Tax Matters
Smart Planning, Succession Solutions & Tax Updates
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Don't Inadvertently Revise your Estate Plan

Over the years, I have had clients retitle their assets and change their beneficiary designations based on the advice of their bank representatives, their family members, their advisors and other ne'er do-gooders. Be careful about taking advise from non-attorneys regarding your assets because you can inadvertently revise your estate plan, trigger taxes and expose your assets to debt collection.

Let's take a look at Ruth, a widower, who stops in at her local bank to make a deposit. While at the branch she chit chats with the teller about her health and her concerns about being able to handle her financial affairs as she gets older. The teller suggests she should simply add her son, John, to all of her bank accounts so that her son can pay her bills, if she falls ill. The solution seems simple enough, but is it? There are risks to retitling your bank accounts into joint names with a non-spouse. Lets address each one.

The Rights of Survivorship Risk. Most joint bank accounts carry the rights of survivorship so that if one joint owner dies, the surviving joint owner automatically inherits the fund. In Pennsylvania, distribution of joint accounts are governed by the Multi-Party Accounts Act ("MPAA"), 20 Pa.C.S.A. Section 6301. The creation of a Will does not defeat the survivorship right created by joint accounts merely because the Will would distribute a decedent's property in a conflicting manner.

In our above example, Ruth, our widower, goes ahead and names her older son, John, joint owner on her bank account. Lets say the account maintains a balance of $100,000. Ruth dies. Since John was named joint owner on the account, John inherits the account (with the $100,000) outright. So what is the problem? Well, what if Ruth has three other children? Ruth's Will, like most Wills, provides that each of Ruth's children is to receive an equal share of her assets. Since Ruth retitled the bank account, the account now passes to John, and not equally among her children.

But wait, John is a good guy and he offers to give each of his siblings $25,000. Problem solved, right? Not so fast. Now John has a gift tax issue because he has given away more than the $14,000 annual exclusion amount in a year provided under federal estate law. He is required by federal tax law to file a gift tax return reporting the gifts. John may or may not owe gift tax on those gifts. On top of potential gift tax issue John will also need to pay someone to prepare the gift tax returns.

John could spread the $25,000 gift over the course of two years. In the first year his siblings each receive $14,000, and the second year his siblings receive the remaining $11,000. But what if John has creditor issues? What if his siblings really need the money the first year?

Alternatively, what if John is not such a good guy. What if John decides to keep the $100,000? After all Ruth did decide to make John joint owner on the account. So now John decides **not** to share the funds with his three siblings. John's siblings would have to bring a legal challenge that would cost them money and create additional discord within the family. The burden would be on the siblings to prove that the joint account was for "convenience purposes only."

Tax Triggers. So Ruth names her son, John, as joint owner of her account. Does the retitling the account in joint names trigger tax? Perhaps. If John decides to use any of the funds in excess of the $14,000 annual exclusion amount, removal of the money from the account can be treated as a gift. Now Ruth might have a gift tax return filing requirement.

What if John dies? As joint owner, Ruth would receive the account outright, however, the account would be subject to Pennsylvania inheritance tax and possibly federal estate tax (depending on value of Ruth's gross assets). Yep, that is correct.... Ruth would likely have to pay tax on her own money if her son dies before

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she dies because the Pennsylvania Department of Revenue - Inheritance Tax Division's position is that one-half of the account is subject to tax **regardless** of source of the funds.

The Rights of Ownership Risk. Don't foreget about rights of ownership. Once Ruth converts her account into a joint account, each account co-owners has the right to spend, give away or transfer the funds to other accounts without the consent or the knowledge of other accounts owners. So John could legally remove, spend or transfer all of the money in the joint bank account and there is nothing Ruth or the bank can do to prevent this.

Creditors, Debt Collection. Joint bank accounts may be subject to debt collection, liens, judgments and divorce proceedings. The MPAA states that a joint account belongs, during the lifetime of all parties, to the "parties in proportion to the net contributions by each to the sum on deposit, unless there is clear and convincing evidence of a different intent." In our example, if Ruth is the sole contributor of the funds in the joint account, John's creditors should not be able to reach the funds unless there is clear and convincing evidence to the contrary.

Unfortunately, the law has not stopped creditors from trying to claim access to joint accounts where one individual is the sole contributor resulting in costly litigation. In fact, many banks place the burden squarely on an account owner to raise the defense that they are the sole contributor, otherwise, the bank will consider each joint owner has an undivided interest in the entire account. For example, National Penn Bank states in its bank service agreement that "unless prohibited by applicable law, **you agree that we may pay all amounts in the account in satisfaction of any legal process, regardless of the account owner whose interest is being attached.**" By signing the bank's deposit account signature card, you are agreeing to the bank's service agreement. Basically, you just contracted out of the protections afforded under Pennsylvania's Multi-Party Account Act.

The Solution... So what is the solution to Ruth's problem? How can she protect her finances but still have John assist her with her financial affairs, if needed. The answer is simple: A well drafted Durable Power of Attorney would have allowed John to handle her financial affairs without inadvertently revising Ruth's estate plan, expose Ruth to John's creditor issues, and trigger unnecessary tax. The good news for many of you is that you already signed such a document. Rely on it. Do not fall prey to the ne'er do-gooders and retitle your bank accounts (or other assets) out of fear of financial helplessness.

A Quick Word on IRAs... Back in July 2014, the US Supreme Court ruled in *Clarke v. Rameker* that inherited IRAs are not "retirement funds" within the meaning of 11 U.S.C. Section 522(b)(3)(c), and therefore not exempt from a bankruptcy estate (i.e., the inherited IRA funds can be used to satisfy creditors claim). This factual situation only applies if an individual who owned an inherited IRA files for bankruptcy. The Supreme Court ruling does not extend to a creditor the right to attach a judgment or a lien to an inherited IRA outside of bankruptcy.

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Mary R. LaSota is an experienced attorney who represents individuals in a wide range of estate, business and tax planning issues. Tax Matters is bimonthly newsletter providing timely smart succession solutions and tax updates. Do you have a question or an idea for the next Tax Matters' issue? Email Mary R. LaSota at mlasota@lasotalawllc.com