Legal and Practical Issues Involved with Inheriting Real Property

You've inherited property, *now what*?

Inheriting property is not a simple task. There are steps that must be taken to insure compliance with the IRS. Steps We will cover those requirements on the next page.

Are you being named beneficiary for an estate? If so read on.

If you are the surviving spouse yhr

Unless you're the surviving spouse of inherited property, in which case, the legal transfer of the property should occur relatively quickly and without tax penalties, receiving an inheritance in almost any other circumstance can be a long and complicated process, that can take the Executor of the Estate and the Court many months, or more, to divide the deceased person's assets, including the home. Often times, this is a very aggravating and stressful process for beneficiaries, who are not only dealing with the loss of a loved one, but also may be struggling financially and need the money to stay afloat.

The following provides some guidance as to the process, advantages, pitfalls, and things to consider when inheriting property:

The first step in the process is to determine whether the deceased person has a valid will. If the deceased person has a valid will and the estate is worth more than $100,000., the Court will follow the terms of the deceased person's will and through the Probate process, make sure the deceased person's debts are paid and assets are distributed accordingly. If the deceased person does not have a valid will, his or her assets will be distributed according to the state laws of intestacy, which are default provisions that are commonly contrary to the deceased person's wishes.

Creating a will is a smart decision; however, many people will be surprised to learn that simply having a will cannot avoid a Court process called "Probate" and sometimes, to the bewilderment of all involved, the desired beneficiaries of the deceased person are not the people who actually inherit the property. Not only will some of the beneficiaries of the deceased person not receive their inheritance, but going through Probate takes the control of inheritance from the family that is very expensive, time consuming, and "public," so any interested party can see what the deceased person owned and who the deceased person owed money to.

Once ownership of a home is transferred to you, Uncle Sam may deduct federal, state and/or local taxes from the estate, if the estate net taxable is worth more than a certain amount.

There is no inheritance tax in California. Estate tax is under the federal estate tax law. Estate taxes are taxes that are levied on an entire estate before it is distributed to individuals, which is imposed on the value of the property at death. The federal government tax rates start at 45% for estates in excess of $3,500,000. If you were to inherit property worth $4 million, for example, the federal estate tax would be $225,000.

If you decide to sell an inherited home, you will probably be required to pay capital-gains tax on the difference between what you net from the sale and your basis (basis equals purchase price plus improvements minus depreciation). One positive thing about inherited property is that it is taxed on the value of the property the day that the owner died. Therefore, the beneficiary gets a "step-up" in basis and pays less capital-gains tax. The current federal capital-gains tax is 15%. If the property is a personal residence and you meet certain guidelines, you can be exempt from capital-gains tax on the first $250,000. if single, or $500,000. if married.

Example: Let's say John Doe buys his home for $10,000.00 in 1945. Sally Q inherits John Doe's property on the day John Doe dies in 2010. At the time of John Doe's death, the property is worth $350,000. Sally Q would pay no capital gains tax if she sells the property for $350,000. a week after John Doe dies as the basis of the property (value upon John Doe's death) is equal to the value of the property upon Sally Q selling the property.
Since the law is constantly changing, the only way to make sure you comply and take advantage of the tax laws with regard to inherited property is to seek the advice of a competentReal Estate Attorney.

Unless you qualify for an exception under the law, most transfers of property call for a reassessment of the property, which will likely increase the property taxes paid on the property. Therefore, as a practical consideration, a beneficiary of inherited real property must make sure that they will be able to pay the increased property taxes as they become due, or ultimately risk the chance of losing the property in the future for delinquent property tax payments.

While inheriting real property can seem like a blessing, many find that they have to sell the inherited real property to pay the estate taxes due. In addition to the large amount of estate taxes that may become due after inheriting a property, there is a quick nine month statutory period after the deceased person's death in which the beneficiary of inherited property must pay the estate taxes due.

Example: If a beneficiary inherits one parcel of land worth $10 million and the estate has no other assets, the beneficiary of the inherited property may have to sell the land to get the cash to pay the $2.9 million in federal estate taxes within nine months of the deceased person's death.

Taxes are not the only complications a beneficiary of inherited real property encounters. The bottom line is that if the home still has a mortgage attached to it, it will have to be paid off. Worse yet, some lenders treat the death of a borrower as a trigger for immediate repayment of the loan. However, if the loan provisions provide for survivorship of the loan through a trust or deed, the loan will remain outstanding and in effect.

Thus, a beneficiary must be careful and make sure they can pay the estate taxes and annual property tax payments, as well as the monthly mortgage payments.

Step 1 - Appraisal: The first step for a beneficiary of inherited real property is to have the property appraised to determine the fair market value at the time of death. This establishes the new tax basis in