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Claims Against a Decedent's Non-Probate Property in Illinois

BY JOEL A. SCHOENMEYER

Introduction

Article XVIII of the Illinois Probate Act[1] (the "Probate Act") addresses creditor claims in probate. However, Illinois statutes have historically had very little to say about the issue of claims against a decedent's **non-probate** property. (For purposes of this article, the term "non-probate property" means property that passes upon the decedent's death by means other than a probate court proceeding. Examples of non-probate property would include property passing (1) pursuant to the terms of the decedent's living trust ("living trust property"), (2) via a beneficiary designation, (3) by an account agreement, or (4) by operation of law.

In the near future, the treatment of a decedent's living trust property will be governed by the terms of the Illinois Trust Code[2] (the "Code"), which becomes

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Comparison of Citations for Certain Provisions of the Illinois Trusts & Trustees Act and the Illinois Trust Code

BY JANE DITELBERG

See page 7 for the full comparison chart of citations for certain provisions of the Illinois Trusts & Estates Act ("T&T Act") and Illinois Trust Code.

Claims Against a Decedent's Non-Probate Property in Illinois

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effective on January 1, 2020[3] (and which will then apply to all trusts created before, on, or after that date[4]). Part I of this article sets forth how the Code deals with claims against living trust property following the death of the person who created the living trust (known as the settlor).

The analysis for other types of non-probate property (which are not affected by the Code) depends on the nature of such property. Part II of this article details how non-probate property other than living trust property is treated under Illinois law for purposes of satisfying claims against a decedent.

Finally, Part III of this article discusses practical considerations for creditors who are faced with the death of their debtor and are attempting to reach the deceased debtor's non-probate property.

Part I: Living Trust Property and the Illinois Trust Code

Section 505(a)(5) of the Code addresses creditor claims against the deceased settlor of a living trust. This Section states that "the property of a trust that was revocable at the settlor's death is subject to claims…." The definition of "claims" used in this Section is fairly expansive – it includes "claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children…."

It is important to note that Section 505(a)(5) includes two ordering rules:

1. The Section applies only "to the extent the settlor's probate estate is inadequate to satisfy… claims, costs, expenses and allowances."
2. The Section is subject to "the settlor's right to direct the source from which liabilities will be paid." In other words, a decedent can by estate planning documents direct from where her or his debts, claims, etc. will be paid if her or his probate estate is inadequate to satisfy these amounts. For instance, these documents might direct payment from non-probate property other than living trust property, or from specific living trust property.

The language of Section 505(a)(5) is consistent with prior Illinois caselaw as it applies to living trust property during a settlor's life.[5] That caselaw is also codified under Section 505(a)(1) of the Code, which states that "[d]uring the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors to the extent the property would not otherwise be exempt by law if owned directly by the settlor."

The language of Section 505(a)(5) is also largely consistent with the language found in the Uniform Trust Code.[6] However, the Section adds some provisions to coordinate the treatment of post-death claims against living trust property with both the Probate Act and Illinois law generally, while reinforcing the general proposition that "[d]istributees of the trust take property distributed after payment of such claims." Those coordinating provisions are as follows:

(A) The personal representative who recovers living trust property must administer such property as a part of the decedent's probate estate.

(B) Liability created under Section 505(a)(5) does not apply to living trust property that is otherwise exempt from creditors under Federal or Illinois law, or to claims that would otherwise be barred against the settlor's estate.

(C) The claims classification and priority system set forth in the Probate Act[7] applies so long as "the personal representative or creditor or taxing authority of the settlor's estate has perfected its right to collect from the settlor's revocable trust."

While the language of the Code provides some welcome guidance to attorneys of creditors, it is important to understand

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Section 505(a)(5)'s focus on the settlor's probate estate as the conduit for reaching living trust property. This focus is reinforced by Section 505(a)(6) of the Code, which provides a release from liability for a trustee who makes a distribution from a trust that was revocable at the settlor's death, so long as two conditions are met: (1) the trustee makes the distribution 6 months or later after such death, and (2) "the trustee did not receive a written notice from the decedent's personal representative that the decedent's probate estate is or may be insufficient to pay allowed claims" (or such notice was received but later withdrawn or revoked). As I discuss in Part III of this article, this short 6-month timeframe (when combined with the focus on the settlor's probate estate) creates significant practical problems for creditors who wish to reach a decedent's living trust property.

Part II: Other Non-Probate Property

While Illinois has now passed the Code, it has not passed – and apparently has no plans to pass – the Uniform Probate Code, Section 6-102 of which[8] addresses the administration of claims against all types of non-probate property, allowing such property to be "clawed back" into a decedent's probate estate. Illinois instead forces practitioners to rely upon a hodgepodge of caselaw and statutes in dealing with non-probate property other than living trust property. As a result, the question of how (or even whether) a creditor may pursue a claim against such property can be a confusing one.

Governmental Claims

As an initial point, practitioners might assume all claims against a decedent's non-probate property are valid, as it is well-established that the government may collect against such property to satisfy a decedent's government-related debts, such as taxes.

For instance, at the federal level, Chapter 11 of the Internal Revenue Code ("I.R.C.") specifically subjects joint property[9] and life insurance proceeds[10] to the federal estate tax,[11] and envisions a situation where the recipient of non-probate property either has paid or is required to pay estate tax on property she or he has received.[12]

The Illinois Estate and Generation-Skipping Transfer Tax Act mirrors the Internal Revenue Code in terms of who must pay the tax,[13] and equitable apportionment (providing for the payment of taxes from both probate and non-probate property) is permitted in some cases.[14]

Illinois law also allows the state to seek reimbursement from an individual's non-probate property for amounts expended on the individual's behalf. Section 5-13 of the Illinois Public Aid Code indicates that amounts paid for the benefit of a person pursuant to that statute "shall be a claim against the person's estate or a claim against the estate of the person's spouse," and goes on to define "estate" (in certain situations involving long-term care insurance) to include the following:

> [a]ny… real and personal property and other assets in which the deceased person had any legal title or interest at the time of his or her death (to the extent of that interest), including assets conveyed to a survivor, heir, or assignee of the deceased person through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement.15

The Illinois Uniform Fraudulent Transfer Act

In order to reach a decedent's non-probate property other than living trust property, a creditor would generally need to employ Illinois's Uniform Fraudulent Transfer Act[16] ("UFTA") to set aside or render void certain transfers made by the decedent to the extent needed to satisfy the creditor's claim.[17] UFTA defines "transfer" broadly to include "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset…." [18] Its provisions would allow a creditor to bring a decedent's previously-transferred property back into her or his probate estate.

UFTA contains two different methods for proving a transfer to be fraudulent. To begin with, a transfer is considered fraudulent – regardless of whether the creditor's claim arose before or after the transfer – if the transfer was made:

(1) with actual intent to hinder, delay, or defraud any creditor[19]; or
(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor (A) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or (B) intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due.[20]

A transfer is also considered fraudulent (with respect to claims arising before the transfer only) if the transferor/debtor makes it "without receiving a reasonably equivalent value in exchange for the transfer… and the debtor was insolvent at that time or… became insolvent as a result of the transfer."[21]

Does the fact that a transfer would be deemed fraudulent under UFTA automatically mean a creditor can reach the transferred assets in order to satisfy a decedent's debts? Not necessarily, as property of a debtor is not an "asset" subject to UFTA if such property is exempt from judgment under other Illinois laws.[22] In addition, UFTA contains limitations periods, which extinguish a cause of action unless it is brought within four years after the transfer was made (or, in a case involving actual intent, upon the later of four years after the transfer was made and one year after the transfer was or reasonably could have been discovered by the claimant).[23]

The remainder of Part II of this article focuses on how UFTA might apply to different types of non-probate property after a debtor's death. In light of the above, practitioners must consider the following questions with respect to each different type of property:

- Does any other Illinois (or federal) law exempt the property in question from judgment?
- Was the decedent's transfer of the property a "transfer" as defined in UFTA and, if so, when did the transfer occur? (This is important for determining whether the limitations periods contained in UFTA prevent the property in question from being reached under UFTA.)

Life Insurance Proceeds

As mentioned above, UFTA defines "transfer" to mean "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset…."[24] On the surface, then, it would appear that a decedent's creditors could use UFTA to reach the proceeds of life insurance on his or her life, as such proceeds were indeed transferred by the decedent/insured to his or her beneficiaries at death. However, Illinois law reaches the opposite result.

To begin with, Illinois law has long exempted life insurance proceeds from creditors. The court in Vieth v. Chicago Title & Trust Co.[25] summarized the common law rule in 1940 by stating the following:

> [T]he proceeds of life insurance are not an asset even to the insured. In fact, they do not come into existence until after death. During life the insured could not by any suit recover the proceeds, and claim them as his own. The creditor can have no right where the insured possessed none.[26]

Additionally, the Illinois Insurance Code[27] and the Illinois Code of Civil Procedure[28] use identical language to exempt the following from the reach of an insured's creditors:

All proceeds payable because of the death of the insured and the aggregate net cash value of any or all life insurance and endowment policies and annuity contracts payable to a wife or husband of the insured, or to a child, parent, or other person dependent upon the insured, whether the power to change the beneficiary is reserved to the insured or not and whether the insured or the insured's estate is a contingent beneficiary or not….

In People ex rel. White v. Travnick[29], the Second District Court of Appeals stated that this statutory language "codifies the holdings of a long line of cases," including the Vieth case. At first blush, the statutory language appears somewhat ambiguous, as it is unclear whether the proceeds exemption applies to "[a]ll proceeds payable because of the death of the insured," regardless of the beneficiary's identity, or only to such proceeds as are "payable to a wife or husband of the insured, or to a child, parent, or other person dependent upon the insured." However, Illinois courts (including the Court in Travnick) have consistently ruled that the life insurance proceeds exemption applies regardless of the identity of the beneficiary of the proceeds.

The First District Court of Appeals's opinion in In Re Estate of Grigg[30] is illustrative of this point. The Grigg case involved a married man named Allen M. Grigg who purchased a $50,000 term life insurance policy and designated a Barbara Bronson (not his wife) as the beneficiary. Following her husband's death, Mrs. Grigg sought to have Ms. Bronson pay the debts of Mr. Grigg's estate from the insurance proceeds she received. Mrs. Grigg's argument was based on a reading of the Illinois Insurance Code language that "the exemption [on life insurance proceeds] for debts of the insured extends only to spouses of the insured or certain related persons dependent on the insured." [31] The Court in Grigg states that "[t]his is a novel argument," noting that "it does not appear that anyone has ever advanced the position of the petitioner in any reported case." [32] The Court goes on to reject the argument, relying instead on a 1934 case[33] as well as a 1937 law review article written by the chairman of the commission that drafted the Illinois Insurance Code.[34]

The Grigg case may represent the law in Illinois with respect to a creditor's ability to reach the proceeds of a decedent's life insurance, but the following three points are worth noting:

1. The Court in *Grigg* bases its holding in favor of Ms. Bronson not on Mrs. Grigg's interpretation of the above language, but on the fact that, even if her interpretation was correct, Mrs. Grigg still could not rely on the cited section of the Illinois Insurance Code for relief. This is because Section 238(a) of the Illinois Insurance Code applies only to "debts or liabilities of the insured," not to debts or liabilities of the insured's **estate**.
2. Interestingly enough, the trial court in this case ruled that Ms. Bronson **was** required to pay Mr. Grigg's **personal** debts from the insurance proceeds. Ms. Bronson did not appeal this ruling, so the First District Court of Appeals did not consider whether it was correct.[35]
3. Contrary to what the Court in Vieth said, life insurance can in fact function as an asset to the insured during his or her lifetime. As the United States Bankruptcy Court for the Central District of Illinois has observed, "[t]he validity of the common law principle that life insurance proceeds are not property of the insured is itself now subject to some doubt, in light of the advent of viatical settlements and accelerated death benefits…." [36]

That being said, even if we ignore the above cases, UFTA states that it "shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this Act among states enacting it." [37] And courts in a number of the states have ruled that life insurance proceeds are not "property" subject to the Uniform Fraudulent Transfer Act or its predecessor, the Uniform Fraudulent Conveyance Act.[38]

Joint Tenancy

As an initial point, it is important to note that this section only discusses the debts of a decedent, not debts that run with real estate, or that were taken on by all owners. Such situations are instead covered by Section 20-19 of the Probate Act, which states as follows:

When any real estate or leasehold estate in real estate subject to an encumbrance, or any beneficial interest under a trust of real estate or leasehold estate in real estate subject to an encumbrance, is specifically bequeathed or passes by joint tenancy with right of survivorship or by the terms of a trust agreement or other nontestamentary instrument, the legatee, surviving tenant or beneficiary to whom the real estate, leasehold estate or beneficial interest is given or passes, takes it subject to the encumberance and is not entitled to have the indebtedness paid from other real or personal estate of the decedent.

Contrary to this rule, the Illinois Supreme Court has stated – in its 1984 decision in *Harms v. Sprague*[39] – that the debt of one joint tenant does not survive that joint tenant's death. Harms involved a mortgage taken by one of two joint tenants (John Harms), who then subsequently died. The Illinois Supreme Court found that "[t]he property right of the mortgaging joint tenant is extinguished at the moment of his death. While John Harms was alive, the mortgage existed as a lien on his interest in the joint tenancy. Upon his death, his interest ceased to exist and along with it the lien of the mortgage." [40]

Tenancy by the Entirety Property

The same rule set forth above, by the Court in *Harms*, should also apply to tenancy by the entirety property. However, because of the creditor protection offered by tenancy by the entirety, this type of interest also raises potential issues involving fraudulent transfers.

The 2000 Illinois Supreme Court decision in *Premier Property Management, Inc. v. Chavez*[41] addressed the interplay between UFTA and the provision in the Illinois Code of Civil Procedure stating that "[a]ny real property… held in tenancy by the entirety shall not be liable to be sold upon judgment entered on or after October 1, 1990 against only one of the tenants." [42] The case involved a lawsuit filed against a man named Jose Chavez. Soon thereafter, Mr. Chavez "conveyed his interest in [his] residence from himself, as sole owner, to himself and his wife, as tenants by the entirety." [43]

The Illinois Supreme Court was forced into action because of a conflict between the First District and Second District Appellate Courts. The Second District had previously ruled that the protection afforded to tenants by the entirety applies regardless of whether the property in question was conveyed with fraudulent intent.[44] Meanwhile, the First District had stated (in a 1997 case titled *In re Marriage of Del Giudice*[45]) that a conveyance of property into tenancy by the entirety could be set aside if the conveyance was made with fraudulent intent.

After the *Del Giudice* case, the language of the Illinois Code of Civil Procedure mentioned above was amended to indicate that protection of tenancy by the entirety property does not extend to cases where "the property was transferred into tenancy by the entirety with the sole intent to avoid the payment of debts existing at the time of the transfer beyond the transferor's ability to pay those debts as they become due." [46] In *Chavez*, the Illinois Supreme Court held as follows:

The sole intent standard of the amended tenancy by the entirety provision is substantially different from the act intent standard of the Fraudulent Transfer Act. The sole intent standard provides greater protection from creditors for transfers of property to tenancy by the entirety…. The General Assembly, by adopting the sole intent standard, has made it clear that it intends to provide spouses holding homestead property in tenancy by the entirety with greater protection from the creditors of one spouse than that provided by the Fraudulent Transfer Act. Accordingly, the Fraudulent Transfer Act's actual intent standard is not to be used to avoid transfers of property made to tenancy by the entirety.[47]

This ruling makes it very difficult to attack transfers into a tenancy by the entirety, as the surviving spouse has only to provide one legitimate reason (besides avoidance of the payment of the debts of one spouse) why the transferor placed the property into tenancy by the entirety.

Retirement Benefits

The passing of an individual's retirement benefits upon his or her death might seem like a "transfer" falling under the purview of UFTA. However, both federal law and Illinois law prevent creditors from reaching a decedent's retirement benefits.

Federal law requires retirement plans that wish to qualify for favorable tax treatment under the Employee Retirement Income Security Act (commonly known as "ERISA") to mandate that "benefits… may not be assigned or alienated." [48] The United States Supreme Court has confirmed that this language prevents such benefits from being reached by creditors.[49]

Illinois law echoes federal law on this point, and in fact goes even further. ERISA applies only to employer-sponsored plans such as 401(k) and pension plans, but the Illinois Code of Civil Procedure exempts from the reach of creditors "[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," [50] and defines "retirement plan" broadly to include even retirement benefits (such as individual retirement accounts) that are not subject to ERISA.[51] Pension plans for government employees are also exempt from creditors.[52]

Payable on Death Accounts

"Payable on death" accounts are known by a variety of other names: POD accounts, transfer on death (or TOD) accounts, and "Totten trusts." These types of accounts, held at a bank or other financial institution, allow the account owner to designate a beneficiary to inherit the account upon the account owner's death. In that way, these accounts are similar in nature to life insurance and retirement benefits. But unlike life insurance and retirement benefits, no Illinois law exempts payable on death accounts from the reach of creditors. In fact, Illinois law clearly indicates the similarities between payable on death accounts and living trusts. For instance, under the Illinois Trust and Payable on Death Accounts Act,[53] an individual setting up a payable on death account has the right to (1) change the designated beneficiary or (2) withdraw all of any part of the account, in each case without giving notice to the current named beneficiary.[54]

The most well-known Illinois case involving payable on death accounts and creditors is *Montgomery v. Michaels*, a 1973 Illinois Supreme Court decision.[55] The *Montgomery* case involved a woman named Bernice D. Montgomery who, during her lifetime, established eight payable on death accounts, with her two children from a prior marriage as beneficiaries. Upon Mrs. Montgomery's death, her husband and administrator (Dr. Earl Montgomery) sought to have the accounts declared illusory and invalid as a fraud on his marital rights. The Supreme Court wound up agreeing with Dr. Montgomery, but for purposes of this article the Court's more interesting ruling involved the question of whether the payable on death account funds had to be used to pay for Mrs. Montgomery's funeral. The trial court had ruled that Mrs. Montgomery's funeral bill must be satisfied from the payable on death accounts, and the Illinois Supreme Court agreed:

In the event funds from other property are insufficient to pay debts and claims against the decedent's estate, then such trust funds are available for the payment of estate debts and can also be reached for the payment of the expenses of administering the estate if there is not sufficient other property for this purpose.[56]

The Court also cites with approval language from the Restatement (Second) of Trusts that creditors of an individual who establishes a payable on death account (the "depositor") can reach account assets after the death of the depositor.[57]

Part III: Practical Problems

Understanding whether a type of non-probate property is reachable by a decedent's creditors is important, but both the Code and the rest of the relevant Illinois law create practical difficulties for a creditor.

To begin with, how will a creditor learn that a debtor has died? And, assuming that a creditor does find out about a debtor's death, what is the appropriate mechanism for obtaining judgment?

A creditor's first and possibly best option is a probate proceeding. If no probate has been opened for the decedent's estate, a creditor could initiate a probate proceeding as follows:

1. Confirm whether a will of the decedent has been filed with the county clerk's office pursuant to section 6-1 of the Probate Act.[58]
2. If no will has been filed, then…
   (a) petition to open the estate (and set a hearing for same) pursuant to section 9-3 of the Probate Act, [59]
   (b) give notice as required by section 9-5 of the Probate Act,[60] and
   (c) appear in court on the hearing date to either open the estate or allow someone with priority under section 9-3 to open the estate.

Once the estate is opened, the creditor can begin a citation proceeding under Article XVI of the Probate Act to discover the nature and extent of the decedent's non-probate property.

If we are speaking specifically of living trust property, the language of Section 505(a)(6) of the Code creates a number of problems for creditors, most of which arise due to the 6-month period referenced in Part I of the article. As probate practitioners know, estates tend to move at their own pace, and that pace can be slower than some might expect. It takes time to learn of a decedent's death, to assess whether a probate estate should be opened (which depends on a full understanding of the value and titling of the decedent's assets, among other things), and to determine the nature and extent of the decedent's debts. This can be difficult for a decedent's family to handle in a 6-month period – for a non-family member, it verges on impossible. Nevertheless, the language of the Code puts creditors in a position where they must be extremely vigilant in order to protect their rights.

If probate proceedings have been initiated, the creditor should immediately file a claim against the decedent's estate, and initiate discussions with the executor or administrator regarding whether the decedent's probate assets are sufficient to pay it and other claims. If the probate assets are not sufficient, then the creditor should make sure the executor or administrator provides written notice to the trustee of the decedent's living trust of this fact. The creditor may in fact want to obtain a court order compelling the executor or administrator to provide this written notice.

If no probate estate has been opened, the creditor will need to open a probate estate as described above, and then file the necessary notice with the trustee of the deceased debtor's living trust. If the creditor is unclear on the existence of a living trust for the deceased debtor, then the creditor should initiate a citation proceeding to discover this information.■

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1. 755 ILCS §§ 5/18-1 et seq.
2. 760 ILCS §3/101 et seq.
3. 760 ILCS §3/9999.
4. 760 ILCS §3/1506.
5. See the Illinois Supreme Court's decision in *Rush University Medical Center v. Sessions*, 980 N.E.2d 45 (2012), which includes a detailed history of the rule – one with "a 500-year lineage" – that a spendthrift clause in a self-settled trust is void as to existing and future creditors of the trust's settlor.
6. Uniform Trust Code § 505 (2000).
7. 755 ILCS §§ 5/18-10.
8, Uniform Probate Code § 6-102 (1969, last amended 2010).
9. I.R.C. § 2040.
10. I.R.C. § 2042.
11. Additionally, property in which the decedent had an interest at death (such as living trust property) could be subject to estate tax pursuant to provisions such as I.R.C. § 2033, I.R.C. § 2036, and I.R.C § 2038.
12. I.R.C. §§ 2205 – 2206, 6324(a)(2).
13. 35 ILCS § 405/6(c).
14. See Schreder, "Even More Uncertainty about Estate-Tax Apportionment," 95 Ill. Bar J. at 306 (June 2007).
15. 305 ILCS § 5/5-13.
16. 740 ILCS § 160/1 et seq.
17. 740 ILCS § 160/8(a)(1).
18. 740 ILCS § 160/2(l).
19. 740 ILCS § 160/5(a)(1). UFTA also sets forth eleven so-called "badges of fraud" which can be used in cases involving allegations of actual intent. See 740 ILCS § 160/5(b).
20. 740 ILCS § 160/5(a)(2).
21. 740 ILCS § 160/6(a).
22. 740 ILCS § 160/2(b)(2).
23. 740 ILCS § 160/10.
24. 740 ILCS § 160/2(l).
25. 30 N.E.2d 126 (Ill. App. 1 Dist. 1940).
26. 30 N.E.2d at 130.
27. 215 ILCS 5/238(a).
28. 735 ILCS 5/12-1001.
29. 806 N.E.2d 270 (2004).
30. 545 N.E.2d 160 (Ill. App. 1 Dist. 1989).
31. 545 N.E.2d at 161.
32. 545 N.E.2d at 161.
33. *Gurnett v. Mutual Life Ins. Co. of New York*, 191 N.E. 250 (1934).
34. Havighurst, Some Aspects of the Illinois Insurance Code, 32 Ill. L. Rev. 391 (1937).
35. 545 N.E.2d at 161.
36. *In re. Ashley*, 317 B.R. 352, 356 n.2 (2004).
37. 740 Ill. Comp. Stat. § 160/12.
38. *See Great Southern Life Insurance Co. v. Agricultural Building Company Industries*, 2002 U.S. Dist. LEXIS 8194 (D. Minn. 2002), *citing Equitable Life Ins. Co. v. Hitchcock*, 258 N.W. 214, 216 (Mich. 1935) *and First Wisconsin Nat'l Bank of Milwaukee v. Roehling*, 269 N.W. 677, 680 (Wisc. 1937).
39. 473 N.E.2d 930.
40. 473 N.E.2d at 934.
41. 728 N.E.2d 476.
42. 735 ILCS § 5/12-112.
43. 728 N.E.2d at 479.
44. *E.J. McKernan Co. v. Gregory*, 643 N.E.2d 1370 (1994).
45. 678 N.E.2d 47.
46. 735 ILCS § 5/12-112.
47. 728 N.E.2d at 482.
48. 29 U.S.C. § 1056(d)(1).
49. *Patterson v. Shumate*, 504 U.S. 753 (1992).
50. 735 ILCS 5/12-1006(a).
51. 735 ILCS 5/12-1006(b).
52. See 40 ILCS5/9-228 (exempting county employee pension plans), 40 ILCS 5/7-217(a) (exempting municipal employee pension plans), 40 ILCS 5/3-144.1 (exempting police officer pension plans), 40 ILCS 5/14-147 (exempting state employee pension plans), and 40 ILCS 5/16-190 (exempting teacher pension plans).
53. 205 ILCS § 625/1-5.
54. 205 ILCS§ 625/4(a); 205 ILCS § 625/4(b).
55. 301 N.E.2d 465 (1973).
56. 301 N.E.2d at 468.
57. 301 N.E.2d at 468, quoting The Restatement (Second) of Trusts § 58, comment e (1959) ("… on death of the depositor if the deposit is needed for the payment of his debts, his creditors can reach it.").
58. 755 ILCS § 5/6-1.
59. 755 ILCS § 5/9-3.
60. 755 ILCS § 5/9-5. Of course, this assumes that the creditor can identify these individuals.

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Resignation	5/12	3/705
Savings Clause	5/19	3/814
Severance and Consolidation	5/4.24	3/417
Small Trust Termination	5/4.26	3/414
Taxes and Expenses	5/4,08	3/709, 3/805, 3/816
Total Return Trusts	5/5.3	3/1101
Transfer of Real Property	5/6.5	3/115
Trust for Disabled Beneficiary	5/15.1	3/509
Trustee Compensation	5/7, 205 ILCS 620/2-3	3/708
Vacancy/Successor Trustee	5/13, 5/14	3/704, 3/707, 3/812
Virtual Representation (who can represent)	5/16.1	3/301-3/307

Other Related Statutes Incorporated into ITC

Oral Trust	740 ILCS 80/9	3/407 but see 3/103(37)
Perpetuities	765 ILCS 305, 310	3/1401-3/1406
Powers of Appointment	760 ILCS 105, 765 ILCS 320-325	3/1301-3/1336
Spendthrift Exception for Child Support	735 ILS 5/2-1403	3/503
Trusts and Dissolution of Marriage	760 ILCS 35	3/605

Topic	**IL T&T Act Cite**	**IL Trust Code Cite**
Accountings	5/11	3/813.1, 3/813.2
Affiliated Investments	5/5.2, 205 ILCS 620/2-11	3/914
Applicability	5/3, 5/16.7	3/102, 3/1506
Certification of Trust	5/8.5	3/1013
Custody of Assets	5/9	3/809
Decanting	5/16.4	3/1201-3/1227
Definitions	5/2	3/103 and *passim*
Delegation to Co-trustee	5/4.10	3/703(e)
Delegation to Third Party	5/5.1	3/807
Directed Trusts	5/16.3	3/808
Eminent Domain/Partition	5/17	3/820
Facility of Payments	5/4.20	3/816(21)
Land subject to future interest	5/17.1	3/821
Lapse	5/5	3/1104-3/1113
Lapse of Withdrawal Right	5/16.2	3/508
Majority of Trustees Act	5/10	3/703(a)
Mutual Funds	5/5.2	3/914. 3/802(e)
Nominee Registration	5/6	3/819
Nonjudicial Settlement Agreements	5/16.1	3/111
Partial Invalidity/Liberal Construction	5/18	3/1502, 3/112
Pet Trusts	5/15.2	3/408
Powers of Trustee	5/4	3/815, 3/816
Prudent Investor Rule	5/5	3/900-3/912
Relations with 3d parties	5/8	3/1012
Reliance on Commissioner of Banks	5/21	3/1014
Representative for Minor or Disabled Person	5/15	3/301-3/307
Resignation	5/12	3/705
Savings Clause	5/19	3/814
Severance and Consolidation	5/4.24	3/417
Small Trust Termination	5/4.26	3/414
Taxes and Expenses	5/4,08	3/709, 3/805, 3/816(15)
Total Return Trusts	5/5.3	3/1101
Transfer of Real Property	5/6.5	3/115

Trust for Disabled Beneficiary	5/15.1	3/509
Trustee Compensation	5/7, 205 ILCS 620/2-3	3/708
Vacancy/Successor Trustee	5/13, 5/14	3/704, 3/707, 3/8
Virtual Representation (who can represent)	5/16.1	3/301-3/307

Other Related Statutes Incorporated into ITC

Oral Trust	740 ILCS 80/9	3/407 but see 3/1
Perpetuities	765 ILCS 305, 310	3/1401-3/1406
Powers of Appointment	760 ILCS 105, 765 ILCS 320-325	3/1301-3/1336
Spendthrift Exception for Child Support	735 ILS 5/2-1403	3/503
Trusts and Dissolution of Marriage	760 ILCS 35	3/605

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Illinois Trust Code Defined Terms

BY SUSAN T. BART

Term	Section
Action	§103(1)
Adverse Party	§1308(a)
Affiliate	§914(a)(1)
Affiliated Investment	§914(a)(2)
Animal Trust	§1223(a)(1)
Appointee	§1302(1)
Appointive Property	§1202(1); §1302(2)
Ascertainable Standard	§103(2)
Authorized Fiduciary	§1202(2)
Beneficiary	§103(3)
Beneficiary with a Disability	§1213(a)(1)
Best Interests	§1213(a)(2)
Blanket Exercise Clause	§1302(3)
Charitable Interest	§103(4)
Charitable Organizations	§103(5)
Charitable Purpose	§103(6)
Charitable Trust	§103(7)
Child	§503(a)
Community Property	§103(8)
Court	§1202(3)
Current Beneficiary	§103(9)
Decanting Power or The Decanting Power	§1202(4)
Determinable Charitable Trust	§1214(a)(1)
Directing Party	§103(10)
Discretionary Distribution	§504(a)
Discretionary Trust	§509(a)(1)
Distribution Trust Advisor	§808(a)(1)
Donor	§103(11)
Environmental Law	§103(12)
Excluded Asset	§1106(a)
Excluded Fiduciary	§808(a)(2)
Term	Section
Exclusionary Power of Appointment	§1302(4)
Expanded Distributive Discretion	§1202(5)
Fiduciary	§808(a)(3)
Fiduciary Capacity	§917(a)(3)
First Trust	§1202(6)
First Trust Instrument	§1202(7)
General Power of Appointment	§103(13)
Gift-in-Default Clause	§1302(5)
Governmental Benefits	§1213(a)(3)
Grantor Trust	§1219(a)(1)
Guardian of the Estate	§103(14)
Guardian of the Person	§103(15)
Impermissible Appointee	§1302(6)
Incapacity or Incapacitated	§103(16)
Income	§1105(2)
Instrument	§1302(7); §1403(b)
Internal Revenue Code	§103(17)
Interested Persons	§103(18)
Interest of the Beneficiary	§103(19)
Investment Trust Advisor	§808(a)(4)
Judicial Proceedings	§1506(2)
Jurisdiction	§103(20)
Legal Capacity	§103(21)
Limited Distributive Discretion	§1212(a)
Mandatory Distribution	§506(a)
Term	Section
Nongeneral Power of Appointment	§103(22)
Noncontingent Right	§1211(a)(1)
Nongrantor Trust	§1219(a)(2)
Nonjudicial Matters	§1506(3)
Paid	§1403(a)
Payments	§1403(a)
Permissible Appointee	§1302(8)
Person	§103(23)
Power of Appointment	§103(24)
Power of Withdrawal	§103(25)
Powerholder	§103(26)
Power	§808(a)(5)
Presently Exercisable Power of Appointment	§103(27)
Presumptive Remainder Beneficiary	§103(28)
Property	§103(29)
Protector	§1223(a)(2)
Qualified Beneficiary	§103(30)
Qualified Benefits Property	§1219(a)(3)
Qualified Perpetual Trust	§1403(c)

Reasonably Definite Standard	§1202(8)
Receiving	§1403(a)
Record	§1202(9); §1302(9)
Resources	§509(a)(2)
Revocable	§103(31)
Second Trust	§1202(10)
Second Trust Instrument	§1202(11)
Settlor	§103(32)
Sign	§103(33)
Special Needs Fiduciary	§1213(a)(4)
Term	Section
Special Needs Trust	§1213(a)(5)
Specific-Exercise Clause	§1302(10)
Spendthrift Provision	§103(34)
State	§103(35)
Successor Beneficiary	§1211(a)(2)
Taker in Default of Appointment	§1302(11)
Terms of the Trust	§103(36)
Terms of the Instrument	§1302(12)
Total Return Trust	§1101(a)
Trust	§103(37), §605(a)(3)
Trust Accounting	§103(38)
Trust Instrument	§103(39)
Trust Protector	§808(a)(6)
Trustee	§103(40)
Unascertainable Beneficiary	§103(41)
Unconditional	§1214(a)(2)
Unitrust	§1113(a)(1)
Unitrust Amount	§1113(a)(2)
Vested Interest	§1211(a)(3)

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You Can't Transfer What You Don't Own—Or Can You?

BY SHERWIN D. ABRAMS

Title to Phillip Alward's property in Moweaqua, Christian County, Illinois, was in a land trust at Chicago Title Land Trust Company. Chase Bank held a mortgage on the property, some 4 acres. In 2012, forgetting that title was in a land trust, Phillip signed and delivered a deed to the property to his son and his son's wife, Grant and Carrie Alward. Grant and Carrie agreed to pay the Chase mortgage. Three years later (2015), Grant and Carrie mortgaged the property to Jacob Holding of Ontario, L.L.C., a California limited liability company, to secure payment of $125,000.

In 2016, Phillip, as sole beneficiary of the land trust, directed Chicago Title to convey the property to him. The trustee did so, and Phillip immediately filed an action to quiet title. Phillip joined Jacob Holding, Grant, and Carrie (his son and daughter-in-law) as defendants in the quiet title action. Phillip contended that his 2012 deed to Grant and Carrie failed to convey title to them because Phillip did not then have title to the property; Chicago Title did. Furthermore, since Grant and Carrie had not obtained title, Phillip contended that their mortgage to Jacob Holding was void.

Grant and Carrie did not contest Phillip's lawsuit. They failed to appear and were defaulted. Jacob Holding and Phillip filed cross motions for summary judgment. The trial court granted Jacob Holding's motion and denied Phillip's motion. It was undisputed that Phillip fully intended to convey title to Grant and Carrie and that he had the power to direct Chicago Title to convey the property. Phillip simply forgot that he did not have title when he signed the deed. The trial court felt that it would be unjust to allow Phillip to regain title to the detriment of Jacob Holding. Thus, the court determined that the mortgage to Jacob Holding was a valid lien on the property.

This was a significant victory for Jacob Holding and its lawyer, who listed the victory on his firm's website as one of his signature achievements.

The victory was short-lived.[1] The appellate court reversed the judgment for Jacob Holding and remanded the case with orders to enter summary judgment for Phillip.[2] While seemingly unjust, the appellate court's decision was also seemingly technically correct. Cases have respected the separate existence of an Illinois land trust. The appellate court held that since Phillip did not have title, his deed to Grant and Carrie did not convey title. Or did it?

The deed from Phillip to Grant and Carrie is unusual. It was prepared by Grant, who is not a lawyer. The appellate court repeatedly referred to the deed as a quitclaim deed.[3] The deed is in fact titled QUIT CLAIM DEED, and it does state that Phillip "conveys, releases, and quit claims to" the grantees, but the deed also includes the following language: "Grantor does hereby grants (*sic*), bargain and sell all of Grantor's rights, title and interest in and to the above described property and premises to the Grantee(s)…". In its opinion the appellate court quoted that language from the deed but did not comment upon it. We will.

Deeds that include the magic words, "grant, bargain and sell," are referenced in Section 8 of the Conveyances Act.[4]

> In all deeds whereby any estate of inheritance in fee simple shall hereafter be limited to the grantee and his heirs, or other legal representatives, the words "grant," "bargain" and "sell," shall be adjudged an express covenant to the grantee, his heirs, and other legal representatives, to-wit: that the grantor was the owner of an indefeasible estate in fee simple, free from encumbrances done or suffered from the grantor, except the rents and services that may be reserved, and also for quiet enjoyment against the grantor, his heirs and assigns unless limited by express words contained in such deed; and the grantee, his heirs, executors, administrators and assigns, may in any action, assign breaches, as if such covenants were expressly inserted: Provided, always, that this law shall not extend to leases at rack-rent, or leases not exceeding 21 years, where the actual possession goes with the lease.[5]

Such a deed is commonly known as a grant deed or a deed of bargain and sale; and it is essentially equivalent to a special warranty deed. Use of the words "grant, bargain and sell" creates a warranty that the grantor himself has not done or suffered anything to create a lien on the property. *Prettyman v. Wilkey*[6] ("These words are held to amount only to a covenant that the grantor has done no act, nor created any incumberance, whereby the estate granted by him could be defeated. In other words, to a covenant only against his own acts.")

So what does this have to do with Phillip's quiet title action? When he signed and delivered his deed to Grant and Carrie, Phillip did not have title to the property so his deed did not convey it. True, but here's the rub. Such a deed conveys after-acquired title. *Taylor v. Kearn*[7]; *King v. Gilson's Adm'x*[8] ("In the case of *D'Wolf v. Haydon,* 24 Ill., 525, it was held, that the words, "grant, bargain, sell," contained in a deed, being a statutory covenant, is sufficient to enable a subsequently acquired title to inure to the grantee.").

Immediately before he filed his action to quiet title, Phillip directed Chicago Title to convey the property to him. Presumably, Phillip did this in order to give him standing to sue; but that could have been a costly mistake. When Phillip acquired title, his after-acquired title inured to the benefit of the persons to whom Phillip had conveyed: Grant and Carrie. As soon as Phillip acquired title, so did Grant and Carrie.

The day after the *Alward* opinion was published on the supreme court's website we emailed counsel for Jacob Holding, cited Section 8 of the Conveyances Act, and asked whether the nature of Phillip's deed to Grant and Carrie had been made an issue in the lawsuit. We have not yet received a reply. There is no mention in the appellate court's opinion of the Conveyances Act or of after-acquired title.

But suppose that Grant and Carrie had appeared in the quiet title action and asserted their after-acquired title. How would that help Jacob Holding? After all, Grant and Carrie did not have title when they signed the mortgage to Jacob Holding. Did their after-acquired title inure to the benefit of Jacob Holding? Yes, because their mortgage states that the mortgagors "hereby mortgage and warrant… the real estate…". Use of the word "warrant" causes a mortgagor's[9] after-acquired title to inure to the benefit of the mortgagee. As the court explained in *Tompkins State Bank v. Niles*:[10]

> The after-acquired-title doctrine can be applied to mortgages as well as to conveyances by warranty deed, when the mortgage instrument contains covenants of title. A mortgage which contains the words "and warrants" has been held to be equivalent to a mortgage containing all covenants of title. When such a mortgage is given, title subsequently acquired by the mortgagor inures to the benefit of the mortgagee, and the mortgagor is estopped from denying that he had title at the time the mortgage was executed. *(Internal citations omitted).*

Apparently, Phillip was not satisfied that Grant and Carrie failed to contest his quiet title action. In 2018, two years after suit was filed, Grant and Carrie conveyed whatever interest they may have had in the property to Phillip. This time their quitclaim deed did not include the magic words, grant, bargain, and sell. This time the deed was not prepared by Grant. This deed was prepared by a lawyer: the very same lawyer who was then representing Phillip in the lawsuit.

The equities in the case *as reported* certainly lie with Jacob Holding, but perhaps we need not have too much sympathy for that company. Public records suggest that Jacob Holding is owned by Edvin Ovasapyan, as is Mainspring Distribution LLC, a Pennsylvania limited liability company. The mortgage to Jacob Holding states that it was prepared by the California law firm of Silverman & Milligan LLP. Stephen Silverman is the lawyer who organized both Jacob Holding and Mainspring. On September 5, 2019 a federal grand jury in San Francisco returned a superseding indictment[11] charging Messrs. Ovasapyan and Silverman for their respective roles in an alleged scheme to defraud purchasers of prescription drugs sold by Mainspring. The indictment claims that Mainspring earned more than $70 million from the allegedly illicit sales.

Curious about the defendant's unusual name, Jacob Holding of Ontario LLC, a California limited liability company? Indicted along with Messrs. Ovasapyan and Silverman was Hakob Kojoyan of Los Angeles. Hakob is a conjugate of Jacob; and while Ontario is a province in Canada, it is also the name of a city in California, some 35 miles east of Los Angeles.

Other Deeds

Sections 9[12] and 10[13] of the Conveyances Act describe other statutory forms of deeds: warranty and quitclaim, respectively. A deed that states that the grantor "conveys and warrants" includes the grantor's assurance that the grantee is receiving title free of any encumbrance, except those expressly stated in the deed, not just free of encumbrances made or suffered by the grantor. Such a deed conveys after-acquired title.

A deed that states that the grantor "conveys and quitclaims" includes no assurance of title. The grantee receives whatever title the grantor held. It is often said that a quitclaim deed does not convey after-acquired title, but that is not quite accurate. A quitclaim deed will convey after-acquired title if words are added expressing an intention to do so.

Practice Pointer

When engaging in estate and gift planning, do not rely on your client to tell you what property he/she owns or how title is held. Check it out.■

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1. As of November 16, 2019, their victory in the trial court is still touted on the law firm's website. No mention is made of the loss in the appellate court.
2. *Alward v. Jacob Holding of Ontario L.L.C.*, 2019 IL App (5th) 180332 (Sept.13, 2019).
3. 32 times!
4. 765 ILCS 5/.
5. 765 ILCS 5/8.
6. 19 Ill. 235, 242 (1857).
7. 68 Ill. 339 (1873).
8. 32 Ill. 348, 348–53 (1863).
9. The appellate court referred to each of Chase Bank and Jacob Holding as a mortgagor. They were not mortgagors; both were mortgagees. The terminology can be confusing. A mnemonic device is to think of borrower and payee: borrower = mortgagor; payee = mortgagee.
10. 127 Ill. 2d 209, 217–18 (1989).
11. Northern District of California, Case No. 3:18-cr-00533-RS.
12. 765 ILCS 5/9.
13. 765 ILCS 5/10.

The Illinois Trust Code: What Is It and What Do I Need to Know? Part 5 – Creditor Rights, Spendthrift Provisions, & Disabled Beneficiaries

BY MICHAEL J. FLECK

Introduction

This is the fifth in a series of practical articles that break down the recently enacted Illinois Trust Code. Part Five covers Articles V, Creditor Rights, Spendthrift Provisions, and Discretionary Trusts. It will also address how to deal with disabled beneficiaries.

Creditor's Claims

It is well settled that Illinois trust law does not afford creditor protection of self-settled trusts.[1] This does not change under the Trust Code. "… [T]o the extent a beneficiary's interest is not subject to a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The court may limit the award to such relief as is appropriate under the circumstances."[2]

Other states do recognize Domestic Asset Protection Trusts (DAPTs), which do allow a self-settled trust to protect against creditors under certain circumstances set forth under state statute.[3]

This rule is subject to Section 504 (Discretionary Distributions). What is a discretionary distribution? A discretionary distribution is a distribution to a beneficiary that is subject to the trustee's discretion regardless of whether the discretion is expressed in the form of a standard of distribution and regardless of whether the trustee has abused the discretion.[4] The Code states that '[R]egardless of whether a trust contains a spendthrift provision, and regardless of whether the beneficiary is acting as trustee, if a trustee may make discretionary distributions to or for the benefit of a beneficiary, a creditor of the beneficiary, including a creditor described [*under the spendthrift provision of Section 503*], may not: (1) compel a distribution that is subject to the trustee's discretion; or (2) obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary, except as provided in Section 2-1403 of the Code of Civil Procedure.[5] This section goes on to state that "[i]f the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee."[6]

As for creditor's claims against the settlor, Section 505 expressly makes it clear that settlor's assets are subject to creditor's claims against the settlor as follows:

Revocable Trusts - During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors to the extent the property would not otherwise be exempt by law if owned directly by the settlor.[7]

Irrevocable Trusts - a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.[8] Notwithstanding that provision, the assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal that is payable by the settlor under the law imposing the tax. 760 ILCS 3/505 (a) does not apply to the assets of an irrevocable trust established for the benefit of a person with a disability that meets the requirements of 42 U.S.C. 1396p(d)(4) (*i.e. special needs trusts*) or similar federal law governing the transfer to such a trust.[9]

After the Settlor's death – Section 505 (a)(5) incorporates Probate Act provisions with respect to creditor's claims of a decedent. Upon the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, *the property of a trust that was revocable* at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances.[10] Distributees of such trusts take after the satisfaction of such claims, on certain conditions set forth in this section, and referencing creditor's claims in the Probate Act. (*emphasis added*)

There is no benefit to withholding mandatory payments (such as income paid at least quarterly). The reason for this is had the mandatory payments been properly made per the trust language, the amount of the payment would no longer be in the trust, and therefore not subject to creditor protection. "[A] creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, including a distribution upon termination of the trust, if the trustee has not made the distribution to the beneficiary within a reasonable time after the designated distribution date."[11] But it may be beneficial to lapse, release, or waive a power to withdraw: "A beneficiary of a trust may not be considered to be a settlor or to have made a transfer to the trust merely because of a lapse, release, or waiver of his or her power of withdrawal to the extent that the value of the affected property does not exceed the greatest of the amounts specified in Sections 2041(b)(2), 2514(e), and 2503(b) of the Internal Revenue Code."[12]

Spendthrift Trusts

Illinois has long recognized spendthrift provisions in trusts with respect to non-settlor beneficiaries. 735 ILCS 5/2-1403 states that no judgment shall be satisfied out of any property held in trust for the judgment debtor if the trust has, in good faith, been created by or if the funds held in trust have come from a person *other than the judgment debtor*. (emphasis added). The Trust and Trustees Act (to be repealed upon the effective date of the Trust Code) references spendthrift provisions as well. [13]

In order to have a valid spendthrift provision for a non-settlor beneficiary, it is critical to ensure that the beneficiary's interest prohibits both voluntary and involuntary transfers. But this can be simply accomplished by stating that the beneficiary's interest is subject to a "spendthrift trust", or words of similar import, as this is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest. A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided, a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary. This does not affect the exercise of a power of appointment.[14]

Disabled Beneficiaries

Section 509 covers trusts for beneficiaries with disabilities. It uses two definitions specific to this section. Under Section 509, a "Discretionary trust" means a trust in which the trustee has discretionary power to determine distributions to be made under the trust. "Resources" includes, but is not limited to, any interest in real or personal property, judgment, settlement, annuity, maintenance, support for minor children, and support for non-minor children.[15]

"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, is not liable to pay or reimburse this 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, except that this exception does 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."[16] Note that this is consistent with current trust law. Third party trusts, properly drafted, remain out of reach of public assistance creditors. Trusts using the disabled beneficiary's funds or under the control of the disabled beneficiary, remain subject to Medicaid spend down requirements and look-back rules.[17]

Finally, under Section (C), the court or a disabled person may irrevocably assign resources of the disabled person to either or both of an ABLE account[18] or a discretionary trust that complies with the federal law.[19]

Up Next:

The Trustee (Article VII) and Trustee Duties (Article VIII); Prudent Investor Rules (Article IX); Trustee Liability and Rights of Others (Article X). ■

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1. See, 735 ILCS 5/2-1403, and *Rush Univ. Med. Ctr. v. Sessions*, 980 N.E.2d 45, 53 (2012) "Illinois law allows execution by a creditor against assets held in a self-settled trust and that the General Assembly thereby intended to preserve the common law trust rule."
2. 760 ILCS 3/501.
3. DAPT Trust states include Alaska, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. Other states have Colorado and Missouri have more creditor protection than Illinois. Note that Illinois has *some* creditor protection such as Tenants by the Entirety, See, 735 ILCS 5/12-112 and 765 ILCS 1005/1c.
4. 760 ILCS 3/504 (a).
5. 760 ILCS 3/504 (b).
6. 760 ILCS 3/504 (c).
7. 760 ILCS 3/505 (a) (1).
8. 760 ILCS 3/505 (a) (2).
9. 760 ILCS 3/505 (a) (3) and (4).
10. 760 ILCS 3/505 (a) (5).
11. 760 ILCS 3/506 (b).
12. 760 ILCS 3/508.
13. 760 ILCS 5/16.1.
14. 760 ILCS 3/502.
15. 760 ILCS 3/509 (a).
16. 760 ILCS 3/509 (b).
17. See, e.g. 42 USCS § 1396p (d) (4) (A), (B), and (C) (Payback, "Miller", and Pooled Trusts).
18. 15 ILCS 505/16.6.
18. 760 ILCS 3/509 (c).

IRAs and Estate Planning

BY ALYX P. DURACHTA

IRAs and other retirement vehicles can be confusing and complex; inheriting such assets, even more so. Below, I will explore various methods to transfer a participant owner's IRA after death.

What do I do with my IRA after I die? A seemingly simple question from a client can open a can of worms. The understanding and awareness of the spousal rollover is fairly common. What happens when there is no surviving spouse, or the spouse chooses not to rollover? Now we are getting into uncharted territory. Do you advise clients to name beneficiaries directly, name their revocable living trust as beneficiary, or create an IRA trust? The deeper you dive in, the more glazed over the client's eyes begin to become. It doesn't have to be that convoluted or confusing for a client. If you start with a question regarding a client's estate planning goals, the makeup of their family, and how much "dead hand" control they would like to have, you can begin to build a roadmap and determine the best planning vehicle. Simple fact finding can go a long way.

Many clients do not realize that the distributions from an inherited IRA are considered taxable income to the recipient.[1] This can have detrimental implications on an unknowing beneficiary. Additionally, inherited IRAs may be accessible by creditors.[2] The U.S. Supreme Court, in 2014, unanimously held that inherited IRAs are not "retirement funds" within the meaning of bankruptcy law, and therefore are not protected from creditors in bankruptcy.[3]

So, what do we do? What does a beneficiary do with an inherited IRA? The Internal Revenue Code ("IRC") provides that a non-spouse beneficiary may stretch out the Required Minimum Distribution ("RMD") over the beneficiary's lifetime, if the proper steps are taken.[4] Below, I will explore three different avenues in naming beneficiaries on one's IRA.

Naming Beneficiaries Outright

Naming beneficiaries outright is likely the most common and simplest avenue for IRA owners. A participant owner simply fills out a beneficiary form, and the deed is done. The upside to this is that naming a beneficiary outright ensures an IRA stretch over the beneficiary's lifetime, kind of.[5] When an individual inherits an IRA in this way, that beneficiary has the ability to liquidate the asset and take a lump sum. Typically, no tax advice is included in the forms that beneficiaries receive, and it will be on the beneficiary to seek such advice. The tax implications of doing so can be crippling, and an ill-advised beneficiary may not realize the tax implication until he/she receives a 1099 from the IRA custodian the following January.

Another pitfall of naming beneficiaries outright is the potential of leaving no designated beneficiary at all. If the named beneficiaries and contingent beneficiaries are deceased, the IRA becomes a part of the decedent's estate. In this instance, the IRA must be paid out in full within five years after the death of the participant owner if the participant dies before turning 70.5, or based on the participant owner's remaining life expectancy if the death occurs after the owner turns 70.5.[6]

Naming a Revocable Living Trust

In order to achieve the stretch benefits, a designated beneficiary of an IRA must be named.[7] That being said, a designated beneficiary must be an individual, and a trust is not an individual. Naming a revocable living trust ("RLT") as the beneficiary of an IRA may still ensure the stretch provisions, so long as the trust is a "see-through" trust. A see-through trust "sees through" non-individuals (ie. the trust), and treats the beneficiaries of the trust as though they were directly named as beneficiaries of the IRA. The eldest beneficiary's life expectancy will be used to determine the RMD, unless properly segregated. If the beneficiaries are of similar age, this will have little impact, but if the age differences in beneficiaries is significant, this can be detrimental to the younger beneficiaries.

In order for an RLT to be considered a see-through trust, the trust must comply with the following[8]:

The trust must be valid under state law;

1. The trust must be irrevocable, or will, by its terms, become irrevocable upon the death of the IRA owner;
2. The beneficiaries of the trust must be identifiable, with respect to the trust's interest in the IRA participant owner's retirement funds, and;
3. The trust document must be provided to the IRA custodian/plan administrator by October 31 of the calendar year immediately following the death of the IRA owner.

In addition to the above-mentioned requirements, no IRA funds may be used for estate administration costs. It is typical for an RLT to contain language stating that the trustee may or must pay for estate administration costs for the grantor decedent.

Drafting and administration pitfalls may occur when naming an RLT as the beneficiary of an IRA. For example, just as the name indicates, an RLT can be amended or revoked during the grantor's lifetime. If an unknowing planner drafts changes to a trust, removing such see-through provisions, the RLT will fail as a designated beneficiary, and the maximum stretch benefits will be lost. Furthermore, the custodian of an IRA may have its own policies and procedures concerning the payout of an IRA. Even if an RLT conforms with tax regulations, IRA custodians may still refuse to comply with the stretch provisions. A ruling from the IRS may be necessary to compel the custodian to comply with the stretch provisions, which could cost thousands of dollars. Such a ruling would not be worth the cost in many situations. In addition to the above-mentioned pitfalls of naming an RLT as the beneficiary of an IRA, the same detrimental tax implications apply to beneficiaries who decide to take the inherited IRA in a lump sum. On the other hand, by naming an RLT as the beneficiary, there is a middle-man (the trustee) who may be in the position to advise the beneficiary on the repercussions of taking the IRA in a lump sum.

Standalone IRA Trusts

The final planning vehicle for review is the stand-alone IRA trust. Clients often prefer to name their children as their trustee of their RLT. Due to the aforementioned deadlines and complexities of naming a trust as the beneficiary of an IRA, an unknowing trustee, such as an adult child, may distribute an IRA improperly, thus resulting in unwanted consequences. Using a separate stand-alone trust gives clients the freedom to name their children as trustees of their RLT, while also naming a more credentialed professional as the trustee of their IRA trust. Additionally, by creating a stand-alone IRA trust, administration provisions are more likely to be clearly laid out to help ensure that the IRA will be distributed properly.

Proposed legislative changes may change the course of this entire conversation. On May 23, 2019, the House passed the SECURE (Setting Every Community Up for Retirement) Act.[9] This proposed law would affect the IRA rules regarding the stretch provisions by requiring the inherited IRA to be paid out over a 10-year period. This could potentially bump beneficiaries into a new tax bracket, and have detrimental effects on this wealth accumulation vehicle.

Each of the above-mentioned distribution methods for an IRA has both its promises and pitfalls. That being said, there is not a one size fits all estate planning method for IRAs, but keeping up-to-date on the law and understanding the client's wishes will help practitioners devise a plan that best suits the client's needs and interests.■

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1. 26 CFR §402(a).
2. See *Clark et ux. v. Rameker*, 573 U.S. 122 (2014).
3. *Id.*
4. IRC §401(a)(9)
5. *Id.*
6. 26 CFR §1.401(a)(9)-4, A-3; 26 CFR §1.401(a)(9)-5, A-5(a)(2).
7. 26 CFR §402(c)(11)(A).
8. 26 CFR §1.401(a)(9)-4, A-5(b).
9. H.R. 1994, Title IV Sec. 401(a)(1)(H)(iii).