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ILLINOIS STATE BAR ASSOCIATION

TRUSTS & ESTATES

The newsletter of the Illinois State Bar Association's Section on Trusts & Estates

Congress may be frozen, but the Supreme Court is acting!

By Phil E. Koenig

Normally, the activity of the United States Supreme Court and the Illinois Supreme Court has little effect on the work of trust and estate lawyers. In 2009, however, there were three decisions of note; one by the U.S. Supreme Court and two by the Illinois Supreme Court that are of significance and importance to trust and estate lawyers.

The United States Supreme Court decided *Kennedy* v. *Plan Administrator for DuPont, 555 U.S.* 129 S. *Ct.,* 865, 172 *L.Ed2d* 662 *(2009),* which extended previous holdings of the Supreme Court on issue of the obligation, if any, of a Plan Administrator to consider documents other than Plan documents in making distribution of Plan assets.

William Kennedy participated in DuPont's Savings and Investment Plan (SIP), a 401k Plan, as an employee of DuPont. In 1974, he named Liv Kennedy, his spouse, as the beneficiary to receive his benefits under such Plan. In 1994, when Liv and William were divorced, the judgment for divorce provided that Liv "is ... divested of all right, title, interest and claim in and to ... any and all sums ... proceeds [from] and any other rights related to any ... retirement plan, pension plan or like benefit program existing by reason of [William's] past, present or future employment." William never changed his beneficiary designation on his SIP following his divorce from Liv; he did change the beneficiary designation on his pension. When he died in 2001, DuPont paid the bal-

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Estate tax or not: Reasons your clients still need estate planning

By Jodie E. Distler Hanzlik[1]

The 2010 estate tax "repeal" has not gone unnoticed by most attorneys and certainly has been the subject of intense scrutiny, dialogue and debate among tax planning professionals. By way of summary, in 2001, the U.S. Congress passed legislation which put in place the current estate, generation-skipping transfer ("GST") and gift tax law. Under this legislation, the estate and GST tax exemption gradually rose (and tax rates declined), reaching a peak exemption of $3.5 million and tax rate of 45 percent. The lifetime gift tax exemption remained constant at $1 million. The 2001 legislation also was scheduled to "sunset" in 2010, meaning that the changes to the transfer tax law that the 2001 legislation put in place would expire in 2010. Therefore, beginning January 1, 2010, the estate and GST tax are no longer applicable. However, the estate tax repeal is, at most, a temporary event which will end abruptly on December 31, 2010. As of January 1, 2011, without further action by Congress, the law as in effect prior to the 2001 legislation snaps back into place with an estate tax exemption and GST tax exemption of $1 million.

Practitioners have been inundated with

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Congress may be frozen, but the Supreme Court is acting!

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ance of his account, some $400,000, to Liv.

William's daughter, Kari Kennedy, as executor of William's estate, sued DuPont and the Plan Administrator, claiming that the divorce judgment was a valid and enforceable waiver of the SIP benefits and that by distributing the assets to the former spouse, the Plan Administrator had violated ERISA, even though the administrator had paid the benefits out in accordance with the Plan documents, as required by ERISA, 29 U.S.C. §1002(8) and §1104(a)(1)(D).

The District Court granted the estate Summary Judgment for the amount of money that DuPont paid to Liv, holding that the divorce judgment constituted a valid waiver and that there was no need to prepare a QDRO in order to invalidate the previous beneficiary designation. The District Court's ruling was based on a series of Fifth Circuit cases that held a written waiver of group term life insurance that is not a part of the Plan documents and is a part of a divorce judgment was binding on the named beneficiary.

The Fifth Circuit Court reversed the Trial Court, observing that the cases on which the Trial Court based its decisions were cases that affected distribution of benefits from welfare plans, the benefits of which are not affected by a QDRO. Rather, the SIP Plan was a pension plan as defined in 26 U.S.C. §1002(1) and the benefits therefrom are subject to the anti-alienation provisions of ERISA, 26 U.S.C. § 1 056, which limits alienation or assignment of benefits by the covered employee to instances where a QDRO is provided. The Supreme Court affirmed the Fifth Circuit Court of Appeals and by so doing resolved a conflict between the circuits. However, the Supreme Court did not adopt the analysis of the Fifth Circuit Court. The Supreme Court held that a waiver, like a disclaimer, is not alienation. It is a refusal and therefore not void under 26 U.S.C. §1056(d)(1) as an effort to alienate an interest in an ERISA Plan that does not qualify as a QDRO.

In making its decision, the Supreme Court rejected other arguments made by the Plan Administrator, even though the Court ultimately held for the Plan Administrator. First, the Court held that it makes no difference that the waiver made was either a waiver or an ineffective Domestic Relations Order. Second, that the waiver was not a QDRO is not by itself determinative of the question of its validity. Third, it is not the existence of the preemption policy that makes the waiver invalid because such a waiver could be countenanced by Federal Common Law.

Rather, the Court held that the basis for determining the waiver to be invalid is that ERISA requires that a Plan be administered in accordance with its written terms (29 U.S.C. §1102(a)(1)) that specify the basis by which payments are to be made by the Plan. A claim to Plan benefits "stands or falls" by the terms of the Plan, so that employers can establish a uniform administrative scheme for processing claims. The Court cited its previous decision in *Egelhoff v. Egelhoff,* 532 *U.S. 141, 121 S.Ct.* 1322, 149 *L.Ed2d* 264 *(2001).* The policy of ERISA is that an administrator is not supposed to consider the legal effect of any document other than the provisions of the Plan in question. In so holding, the Court recognized that their holding still leaves occasions where the policy of adhering only to Plan terms will not eliminate all disputes over entitlement.

The complicated analysis of the Court eliminates concerns as to whether non-Plan documents must be considered in determining the proper payee of welfare benefits where use of a QDRO is not applicable (see *Melton v. Melton,* 324 *F.3d* 941 *(CA7-2003)* or where State law automatically nullifies a beneficiary designation following divorce. Entitlement to Plan benefits is to be determined or based solely upon Plan documents in an effort to streamline and reduce the cost of Plan administration.

This decision overrules part of the holdings contained in two 7th Circuit decisions. *Fox Valley v. Brown,* 897 *F.2d* 275 (7" *Circuit, 1990)* and *Melton v. Melton,* 324 *F.3d* 941 *(2003)* both of which cases held that a designated beneficiary could effectively waive Plan benefits with a non Plan document.

This holding makes clear the importance of being certain that all Plan beneficiary designations should be reviewed as a part of the estate planning process. Doing so is of great importance because the apparent policy seeks to eliminate litigation to determine the legal effect documents that are not part of a Plan.

The Illinois Supreme Court provided two decisions of note; one in September and one in October, neither of which have official citations. In *Estate a/Feinberg, __Ill.2d __, ____ NE.2d , Ill. Dec. (2009),* resolved a question as to whether entitlement to benefits can be conditioned on a beneficiary's religious practices and held that Will and Trust clauses conditioning entitlement to estate benefits on the basis of a religious preference does not always violate public policy.

The Decedent made a Will and Trust making his surviving spouse a lifetime beneficiary of his estate and providing that upon her death, 50 percent of the corpus was to be held for the benefit of descendants of his children. Further, the Trust provided that any descendant who married outside the Jewish faith and whose spouse did not convert to Judaism within one year of marriage would be deemed to died as of the date of the marriage. The Trust gave Decedent's surviving spouse a testamentary power of appointment. Decedent's wife exercised her power of appointment giving a share of Decedent's trust to grandchildren who were not deemed to be deceased under Decedent's trust. Only one of five grandchildren met the entitlement provision.

One of the disgruntled grandchildren brought suit seeking declaration that requirement of marrying with the Jewish faith violated public policy. The Trial Court invalidated the relevant restriction. The Appellate Court affirmed the holding that the provision was invalid because it limited the "rights of an individual to marry a person of his or her own choosing."

The Supreme Court reversed both the Trial Court and the Appellate Court and held that there were two competing interests to resolve:

1. The public policy regarding the freedom of testation, and
2. The public policy relating to restraints on marriage.

Further, the Court emphasized that it does not set or make public policy; it discerns public policy from the State's Constitution statutes and long-standing decisional law.

In considering the breadth of the policy of freedom to give one's property to whom one

desires, the Court stated that the grandchildren had no protected right to inherit from their grandparents. After considering the Probate Code, the Trust and Trustees Act, the Statute Concerning Perpetuities and the abolition of the Rule in Shelley's case, the Court stated that the law protects the right to give away one's property with a minimum of restrictions. It emphasized the testator's right to encourage adherence to the family faith while living, including the right to condition gifts of money on condition of upholding the family faith.

In considering the policy regarding terms that affect marriage or divorce, the Court examined three cases cited as authority by the Appellate Court, *Ransdell v. Boston,* 172 Ill. 439 (1898); *Winterland v. Winterland,* 389 *Ill.* 384 (1945) and *Estate of Gerbing,* 61 Ill.2d 503 (1975).

In reviewing the *Ransdell* decision, the Court noted the distinction made by the Court in *Ransdell* between a condition of entitlement or condition precedent and a condition subsequent which divests one's property rights following vesting. A condition divesting one of property if he married or one that encouraged divorce was void as being against public policy. A condition precedent or condition of entitlement is not against public policy.

The Court reviewed the *Winterland* decision which held void a condition that property be held in trust for a beneficiary until his wife and he were divorced or his wife died. Such a provision was held to stimulate a breakup of the marriage and was thereby void.

Similarly, it reviewed the *Gehrt* decision which considered the validity of a clause that would terminate a trust for a son and distribute the corpus of the trust to him if his wife died or if he and his wife were divorced and remained so for two years. The Court observed that this provision also encouraged divorce and thereby violated public policy.

Comparing these decisions to the case before it, the Court held that because there was no incentive to divorce one's spouse in the subject provision, it did not violate public policy. Further, the clause's effect was not to divest a previously vested interest. The interests in favor of the grandchildren were not vested when the Decedent's widow exercised her power of appointment. Their interests were a mere expectancy.

The second case of interest decided by the Illinois Supreme Court was handed down in October of 2009. *Estate of Ellis* determined that the six-month statute of limitation for bringing a Will contest (755 ILCS 5/8-1) does not necessarily limit the time for bringing an action for tortuous interference with an inheritance expectancy.

The Decedent executed a Will in 1964 naming Shriners Hospital for Children as the beneficiary of her estate. In 1999, the Decedent changed her Will, giving her entire estate to her minister, Bauman. When the Decedent died in 2003, her amended Will was admitted to probate and Bauman was appointed independent executor of the Decedent's Will. In 2006, Shriners became aware of the 1964 Will when Bauman filed the 1964 Will in Court as a part of a Will contest brought by heirs of the Decedent. Shriners brought suit alleging several instances of undue influence. Decedent met Bauman in 1994, when she became a member of the church where Bauman was pastor. As she declined in health, Decedent named Bauman her agent under powers of attorney. She gave Bauman several large gifts of property and money. Shriners sought vacation of the Order admitting the 1999 Will to probate and set forth a tort claim against Bauman for interference with an expectancy of inheritance.

The Trial Court dismissed all three Counts of Shriners' suit, holding that because suit was not brought within six months of the admission of the 1999 Will to probate, Shriners had no claim. Shriners appealed dismissal of the Count for interference with an inheritance. The Appellate Court affirmed, concluding that the legislature would not pass a law barring a Will contest, but allow a tort claim based on the same allegations.

In reversing the Lower Courts' decisions, the Supreme Court noted that the limitation provided by §8-1 was jurisdictional and was not subject to tolling by concealment or other fact. It also stated that in interpreting the subject statute, a Court could not read into the statute conditions or limitations that were not a part of the text of the statute. The statute clearly stated that an action to contest the validity of a Will must be brought within six months of admission of a Will to probate. Such a suit is not an action against a beneficiary but is a *quasi in rem* proceeding to set aside a Will. By contrast, the Court held that an action for interference with an inheritance is brought against a person for intentionally preventing another person from

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receiving an inheritance and is a widely recognized tort. The Court recognized the applicability of the six-month statute to tortuous interference actions where a potential contestant foregoes filing a Will contest in exchange for a settlement and later brings an action for tortuous interference. It also recognized the concern for expeditiously administering the affairs of a Decedent. Neither situation applied to the case at bar. Shriners did not forego its right to file a Will contest in exchange for a settlement, and a Will contest would not have furnished Shriners with the entire relief it sought. Shriners did not learn of its potential rights until long after the Will was admitted to probate. Further, a Will contest would not address the propriety of the gifts made during the Decedent's life. Therefore, the statute did not apply to the facts at hand. In its opinion, the Supreme Court reminded its readers that a tort claim is not available as a way remedying the failure to bring a Will contest where a Will contest is available and that an action for tortuous interference is not a substitute for an untimely failure to file a Will contest.

Normally, the Probate Bar does not receive the attention given it by the High Courts during 2009. Hopefully, the decisions reviewed have given all of us an opportunity to review notions that do not present themselves regularly, but are of great importance in our practices. ■

Estate tax or not: Reasons your clients still need estate planning

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queries from clients regarding the 2010 law and the media speculation surrounding a potential retroactive legislative fix. Currently, many, if not most, tax planning professionals are repeating the same phrase time and time again: the outcome of some tax planning strategies in the current environment is uncertain and therefore subject to increased risk. Many clients have happily seized upon this as a reason to defer the process of estate planning.

Practitioners should be wary of letting their clients continue to postpone the preparation of their estate plans pending enactment of new legislation. To aid practitioners in their attempts to prevent their clients' inertia, this article reviews some of the benefits of estate planning which persist despite the uncertain tax environment.

Planning for Incapacity. As demonstrated by high profile media stories and television dramas, every adult should undergo basic planning for incapacity, including the execution of powers of attorney for property and for health care. These documents ensure that a client's financial matters can be attended to without the costly process of a guardianship proceeding and ensure that an individual familiar with the client's wishes is appointed to make critical health care decisions. In addition to these basic documents, individuals who are engaged in an unmarried relationship should take steps to ensure that their partner has access to residences, vehicles, and other property during the owner's incapacity, if so desired.

Lifetime Gifting. The tax outcomes of certain lifetime gifting strategies in 2010 and beyond are still being debated. However, several gifting strategies remain viable and risk-free techniques to transfer significant wealth tax-free during an individual's lifetime. Foremost among these techniques is outright annual exclusion gifting. Each individual may transfer up to $13,000 outright to another individual each year. When combined with a spouse's annual exclusion gifting power, this means grandparents or parents can transfer up to $26,000 to each grandchild or child in a calendar year. The transfers may be outright, to custodial accounts, to 529 college savings accounts, or to certain trusts. Another powerful lifetime gifting technique is quite straightforward and largely under-utilized. Section 2503(e) of the Internal Revenue Code excludes from taxable gifts payments for tuition and medical expenses of any person. These payments include, but are not limited to, payments to educational institutions for tuition expenses and payments to an insurance company for the cost of health insurance. Treas. Reg. § 25.2503-6(b)(2) and (3). Practitioners should counsel clients interested in wealth transfer, but adverse to the risk inherent in the current tax environment, in these basic techniques which may yield considerable estate tax savings.

Property Disposition. The primary focus of any comprehensive estate plan is the testamentary disposition of the client's property. If a client fails to execute any type of estate plan, the State of Illinois has provided one, referred to as intestate succession law. 755 ILCS 5/2-1. However, this plan rarely corresponds to a client's wishes. For example, if a married client with children passes away, under Illinois intestate succession law, the property is allocated one-half to the surviving spouse and one-half among the surviving descendants. An explanation of the practical implications of this division of property subject to probate can be a useful tool to demonstrate the benefits of implementing an estate plan.

Probate Avoidance. "Probate" used to have a reputation as being long, arduous, and costly. Fortunately, this reputation is not always deserved. Unfortunately, many clients know this reputation is not always deserved or believe that their estates will not be subject to probate. Clients should be made aware that joint ownership of property and beneficiary designations work to avoid probate at the death of the first spouse; however, these mechanisms most likely will not be sufficient to avoid probate at the death of the surviving spouse while still accomplishing the couple's dispositive goals. In addition, estate planning is essential to avoid the probate of real property located in a state other than the client's state of residence. This type of probate, called "ancillary probate," certainly will be costly and should be avoided whenever possible.

Naming Guardians of Minor Children. The need to name guardians of minor children is one of the first reasons clients seek estate planning advice. The importance of this issue does not diminish in an uncertain tax environment. For clients who have a will in place which names guardians, these individuals should be reviewed every three years. Not only will the minor children's needs change as they age, but the financial, family, and health circumstances of the named guardian may change, making such individual a less desirable choice for guardian.

Avoid Guardianship of Minor's Estate. When a minor child inherits property with a value in excess of $10,000, the court may require the appointment of a guardian to protect the child's inheritance. 755 ILCS 5/25-2. This also applies to the child's receipt of the proceeds of a life insurance policy or retirement plan benefits. The appointment of a guardian and the concomitant court oversight likely will drain resources from the child, since all costs associated with the administration of the guardianship estate and the legal representation of the guardian will be paid from the child's assets. Accordingly, it is preferable to avoid formal guardianship proceedings by providing for alternate methods of payment of the inheritance to a minor child through the estate plan, for example, payment should be made to a trust or custodial account for the benefit of the child.

Incentive Trust Distributions. Perhaps one of the most powerful arguments in favor of the use of a trust as a vehicle for wealth transfer is the ability of the grantor to control the terms of the distribution of the trust assets. Commonly, the terms of a trust agreement will provide for the outright distribution of or a right to withdraw trust property at specific ages. Practitioners also can suggest provisions which link access to the trust property with certain life goals. For example, a trust could provide that a beneficiary be given a right to withdraw the trust property upon completion of a college degree. This type of provision provides an incentive to the beneficiary to further his or her education, a common desire for the grantor-parent. Incentive distribution provisions are relatively

simple to draft and administer, and provide clients with peace of mind that their hopes and goals for their children will be relevant after death.

Special Needs Planning. As diagnoses of special needs (which means for purposes of this article an individual who due to a mental, physical, or emotional disability is eligible for government benefits) increase, more families can benefit from additional planning to allocate assets for the benefit of a disabled individual in a manner which will avoid disqualifying the individual from receiving federal and state aid. This can be accomplished by creating a trust with provisions designed specifically for these purposes. A client who is primarily responsible for the care of a special needs child or individual also should ensure that his or her power of attorney for property permits the agent to make discretionary distributions to or for the benefit of the special needs individual and to create and fund a special needs trust for the benefit of the individual. It is imperative that the practitioner inquire whether any family members or other intended beneficiaries are disabled during the practitioner's initial meeting with the client.

Creditor Protection. Although the creditor protection an individual can provide for himself or herself is limited, that individual can provide substantial protection for his or her surviving spouse and descendants. By transferring the beneficiary's inheritance in trust, rather than outright, and limiting the distributions from the trust, a judgment against the beneficiary generally should not be satisfied from the trust assets while the assets remain in the trust. The use of trusts as a vehicle for transferring assets also is effective in keeping a beneficiary's assets separate from his or her spouse's assets, thereby reducing the likelihood that a divorcing spouse could receive a portion of the beneficiary's inheritance through a property settlement.

Charitable Planning. Clients with charitable intentions should be encouraged to proceed with estate planning as well. Without clear direction in a testamentary instrument such as a will, trust or beneficiary designation, gifts to charitable organizations will not be completed upon the death of an individual. Most sophisticated charitable planning techniques, such as charitable lead trusts and charitable remainder trusts, remain largely unaffected by the tax law changes. In addition, with the recent crisis in Haiti, many clients already will be motivated to proceed with the charitable plans.

The above summarizes many of the benefits of estate planning separate from tax minimization goals. Practitioners should counsel their clients on these benefits in order to prevent the client's postponement of planning due to the uncertain tax environment. When a more stable tax regime is in place, the practitioner can then propose appropriate tax minimization and wealth transfer strategies, with the knowledge that a proper planning foundation already has been laid. ■

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April

Thursday, 4/1/10 – Webinar—Advanced Research on FastCase. Presented by the Illinois State Bar Association. *An exclusive member benefit provided by ISBA and ISBA Mutual. Register at: <https://www1.gotomeeting.com/register/458393744>. 12-1.

Thursday, 4/8/10- Webcast—Durable Powers of Attorney. Presented by the ISBA. <https://isba.fastcle.com/store/seminar/seminar.php?seminar=3564>. 12-1.

Thursday, 4/8/10- Springfield, INB Building 307 E. Jackson—Key Issues in Local Government Law: A Look at FOIA, OMA, Elections and Attorney Conflicts. Presented by the ISBA Government Section. 12:30-4:45. Cap 55.

Thursday, 4/8/10- Chicago, ISBA Regional Office—Resolving Financial Issues in Family Law Cases. Presented by the ISBA Family Law Section. 8:30-4:30.

Friday, 4/9/10- Chicago, ISBA Regional Office—Civil Practice Update- 2010. Presented by the ISBA Civil Practice Section. 9-4

Monday - Friday, 4/12/10 - 4/16/10 – Chicago, ISBA Regional Office—40 hour Mediation/Arbitration Training. Master Series Presented by the Illinois State Bar Association and the ISBA Alternative Dispute Resolution Section. 8:30-5:45 each day.

Wednesday, 4/21/10- Bloomington, Double Tree Hotel—Construction Law- What's New in 2010? Presented by the ISBA Special Committee on Construction. 9-4. Cap 80.

Friday, 4/23/10- Champaign, I- Hotel and Conference Center—Practice Tips & Pointers on Child-Related Issues. Presented by the ISBA Child Law Section; co-sponsored by the ISBA Family Law Section. 8:25-4. Cap 70.

Tuesday, 4/27/10- Chicago, ISBA Regional Office—Construction Law- What's New in 2010? Presented by the ISBA Special Committee on Construction. 9-4.

Wednesday, 4/28/10- Chicago, ISBA Regional Office—Intellectual Property Counsel from Start-up to IPO. Presented by the ISBA Intellectual Property Section. 8:30-3:30.

Thursday, 4/29/10- Chicago, ISBA Regional Office—Key Issues in Local Government Law: A Look at FOIA, OMA, Elections and Attorney Conflicts. Presented by the ISBA Government Section. 12:30-4:45.

Friday, 4/30/10- Chicago, ISBA Regional Office—Anatomy of a Trial. Presented by the ISBA Tort Section Council. Time TBD.

May

Tuesday, 5/4/10- Chicago, ISBA Regional Office—Boot Camp- Basic Estate Planning. Presented by the ISBA Trust and Estates Section Council. 9-4. ■

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