



National Investors Title Insurance Company

INNOVATIVE BY INSTINCT

**FAMILY MEMBER TRANSACTIONS:
REAL OR PRETEND?**

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National Investors Title Insurance Company

❖ GENERAL CONSIDERATIONS

- Demographic:
 - Children with aging parents whose principal asset is their home & who require assisted living
 - Siblings seeking to provide one another financial assistance
 - Parents seeking to provide for children while also moving to retirement or smaller homes
 - Co-habitants of properties purchased during higher education marry others & move
 - Parents seeking to relocate children to nearby location for support
 - Inherited property
- Motivation for “Pretend” Sales
 - Homestead owner is otherwise unable to qualify for a home equity or reverse mortgage loan and needs equity from their homestead
 - Inability of children or siblings to qualify for loan to purchase

❖ THE FUNDAMENTAL ISSUE: PRETENDED SALE OF HOMESTEAD

- “Pretend” sales of homestead may be set aside, or liens securing purchases set aside, under Texas Constitution
- Pending foreclosure may cause the family to seek constitutional homestead protections
- May seek to declare as homestead in the course of bankruptcy

❖ THE TEXAS CONSTITUTION

- Article XVI, §50(c) provides in relevant part: “All pretended sales of the homestead involving any condition of defeasance shall be void.”
- Article XVI, §50(d) helps: “A purchaser or lender for value without actual knowledge may conclusively rely on an affidavit that designates other property as the homestead of the affiant and that states that the property to be conveyed or encumbered is not the homestead of the affiant.” BUT see cautionary case law below
- Article XVI, §51 describes generally amount of property that may be designated homestead and uses, further defined by Texas Property Code, Section 41.002 below

❖ TEXAS PROPERTY CODE

- Texas Property Code, Section 41.002 provides definition
 - Rural – 100 acres single adult, 200 acres family, may be in one or more parcels
 - Urban – 10 acres in one or more contiguous lots
 - located within municipality limits or ETJ or platted subdivision, and

- served by police protection & fire protection (paid or volunteer), and
- municipal electric, natural gas, sewer, storm sewer or water (at least 3 of these)
- Texas Property Code, Section 41.005 allows voluntary designation
 - Section 41.005(c) sets out necessary content for designation affidavit
 - must contain sufficient description of the property
 - must contain statement designating property as homestead
 - must name current record title holder of the property
 - for rural homestead, number of acres designated and if out of more than one survey, number of acres in each
 - Designation under 41.005(c) in conjunction with Constitution Article XVI, §50(d) allows for reliance of purchaser or lender for value as to homestead/non-homestead nature of property but remember purchaser/lender must not have actual knowledge to contrary
 - Section 41.005(e) provides that property on which a person receives a tax exemption under Texas Tax Code Section 11.43 is considered designated as the persons' homestead if the property is listed as the person's residence homestead on the most recent appraisal roll for the appraisal district established in the county where the property is located
 - Note that if there is a voluntary designation of homestead under 41.005(c) that designates different property, the voluntary designation prevails over the tax exemption designation
- Texas Property Code, Section 41.003 provides that temporary renting of a homestead does not change its homestead character if the homestead claimant has not acquired another homestead; see also Constitution Article XVI, §51 (“any temporary renting of the homestead shall not change the character of the same, when no other homestead has been acquired”) and *Long Bell Lumber Co. v. Miller*, 240 S.W. 2d 405 (Tex. Civ. App. – Amarillo 1951, no writ), see also Tax Code provisions below as to abandonment
- Texas Property Code, Section 41.004 provides that if a homestead claimant is married, a homestead cannot be abandoned without the consent of the claimant's spouse
- Texas Property Code, Section 41.0021 provides that property held by a trustee for a “qualifying trust” may be considered homestead of the settlor or beneficiary of the trust
 - Contact Texas underwriting to discuss qualification of the trust
 - Separate requirements for instrument conveying to trustee
 - must describe property with “sufficient certainty to identify the property and the interest acquired”
 - must be recorded in the real property records of county where property is located

❖ TEXAS TAX CODE

- Texas Tax Code Section 11.13 defines “residence homestead” in 11.13(j)(1)

- “a structure (including a mobile home) or a separately secured and occupied portion of a structure
- owned by one or more individuals, either directly or through beneficial interest in a qualifying trust
- designed or adapted for human residence
- used as a residence
- occupied as principal residence by an owner or trustor of qualifying trust
- Texas Tax Code Section 11.13(k) & (l) discuss rental or incompatible use, and abandonment
 - qualified residential structure does not lose its character as residence homestead if a portion is rented to another
 - likewise does not lose its character if a portion is used for purposes incompatible with the owner’s residential use
 - homestead exemption does not apply to value of the rented or incompatible portion
 - owner may stop occupying for up to two years if owner does not establish a different principal residence and intends to return
 - owner may stop occupying w/o abandoning due to military service outside U.S. as a member of U.S. or Texas armed forces
 - owner may stop occupying w/o abandoning if taking up residence in a facility that provides “services related to health, infirmity or aging”
- Texas Tax Code Section 11.43 (j) amended and Sections 11.43 (n) and (o) added by H.B. 252
 - application for residence homestead exemption must include a statement that applicant does not claim another residence homestead in Texas or outside Texas
 - application must include copy of driver’s license or state ID
 - application must include a copy of applicant’s vehicle registration receipt or an affidavit stating applicant does not own a vehicle and a copy of a utility bill in the applicant’s name for the homestead property
 - address on driver’s license must match vehicle registration or utility bill provided by applicant, and these addresses must match property claimed as homestead

❖ VARIATIONS ON THE THEME: TEXAS CASES DETERMINING HOMESTEAD

- Lots separated by road or alley
 - Division of tracts by road will not prevent homestead rights from attaching *Hayes v. First Trust Joint Stock Land Bank of Chicago*, 111 S.W. 2d 1172 (Tex. Civ. App. – Fort Worth 1937, writ dismissed w.o.j.)
 - Lots separated by alley, used as playground and lying immediately opposite lots upon which home was located held part of homestead *Panhandle Const. Co. v. Flesher*, 87 S.W. 2d 273 (Tex. Civ. App. – Amarillo 1935, writ dismissed)

- Home located directly across street from second house and occupied by father of property owner denied homestead exemption in bankruptcy *In re Cate*, 170 B.R. 582 (Bankr. N.D. Tex. 1994)
- Homestead does not encompass separate residences located on adjoining lots, even though each house occupied by spouses to same marriage and by other family members *In re Nerios*, 171 B.R. 224 (Bankr. N.D. Tex. 1991)
- Homestead may encompass two residences located on the same lot *Tolman v. Overstreet*, 590 S.W. 2d 635 (Tex. Civ. App. – Tyler 1979, no writ)

❖ UNDERSTANDING STEPS TO PROTECT THE INSURED

- Look back to Texas Constitution Article XVI, §50(d) and Texas Property Code, Section 41.005: affidavits designating and disclaiming
- Verifying no actual knowledge of sham sale
 - Family sale in itself may be basis for lender to be suspicious *Fuller v. Preston State Bank*, 667 S.W. 2d 214 (Tex. Civ. App. – Dallas, 1983, writ ref'd n.r.e.)
 - Examine intention of parties to determine real versus pretend sales: is there an absolute conveyance, was purchase money paid, were preexisting debts paid? If a bank advances funds secured by a lien on a homestead with knowledge or notice that the sale was a pretense, the lien is void. *Ketcham v. First Nat'l Bank*, 875 S.W. 2d 753 (Tex. App. – Texarkana 1994, no writ) See also *In re Jay*, 308 B.R. 251 (Bankr. N.D. Tex. 2003)
- Abandonment
 - Recall Texas Property Code, Section 41.004 requires spouse to abandon also
 - Must establish intent never to return and actual discontinuance of use
 - must voluntarily leave and intend never to return; merely purchasing another property and moving to it does not establish abandonment; establishing a new homestead means old homestead is abandoned as a matter of law *Pierce v. Washington Mut. Bank*, 226 S.W. 3d 711 (Tex. App. – Tyler, 2007, pet. denied)
 - incarceration does not constitute abandonment where intent to return remained and absence from property was involuntary; an extreme example is *Driver v. Conley*, 320 S.W. 3d 516 (Tex. App. – Texarkana, 2010, pet. denied)

❖ GENERAL REQUIREMENTS

- Buyer and Seller must execute satisfactory affidavits designating other property as homestead of the Seller and disclaiming any homestead interest of Seller in the insured property – remember, spouses must join
- Verify ownership and occupancy of Seller's designated homestead

- Verify that homestead designations for ad valorem taxes are consistent with claimed/disclaimed homestead
- Verify that acreage amounts designated/disclaimed are appropriate
- Verify Seller's personal property has been removed from the insured property – may require physical inspection, including photographs
- Contact Texas underwriting for transactions over \$250,000 or any transaction where you are unsure how to proceed
- See page 42 and following in National Investors Texas Supplement online for exceptions in cases where you are not satisfied as to homestead issues:
<http://tx.nititle.com/files/state-supplements/tx-supp.pdf>

❖ Bonus Reading: *Fitzgerald v. Antoine Nat. Bank*, 980 S.W. 2d 228 (Tex.App – Houston, 1998)

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