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REAL ESTATE AND YOUR ESTATE
THE REVOCABLE TRUST DEED

by REALTOR RUSS MILLER

For some reason that I will never understand, one of the first major legal transactions a widow or widower considers after the death of a spouse is transferring the family home to a child or children, or at least adding their names to the deed as Joint Tenants with Rights of Survivorship. Always a bad decision in my opinion. In estates that are subject to heavy Federal Estate Tax, gifting is sometimes advisable as estate planning strategy, but it rarely, if ever, includes the family home.

SAVE 6% BUT PAY 33%???

The reason usually given by the widow to do such an unwise thing is that they want to give the house to the child or children so that the children will save the State Inheritance taxes. There are no savings for the parent. In Pennsylvania the savings are a mere 6%. Why anyone thinks that saving 6% inheritance tax for an heir, who may or may not survive until after your death is important enough to sacrifice all of the security and benefits of individual ownership for the living parent eludes me. Even the income tax benefits, senior citizen tax benefits and veterans benefits (if any) for property owners, during the rest of one's lifetime could amount to many times the potential inheritance tax.

It is true that a child may save state inheritance tax in Pennsylvania and many other states, but when a parent transfers their property to a child for a nominal consideration (usually $1.00 shown on the deed), the child now assumes the same tax base (purchase price) as the parent. When the child sells the property after the death of the parent, all of the capital gains will now be taxed to the child at ordinary income tax. In 1988, that could be 33% instead of the relatively small state inheritance tax. However, when a property is inherited, the tax basis is then "stepped up" to the value at the time of death, therefore the only capital gain would be if there were any increase in value after the date of inheritance, which could be nothing or minimal.

The only way the child could reduce the tax on the capital gain would be if the home were used as the child's principal residence for three out of five years before a sale and if the child were over 55 at the time of the sale. In such a case, up to $125,000 of a gain could be tax exempt from income tax, unless the law changes. No such exemption would be available if the child lived elsewhere.

Joint ownership with children subjects the property to all claims against the children including judgments and creditors claims. It also forfeits or reduces tax breaks and refunds afforded to senior citizens and veterans since ownership has been reduced to one half. Mortgage interest and real estate taxes will no longer be deductible from one's income tax return, and the same income tax of up to 33% (1988 rates) on capital gains will exist on ½ of the property by the surviving child as in the above paragraph.

ALL MAY BE LOST TO AN IN-LAW

If the entire property has been deeded away while you are still living, all of your ownership benefits are completely lost. You may also face the very serious problem of your title passing completely by inheritance to the surviving spouse of your child in the case of the child's untimely death which death could precede yours. How would you like to see your daughter-in-law or son-in-law living in your house with his or her live in friend? If you are still living there, you can be forced to move out of your own house, the very same house that you wanted your child to have in order to save your estate a 6% inheritance tax.

PROTECT THE ASSET FIRST

If saving money is the objective, more important would be steps to avoid probate which could be twice the savings of the Pennsylvania Inheritance Tax. Of even greater importance than all of the tax or probate avoidance techniques, is preserving the safety of the title for the owner and protecting it from loss due to unexpected judgments or creditors' claims against the children. If you want your children to someday own your house, YOU MUST PROTECT AND PRESERVE THE ASSET, first for yourself, then for them.

A WILL IS ONE WAY

The safest way to be sure your children will inherit the family real estate is to state your wishes in a Will. A will however must be probated, thus the relevant expenses are imminent, including executors fees, counsel fees, probate costs and State inheritance taxes which could approximate 18%. If Federal taxes are applicable as with larger estates, then more taxes would be due. If your heir is not a lineal heir, (Mother, Father, children or grandchildren), the cost can increase to 27% excluding federal taxes. Typical charges are:

1. Penna. inheritance taxes, 6% lineal heirs or 15% for collateral heirs.
2. Executor's fees, 6%
3. Counsel and probate fees, approximately 5% to 6%. However your executor or administrator may negotiate for Counsel fees.

AN EASIER WAY

To be sure that your child or children will immediately own your property upon your death, with minimal expenses, a "Revocable Trust Deed" could be the answer.

The revocable trust deed is not generally used by lawyers for two simple reasons: (1) Most are not familiar with the document and, (2) such an instrument, or any other probate, greatly reduces if not completely eliminates the counsel fees at the death of the owner or Grantee/Trustee of the trust. Some lawers may view the trust deed to be tantamount to a REALTOR giving a seller a sales sign to sell his own property.

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This type of deed is a tool of the real estate profession more often used by REALTORS for the special cases warranting it's use as outlined here.

WHEN TO USE A "REVOCABLE TRUST" TYPE DEED

Some desirable uses are as follows:

1. For the couple, individual or the surviving spouse who desires one particular child to inherit the property to the exclusion of others and avoid probate. Alternate beneficiaries may also be named if desired in the event the named child pre-deceases the parent.
2. For any couple or individual wishing that property will pass to any person but not by a Will where it could be contested by any legitimate heir. Example would be from an Aunt to a favorite niece, or from an individual wanting a special friend such as a close companion, to inherit property who would not ordinarily be in the line of descendence.
3. For anyone wishing to avoid probate costs and minimize administration and legal fees. NOTE: THIS TYPE DEED DOES NOT AVOID INHERITANCE OR ESTATE TAXES.
4. For second marriages where one of the spouses comes into the marriage owning property and wants it to pass to their children upon their death. This case can also be coupled with a life estate so that the surviving spouse can live in the property until death, after which the children take possession through the trust deed.
5. For separated persons with children whom they wish to inherit the property after their death without the hindrance of an estranged sprouse. This is not completely foolproof since a spouse cannot be totally disinherited in Pennsylvania, however because the property does not pass by will or intestate rules, it is very unlikely that an estranged surviving spouse will ever start an action to prevent their own children from taking title, furthermore, the estranged spouse may never even discover the trust arrangement. Nothing is perfect, but short of just giving the property away while you are living, this has a better chance of success than most plans.

TRANSFER TAXES

Transfers of this type are generally exempt from state and local transfer taxes if the beneficiaries are issue or siblings of the trustee. If however the beneficiary (in Pennsylvania) should be a collateral heir (excluding siblings) such as a cousin, niece or just a friend, the transfer tax on the value of the property would be due.

THE RIGHT ATTORNEY

Finding an attorney experienced with the use of such a trust may take a little research. Title Insurance Companies are a good source for the revocable trust language that they will insure, both in and out of title.

A WILL IS STILL A NECESSITY

The Revocable Trust Deed should never be considered to take the place of a will but is only part of good estate planning. Wills are still the basic instrument for passing on personal and real property and/or other assets acquired after creating a trust and a real estate trust does not deal with the rest of an estate.

The Mortgage Market

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bond market has made the routine issuance of interest rate commitments in advance of settlement a risky business. Lenders who fail to properly insulate themselves from this risk may be forced to decide between the wholly unacceptable alternatives of rescinding interest rate commitments to applicants or total financial catastrophe.

To preserve professional integrity with customers and to maintain control over the ultimate objective of quality settlements, Realtors should learn to evaluate the interest rate risk management capability of the lenders to whom they make customer referrals.

Since the world of the secondary market and interest risk management is highly complex it is not suggested that it is necessary for Realtors to become experts in this area. However, it would be prudent for all Realtors to have a working knowledge of the fundamental terms and concepts of financial risk management. This can best be accomplished by meeting with the individuals responsible for investments and secondary marketing at the lenders with whom they have working relationships.

Once these meetings are concluded the Realtor should be satisfied on two counts: 1) That their lenders identify in advance of issuing interest rate commitments where the committed loan will be placed; and 2) That their lenders identify what, if any, interest rate risk is posed by a change in the interest rate environment prior to the ultimate settlement and placement of the loan by their institution.

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