Estate Planning Insights

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MULTI-PARTY ACCOUNTS: TRUTH AND CONSEQUENCES

Many people open accounts that have more than one listed account owner or that have one or more persons listed as a beneficiary of the account. The legal effect of these accounts should be determined and understood, to make sure that these accounts are not destroying the estate plan of the person opening the account. Unfortunately, there are serious legal consequences to some of these accounts, so it is important to know the truth about them.

There may be good reasons for creating certain types of multiple party ("multi-party") accounts; however, some types of multi-party accounts cause problems on the death of a party. Many of these accounts are set up for "bad" reasons or due to "bad" advice or incorrect information. It is important for everyone to understand the legal rules that apply to any type of account he or she is going to create.

Types of Multi-Party Accounts. Some of the multi-party accounts specifically provided for by Texas law include: (i) Single-Party Account with "Payable on Death" ("POD") designation, (ii) Multiple-Party Account With Right of Survivorship, (iii) Multiple-Party Account With Right of Survivorship and POD Designation, (iv) Multiple-Party Account Without Right of Survivorship, (v) Convenience Account, and (vi) "Totten Trust" account. In addition, many financial institutions provide additional types of multi-party accounts, such as: (i) "Joint Tenants With Right of Survivorship" (often abbreviated "JTWROS" or "JT TEN"), (ii) Tenants in Common ("TIC"), (iii) Community Property (with or without a survivorship feature), and (iv) Single-Party or Multiple-Party Account with a "Transfer on Death" ("TOD") designation.

Who is a Party to an Account? Under Texas law, a party to an account is a person who has a present right, upon request, to payment from the account. For example, all joint tenants on a JTWROS account would be parties to the account. On the other hand, a POD, TOD or Totten Trust beneficiary is not a party to an account while the original payee (depositor) is living because the funds in the account only become payable to a beneficiary upon the death of the original payee or trustee.

Effect of Certain Multi-Party Accounts. The funds in an account that has a right of survivorship feature will pass automatically to the surviving joint tenant or tenants upon the death of a party to the account. If an account has been set up with a POD or TOD designation, upon the death of the original payee, the funds in the account will pass automatically to the POD/TOD beneficiary/beneficiaries. With a "Totten Trust" account, which is a type of bank account unrelated to an actual trust, the original payee (the depositor) is listed as the Trustee for the benefit of another person (the beneficiary). On the death of the original payee, the funds in a Totten trust account are paid to the listed beneficiary/beneficiaries.

The "Bad" Types of Multi-Party Accounts. The multi-party accounts that should be avoided by *most* people are those that act as an ownership transfer device upon death. This includes (i) accounts titled in the names of two or more persons as "Joint Tenants With Right of Survivorship" (or as a "Multiple-Party Account With Right of Survivorship"), (ii) accounts set up with a POD or TOD designation, in which one or more beneficiaries are named to receive the funds in the account upon the death of the depositor, and (iii) "Totten Trust" accounts. You will find these forms of titling on bank accounts, savings accounts, credit union accounts, certificates of deposit, brokerage accounts, investment accounts, stocks, bonds, mutual funds, etc.

The #1 Most Common Piece of Bad Advice. Clients routinely tell us that when they tried to open or change a joint account, requesting that it *not* have a survivorship feature, they were advised that if they did not structure the account as "Joint Tenants With Right of Survivorship", the account would be "frozen" on the death of the first

joint account holder, and the surviving joint account holder would no longer have access to the account. This is not true. Anyone who is listed on the account as a joint account "owner" continues to have access to the account after the death of the other account owner (just as they had access while both account owners were living). A named party on an account cannot be denied access by the financial institution merely because another party to the account has died.

Access versus Ownership. Before creating a joint account, consider the difference between *access* and *ownership*. In many cases, what an account depositor really wants by naming another person on his/her account is for that person to have "access" to their account, so that the other person can help with transactions. It is not necessary to give the additional party on the account an exclusive ownership interest in the account after the depositor's death if the depositor's only desire is to receive assistance with the account during his/her life. For this reason, Texas has created a pure "Convenience" account. If the account is (mistakenly) titled as "Joint Tenants With Right of Survivorship", however, then the depositor **is** giving the joint account holder more than access, the depositor is transferring ownership of the account to the joint account holder on the depositor's death. This may or may not be what the depositor intends.

Why Are Certain Multi-Party Accounts "Bad"? There are a number of reasons why certain multi-party accounts should be avoided, but the main reason is that these accounts pass outside of a person's estate plan in the person's Will or Living Trust Agreement. Because these accounts pass outside the estate plan, the benefits planned for in the Will or Living Trust may not be achieved. In other words, the provisions in the Will or Living Trust **will not apply** to these accounts. Particularly devastating can be the loss of tax benefits planned for, resulting in a large amount of unnecessary estate taxes being paid. Equally problematic is the fact that contingency planning cannot be done in a multi-party account agreement like it can in a Will or Living Trust Agreement, so that contingencies that occur may produce unintended results. Another way of stating the problem is to say that these assets may or may not pass to the right people upon the death of the depositor, and even if they pass to the right people, they may pass to them in the wrong form. Three specific examples of typical problems with these accounts follow.

Problem #1: The Underfunded Bypass Trust. Married couples who together have an estate larger than the estate tax exclusion amount ($1.5 million in 2005, $2 million for 2006 through 2008, $3.5 million in 2009, and $1 million for 2011 and thereafter) routinely include a "Bypass Trust" (also called a "Credit Shelter Trust" or "Family Trust") in their Wills or Living Trust Agreement so that they do not lose the exclusion amount available to the first spouse who dies. If a married couple does not have a Bypass Trust and all assets pass directly to the surviving spouse on the first spouse's death, then only the second spouse who dies will get to use the exclusion amount to avoid estate taxes–i.e., there is only one estate tax exclusion per couple in that case (instead of one per person). Thus, the Bypass Trust allows both spouses to utilize the estate tax exclusion and, in essence, doubles the amount a married couple can transfer to their children (or other beneficiaries) without estate tax. If a married couple with a Bypass Trust estate plan were to title their bank, brokerage and other accounts as "Joint Tenants With Right of Survivorship", upon the death of the first spouse, the deceased spouse's interest in the account will pass automatically and directly to the surviving spouse, outside of the estate plan in the Will or Living Trust. Therefore, these assets are not available to fund the Bypass Trust created in the Will or Living Trust upon the first spouse's death. The result is that a large portion of the couple's assets will be owned by the surviving spouse, individually, and this could cause the surviving spouse's estate to be above the estate tax exclusion amount available at the time of the surviving spouse's death. If a Bypass Trust is underfunded (because the first spouse's estate tax exclusion amount is not utilized to the extent of the full value of the first spouse's assets), then it is likely that tens or hundreds of thousands of dollars in totally unnecessary estate taxes will be paid upon the death of the surviving spouse. Those persons with taxable estates who are told by bank or brokerage account personnel that the JTWROS form of titling is best because it "avoids probate" should advise their advisors that they are not nearly as concerned with avoiding probate as they are with avoiding tens or hundreds of thousands of dollars in (unnecessary) estate taxes. A married couple wanting a joint account should either title it as a "Multiple-Party Account Without Survivorship", a "Tenants in Common" account, or a "Community Property" account (again, *without* a survivorship feature) so that the tax planning in their Will or Living Trust will be effective.

Problem #2: Unintended (Exclusive) Beneficiary. As mentioned, the "bad" types of multi-party accounts pass outside a person's estate plan at death. Let's look at another example using a JTWROS account. An elderly widow with 3 children has a Will leaving all of her assets (her "estate") to her 3 children in equal shares. Upon reaching a certain age, she decides that she needs help with her banking and other transactions, so she asks her daughter who lives nearby to help her. Rather than naming her daughter as her agent in a currently effective Durable Power of Attorney (granting her daughter power

to handle banking and other transactions), the widow obtains new signature cards from each of her banks and her broker and adds her nearby daughter to all of her accounts. Unfortunately, the form of titling used on the widow's accounts by the banks and the brokerage firm is JTWROS. When the widow later dies, all of her accounts will pass outside her Will solely to that 1 child, to the exclusion of her other 2 children. This happens automatically pursuant to applicable law. One of two possible scenarios results. The daughter who inherited all the accounts may take the position that her mother intended for her to own all of the accounts upon the mother's death because of the help she has given her mother over the years (this position is almost impossible to refute, legally, because no evidence of mistake or fraud can be introduced in court by the other children unless the signature card itself contains a legal "ambiguity", which is very rarely the case). The other possibility is that the daughter agrees that the mother did not intend to leave 100% of the accounts solely to her. The daughter then decides to share the accounts with her 2 siblings. Unfortunately, if this sharing is not done correctly (via a partial, qualified, double disclaimer by the daughter) or cannot be done in a way that produces the correct result (because the daughter has children, for example, who take her disclaimed share of assets passing under the widow's Will), the daughter will be treated by the Internal Revenue Service as making a gift to each sibling. Further, if the amount of the gift is more than $11,000 per person, it will be a "taxable gift", meaning that the daughter must file a gift tax return and use up some of her lifetime gift tax exemption. Obviously, it would be better to avoid this problem in the first place. If the widow did not want to give the daughter a currently effective Durable Power of Attorney so that she could handle banking and other transactions, she could have set up a "Convenience Account" instead of a JTWROS account, listing the daughter as a signatory on the account, for convenience. Another alternative would be to set up each bank account as a "Multiple-Party Account **Without** Right of Survivorship".

Problem #3: Lack of Ability to do Contingency Planning. As most people know, when a person creates an estate plan in a Will or Living Trust Agreement, there is plenty of room in the document to address various contingencies in advance, such as one or more potential beneficiaries predeceasing the Testator and one or more beneficiaries needing a trust for management of their inheritance, either due to financial immaturity or mental incapacity. It is nearly impossible to plan for contingencies with multi-party accounts. Let's look at another example. A widower with 3 children has a Will leaving all of his estate equally to his 3 children. The widower's Will further provides that if any of his children predecease him, their share is to be divided among their children in equal shares (this sort of disposition is often referred to as a "per stirpes" distribution). In addition, the Will provides that if any child or grandchild is either under age 25 or mentally incapacitated at the time of the widower's death, their share is to be held in a trust for their benefit, managed by a Trustee designated in the Will. Suppose the widower has 3 certificates of deposit ("CDs") at the bank and has named each of his children as the POD beneficiary on 1 of the CDs. Unfortunately, the widower and his oldest child are killed in the same car crash. The 2 living children will each still receive the CD on which they are named as the POD beneficiary. Because the oldest child failed to survive his father, that CD will pass as part of the widower's estate per his Will. The assets passing under the Will are divided so that each of the widower's living children will receive 1/3 and the 1/3 that would have passed to his oldest child will be divided into equal shares for the oldest child's children. Unfortunately, the overall disposition of the widower's assets is not in keeping with the per stirpes distribution he wanted because the two living children will each receive 100% of the CD passing to them by POD designation outside the Will and will each also receive 1/3 of the CD on which the oldest child was designated as the POD beneficiary (as well as 1/3 of all of the other assets passing by Will) because that CD is now passing under the Will. Thus, the children of the deceased child will not be treated proportionately in this situation.

Ownership of Funds on Deposit. With respect to "funds on deposit" in joint accounts, while both parties to the account are living, the funds are deemed to be owned by them in proportion to their contributions. If a married person deposits community property into a multi-party account with his/her spouse, the funds in the account are owned by both spouses as community property. An exception exists for married couples where one spouse creates an account funded with his/her separate property. In that case, Texas law creates a presumption that the depositing spouse is making a gift of half of the account (as well as the earnings on that half) to the other spouse, so that both spouses then own 50% of the account as their separate property. Fortunately, if the recipient spouse is a U.S. citizen, the unlimited marital deduction prevents the gift from being a taxable gift. WARNING: If a married person deposits community funds into a multi-party account where the other person on the account is *someone other than their spouse*, a problem can arise. The funds in the account remain community property during the depositor's life, but if they pass by survivorship or POD/TOD upon the depositor's death to a person other than the depositor's spouse, the spouse can attempt to recover his/her half of the proceeds by claiming "fraud on the community".

IRS Estate Tax Rule Regarding Joint Accounts. When one party to a joint account dies, the IRS presumes that 100% of the funds on deposit belong to that deceased party. The Executor of the decedent's estate must rebut the presumption by satisfactory evidence, otherwise all of the funds will be included (and taxed) in the estate of the deceased account owner. ANOTHER PROBLEM with extensive use of the "bad" type of multi-party accounts is that the Executor of the account owner's estate may not have sufficient funds to pay the debts, taxes and expenses of the estate.

How Do You Know How an Account is Titled? Legally, the only document that determines what type of multi-party account a person has is the signature card or account agreement that established the account. Account statements, printed checks, 1099s and other documents are not definitive. If you are not sure how an account is titled, request a copy of the signature card or account agreement.

Conclusion. Not all multi-party accounts are bad; however, those that transfer ownership at death should be avoided by persons who have created an estate plan in a Will or Living Trust. The assets held in a person's accounts should be distributed according to his/her estate plan, not according to the multi-party account rules.

CONGRATULATIONS to Kathryn Miller on her recent marriage to Kevin Connelly.

Contact Us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone, fax or traditional mail at the address and phone number shown below.

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