Introduction

Alongside wills and trusts, beneficiary designations are becoming increasingly popular as part of a complete estate plan. By simply filling out a beneficiary designation form, individuals can bypass probate and designate who will receive a specific asset upon their death. Today, a variety of assets can be transferred through a simple designation form, including bank accounts, stocks, bonds, retirement accounts, life insurance policies, commercial annuities and, in some states, even land, vehicles and boats.  
  
While the process seems fairly straightforward, problems can arise and mistakes can be made when individuals execute these forms without a complete understanding of how they operate. Therefore, when completing a designation form, the owner should work with an advisor to ensure the form successfully achieves his or her goals and to avoid common mistakes.  
  
This article is the final article in a four-part series about beneficiary designations. Part I discussed the different types of beneficiary designations and provided basic information in regard to how they operate. Part II explained the most common beneficiary designation mistakes and how to avoid them. Part III discussed the complexities related to transfer on death (TOD) deeds for real estate. This fourth and final article will discuss common problems and mistakes that can occur when setting up and utilizing TOD deeds and provide tips and guidance regarding some of the most common, and most concerning, TOD deed issues.  
  
**Editor's Note:** Please read Part III prior to reading this article in order to better understand the concepts and solutions discussed in this article. Additionally, this information reflects general trends among states. It is, however, important that professionals review state law to determine the treatment of a transfer on death designation. As this article will illustrate, there are several potential issues that can arise when executing a TOD deed. As such, property owners should consult with advisors before executing a TOD deed and advisors should understand the following areas of caution in order to avoid problems for their clients.

1. Recording Issues

As discussed in last month's article, a TOD deed must be properly recorded to be effective. Along with possible errors in the document's formalities (*e.g.*, missing signature, lack of witnesses or notarization, insufficient legal description and failure to clearly identify beneficiaries by name) there are also potential timing problems that can arise.  
  
In order for a TOD deed to be effective, most states require that the deed be recorded before death. Other states have alternative requirements. California, for example, requires that the deed be recorded within 60 days after execution (see Cal. Prob. Code Sec. 5626). Thus, advisors need to be aware of the timing rules that exist in the state where the property is located to work with their clients to ensure that each TOD deed is recorded in a timely fashion.

Example 1: Five years ago, Grant consulted with an estate planning attorney to draft his will. His will provided that Norbert, Grant's favorite nephew, would inherit Grant's lake house in California. A year later, Grant and Norbert had a falling out. When Grant became very sick last year, he consulted with his attorney and decided to update his estate plan to transfer the lake house to his favorite charity. Grant's attorney prepared a TOD deed, which Grant signed and then gave to his girlfriend, Margaret, with instructions to record the deed. Grant passed away the next afternoon and Margaret was so distraught she forgot to record the TOD deed. Three months later, Margaret found the deed and brought it to the recorder's office to have it recorded.  
  
Because the TOD deed was not timely recorded within 60 days of signing, under California law, the TOD deed will fail. Accordingly, Grant's favorite charity will not receive the property even though that was clearly Grant's intent. Rather, the property will pass through Grant's probate estate where, by the terms of Grant's will, the lake house will go to Norbert. If the TOD deed had been timely recorded, not only would Grant's wishes have been fulfilled, but his estate would have received a charitable estate tax deduction due to the intended real estate gift to the charity.

In order to avoid a similar undesirable outcome, in time-sensitive situations it is advisable to hand deliver the TOD deed to the proper county office. Additionally, the owner should request that the deed be time stamped to avoid future uncertainties.

2. Revocation

There are typically three ways that a TOD deed can be revoked. A TOD deed can be revoked by: (1) executing a subsequent TOD deed; (2) recording an instrument of revocation; or (3) selling or transferring the property. Uniform Real Property Transfer on Death Act Sec. 11 (2009). To be effective, the revocation must be recorded, typically before the death of the property owner.

**Example 2:** Gertrude knew that her health was deteriorating and that she needed to quickly designate a beneficiary for her home. Knowing that her granddaughter Jenny would be graduating from college soon and need a place to live, Gertrude executed a TOD deed naming Jenny as beneficiary. A month later, Gertrude was transferred to an end-of-life care facility. While there, she learned that Jenny was moving across the country to start her career. Gertrude decided to put together a quitclaim deed to convey her home to her other granddaughter, Zoe, who still lived in town. Unfortunately, Gertrude passed away one day before the deed was recorded. As such, the TOD deed was the controlling document and the home was transferred to Jenny.

Again, it is imperative that property owners and their advisors understand the importance of timing and acting promptly when executing documents that will contradict or revoke previously recorded instruments—especially TOD deeds.

3. Naming and Changing Beneficiaries

One of the most detrimental mistakes is failing to revoke a TOD deed when there is a change in circumstances that would require a new beneficiary. The change in circumstance could be a major life event—such as marriage, divorce, birth, adoption—or it could be an instance where the beneficiary predeceases the property owner. While some states allow contingent beneficiaries to be named on a TOD deed (*e.g.*, Texas. See Tex. Estate Code Sec. 114.151-5), not all states provide the same option. If the state does not, it is crucial for the property owner to revoke a TOD deed if the named beneficiary passes away. If the beneficiary predeceases the property owner and there are no other living beneficiaries listed on the deed, then the property will revert to the deceased owner and may be transferred to his or her probate estate.  
  
It is also worth noting that some states require that the beneficiary survive the grantor by a certain amount of days in order to receive the property. Texas, for example, requires that the beneficiary survive the owner by five days. Tex. Estate Code Sec. 114.103.  
  
**Example 3:** Tom executed a TOD deed naming his girlfriend Julia as beneficiary of his Texas home. A year later, Tom and Julia were in a car accident. Tom died instantly and Julia passed away a few hours later at the hospital. As such, the TOD deed designation failed and the home became part of Tom's probate estate.

Advisors also should be mindful of the transferor's intent. While states typically allow property owners to give beneficiaries varying shares of the TOD real estate, in many states, the default under state law is that the TOD deed will grant equal shares to the TOD beneficiaries as tenants in common unless the deed specifically states otherwise. (See Tex. Estate Code Sec. 114.103(a)(3) and Cal. Prob. Code Sec. 5642(b)).

**Example 4:** Donna owns a beach house in Malibu, California, but her permanent residence is located in Indiana. Donna decides to execute TOD deeds for both homes and name her three daughters as beneficiaries. On the California TOD deed, she simply lists her three daughters (*i.e.*, she does not include a provision that specifies the amount of each daughter's share). As such, when Donna passes away, each of her daughters will hold a one-third interest in the California home as tenants in common. This works great for Donna because she hopes that her daughters will keep the home and use it as a shared vacation home when she passes away.  
  
Donna believes that her daughters will choose to sell her Indiana home upon her death. As such, she leaves a 20% interest to her two married and working daughters and a 60% interest to her unmarried daughter who is struggling financially. Donna is happy because the Indiana TOD deed will be able to provide for her daughters according to her goals and her daughters' individual needs.

4. Anti-Lapse

Advisors who are assisting clients in the drafting of their TOD deeds as part of an estate plan need to know whether the state where the property is located has an anti-lapse statute, and if so, whether it applies to TOD deeds. Recall that if a state has enacted an anti-lapse statute and a beneficiary of property predeceases the grantor, the deceased beneficiary's share will be passed on to his heirs, rather than be split among other named beneficiaries. The Uniform Transfer on Death Act was silent as to whether or not anti-lapse statutes should apply to TOD deeds and left it to individual states to consider the issue. While some states apply anti-lapse statutes to TOD deeds (*e.g.*, Minnesota. See Minn. Stat. Sec. 507.071-11), in California and Virginia the anti-lapse statutes do not apply to TOD deeds. Cal. Prob. Code Sec. 5652(2); Virginia Code Sec. 64.2-632. As such, there can be radically different outcomes in California and Virginia when a beneficiary predeceases the owner depending upon whether a will was used (in which case the anti-lapse law applies) or a TOD deed was used (in which case the anti-lapse law doesn't apply) to distribute the owner's real property.

**Example 5:** Gary owns two homes—one in San Diego and one in Monterey. Gary's will provides that his three sons – Nick, Kevin and Brian – will inherit the Monterey home. Gary also signed and timely recorded a TOD deed naming his three sons as TOD beneficiaries of his San Diego home. Gary's son, Nick, passed away two years ago, and Gary passed away last year.  
  
Gary's Monterey home was distributed to his heirs according to his will. Because California has an anti-lapse statute, the one-third interest in the property that Nick would have inherited instead passed to his two daughters. Accordingly, Kevin and Brian now each own a one-third interest in the Monterey property and Nick's two daughters split his interest so they each received a one-sixth interest in the home.  
  
The allocation of the San Diego home, however, occurred differently because that property was transferred in accordance with California's rules related to TOD deeds. California law expressly rejects the idea of anti-lapse with respect to TOD deeds. Under the law, Nick's interest lapsed because he predeceased his father. As a result, Kevin and Brian each received a one-half interest in their father's San Diego home and Nick's daughters did not receive a portion of that real estate.

As the above example illustrates, it is crucial to understand how the TOD deed will operate if one of the beneficiaries predeceases the property owner. This requires the advisor to understand the state's anti-lapse statute and thoroughly review the TOD laws to determine if the state's anti-lapse statute applies. The above example also demonstrates the need to coordinate and understand the relationship between a TOD deed and a will in order to effectively transfer real property.

5. Joint Tenancy and Community Property

While a TOD deed will take precedence over a designation made in a will or trust (as was illustrated in Example 5), a joint tenancy will prevail over a TOD deed designation (as will laws governing community property in many states). This could lead to problems and unintended consequences where a property owner executes a TOD deed for property held as a joint tenancy.

**Example 6:** Lucy and Ethel have been lifelong friends. After their husbands passed away, they decided to become roommates and purchased a home, taking title as joint tenants. A year later, Lucy recorded a TOD deed naming her son, Des, as the beneficiary of her interest in her new home. Lucy passed away five years later. Despite having executed the TOD deed after she took title as a joint tenant, the deed was ineffective because at her death her interest automatically passed to the remaining living joint tenant, Ethel. Since a joint tenancy trumps a TOD deed designation, Ethel, not Des, received Lucy's interest in the property.

Note that in community property states, the same result could occur. For example, assume that a husband executes a TOD deed naming someone other than his wife as the beneficiary of property owned as community property with a right of survivorship. Upon his death, the TOD deed would be deemed ineffective, as community property laws would require the property pass to the surviving spouse. However, the TOD deed can be effective if the wife gives written consent to give up her community property interest. As such, in community property states, attorneys with clients who wish to name someone other than a spouse as a TOD deed beneficiary should make sure that the client receives proper written consent from his or her spouse to avoid unintended consequences. These states follow community property laws in some form or fashion: Alaska (which is an opt-in community property state), Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Note that in some states, like California, a spouse that has given written consent to relinquish his or her interest in community property to a TOD deed beneficiary can later revoke that consent in writing (see Cal. Prob. Code Sec. 5030).

6. Creditors

For beneficiaries, property received under the terms of a TOD deed may not always be desirable. When title vests, a TOD deed beneficiary will receive the property subject to all of the prior owner's interests. Thus, all of the owner's previous mortgages, liens and judgments remain attached to the property. If the beneficiary intends to keep the property, he or she will have to take responsibility for any liens or other encumbrances that affect title. Further, when it comes to using the property to satisfy outstanding debts, creditors of the prior owner take priority over creditors of the new beneficiary.

The types of creditor's claims could include mortgages, taxes, condominium or home association dues, utility receipts, property liens and mechanic liens. Note that some states follow the Uniform Act, which requires that the TOD deed property be available to satisfy creditors' claims against the prior owner's estate for a certain period of time. As such, in states that have adopted this section of the Uniform Act, a TOD deed beneficiary cannot sell the property until a "statutory claim period" has passed (anywhere from four to 18 months) or until a title company agrees to insure the property with the understanding that there are potential creditors' claims looming. Uniform Real Property Transfer on Death Act Sec. 15; ORS Sec. 93.973. (Note that the legislative comment to C.R.S. Sec. 15-15-409—Colorado's TOD deed Statute—explains that "under §15-15-407 the title becomes marketable four months after death if no interests created in the real property by the owner are of record or recorded, however a grantee-beneficiary is still liable for the proceeds for up to three years after the date of death and potentially longer if fraud is involved.").

**Example 7:** Gus had a new roof installed on his home but passed away before paying the contractor. The contractor filed a mechanic's lien against the home to secure payment for the new roof. Ben received Gus' home by way of a TOD deed. Ben will have to pay off the outstanding construction bill in order to obtain a release of the lien.

Because receipt of property under a TOD deed has the potential to negatively impact the finances of the beneficiary, the beneficiary's advisor needs to do research in order to decide if it would be in the beneficiary's best interest to accept or disclaim the property. This should include a title lien search and a visit to the county assessor's office to see if there are any unpaid property taxes. Additionally, it would also be worth contacting the appropriate homeowner's association to determine if there are any outstanding dues or fines owed.  
  
The property owner and his advisor should be mindful and consider how transferring debt-encumbered property under a TOD deed could affect the beneficiary (especially if that beneficiary is a charity). One solution is to leave cash to the beneficiary in a will or trust in order to satisfy any outstanding debts on the property. Alternatively, the property owner could make sure to satisfy any debt obligations before executing the TOD deed or leave other assets to the beneficiary instead.

7. Restitution Demands from the Estate

In addition to property liens, the personal representative of the estate may be able to demand restitution from a TOD beneficiary in order to satisfy other creditors of the deceased. The effect can be extremely problematic for the beneficiary.  
  
For example, in California, a personal representative can make a restitution demand up to three years after the property owner's death. Cal. Prob. Code Sec. 5676(e). Upon receiving the demand, the beneficiary must transfer the property to the estate, plus any interest or net income received after the owner's death. Cal. Prob. Code Sec. 5676(a). This could quickly become a complicated situation if the beneficiary has encumbered the property, made improvements to the property or sold it. In California, if the beneficiary has encumbered the property, he or she must return the property and either pay off the debt or transfer enough cash so that the debt can be paid. The beneficiary might be entitled to reimbursement for improvements made to the property, but only if the improvements were significant. Cal. Probate Code Section 5676(b).  
  
If the beneficiary sold or transferred the property in California and the estate makes a restitution demand, then the beneficiary must return the following: (1) any net income received prior to the transfer/sale; (2) the fair market value of the property at the time of the transfer/sale; and (3) interest on the fair market value of the property at the time of transfer/sale at an annual statutory rate (the rate in California is currently 10% and the interest runs from the date of transfer/sale to the date of restitution). Cal. Probate Code Section 5674(a). Because the estate has up to three years to make a restitution demand, the statutory interest could be quite costly in some instances (as the 10% interest may be disproportionate to the actual market return on the property's value). As such, it could be possible that the beneficiary ends up losing money due to the statutorily imposed interest.  
  
Thus, effectively, beneficiaries of TOD deeds in California not only become liable for the debts secured to the property, but can also be liable for unsecured debts, which are unrelated to the inherited property. Again, to avoid burdening a beneficiary with unintended harsh consequences, a property owner who wishes to use a TOD deed to transfer property should work with an attorney to ensure that there are provisions and funds set aside in the owner's will or trust that will satisfy judgments and creditors so that the TOD deed property is not at risk of being subject to a restitution demand from the owner's estate.

Conclusion

While a properly executed TOD deed can be an effective means of transferring real property to loved ones, property owners and their advisors must exercise caution before moving forward with a TOD deed execution. State law must be consulted and the ramifications for the beneficiary should be considered. Additionally, due to the complexities in this area, it is highly recommended that property owners work with advisors to ensure that the TOD deed is properly executed and to ensure that the TOD deed designation successfully effectuates their estate planning goals.