Property Ownership and Trusts

by Sophia

WHAT'S COVERED

In this lesson, you will identify the multiple ways property can be held and transferred. You will see how problem solving skills can help you make wise choices when it comes to gifts. Specifically, this lesson will cover:

1. Titles and Transfers of Property

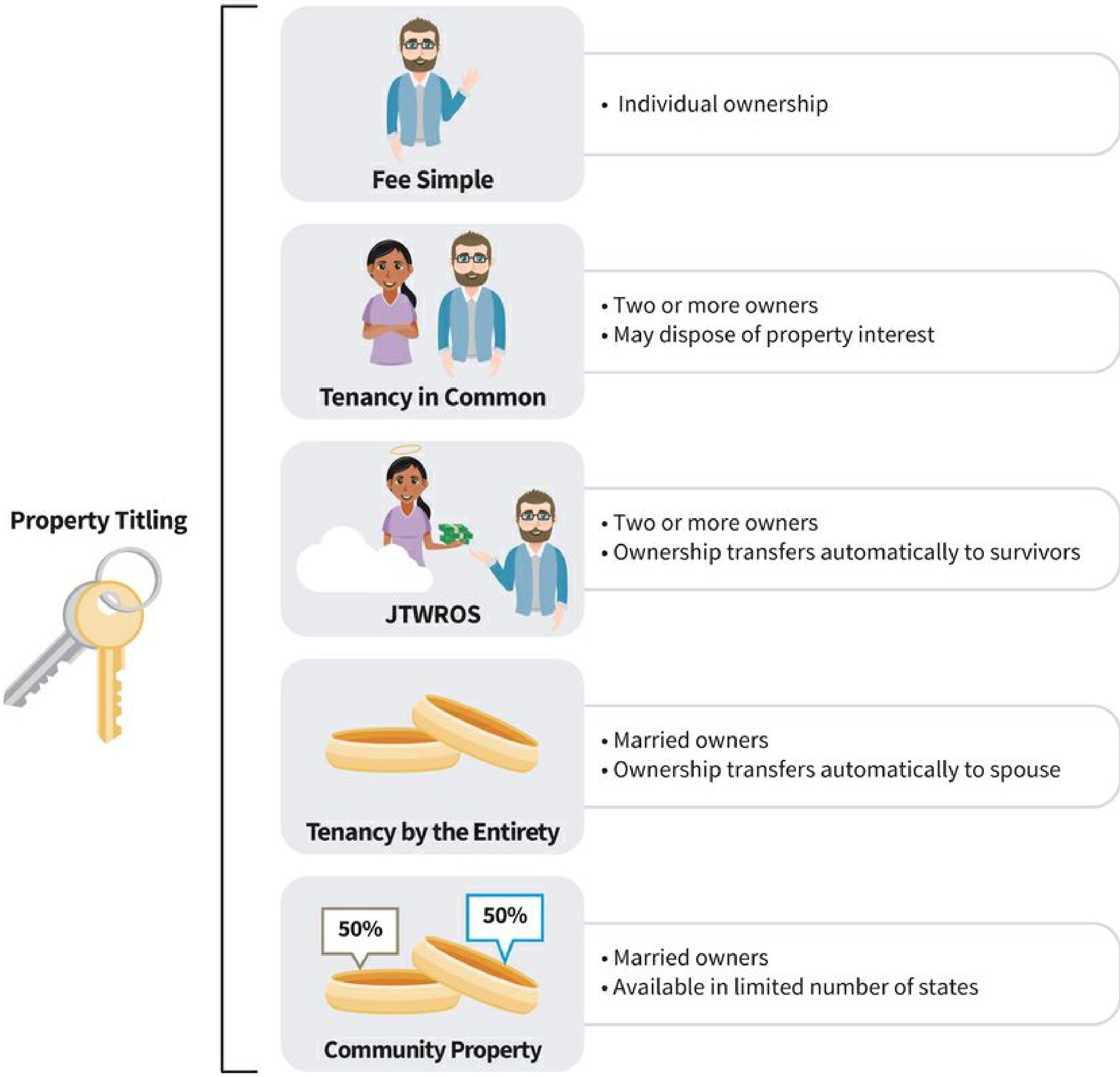
1a. Ways to Title Property

A **title** provides proof of property ownership, whether a house, a car, or a mutual fund. The way you title property is important because titling designates who owns the property and what the owner can do with it. You need a title when you own property with another person. As shown in the illustration down below, there are five ways to title property:

1. **Fee simple:** You are the sole owner of the property.
2. **Tenancy in common:** You own the property with another person. For example, if you and your friend own a car, you would each be allowed to sell or give away your interest in the car. With tenancy in common, your level of ownership can be different, say, 70% for you and 30% for your friend.
3. **Joint tenancy with right of survivorship (JTWROS):** You own the property equally with another person, and each of you has rights of survivorship. That is, when one owner dies, the other owner receives that person's interest in the property. The transfer is automatic.
4. **Tenancy by the entirety:** You own the property with your spouse, and each spouse owns the undivided whole. This form of ownership provides greater protection from creditors. For example, one spouse cannot be forced to sell his or her interest in the property to satisfy the creditors of the other spouse. If one spouse passes away, the surviving spouse already owns the property. This method of titling property is not available in some states.
5. **Community property:** You own the property with your spouse and live in a designated state that allows this special form of titling. (Under this form of ownership, only those living in Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin may elect to own jointly held assets as community property.) One-half of all assets held as community property belong to each spouse. This means that all earnings, property, and anything else obtained during marriage are legally owned 50–50.

It is also possible to title savings bonds and bank and brokerage accounts in a way that transfers the assets at death to a named beneficiary without giving the beneficiary direct immediate ownership of the assets.

- A payable on death (POD) account includes a designation of one or more beneficiaries who will receive the assets when the account owner dies.
- A transfer on death (TOD) registration works the same way for brokerage account assets.



TERM TO KNOW

Title

Proof of property ownership, whether a house or a mutual fund.

1b. Ways to Transfer Property

There are two primary ways you can transfer the title of an asset to someone else when you are still living.

1. You can sell the property.
2. You can give the property away.

When you die, you have essentially the same options, but the process of transfer is different. You, of course, cannot sell or gift your property personally. Instead, these actions tend to be administered under the watchful eye of your state's probate court. **Probate** is the court-supervised process of distributing assets and paying debts after someone's death.

- Probate can be a time-consuming, public process that many people would like to avoid.
- One reason to avoid probate is to maintain family privacy after the death of a loved one.
- Another reason is to ensure that property is transferred and used in the future according to the deceased's wishes (once an asset is transferred to someone else through the probate process, the new owner can do what he or she wants with the property, even if that conflicts with the previous owner's original wishes).

There are ways to avoid probate. The two most common ways include titling property appropriately and using trusts.

- Titling your assets as JTWROS automatically transfers ownership to another person outside the probate process upon your death.
- You can also avoid probate by naming beneficiaries to retirement plan assets, insurance contracts, and other financial products that allow the naming of beneficiaries.

TERM TO KNOW

Probate
The court-supervised process of distributing assets and paying debts after someone's death.

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2. Trusts

A **trust** is a legal entity that holds property and assets for someone or some group. You might establish a trust if you want:

- To own assets for minor children or children who are unable to manage their affairs.
- Someone else to help manage your financial assets.
- To allow for the distribution of assets on a predetermined schedule.

HINT

One of the best ways to avoid probate is through the use of a trust.

When you set up a trust, you can specify exactly how you want your assets invested, who should get income from the trust, and what should happen to the assets when you die. You can create a trust when you are alive or through your will. A trust created through your will is a testamentary trust. You can also create trusts to help charities, to own life insurance, or to achieve other estate-planning purposes, particularly if you have a large amount of money. Be sure to clearly understand the purpose and reason for setting up a trust since it can be expensive.

TERM TO KNOW

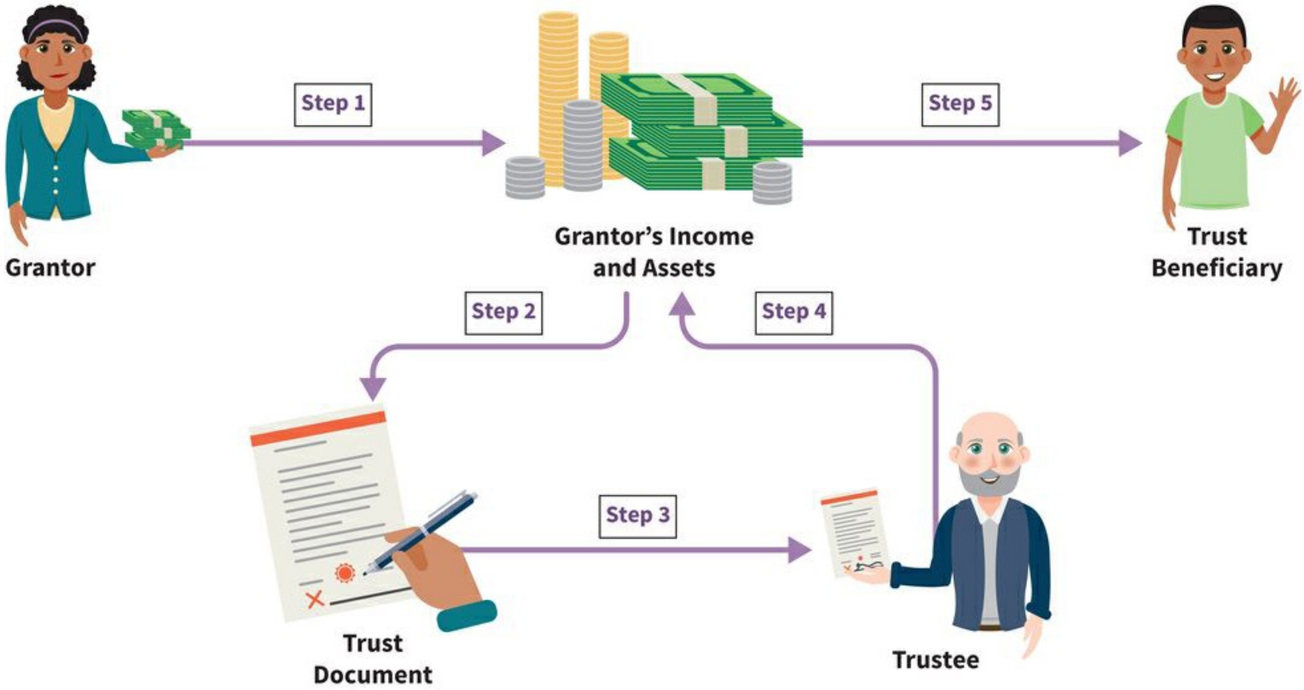
Trust
A legal entity that holds property and assets for someone or some group.

2a. Structure of a Trust

A trust has a specific structure.

- When you establish a trust, you are called the**grantor**. Anything that you can title, like a home, car, or investments, can be owned by a trust.
- Once the trust is established, you then need to determine a beneficiary of the trust. While you are alive, you can be the trust beneficiary. You will also need to name someone or an organization to be the ultimate beneficiary or what attorneys call a remainder beneficiary.
- You must also name a trustee. The **trustee** is the person or organization (such as a bank) that will manage the trust assets and authorize distributions from the trust based on the instructions given by the grantor. You may be the grantor, beneficiary, and trustee of your own trust.

Although it is possible to use an online service to establish a trust, it may make sense to pay an attorney to help you properly draft the appropriate documents. Whether you set up a trust yourself or use a professional for help, the structure of your trust will be similar. The following illustration shows the typical process of establishing and using a trust.



TERM TO KNOW

Grantor

What you are called when you establish a trust.

Trustee

The person or organization (such as a bank) that will manage trust assets and authorize distributions from the trust based on the instructions given by the grantor.

2b. Types of Trusts

When it comes to estate planning and trusts, there are four main trusts that can be established.

1. A living trust, which refers to the fact that the trust is created while the grantor is still alive.
2. An irrevocable living trust, which means that, once established, the trust cannot be changed.
3. A revocable living trust, which allows the grantor (who is almost always the trustee) to do whatever he or she wants with the trust assets while alive, including withdrawing all the assets out of the trust. At the time

of the grantor's death, however, revocable living trusts become irrevocable.

4. A testamentary trust, which is established after the death of the grantor through a person's will. All testamentary trusts are irrevocable.

3. Gifts and Inheritances

3a. Tax Effects

In an interesting twist of the law, you may receive an unlimited dollar amount as a gift – an irrevocable transfer of an asset from one person to another – or as an inheritance – property received when someone dies – totally income-tax-free at the federal level (a few states levy inheritance taxes on the amount of money you receive). Oddly, the gift giver or the deceased person's estate pays the tax on the transfer as follows:

- Anyone who gives more than $15,000 (in 2018) to one person is obligated to file a gift tax return. Depending on the amount of cumulative taxable gifts, the gift giver may pay a gift tax.
- If someone dies and the value of her or his estate – assets less liabilities and other expenses – is greater than $11.2 million, she or he may owe a federal tax.

HINT

These rules do not apply if the gift or estate transfer is made to a charity. As shown in the table below, when it comes to gift and inheritance taxes, it truly is better to receive than to give.

Gift	Inheritance
Gift tax return filed if gift is more than $15,000	Estate tax paid if deceased net worth is more than $11.2 million (2018, indexed for inflation)
Gift giver may pay tax if cumulative taxable gifts are extremely high	Tax paid by deceased's estate
Gift received tax-free	Inheritance received tax-free

Problem Solving: Skill in Action

Kiran recently inherited some money from a family member and he used his problem solving skill to decide how he should use it. He wanted to use the money to put a down payment on a new car. But, after taking this course, Kiran realized that was not wise. He has seen some of his older family members struggle to make ends meet in their later years and wants to avoid a similar situation. So he decided to open an Individual Retirement Account (IRA) and start saving for his future.

TERMS TO KNOW

Gift

The irrevocable and voluntary transfer of property to another living person while alive.

Inheritance

Money or assets received, tax-free at the federal level, at the death of another person.

Estate

Someone's property, which can include personal, real, and intangible assets; assets less liabilities and other expenses.

3b. How Gifts and Inheritances Can Have an Impact on You

If you are just starting out on your lifetime financial journey, it is unlikely that you need to worry about paying gift or estate taxes, or setting up a trust today. But as your wealth grows, these topics may become important. It is likely, for instance, that you will establish a trust at some point in the future. On the other hand, you may be the recipient of a gift or inheritance, or you may be asked by a parent or grandparent to help with the transfer of gifts and property sometime soon. In the meantime, knowing how property is titled and what will happen to your assets if you were to die unexpectedly is an important part of navigating your lifetime financial journey.

SUMMARY

In this lesson, you learned about **titles and transfers of property**. Property can be things like a house, car, or investment fund. There are several **ways to title and transfer property**. Each way depends on the number of property owners, their relationship status, and even the state in which they live.

A **trust** is a legal entity that holds property or assets for someone, typically designed to help that person manage the assets. The **structure of most trusts** involves a grantor, trustee, and a beneficiary. Two primary **types of trusts** are revocable and irrevocable.

Assets may also transfer between two people through a **gift or inheritance**. Should you give or receive a valuable gift, like property, it's important to know the **tax effects** on both sides. Knowing **how gifts and inheritances can have an impact on you** will help you stay the course on your lifelong financial journey. Strong problem solving skills can help you make wise financial decisions about those gifts.

TERMS TO KNOW

Estate

Someone's property, which can include personal, real, and intangible assets; assets less liabilities and other expenses.

Gift

The irrevocable and voluntary transfer of property to another living person while alive.

Grantor

What you are called when you establish a trust.

Inheritance
Money or assets received, tax-free at the federal level, at the death of another person.

Probate
The court-supervised process of distributing assets and paying debts after someone’s death.

Title
Proof of property ownership, whether a house or a mutual fund.

Trust
A legal entity that holds property and assets for someone or some group.

Trustee
The person or organization (such as a bank) that will manage trust assets and authorize distributions from the trust based on the instructions given by the grantor.