Advisory
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WIGGIN AND DANA
Counsellors at Law

Strategies for Owning Property in Multiple States

Ownership of property in multiple states can raise many estate planning issues. Whether you own property directly or through an entity (such as a trust or corporation) may have a dramatic impact on the settlement of your estate and the taxes due. Fortunately, there are numerous ways to structure ownership of property. Which way is best for you and your family will depend on your goals and interests.

In deciding how to hold real property, you should keep in mind a few concepts relating to domicile, probate and state estate taxes.

Domicile versus residence. Although the words domicile and residence are often used interchangeably in conversation, they are two distinct legal concepts. Your domicile is the place you intend to make your home. You may have more than one residence, but you have only one domicile. Domicile is indicated by a number of factors, which can include the location of your principal residence, the length of time that you spend at a residence, where you file your income taxes and your subjective intent as to where your domicile is.

State Estate Taxes. For estates of substantial value, federal estate taxes are always a consideration (even at times, such as 2010, when federal estate taxes are temporarily repealed). But the state in which your property is located may impose a separate state estate tax that should also be considered. Connecticut, New York, New Jersey, Massachusetts and Pennsylvania impose state estate tax; Florida does not. However, if, for example, a person domiciled in Florida owns property in New York, he or she may be subject to New York estate tax on the New York property. Fortunately, through careful planning, it may be possible for the Floridian to avoid this estate tax.

Probate. Probate is the process by which a court grants a person (an executor, personal representative or administrator) authority to deal with property owned by a now deceased individual as directed in the individual's will. During the probate process, beneficiaries and heirs may contest the validity of a will and may object to how an estate has been administered. While this may lead to litigation, probate is not necessarily a bad thing, as it provides a mechanism to resolve legitimate disputes. Nonetheless, probate can be costly, time consuming and stressful for surviving family members. Contrary to a popular misconception, minimizing (or even completely avoiding) probate and minimizing estate taxes do not go hand in hand. More typically, estate taxes apply regardless of whether one or more state probate proceedings are required.

Ancillary Probate. Most individuals own property outright, and, upon death, a will controls the disposition of the individual's property. Typically, the executor named in the will initiates the required probate proceeding and the probate judge grants the executor authority to deal with the decedent's assets. If a decedent owns property in multiple states, the executor must apply to the probate court in each jurisdiction and request authority to deal with property in that place. These additional probate proceedings in other states are called "ancillary probate."

Case Study: To see how effective estate planning can reduce taxes and estate administrative costs, consider the following hypothetical.

> *Assume you are domiciled in Connecticut, and that you own a primary residence in Connecticut, a summer home in Massachusetts and a winter home in Florida. You also own a commercial property in New York. Further assume that your estate planning consists only of*

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Changing Domicile

If you decide to change your domicile, you should consider taking the following steps to establish, objectively and subjectively, that you have done so. When disputes arise over a person's domicile, probate courts look at a number of factors to aid them in determining a person's domicile. Chief among those factors are the following:

- Buying or leasing a residence in the new state.
- Spending more than 183 days per year at the new domicile.
- Filing tax returns from the new state.
- Obtaining a driver's license in the new state and registering cars and boats there.
- Registering to vote in the new state, and voting regularly.
- Filing a declaration of domicile (if available in the new state).
- Moving bank accounts and safe deposit boxes to the new state.
- Declaring a change of address.
- Changing legal documents to reflect your new residency.
- Joining clubs, places of worship and other organizations in the new state.

With the coming of winter, are you thinking of relocating to a warmer climate? If you are, we can help you to transition your legal affairs and ensure that your estate planning documents continue to meet your needs. We have attorneys licensed to practice in numerous jurisdictions, including Florida and California, and we have relationships with attorneys in most other states.

a simple will, leaving all of your assets outright to your spouse, or if you have no spouse, to your children or other family members.

In this scenario, in the event of your death, your executor will need to initiate probate proceedings in four states- Connecticut, New York, Massachusetts and Florida. Your executor will likely need an attorney in each jurisdiction to help with the probate process and to transfer the real estate. Your estate will owe state estate tax in Connecticut, New York and Massachusetts. There will be no state estate tax on your Florida property because that state does not impose a state estate tax.

Is there a way to minimize the administration costs involved in multiple ancillary probate proceedings? Yes, by holding the property jointly with another person or by transferring it to a revocable grantor trust.

Joint Property (with right of survivorship). One of the simplest ways to minimize probate, and therefore reduce administration costs, is to own property jointly with another individual who is given a right of survivorship. For example, if you owned the Massachusetts property noted above jointly with your spouse, then upon your death the property would pass to your spouse by operation of law and no probate proceeding would be required to transfer the property. Nonetheless, this approach may be not the best solution. Jointly held real property is also often associated with tangible personal property (such as household furnishings and vehicles) that can themselves trigger the need for an ancillary probate proceeding. There can also be gift tax issues, and by holding property jointly you may lose the opportunity to make more tax efficient use of the property for estate tax purposes. Thus, the advantages gained by minimizing probate and the related administrative costs through the use of joint property can be lost when weighed against the estate tax consequences.

Revocable Trust. If, instead of owning property outright or jointly, you were to transfer your property to a revocable trust (sometimes known as a "living trust"), probate of the assets in your trust after your death usually will not be required, because the trust owns the property, not you individually. The trust would own the property, but you may be the sole trustee during your lifetime and may distribute trust property to yourself for any reason. The revocable trust would contain the dispositive provisions that would otherwise be contained in your Will, including the creation of trusts that may minimize estate taxes.

For example, assume you execute a revocable trust and are the sole trustee during your lifetime. You transfer all of your property to the revocable trust, including your primary residence in Connecticut, your summer home in Massachusetts, your winter home in Florida and your interest in the commercial property in New York. Upon your death, the successor trustee named in your trust agreement succeeds to the position of trustee. Probate is not required to transfer your properties, as they are already owned by the revocable trust. Probate costs and transaction costs will be reduced. However, your estate will still be responsible for paying state estate tax to Connecticut, Massachusetts and New York.

Estate Tax Savings Strategies

Use of a revocable trust is one way to avoid probate while still owning property. The revocable trust may also include provisions to establish trusts after your death to take advantage of your estate tax exemptions (federal and state).

To achieve further estate tax savings, you may need to consider other options, including irrevocable trusts and corporate entities or partnerships. Alternatively, you could sell or give the property away during your lifetime.

QPRT

A Qualified Personal Residence Trust, or "QPRT" may be an appropriate planning technique, especially if you own residential property that is not subject to a mortgage. With a QPRT, you would transfer residential property, such as the Massachusetts summer home in our example, above, to an irrevocable trust. You may continue to use the residence rent-free for a fixed number of years specified in the trust instrument (the "fixed term"), which should be a period that you are likely to survive. During the fixed term, you would continue to pay the real estate taxes, insurance, and expenses for maintenance and repairs, and may continue to deduct real estate taxes on your tax return. When the fixed term ends, the residence may be held in further trust for the named beneficiaries (presumably family members) or distributed outright to them.

Even after the fixed term ends, you may continue to use the residence. For example, by relying on a further trust, the residence may be retained for a spouse's lifetime and you may use the home together. Alternatively, you may lease the residence from the trust for its fair market value rent. Subject to the terms of the lease, you may be able to use the residence for as long as you wish.

While the initial transfer of the residence to the trust is a taxable gift to the ultimate trust beneficiaries, the value of the gift is less than the then fair market value of the residence, because the value of the gift is reduced by the value of the retained right to live in the residence for the fixed term. Thus, the amount of the taxable gift will be substantially less than the fair market value of the residence.

Assume you transfer the Massachusetts summer home to a QPRT and retain the right to live in the residence for a 10-year term. During the 10-year term, you continue to use the property as you have in the past. At the expiration of the term the property is transferred to a continuing trust for the benefit of your children, and you then rent the residence from the trust at the fair market value. Because you no longer own the property, at your subsequent death there is nothing to probate and there is no property on which to pay Massachusetts estate tax. You would have made a taxable gift when you initially transferred the property to the QPRT, but the value of the gift would have been reduced because of your retained right to live in the property during the initial 10-year term.

There are some downsides to a QPRT. Most notably, to obtain the estate tax benefits described above, you have to give the property away. Even if you can continue to use the property, you would not own it. Also, you would need to survive the fixed term to achieve the estate tax savings. This is especially the case for a Connecticut resident who transfers Connecticut real property to a QPRT, because if the donor does not survive the QPRT term, Connecticut may assess a gift tax at the time the QPRT is established and an estate tax on the property at the donor's death. (Federal law allows a credit for the gift tax in this situation, so only the estate tax would apply.) Assuming you survive the QPRT term, because the transfer to the ultimate beneficiaries is by gift, their tax basis in the property will be the same as yours – a "carry-over" basis. The beneficiaries will not get a "step up" in basis upon your death. Nonetheless, a QPRT has proven to be a powerful estate tax savings vehicle for many families, especially if the hope is that the property will stay in the family for future generations.

Business Entities

Even if you choose to hold on to your property and not give it away during your lifetime, there may be ways to avoid incurring state estate taxes by holding properties in an LLC, corporation or partnership.

If you were to transfer your interest in the commercial property in New York to a Connecticut LLC, you would no longer own real estate in New York, and, instead, would own a membership interest in an LLC that owns New York commercial real estate. While states impose estate tax on real property held in the state, an interest in a business entity, like an LLC, is "intangible" property that is usually considered to be held in the state of one's domicile. In this example, it maybe asserted that your interest in a Connecticut LLC is Connecticut property for state estate tax purposes.

Please note, however, that the law is not entirely settled on whether business entities holding real property are properly characterized as intangibles for state estate tax purposes. Recent developments in New York estate tax law cast some doubt on this, and, in some instances, New York may impose a state estate tax on an LLC or other corporate entity which owns real property in New York, if you are the sole member of the entity, if you control the entity, or if there is no legitimate business purpose for the entity. It is also not clear whether states other than New York will take this position. Planning opportunities using business entities may still be available but the planning analysis has become more complex. You will want to review this issue with your estate planning attorney.

If you own property in multiple states, it is wise to plan to avoid unnecessary probate and state estate taxes. To achieve these goals, revocable trusts, irrevocable trusts (including QPRTs) and ownership of property through entities can be very useful tools. Consider speaking with your Wiggin and Dana attorney to determine how best to structure your holdings to minimize estate administration and tax costs.

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