In many if not most cases, a probate proceeding would be required to pass a deceased person's estate to his heirs unless he has arranged his affairs before his death to avoid probate. Such proceedings typically take from eight months to two years or more, during which time the decedent's estate is tied up. Attorneys' fees and executor's or administrator's commissions are charged. Expenses are incurred for filing fees, appraisal fees and other items. (The fees and costs involved in probate proceedings should not be confused with estate or inheritance taxes.) In general, administrating a probate estate involves a considerable amount of work.

As a rule, it is desirable to avoid probate proceedings. One method (which will not be discussed in this pamphlet) is that of a living trust. Other methods include outright gifts, joint tenancies, community property, and Totten (savings account) trust. Such methods usually involve some loss of control over the asset.

Gifts

An obvious but risky way to avoid probate is to give the property away before death: there is no need to transfer title on death for assets already given away. The equally obvious disadvantage is that the person making the gift loses control over the property after the gift is made. This method of avoiding probate should only be used if one really doesn't need the property or if he is absolutely sure that the person being given the property will use it as he desires.

There may be tax consequences to making gifts. Each person is allowed to give away up to $1,000,000 in gifts during his lifetime without gift tax, but gifts over that amount are subject to that tax. (Gifts qualifying for the annual exclusion do not count towards the $1,000,000 limit. In 2009, the annual exclusion amount is $13,000 per person.)

There may also be income tax consequences. The recipient of a gift is not required to pay income tax on the gift itself, but in some circumstances, he may be required to pay capital gains tax if he sells the property.

Capital gains tax is generally owed if one sells an asset for more than he purchased it for. The amount of the gain is the difference between what the asset is sold for and the amount of its basis.

The basis of something received as a gift is the basis which the giver previously had, which is essentially the amount the original owner paid for it. However, if one receives property by reason of the death of another (such as through his will), the receiver's basis is the fair market value of the property at the time of the death.

The higher the basis one has in an asset, the less tax he will have to pay when it is sold.

For example, suppose Mr. Smith, Sr. wants to give some stock he owns to his son, Smith, Jr. Also, suppose Smith Sr. bought the stock for $100 and it is now worth $200. If he gives the stock to Smith, Jr. who promptly sells it, Jr. will have to pay tax on the $100 gain. However, if Smith, Sr. had waited to give Jr. the stock on his death, and Jr. then sold it, Jr.'s basis would be $200, the same as the selling price. Smith, Jr. would have to pay no tax.

Joint Tenancy

Holding title as joint tenants is a common method used to avoid probate. Property held as joint tenants automatically becomes the property of the surviving joint tenant(s) after one of them dies. Almost any type of assets may be held in joint tenancy, including real estate, bank accounts, stock, and mutual funds. Because a joint tenant's interest in property transfers by operation of law to the surviving joint tenant(s), no probate is required. Accordingly, one may avoid probate proceedings by placing an asset in joint tenancy with the person to whom he desires it to go on his death.

There are many disadvantages to such an arrangement. Depending upon the type of asset involved. In particular, real estate, the previous sole owner of the property may have to obtain the consent and signature of the other joint tenant if he ever wishes to sell, encumber or otherwise dispose of the asset. For other types of property (such as joint bank accounts), the new joint tenant could take it all for himself, even while the contributing joint tenant was alive. The new joint tenant's creditors may attempt to look to the property for satisfaction of their claims.

Another disadvantage that comes up occasionally is that the creation of joint tenancy in real property with someone who is not the parent, child or spouse of the original owner will constitute a change in ownership to some extent, and may trigger an increase in property taxes.

The general rule is that if a party places another's name on property for convenience, the IRS will treat it as having been received as a result of the original joint tenant's death and not in part a gift during life. The basis in the property is the fair market value on date of death and no capital gains tax is due if it is sold immediately. In some cases, the IRS might take the opposite position, so relying on the rule may be risky.

Community Property

Unless a deceased spouse's interest in community property is disposed of by will, it automatically becomes the property of the surviving spouse on death in much the same manner as joint tenancy property. If the deceased spouse has made a will, she may give her half of any of the parties' community property to whomever she wishes, unless title is taken as community property "with right of survivorship" in which case it must go to the surviving spouse no matter what the deceased spouse's will says.

A major advantage in taking title as community property as opposed to joint tenancy is that the income tax basis in the property is increased to the fair market value on the death of the deceased spouse. For joint tenancy property, only the half interest of the deceased spouse receives a step up in basis. This can be a major benefit to the surviving spouse.

Suppose a couple owns an apartment building they purchased for $100,000. When the husband dies, it is worth $2,000,000, and the wife sells it immediately. If the property were held as joint tenants, the wife's basis would be $1,050,000: a stepped up basis in the husband's half interest (half the value of the property, or $1,000,000) plus the basis on her half interest, or $50,000. She would have to pay capital gains tax on $950,000. However, if title were held as community property, her basis would be $2,000,000 and no tax would be owed.

Pay On Death Accounts

Bank and savings accounts may be set up so that on the death of the owner(s), the monies on deposit become payable to someone else. Sometimes such accounts are called Totten trusts. Often the account is in the name of the owner of the money in trust for someone else. While the owner is alive, he may use the money himself, close the account or change the ultimate beneficiary. On the owner's death, the money automatically belongs to the beneficiary.

Such an arrangement only applies to bank or savings accounts, and are not allowed for real property, stocks, bonds, etc.

ABOUT ESTES & ESTES

Estes & Estes represents clients in estate planning and administration matters, as well as litigation relating to those areas. The firm's attorneys have collectively more than 50 years of service to families in South Orange County.

We strive to deliver legal services at the highest level and at the same time, fully understand the unique needs of each of our clients.

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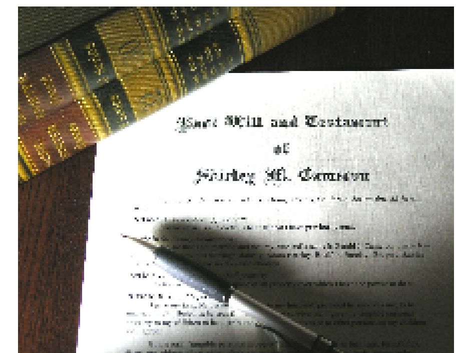
AVOIDING PROBATE WITHOUT A TRUST



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