

Memorandum 2018-58

**Revocable Transfer on Death Deed: Follow-Up Study
Creditor Claims**

In 2006, the Commission¹ recommended that California authorize the use of a revocable transfer on death deed (“RTODD”) to transfer real property on death, outside of probate.²

In 2015, Assembly Bill 139 (Gatto) was enacted to implement the Commission’s recommendation (with some significant changes).³ Among other things, the Legislature added a “sunset” provision, which will repeal the RTODD statute on January 1, 2021 (unless the sunset is extended or repealed before it operates).⁴ In addition, the law requires the Commission to conduct a follow-up study of the efficacy of the RTODD statute, and make recommendations for the improvement or repeal of that law.⁵

This memorandum continues the Commission’s ongoing review of the efficacy of the RTODD statute.

Unless otherwise indicated, all further statutory references in this memorandum are to the Probate Code.

Note: In conducting this study, the Commission will examine a number of specific ways in which the law might be improved. The fact that the Commission is considering those specific issues does not mean that the Commission has reached a decision on the general question of whether the RTODD statute should be repealed or continue in effect. It has not done so.

1. 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.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm’n Reports 103 (2006).

3. AB 139 (Gatto), 2015 Cal. Stat. ch. 293; Prob. Code §§ 5600-5696.

4. Prob. Code § 5600(c).

5. 2015 Cal. Stat. ch. 293, § 21.

BACKGROUND

As a general matter, the beneficiary of an RTODD is personally liable for the transferor's unsecured debts, up to the value of the transferred property.⁶

As an alternative to personal liability, Section 5676 authorizes the decedent's personal representative to pull transferred property back into the decedent's estate for the purpose of paying creditor claims.

Memorandum 2018-33 discussed whether the possibility that a personal representative might pull RTODD property back into the estate could cast a problematic cloud on the beneficiary's title to that property.⁷ In response to that concern, the Commission tentatively decided that Section 5676 should be repealed.⁸ The beneficiary would remain personally liable for the deceased transferor's unsecured debts, but the transferred property could no longer be pulled back into a probate proceeding for the payment of such debts.

In raising the possibility of repealing Section 5676, the staff noted that there might be some other reforms that would need to be made in order to accommodate the repeal.⁹ This memorandum discusses that issue.

SCOPE OF LIABILITY

As noted above, a beneficiary of an RTODD is personally liable for decedent's unsecured debts *up to the total value of the transferred property*.

That scope of liability makes sense if the RTODD property is the only asset available to pay creditor claims. For example, if all of the decedent's other property is conveyed by forms of nonprobate transfer that are not liable for creditor claims (e.g., joint tenancy, pay-on-death bank account), then the RTODD property would be the only asset that is available for the payment of creditors. In that situation, personal liability up to the full value of the ROTDD seems proper.

However, there will be situations in which the decedent has other property that could be used to pay the decedent's debts (e.g., property that is passing in probate or by revocable trust). As a general rule, such property is liable for payment of the decedent's unsecured debts.¹⁰

6. Section 5672. See also Section 5674 (scope of liability).

7. Memorandum 2018-33, pp. 15-23.

8. Minutes (Aug. 2018), p. 13.

9. Memorandum 2018-33, p. 23.

10. See Section 9003 (probate), 18200 (revocable trust).

In that situation, it would seem unfair for the RTODD beneficiary to bear *all* of the liability for the decedent's debts (which could happen if the debts are less than the value of the RTODD property and the creditors choose to enforce their debts solely against the RTODD beneficiary). There should be some mechanism for a fair allocation of the debt between the decedent's different assets (as there is in probate).

Existing law provides a solution to that problem, which is described below. However, the existing solution depends on the return of RTODD property to the probate estate under Section 5676. If that provision is repealed, the Commission may wish to develop an alternative remedy. That possibility is also discussed below.

Existing Solution

In probate and trust administration, the allocation of decedent debt between heirs, devisees, or trust beneficiaries is governed by statutory rules of "abatement." Those rules determine the order in which gifts are abated to satisfy the decedent's obligations.

Section 21402 provides the default abatement order that governs wills and trusts:

- (a) Shares of beneficiaries abate in the following order:
 - (1) Property not disposed of by the instrument.
 - (2) Residuary gifts.
 - (3) General gifts to persons other than the transferor's relatives.
 - (4) General gifts to the transferor's relatives.
 - (5) Specific gifts to persons other than the transferor's relatives.
 - (6) Specific gifts to the transferor's relatives.
- (b) For purposes of this section, a "relative" of the transferor is a person to whom property would pass from the transferor under Section 6401 or 6402 (intestate succession) if the transferor died intestate and there were no other person having priority.

For the purposes of those rules, a "general gift" is a "transfer from the general assets of the transferor that does not give specific property" (e.g., \$10,000).¹¹ A specific gift is "a transfer of specifically identifiable property" (e.g., my watch).¹² Gifts within the same abatement class abate pro rata.¹³

11. Section 21117(a).

12. Section 21117(b).

13. Section 21403.

The mechanism by which existing law applies the abatement rules to an RTODD is Section 5676. Once RTODD property is pulled back into probate administration under that provision, the abatement rules can be applied to determine the RTODD beneficiary's share of the liability. This is stated expressly in Section 5676(f), which provides:

If property is restored to the transferor's estate under this section, that property shall be treated as a specific gift and any proceeds remaining from the sale of the property after the payment of claims shall be returned to the beneficiary.

Once that process has been initiated and the property has been returned, the beneficiary's personal liability under Section 5672 ends. This is stated in Section 5674(a), which provides:

A beneficiary is not liable under Section 5672 if proceedings for the administration of the transferor's estate are commenced and the beneficiary satisfies the requirements of Section 5676.

The Commission's Comment to Section 5672 makes clear that this is the intended way for an RTODD beneficiary to avoid excess liability under Section 5672:

A beneficiary who wishes to avoid the liability imposed by this section may commence a probate proceeding and return the property to the estate under Section 5676.

While that process would work to insulate an RTODD beneficiary from personal liability under Section 5672, its real world effect is not entirely clear.

As a practical matter, what would it mean to "make restitution to the decedent's estate of the property the beneficiary received pursuant to the revocable transfer on death deed..."¹⁴ Must the beneficiary transfer title to the estate? Vacate the premises? That could impose a significant burden if the beneficiary depends on the property as a residence. If the personal representative determines that the RTODD property is liable for a share of the decedent's debts, must the property be sold, with the remaining value returned to the beneficiary as a cash payment? The statute as drafted seems to contemplate that result. But that could be unduly burdensome if the beneficiary wishes to keep the property and has sufficient liquid funds to pay his or her share of the debt outright.

14. Section 5676.

Those kinds of problems also seem to exist in the procedures for disposition of estate property without administration, which are the subject of Study L-4130. For a discussion of the issue in that context, see Memorandum 2018-62.

The uncertainty discussed above would not exist if Section 5676 is repealed. But repeal of that section would also eliminate the mechanism for applying general abatement rules to the RTODD and foreclosing the RTODD beneficiary's personal liability. A possible alternative to that approach is discussed below.

Possible Alternative Approach

As discussed above, Section 5676 provides a mechanism for application of the general abatement rules to RTODD property. But there is another way to achieve the same result.

A new provision could be added to the Probate Code, which would permit an RTODD beneficiary to require the personal representative to determine how much the RTODD beneficiary should pay the estate to satisfy the RTODD property's share of the estate's liability. On payment of that amount to the estate, the RTODD beneficiary's personal liability would end.

That would impose some additional administrative costs on the estate, but that cost could either be absorbed by the estate generally, or it could be specifically allocated to the RTODD beneficiary (whose receipt of property outside of probate is the reason for the additional expense).

Existing Section 5676(d) makes clear that the cost of proceeding under that section is an expense for which the personal representative can be reimbursed: "The reasonable cost of proceeding under this section shall be reimbursed as an extraordinary service under Sections 10801 and 10811." However, the provision says nothing about charging the expense to the RTODD beneficiary. Presumably, the cost is absorbed into the costs of administration and allocated pursuant to general abatement rules.

The approach described above could be implemented by replacing existing Section 5676 with a provision along these lines:

5676. (a) If proceedings for the administration of the transferor's estate are commenced, a beneficiary may submit a written request to the personal representative for a determination of the beneficiary's liability for the unsecured debts of the transferor.

(b) On receipt of a request pursuant to subdivision (a), the personal representative shall determine the share of liability for the decedent's unsecured debts that should be allocated to the property

that was transferred to the beneficiary by revocable transfer on death deed.

(c) In making a determination under subdivision (b), the following rules shall be applied:

(1) The abatement rules provided in Part 4 (commencing with Section 21400) of Division 11 shall be applied as if the property that was transferred to the beneficiary by revocable transfer on death deed were part of the decedent's estate.

(2) The value of the property received by the beneficiary pursuant to the revocable transfer on death deed shall be deemed to be the fair market value of the property at the time of the transferor's death, less the amount of any liens and encumbrances on the property at that time.

(3) The property received by the beneficiary pursuant to the revocable transfer on death deed shall be deemed to be a specific gift.

(d) The personal representative shall provide a written determination of liability to the beneficiary, which states the amount that must be paid to the estate to satisfy the share of the decedent's unsecured debts that was allocated to the property transferred by revocable transfer on death deed.

(e) The reasonable cost of proceeding under this section shall be reimbursed as an extraordinary service under Sections 10801 and 10811. [The beneficiary is liable for the payment of that cost, which shall be separately identified in the written determination of liability.]

The bracketed language in subdivision (e) was included to show how the cost of proceeding under the proposed procedure could be charged to the beneficiary who initiated the process. If the bracketed language is not included in subdivision (e), the cost of proceeding would presumably be absorbed into the overall costs of administration and allocated under general abatement principles.

If such a procedure were created, a conforming change would need to be made to Section 5674(a), along these lines:

(a) A beneficiary is not liable under Section 5672 if proceedings for the administration of the transferor's estate are commenced and the beneficiary satisfies the requirements of has paid the transferor's estate the amount identified in a written determination of liability prepared pursuant to Section 5676 [, including the cost imposed pursuant to subdivision (e) of Section 5676].

Again, the bracketed language would only be needed if the law were to impose the cost of proceeding under proposed Section 5676 on the beneficiary who initiates the process.

If a procedure along the lines set out above is not created and Section 5676 is repealed, Section 5674(a) would need to be deleted.

The Commission should consider whether to include a reform along the lines discussed above in any tentative recommendation in this study (if the Commission decides to recommend that the RTODD law continue, rather than being sunsetted). If so, the Commission should also consider whether to impose the costs of the proposed procedure on the beneficiary who initiates it.

RELATED ISSUES

Existing Section 5674(b) dictates how RTODD property should be valued, for the purposes of determining the scope of an RTODD beneficiary's personal liability for the transferor's unsecured debts:

(b) The aggregate of the personal liability of a beneficiary under Section 5672 shall not exceed the sum of the following:

(1) The fair market value at the time of the transferor's death of the property received by the beneficiary pursuant to the revocable transfer on death deed, less the amount of any liens and encumbrances on the property at that time.

(2) The net income the beneficiary received from the property.

(3) If the property has been disposed of, interest on the fair market value of the property from the date of disposition at the rate payable on a money judgment. For the purposes of this paragraph, "fair market value of the property" has the same meaning as defined in paragraph (2) of subdivision (a) of Section 5676.

Paragraph (1) establishes the baseline value of the property as the fair market value of the property at the time of the transferor's death. The same rule would be used in proposed Section 5676(c)(2) above.

Paragraphs (2) and (3) make adjustments to the baseline value, adding income received from the property and interest (if the beneficiary disposed of the property). Those provisions parallel some of the adjustments made in Section 5676, when the personal representative requires the return of RTODD property (or its value) to the estate.

If Section 5676 is repealed, it is not clear that the adjustments in Section 5674(b)(2) and (3) should be continued.

The Commission has a pending recommendation on the amount of interest to be charged in parallel provisions that govern the disposition of estates without administration, which concluded that the 10% interest rate payable on a money

judgment was too high.¹⁵ **If the interest rate adjustment is continued in Section 5674(b)(3), the Commission should consider extending its recommended interest rate reforms to Section 5674. Either way, the cross-reference to Section 5676 should be deleted.**

The Commission is actively studying the rule imposing beneficiary liability for “net income” in the provisions that govern the disposition of an estate without administration. It has identified some thorny problems in that area.¹⁶ **If the Commission eventually proposes reforms to address the issue in that context, the same reforms should be considered for inclusion in the RTODD statute.**

A much simpler approach would be to simply repeal Section 5674(b)(2) and (3). When imposing liability up to the value of a piece of real property in California, it is unlikely that adjustments at the margin would be worth the added complexity and cost of making them. In all likelihood, the value of the real property would be more than adequate to pay a decedent’s unsecured debts. **The staff favors that approach.**

The Commission should consider how to address this issue.

Respectfully submitted,

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15. *Disposition of Estate Without Administration: Interest Rate* (Aug. 2018).

16. See Memorandum 2018-45.