

Take-Away: Use caution when using a transfer-on-death or a payable-on-death beneficiary designation. They are deceptively easy to understand and implement, but they can cause some unintended consequences.

Background: Avoiding probate is a predominant feature of many estate plans. I suspect, avoiding legal fees is an equally popular goal of most estate plans. Hence, the public's growing interest in, and reliance on, payable-on-death (POD) accounts and transfer-on-death (TOD) accounts which rely exclusively on a beneficiary designation to transfer assets on the owner's death, all without the need for a Will, a Trust, a probate court, or an attorney. It should come as no surprise, then, that the Probate Council of the Estate Planning Section of the Michigan Bar is looking at a proposed Bill regarding the transfer-on-death of real estate by deed. While individuals love the idea of a simple transfer-on-death of their assets outside the delays, fees, and publicity of probate, and without having to hire a lawyer to do so, there can be some unexpected problems associated with relying on a TOD-POD arrangement.

Michigan POD and TOD Statute: Michigan's Estates Protected Individuals Code (EPIC) contains a section entitled Uniform Transfer-On-Death Security Registration, which authorizes both POD and TOD transfers via beneficiary designation. [MCL 700.6301 to 700.6310.] POD arrangements normally cover bank accounts, while TOD arrangements cover a *Security*, which is broadly defined in the statute. [MCL 700.6301(d) and (e).] One of the few limitations under the Michigan statute is that *securities* held as tenants-in-common cannot be registered with a beneficiary designation, but a jointly held *securities* account can be held as a TOD. [MCL 700.6302.] The Michigan statute also makes it clear that the registration of a *Security* under a TOD or POD transfer-on-death is not testamentary, which means that the account or the beneficiary designation does not have to comply with the same formalities that are

associated with the execution of a Will or a Trust.

Advantages: The recognized benefits of a TOD-POD beneficiary arrangement to transfer assets or accounts on the owner's death include the following.

Simplicity: Such an arrangement is simple and inexpensive to create. Lawyers are not required. The account owner can name multiple beneficiaries jointly or a single beneficiary, and name contingent beneficiaries if the identified primary beneficiary does not survive.

Understandable: Account owners fully understand how the TOD-POD works, unlike a Will or Trust with their usual complexity and technical jargon. The beneficiary has no rights in the TOD-POD arrangement until the account owner's death, making it more favorable than joint ownership. No other legal documents are required to interpret or implement the TOD-POD beneficiary designation.

Easy to Administer: These accounts are easy to administer on the owner's death. The designated beneficiary shows up at the TOD-POD sponsor's offices with the account owner's Death Certificate and proof of the beneficiary's identity. That's it.

Probate Avoided: With the transfer of account assets 'outside' the purview of the probate court, the assets can be immediately transferred after the account owner's death, completely avoiding the probate court with its publicity, delays, filings, Inventory fees, and other costs and expenses, e.g., legal fees.

Immediate Access: The designated beneficiary of the TOD-POD arrangement can access the assets immediately after the owner's death, which may prove to be helpful in paying estate expenses and other estate debts, which otherwise await the probate court's appointment of the estate Personal Representative with the legal authority to deal with the decedent's creditors.

Tax Basis Step-Up: If the account owner knows that his/her intended beneficiary of the assets held in the account will be promptly sold by the beneficiary after the account owner's death, then it makes sense for the asset owner to hold the asset in a TOD arrangement with their intended beneficiary named as its designated beneficiary.

Example: Justice Sam Alito and his wife own all their investments jointly as tenant's-by-the-entireties. On the death of one, there will be a 50% income tax basis adjustment, held by the surviving spouse. Sam's wife wants to own Bud Light stock. Sam opposes that investment in Bud Light stock since it has become a symbol of the country's culture wars, and Sam is highly principled, wants no part of Bud Light. Sam's wife knows that if her husband inherits the Bud Light stock from her, he will promptly sell it. If they own the Bud Light stock jointly, there will be a 50% income tax basis adjustment to the Bud Light stock on her death; thus, if Sam survives, he will incur a capital gain on the sale of the Bud Light stock. However, if she owns 100% of the Bud Light stock held in a TOD account, and she names Sam as the TOD's designated beneficiary, then there will be a 100% income tax basis adjustment to the Bud Light stock on her death. In that case, if she dies first, Sam will inherit the Bud Light stock, sell it, and recognize no capital gains on the stock's sale.

Disadvantages: There can be some unintended consequences with the use of a TOD-POD arrangement. Consider the following:

Owner's Incapacity: As noted above, the beneficiary has no rights to the TOD-POD account until the owner's death. Consequently, if the owner is disabled the beneficiary who may need access to the account assets to care for the disabled owner may have to petition the probate court for a conservatorship to access the account funds. A revocable Trust could avoid this problem with a successor trustee named for the Trust who could access the funds held in the account owner's Trust. Of course, a well-drafted durable power of attorney by the account owner can also avoid this inflexible limitation of the TOD-POD account

arrangement.

Inflexible: Once the account owner becomes incapacitated, the owner can no longer change the TOD-POD beneficiary. Similarly, if the designated beneficiary dies before the account owner, if no contingent beneficiary is named, then the TOD-POD account will be subject to a probate proceeding to transfer the account and its assets.

Illiquidity of the Owner's Estate: A TOD-POD arrangement can cause the owner's estate to become illiquid. The account funds are paid to the designated beneficiary; they are not available to the owner's estate. The account owner's estate will usually have primary liability for the payment of the deceased owner's debts, administration expenses, and estate taxes (which has not been a major consideration over the past several years due to the large applicable exemption amount, but it may become a renewed challenge if the transfer tax exemption *sunset* arrives on January 1, 2026.) If the owner's estate is illiquid and debts, expenses, or taxes are unpaid, the estate's Personal Representative may be forced to seek contribution from the TOD-POD beneficiaries to satisfy the outstanding taxes or expenses- enter the lawyers! Each state has its own statutes on contribution from non-probate assets, but often these statutes provide to the estate a very limited remedy of contribution from the designated beneficiary.

Estate Taxes: The Tax Code has several provisions that permit a Personal Representative to seek reimbursement for federal estate taxes that are attributable to some assets that are includible in the account owner's taxable estate, e.g., a TOD-POD arrangement. [IRC 2206 (life insurance), 2207 (general powers of appointment), 2207A (QTIP property includible under IRC 2044), 2207B (a retained, aka *string*, interest in previously transferred property under IRC 2036).] However, the Personal Representative may not receive reimbursement from the non-probate transferee unless the deceased owner, in his/her Will, expressly permits the Personal Representative to formally seek reimbursement or contribution. State law then covers how that is reimbursement and tax

apportionment is implemented. A handful of states have adopted the Uniform Estate Tax Apportionment Act, while other states, like Florida, only recognize a modified equitable apportionment rule.

Minors and Disabled Beneficiaries: While there is no problem with naming a minor as a designated beneficiary of a TOD-POD arrangement, the funds will then have to be transferred to a Uniform Transfer to Minor's Account, or a guardian may have to be appointed for the minor recipient. If the designated beneficiary is then receiving governmental benefits, his/her immediate receipt of the TOD-POD account balance could jeopardize their entitlement to receive Supplemental Security Income (SSI) or Medicaid.

Spendthrifts: Unlike a revocable Trust which often has a spendthrift limitation to prevent the dissipation of an inheritance by the trust beneficiary, there is no spendthrift limitation with the TOD-POD arrangement and the named beneficiary could swiftly squander what they receive from the account as its sole beneficiary.

Conflicts with the Owner's Estate Plan: The use of both TODs or PODs and a Will or Trust can lead to disproportionate distributions. The TOD-POD is a contractual arrangement with the account sponsor. As such, its beneficiary designation, like an IRA, will override the account owner's estate plan.

Example: Donald has multiple TOD and POD accounts. Donald names Huey as the designated beneficiary of Donald's POD money market account which holds \$45,000. Donald names Louie as the designated beneficiary of Donald's TOD *securities* account, which also has \$45,000 of securities. Donald's Will clearly states that his two nephews are to each receive 50% of the residue of Donald's estate, with his clearly expressed intent to treat his nephews equally with respect to their inheritance. Over time Donald's TOD account has grown in value to \$60,000 at the time of his death. Donald's POD account has been tapped by him a couple of times before his death to pay health-related expenses.

At the time of Donald's death, the POD balance is at \$35,000. Huey receives \$60,000 and Louie receives \$35,000, but Donald's Will clearly spells out his intent to treat his nephews equally regarding their inheritances. Does Louie have a claim against his brother Huey for \$12,500, to equalize their distributions?

No What If ? Planning: While the TOD-POD can name a contingent beneficiary, there is no other contingency, like the designated beneficiary's pending divorce, that can be identified and used to delay a distribution to keep it from the reach of the designated beneficiary's creditors. With a Trust there can be a 'hold-back' provision that gives the trustee the authority to withhold a distribution due to the beneficiary's impending misfortunate circumstances.

Real Estate TOD: As mentioned above, the State Bar's Probate Council is currently looking at the Transfer on Death Deed for Michigan, which would function much like the TOD-POD arrangements currently authorized under EPIC. For comparison purposes, New York just adopted its version of the Transfer on Death Deed. That Act requires that the TOD Deed have two witnesses and a notary. The transferor must have testamentary capacity to sign the Deed. The Deed must be recorded during the transferor's lifetime. The Act clearly states that no gift results with the TOD Deed's beneficiary designation, which means that there will be a complete income tax basis adjustment when the transferor dies, i.e., it is an incomplete gift for tax purposes. Some unanswered questions that apply to this New York statute include: (i) can there be a beneficiary designation transfer of title to the real estate to a Trust? (ii) what is the impact of the TOD Deed on existing title insurance of the transferor? (iii) can the designated beneficiary of the TOD Deed also serve as a witness to the Deed? and (iv) can an agent acting under a durable power of attorney execute the TOD Deed on behalf of the transferor with a designated beneficiary?

Conclusion: Since the TOD-POD beneficiary designation overrides the account owner's estate plan, these accounts must be coordinated asset titling with the account owner's estate plan. While a TOD-POD accounts can include

beneficiaries who cannot typically be named as joint owners, e.g., a charity, to avoid probate, they can still create either inconsistencies or confusion when it comes to their role (if any) in the account owner's overall estate plan. In sum, they are easy to understand and implement, but they do carry some overlooked limitations.