

# TWO THINGS CERTAIN®

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## **DIRTY DEEDS OF GIFT: IF IT SEEMS TOO GOOD TO BE TRUE, IT PROBABLY IS!**

*By Spencer M. Baxter*

It's all too often that I have clients who look for the "simple" fix to immediately transfer their family land down to the kids. It always seems that they have been given general advice (sometimes from a lawyer, many times not) that the solution to their dilemma is to use a simple "Deed of Gift." If only simple Deeds of Gift were that simple! On its face a Deed of Gift appears to be innocent and benign. In some cases it is appropriate to use; however their consequences are not often discussed or given due consideration.

A Deed of Gift conveys ownership of property from one individual (the Grantor) to the recipient (the Grantee). There is typically no exchange of money in the transaction, other than a nominal deed preparation fee and recordation expense with the local municipality. From the Grantor's perspective, it seems like a very painless transaction because the deed transfers the property out of the Grantor's estate, they pay no income tax personally, and it avoids probate. Although federal gift tax consequences should also be considered with these types of transactions, this article will not discuss gift tax consequences in the interest of brevity.

### **Transfer on Death Real Property Act**

Utilization of a Deed of Gift will avoid probate, but sometimes the adverse consequences may direct the Grantor to use other alternatives. In the 2009 Session, the Virginia Senate passed Bill 1042 that created the "Transfer on Death Real Property Act." This act allowed for the creation of Transfer on Death Deeds, which rather than pass property through probate at the owner's death, transfers the property directly to the recipients on the deed at the death of the Grantor. In 2011, the Senate passed a Joint Resolution that requested the Virginia Bar Association to further research the use of Transfer on Death Deeds, and report back before the beginning of the 2012 General Assembly session. Unfortunately, there does not appear to have been any progress with the Virginia Bar Association report, nor has anything been enacted by the General Assembly. Currently, Transfer on Death Deeds are not a viable alternative in Virginia.

## **Income Tax Consequences**

The use of a Deed of Gift is not without tax consequences. When property is transferred by a Deed of Gift, the original owner's adjusted cost basis (think purchase price of property) is transferred to the recipient of the gift. For example, let's say Tom initially purchased a piece of property for \$150,000 in 1990 and the current fair market value of the property is \$300,000. Assume for the purposes of this article that Tom's adjusted basis is still \$150,000. When he gives the property with a Deed of Gift to his son Clark, his son takes Tom's adjusted basis of \$150,000 in the property; not the \$300,000 fair market value at the time of gift. If Clark sells the property during his lifetime, he will have to pay taxes on any amount he receives over his \$150,000 basis. If Tom had simply waited to transfer the property to Clark at Tom's death, Clark would have received a step-up in cost basis to the value of the property at Tom's death, wiping out the built-in capital appreciation of the property. Subsequent sale of stepped up basis property usually results in significantly lower taxes. Consideration of the cost basis is especially important if property has been held for a long time, and the cost basis is very low.

## **Conclusion**

In conclusion, Deeds of Gift should be considered with extreme caution and consultation with a tax and estate planning professional is recommended. Utilizing a Deed of Gift without understanding the consequences makes as much sense as sending your social security number and bank account number to someone who emailed you an offer of \$1,000,000 for your help in bringing \$7,000,000 into the United States from his country!



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**About the Author:**

Spencer Baxter is an experienced problem solver who helps individuals and businesses achieve and protect their goals of prosperity, stability and growth through appropriate planning. Spencer takes great pride in making sure that his work for clients is always reliable, correct, and on time.

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