

# Transfer-on-Death Designations

## Understanding the Pros and Cons

Transfer-on-death (TOD) designations provide a simple, direct process for transferring assets to named beneficiaries, bypassing the probate process. While this simplicity is attractive, it can also have drawbacks. That's why it's important to understand both the pros and cons.

### What It Is

A TOD designation is an agreement between you and a financial institution. In it, you can designate the person(s) who will become owner(s) of the assets in your account upon your death.\*

### How It Works

During your lifetime, you retain full ownership and control of assets in a TOD account. You can manage the investments as you see fit, make additions or withdrawals, and move or close the account if you wish. You receive all interest, dividends or other income, and you are responsible for taxes on any income or capital gains. You may change or revoke the TOD designation at any time, as long as you are not legally incapacitated. Beneficiaries do not have any ownership or other rights in the account during your lifetime.

Upon your death, the named beneficiaries become owners of a designated percentage of the account assets. A TOD designation results in a direct transfer to your named beneficiaries. The assets in your TOD account are distributed according to your beneficiary designation and the terms of the TOD agreement and are not subject to probate.

#### A TOD designation may fit if you want to ...

- Make a simple, outright distribution of assets to one beneficiary at your death
- Transfer account assets to several beneficiaries who get along very well and will cooperate in dividing the assets
- Distribute a particular account differently from the rest of your estate plan
- Retain the ability to easily change your beneficiary designation and avoid giving beneficiaries ownership rights until after your death

#### A TOD designation may *not* be a good fit if you ...

- Want a flexible distribution plan that can address multiple contingencies
- Want to create trusts for beneficiaries or restrict how and when they will have access to assets
- Want a comprehensive plan for your overall estate
- Need to designate a particular person, such as an executor or trustee, who can take charge of paying final expenses and wrapping up your financial affairs
- Want assets in the account to be actively managed until distributions to beneficiaries can be made

*\*TOD designations are permitted in all states except Louisiana.*

- Need to include estate-tax-planning provisions in your estate plan
- Have assets that will not be easy to divide among multiple beneficiaries
- Want to name multiple beneficiaries who might have differing ideas about how to divide the account assets

Let's consider that last item in more detail. It's important to understand that if you name more than one beneficiary on a TOD account, all of the beneficiaries become co-owners of the account as "tenants in common" when you die. Because they all now own the account assets together, they all have to agree on decisions regarding those assets. Problems can arise if one beneficiary is uncooperative or unavailable, and disagreements over seemingly simple matters can result in an impasse. For example:

- Disagreements sometimes arise when assets cannot be divided as set forth in the TOD agreement (for example, an account comprising 10 \$1,000 bonds from different issuers and with three beneficiaries, each of whom are designated to receive an equal share).
- Sometimes beneficiaries each want to "pick and choose" among assets from the account but cannot agree about who gets a particular stock or bond.
- Tax reporting can be problematic. Each beneficiary should be responsible for his or her share of the account's income and gains realized after death. However, financial institutions typically can issue only one Form 1099 for an account.
- There can be challenges in finding the named beneficiaries, whether individuals or charities, which can lead to a delay in distributions to the other beneficiaries.
- Charities are sometimes reluctant to open a brokerage account to receive distributed assets, which can also result in delays in distributions to the other beneficiaries.

In contrast, when property passes under a will or trust, there is usually one person (an executor or trustee) in charge. When decisions need to be made, the executor or trustee has the authority to "make the call." Typically, distributions to beneficiaries are made after the executor or trustee has made arrangements to take care of bills, administration expenses and taxes.

TOD is designed to be simple – so it works best when your instructions are straightforward. If you have a complicated situation, you may need a more complex document, such as a will or living trust, to ensure your wishes are carried out.

## How It Is Implemented

You make a TOD designation by filling out a form the financial institution holding the account provides. The form is a legal agreement between you and the firm. Read the TOD agreement carefully because it will explain what the rules and limitations are, what types of assets and accounts are eligible, as well as the mechanics of making distributions.

A TOD designation can have important legal and tax implications, so it makes sense to talk with your attorney and CPA to determine whether a TOD designation is appropriate for your particular situation and whether it fits with the rest of your estate plan.

## Frequently Asked Questions

### *If I have a TOD account, do I still need a will or living trust?*

Yes, in most cases. A TOD designation does not replace a sound estate plan. It affects only the assets in a particular account. You may still need a will or living trust to govern the distribution of other assets.

### *If I have a TOD account, do I still need a durable power of attorney?*

Yes. A TOD designation is effective only at death; you still need to plan for the possibility of your disability or incapacity. A durable power of attorney lets you name a trusted person who can manage assets for you in the event of your incapacity.

### *What happens if my will (or living trust) and my TOD designation do not agree?*

The account with the TOD designation will be governed by the TOD designation, not the will or trust. Assets in your probate estate are governed by your will. Assets titled in the name of your living trust will be distributed according to the terms of that trust.

### *Can I name more than one beneficiary?*

Yes, and you can specify the percentage of the account that you want each beneficiary to receive.

### *Can I name minor children and grandchildren as beneficiaries?*

It's not advisable to name a minor (younger than 18 in most states) directly as the beneficiary. You need to take additional steps to designate an adult who can manage the account for the minor's benefit. One approach would be to designate a custodian under either the Uniform Transfers to Minors Act (UTMA) or Uniform Gifts to Minors Act (UGMA) who could be responsible for the account until the child reaches the distribution age specified under state law (18 or 21 in most states). If you are transferring substantial amounts, or if you want to specify a later distribution age, it may be wise to consult an attorney about creating a trust for a minor child or grandchild.

### *How do beneficiaries get their distributions?*

Typically, beneficiaries must provide a death certificate and an affidavit of domicile and complete a distribution request form. If state law requires, a state tax waiver may also be needed. To facilitate the asset transfer, some financial institutions require beneficiaries to open an account to receive assets from the TOD account. Once appropriate documents are received, assets will generally be distributed in-kind.

### *If I have an account titled as "joint tenants with right of survivorship," can I still make a TOD designation?*

Yes. When one of the joint tenants dies, the account passes to the surviving joint tenant. When the survivor dies, the TOD designation becomes effective, and the account passes to the named beneficiaries. Keep in mind that the TOD designation can be changed or revoked during either joint tenant's lifetime. So after one joint tenant dies, the survivor retains the power to change the TOD designation.

## You can count on us

Your financial professional can provide additional information about TOD designations and help determine whether this is the best way to title your account.

### *If I have a TOD account and give someone power of attorney, can they change my beneficiary designation?*

Generally no. If the power of attorney is accepted, your named agent will be able to manage the account or make withdrawals according to the terms of the power of attorney, but in most cases, he or she would not have the authority to change your TOD designation.

### *Can someone holding a power of attorney create TOD designations for me if I am incapacitated?*

Generally no; a third party cannot establish, revoke or change a TOD designation for you.

### *What's the difference between TOD and POD?*

“POD” means “pay on death,” which is a type of nonprobate transfer permitted under banking laws. Usually POD refers to a beneficiary designation on a bank account, and TOD refers to a beneficiary designation on a securities account (or other types of property in some states).

### *Are TOD accounts subject to estate taxes?*

Potentially yes. While a TOD designation removes assets from the probate process, they are still counted when determining the value of your taxable estate for federal or state estate tax purposes.

### *Do assets in a TOD account receive a “step up” (or “step down”) in cost basis when the account owner dies?*

Yes. Securities held in TOD accounts receive a new cost basis as of the account owner's date of death using the same income tax rules that apply at the death of an individual.

*The contents of this report reflect our understanding of current interpretations of the law and current rules pertaining to TOD designations. The laws are always subject to different interpretations and possible changes; therefore, it is recommended that you seek legal advice. Our firm does not render tax or legal advice. If tax or legal advice is required, seek the services of a qualified professional.*

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