

10 Surprises When Inheriting Real Estate

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Following the death of a loved one, you may become the recipient of an unexpected parcel of real estate. Yet, with every windfall comes great obligations, so be prepared for the surprises you may encounter when inheriting property.

- **Mortgage Transfer**

You may be able to keep the decedent's mortgage intact when you inherit real estate. Typically, upon the transfer of ownership to real estate which is encumbered with a mortgage, there is a due-on-sale clause contained within the contractual documents that created the mortgage and note wherein the entirety of the mortgaged monies will become accelerated on transfer and become immediately due and owing to the lender (i.e., the entire loan is billed rather than just the installment payment). Nonetheless, recipients of real estate incident to the death of the owner needn't concern themselves with such a clause because Federal Law preempts (i.e., overrides) the lender's contractual right to call a mortgage where either the recipient of the property is a relative of the decedent-borrower or where the recipient was a joint tenant on the deed of the property with the decedent-borrower prior to death.

- **Reverse Mortgage**

While a reverse mortgage was a great source of income for the decedent prior to death (it's available to those aged 62 and older), that money has to be repaid to the lender, including all of the capitalized interest thereon. So, your real estate inheritance with a reverse mortgage will not be owned by you free and clear. Instead, the real estate will be encumbered by a significant mortgage that you cannot make monthly payments on and instead, such mortgage needs to be repaid prior to you calling that real estate your own home. You only have 30 days after the date of death to notice the lender whether you intend to pay off the mortgage from (a) other monies, (b) a refinance, or (c) a sale of the real property. Failure to provide this notice may result in a foreclosure proceeding being brought against the Estate. Nonetheless, there may be equity in the property, even after deducting the payoff fees for this reverse mortgage lien, and it's incumbent on a beneficiary / executor to act quickly in providing this notice to the lender in order to preserve the inheritance stake (i.e., equity) in the real estate after the lender is paid-off.

- **Rental**

Where real estate is encumbered by a home loan, not a reverse mortgage, you may be able to rent your inherited real estate without first refinancing the mortgage from a residential home loan to an investment loan. Relevant to the due-on-sale clause discussed herein with respect to mortgage transfers, the recipient of real property who qualifies for due-on-sale preemption can also rent the property for up to 3 years, during any rental term, without the monies in the mortgage becoming due and owing to the lender through a separate exception to the due-on-sale clause pursuant Federal Law. Without this Federal Law preemption, a person with a residential mortgage for their primary residence would be precluded from renting the property without first refinancing to an investment loan. So, those inheriting real estate can utilize the real property inherited as an income stream instead of immediately liquidating through sale or choosing to occupy the premises themselves. Nonetheless, before you rent out your inherited real estate, make sure to comply with the local Town / Village from where the real estate is located with respect to obtaining any requisite rental permits and through avoiding illegal transient (i.e., short-term) rentals or be prepared to face citations with fines and possible jail time.

- **Homeowners Insurance**

You cannot keep the decedent's prior homeowners insurance policy following the death of the decedent-insured when you inherit an Estate. While there is a Federal Law that enables certain recipients of real estate to keep the decedent's mortgage intact, there is no such law with respect to the decedent's homeowners insurance. Nonetheless, the standard homeowners insurance policy does extend insurance benefits initially and upon death of the decedent-insured to the legal representative (i.e., executor or administrator) of such insured during the interim period existing post-death and pre-distribution to the ultimate beneficiary (i.e., while an executor or administrator is probating / administering the Estate). Yet, this extension of limited coverage may be curtailed by other policy exclusions, such as the loss of coverage if the property is vacant for 60 consecutive days before an occurrence of a peril or some other period set forth within the policy. Make sure to read the homeowners policy, which had named the decedent as the insured, to know the rules of the policy and don't assume anything.

- **Testamentary Substitutes**

Sometimes you immediately inherit real estate upon the death of the owner; ownership can transfer without the need for a court order or, even, a deed change. If the property was titled as either a joint tenancy or a tenancy by the entirety, pre-death, than the surviving co-owner automatically will receive full ownership at the time of death of the co-owner without the need to file a probate petition with the surrogate's court. Additionally, when real estate was owned in a trust, pre-death, again, there is no need to go to court to effectuate a transfer of ownership. To determine if your real estate is owned in a testamentary substitute fashion, simply check the deed. Interestingly, real estate that is deeded to a trust, instead of the trustee of the named trust, is an invalid transfer. So, always seek legal counsel when dealing with a decedent's real estate to ensure compliance with applicable laws in order to obtain your rightful ownership interest. Moreover, tax advice is essential given that testamentary substitutes do not avoid Estate taxes regardless of their ability to keep you out of court.

- **Estate Tax**

Before you cash in from your inheritance of your Estate be prepared to pay taxes. Estates of decedents domiciled in New York may be liable for both state and federal Estate taxes. Nonetheless, New York Estates which are valued under \$2,062,500, for those dying on or before March 31, 2015, are exempt from all such taxes. Additionally, Estates valued between \$2,062,500 and \$5,340,000 will only be subjected to New York State's Estate taxes, which range from 5.6% to 16%, and will be exempt from federal Estate taxes. However, Estates valued over \$5,340,000 will not only face New York State's Estates taxes, but also require payment of a federal Estate tax bill, at a rate of 40%, for the amount that the Estate is valued in excess of \$5,340,000. Be sure to check your state's Estate tax law to learn what you owe.

- **Capital Gains Tax**

While the inheritance of an Estate may be subject to Estate taxes, it will fortunately be exempt from any capital gains tax that would have otherwise been due and owing by the decedent had they transferred the real property themselves pre-death. Capital gains tax in New York can reach a rate of 31.5% when combined with federal capital gains tax (check your state's capital gains tax before proceeding). This type of tax is assessed on the gain that a long-term asset has realized from the date of purchase to the date of sale. Fortunately, inherited Estates receive a stepped-up basis to the date of death value of the property for capital gains purposes and, therefore, avoid a great deal of this cumbersome tax on future transactions.

- **Probate**

When property is owned by the decedent themselves, in fee simple absolute, or with another person, as tenants in common, then the inheritance can only be transferred through a court proceeding called probate (the proceeding is called an administration, not probate, if the decedent dies without a Last Will and Testament). In such a proceeding, court fees will become due upon filing the requisite court papers. Thereafter, an individual will be appointed by the court to serve as the fiduciary of the Estate (i.e., appointment is by way of the court issuing letters testamentary or letters of administration), charged with marshalling and distributing the Estate assets, while preserving the value of the Estate in the process, on behalf of the beneficiaries / heirs of the Estate.

- **Heirs at Law**

It's often disheartening to find out that your spouse died without having a Last Will and Testament; particularly when you learn that your spouse's estranged children from a prior marriage now own part of your prized Estate. New York State utilizes a table of consanguinity that prescribes the heirs at law when a decedent died without a Last Will and Testament. Pursuant to this table, a surviving spouse only receives the first \$50,000 and then, must split the remaining Estate assets, 50 / 50, with the decedent's surviving children. Alternatively, where there is no spouse and no children surviving the decedent, the table of consanguinity goes as far as great-grandchildren of the grandparents of the decedent to identify the heirs at law to that Estate.

- **Right of Election** You read your parent's Last Will and Testament at least five times to be sure that it actually says that you get everything while disinheriting your wicked step-parent, but before you throw your celebratory bash at your real estate, first become familiar with your step-parent's right of election. In fact, you cannot disinherit a spouse completely, except if the surviving spouse expressly waived their rights (i.e. incident to a prenuptial agreement). So, regardless what the Last Will and Testament states, your wicked step-parent can elect the greater of \$50,000 or 1/3 of your parent's entire net Estate.

Bonus Concept: Selling your inherited real estate before ensuring your rightful ownership (i.e. confirming deeded ownership through a testamentary substitute by way of competent legal advice or a distribution pursuant to an order of the surrogate's court in an probate / administration proceeding) will result in a dead deal, headaches and potential litigation. Don't jump the gun from thinking you inherited something to disposing of the real property. Instead, be measured in your new found real estate windfall, obtain proper counsel to perfect your rights.

This article was written based on New York Law and those inheriting real estate in other jurisdictions should check their local law for the rules applicable to Estates in that jurisdiction. All are advised to speak to an attorney whenever inheriting any property. This article is provided for informational purposes only. No advice or guarantees of accuracy are rendered herein.

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