



July 21, 2004
Pennsylvania Realty Transfer Tax
No. RTT-04-020
Transfer to Revocable Trust

ISSUE

Are documents that convey Husband and Wife's respective marital interests in real estate to their respective revocable trusts subject to Pennsylvania Realty Transfer Tax?

CONCLUSION

Under the current facts, the documents will be excluded from tax.

FACTS

Husband and Wife intend to execute identical revocable trust agreements and convey their respective interests in six parcels of marital real estate located in * County, Pennsylvania[1] into the Trusts created under those agreements (hereinafter "Trust or Trusts"). The conveyances will be made for nominal consideration of one dollar.

The co-trustees of each Trust are Child A and B, Husband and Wife's children.

Each Trust provides for the following:

- During the Husband and Wife's lifetime, each are entitled to the income and principal of their respective Trust.
- In the event of the Husband or Wife's incapacity the trustees of the incapacitated individual's Trust may pay so much of the income and principal from the incapacitated individual's Trust to the individual's spouse as the trustees in their sole discretion deem necessary for the health, maintenance and support of the spouse.
- Upon the death of Husband or Wife, and if the Husband or Wife is survived by his/her spouse, then the deceased individual's Trust estate is to be divided into a Family Trust share and a Marital Share. The Family Trust share is an amount equal to the federal unified credit amount for federal estate tax purposes. The remainder of the Trust estate will comprise the Marital Share. The Family Trust Share will be distributed to a Family Trust (a unified credit trust[2]). It is assumed that the Family Trust will be established upon the decedent's death. The Marital Share will be distributed to the surviving Spouse.
- The co-trustees of the Family Trust will be Child A and B. The surviving spouse is the lifetime principal and income beneficiary of the Family Trust and Child A and B and their children or their children (collectively lineal heirs) or a separate trust for each such lineal heir's benefit are the remainder beneficiaries.

- Upon the death of the surviving spouse, the surviving spouse's Trust estate shall be distributed to Child A and B and their children or their children (collectively "lineal heirs"), or a separate trust for each such lineal heir's benefit.

DISCUSSION

Realty transfer tax is imposed upon any document that effectuates or evidences the transfer of title to real estate located within the Commonwealth, 72 P.S. § 8102-C, with certain exceptions, 72 P.S. § 8102-C.3.

The Tax Reform Code excludes from the imposition of tax certain transfers to trustees of living trusts. "A transfer for no or nominal actual consideration to a trustee of a living trust from the settlor of the living trust" is excluded from tax. 72 P.S. § 8012-C.3(8.1).

The Code defines a living trust as follows:

"Living trust." Any trust, other than a business trust, intended as a will substitute by the settlor which becomes effective during the lifetime of the settlor, but from which trust distributions cannot be made to any beneficiaries other than the settlor prior to the death of the settlor.

72 P.S. § 8101-C.

The Code does not define what it means for a trust to be a "will substitute." Nevertheless, unquestionably it must mean that the trust must serve substantially the same functions as a will.

A will is defined as an "instrument by which a person makes a disposition of his real and personal property, to take effect after his death, and which by its own nature is ambulatory and revocable during his lifetime." Black's Law Dictionary, 1598 (6th ed. 1990). The Oklahoma Court of Civil Appeals has stated that "a revocable living trust in which the trustor declares himself trustee and also sole beneficiary of the trust income during his life has been widely promoted as a 'will substitute' which purports to avoid the time and expense of probate." Limb v. Aldridge, 978 P.2d 365 (Okla. Ct. App. 1998).

Based upon the above, in order for a trust to act as a will substitute:

1. the settlor must be the trustee of the trust, or in the case of the settlor's incapacity the settlor's guardian or other designee authorized to act on settlor's behalf must be the trustee, or the trustee must be the settlor's nominee or appointee as designated in the trust instrument and have no discretion to distribute the trust corpus or income to anyone other than the settlor during the settlor's lifetime,
2. the settlor must be free to change or revoke part or all of the trust during the settlor's lifetime, this includes changing or revoking a beneficiary designation,
3. the trust may not vest any present interest in the trust corpus or income to any person other than the settlor during the settlor's lifetime, and

4. the trust must provide for the disposition of the trust corpus and accumulated income after the settlor's death.

In this case, it is possible for Husband and Wife to benefit from the income and principal of the settlor spouse's Trust during the settlor spouse's lifetime, but only in the event of the settlor spouse's incapacity. Nevertheless, because spouses are legally obligated to support each other^[3] and because the Trusts only provide that the Trustees may use their discretion to distribute income and principal for the health, maintenance and support of the settlor's spouse, it is the Department's position that such distributions directly benefit the settlor, since such distributions satisfy the spouse's legal support obligation, and not the settlor's spouse. Therefore, those Trust provisions do not violate the rule requiring sole lifetime benefit of trust distributions to the settlor.

In all other respects, the Trusts meet all of the above tests and will be considered living trusts for realty transfer tax purposes. Consequently, any document that effectuates the transfer of title to real estate from Husband to the Trustee of his Trust or Wife to the Trustee of her Trust will be excluded from tax.

[1] Tax parcel identification numbers: * (house and lot), * (duplex and lot), * (duplex and lot), * (duplex and lot), * (duplex and lot) and *, * (townhouse and lot).

[2] A trust created to take full advantage of the Federal unified credit against estate and gift taxes, IRC §§ 2010 and 2505.

[3] 23 Pa.C.S. §§ 4321, *et seq.*