

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

By  
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## Introduction

Article XVIII of the Illinois Probate Act<sup>1</sup> addresses creditor claims in probate. However, Illinois statutes have very little to say on the issue of claims against a decedent's non-probate property.<sup>2</sup>

Some states (such as Wisconsin<sup>3</sup> and Michigan<sup>4</sup>) have adopted provisions for the handling of claims against living trusts, including claims following the death of the trust's creator (also known as the grantor or settlor). The relatively new section 6-102 of the Uniform Probate Code<sup>5</sup> goes even further, addressing the administration of claims against all types of a decedent's non-probate property. But Illinois has yet to enact such provisions, and instead forces practitioners to rely upon a hodgepodge of caselaw and statutes. As a result, the question of how (or even whether) a creditor may pursue a claim against a decedent's non-probate property can be a confusing one for Illinois attorneys.

Dealing with claims against an Illinois decedent's non-probate property is critical in cases where the decedent's probate estate is insufficient to pay all valid claims, or where no probate estate has been opened for the decedent. With the recent rise in popularity of non-probate property such as living trusts and 401(k) and individual retirement accounts, it seems likely that this issue will gain even more importance in the future.

## Governmental Claims

Practitioners might assume all claims against a decedent's non-probate property are valid, as it is well-settled law that the government may collect against such property in order to pay a decedent's government-related debts, such as taxes.

For instance, at the federal level, Chapter 11 of the Internal Revenue Code specifically subjects joint property<sup>6</sup> and life insurance proceeds<sup>7</sup> to the estate tax,<sup>8</sup> and envisions a situation where the recipient of non-probate property either has paid or is required to pay estate tax on property he or she received.<sup>9</sup>

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<sup>1</sup> 755 ILL. COMP. STAT. §§ 5/18-1 to -15 (2006).

<sup>2</sup> That is, property that passes directly to beneficiaries upon the decedent's death, rather than pursuant to his or her will or via intestacy, because of the terms of a trust instrument, beneficiary designation form, or account agreement, or by operation of law).

<sup>3</sup> WIS. STAT. ANN. § 701.065 (West 2001).

<sup>4</sup> MICH. COMP. LAWS ANN. §§ 700.7501-700.7511 (West 2002).

<sup>5</sup> UNIF. PROBATE CODE § 6-102 (amended 2006), 8 U.L.A. 178-179 (Supp. 1998).

<sup>6</sup> I.R.C. § 2040.

<sup>7</sup> I.R.C. § 2042.

<sup>8</sup> Additionally, property in which the decedent had an interest at death (such as property in the decedent's living trust) would be subject to estate tax pursuant to provisions such as I.R.C. § 2033, I.R.C. § 2036, and I.R.C. § 2038.

<sup>9</sup> I.R.C. §§ 2205 – 2206, 6324(a)(2).

The Illinois Estate and Generation-Skipping Transfer Tax Act mimics the Internal Revenue Code in terms of who must pay the tax,<sup>10</sup> and equitable apportionment (providing for the payment of taxes from both probate and non-probate property) is permitted in some cases.<sup>11</sup>

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

Any... real and personal property and other assets in which the deceased person had any legal title or interest at the time of his or her death (to the extent of that interest), including assets conveyed to a survivor, heir, or assignee of the deceased person through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement.<sup>12</sup>

But what about non-governmental claims against a decedent's non-probate property? There are two general arguments for why these types of claims may not be pursued under Illinois law.

### The *Johnson* Argument

The first of these arguments (which I will refer to as the "*Johnson* Argument") is based on the belief that the Illinois Supreme Court's decision in *Johnson v. La Grange State Bank*,<sup>13</sup> and the decisions of Illinois Appellate Courts made in the wake of that case,<sup>14</sup> exempt a decedent's non-probate property from the claims of non-governmental creditors.

*Johnson* actually involved two consolidated cases, both relating to the renunciation of a decedent's will by her surviving spouse pursuant to section 2-8 of the Illinois Probate Act.<sup>15</sup> In each case, the first-to-die spouse made *inter vivos* transfers that reduced the size of her probate estate, and thereby reduced the amount of property her surviving spouse could receive upon renunciation. In one case, the transfers were to a living trust; in the other, to a joint tenancy account. The question before the Court in *Johnson* was whether these transfers should be deemed invalid as a fraud against the "marital rights" of the surviving spouse.

The Court in *Johnson* ruled that the *inter vivos* transfers in both cases were valid. In so deciding, the Court stated that the test for fraud against the marital rights of a surviving spouse involves the question of whether the decedent who made the *inter vivos* transfers had the intent to defraud. If the decedent had present donative intent at the time of the transfers, then the transfers are valid. If, instead, the decedent lacked present donative intent at that

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<sup>10</sup> 35 ILL. COMP. STAT. § 405/6(c) (2006).

<sup>11</sup> See Schreder, "Even More Uncertainty about Estate-Tax Apportionment," 95 Ill. Bar J. at 306 (June 2007).

<sup>12</sup> 305 ILL. COMP. STAT. § 5/5-13 (2006).

<sup>13</sup> 383 N.E.2d 185 (1978).

<sup>14</sup> See, e.g., *In re. Estate of Mocny*, 630 N.E.2d 87 (1st Dist. 1993).

<sup>15</sup> 755 ILL. COMP. STAT. § 5/2-8 (2006).

time, then the transfers were “illusory or colorable and in the nature of a sham transaction,” and are therefore invalid.

It would be incorrect to apply the Court’s opinion in *Johnson* to the issue of creditor claims, as the Court is only considering the question of *inter vivos* transfers and non-probate property in the “marital rights” context. Yet the nature of a renunciation is intrinsically different from that of a creditor’s claim. Simply put, a right of renunciation is not a creditor’s claim – rather, it is a right created only upon and as a result of the decedent’s death, exists only because of section 2-8, and is tied only to the value of the probate property in the decedent’s estate. By contrast, no statutory provision restricts or links creditor claims to the amount of probate property owned by a decedent at his or her death.

### The “No Ownership” Argument and The Illinois Uniform Fraudulent Transfer Act

A potentially better argument is that, upon an individual’s death, his or her non-probate property is no longer owned by him or her. Given that fact, how can such property be reached to pay the decedent’s debts?

In order to reach a decedent’s non-probate property, creditors may be able to utilize Illinois’s Uniform Fraudulent Transfer Act<sup>16</sup> (referred to hereinafter as the “UFTA.”) to set aside or render void certain transfers made by the decedent.<sup>17</sup> The UFTA defines “transfer” broadly to include “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset...”<sup>18</sup>

The UFTA contains two different ways to prove a transfer to be fraudulent.

To begin with, a transfer is considered fraudulent – regardless of whether the creditor’s claim arose before or after the transfer – if the transfer was made:

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

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<sup>16</sup> 740 ILL. COMP. STAT. § 160/1 – 12 (2006).

<sup>17</sup> 740 ILL. COMP. STAT. § 160/8(a)(1) (2006).

<sup>18</sup> 740 ILL. COMP. STAT. § 160/2(l) (2006).

<sup>19</sup> 740 ILL. COMP. STAT. § 160/5(a) (2006).

The UFTA also sets forth eleven so-called “badges of fraud” which can be used in cases involving allegations of actual intent.<sup>20</sup>

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

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

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

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

Note that, with respect to some types of property, neither caselaw nor statutory law addresses creditors in the post-death setting. In those cases, I have tried to extrapolate an answer based on whether a creditor can reach the property during the debtor’s lifetime.

### Living Trusts

The Illinois Code of Civil Procedure contains a limited exemption from judgment for property held for a debtor’s benefit in a trust created by someone other than the debtor<sup>24</sup>; the Trusts and Trustees Act contains a similar exemption for certain trusts created for disabled beneficiaries.<sup>25</sup> However, neither these sections nor any other provisions in Illinois law exempt living trust property (that is, property a grantor places in trust for his own benefit) from judgment.

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<sup>20</sup> 740 ILL. COMP. STAT. § 160/5(b) (2006).

<sup>21</sup> 740 ILL. COMP. STAT. § 160/6(a) (2006).

<sup>22</sup> 740 ILL. COMP. STAT. § 160/2(b)(2) (2006).

<sup>23</sup> 740 ILL. COMP. STAT. § 160/10 (2006).

<sup>24</sup> 735 ILL. COMP. STAT. § 5/12-1403 (2006).

<sup>25</sup> 760 ILL. COMP. STAT. § 5/15.1 (2006).

The general rule regarding living trusts and creditor protection can be found in the Restatement (Second) of Trusts: “where a person creates for his [or her] own benefit a trust with a provision restraining the voluntary or involuntary transfer of his [or her] interest, ... creditors can reach [the trust estate].”<sup>26</sup> Illinois courts follow this general rule.<sup>27</sup>

But what about reaching property in a living trust after the grantor/decedent’s death? At least one court interpreting Illinois law has found this permissible. In *In Re. Morris*,<sup>28</sup> the case cited above, the U.S. District Court for the Central District of Illinois encountered a complicated situation involving a debtor and her spendthrift trust. The debtor, Doris Morris, filed a petition in bankruptcy, and the bankruptcy trustee sought to collect the property in Ms. Morris’s trust. The Court ruled that, even though Ms. Morris subsequently died, the bankruptcy trustee could reach both all of the property in the trust, even property that passed to remainder beneficiaries upon Ms. Morris’s death.<sup>29</sup> This opinion is consistent with the Restatement (Third) of Trusts, which states that “property held in... trust is subject to the claims of creditors of the settlor or of the deceased settlor’s estate if the same property belonging to the settlor or the estate would be subject to the claims of the creditors, taking account of homestead rights and other exemptions.”<sup>30</sup>

One practical matter that arises when considering living trusts and the UFTA involves the timing of the transfer involved. This issue will impact the application of the UFTA’s limitations period. Consider the following somewhat typical scenario:

John Smith creates a living trust in 2007, with himself as initial beneficiary.  
At the advice of his attorney, John Smith fully funds<sup>31</sup> his living trust in 2008.  
Upon John Smith’s death in 2015, his wife Judy Smith becomes the sole beneficiary of his living trust.

For purposes of the UFTA, was the “transfer” made in 2008, when John Smith fully funded his living trust, or in 2015, when the beneficiary of the living trust changed from John Smith to his wife?

If the transfer is deemed to have been made in 2008, then a creditor’s claim could be defeated because of the expiration of the UFTA’s limitations period cited above. On the other hand, a creditor could take the position advanced by California’s 4th District Court of Appeals in *Gagan v. Gonyd*.<sup>32</sup> The Court in *Gagan* stated that the funding of a living trust was not a transfer at all, since the funding did not meet the requirement for “disposing of or

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<sup>26</sup> The Restatement (Second) of Trusts § 156 (1959).

<sup>27</sup> See, e.g., *In Re Morris*, 151 B.R. 900, 906-7 (C.D. Ill. 1993) (“if a settlor creates a spendthrift trust for her own benefit, it is void as to existing or future creditors, and they can reach her interests under the trust”).

<sup>28</sup> 151 B.R. 900 (1993).

<sup>29</sup> 151 B.R. at 906-7.

<sup>30</sup> The Restatement (Third) of Trusts § 25(e) (2003). See also Clifton B. Kruse, Jr., *Revocable Trusts: Creditors’ Rights After Settlor-Debtor’s Death*, Prob. & Prop., Nov./Dec. 1993, at 40 (suggesting that the trend national is toward allowing creditors to reach living trust property after a settlor’s death).

<sup>31</sup> By “fully funds,” I mean that John Smith changes titles and beneficiary designations so that, upon his death, all of his property is either owned by or becomes payable to his living trust.

<sup>32</sup> 86 Cal. Rptr. 2d 733 at 737 (1999).

parting with an asset or an interest in an asset” in the definition of “transfer” under California’s fraudulent conveyance act.<sup>33</sup>

### Life Insurance Proceeds

As mentioned above, the UFTA defines “transfer” to mean “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset....”<sup>34</sup> On the surface, then, it would appear that a decedent’s creditors could use the UFTA to reach the proceeds of life insurance on his or her life, as such proceeds were indeed transferred by the decedent/insured to his or her beneficiaries upon the decedent’s death. However, current law reaches the opposite result.

To begin with, Illinois law has long exempted life insurance proceeds from creditors. The Court in *Vieth v. Chicago Title & Trust Co.*<sup>35</sup> summarized the common law rule in 1940 by stating the following:

[T]he proceeds of life insurance are not an asset even to the insured. In fact, they do not come into existence until after death. During life the insured could not by any suit recover the proceeds, and claim them as his own. The creditor can have no right where the insured possessed none.<sup>36</sup>

Additionally, the Illinois Insurance Code<sup>37</sup> and the Illinois Code of Civil Procedure<sup>38</sup> use identical language to exempt the following from the reach of an insured’s creditors:

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

In *People ex rel. White v. Travnick*<sup>39</sup>, the Second District Court of Appeals stated that this statutory language “codifies the holdings of a long line of cases,” including the *Vieth* case. That being said, the statutory language appears somewhat ambiguous, as it is unclear whether the proceeds exemption applies to “[a]ll proceeds payable because of the death of the insured,” regardless of the beneficiary’s identity, or only to such proceeds as are “payable to a wife or husband of the insured, or to a child, parent, or other person dependent upon the insured.” But Illinois courts (including the Court in *Travnick*) have consistently ruled that the life insurance proceeds exemption applies regardless of the identity of the beneficiary of the proceeds.

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<sup>33</sup> Note that Illinois’s definition of “transfer” is identical to California’s.

<sup>34</sup> 740 ILL. COMP. STAT. § 160/2(l) (2006).

<sup>35</sup> 30 N.E.2d 126 (Ill. App. 1 Dist. 1940).

<sup>36</sup> 30 N.E.2d at 130.

<sup>37</sup> 215 ILL. COMP. STAT. 5/238(a) (2006).

<sup>38</sup> 735 ILL. COMP. STAT. 5/12-1001 (2006).

<sup>39</sup> 806 N.E.2d 270 (2004).

The First District Court of Appeals's opinion in *In Re Estate of Grigg*<sup>40</sup> is illustrative of this point. The *Grigg* case involved a married man named Allen M. Grigg who purchased a \$50,000 term life insurance policy, and designated a woman other than his wife (a Barbara Bronson) as the beneficiary. Following her husband's death, Mrs. Grigg sought to have Ms. Bronson pay Mr. Grigg's personal debts and the debts of his estate from the insurance proceeds she received. Mrs. Grigg's argument was based on a reading of the Illinois Insurance Code language that "the exemption [on life insurance proceeds] for debts of the insured extends only to spouses of the insured or certain related persons dependent on the insured."<sup>41</sup> The Court in *Grigg* states that "[t]his is a novel argument," noting that "it does not appear that anyone has ever advanced the position of the petitioner in any reported case."<sup>42</sup> The Court goes on to reject the argument, relying instead on a 1934 case,<sup>43</sup> and a 1937 law review article written by the chairman of the commission that drafted the Illinois Insurance Code.<sup>44</sup>

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

1. The Court in *Grigg* bases its holding in favor of Ms. Bronson not on Mrs. Grigg's interpretation of the above language, but on the fact that, even if her interpretation was correct, Mrs. Grigg still could not rely on the cited section of the Illinois Insurance Code for relief. This is because section 238(a) of the Illinois Insurance Code applies only to "debts or liabilities of the insured," not to debts or liabilities of the insured's estate.
2. Interestingly enough, the trial court in this case ruled that Ms. Bronson was required to pay Mr. Grigg's personal debts from the insurance proceeds. Ms. Bronson did not appeal this ruling, so the First District Court of Appeals was unable to consider whether it was correct.<sup>45</sup>
3. Contrary to what the Court in *Viet* said, life insurance can in fact function as an asset to the insured during his or her lifetime. As the United States Bankruptcy Court for the Central District of Illinois has observed, "[t]he validity of the common law principle that life insurance proceeds are not property of the insured is itself now subject to some doubt, in light of the advent of viatical settlements and accelerated death benefits...."<sup>46</sup>

Even if we ignore the above cases, the UFTA states that it "shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this Act among states enacting it."<sup>47</sup> And courts in a number of the states have ruled that life

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<sup>40</sup> 545 N.E.2d 160 (Ill. App. 1 Dist. 1989).

<sup>41</sup> 545 N.E.2d at 161.

<sup>42</sup> 545 N.E.2d at 161.

<sup>43</sup> *Gurnett v. Mutual Life Ins. Co. of New York*, 191 N.E. 250 (1934).

<sup>44</sup> Havighurst, *Some Aspects of the Illinois Insurance Code*, 32 Ill. L. Rev. 391 (1937).

<sup>45</sup> 545 N.E.2d at 161.

<sup>46</sup> *In re. Ashley*, 317 B.R. 352, 356 n.2 (2004).

<sup>47</sup> 740 ILL. COMP. STAT. § 160/12 (2006).

insurance proceeds are not “property” subject to the Uniform Fraudulent Transfer Act or its predecessor, the Uniform Fraudulent Conveyance Act.<sup>48</sup>

### Tenancy by the Entirety Property

The 2000 Illinois Supreme Court decision in *Premier Property Management, Inc. v. Chavez*<sup>49</sup> addressed the interplay between the UFTA and the provision in the Illinois Code of Civil Procedure which states that “[a]ny real property... held in tenancy by the entirety shall not be liable to be sold upon judgment entered on or after October 1, 1990 against only one of the tenants.”<sup>50</sup> The case involved a lawsuit filed against a man named Jose Chavez. Soon thereafter, Mr. Chavez “conveyed his interest in [his] residence from himself, as sole owner, to himself and his wife, as tenants by the entirety.”<sup>51</sup>

The Illinois Supreme Court was forced into action because of a conflict between the First District and Second District Appellate Courts. The Second District had previously ruled that the protection afforded to tenants by the entirety applies regardless of whether the property in question was conveyed with fraudulent intent.<sup>52</sup> Meanwhile, the First District had stated (in a 1997 case titled *In re Marriage of Del Giudice*<sup>53</sup>) that a conveyance of property into tenancy by the entire could be set aside if the conveyance was made with fraudulent intent.

After the *Del Giudice* case, the language of the Illinois Code of Civil Procedure mentioned above was amended to indicate that protection of tenancy by the entirety property does not extend to cases where “the property was transferred into tenancy by the entirety with the sole intent to avoid the payment of debts existing at the time of the transfer beyond the transferor’s ability to pay those debts as they become due.”<sup>54</sup> In *Chavez*, the Illinois Supreme Court held as follows:

The sole intent standard of the amended tenancy by the entirety provision is substantially different from the act intent standard of the Fraudulent Transfer Act. The sole intent standard provides greater protection from creditors for transfers of property to tenancy by the entirety.... The General Assembly, by adopting the sole intent standard, has made it clear that it intends to provide spouses holding homestead property in tenancy by the entirety with greater protection from the creditors of one spouse than that provided by the Fraudulent Transfer Act. Accordingly, the Fraudulent Transfer Act’s actual intent standard is not to be used to avoid transfers of property made to tenancy by the entirety.<sup>55</sup>

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<sup>48</sup> See *Great Southern Life Insurance Co. v. Agricultural Building Company Industries*, 2002 U.S. Dist. LEXIS 8194 (D. Minn. 2002), citing *Equitable Life Ins. Co. v. Hitchcock*, 258 N.W. 214, 216 (Mich. 1935) and *First Wisconsin Nat’l Bank of Milwaukee v. Roehling*, 269 N.W. 677, 680 (Wis. 1937).

<sup>49</sup> 728 N.E.2d 476.

<sup>50</sup> 735 ILL. COMP. STAT. § 5/12-112 (2006).

<sup>51</sup> 728 N.E.2d at 479.

<sup>52</sup> *E.J. McKernan Co. v. Gregory*, 763 N.E.2d 1370 (1994).

<sup>53</sup> 678 N.E.2d 47.

<sup>54</sup> 735 ILL. COMP. STAT. § 5/12-112 (2006).

<sup>55</sup> 728 N.E.2d at 482.

This ruling meant that (1) neither the First District in *Del Giudice* nor the Second District in *McKernan* was applying Illinois law correctly and (2) more importantly for purposes of this article, the UFTA cannot be used to attack transfers into tenancy by the entirety.

### Joint Tenancy Property

Of course, the *Chavez* case discussed above says nothing about a situation where property is transferred into joint tenancy (as opposed to tenancy by the entirety). And, since creditors can reach such property during the transferor's lifetime, they should also be able to do so after the transferor's death.

### Retirement Benefits

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

Federal law requires retirement plans that wish to qualify for favorable tax treatment under the Employee Retirement Income Security Act (also known as "ERISA") to mandate that "benefits... may not be assigned or alienated."<sup>56</sup> The United States Supreme Court has confirmed that this language prevents such benefits from being reached by creditors.<sup>57</sup>

Illinois law echoes federal law on this point, and in fact goes even further. ERISA applies only to employer-sponsored plans such as 401(k) and pension plans, but the Illinois Code of Civil Procedure exempts from the reach of creditors "[a] debtor's interest in or right, whether vested or not, to the assets held in or to receive pensions, annuities, benefits, distributions, refunds of contributions, or other payments under a retirement plan,"<sup>58</sup> and defines "retirement plan" broadly to include even retirement benefits (such as individual retirement accounts) that are not subject to ERISA.<sup>59</sup> Pension plans for government employees are also exempt from creditors.<sup>60</sup>

### Land Trusts

No Illinois law exempts land trusts from judgment. In fact, the decision in *First Security Bank of Glendale Heights v. Bawolf*<sup>61</sup> makes it clear that a transfer to a land trust can be a fraudulent conveyance.

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<sup>56</sup> 29 U.S.C. § 1056(d)(1) (2006).

<sup>57</sup> *Patterson v. Shumate*, 504 U.S. 753 (1992).

<sup>58</sup> 735 ILL. COMP. STAT. 5/12-1006(a) (2006).

<sup>59</sup> 735 ILL. COMP. STAT. 5/12-1006(b) (2006).

<sup>60</sup> See 40 ILL. COMP. STAT. 5/9-228 (2006)(exempting county employee pension plans), 40 ILL. COMP. STAT. 5/7-217(a) (2006)(exempting municipal employee pension plans), 40 ILL. COMP. STAT. 5/3-144.1 (2006)(exempting police officer pension plans), 40 ILL. COMP. STAT. 5/14-147 (2006) (exempting state employee pension plans), and 40 ILL. COMP. STAT. 5/16-190 (2006)(exempting teacher pension plans).

<sup>61</sup> 458 N.E.2d 193 (Ill.App. 2 Dist. 1983).

The *Bawoll* case involved a woman (Madlyne Bawoll) who, along with her husband, executed two notes. Mrs. Bawoll then transferred her residence (which apparently was her sole asset) into a land trust with her children as beneficiaries. Around the time of this transfer, Mrs. Bawoll and her husband defaulted on the payment of the notes. While the UFTA was not yet law when the Bawoll case was decided, the Court found that Mrs. Bawoll had committed fraud in law, the definition for which is very similar to one of the definitions of fraud under the UFTA.<sup>62</sup>

### Payable on Death Accounts

“Payable on death” accounts are known by a variety of other names: POD accounts, transfer on death (or TOD) accounts, and “Totten trusts.” These types of accounts, held at a bank or other financial institution, allow the account owner to designate a beneficiary to inherit the account upon the account owner’s death. In that way, these accounts are similar in nature to life insurance and retirement benefits. But unlike life insurance and retirement benefits, no Illinois law exempts payable on death accounts from the reach of creditors. In fact, Illinois law clearly indicates the similarities between payable on death accounts and living trusts. For instance, under the Illinois Trust and Payable on Death Accounts Act,<sup>63</sup> an individual setting up a payable on death account has the right to (1) change the designated beneficiary or (2) withdraw all of any part of the account, in each case without giving notice to the current named beneficiary.<sup>64</sup>

The most famous Illinois case involving payable on death accounts and creditors is *Montgomery v. Michaels*, a 1973 Illinois Supreme Court decision.<sup>65</sup> The *Montgomery* case involved a woman named Bernice D. Montgomery who, during her lifetime, established eight payable on death accounts, with her two children from a prior marriage as beneficiaries. Upon Mrs. Montgomery’s death, her husband and administrator (Dr. Earl Montgomery) sought to have the accounts declared illusory and invalid as a fraud on his marital rights. The Supreme Court wound up agreeing with Dr. Montgomery, but for purposes of this article the Court’s more interesting ruling involved the question of whether the payable on death account funds had to be used to pay for Mrs. Montgomery’s funeral. The trial court had ruled that Mrs. Montgomery’s funeral bill must be satisfied from the payable on death accounts, and the Illinois Supreme Court agreed:

In the event funds from other property are insufficient to pay debts and claims against the decedent’s estate, then such trust funds are available for the payment of estate debts and can also be reached for the payment of the expenses of administering the estate if there is not sufficient other property for this purpose.<sup>66</sup>

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<sup>62</sup> “To prove fraud in law, (1) there must be a voluntary gift; (2) there must be then existing or contemplated indebtedness against the donor; and (3) it must appear the donor did not retain sufficient property to pay his indebtedness.” 458 N.E.2d at 197. Cf. 740 ILL. COMP. STAT. § 160/6(a) (2006).

<sup>63</sup> 205 ILL. COMP. STAT. § 625/1 – 5 (2006).

<sup>64</sup> 205 ILL. COMP. STAT. § 625/4(a) (2006); 205 ILL. COMP. STAT. § 625/4(b) (2006).

<sup>65</sup> 301 N.E.2d 465 (1973).

<sup>66</sup> 301 N.E.2d at 468.

The Court also cites with approval language from the Restatement (Second) of Trusts that creditors of an individual who establishes a payable on death account (the “depositor”) can reach account assets after the death of the depositor.<sup>67</sup>

Of course, in the *Johnson* case discussed above (and decided in 1978), the Illinois Supreme Court reached an opposite result, and attempted to distinguish between *Johnson* and the *Montgomery* case.<sup>68</sup> The Court in *Johnson* also cited to the Lifetime Transfer of Property Act,<sup>69</sup> a 1977 law, in its discussion of *Montgomery*. Section 1 of the Lifetime Transfer of Property Act states as follows:

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 deceased retained any power or right with respect to the property.<sup>70</sup>

But neither the *Johnson* case nor the Lifetime Transfer of Property Act address the payment of creditor claims from a payable on death account. The cases that have commented on the Lifetime Transfer of Property Act (such as the First District Court of Appeals’s decision in *Estate of Mocny*<sup>71</sup>) stress that the Act’s function is merely to “set forth the applicable test for determining when an *inter vivos* transfer is invalid to defeat the marital right of the surviving spouse.”<sup>72</sup> The comments made about the Lifetime Transfer of Property Act when it was a bill in the Illinois House of Representatives make this clear.<sup>73</sup> Furthermore, the first five words of Section 1 of the Act – “An otherwise valid transfer of property” – imply that other standards may render *inter vivos* transfers invalid. Finally, *Estate of Mocny* totally distinguishes the Act from fraud, noting that “[p]roperly stated, the cause of action before us is not one for fraud, but one for illegally defeating a marital right.”<sup>74</sup>

### **Practical Problems**

It is all well and good to speak of how creditors may, in theory, reach certain types of non-probate property after the owner dies, but the lack of a specific Illinois statute creates some practical concerns as well. For instance, how will a creditor of an individual whose estate is not subject to probate learn that the debtor has died? And, assuming that a creditor does find out about a debtor’s death, what is the appropriate mechanism for obtaining judgment?

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

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<sup>67</sup> 301 N.E.2d at 468, quoting The Restatement (Second) of Trusts § 58, comment e (1959) (“... on death of the depositor if the deposit is needed for the payment of his debts, his creditors can reach it.”).

<sup>68</sup> 383 N.E.2d at 191 (“[t]he ‘retention of ownership’ test [used in] *Montgomery* was limited on its facts to Totten trusts.”).

<sup>69</sup> 755 ILL. COMP. STAT. § 25/0.01 – 2 (2006).

<sup>70</sup> 755 ILL. COMP. STAT. § 25/1 (2006).

<sup>71</sup> 630 N.E.2d 87 (1st Dist. 1993). See also *Clay v. Woods*, 487 N.E.2d at 1108 (1st Dist. 1985).

<sup>72</sup> See *supra* note 13. 630 N.E.2d at 91 (1st Dist. 1993).

<sup>73</sup> 80th GA, 1977, pp. 94-95, 5/3/77, 49th day, 29 of 223, H.B. 803.

<sup>74</sup> 630 N.E.2d at 92 (1st Dist. 1993).

1. Confirm whether a will of the decedent has been filed with the county clerk's office pursuant to section 6-1 of the Illinois Probate Act<sup>75</sup> (the "Probate Act").

2. If no will has been filed, then...

- (a) petition to open the estate (and set a hearing for same) pursuant to section 9-3 of the Probate Act,<sup>76</sup>
- (b) give notice as required by section 9-5 of the Probate Act,<sup>77</sup> and
- (c) appear in court on the hearing date to either open the estate or allow someone with priority under section 9-3 to open the estate.

Once the estate is opened, the creditor can begin a citation proceeding under Article XVI of the Probate Act.

Alternatively, a creditor could file a constructive trust action in chancery.<sup>78</sup>

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<sup>75</sup> 755 ILL. COMP. STAT. § 5/6-1 (2006).

<sup>76</sup> 755 ILL. COMP. STAT. § 5/9-3 (2006).

<sup>77</sup> 755 ILL. COMP. STAT. § 5/9-5 (2006). Of course, this assumes that the creditor can identify these individuals.

<sup>78</sup> See Schwartz and DiCarlantonio, "Litigating the Suit To Set Aside a Fraudulent Transfer," in Chancery and Special Remedies (IICLE 2006).