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California catches up on revocable transfers on death

By Robert C. Barnes

On Jan. 1, California played catch-up for a change and joined at least 27 other states that allow a low-cost way of avoiding probate on residential real property. With Assembly Bill 136, the revocable transfer on death (TOD) deed became a new estate-planning tool in California.

Several questions accompany the rise of revocable TOD deeds: Will they be widely used or will their use be limited to residential property owners who have few other assets at death? Will the advantages — avoiding the time-consuming probate process and attendant attorney fees — outweigh the disadvantages, like the title insurance industry's unease and ambivalence in issuing policies insuring revocable TOD deed transactions? And will those who use TOD deeds be more susceptible to fraud, duress and even "elder abuse," as some opponents maintain?

Revocable TOD deeds, aka beneficiary deeds, have been around since at least 1989, but until now the Legislature has refused to add them to the array of approved methods of avoiding probate. Existing methods include revocable trusts, joint tenancies with right of survivorship, and life estates. With AB 136, California joined other states offering this device, at least for five years — since unless it's extended, the new law expires in 2021.

Basically, a revocable TOD deed allows an owner of a real property interest to designate a grantee (who is also a beneficiary) to take title to the interest upon the owner's death. The transfer happens automatically upon evidence of the grantor's death, without the need for probate.

A revocable TOD deed is similar to other "pay on death" methods of avoiding probate for certain non-real estate assets. Insurance policies, securities, bank and brokerage accounts, and IRAs are among the kinds of assets that California law allows to be transferred at death with a pay on death designation.

California's approach to revocable TOD deeds is somewhat different from both other states' and the model Uniform Real Property Transfer on Death Act. New California Probate Code Sections 5600-5696 contain the crux of the new regime and include a mandatory form of revocable TOD deed as well as the form of revocation of a revocable TOD deed, should an owner later change their mind.

In California, a revocable TOD deed may be used only to transfer a condominium, property comprised of one to four residential dwelling units, or 40 acres or less of agricultural land improved with a single-family residence. There is no requirement that the owner live in the property.

A revocable TOD deed is revocable until the grantor's death, but any revocation must be documented on the statutory form. The grantor must have the capacity to enter into a contract at the time of making the revocable TOD deed, and a revocable TOD deed isn't effective unless it is recorded within 60 days after the date it was signed. Finally, a revocable TOD deed does not affect the transferor's Medi-Cal eligibility.

Unlike a normal deed, which requires delivery and acceptance for the transfer to be enforceable, the grantor under a revocable TOD deed doesn't need to deliver it to the grantee/beneficiary during the grantor's life, nor does the grantee/beneficiary need to accept it during the grantor's life. (However, the grantee/beneficiary can disclaim the revocable TOD deed within nine months from the later of the date of the grantor's death or the date on which their interest becomes vested.)

The revocable TOD deed has advantages over other transfers of title for estate-planning purposes in California, such as a deed with the reservation of a life estate for the grantor. Unlike a current deed with a reserved life estate, a revocable TOD deed doesn't affect any ownership rights to the property during the transferor's lifetime. Because the transfer under a revocable TOD deed isn't effective until the grantor's death, there is no completed gift for purposes of gift tax. The grantor can change their mind at any time before death and revoke the revocable TOD deed, by means of a recorded statutory form of revocation, without the consent of the rantee/beneficiary. And there is no ocumentary transfer tax payable, or roposition 13 reassessment, at the time of recording the new revocable TOD deed (under the statute, the change of ownership occurs upon the death of the transferor).

Unlike the current transfer of title to a new grantee, the recording of a revocable TOD deed does not convey any rights to the new transferee and therefore doesn't allow for the unwelcome possibility that the new grantee might mortgage their new interest, or that the property now would be subject to liens and encumbrances that already affect the new grantee's other assets.

Similarly, because a revocable TOD deed does not transfer title until death, its use would also prevent the grim scenario under other types of transfers in which the new grantee, wanting to sell the house, threatens to evict the parent or other grantor.

The time and cost of preparing and recording a revocable TOD deed will likely be much less than would be involved in the probate process for a house or condo. Along the same lines, revocable TOD costs will probably be significantly less than those to prepare a revocable trust agreement.

Despite those advantages, the downsides to a revocable TOD deed are daunting. Unlike revocable trusts, revocable TOD deeds can't be used to avoid estate taxes upon the death of the transferor (although the value of the estates of likely users of revocable TOD deeds may fall below the thresholds for various state and federal estate taxes).

More generally, many transferors may find the device too limited in scope and flexibility, since it only addresses residential real estate and ignores other types of assets that would still be subject to probate, such as non-residential real property, cars and personal property like jewelry. Others may find it insufficiently flexible since it can't accommodate different classes of transferees and the transferor must transfer all of their interest in the residential real property. If the real property is held in a joint tenancy or as community property with right of survivorship and the transferor is the first joint tenant or spouse to die, then the revocable TOD deed is ineffective. And despite the ease with which the statute allows revocable TOD deeds to be revoked, some title insurers have taken the position that they will still reflect a now-revoked revocable TOD deed, and the effect of the later revocation, as exceptions to title in their issued policies, a distinctly unpleasant title exception for later buyers and lenders.

The cautious attitude of title insurance companies toward revocable TOD deeds could further limit the attractiveness of revocable TOD deeds as an estate-planning device. At least one national title insurance company's underwriting policy requires an in-depth factual investigation and senior underwriting review and approval to issue a new owner's policy of title insurance following the death of a revocable TOD deed grantor. There is also a real possibility that title commitments and some policies of title insurance will show an exception to title for the interest of the grantee/beneficiary, something that lenders and new owners could find unpalatable.

In evaluating revocable TOD deed legislation in 2006, the California Law Revision Committee discussed a philosophical problem: Are these deeds simply a self-help substitute for estate planning for the elderly that may actually keep their users from obtaining competent estate-planning advice and therefore result in adverse consequences, where another method or device might be more appropriate? Along the same lines, some opponents (including the California Land Title Association) raised the possibility of the effect of fraud, incompetency and duress in the making of revocable TOD deeds by elderly and vulnerable users.

With the advent of revocable TOD deeds in California, it's unclear whether they will prove to be a worthwhile addition to estate-planning strategies or just a niche tool, to be used in narrow circumstances or, sadly, by unsophisticated parties without qualified advisors. For now they represent an interesting estate-planning alternative to probate but one whose usefulness may be outweighed by serious and uncertain outcomes.

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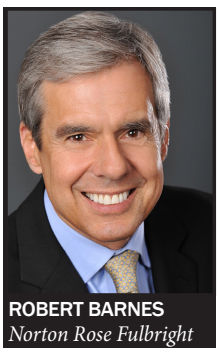

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