

DEATH WITHOUT PROBATE

TOD Deeds—The Latest Tool in the Toolbox

By Dennis M. Horn and Susan N. Gary

Why Avoid Probate?

In recent years, state legislatures, with the active assistance of the trusts and estates and real property bars, have developed ways to help individuals minimize, or avoid entirely, the probate process when they transfer assets on their death. This trend makes sense as a public policy matter, because probate can be expensive and time-consuming. For example, in California statutory fees are set on a sliding scale as a percentage of the gross value of the estate. For an estate of \$250,000, the minimum statutory fees would be \$16,000 for the executor and his attorney. The court could award more for “extraordinary service.” When a decedent’s only asset is a modest house that she wants to transfer to her daughter, that is a significant cost. Also, some people may want to maintain their privacy and a probate proceeding is a

Dennis M. Horn is a partner in Holland & Knight, LLP with a specialty in complex real estate transactions and public-private partnerships. Susan N. Gary is the Orlando J. and Marian H. Hollis Professor at the University of Oregon School of Law with a specialty in estate planning and regulation of nonprofit organizations. Both Mr. Horn and Prof. Gary were ABA advisors to the NCCUSL Committee that drafted the Uniform Real Property Transfer on Death Act.

matter of public record. Just as importantly, probate matters clog the courts at a time when litigation is increasing and states are challenged to fund the courts at adequate levels.

Although probate can be expensive, avoiding probate can be complicated. Typically, an individual owns several different categories of property. Even a person of modest means could own a home with furniture, clothing, jewelry, a bank account, an insurance policy, and perhaps stocks and bonds. This property can be held under various legal arrangements. For example, cash could be held in bank accounts, certificates of deposit, safe deposit boxes, or in tax-advantaged retirement accounts. In the old days, most of this property was transferred on the death of the owner either by will or under state law through intestate succession. Both wills and intestate succession require a probate action in state court.

Probate Avoidance Tools

The challenge has been to fashion flexible legal tools to allow individuals to transfer each of these property types on death while preserving the individual’s right to change his or her mind during life. Specific assets that routinely pass outside of probate include securities registered in transfer on death (TOD) form and bank funds held in pay-on-death accounts, as well as any assets titled in a joint tenancy with right of

survivorship. In addition, the Uniform Probate Code and statutes adopted in many states recognize that many other categories of assets can pass directly to a named beneficiary through contracts. These include life insurance policies, contracts of employment, mortgages, promissory notes, account agreements, custodial agreements, deposit agreements, compensation plans, pension plans, and marital property agreements.

Revocable Trust

The revocable trust is a more comprehensive tool for estate planning. With the revocable trust, as with a will, an individual can make arrangements for the transfer on death of all of his or her assets in one document while preserving the right to control the assets and amend the revocable trust during his or her life. The revocable trust, like a will, is also a useful tool for tax planning and apportionment. Unlike a will, the revocable trust does not require a probate proceeding on death. But revocable trusts have limitations. The legal fees to draft a revocable trust can be several thousand dollars, depending on the complexity of the estate. In addition, the settlor of the trust must title all of his or her assets in his or her name “as trustee under the . . . Revocable Trust” so that the assets will be distributed through the trust. If the settlor fails to change the title for a significant asset, then a probate proceeding will be needed to transfer title to the

asset. These limitations of the revocable trust are especially problematic for individuals who have small estates in which the major asset is a family home or farm. If the primary asset in the estate is a house, the property owner may not want to incur the cost of having a revocable trust prepared.

Joint Tenancy

Instead of using a revocable trust, the property owner could transfer the title to the real property into a form of joint ownership with the right of survivorship. The most common such form is a joint tenancy, but some states also allow spouses to create a tenancy by the entirety. These forms of co-ownership have significant limitations. The transfer creates an irrevocable gift from the original owner to the new co-owner and can have unintended consequences. First, the gift is irrevocable even if the original owner changes his or her mind. Second, the transfer will be a completed gift for gift tax purposes and may require the payment of gift taxes. Finally, the person added to the title has rights in the property while the original owner is alive. The creditors of the person added to the title may be able to reach the asset.

TOD Deed

The latest tool in the probate avoidance toolbox is the Transfer on Death Deed ("TOD Deed"). A TOD Deed allows the owner of real property to execute a deed that names the beneficiary who will succeed to ownership at the owner's death. Because the TOD Deed creates no rights in the beneficiary until the owner dies, the owner can change his or her mind during life, and the beneficiary's creditors cannot attach the beneficiary's interest in the property during the owner's life. The recordation of the TOD Deed also does not create a completed gift for gift tax purposes because no transfer of ownership takes place until the owner dies.

Thirteen states have adopted TOD Deed statutes. In July 2009, the National Conference of Commissioners on Uniform State Laws approved the Uniform Real Property Transfer on Death Act. This new act will likely lead additional states to consider the TOD Deed. This

article examines some of the circumstances in which the TOD Deed and other probate avoidance tools might be used productively in estate planning. The article also examines some of the conflicting interests that emerged in crafting the Uniform Real Property Transfer on Death Act ("Uniform Act"). A copy of the Uniform Real Property Transfer on Death Act, with explanatory comments, can be found at www.law.upenn.edu/bll/archives/ulc/tod/2009_final.pdf.

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When Should TOD Deeds Be Considered?

Small Estate, Simple Estate Plan

A few case studies may be helpful to illustrate the uses and the limitations of the TOD Deed. Suppose that Jane owns a house valued at \$250,000, and the house is Jane's sole significant asset. When she dies, Jane would like to leave the house to her only child, Mary. If the state in which Jane lives does not have a TOD Deed statute, Jane has three options. She can leave the house to Mary by will or under a revocable trust, or she can transfer title to the house to herself and to Mary as joint tenants with the right of survivorship. If she transfers the house by will, Mary will have to probate the estate when Jane dies. If Jane uses a revocable trust, Jane will have to pay a lawyer to draft the

trust and then deed the house to herself as trustee under the revocable trust. If Jane transfers title to herself and Mary as joint tenants with right of survivorship, Jane might need to worry about recordation taxes or transfer taxes. She will also need to worry about Mary's creditors. If Mary incurs a debt that she cannot pay, her creditors may be able to attach Mary's interest in the house. If Jane dies before Mary, the creditors could foreclose on the house to collect their judgment. Another potential complication is that if Jane wants to sell the house and move into an assisted care facility, she will not be able to do so without Mary's consent, because Mary will own an interest in the house. Finally, if Mary decides to save money by using a stationery store deed that does not properly create the joint tenancy with right of survivorship, she could affect her title in ways she does not intend.

By contrast, if the state where Jane lives were to adopt the Uniform Real Property Transfer on Death Act, Jane could accomplish her goals by executing a TOD Deed and recording it in the appropriate land records. A lawyer's assistance to create the deed would be relatively inexpensive. Jane would not make a present gift by executing and recording the deed, and Mary's creditors could not attach the property. If Jane were to change her mind, she could revoke the TOD Deed. A simple form of the TOD Deed and a simple revocation form are included with the Uniform Act and can be adopted as part of the Act. By using the TOD Deed, Jane can accomplish her goal of transferring her house to Mary without probate, at minimal cost, and without the unintended consequences of the joint tenancy.

Larger Estate, Simple Estate Plan

Even if Jane's house is worth more, say \$1 million, if she has only one beneficiary—Mary—the TOD Deed may still be appropriate. At \$1 million, she may have state transfer taxes to consider. She also may have a variety of other assets, and in that case she might find a revocable trust more useful and worth the expense. Nonetheless, a TOD Deed can be used effectively for an expensive house and might even be used in conjunction with a revocable trust.

Jane might establish a revocable trust with her other assets, to prepare for the possibility of incapacity, and then make the trustee of the revocable trust the beneficiary on the TOD Deed.

Indeed, Jane's executor may choose to file a probate action even if Jane has transferred most of her assets through a TOD Deed, a revocable trust, or by some other nonprobate means. It often makes sense to file a probate action to cut off the claims period against the estate or to use a will (and the attendant probate process) to achieve the desired tax apportionment, even when most of the assets have been transferred outside of probate. This is particularly true in jurisdictions where probate proceedings are relatively quick and easy, like Georgia and Texas. In many cases, the estate planner's goal in using probate avoidance devices may be to minimize the size of the estate that passes through probate rather than to eliminate probate. A real estate lawyer can be consulted in connection with the TOD Deed to ensure proper drafting and recordation. The estate planner's role, however, is critical in determining which devices are most appropriate in accomplishing Jane's objectives with minimum tax consequences. The TOD Deed is merely one device among many in structuring Jane's estate.

Small Estate, Complicated Estate Plan

Suppose instead that Jane is married to Joe, the marriage is a second marriage for each, and they each have children from a prior marriage. Jane owns the house, worth \$250,000. Jane could add Joe to the title of the house, as joint tenant or as a tenant by the entirety in some states. A tenancy by the entirety would protect the house from creditors, but under either form of co-ownership, the transfer of a present interest is irrevocable. If Jane changes her mind about giving the house to Joe, she cannot undo the gift. If Jane dies first, the house will belong to Joe. He might agree to give the house to Jane's children, but he could change his mind after her death. Instead, Jane could use a TOD Deed to grant a life estate to Joe and a remainder interest to her

children. Alternatively, Jane could create a trust.

In determining what devices will be effective to accomplish Jane's objective, the estate planner must consider all of the jurisdiction's laws, not only its TOD Deed statute. For example, Florida's constitutional homestead provisions that protect spouses and minor children may conflict with any mode of transfer that attempts to convey property to a third party.



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Larger Estate, Complicated Estate Plan

Now assume that all of Jane and Joe's children are children of their marriage. They have three children and several grandchildren. They want the house to go to the children equally when the second of the two of them dies, but if a child predeceases them, they want the child's share to go to the child's children. Jane and Joe have assets of \$3 million, with a house worth \$1 million and other assets worth \$2 million. A TOD Deed may or may not be appropriate for Jane and Joe. They may want to have a revocable trust so that all of their assets can be managed through one vehicle. Also, the revocable trust may be advisable in case either of them becomes incapacitated. If Jane and Joe want the revocable trust for other estate planning reasons, transferring the house into the trust will be easy.

The TOD Deed is merely a tool and

is not a substitute for a comprehensive estate plan. The estate plan will address such issues as who will pay any estate tax attributable to the property at death, expenses of administration and debts of the decedent if they exceed the probate estate, spousal election claims if the spouse is not the named beneficiary, tax minimization strategies, and issues involving the law of other jurisdictions if the property owner is not a U.S. citizen.

Conflicting Objectives

The drafting committee for the Uniform Act considered how to weigh competing objectives. Trusts and estates lawyers put a premium on making sure that the property disposition reflects the decedent's desires. Real property lawyers put a premium on certainty of title. How were these objectives balanced in drafting the Uniform Act?

Consider the following scenario. Alex, the original owner, records a TOD Deed in January leaving the property to his son John, then executes a valid will in February leaving the same property to his daughter Penelope, and then dies in March. Should the will supersede the TOD Deed because it reflects Alex's intentions at the point nearest to his death? Or should the TOD Deed be the governing instrument because it, not the will, has been recorded in the land records? Here, the Uniform Act comes down in favor of certainty of title. Only a recorded instrument can revoke a TOD Deed.

What if Alex had creditors on his death? Should the creditors be able to attach the property conveyed to John by the TOD Deed? If Alex had made John a joint tenant with right of survivorship, Alex's unsecured creditors typically would not have the right to attach the property after Alex's death. In contrast, the Uniform Act recognizes that one of the purposes of probate is creditor protection. The Act makes the property transferred by a TOD Deed available to satisfy creditor claims, but only under certain circumstances and for a limited period of time. In this case, the interest of creditors' rights trumps the interest of certainty of title. As a practical matter, this means that after John takes title under the TOD Deed, he cannot sell the property until the statutory claim period

has run or he convinces a title company to insure over the potential creditor claims.

What if Alex wants the property to go to his three children but a child predeceases Alex leaving descendants who survive Alex? For wills, a statutory anti-lapse rule gives the deceased child's share to the child's descendants. Similarly, if the will names the testator's spouse as a beneficiary and the owner and spouse later divorce, a statutory revocation by divorce statute will likely revoke any gift to the former spouse under the will. A bequest from a decedent to his murderer will also typically be revoked by statute. These statutes attempt to give effect to a testator's likely intent under certain circumstances, and, in the case of inheritance by murder, they invoke a public policy against murder.

The drafting committee for the Uniform Act discussed whether to apply these default rules from the law of wills to TOD Deeds. The tension here is evident. The rules under wills law help to

give effect to the decedent's intent, but certainty of title will be affected if a possibility exists that someone other than the persons named on the deed will take the property. A beneficiary named in a TOD Deed must survive the owner to take the interest. Beyond the requirement of survival, the Drafting Committee decided that the other default rules should be considered by state legislatures as part of a comprehensive approach to nonprobate transfers. A legislative note reminds states to consider these rules, including anti-lapse, revocation by divorce or homicide, the period of survivorship, and the elective share.

Finally, there is a conflict between the interest in creating easy-to-use probate avoidance devices to save time and money and the concern that people will not seek professional advice when they need it, misuse these devices, and create more problems for their heirs and for the courts. These are valid concerns, especially if a person tries to use a TOD Deed for complicated estate planning.

Of course, Internet or stationery store wills, joint tenancy deeds, and sharp knives raise the same concerns about potential misuse. People can hurt themselves if tools are not used properly. It is debatable how much experts should withhold tools from people in order to protect them from themselves.

Conclusion

There are many circumstances in which probate is both appropriate and necessary. There are also many instances in which professional estate planning is critical to avoiding unnecessary taxes and unintended consequences. Although the debate will continue, the adoption of the Uniform Probate Code, which permits many forms of property to pass outside of probate, and the many specialized devices that have been adopted to facilitate this concept probably means that probate avoidance tools are here to stay. The Uniform Real Property Transfer on Death Act provides another tool. We encourage state legislatures to consider it. ■