Estate Planning Insights

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"ACCOUNT TITLING 101"

*The way an account is titled has **legal** consequences. Many clients unwittingly title accounts in a way that overrides their estate plan in their Will or Living Trust. When opening a new account, pull out this newsletter and study the available options to make sure you don't destroy your estate plan in your Will or Living Trust by choosing the "wrong" form of account titling.*

Preliminary Matters: Why Bother Having a Will or Living Trust When You Can Dispose of *All* of Your Assets Through Account Titling? It is possible to avoid probate completely when you die by having all of your assets pass directly to your chosen beneficiaries via account titling. However, *avoiding probate that way* is usually not a good idea for many reasons, which will be explained in this newsletter. If a person truly wants to avoid probate, the best way to do that is to create *and fully fund* a revocable living trust ("Living Trust") before you die. Remember, however, that Texas is considered by many to have the simplest probate process of all 50 states–at least for persons who die with a valid Will that appoints an "independent executor without bond." Thus, in Texas, avoiding probate is not as important as obtaining the many benefits that can only be obtained through having a good Will or Living Trust. Too may people are "hung up" on avoiding probate to the point that they overlook the most important things they are trying to achieve with their estate plan.

Benefits that cannot be achieved via account titling but only through having your assets pass through your Will and/or Living Trust include (but are not limited to): (i) avoiding the payment of hundreds of thousands (or even millions) of dollars in federal estate taxes by using a "Bypass Trust"; (ii) protecting inherited assets from loss due to a divorce or other lawsuit; (iii) providing for the management of inherited assets for persons who cannot or should not control the inherited assets; (iv) taking care of a second spouse but controlling the assets so that, when your spouse dies, your remaining assets will pass to your own children and not to your spouse's children (or to the new spouse of your spouse); and (v) leaving a final legacy to charity by using a "split interest charitable trust." These are just *some* of the things that cannot be accomplished if your assets pass directly to beneficiaries outside your Will or Living Trust due to the way they are titled.

If you have read this far and you understand the above concept, then you already understand "why" you should not title your accounts in a way that prevents your accounts from being part of your estate plan in your Will or Living Trust. Because it is vitally important for clients to understand this, however, we are going to be purposely repetitive in this newsletter.

Again, think about all of the different provisions you have included in your Will or Living Trust. *You are doing so much more than merely naming the persons to whom you wish to leave your assets at death.* And, yet, this is the most that can be done by trying to do estate planning via certain forms of account titling. These forms of account titling that override your estate plan can be referred to as "multi-party account arrangements" or as "non-probate transfers," but we will simply call them "bad" forms of account titling in this newsletter. (This newsletter is not intended for persons with *really small* estates [e.g., under $100,000]).

As a reminder, in your Will or Living Trust, you might be creating a number of different types of trusts for different people and for different purposes, to become effective upon your death. In other words, you want some or all of your assets to pass into these trusts when you die. For example, married couples often use a "Bypass Trust" to avoid paying hundreds of thousands (and even millions) of dollars in estate taxes on the death of the surviving spouse. People with young children create "Contingent Trusts" for their children and appoint a trustworthy, prudent person or a bank or trust company as the Trustee of such trusts. They do not want their children to gain control of the inherited assets until reaching a certain age or maturity level. In the meantime, the Trustee will make distributions to or for the benefit of their children from their Contingent Trust.

Some people wish to take care of elderly parents who have lost (or might lose) the ability to manage their financial affairs. So, these people will create a trust for their parent in their Will or Living Trust, to which assets will be added upon their death. The Trustee will then use the money in the trust to take care of their parent. Other people create "split interest" charitable trusts, such as "Charitable Remainder Trusts" and "Charitable Lead Trusts," that become effective upon their death. With these types of trusts, it is possible to provide benefits to both individuals and charity and to obtain a charitable deduction for the portion passing to charity at death.

Wealthier couples use "lifetime, creditor-protected trusts" for their children and grandchildren, to protect the inherited assets from loss due to a divorce or other lawsuit, to provide more income tax options with respect to the earnings on the inherited assets, and to avoid paying estate taxes (again) when the children die on the same assets that were already subject to estate taxes in the parents' estates.

Clients who are creating trusts of any type in their Will or Living Trust should AVOID titling accounts in a way that prevents the account assets from reaching those trusts created in their Will or Living Trust.

Some people want to make a "non-standard" (or, customized) distribution of their assets when they die. This is virtually impossible to do properly through account titling. Further, all good Wills and Living Trusts contain "contingency" planning. Contingency planning provides alternative beneficiaries in case the primary beneficiaries fail to survive the Testator/Trustor or fail to survive another person whose interest comes before theirs. It is also impossible to do *real* contingency planning through account titling and multi-party account arrangements.

Finally, the Executor of your Estate or the Trustee of your Living Trust (as applicable) must have funds to pay various charges after you die, such as: funeral expenses, expenses of last illness, debts, including property taxes and credit card bills, final income taxes, estate (or trust) administration expenses, estate taxes, estate (or trust) income taxes, and legitimate claims against your estate. If you use the "wrong" form of title on all of your accounts, the Executor/Trustee will not have any funds to pay these charges. This puts the Executor/Trustee in an untenable position, especially since the Executor/Trustee is *personally liable* for all taxes owed by you and your estate.

Our Opinion. The issue of "account titling" is far more important than most people realize. In our opinion, not enough people understand the **legal effect** of the various forms of account titles that are available today. This problem has now reached epidemic proportions. Because of this, we all must assume primary responsibility for knowing how every single one of our accounts is titled and for understanding the *legal effect* of those account titles.

As discussed above, you are doing a number of things in your Will or Living Trust *besides* simply naming beneficiaries. Therefore, if all of your accounts bypass your Will or Living Trust because of the way they are titled, your estate plan will end up with large holes in it and may even fail completely. *See*, e.g., the examples below.

What Exactly is Meant by "Account Titling"? When we refer to the ***title*** of an account, we mean *more* than merely the names of the parties to the account. Legally, the account title means the "NAMES **PLUS**." It's the "plus" part that most people overlook. It's also the "plus" part that causes the problems.

All accounts have a legal title or registration, even if it's only in the fine print of the original account agreement (and even if that title is selected by your banker or broker, with little or no discussion with you). Again, the particular way an account is titled has *legal significance and consequences and can override your estate plan in your Will or Living Trust.* **Account titles should not be ignored.**

Need To Distinguish "Account Titling" from "Completing Beneficiary Designation Forms." Before we get into the details of particular forms of account titling, please understand that we will NOT be discussing how to complete beneficiary designation forms for ***true*** "beneficiary designation assets." Certain assets are transferred solely by a beneficiary designation form at death and NOT by the person's Will or Living Trust. In other words, the only valid legal document of transfer for a ***true*** "beneficiary designation asset" is the beneficiary designation form.

True beneficiary designation assets include: (i) life insurance, (ii) qualified employee benefit plans (e.g., 401(k) plans, 403(b) plans, profit-sharing plans, thrift plans), (iii) Individual Retirement Accounts (IRAs), including traditional IRAs, Roth IRAs, SIMPLE IRAs and SEP-IRAs, and (iv) annuities. There are also some *non-qualified* employee benefit plans that are "beneficiary designation assets" as well because the particular plan provides that the deceased employee's interest will be transferred at death pursuant to a beneficiary designation form. However, some non-qualified employee benefit plans do not allow employees to complete a beneficiary designation form because the plan itself provides who the beneficiary will be upon the employee's death or states that the employee's interest in the plan will be distributed to the employee's "estate" at death.

If an account or asset is NOT a ***true*** beneficiary designation asset, then you should NOT put a beneficiary on it. If you place a beneficiary on a "regular" account or asset (i.e., one that is **not** a ***true*** beneficiary designation asset), you will be pulling it away from your estate plan in your Will or Living Trust (i.e., it starts out there, so by putting a beneficiary on it, you are sending it somewhere else). Even if you send it back to your Will or Living Trust pursuant to this optional (i.e., not required) beneficiary designation, that is a very roundabout (and unnecessary) path of transfer. **Only *true* beneficiary designation assets should have a designated beneficiary on a beneficiary designation form.**

How do you know if something is a true beneficiary designation asset or not? First, look at the list of ***true*** beneficiary designation assets above (i.e., life insurance, employee benefit plans, IRAs and annuities). Second, consider this: if the ONLY possible method of transfer at death is via a beneficiary designation form, then the asset is a ***true*** beneficiary designation asset. In contrast, if the account or asset is one that *could* be distributed pursuant to some sort of beneficiary designation but is NOT REQUIRED to have a beneficiary designation, then it is **not** a ***true*** beneficiary designation asset and you SHOULD NOT place a beneficiary on it.

The most common examples of accounts and assets that are NOT true beneficiary designation assets are (i) a checking account, (ii) a savings account, (iii) a certificate of deposit that is not <u>inside</u> an IRA, (iv) a money market account that is not <u>inside</u> an IRA, (v) a brokerage/investment account that is **no**t an IRA, (vi) stocks and bonds that are not <u>inside</u> an IRA. In other words, "regular" (after-tax) assets/accounts are not required to have a beneficiary designation. Some people have both IRAs and "regular" (after-tax) investment accounts with a financial institution that are shown together on a comprehensive monthly statement. Note that IRAs will be marked clearly to show that they are IRAs and not "regular" accounts. You *must* complete a beneficiary designation form for an IRA. You SHOULD NOT complete any type of beneficiary designation for a "regular" account.

BOTTOM LINE: In this newsletter, we will NOT be discussing how to complete beneficiary designation forms for ***true*** beneficiary designation assets. That is a topic for another newsletter.

<u>What Do Various Account Titles Mean</u>? We will now explain, one by one, the legal effect of various forms of account titling. In this newsletter, we are not really discussing the titling of other assets, such as real estate, but only the titling of "accounts." Again, the particular form of title will be found somewhere in the original account agreement or signature card. NOTE: What is reflected in an account <u>statement</u> is **not** definitive–only the wording in the actual account agreement or signature card is definitive from a legal standpoint.

1. <u>The "Right of Survivorship" Form of Title</u>. In this category are forms of title that include a "right of survivorship." A right of survivorship means that the account passes directly to the surviving "account members" ("parties") on the death of the first account member. There are several versions of the right of survivorship form of titling. Some of them include the following:

Joint Tenants With Right of Survivorship (sometimes abbreviated "JTWROS" or "JT TEN" or "Jt w/survivorship")

Multi-Party Account with Right of Survivorship

Community Property with Right of Survivorship

<u>Key Wording</u>: The key wording in all of the above is "with right of survivorship."

<u>Parties</u>: One or more persons can be "parties" to the account. Parties means the people who have a current right to request funds from the account.

<u>Ownership while all parties are living</u>: While all of the parties to the account are living, the funds in the account are owned by the parties in proportion to their net contributions to the funds on deposit in the account.

<u>Community Property Reminder</u>: Most assets owned by married couples in Texas are community property. Ordinarily, if a married person places funds in an account, that contribution will be community property, owned half by each spouse (even if one spouse is not a party to the account).

<u>Legal Effect on Death of First Party</u>: Upon the death of one of the parties to the account, that deceased person's ownership interest in the account passes **directly** to the surviving party or parties, outside the probate process.

<u>Massive Misunderstanding</u>: The right of survivorship feature does more than give all of the parties to the account *access* to the account–it actually transfers the interest in the account of the first party to die to the other named party or parties upon death. NOTE: There is a difference between *access* and *ownership*. It is not legally necessary to include a right of survivorship feature on an account merely to provide another person with *access* to the account. Many people who advise a financial institution that they want another person to have *access* to their account while they are living *do not intend* for that person to become the sole **owner** of their account when they die, to the exclusion of their "intended" beneficiaries. Some financial institutions do not honor their customers' intentions in this regard.

<u>Stated Rationale</u>: The mantra of many persons in the financial services industry is that the "right of survivorship" feature is "good" because it "avoids probate," as if avoiding probate is more important than all of the things you are trying to accomplish in your Will or Living Trust. Yes, the right of survivorship feature will cause the account to "avoid probate"–it will cause the account to *avoid* your entire estate plan, too.

<u>Result</u>: The decedent's interest in the account will not pass according to his Will or Living Trust. In many cases, this means the account assets will not pass into one or more trusts created in the decedent's Will or Living Trust. It also means that the funds in the account may be passing in a different manner than the decedent intended. In the case of married couples, it may mean that the Bypass Trust cannot be funded on the death of the first spouse, possibly resulting in the payment of hundreds of thousands (or millions) of dollars of *unnecessary* estate taxes on the death of the surviving spouse. Further, the Executor/Trustee might not have sufficient funds to pay all post-death charges.

<u>Bottom Line</u>: If you use a right of survivorship form of title on an account, that account will not be part of your estate plan in your Will or Living Trust. The right of survivorship form of title is a *substitute for a Will* and, for that reason, some people call it "the poor man's Will." In our opinion, it was designed for "poor people" and only "poor people" should use it (with limited exceptions). One very limited

exception with respect to the right of survivorship form of account titling will be discussed later.

2. <u>Payable On Death, Pay on Death and Transfer on Death Arrangements</u>. Some banks offer a "Pay on Death" or "Payable on Death" arrangement. Both may be abbreviated "POD." Brokerage firms offer a similar arrangement called "Transfer on Death" or "TOD." These arrangements allow the account owner to place one or more beneficiaries on an account *that is not required to have a beneficiary*. These arrangements should be avoided by anyone who wants the terms of his estate plan in his Will or Living Trust to apply to his/her accounts.

<u>Parties</u>: One or more persons can be "parties" to the account. Parties means the people who have a current right to request funds from the account. This always includes the depositor(s) and may include other persons, such as other named "joint tenants." One variation of this arrangement is "Multi-Party Account with Right of Survivorship and POD." In that case, if one joint tenant dies, the account passes to the surviving joint tenant(s), and not to the POD/TOD beneficiaries. The POD/TOD beneficiaries do not have access to the account while the current party/parties are living and do not receive any of the account until the death of the last party.

<u>Ownership while all parties are living</u>: While all of the parties to the account are living, the funds in the account are owned by the parties (but not the POD/TOD beneficiaries) in proportion to their net contributions to the funds on deposit in the account.

<u>Community Property Reminder</u>: *See* community property discussion above.

<u>POD/TOD Beneficiaries</u>: The POD/TOD beneficiary or beneficiaries are the person(s) to whom the account is payable upon the death of the *last* surviving party to the account. The POD/TOD beneficiaries do not have access to the funds in the account while a party is alive.

<u>Comments</u>: While there can be multiple parties to a POD/TOD account, the somewhat more common scenario with this arrangement seems to be a single party account with POD/TOD beneficiaries. As noted, the POD/TOD beneficiaries receive the account upon the death of the (last) party (i.e., the depositor and anyone else who had access to the account while the depositor was living). This is a direct transfer outside the probate process. Normally, if there are multiple POD/TOD beneficiaries, the account is split equally among those of the named beneficiaries who survive. If a POD/TOD beneficiary predeceases the last surviving "party" (which would be the depositor in the case of a sole party), his/her share "evaporates" and is divided among the surviving POD/TOD beneficiaries. Thus, normally, you cannot obtain a "per stirpes" distribution with a pure POD/TOD arrangement. You also cannot have a POD/TOD beneficiary's share pass into a trust created for such beneficiary in your Will or Living Trust because accounts with a POD/TOD arrangement do not pass through your Will or Living Trust.

<u>Bottom Line</u>: Persons with an estate plan in a Will or Living Trust should NOT use POD and TOD arrangements for their accounts because POD/TOD accounts will not be subject to their estate plan in their Will or Living Trust. The POD/TOD beneficiaries will receive the account assets directly, and this may not be consistent with the estate plan in the Will or Living Trust (and could cause other problems–*see* examples below). For our clients, there is very seldom an appropriate case (in our opinion) for using the POD or TOD arrangement on an account.

<u>Owner versus Beneficiary</u>: One of our clients used a TOD arrangement to make his brokerage account payable to his Living Trust. The better practice is to title the account in the name of the Living Trust as *owner*, rather than as (POD/TOD) *beneficiary*. Again, for anyone who has an estate plan in a Will or Living Trust, the rule is that a "regular" account should *not* have a beneficiary on it, and that's exactly what you are doing when you use a POD/TOD arrangement.

<u>Important Distinction</u>: With a ***true*** beneficiary designation asset (see above), beneficiary designation forms are completed so that the beneficiary designation asset (which starts outside your Will or Living Trust) can flow into the estate plan in your Will or Living Trust. With a "regular" account (i.e., an account that is *not* a ***true*** beneficiary designation asset), that account starts out as part of your estate plan to begin with, but if you put a beneficiary on it, you are directing it away from your estate plan. That is an important distinction that everyone needs to understand.

3. <u>The "Totten Trust" Account</u>. There is one other "bad" form of title that should be avoided by persons who have an estate plan in a Will or Living Trust: the "Totten Trust" account. This arrangement (named after a depositor who first used it) can be used with bank accounts, but not with brokerage accounts. With the Totten Trust arrangement, one or more persons are listed as "Trustees" for one or more beneficiaries in a case where there is no actual trust. When this arrangement was first used, it resulted in a court case because the account arrangement did not satisfy state law requirements for the creation of a valid trust. Unlike real trusts created for a beneficiary by a Trustor, the Totten Trust arrangement does not provide any creditor protection for the funds in the Totten Trust account. It is just another type of bank account arrangement used by some people instead of an estate plan.

<u>Parties</u>: One or more persons can be "parties" to the account. Parties means the people who have a current right to request funds from the account. With a Totten Trust account, the parties are labeled as "Trustees," even though there is no real trust.

<u>Ownership while all parties are living</u>: While all of the parties to the account (i.e., the "Trustees") are living, the

funds in the account are owned by the parties in proportion to their net contributions to the funds on deposit in the account.

Community Property Reminder: *See* discussion above.

Legal Effect on Death: Upon the death of the last party to the account (i.e., the death of the last named Trustee), the account passes **directly** to the named beneficiaries of the account, outside the probate process.

Comments: As noted above with the other "bad" forms of titling, the actual results of using the Totten Trust account arrangement could well be different from what you intended. If you like the terms of your Will or Living Trust, then you should avoid the Totten Trust account arrangement so that your accounts can be part of your estate plan in your Will or Living Trust.

4. Account Titles That Are OK. There are several forms of account titling that are OK and will not override your estate plan in your Will or Living Trust. These include (but are not limited to): (i) individual accounts *without* a POD/TOD beneficiary, (ii) Joint Accounts *without* a right of survivorship, (iii) Tenants in Common accounts (this is available with brokerage firms, but usually not with banks, savings and loans and credit unions), and (iv) "Convenience Accounts."

A "Convenience Account" means that a person is added to the account solely *for the convenience of* the party or parties who own the account. The convenience signer can help the parties with account transactions while they are living, but the convenience signer will *not* become the sole owner of the account on the death of the account owner (i.e., the depositor). When the depositor dies, the account will pass according to her Will or Living Trust.

Many people who are worried about losing their mental capacity add someone to their accounts to help them pay bills, make deposits and withdrawals, etc. As noted above, they generally do *not* intend for that person to inherit the entire account when they die, so the Convenience Account is really the correct form of title for this arrangement. In our experience, however, few banks offer this form of title.

Of course, another option is to add the person appointed as your agent in your financial Durable Power of Attorney as a signer on your account. Presumably, you appointed a trusted, financially astute person as your agent in your Durable Power of Attorney to help you with your financial affairs, including your accounts, in the event you later lose your ability to do so. It is very unfortunate that some banks and other financial institutions will not honor a legally valid Power of Attorney and will force their customers to use "bad" forms of account titling and account arrangements instead (as noted above).

Actually, with respect to married couples in Texas, the most legally correct form of title for their accounts would be "Community Property." However, very few financial institutions offer this form of title, *despite the fact that they are doing business in Texas*. We believe they should offer this form of title for accounts because it is the most appropriate form of title for nearly all married couples. However, you would NOT want to use "Community Property With Right of Survivorship" because that is going beyond an "appropriate" label and turning it into a "bad" label (because of the addition of the *right of survivorship*).

There are variations of the above wording that can be used. For example, instead of "Joint Tenants Without the Right of Survivorship," one could label the account "Multiple-Party Account Without Right of Survivorship" or, for a married couple, "Community Property Account Without the Right of Survivorship." NOTE: We have never indicated that having joint accounts is "bad," only that including a *right of survivorship* feature in the title is bad for those doing tax planning, trust planning and contingency planning in their Will or Living Trust.

One *Exception* to the Above: When someone dies, there is a delay in time between the date of death and the date when the Executor is officially appointed as Executor of the Estate. Once the Executor is appointed and qualified to serve, he will have access to *all* of the (probate) assets in which the deceased person owned an interest at death. However, during this gap period, funeral expenses and certain other expenses may need to be paid. Thus, the *exception* to the above is this: married couples may have one joint checking account (preferably with no more than $50,000 in it) that includes a right of survivorship feature so that the surviving spouse will have immediate access to sufficient funds to make it through the gap period. Again, the gap period can be as little as two weeks and some bills can be paid with a credit card, but we recognize that, in some families, this gap can lead to a desperate situation.

The "gap problem" is not as easily solved in the case of single persons, however. Absent pre-paying your funeral expenses, if you are single and your children are the equal beneficiaries of your estate (and if you believe they will work well together), you may wish to have one checking account with enough funds in it for the gap period that either names *all* of your children as POD beneficiaries or names all of your children as parties to the account, with a right of survivorship. Again, this is an *exception* to the above, applicable to one relatively small account ($50,000 or less).

If you have more than one child and you name just one child on your account as POD beneficiary or as party with you as JTWROS, a technical problem will arise that is best avoided. In that case, that one child will be entitled to all of the funds in that account as the *owner* of those funds on your death, and if that child uses those funds to pay your funeral expenses and other immediate bills that must be paid, that child will be entitled to be *reimbursed by your estate* later because he is merely loaning personally owned funds to your estate. In other words, the funeral expenses and immediate bills can end up getting paid twice in that case.

Sometimes the child in this case will ignore the technical rules and make a *gift* of his personally owned funds to the estate, to enable the estate to pay these bills. It is doubtful that this gift would ever get reported to the IRS. We cannot advise people to ignore the federal gift tax rules, however.

Time to Check Your Account Titles: Here is the **homework assignment** for all of our clients: contact each bank, brokerage firm, investment company and other financial institution where you have accounts and ask them to provide you with copies of the *original account agreement* (sometimes called a "signature card") that established your account, and any subsequent account agreement(s) that may have altered your account. The exact form of title of a particular account will be somewhere in the "fine print" of that document. A monthly or quarterly account statement is NOT a definitive indicator of the actual title of the account–only the account agreement itself is legally controlling.

You should do this homework, at least, with respect to all of your "sizeable" accounts (you can ignore your checking account if it has $50,000 or less in it). You are looking for *any* "bad" wording, such as: "Joint Tenants With Right of Survivorship," "JTWROS," "JT TEN," "JT w/survivorship," "Multi-Party Account With Right of Survivorship," "Community Property With Right of Survivorship," "Pay on Death," "Payable on Death," "POD," "as Trustee for" [this is the "Totten Trust" arrangement], "Transfer on Death," or "TOD" (note that the capitalization is not the key–it's the words or letters themselves).

For the most part, these titling arrangements have only 1 advantage (they "avoid probate") and up to 6 disadvantages (all of which we have discussed before and will show by examples below). And, while there are sometimes other considerations (such as FDIC and FSLIC insurance limits), overriding your estate plan by using a "bad" form of title is *not* the way to address that issue.

Some Real Life Examples. And, now, to bring together the above discussion and show the results of using "bad" forms of titling on your accounts, some real-life examples:

Example No. 1. A widow who had sizeable accounts and CDs at various banks created an estate plan leaving her estate in equal shares to her three children (two sons and a daughter). Although she had a financial durable power of attorney appointing her daughter as her agent to handle her financial matters in the event of her mental incapacity, while she was still competent, she and her daughter went to each bank where she had accounts and CDs. The widow told each bank that she wanted to add her daughter to her accounts *now*, so that her daughter could start helping her pay her bills and become familiar with her accounts and financial affairs. The widow figured that this advance experience, under her watchful eye, would make it easier for her daughter to handle her accounts later, if she did, in fact, lose her mental capacity. The "helpful banker" at each bank added the widow's daughter to the widow's accounts (i.e., put both of their names on the accounts), titling each account as "Joint Tenants with Right of Survivorship" (JTWROS). While the JTWROS arrangement does give each joint tenant (i.e., party) current access to the account, it goes well beyond that--it actually gives the entire account to the surviving joint tenant, directly, when the first "tenant" dies. Thus, when the widow died, her daughter inherited *all* of the widow's accounts, to the exclusion of the other two children. The daughter felt entitled to the accounts for all the help she had given her mother during her mother's life. Under applicable state law, the other two children may have no cause of action against their sister who inherited everything because the title of each account was *unambiguous* and the widow herself had set up the arrangement while she still had her mental capacity. Even in a state where a lawsuit could be brought under these facts, the "helpful banker's" testimony is always going to be that (i) the widow had mental capacity when she made this change to her accounts and (ii) she specifically wanted her accounts to be set up as JTWROS.

In other, similar cases, the child who inherits everything sometimes ignores the JTWROS arrangement and shares the account proceeds with her siblings. Technically, the IRS treats the transfer by the surviving joint tenant to the other children of the decedent as a *taxable gift* to the extent the amount given to each sibling exceeds the annual gift tax exclusion (currently $13,000 per recipient). This is the correct legal result under the facts and the law.

Sometimes *disclaimers* can be used to fix these mistakes, but sometimes they can't. Every day lawsuits are filed with respect to JTWROS accounts, many fraught with technical problems. Even if "the right persons" win the lawsuit, they still lose due to the legal fees involved. Thus, avoiding indiscriminate use of JTWROS should also prevent lawsuits.

Example No. 2. A widower had a very large brokerage account. He also had a Will leaving his estate in equal shares to his four children. The Will further provided that, if any child failed to survive him, the deceased child's share would be distributed to his/her children (if any), in equal shares. This is a common distribution scheme (and one type of contingency planning) that is referred to as a "per stirpes" distribution. The broker convinced the widower to use a "Transfer on Death" (TOD) arrangement for his brokerage account "to avoid probate." (The POD arrangement offered by many banks is similar to the TOD arrangement.) The widower completed the TOD form, naming his four children as the direct, equal beneficiaries of his brokerage account. Unfortunately, the widower and one of his sons were killed together in a car accident. Pursuant to the TOD arrangement, the widower's brokerage account was distributed solely to his three surviving children. The children of the deceased son did not receive a share of the brokerage account. If the widower had *not* placed the TOD arrangement on his brokerage account, the children of the deceased son would have split their deceased parent's ¼ share of the account pursuant to the *per stirpes* distribution in the Will (which is what the widower wanted). And, while some TOD forms might offer a *per stirpes* option to cover this possibility, it is unlikely that a *per stirpes* share passing by TOD to a minor child (a person under 18) will end up being held in the Contingent Trust created for young beneficiaries in the customer's Will. Thus, using the TOD arrangement is not as good an option as having the brokerage account be part of the customer's estate plan in his Will or Living Trust.

Example No. 3. (The following is a composite of numerous couples who have been clients of the firm.) A married couple with a $4 million estate had Wills that created a Bypass Trust on the death of the first spouse. The *primary* purpose of the Bypass Trust was to avoid paying significant (otherwise avoidable) estate taxes on the death of the surviving spouse. Secondary reasons for including a Bypass Trust in the couple's Wills were (i) to protect the assets from creditors' claims, such as a tort creditor suing for personal injuries as a result of a car accident, (ii) to prevent the assets from being diverted to a new spouse in the event of remarriage by the surviving spouse, (iii) to allow distributions to be made to children and grandchildren that are not subject to the gift tax rules and gift tax limitations, and (iv) to provide more income tax options with respect to the income earned by the assets in the Bypass Trust.

The husband died in 2006, when the estate tax exemption amount was $2 million. Unfortunately, all of the couple's bank accounts, CDs, credit union accounts and brokerage accounts were titled in both spouses' names as "Joint Tenants with Right of Survivorship." The wife delayed seeking our help with respect to the post-death state law and federal tax law matters that must be handled when someone dies. By the time she came to see us, all of the accounts had already been re-titled into her name pursuant to the right of survivorship feature. Further, the wife had been using the accounts–making deposits and withdrawals, selling assets, transferring assets, etc. Thus, all of the assets now belonged to the wife, individually.

Estate Tax Reminder: No immediate estate taxes were payable when the husband died because of the unlimited marital deduction. However, when one spouse dies and leaves assets *directly* to a surviving spouse, the deceased spouse is "wasting" his/her estate tax exemption amount. Married couples do not automatically get two exemptions from the federal estate tax just because they are two people. It takes advance planning in most cases to avoid wasting the first spouse's exemption from the estate tax. Again, leaving assets directly to the surviving spouse results in *wasting* the first spouse's estate tax exemption amount and, in many cases, results in paying "unnecessary" (i.e., otherwise avoidable) estate taxes on the death of the surviving spouse.

Thus, in this case, when the wife died in 2008 with an estate still worth $4 million, federal estate taxes in the amount of $900,000 had to be paid to the IRS. This is because the wife was only one individual and, therefore, the wife's estate was only entitled to one exemption from the federal estate tax, not two. With a $4 million estate and only a $2 million exemption when the wife died, the excess $2 million was taxable at a 45% estate tax rate. If we had been able to place the husband's entire estate of $2 million (his half of the community property) into the Bypass Trust created in the husband's Will at the time of his death, no (i.e., zero) estate taxes would have been payable by the wife's estate on her later death. Thus, the right of survivorship feature, while convenient, caused the government to receive $900,000 that otherwise could have gone to the couple's children.

Portability. For the estates of persons who die in 2011 and 2012, there is a way to avoid paying "unnecessary" estate taxes on the death of the surviving spouse without funding a Bypass Trust: electing the "portability" option added by the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010." The portability option is currently set to expire on December 31, 2012. Further, it is *more expensive* to transport the estate tax exemption of the first spouse to die to the surviving spouse using the portability option than it is to fund a Bypass Trust, although, in certain cases, it may be the better (or only) approach. Remember, however, that there are many other advantages of using a Bypass Trust besides preserving the estate tax exemption of the first spouse to die, some of which were described above. Further, even if elected, the portability option can be lost if the surviving spouse remarries and the new spouse dies first, with little or no remaining estate tax exemption amount. Thus, portability may be of some remedial benefit, but, considering both tax and non-tax issues, it is just not as good, overall, as fully funding a Bypass Trust on the first spouse's death. Hopefully, though, Congress will continue the portability option beyond 2012.

Other Problems Caused by "Bad" Forms of Titling. As shown above, "bad" forms of titling frequently cause gross distortions to a client's estate plan. Besides adverse tax consequences and unintended distribution of the assets to the "incorrect" person(s), "bad" forms of titling have also caused beneficiaries to receive funds directly that should have been held in trust for them. Further, in some cases, "bad" account titles have caused the Executor of the decedent's Estate (or the successor Trustee of his Living Trust) not to have any funds with which to pay the decedent's final income taxes, expenses of last illness, funeral expenses, debts, property taxes, insurance and maintenance on the decedent's home during the post-death administration process, and post-death charges, such as administration expenses (attorneys' fees, accounting fees, appraisal fees), federal and state estate taxes (a/k/a death taxes), federal and state income taxes on post-death income earned by the Estate or Living Trust, etc. Also, because an Executor or successor Trustee of a Living Trust is *personally liable* for all taxes owed by the decedent, this cash shortage could put the Executor or successor Trustee in an untenable position. Be wary of accepting an Executor or Trustee position in a case where all of the decedent's assets are passing directly to beneficiaries via account titling.

Fully Funded Living Trust. For those clients whose primary goal is to avoid probate (a goal that we question, at

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least in the case of clients whose only real estate is located in Texas), but who don't want their entire estate plan to be "gutted" through the use of "bad" forms of account titling, the best way to accomplish your goals is to use a "fully funded" revocable Living Trust. This means that every single asset and account you own must be titled in the name of your Living Trust (as the *owner*) before you die. It also means that your Living Trust should be named as the beneficiary (or, if you are married, as the contingent beneficiary, at least) of all of your ***true*** beneficiary designation assets. Some of our clients use a fully funded Living Trust, for a *variety* of reasons, and that does lend itself to avoiding "bad" forms of account titling.

Not every estate planning client wants or needs to use a fully funded Living Trust, however. It is definitely a more costly estate plan. And, remember, *avoiding probate does not avoid estate taxes.* There is no tax benefit whatsoever of using a Living Trust versus using a Will. So, be sure you understand what you really will be accomplishing by "avoiding probate" if that's your goal.

Closing. Thus, for the vast majority of our clients, preserving the integrity of their estate plan boils down to avoiding "bad" forms of account tiling, as much as possible. Because many financial institutions only offer "bad" forms of account titling, it may be necessary, in some cases, to move accounts to other institutions or to send a "Section 440" letter (a type of notice authorized by Section 440 of the Texas Probate Code). Avoiding "bad" forms of title appears to be a constant "battle," however.

Are You Due For An Estate Planning Check-Up? We recommend that all of our clients come back for a comprehensive estate planning "check up" at least once every 5 years. Both state law and federal tax law change frequently and rapidly these days. In addition, changes in your personal and financial situation affect your estate plan. Are ***you*** due for a check up?

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 above. You can also reach us by email addressed to:

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