WIGGIN
WIGGIN AND DANA

ADVISORY

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If you have any questions about this Advisory, please contact:

MICHAEL T. CLEAR
203.363.7675
mclear@wiggin.com

VERONICA R. S. BAUER
561.701.8701
vbauer@wiggin.com

ROBERT W. BENJAMIN
212.551.2602
rbenjamin@wiggin.com

DANIEL L. DANIELS
203.363.7665
ddaniels@wiggin.com

HELEN C. HEINTZ
203.363.7607
hheintz@wiggin.com

DAVID W. KESNER
203.498.4406
dkesner@wiggin.com

CHARLES C. KINGSLEY
203.498.4307
ckingsley@wiggin.com

LEONARD LEADER
203.363.7602
lleader@wiggin.com

VANESSA L. MACZKO
203.363.7667
vmaczko@wiggin.com

RANI NEWMAN MATHURA
561.701.8703
rmathura@wiggin.com

STRATEGIES FOR OWNING PROPERTY IN MULTIPLE STATES

Ownership of real property in multiple states can raise many estate planning issues. How the property is titled (i.e., whether the property is owned directly or through an entity, such as a trust or a limited liability company, 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 depending on your goals, family structure and interests.

KEY CONCEPTS

In determining 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 call home – this involves an element of intent as well as bodily presence. Your residence, however, is any place you may live. You may have more than one residence, but you can only have one domicile. When analyzing someone's intent regarding their domicile, authorities will look at a number of factors, including the location of your principal residence, the length of time that you spend at a residence, where you file your income taxes, where you vote and where you keep your prized possessions.

State Estate Taxes

For estates of substantial value, federal estate taxes are always a consideration. But the state in which your property is located may impose a separate state-level estate tax that should also be considered. Connecticut, New York, 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

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ERIN D. NICHOLLS
203.498.4319
enicholls@wiggin.com

CAROLYN A. REERS
203.363.7668
creers@wiggin.com

MATTHEW E. SMITH
203.363.7639
msmith@wiggin.com

KATERYNA BAKHNAK
212.551.2855
kbakhnak@wiggin.com

MARY MARGARET COLLEARY
212.551.2637
mcolleary@wiggin.com

RUTH FORTUNE
203.363.7658
rfortune@wiggin.com

MI-HAE K. RUSSO
212.551.2619
mrusso@wiggin.com

MARISSA A. O'LOUGHLIN
203.363.7674
moloughlin@wiggin.com

KAITLYN A. PACELLI
203.363.7635
kpacelli@wiggin.com

ANDREW S. PHILBIN
203.363.7606
aphilbin@wiggin.com

BETH A. SCHARPF
212.551.2634
bscharpf@wiggin.com

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 may have to apply to the probate court in each jurisdiction and request authority to deal with property in that state. These additional probate proceedings in other states are called "ancillary probate."

CASE STUDY

To see how effective estate planning can reduce estate administrative costs, avoid ancillary probate and minimize estate taxes, consider the following hypothetical:

Assume you are domiciled in Connecticut, and that you own a primary residence in Connecticut, a summer cottage in Massachusetts and a condo in Florida. You also own a commercial property in New York. Further assume that your estate planning consists only of 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 a local attorney in each jurisdiction to help with the probate process and to transfer the real estate. In addition, your estate could owe state estate tax in Connecticut, New York and Massachusetts. There will be no state estate tax on your Florida condo, because that state does not impose an estate tax at the state level.

STRATEGIES FOR AVOIDING ANCILLARY PROBATE

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 trust. To learn more about these strategies, read below:

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 cottage noted above jointly with your spouse, then upon your death the cottage would pass to your spouse by operation of law and no probate proceeding would be required to transfer the cottage. Nonetheless, this approach may be not the best solution. Jointly held real property

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of the furniture and furnishings therein. Such tangible personal property can trigger the need for an ancillary probate proceeding. There can also be gift tax issues when you name a joint tenant of your real property. In addition, 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. And despite the trust's ownership, you can still have full access to the assets by acting as the trustee during your lifetime.

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 cottage in Massachusetts, your condo 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.*

STRATEGIES FOR MINIMIZING ESTATE TAX

Is there a way to minimize estate tax and avoid probate? Yes, the 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, as described below.

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 cottage 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.

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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 by paying the trust the fair market value rent. While the thought of renting your home may seem undesirable, it is in fact a great estate planning tool, because, if it is structured correctly, it results in a shift of wealth without the imposition of a gift tax. 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-current 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. Currently, the rise in interest rates make QPRTs an appealing option as the high interest rate reduces the value of the taxable gift.

Example. *Assume you transfer the Massachusetts cottage to a QPRT and retain the right to live in the cottage for a 10-year term. During the 10-year term, you continue to use the cottage as you have in the past. At the expiration of the term the cottage is transferred to a continuing trust for the benefit of your children, and you then rent the cottage from the trust at the fair market value. Because you no longer own the cottage, 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 cottage to the QPRT, but the value of the gift would have been reduced because of your retained right to live in the cottage during the initial 10-year term.*

Spousal Lifetime Access Trusts

In the present climate of high estate tax exemption levels, many clients are looking at making large gifts to utilize their current exemptions before they are scheduled to sunset on December 31, 2025. For clients who want to do this but are uneasy about departing with their assets, funding an irrevocable trust for their spouse using real estate is a great option.

Example. *If you were to transfer your interest in the Florida condo (or a fractional interest in the condo) to an irrevocable trust for your spouse (a "Spousal Lifetime Access Trust" or a "SLAT"), you would no longer own the real estate in Florida. As a result, you would avoid probate in that state. The owner of the condo would be the SLAT, but as a beneficiary of the SLAT, your spouse would be permitted to reside in the condo.*

Similar to the discussion above regarding the QPRT, the Florida condo may be retained for your spouse's life and you may use the home together. Alternatively, you may lease the residence from the trust by paying the trust the fair market value rent, again a

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RESOURCES

Advisory
Domicile and Residence

Advisory
Qualified Personal Residence Trusts

Advisory
Spousal Lifetime Access Trusts

Podcast
SLATs and Gifting

Podcast
Legacy Assets in Estate Planning

great estate planning tool. Please note, however, that if you are considering using a Florida home, in particular, to transfer to the SLAT, you should be careful to navigate the homestead exemption opportunities in that state, which may become available to you if you ever become a Florida domiciliary.

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 the property (or properties) in an LLC, corporation or partnership.

Example. *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 may be 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, so you will want to review this issue with your estate planning attorney.

FINAL THOUGHTS

If you own property in multiple states, it is wise to plan to reduce estate administrative costs, avoid unnecessary probate, and minimize estate taxes at the state and federal level. To achieve these goals, revocable trusts, irrevocable trusts (including QPRTs and SLATs) 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 real estate holdings to minimize estate administration and tax costs.