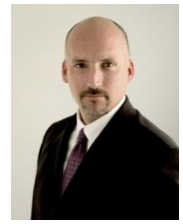
ManfrediLevine
ATTORNEYS
Manfredi, Levine, Eccles, Miller & Lanson, APC

Sam C. Manfredi
Ronald B. Levine
Matthew R. Eccles
Mark F. Miller*
Don E. Lanson
David V. Hadek
Peter J. Krupinsky
William G. Lieb
*also admitted in NY

Property Transfer Pitfalls:
Things That TILT The Transaction
(Title, Insurance, Liability and Taxes)


Don Lanson

Transferring real property in California is becoming increasingly problematic based upon a number of economic and practical factors. Over the last year I have noticed a number of common pitfalls relating to real estate transfers that I have grouped into one of four categories under the acronym TILT (which harkens back to my pinball days). In this regard, I have found that most problems these days relate to title (how it is held and transferred), insurance, liability and taxes. Please note that the below list is not exhaustive of all of the potential pitfalls that a party could encounter in a real estate transfer, but rather simply the ones that I have found most common recently.

A. Transferring Title: The first area of common pitfalls is in the mechanics of transferring title, including the ways in which title can be held and the method of transfer.

1. **Common Pitfalls as to the Method of Owning Title:**
   a. Sole Ownership: An individual as an unmarried person or individual as a married person as their sole and separate property.
      i. Pitfall - Spousal Quitclaim: If property is acquired during marriage it is presumably deemed community property unless otherwise specified. Aside from specifying separate ownership on the grant deed, a quitclaim deed from the disclaiming spouse should also be recorded. Failure to record the quitclaim deed may create a presumption of community property ownership, which would then require the signatures of both spouses (it would be deemed jointly owned).

3262 E. Thousand Oaks Blvd., Suite 200 • Westlake Village, CA 91362 • 805.379.1919 • 805.379.3819 FAX • www.manfredilevine.com

b. Joint Ownership: Can be held as community property by spouses, either with or without right of survivorship, were each owns 50% of the whole with no automatic passing of title, but could obtain a step up in basis upon the death of the first spouse. Alternatively, can be held under joint tenancy, where each owns 100% of the whole so title can be automatically passed upon the filing of an affidavit of death of joint tenant, but holding title in this way creates difficulties for a 1031 exchange and is an extremely ineffective estate planning device. Lastly, ownership can be held as tenants in common with each owner having whatever stated percentage that was agreed upon, with each able to pass their interest separately, which is easier for 1031 exchanges but requires an instrument or court order to effectuate.
   i. Pitfall – Limitations of Joint Tenancy: Conveyance must transfer "to two or more persons at the same time the same title to the same interest with the same right of possession", i.e., creation of a joint tenancy requires the four unities of time, title, possession and interest. So, corporations cannot be a joint tenant (they technically never die), vehicle cannot be used for 1031 exchange, very difficult for one joint tenant to use interest as collateral for a loan and is an effective estate planning device.
   ii. Pitfall - Tenancy In Common: As each interest is separate and distinct, holding title in this manner can create strange bedfellows.

c. Entity Ownership: Ownership can be put into a corporation, a limited liability company or a partnership, each of which have different benefits and burdens of holding title, as well as the applicable rules and procedures to be followed. Special consideration must be given to ramifications of a material change in ownership, authority to act on behalf of the entity as to ownership, and tax consequences (e.g., transfers to or from entity can inadvertently cause transfer tax, reassessment or other costly errors).
   i. Pitfall - Failure to Follow Statutory Requirements: Entity formalities must be complied with in order to ensure transaction cannot be challenged.

d. Power of Attorney: A contract regarding real property may be entered into pursuant to the terms of valid and enforceable right under a Power of Attorney.
    i. Pitfall - Failure to Timely Verify Validity: A Power of Attorney is an extremely important document, and provides extensive rights to the person that holds the benefit under the document to act for another. But the document typically will have limitations as to time and actions that can be taken.

e. Trustee Ownership: Ownership must be in the names of the trustees instead of the trust itself, and there are exceptional benefits (e.g., obtaining a step up in basis) as well of potential pitfalls (e.g., trust disputes for left out beneficiaries are increasing) associated with this popular method of avoiding probate.
    i. Pitfall - Successor Trustee's Duties After Trustor's Passing: Once the trustor has passed away there are required duties that the successor trustee must comply with in order to have the requisite authority to act on behalf of the trust.

2. Common Pitfalls as to the Methods of Transferring Title:

a. Grant Deed: A California grant deed transfer's an owner's interest and assures the buyer/grantee that they are receiving valid title to the property, that the title has not been conveyed to someone else, and that there are no hidden owners or easements.
    i. Pitfall – Seller Possession After Sale: Many sellers want to remain on property after the sale is completed because there new residence is not available yet, which technically is a violation of the Grant Deed, but can be resolved by way of a lease.

b. Quitclaim Deed: A quitclaim deed is made from the grantor to the grantee without any warranties or guarantees, and instead is merely a transfer of any real or potential interest that the grantor may have. A quitclaim deed is often used to release a person's unrecorded interest in real property, to clear a cloud affecting title to the property, or to release one spouse's interest in real property to the other spouse.
    i. Pitfall – Existing Encumbrances Remain: Transfer by quitclaim deed does not remove any existing

encumbrances, including lender liens, mechanic's liens or judgment liens.

c. By Death of Prior Owner: Will, trust, or Transfer on Death Deed. As for the last (and latest) method of transferring title, the issue is still evolving so we'll discuss a limited pitfall.
   i. Potential Pitfall – Title Insurance: Title representatives are not in uniform agreement as to how title companies will deal with Transfer on Death Deeds as it's a recorded document that creates notice of an issue, e.g., if the owner seeks to sell the property with such a document recorded against the property there is a concern that it may need to be withdrawn in order for the sale to continue

d. Adverse Possession: Property can be acquired involuntarily by something called adverse possession, which requires that the "taker" demonstrate, among other things, actual, open, notorious, hostile and uninterrupted possession for 5 years; it also requires that the "taker" have paid the property taxes for the entire 5 year period as well.
   i. Pitfall – Factors are Case Specific: As in most things under the law, evaluation of the elements is not a static process, but rather is case specific based on an equitable evaluation of the specific facts at issue. So, whether one or more element has been satisfied.

B. Insurance: The second common area of pitfalls involves the limitations of title insurance.

1. **What Does Title Insurance Provide**: Title insurance is a contractual obligation that protects against losses that occur when title to a property is not free and clear of defects (e.g. liens, encumbrances and defects that were unknown when the title policy was issued).

   a. Pitfall – CLTA v. ALTA Policy: Most people don't know that there are two different policies available to them when they acquire real property. The standard policy is a California Land Title Association ("CLTA") policy that protects homeowners from financial loss associated with title fraud or forgery, and any recorded claim on the title, including unpaid taxes by a previous owner. An American Land Title Association Policy ("ALTA") protects against everything covered in a CLTA policy, as well as many additional risks, including easements or encroachments not shown by public records, as well as conflicting boundary lines and water rights.

b. Pitfall – Evaluation is Not Always Thorough: Before issuing the policy, the title company is supposed to conduct a thorough evaluation for title defects, including deeds, mortgages, wills, divorce decrees, court judgments, tax records, liens, encumbrances, bail bonds and maps. However, the cost to conduct such an evaluation for every transaction would be prohibitive, so the insurer may balance the cost of doing a thorough report against the chance of a claim being tendered.

2. **What Title Insurance Does Not Provide**: The title insurer's obligation under most policies is to simply reimburse the insured losses that are covered, up to the face amount of the policy, and any related legal expenses. Such protection is limited to the initial purchaser and only covers defects arising prior to ownership (so, it does not cover subsequent issues like tree roots).
   a. Pitfall - Reimbursement Limited to Diminution in Value: The policy does not provide for all damages that the homeowner might believe they have suffered, but instead only the difference between the property value with and without the title defect.
   b. Pitfall – Transfer to Trust or Entity Could Invalidate Coverage: Coverage on policies issued before 1998 could be affected to the extent the homeowner transfers their property to a revocable living trust. Transfers to an entity will likely result in coverage being invalidated, unless there is an additional insured endorsement.

C. Liability:

1. **Professionals**: Every real estate transaction involves numerous professionals, including brokers and agents, escrow and title officers, inspectors, lenders, and possibly attorneys, accountants and wealth advisors. Each of those professionals could be subject to liability based upon one or more potential pitfall.

a. Pitfall -Document Preparation: Preparing transfer or trust deeds can create the potential for malpractice decades down the line. CCP 340.6 provides for a 1 year statute of limitations for negligent claims by a client against a lawyer, but the statute is tolled until such time as the client suffers actual injury. Any error in the legal description or even the spelling of the names could be a basis for liability, which may take decades for the parties to actually recognize and suffer injury from.
b. Pitfall – Wire Transfers: Once escrow has closed, the escrow or title officer will usually have the seller's instructions as to where to send the remaining proceeds after all other debts of been paid. Increasingly, hackers are successfully manipulating communications with the escrow/title officer to have such residual proceeds redirected

2. **Sellers**: The seller (and the realtors as well) must disclose "any fact which would materially affect the value or desirability of the property which is not known to or readily observable by the buyer." What is "material" is a question of fact based upon the circumstances.
   a. Pitfall - Limited Inspection: Buyers seeking to minimize their cost may foregoing inspection, or not authorize the inspector to look at "separate structures" or conduct any testing, only to find out later on that material issues with regard to those matters existed but were not disclosed or inspected.
   b. Pitfall – Neighbors: In addition to disclosing facts about the building, the seller must also disclose facts about the neighborhood whenever those facts would materially impact the value of the property.
   c. Pitfall – The "As-Is" Sale: Sellers seeking to limit their liability may attempt to phrase the transaction as an "as-is" sale, with no representations or warranties, but such a designation does not overcome the statutory obligation to disclose material facts.

D. Taxes (Property): The last factor in considering common transfer pitfalls concern that potential for increased property taxes. Before Prop. 13, the property tax rate was close to 3% of market value, with no limits as to increases for increased property value. Prop. 13 capped the maximum amount not to exceed one percent (1%) of the full cash value of the property. The "full cash value" meant the assessor's valuation as shown on the 1975-76 tax bill or the appraised value of real property when purchased, newly constructed, or a change in ownership occurs after the 1975 assessment. The full cash value base may be increased no more than two percent (2%) for any given year, but it may be reduced based on various stated factors (e.g., substantial damage or other factors showing decline in value).

1. **Change "in" and "of" Ownership**: A "change in ownership" is essentially any transfer of a present interest in or beneficial use of real property, whether the transfer is voluntary, involuntary, by operation of law, by grant, gift, devise, inheritance, trust, contract of sale, addition or deletion of an owner, property settlement, or any other means. A "change of ownership" of a registered entity can trigger reassessment if there is a purchase of more than 50% ownership in the entity, or cumulatively more than 50% of the original owners' interests are transferred. A Change in Ownership Statement (COS) must be filed with Board of Equalization within 90 days of transfer.
   a. Pitfall-Failure to file Change in Ownership Statement: If an investment property was owned by a partnership held in the name of two brothers, and 30% of the partnership is transferred to a friend, the property tax basis would not change. If, however, the friend receives a 51% interest in the partnership, a COS must be filed for purposes of property tax reassessment, and affiliate or do so could result in a monetary penalty.
   b. Pitfall - Transfer to Entity to Jointly Own with Children: Parents wanting to create opportunities for their children may seek to transfer property owned by them into an LLC owned by them and their children, but doing so would likely trigger reassessment. The better way would be to first transfer an interest to the child, which would qualify for the parent-child exclusion, then have the parties transfer their interest to an LLC with them holding the same ownership interest in the entity as the property.
2. **Parent/Child and Grandparents/Grandchild Exclusion**: The exclusions allow parents and grandparents to transfer a principal residence to their children or grandchildren without reassessment.

   a. Pitfall – Limitation of Grandparent Exclusion: The exclusion does not apply to grandchildren unless both parents are deceased. Therefore, it may be imprudent to have living grandchildren as trust beneficiaries unless both parents are deceased; otherwise, each time a new grandchild is born the property could be reassessed.

3. **Senior Citizen's Replacement Dwelling**: Prop. 60 allows for the onetime transfer of your primary home's current tax base to a replacement property of equal or lesser value after the age of 55 of either spouse, providing that the replacement property is within the same county. Prop. 90 expands on Prop. 60 and allows counties to voluntarily extend the transfer into their county from all 58 California counties (only counties that participate are Alameda, El Dorado, Los Angeles, Orange, Riverside, Santa Clara, San Bernardino, San Diego, San Mateo, Tulare and Ventura).
   a. Pitfall – Not Following Specific Qualification Requirements: The replacement property must be purchased or built within two (2) years of the sale of the original property, and the claim must be filed within three years of purchasing or completing new construction of the replacement property. If a claim is filed after the three-year period, relief will be granted beginning with the calendar year in which the claim was filed.
   b. Pitfall - Manipulating Sales Price to Limit Reassessment: "Market value" is not the sales price, but rather the fair market value as determined by the assessor. If the assessor determines that the replacement property is not equal or lesser value, the benefit will be denied as there is no partial benefit that can be granted.

4. **Property Tax Appeals**: A homeowner can appeal the assessor valuation by demonstrating that the valuation was improper. It's not a difficult process, but it is a process all the same, and requires submission of sufficient evidence to overcome the assessor determination.
   a. Pitfall - Downside of Appealing: Homeowners seeking to lower their property taxes need to appreciate that reconsideration could result in an increase in the valuation, reveal code violations, and ultimately result in a larger increase later on.