

Memorandum 2019-16

**Revocable Transfer on Death Deed: Follow-Up Study —
Remaining TEXCOM Issues**

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added a “sunset” provision, which will repeal the RTODD statute on January 1, 2021 (unless the sunset is extended or repealed before it operates).⁴ In addition, the law requires the Commission to conduct a follow-up study of the efficacy of the RTODD statute, and make recommendations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 The deadline for completion of that study is January 1, 2020.⁶

In 2017, the Commission received a letter from the Executive Committee of the Trusts and Estates Section of the California Lawyers Association (“TEXCOM”) raising a number of concerns about the RTODD statute. A copy of that letter is attached as an Exhibit.

Many of the issues raised by TEXCOM have been considered by the Commission and provisionally resolved. Others have not yet been addressed.

In order to expedite the process of presenting the remaining TEXCOM issues, the staff intends to prepare a series of supplements to this memorandum. Each

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. See also 2016 Cal. Stat. ch. 179.

6. *Id.*

will address a single issue or related group of issues. The staff intends to produce the following supplements:

- **First Supplement. Execution and Revocation** (discussing TEXCOM issues 4-6).
- **Second Supplement. Conflicting Instruments and Forms of Ownership** (discussing TEXCOM issues 7-8).
- **Third Supplement. Marketability** (discussing TEXCOM issue 12).
- **Fourth Supplement. Survival of Encumbrances** (discussing TEXCOM issue 13).

The order and content of those supplements could change. There could also be additional supplements, if required as a vehicle for presenting and discussing new public comment.

Commissioners should retain this memorandum for reference when reading the supplements; the staff does not intend to reproduce TEXCOM's letter as an attachment to the supplements.

Respectfully submitted,

Brian Hebert
Executive Director



TRUSTS & ESTATES SECTION

THE STATE BAR OF CALIFORNIA

June 1, 2017

VIA E-MAIL AND U.S. MAIL

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Re: Comments from TEXCOM
Study L-3032.1 (Revocable Transfer on Death Deed: Follow-Up Study)

Dear Mr. Hebert:

Thank you for soliciting comments from the Executive Committee of the Trusts and Estates Section of the State Bar of California ("TEXCOM") regarding California's revocable transfer on death deed ("RTODD") law enacted in Assembly Bill 139 of 2015 (Stats. 2015, ch. 293). TEXCOM appreciates the Commission's interest in TEXCOM's views regarding the RTODD law. As you know, attorneys appointed to TEXCOM have technical expertise in the area of trusts and estates law, including planning, administration and litigation regarding nonprobate transfers such as those made by RTODDs.

As we have discussed, TEXCOM expects to relate to the Commission information regarding experiences relating to RTODDs at some point in the next 18 months. The RTODD law still being quite new, TEXCOM anticipates surveying its members once some additional time has passed in order to attempt to obtain information regarding California trusts and estates attorneys' practical experiences with RTODDs that may, in turn, be reported to the Commission. Pending completion of that survey, and as we have discussed, this letter will contain TEXCOM's comments regarding the RTODD law itself.

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General Comment

As you know, TEXCOM has continuing concerns regarding the law providing for statutory RTODDs. TEXCOM agrees in principle with the goal of providing a mechanism by which persons could pass on their real property at death without the need for expensive estate planning during lifetime or a court-supervised probate administration after death. However, TEXCOM believes that RTODDs, as enacted in Statutes of 2015, chapter 293, (i) potentially facilitate the victimization of vulnerable persons by fraud, abuse and undue influence, (ii) will lead to costly litigation regarding the validity and effectiveness of RTODDs, (iii) will lead to undesirable consequences for recipients of property received by RTODD, including the possibility of liability to creditors and the decedent's estate, and (iv) make the property that is subject of the RTODD less marketable, leading to frustration on the part of the recipients of the property, and the need to clear title through the legal process.

TEXCOM believes the RTODD law is fundamentally flawed in a way that TEXCOM fears is not capable of being remedied. Although the statute is well-intentioned—providing owners of certain real property a means of passing that property to chosen beneficiaries at death without the need to incur the expense of engaging competent legal counsel or other professional advisors—the practical pitfalls destroy its effectiveness. The most common drafter of a RTODD will be the property owner himself/herself, usually drafting a deed for the very first time. Costly mistakes—some affecting the very validity of the RTODD—are inevitable. Knowledgeable attorneys will generally not recommend RTODDs because they have more appropriate tools at their disposal.

For these reasons, and some others discussed in this letter, TEXCOM believes that consideration should be given to repealing the RTODD law or allowing it to be automatically repealed effective on January 1, 2021, pursuant to the sunset provision in California Probate Code section 5600, subdivision (c).¹ However, TEXCOM acknowledges that the Commission is supportive of RTODDs, having recommended in *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm'n Reports 103 (2006) (the "2006 Recommendation") that RTODDs be adopted in California. So, to the extent that the Commission concludes that RTODDs should remain authorized by California statutory law, this letter will provide TEXCOM's observations regarding deficiencies in the law that should be reconsidered.

¹ Unless otherwise indicated, all further statutory references are to the California Probate Code.

Areas of Specific Concern

Following is discussion regarding specific areas of concern that TEXCOM has identified regarding the RTODD law enacted in Statutes of 2015, chapter 293:

1. Definition of “real property.” The definition of “real property” contained in Probate Code section 5610 (which limits the types of real property that are eligible to be transferred by RTODD) includes:

(a) *Real property improved with not less than one nor more than four residential dwelling units. [and]*

...

(c) *a single tract of agricultural real estate consisting of 40 acres or less that is improved with a single-family residence.*

Thus, it appears from section 5610, subdivision (c), that agricultural property of more than 40 acres was intended to be excluded from the definition of “real property.” However, as long as agricultural real property (of potentially unlimited size) is improved with not less than one nor more than four residential dwelling units, such real property would come within the definition of “real property” under subdivision (a).

2. Time for Determining Qualification Under Definition of Real Property. Section 5614 provides that a “[r]evocable transfer on death deed” means an instrument created pursuant to this part that . . . makes a donative transfer of real property to any beneficiary.” As discussed above, section 5610 limits the type of real property that may be the subject of a RTODD to the types of real property described in that section. However, the statutes are ambiguous regarding when the real property must come within the statutory definition of “real property.” In other words, must the real property be “real property,” as defined, at the time that the RTODD is executed? Or, at the time that the RTODD operates because of the transferor’s death? Suppose that a parcel of real property was improved with a residence at the time a transferor signs a RTODD with respect to the property; however, before the transferor dies, the residence is demolished such that the property is unimproved at the time of the transferor’s death. Such property would have come within the definition of “real property” at the time that the RTODD was executed, but would not come within the definition of “real property” at the time that the RTODD operates because of the transferor’s death. The intention in this regard should be clarified.

3. Eligible Beneficiaries. TEXCOM is aware that Statutes of 2016, chapter 179, section 1, amends Section 21 of Chapter 293 of the Statutes of 2015 (the section requiring the Commission to study the effect of California’s RTODD) to require that the Commission address, “[w]hether it is feasible and appropriate to expand the revocable transfer on death deed to include . . . [t]ransfers to a trust or other legal entity.” However, TEXCOM notes that trusts and legal entities are already authorized to be named as beneficiaries of RTODDs, without any expansion of the enacted statutes required. Pursuant to section 5608, the beneficiary of a RTODD

may be any “person.” And, in turn, section 56 defines “person” to include, “an individual, corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership, limited liability company, association, or other entity.” Thus, regardless of whether such was intended by the Legislature, trusts and legal entities are already eligible to be named as beneficiaries in RTODDs. In TEXCOM’s view, allowing for transferors to name trusts and legal entities as beneficiaries of RTODDs invites confusion and errors by unknowing transferors; thus, the better rule would be to provide that only individuals may be named as beneficiaries in RTODDs.

4. Manner of Execution. Section 5624 provides as follows: “A revocable transfer on death deed is not effective unless the transferor signs and dates the deed and acknowledges the deed before a notary public.” This section is ambiguous with respect to what is actually required of the transferor in at least two respects:

a. It appears that section 5624 requires that the transferor must personally date the deed such that a RTODD containing a typewritten date of execution likely would not satisfy the execution requirement contained in section 5624. This should be clarified if it was contrary to the intended requirement.

b. Section 5624 could be read to require that the transferor sign and date the deed before a notary public. Generally, a document need not be signed in the presence of the notary public; all that is required in order to obtain a notary public’s acknowledgment is that the signer personally appear before the notary public, and acknowledge having executed the document (including, for example, having executed the document outside of the presence of the notary public). (Civil Code § 1189.) The intention in this regard should be clarified.

5. Timing of revocation of RTODD. The statutes are unclear regarding whether a revocation of a RTODD must be recorded prior to the transferor’s death. On the one hand, section 5632 requires that an instrument revoking a RTODD “shall be executed and recorded before the transferor’s death” However, on the other hand, section 5628, subdivision (a), specifically authorizes revocation of a RTODD by a second, subsequent RTODD, and under the general rule of section 5626, subdivision (a), relative to the time to record a RTODD, the second RTODD would be valid if recorded within 60 days of execution, even if after the transferor’s death. This matter should be clarified. The Commission should consider whether any instrument that would have the effect of revoking a RTODD should be required to be recorded prior to the transferor’s death. In TEXCOM’s view, requiring that a revocation of a RTODD be recorded prior to the transferor’s death imposes a risk that transferors’ desires to revoke RTODDs may be frustrated when, for example, recordation of a RTODD before the transferor’s death is impractical (e.g., where the transferor signs the revocation of a RTODD far away from the relevant county recorder’s office), or impossible (e.g., where the transferor signs the revocation of a RTODD during a weekend when the revocation cannot be recorded until the next business day). Sections 5632 and 5628 should be harmonized to provide that any instrument revoking a RTODD shall effect a revocation if the instrument is recorded within 60 days of execution, even if the recordation occurs after the transferor’s death.

6. Attorneys-in-fact. The RTODD law is silent regarding whether an attorney-in-fact may execute or revoke a TOD deed. This should be clarified. The Commission's 2006 Recommendation observed that California law (section 4264) allows an attorney-in-fact named in a power of attorney to create, modify, or revoke the principal's trust, make or revoke a gift of the principal's property, create or change survivorship interests in the principal's property, and designate or change a beneficiary to receive property on the principal's death, provided that the principal expressly authorizes the act in the power of attorney. The Commission further observed that this rule would appear to cover revocation of a revocable TOD deed as well, but recommended that the power of attorney law should be revised to make the coverage explicit. TEXCOM agrees that the power of attorney law should be revised to allow for attorneys-in-fact to make or revoke RTODDs, provided that the principal expressly authorizes the act in the power of attorney.

7. Conflicting dispositive instruments. Section 5660 relating to conflicting dispositive instruments is confusing and ambiguous. The meaning of an "instrument [that] makes a revocable disposition of the property" is unclear and should be clarified.

8. Joint tenancy and other rights of survivorship. Section 5664 provides that, if at the time of the transferor's death, title to the property described in the RTODD is held in joint tenancy or as community property with right of survivorship, the revocable transfer on death deed is void, and the transferor's interest in the property is governed by the right of survivorship and not by the revocable transfer on death deed. This is contrary to the 2006 Recommendation, which proposed a rule whereby the death of the transferor severs the joint tenancy as to the interest of the transferor, and the interest of the transferor passes pursuant to the RTODD. The Commission's recommendation in this regard seems superior and more consistent with the likely intentions of makers of RTODDs. Section 5664 should be revised accordingly.

9. Creditors' rights in property subject to RTODD. The provisions dealing with the liability to creditors and to the transferor's estate of a beneficiary of a RTODD are highly problematic and should be reconsidered. Among the problems with the RTODD law in this regard are the following:

a. Misapplication of provisions from Sections 13200-13210 (Affidavit Procedure for Real Property of Small Value). With respect to the rights of creditors in RTODD property following the death of the transferor, the law follows the existing California model applicable to a successor who takes property of a decedent without probate under the affidavit procedure for real property of small value contained in sections 13200-13210. That model has some major deficiencies when applied to RTODD property. To the extent the Commission feels that continuing to model the provisions dealing with creditors' rights after the procedure applicable to a successor who takes property without probate under the affidavit procedure for real property of small value contained in sections 13200-13210, some problems with the existing statutes that should be considered by the Commission are discussed below.

i. The affidavit procedure for real property of small value only applies where the gross value of all real property in the decedent's estate located in California does not exceed \$50,000. Needless to say, the property that can be the subject of a RTODD can be much more valuable. So, while the beneficiary's liability to creditors or to the transferor's estate are somewhat modest in the context of the affidavit procedure for real property worth no more than \$50,000, the stakes—along with the burdens placed on recipients of RTODD property—are increased dramatically where more valuable properties are involved as will be the case with RTODDs. For example, the possibility of accrual of interest at 10% per year may be of little concern to a recipient of property worth only \$50,000 who chooses to use the affidavit procedure of section 13200 (the risk being only \$5,000 per year), but when the similar provisions of section 5676 are applied to a RTODD beneficiary who would receive a property worth, say, \$1 million, that beneficiary risks accrual of interest at the rate of \$100,000 per year.

ii. The affidavit procedure for real property of small value is only an optional procedure that the beneficiary may choose to employ or not employ. If the beneficiary desires to avoid the risks associated with that procedure, the beneficiary may simply commence probate proceedings, in which the liability of the estate to creditors (and, by extension, the extent to which the beneficiary will bear such liability) will be settled without the beneficiary being exposed to personal liability. This is not the case with respect to RTODDs, which imposes upon the beneficiary the specter of liability for restitution of the property to the decedent's estate, liability for net income received on the property, plus prejudgment interest at the rate of 10% per year (see item #9.a.iii. immediately below).

iii. The beneficiary's liability to creditors includes interest at the legal rate (currently 10% per year pursuant to Code of Civil Procedure section 685.010). This seems harsh, as this is the rate typically applicable to post-judgment interest, where the debtor has been adjudged to have incurred some type of liability for a wrongful act. With RTODDs, the beneficiary may have done nothing wrong at all; his/her only misfortune was having been the beneficiary under a RTODD as opposed to a will, revocable trust or joint tenancy.

b. Liability where beneficiary has made a significant improvement.

i. The provisions of section 5676 dealing with the beneficiary's liability to the transferor's estate where the beneficiary has made a "significant improvement" to the property (§5676) can be quite punitive, and should be reconsidered. Take, for example, a transferor's child who receives property under a RTODD unaware that the transferor had some unpaid unsecured debts. If that child makes a "significant improvement" to the property, then the child is exposed to the fair market value of the property at the time of the improvement, less liens and encumbrances on the property at that time, plus

interest on the net amount at the rate payable on a money judgment, because the personal representative has the option to decline to accept the improved property, and instead demand that amount under section 5676, subdivision (b). This could result in substantial hardship on RTODD beneficiaries who improve property received. The logic of this is unclear and should be reconsidered.

ii. A beneficiary who has made a significant improvement of RTODD property after receiving it and is required to restore the fair market value of the property, plus net income, plus interest, is seemingly not entitled to credit for payments made by the beneficiary toward encumbrances that existed before the transferor's death, an important and inequitable omission in section 5676, subdivision (b). This should be corrected to give RTODD beneficiaries credit for payments made by the beneficiary toward encumbrances that existed before the transferor's death.

iii. Although section 5676, subdivision (b)(1) provides that (under certain circumstances) where a beneficiary restores the property to the estate of the transferor after having made a significant improvement to the property, the estate shall reimburse the beneficiary for the amount by which the improvement increases the fair market value of the property restored, the statutes do not provide any clear guidance regarding how a beneficiary is reimbursed for the value of property attributable to improvements made. Third parties should not unfairly benefit from a beneficiary's devotion of personal resources to improving the property. Thus, any reimbursement due to a beneficiary for improvements made to property that passed by RTODD should enjoy the highest priority, akin to that of a secured creditor.

c. Credit for payment of pre-death encumbrances. A beneficiary required to restore property to the transferor's estate is seemingly not entitled to credit for payments made by the beneficiary toward encumbrances that existed before the transferor's death, an important and inequitable omission in section 5676, subdivision (a)(1). This should be corrected.

d. Payment by beneficiary of post-death encumbrances. Pursuant to section 5676, subdivision (a)(2), if a beneficiary encumbers property after the death of the transferor, and then disposes of the property before restitution is requested to be made, the beneficiary may be made to restore to the decedent's estate the fair market value at the date of disposition less liens existing at that time, plus net income received by the beneficiary, plus interest. This approach assumes that the liens existing at the time of disposition already encumbered the property when the beneficiary received it, and does require the beneficiary to repay the decedent's estate the proceeds of any loan that the beneficiary may have obtained secured by the property after the transferor's death. This appears to be an oversight and should be corrected.

e. Casualty insurance proceeds not contemplated. The provisions dealing with the beneficiary's liability to the transferor's estate do not require the beneficiary to restore to the transferor's estate the proceeds, if any, of any casualty insurance claims. This should be reconsidered, lest a devastating fire on property received by a RTODD beneficiary result in a windfall to that beneficiary.

f. Ambiguity of the phrase "net income". The measure of a RTODD beneficiary's liability to creditors includes "the net income the beneficiary received from the property." The statute would benefit from a definition of "net income." While one might expect that "net income" would include a reduction for maintenance expenses actually incurred, seemingly less clear are issues of reasonable repairs, depreciation, income tax liability on rental income, the value of the beneficiary's personal labor that created the income received, etc.

g. Priority for reimbursement of payments to creditors made by the beneficiary. Where a beneficiary is required to restore property or an amount to the estate of a deceased transferor, that liability is reduced by any property or amount paid by the beneficiary to a creditor of the deceased transferor directly. However, there is no guidance regarding how the beneficiary is to be reimbursed for those payments. Any reimbursement due to a beneficiary for amounts paid directly to creditors should enjoy the highest priority, akin to that of a secured creditor.

h. Reimbursement for certain necessary payments. Where a beneficiary is required to restore property to the estate of a deceased transferor, the law should provide for the beneficiary to be reimbursed for certain payments that benefitted the property, such as property taxes and insurance premiums. Without provisions requiring those reimbursements, the transferor's estate will unduly benefit from the beneficiary's expenditure of resources on these necessary expenses.

10. No requirement that restitution be required in order to satisfy creditors. The personal representative of a decedent's estate may require a beneficiary who received property pursuant to a RTODD to restore that property to the estate, even if there is adequate property already subject to probate administration to provide for the payment of creditors claims. The Commission should consider whether this should be the case. That is, should property that passed by RTODD be exposed to restoration to the deceased transferor's estate even if that property is not required to pay creditors claims? We suggest no.

11. Liability of beneficiaries of different properties. The RTODD law provides no guidance regarding the priority or apportionment of debts among beneficiaries of different properties that pass by RTODD. This should be addressed. Also, where a decedent executes RTODDs for more than one property, the law allows the personal representative to demand that one beneficiary restore the property to the decedent's estate, while leaving other RTODD beneficiaries undisturbed. This should be addressed.

12. Marketability issues and clouds on title. The new RTODD law creates several challenges in terms of the marketability of real property that should be considered further, some of which are discussed below.

a. Pursuant to section 5694, subdivision (a), if a successful contest of a RTODD was filed and a *lis pendens* recorded within 120 days of the transferor's death, the court must order the RTODD void and transfer the property to the person entitled to it. So, any property held pursuant to a RTODD deed will effectively be unmarketable by the beneficiary for the 120-day period after the transferor's death, because no title company will insure title during that period. This should be considered further.

b. Related to the issue raised in item #2 above, will title insurance companies determine whether real property held pursuant to a TOD deed was of a type that may be passed by RTODD because it comes within the definition of "real property" contained in section 5610? Or, will title insurers simply insist upon an exception to title insurance coverage, adversely affecting the marketability of the property? This should be considered further.

13. Survival of encumbrances. Pursuant to section 5652, subdivision (b), property is transferred by RTODD, "subject to any limitation on the transferor's interest that is of record at the transferor's death, including, but not limited to, a lien, encumbrance, easement, lease, or other instrument affecting the transferor's interest, whether recorded before or after recordation of the revocable transfer on death deed." Section 5652 seems to create a special rule for encumbrances on property held pursuant to a RTODD, to the effect that the property passes free and clear of any unrecorded liens, encumbrances, leases, etc., at the transferor's death. This is contrary to the general rule relating to real property liens and encumbrances, and could have significant effects. Suppose an owner of real property held pursuant to a RTODD enters into an agreement to sell the property, but dies during the escrow period. Were the property not held pursuant to a RTODD, the decedent's successor would be required to perform under the contract made by the decedent. However, section 5652 seems to allow for the beneficiary under a RTODD to disavow without any consequence any unrecorded agreements made with respect to the property by the transferor while living. This should be addressed.

14. Effect of sunset provision. The second sentence of Section 5600, subdivision (c), attempts to preserve the validity and effect of RTODDs executed before January 1, 2021, and the ability of transferors to revoke such RTODDs, in the event that the RTODD law is automatically repealed. However, that sentence itself would be repealed by the sunset

June 1, 2017

provision contained in the first sentence of section 5600, subdivision (c). The principle that the validity of existing RTODDs (and the ability of transferors to revoke existing RTODDs) would survive repeal of the RTODD law does not seem to have been enacted by the Legislature in a provision that would survive the automatic repeal. This should be considered.

Thank you for your consideration of TEXCOM's comments in this regard. If you have any questions, or if I may provide any additional information regarding TEXCOM's perspective on these matters, I invite you to contact me anytime by e-mail at mpoochigian@bakermanock.com, or by telephone at (559)432-5400.

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Respectfully submitted,



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