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## DO YOU REALLY WANT TO AVOID PROBATE?

*The Probate Process and Techniques for Avoiding Probate*

### INTRODUCTION

The word “probate” is commonly used to refer to the administration of a deceased person’s estate, regardless of whether the person died **testate** (with a valid will) or **intestate** (without a valid will). If a person dies testate, then their estate is distributed in accordance with the provisions in their will. If a person dies intestate, then his or her estate is distributed in accordance with the provisions of the state’s intestate succession law. The term **heirs** refers to those persons entitled to the property of the deceased under the intestate succession law.

In Michigan, probate administration is under the jurisdiction of the **probate court**, which is generally organized along county lines. A petition to admit a will to probate or a petition for the administration of the estate of a person dying intestate is properly filed in the probate court in the county in which the person resided at the time of his or her death.

Probate administration may not be necessary upon the death of an individual. If the person owned no property titled in his or her name alone, then there is no property to administer and no need for probate. For example, if spouses own all of their property together as husband and wife, then upon the death of the first spouse, the property passes automatically to the surviving spouse without the need for probate.

The administration of a decedent’s estate is the task of the **personal representative**. “Personal representative” is the term used under Michigan law for the position which was formerly called the “executor” or “administrator”. In most instances, the personal representative hires an attorney, and perhaps other professionals

(e.g. accountant, realtor) to perform services related to the administration of the estate. Many of the services provided are in satisfaction of requirements of the probate process. Most of the cost of probate is the fees for attorney services. Because attorneys typically bill by the hour, the more time spent in complying with probate requirements, the greater the fees incurred.

It is important to note that the avoidance of probate does not necessarily mean a complete avoidance of attorney fees and other costs upon death. An attorney may still be necessary for the coordination of asset transfers and preparation of required tax returns. Family members may need to hire an attorney to assist with managing a trust. However, in most cases, the avoidance of probate should reduce these fees.

Concern over the costs related to probate administration has led many individuals to take steps to ensure that there will be no need for probate administration upon their deaths. This concern is usually grounded in a desire to reduce death related expenses as much as possible for maximum estate preservation. A number of techniques for achieving this goal are employed. They all have one thing in common – the individual dies owning no property or assets titled in his or her name alone.

## **THE PROBATE PROCESS**

If the estate of a deceased person consists of property valued at **\$20,000 or less** (in 2009), then a shortened probate procedure is available. The probate court issues an order that the property be turned over to the person who paid the funeral expenses, with any remaining amount going to the surviving spouse or, if there is no surviving spouse, to the heirs. The probate court has a form for this procedure.

Probate proceedings for estates larger than \$20,000 are governed by the rules of either ***informal probate*** or ***formal probate administration***. The rules of informal probate eliminate the need for a petition or proceeding before the probate court for most of the steps in the probate process. The rules of formal administration retain the supervision of the probate court over certain steps in the probate process. The law allows a probate

estate to be closed after 5 months if all claims and other matters are resolved.

Probate proceedings are generally public in nature. In most circumstances, anyone can examine the court file for a deceased person's estate. The personal representative is given the discretion not to file the inventory of the estate with the court. Therefore, the value and nature of the estate may not be available to the general public.

If the only asset or assets of the estate are an automobile or automobiles valued at \$60,000 or less, then transfer of ownership to the spouse or next of kin can be accomplished through the Secretary of State and no probate proceedings are necessary.

## **PROBATE AVOIDANCE TECHNIQUES**

As discussed above, probate administration is required when an individual dies owning real property or other assets titled in his or her name alone. If the deceased person did not own any assets in his or her name alone at the time of his or her death, then there is normally no need for probate. [Michigan law allows certain assets which are not required to pass through the probate process—e.g. a joint bank account—to be brought into a probate estate if needed to pay expenses.]

### **Lifetime Gifts**

An individual can transfer property to others and thereby avoid owning such property at the time of death. A lifetime gift, also known as an *inter vivos gift*, can be used to prevent specific assets from passing through probate at death. The income tax and gift tax effects of any significant gift should be considered carefully. For example, the recipient of your gift will have to use your basis in the property for capital gains purposes when the property is sold. **If you give away the full title to your home during your lifetime, the taxable property value will be uncapped and you will lose the lower primary residence tax rate and the homestead property tax credit.** Caution: a gift once made may not be returnable.

## **Joint Tenancy / Tenancy by the Entirety**

Property which is owned by two or more individuals as ***joint tenants with full rights of survivorship*** passes directly to the surviving joint tenant or tenants upon the death of a joint tenant. For example, if A and B own a house as joint tenants with full rights of survivorship, then upon the death of A, with B surviving, B is the sole owner of the house. The house need not pass through probate.

Joint tenancy ownership is available for both real property (e.g. house, land) and personal property (e.g. stocks, bonds, bank accounts). Property owned as husband and wife (***tenants by the entirety***) provides rights of survivorship similar to joint tenancy (i.e. upon the death of the first spouse, the surviving spouse becomes the owner of the property).

Joint tenancy ownership is frequently used to avoid probate; however, it has some disadvantages. By making another individual or individuals the joint tenant owner of an asset, you are giving up total control of the asset. For example, if a woman transfers ownership of her house from herself as sole owner to herself and her child as joint tenant owners, then the child's approval is necessary for any future sale of the house. Another disadvantage is the possible exposure of the jointly owned asset to the creditors of the joint tenants. There may also be adverse tax consequences – e.g. a reduced capital gains exclusion when a residence is sold. If you add a joint owner to the title to your home it could affect your homeowner and title insurance. You should check with your insurance providers to make sure you have coverage.

Some financial institutions and corporations limit the number of individuals who may own an account, shares of stock, or bond as joint tenants. This may present a problem for someone desiring to use joint tenancy to pass property to more than one individual at death. For example, a woman with a \$10,000 certificate of deposit may want to avoid probate in the transfer of the CD to her son and daughter at her death. If the financial institution limits her to adding only one other individual as a joint tenant owner of the CD, she may be tempted to make one of the

children a joint tenant owner of the CD with herself, with the "understanding" that such child will share the funds equally with his or her sibling. Such a choice should be carefully considered because the surviving joint tenant child will normally have no legal duty to share the funds with his or her sibling upon the parent's death.

### **Payable On Death Accounts**

Some financial institutions have accounts which are paid to a named beneficiary when the owner dies. They may be called payable on death (POD), transfer on death (TOD), trust or beneficiary accounts. Securities such as stocks and bonds can also be titled in such a death beneficiary form. This type of ownership avoids probate but does not have the risks of joint title because the beneficiary has no access to the account until the owner dies. You may have to check with various financial institutions to see if this form of ownership is available as not all of them offer it.

### **Living Trust**

In recent years the use of *living trusts* to avoid probate has grown. A living trust is a trust created during the lifetime of the grantor (the creator of the trust). Typically, the living trust takes the form of a *revocable grantor trust*, which is created by a transfer of the grantor's property to himself or herself as the trustee of a trust under which he or she is the lifetime beneficiary. The trust usually provides that the income from trust property is to be paid to the grantor during his or her lifetime and that the grantor has the power to withdraw assets from the trust. The grantor typically retains the right to revoke the trust or modify the terms of the trust at any time until he or she dies or becomes legally incapacitated. After creating the trust, the grantor "funds" the trust by transferring all of his or her property to the trust. In this way, the grantor can avoid owning any property in his or her name at death, and thereby avoid probate.

The initial cost of preparing a living trust usually exceeds the cost of preparing a will. This is a reflection of the additional time required in the preparation and implementation of a living trust. Although there is no legal barrier to drafting your own trust, the complexities of property and tax law make it a risky endeavor. **The advice and counsel of an experienced attorney is strongly recommended.** There can also be subsequent costs which might be incurred in connection with the trust.

### **Transfer with Retained Life Estate**

The transfer of real property with the retention of a life estate can avoid probate. For example, the sole owner of a house transfers it to her child but retains the right to possess the house until her death. She has retained a ***life estate*** (also known as "life lease"). The child's interest in the house is known as a ***remainder***. The child becomes the owner of the house upon the parent's death without the need for probate.

Before using a transfer with a retained life estate to avoid probate administration of real property, the tax effects of such a transfer should be carefully examined. Such a transfer may result in a lower tax basis for the remainder owner of the property. Consideration should also be given to how house expenses will be shared. Here again it is a good idea to consult with a lawyer, to discuss the preparation of a deed, and also to explore the advantages and disadvantages of this probate avoidance option.

### **Deed Delivered After the Death of the Grantor**

A deed signed before the death of the owner but delivered and recorded after his or her death is sometimes suggested as a way to avoid probate of real property. This deed usually takes the form of a ***quit claim deed***. The use of this scheme has caused many to incorrectly consider a quit claim deed to be a will substitute. A quit claim deed is simply a deed which contains no warranties concerning the title. It is not a will substitute, and, in fact, the transfer described above is not a legally valid transfer of real property.

For a deed to effectively transfer real property, it must be delivered during the owner's lifetime. If an owner signs a deed but retains control of the deed during his or her lifetime, then a valid delivery has not taken place, and the deed is not operative. This scheme sometimes works because no one questions it. However, if an heir is left out of the deed he or she may challenge it in probate.

Aside from the legal invalidity of such a transfer there may be detrimental income tax effects. In a lifetime transfer of property, the person who receives title takes the tax basis of the person who transfers title. This can result in a significant capital gain on the sale of the property and ultimately increase income tax liability. When property is transferred at the title holder's death, the donee (person who receives title) gets a "stepped-up" basis equal to the fair market value as of the owner's death.

For example, if a parent with a tax basis of \$20,000 in her house makes a lifetime transfer of the house to her child, the child's tax basis in the house is also \$20,000. If the child sells the house upon the parent's death for the then fair market value of \$100,000, the child has incurred a capital gain of \$80,000. Such gain would be taxed as income of the child. If instead, the parent left the house to her child through her will or through a living trust, the child's tax basis in the house would be the fair market value of the house on the parent's date of death (\$100,000). If the child sells the house soon after the parent's death there would be little if any taxable capital gain.

Property tax issues should also be considered. It is important to retain some title to your home during your lifetime, e.g. a joint interest or life estate. Otherwise once the deed is recorded after your death, the taxable property value will be uncapped retroactive to the date you signed the deed. This could result in sizeable tax, interest and penalty assessments against the property. It is also important to know with regard to these transfers that the Michigan Department of Treasury, by statute, requires the filing of a property tax affidavit. The affidavit "must be filed whenever real estate or some types of personal property are transferred ***even if you are not recording a deed.***" It must be

filed by the new owner with the assessor for the city or township where the property is located within 45 days of the transfer. If it is not filed timely, a penalty of \$5/day (maximum \$200) applies.

## **SUMMARY**

It is sometimes desirable to avoid probate, however the techniques used to do so are complicated. In many situations it is not desirable to avoid probate. The consequences resulting from one technique or another should be thought through carefully. The unique nature of each individual's situation makes the advice and counsel of an experienced attorney the best method for determining your specific needs and course of action.

*If you are a senior, you can get specific questions answered at the Legal Hotline for Michigan Seniors. Call **1-800-347-5297** (**372-5959** for the Lansing area).*

*The Legal Hotline is a program of Elder Law of Michigan, INC., a non-profit organization. If you would like to support our work, please consider sending a tax deductible donation to the Legal Hotline, 3815 W. St. Joseph, Suite C-200, Lansing, MI 48917. Thank you.*