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Can't I Just Use a Transfer on Death (TOD) Designation on my Investments Instead of a Trust (or Will)?

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This is a question asked of us many times over the years. The answer to this one aspect of estate planning, merely the avoidance of probate, is "Yes"! However, when designing a comprehensive estate plan, avoiding probate (when and if necessary) is just one of the many facets of a well thought out plan. Let's consider some additional issues that need to be addressed other than just that of avoiding probate.

1. Transfer on Death (TOD) designations do not give access to the account during the lifetime of the owner if the owner becomes incapacitated. A Power of Attorney or court supervised Guardianship proceeding will also be needed. These actions gobble up time and money during a time which is already stressful because of a medical event upon the account owner.

2. TOD's employ no tax planning. They are simply designations on an investment account that "points" the investment to a beneficiary immediately upon death of the account owner. There are multiple levels of tax considerations needed at both the State and Federal levels when contemplating intergenerational transfers.

3. TOD's do not protect the recipients of the funds from the perils of everyday life (Divorce, Death, Disability, Bankruptcy and Bad Decisions). As the recipient of TOD assets, a person may have their own financial issues currently or in the future which could subject those inherited assets to loss.

4. TOD's prevent strategic multi-generational planning. With the passage of the Secure Act affecting everyone who dies after January 1, 2020 owning an Individual Retirement Account (IRA), new planning initiatives are now available to use Trusts to receive IRA's since almost all inherited IRA's have a 10-year payout. However, IRA beneficiaries may now want to defer the receipt of an inherited IRA to the next generation (even if a minor) while still controlling the IRA account distributions. This maneuver is almost impossible when simply naming individual beneficiaries of an IRA account.

5. TOD's do not help ensure that the assets stay in the family "bloodline". Many clients indicate that they've worked hard for their money and saved for decades to amass a nest egg. Well, once you name a beneficiary as the TOD recipient of your investment account, the assets can go anywhere after they receive them – including to a spouse who later may transfer them to a new spouse or children from a prior or successive marriage. Clients have told us that they prefer the inheritance stays in the family bloodline and if one lineage has no successors then the other family line receive the remaining assets.

6. Even though certain investment accounts, bank accounts and IRA's can be designated as TOD, there are many that cannot. Assets such as your home, investment properties, vacation homes, family camps, closely held business interests, etc., may not be able to be set up as TOD in Pennsylvania. So, these assets must still be dealt with through probate or other means. Furthermore, if any real estate assets are located outside the state in which the client resides, there may be another surprise waiting called "ancillary probate". Nothing like having to hire two law firms (and pay both) in two different states to round up the estate assets.

The good news is that through comprehensive planning, usually involving some type of family trust, all of the issues enumerated above which TOD account designations cannot solve, actually can be solved.

So, the next time someone (maybe one of your advisors) offers to give you legal advice about how to just name your investment accounts as TOD so you can avoid comprehensive estate planning, ask him or her to sign the following indemnification agreement (since we are talking legal advice here, right?).

"I, (insert advisor name), have advised my clients (insert client names) that they do not need to engage in comprehensive estate planning for their estate for issues arising during lifetime or after death and that the clients should simply name all financial assets with a Transfer on Death designation for their intended beneficiaries. I (insert advisor name) agree to indemnify and hold harmless clients against all claims, liability, court costs and all attorney's fees resulting from client's exposure to any of the following: unintended tax exposure of any nature at the local, state or federal level; loss of value or wasting of assets received by a TOD beneficiary who is under a disability now or in the future or is sued, divorced, files bankruptcy, dies without his own estate plan to keep clients assets in the family bloodline or makes foolish investments or purchases. I also will indemnify client for the additional costs of probate in any jurisdiction in which the client owns an interest in real estate."

Okay, so not too many advisors will sign this indemnification agreement, so here's one that more accurately depicts the "advice".

"I, (insert advisor name) have advised my clients (insert client names) that on the investments which I manage they should name a Transfer on Death (TOD) beneficiary for the sole purpose

of avoiding probate of these specific investment accounts. I have given no other advice about the balance of their estate plan and they should seek legal counsel to determine the best course of action."

In summary, "advice" given by everyone**,** from the bank teller to the neighbor you watch football with**,** recommending designating investment accounts as TOD only addresses one very narrow aspect of comprehensive estate planning. The costs of ignoring the rest greatly outweighs the cost of addressing all the issues now.

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