11 Asset Protection During Estate and Trust Administration

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I. [9.1] INTRODUCTION

Whenever adequate asset protection planning has not been accomplished during the decedent's lifetime, practitioners should consider postmortem asset protection planning opportunities. Such postmortem planning broadly includes (a) protecting assets against the decedent's creditors, (b) protecting assets during the period of administration (*e.g.,* safeguarding business or real estate assets from claims specific to such assets) and avoiding dissipation of assets by minimizing costs (*i.e.,* avoiding creation of new creditors), and (c) protecting assets against the existing or future creditors of the decedent's heirs, legatees, and/or beneficiaries. Reference to "creditors" can include any party to whom funds could be due, including vendors or service providers with outstanding bills, plaintiffs in existing legal actions, any parties who may have unasserted claims (*e.g.,* potential slip-and-fall allegations), taxing authorities, and the like. Ultimately, the goal of postmortem asset protection planning, as in all asset protection planning, is to maximize the economic value and security ultimately received by the decedent's desired beneficiaries or default takers.

This chapter discusses a myriad of asset protection issues that practitioners might consider during the estate and trust administration process. Sections 9.2 – 9.17 below describe options for deciding whether probate is desirable even if it is not necessary and how to deal with potential creditors and their alleged claims during probate. Sections 9.18 – 9.32 discuss disclaimers, both how they can be used for asset protection and their limitations. Sections 9.33 – 9.39 address options for maximizing protection of assets that are inherited outright by minor or disabled beneficiaries. Sections 9.40 – 9.54 consider how to deal with asset protection issues while funding continuing trusts.

II. POSTMORTEM ASSET PROTECTION DURING PROBATE

A. [9.2] To Probate or Not To Probate?

Estate planning practitioners typically advise clients to structure their affairs in order to avoid probate. Probate can be avoided when the gross value of the decedent's personal estate (all assets owned outright and that do not transfer to a beneficiary directly via contract) is below the $100,000 probate threshold. In addition, the affiant of a small estate affidavit must either certify that there are no known creditors or describe any known debts of the decedent and agree to pay them before assets are distributed to heirs or legatees. 755 ILCS 5/25-1.

Conventional wisdom posits that, when possible, it is best to avoid both the costs and delays of probate. In some cases, it further may be undesirable to create a forum that might attract the attention of alleged creditors. Even though the period for creditors to assert claims against the decedent's assets remains open for two years, these considerations, nonetheless, often lead to the decision to avoid probate. See Kim Kamin and Elizabeth Garlovsky, Ch. 2, *Opening the Probate Estate and Alternatives to Probate,* ILLINOIS ESTATE ADMINISTRATION (IICLE®, 2019), for more about small estate affidavits, bonds in lieu of probate, and other details about avoiding probate.

Moreover, even when use of the small estate affidavit appears viable, the decedent may have unknown alleged creditors. If the likelihood of such creditors is high or if the amount of such

potential claims could be large, then it is often advisable to flush out or bar such creditors by using the probate process. This enables the personal representative to take advantage of the statutory six-month claims period for creditors. Commonly known as a nonclaim statute, 755 ILCS 5/18-3(a) requires personal representatives to publish notice for unknown creditors and provide actual notice to known creditors that claims may be filed against the estate within six months after the first publication. Any claim not filed in that period is barred. 755 ILCS 5/18-12(a). If such notice is not published as part of the court probate process, or a known or "reasonably ascertainable" creditor is not given actual notice, a potential claimant will have two years from the date of death to file a claim under the general statute of limitations. 755 ILCS 5/18-12(b).

The decision regarding whether to probate, when probate is not otherwise legally required, must be made on a case-by-case basis. The named executor (or other potential personal representative) should make reasonable inquiry about whether the decedent may have potential unidentified creditors. Even if no creditors are discovered, it may be prudent to probate if the decedent's occupation or activities suggest risk, such as when the decedent was running a business, may have personally guaranteed loans, or was engaged in an occupation in which malpractice or other claims may be festering. When the probate path is taken, choosing the streamlined process of independent administration is normally the best route to follow. 755 ILCS 5/28-1, *et seq.*

In some situations, when there are known creditors whose claims appear valid and exceed the value of any assets in the probate estate, family members (other than a spouse and dependent children who are entitled to statutory awards) may decide that the best course of action is just to walk away rather than invest their own time, funds, and energies into probating the estate. If the named executor or family members with priority for naming an administrator fail to open a probate estate, creditors do have a right to petition to open an estate for the decedent to protect their rights to file a claim. 755 ILCS 5/6-2, 5/9-3, 5/9-4. A creditor must follow the normal procedures to open the probate estate, including establishing the heirship of the decedent. 755 ILCS 5/5-3.

Note that, regardless of whether there will be probate, if there is a will, anyone in possession of that will must file it with the court of the county in which the decedent resided within 30 days after the death of the decedent, or if the decedent had no known place of residence, the county where most of the estate's property was located. 755 ILCS 5/5-1, 5/6-1. Also, the Probate Act of 1975, 755 ILCS 5/1-1, *et seq.,* (the "Probate Act") requires any person named as an executor to declare his or her refusal to act in that capacity within 30 days of acquiring knowledge of his or her role as executor. 755 ILCS 5/6-3(a).

Furthermore, the Probate Act permits, and in some instances requires, the court in which a will is filed to probate the last known will without any party filing a petition to probate that will "unless it appears to the court that probate thereof is unnecessary and failure to probate it will not prejudice the rights of any interested person." 755 ILCS 5/6-3(b). *See, e.g., In re Estate of Nicola,* 275 Ill.App.3d 497, 656 N.E.2d 431, 433, 212 Ill.Dec. 108 (3d Dist. 1995) (finding court had duty to probate decedent's last known will even though only earlier will had been presented for probate). As a practical matter, an Illinois court is unlikely to initiate the probate of a will if no other party attempts to open a probate estate.

If no other party steps forward to open an estate, heirs or legatees might simply wait out the two-year statute (which is "self-executing" in that it requires no notices or publication) and then employ a small estate affidavit to claim title to any assets. In addition, under the Revised Uniform Unclaimed Property Act, 765 ILCS 1026/15-101, *et seq.,* a decedent's accounts are deemed to have been abandoned after a specified statutory period, and a financial institution is required to send notice to the address of record (if available) and, if no response is received, to deposit such funds with the Unclaimed Property Division of the Illinois State Treasurer's Office. 765 ILCS 1026/15-501, 1026/15-502. The time required before legal abandonment varies by the type of asset, but in many cases for a decedent's property the time will be three years. 765 ILCS 1026/15-201. At that point, the two-year statute of limitations for estate claims will have expired, and heirs or legatees can file a claim for the assets directly with the state. 765 ILCS 1026/15-903.

To make a claim, any heir or legatee requesting property held by the State of Illinois in situations in which the estate is valued at less than $100,000 and there was no will or probate activity need provide only the following documentation (according to instructions provided by the Illinois State Treasurer's Office):

1. the death certificate for the original owner;

2 a properly completed claim form;

3. proof of ownership by the decedent;

4. a completed small estate affidavit; and

5. (a) if the decedent died testate, a court-certified copy of the decedent's will; or

   (b) if intestate, documentation establishing the claimant's relationship to the deceased (*e.g.,* relevant birth certificates, death certificates, marriage records, and/or adoption records).

When the unclaimed property value is in excess of $100,000 or the property being held would otherwise bring the decedent's probatable estate value over $100,000, such heirs or legatees must go through the probate process and provide current letters of office or administration to claim the assets.

B. Notice Requirements

1. [9.3] Duty To Publish

Once the decision to initiate probate has been made, the best practice is to open the probate estate as soon as possible after the decedent's death in order to begin the running of the claims period. The representative of the decedent's estate must publish notice for all unknown creditors of the estate. This notice must appear once each week for three successive weeks in a newspaper published in the county where the estate is being administered. It must set forth (a) the death of the decedent, (b) the name and address of the representative and of his or her attorney, and (c) the

deadline date before which claims must be filed before such claims will be barred. 755 ILCS 5/18-3. The representative must file proof of publication of such notice with the clerk of court. 755 ILCS 5/18-3(b). For unknown creditors, the deadline to file a claim is six months from the date of first publication. 755 ILCS 5/18-3(a). Any claim filed after this deadline will be barred by the court. 755 ILCS 5/18-12(a)(3). Note that the normal statute of limitations for a particular claim also applies, and if it expires first, that earlier deadline will apply.

2. [9.4] Duty To Notify All "Known Creditors"

The representative of the estate must also mail or deliver the information listed in §9.3 above to all creditors whose name and address "are known to or are reasonably ascertainable by the representative." 755 ILCS 5/18-3(a). The authors recommend sending notice with a generic title and including only the basic information required by statute.

3. [9.5] Timing for Notification by Mail

For known creditors, the deadline to file a claim is three months from the date of mailing or delivery of the notice or six months from the date of first publication, whichever is later. 755 ILCS 5/18-3(a). Any claim filed after this deadline will be barred by the court. 755 ILCS 5/18-12(a)(1). Since this limitations period expires at the later of three months from the date of notice or six months from the date of publication, it is best to ensure that known possible creditors receive notice no later than three months after the date of publication. It also is advisable to send such notice no sooner than three months before the date the statutory six-month period will expire. This avoids giving such creditors any more time than necessary to file claims.

4. [9.6] Duty To Search for Creditors

Identifying all known creditors of an estate can be a challenging process with significant consequences. If a court determines that a creditor's identity is known or "reasonably ascertainable," and that the creditor did not receive sufficient actual notice, the court will extend the limitation on filing claims beyond the six-month nonclaim period, potentially as far as the two-year statute of limitations in 755 ILCS 5/18-12(b). In *Tulsa Professional Collection Services, Inc. v. Pope,* 485 U.S. 478, 99 L.Ed.2d 565, 108 S.Ct. 1340, 1348 (1988), the Supreme Court held that a "known or reasonably ascertainable" creditor suffers a violation of due process of law if its claim was barred under a nonclaim statute and it received only publication notice of its right to file a claim.

The Illinois First District Court of Appeals followed *Pope* in determining that a creditor of an estate whose claim was barred because it was filed over ten months after initial publication suffered a violation of due process. *Rose v. Kaszynski,* 178 Ill.App.3d 266, 533 N.E.2d 73, 127 Ill.Dec. 455 (1st Dist. 1988). The *Rose* court followed the *Pope* standards and found that the executor of the estate knew or should have reasonably ascertained the identity of the creditor, and her failure to do so rendered the statutory six-month claims period inapplicable to the creditor's claim. 533 N.E.2d at 75. The court did not specify that the creditor's freedom to file extended out to the two-year statute of limitations, but the reasoning in *Pope* supports this outcome. The *Pope* court based its finding of a denial of due process largely on the degree of state action brought about by the Oklahoma nonclaim statute and distinguished the nonclaim statute, similar to

Illinois' six-month statute, from a self-executing statute of limitations like the alternate two-year statute established by 755 ILCS 5/18-12(b). "While this enactment [of a general statute of limitations] obviously is state action, the State's limited involvement in the running of the time period generally falls short of constituting the type of state action required to implicate the protections of the Due Process Clause." *Pope, supra,* 108 S.Ct. at 1345 – 1346.

There are still no clear guidelines for how diligent a representative must be in compiling a list of known creditors. Although 755 ILCS 5/18-3(a) was amended after *Pope* to incorporate the "reasonably ascertainable" language, it defines neither "reasonably ascertainable" creditors nor what constitutes reasonably diligent efforts to search for them. The court in *In re Estate of Anderson,* 246 Ill.App.3d 116, 615 N.E.2d 1197, 186 Ill.Dec. 140 (4th Dist. 1993), when remanding to the lower court to determine whether an executor provided sufficient actual notice to a known creditor, attempted to lay out some minimum standards for reasonable diligence. Such standards "necessitate a good-faith search of decedent's personal and business financial records to disclose debts of the estate, a search comparable to that required to marshal assets and compile a complete inventory of the estate." 615 N.E.2d at 1206. An inspection of personal records most likely would require a search of the decedent's wallet and personal mail to determine possible debts owed to utilities, credit card companies, mortgage lenders, and others. As the decedent in *Anderson* managed a trucking business, the court indicated that, for business records, "reasonably diligent efforts might include inquiry of those persons and concerns with whom Anderson Trucking had continuing business . . . as to what debts, if any, decedent had outstanding." *Id.* Now that many individuals receive their personal mail via electronic means, executors should take the necessary steps to gain access to the decedent's electronic accounts, particularly the decedent's e-mail, to ascertain potential creditors and business dealings.

When determining whether the notice given in particular circumstances is sufficient to ensure actual notice to a creditor (and thus guarantee that the limitations period applies), courts have similarly invoked the need for analysis on a case-by-case basis. The Illinois Fifth District Court of Appeals, drawing on both federal and Illinois state cases, has described a four-part set of guidelines for this determination: "(1) whether the form of notice relies on mere chance to reach the attention of the other party . . .; (2) whether the form of notice is designed to attract the attention of the other party . . .; (3) whether the actual means of providing notice is reliable . . .; and (4) whether the means of notice was reasonable when compared to other alternatives." [Citations omitted.] *In re Estate of Winters,* 239 Ill.App.3d 730, 607 N.E.2d 370, 373, 180 Ill.Dec. 476 (5th Dist. 1993). *See also In re Estate of Malone,* 198 Ill.App.3d 960, 556 N.E.2d 678, 145 Ill.Dec. 60 (1st Dist. 1990).

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✓ When in doubt, the safest practice is to send notice by mail to any possible creditor in order to ensure that the six-month limitation period covers all claims against the estate, rather than risk a judicially imposed extension similar to the one in *Rose*.

C. [9.7] Priority of Claims

When there are limited assets and a large number of creditors, it is advisable to make use of the claim priority rules, which may protect the estate's assets from all or most of the creditors. The claims hierarchy, established in the Probate Act, is as follows:

1. funeral and burial expenses, expenses of administration, and statutory custodial claims;

2. the surviving spouse's or child's award;

3. debts due the United States;

4. reasonable and necessary medical, hospital, and nursing home expenses for the care of the decedent during the year immediately preceding death, and money due employees of the decedent of not more than $800 for each claimant for services rendered within four (4) months prior to the decedent's death;

5. money and property received or held in trust by the decedent that cannot be identified or traced;

6. debts due the State of Illinois and any county, township, city, town, village, or school district located within Illinois; and

7. all other claims. 755 ILCS 5/18-10.

The vast majority of creditors will be seventh-class creditors. It is important to remember that funeral and burial expenses, attorneys' fees, fees of the personal representative, awards to a surviving spouse and children, and taxes must all be paid before them.

For insolvent estates, the family will want to maximize the amounts they receive through awards and as fees for service as personal representative since those are the highest priority and may be paid before any other creditors are paid. The awards to a surviving spouse and dependent minor or children are initially at the discretion of the estate's representative. 755 ILCS 5/15-3(a). When there is a surviving spouse, the minimum award is $20,000 for the surviving spouse and $10,000 for each minor child. 755 ILCS 5/15-1. When there is no surviving spouse, the minimum award for minor children is at least $10,000 per child, plus an additional $20,000 to be divided equally or as the court directs if there is more than one such child. 755 ILCS 5/15-2. Effective as of June 1, 2018, the Probate Act modifies the level of awards for adult dependent children who are likely to become public charges. The new minimum award for each such child is $5,000, but the total award is to be consistent with the level of support provided by the decedent before his or her death. 755 ILCS 5/15-1(a-5). In either case, the award is intended to cover living expenses for nine months "in a manner suited to the condition in life" of the surviving spouse and/or dependent children and can be adjusted accordingly. 755 ILCS 5/15-1, 5/15-2. On petition of the surviving spouse, the representative, an heir or legatee, or a creditor, the court may increase or diminish the award as justice requires. 755 ILCS 5/15-3(b).

Awarding the spouse more than the statutory minimum is a legitimate means of distributing the remaining probate assets, but Illinois courts can and do exercise discretion to reduce the

award under §15-3(b). *In re Estate of Caffrey,* 120 Ill.App.3d 917, 458 N.E.2d 1147, 76 Ill.Dec. 493 (1st Dist. 1983), summarizes the court's discretion in such a situation. A creditor of the estate had petitioned for a reduction in the surviving spouse's award, and the appeals court affirmed the

reduction, agreeing with the trial court's decision to take into account the significant nonprobate assets that the decedent passed to his wife and children. The court acknowledged a duty to generously recognize the needs of a surviving spouse, stating that it "is not limited to consideration of the projected needs of the spouse as of the date of the decedent's death but should consider later circumstances affecting the needs of the spouse" (458 N.E.2d at 1150) and that "the fact that the widow has independent means will not bar her from an award" (458 N.E.2d at 1149, quoting *In re Estate of Handmacher,* 60 Ill.App.2d 376, 208 N.E.2d 604, 606 (5th Dist. 1965)). Nonetheless, the *Caffrey* court ultimately affirmed the reduction because "the trial court was correct in considering non-probate assets which the widow received in its determination of the sum necessary for her proper support." *Caffrey, supra,* 458 N.E.2d at 1150.

PRACTICE POINTER

✓ Distributing a list of all creditors and their relative places in the hierarchy of the priority rules may be a good means of discouraging creditors from filing claims. Upon sending the initial notice to each known creditor, consider attaching a distribution list of all other creditors receiving the same notice. Whether to attach this list should be decided on a case-by-case basis. If the estate has many creditors, seeing the total number of potential claims may deter creditors from investing time and resources to pursue what may likely be a very small or nonexistent recovery. Conversely, if the estate has only a few creditors, seeing this list may inspire the competitive creditor to pursue a claim to make sure its share of the estate is not distributed to a rival. Similarly, alerting a creditor to the fact that its claim is preferred over all others may also inspire it to pursue a claim that otherwise might have been abandoned.

Upon distributing all the assets of the estate, an independent representative must send a final report and accounting to all interested persons (which includes unpaid creditors) and file the final report with the court. 755 ILCS 5/28-11(b). The accounting should show how the estate's assets were divided among funeral costs, taxes, legal and probate costs, family awards, and creditors. After the final report has been filed with the court, an unpaid creditor who receives the report will have 42 days to object to the distribution. 755 ILCS 5/28-11(e). When claims have been allowed, but will not be paid in full or at all due to insufficient estate assets, the remaining creditors are among the interested parties that must receive the final report and final accounting. If no objection is filed with the court within 42 days, the estate can be closed. *Id.* Since most creditors do not wish to throw good money after bad, in the authors' experience, if the accounting is in order, the creditors typically do not bother to object.

D. Defending and Defeating Claims

1. [9.8] Disallow

Upon receiving an unpaid invoice or other form of claim that has not been filed with the court, a personal representative should send notice of disallowance for any claim he or she intends to contest. The representative may disallow all or any part of any claim by delivering a notice of disallowance to the claimant and the claimant's lawyer, if known, stating that the claim

will be barred if not filed with the court within two months or on a later date specified in the notice. 755 ILCS 5/18-11(b). For a sample disallowance of claim, see Cook County Circuit Court Form CCP N505, "Notice of Disallowance of Claim," available at www.cookcountyclerkofcourt.org/Forms/pdf_files/CCPN505.pdf.

2. [9.9] Defend

If the claimant does file with the court, the next step is to defend questionable claims to the extent possible. As a preliminary matter, it is generally a waste of time and resources to attack the form of a claim unless it fails to meet the baseline standards under the Probate Act. To state a valid claim, the claim need only be in writing and "state sufficient information to notify the representative of the nature of the claim or other relief sought." 755 ILCS 5/18-2. Illinois law is well settled that, for a probate claim, formal pleading is unnecessary and substance trumps form. *See, e.g., Thomson v. Black,* 200 Ill. 465, 65 N.E. 1092, 1093 (1902) ("In allowance of claims against estates the probate court disregards mere matters of form, and looks to the substance."); *In re Estate of Wagler,* 217 Ill.App.3d 526, 577 N.E.2d 878, 880, 160 Ill.Dec. 553 (3d Dist. 1991) ("Technical legal form is not required in presentation of a claim against an estate, and proceedings in probate court for the allowance of claims are not governed by the technical rules which apply to a formal suit at law.").

However, although a creditor need not file a formal complaint with the court in order to file a claim against an estate, all other ordinary litigation defenses and procedures apply to defending such claims. The Probate Act provides that the Illinois Civil Practice Law, 735 ILCS 5/2-101, *et seq.,* applies to all proceedings under the Probate Act, with the exception of certain proceedings regarding the lease, sale, or mortgage of real estate. 755 ILCS 5/1-6. Therefore, the representative can attack the claim using a motion to dismiss under 735 ILCS 5/2-619(a). 735 ILCS 5/2-619(a) permits a pleading to be dismissed "based upon certain defects or defenses," including the following:

> **(1) That the court does not have jurisdiction of the subject matter of the action, provided the defect cannot be removed by a transfer of the case to a court having jurisdiction.**
>
> **(2) That the plaintiff does not have legal capacity to sue or that the defendant does not have legal capacity to be sued.**
>
> **(3) That there is another action pending between the same parties for the same cause.**
>
> **(4) That the cause of action is barred by a prior judgment.**
>
> **(5) That the action was not commenced within the time limited by law.**
>
> **(6) That the claim . . . has been released, satisfied of record, or discharged in bankruptcy.**
>
> **(7) That the claim asserted is unenforceable under the provisions of the Statute of Frauds.**

(8) That the claim asserted against defendant is unenforceable because of his or her minority or other disability.

(9) That the claim . . . is barred by other affirmative matter avoiding the legal effect of or defeating the claim. *Id.*

Even if a motion to dismiss is not granted, the estate can still defend the claim using any defense permitted in civil law. It can also (a) file a counterclaim, if appropriate, and (b) appeal an adverse judgment, assuming the estate has any grounds for the appeal. 755 ILCS 5/26-1 ("Appeals may be taken as in other civil cases.").

Common questions to consider in defending a claim include (a) whether the claim is properly against the estate, (b) whether the claim is contingent, and/or (c) whether the claim is based on an oral agreement with or promise by the decedent.

a. [9.10] Whom Is the Claim Against?

The threshold determination is whether the claim is properly against the estate. Does the claim truly run to the decedent, or is it a personal obligation of a beneficiary or some other party, such as a business in which the decedent held an interest? Sometimes a closer analysis reveals that the claim is not truly against the decedent after all.

Obligations that arise after the opening of probate are not subject to the claims limitations statute. In *Puhrman v. Ver Vynck,* 99 Ill.App.3d 1130, 426 N.E.2d 921, 923 – 924, 55 Ill.Dec. 596 (1st Dist. 1981), the estate's administrator took possession of a mobile home on the plaintiff's property as part of the decedent's estate. Continuing rental obligations came due on the mobile home's property, which the plaintiff charged to the administrator. The administrator claimed these obligations were claims against the estate and, therefore, barred by the six-month nonclaim statute. The court, however, characterized these rent claims as contingent, citing *Chicago Title & Trust Co. v. Corporation of Fine Arts Bldg.,* 288 Ill. 142, 123 N.E. 300, 305 – 306 (1919), for the well-settled precedent that "the right of recovery for initially contingent claims, once they vest subsequent to the running of the statute of limitations, is against the administrator personally." 426 N.E.2d at 924. The court did recognize that, in such a situation, the administrator may charge such a claim as an expense of administration of the estate. *Id.*

b. [9.11] Is the Claim Contingent?

As illustrated by *Puhrman v. Ver Vynck,* 99 Ill.App.3d 1130, 426 N.E.2d 921, 923 – 924, 55 Ill.Dec. 596 (1st Dist. 1981), another important question is whether the claim is "contingent." The Probate Act allows creditors to file claims against the estate that are not due at the time of death. 755 ILCS 5/18-4. However, the law is settled that if a claim does not come due during the period of limitations for filing claims, it is considered a contingent claim, and the creditor has no right of recovery against the estate. In denying a claim for rent that would not come due until after the statutory claims period expired, the Illinois Supreme Court stated:

It is well settled in this state that claims dependent on a contingency which may or may not ripen into a liability cannot be proved and allowed. . . . The holder of a

> **contingent claim is not a creditor of the estate. If his claim remains contingent during the whole of the year allowed for the exhibition of the claims against the estate he cannot participate in the distribution by the administrator.** *Chicago Title & Trust Co. v. Corporation of Fine Arts Bldg.,* 288 Ill. 142, 123 N.E. 300, 305 (1919).

The Illinois Second District Court of Appeals has further defined a "contingent claim" as "one in which liability is dependent upon a future event, the happening of which is not within the control of either party and which might or might not happen." *In re Estate of Rice,* 96 Ill.App.3d 1137, 421 N.E.2d 1034, 1037, 52 Ill.Dec. 171 (2d Dist. 1981). *See also Puhrman, supra,* 426 N.E.2d at 924 ("debts of a decedent which accrue or mature after his death, but which may never come due, are merely contingent claims"); *Collins v. Northern Trust Co.,* 63 Ill.App.2d 83, 211 N.E.2d 608, 609 (1st Dist. 1965) ("This section [the predecessor to 755 ILCS 5/18-4] refers only to claims on which there is an absolute liability although time of payment is postponed. The holder of a contingent claim is not a creditor of the estate." (citing *Chicago Title & Trust Co., supra*)). *But cf. In re Estate of Gallagher,* 383 Ill.App.3d 901, 890 N.E.2d 1249, 1252, 322 Ill.Dec. 330 (1st Dist. 2008) (debts evidenced by decedent's promissory notes, signed as general partner of several partnerships, were not contingent on default by those partnerships, as consideration was exchanged at time notes were executed and "[t]here was nothing more required for liability on the notes to become absolute").

Pending court adjudication of the merits of a claim does not make the claim contingent. If a suit is filed based on events occurring before the decedent's death, a court will consider the result of that adjudication to be an absolute claim. The plaintiff-claimant in *Rice, supra,* asserted that the probate court could not adjudicate his suit to recover damages for undue influence on his father. 421 N.E.2d at 1036. The plaintiff had filed the suit in federal district court, but had also filed a "claim" with the probate court for an amount sufficient to satisfy any judgment. 421 N.E.2d at 1035. Based on this claim, the probate court began discovery proceedings, but the plaintiff challenged its authority to adjudicate the suit, asserting that the filing was a notice of a contingent claim that provided nothing on which the court could rule. *Id.* After defining a "contingent claim" as "one in which liability is dependent upon a future event," the court distinguished Rice's claim, stating that the liability that Rice asserted "is predicated on events which occurred before the death of Ada L. Rice. The fact that the liability . . . depends on future adjudication on the merits obviously cannot deprive the court of authority to hear the matter as this may be true in every claim presented to the probate court." 421 N.E.2d at 1037.

c. [9.12] Is the Claim Based on Oral Promises?

Some claims are based on an oral agreement with the decedent. When the claim is based on any verbal promises or obligations, the applicable statute of frauds provides:

> **No action shall be brought, whereby to charge any executor or administrator upon any special promise to answer any debt or damages out of his own estate, or whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriage of another person, or to charge any person upon any agreement made upon consideration of marriage, or upon any agreement that is not to be performed within the space of one year from the making thereof, unless the**

> **promise or agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized.** 740 ILCS 80/1.

The Dead-Man's Act, 735 ILCS 5/8-201, may bar the claimant from testifying to the substance of a verbal promise by the decedent or other allegations pertaining to the claim. In a proceeding on any action in which any party sues or defends as the representative of a deceased or legally disabled person, the Dead-Man's Act generally prohibits the testimony of an adverse party or a person directly interested in the action about conversations with, or events that occurred in the presence of, the decedent. Because the purpose of the provision is to protect decedents' estates from fraudulent claims and "to equalize the position of the parties in regard to the giving of testimony" (*Fleming v. Fleming,* 85 Ill.App.3d 532, 406 N.E.2d 879, 883, 40 Ill.Dec. 676 (5th Dist. 1980)), the Act "bar[s] only that evidence which the decedent could have refuted" (*Rerack v. Lally,* 241 Ill.App.3d 692, 609 N.E.2d 727, 730, 182 Ill.Dec. 193 (1st Dist. 1992)). *See also Brown, Udell & Pomerantz, Ltd. v. Ryan,* 369 Ill.App.3d 821, 861 N.E.2d 258, 308 Ill.Dec. 193 (1st Dist. 2006).

On the other hand, the Dead-Man's Act allows an adverse or interested party to testify to a conversation with the decedent or an event witnessed by the decedent if testimony or a deposition is introduced in evidence on behalf of the representative of the deceased regarding the same conversation or event. 735 ILCS 5/8-201(a). *See Bernardi v. Chicago Steel Container Corp.,* 187 Ill.App.3d 1010, 543 N.E.2d 1004, 1009, 135 Ill.Dec. 436 (1st Dist. 1989) (admitting adverse party's testimony to conversation with decedent and events in decedent's presence when witness's purpose was to give his own version of events described by opposing side's witnesses). The Dead-Man's Act also does not affect the availability of testimony of any persons who are non-interested parties to the claim. *See Zang v. Alliance Financial Services of Illinois, Ltd.,* 875 F.Supp.2d 865 (N.D.Ill. 2012).

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✓ Therefore, when defending a claim based on an oral promise, the personal representative should avoid introducing any evidence or testimony regarding the decedent's statements to the claimant unless the personal representative has evidence or other means to impeach the claimant's testimony.

3. Other Considerations

a. [9.13] Claims Against Nonprobate Property

Sometimes a creditor will make a claim against nonprobatable property such as a revocable living trust, a joint tenancy account, or the proceeds from the decedent's life insurance. Generally, courts allow such claims only if it can be proven that property was fraudulently conveyed to another party in an effort to avoid creditors. Absent proof of fraud, creditors cannot normally reach nonprobate assets such as life insurance proceeds, retirement accounts, Illinois land trusts,

spendthrift trusts, or *Totten* trust accounts. For a discussion of claims against these types of property, as well as claims of fraudulent conveyance, see **ILLINOIS ESTATE ADMINISTRATION §§4.84 – 4.102 (IICLE®, 2014)**.

Illinois law is less clear regarding creditors' rights to certain other common forms of nonprobate property such as revocable or living trusts and joint tenancy accounts.

(1) [9.14] Living trusts

Funded living trusts are often viewed as an attractive means of protecting assets from surviving spousal rights or other probate claims. *See, e.g., Johnson v. LaGrange State Bank,* 73 Ill.2d 342, 383 N.E.2d 185, 22 Ill.Dec. 709 (1978) (holding revocable trust not subject to spouse's elective share at death). *But cf. Rush University Medical Center v. Sessions,* 2012 IL 112906, 980 N.E.2d 45, 366 Ill.Dec. 245 (2012) (holding that decedent's self-settled spendthrift trust was void as to his creditors, and allowing estate claimant to recover from trust notwithstanding spendthrift provision). However, when the trust instrument specifically directs the trustee to pay the grantor's "legally enforceable debts," the revocable trust assets may unintentionally be made available to creditors' claims. This is typically a risk when a claim has been permitted in probate, the probate assets are insufficient, and the trustee of the revocable trust is obligated to satisfy the claim out of trust assets per the terms of the trust instrument.

Even when a probate claim is not made, trust provisions directing the trustee to pay the grantor's debts can be problematic. In *Society of Lloyd's v. Estate of McMurray,* 274 F.3d 1133 (7th Cir. 2001), the United States Court of Appeals for the Seventh Circuit, interpreting Illinois law, determined that such a provision allowed a claim on revocable trust property even after the two-year statute of limitations on estate claims had expired. In this case, the settlor placed the majority of his real and personal assets in a revocable trust one week after a deadline to pay insurance premiums to the plaintiff (Lloyd's) expired. 274 F.3d at 1134 – 1135. The trust instrument contained a provision requiring the trustee to "pay from the residuary trust estate without reimbursement [the decedent's] legally enforceable debts." 274 F.3d at 1136. The plaintiff filed suit and obtained a judgment in an English court for the premiums. The grantor died before the judgment was issued, and the plaintiff did not file a claim to recover on its judgment from either the estate or the trust assets until after the two-year statute of limitations had expired. 274 F.3d at 1135. The district court held that the statute of limitations barred any claim on the estate, but did not bar recovery from the trust assets. *Id.*

The Seventh Circuit upheld this judgment, finding that the trustee's obligation to pay the decedent's "legally enforceable debts" was not subject to this time limitation. In reaching its conclusion, the court dismissed the trustee's assertion that because the plaintiff missed the deadline to file a claim against the estate, the decedent's debt was no longer "legally enforceable." Calling this a "tortured reading of the trust instrument," the court determined that the debt became legally enforceable when the English court entered judgment against the decedent and stated that the trust instrument clearly instructed the trustee to pay, not to "hide behind legal technicalities in an attempt to avoid paying valid debts." 274 F.3d at 1136.

The Seventh Circuit acknowledged that equitable concerns might require a different conclusion in other scenarios. The court was particularly strict with the trustee in part because the

trustee had notice of the judgment well within the two-year statute of limitations. The court recognized the equitable difference between this situation and one "in which a long-lost creditor seeks to enforce a forgotten debt . . . compromising the State of Illinois' interest in swift resolution of the decedent's affairs." *Id.* The Seventh Circuit also distinguished *Exchange National Bank of Chicago v. Harris,* 126 Ill.App.3d 382, 466 N.E.2d 1079, 81 Ill.Dec. 277 (1st Dist. 1984), on the grounds that the plaintiff creditor in that case sought an extraordinary remedy against the estate. Similar to *McMurray, supra,* the creditor in *Harris* asserted that a trust provision requiring the trustees to pay all "legally enforceable claims against [the grantor] or his estate" enabled it to recover from the trust even though the statute of limitations on estate claims had run. 466 N.E.2d at 1083. However, unlike the *McMurray* plaintiff, the *Harris* plaintiff did not yet have a judgment to enforce. Instead, it sought to enjoin the trustees from distributing the trust assets pending the outcome of its legal action against the estate. 466 N.E.2d at 1081. The *Harris* court upheld the dismissal of the plaintiff's action on the grounds that it was seeking an improper equitable attachment. 466 N.E.2d at 1083. The Seventh Circuit in *McMurray* agreed with the *Harris* reasoning, but differentiated the case at bar and found for the plaintiff because it sought "only to enforce a valid judgment." *McMurray, supra,* 274 F.3d at 1137.

The *McMurray* decision exemplifies the various factors that may determine whether a creditor is successful in a claim against a revocable trust. The language of the trust provisions, the type and timing of the claim, and the remedy sought by the creditor all may be relevant to such a claim.

(2) [9.15] Joint tenancy accounts

Illinois courts presume that when a bank account holder lists another person as joint tenant on that account, he or she intends to make a present gift to that person and, accordingly, the joint tenancy account is not a probate asset. *Murgic v. Granite City Trust & Savings Bank,* 31 Ill.2d 587, 202 N.E.2d 470 (1964); *Konfrst v. Stehlik,* 2014 IL App (1st) 132113, 13 N.E.3d 278, 382 Ill.Dec. 865. However, this presumption is rebuttable. *See In re Estate of Blom,* 234 Ill.App.3d 517, 600 N.E.2d 427, 175 Ill.Dec. 496 (2d Dist. 1992); *In re Estate of Goldstein,* 293 Ill.App.3d 700, 688 N.E.2d 684, 227 Ill.Dec. 991 (1st Dist. 1997); *In re Estate of Shea,* 364 Ill.App.3d 963, 848 N.E.2d 185, 302 Ill.Dec. 185 (2d Dist. 2006) (when presumption of lifetime gift was overcome, joint tenant could not support claim to account as testamentary gift).

Accordingly, with a joint tenancy bank account, it is advisable to collect proof of donative intent in order to ensure that the account is not deemed a probate asset. The creditor has the right, under 755 ILCS 5/16-1, to demand such proof and, if donative intent is lacking, the assets in the account become probatable property of the decedent's estate.

The court, in *In re Estate of Regelbrugge,* 225 Ill.App.3d 593, 588 N.E.2d 351, 167 Ill.Dec. 710 (2d Dist. 1992), laid out some of the facts and the shifting burdens involved in establishing proof of intent when dealing with a joint account. In this case, the sister of the decedent could not provide a valid signature card for a joint account naming her and the decedent, which prevented the presumption of donative intent from arising. The burden thus shifted to the sister to prove a valid joint tenancy, requiring proof that

> **(1) an interest in personal property was created by means of a written instrument; (2) the instrument expresses the intent to create a joint tenancy by expressly providing that the property so held is subject to the rights of survivorship between the owners; and (3) the instrument complies with the requirements of a will as to definiteness of description of subject matter, parties, and certainty of its object**. 588 N.E.2d at 353.

The estate administrator contended that without a signature card, the decedent's sister could not prove the existence of a valid joint account. *Id.* While the trial court agreed with the estate, the appellate court reversed, finding that a joint account can be proved by evidence other than a signature card. "Relevant factors include the exercise of authority and control over the account and the survivor's understanding of the account." *Id.* Because (a) the sister testified that she had signed the missing signature card, deposited money in the account, and understood her right to withdraw from the account; and (b) the bank produced records that she had received account statements, the court was satisfied that the decedent intended to create a joint tenancy account. *Id.* At this point, the burden shifted to the estate to overcome the presumption of a valid joint tenancy. The estate made the argument that the sister's name was on the account for convenience only. However, the court found it a reasonable conclusion that if any name was placed on the account for convenience, it would have been the decedent's former wife, who lived near the decedent and helped him with shopping and cashing checks. 588 N.E.2d at 354. Since the former wife's name was not on the account, the court found that the estate did not prove by clear and convincing evidence that the account was for convenience only. *Id.*

Similar problems to those in revocable trusts and joint tenancy accounts can arise with "payable on death" (POD) accounts since Illinois law is also unclear regarding creditors' rights to POD accounts. For a discussion of claims against POD accounts, see **ILLINOIS ESTATE ADMINISTRATION §4.87 (IICLE®, 2014)**.

Residential real property in Illinois can be transferred using a "transfer on death" (TOD) instrument, which passes title to the designated beneficiary or beneficiaries at the current owner's death. A TOD instrument must be executed using all of the formalities of a conventional deed, must state that it is effective only at the owner's death, and must be recorded with the appropriate Illinois county or counties. 755 ILCS 27/40. Once effective, the instrument is considered nontestamentary, so the property passes outside of probate. 755 ILCS 27/30. For asset protection purposes, a TOD instrument may introduce the same problems as those of POD accounts. The legislation states only that "a beneficiary of a transfer on death instrument is subject to the claims of creditors and statutory claimants to the same extent as a beneficiary of any nontestamentary transfer." 755 ILCS 27/85.

(3) [9.16] Living trusts as tenants by the entirety

P.A. 96-1145 (eff. Jan. 1, 2011) amended the Joint Tenancy Act, 765 ILCS 1005/0.01, *et seq.,* and the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* to allow certain revocable trusts to own real property as tenants by the entirety. There are three requirements to qualify: (a) the real property must be owned in the name of the trustees of one or more revocable inter vivos trusts, of which the settlors are husband and wife; (b) the husband and wife must be the primary

beneficiaries of the trust or trusts; and (c) the deed conveying title must specifically state that the interests of the husband and wife in the real property are to be held as tenants by the entirety. 765 ILCS 1005/1c. As with individually owned tenancy by the entirety property, the trust-owned property is exempt from collection proceedings arising from a debt incurred by only one of the tenants (unless title was conveyed solely to avoid payment on debts existing at the time of transfer). 735 ILCS 5/12-112.

The legislation, however, failed to specify how the property interests are to be allocated following the death of the first tenant. With individually owned tenancy by the entirety property, sole title passes outside of probate to the surviving spouse. Thus, after the first spouse's death, while tenancy by the entirety property may be protected from the decedent's creditors along with other nonprobate property, it ceases to offer any further asset protection to the surviving spouse. With trust-owned tenancy by the entirety property, by contrast, it is unclear under the amended statute whether the property should pass in an equivalent manner (*i.e.,* solely to the surviving spouse's trust), or if the decedent's partial interest should instead be allocated pursuant to the terms of the decedent's trust. Though the General Assembly has not, as of the time of this writing, clarified its intent, in the authors' experience most practitioners believe that the former result is the correct one. If true, this would mean that trust-owned tenancy by the entirety property does not offer any additional asset protection for the surviving spouse, other than probate avoidance at the surviving spouse's death or upon the simultaneous death of both spouses.

b. [9.17] Substituting Estate in Existing Litigation

If a claim is based on a pending action against the decedent, the creditor must either file the claim in probate court or properly substitute the executor as a defendant within the claims period in order to maintain a claim against the estate. *In re Estate of Worrell,* 92 Ill.2d 412, 442 N.E.2d 211, 213 – 214, 65 Ill.Dec. 900 (1982), citing *Morse v. Pacific Ry.,* 191 Ill. 356, 61 N.E. 104, 105 (1901). The claimant in *Worrell* had not substituted service in a pending lawsuit because he did not learn about the decedent's death until after the nonclaim statute had run. 442 N.E.2d at 212. The *Worrell* court discussed the importance the legislature places on giving notice of a claim to the administrator by requiring a claimant, under 755 ILCS 5/18-1(b), to send notice to the administrator even if he or she decides to file the claim only with the court. 442 N.E.2d at 214. The court held that because the claimant had not substituted service or filed a claim in the probate court within the claims period, any claim against the estate resulting from the judgment would be barred as untimely filed. *Id.*

Although the rule set forth in *Worrell* remains good law, *Tulsa Professional Collection Services, Inc. v. Pope,* 485 U.S. 478, 99 L.Ed.2d 565, 108 S.Ct. 1340, 1348 (1988), does have an impact on it. The court in *Rose v. Kaszynski,* 178 Ill.App.3d 266, 533 N.E.2d 73, 74, 127 Ill.Dec. 455 (1st Dist. 1988), held that the *Pope* decision would have resulted in a different outcome in *Worrell* because of the executor's failure to notify the claimant. The claimant in *Rose* had brought a contract suit against the decedent but failed to substitute service in time because he received notice of the decedent's death less than a week before the expiration of the statutory claims period. As detailed in §9.6 above, the court held that the executor had not given sufficient notice to the claimant and allowed him to join the executor in the suit. This case stands as a reminder of the importance of providing appropriate notice to potential creditors upon the opening of the estate.

III. POSTMORTEM ASSET PROTECTION WITH DISCLAIMERS

A. [9.18] What Is a Disclaimer?

A disclaimer allows someone to refuse property, in whole or in part, that would otherwise pass to that person through testamentary or inter vivos transfer. 755 ILCS 5/2-7(a). Disclaimers enable postmortem asset protection to minimize taxes and avoid creditors. Although a disclaimer is irrevocable, it does not preclude the disclaimant from receiving the same property in another capacity or from receiving other interests in the property. 755 ILCS 5/2-7(d). For example, if a surviving spouse disclaims an interest the spouse would otherwise inherit outright (such as insurance proceeds) and the alternative taker is a trust, the spouse could still be a beneficiary of that trust and/or a trustee of that trust. See, *e.g.,* Pvt.Ltr.Rul. 200503024 (Jan. 21, 2005). But see also 26 C.F.R. §25.2518-3(a)(1); Tech.Adv.Mem. 8546007 (July 30, 1985); Pvt.Ltr.Rul. 199949023 (Dec. 10, 1999).

The Probate Act provides default rules for how disclaimed property will be distributed when the instrument transferring the property does not contain its own instructions. 755 ILCS 5/2-7(d). Under the Probate Act, property distribution varies depending on whether the disclaimed property involves a present or future interest.

For a present interest, property distribution depends on how the property is transferred. If the transfer is due to a death, the property is transferred as if the disclaimant had predeceased the decedent. 755 ILCS 5/2-7(d)(1)(a). For example, in *Horwitz v. Ritholz,* 125 Ill.App.3d 193, 465 N.E.2d 642, 80 Ill.Dec. 530 (1st Dist. 1984), when the sole beneficiary who received shares of a Canadian corporation under her husband's will disclaimed her shares, they passed to her sons as probate assets under the husband's will. On the other hand, if the transfer is under a revocable instrument or contract, the property is transferred as if the disclaimant had died before the date the document's maker relinquished control over the property. 755 ILCS 5/2-7(d)(1)(b). Finally, if the transfer is due to any other inter vivos transfer, the interest is treated as if the disclaimant died before the date of the transfer. 755 ILCS 5/2-7(d)(1)(c). See §§9.20 – 9.23 below for a discussion of how to determine the transfer date.

If the property interest disclaimed is a future interest, the property is treated as if the disclaimant had died before the event that would otherwise vest that interest. 755 ILCS 5/2-7(d)(2). This way the future interest is accelerated into possession so that the owner may enjoy the property as soon as any other intervening interests expire.

Although disclaimer is a creature of state law, the tax treatment of disclaimed property is governed by the Internal Revenue Code. Disclaimers that meet certain Internal Revenue Code requirements are not treated as separate transfers by the disclaimant for federal transfer tax purposes.

B. [9.19] How Can Disclaimers Help with Asset Protection?

A disclaimer enables a person concerned about creditor protection to avoid his or her creditors by disclaiming the assets he or she would otherwise inherit to divert those assets to an alternative disposition. The Illinois Supreme Court recognizes the right to disclaim regardless of

one's motives. *See, e.g., People v. Flanagin,* 331 Ill. 203, 162 N.E. 848 (1928) (holding that devisees can reject devise even when motive is to minimize inheritance tax); *Tompkins State Bank v. Niles,* 127 Ill.2d 209, 537 N.E.2d 274, 130 Ill.Dec. 207 (1989) (holding that debtor can disclaim to avoid creditors, discussed further in this section below).

A person who makes a "qualified disclaimer" for federal tax purposes is treated as if the person never had an interest in the disclaimed property. Therefore, federal gift and generation-skipping transfer (GST) tax that might otherwise apply if the disclaimant were to transfer such property to the recipient directly will not apply to the transfer. 26 U.S.C. §2518(a). *See also* Pvt.Ltr.Rul 201803003 (January 19, 2018). It is, of course, still possible that the assets will be subject to estate or GST tax depending on the alternative disposition. Nonetheless, disclaimers make avoidance of creditors possible by shifting assets away from an heir, legatee, or beneficiary with potential creditor problems either to another individual (such as a child or sibling of the disclaimant) or to a trust with spendthrift protections.

For example, if a surviving spouse who is the primary beneficiary of a decedent's insurance policy inherits the cash outright, his or her creditors can reach the cash. If the surviving spouse disclaims, however, those proceeds might be redirected to the decedent's revocable living trust with a spendthrift clause that can protect the cash from creditors. Similarly, a beneficiary of a trust may wish to disclaim his or her beneficial interest in the trust in order to accelerate an alternative disposition or take advantage of GST opportunities.

Note that a spendthrift clause does not limit the right of the beneficiary to disclaim his or her interest in the trust. 755 ILCS 5/2-7(a). *See, e.g., In re Estate of Aylsworth,* 74 Ill.App.2d 375, 219 N.E.2d 779 (3d Dist. 1966) (when life tenant agreed with remainderpersons to disclaim trust interests in exchange for life tenant naming them as sole beneficiaries in his will, disclaimer of life interest would have been valid despite spendthrift provision had life tenant not violated disclaimer law by otherwise "accepting" interest in property).

Disclaimers shield assets because of the "relation back" clause of the Probate Act. 755 ILCS 5/2-7(d)(2). There is no property interest a creditor can attach because no interest ever vests — the disclaimer "relates back" to the moment when the disclaimant becomes entitled to acquire the property. *Id*. For example, if a legatee disclaims his or her legacy six months after the testator's death, the disclaimer is deemed to have occurred at the testator's death so that the disclaimant never had any interest in the property even during the six months after the decedent's death and prior to the disclaimer.

Illinois courts apply the relation back clause in §2-7(d)(2) broadly. For example, in *Tompkins State Bank, supra,* the court held that the mortgagor's disclaimer of his interest in property as devisee was to be treated as relating back for all purposes to the date of the testator's death, so nothing on which the creditor could impose a lien passed to the beneficiary. Likewise, the relation back clause has also been used to shield property from creditors during bankruptcy. Though some courts in other states have held that a disclaimer can be a fraudulent transfer under the Bankruptcy Code, 11 U.S.C. §101, *et seq.* (*see, e.g., In re Kloubec,* 247 B.R. 246 (Bankr. N.D. Iowa 2000)), Illinois courts and the Seventh Circuit have held that because of the relation back clause in §2-7(d), a bankruptcy trustee generally cannot recover the disclaimed property. The courts have applied this theory both to prepetition disclaimers and postpetition disclaimers

otherwise satisfying the 180-day limitations described in §9.31 below. *In re Atchison,* 925 F.2d 209 (7th Cir. 1991) (denying trustee's ability to seize inheritance, debtor disclaimed less than three months before bankruptcy filing despite 11 U.S.C. §548(a), which makes any transfer within two years of bankruptcy filing available to the bankruptcy trustee). *See Barmann v. Wood (In re Wood),* 291 B.R. 829 (Bankr. C.D.Ill. 2003) (relying on *Atchison* to deny trustee's ability to seize inheritance debtor disclaimed more than eight months after his bankruptcy filing). See §9.31 below for important limitations on the ability to use disclaimers to avoid bankruptcy creditors.

C. Requirements for Validity

1. [9.20] Federal Requirements

To reap any transfer tax benefits of disclaiming property, the disclaimer must be qualified. Internal Revenue Code §2518(b) establishes the requirements for a qualified disclaimer:

> **For purposes of subsection (a), the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if —**
>
> **(1) such refusal is in writing,**
>
> **(2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of —**
>
> **(A) the day on which the transfer creating the interest in such person is made, or**
>
> **(B) the day on which such person attains age 21,**
>
> **(3) such person has not accepted the interest or any of its benefits, and**
>
> **(4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either —**
>
> **(A) to the spouse of the decedent, or**
>
> **(B) to a person other than the person making the disclaimer.** 26 U.S.C. §2518(b).

2. [9.21] State Requirements

The right to disclaim in Illinois was first recognized in *People v. Flanagin,* 331 Ill. 203, 162 N.E. 848 (1928), and later codified in what is now 755 ILCS 5/2-7(a).

This section, inter alia, provides:

> **A person to whom any property or interest therein passes, by whatever means, may disclaim the property or interest in whole or in part by delivering or filing a written disclaimer as hereinafter provided. A disclaimer may be of a fractional share or undivided interest, a specifically identifiable asset, portion or amount, any limited interest or estate or any property or interest derived through right of survivorship.** 755 ILCS 5/2-7(a).

The Disclaimer Under Nontestamentary Instrument Act, 760 ILCS 25/0.01, *et seq.*, extends the right of disclaimer to transfers under nontestamentary instruments. 760 ILCS 25/1. However, to be valid under Illinois law, all disclaimers must meet the requirements of 755 ILCS 5/2-7.

a. [9.22] Form of Disclaimer

Illinois requires that the disclaimer "(1) describe the property or part or interest disclaimed, (2) be signed by the disclaimant or his representative and (3) declare the disclaimer and the extent thereof." 755 ILCS 5/2-7(b). Sections 9.56 – 9.59 below contain sample disclaimers.

b. [9.23] Delivery

Illinois also requires delivery of the disclaimer to the transferor, donor, trustee, or other person who has legal title to the property. 755 ILCS 5/2-7(c). If none of these individuals is discernible, the disclaimer either must be delivered to a person having possession of the property or must be filed or recorded. *Id.* If the interest is passing due to death, an executed counterpart of the disclaimer may be filed with the clerk of the court in the county in which the estate of the decedent is administered, or in which it could be administered if not yet administered. *Id.* If an interest in real estate is disclaimed, an executed counterpart of the disclaimer may be recorded in the recorder's office in the county in which the real estate is located. *Id.*

D. [9.24] Timing Issues

If the disclaimant is willing to treat the disclaimed property interest as a gift for tax purposes, the disclaimer can be made at any time as long as all other requirements are met and no other limitations apply. However, if the disclaimant wants the federal gift tax benefits of the disclaimer, the Internal Revenue Code time limits and local law limits (if any) will apply.

Before 1977, federal law required that disclaimers be made within a "reasonable time" after knowledge of the existence of the transfer to avoid being treated as a gift. *Jewett v. Commissioner,* 455 U.S. 305, 71 L.Ed.2d 170, 102 S.Ct. 1082 (1982). *See* Pvt.Ltr.Rul. 201831003 (August 6, 2018) for additional guidance of what is a "reasonable time" regarding pre-1977 disclaimers. However, as of January 1, 1977, federal law requires that the disclaimer be received by the transferor of interest or his or her legal representative nine months after the later of (1) the day on which the transfer creating the interest in such person is made or (2) the day on which such person attains age 21. 26 U.S.C. §2518(b)(2).

Unfortunately, the date on which the transfer creating the interest occurs is not always obvious. For inter vivos transfers, a transfer creating an interest occurs when there is a completed gift for federal gift tax purposes. 26 C.F.R. §25.2518-2(c)(3)(i). For transfers made by a decedent at death or transfers that become irrevocable at death, the transfer creating the interest occurs on the date of the decedent's death. *Id.* For joint tenancy assets, the Seventh Circuit has held that the timeliness of a disclaimer of a survivorship interest is calculated from the date of death of the first joint tenant, not the date the tenancy is created. *Kennedy v. Commissioner,* 804 F.2d 1332 (7th Cir. 1986).

Illinois does not impose any additional time limits on disclaimers. 755 ILCS 5/2-7.

E. Limitations When Using Disclaimers

1. [9.25] Bars to Disclaimer

Sometimes disclaimer is not permissible. The Probate Act, the Omnibus Budget Reconciliation Act of 1993, Pub.L. No. 103-66, 107 Stat. 312, and United States Supreme Court precedent establish bars to disclaimer.

a. [9.26] Illinois Probate Act of 1975: General Bars to Disclaimer

Disclaimer is not an option when pre-1976 interests will be destroyed. The current statute governing disclaimers in Illinois became effective on January 1, 1976. 755 ILCS 5/2-7. According to 755 ILCS 5/2-7(e), "no interest which has arisen prior to that date in any person other than the disclaimant shall be destroyed or diminished by any action of the disclaimant taken pursuant to this Section." Furthermore, the Probate Act dictates that the right to disclaim property is explicitly barred by

> **(1) a judicial sale of the property, part or interest before the disclaimer is effected; (2) an assignment, conveyance, encumbrance, pledge, sale or other transfer of the property, part or interest, or a contract therefor, by the disclaimant or his representative; (3) a written waiver of the right to disclaim; or (4) an acceptance of the property, part or interest by the disclaimant or his representative.** *Id.*

Note that acceptance must be affirmatively proven to constitute a bar to a disclaimer. While acceptance of delivery or receipt of benefits does constitute acceptance, the mere lapse of time or creation of an interest in joint tenancy does not. An attempt by the disclaimant to control the disposition of the property also may constitute acceptance and void the attempted disclaimer. *See In re Estate of Sterba,* 2016 IL App (3d) 150483, 56 N.E.3d 1118, 404 Ill.Dec. 705 (2016).

b. [9.27] Omnibus Budget Reconciliation Act of 1993: Bar to Disclaimer for Public Aid Recipients

The Omnibus Budget Reconciliation Act of 1993 eliminated the ability of a public aid recipient to disclaim and remain eligible for benefits. 42 U.S.C. §1396p(h)(1). That statute defines "assets" to include

> **all income and resources of the individual . . . including any income or resources which the individual . . . is entitled to but does not receive because of action . . . by the individual [**or**] by a person, including a court or administrative body, with legal authority to act in place of or on behalf of the individual.** *Id.*

Accordingly, neither an individual nor such individual's guardian may disclaim assets valued in excess of the resource limitations without affecting that individual's eligibility for Supplemental Security Income (SSI) and Medicaid. Note that Illinois is one of only ten states whose Medicaid eligibility rules are more restrictive than those used by the Social Security Administration for SSI. However, the Illinois Public Aid Code, which governs the state's Medicaid program, includes a provision incorporating the federal definition of assets quoted above. 305 ILCS 5/5-2.1(a).

c. [9.28] Supreme Court: Bar to Disclaimer for Federal Tax Liens

In *Drye v. United States,* 528 U.S. 49, 145 L.Ed.2d 466, 120 S.Ct. 474 (1999), the United States Supreme Court definitively established another bar to disclaimer. The Court held that the mere right to receive property constitutes an interest for purposes of a federal tax lien. Thus, a federal tax lien is not defeated by a disclaimer. *Cf. United States v. Weisman,* 102 A.F.T.R.2d 2008-6874 (M.D.Fla. 2008) (disclaimer filed on same day as receiving notice of tax deficiency not subject to tax lien that did not attach until more than two years later). The Seventh Circuit has not ruled directly on the issue, but other courts have been mixed in how broadly they have applied the precedent. Some courts limited the holding's application to tax lien cases and honored the disclaimer. *See, e.g., In re Nistler,* 259 B.R. 723 (Bankr. D.Or. 2001). Other courts have extended the holding to disclaimers made even prepetition in bankruptcy and determined the disclaimer in question to be a fraudulent conveyance. *See, e.g., In re Kloubec,* 247 B.R. 246 (Bankr. N.D. Iowa 2000). *But see Royal v. Probate Estate of Sanford (In re Sanford),* 352 B.R. 885 (Bankr. D.Wyo. 2006), *rev'd on other grounds,* 369 B.R. 609 (B.A.P. 10th Cir. 2007); *In re Costas,* 555 F.3d 790, 795 (9th Cir. 2009); *In re Laughlin,* 602 F.3d 417, 426 (5th Cir. 2010).

2. [9.29] Other Limitations on Use of Disclaimer

In some situations, disclaimer is not barred outright but is limited in how it may be used. For example, use of disclaimer is limited when made by a fiduciary during postpetition bankruptcy.

a. [9.30] Personal Representative or Other Fiduciary

Special rules apply when a personal representative, guardian, or trustee attempts to disclaim property. When there is no governing instrument specifically authorizing disclaimer without court approval, Illinois law permits the legal representative of a decedent or ward to disclaim only with leave of court. 755 ILCS 5/2-7(a). A court may approve the disclaimer by a decedent's representative if the court "finds that the disclaimer benefits the estate as a whole and those interested in the estate generally even if the disclaimer alters the distribution of the property, part or interest disclaimed." *Id.* A court may approve the disclaimer by a representative of a ward if the court "finds that it benefits those interested in the estate generally and is not materially detrimental to the interests of the ward." *Id.*

As a practical matter, a court is unlikely to permit a representative to disclaim when there are legitimate creditors of the estate, since a creditor is an interested party whose interests must be considered by the court before approving the disclaimer. *In re Estate of Heater,* 266 Ill.App.3d 452, 640 N.E.2d 654, 203 Ill.Dec. 734 (4th Dist. 1994) (finding lower court abused discretion in allowing administrator to disclaim when it failed to consider interests of Illinois Department of Public Aid, legitimate creditor with interest in estate). Similarly, a court may not permit a personal representative to disclaim when it appears that the decedent did not desire a disclaimer. *See In re Estate of Morgan,* 82 Ill.2d 26, 411 N.E.2d 213, 44 Ill.Dec. 244 (1980) (affirming that probate court did not abuse discretion in not allowing executor to disclaim despite tax and cost savings that could be achieved by disclaimer when decedent failed to disclaim in three months prior to death).

Similarly, a trustee may disclaim only when the governing instrument so permits and it is in the beneficiaries' best interests to do so.

b. [9.31] Bankruptcy

There are further limitations as to when disclaimers may be used to avoid creditors during bankruptcy. Courts have held that disclaimers may be used to avoid creditors if filed prepetition (*In re Atchison,* 925 F.2d 209 (7th Cir. 1991)) or eight months postpetition (*Barmann v. Wood (In re Wood),* 291 B.R. 829 (Bankr. C.D.Ill. 2003)). *See also In re Chenoweth,* 3 F.3d 1111 (7th Cir. 1993) (finding date of death, not date will is admitted to probate, begins 180-day period since otherwise legatee who wanted to keep legacy out of bankrupt's estate could do so merely by delaying admission of will until after 180-day period expired). The court has held that under the Bankruptcy Code (11 U.S.C. §541(a)(5)), property that the debtor becomes "entitled to acquire," whether by bequest, devise, or inheritance, within 180 days of filing for bankruptcy is property of the bankrupt estate. In *Chenoweth,* the court held that a debtor becomes entitled to acquire the property at the testator's death, not after the will goes through probate. Therefore, the Seventh Circuit affirmed the bankruptcy court and district court's holding that the disclaimed property was the property of the bankrupt's estate. The court concluded that the disclaimer constituted an unauthorized transfer of the property of the bankruptcy estate and was thus avoidable under 11 U.S.C. §549. Note that the court distinguished *Chenoweth* from *In re Detlefsen,* 610 F.2d 512 (8th Cir. 1979), in which the Eighth Circuit was interpreting the old version of the Bankruptcy Code, which used the language "vests" within six months, rather than "becomes entitled to acquire" within 180 days, as provided in the new Code.

Finally, a debtor may not be able to disclaim property after the bankruptcy court has issued an order regarding the disposition of the assets, regardless of the disclaimer's effective date under state law. *In re Johnson,* No. 10-91970, 2011 WL 1884584 (Bankr. C.D.Ill. May 16, 2011). The debtor in *Johnson* filed for Chapter 13 bankruptcy and executed a disclaimer two days after the court approved the debtor's plan for financial reorganization, required under Chapter 13. The court distinguished the case from *Atchison, supra,* and *Wood, supra,* relying instead on a U.S. Supreme Court precedent that "a Chapter 13 plan is final and binding on all parties" (2011 WL 1884584 at *2, citing *United Student Aid Funds, Inc. v. Espinosa,* 559 U.S. 260, 176 L.Ed.2d 158, 130 S.Ct. 1367 (2010)), and ordered the disclaimed property included in the bankruptcy estate.

F. [9.32] Fiduciary Concerns

When presented with a document in which an heir, legatee, or beneficiary states that he or she is disclaiming property, a personal representative, trustee, or custodian should be adequately protected under Illinois law by accepting and honoring the disclaimer. Illinois law provides that any person may presume, "in the absence of actual knowledge to the contrary," that a disclaimer delivered or filed as required is a valid disclaimer. 755 ILCS 5/2-7(e).

Nonetheless, a cautious fiduciary who is concerned about the propriety of a disclaimer may wish to file a petition to spread the disclaimer of record with the applicable court and provide notice of such petition to any parties who may be affected by the disclaimer or otherwise interested in it. *See, e.g., In re Estate of Hansen,* 109 Ill.App.2d 283, 248 N.E.2d 709 (1st Dist. 1969), in which the decedent's husband was granted leave to spread of record his disclaimer to property he may have otherwise received under his wife's will.

For an additional discussion of the potential problems with disclaimers and a list of specific postmortem planning techniques to be used with disclaimers, see Michael E. Morden et al., Ch. 17, *The Effective Use of Disclaimers in Estate Administration,* **ILLINOIS ESTATE ADMINISTRATION (IICLE®, 2014)**.

IV. [9.33] POSTMORTEM ASSET PROTECTION FOR SPECIAL RECIPIENTS

There are special considerations when the decedent's property may otherwise go outright to a minor, a disabled person, or another individual receiving or eligible for public aid. The best method of asset protection for minors is to hold their assets in continuing spendthrift trusts that will be protected from future creditors and divorcing spouses. Similarly, trust planning is essential for disabled recipients of property whose inheritance must be held in a special-needs trust in order for the individual to continue to qualify for state aid. However, when the decedent has not engaged in proper trust planning, it is incumbent on the practitioner to consider whether there are postmortem planning options available that will provide increased protection for the assets.

A. [9.34] Guardianship Estates

When a minor or disabled heir will inherit property with a value in excess of $10,000, the court administering probate typically requires a guardian to be appointed to protect the person's inheritance. See 755 ILCS 5/25-2. In some ways, the heir benefits from this appointment. Court supervision of the guardianship estate's expenditures can help protect the heir's assets from creditors. Court supervision of the guardian's decisions also provides the heir protection against the misuse or misappropriation of his or her assets.

In some rare instances, petitioning for guardianship may be the only way to protect the assets from the heir's own improvidence. Guardianship can protect assets when the heir — "because of

gambling, idleness, debauchery or excessive use of intoxicants or drugs" — demonstrates a proclivity to waste his or her assets so as "to expose himself or his family to want or suffering." 755 ILCS 5/11a-2.

Most of the time, however, guardianship and its costs merely dissipate assets that otherwise could be available for the heir. Accordingly, in most situations, formal guardianship proceedings should be avoided if at all possible.

B. [9.35] Custodial Accounts

The Probate Act contemplates that the court has the authority to put a minor or disabled person's inheritance into a custodial account without going through the expense of establishing a guardianship estate. 755 ILCS 5/1-2.17, 5/24-21, 5/28-10(e). If the court determines that depositing the inheritance into an account under the Illinois Uniform Transfers to Minors Act (UTMA), 760 ILCS 20/1, *et seq.,* is in the best interests of the minor, then it has the authority to do so. See also 760 ILCS 20/4, 20/7(c)(ii).

Nonetheless, assets in a minor's estate or custodial account subject to court order held for a minor heir must be distributed outright to that minor (if he or she is not disabled) when that individual reaches the age of 18 years. 755 ILCS 5/11-14.1, 5/24-1(a). Accordingly, there are few postmortem planning options for protecting assets a minor will receive outright upon reaching the age of majority.

Ideally, even when the decedent has not done any trust planning for minor or disabled beneficiaries, the decedent will die testate with a will specifying that assets can be distributed to a legatee's custodian. A sample of this type of provision is as follows:

If any portion of my estate is distributable to a beneficiary who is then under the age of twenty-one years or is otherwise then disabled, my executor may distribute that beneficiary's share, without further responsibility, either directly to that beneficiary, to a qualified individual or trust company designated by my executor as custodian for that beneficiary under an applicable Uniform Transfers to Minors Act or similar law, or to the individual having personal custody of that beneficiary (regardless of whether he or she is court-appointed), and the receipt of the distributee shall discharge my executor.

A transfer to a custodian who can hold the property subject to the UTMA enables the assets to be held in trust beyond the time a minor reaches the age 18. Under Illinois law, property transferred to a custodial account pursuant to authority in the governing will, trust, or other instrument can be held until the child reaches the age of 21. 760 ILCS 20/21(a)(1). This permits the property to be held longer by the custodian and can help protect the assets.

A beneficiary's creditor, however, may be able to reach UTMA assets regardless of the beneficiary's age. UTMA assets may be used to satisfy a tort judgment against a minor. See 760 ILCS 20/18(a)(iii); *Pope v. First of America, N.A.,* 298 Ill.App.3d 565, 699 N.E.2d 178, 232 Ill.Dec. 731 (3d Dist. 1998) (bank could deduct money from minor's UTMA account as setoff for illegal withdrawal made by minor from another customer's account). Creditors might also reach

UTMA assets under another statutory provision. 760 ILCS 20/15(b) allows the court to disburse UTMA assets "[o]n petition of an interested person" to the extent "the court considers advisable for the use and benefit of the minor." The UTMA does not define "interested person." However, a comment to the analogous provision in the Model Uniform Transfer to Minors Act (§14) includes creditors in the definition of "interested person." A beneficiary's creditor would have a strong argument for disbursement. A beneficiary's default would hurt the beneficiary's ability to obtain credit, limiting his or her ability to get reasonable interest rates on a mortgage or student loans. The court could avoid these injuries to the beneficiary by allowing the creditor to reach the UTMA assets.

Under Illinois law, prior to the time the minor reaches age 21, the custodian may also transfer the custodial property to a particular type of trust called a "minor's trust" or a "2503(c) trust." 760 ILCS 20/15(a-5). This type of trust requires that at age 21 the beneficiary has a right to withdraw all the trust account assets. 26 U.S.C. §2503(c). However, the right to withdraw can be limited to as few as 30 days. Thus, as long as the child is given adequate notice of his or her right to withdraw, if the child fails to withdraw the property within the particular time period given (*e.g.,* 30 days), then the property can remain in the trust for an indefinite time period. The continuing trust terms can provide that assets be distributed only in the trustee's discretion for the beneficiary's needs, can include spendthrift protections, and can otherwise provide asset protection against creditors or divorcing spouses.

C. [9.36] Use of Holdback Trusts

Often a trust permits a trustee to continue holding assets in trust that otherwise would be distributed to a beneficiary under a particular age or who is "disabled." These holdback provisions typically permit distributions in the trustee's discretion subject to a health, support, and education (and possibly broader) standard, and the trust assets will otherwise be protected by whatever spendthrift provisions are included in the governing document.

For beneficiaries under the designated age for whom creditor protection is desirable, a trustee should be advised to exercise this authority and hold the trust assets in continuing trust until the beneficiary reaches that age. However, even if the beneficiary is over the designated age as long, as the definition of "disabled" is broad enough the trustee may have flexibility to hold in further trust that beneficiary's distributive share that would otherwise be distributed outright. A definition of "disabled" in a trust document may be something along the following lines:

A person shall be considered "disabled" if a minor, if under legal disability, or if in any condition (whether temporary or permanent) that substantially impairs that person's ability to transact ordinary business. The trustee may rely exclusively on a certification of a physician who has examined or treated the individual in question within the previous three months in making this decision.

Accordingly, if the beneficiary has a drug addiction or a gambling problem or is otherwise unable to handle his or her business affairs, a trustee may have the authority to hold those assets in trust for as long as the condition applies and therefore protect the trust assets from the beneficiary's creditors.

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✓ Even if the document does not require one, the authors recommend arranging a psychiatric evaluation of such a beneficiary so that the trust records will include a report concluding that the beneficiary is unable to handle his or her ordinary business affairs (or whatever other standard is required by the governing trust instrument).

D. Omnibus Budget Reconciliation Act of 1993 Trusts

1. [9.37] Omnibus Budget Reconciliation Act of 1993

Assets inherited outright by those who are already on or would qualify for means-tested governmental benefits typically will disqualify the individual for such benefits. See 42 U.S.C. §1382(a). Such inherited assets cannot be placed into a traditional special-needs trust because such trusts cannot be created for an individual using that individual's own property. *See Department of Mental Health & Developmental Disabilities v. Phillips,* 114 Ill.2d 85, 500 N.E.2d 29, 102 Ill.Dec. 407 (1986). The relevant federal statutes, however, do allow for the creation of a special type of trust for a person using that person's own property, or property the person is entitled to receive, that would still permit that person to qualify for certain governmental benefits such as Medicaid and social security income.

Under the Omnibus Budget Reconciliation Act of 1993 funds from an inheritance can be placed into a trust for the benefit of a person with a disability. 42 U.S.C. §1396p(d)(4). Assuming that the trust meets certain requirements, the disabled person will be eligible for benefits even after the trust has been created. However, when the person dies, the state must be reimbursed for the amount of dollars it has spent on the person. Thus, the §1396p(d)(4) exception preserves assets for a disabled person's supplemental needs as long as the disabled person is alive — but does not necessarily preserve excess assets for siblings or other family members. This trust is often referred to as a "payback trust" because the state will be paid back for need-based services provided.

2. [9.38] Payback Trusts in Illinois

Illinois authorizes use of a disabled person's funds (or funds such individual is eligible to receive) to create a special-needs payback trust under an enabling statute. The statute provides:

> **A discretionary trust for the benefit of an individual who has a disability that substantially impairs the individual's ability to provide for his or her own care or custody and constitutes a substantial disability shall not be liable to pay or reimburse the State or any public agency for financial aid or services to the individual except to the extent the trust was created by the individual or trust property has been distributed directly to or is otherwise under the control of the individual, provided that such exception shall not apply to a trust created with the property of the individual with a disability or property within his or her control if the trust complies with Medicaid reimbursement requirements of federal law.** 760 ILCS 5/15.1(a).

At the death of the disabled individual and after reimbursing Medicaid expenditures, any remaining assets in the trust are liable to the State of Illinois for reimbursement of "any other service charges outstanding" at that time. *Id.* See also 305 ILCS 5/5-2.1a; 405 ILCS 5/5-105. Such trusts can take one of two forms, either a stand-alone, self-settled payback trust under 42 U.S.C. §1396p(d)(4)(A) or a pooled trust under 42 U.S.C. §1396p(d)(4)(C). Notably, a §1396p(d)(4)(A) trust can be created only for a disabled individual who is under the age of 65.

It is also important to note that because the Omnibus Budget Reconciliation Act of 1993 relies on the definition of "disability" for social security purposes, payback trusts can be set up even for qualified individuals who are not adjudicated as incompetent under state law. See 42 U.S.C. §1382c(a)(3). Cf. 755 ILCS 5/11a-2. If, however, an individual who is disabled under state law inherits assets, those assets can be placed in a special-needs trust only by leave of the court with jurisdiction over the disabled person's guardianship, and the court must approve the terms of such trust.

Generally, the terms of an individual Illinois special-needs payback trust should be along the lines described in SPECIAL-NEEDS TRUSTS (IICLE®, 2016). In addition, the trust should be sure to limit any reimbursement "to the extent required by applicable law."

3. [9.39] Pooled Trusts

Pooled trusts (also known as "community payback trusts") are also authorized by the Omnibus Budget Reconciliation Act of 1993. 42 U.S.C. §1396p(d)(4)(C). The statute requires that a pooled trust must be administered by a not-for-profit organization and, unlike the 42 U.S.C. §1396p(d)(4)(A) trusts described in §9.38 above, pooled trust accounts under §1396p(d)(4)(C) can be created for a disabled individual even if he or she is over the age of 65. Another distinguishing characteristic is that a pooled trust can be created by the disabled person if he or she is deemed disabled for social security purposes, but has not been adjudicated incompetent. In order to minimize creation and transaction costs, a pooled trust can be a particularly attractive option for smaller trust estates or to minimize costs when a professional trustee is desirable. The trustee creates the pooled trust, and each beneficiary joins the trust through a joinder agreement. The funds are pooled for investment and management purposes, but each beneficiary maintains a separate subaccount. The trustee charges an annual fee for its services, typically based on a minimum fee plus a percentage of assets under management in the subaccount.

When the disabled person dies, any assets remaining in the trust will be paid back to the State of Illinois as reimbursement for the benefits that were paid on the person's behalf. Any funds remaining after payment to the state may then be paid to family members and heirs, or as otherwise provided in the joinder agreement with the trustees of the pooled trust. The disabled person's guardian or other representative may elect to permit any residuary funds to remain in the pooled trust and benefit the other disabled beneficiaries of such trust.

There are presently a number of charitable organizations that offer pooled trust services in Illinois, including: (a) the Illinois Disability Association; (b) Life's Plan, Inc.; (c) Midwest Special Needs Trust; (d) the Evangelical Lutheran Church in America Foundation; (e) DayOne Reliance Inc.; and (f) the Charities Pooled Trust.

V. POSTMORTEM ASSET PROTECTION IN TRUST FUNDING

A. [9.40] General Considerations and Assumptions

When competent heirs, legatees, and beneficiaries inherit assets outright, they can use various asset protection strategies through their own estate planning. See generally Chapters 5 – 8, 10, and 11 of this handbook for discussions of self-settled asset protection trusts, lifetime qualified terminable interest property (QTIP) trusts, and other available planning techniques. However, because one's ability to protect one's own assets is usually more limited than the ability of a trust settlor to provide for the protection of a beneficiary's assets, it is best for a personal representative or trustee during the administration process to consider whether additional asset protection measures are available and desirable. Even in situations in which basic planning has been done and the plan anticipates the creation of continuing trusts, a practitioner can add value by recommending how to fund the various continuing trusts.

Even following recent changes in federal estate tax law, the most common structure in contemporary trust planning for a decedent of means is to create a so-called "A/B" plan. The structure of such a plan maximizes use of the decedent's applicable exclusion amount and GST tax exemption, as well as the unlimited federal estate tax marital deduction. Prior to changes in the federal estate tax in 2012, this planning structure (or some variation of it) was seen in almost all estates that were potentially subject to estate tax at the death of either spouse. Although often less crucial now that an individual's estate tax exclusion is "portable" to his or her surviving spouse, A/B plans remain extremely common, particularly when asset protection, in addition to tax planning, is a priority. However, as applicable exclusion amounts continue to rise, and thus fewer estates will be subject to estate taxes, many estate plans might shift towards creating a single-fund QTIP to receive a second basis step-up at the surviving spouse's death, in lieu of the benefits of an A/B plan which not be as effective as when exclusion amounts were lower.

The A/B trust structure provides that at the first death, a separate trust (the B share) is created that takes advantage of the decedent's applicable exclusion amount (in 2019, $11.4 million minus lifetime taxable gifts and certain nondeductible expenses). The balance (the A share) goes to the surviving spouse in trust, typically a QTIP marital trust. When the decedent's generation-skipping transfer tax exemption is unused, or has been used during life only to the same extent as the decedent's applicable exclusion amount, the entire remaining GST exemption should be applied to the B trust.

In order to address funding issues, §§9.41 – 9.52 below assume that the decedent's testamentary plan provides for the creation of A/B trusts, that the decedent's assets are sufficient to fund both a B trust (exempt from federal transfer tax and GST tax) and a QTIP marital trust, and unless otherwise indicated, that the decedent's available GST tax-exempt property is equal to the property that will be exempt under the applicable exclusion amount.

B. Asset Selection

1. [9.41] Initial Funding Considerations

The B trust described in §9.39 above will hereinafter be called the "family trust" (it is also sometimes referred to as the "exclusion trust," the "bypass trust," or the "credit shelter trust"). In

analyzing the best way to fund a family trust, the practitioner should consider both the trust's substantive terms and the type of funding formula required by the governing instrument.

Family trusts do vary in their substantive provisions, and this may have an impact on funding decisions. Some family trusts name only the spouse as beneficiary during his or her life, although it is often better to include descendants as permissible beneficiaries or at least as permissible donees under a lifetime limited power of appointment granted to the surviving spouse. Also, some family trusts require that all income be distributed to the surviving spouse during his or her lifetime, while others make such distributions discretionary.

Trust instruments can also differ in the formula provided for funding the marital and family trusts. A formula can be either a pecuniary type or a fractional-share type. A "pecuniary formula bequest" is one in which the recipient is given an actual dollar amount of property, defined in terms of a formula. Thus, when a pecuniary formula is used, the amount generally does not fluctuate as a result of any post-valuation-date changes in the decedent's estate. A pecuniary formula can define either the marital amount, with the family trust portion passing in the residue, or the family trust portion, with the residue of the estate qualifying for the marital deduction.

Any transfer of the right to receive income in respect of a decedent ("IRD": income the decedent earned before death but had not yet recognized for income tax purposes because of the decedent's method of accounting) that is used to satisfy a pecuniary amount will cause the income to be immediately realized. 26 U.S.C. §691(a)(2). Examples of IRD are retirement benefits and the proceeds from an installment sale. If IRD is allocated to a pecuniary bequest, the entire gain is realized even though the benefit or proceeds themselves may not be received immediately. Thus, to the extent possible, it is usually desirable to use other assets first to fund the pecuniary bequest.

A "fractional-share marital formula" expresses the amount of the marital bequest in terms of a proportion of the assets involved rather than in terms of a specific dollar amount. Accordingly, no specific liability is created, and satisfying the bequest with appreciated assets does not generate capital gain.

The fractional-share formula may entitle the beneficiary to a fractional share of each asset of the estate. This deprives the executor of any flexibility in picking and choosing the assets to be left to the marital share for tax or nontax purposes. When the marital share is required to receive a fractional part of each asset of the estate, the spouse's share automatically participates in the post-death appreciation or depreciation of the assets of the estate. All distributions of principal under a fractional share will carry out the distributable net income of the estate or trust, thus generating a distributable net income deduction to the estate or trust and taxable income to the transferee.

The IRS has hinted that an executor might pick and choose specific assets to be allocated to the marital trust under a fractional-share formula, instead of allocating fractional interests in each asset of the estate, without realizing capital gain on satisfaction of the marital bequest. Tech.Adv.Mem. 8145026 (July 31, 1981). The fiduciary must have the power to make distributions and allocations on a non-pro rata basis, under either state law or the instrument, for this option to be available. It is common for documents to permit the fiduciary to "allocate different kinds or disproportionate shares of property or undivided interests in property among the beneficiaries or separate trusts." When this power exists, many fiduciaries as a practical matter do

fund fractional bequests on a non-pro rata basis, at least to some extent. However, until there is a public ruling or other authority, there is a risk that a non-pro rata funding of a fractional-share marital bequest could result in realization of capital gain.

2. [9.42] Conventional Wisdom

Assuming the trustee has the flexibility to determine which assets to use for funding purposes, conventional wisdom is to fund the family trust with appreciating assets that produce little or no income and to push income-producing assets into the marital trust. Since the family trust will be exempt from tax at the surviving spouse's death and such assets can pass tax-free to children (and to future descendants if the family trust is also generation-skipping transfer tax-exempt), the goal is for it to grow as much as possible, thereby increasing the value of the assets that children and other descendants will ultimately have available to them for their benefit. In contrast, since the marital trust will be included in the surviving spouse's taxable estate, it will be beneficial for the spouse to use the income from the marital trust to pay his or her expenses for the balance of his or her life, minimizing concerns as to whether the value of the trust principal will increase.

3. [9.43] Funding Marital Trusts To Maximize Asset Protection

In order to qualify most marital trusts for a federal estate tax marital deduction, the spouse must be entitled to all of the income from the trust. If the trustee has the discretion to withhold income payable to the spouse, the trust property will be disqualified for marital deduction because 26 C.F.R. §20.2056(b)-5 requires the spouse's "right to income" and that the income be "payable annually." *See Wisely v. United States,* 893 F.2d 660 (4th Cir. 1990). This means that a creditor of the spouse can garnish any income he or she will receive. Although Illinois law does not appear to expressly address the issue, some states will permit a beneficiary's personal creditor to file a garnishment action against the trust so that the trustee must pay directly to the creditor any mandatory distributions that otherwise would have been paid to the beneficiary. *See United States v. Harris,* 854 F.3d 1053 (9th Cir. 2017).

If the spouse is a spendthrift or has potential creditors who might attack any income he or she receives, it can make sense to fund the marital trust instead with non-income-producing assets. If the marital trust does not produce income, then the creditors cannot pursue it. While the trust will provide that the spouse can force the trustee to make marital property productive, a creditor may not be able to do so as easily.

No case has ruled on whether a trustee of a spouse's bankruptcy estate can compel the trustee of the marital trust to reinvest nonproductive assets. The likely answer to this question is that the trustee of the bankruptcy estate may step into the spouse's shoes and exercise the right to compel because, under the Bankruptcy Code (11 U.S.C. §541) any equitable interest of the spouse becomes the property of the bankruptcy estate and the right to compel the conversion is an equitable interest. However, an ordinary creditor may not have this right even though the creditor can garnish the spouse's nonexempt income and attach the spouse's nonexempted property.

4. [9.44] Additional Considerations for Family Trusts and Descendants' Trusts

Generally the considerations for funding a trust for descendants will be identical to the issues in funding the family trust. Often continuing trusts will provide that generation-skipping transfer tax exempt property shall be held in further trusts at least until the generation of grandchildren (in order to avoid further taxation at the children's death). Non-GST exempt assets are often subject to withdrawal rights. To the extent a beneficiary has withdrawal rights that are not disclaimed upon the creation of the interest, it is advisable to fund that trust with assets that are less desirable for creditors (*e.g.,* nonliquid assets, LLC, or other closely held business interests). Typically descendants' trusts do not require mandatory distributions and accordingly should receive spendthrift protection. 735 ILCS 5/2-1403 (under Illinois law, except for unpaid child support when the parent is the sole beneficiary of the trust, judgment debtors of a beneficiary cannot reach the property held in a legitimate trust).

C. Trust Changes

1. [9.45] Situs and Governing Law

Often trusts contain language enabling the change of trust situs or trust law. For example, a provision might read something like the following:

This instrument and all dispositions hereunder shall be governed by and interpreted in accordance with the laws of the State of Illinois; provided, however, that the trustee may, by written instrument filed with the trust records, change the situs and governing law of any trust to that of another state.

During trust funding, one consideration should certainly be whether it is possible to make certain changes desirable for the trust to continue to be administered in Illinois and under Illinois law or whether it is desirable to change the trust's situs and/or governing law.

Illinois is not considered among the best states for general liability protection. See, *e.g.,* U.S. Chamber of Commerce Institute for Legal Reform, *2017 U.S. Chamber of Commerce State Liability Systems Ranking Study,* available at www.instituteforlegalreform.com/states (study of corporate attorneys concluding that, overall, Illinois was the third worst when considering such issues as treatment of tort and contract litigation and punitive damages, while South Dakota, Vermont, and Idaho were best). More specifically in a trust context, the typical issue is whether another state could provide heightened spendthrift protection. See, *e.g.,* 735 ILCS 5/2-1403 (a judgment for child support is enforceable against a beneficiary's interest in the trust). In situations in which situs and/or governing law can be moved to a jurisdiction that may be less favorable to creditors, such a move should be explored. See IIA Austin Wakeman Scott and William Franklin Fratcher, THE LAW OF TRUSTS §152.1 (4th ed. 1987) (discussing spendthrift trusts in various states and noting that states like Delaware and Nevada provide exclusion of creditors from reaching beneficiary interest if it is so expressed in the trust instrument). Depending on the particular situation, the types of claims that could be made against a trust beneficiary or the trust assets, and the potential connections the trust might have with another state, a case-specific analysis could be done as to which states might provide the best protection under the circumstances.

2. [9.46] Changing Trust Terms

While more aggressive than merely changing trust situs or the trust's governing law, a practitioner should consider whether there is an ability to amend the trust or merge it with another trust to maximize protection of trust assets. Since even a revocable living trust becomes irrevocable at the settlor's death, typically the methods for amending a trust are (a) by court order as in a trust reformation action; (b) by agreement under a virtual representation statute if applicable; or (c) by having a trust protector or its equivalent amend the trust if the underlying instrument has so enabled. The trust assets might also be moved into another trust to be governed by the terms of a different governing instrument, either by merging the trusts or by exercising a power of appointment.

a. [9.47] Construction or Reformation Actions

When the trust terms must be clarified or amended, a fiduciary might be advised to file a petition in court for construction or reformation. Because a more detailed discussion of such actions is beyond the scope of this chapter, please refer to Richard A. Campbell and Gina E. Oderda, Ch. 6, *Construing and Modifying Wills and Irrevocable Trusts,* LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS (IICLE®, 2016).

b. [9.48] Virtual Representation Agreements

The Illinois virtual representation statute enables a trustee to avoid costly litigation and respond to beneficiaries' wishes. The statute allows the trustee, current beneficiaries, and remainderpersons to enter into agreements without the appointment of a guardian ad litem or court approval. Under this statute, if all of the competent current beneficiaries and presumptive remainder beneficiaries sign an agreement, they can bind those beneficiaries who would take only if the signatories do not survive to the distribution date. The statute is based on the equitable doctrine of virtual representation, which generally provides that, in appropriate circumstances, current beneficiaries may represent and bind the interests of future beneficiaries. 760 ILCS 5/16.1. Following revisions effective in 2010, the statute incorporated language, adapted from the Uniform Trust Code (UTC), explicitly permitting minor, disabled, and unborn beneficiaries to be represented by another party with "substantially identical interests" under the trust. See also UTC §304, cmt (2010). As of January 1, 2015, Illinois law further liberalizes the standard by allowing a minor, disabled, or unborn beneficiary to be represented by another whose interest in the trust is "substantially similar" with respect to the particular question or dispute. 760 ILCS 5/16.1(a)(1). This 2015 amendment also explicitly authorizes representation by a beneficiary's parent, guardian, or agent, and confirms that a virtual representation agreement may be used to address any matter involving the trust that could be approved by a court. In addition, a trustee can submit a prospective agreement for court approval to verify that representation was proper. The trustee must obtain court approval if the parties are agreeing to terminate the trust.

c. [9.49] Trust Protectors

A "trust protector" is an individual or group of individuals with authority to make changes to the administrative provisions or the substantive provisions of the trust instrument. If the governing instrument provides for a trust protector, and depending on how expansive the powers given to the trust protector may be, the trust protector may have the authority to revise the trust in order to move it to another jurisdiction or terminate a beneficiary's interests if such revisions can help with asset protection.

d. [9.50] Trust Mergers

Many trust instruments contain provisions enabling merger with certain other trusts (*e.g.,* trusts held by the same trustee for the same beneficiaries). When those terms are quite liberal, it may be possible to merge a trust that provides inadequate creditor protection into a trust that provides better protection. Even when the trust instrument is silent on this issue, §4.25 of the Trusts and Trustees Act, 760 ILCS 5/1, *et seq.,* permits the trustee of a trust to consolidate two or more trusts having "substantially similar terms" into a single trust.

e. [9.51] Trust Decanting

760 ILCS 5/16.4 expressly authorizes trustees of trusts governed under Illinois law to distribute property directly from one trust instrument into another, a process known as "decanting." Intended to facilitate trust transactions that have become increasingly common in New York, Delaware, Florida, Nevada, and many other jurisdictions, the statute provides additional flexibility for trustees to update administrative provisions and, in some circumstances, to adjust beneficial interests, add or modify powers of appointment, and make similar substantive changes to existing trusts.

The degree of flexibility provided under the statute depends in large part on whether the initial trust instrument provides the trustee with "absolute discretion" — defined as a "right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust, whether or not the term 'absolute' is used," including a power to distribute for the beneficiaries' best interests, welfare, or happiness — or limits distributions to an ascertainable standard. 760 ILCS 5/16.4(a). A trustee who holds such absolute discretion

> **may distribute part or all of the principal of the trust in favor of a trustee of a second trust for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust.**
>
> > **(1) If the authorized trustee exercises the power under this subsection, the authorized trustee may grant a power of appointment (including a presently exercisable power of appointment) in the second trust to one or more of the current beneficiaries of the first trust, provided that the beneficiary granted a power to appoint could receive the principal outright under the terms of the first trust.**

> **(2) If the authorized trustee grants a power of appointment, the class of permissible appointees in favor of whom a beneficiary may exercise the power of appointment granted in the second trust may be broader than or otherwise different from the current, successor, and presumptive remainder beneficiaries of the first trust.**
>
> **(3) If the beneficiary or beneficiaries of the first trust are described as a class of persons, the beneficiary or beneficiaries of the second trust may include one or more persons of such class who become includible in the class after the distribution to the second trust.** 760 ILCS 5/16.4(c).

A trustee who does not hold such absolute discretion, by contrast, is limited to distributing property into a second trust that has the same current, successor, and remainder beneficiaries as the initial trust, does not change the standards for distributions as to the beneficiaries, and does not alter the grantees or potential appointees of any powers of appointment. 760 ILCS 5/16.4(d). Whether the decanting authority is broad or narrow, the trustee may exercise it by providing written notice to all legally competent current beneficiaries and remainder beneficiaries. Unless a beneficiary objects within 60 days after notice is sent, the trustee may decant without their consent and without court approval.

Although the statute does not permit a trust to be decanted if doing so will impede a beneficiary's current right to mandatory distributions, a current right to annuity or unitrust interest, or a current right to withdraw trust assets, it does allow any such rights to be modified or eliminated if they have not yet come into effect. 760 ILCS 5/16.4(n). Decanting also may be used to extend the term of a trust that would otherwise terminate (though not beyond the perpetuities period applicable to the initial trust). 760 ILCS 5/16.4(g). Both of these provisions may be of great use when a trustee considers decanting a trust for asset protection purposes. Finally, the statute specifies that, if a trustee acts reasonably and in good faith under its terms, a decision to decant trust property will not expose the trustee to fiduciary liability. 760 ILCS 5/16.4(u).

3. [9.52] Changing Fiduciaries

In some situations, it may be desirable to change fiduciaries in order to avoid a beneficiary acting as his or her own trustee or to gain access to an alternative venue or rule of law for a particular tax dispute or litigation matter.

For example, in the case of an estate seeking redetermination of tax liability, venue is determined under the Internal Revenue Code. 26 U.S.C. §7482(b). Section 7482(b) provides that such decisions may be reviewed by the United States court of appeals for the circuit in which the petitioner is a legal resident. For an estate, the petitioner would be the executor instituting a case on behalf of the estate defending against a deficiency. When there are multiple executors, the case can be heard in the circuit where any one of them resides. *Estate of Israel v. Commissioner,* 159 F.3d 593 (D.C.Cir. 1998). The court in *Israel* held that under §7482(b), when "the taxpayer is an estate, and some executors reside in one circuit, while others reside in another circuit or outside the country, convenience is served if venue lies in the circuit where *any* executor who was a petitioner and is now an appellant resides." [Emphasis in original.] 159 F.3d at 595 – 596.

Since some appellate circuits can be more favorable than others depending on the nature of the dispute, there are times a practitioner should consider advising either that the fiduciary be replaced or that a co-fiduciary be appointed. Assuming that all the relevant parties are in agreement on the strategy, the simplest method for doing so is merely to replace the fiduciary or appoint a co-fiduciary. The acting trustee (or executor as the case may be) can resign and a new fiduciary can be appointed instead. If the trust instrument does not provide a mechanism for replacing fiduciaries, a successor trustee may be appointed by a majority in interest of the beneficiaries then entitled to receive trust income or, if none, by a majority of the beneficiaries then eligible to have the benefit of the trust income. 760 ILCS 5/13(2).

D. [9.53] Creation of Holdings Entity for Asset Management

When the decedent owns assets outright such as investment real estate, closely held business interests from multiple ventures, or other assorted investment assets and has not consolidated these holdings into an investment holdings company of any sort, it may be desirable to create a postmortem limited liability company or family limited partnership to hold the assets. Creating such entities does not protect against existing creditors, but it can protect the underlying assets from future creditor claims. Creditors generally prefer a liquid asset rather than a membership interest that is not marketable. Furthermore, even creditors holding a charging order against the passive membership interests are not automatically entitled to any payment from the LLC. They may even have to pay tax out of their own pockets for their share of the LLC's income.

As an initial matter, a practitioner must consider whether the existing will or master trust expressly permits the executor/trustee to create such an entity and, if not, whether Illinois law permits it under the circumstances.

In supervised administration, if the decedent did not leave a will authorizing an executor to create or invest in such entities, the personal representative of the estate cannot form a holdings or investment entity such as a limited partnership or LLC using the estate's assets without a court order. 755 ILCS 5/21-1 through 5/21-2.15 (listing authorized investments). See particularly 755 ILCS 5/21-1.06 (permitting representative to invest in any investment authorized by court). *See also Penn v. Fogler,* 182 Ill. 76, 55 N.E. 192 (1899) (administrator has no power or authority to invest in private partnership). In petitioning the court for an order to form a partnership or other appropriate entity, the primary argument would be based on the personal representative's fiduciary duty to prevent loss and depreciation. *See, e.g., In re Busby's Estate,* 288 Ill.App. 500, 6 N.E.2d 451 (1st Dist. 1937). Thus, a personal representative can argue that the court should grant an order for the executor to place any assets at risk of incurring liabilities into limited liability form. Such an entity may prevent loss of other estate assets because post-death liability arising from the at-risk or "dangerous" assets may erode other assets of the decedent. This is a particular concern when the administration and transfer process is protracted as it often is when the decedent's pre-death planning was insufficient.

Under independent administration, however, a personal representative may invest not only in the investments described in 755 ILCS 5/21-1 through 5/21-2.15, but "if the independent representative determines that the estate is solvent and all interested persons other than creditors approve," the representative may invest estate assets in "any investments authorized for trustees under the prudent man rule . . . of the 'Trusts and Trustees Act.' " 755 ILCS 5/28-8(j).

If there is a will containing language that permits an executor to form new entities, the executor should be empowered to do so during independent administration without a court order. However, it is much less common for a will to contain such express authorization than for a trust to do so.

There may be greater flexibility to create such an entity if the assets are already titled in trust or pour into a trust under the residuary provisions of the will. Even absent an express provision enabling the formation of an entity, trustees of trusts have much broader authority than estate representatives to invest the assets of the trusts, including incorporating a business. 760 ILCS 5/4.23 (trustee has the power to incorporate unincorporated business owned by trust); 760 ILCS 5/4.24 (trustee has power to "enter into new partnership agreements").

Creating limited liability forms of ownership for the decedent's assets not only provides insulation from liability for the dangerous assets, but also provides a vehicle for central management and coordination among different types of assets. This helps reduce the complexity and expense associated with dividing the assets among multiple trusts. For example, assume a decedent died owning a building and marketable securities. If, during the administration of the estate, someone slips and falls on the premises of the building, that plaintiff may sue the estate to reach other assets of the estate, such as the securities. If the personal representative forms a partnership or LLC to own the building, only the building should be subject to the slip-and-fall claim. Once the building entity is formed, another entity could be formed to include all other assets of the estate and all the membership interests of the building entity. The children and the spouse of the decedent can contribute a small amount of money to the entity for a small fraction of the entity's interests that have voting rights that give the children or the spouse control of the entity. In contrast, the estate or trust receives a majority of the equity interests in the entity, but this majority interest is nonvoting and does not confer any power of managing the affairs of the entity. It is important that the estate be given no control of the entity's affairs. In addition, transfer into an entity should not be a replacement for maintaining adequate liability insurance on any real property or other insurable assets.

If the family and marital trusts under an A/B plan have already been funded with other assets, the creation of an LLC or other such entity can still be used to achieve asset protection along with other benefits. By layering a privately controlled holdings entity on top of spendthrift trusts, which own stakes in the entity, even creditors of a beneficiary who are able to breach the spendthrift protections may be forced to pursue successive (and more costly) legal remedies against both the trust and the LLC.

E. [9.54] Inherited Individual Retirement Accounts

Qualified retirement plans and individual retirement accounts (IRAs) can provide significant asset protection benefits. Under the 2005 revisions to the Bankruptcy Code, interests in various tax-qualified retirement accounts, including employer-sponsored 401(k), 403(b), and 457(b) plan accounts; traditional IRAs; Roth IRAs; simplified employee pensions (SEPs); and simple retirement accounts (SIMPLE IRAs) are all excluded from a debtor's bankruptcy estate. This exemption applies to the entire balance in a debtor's employer-sponsored plans, as well as

rollover IRAs funded from such plans, and up to $1 million in non-rollover IRAs. 11 U.S.C. §522(d)(12). Outside of bankruptcy, Illinois law broadly shields such accounts from claims by an individual's creditors. The Code of Civil Procedure provides:

> **A debtor's interest in or right, whether vested or not, to the assets held in or to receive pensions, annuities, benefits, distributions, refunds of contributions, or other payments under a retirement plan is exempt from judgment, attachment, execution, distress for rent, and seizure for the satisfaction of debts if the plan (i) is intended in good faith to qualify as a retirement plan under applicable provisions of the Internal Revenue Code of 1986, as now or hereafter amended, or (ii) is a public employee pension plan created under the Illinois Pension Code, as now or hereafter amended.** 735 ILCS 5/12-1006(a).

After the original owner's death, his or her interest in such accounts will pass according to the beneficiary designations on file with the respective account sponsors. Accounts passing to a surviving spouse may be consolidated with an IRA in the name of the spouse, using a qualified rollover under Internal Revenue Code §408(d)(3). For an individual recipient other than the decedent's spouse, often it is desirable to allocate the interest to an "inherited IRA" rather than to take the balance as a lump-sum distribution. An inherited IRA cannot be combined with an IRA funded from the beneficiary's own contributions, but does allow the required minimum distributions to be stretched out over the new beneficiary's life expectancy, extending the income tax deferral from the original account. See 26 U.S.C. §§408(d)(3)(C), 72(s)(2). A trust may establish an inherited IRA as well, although a variety of restrictions and special rules apply, and practitioners should take care when drafting trust documents expected to receive retirement account proceeds to ensure that they qualify. Discussion of such rules is outside the scope of this chapter, but for more information, see Jay P. Tarshis Ch. 5, *Naming a Trust as a Beneficiary,* RETIREMENT BENEFITS ISSUES IN ESTATE PLANNING (IICLE®, 2015).

While the protection in bankruptcy for retirement assets is clear during the original owner's life (as well as for a surviving spouse, when the assets are combined with the spouse's own in a qualified rollover), whether that protection extends to an inherited IRA has been hotly disputed. In 2014, the U.S. Supreme Court resolved a circuit split on this issue, sustaining the Seventh Circuit Court of Appeals' view that inherited IRAs, notwithstanding their income tax characteristics, do not constitute "retirement funds" within the meaning of the Bankruptcy Code, and thus are not exempt from the debtor's bankruptcy estate. *Clark v. Rameker,* 573 U.S. 122, 189 L.Ed.2d 157, 134 S.Ct. 2242 (2014). For the earlier appellate decision, *see In re Clark,* 714 F.3d 559 (7th Cir. 2013). The Supreme Court rejected the contrary reasoning offered in other cases and decided in the debtor's favor, including a Bankruptcy Appellate Panel of the Eighth Circuit Court of Appeals (*Doeling v. Nessa (In re Nessa),* 426 B.R. 312 (B.A.P. 8th Cir. 2010)) and the Fifth Circuit Court of Appeals (*In re Chilton,* 674 F.3d 486 (5th Cir. 2012)).

PRACTICE POINTER

✓ The Supreme Court's decision in *Clark, supra,* increases the attractiveness of naming a trust or trusts as successor beneficiary of retirement accounts. Since the trustee will then

establish the inherited IRA, rather than the beneficiary in his or her individual capacity, the assets can remain protected from a beneficiary's personal creditors through the trust's spendthrift clause.

VI. [9.55] CONCLUSION

By considering and providing counsel on postmortem planning opportunities for asset protection during estate and trust administration, a practitioner in Illinois can address planning deficiencies in a decedent's estate plan as well as help maximize the ultimate value and security of assets that will be available for use by the decedent's heirs or other desired beneficiaries.

VII. APPENDIX — SAMPLE FORMS

A. [9.56] Notice to Possible Creditors

NOTICE

TO: The Attached Distribution List
[or name specific possible creditor**]**

You are hereby notified of the death of [name of deceased**] on [**date of death**]. Letters of office were issued on [**date of issuance**], as [**Independent**] Representative, whose attorneys of record are [**attorneys' names**].**

Claims against the estate may be filed in the office of the clerk at [address of clerk's office**] Illinois, or with the representative, or both, on or before [**date**], or within three months from the date of the mailing of this notice, whichever is later. Any claim not filed on or before that date is barred.**

Dated: _____, 20__

_____

_____,
[Independent**] Representative**

Atty Name _____
Firm Name _____
Attorney for _____
Address _____
City & Zip _____
Telephone _____
Atty No. _____

B. Disclaimer Forms

1. [9.57] Qualified Disclaimer of Assets

QUALIFIED DISCLAIMER

TO: [Executor/Trustee/Custodian**]:**

This Disclaimer is executed by [name of executor**], of [**town where executor resides**], Illinois, this [**date of filing**].**

WHEREAS, [name of deceased**] (Decedent) died on [**date of death**];**

WHEREAS, under the [insert details about will/trust/insurance policy or other asset**], I am entitled to receive _____;**

WHEREAS, I wish to disclaim any and all right, title, and interest I may have in _____ to which I may otherwise be entitled;

WHEREAS, (a) I have made no assignment, conveyance, encumbrance, pledge, sale, or other transfer of such property or any contract therefor, (b) I have not executed a written waiver of my right to disclaim such property, (c) I have not accepted any benefits from such property, and (d) there has not been a judicial sale of such property, in each case as of the date of this Disclaimer; and

WHEREAS, I intend this Disclaimer to be a qualified disclaimer under §2518 of the Internal Revenue Code of 1986, as amended from time to time (the "Code").

NOW THEREFORE, pursuant to §2-7 of the Probate Act of the State of Illinois (755 ILCS 5/2-7) and §1 of the Disclaimer Under Nontestamentary Instrument Act of the State of Illinois (760 ILCS 25/1) and the Code §2518, I hereby irrevocably and unqualifiedly disclaim and refuse to accept any and all right, title, or interest I have in _____.

This Disclaimer shall be binding on me and all persons claiming through or under me.

Dated: [date**]**

_____
[insert name of disclaimant**]**

Subscribed and sworn to before me this _____ day of _____, 20__.

_____
Notary Public

ACKNOWLEDGMENT OF RECEIPT

The undersigned hereby acknowledges receipt of the above Disclaimer.

Dated: _____, 20__ **_____**

_____

2. [9.58] Nonqualified Disclaimer of Assets

NONQUALIFIED DISCLAIMER

TO: [Executor/Trustee/Custodian**]:**

This Disclaimer is executed by [name of executor**], of [**town where executor resides**], Illinois, this [**date of filing**].**

WHEREAS, [name of deceased**](Decedent) died on [**date of death**];**

WHEREAS, under the [insert details about will/trust/insurance policy or other asset**], I am entitled to receive _____;**

WHEREAS, I wish to disclaim any and all right, title, and interest I may have in _____ to which I may otherwise be entitled; and

WHEREAS, (a) I have made no assignment, conveyance, encumbrance, pledge, sale, or other transfer of such property or any contract therefor, (b) I have not executed a written waiver of my right to disclaim such property, (c) I have not accepted any benefits from such property, and (d) there has not been a judicial sale of such property, in each case as of the date of this Disclaimer.

NOW THEREFORE, pursuant to §2-7 of the Probate Act of the State of Illinois (755 ILCS 5/2-7) and §1 of the Disclaimer Under Nontestamentary Instrument Act of the State of Illinois (760 ILCS 25/1), I hereby irrevocably and unqualifiedly disclaim and refuse to accept any and all right, title, or interest I have in _____.

This Disclaimer shall be binding on me and all persons claiming through or under me.

Dated: _____, 20__

_____
[insert name of disclaimant**]**

Subscribed and sworn to before me this
_____ day of _____, 20__.

_____
Notary Public

ACKNOWLEDGMENT OF RECEIPT

The undersigned hereby acknowledges receipt of the above Disclaimer.

Dated: _____, 20__ **_____**

_____

3. [9.59] Disclaimer of Beneficial Interests in Trust

DISCLAIMER OF BENEFICIAL INTERESTS

TO: [Name of trustee**] as trustee of the [**name of trust**] Trust, dated [**date**] (the "Trust")**

This Disclaimer is executed by [name of executor**], of** town where executor resides**, Illinois, this [**date of filing**].**

WHEREAS, I am the sole lifetime beneficiary of the Trust, and at my death all of the assets and undistributed income of such Trust are to be distributed in continuing trusts for my descendants, per stirpes;

WHEREAS, (a) I have made no assignment, conveyance, encumbrance, pledge, sale, or other transfer of such property or any contract therefor; (b) I have not executed a written waiver of my right to disclaim such property; (c) I have not accepted any benefits from such property; and (d) there has not been a judicial sale of such property, in each case as of the date of this Disclaimer; [and**]**

[WHEREAS, I intend this Disclaimer to be a qualified disclaimer under §2518 of the Internal Revenue Code of 1986, as amended from time to time (the "Code").**]**

NOW, THEREFORE, pursuant to §2-7 of the Probate Act of the State of Illinois (755 ILCS 5/2-7) and §1 of the Disclaimer Under Nontestamentary Instrument Act of the State of Illinois (760 ILCS 25/1) [and the Code §2518**], I hereby irrevocably and unqualifiedly disclaim and refuse to accept any and all right or interest I now have or may have in the future in and to any portion of the property distributable to me under the Trust.**

This Disclaimer shall be binding on me and all persons claiming through or under me. I hereby sign this Disclaimer on the date first above written.

_____
[insert name of disclaimant**]**

Subscribed and sworn to before me this
_____ day of _____, 20__.

_____
Notary Public

ACKNOWLEDGMENT OF RECEIPT

The undersigned Trustee hereby acknowledges receipt of the above Disclaimer.

Dated: _____, 20__ **_____**

_____, trustee