Study L-3032 October 24, 2006

First Supplement to Memorandum 2006-38

Beneficiary Deeds
(Additional Comments on Tentative Recommendation)

Attached to this memorandum is the following comment received after issuance of Memorandum 2006-38, concerning the tentative recommendation on *Revocable Transfer on Death (TOD) Deed* (August 2006).

MULTIPLE OWNERS

Joint Tenancy and CPWROS

David Mandel, of the Senior Legal Hotline, is concerned about the treatment of a revocable TOD deed that is jointly executed by co-owners of property held in survivorship form — i.e., held as joint tenants or as community property with right of survivorship. Exhibit pp. 1-4.

He indicates that large numbers of his clients — low income elderly people — are homeowners and the vast majority of them hold title in survivorship form. "Their conscious wish, by and large, is for the surviving spouse to assume full, unimpeded ownership upon the death of the first." Exhibit p. 2.

Mr. Mandel notes that if a jointly-executed revocable TOD deed were to create a different result, such as passage of the interest of each owner to the TOD beneficiary on the death of that owner (as advocated by the staff) that would have serious consequences for the survivor:

- It will often trigger reassessment for property tax purposes, taking a significant bite out of what may be suddenly reduced income following the first spouse's death.
- Unless the new co-owner(s) quitclaim title back to the surviving JT, s/he will be precluded from ever using accumulated equity, through a reverse mortgage, for instance, to ensure the ability to remain in the house by funding repairs, home care, etc.

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

- A surviving JT often prefers to sell the house and move after the other's death. That will be impossible without cooperation of the new co-owner(s), and even with their cooperation, they would have no legal obligation to give their share of the proceeds to the surviving JT.
- A debt of the non-resident co-owner could easily become a lien against the home.

He indicates that, while it would be possible to avoid these consequences by drafting for the result desired by a particular couple, many will not be represented by counsel or obtain legal advice.

Mr. Mandel therefore advocates that if a revocable TOD deed is jointly executed by co-owners who hold the property in survivorship form, the deed should not take effect until the death of the survivor. The TOD deed would remain entirely revocable by the survivor, "as with the typical couple's inter vivos trust". Exhibit p. 3.

He would also provide a separate statutory deed form, for use by co-owners who hold their property in survivorship form and who wish jointly to designate a POD beneficiary. The title and introduction to the form would explain succinctly that it is for use by two or more joint owners who wish jointly to name beneficiaries. The form would then offer a simple, clear choice between two options — irrevocability on the death of the first, or only on the death of the last.

"Without undue complication, this would enable use of the TOD deed by large numbers of the intended members of the public — perhaps even a majority — who would otherwise be at risk of having their true intent foiled and perhaps being caused significant harm during the remainder of their lives." Exhibit p. 3.

Staff Analysis

The staff believes that Mr. Mandel makes a powerful case for the position that property held in survivorship form should pass to the survivor before passing to the ultimate TOD deed beneficiary, and that the deed should remain revocable until the death of the last co-owner.

The staff agrees that in many situations that is the result that would be desired by co-owners. However, in many other situations that would not be. As the California Judges Association points out, a common source of litigation is the attempt of a surviving spouse to change a disposition made by a deceased spouse. (CJA would simply preclude joint execution of a revocable TOD deed by co-owners.)

The staff believes that co-owners should be able to jointly execute a revocable TOD deed, and should be allowed to specify whether or not anything passes to the TOD beneficiary on the death of the first co-owner. The real questions are (1) what should be the default rule if the co-owners fail to specify the consequences, and (2) what should be the contents of the statutory form revocable TOD deed?

Default Rule

If co-owners jointly execute a revocable TOD deed but fail to indicate the consequences on the death of the first co-owner, should the law provide that the interest of the decedent passes to the TOD beneficiary or should the law provide that the interest of the decedent passes to the surviving co-owners and then to the TOD beneficiary on the death of the last surviving co-owner?

The staff has taken the position that the interest of the decedent should pass to the TOD beneficiary immediately. We are concerned that otherwise the surviving co-owner could encumber or waste the property, or even revoke the TOD deed completely, thereby frustrating the dispositional plan of the first to die of the co-owners.

A typical scenario involves a joint tenancy between spouses who name their children as TOD beneficiaries of the property. After the death of the first spouse, the survivor remarries, revokes the deed and passes the property to the second spouse rather than the children of the first spouse. When a joint tenant names a TOD beneficiary, does the joint tenant really intend that the interest goes to the named beneficiary only at the discretion of the survivor? We do not think the law should allow the dispositive scheme of the first decedent to be defeated in that way unless the co-owners affirmatively agree to it.

Mr. Mandel argues for a default rule that would give the survivor full flexibility to deal with and dispose of the property. That position is based on his experience with his clients:

> The vast majority of couples who own their homes do so in one form or the other that includes a right of survivorship. Their conscious wish, by and large, is for the surviving spouse to assume full, unimpeded ownership upon the death of the first. And to some extent, the public has been educated that ownership WROS ensures this outcome, superceding, for instance, any claims by beneficiaries named in the individual will of the first spouse to pass.

Exhibit p. 2. Under the default rule proposed by Mr. Mandel, nothing would pass to the TOD beneficiary on the death of the first co-owner unless the deed affirmatively requires it.

Which rule should be the default depends to a large degree on the Commission's sense of what most people would want. Mr. Mandel has a lot of experience, and he is not alone in his perspective. On the other hand, other experts in this field who have commented on the tentative recommendation, including the California Judges Association and the Executive Committee of the State Bar Trusts & Estates Section, see it differently.

A major reason to stick with the rule that the interest of a co-owner passes to the TOD beneficiary on the death of that co-owner as the default is that it is significantly simpler. If we were to prescribe as a default that the interest of a co-owner passes to the survivors and then to the TOD beneficiary, subject to revocation by a survivor, we would need to write a complex set of rules governing ownership rights among survivors, the consequences of revocation by one survivor but not all, etc. Those rules should be stated in the revocable TOD deed by co-owners who want that result, not by a complex statutory scheme.

Statutory Form Deed

Mr. Mandel raises the possibility of two statutory form deeds, rather than one. Although he agrees with the basic concept of a simple deed with a few basic options, he thinks that the circumstances of a jointly executed deed demand a separate form:

> Nevertheless, I would suggest that <u>for this one purpose only</u>, because it stands to affect such a high proportion of TOD deed users, a second form be developed and incorporated into the legislation. The title and introduction could explain very succinctly that it is for use by two or more joint owners who wish to jointly name beneficiaries. And it would then offer a simple, clear choice between the two options: Irrevocability upon the death of the first, or only upon the death of the last. It can easily further explain that if the second option is chosen, then a surviving co-owner(s) will retain full power to revoke or amend the deed after the death of the first.

Exhibit p. 3 (emphasis in original).

Is a separate form necessary to deal with the joint tenancy situation? A few lines could be added to the basic form, offering co-owners a choice. For example:

> **Joint Tenancy or Community Property With Right of Survivorship**
>
> If you own this property as joint tenancy or community property with right of survivorship and if your co-owners join in this deed, you may select one of the following options:
>
> _____ On the death of a co-owner, the interest of that co-owner shall pass to the named beneficiary and not to surviving co-owners.
>
> _____ On the death of a co-owner, the interest of that co-owner shall pass to surviving co-owners, and on the death of the last surviving co-owner the property shall pass to the named beneficiary. A surviving co-owner may revoke this deed as to the interest of that co-owner, including any interest acquired by reason of the death of a co-owner.

However, the staff can see numerous complications that are not addressed by this relatively simple provision. For example, what happens if an option is selected by one co-owner but not others, or if co-owners select different options? What happens if one co-owner revokes the deed before the death of any co-owner?

This is perhaps the reason Mr. Mandel suggests a separate deed form, which can include plenty of warnings and can detail various consequences. But to the staff, these complications suggest that perhaps **a statutory form deed should not be used at all for the survivorship option**:

> **Co-Owners**
>
> If you are a co-owner of this property, on your death your interest in the property will pass to the named beneficiary and not to surviving co-owners. IF YOU WANT A DIFFERENT RESULT, SUCH AS PASSAGE OF THE PROPERTY TO SURVIVING CO-OWNERS WITH THE RIGHT TO REVOKE THIS DEED, YOU SHOULD NOT USE THIS FORM BUT SHOULD CONSULT AN ESTATE PLANNING PROFESSIONAL.

That would not preclude a forms publisher from designing a form that would achieve the type of result that Mr. Mandel envisions.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

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October 22, 2006

California Law Revision Commission
9000 Middlefield Road
Room D-1
Palo Alto, CA 94303
(Sent by e-mail)

Re: Revocable transfer on death deed

Dear Commissioners:

As you know, I have followed your work on the TOD proposal closely, attended some of your meetings. I have been extremely impressed by the overall process and pleased that my previous comments and suggestions have been considered along the way, with some of them adopted in the current recommended legislation.

As before, I am contributing my opinions as an individual, not as a representative of my agency or of the senior legal services community. But also as before, my views reflect discussion among and input from others in that community.

There are a few items, an early recording requirement, for instance, where my conclusions have differed from the commission majority, but on this and several other points I can see the pros and cons of both sides of the argument and am not greatly concerned by the outcome. If it is discovered in future years that lack of an early recording requirement is causing an undue amount of fraud or confusion, that can be amended, as can other provisions.

In one fundamental matter, however, I am very concerned by the direction that the commission seems to be taking: That of a revocable TOD deed executed together by joint tenants – typically, but not necessarily, spouses – or as community property with right of survivorship, which for the purposes of this issue is identical. (For brevity, I will use JT in reference to both from hereon in when referring to this identical aspect.) I have written on this matter before, but will do so here at greater length; and I will cite some statistics from our practice that I hope will help to persuade.

The recommendation sets a default rule for co-owned property subject to a TOD deed in proposed Sec. 5662 (a): "The property interest of a co-owner passes to the beneficiary on the death of that co-owner." In the absence of an exception elsewhere in the statute this applies to all co-owned property, including that held in a manner for which right of survivorship between co-owners would normally apply. In other words, at the death of the first spouse or other joint tenant, the effect of the joint tenancy is immediately and irrevocably nullified. The survivor does not attain ownership of the entire property but instead becomes a co-tenant with one or more people named as beneficiaries on the TOD deed.

Subsequent Section 5664 properly affirms the rule for a holder in JT who separately

executes a TOD deed – an act which on its face indicates an intent to effect a severance upon his or her death. Section 5668 then confirms the same for CPWROS, and Section 5666 dictates the necessary differentiation between JT and CP as far as notice is concerned. I have no problem with any of these sections.

But application of the same rule to couples who hold property as JTs and <u>together</u> execute a TOD deed will result in unintended consequences severely detrimental to a large number of people that the TOD deed legislation is intended to serve.

Over the past decade, the Senior Legal Hotline (SLH) has counseled thousands of seniors in situations that would have made them likely victims of such unintended error. This year to date, we have handled 707 cases involving requests for assistance with "estate planning/wills and trusts." Of those, approximately 271 involved married couples. (Some extrapolation is necessary, as full demographic data are not always obtained.)

Of the 707 cases, 443 involved clients who owned their own homes. Of the 194 identified as low-income, 116 were homeowners. Moreover, SLH low-income figures are known to be significantly understated, due to data collection issues; and a large majority of those who don't fall into the "low-income" category are, thanks to Social Security, barely over the line. These will be the users of TOD deeds.

The vast majority of couples who own their homes do so in one form or the other that includes a right of survivorship. Their conscious wish, by and large, is for the surviving spouse to assume full, unimpeded ownership upon the death of the first. And to some extent, the public has been educated that ownership WROS ensures this outcome, superceding, for instance, any claims by beneficiaries named in the individual will of the first spouse to pass.

A diametrically opposite outcome caused by use of a TOD deed as a will substitute – which is how the commission has declared it views the instrument – would be not only surprising to many former JTs. Even though they might have no quarrel with the identity of the ultimate beneficiary/ies, being forced to share ownership prematurely with even an intended heir can have dire consequences:

- It will often trigger reassessment for property tax purposes, taking a significant bite out of what may be suddenly reduced income following the first spouse's death.
- Unless the new co-owner(s) quitclaim title back to the surviving JT, s/he will be precluded from ever using accumulated equity, through a reverse mortgage, for instance, to ensure the ability to remain in the house by funding repairs, home care, etc.
- A surviving JT often prefers to sell the house and move after the other's death. That will be impossible without cooperation of the new co-owner(s), and even with their cooperation, they would have no legal obligation to give their share of the proceeds to the surviving JT.
- A debt of the non-resident co-owner could easily become a lien against the home.

We are certain that couples who call SLH, as well as singles, will be very interested in using TOD deeds. For those who do in fact call us, we may be able to create a customized deed form, if the statute permits, that would give precedence to the surviving JT's right of survivorship, triggering the transfer to a TOD beneficiary only after the death of the second.

But even under the best of circumstances regarding SLH's ability to serve more members of

the public, many, many couples will not call us or obtain other quality legal advice. They will read or hear that JT/CPWROS trumps a beneficiary designation in a will and assume that the same applies to this will substitute. And they will be in for a very unpleasant – often damaging – surprise.

I therefore believe that the statute should determine a different default for JTs who jointly execute a TOD deed: It should not take effect until the death of the second, and as with the typical couple's inter vivos trust, should remain entirely revocable by the survivor(s).

I believe a large part of what led the commission staff and others to take the other route until now is the desire to include in the legislation a relatively simple model deed form that could be used successfully by most people for whom this instrument is designed. I concur with this desire; and I recognize that establishment of a different default for joint tenants would complicate matters on the form. Moreover, the commission has been reluctant to see the legislation result in the creation of multiple deed forms for the many different scenarios that could exist depending on who is using the instrument and what his or her intentions are. I also concur with this sentiment, in general.

Nevertheless, I would suggest that for this one purpose only, because it stands to affect such a high proportion of TOD deed users, a second form be developed and incorporated into the legislation. The title and introduction could explain very succinctly that it is for use by two or more joint owners who wish to jointly name beneficiaries. And it would then offer a simple, clear choice between the two options: Irrevocability upon the death of the first, or only upon the death of the last. It can easily further explain that if the second option is chosen, then a surviving co-owner(s) will retain full power to revoke or amend the deed after the death of the first.

Without undue complication, this would enable use of the TOD deed by large numbers of the intended members of the public – perhaps even a majority – who would otherwise be at risk of having their true intent foiled and perhaps being caused significant harm during the remainder of their lives.

I would therefore rewrite Section 5662 as follows (additions are underlined), and would draft a second model deed form for use by co-owners, as described above.

5662. Co-owned property

5662. If co-owners of real property join in a revocable transfer on death deed of the property, unless the deed otherwise provides:

(a) For joint ownership that includes a right of survivorship, that right of survivorship remains in effect unless severed and the property interest passes to the TOD beneficiary only upon the death of the last of the joint owners. Surviving owners may revoke or amend the TOD deed even after the death of such a joint owner.

(b) For joint ownership that does not include a right of survivorship, the property interest of a co-owner passes to the beneficiary on the death of that co-owner.

(c) A co-owner may revoke the transfer on death deed as to the interest of that co-owner. The revocation does not affect the transfer on death deed as to the interest of another co-owner.

(d) If a co-owner with right of survivorship effects such a revocation and one or more other co-owners do not, the right of survivorship is terminated as for the co-owner who revokes. If there are more than one other co-owner, the right of survivorship remains in effect among them.

* * *

I have three further brief remarks relating to comments by others discussed in memo 2006-38, page 18:

- John A. Cape's excellent letter (Ex. 15-17), includes a paragraph expressing exactly the concerns I have stated above. Unfortunately, that paragraph is quoted (page 14) in the discussion on life estates, due to his apparent mislabeling of it in his letter. Nevertheless, the example in that paragraph of his comment hits the nail on the head. Elsewhere, he also concurs with my recommendation for a default giving precedence to right of survivorship when a deed is executed by co-owners under that condition.
- The solution to this dilemma suggested by the California Judges Association (Ex. 23-24) is that joint TOD deeds should be "discouraged." Mary Pat Toups (Ex. 9-10) goes further and says they should not be allowed. I believe this is the wrong way to go. Creating an explicit, clearly explainable option consistent with the wishes of a very large segment of the public eager to use TOD deeds is far preferable to making it difficult or even impossible for them to use them.
- The State Bar Trusts and Estates Section (Ex. 25-30) is much closer to the right track in suggesting that co-owners executing a deed jointly be given a choice. This is exactly what I am proposing. Only instead of a one-size-for-all default on a form that is a misfit for a large section of the population, I suggest two separate defaults on two separate forms, clearly distinguishable by users: one for sole owners, one for joint owners.

* * *

Finally, I am reminded in my very first comments on this issue, written when the original AB12 was being considered by the Assembly Judiciary Committee and long before the commission began its work, I drafted two deed forms, one for use by a single owner, one for joint owners. In many areas, my thinking on the subject of TOD deed provisions has evolved in the 18 months that have passed since then. I have come to appreciate the many complications and related issues that the commission has dealt with so admirably.

If I were asked to rewrite my draft deeds today, they would be vastly improved in light of the commission's excellent work, and in some ways, much simpler. But this fundamental need to distinguish the typical needs and desires of joint owners with right of survivorship from those of others remains. I truly hope the commission will come to see the logic and wisdom of enshrining this distinction in the proposed statute and in two model deeds.

Respectfully submitted,

David L. Mandel
Supervising Attorney