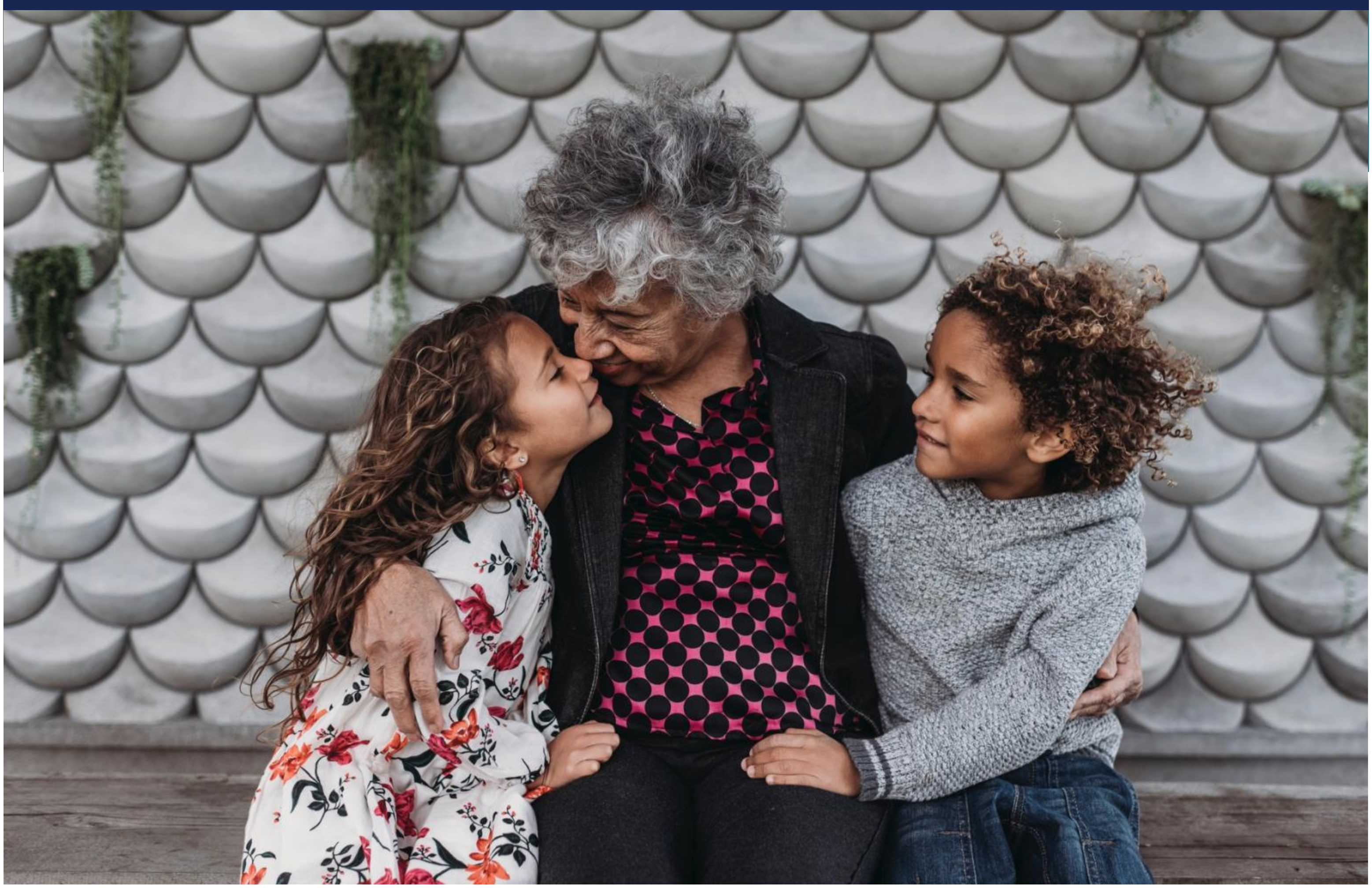
# THE RISKS OF DIRECT BENEFICIARY DESIGNATION AND JOINT OWNERSHIP AS ESTATE PLANNING STRATEGIES



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# THE RISKS OF DIRECT BENEFICIARY DESIGNATIONS AND JOINT OWNERSHIP AS ESTATE PLANNING STRATEGIES

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For many American couples, "till death do us part" also means, "till death do we hold property in joint tenancy."

It often happens automatically. When couples open a checking account, buy a car, purchase a home, or acquire just about any other asset you can think of, the first impulse is to put the title in the names of both spouses as joint owners, known as joint tenancy. That way, if one were to die, the survivor would automatically own the account or property.

Married couples aren't the only ones relying on joint tenancy. It is widely used between friends, life partners, parents and their children, for example. It's an ownership method so pervasive many consumers say they know of no others.

Another popular way to set up financial accounts and real esate ownership is "pay-on-death" (POD) also called "transfer-on-death" (TOD). Like joint tenancy, naming loved ones as direct beneficiaries when the owner dies is held out as a way to do estate planning and avoid probate proceedings without making a Will or Living Trust.

Joint ownership and POD/TOD are admittedly easy and quick steps and would seem to be effective. The reality is that passing on financial accounts and real estate upon the death of an owner involves a multitude of financial, practical, and legal issues. Sometimes, tax issues as well. **Many of those issues are of a nature that, when people are eventually exposed to their impact, the reaction is either "I never thought about that" or "I did not know that is what would happen"**. Often, the loved ones who survive the owner of accounts or real estate learn of the issues when it is too late to do anything about them. They must suffer the consequences or attempt to correct what they see as mistakes or unintended results through costly court actions.

Joint tenancy and TOD/POD may circumvent probate and avoid the need for a Will or a trust for the subject accounts or property -- *at least for the moment*. If used without an informed and in depth consideration of all relevant factors and family concerns could lead to end results that are unintended and shockingly different than expected and desired. To use a common metaphor, they are like an iceberg. What you see is just the tip above the water (the simplicity of JTWROS or POD). The dangers are beneath the surface of the water where you do not see them (the deficiencies and shortcomings).

*Goals of this study*. The purpose of this study is to expose the dangers and risks of relying on transfer-on-death, payable-on-death, and joint ownership strategies as a replacement for a Will or Living Trust. Comparisons will be made to Living Trusts and Wills as appropriate. An awareness of the issues raised in this report should help you make informed decisions with respect to your own planning, and help prepare you to ask the appropriate questions when working with your fiancial professionals.

This is a deceptively complicated topic that appears simple at first glance. It makes for a bit of a lenghty paper. This report is not a substitute for consulting with an experienced estate planning lawyer. Nor is it a thorough and exhaustive study of all factors and considerations that may be relevent in your circumstances. This study identifies the most significant issues and possible solutions and will prepare you for meeting with an attorney. It explains the risks and possible complications of these strategies that are often overlooked or disregarded. Final planning decisions should be made after consulation with a qualified estate planning attorney.

## WHY JOINT TENANCY AND TOD/POD ARE COMMONPLACE

Joint ownership/joint tenancy and TOD/POD proliferate for several reasons. As mentioned, many persons in financial services recommend these approaches. Or consumers choose these options because they've heard they are a cost-free way to avoid probate at the death of an owner without paying legal fees to create a Will or Living Trust.

*The attraction of simple.* The concept behind joint tenancy is simple. At the death of one of the owners, joint tenancy immediately vests full ownership of an account or real estate to the surviving joint owner(s) by operation of law. That's why the proper technical name for joint tenancy is *Joint Tenancy with Right of Survivorship* (JTWROS or Joint Tenancy in this report). Note that state laws differ and may affect the proper wording that is required for a jointly held account or real estate interest to pass to the surviving owner(s).

The designation of a transfer-on-death beneficiary for real estate or financial accounts is a simple concept as well. The TOD/POD titling means ownership vests in the designated beneficiary(ies) as a matter of contract and state law, automatically upon death of the owner. Not every state's laws, however, authorize TOD for real estate.

Under both techniques, title in the co-owners or beneficiaries is vested with simple, inexpensive paperwork and there is no probate, which is an attractive outcome to some people. But what is the true cost of that simplicity?

## PROBATE, AFTER ALL

Joint tenancy alleviates the need for probate when the first owner dies. But when the second/last owner dies, the entire estate goes through the often costly, time-consuming and nightmarish probate process.

> *After 30 years of marriage, Gene and Marjorie Cummings had accumulated the usual trappings of married life. The home they bought 25 years ago for $100,000 was now worth $500,000. When they added in the value of their autos, furnishings, and cash accounts – all held in joint tenancy – they were amazed to discover their estate was worth $1.5 million. When Gene died suddenly, Marjorie immediately became the sole owner of their $1.5 million estate by operation of law, circumventing the probate courts. But upon her death 15 years later, the entire estate – now worth over $2 million – was subject to probate.*[1]

[1] This example and the others used throughout this report is fictional and is used for illustrative purposes only.

Like joint tenancy, direct beneficiary designation (TOD/POD) is not always effective to avoid probate. Let's change the facts in the story of Gene and Marjorie Cummings in the preceding paragraph, to see how probate can happen even with direct beneficiary designations.

> *After Gene died, Marjorie set up the bank accounts to name each of their 3 children as pay-on-death direct beneficiaries, in equal shares. The oldest child, Donald, was a widower. He died before Marjorie in a tragic accident at work, leaving 2 children ages 11 and 13. Donald's one-third share of the accounts was therefore payable to his estate, and a probate proceeding was necessary to collect those funds. His Will left his estate to his children in equal shares, but because they were minors it was necessary to open a probate court guardianship for each of them to appoint a guardian to manage the money. When a child would reach 18 years of life, the law required the guardianship to terminate and each child received their money outright. Donald's oldest child couldn't resist the temptation that money represented and decided not to go to college in favor of a life of leisure, living off the money until it was gone. The younger child quickly spent the money on a fancy car, electronics, and other material objects, once he turned 18.*

In this version of the story, direct beneficiary designation (POD) resulted in 4 probate proceedings, and the release of the money to the grandchildren at the tender age of 18 years. It could be argued that Marjorie could have added contingent beneficiaries to the POD arrangement, but she did not realize this. Also, as is often the case, once she set up the accounts, she no longer paid any attention because she thought her planning was complete.

Good planning means taking into account all foreseeable events, such as the death of an heir or the possibility an heir would be too young to responsibly handle money. Had Marjorie made a funded, revocable Living Trust, then Donald's share would have passed to his children without the necessity of probating his estate. The money for his children would have been held in trust and managed by a responsible adult as Trustee until they reached an age Marjorie felt they would have been financially responsible. It would have been protected for good purposes, such as a college education.

## LOSS OF CONTROL AND EXPOSURE TO RISK

*Joint Tenancy in marriages the second time around.* Today many Americans marry more than once, either after divorce or loss of a spouse. Often, remarriage means that either one or both partners have children from a previous marriage. Whenever a parent holds property in joint tenancy with a spouse who is not the parent of his or her children, those children are effectively disinherited from those assets. That's one reason why parents with children from a prior marriage *should rarely*, if ever, own property in joint tenancy with a new spouse. Instead, remarried parents should choose ownership strategies that will help them ensure their children are well provided for in the event of their death. This is possible even if the spouses wish to leave an estate for each other.

Direct beneficiary designation of accounts or real estate to pass to the new spouse puts the children of the first spouse at risk just like jointly titling the assets with the new spouse.

Living trusts are ideal for such situations. Assets can be left in trust for benefit of the new spouse for life, and for benefit of the deceased spouse's children. When the new spouse dies, the assets pay to the first spouse's children or continue in trust for their benefit. The new spouse is not given the power to alter the inheritance plan, and his or her access to the funds would be through an independent Trustee or Co-Trustee serving with the spouse. This allows for the needs of the surviving spouse, protects that first spouse's children from loss of the intended inheritance, and allows for distributions for support of the deceased spouse's children if that is the intent.

Even when children from a prior marriage are not a factor, you may want to think twice about whether you want to give up total control over how the fruits of your life's work are distributed at your death. Since many widows and widowers will eventually remarry, there is a strong likelihood that someone your spouse may marry in the future will be the ultimate beneficiary of your estate that you leave to your spouse through joint tenancy or transfer-on-death. For some people, that is of little concern. But most of us would rather see our assets benefit a relative, friend or favorite charity, rather than some stranger we have never met.

> *Jerry and Raine Symington had been married 23 years, when Jerry died of a stroke. The Symington's had no children, but Jerry had a niece and nephew who were dear to him. At his death, ownership of all Jerry's assets passed to Raine, his wife, because he set them up to be jointly owned with her or payable to her directly as beneficiary. A few years later, Raine remarried a man with two children of his own. He outlived Raine, and inherited all her assets, which his own children ultimately inherited from him. In the end, Jerry's niece and nephew, the two people Jerry loved most next to his wife, were disinherited while his estate went instead to another man's children whom he'd never met.*

If Jerry and Raine had set up a Living Trust, when Jerry died he could have left some or all of his assets in trust for Raine's benefit. When she died, the remaining assets would have paid to Jerry's beloved nephew and niece. Raine's second husband would not have inherited those assets.

*Joint Tenancy means loss of control and risk of financial loss.* When you own property with a joint owner, each of you owns a half interest in the asset. Your co-owner has the same rights as you over financial accounts. This may not be of concern if the co-owner is your spouse. But if the co-owner is someone else, the implications can be serious. For example, your co-owned accounts or real estate could be at risk for the following situations involving your co-owner:

- To pay a court judgment in a lawsuit against your co-owner
- To pay your co-owner's back taxes
- To be distributed to pay your co-owner's creditors in her bankruptcy
- Division and distribution to your joint owner's ex-spouse in a divorce
- To pay for your co-owner's nursing care costs as a condition for him to qualify for Medicaid nursing care benefits

- Higher income tax when the property is sold after death of the original owner (see the section below entitled "Capital Gains Exposure for Joint Tenancy")

Of these risks, exposure of jointly owned assets to the debts, taxes, or bankruptcy of your co-owner can be especially costly.

> *Ronald wanted his estate to pass to his daughter Jessica without probate when he died. But he didn't want to hire a lawyer to make an estate plan. So he put his daughter on his house title as joint owner with rights of survivorship. The house was worth $400,000. He also put her name as joint owner with rights of survivorship on his investment account that held $500,000 of securities, which he was relying on in his retirement.*
>
> *Jessica had her own business. It got into financial trouble a few years later and she closed it down. She defaulted on some substantial loans and other debts. Several of her creditors sued her and got court judgments totaling $750,000. The holders of the judgments filed liens against Ronald's house because Jessica was part owner. They filed a foreclosure proceeding against the house. Other creditors filed legal proceedings to attach and liquidate his investment account to provide funds to satisfy Jessica's debts.*
>
> *Ronald had to hire a lawyer and pay substantial legal fees to fight the legal proceedings to foreclose on his house and take his securities from his investment account. Because putting her name on the investment account and house constituted a completed gift under the law of the state where Ronald lived, Jessica was treated as half owner and half the securities were ordered sold and the proceeds paid to Jessica's creditors. Ronald prevented a foreclosure sale of his house by buying Jessica's half interest through a payment of $200,000 to her creditors. If he had not been able to do that, then the house would have been sold at a Sheriff's auction sale. He would have kept half the proceeds, but he would have lost his home. The other half would have been paid to Jessica's creditors who foreclosed.*
>
> *If Jessica had filed bankruptcy before the lawsuits progressed to a court judgment, then her half interest in Ronald's house and in his securities would have been part of Jessica's bankruptcy estate and the bankruptcy trustee would have administered and sold those as part of her bankruptcy. The result to Ronald would have been the same as under the court judgments.*

In addition to risk of loss explained above, joint tenancy can interfere with day-to-day management of your assets. Consider, for example, the following practical consequences of holding financial accounts in joint tenancy with someone else. As stated, these may or may not be significant to you if your spouse is the other owner:

- You may not be able to withdraw money from your account without the other owner's consent.

- The joint owner has as much right to the funds or securities held in the account as you and you have no safeguards against the co-owner taking your money without permission.
- You may have to obtain your joint owner's consent before you engage in certain transactions involving your account.
- You may have to deal with your joint owner's Power of Attorney Agent, if she is incapacitated, who may be someone you do not know or get along with. The agent may seek to make withdrawals or sell co-owned assets to pay living expenses of the co-owner.
- If the co-owner does not have a Power of Attorney, your asset may fall under the jurisdiction of your joint owner's living probate Guardianship, if your joint owner becomes incapacitated through illness or injury. You will have to prove and defend your ownership interests and defend against a possible sale or liquidation that may be forced to provide funds for the co-owner's living expenses.
- If your joint owner is a minor child, your shared property may be the subject of guardianship proceedings, which are costly.
- If your joint owner is youthful, there is the risk that her financial inexperience, emotional immaturity, or the inevitable mistakes that are part of the growing experience, may have a disastrous financial impact on your asset.
- Jointly owned assets may cause a special needs individual to lose qualification for government entitlements.
- The laws of the state where the joint account is located will control what happens to the account when an owner dies, and it may not be as simple and quick as you may think. The financial institution that holds the account may also have technical requirements that would cause delay or unintended consequences.

*Joint Tenancy and Transfer-on-death/Pay-on-death cannot plan for or protect against family issues*. Vesting of an account or real estate automatically in a co-owner upon an owner's death ignores situations in which giving money or property directly to heirs. Sometimes it is not prudent to allow adult heirs to immediately control what you want them to inherit. But co-ownership or TOD/POD result in a lump sum, immediate division and distribution, without any opportunity to make conditions or stipulations apply. Consider this story:

> *Fred and Wilma Flintstone wanted to leave their entire estate to their daughter, Pebbles. She is a wonderful child but is just not good with money. At age 24, she is yet to hold a steady job, cannot manage her money and pay her bills without help from Fred and Wilma, and has not completed her college degree. They planned to visit an estate planning lawyer to set up a Living Trust to hold and manage Pebbles' inheritance until she was 35 years old, when they died in a plane crash on their vacation. Pebbles was named as direct beneficiary on their IRAs, and the sole heir under their Wills. She inherited the IRAs directly and received all the other assets outright and free of stipulations after probate. She abandoned college and went on a spending spree. Two years later, she was broke and still had not finished college.*

As Fred and Wilma realized, the solution for Pebbles was to leave their estate in trust for her benefit, with stipulations, conditions, and timing requirements for release of the money. If they had done that, it would be a very different and better picture for Pebbles today. Sadly they procrastinated too long.

Noteworthy situations where it would be imprudent to use joint tenancy or TOD/POD as a substitute for a Will or Living Trust would include:

1. When heirs who are young and inexperienced with money or financially irresponsible, as they will likely lose an inheritance to foolish spending. In addition, poor debt management could lead to a bankruptcy and loss of inherited assets (see below).
2. When heirs have been sued and have court judgments against them, as their creditors can seize those assets through legal processes and have them sold to raise cash to pay their court judgments .
3. Where an heir has filed bankruptcy within the past 180 days or is in a debt repayment plan under Chapter 13 of the Bankruptcy Code, as they cannot keep the inherited assets.
4. If a beneficiary has special needs. If such a person is receiving government entitlements such as Medicaid or SSI or is expected to be eligible for such benefits in the future, an outright inheritance of jointly owned or TOD/POD assets would cause loss of government benefits until the money is spent for their needs.
5. If heirs are elderly or incapacitated and cannot manage their own affairs, a probate court guardianship may be necessary to appoint a guardian for them if they do not have an effective property power of attorney.
6. Married heirs in a troubled marriage could lose some inherited assets in a divorce, depending on state law and how the inherited assets are managed.
7. Where beneficiaries cannot be located, distributions for everyone else named as a beneficiary of an asset can be delayed until the missing person is found (see further discussion below).
8. A change in relationship to a beneficiary may not automatically revoke a designation as beneficiary. For example, will a divorce invalidate a spouse as a named beneficiary? That depends on state law or the provisions of the custodial agreement.
9. There may be fees charged by the custodian to terminate and distribute the account.

In comparison, holding assets in a Living Trust, or making a Living Trust the TOD/POD beneficiary, eliminates all these negative considerations. Here's how a Living Trust would apply to each of the above points, number by number:

1. Using a Living Trust, you can establish terms stipulations and conditions for distributions to heirs, e.g. delays until an age where they are expected to be more mature and financially responsible. A trust can include provisions that would protect loss of inherited assets in a beneficiary's future bankruptcy.
2. A Living Trust can be drafted to prevent creditors from seizing inherited assets, even if they have a court judgment .
3. A trust can include provisions that would protect loss of inherited assets in a beneficiary's pending bankruptcy.
4. A Living Trust can hold inherited assets and make them available to a Special Needs Beneficiary to supplement government benefits, and those benefits would not be affected.
5. Assets can be managed by a trustee under a Living Trust for benefit of an incapacitated beneficiary, without needing a guardianship. .

6. A Living Trust can protect inherited assets from being considered marital assets subject to division in an heir's divorce.
7. A trustee under a Living Trust will divide trust assets into separate shares for each beneficiary. The circumstances of one beneficiary, including a beneficiary's absence, will not affect the other beneficiaries.
8. State law in Ohio, and likely other states, provides that a divorce terminates the former spouse's inheritance under a Living Trust that names the spouse as a beneficiary.
9. There are no fees charged to a trustee who is owner of an account when the trustor dies.

*Unique issues for real estate.* Leaving real estate to more than one joint owner, or under a TOD designation, is especially tricky after the first owner's death. All the co-owners who survive the death of a joint owner are "partners" in the property and must agree and cooperate on all issues. This includes whether the property will be sold, and if so, at what price, and how the property will be used and who pays the expenses of the property and occupies it until it is sold.

Depending on the law of the state where the property is situated, you may have to obtain the approval of your co- owner's spouse before you can dispose of your real estate. You cannot gift, mortgage, or sell the property without the co-owner's signature (and possibly his/her spouse's signature) as well. The potential for disputes and issues abound.

Holding assets in a Living Trust avoids all types of probate and all the risks of loss of control and financial loss that exist when assets are held jointly with someone other than your spouse. Living trusts can avoid all the other risks mentioned. Making a Will can manage or avoid some risks of JTWROS and TOD/POD.

Creating a Will or Living Trust has the added benefit of assuring valid debts are paid. The fiduciary can be given direction to pay valid debts and funds are made available for that purpose. Where debts are disputed, payment from Living Trust assets is not required under current Ohio law, unless the trust agreement says so. If a Will is probated, all creditors of the decedent must file claims within a limited time or else their claims are no longer valid. This can be useful where there are disputed claims or substantial debts. The payment of those debts or claims can be legally limited to the probate assets. Relying on joint tenancy and TOD/POD leaves debts unaddressed.

## COMPLICATIONS WHEN THERE IS NO FIDUCIARY

In cases where *all* accounts and real estate are set up to pass directly to named beneficiaries or to co-owners, there will be no estate fiduciary appointed. A fiduciary is a person who acts on behalf of another person or persons to manage assets. When a person dies, his or her estate fiduciary is known as the Personal Representative under a Will, or as the Executor. If there is no Will, the fiduciary is known as the Administrator and is appointed by the probate court. Under a Living Trust, the fiduciary is known as the Trustee. Each type of fiduciary for an estate of a deceased person is responsible for and has the authority to carry out certain important matters for the decedent. These include, for example:

- Assure the proper heirs inherit

- Pay debts
- Pay burial and funeral costs
- Pay administrative expenses
- File tax returns for the decedent
- Maintain real estate and pay expenses including insurance until it is sold or distributed to heirs
- Resolve disputes with third parties
- Collect estate assets
- Inventory and divide and distribute personal effects
- Account to the beneficiaries for estate transactions
- Obtain tax identification number from the IRS

These are important tasks. If there is no money held by a fiduciary with authority to settle a decedent's estate, these matters may be left undone. That would cause complications, delays, and unpredictable issues and hassles for family.

There may be an estate fiduciary appointed under a Will or Living Trust, but other accounts or real estate may be jointly owned or POD and there will be no fiduciary appointed for those assets. That poses the same issues as above for those assets.

## HIDDEN LANDMINES OF TOD/POD AND JTWROS

The beneficiaries control assets set up for inheritance under these techniques. But they must comply with the requirements and processes established by the financial institutions that hold financial accounts.

Each financial institution will have its own requirements at death of an account owner. Their custodial agreements should be reviewed in advance. Some are lengthy and complex. The process for each financial institution must be followed, and if not observed perfectly the paperwork will be rejected.

Because each financial institution has its own rules, each will have its own forms and custodial agreement. Some forms are easy, and some are confusing. Some custodial agreements are brief, or can be 20 or 30 pages long, or even more than 100 pages. To be sure the TOD/POD or JTWROS designations work the way you want – or as you think they will work – you should read them but understanding them may require the help of a lawyer.

Even if you read and understand the provisions of a financial institutions custodial agreement that governs a TOD/POD or JTWROS account, companies typically reserve the right to change the terms of the agreement at any time, without advance notice to account holders and with no necessity of their consent. It is up to you to monitor the accounts and determine when changes to the terms are made, then evaluate how the changes impact you. Then there will be a process to follow that the company establishes to change account titling or beneficiary designations, or to move the holdings to another financial institution. That would start the process all over again.

There is no uniformity of practices or standards in the financial industry about how JTWROS or POD accounts work when an owner dies. Important points to know about each institution's policies include:

- How the share of a deceased beneficiary is handled under the default provisions of the custodial agreement. Will it pay to the remaining named beneficiaries or to the children of the deceased beneficiary? Does the financial institution honor a *per stirpes* instruction, which means the share of a deceased beneficiary filters to his children, grandchildren, etc., or if there are none, then to the deceased owner's other living children or their issue? Will the institution allow you to specify a *per stirpes* beneficiary designation, or do the standard provisions apply no matter what? Are those standard provisions what you would want to apply?
- What are the documentation requirements for a beneficiary to claim an account? E.g. indemnification against claims, certified copy of death certificate, affidavit of domicile, tax waiver, notarization, gold medallion signature guarantees, or other requirements.
- Who is authorized to claim an account?
- Will the beneficiaries be required to open an account at that financial institution to claim their share of the account holdings? Or can they have the holdings transferred to their account at other financial institutions?
- If there is a dispute, how is it resolved? By arbitration? If so, where – in the locality where the decedent lived, or in the state where the financial institution has its principal office (the latter is the correct answer).
- Will the company require *every* beneficiary to present acceptable paperwork before it pays anyone?
- If beneficiaries are minors (under age 18 years in most states), what is the company's policy? Will a court-appointed guardian be necessary? Will they pay the money to a person to act for the minor and if so would you agree with who that person would be? Will payment to an account under the Uniform Transfers to Minors Act (UTMA) be allowed, making a guardianship unneeded?
- Is there a time limitation on claiming JTWROS or TOD/POD accounts? If so, the beneficiary/ies may be deemed to have died before the account holder if the process is delayed too long. If so, and if there are no back-up beneficiaries designated, then the money will be paid to either the state where the owner lived or where the company is located. Would the time limitation apply if a beneficiary is missing and that is causing all distributions to be delayed?

In comparison to a Living Trust as owner or TOD/POD beneficiary, the process is simple, quick, and none of the above are of concern. The trust is the account owner, and the trustee in charge of the trust has all the same rights as the original owner.

*Issues Where There are Multiple Named Beneficiaries.* Where more than one person is a co-owner or POD beneficiary, it can be even more difficult. Some financial institutions require all beneficiaries to submit their claims at one time and will withhold funds or securities until then. This can lead to indefinite delays. Here are a few situations in which delays could be expected if *all* beneficiaries must present claims at the same time:

- Beneficiaries are not available due to travel, illness, or other reasons.
- There can be disputes between beneficiaries as to how the account should be divided, if instructions are not clear.
- Beneficiaries who are minors or incapacitated could require a guardianship to be set up in the probate court.
- If a charity is named as a POD beneficiary, delays may ensue if the charity wants legal review or must wait for review by a governing body.
- If a beneficiary to a JTWROS or POD account is receiving Medicaid or SSI benefits, the benefits must stop and cannot resume until the assets are spent for care or protected in another way from being countable.

Where a Living Trust is account owner or TOD/POD beneficiary, these circumstances do not affect the smooth settlement of the estate.

*Issues caused by delays in processing TOD/POD claims*. Who will manage the investments held in POD or joint ownership stock or mutual funds accounts during the delay? What if the market is volatile, and securities lose value? What if some beneficiaries have serious financial needs during the processing period? Can automatic deductions from cash accounts be stopped? If the account owner had established trade and re-balancing authority for a custodian, that will cause trading costs. How can that be terminated?

No one has clear authority to act on any of these matters if there are multiple beneficiaries or co-owners. These issues are manageable where a fiduciary is appointed under a Will that is probated, or where a Trustee under a Living Trust owns the accounts. The Trustee will not need probate court involvement to act, unlike a Personal Representative under a will. Either type of fiduciary can take timely actions.

Timing issues may be especially crucial with retirement accounts. Participants under 401k and 403b plans, as examples of employer sponsored retirement plans, and IRA owners, must take Minimum Required Distributions under government rules once they reach age 70 ½ years. Those accounts can be inherited as tax-deferred accounts or cashed out immediately by the heirs. But before a non-spouse beneficiary can receive an IRA or qualified plan distribution, the Minimum Required Distribution for the year of the owner's death must be taken out.

An account custodian or plan administrator may require all beneficiaries to set up their inherited accounts before they pay anyone. Where there is no fiduciary, who handles and coordinates this process? The process can be delayed for any other reasons discussed above, and the account is frozen in the meantime.

*Tax Issues Where There is No Fiduciary*. Co-ownership and JTWROS also create tax issues. Investment accounts and even cash accounts Will generate income in the form of interest or dividends. Capital gains may be incurred under trading authorization left by a deceased owner under the account terms. Mutual funds generate capital gains from time to time by their nature.

Who will the income be reported to? The estate or the ultimate heirs? If the income is reportable to the estate, who will prepare and file the decedent's estate income tax return, IRS and state forms 1041? Will the tax liability link to the recipient of the income, or will the eventual beneficiaries have a tax liability on their share of the income before they actually receive any money? Will the beneficiaries named on the account receive 1099 forms from the financial institution for interest and dividends even before they get their share of the money or securities? (This could happen because their Social Security Numbers are often, if not always, required to set them up as direct-pay beneficiaries.)

If the accounts paid income both before the owner's death and afterwards, and no one as fiduciary contacted them, will the income reported on 1099 forms be split between these periods? If not, would that be fair?

If there is no estate fiduciary, who will file the decedent's final 1040 income tax returns?

Using TOD/POD or JTWROS may avoid probate, but are they worth all the other complications and risks? Naming a fiduciary under a will for at least some of the estate assets, or a Trustee under a Living Trust as owner or beneficiary, is a more reliable and simple approach.

## TOD/POD AND JTWROS ASSETS ARE AT RISK UNDER MEDICAID

Aging Baby Boomers and seniors rank the loss of their life's savings to pay for nursing care as a primary – if not the most important – concern when it comes to their estate planning today. This concern is well placed for a couple of important reasons.

First, the cost of skilled nursing care can be $10,000 or $11,000 a month depending on what part of the country you reside. It is not hard to imagine burning through the assets you hoped to pass to heirs at that rate, going broke in the process.

Second, the government has a program to help citizens pay for long term nursing care. That program only applies to those who cannot afford to pay for nursing care because their estate is less than the maximum permitted by law. For unmarried persons, that is $2,000 in Ohio. For a married couple where one lives in the marital home and the other is in a nursing facility, the couple can keep half their combined assets, but not more than $126,250 plus a $2,000 personal allowance, in Ohio. The marital home is not counted as long as the equity is not over $572,000. If both spouses are receiving Medicaid in Ohio, they can keep only $3,000 between them.

Thus, you must go broke or almost broke before Medicaid will help. That affects your legacy for your heirs and your spouse's quality of life.

Assets you set up in joint ownership or TOD/POD are countable resources for Medicaid. They cannot be protected. On the other hand, certain types of Living Trusts can protect non-IRA financial accounts and real estate, if the planning is undertaken 5 years before applying for Medicaid. Saving a buck or two by taking the easy option of JTWROS or TOD/POD may cost your family a great deal because those assets are countable for Medicaid and must be spent down.

## CAPITAL GAINS EXPOSURE FOR JOINT TENANCY

The capital gains tax, that often-debated revenue generator for the federal government, is a tax levied against your profit when you sell a capital asset such as securities, real estate, or a company. To determine the amount of capital gains against which the tax will be applied, you deduct your *cost basis* in the asset – meaning your investment in it – from the price it fetches when you sell it. The difference is your capital gain, and that's the sum which will be used to compute your capital gains tax. For instance, if you buy stocks or mutual funds for $125,000 and sell them for $200,000, you would owe capital gains taxes on $75,000.

The federal government provides a capital gains tax break on assets in a person's estate. Called a *step-up in basis*, it simply means that when you die, the government will consider your heir's *cost basis* in an asset to be its current market value, not your original purchase price. So, if stocks and mutual funds you bought for $125,000 are worth $200,000 when you die, your heir's cost basis would be $200,000. If your heir sells them for that price, no capital gains tax will be due.

Putting real estate, stock or mutual fund accounts, or other capital assets such as collectibles, in joint tenancy with someone other than your spouse can result in sacrifice of the step-up in cost basis and a costly tax bill.

> *George Worthington, an Ohio resident, owned a duplex apartment building he bought 40 years ago for $50,000.00. When he died last year, the property was appraised at a whopping $500,000.00! George wanted to plan to avoid probate when he died. So, based on advice from his favorite teller at his bank, and the recommendation from a friend, George changed the title on the building to him and his son, Daniel, as joint owners with rights of survivorship. Adding Daniel to the title constituted an immediate gift of a one-half ownership interest in the property to him.*
>
> *When George died 8 years later, Daniel inherited the property. He sold the property shortly afterwards for $500,000.00. His cost basis for the first half of the property was $50,000.00, which was his father's cost to purchase it years ago. That meant the building received the favorable step-up in basis treatment on only half its value. So, much to Daniel's dismay, instead of a cost basis of $500,000, he had a cost basis of only $300,000.00 ($50,000.00 for the half his father gave him before he died, and $250,000.00 for the other half he inherited). Thus, when he sold the property for $500,000.00, he had to pay capital gains tax of 15% on the $200,000.00 of capital gains, or $30,000.00, based on his income tax bracket. If George had left the property to Daniel at his death instead of giving him half ownership before he died, then Daniel would not have had to pay the $30,000.00 capital gains tax when he sold the property.*
>
> *In addition, if his modified adjusted gross income was $200,000.00 or more, Daniel would have had to pay an additional surtax of 3.8% on the $200,000.00 gain, or another $7600.00.*

If George had held the property in a revocable Living Trust and left the duplex to Daniel under the trust when he died, the property would have passed without probate and the $30,000.00 capital gains tax would not have applied. Nor would the 3.8% investment tax have been a risk.

George could also have made the duplex transfer to Daniel on his death directly instead of through a trust, but that would have had other risks discussed elsewhere in this report.

A very taxing situation occurs for married couples who live in one of the nine community property states – Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. They pay a high price when they put assets in joint tenancy rather than owning them as community property. In these states, using joint tenancy can expose your estate to costly capital gains taxes.

## A TAXING ISSUE

As an estate taxation planning device, joint tenancy is not optimal. As the death of the first owner, there may be little concern. Through the Unlimited Marital Deduction, the government lets spouses pass assets to one another at death estate tax-free. However, when the survivor dies, estate taxes can reduce the legacy the couple thought they were leaving behind. Why? At the death of the survivor, the value of the entire property is included in the survivor's estate. If the sum of all the survivor's property is less than the amount that can be passed free of estate tax, this may not be a problem. This amount is $11.4 million for federal tax purposes in 2019, indexed for inflation. But some states have a separate state estate or inheritance tax which kicks in at a much lower level. Also, the current $11.4 million exemption is scheduled to be repealed under a sunset provision in the law, effective December 31, 2025. After that, the $5.0 million per person exemption under prior law goes back into effect, indexed for inflation.

## JOINT TENANCY CAN CAUSE GIFT TAX

Joint tenancy is often used as a method of ownership between non-spouses. For instance, friends often buy property together. An aging relative will often make a younger relative a joint owner on property or cash accounts. Parents make their children joint tenants with them on everything from cash accounts to cars to the family home.

Unfortunately, IRS policy is to consider such transfers to joint tenancy as gifts and not estate planning strategies. That's why the step taken to avoid wills and probate could in the long run cost more money than it saves. Let's look at some examples.

When a non-spouse is added to the title of property as a joint owner, the government deems it to be a gift unless a limited exception applies. Gift taxes will become due, and the *donor* – the person making the gift – will usually be liable for the taxes. How much gift tax is due and when it is due depends on the asset.

Elderly relatives commonly add a younger relative or an adult child to their checking accounts, savings accounts and other cash accounts as a convenience. As long as the new joint owner withdraws money strictly for the use of the original joint owner, no gift taxes are due. But if he or she withdraws money for personal use, that constitutes a gift from the original joint owner to the other joint owner. If the value of that gift exceeds the annual gift tax exclusion (see below), the joint owner is required to file a federal gift tax return, form 709. If the donor/original owner has already applied his lifetime transfer tax exemption for other gifts, then he will have to pay gift tax on that amount. That tax is 40% of the taxable gift under current law.

When a joint owner who is not the original owner's spouse is added to the title of real property, the government considers that to be a completed gift. Gift taxes will then be due on the portion of the property the new joint owner receives. For example, if a father decides to add his son as his joint owner on his personal residence, the government will consider that the son has been given a gift equal to half the home's value, and expect the father to pay gift taxes accordingly, or at minimum file a gift tax return and reduce his lifetime exemption from federal estate taxation by the amount of the taxable gift.

Of course, there are some exemptions available for gifts. Each year you may give away up to $15,000[2], indexed for inflation, per individual donee, to as many individuals as you want, with no gift taxes due. Gifts in excess of that $15,000 are applied to your lifetime exclusion from gift and estate taxation in the amount of $11.4 million.

So, in many cases, the mere fact that you've added someone's name as joint owner to your checking account or real property may not actually require you to part with cold hard cash because the gift is likely sheltered from tax under the gift and estate tax exemption. Even if your gift falls within the exclusions described above, however, you are supposed to report it on a federal gift tax return.

> *Rebecca Waters was nearing 70 and in frail health. Because she was concerned that illness might make her unable to attend to her affairs, she added her daughter Susan onto her bank accounts and home as joint owner. Susan used the money for her mother's benefit, until Susan's car broke down and needed costly repairs. Rebecca insisted her daughter use her funds to pay for them. When tax time came around, Rebecca never thought once about reporting on a gift tax return the cash Susan withdrew for her own use or the "gift" of half Rebecca's home. But a tax audit of Rebecca's return a few years later uncovered these omissions.*

## FITTING JOINT TENANCY AND TOD/POD IN YOUR ESTATE PLAN

Thus far this paper has focused on treating JTWROS and TOD/POD as the core estate plan. That is, relying on these strategies *instead* of a Will or a funded revocable Living Trust, which discussed below. Joint tenancy ad TOD/POD can play a role in a good estate plan if undertaken as part of a comprehensive, thoughtfully designed estate plan that considers the many issues raised above.

The following section puts JTWROS and TOD/POD in perspective when included in what is widely considered the most effective and flexible estate planning strategy today for many Americans – the funded revocable Living Trust.

## MOST EFFECTIVE ALTERNATIVE TO JOINT TENANCY AND TOD/POD

Early on we said that joint tenancy is so pervasive that many people are hard-pressed to think of an alternative. Fortunately, there are several. For instance, you can own property solely in

[2] In 2019.

your own name. Or you and another person can own property as *tenants in common,* which does not vest title in the surviving owner and requires a probate. If you live in a *community property state*, you can elect that ownership option. Or, in some states, you can seek the special creditor protection spouses receive under *tenants by the entirety* for real estate. Each of these options avoids some of the pitfalls of joint tenancy.

However, none of them – and that certainly includes joint tenancy – is a *replacement* for the thoughtful estate planning that a qualified estate planning attorney can provide you. **In fact, all the objectives you might try in vain to achieve through joint tenancy or TOD/POD can be achieved more effectively through a popular estate planning option known as the funded Revocable Living Trust.** With a Revocable Living Trust, for example, you can:

- Control exactly how your estate is distributed – including who your beneficiaries will be, when they will receive your legacy and how they will receive it.
- Ensure that children from another marriage – or children who have special needs – will receive fair treatment from your estate.
- Reduce your estate taxes or eliminate them completely.
- Take advantage of all other tax breaks to which you might be entitled.
- Retain complete control over your assets while you live.
- Put your legacy out of the reach of your heirs' predators, creditors and others seeking a piece of your estate.
- Choose when, where and how you will make gifts to friends, family and worthwhile organizations.
- Enjoy peace of mind in the knowledge that you can make provisions for your care should injury, illness or some other incapacity make you unable to do so for yourself.
- Protect your privacy.
- Provide protection of inherited wealth from the poor judgment, lack of discretion, and foolish spending or investing habits of inexperienced or spendthrift heirs.
- Prevent loss of inherited assets in an heir's divorce.
- Much more

*How to responsibly use TOD/POD and JTWROS to make an estate plan.* Creating an estate plan based on a Living Trust allows all your goals to be met, including avoiding probate, without the risks and complications described above that are possible with joint ownership or TOD/POD.

In a Living Trust-based estate plan, joint tenancy and TOD/POD are used to support the trust. The trust coordinates all elements of the plan. For example, it is common for spouses to hold a personal checking account in joint ownership with rights of survivorship, for obvious reasons of convenience. Separate checking accounts can be made POD to the surviving spouse, or to the trust if there is no surviving spouse. Real estate in Ohio can be owned by spouses in JTWROS, with a Transfer on Death Designation Affidavit (TODDA) connected to the property so that title vests in the trust when the second spouse dies so that the property passes to heirs without probate.

Unmarried individuals can set up real estate with a TODDA so title vests in their trust at death without probate. Checking accounts can be handled in a similar fashion.

Certain assets must have a beneficiary designation attached, as there is no other way to pass the asset or proceeds of the asset at the death of the owner. Prime examples are annuities, life insurance, or IRAs and 401k plans (and similar employer sponsored plans). Such accounts are typically set up to pay to a surviving spouse, if any, or if not, then contingent beneficiaries are designated. The contingent beneficiaries can be children or other named persons, or the trust. Family and personal considerations guide these choices, as suggested in the above materials and examples. If the contingent beneficiaries are named persons, then the trust would typically be the back-up beneficiary for a pre-deceased named beneficiary. The goal and effect would be to position the trust to receive, handle, and distribute the proceeds of these types of assets, because that would avoid the risks inherent to direct beneficiary designation payouts as described in this report. *This is especially noteworthy for those who have high balance retirement accounts that are a significant part of an estate. Just because those accounts can pay without probate to named beneficiaries does not mean that the issues we have discussed are handled or disappear.*

Direct beneficiary designations and co-ownership with rights of survivorship assume that the specifically named beneficiaries survive without personal issues that would affect inherited assets or the deceased owner's goals and wishes. These strategies assume there will be no forces or factors outside the control or predictability of the deceased owner or the beneficiary that would have an undesirable effect. They are inflexible. They leave assets exposed to pay for the cost of nursing care under the Medicaid spend-down rules.

## CONCLUSION

Joint ownership and TOD/POD are touted by some as the panacea for estate planning because they do away with the need for a Will or Living Trust. This study exposes the fallacies and the inherent risks of that mindset.

If there is any strategy that might be considered an estate planning panacea (a solution or remedy for all issues), it would be the funded revocable Living Trust. It is the strategy preferred and recommended by the knowledgeable estate planning professionals. To learn more about the peace of mind and protections of this flexible and powerful planning tool, contact Zimmer Law Firm for a copy of the report, "Living Trusts: Weighing the Benefits", or visit our website. Contact the firm about how to receive a complimentary, no-obligation consultation.

## ABOUT THE ZIMMER LAW FIRM

Zimmer Law Firm, LLC is a charter member of the American Academy of Estate Planning Attorneys. It is the only member firm in Southwestern Ohio. The Firm has been providing quality estate planning services since it was founded in 1993. The fastest growing demand for its services has been asset protection from the cost of long term nursing care. Whether you need an Elder Law attorney, an attorney for general estate planning with trusts or wills, or an attorney to help settle an estate, our team of qualified staff are here to help you and your loved ones.

In these turbulent times, access to an experienced lawyer to protect your estate and accomplish your goals is more important than ever. If you or your family would like a complimentary consultation to discuss your estate plan or how to protect your estate from depletion to pay for long term nursing care, call us today at **513-721-1513** or visit our website at **www.zimmerlawfirm.com**. Check our website for upcoming seminars, or learn more about the firm at www.avvo.com where you will also find testimonials from our clients. See why *Cincinnati Magazine* recognizes us as a Five Star Wealth Manager. If you would like to receive email announcements for upcoming seminars, call to be added to our seminar mailing list.

## A MESSAGE FROM THE FIRM FOUNDER

The goals of Zimmer Law Firm are to make asset protection and estate planning pleasant, easy, and understandable processes for clients. We believe that planning is much more than just creating legal documents. Rather it is about establishing relationships with clients and their family by providing a continuum of services through the passages of their lives. What we do makes an important difference and we take great professional pride and satisfaction in that.

If you or your loved ones would like a complimentary consultation to review your estate plan or to implement a plan, visit our website at www.zimmerlawfirm.com or call us today at 513-721-1513 (Toll-Free 1-866-799-4050) to schedule an appointment. See for yourself why *Cincinnati Magazine* has recognized the Firm as a Five Star Wealth Manager. For the latest news about estate planning or upcoming law firm events, subscribe to our blog and "like" us on Facebook. Check our website for upcoming educational events. We continue to expand our capabilities and services to meet the demands of a complex and changing estate planning world. Our experience has shown us what was a solution yesterday may no longer be adequate to fully protect our clients today.

This report reflects the opinion of the Zimmer Law Firm. It is based on our understanding of state and federal laws and is intended only as a simple overview of the planning issues. We recommend you do not base your own planning on the contents of this report alone. Review your estate planning goals with a qualified estate planning attorney.

## ABOUT THE ACADEMY

The Academy is a national organization dedicated to promoting excellence in estate planning by providing its exclusive membership of attorneys with up-to-date research on estate and tax planning, educational materials, and other important resources to empower them to provide superior estate planning services. The Academy expects members to have at least 36 hours of legal education each year specifically in estate, tax, probate and/or elder law subjects.. The Academy has also been recognized as a consumer legal source by *Money Magazine and Consumer Reports Money Adviser,* and its Education Department has been quoted by other consumer press.

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