SHERMAN WELLS
SYLVESTER & STAMELMAN LLP

TAX AND TRUSTS & ESTATES UPDATE

May 2019

The Perils of "Transfer on Death" (TOD) and "Payable on Death" (POD) Accounts

We are finding that our clients' bankers, brokers, and other investment advisors are more and more likely to counsel them to name "beneficiaries" for their after-tax accounts.

While pre-tax accounts such as IRAs, 401Ks, 403b plans, and pension and profits sharing plans should have particular beneficiaries named in order to avoid rather immediate and potentially significant income taxes after the death of the account holder, after-tax accounts (e.g., regular bank and investment accounts) should generally not have named beneficiaries.

Here are some examples that demonstrate the possible problems of naming beneficiaries for these accounts.

• Janet names her two children, Sam and Sue, as beneficiaries of her brokerage account. Unfortunately, Sue predeceases her mother. Based on the format of the account's beneficiary designation, 100% of the account passes to Sam at Janet's death, and Sue's children, Jack and Jill, get nothing.

Assume, though, that the account paperwork gave Janet the option of checking a box next to each child's name that allowed that child's share to go to his or her children (i.e., Janet's grandchildren) if the child did not survive Janet. Janet had checked that box, but Jack is 10 and Jill is 12. Since they are not yet adults, guardians will need to be appointed for Jack and Jill.

Assume further that the account is worth $1 million, so that Jack's and Jill's shares are $250,000 each. Once Jack and Jill turn 18, they will be entitled to get all of their money immediately from their guardian, no strings attached.

• Walter has five grandchildren. He opens five separate certificates of deposit (CDs) and names each grandchild as a beneficiary of a CD. Walter's health fails, and he can no longer manage his finances on his own. Furthermore, Walter's care becomes increasing expensive so that his son, Max, who has Walter's power of attorney, needs to start to liquidate some of Walter's CDs to pay for his care. Max does not know that beneficiaries have been named for each CD. Max liquidates two of the five CDs to pay his father's expenses. Then Walter dies. Two of the five grandchildren receive nothing from their grandfather.

• Sylvia names her three children as equal beneficiaries of her investment account. Virtually everything that Sylvia owns is in this account. Sylvia has a will, and she names her son, Bill, as executor. Sylvia's son, Norman, has creditor problems, and Sylvia's daughter, Carol, is a spendthrift. Furthermore, in addition to funeral expenses, Sylvia's estate has some significant debts,

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including income taxes on the sale of Sylvia's home earlier in the year. Bill, as executor, has no money to pay these debts and expenses, since Sylvia named beneficiaries on her investment account and there are no other assets in the estate to be controlled by the will. Norman's creditors are all ready to pounce on his share of the account, and Carol immediately used her share to pay off the arrearage in her mortgage payments to avert foreclosure on her home. Bill ends up paying for the funeral himself. Meanwhile, he is not yet touching his share of his mother's account while he awaits whatever process the IRS will bring to bear to collect his mother's outstanding income taxes from the account's beneficiaries (as the IRS would be entitled to do).

Decisions about POD and TOD designations[1] should be made with the same degree of deliberation that goes into the preparation of your will, and should generally not be put into place without first consulting with an attorney.

[1] These accounts are also sometimes designated as "In Trust For" (ITF) accounts

Information That Can Help Your Family at the End of Your Life

Losing a loved one is never easy. However, you can help make the necessary aspects of dealing with that loss just a bit easier if you prepare some guidance in advance to help those you leave behind find their way as they work through the details of preparing for a funeral, dealing with your estate, etc. This sort of guidance can be similarly helpful if a loved one has become disabled.

We've found that it's very helpful for an executor, next of kin, and others, to be advised in advance of the location of, or wishes regarding, the following:

- Last Will (and signed and dated list of disposition of personal articles, if any)
- Power of Attorney
- Living Will/Health Care Proxy
- Organ donation preference
- Funeral arrangements/wishes
- Memorial fund preferences
- Pallbearer preferences
- Address book or other list of people to be notified of death

And the following can be necessary, or at least useful (and save time and legal fees), to effectively administer an estate:

- Prior three years of income tax returns and related work files
- Any gift tax returns filed by you
- Bank and brokerage statements
- Bank books
- Original stocks and bonds
- Records of loan receivables
- Records of outstanding loans payable and/or guarantees of indebtedness
- Credit card statements and records regarding any other debts
- Attorney, accountant, financial planner, private banker, insurance agent and investment advisor names, addresses, phone numbers and email addresses
- IRA or pension statements, and summary plan descriptions for pensions
- Information regarding any pending lawsuits filed by you or against you
- Estate tax records of any estate benefiting you (predeceased spouse, parent, etc.)

As Sherman Wells continues to expand, we would like to warmly welcome the newest member of our Tax and Trusts & Estates Group:

Ann K. Young, Associate

Ann advises clients and assists in the preparation of various estate planning and estate administration documents. Prior to joining Sherman Wells, Ann was an associate at Paul, Weiss, Rifkind, Wharton & Garrison LLP in New York City. Ann has a bachelor's degree from Rhodes College and a master's degree from Columbia University. Ann is a magna cum laude graduate of New York Law School, where she was editor-in-chief of the New York Law School Law Review. Ann is also the parent of a young son, Reuben.

Welcome to the Sherman Wells Team, Ann!

- All insurance policies and coverage, including life, auto, and homeowner (including homeowner riders)
- Deeds to all residential, commercial and investment real property
- Partnership agreements, limited liability operating agreements and shareholder agreements
- Three years of financial statements for your businesses
- Employment or consulting agreements
- Trust agreements (created by you, or for your benefit, or of which you are a trustee)
- Birth certificates or immigration papers
- Military service records
- Children's adoption papers
- Divorce settlement agreements or judgments
- Safe combinations
- Safe deposit box key
- Any relatively current appraisals of any property
- Information concerning cost basis (including capital improvements and other after-tax additions to value) of capital assets
- Passwords necessary to allow electronic access to all electronic accounts, social media, email, etc.

Note, in particular, that if your original Last Will and Testament cannot be located, there will be a presumption that it's been revoked, and that presumption can only be rebutted with an action in court, which may or may not be successful.

We urge all of our clients to consider sharing this information, or at least the location of this information, with those close to them. It can be a tremendous help during an otherwise difficult time.

New Jersey Trustee Uniform Trust Code Disclosure Requirements – A Reminder

As discussed in our previous alerts, the Uniform Trust Code ("UTC"), which is now the law in New Jersey, requires trustees to make certain disclosures to trust beneficiaries. Under the UTC, a trustee of a New Jersey irrevocable trust must advise certain beneficiaries of the trust about the existence of the trust and keep such beneficiaries "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests."

For individuals establishing new trusts after the UTC effective date (July 17, 2016), the law provides that the terms of a trust may override the duty to make disclosures to trust beneficiaries, with certain limits. If the trust terms so provide, the trustee does not have to make affirmative disclosures regarding the existence of the trust or its administration. However, notwithstanding any provision in the trust to the contrary, the trustee must respond to a request made by a "qualified" beneficiary of the trust (essentially, a current beneficiary or the person(s) next in line to benefit from the trust after the current beneficiaries) who is at least 35 years old for a copy of the trust instrument or other information reasonably related to the administration of the trust. The codification of this duty to respond to a beneficiary's request for information regarding a trust's administration does little to change the obligations of trustees under prior law, because beneficiaries were already entitled to demand that a trustee account for his or her acts and proceedings as trustee.

The UTC also contains a mechanism for trustees to protect themselves from later challenges by trust beneficiaries. Specifically, the UTC provides that a beneficiary of a trust may not commence a proceeding against a trustee for breach of trust more than six months after such beneficiary was sent a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the six-month time frame allowed for commencing a proceeding. The report must contain adequate information regarding trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets, and, if feasible, their respective market values.

If you have one or more existing trusts, or are serving as the trustee of one or more existing trusts, and would like to discuss how to comply with these disclosure requirements, please contact your attorneys for guidance.

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