Study L-1064 May 28, 2004

Memorandum 2004-32

Multiple Party Accounts: Ownership of Amounts on Deposit (Comments on Tentative Recommendation)

In February 2004, the Commission circulated for public comment its tentative recommendation relating to ownership of amounts withdrawn from a joint account.

The recommendation would revise the California Multiple-Party Accounts Law to make clear that ownership of funds withdrawn from a joint account is based on the proportionate contributions of the parties to the account. This would reverse the rule of *Lee v. Yang*, 111 Cal. App. 4th 481, 3 Cal. Rptr. 3d 819 (2003), which holds that a party who withdraws funds from a joint account owns the funds regardless of their source.

The recommendation would also clarify the rule that withdrawal of sums on deposit in a joint account severs the right of survivorship in the amounts withdrawn to the extent of the withdrawing party's ownership interest in them. This codifies existing law.

Attached to this memorandum are the following materials:

GENERAL REACTION

We received little new input on the tentative recommendation. Both the Executive Committee of the State Bar Trusts & Estates Section and the Executive Committee of the State Bar Family Law Section have written to say that they support the proposals. See First Supplement to Memorandum 2004-10 (1/28/2004) (available at www.clrc.ca.gov).

The California Bankers Association is generally supportive of the thrust of the tentative recommendation, but has some concerns. Exhibit p. 1. Their concerns are discussed below.

The attached article — Granberg, *What's Yours is Mine, in Joint Bank Accounts, 'Lee' Decides*, S.F. Daily Journal 5 (May 14, 2004) — while it does not address the

tentative recommendation, is critical of the decision in *Lee v. Yang*, which the tentative recommendation would reverse. The article calls the decision "surprising" and refers to the dissent in the case as "compelling." Exhibit p. 3.

IMMUNITY OF FINANCIAL INSTITUTION

The California Bankers Association is concerned that the law might be construed to impose a duty on a financial institution to monitor deposits or withdrawals to an account for the purpose of determining the proportionate contributions of parties to the account. "With myriad deposits and withdrawals on an account, financial institutions would have no way to determine the level of contributions made by each individual party to the account."

CBA suggests addition of the following language to each section of the tentative recommendation to address their concern:

> This section shall not impose any obligation or impose a duty on financial institutions to monitor deposits or withdrawals to the account or any other account activity. A financial institution is not required to do any of the following:
>
> (1) Inquire as to the source of funds received or deposit to an account, or inquire as to the proposed application of any sum withdrawn from an account, for purposes of establishing net contributions.
>
> (2) Determine any party's net contribution.
>
> (3) Limit withdrawals or any other use of an account based on the net contribution of any party, whether or not the financial institution has actual knowledge of each party's contribution.

The staff agrees with the CBA position in principle. The Multiple-Party Accounts Law is designed to facilitate transactions and expressly authorizes a financial institution to honor a withdrawal by an authorized party, leaving it to the parties to straighten out their rights as among themselves.

However, the staff does not think we need to repeat the same language in every section where the term "net contribution" is used. The Multiple-Party Accounts Law already includes a general provision essentially identical to the language CBA proposes for inclusion in the individual sections. The staff would rely on the general provision, with a specific cross-reference to the sections that concern CBA:

Prob. Code § 5401 (amended). Rights of financial institution

5401. (a) Financial institutions may enter into multiple-party accounts to the same extent that they may enter into single-party accounts. Any multiple-party account may be paid, on request and according to its terms, to any one or more of the parties or agents.

(b) The terms of the account or deposit agreement may require the signatures of more than one of the parties to a multiple-party account during their lifetimes or of more than one of the survivors after the death of any one of them on any check, check endorsement, receipt, notice of withdrawal, request for withdrawal, or withdrawal order. In such case, the financial institution shall pay the sums on deposit only in accordance with such terms, but those terms do not limit the right of the sole survivor or of all of the survivors to receive the sums on deposit.

(c) A financial institution is not required to do any of the following pursuant to Section 5301, 5303, or any other provision of this part:

(1) Inquire as to the source of funds received for deposit to a multiple-party account, or inquire as to the proposed application of any sum withdrawn from an account, for purposes of establishing net contributions.

(2) Determine any party's net contribution.

(3) Limit withdrawals or any other use of an account based on the net contribution of any party, whether or not the financial institution has actual knowledge of each party's contribution.

(d) All funds in an account, unless otherwise agreed in writing by the financial institution and the parties to the account, remain subject to liens, security interests, rights of setoff, and charges, notwithstanding the determination or allocation of net contributions with respect to the parties.

Comment. Subdivision (c) of Section 5401 is amended to state expressly that a financial institution has no duty with respect to tracing net contributions of a party under either Section 5301 (ownership during lifetime) or 5303 (right of survivorship and terms of account). This is not a change in, but is declarative of, existing law.

We have sent this language to CBA for review, but have not yet heard back from them.

CONCLUSION

There appears to be general consensus that the rule of *Lee v. Yang* is not a good one, and that the corrective language proposed in the tentative

recommendation is appropriate. The staff recommends that the Commission approve the draft as its final recommendation, for submission next legislative session, with the clarifying language set out above relating to financial institutions.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

1121 L Street, Suite 1050, Sacramento, CA 95814 T. 916.441.7377 F. 916.441.5756

May 14, 2004

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

RE: Comments for Tentative Recommendation Relating To Ownership of Amounts Withdrawn From Joint Account

Dear California Law Revision Commission:

California Bankers Association (CBA) has reviewed the Tentative Recommendation issued in February of 2004 pertaining to Ownership of Amounts Withdrawn from Joint Accounts.

CBA understands that the California Law Revision Commission (CLRC) is recommending that the California Multiple-Party Accounts Law be revised to affirm that ownership of funds withdrawn from a joint account is proportionate to the level of contributions of the parties who hold the account. We further understand that this recommendation results from, and seeks to reverse, the ruling in *Lee v. Yang,* 111 Cal. App. 4th 481.

While CBA is generally supportive of CLRC's tentative recommendation, our members do have some concern. Specifically, CBA strongly urges CLRC to include a provision within their proposed amendments to Probate Code §5301 and §5303 that would insulate financial institutions by not imposing any duty or obligation on a bank, financial institution, or other depository to monitor deposits or withdrawals to the account or any other account activity.

Indeed, both the Tentative Recommendation and the opinion in *Lee v. Yang* identify the complexity of "tracing" the amount of ownership on net contributions when funds are commingled. With myriad deposits and withdrawals on an account, financial institutions would have no way to determine the level of contributions made by each individual party to the account.

Usery v. First National Bank of Arizona, 586 F.2d 107 further distinguishes and supports our concerns over the difficulty of tracing. In Usery, the Court determined that tracing account activity would be cost burdensome and therefore unreasonable.

As such, CBA recommends adding the following language:

Section 5301(d):

(d) This section shall not impose any obligation or impose a duty on financial institutions to monitor deposits or withdrawals to the account or any other account activity. A financial institution is not required to do any of the following:
(1) Inquire as to the source of funds received for deposit to an account, or inquire as to the proposed application of any sum withdrawn from an account, for purposes of establishing net contributions.
(2) Determine any party's net contribution.
(3) Limit withdrawals or any other use of an account based on the net contribution of any party, whether or not the financial institution has actual knowledge or each party's contribution.

Section 5303(d):

(d) This section shall not impose any obligation or impose a duty on financial institutions to monitor deposits or withdrawals to the account or any other account activity. A financial institution is not required to do any of the following:
(1) Inquire as to the source of funds received for deposit to an account, or inquire as to the proposed application of any sum withdrawn from an account, for purposes of establishing net contributions.
(2) Determine any party's net contribution.
(3) Limit withdrawals or any other use of an account based on the net contribution of any party, whether or not the financial institution has actual knowledge or each party's contribution.

CBA would like to thank the CLRC for considering its comments relative to this tentative recommendation and we respectfully urge CLRC to adopt these provisions within their recommendation. CBA would be pleased to discuss our position and suggested amendments should there be questions or concerns.

Sincerely,

Kevin Gould
Legislative Advocate

KG:af

What's Yours Is Mine, in Joint Bank Accounts, 'Lee' Decides

By Ronald S. Granberg

Al and Bob open a joint-tenancy bank account together: Al deposits $90,000 and Bob deposits $10,000. They make no express agreement regarding ownership of the money. If either account holder dies, the other owns the entire $100,000 by right of survivorship. While both men live, Al owns 90 percent of the account balance and Bob owns 10 percent of the account balance (accrued interest is owned pro rata) under the proportionate ownership rule of the Multiple-Party Accounts Law found at Probate Code Sections 5100-5407.

However, if Bob withdraws the $100,000 (even if he does so without Al's knowledge or consent), he automatically owns it all. This surprising result is mandated by *Lee v. Yang*, 111 Cal.App.4th 481 (2003).

Before 1980, a joint-tenancy bank account was subject to Civil Code Section 683, which provided that it was "owned by two or more persons in equal shares" irrespective of the account owners' relative contributions. Under this equal ownership rule, Al and Bob each would have owned $50,000.

The equal ownership rule was criticized by those who didn't think Al intended to lose $40,000 merely by opening a joint bank account with Bob. A person might open a joint bank account for purposes of convenience, not gift.

In 1980, the state Law Revision Commission recommended that the state adopt Uniform Probate Code Article VI relating to multiple-party bank accounts. Although the recommendation wasn't adopted, some narrow legislation resulted.

In 1982, the commission renewed its recommendation. In response, the state Legislature passed the Multiple-Party Accounts Law, effective July 1, 1984. The law pertained only to accounts in industrial loan companies and credit unions, however.

In 1989, the commission recommended that the law be extended to include accounts in banks and savings and loan associations. Legislation so providing became effective July 1, 1990. The law now controls multiparty accounts in all common financial institutions. Civil Code Section 683 was amended to exempt multiparty accounts from its equal ownership rule.

Probate Code Section 5301(a) contains the proportionate ownership rule: "An account belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each to the funds on deposit, unless there is clear and convincing evidence of a different intent." Probate Code Section 5134(a) defines net contributions as 1) a party's deposits, minus 2) withdrawals not paid to, or used for, other party, plus 3) a pro rata share of accumulated interest. Under the proportionate ownership rule, Al owns 90 percent and Bob owns 10 percent of their joint account.

In March 1999, Holden Lee proposed marriage to Janet Yang. Yang accepted his proposal and left her $500,000-per-year job in Hong Kong for a $70,000-per-year job in San Francisco, where Lee lived. The wedding was set for September 1999. In June 1999, Lee added Yang's name to his three bank accounts. Yang deposited a couple of her paychecks into one of the now-joint accounts.

When Yang discovered that Lee was bisexual, she "felt betrayed," "made several suicide attempts," and withdrew $347,000 from the accounts. Although the facts are not specific in this regard, Lee apparently had contributed the bulk of the funds Yang withdrew.

The wedding was off. Instead of marrying each other, Lee and Yang sued each other. Lee wanted his money back.

The trial court 1) found that Lee had not intended to make a gift to Yang of his funds in the accounts; 2) determined that the account ownership must be determined under Civil Code Section 683's equal ownership rule, not under the Multiple-Party Accounts Law's proportionate ownership rule; and 3) ruled that Yang was entitled to keep the entire $347,000. Both parties appealed.

The *Lee* appellate court's majority and dissenting opinions agreed that the trial court had applied the wrong law: The Multiple-Party Accounts Law, not Civil Code Section 683, controlled. The majority affirmed the trial court's decision, allowing Yang to keep the $347,000. The dissent, on the other hand, argued that the judgment should have been reversed and the case should have been remanded for the trial court to properly apply the Multiple-Party Accounts Law. The dissent presented compelling arguments why the law's proportionate ownership rule requires Yang to return funds to Lee.

The *Lee* majority acknowledged that the law applies the proportionate ownership rule to funds on deposit in a multiparty account: The majority held, however, that the moment a joint account owner ("the Withdrawing Cotenant") withdraws

Under 'Lee,' withdrawn funds are owned completely by the withdrawing co-tenant, thus creating a new sole ownership rule, which had never been applied.

funds from the account, the funds withdrawn are exempt from the proportionate ownership rule unless the co-tenant who contributed the funds ("the Contributing Cotenant") can prove that the parties expressly so agreed.

In fact, under the majority view, the withdrawn funds are not even subject to the old equal ownership rule but are, instead, owned completely by the withdrawing co-tenant. Thus, *Lee* created a new sole ownership rule, which had never been applied. In our hypothetical situation, once Bob withdraws the $100,000 (even if he does so without Al's knowledge or consent), he owns it all. By his unilateral and unconsented act, Bob made the $100,000 his, the same way Yang made the $347,000 hers.

The *Lee* majority stated that the Multiple-Party Accounts Law was unclear regarding ownership of withdrawn funds and concluded that it should review the Law Revision Commission comments preceding the law's enactment in order to clarify the issue. The dissent pointed out that the commission clarified the issue by stating, "Withdrawal of funds does not ... affect the ownership rights of the parties to the funds withdrawn."

The majority found less significance in this clear statement than in the commission's oblique reference to federal gift tax regulation 26 C.F.R. Section 25.2511, finding that the commission's reference to the regulation means that funds taken by a withdrawing co-tenant must be gifts from the contributing co-tenant.

The commission had stated, "[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, 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.

"[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 their lifetime in proportion to their net contributions. 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."

The dissent countered that the gift tax regulation determines when a gift occurs (if one does), not whether a gift occurs, and that the regulation "does not address ownership interests at all." The dissent stated, "The regulation's example makes this clear. It states: When A establishes a joint account for A and B, 'there is a gift to B when B draws upon the account for his own benefit, to the extent of the amount drawn without any obligation to account for a part of the proceeds to A.' (26 C.F.R. Section 25.2511-1(h)(4) (2003)). Thus, the regulation identifies when the taxable event occurs, but only assuming there was a transfer of ownership from A to B under governing principles of property law. The issue of whether there is an 'obligation to account for a part of the proceeds' is determined by state law — here, section 5301 of the CAMPAL."

The dissent went on to explain how the majority's interpretation of the law violated rules of statutory construction, because it rendered meaningless Probate Code Section 5303(c) and the clause "or withdrawn from" in Probate Code Section 5405(d).

When account holders go their separate ways, an accounting will be required if they wish to calculate their respective ownership interests in account funds. The accounting may be difficult. For example, if Al and Bob decide to divide their account after having made hundreds of account contributions (some contributions made by Al, others by Bob) and after having written thousands of account checks (some checks written for Al's benefit, others for Bob's), detailed tracing will be required in order for them to determine their respective ownership interests in the ending account balance.

A more cumbersome tracing could be necessary in order for account holders to determine their respective ownership interests in withdrawn funds. The *Lee* majority cited potential accounting difficulties as a reason to refuse to apply the proportionate ownership rule to withdrawn sums. The *Lee* dissent considered accounting difficulties the cost of fairness.

Of course, a contributing co-tenant will trace funds (still-deposited funds or withdrawn funds) only if it is worthwhile for him to do so. For example, it would be futile for Al to trace funds that Bob withdrew, if Bob has spent the funds and lacks other means to refund them to Al.

Under *Lee's* dissenting opinion, Bob would have the right, if he so chose, to trace withdrawn funds and try to recover them from Al. Under the *Lee* majority opinion, however, Bob lacks that option. Al owns whatever he withdrew.

Ronald S. Granberg is a sole practitioner in Salinas.