Many homeowners confused on use of quit claim deeds

by Ilyce_Glink

A few weeks ago, I published a question from a reader concerning a mother who wanted to transfer ownership of her property to her son. Everyone signed off on the quit claim deed but the deed wasn't recorded to make it official until after the mother died.In response to that column, I received a letter from another reader who did a similar thing."When she was widowed, my mother immediately had a quit claim deed drawn up with both my brother's name and my name on it. She kept it in her file box for over 20 years until her death with the instructions that I was not to have it recorded until after her death," my correspondent wrote."If she would have recorded it before she died, then our tax basis when we sold the house would obviously be what she paid for the house. By recording it after she died, we owned the home outright and could sell it with the tax basis being what it was worth when she died, plus we avoided having to go through probate (all her bank accounts already had our names on them) which is what the purpose was," she continued. She concluded, "I called the lawyer a couple weeks before (Mother) died to make sure that I should wait to have the quit claim deed recorded and he assured me that it was to our best advantage to wait until she passed."Apparently, my correspondent's mother had remarried and had also drawn up a quit claim deed for the property in her husband's name. This deed was also kept in her file box. When her husband died, the mother instructed my correspondent to ignore that quit claim deed and proceed with recording the other one after her death.I probably receive between 5 and 10 letters each week regarding quit claim deeds and their uses. From these letters, I can tell that many homeowners are confused about the proper use of a quit claim deed. There's plenty of misinformation out there, and this letter seemed to fall into that category.What would an estate attorney think of the advice this reader received?"This is a recipe for disaster," said Gregg Simon, an estate attorney and chair of the Wealth Transfer and Succession Planning Group at Much Shelist Denenberg Ament and Rubenstein, a large law firm based in Chicago.Simon said that while my correspondent is correct about what taxes would have been owed if the mother had gifted her children the property while she was still alive, the correspondent and her brother would have been entitled to the step-up in basis to the fair market value if they inherited the property - not the value of the home when it was purchased, but the value of the home when the mother died."There would even be a basis step-up if Mom transferred the property to her children during her lifetime but retained the right to live there the rest of her life," Simon explained, although he said that proving a life estate can be difficult unless there is something in writing.The real risk with using the quit claim scheme, Simon explained, is that in order to transfer the property legally, there needs to be a valid delivery of the deed."Here there was no delivery. Once Mom died, there was no one with legal authority to deliver the deed. The 'agency' to record the deed for Mom legally terminated as of her death," Simon continued. "There's a strong argument here that the deed to the children is a "nullity" and that they did not receive good title. This could have created serious problems at closing if this issue was raised, and the children are lucky that it was not."Simon said he has seen situations where attorneys hold deeds to be recorded after death, but once the owner of the asset dies, the attorney's legal power to record the deed terminates. So, the attorney would have no legal authority to record the deed, according to Simon.The good news is that a deed doesn't necessarily need to be recorded to be a valid transfer of ownership."The sons here could argue that Mom delivered the deed to them and then they kept it in the safe box, to which both they and their mother had access. But it may be possible for the IRS to argue that in effect Mom transferred the property while she was living and that there was no basis step up. But the argument that Mom retained the right to live there, allowing the basis step up would then likely prevail," Simon explained.What are some better alternatives that would have allowed the children in this case to receive a step-up in basis and avoid probate without the risk that the IRS would disallow the transfer?According to Simon, the mother could have created a revocable trust and placed title to the property in the trust. The trust would provide that upon the mother's death, the property would pass equally to her children.Another option would be to record a "transfer on death deed." Simon says that many states allow a homeowner to use a transfer on death deed so that, for example, upon a mother's death, the property would automatically pass to her children. The kids would avoid probate and would receive the step-up in basis.Â© 2007 Real Estate Matters - TMS