Study L-1064 December 19, 2003

Memorandum 2004-10

Multiple Party Accounts: Ownership of Amounts on Deposit

The Commission maintains a continuing review of laws enacted on its recommendation, and from time to time recommends clarifying or corrective legislation when circumstances warrant it.

The California Multiple-Party Accounts Law, located at Probate Code Sections 5100-5407, was enacted on Commission recommendation. The law governs rights and duties of parties to a multiple party account and of the financial institution that holds the account. Probate Code Section 5103(a) states:

> An account belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent.

A recent court of appeal case, *Lee v. Yang*, 111 Cal. App. 4th 481, 3 Cal. Rptr. 3d 819 (2003), interprets the law to allow a party to a multiple party account to withdraw funds in the account, regardless of the source of the funds, without having to account to the other parties. The controversial ruling drew a strong dissent, and is criticized in 25 *Estate Planning & California Probate Reporter* 59 (2003).

This memorandum reviews the issues and policies involved in the case, and addresses the question whether clarifying or corrective legislation is necessary.

CALIFORNIA MULTIPLE-PARTY ACCOUNTS LAW

The California Multiple-Party Accounts Law was first enacted in 1983, on recommendation of the Law Revision Commission. See *Recommendation Relating to Nonprobate Transfers*, 16 Cal. L. Revision Comm'n Reports 129 (1982). At that time, for political reasons, the statute applied only to credit unions and industrial loan companies. The statute was subsequently expanded to cover banks and savings and loan associations. See *Recommendation Relating to Multiple-Party Accounts in Financial Institutions*, 20 Cal. L. Revision Commission Reports 95 (1990).

The purpose of the law is to provide rules governing the ownership of multiple party accounts in banks and other financial institutions, to clarify rights of creditors of the parties, and to simplify the procedure for transfer of funds by the bank or other financial institution following the death of the depositor. The law enacts the substance of Part VI of the Uniform Probate Code.

The law distinguishes joint accounts, which are payable on request to any party, from pay on death accounts and trust accounts, to which a beneficiary has restricted access. Under the law, the parties to a joint account have unrestricted withdrawal rights, regardless of ownership interests, and a financial institution may pay out to a withdrawing party without fear of liability that the withdrawing party may be taking out a greater share than that party's actual ownership interest in the account. A joint account belongs, during the lifetime of all the parties, to the parties in proportion to the net contribution by each to the sums on deposit, unless there is clear and convincing evidence of a different intent. Prob. Code § 5301.

The general rule that a joint account belongs, during the lifetime of the parties, to the parties in proportion to the net contribution by each to the sums on deposit, changed the rule under former law. Under former law, if a joint account provided for rights of survivorship, the account was presumed to be a joint tenancy and each joint tenant was presumed to have an equal interest in the account. *Wallace v. Riley*, 23 Cal. App. 2d 654, 667, 74 P. 2d 807 (1937).

The Commission's recommendation explained this change in the law:

> **Rights During Lifetime**
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> Present law applicable to banks and savings and loan associations presumes that funds in a joint account belong equally to the parties during their lifetimes, without regard to how much each contributed to the account.[27] But a person who deposits funds in a multiple-party account normally does not intend to make an irrevocable present gift of any part of the funds deposited,[28] and many people believe that depositing funds in a joint account in a bank or savings and loan association has no effect on ownership of the funds until death.[29]
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> The California Multiple-Party Accounts Law conforms to the common understanding of depositors by presuming that funds in a joint account belong to the parties during lifetime in proportion to their net contributions.[30] This rule is consistent with the federal gift tax rule that no completed gift occurs when the account is opened;

> instead the gift occurs when the nondepositing party withdraws funds from the account.[31]
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> 27. See Wallace v. Riley, 23 Cal. App. 2d 654, 667, 74 P.2d 807 (1937).
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> 28. Uniform Probate Code §6-103 comment.
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> 29. State Bar of California, The Uniform Probate Code: Analysis and Critique 184-85 (1973). See generally, Griffith, *Community Property in Joint Tenancy Form*, 14 Stan. L. Rev. 87 (1961).
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> 30. Prob. Code §5301(a). The presumption may be overcome by clear and conflicting evidence that the parties had some other intention. Id.
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> 31. Treas. Reg. § 25.2511-1 (1958).

20 Cal. L. Revision Comm'n Reports at 108 (1990). This explanation parallels the Commission's earlier explanation at 16 Cal. L. Revision Comm'n Reports at 138 (1982).

LEE V. YANG

Facts

Holden Lee has a master's degree in business administration; he works in Hong Kong and the United States in the fields of development and private investment. Janet Yang holds a bachelor of science degree in electrical engineering; she worked for Merrill Lynch in New York and Hong Kong and then for Salomon Smith Barney in Hong Kong as a research analyst, eventually earning $500,000 a year.

The two met in Hong Kong in 1995 and started dating in 1996. Holden moved to San Francisco in 1997 to start a new job. The courtship continued and in March 1999 Holden proposed to Janet. She accepted. The wedding was set for September 1999. The couple agreed that Janet would move to San Francisco.

In spring 1999 the parties each added the other as a signatory on their respective Hong Kong accounts. Before moving to San Francisco, Janet wired $60,000 to one of Holden's bank accounts.

Janet arrived in San Francisco in June 1999, and began living with Holden. Holden added her to three of his accounts.

Janet started working at Draper International earning $70,000 annually. She had her payroll checks deposited directly into one of the joint accounts.

Several weeks before the scheduled wedding, Janet discovered love letters written to Holden by different men from various parts of the world. She was shocked, felt betrayed, and made several suicide attempts.

Janet made withdrawals totaling approximately $345,000 from the joint accounts. She transferred the funds initially to a new local account and then to a Maryland account that she held jointly with her parents.

Janet and Holden canceled the wedding and sued each other. On the issue of Holden's right to recover funds that Janet withdrew from the joint accounts, the trial court ruled that Holden was not entitled to recovery. The court's decision was affirmed by a split panel of the First Appellate District Court of Appeal.

Majority Opinion

Holden's primary contention was that he owned the funds that Janet withdrew from the joint accounts and therefore she must reimburse him. The court disagreed.

The court noted enactment of the multiple party accounts law on Law Revision Commission recommendation, establishing the rule that an account belongs, during the lifetime of all parties, to the parties in proportion to the net contribution by each to the sums on deposit, unless there is clear and convincing evidence of a different intent. The court distinguished sums remaining on deposit from sums withdrawn. "This proportionate ownership rule, however, does not articulate a rule of ownership as to funds withdrawn by a party, irrespective of that party's net contribution." 3 Cal. Rptr. 3d at 826.

The court concluded that the law is unclear as to ownership of funds that have been withdrawn and are therefore no longer on deposit. The court looked to the Law Revision Commission's recommendation for guidance as to legislative intent.

The Commission's recommendation states that the net contribution rule applies to amounts withdrawn as well as to amounts on deposit. The recommendation notes that "the source of the funds deposited is taken into account in determining the interests in funds deposited in **or withdrawn from** a joint account", citing to Probate Code Section 5301(a). 20 Cal. L. Revision Comm'n Reports at 105 (emphasis added). The Commission's letter of transmittal of the recommendation to the Governor and Legislature addresses this point in further detail:

> The multiple-party accounts law ... permits a person having the present right of withdrawal to sever the joint tenancy by withdrawing the funds from the account. **Withdrawal of the funds does not, however, affect the ownership rights of the parties to the funds withdrawn.**

20 Cal. L. Revision Comm'n Reports at 97-98 (1990) (emphasis added).

The court discounted this language, and focused instead on the Commission's reference elsewhere in the recommendation to the federal gift tax rule. That rule states that creation of a joint account does not result in a completed gift to the cotenant; rather the gift occurs when the nondepositing party makes a withdrawal from the account. The court reasoned the correct rule should be that withdrawal constitutes a gift to the extent there is no independent legal obligation requiring the party to account for the proceeds. "Whether such an obligation exists depends on the objective facts and circumstances of the transaction rather than on the transferor's subjective intent." 3 Cal. Rptr. 3d at 827.

The court concluded that in this case there was substantial evidence that there was no agreement between the parties restricting Janet or the amount she could withdraw from the account. "The inescapable inference is that likewise there was no restriction on the use of the withdrawn funds and hence no legal obligation to account for or return them." 3 Cal. Rptr. 3d at 828. By virtue of Janet's unrestricted right to withdraw and apply funds to her own benefit, ownership of the funds passed to her by way of gift.

Dissent

The dissent pointed out that under the multiple party accounts law withdrawal rights and ownership rights are not coextensive. While a signatory to the account has full withdrawal rights, ownership of the account is presumed to be based on net contributions, and the presumption may only be overcome by clear and convincing evidence. The dissent noted that the core distinction between ownership of the funds and the power of withdrawal is clearly articulated in the Law Revision Commission material. The dissent would reverse the trial court's ruling "insofar as it placed upon Holden, and not Janet, the burden of proving ownership of the funds he deposited." 3 Cal. Rptr. 3d at 829.

The dissent pointed out that a rule allowing a party to an account to withdraw and keep 100% of the funds is contrary to the purpose of the multiple party accounts law, which was adopted to avoid the imputation of a gift of sums deposited into a joint tenancy account. Under the decision in this case, a depositor of funds is actually worse off than under former law. Under former law the depositor would retain a 50% interest in funds deposited in the account, whereas under the majority's interpretation the depositor could be divested of 100% of the funds deposited by the simple act of withdrawal by another party. "I would conclude that the Legislature intended to safeguard the depositor's (Holden's) rights by requiring the withdrawing party (Janet) to prove that she is entitled to keep the depositor's funds — not vice versa." 3 Cal. Rptr. 3d at 831.

The dissent also noted the Commission's statements that ownership rights of the parties are not affected when sums on deposit are withdrawn, and cited to Uniform Probate Code commentary to UPC § 6-103, which is the source of, and identical to, the California statute:

> Th[is] section does not undertake to describe the situation between parties if one withdraws more than he is then entitled to as against the other party. [Other sections] protect a financial institution in such circumstances without reference to whether a withdrawing party may be entitled to less than he withdraws as against another party. **Presumably, overwithdrawal leaves the party making the excessive withdrawal liable to the beneficial owner as a debtor or trustee.** Of course, evidence of intention by one to make a gift to the other of any sums withdrawn by the other in excess of his ownership should be effective.

UPC § 6-103 comment (emphasis added). (The majority discounted this evidence of legislative intent because, although the Commission set out the UPC commentary in its initial recommendation on the matter, it did not set it out again in the subsequent recommendation.)

The dissent noted that the majority's reliance on the federal gift tax rule is misplaced. That rule only determines when a taxable transfer occurs (at the time of withdrawal), not whether a taxable transfer has occurred at all. The federal regulation makes clear that if A establishes a joint account for A and B, a taxable event occurs when B draws upon the account, "to the extent of the amount drawn without any obligation to account for a part of the proceeds to A." Whether there is an obligation to account is determined by state property law, not federal gift tax law.

The dissent concluded:

> In the majority's view, a joint tenancy account holder with an urgent need for cash, or merely harboring a vengeful motive, can

> wipe out an entire account with impunity unless the owner of the funds can prove that there had been a prior, enforceable agreement restricting the power of withdrawal or the use of the funds. This approach — requiring an owner of funds to prove he has not made a gift — is contrary to the presumption of ownership and burden of proof set forth in section 5301; is contrary to general notions of property law (see, e.g., Blonde v. Estate of Jenkins (1955) 131 Cal.App.2d 682, 686, 281 P.2d 14["[t]he donee has the burden to prove the gift"]); and is contrary to the Commission's comments that "[w]ithdrawal of ... funds does not ... affect the ownership rights of the parties to the funds withdrawn" and that "the source of the funds deposited is taken into account in determining the interests in funds deposited in or withdrawn from a joint account." (1990 Recommendation, supra, 20 Cal. Law Revision Com. Rep., at pp. 98, 105, italics added, fn. omitted.)

3 Cal. Rptr. 3d at 834.

Reaction to Opinion

The staff believes the dissent has more accurately captured the legislative intent of the statute than the majority.

The staff is not alone in its evaluation. The *Estate Planning & California Probate Reporter* reports this case in its October 2003 issue, with the observation that, "The dissent appears to have the better reading skills." 25 *Estate Planning & California Probate Reporter* at p. 60 (2003).

We have also asked the reporter for the Uniform Probate Code (Professor Richard Wellman) for his reaction to the case. His response is:

> The dissent has it right, in my opinion. The idea that "sums on deposit" are transformed, as to ownership rights between the individuals, by being withdrawn by one party confounds gift rules, and distorts the clear legislative distinction of rights between the bank and the parties, on the one hand, and the rights between the parties on the other. The majority seems to have been bamboozled by the 1958 gift tax regulation. The feds may ignore absence of donative intent for tax purposes, I guess, but ignoring gift rules leaves a terrible mess regarding ownership between individuals. Property rules should not be ignored simply because parties find it convenient to trust one another.

Email from R. Wellman to N. Sterling (Nov. 18, 2003).

UNIFORM ACT

The California law is drawn from the Uniform Probate Code multiple party account provisions. California law requires that a statute based on a Uniform Act must be uniformly construed:

> A provision of this code, insofar as it is the same in substance as a provision of a uniform act, shall be so construed as to effectuate the general purpose to make uniform the law in those states which enact that provision.

Prob. Code § 2(b).

Text of Uniform Act and Comment

At the time the California statute was written, Uniform Probate Code Section 6-103(a) provided:

> A joint account belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent.

The Uniform Law Commissioners' Comment to the section addressed the question of withdrawal by a party of more than the party's proportionate contribution:

> This section reflects the assumption that a person who deposits funds in a multiple-party account normally does not intend to make an irrevocable gift of all or any part of the funds represented by the deposit. Rather, he usually intends no present change of beneficial ownership. The assumption may be disproved by proof that a gift was intended. Read with Section 6-101(6) which defines "net contributions," the section permits parties to certain kinds of multiple-party accounts to be as definite, or as indefinite, as they wish in respect to the matter of how beneficial ownership should be apportioned between them. It is important to note that the section is limited to describe ownership of an account while original parties are alive. Section 6-104 prescribes what happens to beneficial ownership on the death of a party. The section does not undertake to describe the situation between parties if one withdraws more than he is then entitled to as against the other party. Sections 6-108 and 6-112 protect a financial institution in such circumstances without reference to whether a withdrawing party may be entitled to less than he withdraws as against another party. Presumably, overwithdrawal leaves the party making the excessive withdrawal liable to the beneficial owner as a debtor or

> trustee. Of course, evidence of intention by one to make a gift to the other of any sums withdrawn by the other in excess of his ownership should be effective.

Note that the Comment indicates that the question of overwithdrawal is not resolved by the Uniform Act but is governed by general law. The Comment goes on to suggest that under general law "presumably" a party making an excessive withdrawal would be liable for the amount of the overwithdrawal.

Both the Uniform Probate Code and the Comment have since continued to evolve. The multiple party account provisions were revised in 1989 and made part of a larger article in the Uniform Probate Code on nonprobate transfers; the relevant provision on ownership rights is now Section 6-211. The National Conference of Commissioners on Uniform State Laws has also promulgated the statute as a free standing act apart from the Uniform Probate Code. See Uniform Multiple Person Accounts Act (Section 11(b)) and Uniform Nonprobate Transfers on Death Act (Section 211(b). A majority of states have enacted the statute in one or another of these forms.

Interestingly, the commentary accompanying the statute has also been revised. The commentary no longer suggests what the consequences of overwithdrawal might be:

> The section does not undertake to describe the situation between parties if one party withdraws more than that party is then entitled to as against the other party. Sections 6-221 and 6-226 protect a financial institution in that circumstance without reference to whether a withdrawing party may be entitled to less than that party withdraws as against another party. Rights between parties in this situation are governed by general law other than this part.

The matter is thus left to case law.

Case Law

When confronted with the issue of overwithdrawal by a party to a multiple party account, the courts of other states that have enacted the Uniform Act have concluded that the withdrawing party's ownership right must be limited to the party's net contribution. Three cases are illustrative.

In *Erhardt v. Leonard*, 104 Idaho 197, 657 P.2d 494 (Idaho App. 1983), a grandmother created a joint account with her grandson. The grandson emptied the account of its $13,677.57, without the knowledge of the grandmother. When the grandmother learned of it, she requested return of the funds. The grandson refused. The grandmother brought suit.

> The first issues we will address concern the ownership of the funds in the joint account, and the effect on that ownership made by the grandson's withdrawal of the funds. The grandson contends that he had a right to withdraw the funds in the account because he was a joint tenant, that there was nothing improper about his withdrawal of the funds, and that the withdrawal terminated all ownership rights the grandmother had in the funds. We disagree.
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> A joint savings account is a contractual agreement between a financial institution and the named depositors. In re Chase's Estate, 82 Idaho 1, 348 P.2d 473 (1960). Account contracts, such as the joint savings account in this case, define the power of withdrawal held by each party to the account, as a means of protecting the financial institution. See I.C. 15-6-102. But the actual ownership of the funds in the account is not affected by the account contract. Idaho First National Bank v. First National Bank of Caldwell, 81 Idaho 285, 294, 340 P.2d 1094, 1099 (1959).
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> During the lifetime of the parties to a joint account, ownership of the funds in the account is determined by the net contributions of each party to the account, unless there is clear and convincing evidence of a different intent. I.C. 15-6-103(a). Establishment of a joint account may effect a gift by the depositor to the other party or parties to the account. Idaho First Nat. Bank, supra; Gray v. Gray, 78 Idaho 439, 304 P.2d 650 (1956). In determining the effect of a joint account agreement, the significant consideration is the intent of the depositor. The party asserting that a gift was intended must prove all the elements of a gift, excepting irrevocable delivery, by clear and convincing evidence. Matter of Estate of Lewis, 97 Idaho 299, 543 P.2d 852 (1975); In re Bogert, 96 Idaho 522, 531 P.2d 1167 (1975); Idaho First Nat. Bank, supra.
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> Both the grandmother and the grandson were parties to the joint savings account. The grandson was a non-contributing party; only the grandmother had made contributions to the sums on deposit in the account. Pursuant to I.C. 15-6-103(a), absent clear and convincing proof of a contrary intent, the grandmother was the sole owner of the funds in the account. See also I.C. 15-6-101(6). The grandson's withdrawal of the funds was an invasion of her property.

104 Idaho at 497-98, 657 P.2d at 200-01.

In *Matter of Estate of Maxfield*, 856 P.2d 1056 (Utah 1993), husband and wife established seven joint accounts and certificates of deposit and made varying contributions to them, to a total of approximately $275,000. Wife thereafter withdrew all funds and placed them in separate accounts. Husband commenced litigation to recover the funds. The parties agreed that Section 6-103(1) of the Utah Uniform Probate Code governed the determination of ownership of the funds the wife had withdrawn from the joint accounts. The question for court resolution was whether tracing of net contributions was required to determine ownership of the withdrawn funds. The court held that tracing of net contributions was required. The court remarked:

> To bring uniformity to the law and to eliminate confusion caused by conflicting decisions, the Uniform Probate Code in section 6-103 (Utah Code Ann. 75-6-103) provides a clear test to be applied when determining the ownership of funds on deposit in a joint account during the lifetime of the parties. The editorial board comment to section 75-6-103 states:
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> > This section reflects the assumption that a person who deposits funds in a multiple-party account normally does not intend to make an irrevocable gift of all or any part of the funds represented by the deposit. Rather, he [or she] usually intends no present change of beneficial ownership. The assumption may be disproved by proof that a gift was intended.
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> In contrast, companion section 6-104 (Utah Code Ann. 75-6-104) provides that on the death of a joint owner, the funds on deposit belong to the survivor(s) unless there is clear and convincing evidence of a different intent. The Supreme Court of Ohio has observed that "the presumptions created by these two sections accurately reflect the common experience of mankind in regard to joint and survivorship accounts." In re Estate of Thompson, 66 Ohio St.2d 433, 439, 423 N.E.2d 90, 94 (1981).
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> Page 4 of the 1992 supplement to volume 8 of Uniform Laws Annotated indicates that twenty-seven states have adopted the provision found in section 75-6-103 dealing with multiple-party accounts. Appellate courts in those jurisdictions hold uniformly that this statute requires a joint owner of a bank account to establish by clear and convincing evidence that the other joint owner, when depositing his or her own separate funds in the account, intended to make a gift of one-half of the deposit to the other joint owner. Battiste v. Battiste, 135 Ariz. 470, 662 P.2d 145 (Ct.App.1983); Erhardt v. Leonard, 104 Idaho 197, 657 P.2d 494 (Ct.App.1983); Szelenyi v. Miller, 564 A.2d 768 (Me.1989). The provision of the statute, including the burden of proof imposed on the nondepositing joint owner, is not altered or changed in any way when the joint depositors are married to each other. The funds retain their separate character unless a gift is proved. Noble v. Noble, 26 Ariz.App. 89, 93, 546 P.2d 358, 362 (1976); Battiste, 135 Ariz. at 473, 662 P.2d at 148; Szelenyi, 564 A.2d at 770.

856 P.2d at 1057-58.

In *Vaughn v. Bernhardt*, 345 S.C. 196, 547 S.E.2d 869 (2001), an aunt created several joint accounts with her nephew. A week before the aunt died, the nephew transferred all funds from the joint accounts into a new account in his sole name. The personal representative of the aunt's estate brought an action to recover the withdrawn funds. The Supreme Court of South Carolina ruled in favor of the aunt's estate. The multiple party account statute says that during the lifetime of the parties an account belongs to the parties in proportion to their net contributions. The nephew made no contribution to the account. Therefore he did not acquire ownership rights by withdrawal. The court cited to an Indiana case on all fours, which stated:

> The right to withdraw and the right to ownership, however, are separate and distinct rights. The deposit agreements establish a party's right to withdraw funds and govern the relationship between the bank and the joint tenants. Although the deposit agreements clearly gave [the joint tenant] the right to withdraw funds from the account, the deposit agreements alone do not create an ownership right in the funds that were withdrawn.

Shourek v. Stirling, 621 N.E.2d 1107, 1110 (Ind. 1993).

(Both the South Carolina case, and the Indiana case on which it relied, went on to hold not only that the sums withdrawn belong to the estate, but that the joint tenant does **not** ultimately receive those sums by right of survivorship in the joint account. That is because the multiple party account statute prescribes a right of survivorship only for sums on deposit at the time of death, and the joint tenant's withdrawal of the funds during life left no sums on deposit at the time of death to pass by right of survivorship. We analyze this reasoning at the conclusion of this memorandum.)

POLICY CONSIDERATIONS

What should the law be if a cotenant withdraws more than the cotenant's share of funds from a joint account?

Intention of the Parties

Often a depositor will add another party's name to the account so that the property will pass to the joint owner free of probate; there is no intention to make a lifetime gift. Frequently the name of another party is added for the purpose of enabling the named party to engage in transactions on behalf of the depositor — in effect a power of attorney.

Before enactment of the multiple party accounts law, parties to a joint account were presumed to own the account in equal shares. This was the law not only in California but also the prevailing view throughout the country: Joint accounts are presumed to be vested in the parties as equal contributors and owners in the absence of evidence to the contrary; the presumption is rebuttable, the intention of the parties being the controlling factor. See 10 Am. Jur. 2d, Banks & Financial Institutions § 671 (1997).

The purpose of the multiple party accounts law was to change the presumption from equal ownership to ownership based on net contributions. "The multiple-party accounts law conforms to the common understanding of depositors by presuming that funds in a joint account belong to the parties during lifetime in proportion to their net contributions." *Recommendation Relating to Multiple-Party Accounts In Financial Institutions*, 20 Cal. L. Revision Comm'n Reports 95, 97 (1990).

The presumption of ownership based on net contributions effectuates the policy of recognizing the normal situation involved in establishing a joint account. The dissent in the *Lee v. Yang* articulates this policy:

> In my view, if a cotenant removes more than his or her share of funds from a joint account, the [multiple party accounts law] properly places on that person the burden of proving, by clear and convincing evidence, ownership rights in those funds by gift or otherwise. This burden of proof comports with the ethical principle that those who are added as cosignatories on a joint account — invariably persons in close, trusting personal relationships — will respect the other party's ownership of deposited funds.

3 Cal. Rptr. 3d at 834.

Presumption of Gift

The effect of the decision in *Lee v. Yang* is the opposite of that intended by the law. Rather than putting a depositor in a better position with respect to ownership of funds withdrawn from a joint account, it puts the depositor in a worse position. At least under prior law the depositor was presumed to own half the funds withdrawn from the account; under *Lee v. Yang* the depositor is presumed to own none of the funds withdrawn.

How did the court in *Lee v. Yang* come to such a result? The staff believes the court misunderstood the federal gift tax rule. The court's oversimplified reading of the rule is that if A creates a joint account with B, there is a gift to B when B draws on the account for B's own benefit. What the federal rule actually says is in that situation there is a gift to B **to the extent** B has no obligation to account to A for the proceeds. Treas. Reg. § 25.2511-1 (1958).

Whether or not B has an obligation to account to A for the proceeds is determined by state property law, not by the federal gift tax law. As the dissent in *Lee v. Yang* rightly points out, the court's reliance on federal estate tax law for its answer to the state property question begs the question. 3 Cal. Rptr. 3d at 833-34.

Tracing

In support of its decision that the withdrawing party is presumed to own the funds withdrawn, the court in *Lee v. Yang* notes that rule avoids the painstaking tracing and accounting of funds that parties would otherwise be advised to undertake.

While this is a factor, the staff does not believe it is a significant one. Most accounts are spousal accounts. The remainder are accounts to which one depositor adds the name of another for purposes of caring for the depositor in old age or for the purpose of transferring the funds at the death of the depositor. Rarely do nonmarital parties commingle funds in such a way that tracing is a problem.

The multiple party accounts law recognizes potential tracing problems, and deals with them directly. In the absence of proof otherwise, the net contribution of each of the parties is deemed to be an equal amount. Prob. Code § 5314(b). This is a preferable way to deal with tracing problems.

Commingled Funds

Marital Accounts

The situation is different if the parties to a joint account are married to each other. In that case the parties may well intend to commingle their funds, and to allow each other to apply the funds to their individual and common benefit. In fact the vast number of joint tenancy accounts are marital accounts.

The multiple party accounts law deals with marital accounts separately. Probate Code Section 5301, which prescribes ownership by the parties in proportion to their net contributions and which applied in *Lee v. Yang*, does not apply to a joint account between spouses.

Under Probate Code Section 5305, the net contribution of married persons to a joint account is presumed to be and remain their community property. A spouse may rebut the presumption by tracing to separate property deposits or by proving a contrary written agreement. The community property laws impose fiduciary obligations on the spouses in the management and control of the community property, and preserve equal ownership interests in the property.

There is also a practical reason for presuming equal ownership of a marital account. A net contribution rule would be difficult to implement in most cases. Funds in marital accounts are commingled, withdrawals are made routinely for expenses that may be difficult to characterize as community or separate, receipts and other records may be discarded, and the marital finances may become inextricably intermeshed over the course of many years. The equal ownership presumption avoids the problems inherent in attempting to disentangle the interests of the spouses.

Domestic Partners

While most joint accounts are marital accounts, it is likely that accounts between nonmarital partners, including registered domestic partners, are becoming increasingly common. There is a substantial likelihood of commingling of funds in that situation. On the other hand, domestic partners may be more careful than marital partners in entering into a written agreement that specifies their property rights.

Current law on property rights of **registered** domestic partners appears adequately to deal with the joint bank account issue. Under existing Civil Code Section 299.5(e), "Any property or interest acquired by the partners during the domestic partnership where title is shared shall be held by the partners in proportion of interest assigned to each partner at the time the property or interest was acquired unless otherwise expressly agreed in writing by both parties."

That statute is repealed effective January 1, 2005. On that date it will be replaced by a community property regime for registered domestic partners.

> Registered domestic partners shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, court rules,

> government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses.

Civ. Code § 297.5, as enacted by 2003 Cal. Stats. ch. 421, § 4 (operative 1/1/05). The Secretary of State is required to notify registered domestic partners, and prospective registered domestic partners, that "for purposes of California law, domestic partners will have a great many new rights and responsibilities, including laws governing community property." Civ. Code § 299.3, as enacted by 2003 Cal. Stats. ch. 421, § 4 (operative 1/1/04).

The multiple party accounts law invokes community property principles to determine spousal property rights in joint accounts. The law will not require further revision to address the property rights of registered domestic partners.

Heart Balm

Had Mr. Lee and Ms. Yang become married and Ms. Yang become disaffected several weeks after, rather than several weeks before, the wedding, the marital property statute would have applied. The joint accounts would have been presumed community, but the parties would have been permitted to trace the funds to their separate property sources.

The core problem of the case is that the parties commingled their funds as if they were married, even though they were not. The law is ill-designed to deal with that situation.

The court may also have been troubled by the fact that Ms. Yang had given up her highly paid position and relocated from Hong Kong in reliance on the prospective marriage. California, like most other jurisdictions, has enacted "heart balm" legislation that precludes recovery of damages in breach of promise situations. Civ. Code § 43.5.

This appears to be an instance of a hard case making bad law. The staff believes that the law requires revision to correct the *Lee v. Yang* holding.

STAFF RECOMMENDATION

Overwithdrawal

The multiple party accounts law does not directly answer the question of liability for overwithdrawal by a party. *Lee v. Yang* uses the federal gift tax analogy to conclude that overwithdrawal results in a gift. This is circular reasoning — under federal law there is a taxable gift in the case of an overwithdrawal by a party if state law does not impose liability for the amount overwithdrawn. Whether California law does, or should, impose liability for the amount overwithdrawn is the question we must address.

The original commentary to the Uniform Act, quoted in the Commission's initial recommendation on the matter and part of the legislative history of the California multiple party accounts law, suggests that California law should impose liability for overwithdrawal — "Presumably, overwithdrawal leaves the party making the excessive withdrawal liable to the beneficial owner as a debtor or trustee." However, more recent versions of the Uniform Act commentary back away from that position and are silent on the matter — "Rights between parties in this situation are governed by general law other than this part."

Cases in other jurisdictions that have addressed the question have concluded that the net contribution rule applicable to determination of property interests in a joint account should apply to amounts withdrawn from the account. This is significant since the legislative intent is that a statute based on a uniform act be construed uniformly.

Determination of rights between parties to a joint account in the case of overwithdrawal is not a simple matter. The situation with Mr. Lee and Ms. Yang is illustrative. Both parties made deposits and withdrawals from the accounts. Many of the withdrawals were intended to benefit the prospective community. Others were intended for individual benefit. Where community benefit ends and individual benefit begins is a nebulous matter. Even where individual benefit is clear, there probably is tacit consent between the parties, at least so long as there is a harmonious relationship. Where this continues over many years, it is difficult to sort everything out.

Tracing would be relatively easy over a short period such as in *Lee v. Yang*. However, the rule ultimately adopted must work in a variety of circumstances. The court in *Lee v. Yang* rightly thought ahead to the impact the rule it announced would have on more complex cases.

On the other hand, the multiple party accounts law already takes into account the complexities involved in properly accounting for deposits and expenditures. The law provides that in determining the net contribution of the parties, the net contribution is presumed to be an equal amount in the absence of proof otherwise. Prob. Code § 5134.

The majority in *Lee v. Yang* thought there should be a presumption of gift in favor of the withdrawing party, with the burden on the depositing party to prove an agreement otherwise. The dissent thought there should be a presumption that the withdrawing party owns the funds withdrawn only to the extent of the party's net contribution — overwithdrawal does not transfer present ownership of the funds absent a showing by clear and convincing evidence of the depositor's intent to make a gift of them.

The staff thinks the concept of "net contribution" for amounts on deposit makes sense and should be extended to amounts withdrawn. Although that approach arguably engages us in complex tracing and implied consent issues, that should not be too much of a problem because of the presumption of equal net contributions in the absence of proof otherwise and because the types of cases where the issue will come up will be fairly rare and unique, such as in *Lee v. Yang*.

Prob. Code § 5301 (amended). Ownership during lifetime

5301. (a) An account belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each ~~to the sums on deposit~~, unless there is clear and convincing evidence of a different intent.

(b) In the case of a P.O.D. account, the P.O.D. payee has no rights to the sums on deposit during the lifetime of any party, unless there is clear and convincing evidence of a different intent.

(c) In the case of a Totten trust account, the beneficiary has no rights to the sums on deposit during the lifetime of any party, unless there is clear and convincing evidence of a different intent. If there is an irrevocable trust, the account belongs beneficially to the beneficiary.

Comment. Section 5301 is amended to avoid the implication that the net contribution rule is used only to determine the ownership interests of the parties in sums remaining on deposit. See Section 5150 ("sums on deposit" defined). The net contribution rule is used also to determine whether a party has withdrawn from the account an amount in excess of the party's ownership interest. The amendment reverses the holding of *Lee v. Yang*, 111 Cal. App. 4th 481, 3 Cal. Rptr. 3d 819 (2003). In the absence of proof otherwise, the net contribution to an account of each of the parties having a present right of withdrawal is deemed to be an equal amount. Section 5134 ("net contribution" defined).

Severance of Joint Tenancy

Severance by Withdrawal of Funds

We should also address the issue raised by the Indiana and South Carolina cases discussed above. Those cases hold that overwithdrawal by a party requires reimbursement by the party, but overwithdrawal also severs the joint tenancy as to the amount overwithdrawn. The net effect of the holding is to defeat the intent of a depositor who sets up a joint account with the express purpose of passing the funds to the surviving joint tenant on death of the depositor.

The South Carolina court is troubled by this outcome.

> The effect of our decision today may be to frustrate the Decedent's intent, but to hold otherwise would be to ignore the plain meaning of the statute. Furthermore, accounts with right of survivorship provisions are often set up to allow caretakers to assist elderly people with the management of their finances. Their financial protection can best be honored by adhering to the statutory presumption.

Vaughn v. Bernhardt, 345 S.C. 196, 200 , 547 S.E.2d 869, 871 (2001).

On the surface the cases appear to be technically correct. Withdrawal of funds from a joint account should sever the joint tenancy as to the funds withdrawn.

However, withdrawal of funds by a party should terminate survivorship rights only with respect to that party's ownership interest in the account. If the withdrawing party's only interest in the account is a right to receive funds on the death of the depositing party, the withdrawing party should not be able to alter property rights in the account.

The problem is caused by use of a joint account for purposes for which it is not intended. One reason for enactment of the multiple party accounts law was to provide a vehicle to enable a person to pass funds in a bank account to a beneficiary without conferring on the beneficiary any present ownership rights. The law authorizes a P.O.D. (pay on death) account in which the depositor names a beneficiary to receive funds remaining in the account on the death of the depositor, without creating present ownership rights in the beneficiary. The majority in *Lee v. Yang* takes note of this:

> Options exist, short of the unrestricted multiparty account, that would avert the danger that a lesser contributor would clean out the account for personal use. For example, other types of multiple-

> party accounts are available such as a P.O.D. "pay on death" account. (5132, subd. (b), 5139.)

Cal. Rptr. 3d at 828.

California Law

California has some history on this issue. At a time when the multiple party accounts law was limited to credit unions and industrial loan companies, a case came before the court of appeal involving severance of a joint tenancy in a **bank account** by withdrawal of funds. *Estate of Propst*, 203 Cal. App. 3d 993, 250 Cal. Rptr. 362 (1988), now vacated, held that property purchased with funds withdrawn from the joint tenancy bank account by **the depositor** remained subject to the survivorship right of the nonconsenting joint tenant. The Law Revision Commission used this holding as an example of the type of unfortunate result that could be avoided by extension of the multiple party accounts law to bank accounts:

> A recent Court of Appeal decision held that a joint tenant of a bank account could not sever the joint tenancy without the consent of the other joint tenant. The court held that property purchased with the funds withdrawn from the account was subject to the survivorship right of the nonconsenting joint tenant. The multiple-party accounts law gives the opposite result; it permits a person having the present right to withdrawal to sever the joint tenancy by withdrawing the funds from the account. Withdrawal of the funds does not, however, affect the ownership rights of the parties to the funds withdrawn.

Recommendation Relating to Multiple-Party Accounts in Financial Institutions, 20 Cal. L. Revision Commission Reports 95, 97-98 (1990).

On recommendation of the Commission, a new provision was added to the multiple party accounts law, to make clear that a party can terminate survivorship rights as to that party's property by withdrawing funds from a joint account:

> Withdrawal of funds from the account by a party with a present right of withdrawal during the lifetime of a party also eliminates rights of survivorship upon the death of that party with respect to the funds withdrawn.

Prob. Code § 5303(c).

On enactment of this provision, the Supreme Court vacated the court of appeal decision in *Propst* and issued a new ruling consistent with the revised multiple party accounts law. "Accordingly, we hold that in the absence of prior agreement, a joint tenant of personal property may unilaterally sever his or her own interest from the joint tenancy and thereby nullify the right of survivorship, as to that interest, of the other joint tenant or tenants without their consent." *Estate of Propst*, 50 Cal. 3d 448, 461-62, 268 Cal. Rptr. 114, 788 P.2d 628 (1990).

Note that this rule enables a party to terminate survivorship rights in that party's own property by withdrawal of funds from the joint account. It does not enable a party to affect survivorship rights of other parties by overwithdrawal of funds from the account. Thus in the Indiana/South Carolina type of case, where the joint account beneficiary withdraws funds to which the beneficiary made no net contribution, the right of survivorship would not be severed.

Policy Considerations

Why would the depositor's estate seek to recover the withdrawn funds, thereby frustrating the depositor's intent to pass the funds at death to a party named to the account? Setting aside the possibility of conflict among beneficiaries for a greater share of the estate, it may be important to recover the funds to pay the decedent's debts or to pay a share of estate tax liability.

However, it is not necessary to destroy the survivorship right in order to achieve this purpose. Under the estate tax proration statute the recipient of property from the decedent by right of survivorship is assessed for a proportionate share of the estate tax, and the personal representative has an enforceable right to recover that amount from the property recipient. Prob. Code §§ 20200 ("property" defined), 20111 (proration), 20116 (recovery by personal representative).

Liability for the decedent's debts is more problematic. A nonprobate asset such as joint tenancy property is not part of the decedent's estate for purposes of administration and is not ordinarily liable for the decedent's debts. The trust law makes a decedent's inter vivos trust liable for the decedent's debts to the extent the estate is inadequate. Prob. Code § 19001. However, there is no similar statute applicable either to nonprobate property generally or joint tenancy property specifically. This is a major defect of California probate law that the Commission has identified in the past as in need of attention; the issue resides on the Commission's "probate back burner".

Clarification of Statute

In any event, the California statute allowing a party to a joint account to sever the right of survivorship as to that party's ownership interest in the account does not appear to be as artfully drawn as it could be. The statute and Comment might be revised to more clearly address the issue:

Prob. Code § 5303 (amended). Right of survivorship and terms of account

5303. (a) The provisions of Section 5302 as to rights of survivorship are determined by the form of the account at the death of a party.

(b) Once established, the terms of a multiple-party account can be changed only by any of the following methods:

(1) Closing the account and reopening it under different terms.

(2) Presenting to the financial institution a modification agreement that is signed by all parties with a present right of withdrawal. If the financial institution has a form for this purpose, it may require use of the form.

(3) If the provisions of the terms of the account or deposit agreement provide a method of modification of the terms of the account, complying with those provisions.

(4) As provided in subdivision (c) of Section 5405.

(c) During the lifetime of a party, the terms of the account may be changed as provided in subdivision (b) to eliminate or to add rights of survivorship. Withdrawal of funds from the account by a party ~~with a present right of withdrawal during the lifetime of a party~~ also eliminates rights of survivorship ~~upon the death of that party~~ with respect to the funds withdrawn <u>to the extent of the party's net contribution to the account</u>.

Comment. Section 5303 is amended to make clear that, although a party may sever the right of survivorship in a joint account by withdrawal of funds, the severance is limited in the case of an overwithdrawal. A party's ownership interest in an account, and the concomitant power to terminate a right of survivorship by withdrawing funds from the account, is determined by the party's net contribution to the account. See Section 5301 (ownership during lifetime). This codifies the rule in *Estate of Propst*, 50 Cal. 3d 448, 461-62, 268 Cal. Rptr. 114, 788 P.2d 628 (1990) ("Accordingly, we hold that in the absence of prior agreement, a joint tenant of personal property may unilaterally sever his or her own interest from the joint tenancy and thereby nullify the right of survivorship, as to that interest, of the other joint tenant or tenants without their consent.").

Under this approach, overwithdrawal does not affect survivorship rights in amounts in which the withdrawing party has no lifetime ownership interest. Suppose, for example, that parents create a joint account with their child. Their intention is that at death the property will pass to the survivor of the spouses, and on the death of the survivor, to the child. (A better way to do this would be to create an account between parents, with child as pay on death beneficiary. But people persist in using the joint account form.)

If the child draws all the money out of the account during the lifetime of the parents, that should affect neither lifetime ownership rights of the parents nor survivorship rights between the parents. When the first spouse dies, the survivor should become owner of all the funds, notwithstanding their withdrawal from the account by the child.

Under the proposed clarification of the statute set out above, the child's withdrawal of funds would not affect the survivorship right of the surviving spouse. The child's withdrawal would terminate the survivorship right only as to the child's ownership interest in the account (which is zero).

CONCLUSION

The staff would convert this memorandum into the form of a tentative recommendation and circulate it for comment. We would seek comments from both the probate bar and the family law bar, in addition to those having a more general interest, such as the judiciary and general practitioners. We may also be able to obtain more formal input from the Joint Editorial Board for Uniform Trusts and Estates Acts.

Respectfully submitted,

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