

## **Trust Owned Residential Real Estate**

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*Stacy K. Mullaney  
Chief Fiduciary Officer  
Fiduciary Trust Company*

*Liza Connelly  
Vice President  
Boston Private Bank & Trust*

#### A. Nominee trusts

- a. *General* - Nominee trusts, also commonly referred to as realty or residence trusts, are used to hold real estate. A nominee trust, like all trusts, creates a segregation of ownership between the trustee and beneficiaries. The trustee holds legal title to real estate and beneficiaries hold equitable title to real estate. The role of the trustee in a nominee trust is passive as the trustee is a 'nominal' holder. A nominee trust provides that the trustee shall only take action as directed by all or a majority of the beneficiaries, depending on the terms of the trust.
- b. *Tax attributes* - Because the beneficiaries control the actions of trustee with respect to the trust property, the beneficiaries are responsible for tax liabilities attributable to the trust property and entitled to any related tax deductions and exclusions in proportion to their ownership interests.
- c. *Trustee considerations* - Nominee trusts should generally have more than one trustee or a corporate trustee so that there is never a gap in trusteeship and an absence of authority over the trust property. Furthermore, a remaining trustee can always certify the resignation or removal of a prior trustee and the appointment of a successor trustee. Continuity of authority is essential with real estate ownership. A sole beneficiary and a sole trustee should never be the same person as this creates a merger of legal and equitable title and collapses the trust.

- d. Nominee trusts are used for several reasons:

*Privacy*

Nominee trusts provide privacy for owners of real estate. As noted above, while the trust instrument (or trust certificate) is filed with the registry of deeds, the Schedule of Beneficial Interests is a separate document that is not filed. As such, the true owners of the property, and any changes in ownership, remain confidential.

*Fractured/multiple ownership*

Nominee trusts are often used to simplify title where there are multiple owners of real estate. The trustee is the single legal representative for the trust able to take any action on behalf of the trust. Notwithstanding multiple owners, the trustee can secure insurance and execute notes, mortgages, sales documents, contracts, etc. affecting the property.

*Transferability of Beneficial Interests*

Nominee trusts facilitate the easy transferability of title among beneficiaries. When an ownership interest is transferred by one beneficiary to another through sale, gift or devise, a new deed does not need to be prepared and recorded in order to change ownership of the property or the percentage interest in a property. Nominee trusts are therefore useful where owners of the property will be changing over time as a result of ownership transfers. For example, in the case of a family vacation property where parents may want to transfer some or all of the property to their children. These gifts are often made over time in a tax efficient manner utilizing the annual gift exclusion (\$14,000 for 2016) or the lifetime gift and estate tax exclusion amount (\$5,450,000 per individual for 2016).

*Avoidance of Probate*

A nominee trust can be used as a means to avoid passing title to real estate through probate in the jurisdiction where the property is located. Probate assets are assets that are owned individually by a decedent. When real estate is transferred to a nominee trust, the trustee holds legal title, not the original owner of the property or the beneficiaries. Therefore, the real estate is not subject to the probate process, which can be time consuming and expensive. Furthermore, because real estate is always governed by the law of the state where the real estate is located, not the state where the owner resides, if an owner of real estate dies a resident of one state owning real estate in another state, a separate 'ancillary' probate will have to be done in the state where the property is located.

e. The layered use of Nominee Trusts and Revocable Trusts in Massachusetts – Trustee Certificates

With respect to what documents need to be recorded when real estate is transferred to a revocable trust, until 2003, Massachusetts was one of the few states that required the entire trust document to be recorded when real property was held in trust. This was counter to the generally accepted notion that inter vivos trusts were meant to be private trusts and often containing sensitive financial and family information generally not subject to disclosure. To keep the terms of the revocable trust private, Massachusetts legal professionals traditionally structured ownership in layered trusts in order to prevent the trust terms from becoming a matter of public record. The estate planning attorney would establish a nominee trust of which the revocable trust was sole beneficial owner. Only the nominee trust would be recorded.

Consistent with most other states, Massachusetts now permits a Trustee's Certificate to be recorded instead of the entire trust (MA gen. law. 184 Section 35) A Trustee's Certificate executed under the penalties of perjury and signed by the trustee stating (1) the identity of the trustee, (2) the authority of the trustee to act, and (3) the existence or non-existence of any condition precedent to acts of the trustee which may be germane is binding on all trustees and the trust estate or other person relying in good faith on the certificate. It is good practice to record the Trustee's Certificate at the time real estate is transferred into trust. The permitted use of a trustee's certificate has led to a reduction in use of nominee trusts by Massachusetts legal practitioners.

f. Trustee Liability – Given that the role of the trustee in a nominee trust is a directed role in that the trustee may only act at the direction of the beneficiaries so the trust, there are few liability concerns. The exception may be the independent responsibility to transfer the property out to the beneficiaries when the trust terminates. Nominee trusts, like all trusts in Massachusetts, are subject to the rule against perpetuities and as such will terminate at some point in time.

B. Revocable and Irrevocable Trusts

- a. Benefits of trust-owned – Placing real estate in trust (revocable and irrevocable) is a common estate planning practice for many reasons.
- *Avoidance of probate* – assets held in a decedent's revocable trust are not subject to probate.
  - *Flexibility* – the grantor of a revocable trust can change the trust terms during his or her lifetime. This means that the terms for the

disposition of real estate at the grantor's death can be altered without any change in title.

- *Continuity of Ownership* – real estate held in trust remains in the name of the trustee both before and after death so there is no disruption in ownership of the asset.
  - *Continuity of Management* – continuity of ownership of the asset means management of the property is continuous. The trustees can continue to manage and deal with matters affecting the property (insurance, tenancy, repairs, improvements, etc.) during the donor's incapacity or at death. Note that a sale of real estate held in a revocable trust following the grantor's death may require a release of lien.
- b. *Practical Considerations and complications* – A trust is not a natural person. Placing assets in trust can often cause difficulty in dealing with third parties who do not understand the operation of trusts and the trustee's authority to act. Transferring ownership to a trust can cause difficulty in obtaining financing, insurance, or contracting generally with third parties. Prior to the transfer of real estate to the trustee of a trust, the owner should be aware of any recording fees that may be assessed and ensure that title insurance will not be affected by the transfer. If there is a mortgage, the transfer should not trigger an acceleration of the indebtedness due, but this should be confirmed with the lender. Insurance policies should be changed to indicate the trust as the primary insured or additional insured.

### C. Third Party Reliance and Trustee Succession

- a. *Third party reliance* - The biggest issue with trusts holding real is the need for third parties to ascertain a trustee's authority to enter into any transaction on behalf of the trust. As legal owner of the real estate, the nominee trust instrument or a certificate that sets forth information about the trust must be recorded with the registry of deeds. (Mass. Gen. Laws Ch. 184, §35; Mass Gen. Laws Ch. 203, §2) Subsequent documents reflecting a change in the trustee or the trust terms must also be recorded. Only those instruments that are recorded provide notice to third parties as to the trustee's authority to act. Furthermore, any recordable instrument purporting to affect an interest in real estate executed by any person or persons who, in the records of the registry of deeds, appears to be the trustee of a trust shall be binding on the trust in favor of a purchaser or other person relying in good faith on such instrument. This is true notwithstanding a subsequent amendment, revocation, removal or resignation of the trustee or other matter affecting the trust unless such document is recorded. (Mass. Gen. Laws Ch. 184 §34)

- b. *Trustee Succession* – In order for change in trustee documents such as resignations, removals, and acceptances to be recorded it must be a recordable instrument. The document will need to be notarized in order for it to be recorded. If you have a trust that holds real estate or that may hold real estate, it is good practice to have all trustee documents notarized.

#### D. Receipts and Expenditures

The trustee must first look to the specific terms of the trust instrument for guidance and direction on matters related to receipts and expenditures related to real property held in trust. The trust instrument will often guide the trustee as to what expenses the trust is responsible for paying related to such real estate. As between the allocation of receipts and expenses between principal and income of a trust, Massachusetts General Laws Ch. 203D (Principal and Income Act) provides the trustee with some guidance. MGL Ch. 203D, Article 3 governs apportionment and the following sections of MGL Ch. 203D provides specific guidance as to expenditures related to real estate.

##### Receipts and Expenditures Related to Trust Principal

###### *Receipts*

- Donor gift of property
- Property appointed from another trust or estate
- Awards for environmental damages caused by others

###### *Expenditures (MGL Ch. 203D, Section 26)*

- (2) Expenses associated with preparing a property for sale;
- (3) Principal payments on any a mortgage on the property;
- (4) Expenses of a legal proceeding to confirm the ownership of, or permissible use of the real estate;
- (5) Premiums paid on an insurance policy for coverage other than for the loss of the real estate or the loss of rental income from or loss of use of the real estate;
- (7) Expenses related to environmental matters, including, reclamation, assessing environmental conditions, remedying and removing environmental contamination, and monitoring such efforts; defending claims based on environmental matters.

##### Receipts and Expenditures Related to Trust Income

###### *Receipts*

- Rental income
- User fees from beneficiaries, akin to rental income

###### *Expenditures (MGL Ch. 203D, Section 25)*

- (2) All of the ordinary expenses incurred in connection with the administration, management and preservation of the trust property, including:
  - Interest payments on loans secured by the real estate;
  - ordinary repairs and annual maintenance to permit the continued use of the real estate;
  - real estate taxes;
  - expenses of a proceedings or other matter that primarily concerns the trust's income interest.
- (3) homeowners insurance premiums.

#### E. Taxation Issues

Grantor Trusts & Non grantor Trusts - can be amended or dissolved by the grantor, it is classified as a "grantor trust." This means that the grantor is responsible for tax liabilities attributable to the trust property and entitled to any related tax deductions in proportion to their ownership interests.

1. *Maintaining Tax Cost Basis – Capital Improvements – IRC §121*  
It is the responsibly of the trustee to maintain proper tax cost basis. This includes ensuring that capital improvements are paid for by the trust-owner and adding to basis those expenses deemed capital improvements under the tax code. Record-keeping and documentation by the trustee is important for this purpose.
2. *Gain on Sale – Section 121 of the Internal Revenue Code* provides that a taxpayer can generally exclude up to \$250,000 (\$500,000 for married couples filing a joint return) of a gain realized on the sale or exchange of the taxpayer's principal residence if for at least two years out of the five-year period immediately preceding the date of sale, the taxpayer owned and used the property as a principal residence. Generally, the ownership condition of this section will require the taxpayer to own the property directly and not through an entity. However, if the home is owned by a trust, the exclusion will be available to the extent the taxpayer is considered an owner of the trust under the grantor trust rules. Therefore, the Section 121 exclusion is available to the grantor of a revocable trust.

#### F. Insurance Considerations

Insurance should be in place at all times to cover real estate held in trust. The primary insured should be the trust and the policy coverage should accurately reflect the current status and use of the property (rental, occupied, vacant, etc.), otherwise policy coverage may not be effective. The coverage amounts should be checked periodically and an appropriate umbrella policy for liability should be

attached. To minimize the chance of administrative errors or oversight, consider paying the annual premium in full. A refund can always be obtained if the property is later sold or otherwise transferred.

#### G. Sale of Trust-owned Real Estate

- a. *Trustee's authority to Sell Real Estate* - Unlike the nominee trustee where the trustee obtains its authority to act by a direction from the beneficiaries, a trustee of a revocable trust derives its authority from the terms of the trust and applicable common and statutory laws. The power to deal with trust property is an essential duty of the trustee. Most trusts provide the trustee with the power to acquire or sell trust property either explicitly or by reference in the trust to statutory fiduciary powers. If the trust is silent, common law or a statutory Uniform Trust Code will likely provide the trustee with the authority. (See Uniform Trust Code section 816)
- b. *Fiduciary Duties*– The law imposes a number of fiduciary duties on the conduct of a personal representative in administering an estate or a trustee in administering a trust. The sources of this law are “common law” (legal precedents created over many years by judges deciding court cases) and statutes enacted by legislatures. In recent years, Massachusetts has enacted a statute referred to as the Uniform Trust Code (Mass. General Laws Chapter 203E). Section 106 of the Uniform Trust Code states that the common law will continue to supplement the provisions of this trust statute.

Article 8 of the Trust Code imposes a number of general fiduciary duties on trustees. These general duties also apply to the personal representative of an estate (*see* Mass. General Laws Chapter 190B, § 3-703) they include duties of:

1. *Loyalty* – The trustee must administer a trust solely in the interest of the beneficiaries.
  2. *Impartiality* – The trustee must be impartial in investing, managing, and distributing property in the trust.
  3. *Prudence* – The trustee must meet a “prudent person” standard and exercise reasonable care, skill, and caution.
- c. *Fiduciary's specific duty to obtain the highest price* – In Article 8, the Trust Code also gives a trustee specific powers. These include certain powers pertaining to real property, such as the power to:
    1. make ordinary and extraordinary repairs and improvements

2. take certain actions concerning possible violations of environmental law

Under the statute, a trustee has the power to acquire or sell property (of any kind) “for cash or on credit, at public or private sale . . . .”

In connection with the sale of real estate, the common law in Massachusetts imposes on a personal representative of an estate or a trustee of a trust the duty to:

***Sell the property at the highest price (more accurately, the most advantageous sale) that can be achieved before the closing.***

This puts a trustee in the position of having to repudiate an initial offer upon the receipt of a subsequent higher one. Obviously, this fiduciary duty can complicate the process of selling real estate. A case decided in 1974 illustrates the challenges a fiduciary faces in selling real estate.

- i. *Onanian v. Leggat* (MA Appeals Court 1974) – One real estate lawyer described this case as “one of the most sobering decisions I have ever read . . . .” William V. Hovey, *Fiduciary Beware: Duty to Obtain Highest Price*, Mass Lawyers Wkly, April 18, 2005. (*Hunt v. Rice* (MA Appeals Court, 1988) is another case on this issue)
  - a. In November 1970, executor Leggat signed a P&S agreement to sell real estate in the estate for \$32,500, with title to pass on or before January 1, 1971. The P&S stated that the sale was contingent upon the issuance of a license to sell from the Middlesex County Probate Court.
  - b. Leggat filed a petition with the Probate Court asking for license to sell the real estate in accordance with the “offer” (no reference was made in the petition to the P&S) or for a “larger sum.” On December 15<sup>th</sup>, the Probate Court issued a decree to that effect.
  - c. On December 29<sup>th</sup>, Leggat told the purchaser that a license to sell had been obtained, but that another prospective purchaser was interested and that the property would be sold to the highest bidder on January 4<sup>th</sup>.
  - d. The first purchaser filed a lawsuit seeking specific performance, while also bidding \$35,155 and obtaining the property for that price.

- e. *Appeals Court holding* – The court said that Leggat’s fiduciary duty to the beneficiaries of the estate to obtain the highest price was “separate and distinct” from his contractual obligation to the purchaser under the P&S agreement.

The Court ruled that Leggat was *personally* liable to the purchaser for the difference between \$35,155 and \$32,500, plus interest.

- ii. The lessons for fiduciaries of *Onanian v. Leggat* are to take the following steps, either as alternatives or in combination depending upon the situation –

- a. *Do not sign an offer* – Fiduciaries will resist the pressure to sign an offer because this generally results in a binding contract. (*McCarthy v. Tobin*, 429 Mass. 84 (1999)) The better practice is to focus on carefully drafting a purchase and sale agreement to be signed by both parties. At the very least, the fiduciary should consult legal counsel before signing any offer.

- b. *Include protective language in the P&S agreement* – A fiduciary may require that the P&S agreement include a higher offer clause such as the following:

“Buyer agrees that since Seller is under a fiduciary obligation to realize the best price obtainable for the premises, Seller shall not be obligated to consummate the sale to Buyer if, at any time prior to the closing, Seller receives a bona fide written offer to purchase the premises for a price greater than the purchase price specified herein, provided that Seller shall give Buyer the opportunity to match or exceed any such offer by executing an amendment to this agreement within five (5) days of notification to Buyer by Seller that such a higher offer has been received.”

1 Belknap, Newhall’s Settlement of Estates and Fiduciary Law in Massachusetts §12.5 (5<sup>th</sup> ed. 1994)

These terms would be the subject of negotiation. For example, the agreement might specify a \$ amount that would be insufficient to overturn the first offer.

- c. *Obtain assents and releases from beneficiaries* – A personal representative of an estate or a trustee might obtain a level of protection in closing a real estate sale by obtaining assents and releases of all claims from all beneficiaries.
- d. *Obtain a license to sell* – In the P&S agreement, a fiduciary might make closing the sale contingent on obtaining a license to sell. The fiduciary then should petition the court for a license providing that the price stated in the *P&S agreement* is presumed to be the highest obtainable price and that the fiduciary has fully satisfied his/her duty. If a higher offer is received after issuance of the license, but before the closing, the fiduciary should return to the probate court seeking instruction.

Obviously, the process of petitioning for a license to sell is cumbersome, potentially expensive, and not ideal for parties anxious to complete a transaction.

*Guardians or conservators* function under close court supervision and, unlike personal representatives and trustees, do not have title to the property of their wards. They are required by statute to obtain a license in order to sell real estate. (Mass. General Laws Chapter 190B, § 5-423(c); *Miller v. Finnin*, Mass. Appeals Court unpublished opinion decided under prior law (2006))

- e. *Require exculpatory language in wills and trusts* – This language would state that the fiduciary shall not be personally liable for any action taken in good faith, including the sale of real property pursuant to a contract, notwithstanding the existence of any offer to purchase the property at a higher price.

#### H. Trustee Fees for Trust-owned Real Estate – a very *informal* survey

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