



Richland Properties

## ***Real Estate News & Information***

### **Estates, Probates, and Property Inheritances**

#### **Ideas to Consider When Administering An Estate, Receiving Property Inheritances & Selling the Estate's Real Property**

No person likes to be in the position of dealing with legal, tax, and business issues surrounding the death of a loved one or close friend. However, at some point almost everyone will have to deal with issues involving an estate. This article discusses some of the common issues that are encountered by estates and their representatives when the estate owns real property in California.

#### ***Sell or Keep the Real Property?***

Most estates own some type of real property. As a result, the heirs and the estate's representative are usually confronted with the decision of whether to sell or keep the estate's property. This decision will depend on many factors that are unique to each estate. Below is a list of some of the factors that the estate's heirs should consider when making their decision to sell or keep the estate's real property.

#### ***Income Tax Basis of Inherited Property***

Generally, property owned by the decedent is revalued at the date of death of the decedent to give the property a new income tax basis for the heirs. This revaluation is commonly referred to as a "step-up" in basis because the property's income tax basis is usually increased. This is a "free" one-time step-up in the tax basis which allows all of the decedent's prior capital gains to be forgiven. This basis increase occurs because the decedent's property was usually purchased a long time before death and has a low income tax basis at the time of death.

How title is held by the decedent is very important for the heirs of the estate in determining the amount of the "step-up" in basis of the property. This is especially true when the decedent did not own 100 percent of a piece of property. This most often occurs when the decedent co-owned property with their spouse and to a lesser extent with their children or relatives.

California is a community property state and California property owned by a husband and wife is generally either community property or property that is separate property. For estate tax purposes, community property generally receives a "step-up" in basis for 100 percent of the property and not just for the one-half that is usually owned by the decedent.

Property that is co-owned by a decedent spouse that is not community property generally will receive the basis "step-up" for only the share of the property that is owned by the decedent. Therefore it is very important to determine if a married decedent has community property or separate property.

For most married people, title is usually held on the deed to their property in joint tenancy, in a living trust, or as community property. Living trust agreements usually state in the agreement which property will be considered community property. Property held in joint tenancy may sometimes be considered community property, but you have to take certain steps to substantiate this fact and you should consult with your legal

and tax advisor for guidance in this area.

### ***Appraisals/Valuation***

If the estate decides to sell the property shortly after the death of the decedent, then it is generally not that important to get an appraisal of the property unless the property is going to be probated or the estate representative feels an heir may question the sale of the property. A formal appraisal would generally not be necessary because the property's value for estate tax purposes on the date of death of the decedent will probably be the same as the property's selling price. However, if the value of the property is experiencing large swings in value in a short period of time before the property will be sold, then it may be wise to discuss with your tax advisor the benefits of getting an appraisal of the property. Many estate representatives do decide to get appraisals of the estate's real property to provide to heirs

Once a decision has been made by the heirs and the estate's representative to keep the real property, an appraisal of the property should be obtained by a licensed real estate appraiser. An appraisal should generally be obtained even if the value of the estate is below the level that will require an estate tax return. Also, an appraisal should be obtained even when the estate is exempt from estate taxes because all of the property is inherited by a qualified spouse.

The estate should obtain an appraisal of the real property for the following three reasons: (1) it sets the value for estate tax purposes if an estate tax return will be filed, (2) it establishes the income tax basis for the estate's property that will be used for computing any future allowable depreciation deductions if the property will be used as a rental property, and (3) it establishes the income tax basis of the estate's property which will be needed in the future when the property is sold or given away by the heirs. It should be noted that if the estate does not own a 100 percent interest in a property, then only the portion of the property actually owned by the estate will be affected by the appraisal.

### ***Property Tax Reassessment/Exemption***

In California there is an exception to the general rule that real property is reassessed for property tax purposes when there is a change in ownership. This exception allows parents and children to transfer certain property among themselves without having the property reassessed at the time of the transfer. The old property tax base is "rolled over" and the new owner pays property taxes at the old owner's assessed value.

Transfers of property between parents and children that may qualify for this treatment are (1) transfers of a principal residence and (2) transfers of the first \$1,000,000 of value (value is defined in the law), per transferor, of certain property other than a personal residence. The parents, children and the property transferred have to meet certain criteria. In general these rules apply to transfers upon death if all of the law's provisions are met. You should discuss with your legal and tax advisor how the law is applied to your specific case.

### ***Selling The Estate's Real Property***

#### **Non-Probate Property**

Real property that generally does not have to be probated is property that is held in joint tenancy and property held in a living trust. For property held in joint tenancy, generally an affidavit of Death of Joint Tenant is filed at the county recorder's office. Once done, a sale of the property can usually proceed like a regular sale of property. However, your tax advisor may advise against this if there are concerns over the property's status as community property. Check with your tax advisor for details.

Property held in a living trust can be sold by the successor trustee while still in the trust or sold later

by the beneficiaries. If the successor trustee decides to sell the property out of the trust, a real estate agent can advise you about some of the unique rules that apply to these sales.

Community property can usually be sold after the surviving spouse waits a specified amount of time and files certain documents with the county recorder's office. See your legal advisor for details.

### ***Probate Property***

The estate representative will usually probate the estate under the California Independent Administration of Estates Act, the "IAEA." Under the IAEA, the estate representative will be given certain powers by the probate court. These powers are called "Full" powers or "Limited" powers. An estate representative with Limited powers is not allowed to sell real property without court confirmation. An estate representative with Full powers can sell real property without court confirmation as long as the heirs receive proper notice and do not object. Today more and more probates are being handled this way.

Sales of probate property without court confirmation are very similar to regular sales of property. As a result, there are usually more buyers interested in purchasing these properties and more realtors willing to show these properties than for properties that have to go to court for confirmation. Additionally, a sale of the estate's property that has to go to court for confirmation has more perceived risks because the selling procedures are different from a normal sale.

For example, for court-confirmed sales, the buyer's earnest money deposit usually has to be a cashier's check equal to 10 percent of the purchase price. Under regular sales, buyers usually come up with an earnest money deposit equal to 3 percent of the purchase price. Also, under a sale requiring court confirmation, the buyer's loan contingency period has to be removed before the sale is filed with the court for confirmation. As a result, the buyer usually has a very short time period to arrange financing.

Additionally, the buyer of a property requiring court confirmation spends time and money on inspections, bank appraisals, etc., and can lose all of this money and time if another buyer comes to court and overbids them on the day of the confirmation. As a result, probate properties sold without court confirmation usually sell faster and for greater amounts than sales requiring court confirmation. There are other arguments for and against sales with court confirmation and for sales without court confirmation. You can discuss these with your legal advisor for your particular situation.

### ***Transferring the Estate's Property***

Once the heirs of an estate decide not to sell the estate's real property, the next decision is usually to transfer the property to the heirs. Before transferring any property you should consult with your legal and tax advisors because the transfer could have significant legal and tax ramifications.

How property is transferred to the heirs will depend on how title to the property was held by the decedent and whether or not the property was co-owned with someone else. Generally property owned by the decedent is held one of several ways: (1) 100 percent as an individual, (2) co-owned with someone else as joint tenants, tenants-in-common or community property, or (3) by an entity such as a living trust.

Property that is 100 percent owned and held by the decedent individually in their name will generally have to be transferred under the laws covering probate transfers. Probate sales of real property will be discussed below. Property that is co-owned by the decedent may be transferred with or without probate depending on how title is held and depending on the goals of the heirs and/or the remaining co-owners who receive the property.

Property owned in a living trust can be transferred to the beneficiaries according to the terms of the

living trust agreement. Generally, most trusts will allow the successor trustee or trustees to deed the property directly to the beneficiaries if there are no other estate planning objectives listed in the trust agreement. Each living trust agreement should be consulted for the specific method of transferring property.

When making property transfers, the heirs of an estate should also consider the impact of other laws that could be triggered by the transfer such as state and local transfer taxes, state and local energy and retrofit ordinances, state and local laws regarding smoke detectors and water heating bracing, and lender rights under existing loans against the property.

### ***Miscellaneous***

Many properties owned by estates remain vacant for long periods of time while the heirs decide what to do with the property. Under many insurance policies, properties remaining vacant for a period of 30 to 60 days can be denied certain types of insurance coverage. Check with your insurance agent to see that you do not have this problem. Heirs who decide to keep the estate's real property should consider getting the property inspected by qualified roofers, contractors, and termite companies. Many times the heirs are not familiar with the condition of the property they are inheriting, and these inspections can help identify deferred maintenance such as bad roofs and termite and dry rot problems.

Estate representatives should be aware of their obligation to ensure that all of the estate's tax liabilities are paid. The estate representative might want to consider applying for and receiving a release from personal liability from the IRS before paying out money or property to the heirs. See your legal and tax advisor to determine if this is necessary in your case.

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