



# COMMITTEE REPORT: ESTATE PLANNING & TAXATION

By **Natalie M. Perry**

## Pros and Cons of Pay-on-Death Accounts

Beware of unintended results

**P**ay-on-death (POD) or transfer-on-death (TOD) accounts are tools used in the estate-planning process to provide for streamlined administration and avoid probate proceedings on the account owner's death (POD and TOD referred to collectively for simplicity as POD accounts).<sup>1</sup> POD statutes allow the account owner to implement a POD registration but don't require it.

Though POD accounts aren't difficult to implement, when clients use these accounts, advisors should carefully consider the overall planning, including the estate plan, to address all goals and avoid unintended consequences. While POD accounts can provide for a smooth transition to a named beneficiary on the account owner's death, they can often result in a disproportionate or inadvertent transfer of funds. POD accounts also cause unintended results in certain situations when compared with traditional estate planning.

### Account Descriptions

Broadly speaking, the term "pay-on-death" is used for bank accounts, while the term "transfer on death" is used for securities. The phrase "*Totten* trust" also is used when a bank account in the account owner's name has a designated beneficiary, as it's similar to a trust.<sup>2</sup> Typically, a bank or securities account doesn't have a named beneficiary, so the account owner would have to take an extra step to name a designated beneficiary.

The procedure to implement a POD designation is often very simple. Most states have laws that govern how a POD account will operate.<sup>3</sup> The

account owner's attorney often won't be involved in the process. In some situations, an employee of the financial institution may encourage the account owner to designate a beneficiary, but the employee may or may not be aware of the account owner's estate plan. The guidance an account owner may receive concerning a POD designation and coordination with the estate plan will vary.

### Comparison to Joint Account

Like a joint tenancy account, the account with a POD designation passes by operation of law without reference to the account owner's will or revocable living trust. Often, clients will rely on titling property in joint tenancy with the right of survivorship to ensure a smooth transfer to a beneficiary at death. See "Case Study 1," p. x.

### Case Study 1

*Parent and child have a joint tenancy asset*

An elderly client wishes to add her adult child as a joint account owner so that the account passes directly to the child when the client dies and avoids probate. Now that the child is treated as an owner, the child's consent must be given to make account changes or liquidate the account, excluding accounts created for convenience.<sup>1</sup> If either account owner has unpaid debts or taxes, the account will likely be subject to claims by creditors of both owners.

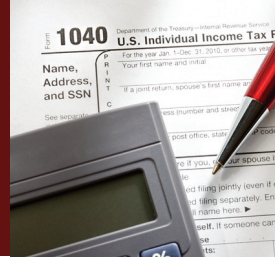
### Endnote

1. See, e.g., *In re Estate of Harms*, 603 N.E.2d 37, 41 (4th Dist. 1992) and *Konfrst v. Stehlik*, 13 N.E.3d 278, 287 (1st Dist. 2014) (finding that mere "convenience" accounts don't carry with them rights of survivorship, unless the owner manifests expressly or implicitly a desire to include rights of survivorship).

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funds in the account or make any changes to the account while the account owner is alive. Only the owner's creditors may access the account. Finally, POD accounts can include beneficiaries who can't typically be named as joint owners,<sup>4</sup> for example, charities or the owner's living trust, and still avoid probate on the account owner's death.

POD accounts may also have joint owners. In such a case, the POD beneficiary can't access the funds until the last owner's death. Therefore, beneficiary designations on POD accounts may (and often are) be used together with other planning tools such as wills, revocable trusts and joint tenancy.

## Coordination is Key

Estate planning isn't limited to a will and trust; it also extends to titling assets consistently with your client's planning and coordinating beneficiary designations. Each part of the plan must be coordinated to prevent an unintended result. A client may assume that their will and revocable trust will resolve any discrepancies between the distribution of assets in the estate plan and the named beneficiary forms.<sup>5</sup> However, the POD designation will trump the estate plan, so the attorney and other advisors must coordinate the asset titling with the estate plan.

## POD Pros

Here are some benefits of establishing a POD account:

- **Ease of creation.** These accounts are simple and inexpensive to create. Legal advice isn't required. Account owners can name multiple beneficiaries or name a primary beneficiary and contingent beneficiary.
- **Easy for clients to understand.** When created, the account owner often fully comprehends the arrangement (unlike a will or trust). No complicated language or legal documents are necessary.<sup>6</sup>
- **Simple to administer.** POD accounts streamline the process of transferring assets to the beneficiary after the account owner passes away.
- **Probate avoidance.** Accounts with a POD designation will avoid probate, which may save time and administration costs.<sup>7</sup>

- **Quick access.** Perhaps the key advantage and why these accounts are so common is the beneficiary's ability to access funds immediately after death. The probate process takes much longer to provide funds to cover estate administration expenses.

Situations may arise in which coordination can't be achieved.

## Cons of POD Accounts

Here are some disadvantages to be aware of:

- **Incapacity of owner.** A POD account beneficiary can't access the funds in the account while the account owner is alive. If the account owner becomes incapacitated, the family wouldn't be able to access funds without seeking guardianship.<sup>8</sup>
- **Lack of flexibility.** An owner can't change the beneficiary of a POD account once incapacitated.<sup>9</sup> If the beneficiary predeceases the account owner, then a probate proceeding may be required to transfer the account.
- **Lack of liquidity.** POD accounts can cause a liquidity problem for the estate representative. The payment of funds directly to beneficiaries may leave the estate without funds to pay taxes and expenses. Generally, a decedent's probate estate has primary liability for payment of the decedent's final debts, taxes and expenses of administration.<sup>10</sup> The representative could be forced to seek a contribution from the POD beneficiaries to satisfy outstanding taxes and expenses. The beneficiary of a POD asset is *probably* required to contribute toward estate obligations if there are insufficient assets in the probate estate.<sup>11</sup> There are a few statutory and common law rights of reimbursement from non-probate assets. If probate assets are limited, it can be challenging to ascertain how to pay estate obligations and how other assets must contribute toward these obligations. State and federal law don't directly address these questions.



## FEATURE: ESTATE PLANNING & TAXATION

- **Apportionment of estate tax.** Internal Revenue Code Sections 2206, 2207, 2207A and 2207B permit the “executor”<sup>12</sup> to seek reimbursement for federal estate taxes attributable to certain assets included in the decedent’s taxable estate, but the executor may not receive reimbursement unless the decedent permits the executor to do so in their will.<sup>13</sup> State law governs what happens beyond that. The Uniform Estate Tax Apportionment Act (UETAA), enacted in 12 states, provides that estate taxes are to be apportioned “ratably to each person that has an interest in the apportionable estate.” In Illinois, equitable apportionment has only been applied to apportion estate taxes and legal fees associated with preparing and filing estate tax returns.<sup>14</sup> New York law recognizes equitable apportionment and specifically provides that beneficiaries of non-probate assets must also bear a portion of estate taxes if the assets the beneficiary received were included in the gross taxable estate.<sup>15</sup> Florida recognizes “modified equitable apportionment;” however, a POD account also bears a portion of the estate taxes in the proportion that the value each account bears to the total value of all such interests included in the measure of the tax.<sup>16</sup>
- **Contradiction of estate plan.** Situations may arise in which the coordination can’t be achieved. Disproportionate distributions can and occasionally do result, as outlined in “Case Study 2,” p. x.
- **Distributions to minors or persons with disabilities.** There’s typically no prohibition on naming a minor or disabled individual as the beneficiary on a POD account. This could result in an unintended loss of funds. If a disabled beneficiary is collecting government benefits such as Supplemental Security Income or Medicaid, a sudden cash windfall could cause the beneficiary to fail to qualify for benefits even temporarily.<sup>17</sup> Distribution to a minor child may require a guardianship proceeding. Further, distribution to a spendthrift beneficiary can result in squandering of inheritance. In contrast, estate-planning documents will typically include provisions to avoid direct distributions to these individuals<sup>18</sup> to prevent these issues.
- **Disinheritance:** An individual may name a trusted adult as a beneficiary on the account, intending that the assets be used to support a minor or disabled individual. The named beneficiary could refuse to use the money as the owner intended, thus disinheriting the intended beneficiary. The trusted adult has no obligation to use the funds for another individual.<sup>19</sup> If the trusted adult complies with the owner’s wishes, a taxable gift could result.<sup>20</sup>

### Comparison to Living Trust

POD accounts can indeed offer advantages over a typical estate plan. Despite the advantages, individuals with other assets, such as real estate, investments or business assets, will still require a living trust. Further, POD accounts will often fail to accomplish an individual’s testamentary intent.

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POD accounts can serve an important function, and clients will continue to use them.

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### Incorporating Into Estate Plan

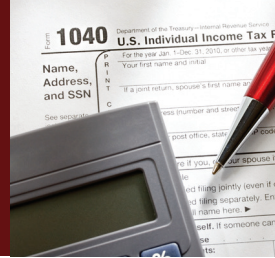
POD accounts can serve an important function, and clients will continue to use them. Ensure the account

### Case Study 2


#### Multiple accounts

A client with multiple accounts may decide to structure each account as a POD. The parent lists Child A as the beneficiary of a money market account and Child B as the beneficiary of a securities account with similar balances as of the POD designation. However, the securities account will fluctuate in value with the market. And the client may withdraw funds from the money market account and fail to recall the plan for equal distribution. In this case, it’s likely that disproportionate distributions will result between Child A and Child B.

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owner understands selections in the beneficiary designation form that best align with their intent. Advisors working with individuals on their planning should specifically inquire about POD accounts in a questionnaire to help uncover potential pitfalls. On discovering the existence of POD accounts, the advisor can help the individual facilitate their estate-planning goals.

—The author thanks her colleague, Victoria Cejka, of Harrison LLP, for her substantial contribution to this article. 

## Endnotes

1. Uniform TOD Security Registration Act (UTODSRA) Section 9 specifically provides that a transfer resulting from a transfer-on-death registration is effective by reason of contract and isn't testamentary. Similarly, Uniform Probate Code (UPC) Section 1-201 defines "beneficiary designation" as a nonprobate transfer at death.
2. See "Totten Trust" definition, *Black's Law Dictionary* (11th ed. 2019).
3. UTODSRA was enacted in all states *except* Texas and Louisiana. The stated intent of the statute *isn't* to force any particular account registration, but, rather, to encourage and protect financial intermediaries who offer securities accounts to allow registration of an account showing the owner's name and the designated beneficiary at the owner's death. In contrast, 19 states have adopted the UPC. UPC Section 2-706 expressly recognizes beneficiary and alternative beneficiary designations for assets such as accounts with POD designations and transfer-on-death registrations and provides an anti-lapse statute for beneficiary designations under which the beneficiary must survive the decedent.
4. 12 C.F.R. Section 330.9(c)(i).
5. This could be accomplished with proper drafting if the drafter is aware of the account's existence.
6. The financial institution will have an account agreement that governs the account.
7. See *supra* note 1.
8. This may not be the case if the owner has a durable property power of attorney. For example, the statutes governing property powers of attorney in Florida and Illinois grant the acting agent the same powers of an owner concerning the principal's accounts, including that the agent can withdraw from the account that has a beneficiary named. See 755 ILCS 45/3-4(b) and Fla. Stat. Section 709.2202(5). New York's laws state that the authority granted to the agent shall *not* include the power to modify the designation of beneficiaries in effect for any *Totten* trust, unless the principal expressly grants that power to the agent in the "Modifications" section of the power. See N.Y. General Obligations Law, Section 5-1502D(1)(b).
9. *Ibid.*
10. Illinois statutes generally provide for payment of all claims, debts, expenses and estate taxes from all probate assets, except specifically bequeathed property, unless necessary to pay those estate obligations. See 755 ILCS 5/18-14, 19-1, 20-4(b); Fla. Stat. Sections 733.702, 733.710, and 733.2121; and N.Y. EPTL Sections 12-1.1 and 12-1.2.
11. See Elaine H. Gagliardi, "Remembering the Creditor At Death: Aligning Probate and Nonprobate Transfers," 41 *Real Prop. Prob. & Tr. J.* 819 (2007).
12. Internal Revenue Code Section 2203 provides that "executor" means the executor or administrator of the decedent, or if none is appointed, qualified, and acting within the United States, then "any person in actual or constructive possession of any property of the decedent." *Ibid.*
13. IRC Section 2206 permits the executor to seek reimbursement for federal estate taxes attributable to life insurance proceeds included in the gross estate under IRC Section 2042; however, reimbursement doesn't apply if the decedent directs otherwise in their will. Section IRC 2207 permits the executor to seek reimbursement for federal estate taxes attributable to property over which the decedent had a general power of appointment under IRC Section 2041; however, reimbursement doesn't apply if the decedent directs otherwise in their will. IRC Section 2207A permits the executor to seek reimbursement for federal estate taxes attributable to property includable in the decedent's gross estate under IRC Section 2044 (that is, qualified terminable interest property trust); reimbursement doesn't apply to the extent that the decedent in their will (or a revocable trust) specifically indicates an intent to waive any right of recovery under the IRC. IRC Section 2207B permits the executor to seek reimbursement for federal estate taxes attributable to property over which the decedent retained an interest includible in their estate under IRC Section 2036; reimbursement doesn't apply to the extent that the decedent in their will (or a revocable trust) specifically indicates an intent to waive any right of recovery under the IRC.
14. See *Roe v. Estate of Farrell*, 372 N.E.2d 662 (Ill. 1978) (applying equitable apportionment for estate taxes and legal fees incurred to compute and report the estate taxes between probate and nonprobate assets in an intestate estate) and *In re Estate of Gowling*, 411 N.E.2d 266 (Ill. 1980) (recipients of nonprobate assets were required to pay taxes attributable to assets they received when the will didn't direct payment from probate assets).
15. N.Y. EPTL Section 2-1.8(e).
16. Fla. Stat. Section 733.817.
17. See Amber K. Quintal, "Planning for Individuals with Disabilities: Special Needs Trusts," 22 *The Practical Tax Law*, 17 (2008) ("Special needs trusts are means for persons with disabilities to qualify to



## FEATURE: ESTATE PLANNING & TAXATION

receive government benefits from needs-based programs while having access to additional funds to pay for supplemental expenses not covered by the government benefits.”).

18. Uniform Trust Code Sections 502 and 503. To the extent a trust is protected by a spendthrift provision, a beneficiary’s creditor may not reach the beneficiary’s interest until the trustee makes a distribution.
19. The beneficiary of a POD account receives the account outright. This is in contrast to trusts, which create a relationship between the trustee, who holds legal title to the asset, and the beneficiary, who holds beneficial (or equitable) ownership of the asset. Robert H. Sitkoff, “Trusts and Estates: Implementing Freedom of Disposition,” 58 *St. Louis U. L. J.* 643, 658-59 (2014).
20. See IRC Sections 2501, 2503 and 2512.