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Common Legal Issues in Dealing with Trusts and Divorces

In Divorce we Trust?

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- On all matters touched upon by this presentation, it is recommended that you consult with your attorney for: 1) definitive interpretations of the laws and regulations involved, and 2) specific guidance on your business practices.
- The stories you are about to hear are true. The names were changed to protect the innocent.

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Underwriters in Edward Lloyd's "Coffee House", London, England

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Underwriting slip for the Titanic

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Just what is a trust?

A **trust** is an agreement between the creator of the trust and the trustee of the trust to manage the trust assets for benefit of someone.

The trust creator is called the “**settlor**” or “**grantor**” or “**trustor**” or “**trustmaker**”.



The **trustee** is the person appointed by the Settlor to manage the assets. A **successor trustee** is a person to act as the trustee in the event that the initial trustee is unable or unwilling to continue acting as trustee.

trustee




The trustee manages the trust assets for the benefit of the “**beneficiaries**” of the trust and may ultimately distribute the assets to the beneficiaries, according to the terms of the trust.





For example, in his will, Mr. X creates a trust by appointing Mrs. Y to act as trustee on his death. Upon his death all of his assets go to the trust, and are distributed to the beneficiaries of the trust when they turn 18.

The beneficiaries are Mr. X's minor children.

This is called a testamentary trust (that is, a trust created in a will).




A living trust (also called an *inter vivos* trust) is a revocable trust where the settlor also appoints him or herself as trustee. Usually the settlor is also the initial beneficiary. When the settlor dies, a successor trustee takes over and acts on behalf of the remaining beneficiaries under the terms of the trust.




Revocable or Irrevocable

If a trust is revocable, it may be revoked by the settlor at any time.

What is a revocable trust?






Irrevocable Trusts

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 rest to as ASSIGNEE, under the te
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 -age of th

An irrevocable trust cannot be revoked. Transferring property to the trustee of an irrevocable trust is like deeding the property to a third-party. The settlor no longer has any power over the property.

An irrevocable trust, if properly set up and administered, may shield assets from claims against the settlor by creditors.

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PAST DUE

A revocable trust does not offer the trust protection from claims against the settlor.

If the trustee has the power to revoke the trust, creditors can go after trust property and liens against the settlor will attach to trust property.

When the grantor in a conveyance reserves to himself an unqualified power of revocation, he is thereafter deemed still to be the absolute owner of the estate conveyed, so far as the rights of his creditors and purchasers are concerned.
 MCL 556.128

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Trusts and Title Problems

Problem 1: Just who is the trustee

A typical living trust.

Settlor is the trustee and initial beneficiary.

Successor trustee takes over when the initial trustee is incapacitated or dies.

Incapacity will be determined by the opinion of a Licensed medical doctor.

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But capacity is a legal matter and not necessarily a medical matter.



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Many doctors, fearing lawsuits, may refuse to provide a clear-cut opinion.

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Problem 2: Deeding property to the trust, instead of the trustee.

A trust is a document, or a relationship, whose terms are spelled out in a document. A trust is not a legal entity.



Property should be titled in the trustee, and the trust itself should be identified, such as "John Smith, as trustee of the John Smith Living Trust dated 06/12/2012".

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Titling the property in the trustee, along with the name of the trust allows the title company to compare the title to the property with any certificate of trust that is, or will be, recorded.



Titling the property differently can cause problems!



“But what happens if the grantors decided to the trust, instead of to the trustee?”

Such as a deed to:

The Paul Jones Living Trust dated 10/01/2001.

Technically, the deed is void as there is no legal grantee.



“How do I fix it?”, you may ask.

Talk to your title company. They may be willing to insure over it. Otherwise you will have to get a new deed from the grantor to the trust.

(or a new title company).



But wait, it gets worse!

While deeding to the trust, instead of the trustee, is bad, deeding to the trustee, without describing the trust is worse.



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A deed to, for example, John Smith, trustee, without a description of the trust vests title in John Smith, individually. *

That can be a huge problem if Mr. Smith has had state or federal tax liens filed against him.

*Michigan Land Title Standard 8.2.


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Problem 3: Failure to deed the property to the trustee of the trust at all.

The trust is signed, and later on the settlor and initial trustee dies. The successor trustee wants to distribute the property to the beneficiaries, or sell the property.



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Old Republic Title Insurance Company
100 W. Alabama Street, 7th Floor
Dallas, Texas 75201


Report Date: November 06, 2019 10:45 AM
POLICY: 100000111111
APPLICANT: 100000111111

Client: Mike & Julie

1. Title Insurance - Order: 22,324.40/100

<small>1. Policies Issued</small>	<small>Proposed Amount of Premium:</small>
<small>2. Policies to be Issued</small>	<small>Amount: To Be Determined</small>
<small>(a) ALL IN, 90% LUMP-SUM POLICY CASH ON HAND/RENTAL</small>	<small>Premium: \$</small>
<small>(b) ALL IN, 90% LUMP-SUM POLICY CASH ON HAND/RENTAL</small>	<small>Premium: \$</small>
<small>(c) ALL IN, 90% LUMP-SUM POLICY CASH ON HAND/RENTAL</small>	<small>Premium: \$</small>
<small>3. The name on the title is the last disclosed or address on the County Records Fee Report.</small>	
<small>4. This is the Fee Study used or name is the last used in the Effective Fee used in FEDERAL INCOME TAX REPORTING CORPORATION</small>	
<small>5. The last address on the County Records is shown as follows: Last in Order of: 100000111111 (100000111111) according to the Report as recorded in Plot Book 201 Page 14 of the Public Records of Tarrant County, Texas.</small>	

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But the title insurance commitment shows that the property is still owned by the settlor (creator of the trust), individually.

Why did this happen?



No one ever did a deed from the settlor to the trustee.


Creating a trust does not transfer title to real estate.




This is a problem when the settlor (creator of the trust) has died.

On a smaller transaction, you might convince a title company to accept an affidavit of heirs from a person with personal knowledge, in lieu of opening probate.

But you still have to get deeds signed by all the heirs.






Problem 4: Property deeded in to trust, but deeded out individually.

Assume the following facts:

1. John Jones owns the property.
2. John Jones has a living trust created and deeds the property to John Jones, as trustee for the John Jones Living Trust dated June 1, 2016.
3. John Jones decides to sell the property, and sells it by warranty deed, signing as John Jones (and nothing else).
4. Does the purchaser have good title?

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Yes, according to an unpublished opinion of the Michigan Court of Appeals.




Under these circumstances, the court concluded that the trustee intended to transfer the property to the buyer, but simply left off the "description" that he was acting as trustee. The court found the transaction was valid.

McDonnell v Erickson, unpublished opinion per curiam of the Court of Appeals issued June 26, 2014 (Docket No. 315343).

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Problem 5: Passive Trusts



A passive trust is a trust where the trustee has no duties.

The trustee can only do what the beneficiaries of the trust tell him or her to do.

Passive trusts are often set up for the sole purpose of hiding the ownership of the property.

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Under the law, property deeded into a passive trust actually transfers legal title to the beneficiaries, whether they want it or not.*



*Michigan Land Title Standard 8.1



Title



Settlor



Passive Trustee



Beneficiaries of Passive Trust





MISCELLANEOUS

RULE TO THE CONTRARY



Domestic Asset Protection Trusts (DAPTs).

A DAPT is a specialized, irrevocable trust that allows the settlor to be a beneficiary and still exercise some control.

A DAPT is primarily used to shield assets from creditors, ex-spouses, etc.

You are not likely to see a DAPT unless dealing with a very sophisticated (read wealthy) customer, with substantial assets.



Problem 6: Trust Property Held Jointly

Paul had a living trust created. He deeded his property to his brother John, as trustee of the Paul Trust, and his sister Mary, as joint tenants with full rights of survivorship.

What's wrong with that??.....





Trusts Don't Die
If the trustee dies, a new successor trustee comes into existence.



A court would probably find them to be tenants in common, with a 50% interest each.



Certificates of Trust

There used to be two forms of certificates of trust.

MCL 565.431 *et. seq.* was found in the real estate section of the Michigan statutes.

MCL 700.7912 *et. seq.* is found in the Michigan Trust Code section of Michigan statutes.

The main difference between the two was that a trust code certificate of trust could be signed by a successor trustee. The real estate certificate of trust could not.



That forced successor trustees to hire a lawyer to draft and sign a certificate of trust if one was needed.



MCL 700.7912 et. seq.
Trust Code Certificate of Trust

- 1.The name of the trust and the date of the trust instrument and any amendments.
- 2.The name and address of the currently acting trustee.
- 3.The powers of the trustee relating to the purposes for which the certificate is being offered.
- 4.The revocability or irrevocability of the trust and the identity of any person holding a power to revoke the trust.
- 5.The authority of co-trustees to sign or otherwise authenticate and whether all or less than all are required in order to exercise powers of the trustee.



A purchaser who relies on a certificate of trust is considered a *bona fide* purchaser.

**BONA
FIDE**

That is important!



Is it necessary to record a certificate of trust?

What About Land Title Standard 8.3?

A DEED BY A TRUSTEE UNDER A TRUST WHOSE NECESSARY TERMS ARE EXPRESSED IN THE INSTRUMENT CREATING THE TRUSTEE'S ESTATE **DOES NOT VEST MARKETABLE TITLE** OF RECORD IN THE GRANTEE UNLESS THE INSTRUMENT CONTAINING **THE TRUST TERMS OR A CERTIFICATE OF TRUST** EXISTENCE AND AUTHORITY COMPLYING WITH THE REQUIREMENTS OF ACT 133 OF THE MICHIGAN PUBLIC ACTS OF 1991 (A) **IS OF PUBLIC RECORD**, (B) ESTABLISHES A VALID TRUST AND (C) CONTAINS A VALID AUTHORITY FOR THE CONVEYANCE.



But what does that even mean????

Despite the reputation of the Land Title Standards as authoritative, there is no known support for the statement that title is not marketable if a certificate of trust is not recorded.



MCL 565.431
An instrument conveying, encumbering, or otherwise affecting an interest in real property, executed pursuant to an express trust, may be accompanied either by a copy of the trust agreement or by a certificate of trust existence and authority....

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Trustees and Powers of Attorney

Not favored. The trustee is a fiduciary chosen to act trustee.

However, when the settlor is the trustee sometimes the title company will agree to insure.

Be prepared to answer the following questions:

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1. Does the trust authorize the trustee to use a power of attorney?
2. Does the power of attorney state that the power to act as trustee is being delegated?
3. Is the trustee making the actual decision to sell/mortgage and is the attorney in fact merely carrying out the trustee's wishes,

OR, is the attorney in fact making the decisions?

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Self Dealing and Gifts



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Self dealing is where the trustee profits from the transaction involving trust property.

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Now, time for some.....



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A trustee is a *FIDUCIARY* under the law.

MCL 700.1212 Fiduciary relationship.

(1) A fiduciary stands in a position of confidence and trust with respect to each heir, devisee, beneficiary, protected individual, or ward for whom the person is a fiduciary. A fiduciary shall observe the standard of care described in section 7803 and shall discharge all of the duties and obligations of a confidential and fiduciary relationship, including the duties of undivided loyalty; impartiality between heirs, devisees, and beneficiaries; care and prudence in actions; and segregation of assets held in the fiduciary capacity. With respect to investments, a fiduciary shall conform to the Michigan prudent investor rule.



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700.7803 Impartiality; use of standards of Michigan prudent investor rule.

The trustee shall act as would a prudent person in dealing with the property of another, including following the standards of the Michigan prudent investor rule. If the trustee has special skills or is named trustee on the basis of representation of special skills or expertise, the trustee is under a duty to use those skills.



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Self dealing is prohibited—unless the trust itself allows for it.

Similarly, gifts by the trustee are prohibited—unless the trust allows it.

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What do you think?

Bob is the trustee for his father, John's, living trust. The trust specifically authorizes gifts, but not self dealing. Bob and his half-brothers, Sven and Lars, are not beneficiaries of the trust.

Bob's father goes into a nursing home. Bob deeds the property to himself and his two half-brothers, Sven and Lars. Is the transaction valid?



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Probably yes as to Sven and Lars, but no as to Bob. While the trust authorized gifts, as to Bob the transaction was both a gift and self dealing.

Next question.....same trust.

Bob wants to buy his father's trust property, and deposit the money into the trust's bank account to take care of his father. Bob has the property appraised by an independent appraiser and pays the trust one dollar more than the appraised amount.

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Maybe. But Bob, as trustee, is a fiduciary. Could he have done more? Could he get more money for the property by listing with a competent REALTOR®? If the transaction is challenged, Bob will have to prove that the best interests of the trust were served.

Last question.

The trust specifically states that if John is still in a nursing home six months after going to live there, Bob is authorized to deed the property to himself for one dollar.

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Bob finally gets the house!



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Trustees and Tax Liens



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Problem #1

Richard is trustee of his wife's (Liz) living trust. Richard is not a beneficiary. A federal tax lien is recorded against Richard.

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Answer #1.

The lien does not attach to the trust property.

There *could* be a different result if Richard was a beneficiary under the trust. The IRS might be entitled to his share of the proceeds.



Problem #2

Richard is the settlor and beneficiary of his own living trust. A lien is recorded against Richard individually.




Answer Problem #2

The lien attaches!!




Things that are "trust-like".



SELF DIRECTED IRAS


Self-directed IRA's and some types of pension and profit sharing plans can hold title to real estate. These are not state-law trusts, but are creatures of the Internal Revenue Code.




Nevertheless, we treat them as if they were trusts.

With a self-directed IRA, instead of a trustee, there is a "custodian". The custodian signs all documents, and not the beneficiary (or owner of the IRA). A typical signature line might be:


Equity National Bank, as custodian for Paul Jones IRA, account number 23832



By: John Smith
Its: Vice President




By the way,



When dealing with self-directed IRA's and pension and profit sharing plans, it is generally **not** wise to rely on your title company for tax advice.

Generic Wise Man



Title Issues in Divorce



Pesky issues that create title problems later on.



True Title Story #1



Tom and Mary owned a house. They both signed the 250k note and mortgage.

Mary is awarded the house in the divorce.

The divorce judgment says that the mortgage on the house is Tom's sole responsibility and he indemnifies her from any loss or damage as a result.





Tom stops making payments and files for bankruptcy.

The bank forecloses on the house, sells it at foreclosure sale, and ultimately sues Mary for a deficiency judgment.

Is that legal?





YES!

The bank was not part of the divorce action and the judgment of divorce has no effect on the rights of the bank.



Takeaway:



Divorces only have an affect on the parties. Third parties, such as lenders, are unaffected.



True Title Story #2

Todd and Lisa got married and then divorced. Todd owned the house, which had a value of \$200,000.00.

The judgment of divorce stated that Lisa got the house, and that Lisa was indebted to Todd in the amount of \$100,000.00. Lisa was ordered to pay Todd the \$100,000.00 over the following three years.





Lisa sold the house, left town, and disappeared.




Todd sued the new owner claiming that he had a lien on the property

AND....






Todd lost for two reasons. First, the judgment referred to a debt, not a lien.




Second, the judgment of divorce was not recorded at the Register of Deeds office. So, there was no constructive notice of it, and the purchaser took title free of it.



Moral of the story:

If you want something to be a lien, call it a lien. Don't leave it up to interpretation, and record the judgment.



True Title Story #3

The real estate was owned by John. Mary was awarded ownership of 2838 Western Circle Drive, which was described in the judgment as "2838 Western Circle Drive".

Who owns the acreage and the property on the other side of the driveway? Can John sell it?

Who owns the guest house just North of the main house? Can Mary sell it?





**AND
THE MORAL
OF THE
STORY IS...**

Use legal descriptions if at all possible.

Better yet, get a title search.



Deeds and Divorce



Sure, an online deed form can be used by the parties to implement their divorce judgment. But imprecision results in future problems, as we shall see.....



True Title Story #4

John and Mary get divorced. Mary is awarded the house. John receives a \$10,000.00 lien on the house. The divorce is not recorded.



As required by the judgment, John gives a quit-claim deed to Mary.

The deed has no special language in it.



Can Mary sell the property without paying off the lien?



Probably YES!

The quit-claim deed gives up ALL interest that John has in the property, including his lien rights.

A title company may ask to see the unrecorded divorce, to avoid being brought into a lawsuit later on, but is not required to.



Since the judgment is not recorded, and the deed is unrestricted, a purchaser would be a bona-fide purchaser.



So how could John have protected himself?

The deed could have said "subject to a lien in favor of John as stated in the judgment of divorce dated June 1, 2015",

or



"Subject to a \$10,000.00 lien in favor of the grantor".

But beware of:

"Pursuant to a judgment of divorce".



Just what does that even mean?

“Pursuant to a judgment of divorce”.



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At best, it is ambiguous

So how could John have protected himself?



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John could have recorded the judgment at the register of deeds office.



REGISTER OF DEEDS



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URBAN LEGEND


Q But what if the judgment doesn't have language about recording the judgment at the register of deeds? That is, the self-actuating language. What if one of the parties refuses to sign a deed? I thought that language in the judgment was necessary.

A If the judgment awards the property to someone, recording the judgment transfers title. Special language is unnecessary.

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MCL 565.401

(1) If a final judgment is rendered in any suit or action at law that affects or relates to the title of real estate, by a court with competent jurisdiction, a copy of the judgment, duly certified by the clerk of the court and under the seal of the court, may be received and recorded in the office of the register of deeds for the county where the real estate is situated. **When recorded, the judgment has the same effect as evidence and notice of title as the recording of deeds and other conveyances**, and the register of deeds is entitled, for the recording of the judgment, to the same fees as for the recording of deeds.

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True Title Story #5

(this one happens about once every two weeks)

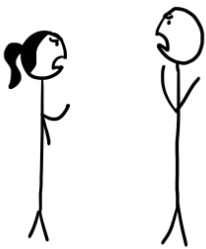


John and Jane buy some property on land contract.

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The contract will be paid off in 5 years, so John and Jane have the seller sign a deed, and the deed is put in escrow with the title company. The grantees on the deed are Jane and John.





Jane and John get divorced and the property is awarded to Jane. Jane pays off the land contract and the deed in escrow is recorded.





The Trust/Divorce Combo

Brad is getting a divorce from Angie. The property is titled in "Brad and Angie, as trustees of the Brad and Angie Living Trust dated November 3, 1997".



Angie is awarded the property in the divorce.

Problems?



1. Technically, Brad and Angie don't own the property. They own it as trustees of the trust only. Has the property really been awarded to Angie?
2. The divorce judgment appears to take the property out of trust. What happens if Angie dies? Does the successor trustee of Angie's trust (if there is one) administer the property or must Angie's estate be probated?



A divorce judge has the power to alter the ownership of property held in an inter vivos (or "living") trust.



But they can't get it right if the parties, and their lawyers, don't know how title is actually held.

[Insert shameless plug here:]

↓

Consult your favorite Old Republic Title Agent!

Probate (or Estate) Ownership

Estates of Inheritance

At English common law there were two estates of inheritance: fee simple and fee tail.

Fee tail ownership only allowed the owner to transfer the property (by deed or will) to his immediate heirs—basically his oldest male child. This was intended to keep the large-feudal tracts of land from being split up. Every subsequent owner would be similarly bound. The property stayed in the family.

A deed for a fee tail estate would typically read “to John Smith, and the heirs of his body”.

The fee tail estate in land has been abolished by law. An attempt to create a fee tail results in fee simple.

Fee simple remains as the estate by which nearly everyone holds title.

Fee Simple

At early English common law, a fee simple estate could only be created by specific language. The deed had to say the name of the grantee and then recite "his heirs".

By statute the magic "his heirs" language is no longer necessary to create the estate inheritance called "Fee Simple":

It shall not be necessary to use the words "heirs and assigns of the grantee" to create in the grantee an estate of inheritance; and if it be the intention of the grantor to convey any lesser estate, it shall be so expressed in the deed.
MCL 565.153



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Attributes of Fee Simple

Freely alienable (sellable). Restrictions on its sale are generally void.

Allows the use of the land for any purpose that does not adversely affect neighboring property (subject to government regulation of course).

Includes subsurface rights and the right to sever them.



Fee simple ownership that has no limitations is called "Fee Simple Absolute".

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On the death of the owner, title to real estate automatically vests in the heirs of the owner. Even if nothing else is done.




But.....

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This ownership by the heirs is subject to right of the personal representative of his or her estate to do something else with the property.


Once again, we use the word "Estate", but his time with a different meaning. In the context of dead people and probate proceedings, an "estate" is the total of everything the person owned at the time he or she died.

Sometimes this "estate" is called the probate estate or the decedent's estate.



Probate proceedings provide an orderly way to:



1. Pay debts of the deceased.
2. Orderly distribute the assets of the deceased according to the will or according to law if there is no will.
3. Pay estate taxes, if any.



When probate proceedings are started, the court will appoint a person to be the "personal representative" of the decedent's estate.

The personal representative is given "letters of authority".


This document tells you if the personal representative can deal with real estate without court permission.

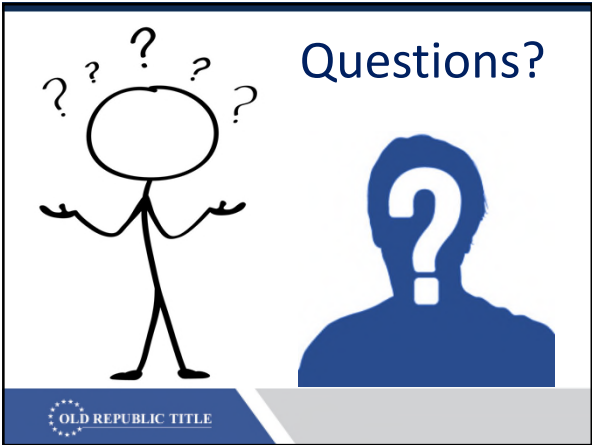



The personal representative has the task of distributing the deceased's property according to his or her will, or according to the laws.

Like a trustee, a personal representative is a fiduciary and is subject to the gift and self-dealing rules we previously discussed.


Often, the personal representative is also an heir, and must transfer estate property to himself—Expect that such a transaction will get scrutiny and that court permission may be necessary.

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OLD REPUBLIC TITLE says:

Thank You!

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