

## Planning With Special Needs Trusts in Texas

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### III. DRAFTING STRATEGIES FOR SPECIAL NEEDS TRUSTS

**A. Quality of Life Considerations**– The most important thing to keep in mind in drafting Special Needs Trusts is the goal or purpose of the trust. The purpose of a Special Needs Trust is to enhance the quality of life of a disabled or special needs beneficiary. Why put the beneficiary through the pain and difficulty of dealing with a trust that restricts their access to their money or assets If the trust does not serve that purpose? In determining if the trust will be able to enhance the quality of life of the beneficiary first we have to assess the current and future needs and desires of the beneficiary. In order to evaluate these issues the beneficiary should be consulted if they are able to communicate their desires and aspirations. If the beneficiary is unable to communicate concerning these topics then a close family member or care giver as well as a medical professional should be consulted. Many times the medical professional is the person best able to predict the future needs and abilities of the beneficiary. This analysis must concentrate on the future potential for the beneficiary to obtain employment and to function in society without the need of government benefit programs. In most cases this analysis will be short indeed, many times the beneficiary will be severely injured or suffering from a catastrophic illness that completely negates any possibility of their later obtaining employment and ending their need for government benefits. The current status or the status of the beneficiary prior to the occurrence of the event that precipitated the current health problems should be considered. Where they working at the time? Is the person mentally sound with only physical problems? Will it ever be possible for the beneficiary to live independently or with a minimum of assistance from others? Do they expect to have a family one day? Is the person apt

to be a star athlete in the Special Olympics? Does the person have a family that they were responsible for supporting?

Once information is obtained about the needs and the potential abilities of the beneficiary then one important question must be answered. How will this person pay for their medical care in the future? Even if the assets available to the beneficiary and their family would allow for the purchase of private insurance it may not be available at any price because of underwriting problems. It may be that the person will be able to qualify for Medicare benefits based on their own earnings record or that of a parent or grandparent. All of the other issues may be subjugated to this one problem. No matter what we hope to do for the beneficiary regarding quality of life, the one overriding factor that overwhelms all other considerations may be that the beneficiary must have a trust that will protect eligibility for Medicaid benefits or all will be lost to medical bills within a very short time.

**B. Specific Needs to Consider for the Individual**—Once the decision has been made that a Special Needs Trust can provide enhancement of the quality of life of the beneficiary and is an appropriate vehicle to achieve that goal the specifics of the trust must be considered. This is where the draftsman is forced to rely more on their own knowledge and experience rather than the needs and desires as expressed by the beneficiary. The draftsman should have a working knowledge of the problems and potential solutions that exist for a person with special needs and draft the trust to ensure that the trustee is given the necessary guidance and authority to provide for the needs of the beneficiary. Some draftsman of Special Needs Trusts specify a list of priorities as a guide for the trustee to use in deciding what action is appropriate. One

author has used the following:

- a. First, protect the beneficiary's medical care;
- b. Secondly provide for the beneficiary's comfort and maintenance;
- c. Then, protect the beneficiary's personal care;
- d. Next provide the beneficiary with transportation and recreation;
- e. Finally, protect the beneficiary's education and work activity programs.

It is this author's approach to provide a broad statement of the purpose of the trust such as:

It is the principal purpose and the intent of the Grantor and parties herein to provide a system for fund handling, fiscal management, investment and disbursement, respite care, personal attendant services, advocacy, social development services, habilitation care management and moral guidance for the beneficiary.

After providing the broad statement of the purpose of the trust more specific examples of special needs of the beneficiary are given, but it is made clear that these examples are only precatory in nature and not specific instructions. This is advocated because the flexibility it offers the trustee as the needs of the beneficiary change. This is a considerable advantage over a strict prioritized list to which the trustee must adhere. Another facet to recommend the broad approach is that if the trust is ever attacked by the authorities administering public benefits programs, in an attempt force the disbursement of funds, courts in seeking to decide such cases will always look to the intent of the grantor and the broader the purpose the more room there is to

advocate for a specific interpretation.

There are times when the specific needs of a beneficiary or the specific desires of the grantor need to be included to force the trustee to provide the benefit or service for the life of the trust. One such example might be to mandate that the trustee engage the services of a geriatric care manager (GCM) to visit and advise the trustee on the care needs of the beneficiary. The specifics of such may be as precise as to mandate the professional credentials of the GCM and the number of times a month the GCM is to personally visit the beneficiary.

Whatever approach is taken the draftsman must be mindful of the potential for changes in the regulations that govern public benefit programs and of the future needs of the beneficiary. No consideration has been given to drafting provisions for the benefit of future beneficiaries as most often the trust will be prepared to benefit the needs of the current beneficiary only. Language should be included to instruct the trustee that the needs of future beneficiaries are not to be considered as traditional trust law would require the trustee to be mindful of the rights of future beneficiaries. An example of such a provision would be:

In carrying out the provisions of this Trust, the Trustee shall be mindful of the probable future needs of the Beneficiary but not of the Trust remainder beneficiaries.

**C. Tax Savings Strategies**– There are several different areas of taxation that need to be considered when drafting a Special Needs Trust. These areas break down into both income tax considerations and gift or estate tax issues. The treatment of a Special Needs Trust for tax purposes will be different if the trust is a testamentary

or third party trust or a self settled trust.

1. **Third Party Trusts Income taxes.** When a trust is created by a third party for the benefit of another person and the assets or money used to fund the trust are not the assets of the beneficiary then the trust will normally be a separate tax paying entity from the grantor or beneficiary. The trust must obtain its own taxpayer identification number and file annual fiduciary tax returns. In most instances the trust will not make direct distributions to the beneficiary but will make distributions to other parties for goods or services that will be provided to the beneficiary by third parties. This methodology will be employed to prevent the disbursements from being considered income to the beneficiary by public benefit programs like SSI and Medicaid. When disbursements are made to third parties for the benefit of the beneficiary or if disbursements are made directly to the beneficiary the trust will send the beneficiary a K-1 that will report the disbursements as income on the beneficiary's social security number. Any public benefit programs for which the beneficiary is eligible will cross match these K-1's to the beneficiary's social security number and count these disbursements as income to the beneficiary, thereby potentially disqualifying the person from the programs. It is very important that the trustee maintain accurate records and report all disbursements to the benefit programs to make sure that disbursements that are not intended to be income to the beneficiary are not counted as income by these programs. Many trustees will not want to assume this responsibility but it is a critical duty that the trustee must perform.

2. **Self Settled Trusts Income taxes.** The IRS will treat these trusts as grantor trusts even if the nominal grantor is someone other than the beneficiary.

The IRS takes the position that if the assets used to fund the trust belong to the beneficiary then it will be considered a grantor trust no matter who is listed as the grantor on the trust. Under the grantor trust rules found at Sections 671-678 of the Internal Revenue Code the income from the trust will be taxable to the beneficiary whether or not any distributions are made. This is really an advantage as the tax rates or brackets for trusts are “compressed” and would result in a much higher marginal rate if the income was taxed at the trust level.

**a. Reporting Requirements.** The reporting requirements of grantor trusts are set forth at Treas. Reg. Section 1.671-4(b). If a trust has a single grantor that is treated as the owner of all of the income and the trustee is not the grantor then the regulations allow the trustee to use two different methods to report taxable income.<sup>1</sup>

**i.** The trustee is permitted to furnish the name and social security number of the grantor to all the account holders such as banks and all income payors, along with the address of the trust and obtain a signed Form W-9 from the grantor/beneficiary or;

**ii.** The trustee can give the name and address and TIN of the trust to all account holders and income payers; issue a Form 1099 to the grantor showing the income of gross proceeds received by the trust and file a Form 1041 without income, deductions or credits but with an attached statement showing the beneficiary/grantor’s name, address, social security number and the amount of the income, deductions and credits.

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<sup>1</sup>Morris, Stuart, *Tax Saving Strategies for Special Needs Trusts*, Stetson

The advantage of the second approach is that all of the income attributable to the assets of the trust is reported to the trust tax identification number and then sent on to the beneficiary. By using this method all of the income from trust assets can be kept separate from any other income that the beneficiary might have from other sources. The trustee must notify the beneficiary that all income, deductions and credits must be reported on their individual tax return.

**b. Taxes Upon Funding.** In most instances the funding for a self settled Special Needs Trust will be done with the proceeds from a personal injury settlement or judgement. IRC 104(a)(2) exempts damages received due to a personal injury or sickness from gross income subject to taxes. Many times the funding for such a settlement will be accomplished by the use of a structured settlement. The periodic payments are also not taxable. Therefore, in most instances the assets received and in turn used to fund a self settled Special Needs Trust will not be taxable to the beneficiary.<sup>2</sup> Once the assets are placed in the trust then any income produced is taxable.

**3. Federal Estate Taxes.** If the trust is a third party Special Needs Trust funded with the assets of someone other than the beneficiary and the grantor retains no interest in or control over the assets, the funding of the trust will be considered a completed gift and will no longer be considered part of the taxable estate of the donor. If the trust is a self settled trust then the assets will be included in the grantor/beneficiary's estate upon death. A significant problem can be created if the

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University College of Law Special Needs Trust IV. (Oct.18, 2002).

<sup>2</sup> *id. at p. 15.*

settlement is funded with an annuity payable to the trust during the lifetime of the beneficiary with guaranteed payments continuing after the death of the beneficiary. In this situation the total present value of the remaining payments of the annuity will be subject to estate tax in the beneficiary's estate. The attorney involved in such a transaction should make sure that there is sufficient liquidity in the trust to pay any estate taxes that would be due in the event of the death of the beneficiary. It is possible that any annuity purchased as part of a structured settlement can include a commutation rider that will protect against the need to pay the estate taxes.

**4. Gift Taxes.** In third party trusts the gift tax consequences would be the same as if the grantor/donor were to give assets to any trust. If the gift is considered a completed gift for estate tax purposes then it will be likewise subject to gift tax. In self settled Special Needs Trusts the issue is again whether a completed gift has been made but the provisions of these trusts will cause the gift to be considered an incomplete gift in most instances. As mentioned above it is an advantage to have the assets in the trust taxable for income tax purposes to the beneficiary i.e. a grantor trust. Although the rules for d4A Special Needs Trust require that the grantor/beneficiary give up the ability to control the property or to demand a distribution be made for their benefit, other provisions will render the funding of the trust an incomplete gift under the tax rules so that there are no gift taxes. In most of these trusts the disabled person will maintain a power of appointment over the disposition of the trust assets upon their death. The power of appointment will cause the trust assets to be included in the beneficiary's estate upon death and hence the transfer of the assets to the trust will not be considered to be a completed gift for gift tax purposes.

Attorney Stuart Morris of Boca Raton, Florida a nationally recognized expert in the taxation of trust advises caution however to personal injury attorneys that agree to accept the proceeds of a settlement and deposit same into their escrow accounts for later transfer to the beneficiary/grantor and funding into the trust. He advises that the attorney should accept the check from the defendant or its insurance company made directly payable to the attorney as attorney for the trust.

**D. Regulations Governing Special Needs Trusts--** In order to achieve the desired result in drafting Special Needs Trusts the ultimate goal of improving the quality of life for the beneficiary must always be foremost in the mind of the draftsman. Step one in achieving that goal is to make sure that the beneficiary maintains eligibility for government programs that provide income and medical benefits, namely SSI and Medicaid. It would be useless for the draftsman to draft a trust that complies with the rules for establishing such a trust but to ignore the rules regarding obtaining and maintaining benefits under these federal programs. The rules governing how the trust should be created are fairly simple. The rules for obtaining eligibility for SSI and Medicaid are extremely complex. Well known author and expert on public benefits David J. Lillesand puts it this way:

“In other words there are two ways the practicing Social Security attorney can adversely affect the client: draft the trust improperly, so that it is not approved by SSA, and draft a trust in a way that restricts the trustee from providing the full benefits due the client according to the SSA rules.”

**1. Federal Law and Regulations.** The Social Security Act was passed in 1935 and created what is known to most people as the federal retirement

program. The act has been expanded by Congress many times. In 1939 benefits for spouses and children of a retired worker were added along with benefits for the survivors of a deceased worker. Later, benefits were added for disabled workers (1956) and in 1965 Medicare was created. The Medicare Act is divided into two separate benefit programs: Part A 42 U.S.C. § 1395c-1395i and Part B 42 U.S.C. § 1395j-1395w. Title II of the Social Security Act contains the provisions for Disability Insurance Benefits (DIB) codified at 42 U.S.C. 401 et seq. Title XVI of the Social Security Act, 42 U.S.C. 1381-1383f. is the law creating the Supplemental Security Income (SSI) program. The Supplemental Security Income (SSI) program was passed as an amendment to the Social Security Act in 1972. The Medicaid program laws are found at 42 U.S.C. 1382 et seq. These statutes provide the law that creates the programs but the Social Security Administration promulgates regulations that implement the law and control the workings of the programs.

The regulations concerning the SSI program are found at Code of Federal Regulations (Employees' Benefits) Section 20, Chapter III. 20 C.F.R. . 416.101-2227. There is not a single regulation that addresses Special Needs Trusts. Special Needs Trusts are covered like all other trusts in the section dealing with "resources". The resource rules for trust and other assets are found at 20 C.F.R. 416.1201-416.1266.<sup>3</sup>

The Omnibus Budget Reconciliation Act of 1993 (OBRA '93) created the specific statutes that define what has become known as Special Needs Trusts. The law basically created safe harbor provisions for these types of trusts at 42 U.S.C. 1396p (d) (4) (A) and (C). The sections are very short. If a trust is created in compliance with

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<sup>3</sup> Lillesand, David, *SSI Analysis of Special Needs Trusts Using the POMS*, Stetson University College of Law Special Needs Trust IV. (Oct.18, 2002).

these sections the assets of the trust will not be counted as an available resource for Medicaid eligibility purposes. On December 14, 1999 President Clinton signed into law the Foster Care Independence Act of 1999 (H.R. 3443). This law adopted the Medicaid trust rules for the SSI program. The Medicaid program uses most of the same rules as the SSI program for financial eligibility determinations these regulations are found at 42 C.F.R. §§ 440.1 - 440.180.

**2. Program Operations Manual System (POMS).** The POMS is a huge set of instructions that SSA publishes to guide all of its employees in handling Social Security matters. Although the POMS has no official status, it is not law and cannot be relied upon like a duly promulgated regulation it is the law as far as most SSA claims representatives are concerned. The POMS will be the source that an employee of the SSA will turn to in evaluating all issues concerning the drafting and administration of a Special Needs Trusts. It is available online at <http://policy.ssa.gov/poms.nsf> . If you cannot remember the URL you can go to [www.SSA.gov](http://www.SSA.gov) and navigate to it easily.

**3. Social Security Rulings.** The Social Security Administration also issues what are called Social Security Rulings. The rulings are published periodically by the Social Security Administration and are binding on all components of SSA. 20 C.F.R. 402.35 (b) (1). These rulings along with the regulations mentioned above constitute the official interpretation of the Social Security Act by the agency. There are no rulings on Special Needs Trusts. <sup>4</sup> The rulings are very poorly indexed but are available at [www.ssa.gov](http://www.ssa.gov) .

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<sup>4</sup> *Id.* at p. 7.

**4. Texas Laws and Regulations.** There are two Texas statutes that are critical to creating a Special Needs Trusts in Texas. These are Section 867 of the Texas Probate Code entitled Creation of Management Trust and Section 142.005 of the Texas Property Code entitled Trust for Property. All Special Needs Trusts created by State Courts in Texas will be created pursuant to these statutes. The draftsman of any self settled supplemental needs trust must have a through working knowledge of these statutes before attempting to create such a trust in Texas.

**5. Medicaid Eligibility Handbook and Texas Administrative Code.**

Although the most important program rules to be concerned with in drafting Special Needs Trusts maybe SSI related, the specific rules governing the Texas Medicaid program must be considered when drafting a Special Needs Trusts for a disabled person in Texas. The Medicaid program is a joint federal/state program and the general rules and eligibility requirements are set forth by the federal law.

Notwithstanding that premise, states are allowed to promulgate their own regulations for administering the Medicaid program in their particular state. If a beneficiary were to need long term care benefits at some point in their life, then the rules of the Texas long term care program would be the rules upon which the beneficiary's eligibility would depend. The regulations of the Texas Medicaid Program are promulgated under the Texas Administrative Procedure Act. Medicaid regulations in the Texas Administrative Code can be accessed through <http://www.sos.state.tx.us> The TAC sections dealing with Medicaid can be found at 40TAC Social Services and Assistance. The Department of Human Service rules are found in the Medicaid Eligibility Handbook (MEH) which can be purchased viewed online at

<http://www.dhs.state.tx.us/handbooks/meh/1000/1110.htm>.

#### IV. **ADMINISTRATION OF SPECIAL NEEDS TRUSTS**

**A. Who May Act as Trustee?** The federal statutes and regulations concerning Special Needs Trusts place no restrictions on who may serve as a trustee of a d4A Special Needs Trust. The federal law mandates that the trustee of a d4C pooled trust must be a non-profit corporation. There are no restrictions at the state level if the trust is a third party created Special Needs Trusts. If the Special Needs Trust is to be a self settled Special Needs Trust created by a Texas Court the statutes mentioned in section D. 5 above mandate the selection of a trustee.

Section 142 of the Property Code mandates the appointment of a corporate fiduciary.

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

Section 867 requires the appointment of corporate fiduciary in most cases but allows a noncorporate fiduciary to be appointed under certain circumstances. 867 states:

(c) If the value of the trust's principal is \$50,000 or less, the court may appoint a person other than a financial institution to serve as trustee of the trust only if the court finds the appointment to be in the ward's best interests.

(d) If the value of the trust's principal is more than \$50,000, the court may appoint a person other than a financial institution to serve as trustee of the trust only if the court finds that:

(1) no financial institution is willing to serve as trustee; and

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

(e) Before making a finding that there is no financial institution willing to serve as

trustee under Subsection (d)(1) of this section, the court must check any list of corporate fiduciaries located in this state that is maintained at the office of the presiding judge of the statutory probate courts or at the principal office of the Texas Bankers Association.

If a noncorporate fiduciary is allowed then the selection of the proper trustee to serve is one of the most important decisions to be made. Selection of a competent trustee will result in the trust operating as it is intended and insuring the beneficiary's needs will be met. Failure to appoint the right trustee can frustrate the entire purpose of the trust and result in the beneficiary losing eligibility for crucial public benefits. Experts in the field are unanimous in their insistence that a quality trustee be selected. Mary T. Schmitt Smith states the case thus:

Criteria for a Trustee includes commitment to assume the responsibility, knowledge of the beneficiary and benefits rules (or ability to attain such information), and willingness to delegate duties to others, including professionals, where appropriate.<sup>5</sup>

When choosing a trustee, factors to be considered include the fees charged by a professional fiduciary, the trustee's knowledge of public benefit programs and their regulations, as well as the beneficiary's special needs and circumstances.<sup>6</sup> Many times the factors may weigh heavily in favor of a family member possibly even a parent. There will be great potential for conflicts of interest if a close family member is named. Additionally, family members may lack knowledge of the duties and responsibilities that

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<sup>5</sup> Smith Schmitt, Mary T., *Preparing a Special Needs Trusts in Anticipation of Administration*, p.3. Stetson University College of Law Special Needs Trust IV. (Oct.18, 2002).

<sup>6</sup> Margolis, Harry S., *Special Needs Trusts in the Context of Personal Injury Settlements*, at p. 11, National Academy of Elder Law Attorneys Institute, (November 16-19, 2000).

are placed on them when acting as a fiduciary.

Traditionally banks and trust companies have been the first choice for such duties even in situations where their selection is not required by law. The major drawback with the selection of a bank besides cost may be the inflexibility that such an institution may offer. Special Needs Trusts present myriads of unusual situations that most banks and trust companies are unlikely to have dealt with in the past. Most bank trust departments will have no knowledge of the rules of public benefit programs. They will likewise be unfamiliar with the special needs of the disabled beneficiary and the types of expenditures that will be needed for their care and maintenance.<sup>7</sup>

In many areas of the United States attorneys have begun to be the prevalent choice as trustees of Special Needs Trusts. The requirements of knowledge of the eligibility requirements of benefit programs, the experience in dealing with disabled clients and their families all have legal components that attorneys are well suited to handle. The negative aspect of naming an attorney as trustee would be lack of continuity in the event the attorney would become ill or pass away themselves.<sup>8</sup>

**B. Responsibilities When Serving as a Trustee.** The job of a trustee is to understand and to carry out the terms of the trust. In fulfilling the duties as set forth in the trust the trustee must keep in mind the overall intent of the trust. This intention should be clearly spelled out in the trust document. The language should be unambiguous and simple. The purpose or intent of the trust should be to improve the

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<sup>7</sup> Fleming, Robert B., *Choosing the Trustee*, p.6. Stetson University College of Law Special Needs Trust. (Oct. 22-23, 1999).

<sup>8</sup> *Id.* at p. 7.

quality of life for the beneficiary. Other secondary goals can be included but they must always be viewed through the prism of how they will impact on the primary goal. Any action taken or not taken must be in the best interest of the beneficiary.

In order to carry out this prime directive the trustee must do several things. First, the trustee must read and understand the terms of the trust. Without a thorough understanding of workings of the trust nothing can be accomplished. If the trustee does not understand every line and syllable of the trust then professional help should be obtained to explain in detail the meaning of each section so that it is understandable. It may be helpful for the trustee to break the trust document apart into specific sections and to set out in their own words on a piece of paper what they believe this section or article means in terms of their duties. Once they have done so, they can have these memos of understanding reviewed by a professional skilled in that particular area such as investing, accounting, or legal matters. If there is any misunderstanding about the duties or responsibilities this should help to alleviate them.

Once a through understanding of the trust is obtained the trustee must then become familiar with the specific facts of the beneficiary's life and their needs. If there is a life care plan for the beneficiary the trustee should carefully review it to make sure that long-term goals and needs are considered as well as any immediate needs that present themselves. In order to understand and deal with the needs of the beneficiary the trustee must be familiar with the public benefit programs that the beneficiary is or may be enrolled in. Without a working knowledge of the eligibility requirements of each of the possible programs that the beneficiary may need then it is impossible for the trustee to evaluate any course of action with regard to its affect on the quality of the

beneficiary's life. (see number one above) It may be impossible for the trustee to accomplish this goal with any efficacy without the aid of a social worker or attorney experienced in these matters. The trustee should likewise maintain a relationship with knowledgeable professionals in this realm to provide advice on matters as they arise in the future.

With the proper background as set forth above, the trustee is now equipped to carry out the mandate of the trust. What can be done to improve the quality of life of the beneficiary? This is where the choice of a quality trustee pays off. If the trustee is an institutional entity they may believe that all they are required to do is to sit back and wait for someone, possibly a parent or loved one of the beneficiary to come to them and request that money be disbursed for this reason or for this need. That is not the trustee's duty. The trustee should be trying to actively find ways to improve the quality of life for the beneficiary. If the trustee is unable to do this job because of lack of knowledge or training then they must hire someone with expertise to do the job for them. The trustee should develop a check list of areas of inquiry to pursue. Things like what changes could be made in the housing situation of the beneficiary that would improve the quality of their life. Are there any educational opportunities that the beneficiary could benefit from? Are there any opportunities for social interaction that the beneficiary has not availed themselves of? Most often it will require the services of a trained social worker or geriatric care manager to make determinations about these types of matters. Many times because of their close involvement parents may not be able to see the big picture for a child. The trustee should be able, with the help of professionals, to map out a plan or strategy for the short, intermediate, and long-term

needs and goals of the beneficiary. As previously mentioned a life care plan that was prepared for litigation purposes may help. Because it was specifically prepared for a lawsuit it may not contain the information or planning that is necessary to carry out the prime mission of the trustee.

In addition to these overall responsibilities, the trustee must make sure that all of the ministerial duties are performed. The trustee must prepare documentation and furnish reports to all of the public benefits programs that the beneficiary is enrolled in so that later tape matches of income attributable to the social security number of the beneficiary will not result in disqualification from these programs. If the trust is a court created trust then the trustee may be required to file an annual accounting with the court and with the caretakers of the beneficiary.

Finally, the trustee must have in place some system for updating and maintaining the plans described above. The system should include personal contact and evaluation of the beneficiary on a regular basis. Some trusts mandate this type of action as often as twice a month. If the beneficiary has serious medical problems then this system must include reports of the beneficiary's medical status and current treatment. The planning for future medical expenses may be a significant burden in some cases. There may be treatment available that will not be covered by public benefit programs such as Medicaid that would greatly enhance the quality of life for the beneficiary.

**C. The Prudent Investor Rule.** The Texas Trust Code at 113.056 Standard for Trust Management and Investment, sets forth the requirements for a trustee when managing the investments of a trust such as a Special Needs Trust. The

code applies the standard of a “Prudent Person”<sup>9</sup> to the management and investment authority granted to trustees.

..... a trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as the probable increase in value and the safety of their capital.

Additionally the Code in the last sentence of section 113.056(a) allows a trustee to consider the investments of the total assets of the trust rather than looking at each individual investment as a separate decision. This allows the trustee to utilize what is called the “Prudent Investor” standard for determining if an investment is appropriate for the assets of the trust. Author Carolyn H. Sawyer in *Administration of Special Needs Trusts*, describes the affect of the Prudent Investor Rule and its impact:

“Modern portfolio theory provides mathematical analysis to determine measures of risk and return of a particular portfolio. The lesson to be learned is that a balance of the two provided by appropriate diversification tilted toward the purpose of the trust is the goal”.

If the trustee is a noncorporate fiduciary then section 113.060 of the Trust Code entitled Authority to Delegate Investment Decisions will be a significant aid in performing the duties of trustee. This section allows the trustee to escape liability for making decisions concerning investments by following certain steps set forth in 113.060 (c). If the trustee uses ordinary prudence and discretion in selecting an investment agent then the trustee will not be liable for the investment decisions made

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<sup>9</sup> Green, Deborah A., *Court-Created Trusts under 867 of the Texas Probate Code*. P.10. University of Texas Law School Intermediate Estate Planning Guardianship

by the professional manager.

**D. Attorneys Fees.** In drafting the trust specific authority should be granted to the trustee to pay fees associated with the drafting of the trust and its administration. As mentioned above the trustee should maintain an ongoing relationship with an attorney that is knowledgeable about the eligibility requirements of the public benefits programs for which the beneficiary may need to seek eligibility. It should be specifically mentioned that any fees associated with obtaining advice of an attorney in the administration of the trust is a proper charge to the trust. A recent change in the POMS specifically authorizes the payment of reasonable fees associated with winding up the trust at the death of the beneficiary prior to the State Medicaid being reimbursed under the payback provision. POMS SI 01120.203B.

If the trust is a court created trust it is the author's practice to authorize the payment of attorney fees for the drafting of the trust in the order signed by the court that creates the trust.

**E. Fund Disbursements.** The distribution standards used in Special Needs Trusts vary dramatically depending on the needs and location of the beneficiary. The types of standards break down along lines of mandating that the trustee provide or not provide certain distributions. Other standards specifically leave any decision to make or withhold a distribution completely within the discretion of the trustee. The goal should be to allow the greatest flexibility to make distributions consistent with the intent of the trust to improve the quality of life of the beneficiary while still maintaining protection from the trustee being forced to provide support for the beneficiary that will ultimately

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& Elder Law Conference, Galveston, Texas (August 16-17, 2001).

lead to disqualification from public benefit programs. In prior years a strict supplemental needs only standard was more often than not employed as there were few guidelines to follow and most draftsmen were cautious to protect eligibility for means tested programs.

In some states such as New York and Ohio state law proscribes the type of distribution standard that may be included in a trust. Texas has no statute mandating any specific distribution language in a Special Needs Trust.

The type of standard used is determined by the attorney drafting the trust. Research on the issue will provide tons of scholarly debate about what standard is appropriate. In determining what standard to use it will be helpful to refer to several sources. To gain an understanding of the judicial interpretations for various standards the draftsman would do well to obtain copies of Clifton B. Kruse, Jr.'s Third-Party and Self-Created Trusts 3<sup>rd</sup> ed. , published by the Section of Real Property, Probate and Trust Law of the ABA. This work and its two predecessors brings together the case law on how different distribution standards have been received in the courts. It also explains the impact of statutory changes made by the various federal laws that have impacted this area of work. Another excellent source of analysis is provided on the website of Cynthia Barrett an Oregon Elder Law attorney and former president of the National Academy of Elder Law Attorneys. (CynthiaBarrett.com) Ms. Barrett has identified six distribution standards ranging from a mandated support standard to a standard allowing the trustee to knowingly make disbursements that will reduce or eliminate public benefits. One of the best contemporary articles on distribution standards is by Stuart D. Zimring of North Hollywood California entitled *Distribution*

*Clauses: A Smorgasbord of Options*, Special Needs Trusts IV, Stetson University College of Law St. Petersburg Fla. (October 18<sup>th</sup>, 2002). In his article Mr. Zimring provides examples of many clauses used by leading trust experts from across the country.

No one clause or standard will work for every beneficiary. The considerations to be made in determining the standard to be used include such things as what benefit programs does the beneficiary need or how knowledgeable is the trustee about such programs. Many times a beneficiary will be able to take advantage of the limited loss of SSI that a disbursement might cause and still maintain eligibility for the program. (Remember \$1.00 of SSI will maintain Medicaid eligibility) Other trusts may be drawn to allow the use of funds for support under limited circumstances.

The author's current favorite allows the trustee to use funds to make disbursements that would result in a decrease in the SSI of the beneficiary under the program's one-third reduction rule or presumed maximum value rule as long as it does not result in a total loss of benefits. This is a very flexible standard as it can allow the trustee to make all kinds of disbursements without the necessity of including language describing a specific distribution. In drafting third party created Special Needs Trusts a purely discretionary standard may be used. The decision to make or withhold a distribution is totally the province of the trustee. The trustee cannot be compelled to make a distribution if, in the trustee's judgement only, the distribution would not be in the beneficiary's best interest. This standard has been approved many times by the SSA in cases where the beneficiary is currently receiving SSI.

**F. Monitoring of Special Needs Trusts.** The ongoing administration of

Special Needs Trusts is to quote the cliché “where the rubber meets the road”. The beneficiary may be receiving public benefits at the time the trust is created and funded and the first action taken by the trustee results in a disqualifying disbursement. If the trustee is a family member it may be very difficult indeed to impress upon them the need for forethought in making a distribution. If the draftsman is only employed to draft the trust, then letters explaining the dangers associated with administration of the trust must be sent to the trustee, other lawyers involved in the case, to the beneficiary and to any care givers of the beneficiary. These letters should include as much as possible an explanation of the impact that distributions from the trust can have, namely disqualification from the programs the trust was created to protect.

The requirement that the trust be reported to the different agencies providing benefits to the beneficiary must be set forth in writing to the trustee along with the duties of reporting the disbursements to the same agencies.

The responsibility for filing tax returns must be communicated to the trustee. If the trustee is a family member they may have not had to file income tax returns in the past and may need assistance in finding a professional to assist in preparing such a return.

A system must be created for ongoing analysis of distributions to be made. It is not sufficient for the attorney monitoring the trust to be given a monthly report of activity of the trust as it will be too late to prevent a prohibited distribution. One method that has worked well for the author is to create a list of distributions that the trustee can make without prior approval of the attorney. Any distributions that the trustee would make other than those set out in the list would require written approval of the attorney.

If a family member is the trustee they will most often seek to have disbursements approved by means of a phone call. The attorney should never allow this to happen. There should be no emergency type distribution that needs to be made such that a fax or letter describing the amount and purpose, as well as the party to which the funds are to be paid cannot be completed.

The administration of a Special Needs Trusts is as much art as it is science. Many times the only course of action is to contact the case worker for the agency that is providing benefits for the beneficiary and ask how they would treat a specific disbursement. In order to allow for such action it must be made clear to the trustee that it make take time to determine the result of such a distribution.

## **TEXAS STATUTES AND CODE**

### **PROBATE CODE**

#### **Chapter XIII. GUARDIANSHIP**

##### **Part 4. ADMINISTRATION OF GUARDIANSHIP**

###### **Subpart N. MANAGEMENT TRUSTS**

*Current through End of 2001 Regular Session*

**§ 867. Creation Of Management Trust.**

(a) In this section, "financial institution" means a financial institution, as defined by Section 201.101, Finance Code, that has trust powers and exists and does business under the laws of this or another state or the United States.

(b) On application by the guardian of a ward or by a ward's attorney ad litem or an incapacitated person's guardian ad litem at any time after the date of the ad litem's appointment under Section 646 or another provision of this code, the court in which the guardianship proceeding is pending may enter an order that creates for the ward's or incapacitated person's benefit a trust for the management of guardianship funds or funds of the incapacitated person's estate if the court finds that the creation of the trust is in the ward's or incapacitated person's best interests. Except as provided by Subsections (c) and (d) of this section, the court shall appoint a financial institution to serve as trustee of the trust.

(c) If the value of the trust's principal is \$50,000 or less, the court may appoint a person other than a financial institution to serve as trustee of the trust only if the court finds the appointment to be in the ward's best interests.

(d) If the value of the trust's principal is more than \$50,000, the court may appoint a person other than a financial institution to serve as trustee of the trust only if the court finds that:

(1) no financial institution is willing to serve as trustee; and

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

(e) Before making a finding that there is no financial institution willing to serve as trustee under

Subsection (d)(1) of this section, the court must check any list of corporate fiduciaries located in this state that is maintained at the office of the presiding judge of the statutory probate courts or at the principal office of the Texas Bankers Association.

(f) The order shall direct the guardian or another person to deliver all or part of the assets of the guardianship to a person or corporate fiduciary appointed by the court as trustee of the trust. 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.

**History.** Amended by [Acts 2001, 77th Leg., ch. 994, Sec. 1](#), eff. 9/1/2001.

## **TEXAS STATUTES AND CODE**

### **PROPERTY CODE**

#### **Title 10. MISCELLANEOUS BENEFICIAL PROPERTY INTERESTS**

##### **Subtitle A. PERSONS UNDER DISABILITY**

###### **Chapter 142. MANAGEMENT OF PROPERTY RECOVERED IN SUIT BY A NEXT FRIEND OR GUARDIAN AD LITEM**

*Current through End of 2001 Regular Session*

**§ 142.005. Trust for Property.**

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

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

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

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

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

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

(5) the trustee serves without bond; and

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

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

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

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

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

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

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

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

## **TEXAS STATUTES AND CODE**

### **PROPERTY CODE**

#### **Title 9. TRUSTS**

#### **Subtitle B. TEXAS TRUST CODE: CREATION, OPERATION, AND TERMINATION OF TRUSTS**

#### **Chapter 113. ADMINISTRATION**

#### **Subchapter B. DUTIES OF TRUSTEE**

*Current through End of 2001 Regular Session*

**§ 113.056. Standard for Trust Management and Investment.**

(a) Unless the terms of the trust instrument provide otherwise, in acquiring, investing, reinvesting, exchanging, retaining, selling, supervising, and managing trust property, including an investment vehicle authorized for the collective investment of trust funds pursuant to Part 9, Title 12, of the Code of Federal Regulations, a trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as the probable increase in value and the safety of their capital. In determining whether a trustee has exercised prudence with respect to an investment decision, such determination shall be made taking into consideration the investment of all the assets of the trust, or the assets of the collective investment vehicle, as the case may be, over which the trustee had management and control, rather than a consideration as to the prudence of the single investment of the trust, or the single investment of the collective investment vehicle, as the case may be.

(b) Within the limitations of Subsection (a) of this section, a trustee may acquire and retain every kind of property and every kind of investment that persons of ordinary prudence, discretion, and intelligence acquire or retain for their own account.

(c) Within the limitations of Subsection (a) of this section, a trustee may indefinitely retain property acquired under this section without regard to its suitability for original purchase.

(d) Within the limitations of Subsection (a) of this section, whenever the instrument directs, requires, authorizes, or permits investment in obligations of the United States government, the

trustee may invest in and hold such obligations either directly or in the form of interests in an open-end management type investment company or investment trust registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., or in an investment vehicle authorized for the collective investment of trust funds pursuant to Part 9, Title 12 of the Code of Federal Regulations, so long as the portfolio of such investment company, investment trust, or collective investment vehicle is limited to such obligations and to repurchase agreements fully collateralized by such obligations.

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