Dividing Real Property Can Lead to Differences Among Competing Interests

BY ELIZABETH POLLINA DONLON

The practice of having parents transfer a home to their children while retaining a life estate for themselves has become a common part of elder law planning. In estate planning, it is not unusual for a spouse in a second marriage to grant a life estate in a residence to the surviving spouse and the remainder interest to his or her children from a prior marriage.

In the typical case, when the life tenant wants to continue to live in the house indefinitely and the remainderpersons are patient, everything proceeds smoothly. Non-typical cases can pose some vexing complications. What happens, for example, if the life tenant wants to relocate? Can he or she force the remainderpersons to agree to a sale? If so, how are the proceeds to be divided between the competing interests?

These and related questions were addressed in In re Sauer, a two-part decision of the Nassau County Surrogate’s Court, which provides new insights into the treatment of life estates and the standards that apply when a life tenant seeks to sell real property and the remainderpersons are opposed to a sale.

Threshold Question

As a threshold question, the court considered whether the decedent intended to give her surviving husband a true life estate or simply a right of occupancy. A right of occupancy is only a personal privilege, but a life estate imposes additional obligations upon the holder. In this case, the decedent’s will said her husband “shall continue to live, for his lifetime should he so choose, in our marital residence and he shall not be asked, forced nor required in any matter to sell the premises until he so desires as long as the maintenance is paid for by my husband, including all taxes and insurance thereon.” The court found that these obligations and the right to veto a sale effectively gave the surviving husband a life estate.

The husband and wife had purchased the property as tenants in common, and thus her one-half interest in the property was subject to the provisions of her will. Although case law is sparse, there is considerable statutory authority regarding sales of “divided” property interests. The authority for asking the court for permission to sell real property is found in both the Surrogate’s Court Procedure Act 1904 (SCPA) and in Real Property Actions and Proceedings Law § 1601 (RPAPL). Although the husband applied to the Surrogate’s Court, proceedings under the SCPA are not deemed exclusive, and the Surrogate’s Court has jurisdiction granted to it by the SCPA or other provisions of law. Furthermore, statutes that relate to the same thing are said to be in pari materia and are to be construed together. Although the RPAPL provides for the application to be made to the Supreme Court, the Surrogate’s Court concluded that it had concurrent jurisdiction to order the disposition of real property for any other purpose the court deems necessary.

SCPA 1918 provides for a determination of the interest of the parties, life tenant and remainderpersons and the protection of their interests in the disposition of real property. Any person interested — including a life tenant — can petition for authorization to dispose of the decedent’s real property. In an SCPA Article 19 proceeding involving a life estate, the “court must determine whether the interests of all the parties will be better protected or a more advantageous disposition can be made of the real property by including the disposition of such right or interest...” RPAPL § 1602, in turn, provides that when the ownership of real property “is divided into one or more possessory interests and one or more future interests, the owner of any interest in such real property... may apply to the court designated.

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in § 1603 for an order directing that said real property . . . be . . . sold."

Expediency Test

An application to sell divided real property may be granted, the court stated, if it is satisfied that the act to be authorized is "expedient." 10 Webster's dictionary defines expedient as "characterized by suitability, practicality and efficiency in achieving a particular end; fit, proper and advantageous under the circumstances." Under SCPA 1902(7), to justify a sale "some estate purpose must be served, the action must serve to carry out the provisions of the Will or be of benefit to those interested in the estate." 11 In determining whether a sale would be expedient, the court looked to a case in which a petition to sell was granted where the purchase price was well in excess of the appraised value, the rent was insufficient to pay the taxes, the house was unoccupied, and the life tenant would have to expend a considerable sum of money for taxes, insurance and maintenance of the house. 12

In the Sauer case, the surviving husband said he wanted to sell because the real estate market was high and he wanted to relocate. The court reasoned that the only way to carry out the provisions of the will would be to allow him to sell the property. In granting his application to sell the premises over the objections of the executrix, the court wrote: "Granting the application is expedient, as well as suitable, practical and efficient in reaching the end, which is to allow the life tenant to sell the property, the power of which he was given pursuant to the decedent's will." 13

Valuing and Paying Out the Life Estate

Although the property could be sold, two questions remained: how to value the life estate and whether the holder should be paid a sum "in gross" or be entitled only to the income generated from the investment of the sale proceeds. The husband contended that he was entitled to receive a dollar amount representing the value of his life estate, net of the principal balances of the outstanding mortgage loans and subject to adjustment for customary selling expenses. He maintained that the actuarial value could be readily calculated with reference to the sale price (fair market value) of the underlying one-half interest in the real property.

The executrix argued that if the life tenant were to receive a sum in gross, the remainderpersons would suffer undue hardship due to the loss of approximately one-third of the value of the estate. She also continued to argue that it was not her mother's intention to give her husband the full value of his life estate and that she only intended to give him the "use and occupancy" of the home. 14

"Unreasonable hardship" Acknowledging a paucity of reported decisions in this area, Surrogate Riordan looked again to statutory authority in examining whether the husband was entitled to a "sum in gross" or another form of value for his life estate. According to RPAPL § 967, a tenant for life is entitled to have a portion of the proceeds of the sale invested, secured or paid over in such manner as the court deems calculated to protect the rights and interests of the parties. Furthermore, RPAPL § 968 provides that "the power to determine whether the owner of a particular estate shall receive, in satisfaction of his estate or interest, a sum in gross or shall receive the earnings, as they accrue, of a sum invested for his benefit in permanent securities at interest, rests in the discretion of the court . . . The application of the owner of any such particular estate for the award of a sum in gross shall be granted unless the court finds that unreasonable hardship is likely to be caused thereby to the owner of some other interest in the affected real property." 15

According to the court, RPAPL § 968 was enacted to clarify that when the parties agree on the invested sum or sum in gross, the agreement must be given effect. When the parties disagree, however, the choice is to be made by the court, and "when the life tenant requests the lump sum, the court is required to give it to him 'unless unreasonable hardship is likely to be caused thereby to the owner of some other interest in the affected land.'" 16 The court concluded that payment of a gross sum would be allowed where the withdrawal of the value of the life estate would leave a balance that, with accumulated interest over a period of the life tenant's life expectancy, would restore the fund to its present corpus for the remainderpersons. 17 Thus, the life tenant's application would be denied if the payment of a gross sum resulted in the depletion of the entire fund, 18 or if the remainderpersons showed that the payment of a gross sum to the life tenant would defeat the interest of the testator, or where it appeared that the life tenant could only survive for a short period and it would be "manifestly unjust to the remainderman." 19

In the Sauer case, because the executrix failed to show that granting the life tenant's application would result
in unreasonable hardship to the remainderpersons, the court allowed the life tenant to be paid a sum “in gross” representing the value of his life estate, and it directed the New York Commissioner of Insurance to compute such value based on the life tenant’s age at the time the real property was sold. Employing the applicable mortality tables (1980 CSO) and a 4% interest rate, the Insurance Department thereafter determined and certified the value of the life estate to the court. For a 79-year-old male, the resulting factor was .21483 or approximately 21% of the estate’s one-half of the net sales proceeds.

Retaining vs. Granting a Life Estate

Retaining a life estate in residential real property is a popular planning technique for many good reasons. Although title vests in the remainderpersons upon the conveyance by deed, the reservation of a life estate allows the life tenant to rest easy, generally assured that no one – i.e., the remainderpersons – can force a sale of the premises during the life tenant’s lifetime.

Unless the life tenant’s death occurs in 2010, when new estate and income tax rules under IRC § 1022 are scheduled to take effect, the remainderpersons will acquire a stepped-up basis in the property. If the parties agree to sell the property during the life tenant’s lifetime, the capital gain and any capital gains tax will be allocated between the life tenant and the remainderpersons in proportion to the values of their respective interests, as determined under the Internal Revenue Code. If the life tenant requires nursing home care and the property is sold, the value of his or her retained life estate, determined under different actuarial tables, will come into play for Medicaid planning purposes. Most estate law and elder law practitioners are aware of these and other planning implications of retaining a life estate.

Granting, as opposed to retaining, a life estate in real property is an entirely different matter, which may engender unanticipated tensions between the life tenant and the remainderpersons. As the Sauer decisions demonstrate, the life tenant may indeed be able to force a sale of the premises on the remainderpersons and, unless the remainderpersons can affirmatively demonstrate unreasonable hardship, the life tenant will be entitled to receive a lump sum from the sales proceeds equivalent to the actuarial value of his or her life estate.

The Sauer decisions also bring home the attorney’s role in the estate planning process: ascertaining and accomplishing the clients’ dispositive intentions. When faced with a situation where, at first glance, granting a life estate to one party and a remainder interest to another appears to be an appropriate planning technique, it is critical that the client be aware of the implications associated with conveying divided interests in real property.

Implications of Life Estates

The right to a life estate has a wide variety of implications that need to be considered when the provision is used.

Too much, not enough or just right? Given the lesson of Sauer, is it too much to give someone a life estate? It is a valuable property right, defined as an interest in real property that a party holds during his or her lifetime, with an exclusive right of possession, enjoyment and control. It thus involves far more than the mere right to occupy the premises, which is subject to divestiture on the occurrence of a specified event (e.g., failing to pay required expenses, involuntary absence in excess of a specified period, etc.).

The use of a life estate may be required for a particular client’s estate tax plan. A life estate passing to a surviving spouse qualifies as “qualified terminable interest property” for which the estate tax marital deduction treatment may be elected under the QTIP rules, whereas a right to occupy or a tenancy for a term of years does not. Now that the estate tax exemption is $1 million and rising, however, the estate tax marital deduction may not even play a small role in deciding whether a life estate is the answer to the estate planning question.

As far as the client’s dispositive intentions are concerned, perhaps a life estate is not enough. If the client really wishes to favor the life tenant over the remainderpersons, he or she must be specific. In a footnote in

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Sauer Part 1, the court added: "The conveyance of the life estate coupled with a power of sale may in some cases convey fee absolute. In New York, however, there must be some language in the will which indicates that the interest in the property is greater than the life estate or that the testator intended the power of sale benefit the holder of the life estate."26

Also, it is important to realize that a life estate is not the same as an income interest in a trust, and different criteria apply before an application to sell is granted. For example, a trustee was allowed to sell a residence in which the income beneficiary was provided with the exclusive possession and use during her lifetime and to distribute to the income beneficiary "that portion of the proceeds commensurate with the actuarial value of her life estate," even though the sale would effectively terminate the trust and frustrate its main purpose.27

What if the life tenant lives a very long time?
More often than not, it is the remainderpersons who become impatient about selling the house. If the life tenant has longevity on his side, then what? If there is concern about when the remainderpersons will see their interests materialize, perhaps a tenancy for a term of years would be more appropriate. Also, unlike a conveyance subject to a life estate by deed, a bequest under a will allows a testator to select from a variety of alternate dispositions of the real property in the event that the life tenant outlives the remainderpersons.

Tenancies in common are not uncommon when there is a second marriage and children from a first marriage. If the property in question is not disposed of before the life tenant dies, at death the one-half interest that had been subject to the life estate may vest in the surviving issue of the first person to die, or otherwise as set forth in the governing instrument. In the Sauer case, six sellers, who were already less than cooperative with each other, would have been involved in negotiating the terms of a sale. And what if one or more of those remainderpersons had predeceased the life tenant? Then, more remainderpersons, and possibly their surviving spouses or minor children, could be involved – a real estate nightmare.

Economic burdens, including encumbrances Surrogate Sobel of Kings County once wrote: "As any Surrogate experienced with accountings at the termination of a legal life estate is aware, a legal life estate in real property is a nuisance and only tolerable where the life tenant is relieved of the burden of amortization of mortgages and the assumption of taxes and other maintenance expenses."28

As a life tenant and under the terms of the will, the surviving spouse in the Sauer case had to pay the real estate taxes, utility bills, insurance and the interest portion on the two mortgages on his Nassau County house. He found it difficult to do so without his late wife's financial contribution. Depending on the expenses and the life tenant’s financial situation, a continuing life estate may prove to be more of a burden to the life tenant than a benefit. Such ongoing costs may prove to be too financially difficult for the life tenant whose only alternative to selling would be to rent out the property – with all the attendant burdens of being an absentee landlord.

If there's a mortgage on the house, the life tenant is responsible for mortgage interest; the remainderpersons are responsible for the principal portion of such indebtedness. Does the client want the life tenant to be in the perhaps untenable position of having to rely on the remainderpersons to pay their ratable share of the principal on the mortgage loans in a timely manner? If the client intends for either the life tenant or the remainderpersons to bear both the interest and principal portions of a mortgage loan, then that intention must be spelled out.

Expect the unexpected A life tenant has a present, possessory interest which, more often than not, he or she will continue to enjoy for life. While the life tenant is alive, the remainderperson’s interest is a future interest. If, through a sale, the life tenant wants to convert his or her interest into a financial one, the remainderpersons should not be opposed. Depending on such variables as the life tenant’s age and health and the state of the economy (e.g., real estate values and interest rates), however, the remainderpersons may prefer to wait for the life estate’s natural conclusion – the life tenant’s death – to realize the undiminished value of their future interest in the real property.

Nonfinancial considerations, such as a soured relationship between the life tenant and the remainderpersons, may also come into play. In anticipation of a potential conflict between the life tenant and the remainderpersons arising from a “house divided,” the wise testator will take into account the possibility of a lifetime sale of the premises and accordingly set forth how the proceeds are to be divided.

Timing issues The court is authorized to remit the facts to the New York Insurance Department to determine the actuarial value of a life estate.29 If the court in Sauer Part 2, had looked instead to the actuarial tables used for tax purposes, the life tenant’s interest would have been considerably greater.

Under the Internal Revenue Code, the value of a life estate in property is computed with reference to the transfer date, the age of the measuring life (which takes into account more current – and unisex – mortality factors), and the applicable IRC § 7520 rate, which changes monthly. For the month of the sale (February 2003), the applicable interest rate was, coincidentally, 4%; for a 79-year-old, the applicable factor was .27857. If the sale had
occurred a year earlier (February 2002), when the life tenant was 78 and the applicable interest rate was 5.6%, the applicable factor would have been .36964.

Mortality tables aside, a delay in a sale generally works against the life tenant as life expectancy decreases. If the interest rate rises substantially, a delay in the sale may work to the life tenant’s advantage, despite the decrease in life expectancy. Similarly, if real estate values appreciate substantially during the period between the date of death and the date of sale, it is also possible for both the life tenant and the remainderpersons to benefit from a delayed sale. Although a house divided will not stand, a booming real estate market can generally cushion the fall.


3. Under SCPA Art. 19, an interested party may petition for the disposition of a decedent’s real property in order to accomplish “any other purpose the court deems necessary.” Co-owners of real property may not be interested parties, unless they also take through an estate. If not, then their remedy is to seek a partition of the property. See Turano & Radigan, New York Estate Administration (2003 ed.), Lexis-Nexis Group, § 17.02(d), p. 569.


6. SCPA 1902(7).

7. *In re Bolton*, 79 Misc. 2d 895, 362 N.Y.S.2d 308 (Sur. Ct., Tompkins Co. 1974). In *Bolton*, the Tompkins County Surrogate wrote: “While renunciation of her life estate might be an answer to sale of the [subject property], it does not seem necessary that a life tenant be required to consent to a forfeiture of the benefits of a life interest in order to dispose of the existing corpus of the life estate.”

8. SCPA 1904(1).


10. RPAPL § 1604.


14. In a footnote to *Sauer Part 2*, 195 Misc. 2d 232, 757 N.Y.S.2d 709 (Sur. Ct., Nassau Co. 2003), the court observed: “This issue was resolved in the prior decision of the court where one of the considerations of the court was that the executrix conceded that the decedent gave Arthur Sauer a life estate in the home.”

15. *Id.* at 232–33 (quoting RPAPL § 968) (emphasis added).


19. *Id.* at 321.

20. *In re Fisher*, 169 Misc. 2d 412, 414, 645 N.Y.S.2d 1020 (Sur. Ct., Rockland Co. 1996). In *Fisher*, the life tenant and executor consented to the sale of the premises; the only issue was the date of valuation of the life estate: as of the date-of-death or as of the date of the sales transaction.

21. RPAPL § 403, which has not been amended since 1984, requires the use of mortality tables prescribed by Insurance Law § 4217.

22. RPAPL § 402 mandates the use of a 4% interest rate, compounded annually.


25. IRC § 2056(b)(7).


29. RPAPL § 406 authorizes a court to transmit such statement of facts as is necessary to permit the required computation. Certification under RPAPL § 406 is conclusive evidence that the valuation method adopted therein is correct.