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PROBATE: WHAT IT IS AND WAYS TO AVOID IT

I. WHAT IS PROBATE?

Probate is the legal process for settling an estate after someone has died. It is also known as estate administration. The main purpose of probate is to provide inheritors of a deceased person's property with clear title to the property.

During probate, the decedent's personal representative (also called the executor if the decedent left a will or the administrator if the decedent did not have a will) locates the decedent's assets, pays his or her debts, and distributes the remainder of the estate to the inheritors. If the decedent left a will, the inheritors are the beneficiaries named in the will. If the decedent died without a will (intestate), the inheritors are the heirs specified by state law.

Probate isn't always required after a death. A deceased person's property can be divided into two categories: assets that have to be probated (probate assets) and assets that don't (non-probate assets). No probate will be necessary if the decedent owned only non-probate assets.

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II. PROPERTY THAT MUST BE PROBATED

A. PROBATE ASSETS

Probate assets are (1) property the decedent owned solely in his or her name, (2) property the decedent owned as a tenant in common with one or more co-owners, and (3) personal property that does not have title documents. Sometimes whether a personal effect is subject to probate depends on the fair market of the item as determined by state law.

Examples of probate assets include:

- Real estate titled solely in the decedent's name or titled in tenancy in common (not joint tenancy) regardless of value. Coins, clothing, jewelry, furniture, appliances.
- Motor vehicles titled solely in the decedent's name including cars, boats, and RVs. Proceeds of life insurance on the decedent's life payable to the decedent's estate. Brokerage or retirement accounts that designate the decedent's estate as the beneficiary.
- Business interests like a partnership or LLC membership, or shares in a corporation held in the decedent's name

Non-probate assets generally fall into three categories:

- Assets that pass by right of survivorship.
- Assets that pass by beneficiary designation.
- Assets held in trust.

B. NON-PROBATE ASSETS

Non-probate assets completely bypass the court process and go directly to the named beneficiary. They don't require a probate court order to pass the title.

Examples of non-probate assets in the first category include:

- Real estate held in joint tenancy with rights of survivorship. Under this type of title, the decedent's share of the property passes to the surviving person listed on the title.
- Bank and brokerage accounts held in jointly with right of survivorship.
- Automobiles, boats or RVs titled jointly with rights of survivorship.

Non-probate assets in the second category include:

- Real estate subject to a transfer on death deed (TODD).
- Bank and brokerage accounts with transfer on death (TOD) or payable on death (POD) beneficiaries.
- Life insurance on the decedent's life that designates someone other than the decedent's estate as the beneficiary.
- Retirement accounts that name a beneficiary other than the decedent's estate.
- Non-probate assets in the third category include:
- Any property held in a revocable living trust.

C. PROBATE ESTATE VS. TAXABLE ESTATE

People often confuse the probate estate with the taxable estate. A decedent's probate estate and his or her estate for estate tax purposes are two different things. A decedent's probate estate consists only of property that passes through probate. A decedent's estate for estate tax purposes consists of all property the decedent owned at death, regardless of whether it must be probated. It includes real estate, trusts, cash, investments, insurance, vehicles, jewelry, and other personal property.

For example, you may own insurance on your life with a named beneficiary. As long as the beneficiary is living when you die, the insurance proceeds will pass to the beneficiary as a non-probate asset.

However, the entire death benefit paid to your beneficiary will be counted in calculating the amount of your taxable estate. The insurance proceeds won't be part of your estate for tax purposes if someone other than you, such as an Irrevocable Life Insurance Trust (ILIT), owns the policy.

Since the threshold for federal estate tax is so high, most estates do not have to pay estate tax.

III. WHAT HAPPENS DURING PROBATE

A. OVERVIEW

The functions of probate are to:

- Validate the will, if the decedent left one, and appoint a personal representative to settle the estate.
- Identify, inventory, and value all probate property included in the decedent's estate. Enforce the estate's rights to income and property to which the decedent was entitled. Handle any matters involving the decedent's business interests.
- Pay the decedent's debts and taxes, including estate taxes if any are due.
- Resolve any disputes among the potential inheritors or between the estate and potential inheritors, creditors, or other parties.
- Distribute property to beneficiaries of a will or heirs as provided by law if the decedent did not leave a will.

As outlined below, probate can be supervised or unsupervised and contested or uncontested.

B. SUPERVISED VS. UNSUPERVISED PROBATE

In many states, a probate procedure can be either supervised (also known as dependent administration) or unsupervised (also known as independent administration). In a supervised probate, the probate court assumes a greater role. The decedent's personal representative must get court approval before conducting financial transactions or making major decisions regarding the estate. For example, the personal representative may need to get the court's approval before selling the decedent's home.

An unsupervised probate allows the executor to make decisions about the estate and distributions without having to report to the court. If the decedent died with a will, the executor must follow the deceased's wishes outlined in the will.

In general, unsupervised probate estates tend to move faster through the probate process because the court does not need to be as involved. Depending on state law and circumstances, you can specify whether or not you want your estate to be supervised in your will. If you die without a will, or if you don't specify your preference, whether your estate is supervised may be determined by its value. For example, in many states, estates valued under $50,000 in total assets are automatically designated as unsupervised estates.

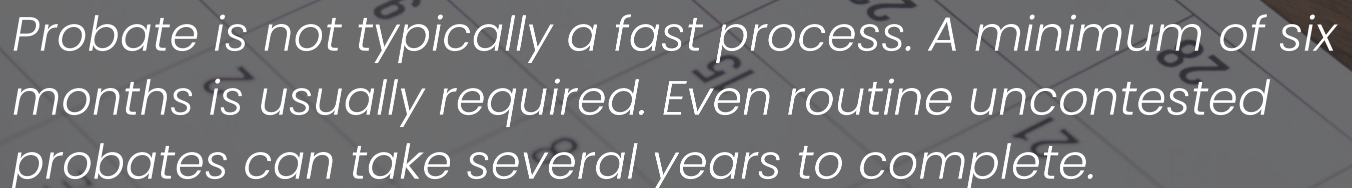
C. CONTESTED VS. UNCONTESTED PROBATE

Probate can be contested or uncontested. Most contested issues arise because a disgruntled heir is seeking a larger share of the decedent's property than what he or she actually received.

Arguments often raised include:

- The decedent was improperly influenced in deciding how to leave his or her property.
- The decedent did not have sufficient mental capacity to understand what he or she was doing at the time the will was executed.
- The decedent did not follow the necessary legal formalities in drafting his or her will and so the will is invalid.

The majority of probated estates, however, are uncontested.



IV. MAKING THE DECISION

A. WHY YOU MIGHT WANT TO AVOID PROBATE

Probate expenses can shrink your estate significantly. Cost is probably the most important reason people decide to avoid probate. Attorneys' fees are often the biggest expense. Most personal representatives decide to hire an attorney to navigate the probate process. It can be difficult for a non- attorney to figure out the procedures, forms, and deadlines. Courts do not always have clear instructions available for non-lawyers or staff available to help. Some states require the personal representative to hire an attorney. Attorneys' fees can be expensive. In some states, they are based on the value of the estate. In others, on the amount of time the attorney spends and what the judge thinks is reasonable. It is not unusual for them to run into the tens of thousands of dollars depending on the complexity and size of the estate and whether the estate is contested.

Additionally, there can be fees for executors, court filings, appraisers, and other expenses, such as real estate taxes, insurance, utilities, and property maintenance. These fees are all deducted from the estate and can take a big bite out of it. For smaller probated estates, fees can greatly diminish the distributions the heirs receive.

Probate can take a long time. Probate is not typically a fast process. A minimum of six months is usually required. Even routine uncontested probates can take several years to complete. If probate is contested, it can take many years to settle the case. While the probate drags on, the beneficiaries and heirs wait to get their distributions. By contrast, when probate avoidance methods are used, property transfers can be completed in weeks.

Probate filings are public. Many court probate filings are a matter of public record. Probate could open up information to the public that you would prefer to keep confidential.

B. WHY YOU MIGHT NOT WANT TO AVOID PROBATE

You live in a state where probate is streamlined and relatively inexpensive. Avoiding probate is generally a good plan. However, in some states probate is less complicated and expensive than in others. In these states, the costs of probate avoidance may exceed the costs of probate if your method of avoiding probate is a revocable living trust. A revocable living trust is more expensive to have prepared than a will. Even once it is created, the trust must be maintained until death. If you bring your estate planning attorney an inventory of your assets and liabilities, he or she can advise you whether avoiding probate will save money in the long run.

Your estate qualifies for simplified or expedited procedures for small estates. Virtually all states have some type of expedited or simplified probate procedure for "small estates." One such procedure allows the inheritor to claim an asset with an affidavit. The inheritor simply signs an affidavit stating under oath that he or she is entitled to the asset under a will or state law and presents the affidavit with a death certificate to the person or institution (a bank, for example) holding the asset. What constitutes a "small estate" varies widely from state to state from ten or fifteen thousand to several hundred thousand dollars. If your most valuable assets are held as non-probate assets, any remaining assets that must pass through probate may qualify for simplified procedures.

You expect challenges to your estate plan. If you expect your estate plan to be challenged by disgruntled relatives, friends, or associates who are likely to be unhappy with your choices, probate offers an efficient forum in which to resolve the conflict. Challenges to a will or living trust are rare, and the grounds are limited and difficult to prove. They typically include fraud, undue influence, duress, or mental incompetence.

You have significant complex debt problems. Probate may be an advantage if you have many creditors. When an estate is probated, creditors have a deadline by which they must file claims against the estate. If a creditor misses the deadline, the debt is extinguished. Valid claims must be paid before your estate is administered. Your heirs or beneficiaries get their inheritance without worrying about creditors appearing to claim some or all of it. Few estates are in this category, however.

Your estate planning attorney can help you choose and implement the most appropriate methods for your property and estate planning goals.

V. WAYS TO AVOID PROBATE

Your estate planning attorney can help you weigh the pros and cons of probate and give you an idea of the probate costs in your jurisdiction. If you decide you want to avoid probate, you will need to minimize or eliminate your probate assets and convert them to non-probate assets.

The principal probate avoidance methods are explained in this section. They are:

- The revocable living trust (RLT).
- Joint tenancy with right of survivorship.
- Transfer on death deeds (TODDs) and vehicle registrations.
- Transfer on death/pay on death (TOD/POD) designated accounts and securities registrations. Beneficiary designations.
- Lifetime gifts.

Notice that a will is not included in this list. Disposing of probate assets in a will does not avoid probate.

In some cases, you may need more than one of these options to fully avoid probate. Your estate planning attorney can help you choose and implement the most appropriate methods for your property and estate planning goals.

A. REVOCABLE LIVING TRUST (RLT)

1. WHAT IS AN RLT?

An RLT is the most versatile probate avoidance mechanism, but also the most expensive to create and complex to maintain. An RLT is a trust that you create to hold your property while you are alive and to distribute it among your beneficiaries on your death.

The principal reasons for creating a living trust are to (1) avoid probate, (2) provide for property management during your life, especially if you become incapacitated, and (3) specify what should happen to your assets after your death. Like a will, an RLT can establish trusts that will go into effect on your death to minimize estate taxes and provide property management for your beneficiaries, including minors.

The typical living trust document:

- Names you as the trustee with the power to manage and access trust assets as you deem necessary.
- Names a successor trustee to take over management of the trust property for your benefit on your incapacity and to turn the trust property over to the beneficiaries after your death.
- Names the beneficiaries who are to receive the trust property on your death and specifies what specific assets or shares of the trust property they get.
- Provides that you can revoke or amend the trust at any time until your death, at which time the trust becomes irrevocable.

At your death, the successor trustee pays your taxes and debts and distributes the trust property to the beneficiaries in accordance with the terms of the trust. With a properly drafted and funded living trust, your estate will not need to go through probate. If no assets are in your name when you die, no probate will be needed to transfer title to your heirs.

As the settlor (creator) of the trust, you are able to manage, revoke, and change your trust based on your circumstances or wishes. You can also access assets placed in the trust during your lifetime. An asset must be in or owned by the trust at the time of your death to avoid probate.

Even if you establish a living trust, you should still have a will to dispose of any property you own that is not transferred to the trust.

2. ADVANTAGES OF AN RLT

RLT's are recognized everywhere and can be used to pass all types of assets. You can set up an RLT in any state and transfer to it the assets you own that would otherwise need to be probated. Assets that are commonly held in an RLT include real estate, bank accounts, motor vehicles, and life insurance and retirement plan distributions.

RLTs provide maximum flexibility in how you can distribute your assets. You can leave property in trust for minors or young adults or vulnerable beneficiaries, leave beneficiaries unequal shares, and defer distributions until the beneficiaries have reached specified ages or achieved certain milestones or accomplishments (e.g. college graduation). You can name contingent beneficiaries who will inherit if one or more of your primary beneficiaries die before you do. You can leave a bequest to a charitable organization.

If you decide you want to avoid probate, you will need to minimize or eliminate your probate assets and convert them to non-probate assets.

You keep control of trust assets. During your life, you have complete control over the trust assets, just as though the trust did not exist. You can use the trust property and any income generated by it as you please. If you want to sell or refinance trust property, you can do so in your capacity as trustee of the trust or you can transfer the property from the trust back to your own name, whichever the buyer, financial institution, or title company prefers.

You can amend or revoke the trust. During your life, you can change the terms of the trust as you see fit or revoke it entirely in a signed notarized document. For example, you may need to amend your trust to change your successor trustee or to add or remove beneficiaries or change what or how much you want to leave them.

You can provide for your incapacity. Should you become incapacitated, your successor trustee takes over the management of the trust assets and makes sure that your bills are paid and you are taken care of without the need for court intervention.

You can keep your estate plan private. By avoiding probate, your trust agreement remains a private document. Unlike a will that is admitted to probate, an RLT does not become a matter of public record. For this reason, RLTs are very popular with high profile individuals.

3. DISADVANTAGES OF AN RLT

An RLT is more expensive than a will (which does not avoid probate) and other probate avoidance devices. The upfront setup costs of an RLT can be expensive, often costing several thousand dollars.

Less expensive and less complex probate avoidance devices may be adequate for your estate. But they may not be available for all of your assets or have other drawbacks.

An RLT must be funded and maintained. To complete the creation of the trust, you must transfer your property into it. If the property is real estate, you must execute a new deed in which you hold the property as trustee of the trust.

Similarly, if the trust property has title documents (e.g., securities, bank accounts, vehicles), you must change the name on the title. Assets without title documents (e.g., jewelry, antiques, equipment) can be listed on a schedule that accompanies the trust document or you can sign a document transferring the ownership of specified assets to the trustee.

If your assets are not held in the trust at the time of your death, they can still be subject to probate.

B. JOINT TENANCY

1. WHAT IS JOINT TENANCY?

Joint tenancy is one way that people can co-own property. Joint tenancy is a method of avoiding probate because property held in joint tenancy comes with a right of survivorship. When one joint tenant dies, his or her share of the property passes to the other joint tenants automatically without any need for probate.

The right of survivorship is intrinsic or built-in to the form of ownership. A joint tenant cannot leave his or her interest in the property to anyone other than the other joint tenant(s). If a joint tenant tries to do so in a will, the bequest is void.

For example, if spouses own a home in joint tenancy with a right of survivorship, when one dies, his or her one-half interest automatically passes to the other. In another example, if three siblings own a home in joint tenancy with right of survivorship (each a 1/3 share) and one passes, the remaining two siblings will automatically split the decedent share. The new ownership, in this case, will be 50/50.

In comparison, if two or more people own property as tenants in common, when one dies, his or her share does not pass to the surviving owner or owners automatically. It will need to be probated. A deceased owner's share passes either to the beneficiary or beneficiaries named in the owner's will or to the owner's heirs under state law if there is no will.

Joint tenancy is a common way to own real estate, but any type of property can be owned in joint tenancy including vehicles and bank accounts.

Joint tenancy often works well as a probate avoidance mechanism for married couples, people with stable long term relationships, and people who contribute to the purchase and maintenance of the property. It is most risky when created by gift as a way to leave an inheritance with the sole purpose of avoiding probate. Before transferring property into a joint tenancy, you want to be sure that you trust the other person.

2. ADVANTAGES OF JOINT TENANCY

Joint tenancy is easy and inexpensive to create. For real estate, it usually requires executing a deed with the particular language required by the state where the property is located. Typically, the deed must state that title is held in joint tenancy with right of survivorship. A few states require some additional paperwork.

The procedure is similar for other types of property. The title documents simply have to include the wording required by your state to create a joint tenancy with right of survivorship. Your state's motor vehicle department and the financial institutions where you have accounts will have standard forms for creating a joint tenancy.

It's easy to transfer title to the survivor. To get title in the surviving owner's name, little paperwork is usually needed. The surviving owner files a certified copy of the death certificate and maybe an additional form required by the state or local recorder's office.

3. DISADVANTAGES OF JOINT TENANCY

A joint tenancy immediately gives co-owners equal rights and it cannot be revoked. Unlike an RLT or pay on death deed, a joint tenancy takes effect immediately. It gives the recipient the same rights in the property as the owner making the gift. And once completed, it cannot be revoked.

Example: Ed transfers his home into a joint tenancy with his nephew Hal intending for Hal to inherit the property when he dies. Ed later has a serious disagreement with Hal and wants sole ownership of the property back. Unless Hal agrees to transfer (or sell) his interest in the property to Ed, there's nothing Ed can do.

As a general rule, any co-owner of a joint tenancy bank account can withdraw all of the funds in the account. A two-signature requirement for withdrawals can prevent this result, but it can be inconvenient to get a second signature every time you want to make a withdrawal or write a check.

A joint tenancy can be converted to a tenancy in common. Although a joint tenancy cannot be reversed, in most states, as long as all joint tenants are alive, one joint tenant can terminate the joint tenancy and convert his or her share to a tenancy in common, which he or she can then sell or leave by will to anyone.

Example: Don owns a family farm. He puts the farm in joint tenancy with his son Dave intending for Dave to operate the farm after he dies. Dave instead converts his share into a tenancy in common and sells it to a neighboring farm owner. Don unexpectedly finds himself in partnership with his neighbor.

All co-owners must agree on property management decisions. To sell, mortgage, or improve the property, all owners need to agree.

Example: Louise transfers her home into joint tenancy with her daughter. Later she decides she wants to sell it and use the proceeds to move to an assisted living facility. But her daughter refuses to agree to the sale. Even if Louise converts her share of the home into a tenancy in common, it may be impossible or difficult to sell and will not be worth as much as the entire home.

Creditors of one joint tenant can reach the property. If a joint tenant has debts, goes bankrupt, owes taxes, or sued, the joint tenant's creditor may be able to place a lien against the property or even sell the property to satisfy the debt. The non-debtor joint tenant, however, is entitled to the value of his or her share from the sale proceeds.

Children from prior relationships may lose out. Joint tenancy may not be the best option for spouses with children from prior relationships. When the first spouse dies, the property passes to the survivor.

The children of the deceased spouse could be deprived of an inheritance from the property when the second spouse, who is not their parent, dies.

Example: Fred and Ann take title to their home as joint tenants. Fred has a son from a previous marriage and Ann has a daughter. Fred dies and Ann inherits the property. When Ann dies, she leaves her entire estate to her daughter, including the home. Fred's son gets no share of it.

A trust may be preferable if you want to leave the property to more than one person. Although you can create a joint tenancy with more than one other person, a trust or even probate may be a better choice. One person, the trustee or personal representative, can more efficiently manage and sell the property. Having one person in charge can minimize delays and disagreements. Also, in most states, you cannot give joint tenants unequal shares. All joint tenants own the property equally.

A trust may be preferable if your beneficiary is a minor. Minors cannot own property worth more than a few thousand dollars outright. In most states, you can name a custodian under the Uniform Transfers to Minors Act to manage property given to a minor. The drawback is that the child gets full control of the property at the age specified by state law, which is usually 18 or 21. Property can remain in trust until the child is older. If you don't name a custodian (or leave the property in trust), a court will need to appoint a guardian to manage the property.

Creation of a joint tenancy can have gift tax consequences. If you create a joint tenancy by gift and the value of the interest is more than the annual gift tax exclusion, you will need to file a gift tax return. You will need to pay taxes only if the total value of taxable gifts and your taxable estate exceeds the estate tax exemption.

4. COMMUNITY PROPERTY WITH RIGHT OF SURVIVORSHIP

There are seven community property states in the United States- Alaska, Arizona, California, Idaho, Nevada, Texas, and Wisconsin. In these states, you can co-own your community property with your spouse in joint tenancy with a right of survivorship. When one spouse dies, the other will automatically own the community property. No probate is necessary to transfer title and the process of transferring title to the surviving spouse is simple. Usually, you only need to present a death certificate.

5. TENANCY BY THE ENTIRETY

Tenancy by the entirety is similar to joint tenancy but is generally limited to married couples and is allowed only in some states. Like joint tenancy, when one of the spouses dies, his or her interest in the property passes to the other without probate. Tenancy by the entirety offers better protection to one spouse from the creditors of the other. When the debt is owed by one spouse, in most states, the creditor cannot seize and sell the property.

C. TRANSFER ON DEATH DEEDS (TODD) FOR REAL PROPERTY

1. WHAT IS A TODD?

For many individuals, their home is their only asset of significant value that will be subject to probate on their death. In these instances, some states provide a relatively easy process to avoid probate of the home, a transfer on death deed (TODD). A TODD allows a homeowner to identify one or more beneficiaries who will receive the home on the homeowner's death.

For a TODD to be effective, the document must be signed and dated, usually before a notary, and recorded within a certain time frame at the local county records office where the property is located. There may also be restrictions on the type of property that can be transferred by a TODD. For example, TODDs may be restricted to residential real estate with a specified number of units or land of less than a certain acreage.

All payment obligations associated with the property after the owner's death remain. This includes mortgages and liens. The beneficiary will inherit these responsibilities along with the property.

2. STATES THAT ALLOW TODDS

As of the publication of this booklet, the following states allow TODDs:

> Alaska, Arizona, Arkansas, California, Colorado, District of Columbia, Hawaii, Illinois, Indiana, Kansas, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Texas, Virginia, Washington, West Virginia, Wisconsin, Wyoming.

A few states (e.g., Florida, Texas) allow Lady Bird deeds (also called enhanced life estate deeds) that are similar to TODDs.

As time passes, additional states may permit TODDs.

3. ADVANTAGES OF A TODD

A TODD is easy and inexpensive to create. You need only sign and notarize a deed and have it recorded. The deed must say that it does not take effect until your death. Despite the ease of creation, it's a good idea to have a TODD prepared by an attorney to ensure the deed complies with the law of your state. You don't want to make an error with such a valuable asset.

You retain full rights to your property during your lifetime. Unlike a joint tenancy, the beneficiary has no right to your property while you're alive. If you own your home jointly, the transfer on death deed does not apply until all the owners have died. This means you can mortgage, sell, improve, etc. your home as you see fit. If you sell the home, the TODD ceases to be valid.

You can revoke a TODD. Also unlike a joint tenancy, you can revoke a TODD whenever you want so long as you are legally competent. Revocation is accomplished by filing a revocation statement or a new TODD naming a different beneficiary.

The transfer of assets to the beneficiary on death is quick and easy. The beneficiary simply records a certified copy of your death certificate and maybe an additional form required by the state or local recorder's office.

4. DISADVANTAGES OF A TODD

A TODD cannot be used in every state. If your property is in a state that does not recognize TODDs, you cannot use one to pass your property on your death. You will have to use a different method to keep the property out of probate.

Formal execution and recording requirements must be met. If the TODD is not properly notarized or recorded by the deadline specified in state law, the TODD may not be effective.

If the person named in the TODD dies before the property owner, the deed will have no effect. The property may end up in probate unless the owner makes other arrangements. If you name more than one beneficiary, the property will pass to the survivor.

If the property is owned with a right of survivorship, it passes to the surviving joint owner on the death of the first joint owner, not to the TOD beneficiary. The TODD beneficiary receives the property only if the last surviving joint owner is the one who executed the TODD. In this case, both or all co-owners would need to execute a TODD naming the same beneficiary.

A trust may be preferable if you have multiple beneficiaries. Although you can name more than one beneficiary, a trust or even probate may be a better choice. One person, the trustee or personal representative, can more efficiently manage and sell the property. Having one person in charge can minimize delays and disagreements. Also, state law may restrict your ability to leave unequal shares to multiple beneficiaries.

A trust may be preferable if your beneficiary is a minor. Minors cannot own property worth more than a few thousand dollars outright. In most states, you can name a custodian under the Uniform Transfers to Minors Act to manage property left to a minor. One drawback is that the child gets full control of the property at the age specified by state law, which is usually 18 or 21. With a trust, distribution can be deferred longer. If you don’t name a custodian (or leave the property in trust), a court will need to appoint a guardian to manage the property.

A TODD transfers only real estate. And the types of real estate that can be transferred may be limited. You will need to make other arrangements to avoid probate if you own other probate assets.

D. TRANSFER ON DEATH REGISTRATION FOR CARS

These states currently allow transfer on death registration for cars:

> Arizona, California, Connecticut, Indiana, Kansas, Missouri, Nebraska, Nevada, Ohio, Texas, Vermont.

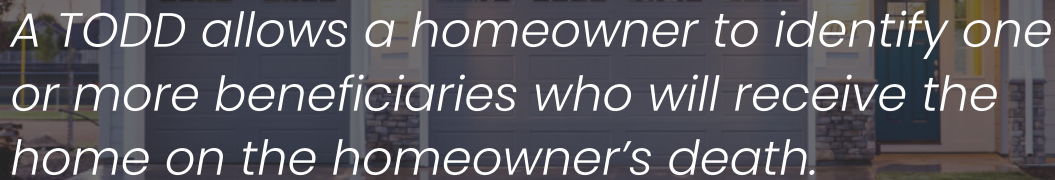
These work the same way as TODDs. During your life, the beneficiary has no rights to the car. You can use it or sell it. And you can revoke the registration.

As time passes, additional states are likely to be added. Check with the motor vehicle department in your state to see if TOD registrations or other simplified procedures for transferring ownership of a vehicle on death are allowed. If so, the department should be able to furnish you with instructions and the necessary forms.

E. TRANSFER ON DEATH DESIGNATED BANK ACCOUNTS & SECURITIES REGISTRATIONS

1. WHAT IS A TOD OR POD ACCOUNT?

Many states allow you to designate a pay on death beneficiary or beneficiaries on your bank account, brokerage accounts, and securities. These accounts are usually called payable-on-death (POD) or transfer-on-death (TOD) accounts. Until your death, you have complete control over the account. This means your beneficiary has no right to or control



over the money or securities. If you spend all the money or sell the securities before your death, the beneficiary receives nothing.

On your death, whatever is left in the POD or TOD account transfers immediately to the beneficiary without probate. As a practical tip, don't assume that your account is automatically a TOD or POD account. Banks have specific formalities for setting up these accounts.

2. ADVANTAGES OF TOD/POD DESIGNATIONS

A TOD/POD designation is easy and inexpensive to create. There is typically no extra cost to set up the account or convert an existing account. The financial institution or broker provides the required form for you to sign.

The beneficiary has no access to the account or security while you are alive. You won't need to worry about the beneficiary emptying your account, which he or she can do if you create a joint tenancy.

You can revoke a TOD/POD designation. Also unlike a joint tenancy, you can revoke a TOD/POD designation whenever you want so long as you are legally competent.

You can name more than one beneficiary. In most, but not all states, you can leave them unequal shares.

The transfer of assets to the beneficiary on death is quick and easy. The beneficiary simply presents identification and a certified copy of your death certificate to get access to the funds or securities. Early withdrawal penalties are usually waived.

3. DISADVANTAGES OF TOD/POD DESIGNATIONS

You usually cannot name contingent beneficiaries. If the sole beneficiary dies before the account owner, the POD designation has no effect. The funds in the account could end up in probate.

If the account has multiple beneficiaries and one dies before the account owner, his or her share passes to the other beneficiaries, not to his or her children.

F. BENEFICIARY DESIGNATIONS FOR LIFE INSURANCE AND RETIREMENT ACCOUNTS

Life insurance proceeds and retirement accounts such as IRAs, profit-sharing plans, and 401(k) plans, can be passed outside of probate through beneficiary designations. So long as you complete a beneficiary designation and name someone other than your estate as the beneficiary, life insurance proceeds and the balance left in your retirement accounts when you die will pass to the beneficiary or beneficiaries outside of probate.

In community property states if a life insurance policy was purchased with community funds, your spouse is entitled to half the proceeds no matter whom you name as a beneficiary. If your intended life insurance beneficiary is a minor, you will want to make the benefits payable to a trust or name a custodian to manage the funds under the Uniform Transfers to Minors Act. Otherwise, a court will need to appoint a guardian.

With retirement accounts on which you did not pay income taxes, you typically want to name “natural persons” (e.g., spouse or children) as beneficiaries. They will have to pay income tax on the money left in your accounts. But they will be able to spread the payments (and thus the tax) over their life expectancies, rather than take a lump sum. On some types of accounts (401(k) or 403(b) plans), you must name your spouse as the beneficiary unless he or she signs a waiver. If you live in a community property state, your spouse will have a right to half of the balance in your retirement accounts that is community property.

Beneficiary designations for life insurance and retirement accounts are an important component of your estate plan. Your estate planning attorney can advise you on how to complete them so that they are consistent with your estate planning objectives.

You’ll want to review your beneficiary designations periodically to make sure they are up to date, especially if you divorce or your spouse or designated beneficiary predecease you.

G. LIFETIME GIFTS

Sometimes giving your property away during your lifetime can be an effective way to avoid probate. Assets you give away during your lifetime will not have to go through probate after your death. As an added bonus, you get to see your loved ones enjoy and appreciate your gifts.

Making gifts while you are alive can also be an effective strategy for eliminating or minimizing estate taxes if your estate is so large that you could have estate tax liability. Each year you can gift up to a certain dollar amount tax-free to a beneficiary and a certain total amount during your lifetime. In 2019, the yearly annual gift exclusion is $15,000. The total estate and gift tax exemption is $11.4 million per individual. This means an individual can leave $11.4 million and pay no federal estate or gift tax. A married couple can leave up to $22.8 million.