:94.

168. *See* 2 TEX. PRAC. GUIDE WILLS, TRUSTS, & EST. PLAN. *Section 1301 Management Trusts* § 5:40, Westlaw (July 2018 update).

169. *See* TEX. EST. CODE ANN. § 1301.203 (Supp.).

170. *Id.* § 1301.203(b).

171. *Id.* § 1301.204(a).

one is appointed; or, to the personal representative of a deceased beneficiary.¹⁷² The court may not require the trustee of a trust for a person with only a physical disability to prepare and file a final account with the court.¹⁷³

C. Application and Order to Discharge

After the judge signs and enters the order approving the final account, the trustee of a Chapter 1301 trust must deliver any property remaining in the trust to the former ward, a successor trustee, or the representative of the deceased ward's estate.¹⁷⁴ The trustee should obtain a receipt from the person or entity to whom the property was delivered and file it with the court along with the application and order to discharge the trustee.¹⁷⁵ If the trustee was an individual required to post a personal bond with the court upon creation of the trust, an application and corresponding order should be filed to request release of the bond from the clerk's office.¹⁷⁶

Practice Tip #6: Upon termination of a special needs management trust due to the death of the beneficiary, current Social Security regulations permit the trustee to pay some administrative expenses before reimbursing the state Medicaid agency for medical expenses paid on behalf of the beneficiary.¹⁷⁷ For instance, at the death of the trust beneficiary, the trust is allowed to pay taxes owed from the trust due to the death of the beneficiary and reasonable administration fees associated with terminating and wrapping up the trust.¹⁷⁸

X. USE OF MANAGEMENT TRUST IN CONJUNCTION WITH GUARDIANSHIP OF THE ESTATE

In most instances, the creation of a Chapter 1301 management trust will eliminate the need for a guardianship, and will serve the needs of the ward's estate in lieu of a guardianship.¹⁷⁹ There may be times, however, when it is in the best interests of the ward to combine the advantages of a trust (e.g., flexibility of investment power and ease of managing the ward's funds without having to gain court approval) with a guardian's hands-on approach to providing for the ward's daily living needs.¹⁸⁰ The special demands of

172. *Id.*

173. *Id.* § 1301.204(b).

174. *Id.* § 1301.204.

175. *Id.*

176. *Id.*

177. *See Exceptions to Counting Trusts Established on or After January 1, 2000*, SOC. SEC. ADMIN. (July 26, 2018), <https://secure.ssa.gov/poms.nsf/lnx/0501120203> [perma.cc/62WD-QE58].

178. *Id.*

179. *See* TEX. EST. CODE ANN. § 1301.053 (Supp.).

180. *See, e.g.,* *Ablon v. Campbell*, 457 S.W.3d 604, 606 (Tex. App.—Dallas 2015, pet. denied) (“Fred’s guardian ad litem filed an Application for Creation of Management Trust, seeking to have all of Fred’s property put into a management trust.”).

caring for a ward who is profoundly disabled or lives in a remote location may be more easily met by having a guardian with access to a limited amount of cash to meet ordinary expenses, along with a management trust overseen by an institutional trustee with expertise in managing large portfolios of investments.¹⁸¹ In such cases, the applicant evaluating options for handling a ward's finances should consider some of the issues discussed below.¹⁸²

A. Availability of Cash for Ordinary Expenses

The advantage of having a guardian to provide for a ward's immediate and changing needs may best be served by having a checking account with a cash balance in an amount calculated to provide for the ward's usual monthly needs for food, clothing, medications, etc.¹⁸³ That amount would be specified in the order creating the management trust as the maximum monthly balance to provide for the ward's needs.¹⁸⁴ The order would also include a provision directing the trustee to transfer each month into the guardianship checking account an amount equal to the difference between the current balance and the maximum monthly balance approved by the court, upon receipt of written documentation that the funds spent from the account in the prior month were for appropriate.¹⁸⁵ For any needs of the ward that could not be met with the available funds maintained by the guardian, the guardian would request the trustee to disburse additional funds for a specific purpose.¹⁸⁶ The trustee would pay directly from trust assets all other normal monthly expenses of the ward, such as a mortgage, utilities and health insurance.¹⁸⁷

B. Coordination of Efforts

Meeting a ward's needs through the efforts of a trustee and a guardian requires good communication and a willingness to collaborate for the benefit of the ward.¹⁸⁸ This means that the trustee must be easily accessible by phone, fax, e-mail, or other means of communication, and the guardian and caregivers for the ward must provide timely oral and written information about the ward's needs and expenses.¹⁸⁹ Both the trustee and the guardian must be willing and able to share information as needed, and to sign any authorizations or other forms required by third parties.¹⁹⁰ Turf wars about

181. TEX. EST. CODE ANN. § 1301.053 (Supp.).

182. *See infra* Part X.A.

183. TEX. EST. CODE ANN. § 1301.053 (Supp.).

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* § 1301.055.

189. *Id.*

190. *Id.*

who will pay what bills, failure to keep good records, and delays in responding to each other can quickly obviate any benefits provided by the dual trustee/guardian arrangement.¹⁹¹

The trustee and guardian would also need to cooperate about recordkeeping for tangible assets purchased and maintained by the guardian with funds disbursed from the trust.¹⁹² For example, if the guardian receives distributions of trust assets for purchase of a vehicle or special equipment for the ward, those assets would likely be titled or held under the guardianship, but purchase orders, receipts, or other records showing ownership and value of the asset should be shared with the trustee, so that the trustee can properly document the use of trust funds.¹⁹³ Similarly, if the guardian rents a safe deposit box using trust funds, a list of the contents of that box should be provided to the trustee, so that both parties are informed of the location of important records related to use of trust assets.¹⁹⁴

C. Careful Reporting

To keep the court fully apprised about the funds available to meet the ward's needs, both the trustee and the guardian of the estate must account for the funds held within their respective custody and control.¹⁹⁵ The guardian would prepare and file an annual accounting of the receipts to and expenses paid from the guardianship account, and the trustee would provide the usual annual account for the management trust.¹⁹⁶ The amount of funds transferred from the trust into the guardianship account would need to match the vouchers provided to the trustee, and the trustee would have to show that the funds reportedly transferred to the guardian matched the transaction records for the trust.¹⁹⁷ Information for income tax returns and reporting for receipt of governmental benefits would also need to be coordinated.¹⁹⁸

D. Coordination of Compensation

To avoid overcharging the ward's estate for fees paid to the guardian and the trustee, the compensation for the guardian and for the trustee should be calculated based on the actual funds received or disbursed by that party.¹⁹⁹

191. *Id.*

192. 7APT2 TEX. JUR. PL & PR. FORMS *Creation of Management Trust* § 131:88, Westlaw (database updated January 2019).

193. The author create this example for the purpose of this article.

194. *Id.*

195. *See supra* Section VII.B.

196. 7APT2 TEX. JUR. PL & PR. FORMS *Terms of Management Trust* § 131:88, Westlaw (database updated January 2019).

197. *Id.*

198. *Id.*

199. *See supra* Section VI.C.

For instance, the guardian should not be entitled to count as a “receipt” for purposes of compensation an amount received as a distribution from the trust, if those funds had already been accounted as “income” to the trust.²⁰⁰ Otherwise, there would likely be “double-dipping” between the trustee and the guardian, regardless of intent.²⁰¹ This means however, that the 5% in 5% out rule might have to be adjusted by the court to provide for appropriate remuneration in light of the guardian’s actual efforts on behalf of the ward.²⁰² Likewise, if the trustee were not compensated according to a set fee schedule, the court would need to consider whether transfers of funds from the trust to the guardian’s checking account would qualify as “disbursements” upon which a commission would be paid.²⁰³ As long as both the trustee and guardian are forthcoming and transparent about their accountings and calculation of requested compensation, the court can easily determine and award an appropriate amount of compensation to each fiduciary.²⁰⁴

E. Termination of Guardianship

Upon the termination of the guardianship, whether by death or restoration of capacity, the court would need to provide for all funds remaining in the guardianship account to be returned to the trustee of the management trust, so the balance of the trust assets could be fully distributed according to the trust terms.²⁰⁵ Thus, the final accounting of the guardianship would be completed and approved, the refund of any guardian’s bond premium would be deposited into the trust account, and the guardian would be discharged before the trustee filed its final accounting for the trust.²⁰⁶

XI. CONCLUSION

Whether a management trust is used in lieu of or in conjunction with a guardianship of the estate, the attorney serving as an *ad litem* or representing a guardian or trustee should carefully consider all options available for managing a ward’s finances.²⁰⁷ The circumstances of each case will dictate the benefit of either a trust or guardianship, and the conditions under which a ward’s estate will be administered.²⁰⁸ Understanding the advantages, opportunities, and requirements for handling a management trust is vital to

200. See *supra* Section VI.C.

201. See *supra* Section VI.C.

202. See *supra* Section VI.C.

203. TEX. EST. CODE ANN. § 1155.003 (Supp.).

204. See *supra* Section VI.C.

205. TEX. EST. CODE ANN. § 1301.152 (Supp.).

206. *Id.*

207. See *supra* Section V.A–D.

208. See *supra* Part VI.

properly provide for the best interests of a ward or incapacitated person for whom the trust is established.²⁰⁹

209. See *supra* Parts VI–VIII.