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Wills, Trusts, Estate Planning & Probate

Preparing a Pathway of Protection



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Avoiding Probate In Two States - Good Idea?

A number of our Georgia clients own real estate in another state. By law each state has a right to control how that real estate gets handled after the death of the owner. Often that would require



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probating a client's property here in Georgia and in the other state as well. When I tell clients about the possibility of multiple probate actions, they often exclaim, "Oh no! Not two probates!"

This response is somewhat justified, given the horror stories many clients have heard about the probate process from friends and family throughout the country. For it is true that in some states going through probate (the court process required to legally transfer property after the death of an individual) can be complicated. Having a good Georgia Will that contemplates this possibility is helpful, but probate in some states like California and, to a lesser degree, Florida can end up being a very expensive and time-consuming situation. So what can be done to prevent this from happening?

More than once I have been told by my clients they have a very simple solution: They will transfer (before their death) the property to a much younger family member who they trust. Sounds good, right?

Let's take a concrete example and walk through a few scenarios. Kay (not her real name) has come to see me. Kay is quite ill, has no husband and is concerned about what would happen to her property if she were to pass away. Her only child, Barbie, who she loves dearly, recently got married to a young man she doesn't know well. Kay has



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California property that she inherited from her family years ago. Seems like the perfect situation. Just gift it to Barbie now, since she will get it anyway!

A few more facts. Kay has an estate worth about \$1.5 million. In the early 1980s, Kay's grandfather bought the California property, which is 100 acres of farmland, for \$2000 an acre for a total investment of \$200,000. The property today is worth conservatively about \$1.2 million. Assume Kay transfers the property to Barbie, who shortly thereafter sells the property for \$1.2 million. What are the tax consequences? Since Barbie received the property as a gift, the "carryover basis" rules apply and her gain over her basis is \$1 million. Thus, applying the 15% capital gains tax that would apply based on Barbie's income, she would have to pay the federal government \$150,000. Compare this to Barbie receiving the property under Kay's Will. Here, the property gets a "stepped-up basis" to its fair market value at Kay's death (\$1.2 million), so if Barbie sells it for \$1.2 million, she would have zero capital gain. Thus, instead of \$150,000 in taxes, Barbie would pay zero taxes. So gifting is definitely not a good idea.

"Well," Kay said, "I have another idea. What if I just sell the property to Barbie for a nominal sum like \$1. No gift. No tax. Right?" I had to explain that this



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approach was actually worse. Her daughter would then have an even lower basis (\$1), so all but \$1 is subject to the 15% tax.

"Okay, that won't work," Kay agreed. "But I've just got to ask. What if the property was worth about what I paid for it? So there's no real capital gains tax problem. Then would it make sense to transfer the property to my daughter to avoid the expenses and hassle of California probate?"

I responded, "You said Barbie recently got married to a young man you don't know well. What if you gifted the property and then Barbie was killed in a car accident before you died? Then her property will likely go to her husband, as Barbie's sole heir at law. Would your new son-in-law give your property back to you or use it for your benefit?" Kay frowns.

"OK, I get it," Kay confirmed. "Do you have any ideas?"

I then tell Kay that I believe a Revocable Trust appears to be a good solution to consider here. Kay could set it up, fund it with her California property, and be her own Trustee as long as she is not incapacitated. Also, she could name Barbie as successor Trustee, in case of Kay's disability or death. This approach would allow Kay get a step-

up basis with all the tax advantages, yet avoid California and Georgia probate on the property. And because the trust is revocable, Kay can change her mind at any time and modify any of its provisions. She doesn't even have to file a separate tax return during her lifetime. Finally, I mention that we could even name another relative or friend as a back-up Trustee, if Barbie were not able to act. Trusts can be very useful and flexible, contemplating a lot of unusual situations. After considering all of her options, Kay liked this approach best.

Moral of the story: Avoiding probate in two states is generally a good idea, but the way you do it matters - A lot!