

LawyersUSA

Bequeathing encumbered property

by Jeffrey A. Baskies

Columnist

Published: May 5, 2008

When working with clients on their estate plans, one issue to consider is whether specifically devised property should be distributed debt-free or subject to any mortgages. Failure to consider the impact of this direction can ruin an otherwise simple estate plan.

At the core, the issue is whether a client wishes a specific devisee to bear the indebtedness associated with devised property or if the devisee should receive the property free of liens – and thus the residuary beneficiaries should bear the impact.

On the one hand, many estate plans direct that all "debts and expenses" will be paid from the residue of the estate. Further, any general/unsecured debts of the decedent are generally borne by the residuary beneficiaries.

This means the residuary beneficiaries pay the unsecured debts, the expenses of administration, the fees (executor fees, attorney fees, accountant fees) and sometimes the taxes.

If there are no pre-residuary/specific devises, then all of the encumbered property will pass through to the residuary beneficiaries, who will receive the property and the debt (and thus the net value).

Further, when clients tell us they want specific gifts/devises, they often intend those gifts to be free of encumbrances. For example, when a client says "I want my daughter to get my house and \$250,000," it is distinctly possible she means "I want my daughter to receive my house – free of any debt – and \$250,000 –

unreduced for fees, expenses or taxes."

If the client just says "I want my daughter to get my house and \$250,000" and we don't probe her intentions further, we may misunderstand her estate planning goals, and draft a plan that is contrary to her wishes. We may create a plan where the daughter gets the home subject to debts and the \$250,000 devise is reduced for taxes.

It's easy to see how important it is to ask the appropriate follow-up questions to glean the clients' wishes.

This issue also has specific state law implications. For example, the law in your state may provide that unless you direct otherwise, a devisee of encumbered property receives the property subject to any secured debt. The law in Florida (where I practice) includes such a direction.

Thus, if a client had a \$200,000 mortgage on the \$250,000 home, then instead of receiving assets having a net value of \$500,000 (an unencumbered home of \$250,000 value plus a \$250,000 pecuniary devise), her daughter will only receive net assets of \$300,000 (an encumbered home of \$250,000 value less the \$200,000 debt plus a \$250,000 pecuniary devise).

Now, that may have been the client's intention; however, we may not properly effectuate her intent if we don't probe and follow up on issues like this.

If the client prefers the specific devisee receive the property debt-free, then we also need to discuss how paying the debt can dramatically impact the residuary beneficiaries of the estate. While today there may be sufficient assets to pay the debt and leave a residue in line with the client's intent, there is no assurance that will be the case in the future.

By changing asset title (making some accounts "in trust for" or joint, for example), by increasing a mortgage or taking out an equity line, or by making changes in the client's assets, the direction to pay the debt may create a huge difference in the share for the residuary beneficiaries.

For example, today the residue could be \$1 million and it could be left to the client's two other children. As a result, the impact of a \$200,000 charge is a 20% change to them. But if the estate at death is only \$400,000, that same direction could reduce their shares by 50%.

Because the residuary beneficiaries will have to use other assets to pay the estate expense and debts, a direction to pay off encumbered/devisee property can significantly change the residuary shares.

For more on this issue, including discussion of a recent Florida case that highlights these issues, see the [article](#) on page 20.

Jeffrey A. Baskies, Esq. is a founding partner in the Boca Raton, Fla. firm of Katz Baskies LLC. He focuses his practice on Trusts & Estates and Tax & Business law and represents successful entrepreneurs and business-owners in their personal and business planning. Previously, he was the President and CEO of Lawyers Weekly, Inc.