WHAT EVERY ESTATE PLANNER SHOULD KNOW ABOUT DIVORCE LAWS

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I. PREMARITAL AGREEMENTS

A. Common law governs premarital agreements executed before January 1, 1990. The Illinois Uniform Premarital Agreement Act, 750 ILCS 10/1-10/11 controls such agreements entered into from January 1, 1990 and later.

B. Common Law Requirements:

1. Must be in writing. 740 ILCS 80/1; *In re Marriage of Jelinek,* 244 Ill. App.3d 496, 613 N.E.2d 1284 (1st Dist. 1992). .

2. Disclosure of net worth. Once individuals are engaged to be married there exists a confidential and fiduciary relationship requiring that each party be given information from the other as to other's net worth. *Fleming v. Fleming*, 85 Ill.App.3d 532, 406 N.E.2d 879 (5th Dist. 1980).

3. If there is a need for maintenance, a waiver of maintenance will not be enforceable unless some provision made in lieu of maintenance. *Volid v. Volid* 6 Ill.App.3d 386, 286 N.E.2d 42 (1st Dist. 1972); *Eule v. Eule* 24 Ill.App.3d 83, 320 N.E.2d 506 (1st Dist. 1974).

4. The fairness of the maintenance provision in a premarital agreement is gauged as of the time of dissolution of marriage. *In re Marriage of Burgess* 138 Ill.App.3d 13, 485 N.E.2d 504 (3rd Dist. 1985) But see *Warren v. Warren* 169 Ill.App.3d 226, 523 N.E.2d 680 (5th Dist. 1988).

5. No requirement that counsel represent a party. *In re Estate of Hopkins* 166 Ill.App.3d 652, 500 N.E.2d 415 (2nd Dist. 1988).

C. Illinois Uniform Premarital Agreement Act:

Presented April 19, 2002 for Illinois Institute of Continuing Education Seminar, Chicago, IL

1. Must be in writing.

2. No need to recite consideration.

3 Any amendments must be in writing.

4. Parties may contract as to:

   a. Rights and obligations to property;

   b. Right to manage property;

   c. Disposition of property upon separation, divorce or death;

   d. Waiver of maintenance or modification of maintenance;

   e. Making of a will, trust, or other instrument to carry out the terms of the agreement;

   f. Life insurance policies;

   g. Choice of law; and

   h. Any other matter not in violation of public policy or statute imposing criminal penalty.

5. Premarital Agreement not enforceable if:

   a. not entered into voluntarily; and

   b. agreement unconscionable when executed and before execution a party against whom enforcement is sought:

      (1) not provided a fair a reasonable disclosure of the property or financial obligations of the other party.

      (2) did not voluntarily and expressly waive, in writing, the right to disclosure of the property of financial obligations of the other party beyond that provided.

      (3) did not have, or could reasonably could not have had, an adequate knowledge of the property or financial obligations of the other party.

6. A court may override a provision modifying or eliminating spousal if such a provision causes a party undue hardship not reasonably foreseeable at the time of the execution of the agreement.

D. Effect on Wills

1. The husband entered into a premarital agreement providing that left his wife one-third of "residue" of his estate. Husband named daughters from a previous marriage as beneficiaries of annuity policies. This was not a breach of the premarital agreement in that "residue" was a term of art meaning what was left over after charges, debts and legacies. *Bergheger v. Boyle* 258 Ill.App.3d, 629 N.E.2d 1168 (5th Dist. 1994).

2. Where a husband entered into a premarital agreement promising to execute a last will and testament providing wife with one-fifth interest in and to all his property and parenthetically expressed an intention to leave each child one-fifth each, this did not constitute a promise that he would in fact make a will that would leave the remainder of his property to the children. *Stichter et al v. Auidema* 269 Ill.App.3d 455, 646 N.E.2d 296 (3rd Dist. 1995).

E. Effect on Qualified Retirement Plan Benefits

1. Employee Retirement Income Security Act ("ERISA") required that qualified retirement plan death benefits must be paid to a surviving spouse unless a valid waiver was obtained. Later, the Retirement Equity Act of 1984 ("REA") required that certain benefits, qualified survivor annuities, must be paid to a married plan participant and spouse.

2. There may be a spousal consent to waive a survivor annuity as long as all of the following requirements are met:

a. consent or waiver must be in writing;

b. it must acknowledge the effect of the waiver;

c. it must either recite who the beneficiary is or expressly permit the plan participant spouse to waive the survivor annuity benefit and change the designated beneficiary at any time without consent of the other spouse;

d. a plan representative or notary must witness it;

e. it must be made within the applicable election period; and

f. specific plan requirements for waivers and consents must be followed.

3. Can a Premarital Agreement result in a valid waiver?

a. Some cases have held no:

(1) In *Pedro Enterprises, Inc. v. Perdue*, 998 F.2d 491 (7th Cir. 1993) the Seventh Circuit decided that a premarital agreement entered into before a retirement plan came into existence was not an effective waiver of spousal rights.

(2) In *Hurwitz v. Sher*, 982 F.2d 778 (2nd Cir. 1992) the Second Circuit ruled that the failure to satisfy statutory requirements: designating a beneficiary or acknowledging the effect of a waiver, resulted in the prenuptial agreement effectively waiving retirement benefits.

(3) In *Lasche v. Lasche Basic Profit Sharing Plan*, 111 F.3d 863 (11th Cir. 1997) the Eleventh Circuit held that a waiver in both a premarital and postnuptial agreement of the husband's retirement benefits was ineffective because the waiver was not witnessed as required by statute.

b. Some have held yes:

(1) An Illinois Appellate Court found a waiver of benefits in a premarital agreement enforceable although the wife was not yet a spouse when she signed it and the witness requirements of the Treasury Regulations were not met. *In re Estate of Hopkins*, 214 Ill.App.3d 427, 574 N.E.2d 230 (1991).

(2) A Colorado Appellate Court held that ERISA did not preempt the validity of a premarital agreement waiving interest in a qualified plan. *Rahn v. Rahn*, 914 P.2d 463 (Colo.App. 1995).

c. The U.S. Supreme Court has spoken. In *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001) the Court found that ERISA preempts a state statute (Washington) that automatically removed a divorced spouse as beneficiary of a benefit plan.

II. ENTRY OF DISSOLUTION OF MARRIAGE

A. 755 ILCS 5/4-7(b) provides that upon dissolution of marriage or declaration of invalidity of marriage the testator revokes every legacy or interest or power of appointment given to or nomination to fiduciary office of the testator's former spouse in a will executed before the entry of the judgment of dissolution of marriage or declaration of invalidity of marriage and the will takes effect in the same manner as if the former spouse had died before the testator.

B. 760 ILCS 35/1 provides that judicial termination of the marriage of the settlor of a trust revokes every provision which is *revocable* by the settlor pertaining to the settlor's former spouse in a trust instrument or amendment thereto executed by the settlor before the entry of the judgment of judicial termination of the settlor's marriage, and any such trust shall be administered and construed as if the settlor's former spouse had died upon entry of the judgment of judicial termination of the settlor's marriage unless the judgment of judicial termination of marriage expressly provides otherwise.

1. Operation of law terminated the former spouse's status as beneficiary of the other spouse's IRA. *In re Estate of Davis*, 225 Ill.App.3d 998, 589 N.E.2d 154 (2nd Dist. 1992).

2. The Seventh Circuit in *Fox Valley & Vicinity Construction Workers Pension Fund v. Brown*, 897 F.2d 275 (7th Cir. 1990) held that because the parties signed a voluntary property settlement agreement that included an explicit mutual waiver of rights each had in other's pension plan, the Wife was not entitled to be a beneficiary of the interest the husband had in his qualified pension plan.

3. A waiver by the wife in a property settlement agreement of any interest in the husband's life insurance policy barred the ex-wife from collecting as a beneficiary. *Mutual Life Insurance Co. v. Juntanen*, 189 Ill.App.3d 224, 545 N.E.2d 224 (1st Dist. 1989).

4. What can be done when irrevocable trusts are created prior to a filing of petition for dissolution of marriage?

a. fraudulent transfers and intent to dissipate the marital estate.

III. CHILD SUPPORT AND EDUCATIONAL TRUSTS

A. 750 ILCS 5/503(g) provides a court with the ability to establish a trust for the benefit of a minor, dependent or incompetent child to protect and promote his best interests for his support, maintenance, education and general welfare.

1. The amount to be placed in such a "503(g)" trust was calculated by the Second District. *In re Marriage of Wolfe*, 298 Ill.App.3d 510, 699

N.E.2d 190 (2d Dist. 1998). The Court refused to accept the trial court's award of 20% of the husband's Structural Work Act settlement. It ruled that the child support amount should have been based on the husband's net income per 750 ILCS 5/505(a)(3). The trial court should have deducted from the settlement, an amount representing damages for medical expenses, pain and suffering and the 10% awarded to the wife as marital property. The trial court should have then determined the amount of the child support payments until the child reached majority based upon the future lost wages as calculated in the settlement. If there was a deviation, the trial court should have made a specific finding. Further, the terms of the trust must be described with sufficient particularity to: the amount and frequency of regular child support payments from the trustee to the custodial parent, payment for reasonable expenses for health, education, and general welfare, and the termination of the trust upon emancipation and the return of any residue to the party who funded the trust.

B. The Fifth District upheld a trial court's ordering of a 503(g) trust to be established by a husband and funded with a settlement he obtained so as to serve as the source from which to pay his children's college expenses. *In re Marriage of Harsy*, 193 Ill.App.3d 415, 549 N.E.2d 995 (5th Dist. 1990).

IV. CHILD SUPPORT AND CHILD'S EDUCATION PAID BY THE DECEDENT PARENT'S ESTATE

A. The death of a divorced parent who is obligated to pay for support or educational expenses is not terminated by the death of that parent unless otherwise agreed to in writing or expressly provided in a judgment. 750 ILCS 5/510(d).

1. In the instance of a child who intentionally caused the death of a parent, that parent's estate was not liable for that child's continue support. *In re Estate of Frederick B. Braun*, 222 Ill.App.3d 178, 583 N.E.2d 633 (2nd Dist. 1991).

2. *In re Estate of Downey*, 293 Ill.App.3d 234, 687 N.E.2d 339 (4th Dist. 1997) hold that an agreement to provide for life insurance to secure child support is enforceable despite that there is no authority for a court to order life insurance to secure maintenance payments. The Court relied upon 750 ILCS 5/503(g) and 750 ILCS 5/513 as authority.

V. CONFLICT OF INTEREST FOR THE ATTORNEY ESTATE PLANNER

A. What happens when the attorney consults with both the husband and wife, prepares their estate plan and a petition for dissolution of marriage is later filed?

1. Who is the client?

2. Is there any confidentiality?

3. What if one of the spouses provides and discusses with the attorney additional facts outside of the presence of the other spouse?

VI. ACKNOWLEDGMENT OF PREMARITAL AGREEMENTS

A. In planning for couples with premarital agreements, the draftsman should carefully review the parties' premarital agreements and any testamentary requirements thereunder, such as the disposition of a residence, bequests to a surviving spouse, treatment of joint tenancy property, etc.

The estate planner should also review the client's assets and titling of assets affected by the agreement and the client's estate planning documents.

B. If the client's testamentary dispositions conform to the terms of the prenuptial agreement, i.e. the spouse is to receive no assets at the client's death, a clause may be inserted in the will or trust acknowledging that no provision has been made for the spouse, or certain provisions have been included, consistent with the terms of the prenuptial agreement.

C. If the client has made provisions leaving a spouse assets or bequests which are greater than those required under the terms of the prenuptial agreement, i.e. leaving specific amounts or shares to the surviving spouse or titling assets in joint tenancy with the surviving spouse which are intended to pass to him or her, the will or trust may acknowledge both the prenuptial agreement and that the client has made provision for the surviving spouse inconsistent with the terms of that agreement.

D. Examples of these clauses may be:

1. My spouse, _____ and I executed a prenuptial agreement dated _____, _____. I hereby acknowledge that as of the date hereof said agreement is in full force and effect and has not been amended. I have made no provision for my spouse hereunder, consistent with the terms of said agreement.

2. I hereby acknowledge that my spouse, _____ and I entered into a prenuptial agreement dated _____, 2002. All of my obligations thereunder have been satisfied as of the date of this will, or under the terms of this will,

and, except as specifically provided herein, I have made no provision for my spouse hereunder based upon the terms and provisions of that prenuptial agreement.

3. I hereby acknowledge that my spouse, _____, and I entered into a prenuptial agreement dated _____, _____, which agreement is in full force and effect as of the date hereof. Under the provisions of Articles ____ and ____ of this will I have bequeathed certain assets to my spouse consistent with the terms of that prenuptial agreement. Notwithstanding the specific bequests hereunder which are consistent with the terms of that prenuptial agreement, it is my intent that any property held in joint tenancy with my spouse at the time of my death and/or any property, life insurance benefits, retirement benefits or other items passing by beneficiary designation to my spouse at the time of my death are intended to pass to my spouse as so directed.

VII. SPOUSAL CLAIMS AGAINST ASSETS TRANSFERRED DURING LIFE

A. Under the Illinois Probate Act, 755 ILCS 5/2-8, a surviving spouse may renounce a testator's will, whether or not the will contains any provision for the benefit of the surviving spouse, and take one-third of the entire estate if the testator leaves a descendant, or one-half of the entire estate if the testator leaves no descendant. Absent a prenuptial or postnuptial agreement limiting the surviving spouse's rights to take under this provision, probate assets are exposed to spousal claims through renunciation at the time of an individual's death.

B. Under the Illinois Lifetime Transfer of Property Act, 755 ILCS 25/1:

> An otherwise valid transfer of property in trust or otherwise, by a decedent during his or her lifetime, shall not, in the absence of an intent to defraud, be invalid, in whole or in part, on the ground that it is illusory because the decedent retained any power with respect to the property.

1. Several Illinois cases have considered this questions in which a surviving spouse has made a claim against assets held in a decedent's living trust, joint tenancy accounts or land trusts, on the grounds that those assets should be construed as part of the probate estate and consequently subject to the spouse's rights to renounce the will and take a statutory share.

Other probate beneficiaries have raised similar claims in an attempt to increase the size of the probate estate.

2. This statute was enacted in 1977 following the Supreme Court's decision in *Montgomery v. Michaels*, 54 Ill.2d 532, 301N.E.2d 465 (1973) which held that a Totten Trust was sufficiently testamentary in nature that it should be construed as part of the decedent's testamentary estate and subject to the surviving spouse's statutory election share.

   Following enactment of the statute, in *Clay v. Woods*, 139 Ill.App.3d 711, 487 N.E.2d 1106 (1st Dist. 1985) the 1st District held that a Totten Trust did not constitute property of the deceased husband's estate for purposes of determining the surviving spouse's statutory share where there was no indicia of intent to defraud the wife in the facts before the court. However, the Supreme Court in *Johnson v. LaGrange State Bank*, 73 Ill.2d 342, 383 N.E.2d 185 (1978) found that the Totten Trusts were substantially testamentary in character and consequently subject to claims of the surviving spouse as if the property had passed under the decedent's will or were otherwise includable in the probate estate.

3. In *Johnson v. LaGrange State Bank*, 73 Ill.2d 342, 383 N.E.2d 185 (1978) the Supreme Court considered the surviving spouse's claim against a revocable Inter vivos trust in which the decedent had declared herself trustee and retained complete ownership and control over the trust property during her lifetime. The court in *Johnson v. LaGrange* initially noted the general rule in Illinois that the owner of property has an absolute right to dispose of his property during his lifetime in any manner he sees fit, and may do so even though the transfer is for the precise purpose of minimizing or defeating the statutory marital interest of the spouse in the property conveyed. *Johnson v. LaGrange State* Bank, 73 Ill.2d, 342, 357.

   The court further noted that such a gift or transfer is not vulnerable or subject to attack by the surviving spouse "unless the transaction is a sham and is "colorable" or "illusory" and is tantamount to a fraud." *Johnson v. LaGrange State Bank*, 73 Ill.2d 342, 358. In defining these terms the court noted ". . . that an illusory transfer is one which takes back all that it gives, while a colorable transfer is one which appears absolute on its face but due to some secret or tacit understanding between the transferor and transferee the transfer is, in fact, not a transfer because the parties intended that ownership be retained by the transferor." *Johnson v. LaGrange State Bank,* 73 Ill.2d 342, 359.

   The "fraud" at issue in these cases is not that of common law fraud but rather an examination of "fraud on marital rights" in the establishment of a trust or other asset transfer. The court held:

   > We conclude that Inter vivos transfer of property is valid as against the marital rights of the surviving spouse unless the transaction is tantamount to a fraud as manifested by the

> absence of donative intent to make a conveyance of a present interest in the property conveyed. Without such an intent the transfer would simply be a sham or merely a colorable or illusory transfer of legal title.

The court then found that while under the inter vivos trust the decedent retained control and the ability to revoke the trust, the creation of the trust indicated donative intent and the trust assets were not part of the testamentary estate for purposes of determining the husband's statutory share.

4. In *First National Bank of Joliet v. Hampson*, Ill.App.3d 1057, 14 N.E.2d 1109 (3rd Dist., 1980) the Third District analyzed a revocable inter vivos trust under which the grantor/decedent served as trustee and held that the inter vivos trust was a valid trust and consequently the assets held thereunder passed under the terms of the trust rather than through the testamentary estate. While the court was addressing the claims of a surviving child rather than the spousal rights under the Probate Act, the court found that, while the decedent reserved the power to modify, amend or terminate the trust, and he served as trustee, the trustee held those powers in a fiduciary relationship and the powers cannot be attributed to the settlor even though they are one in the same person. Similarly, the court noted that legal title to the assets held in trust passed from the settlor at the time of conveyance and that the interests in the remainder beneficiaries were vested per the terms of the trust, subject to potential divestment and constituted present interest in the trust corpus at the time of transfer. Based upon these findings the Court upheld the validity of the trust and rejected the trust corpus as an asset of the probate estate.

5. In *Payne v. River Forest State Bank and Trust Company*, Ill.App.3d 1128, 401 N.E.2d 1229 (1st Dist. 1980) the Court noted that in order to establish an "intent to defraud" the rights of a surviving spouse a plaintiff must show the transfer of property was "colorable or illusory" based upon evidence indicating an absence of present donative intent and the settlor's retained power to revoke the transfer. The *Payne* Court noted the criteria set forth in *Johnson v. LaGrange State Bank* that a surviving spouse's marital rights can be defeated by an actual transfer of property but a purported transfer in which the owner does not intend to convey a present interest but intends to retain total and complete control indicates an intent to defraud the surviving spouse and subject the transferred property to treatment as a probate asset and consequently subject to the spouse's statutory claim. The "fraud" relates to the absence of present donative intent to transfer an interest in property, not the presence of an intent to defeat statutory and marital rights of a surviving spouse.

6. The analysis of the Supreme Court in *Johnson v. LaGrange State Bank*, was similarly followed by the 1st District in *Estate of Mocny*, 257 Ill.App.3d

291, 630 N.E.2d 87 (1st Dist. 1993) in which the 1st District Appellate Court found that the establishment of joint tenancy accounts carry a presumption of present donative intent which renders the transfer valid and effective to defeat the marital interest of the transferor or surviving spouse. The court further noted, however, that this presumption can be overcome only by clear and convincing evidence to the contrary and only by evidence that the transfer was made solely to establish a convenience account will satisfy this criteria.

In this case, the Court further noted that the beneficiary designations made by an individual to direct the proceeds of life insurance policies are not vulnerable to challenge in a cause of action for illegally defeating marital rights because every life insurance policy, by its nature, is a testamentary transfer.

VIII. EFFECT OF DIVORCE ON SPOUSAL DESIGNATIONS IN TESTAMENTARY INSTRUMENTS

A. Under the Illinois Probate Act, 755 ILCS 5/4-7, upon the dissolution of marriage or declaration of invalidity of a marriage all legacies, interests or powers of appointment granted to a spouse, or the nomination of the spouse to a fiduciary office in a will which has been executed before the entry of the judgment of dissolution of marriage or declaration of invalidity is void, and the will is to take effect in the same manner as if the former spouse had died before the testator.

B. Similarly, under the Illinois Trust and Dissolutions of Marriage Act, 760 ILCS 35/1, upon a judicial termination of marriage of the settlor of a trust, every provision which is revocable by the settlor pertaining to the settlor's former spouse in a trust instrument or amendment which has been executed by the settlor before the entry of the judgment of judicial termination is revoked and the trust is to be administered and construed as if the settlor's former spouse had died upon entry of the judgment of judicial termination of the settlor's marriage. Under this statute a provision is considered "revocable by the settlor" if the settlor has the power at the time of entry of the judgment of judicial termination of marriage to "revoke, modify or amend said provision, either alone or in conjunction with any other person or person". Note that under this definition, if the settlor has reserved no such powers to revoke or amend the trust, i.e. under the terms of an irrevocable life insurance trust or gift trust, the dissolution of marriage would not affect the spouse's right to serve as trustee.

The terms of settlement between the parties might include a specific provision whereby the spouse would resign as trustee and/or renounce all rights under the trust, and the order of dissolution might so reflect this agreement.

A revocable, non-amendable trust instrument may include a provision indicating that upon the termination of marriage all rights of the spouse designated therein, including the right to serve as trustee and as a beneficiary, would terminate.

The draftsman might also consider and discuss with the client a provision indicating that the term "spouse" contained in the trust should refer to that individual to whom the grantor is married from time to time. However, this provision should be expressly discussed with the client and considered in the context of any subsequent marriage. If the grantor, in conjunction with a later marriage, enters into a prenuptial agreement with a second spouse, this provision of the trust instrument should be considered and, if it is intended that the spouse waive any rights under that trust, the prenuptial agreement should expressly address such waiver.

C. Note that the above provisions only take effect upon the judicial termination of marriage.

D. There is no corresponding provision for termination of a former spouse's rights under a life insurance policy absent a specific change in the beneficiary designation or a specific termination of the former spouse's rights under the order of dissolution.

E. 1990 revisions to the Uniform Probate Code included changes to the "revocation on divorce statute" and add a new Section 2-804 to the Code to cover will substitutes including revocable trusts, life insurance, retirement plans, transfer on death accounts, and other dispositions of property which the decedent had established before the divorce and which were revocable at the time of the decedent's death. Illinois has not adopted this statute.

F. The United States Supreme Court and *Egelhoff ex-rel.Breiner*, 121 S.Ct. 1322 (S.Ct. 2001) held that ERISA overrode state statutes which provided for "revocation-on-divorce" of beneficiary designations under employer-provided life insurance and pension plans. Consequently, any change in beneficiary designation must be reflected in the order and implemented under ERISA standards.

IX. PRE-DIVORCE PLANNING

A. While the statutory provisions noted above or the terms of an order of dissolution may cure or address beneficiary or fiduciary designations of a former spouse, these provisions only become effective upon the dissolution of marriage. During a period of separation or pending divorce, these designations are unaffected. Consequently, clients in such situations should carefully consider the terms of their wills or living trusts as well as other assets passing through titling, such as joint tenancy property, life insurance beneficiary designations, retirement plan beneficiary designations, annuity contracts and payable on death accounts.

B. Beneficiary designations on IRAs may be changed without spousal consent. However, ERISA qualified plans require spousal consent for beneficiary changes. A client may consider withdrawing from a qualified plan and transferring plan assets to an IRA if this option is available.

C. Irrevocable designations, such as under an irrevocable life insurance trust, may be reviewed to determine if a trustee or a designated third party has the ability to amend or modify the terms of the trust.

D. Joint tenancy accounts may be closed or joint tenancy assets severed.

E. Note the potential issue of fraudulent conveyances to clients, that such transfers may have no effect on the "marital property" character of assets in the context of divorce proceedings, and that such transfers may be treated as "dissipation" of marital property which may be adjusted for in the division of marital property.

F. Client may consider establishing revocable living trusts, joint tenancy accounts or gift trusts, or the direct gifting of property, to minimize potential claims of a surviving spouse or a statutory share under the Probate Act in the event of death while divorce proceedings are pending. Such transfers may be subject to a spousal challenge as noted under Section VII. above and may be subject to claims of dissipation of marital assets in the divorce property proceedings. As noted above, the standard is a determination of an "intend to defraud" and Illinois cases have consistently held that an owner of property has the absolute right to dispose of his property during his lifetime in any manner he sees fit even when the transfer is conducted to minimize or defeat a spouse's statutory marital ownership interest in the property conveyed. See *Wood v. Wood*, 284 Ill.App.3d 718, 672 N.E.2d 385 (4th Dist. 1996) and *Lesnik v. Estate of Lesnik*, 82 Ill.App.3d 1102, 403 N.E.2d 683 (1st Dist. 1980).

X. EFFECT OF ESTATE PLANNING ASSET TRANSFERS ON MARITAL PROPERTY

A. Under the Illinois Dissolution of Marriage Act (750 ILCS5/503) property is characterized as either "marital" or "non-marital."

"Marital property" is defined as "all property acquired by either spouse subsequent to the marriage" except types of property classified as "non-marital property." Marital property is subject to division between the spouses in divorce while non-marital property is exempt from such division.

Non-marital property includes gifts or inheritances received by a spouse, pre-marital assets and similar property.

B. In order to maximize the potential use of the applicable exclusion amount in estate planning for a married couple, in many instances each spouse will adopt a will or living trust which provides for the creation of a trust at the death of the first spouse to hold assets equivalent to the applicable exclusion amount in trust for the benefit of the surviving spouse for life. However, this plan or structure may be defeated if at the death of the first spouse there are no assets in his or her estate or passing through the terms of his or her will or living trust to fund that trust. For instance, if all of the couple's assets were held in joint tenancy, they may automatically pass by operation of law to the surviving spouse (unless a disclaimer is used to push joint tenancy assets into that spouse's estate). Similarly, if all assets were titled to the surviving spouse, at the death of the first spouse, there would be no assets to pass through his or her estate.

In conjunction with this structuring, estate planners frequently recommend the division of assets between spouses, such as the severance of joint tenancy property or the transfer of assets previously held in one spouse's name to the other spouse. This rearrangement of assets may create several potential issues in the event of a later divorce regarding the characterization of assets as "marital" or "non-marital" at that time:

1. If the assets were originally in joint tenancy and were severed, this may be a limited issue because joint tenancy assets would generally be classified as "marital property" and this character would continue after the severance. However, if the severance was treated as "gifts" between the spouses the result may be skewed if one spouse's assets have appreciated substantially in value while the other spouse's have remained fixed in value.

2. If the assets were initially marital property, but titled in only one spouse's name and then transferred to the other spouse, the transfer may be characterized as a gift from the transferring spouse to the recipient and consequently the marital character of the assets may be argued to have changed to non-marital property of the recipient spouse. In that scenario, the recipient spouse may then argue that the remaining assets held in the name of the transferring spouse continued to retain their marital character and were subject to division between the spouses at the time of dissolution of marriage while the "gifted" assets were non-marital property. Interspousal gifts may be made under Illinois law, converting marital property to non-marital property. However, there is a presumption that property acquired after marriage retains its "marital" character absent clear, convincing and unmistakable evidence" to the contrary. In *re Marriage of Weiler*, 258 Ill.App.3d 454, 629 N.E.2d 1216 (5th Dist. 1994). In *re Marriage of Lee*, 246 Ill.App.3d 628, 615 N.E.2d 1314 (4th Dist. 1993), mandate recalled 623 N.E.2d 1361, appeal denied 153 Ill.2d 560, 624 N.E.2d 808.

3. If the assets were originally titled in one spouse's name and treated as non-marital, i.e. pre-marriage or inherited assets, the transfer of these assets to the other spouse may be characterized as a gift and consequently become non-marital assets of the other spouse. In that scenario, the gifted assets are no longer treated as non-marital property of the transferring spouse but rather may be characterized as non-marital property of the recipient spouse. In *re Marriage of Weiler*, 258 Ill.App.3d 454, 629 N.E.2d 1216 (5th Dist. 1994). In *re Marriage of Lee*, 246 Ill.App.3d 628, 615 N.E.2d 1314 (4th Dist. 1993), mandate recalled 623 N.E.2d 1361, appeal denied 153 Ill.2d 560, 624 N.E.2d 808.

C. In cases in which clients are dividing assets and these issues may arise at a later time, estate planners may wish to consider an acknowledgment letter in which the clients acknowledge that the division and retitling of assets is being done for estate planning purposes and in the event of a later dissolution of marriage proceeding it is intended that these assets be characterized as "marital" rather than "non-marital" property. For an example of this type of acknowledgement see Exhibit A of these materials.

D. There is some question as to whether this type of acknowledgment letter indicates or is evidence of a retained interest in property which would cause inclusion of that property in the estate of the first spouse to die for federal estate tax purposes under Section 2036 or other provisions of the Internal Revenue Code. Presumably, even if the assets were includable for federal estate tax purposes in the estate of the first spouse to die this would be a limited issue because the assets would pass to the surviving spouse and qualify for the marital deduction. However, this could arguably be a potential problem for the surviving spouse if the credit shelter trust of the first spouse is funded with assets which were derived from this division of property and the I.R.S. were to contend that the second spouse died as the beneficiary of a trust which he or she had "funded" and consequently brought those trust assets into his or her taxable estate.

XI. EFFECT OF 2001 TAX ACT ON TESTAMENTARY TRUST

In some cases, an individual may have adopted a will or living trust which provided that at his or her death the unified credit or applicable exclusion amount was directed to his or her children, either outright or in trust, with the excess then directed to a QTIP marital trust for the benefit of the second spouse for the remainder of the spouse's lifetime.

This design may have been adopted based upon the client's assets and the unified credit amounts available at the time of adoption. The portion of the estate passing to children may be determined through a formula which directed the unified credit amount to the children with the excess passing to the marital trust.

These documents should be carefully reviewed with clients following enactment of the Economic Growth and Tax Relief Act Reconciliation Act of 2001 and the increase in the applicable exclusion amount, taking into consideration the client's current assets. While a funding formula may have worked well when the unified credit was $600,000.00, it may result in a significantly different and unexpected result in light of the increased exclusion level.

For example, an individual with an estate of $1,200,000 may have adopted this type of structure based upon a presumed $600,000.00 unified credit amount passing to the children and $600,000.00 passing to the marital trust. With the applicable exclusion amount at $1,000,000.00, instead of an equal division of these assets, the surviving spouse's trust may be funded with only $200,000.00 while the children receive $1,000,000.00. This result may be even more dramatic as the scheduled exclusion amount rises over the next several years.

XII. QTIP TESTAMENTARY TRUST

In the case of second marriages, many individuals wish to provide income for their surviving spouse for the remainder of his or her lifetime with the assurance that the principal of their assets will ultimately pass to their children at the time of the surviving spouse's death. The most common structure for this arrangement is through the creation of a testamentary QTIP marital trust.

A. This trust is designed to qualify for the marital deduction at the time of the first spouse's death by satisfying certain requirements under IRC Section 2056(b) including a requirement that the surviving spouse be the only beneficiary of the trust for the remainder of his or her lifetime and that all of the income from this trust be distributed to the surviving spouse during that term. Following the death of the surviving spouse, this trust is charged with paying the incremental estate tax which may be due in the surviving spouse's estate as a result of inclusion of the QTIP trust in the surviving spouse's taxable estate. Generally, this provision is included in the terms of the QTIP trust or is statutorily directed under IRC Section 2207A, unless the surviving spouse specifically directs that the taxes resulting from inclusion of the QTIP marital trust in his or her estate be paid from the assets of his or her estate.

B. The QTIP trust is normally coupled with an applicable exclusion trust to utilize the applicable exclusion amount available in the first spouse's estate so that those assets are untaxed in the second estate. This is accomplished by the executor making a QTIP election to treat the QTIP marital trust as qualifying for the marital deduction in the first estate, subject to inclusion and taxability in the second spouse's estate.

While the QTIP trust may have only the surviving spouse as a beneficiary in order to qualify for the marital deduction, the applicable exclusion amount may be utilized to fund specific bequests to children or other non-spousal

beneficiaries or to fund a trust which is partially available for the benefit of children as well as the surviving spouse. Consequently there is much flexibility in utilizing the applicable exclusion portion of an individual's estate, coupled with the QTIP trust assets passing to the surviving spouse.

C. If the surviving spouse has a small estate and it is not anticipated that the applicable exclusion amount would be fully utilized at the time of his death, a QTIP election for the marital trust created at the time of the first spouse's death is generally advisable in order to take advantage of the applicable exclusion amount available in the second spouse's estate. This may be particularly true as the applicable exclusion amount is scheduled to rise over the next several years prior to the scheduled repeal of the federal estate tax.

On the other hand, if the second spouse has significant assets and it is anticipated that his estate will be taxed at the highest marginal brackets, electing out of paying estate tax at the death of the first spouse by making a QTIP election may ultimately be financially detrimental to the first spouse's beneficiaries because, while the estate tax liability is deferred, it may be significantly higher because the QTIP trust assets are going to be taxed at the highest marginal rates in the surviving spouse's estate. For example, the QTIP election may result in the trust assets being taxed at a 50% rate in the second spouse's estate, rather than a 41% rate in the estate of the first spouse.

In addition, the QTIP marital trust will be taxed in the second spouse's estate based upon the value of the assets at the time of his or her death. If the QTIP election is not made, while the trust assets are taxed at the first death, any appreciation in value of those assets will be untaxed in the second estate because they are not includable in the second spouse's estate.

This analysis frequently requires a careful review of each spouse's assets at the time of the first death as well as consideration of the surviving spouse's health, life expectancy, etc. This analysis is further compounded by the scheduled increased applicable exclusion amounts under the federal estate tax system and ultimate repeal of the tax.

D. In some cases, children may receive the applicable exclusion amount from the decedent's estate while the QTIP marital trust is held for the surviving spouse. In those cases, the decedent may wish to insure that his or her spouse has sufficient cash flow to maintain their lifestyle for the balance of the surviving spouse's life. The QTIP trust may include a provision directing the trustee to distribute all of the income of the trust annually but if that income does not reach a specified level, i.e. $100,000 per year, the trustee is directed to distribute principal sufficient to total that amount for the year. This may also minimize potential disputes concerning the trustee's discretionary power to use principal of the trust for the surviving spouse's benefit.

This approach may also allow the trustee to focus investments of the trust on growth type investments while assuring the surviving spouse of a cash flow stream. The trust provisions may include a waiver of the general "prudent investor" rule for the trustee and specifically allow the trustee to invest a disproportionate share of the trust in growth stocks or assets. The trust may include a provision directing the trustee to distribute a portion of each year's growth, i.e. 20% of appreciation, to the spouse in conjunction with income distributions.

E. In some instances, it may be advisable to include a limited testamentary power of appointment whereby the surviving spouse could appoint a portion of the QTIP marital trust to the first spouse's children or other decedents, either in trusts or outright. This may allow some flexibility to protect assets which might otherwise be exposed to a child's judgment claims, etc. The terms and limitations on this type of power should be carefully considered.

XIII. LIFETIME QTIP TRUST

A. In some second marriages, one spouse may have significant assets while the other has few. Because the federal estate tax system allows each spouse an individual applicable exclusion amount exemption (currently $1,000,000) there is the potential to combine the benefit of these exclusion amounts by taking advantage of the exclusion in each spouse's estate. However, in many instances, the asset-endowed spouse may be unwilling or uncomfortable in gifting assets directly to her spouse because there is no assurance that those assets will ultimately pass to her children at her husband's death.

One method to take advantage of the less wealthy spouse's applicable exclusion amount is for the wealthier spouse to gift assets into a QTIP gift trust while both spouses are living. This trust provides for the benefit of the less-wealthy spouse by directing the distribution of income to him or her for the remainder of his or her lifetime. At the time of funding this trust, an election is made that the trust will be treated as part of the beneficiary spouse's estate at the time of his or her death. The trust would also be directed to pay the estate taxes resulting from inclusion of this trust in the beneficiary spouse's estate at the time of death or it is mandated under IRC Section 2207A. However, the beneficiary spouse need not be given a power of appointment or direction over the trust corpus at the time of death and consequently the donor spouse may direct that the trust assets be distributed for the benefit of his or her children following the death of the beneficiary spouse.

This transfer effectively moves the QTIP trust assets out of the wealthier spouse's estate (there is no gift tax effect because the gift is treated as a spousal gift under IRC Sectopm 2523(f)); allows the use of the applicable exclusion amount available to both estates, thus doubling up the benefit that might

otherwise be lost because of the minimal assets owned by one spouse; and insures that the trust assets ultimately pass to intended beneficiaries.

B. In PLR 9437032 the donor created a QTIP gift trust which granted a qualified income interest for life to the donee's spouse and a qualified income interest for the donor in the event the donor survived the donee spouse. The Service ruled that if a proper QTIP election was made for gift tax purposes at the time the trust was created the transfers to the trust would qualify for a gift tax marital deduction. If the donor predeceased the donee spouse no portion of this trust would be includable in the donor's estate. If the donor survived the donee spouse and the donee's executor made a QTIP election with respect to the assets held in the QTIP trust at the time of the donee's death, then only that portion of the trust assets for which QTIP treatment was elected would be includable in the donor's gross estate at the time of the donor's death. If the donee spouse predeceased the donor and no QTIP election was made, then the trust property would be fully includable in the donee's gross estate but would not be includable in the donor's gross estate at the time of the donor's death.

EXHIBIT A

ACKNOWLEDGMENT

The undersigned, _____ and _____, husband and wife, hereby acknowledge that incident to their estate planning they may from time to time transfer to or retitle assets to either or both of them either individually, in the name of their respective **self declarations of trust/revocable trusts**, in joint tenancy, as tenants in common, or otherwise. In making such transfers, it is neither the desire nor intent of either _____ or _____ that any assets so transferred shall be treated as a Agift≅ under the Illinois Marriage and Dissolution Act (750 ILCS 5/503(a)(1) et al.) which would result in the recharacterization of any such assets as Anon-marital property≅ in the event of a subsequent divorce or dissolution of marriage, it being the intent of the parties that, absent express acknowledgment otherwise, all such assets shall be treated as Amarital property≅ under the Illinois Marriage and Dissolution Act (750 ILCS 5/503 et al.) or the law of any controlling jurisdiction in the event of such divorce or dissolution of marriage.

Dated:_____

_____

Subscribed and sworn to before me this _____ day of _____,2005.

_____

_____

Notary Public

Dated:_____

_____

Subscribed and sworn to before me this _____ day of _____, 2005.

_____

_____

Notary Public

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