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Trusts & Estates

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

A call to account
1

Powers of attorney, living wills, advance directives and religion
1

U.S. v. Balice: IRS successfully pierced trust
5

Getting to know the Trusts & Estates Council members
6

Post-death conservation easements—Another way to save the farm?
7

A call to account

BY CARY A. LIND

Two of a fiduciary's classic duties to beneficiaries (in connection with trusts and estates) are the duties of care and loyalty. The duty of care requires the assets of the trust or estate to be properly administered. The duty of loyalty requires the executor or trustee to act solely in the interest of the beneficiaries and not in his or her own interest. One of the ways to satisfy both of those duties is to give the beneficiaries thorough information on how the estate or trust has been administered.

The purpose of this article to address the "garden variety" accounting. There are more involved accountings that deal with more complicated situations such as a principal and income accounting, and I am sure there are other kinds of accountings that are not "simple." I leave those for other

Continued on next page

Powers of attorney, living wills, advance directives and religion

BY MICHAEL J. MASLANKA

When preparing such estate planning documents for clients, it is imperative that the attorney inform the client that what these documents say and do can be tailored to the client's personal needs, wishes, desires and directions. In that regard, the client must know that she or he can include directions to the agent and service providers, to make decisions and act in ways that do not offend or contradict the religious principles and beliefs of the client. I recently reviewed a Health Care Proxy form and an Advance Medical Directive form that the Roman Catholic Church approved. Those estate planning documents look similar to generic powers of attorney and living wills, but also contain clear and specific references to religious doctrine and publications, which the client can direct the agent to follow. Other religious denominations may have their own suggested or recommended language to consider.

Providing this type of information to the client can certainly aid the client in choosing the client's agent, and also show how detailed the client can be in creating estate planning documents. The client will likely appreciate the explanation that personal preferences and wishes can be honored and incorporated into these types of documents. ■

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A call to account

CONTINUED FROM PAGE 1

attorneys to explain. For the remainder of this article, I will refer to the "estate," but similar rules apply for most trust accountings.

An accounting is supposed to summarize the financial aspects of an estate. In preparing the accounting, bear in mind that the better job you do, the less telephone calls and/or emails with further questions you will receive from the beneficiaries. An accounting should start with the inventory values, which are the baseline for the estate's assets, either as of the date of death for a decedent or as of the date of appointment in a disabled estate. It should show everything that comes in, everything that goes out, and the balance remaining. What happens then will be discussed below. An accounting normally deals with cash - "cash in, cash out." What is not cash is held "in kind" until it is valued as if it were cash or is distributed in kind.

In my practice, I have encountered at least two different kinds and two different theories of what an accounting should contain. The summary in the preceding paragraph is what I call "the pot theory" (no, not that kind of pot). You only need to show what starts in the pot, what comes in, what goes out, and what is left. Transfers between assets in the pot are ignored. So long as the pot is "right" at the end, the internal movements do not matter.

Some attorneys and fiduciaries believe to the contrary that it is also necessary to "trace" the assets from one account to another and to show what disbursements and distributions were made from what account. I know of no authority for that requirement in any statute or rule, and it only increases the cost to prepare or to review an accounting. In the end, tracing should yield the exact same result as the pot approach does.

Cook County has local rules for inventories (Rule 12.9) and accounts (Rule 12.13). The Cook County requirements are not necessarily the same as for other counties, but they set out a very good format for allowing the court and the parties to more easily review the finances of the estate. Too often, these rules are totally disregarded. Assets are to be numbered, and the numbers are to be consistent from inventory to accounting to accounting. Once an asset is disposed of or otherwise drops out of the accounting, it is omitted in subsequent accountings. New numbers should be given to new assets.

Probate accountings traditionally separated inventory assets from non-inventory assets. I believe that the historical reason for doing so was that at one time, claims could only be satisfied against inventoried assets. If more assets were found later, the claimants could not compel payment out of those assets. Today *all* assets of an estate are subject to the claims of creditors, so the inventory value has only limited importance in accountings.

Although not required by rule or statute, in my experience it is far better to lump together receipts and disbursements by category. That allows all parties to easily spot anything that looks suspect. Interest payments, dividend payments, and the like should be listed date-by-date under the asset that they relate to. That way, it is easy for anybody looking at the accounting to look on a monthly, quarterly, or other basis to see that all receipts are included. The same procedure is appropriate for disbursements. (Disbursements under Cook County Rule 12.13 are to be numbered, identified, showing "the date, the name of the recipient, the purpose, and amount of the disbursement . . .") For example, if the estate owns real estate, all of the utility bills should be separated by utility and listed in order. If the house takes a year to sell, there should be the correct number of periodic payments for gas, electricity, water, real estate taxes, etc. Any beneficiary (not to mention the attorney presenting the accounting) looking at those entries can immediately determine if anything is missing.

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ILLINOIS BAR CENTER
424 S. SECOND STREET
SPRINGFIELD, IL 62701
PHONES: 217-525-1760 OR 800-252-8908
WWW.ISBA.ORG

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Jennifer L. Bunker
Colleen L. Sahlas

MANAGING EDITOR / PRODUCTION
Katie Underwood
kunderwood@isba.org

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Once in a while, I am given an accounting that is solely in chronological order. Such listings of receipts or disbursements are much harder to deal with, because it is tedious to track specific types of payments, and they make the court and interested parties do all the work that should be done by the representative in the accounting itself.

Regardless of what format is used, the accounting will come down to a balance left in the estate. If there is money left over but not enough to pay all claims, the claims need to be shown by class. Doing so discourages any of the lower class creditors from challenging the accounting, because they cannot get paid unless there are dramatic reductions in claims ahead of them.

With any accounting, you should do a formal "justification" at the end showing all of the assets actually held at the end of the period covered by the accounting. This must be done for at least two reasons. First, it shows the court and the interested parties where the assets are held. Second, it shows that the accounting that you have so carefully prepared actually matches with reality. If it does not match, you need to find the discrepancies and correct them. If there is not enough money left in the estate to pay what is shown, the problems are obvious. If there is too much money, that presents different problems. If the account is a final account, you are not required to include a justification in the accounting, but you should still do one for the same reasons, i.e., to compare what the accounting that shows you have and what the assets actually are. Finally, there is no reason not to use the accounting for communication and explanation of the representative's positions, so long as those positions are correct.

While accountings should be done for the benefit of the beneficiaries, when an estate is administered in independent administration, the Court may never see the accounting, so long as the beneficiaries state that they have "received" an accounting and are satisfied with it. Especially in estates with few beneficiaries who are likely to be related, I tell my clients/representatives that so long as all of the beneficiaries sign off, I have no requirements as to what the accounting must look like, and the Court will not care. Some families do not even bother to put together an accounting, and some may just trust what the family member tells them without additional proof.

I get involved in a lot of estate and trust disputes; many involving accountings. Some Probate representatives and trustees feel that providing an accounting is all that they need to do. However, an accounting is only numbers on paper. The fiduciary's duty of loyalty requires full disclosure and production of *all* documents related to any entries on the accounting (at least if they are asked to provide them). That may be 20 pages or it may be 1,000 pages or more. If the beneficiaries request the back-up documentation, they are entitled to have copies of it. It is remarkable how many fiduciaries think that they have no obligation to produce any documents or may resist production just because they do not want to (or because they want to conceal financial misbehavior). Once a fiduciary refuses to produce those documents, my alarm bells go off, and I wonder what he or she is hiding.

If anyone would like copies of accountings that illustrate particular issues, please feel free to contact me, and I will have them scanned to you.

With the foregoing in mind, when you are called to account, may all your accountings balance and may they all be readily accepted by the beneficiaries and claimants to whom they are sent. ■

Attorney Cary A. Lind is the Principal of Cary A. Lind, P.C., in Arlington Heights, Illinois.. Cary has been practicing law since 1973, and focuses his practice in trusts and estates. He is a prolific author of legal articles. He can be reached at (847)577-0030.

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U.S. v. Balice: IRS successfully pierced trust

BY MARTIN M. SHENKMAN

The Internal Revenue Service successfully pierced the trust created by a taxpayer to satisfy a tax lien on the basis that the trust was a mere nominee for the taxpayer and could be disregarded. In all planning, consider the risk that a court might disregard and pierce a trust as being a mere nominee for the settlor. This issue should be part of the discussion with clients as to why proper formation, funding and formalities of operating are vital for a plan to succeed. The lessons of *Balice*, acknowledging that it's yet another very bad fact case, might still provide some insight to practitioners and clients structuring trusts for asset-protection planning, divorce planning, as well as estate-tax planning.[1] Poor planning and execution can undermine a trust plan.

The court determined that a trust to which the taxpayer transferred his residence was a mere nominee and permitted the IRS to foreclose on the property to satisfy a federal tax lien. A nominee is a person or entity who "holds bare legal title to property for the benefit of another."

Determining Whether Person or Entity Is Nominee

Evaluate the following factors in determining whether the person or entity is a nominee on behalf of another:

1. Did the nominee pay adequate consideration for the property?
2. Did the taxpayer transfer property to the name of the nominee in anticipation of a suit (or, in this case, in anticipation of IRS collection efforts)?
3. Did the transferor continue to use the property?
4. Did the transferor retain enjoyment of the benefits of the transferred property?
5. Was there a close relationship between transferor and the nominee?
6. Was the transfer recorded in the case of real estate?

The reality in *Balice* is that the taxpayers behaved so inappropriately that finding against them may have been the only just result. That, however, may not ensure that future courts won't apply some of the factors cited in the *Balice* analysis in attacking other trusts.

Bad Facts

In *Balice*, the facts concerning the trust were bad. The IRS filed the action to reduce to judgment defendant Michael Balice's tax liability for several years and to foreclose on a residential property at 70 Maple Avenue in Metuchen, N.J., that was held in a trust. The taxpayers had unpaid tax liabilities for many years and brought suit. The court held in favor of the IRS. The taxpayers attended a seminar that taught how to create trusts to obtain tax protection, and they signed a quitclaim deed transferring title of their property to a trust for no consideration. Following deeding the house to the trust, the taxpayers continued to live in and exercise control over that property. The court found that the couple exercised complete control over the trust checking account. The court also noted that the trust bank account statements were sent to the the taxpayers' home. At one of the trials, the taxpayers admitted that the trust was created to protect the property from liabilities. Although the taxpayers didn't fact record a deed transferring the house to the trust, the court found that all the other factors indicating a nominee were met.

In *Balice*, as in so many other bad-fact cases, the background bad facts were ugly and had to have colored the court's view of the situation. The taxpayers didn't file a tax return for several years despite earning income. Their income was earned by marketing products that purported to teach others how to avoid income tax by creating sham trusts. They were convicted of conspiracy to defraud the United States, wire and mail fraud, and attempt to evade income tax. So, while *Balice* might be dismissed as just a case of bad actors, it may still be worthwhile to try to glean some relevant planning lessons.

Comparison to a SLAT

Some of the facts in *Balice* are unclear. It appears from the case that both the husband and wife created the trust and both transferred the house to the trust, but it appears that Marion, the wife, served as trustee. Recognizing the limitations of comparing a really bad-fact case like *Balice* to a reasonably planned trust, it still may nonetheless be worth trying to extract some lessons.

A spousal lifetime access trust (SLAT) is a common planning technique. A wife, for example, may create a trust for her husband and descendants and then gift assets to that trust. The husband can benefit from the assets in that trust, and according to most if not all commentators, the wife might indirectly benefit by virtue of her relationships with her husband. For example, if the wife's SLAT purchased a vacation home, the wife might be able to stay in that property as a result of her being married to her husband. Leaving aside the bad-actor issues in *Balice*, and what was at best unartful and careless planning and trust administration, might a court look at a SLAT in a similar fashion as the court did in *Balice*? Hopefully, perhaps likely not. But what if there's an aggrieved creditor seeking assets in that SLAT? What if the SLAT wasn't carefully operated? What if the husband took distributions from the SLAT, deposited those distributions into a joint checking account with his wife, and his wife thereafter paid both marital and personal bills from that account? A few innocent mistakes a year in administering a trust formed with proper intent might well set a stage for a claimant to argue something sinister was afoot.

While clearly the facts in *Balice* were worse than in most cases practitioners ever confront, where might a court draw the

line? Clients are too often reticent to spend the time or incur the professional fees to have their advisors help them administer a trust. While *Balice* is extreme, clients should take it as a warning that the costs and time to have their advisors administer a trust may well prove worthwhile.

Planning Lessons

While practitioners might dismiss *Balice* as just another bad-fact case, which it is, it's worthwhile to instead draw planning lessons from it.

1. If the trust doesn't pay consideration for the property, document that the property was gifted properly to the trust. Prior to any gifts, assemble some due diligence to confirm that the gift transfer isn't a fraudulent conveyance. Have the client/transferor sign a balance sheet reflecting reasonable net worth before and especially after the transfer.
2. Have the client disclose/document any known claims or suits. Consider performing some due diligence to corroborate that statement from the client. The Internet can make this rather cost effective even on a small-dollar transaction.
3. If the transferor will continue to use the property post-transfer, be certain that the trust authorized use of personality and consider the merit of having an independent trustee or at least someone other than the transferor serve in a fiduciary capacity. Even if the trust can permit the settlor use of property, for example, in a self-settled trust, discuss with the client the merits of paying a fair rent, along with a lease agreement between the client and the trust, instead of using property immediately after a transfer, which would suggest an implied arrangement with the trustee to do so.
4. The court in *Balice* noted a close relationship with the transferor and nominee. With the availability of administrative trust services from so many trust companies, the cost of having a truly independent trustee to infuse more impudence into a trust transaction is not particularly costly but may prove quite helpful.
5. While the *Balice* court considered the recordation of real estate, the generic view of this issue is to be certain to follow all formalities. This will almost always require a collaborative effort of the client's advisors as each of the CPA, trust officer, attorney and insurance consultant will have distinct tasks to fulfill to adhere to formalities.

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1. *U.S. v. Balice,* Case 2:14-cv-03937-KM-JBC, (D.N.J. Aug. 9, 2017).

Martin M. Shenkman, CPA, MBA, PFS, AEP (distinguished), JD, is an attorney in private practice in Fort Lee, New Jersey and New York City. His practice concentrates on estate and tax planning, planning for closely held businesses, and state administration.

Note from the Co-Editors: This article was originally published by wealthmanagement.com on September 5, 2017. The original article can be found at <http://www.wealthmanagement.com/estate-planning/us-v-balice-irs-successfully-pierced-trust>. We thank the author, Martin M. Shenkman, and wealthmanagement.com for allowing us to republish this article.

Getting to know the Trusts & Estates Council members

BY COLLEEN L. SAHLAS, CO-EDITOR OF THE TRUSTS AND ESTATES NEWSLETTER

Have you ever wondered who comprises the ISBA's Trusts & Estates Council? For example, who are the Council members, in what location do they practice, at what firms have they been employed, and what are their achievements and legal experience? Here's the latest in an article series which acquaints our Section's newsletter readers with its Council members. Stay tuned for future issues which will feature other Council members who've joined the Trusts & Estates Council since March, 2015.

TIFFANIE B. POWELL is a solo practitioner at Tiffanie B. Powell and Associates, P.C., in Matteson, Illinois. She is a dedicated wife, mother and practicing attorney with 17 years of legal experience. She focuses on estate planning (wills, trusts and powers of attorney), probate and real estate matters. She is a trustworthy advocate for her clients and provides ethical advice you can count on.

Tiffanie currently serves as an Arbitrator with the Circuit Court of Cook County Mandatory Arbitration Program, is a member of the Illinois State Bar Association's Trusts & Estates Section Council, and enjoys her membership with the Professional Women's Network. Tiffanie is also a passionate speaker and spends a significant amount of her time educating others on the importance of proper estate planning and fiscal responsibility.

In furtherance of her commitment to higher learning, Tiffanie holds a Bachelor of Science degree in Business Administration from Truman State University in Kirksville, Missouri, a Juris Doctor degree from the University of Missouri -Columbia School of Law, and a Master of Science degree in Nonprofit Management from Spertus College in Chicago.

Today, Tiffanie draws upon all of her experiences to provide exceptional legal services to her clients, and she welcomes every opportunity to share her passion for law with the communities she serves. ■

Post-death conservation easements—Another way to save the farm?

BY ANDREW G. WHITE

After a farm client passes away is hardly the time to begin planning for estate taxes. If faced with a taxable farm estate the practitioner must search for all possible tools to lower the tax. Fractional interest discounts, Section 2032A and customary estate deductions may not be enough. Those tools may not apply or the estate may be large enough that the tax is still substantial. If faced with that problem the possibility of the estate granting a conservation easement prior to the filing of the estate tax return should be considered.

One may think of conservation easements as being used for wetlands, timber, or grasslands but in fact they are also appropriate for the preservation of the tillable, rural farmland that covers a large portion of Illinois. The easements can have significant value when the land is near development. However, the fact that the land is rural, flat, tillable, and isolated from the pressure of urban and commercial development does not prohibit the grant of a conservation easement.

A conservation easement is a contribution of a qualified real property interest to a qualified organization to be used exclusively for conservation purposes. The conservation purpose must be protected in perpetuity 26 CFR 1/170A-14. Typically these easements are granted to local land preservation groups or conservancy trusts organized as a section 501(c)(3). Conservation purposes include, among other things the preservation of farmland. See 26 CFR 1.170A-14.

I have utilized conservation easements to reduce estate taxes in limited circumstances. The estate must be large enough to have a substantial estate tax burden and contain enough real estate for the easement to make financial sense. Further the family must have some desire to preserve the land for agricultural purposes. However, as is often found with charitable gifts the driving force is often tax savings. The IRS provides two ways for a postmortem conservation easement to reduce estate tax:

1. Charitable Gift. Form 706 Schedule O

The value of the conservation easement is often determined by using a before and after approach. The land is first appraised as it was on the date of death prior to the easement and then appraised subject to the conservation easement. The difference in valuations equals the value of the conservation easement. The easement value is treated as a charitable bequest added to Schedule O.

2. Additional estate tax exclusion. Form 706 Schedule U

In addition to the reduction in land values provided in #1 above, Section 2031(c) provides an estate with an exclusion of up to $500,000. The rules for calculating the exact exclusion amount are beyond the scope of this article, but if the granting of a conservation easement reduced the land value by more than 10%, then the estate is allowed to deduct an additional exclusion. See Section 2031(c)

The positive aspects of a conservation easement are the preservation of farmland and the potential for estate tax savings. There are of course drawbacks which the heirs must also consider, those include:

- The land cannot be developed for perpetuity. This would include commercial development, subdivisions, wind farms and solar farms. Farm improvements which are part of the farming operation may be allowed.
- The expense of establishing the easement. There are additional costs involved in creating the easement, including a second specialized appraisal, meeting with potential charities to receive the easement, educating heirs, correctly calculating the tax exclusion on the estate tax return and fees charged by the charitable entity for accepting and holding the easement.
- The donee preservation group holds the right to enforce the terms of the easement and come on the property to inspect it in perpetuity.
- IRS scrutiny. It appears that past problems association with sham conservation easement programs has caused the IRS to closely review this planning option.

Despite the negatives, there are only a few other tools available for the estate's attorney to use after death which have the possibility of saving substantial estate taxes. Besides saving taxes, if there is a desire on the part of the family to truly preserve farmland and leave a legacy, then this may be a way to help save the farm. ■

This article was originally published in the June 2017 issue of the ISBA's Agricultural Law newsletter.

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