COHEN GARELICK & GLAZIER
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Estate Planning: A Gift of Debt

If you inherit property, of course you should be grateful and count your blessings. Still, consider the possibility that the gift may come with a big string attached—a debt linked to the property, such as is particularly common with real estate or a car. In that event, the question arises as to whether the debt must be satisfied from the particular asset or from the decedent's estate more generally. How this question is answered can cause a big swing in the respective gift amounts for beneficiaries of an estate.

Historically, the law presumed that the debt was not to be paid from the property that was connected to it. The reasoning was that a true gift should not come laden with such a burden. Over time, as taking on debt became commonplace, this thinking changed and statutes flipped the conventional assumption. Increasingly, these laws start from the premise that the property left to someone includes the debt on the property, unless the decedent in his or her will clearly indicated a different intent. That is where careful estate planning, with professional guidance, comes in.

It is best to leave no doubt for the ordinary lay reader of a will. A general directive in the will to pay all debts of the testator is too nebulous. Instead, if the intent is not to keep the asset joined to the debt, language something like this should be used in a will: "If [the specific asset] is subject to a mortgage, security interest, or other lien, I direct that my executor pay the debt from other property of my estate which is not given to a specific person or entity."

This scenario was played out recently in a case in which a farmer left to his (favored?) son three different farms, each of which was encumbered by debt. To his other son he left the residue of the estate. When the father died, the executor used part of the estate proceeds to pay off the loans to the farms, so that the first son would receive them debt free. Not surprisingly, the second son, whose inheritance was thereby diminished, brought the matter to court.

The second son prevailed, forcing payment of the debts for the farms to come from the farms themselves. The father's will directed in a general way that debts were to be paid from the estate. However, under the relevant state statute, that was not a sufficiently explicit indication of intent to satisfy the debts on the farms from the residuary estate. In other words, the will had not clearly shown an intent that the first son was to receive the farms debt free. As a result, the first son got the three farms, but he, not the second son, also got the responsibility for paying off the attached encumbrances, which totaled almost a quarter of a million dollars.

Work with a Cohen Garelick & Glazier estate planning attorney to ensure the intent of your will is clear and leaves no room for dispute. Further, our attorneys work with you to create an estate plan that safeguards your interests while you are still alive. At the same time, we work to protect your legacy when you are gone.