

# LEGAL ALERT

February 1, 2010

## JOINT TENANCY:

### AN ESTATE PLANNING TOOL NOW ENSURED TO THWART AN “UNCAPPING” OF THE TAXABLE VALUE UPON THE TRANSFER OF REAL PROPERTY

By Kristen A. Campbell and Stephen C. Chambers

*“Uncapping” defined: In the process commonly known as “uncapping”, the taxable value of real property is reassessed and set at the current state equalized value (the “SEV”) of the real property. When there is a change of ownership of real property, the taxable value is uncapped and a reassessed taxable value is set based on the SEV in the year following the transfer of ownership.*

In December 2009, the Michigan Court of Appeals gave Michigan citizens an early Christmas gift. Since 1994 and the adoption of “Proposal A”, property owners have feared an “uncapping” of the taxable value upon the transfer of their real property. So was the case of a son who was a joint tenant, with rights of survivorship of a property with his father who was now deceased. The son brought the case against the City of Charlevoix arguing that the death of a joint tenant should not constitute a transfer and thus an uncapping. The Michigan Court of Appeals ruled in favor of the son and held that the death of a joint tenant did not constitute a transfer of ownership within the meaning of the General Property Tax Act (the “GPTA”). Therefore, the taxable value of the real property could not be uncapped and reassessed at the higher State Equalized Value (SEV).

The GPTA has rules on what does and does *not* constitute a transfer of ownership. A transfer does not occur if: (1) at least one of the persons was an original owner of the real property

before the joint tenancy was created, *and* (2) if the real property is held as a joint tenancy *at the time of conveyance*, at least one of the persons was a joint tenant when the joint tenancy was initially created and that person has remained a joint tenant since that time.

In the case in question, the first requirement was met because the deceased parent and the taxpayer son created a joint tenancy by a quitclaim deed and the deceased parent was an original owner of the property before the conveyance adding the son’s name to the title. The Court explained that the second requirement is a conditional requirement and was not applicable because the condition triggering it was not present – the decedent’s death did not constitute a “conveyance” within the meaning of the GPTA.

The Court held that the term *conveyance* as used in the second element of the statute gives it a peculiar and appropriate meaning and it requires that there be some instrument that affects the title of the real property. Although

the decedent's death had an affect on the real property's title, it did not constitute a *conveyance* because no instrument in writing was created that affected the property's title. The most recent conveyance occurred when the joint tenancy was created between the deceased and the taxpayer in 2004, and prior to that time, the real property was not held as a joint tenancy because the deceased parent was the sole owner of the real property. The Court concluded that because the taxpayer met the requirements of the GPTA, there was no *transfer* of ownership and the taxable value of the real property should not have been "uncapped." The Court did not address the question of whether the creation of the joint tenancy between the taxpayer son and his brother results in an uncapping.

If the Michigan Supreme Court does not overrule this decision and the Legislature does

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not revise the GPTA, more property owners will be encouraged to use an estate plan that includes holding property in joint tenancy with rights of survivorship. With joint tenancy an owner of real property, such as a family cottage, can create a joint tenancy with one or more members of the next generation and avoid an uncapping on the death of the parent. An added advantage of joint tenancy is the avoidance of probate as title passes on death to the surviving joint tenant.

*To explore this potentially new exemption from uncapping real property, please contact either Kristen Campbell at [kcampbell@shrr.com](mailto:kcampbell@shrr.com) or 231.486.4542, or Stephen Chambers at [schambers@shrr.com](mailto:schambers@shrr.com) or 231.486.4546. In the meantime, we will be following this case as it makes its way to the Michigan Supreme Court and will update you on any new ruling.*

## ARE YOU READY FOR ROTHS?

By: George F. Bearup, Attorney

**B**eginning in 2010 anyone can convert a traditional IRA to a Roth IRA. A Roth *conversion* is technically a distribution from a *traditional* IRA that is moved into a Roth IRA.

This "conversion contribution" may be transferred from (or back to) a *traditional* IRA before the extended due date of the taxpayer's

tax return for the year the distribution from the *traditional* IRA occurred, which is usually October 15 of the following year. The taxpayer has this period of time following the conversion to change his or her mind. This process is called a *recharacterization* of the IRA contribution. If a recharacterization occurs, the Roth IRA money is reallocated to a *traditional* IRA.

The effect of the recharacterization of a Roth IRA is that the taxpayer contribution is treated as if it was retractively made directly to a *traditional* IRA. In short, if a taxpayer converts funds from a *traditional* IRA to a Roth IRA, that taxpayer can change his or her mind and “undo” the conversion and move the money back and not pay any income tax on the amount converted to the Roth, flexibility that has been referred to as a “legal Mulligan.”

Because of this opportunity to recharacterize a Roth conversion by the following year’s October 15, some estate planning documents may need to be modified.

Durable Powers of Attorney should be amended to give the taxpayer’s agent the authority to make all tax elections, including the election to recharacterize a Roth IRA.

The ability to recharacterize a Roth IRA into a *traditional* IRA extends beyond death. Accordingly, the taxpayer’s Will should be modified in anticipation of a recharacterization decision. This is an important grant of authority particularly where the beneficiaries are different, e.g., in a second marriage when the children of the first marriage are to receive the Roth IRA and the surviving spouse is to receive the decedent’s other property with the corresponding burden to pay all of the decedent’s income taxes. A Will’s administrative provisions should expressly give to the estate’s Personal Representative the discretion, without court authority, to recharacterize an IRA and to name the beneficiary of the new IRA, to avoid contested probate court hearings and dealing with an unhappy Roth beneficiary.

When completing the beneficiary designation for the Roth IRA, language should be added

that provides: “the beneficiary of this IRA takes subject to my estate’s Personal Representative’s right to recharacterize.” Additionally, the taxpayer’s IRA beneficiary designation should integrate the Roth IRA into the taxpayer’s overall estate plan. The conversion of all or a substantial portion of a *traditional* IRA into a Roth IRA will necessitate the use of liquid assets to pay the accelerated income tax on the Roth conversion. Also, a properly phrased beneficiary designation is critical to ensure that *separate shares* in the IRA to maximize the opportunity for post-death “stretch out” distributions by each named beneficiary.

*Roth conversions are a great opportunity. Just make sure you think carefully about the unintended consequences of such a conversion on your estate plan.*

The Roth IRA is a unique asset since the income that it generates is income tax-free. It will be a tragedy if estate taxes are paid using assets held in a Roth IRA. Often federal estate tax allocation clauses require an

“equitable allocation” of any estate tax burden that is spread over all of the decedent’s assets that cause the estate tax liability, including a Roth IRA. It makes sense to re-examine all federal estate tax allocation clauses in Wills and Trusts. Consider exempting the Roth IRA from any estate tax burden to maximize the real value of that unique asset. But keep in mind that such an exemption then shifts the estate tax burden caused by the Roth IRA onto potentially other beneficiaries, which creates a financial hardship on them and further depletes their inheritances.

Roth conversions are a great opportunity. Just make sure you think carefully about the unintended consequences of such a conversion on your estate plan.

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