

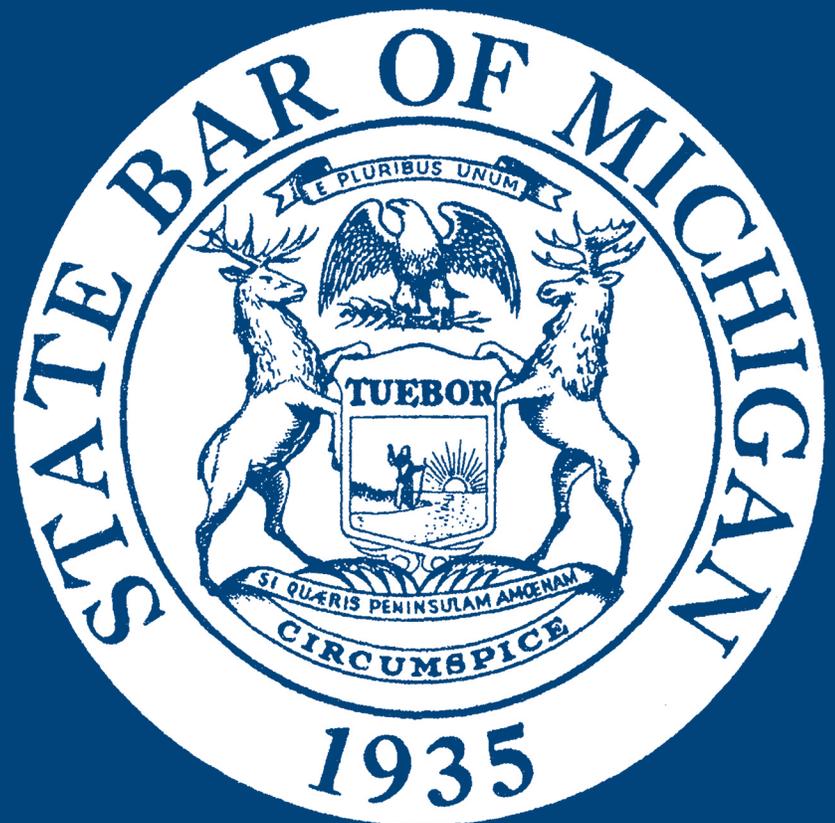
# MICHIGAN PROBATE & ESTATE PLANNING JOURNAL

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## Lady Bird Deeds

By Patrick J. Bond<sup>1</sup>

### Introduction

The purpose of this article is to help legal practitioners understand, implement, and effectively use Lady Bird deeds in their estate planning and Medicaid planning practice. Part One will define a Lady Bird deed, Part Two will explain how it operates, Part Three will discuss the benefits of using this type of deed, and Part Four will present specific scenarios in which Lady Bird deeds are useful.

### I. What Is a Lady Bird Deed?

The Lady Bird deed presumably acquired its name after President Lyndon B. Johnson used this type of deed to convey land to his wife, “Lady Bird” Johnson. Lady Bird deeds are primarily used to avoid the probate of real estate, but they can be used to transfer other assets like tangible personal property such as household furnishings. When used in long-term-care Medicaid planning, the Lady Bird deed offers the additional benefit that its execution is not considered a divestment for Medicaid purposes, even though it transfers ownership of property at death without probate.

A Lady Bird deed is merely a *style* of either a warranty deed or a quitclaim deed. A warranty deed is a deed where the grantor passes good, clear title to the grantee and warrants that the grantor is (1) lawfully seized of the property, (2) has good right to convey the property, (3) guarantees the quiet possession of the property, (4) is transferring the property free from all encumbrances not of record, and (5) will defend the title to the property against all lawful claims.<sup>2</sup> A quitclaim deed also is intended to pass title; however, it does not profess that such title is necessarily valid against third parties. In other words, a quitclaim deed does not provide the grantee any warranties.<sup>3</sup> What makes the Lady Bird deed unique is its language, which creates a power of appointment and names a default

beneficiary to take the property in the event that the power of appointment is not exercised.

### II. How a Lady Bird Deed Operates

#### Power of Appointment

Under Michigan law, a power of appointment is defined as

a power created or reserved by a person having property subject to his disposition which enables the donee of the power to designate, within any limits that may be prescribed, the transferees of the property or the shares or the interests in which it shall be received....<sup>4</sup>

In other words, the creation of a power of appointment gives someone authority to dispose of property. The “donor” of a power of appointment is defined as “the person who creates or reserves the power.”<sup>5</sup> The “donee” of the power of appointment is “the person to whom the power is granted or reserved.”<sup>6</sup> In a Lady Bird deed, the grantor is both the donor and the donee.

Further, a power of appointment can be created as a “general” or a “special” power of appointment. A general power of appointment is defined as

a power exercisable in favor of the donee, his estate, his creditors or the creditors of his estate, whether or not it is exercisable in favor of others. A power to appoint to any person or a power which is not expressly restricted as to appointees is a general power....<sup>7</sup>

A “special” power of appointment is defined as “a power exercisable only in favor of 1 or more persons not including the donee, his estate, his creditors or the creditors of his estate.”<sup>8</sup>

Additionally, powers of appointment can authorize a donee to dispose of property only during the donee’s lifetime (i.e., *inter vivos*), or it may

authorize a donee to dispose of property only at the donee's death (i.e., testamentary), or both. The person who takes the property through an exercise of a power of appointment is called an "appointee."<sup>9</sup> If a power of appointment is exercised testamentary, it is often exercised through a will, whereby the will of the donee might read something like the following:

Under the Revocable Living Trust of [Donor's Name], a trust has been established for me and in which I have been given a power of appointment over the trust property. I desire to exercise the power of appointment to the maximum extent possible, and, as of the date of my death, I appoint all the property to my children in equal shares.

Powers of appointment create flexibility by allowing a donee more time to choose to whom and how the donee wishes to dispose of the property, e.g., to a trust or outright. In other words, the decision of to whom the property will pass does not need to occur at the creation of the power of appointment but can be made a long time in the future.

While Lady Bird deeds can be drafted to give the donee a testamentary power of appointment or a special power of appointment, these deed types are beyond the scope of this article. Practitioners should be cautious when drafting such Lady Bird deeds because they can create gift tax issues for the donee, needless creditor-protection issues for the donee's estate, or Medicaid divestment issues. This article will focus on the type most practitioners use, which is a Lady Bird drafted to create a general inter vivos power of appointment.

The following is suggested language to create a general inter vivos power of appointment:

Grantor (i.e., the donor), [Grantor's Name], conveys and warrants to herself (i.e., the donee), [Grantor's Name], and reserves a power of appointment to appoint the property during her lifetime to herself, her estate, her creditors, or the creditor of her estate.

Because the above-mentioned language might be difficult for the lay person to understand, the drafter may wish to include the following text to create this power of appointment:

Grantor (i.e., the donor), [Grantor's Name], conveys and warrants to herself (i.e., the donee), [Grantor's Name], for her lifetime coupled with an unrestricted power to convey the property during her lifetime, pursuant to Michigan Land Title Standards 5th 9.3.<sup>10</sup> This power to convey creates a general inter vivos power of appointment, which includes the power to sell, gift, mortgage, and lease (or otherwise dispose of the property), and to retain the proceeds from the conveyance.

The exhibits of Lady Bird deeds at the end of this article create this general inter vivos power of appointment. Remember that the grantor is considered both the donor and the donee of the power of appointment. The Lady Bird deed creates the power in the grantor to designate the ultimate transferees of the property because the grantor has created in himself or herself the power to sell, gift, mortgage, or lease (or otherwise dispose of the property) during his or her lifetime and retain the proceeds from the conveyance. If the grantor does not dispose of the property before the grantor's death, the beneficiaries named in default of the grantor's exercise of the power of appointment will take the property.

### **Gift in Default of the Exercise of the Power of Appointment**

The remaining language in a Lady Bird deed directs to whom the property passes if the grantor does not exercise the general inter vivos power of appointment. This provision is called the "gift in default." A gift in default is defined as "a transfer to a person designated in the creating instrument as the transferee of property if a power is not exercised or is released."<sup>11</sup>

Language creating the gift in default of the exercise of the power of appointment might read something like this:

If [Grantor's Name] (i.e. the donee) has not previously conveyed the property prior to her death, the property is conveyed as tenants-in-common to the following individuals....

Generally, the grantor's children are named as the persons to take the gift in default of the exercise of the power of appointment; the author calls these persons "default beneficiaries." A trust may also be a default beneficiary.

### III. The Benefits of a Lady Bird Deed

#### Property Avoids Probate

Provided the donee has not previously conveyed the property, upon the donee's death the ownership of the property is immediately transferred to the default beneficiary and avoids probate. The apparent authority for this nonprobate transfer is found in MCL 700.6101:

(1) A provision for a nonprobate transfer on death in a ... deed of gift ... or other written instrument of similar nature is considered non testamentary.<sup>12</sup>

....

(c) Property the decedent controls or owns before death that is the subject of the instrument passes to a person the decedent designates either in the instrument or in a separate writing....<sup>13</sup>

#### Property Obtains the Basis Step-Up

When the default beneficiary receives the property at the grantor's death (remember, the grantor is both the donor and donee), it is included in the grantor's gross estate and thus receives a basis step-up. The property is included in the grantor's gross estate because it is considered property in which "the decedent had an interest."<sup>14</sup> The decedent maintained this interest because the grantor never "parted with dominion and control as to leave in him no power to change its disposition." Thus, the apparent gift to the default beneficiary at the time of the execution is incomplete<sup>15</sup> because its language indicates the property could not pass to the default beneficiary

except upon both the failure to exercise the power of appointment and the grantor's subsequent death. The property is therefore included in the grantor's gross estate.

If property is included in the grantor's gross estate, IRC 1014(b)(9) requires a basis step-up; the property obtains this step-up if (1) "the property is required to be included in determining the value of the decedent's gross estate," and (2) the property "was acquired from the decedent by reason of death."<sup>16</sup> Because of the explicit language in the Lady Bird deed, the property is considered acquired from the decedent because the default beneficiary cannot take unless and until the donee dies. Thus, the property is included in the gross estate and acquired from the decedent.

This is not to say the other common forms of real property ownership transferred for less than full and adequate consideration (e.g., transfers with a retained life estate,<sup>17</sup> revocable transfers,<sup>18</sup> or joint interests<sup>19</sup>) won't also enjoy the same basis step-up through IRC 1014(b)(9) in certain situations.

#### A Lady Bird Deed is Not a Transfer for Gift Purposes

Because the execution of the Lady Bird deed does not transfer property ownership, there is no gift for federal gift tax purposes. At death, and only at death, the default beneficiary takes the fee if the donee hasn't previously exercised the power of appointment. Unlike a transfer of real property reserving a life estate, a transfer of real property into joint tenancy, or a transfer of real property into tenants in common, the execution of the Lady Bird deed vests no incidents of ownership in any third party. Thus, there is no gift.

#### A Lady Bird Deed is Not a Divestment for Medicaid Purposes

The Deficit Reduction Act of 2005 (DRA), passed on February 8, 2006,<sup>20</sup> changed the divestment-penalty starting date for nursing home

Medicaid. Thus, if a transfer is made within 36 months (or 60 months under the DRA)<sup>21</sup> from the date of the Medicaid application, any transfer without consideration should be avoided. Under the DRA, the divestment-penalty period begins on the date the patient enters the nursing home, has applied for Medicaid, and would otherwise be eligible for Medicaid except for the divestment penalty.<sup>22</sup> Before the DRA, the penalty period began much earlier, during the month of the gift.<sup>23</sup>

Now, the patient who gratuitously transfers property reserving a life estate, transfers property into joint tenancy, or transfers property into tenancy in common, creates a divestment penalty if the transfer is made within the monthly time parameters mentioned above. Lady Bird deeds should be used to avoid this penalty.

### **The Lady Bird Deed Does Not Uncap Property Taxes, and No Property Transfer Affidavit Needs To Be Filed**

Property taxes are uncapped when there is a “transfer of ownership.”<sup>24</sup> See the *Transfer of Ownership and Taxable Value Uncapping Guidelines* from the Michigan Department of Treasury for a summary of the uncapping rules.<sup>25</sup> Upon execution, the Lady Bird deed does not transfer the property but merely creates a power of appointment and provides for a gift in default. It is not until the death of the donee (also the donor), and his or her failure to previously exercise the power of appointment, that there is a transfer of ownership to the default beneficiary. The definition of a gift in default makes it clearer that no transfer occurs upon execution. Under MCL 556.112(j), a “gift in default” means “a transfer to a person designated in the creating instrument as the transferee of property *if* a power is not exercised” (emphasis added). The only time we are certain that the power is not (and will never be) exercised is at the death of the donee. Thus, it is the death of the donee—not the creation of the Lady Bird deed—that signifies the transfer of property to the default beneficiary.

If there has been a “transfer of ownership,” the Property Transfer Affidavit must be filed in the appropriate assessing office of the local unit of government in which the property is located.<sup>26</sup> Although the Michigan Department of Treasury’s Property Transfer Affidavit<sup>27</sup> makes reference to the disclosure of “exemptions,” the statute indicates nothing about a requirement to notify the assessing office that an “exemption” exists.<sup>28</sup> According to the Department’s form, the purpose of the property transfer affidavit is “to ensure the property is assessed properly and receives the correct **taxable value**” (emphasis in original). Because the property is not transferred to the default beneficiary until the grantor’s death, it is only at this time that the tax assessor’s office has an interest in ensuring that the transfer of ownership is assessed properly. Thus, within 45 days after the donee’s death the default beneficiary must file the Affidavit.

### **Lady Bird Deeds Provide Creditor Protection**

Lady Bird deeds provide creditor protection to default beneficiaries. Unlike other common transfers of real estate, a Lady Bird deed does not provide the default beneficiary any incidents of ownership in the property until the donee’s death. Thus, during the donee’s lifetime, a default beneficiary’s creditor cannot satisfy claims from the property. If the default beneficiary has an existing creditor, the donee could always remove that beneficiary (by exercising the power of appointment) so the transfer will not vest in him or her at the grantor’s death. See Exhibit 1 for an example of a Lady Bird deed that exercises the power of appointment and creates another Lady Bird deed. The creditor protection is not available for the grantor because the property of a donee (i.e., the grantor) of an unexercised general power of appointment is subject to the donee’s creditors to the extent that the donee’s individual assets are insufficient to satisfy the creditor’s claim.<sup>29</sup>

Lady Bird deeds also provide creditor protection to the married couple holding real property as husband and wife. Because the Lady Bird deed is not a transfer of ownership upon its execution, the home continues to remain within tenancy-by-the-entireties protection.

#### IV. Where Lady Bird Deeds Are Useful

This section presents various real-world scenarios in which Lady Bird deeds are useful and explains how these deeds are applied in each case. In each of these scenarios it is assumed that the client wishes to control his or her assets while alive and to provide for him or herself during incapacity. When the client dies, he or she wishes to give all assets to the person(s) of his or her choice, whenever and however he or she chooses. The client also wishes to avoid every possible tax, court cost, and administrative cost, and to keep legal fees to a minimum.

##### The Single Client

Lady Bird deeds are a great estate planning tool to avoid probate for the single client. For example, consider the following hypothetical situation:

Client is single and 50 years old. She has no children and no living parents. The attorney's initial consultation reveals that Client owns the following assets: (1) a \$10,000 vehicle, (2) a \$20,000 term life insurance policy, (3) a \$50,000 401(k) plan, (4) \$1,500 in a checking account, (5) a home worth \$150,000, and (6) \$5,000 in household furnishings. The attorney also learns that Client would like to leave all assets to her two siblings to divide equally. The siblings are in good health and very responsible. Client wants an effective, yet simple, estate plan with a minimal legal fee.

The attorney first plans for Client's incapacity by drafting a Health Care Power of Attorney, an Authorization to Disclose Protected Health Information, and a Financial Durable Power of Attorney. Client names her sister, who is a nurse, as the patient advocate under the Health Care

Power of Attorney and as the personal representative under the Authorization to Disclose Protected Health Information. Client names her brother, who is a CPA, as the agent under the Financial Durable Power of Attorney.

The attorney then plans for the post-death distribution of Client's assets. The vehicle will pass outside of probate to the siblings by way of the authority found in the Michigan Vehicle Code.<sup>30</sup> The siblings will then find a buyer for the vehicle and complete the Certificate of Heir to a Vehicle<sup>31</sup> upon its sale.

Client names her siblings as the beneficiary of both her \$20,000 term life insurance policy and her \$50,000 401(k). She also adds them as the payable-on-death beneficiaries to the checking account. The attorney drafts a Lady Bird deed and names the siblings as the default beneficiary. An example of this Lady Bird Deed (The Single Client) is found as Exhibit 2.

The remaining asset is the household furnishings. When Client dies, this asset must pass through probate unless the attorney prepares some sort of instrument that includes a provision for nonprobate transfers, which is authorized in MCL 700.6101. Much like the Lady Bird deed relating to real property, the attorney may wish to create a similarly designed instrument, called a "deed-of-gift," relating to the furniture. Exhibit 3, entitled Deed-of-Gift of Tangible Personal Property, is an example of this instrument. Without such an instrument, the household furnishings will have to pass by way of a Petition and Order of Assignment as authorized under MCL 700.3982, which relates to the distribution of small estates.<sup>32</sup>

Thus, the attorney has effectively planned for Client's disability by creating the Health Care Power of Attorney, the Financial Durable Power of Attorney, and the authorization for disclosure of protected health information. The attorney has also effectively disposed of Client's assets at her death according to her wishes, while keeping the legal fees to a minimum.

Part of the reason why the legal fees remained minimal is because neither a trust nor a will was created. These documents were not used because Client wished to limit her legal fees and because a will and a trust were not absolutely necessary. By arriving at a plan for post-death distribution, Client saved a future expense because she avoided the necessity of probating her estate. Even if she had died without a will and with the winning lottery ticket in her pocket, the lotto proceeds would still have been divided equally between her siblings under the law of intestate succession, MCL 700.2103(c).

### **The Married Client**

Husband and wife each own the same assets as the single client, except that in this case there is only one home, which is owned as tenancy by the entireties. The couple has one 30-year-old son who is healthy and responsible. Each spouse wishes to name the other as the patient advocate under the Health Care Power of Attorney, the personal representative under the Authorization to Disclose Protected Health Information, and the agent under the Financial Durable Power of Attorney. They name their son as a successor patient advocate, personal representative, and agent.

The couple's respective vehicles will pass to the surviving spouse by way of MCL 257.236. Each spouse names the other spouse as the primary beneficiary on both the \$20,000 term life insurance and the \$50,000 401(k), and the adult son is named as the contingent beneficiary. Each spouse names the other as the payable-on-death beneficiary on the checking account.

The attorney drafts a Lady Bird deed from the husband and wife to themselves as tenants by the entireties. On the death of the survivor, the house passes to the adult child who is named as the default beneficiary. An example of the Lady Bird Deed (the Married Client) is found as Exhibit 4.

Only the household furnishings remain. To avoid confusion about their ownership, the

attorney creates an instrument entitled Declaration of Joint Ownership of Tangible Personal Property, which makes it clear that the furniture is owned jointly with rights of survivorship. In addition, the attorney prepares the Deed-of-Gift of Tangible Personal Property for the nonprobate transfer of the household furnishings on the survivor's death. An example of this instrument, entitled Declaration of Joint Ownership of Tangible Personal Property and Deed-of-Gift of Tangible Personal Property, is found as Exhibit 5.

### **The Married Client with a Minor Child**

Let's now assume that the married couple had each previously created a revocable living trust for the protection and management of the assets during their lifetime and for the post-death protection and management of the assets for their two-month-old son.

As in the married-client scenario, each spouse here wishes to name the other as both the patient advocate under the Health Care Power of Attorney, the personal representative under the Authorization to Disclose Protected Health Information, and the agent under the Financial Durable Power of Attorney. They name their respective oldest siblings as successor patient advocates, personal representatives, and agents.

The couple's respective vehicles will pass to the surviving spouse by way of MCL 257.236. Each spouse names the trust as the beneficiary of their term life insurance policy. They name each other as the primary beneficiary on the 401(k) plan, with the trust as the contingent beneficiary. As well, both spouses transfer ownership of their separate checking accounts to their respective trusts.

As in the married-client scenario, the attorney drafts a Lady Bird deed from the husband and wife to themselves as tenants by the entireties.<sup>33</sup> On the survivor's death, the property passes to the survivor's trust as the default beneficiary. The attorney then prepares the Declaration of Joint Ownership of Tangible Personal Property and the Deed-of-Gift of Tangible Personal Property.

If the minor son is a special-needs child, the default beneficiary should still be the trust. However, the attorney could draft the clients' revocable trust so that the share passing to the child gets poured into a free-standing, third-party special-needs trust for the benefit of the son.

### The Client Entering a Nursing Home for Long-Term Care

The assets are the same as in the single-client scenario. However, the client here is 80 years old, lives in a nursing home, and suffers from late-stage Alzheimer's disease. The client has two healthy and responsible adult children. If the client wishes to qualify for nursing home Medicaid, he must spend-down his countable assets to \$2,000 or less. His countable assets are the \$50,000 in his 401(k) plan. The vehicle, the term-life insurance, the \$1,500 checking account, the home, and the household furnishings are not counted because they are considered "excluded" assets.<sup>34</sup>

To spend-down the \$50,000 in the 401(k), the agent under the durable financial power of attorney liquidates the account and uses the after-tax proceeds to replace the degraded roof, patch the cracks in the driveway, and build an enclosed patio and deck onto the home. The remaining funds are used to buy an irrevocable prepaid funeral contract.<sup>35</sup> Client has thus converted his countable assets to excluded assets. His total assets now consist of the vehicle, the term life insurance, the \$1,500 in the checking account, the household furnishings, and the home.

Again, the client names his oldest child as the patient advocate under the Health Care Power of Attorney, the personal representative under the Authorization to Disclose Protected Health Information, and the agent under the Financial Durable Power of Attorney.

Upon the client's death, the vehicle will pass to his children by way of MCL 257.236. The children are named as beneficiaries on the term life insurance policy, and are added as payable-on-death beneficiaries to the checking account.

The attorney drafts a Lady Bird Deed and Deed-of-Gift of Tangible Personal Property so that both the home and furniture pass to the default beneficiaries (i.e., the children) upon death.

### Conclusion

The Lady Bird deed is a simple and effective device to avoid probate without giving the default beneficiary any incidents of ownership in the property until the donee's death. This provides estate planning flexibility because the grantor can change his or her mind regarding whether certain persons should inherit the property outright, in trust, or not at all. Further, unlike some other types of conveyances, Lady Bird deeds are not considered gifts for federal gift tax purposes or divestments for Medicaid planning purposes, and they do not uncap the property taxes until the default beneficiary inherits the property at the grantor's death.

### Notes

1. Mr. Bond gratefully acknowledges the assistance of attorney Jon B. Gandelot, of Gandelot & Associates, in reviewing and editing this article.
2. MCL 565.151.
3. MCL 566.152.
4. MCL 556.112(c).
5. MCL 556.112(d).
6. MCL 556.112(e).
7. MCL 556.112(h).
8. MCL 556.112(i).
9. MCL 556.112(f).
10. The *Michigan Land Title Standards* is a series of statements on selected aspects of the law of land titles and is used as a reference source by many title companies. The examples listed in Standard 9.3 are, in essence, Lady Bird deeds. Standard 9.3 is referenced in the Lady Bird deed merely for convenience to the reader.
11. MCL 556.112(j).
12. MCL 700.6101(1).
13. MCL 700.6101(1)(c).
14. IRC 2033.
15. Treas Reg 25.2511-2 (Cessation of donor's dominion and control).
16. IRC 1014(b)(9).
17. IRC 2036 (Transfers with Retained Life Estate).

18. IRC 2038 (Revocable Transfers).
19. IRC 2040 (Joint Interests).
20. As of the date of writing, the Michigan Department of Human Services had not yet changed its *Program Eligibility Manual*. Thus, presumably, all the DHS caseworkers are still implementing the prior law.
21. 42 USC 1396p(c)(1)(B)(i).
22. "In the case of a transfer of asset made on or after the date of the enactment, ... the date specified ... is the first day of a month during or after which assets have been transferred for less than fair market value, or the date on which the individual is eligible for medical assistance under the State plan and would otherwise be receiving institutional level care...but for the application of the penalty period, whichever is later...." 42 USC 1396p(c)(1)(D)(ii).
23. The penalty period will begin on the first day of the calendar month in which divestment occurred, provided it is not already part of a penalty period. See PEM Item 405; see also 42 USC 1396p(c)(1)(D)(i).
24. MCL 211.27a(6).
25. Available at [http://www.michigan.gov/documents/Transfer\\_of\\_Ownership\\_Q&A\\_128474\\_7.pdf](http://www.michigan.gov/documents/Transfer_of_Ownership_Q&A_128474_7.pdf).
26. MCL 211.27a(10).
27. Available at [http://www.michigan.gov/documents/l4260f\\_2688\\_7.pdf](http://www.michigan.gov/documents/l4260f_2688_7.pdf).
28. MCL 211.27a is absent a requirement to notify the assessing office if there has been no "transfer or ownership."
29. MCL 556.123.
30. MCL 257.236.
31. Available at [http://www.michigan.gov/documents/tr-29\\_16195\\_7.pdf](http://www.michigan.gov/documents/tr-29_16195_7.pdf).
32. MCL 700.3982.
33. See Exhibit 6 – Lady Bird Deed (The Married Couple With Minor Child).
34. See PEM Item 400 for a description of countable and excluded assets.
35. Irrevocable prepaid funeral contracts are deemed "unavailable" and thus not counted. PEM Item 400, at 29.



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