

A MATTER OF TRUST
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Our convention was great! We had so many national experts with incredible information and motivational presentations. I've taken ideas from every speaker I listened to, and will incorporate them in my real estate investing and the advice I give to my clients.

BUT, we as Pennsylvania investors have to be CAREFUL when following the advice of national experts. Why? Because Pennsylvania's real estate law, the Pennsylvania Department of Revenue and the Pennsylvania Securities Commission do not follow the same format or rules as most other states.

For example, most of you know that a residential lease drafted for another state can get you in trouble in PA. That is because we have a Plain Language Consumer Contract Act that applies to all Consumer contracts in Pennsylvania, including residential leases (73 Pa.C.S.A. §2201). Most leases you get from National Speakers should not be used here. Your risk is a thousand dollar fine, actual damages a tenant claims for your violation of the law, and the tenant's legal fees. It is much cheaper to buy and use a "Pennsylvania Plain Language Lease". Buy one we offer for sale, or let us look at your lease to see if it is legal!

The next hot issue is the Land Trust. Do I know and understand Land Trusts? Yes. I've worked with investors for 20 years as a lawyer in Pittsburgh. I used Land Trusts in the 80's and 90's, and have participated in ACRE since the early 1990's, when Ron LeGrand talked Sean Casey into moving to Florida to work with him. We formed hundreds of Land Trusts for our legal clients. We closed countless real estate transactions for those clients using those trusts as Title Agents for Lawyers' Title and First American Title, two of the largest Title Insurance Companies in Pennsylvania.

Do we recommend or use Land Trusts for real estate investors in Pennsylvania today? No! We still have the forms we wrote on our computers, but only use them after we send a waiver letter to a client who wants a trust, AGAINST OUR ADVICE.

You heard Ron LeGrand and other speakers talk about Land Trusts to hold title to property. When I talked to Ron after his presentation, he came into lunch and announced that he wasn't aware of some of the recent changes here that created problems for those using Land Trusts. What are the problems I talked to Ron about?

First, we have a Capital Stock Tax in Pennsylvania. It used to be a tax only on the "Capital Stock" of Pennsylvania corporations. In 1998, the law was changed to extend the tax to Limited Liability Companies, Business Trusts and Corporations (72 P.S. § 7601, Act 7 of 1998).

So, Business Trusts have to pay the Capital Stock Tax, based on both their income and assets. That means Business Trusts have to file tax returns with the Pennsylvania Department of Revenue, SEPARATELY from your personal return. If the Trust files a separate state return under its own Tax I.D. number, it will also have to file a Federal tax return under the same Tax I.D. number.

Second, Business Trusts must also file their Trust Agreement including identification of Trustee and beneficiaries with the Corporation Bureau of the Pennsylvania Department of State. See the law on this at 15 Pa.C.S.A. §9503 (2004). You can choose to violate this law, and subject yourself to liability if you are caught, but WE CAN'T ADVISE YOU TO BREAK THE LAW. And remember, the deed you take in the name of a Trust is also a PUBLIC RECORD, so you not only break the law, but you advertise that you break it, too.

Third, Business Trusts have been used by Pennsylvania real estate investors to avoid paying transfer tax on the transfer of beneficial interests in those trusts. How did they do it?

Seller “S” wanted to sell to Investor “I”. Instead, I had S form the “S Living Trust”, and S transfers the property to the S Living Trust without paying transfer tax. There is an exception to the transfer tax for conveyance to Living Trusts. Next, I has S make I the Trustee of the Trust. Then, I had S assign the beneficial interest in the Trust to I, and no transfer tax is paid on that transfer either. The State lost the transfer tax not once but twice, since the Trust didn’t qualify for the Living Trust exemption if the beneficial interest could be assigned to I, who was not a spouse, parent, child, brother or sister of S. (72 P.S. §8102-C.3)

The Department of Revenue didn’t like the transfer tax fraud investors were engaging in, so they now do audits of some transfers from Trusts to see if the correct taxes were collected. The Department sends a letter to Buyer, Seller and the Closing Agent asking for information about the Trust and the Transaction, and can impose fines, investigation costs (and extra sets of transfer tax if there was a transfer of beneficial interest). So, all other things being equal, I recommend avoiding the extra risks of transfer tax audit by avoiding taking title in the Trust in the first place.

You or the speaker giving advice to use the Trust argues that it is a “Living Trust” or a “Massachusetts Trust”, not a Business Trust, so the above issues don’t apply. **WRONG!** Pennsylvania only allows 3 types of trusts: Living Trusts, Ordinary Trusts and Business Trusts. By law, the Settlor or person creating the Living Trust must remain **FULLY PERSONALLY LIABLE** for claims against the Trust assets. This eliminates any asset protection purpose of the Living Trust. Also, a Trust whose beneficial interest can be transferred to anyone not a parent, child, sibling or grandchild, does not qualify as a Living Trust.

How do I know what the State will do with this law? Am I just scaring you about these transfer tax issues? No, I not only read the law, I’ve been to Harrisburg to argue transfer tax

issues for several present and former ACRE members, at both the administrative and court levels of the process. Despite my best arguments for the real estate investors, I lost those cases and they had to pay not only attorneys' fees and the taxes, but interest for not paying the tax on time and costs of the State's prosecution. Fortunately, I wasn't the one who advised these clients not to pay the tax up front; I just tried to avoid the problems the State was creating for them after the fact. But now, knowing what I know, I advise all of my clients not to try to avoid transfer taxes with trust shell games, because I know first hand that if you are caught, you will lose. I've had other clients ask me to take their transfer tax fights to Harrisburg again, on the same issues. But as much as I like to make money practicing law, I can't recommend them paying for a fight I KNOW THEY WILL LOSE. SO, DON'T TRY TO USE A TRUST TO AVOID TRANSFER TAX.

Next, I want to address what you do to get the deed. Pennsylvania has a special Consumer Protection Law for senior citizens (73 P.S. §201-3), the "Unfair Trade and Consumer Protection Law". If a prospect over the age of sixty (60) calls you, and you drive to their home to get the deed, and you write it up for a price so good it is WAY BELOW MARKET VALUE, you may get a call, a visit or a suit from the Consumer Protection Division of the Attorney General's Office (73 P.S. §201-8). Do I just happen to know this law too? No. Unfortunately, I have clients facing hundreds of thousands of dollars claimed in lawsuits filed by the Attorney General for elderly consumers pending RIGHT NOW. I'll probably be in Commonwealth Court in Harrisburg on motions on those issues in April. So, be very careful when getting the deed from the elderly or you could be my next case!

What about getting the deed from other sellers? EVERY seller's signature on a deed, mortgage or other document transferring an interest in real estate in Pennsylvania has to be

NOTARIZED to be able to be RECORDED. The Recorder of Deeds won't or shouldn't accept signatures without notarization, and if they do get recorded by mistake, the document can be stricken from recording. No problem, you say, "I'll just become a Pennsylvania notary, and notarize my own deeds from sellers, memoranda of installment land contracts, trust documents, etc. That would be convenient, but I'm also a notary in Pennsylvania, and can tell you it is a violation of the Pennsylvania Notary Law to notarize a transaction in which "you have a pecuniary interest." (that means financial) (57 P.S. §165). And the law requires a notary to be present in person and verify the identity of the person signing for the notarization to be valid, except in certain special circumstances involving lawyers (57 P.S. §158.1).

So, if you get the deed, you should take a Pennsylvania Notary without a financial interest in the deal with you to notarize the seller's signature, or the deed you get won't be valid, regardless of whether the seller is senior citizen or not and regardless of what entity you put title into.

Some people also tell you to get the deed, but hold onto it and not record it with the Recorder of Deeds, especially if it is "subject to" and could violate the "due on sale" clause in the Seller's mortgage.

They are right about the "due on sale" clause, but most banks only call the loan if they know the property has transferred and either interest rates have gone up and they can earn more interest on their money or you default on the loan after the deed is recorded.

The risk of not recording the deed is often as great as or greater than the due on sale clause.

Pennsylvania is a “race-notice” jurisdiction, meaning that if a seller gives two deeds or an owner gives two mortgages, with limited exceptions, the document recorded first conveys first regardless of the date of notarization.

And further, new judgments and other liens against a seller will continue to attach to a property after you get the deed, until you record the deed. And once they attach, a subsequently recorded deed doesn’t “detach” the liens, so they cloud the title. Similar rules apply to the priority of mortgages and liens, and we close loans and real estate sales almost every day in Pennsylvania, following these rules through our settlement companies and as Title Agents.

Even worse, a deed not recorded within ninety (90) days of the date signed and notarized raises a question as to whether it is a valid deed (21 P.S. §444). So think twice before not recording the deeds you get!

Finally, I want to touch on Private Money Financing and the Pennsylvania Securities Commission. Some speakers have mastered the art of soliciting, obtaining and profiting from Private Money loaned directly to them for real estate mortgages in other states, but Pennsylvania is different. If you borrow Private Money through EQT Investments, ReCasa, Brookview or other Private Lenders, you are not raising the money, just borrowing it, and you are OK with the Securities Commission. But those of you who remember when I brought Phil Rutledge, former chief counsel to the Pa. Securities Commission to speak at an ACRE meeting two years ago know that SOLICITING those investors can put you on the wrong side of a Securities Commission

Enforcement action and cease and desist order. That probably won’t happen if the money you seek is from family and close fiends, and seller financing is not a securities issue because the seller is involved in the transaction. But I’ve had eight (8) clients who are ACRE members face

Securities Commission investigation or legal action for soliciting private money loans, and face investigative costs, legal fees, fines and penalties for following out of state samples of how to raise your own private money. So get Pennsylvania advice before you do it here!

This article isn't meant to knock or bash our great national speakers or their ideas or programs. They are great, and unless you are a professional athlete, actor or recording artist, I don't know of any better way to make more money in less time than real estate investing. I'm a real estate investor, my family is comprised of real estate investors, my partner, and many of my friends and clients are real estate investors. Education from national speakers has helped many of us to be better real estate investors, and me to be a better lawyer, title agent and notary, too.

But look at the bright ideas in all of the programs wearing your "Pennsylvania Law" sunglasses to filter out the bright rays that tan elsewhere, but can burn here.