



*Twilite  
Technology  
Center*

HIGH SPEED INTERNET COMMUNICATION FROM A CLASSROOM SETTING  
THAT REACHES AROUND THE STATE, THE COUNTRY & THE WORLD

# **SETTLEMENT/ TRANSFER OF OWNERSHIP**

*Instructor*

*Cees Halcombe*

# Settlement/Transfer Of Ownership

## Tax Issues

1. Real property taxation (ad valorem, and special assessments)
2. Tax terminology (capital gains, tax basis, 1031 tax deferred exchanges)



## REAL PROPERTY TAXES

### Ad Valorem

### Ad Valorem – Real Property Taxes

(**“According To Value**) Each property is taxed based on its value. In Montana property taxes are paid at the end of May and at the end of November.

**Property taxes are a tax deduction, special assessments are not deductible.**

## TAX TERMINOLOGY

An agent should keep informed of the rapid changes occurring in the industry.

### Homeowners’ Interest Tax Deductions

The federal government encourages home ownership by providing income tax advantages such as tax deductions, deferments and exclusions to buyers of homes.

These tax benefits are different for a property used as a principal place of residence than for property purchased for investment purposes. In general, homeowners may deduct the following from their gross income to reduce their taxable income.

# Annual Income Tax Deductions Allowed

1<sup>st</sup> & 2<sup>nd</sup> Homes (that meet the definition of “qualified residence interest”)

(1) Property Taxes      (2) Mortgage Interest  
When Selling:

**Loan Origination Fees - Loan Discount Points - Prepayment Penalty Fees - Casualty losses to the real estate not covered by insurance**      Home Equity Loans

Interest on a loan up to \$100,000 can be deducted. If funds are used to improve the property (“acquisition indebtedness”) interest on a loan of up to \$1,000,000 can be deducted.

## Transfer Tax

State tax on sale price at time of transfer of ownership. Gets data on fair market value of property. Seller or, Grantor or, Lessor must pay tax.

Income/Investment Property

**Deductions Allowed On Rental Property:**

Property Taxes

Mortgage Interest

Repairs & Maintenance

Insurance

Utilities

Property Manager’s Fee

**Depreciation on improvements (not land) – based on original purchase price plus capital improvements, minus land value.**

**IRS allows residential investment property 27.5 yrs for depreciation**

**Deductions Not Allowed On Rental s**  
**Mortgage Principal Payments**  
**Land Depreciation /Capital Improvements**





# Taxes

## Special Assessments



**Additional taxes to pay for Civic Improvements, such as sidewalks, curbs, gutters, sewers, streets, or any improvement that benefits an owner's property. Each property pays a prorated share. If special assessments are not paid they become a tax lien and could create a tax sale. Special Assessment payments are not deductible since they improve the property. You can pay cash as they are assessed or over 10 years with interest. A buy/sell agreement must state who is to pay.**

## Taxable Gain on Residential Property Sale (Capital Gains)

A sale of owner occupied residential property normally results in a profit (capital gain) for the homeowner. The Taxpayer Relief Act of 1997 lowers the maximum tax rate for individuals on the net capital gain from sales or exchanges.

According to the **Act \$250,000 of gain for an individual or \$500,000 for a married couple filing a joint return can be excluded from income if the residence is their principal residence.** The property must be lived in as a primary residence for two (2) of the last five (5) years (not necessarily consecutive).

**100% of capital gains if taxable are taxed at a maximum of 20% unless the taxpayer is in the 15% tax bracket then the rate is 10%.**

**Capital gain on commercial property is 100% taxable.**

**Foreign Investment In Real Property Tax Act (FIRPTA) – Sales of over \$300,000 by a non-resident selling property in the US requires that the buyer withhold 10% of the purchase price from the gross proceeds. IRS can determine the seller's tax liability at a minimum rate of 21%.**

## **Income Tax Implications for Real Estate Investments**

**In the past, real estate investments were beneficial because tax laws allowed investors to use losses generated by these investment to shelter incomes from other sources. Present day tax benefits include tax deductions for depreciation, the deferral of capital gains when property is exchanged and deductions of losses from real estate investments.**

### **Capital Gain**

**Is the taxable profit that is realized from the sale or exchange of an asset. Capital gains laws became effective May 7, 1997.**

#### **Short Term Capital Gain**

**The asset is owned for 12 months or less.**

#### **Long Term Capital Gain**

**The asset is owned for more than 12 months.**



## Computing Capital Gains

<b>Selling Price:</b>			<b>\$125,000</b>
<b>Less:</b>			
	<b>7% Commission</b>	<b>\$8,750</b>	
	<b>Closing Costs</b>	<b><u>\$ 800</u></b>	
		<b>\$9,550</b>	<b>- <u>9,550</u></b>
<b>Net Sales Price:</b>			<b>\$115,450</b>
<b>Basis:</b>	<b>Original Cost</b>	<b>\$60,000</b>	
	<b>Improvements</b>	<b><u>\$ 5,000</u></b>	
		<b>\$ 65,000</b>	
<b>Less:</b>	<b>Depreciation</b>	<b><u>- \$12,000</u></b>	
<b>Adjusted Bases</b>		<b>\$53,000</b>	<b>- <u>\$53,000</u></b>
<b>Total Capital Gain</b>			<b>\$62,450</b>

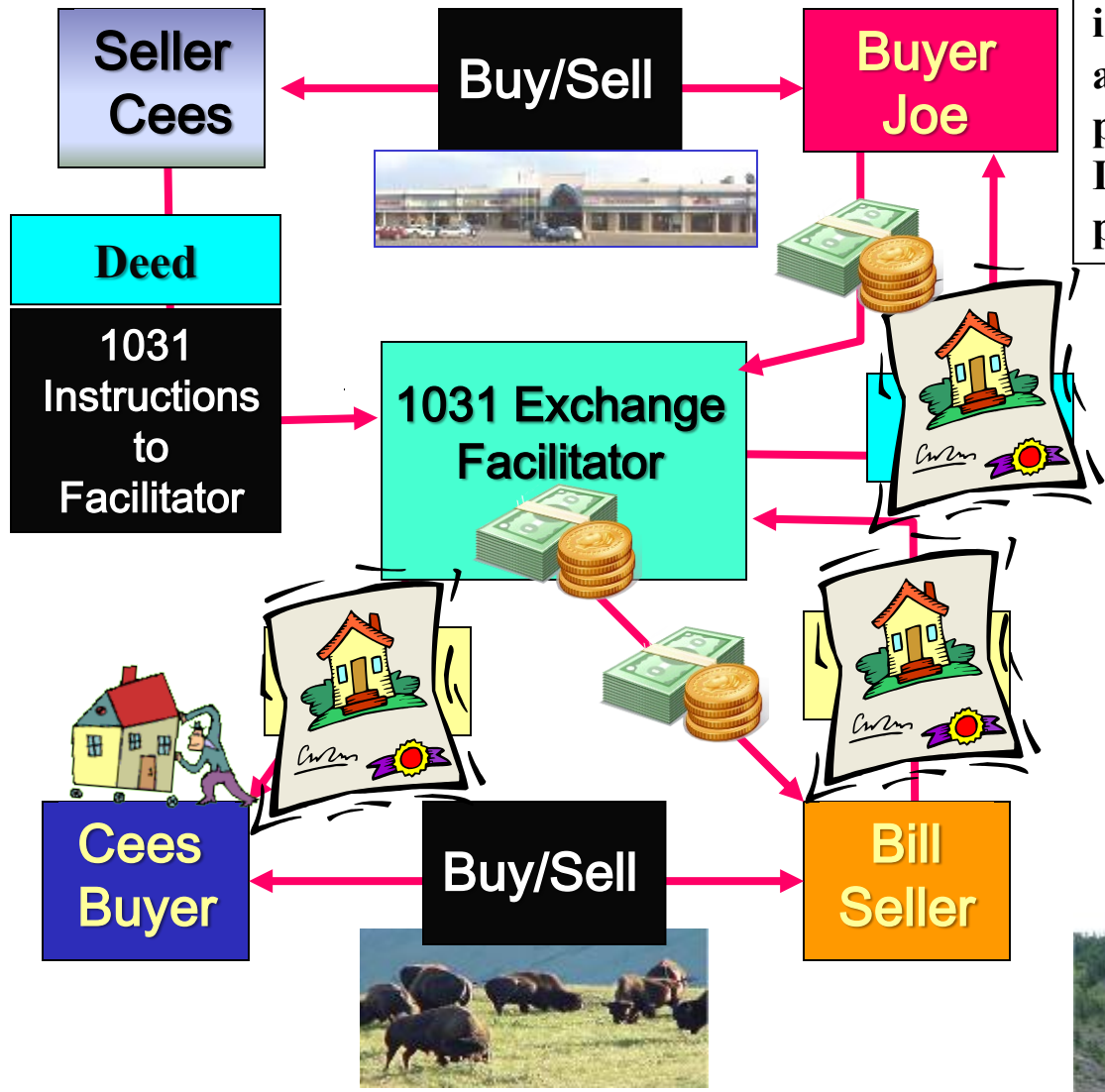




# 1031 Exchange



Involves a minimum of two transactions. A seller of an income producing property exchanges his income producing property for another income producing "like kind" property. It's a deed for a deed. The IRS allows deferred capital gain payment by exchanging properties.



## Income Producing Property



## Rental Property



## Property Held For Investment

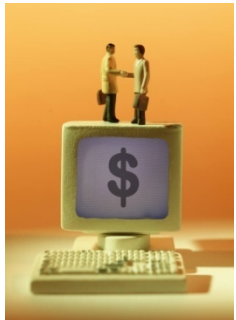


# Depreciation

Cost recovery, is a form of tax deduction and allows an investor to recover the cost on an income producing property used in a trade or business. The cost of the property may be depreciated or deducted over an arbitrary period. *Land cannot be depreciated; only the improvements on it are depreciated.* Only the straight line method of depreciation, meaning depreciation taken periodically in equal amounts, is used now.



## Syndicate



**Is formed when two or more people unite and pool their resources to own, develop and/or operate an investment.**

May take the form of a Real Estate Investment Trust ,(REIT), general partnership, limited partnership, corporation, tenancy in common or joint tenancy.

# Real Estate Investment Trust

The main advantage of a REIT is that investors can avoid double taxation when certain requirements are met. The trust does not have to pay corporate income tax as long as 95 percent of its income is distributed to its shareholders, 75% of the trust's income comes from real estate and certain other qualifications are met.



A security originates when a party joins with others in the expectation of making a profit from the efforts of others. Any pooling of money that attracts investors and meets the definition of a public offering may be federally regulated by the Securities and Exchange Commission (SEC) or by [state blue-sky laws](#).

## Titles

1. Title search
2. Title insurance (owner's, seller's, and mortgage's)
3. Title problems
4. Legal procedures (quiet title, foreclosure, bankruptcy, judgments)
5. Liens and order of priority (mortgages, trust deeds, construction/mechanics liens, judgments by court)
6. Legal proceedings against property (attachments and notice of pending legal action)



# TITLE SEARCH

**A deed transfers the title from the grantor to the grantee. The title is found within the deed and is used to show ownership of land. This means that the title represents facts that, if proven to be true, will enable a person to recover or retain ownership of a parcel of real estate.**

**A title search is conducted on the property to assure both buyer and lender that the seller can deliver a marketable title at closing. The title search is carried out by a lawyer, abstractor or title insurance company who prepares a chain of title.**

## Chain Of Title

**A record of property ownership from the very beginning to present. Each owner is linked to the next to form an unbroken chain which tracks the transfer of title from owner to owner throughout history. If the chain has a break this creates a “cloud on the title”. To remove the cloud a court action called a “suit to quiet title” is used (“quit claim deed”).**

## Title Search

**An examination of all the public records to determine if defects exist in the chain of title. This is controlled by the Marketable Title Act.**

## Abstract Of Title

**A summary report of the chain of title (normally an attorney’s opinion of title) Abstractor – the person who prepares the abstract.**

**Certificate Of Title** A statement of opinion of the title status on a the day the certificate is issued.

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**Marketable Title**

To be Marketable (Merchantable) a title must: disclose no serious defects – not expose a purchaser to litigation or threaten quiet enjoyment of the property – convince an informed buyer that the property can be sold. Concerns of Marketable Title must be resolved before closing.

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**Title Insurance**

If a title is considered to be insurable, title insurance company issues a title insurance policy insuring the current owner against future losses based on title problems. Should the title insurance company pay a loss they have the right to collect losses through subrogation (they replace the insured). Title insurance doesn't cover all title defects.

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**Owner's Policy** An owners' title policy is issued for the benefit of the owner or the owner's heirs.

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**Mortgagee's Policy**

Lender's policy covers the loan balance & may decrease as balance is reduced.

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**Title Problems** Title problems are hidden mistakes in a prior deed, will, mortgage or other document that may give someone else a valid legal claim against a property.  
Hidden defects include:

**Incorrect Information**

**A lien or claim**

**Claims to Ownership**

**Transfer of an Invalid Deed**

### **LEGAL PROCEDURES**

Should there be a claim against a title, the title insurance company negotiates with the other party to settle the claim, defends the title in court (if necessary), satisfies any covered claim for which it is responsible and pays for the costs incurred in defending the title.

**Suit To Quiet Title**

Is a court action intended to establish or settle the question of ownership of or interest in a particular property.

**Coverage**

**Standard coverage policy – extended coverage is provided by an *American Land Title Association (ALTA) Policy.***



## Owner's Title Insurance Policy

Standard Coverage	Extended Coverage	Not Covered by Either Policy
<ol style="list-style-type: none"><li>1. Defects found in public records</li><li>2. Forged documents</li><li>3. Incompetent grantors</li><li>4. Incorrect marital statements</li><li>5. Improperly delivered deeds</li></ol>	<p>Standard coverage plus defects discoverable through the following:</p> <ol style="list-style-type: none"><li>1. Property inspection, including unrecorded rights of persons in possession</li><li>2. Survey Examination</li><li>3. Unrecorded liens not known of by policy holder</li></ol>	<ol style="list-style-type: none"><li>1. Defects and liens listed in policy</li><li>2. Defects known to buyer</li><li>3. Changes in land use brought about by zoning ordinances</li></ol>

**A New Orleans lawyer sought an FHA loan for a client. He was told the loan would be granted if he could prove satisfactory title to a parcel of property being offered as collateral.**

**The title to the property dated back to 1803, which took the lawyer three months to track down. After sending the information to the FHA, he received the following reply (actual letter):**

**"Upon review of your letter adjoining your client's loan application, we note that the request is supported by an Abstract of Title. While we compliment the able manner in which you have prepared and presented the application, we must point out that you have only cleared title to the proposed collateral property back to 1803. Before final approval can be accorded, it will be necessary to clear the title back to its origin."**

**Annoyed, the lawyer responded as follows (actual letter):**



**Your letter regarding title in Case No. 189156 has been received.**

**I note that you wish to have the title extended further than the 94 years covered by the present application. I was unaware that any educated person in this country, particularly those working in the property area, would not know that Louisiana was purchased, by the U.S., from France in 1803, the year of origin identified in our application.**

**For the edification of uninformed FHA bureaucrats, the title to the land prior to U.S. ownership was obtained from France, which had acquired it by Right of Conquest from Spain. The land came into the possession of Spain by Right of Discovery made in the year 1492 by a sea captain named Christopher Columbus, who had been granted the privilege of seeking a new route to India by the Spanish monarch, Isabella. Good queen,**



**Isabella, being a pious woman and almost as careful about titles as the FHA, took the precaution of securing the blessing of the Pope before she sold her jewels to finance Columbus' expedition.**

**Now the Pope, as I'm sure you may know, is the emissary of Jesus Christ, the Son of God, and God, it is commonly accepted, created this world. Therefore, I believe it is safe to presume that God also made that part of the world called Louisiana.**



**God, therefore, would be the owner of origin and His origins date back, to before the beginning of time, the world as we AND the FHA know it.**

**I hope to heck you find God's original claim to be satisfactory.**

**Now, may we have our damn loan?"**

**The loan was immediately approved.**





# Types of Liens



## Liens

### Specific

### General

#### Voluntary (Mortgage)

#### Involuntary (Taxes)

#### Vendor's Liens (Mech. Liens)

#### Involuntary (IRS Taxes)

Equitable

Statutory

Equitable  
Judgment  
Sale

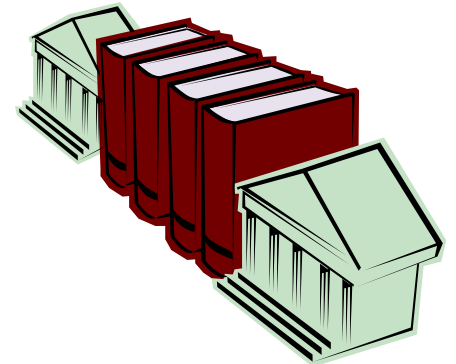
Statutory  
Law

Equitable

Statutory

Equitable

Statutory



# Liens

**LIEN** A monetary charge that provides security for a debt or obligation of the owner that is placed against the property. It can be voluntary (a mortgage) or involuntary (mechanic's lien, taxes).

**General Lien** Affects all property both personal and real. A lien on real estate attaches to the property when it is filed. Liens on personal property are in affect only when the property is seized.

**Specific Lien** Secured by specific property either personal or real.

**VOLUNTARY LIEN** Is created by the property owner's actions – a mortgage loan.

**INVOLUNTARY LIEN** Is not a matter of choice. It is created by law. May be statutory or equitable.

**STATUTORY LIEN** created by statute (law). A real estate tax lien is an involuntary, statutory lien.

**EQUITABLE LIEN** Arises out of common law. It is created by a court to a achieve fairness. A court order to pay a delinquent bill is an involuntary, equitable lien.

**EFFECT OF LIENS ON TITLE** Liens may reduce the value of a property but it can be transferred to a new owner with the lien in place. A lien runs with the land until satisfied.

## PRIORITY OF LIENS

Concerns the order that liens are to be paid off (satisfied) usually “*first come, first served*”. Exceptions are real estate and special assessment liens.

## SUBORDINATION AGREEMENT

Written agreements between lien holders to change the priority of mortgages, judgment, and other liens.

## Real Estate Tax Liens

There are two types of real estate taxes; general real estate taxes (ad valorem) and special improvements (assessments).

## Ad Valorem Tax

“According To Value” – is the tax used to support the government at all levels.

## Assessment

Official valuation process by county assessors. The assessed value is based on sale prices in most cases.

## Mortgage Lien

A **deed of trust lien is a voluntary lien on real estate** given to a lender by a borrower as security for a real estate loan. It usually is a 1<sup>st</sup> lien and will take priority over other junior liens - excluding tax liens.



# Liens



## Mechanic Lien

**A lien to recover payment for work performed.**

## Judgments

**A judgment is a decree issued by a court. When money is awarded it is called a money judgment. It is general – against personal and real property.**

## Lis pendens

**Litigation pending - Is when a notice of a possible future lien is recorded.**

## Attachments

**Writ of attachment is situation where the court retains custody of the property until a suit concludes.**

## Writ of Execution

**A court order authorizing an officer of the court, (a sheriff), to sell the property of a defendant to satisfy a judgment.**

## Inheritance & Estate Tax Liens

**Federal Estate Taxes and State Inheritance Taxes are general, statutory, involuntary liens against a deceased person's estate.**

## Bail Bond Lien

**Posting of Real Estate for bond.**

## IRS Tax Lien

**Failure to pay income tax can result in an IRS tax lien.**

## Settlement Procedures

1. Purposes and procedures of settlement
2. Real Estate Settlement Procedures Act (RESPA)
3. Closing statements (calculate amount owed by buyer, calculate net to seller)
4. Obligations of settlement agent
5. Calculations regarding proration/prepayment
6. Warranties associated with deeds (warranty, quitclaim deeds)
7. Settlement statement (Hud-1)
8. Other settlement documents (bill of sale, note, deed of trust)
9. Transfer tax
10. Negotiations between buyers and sellers leading to agreement





## **Real Estate Settlement & Procedures Act (RESPA)**

**Enacted to protect customers from lenders. It ensures that borrowers have important, accurate, and timely information concerning the actual costs of settling or closing a transaction. All Federally related loans require its use. The regulations apply to first-lien residential mortgages for the purchase of one to four family homes, cooperatives and condominiums for investment or occupancy. It also governs second or subordinated loans for home equity loans.**

**It is enforced by HUD**

**RESPA does not cover purchase money mortgage, installment contracts, or a buyer's assumption.**

**RESPA is primarily aimed at lenders, some of its provisions apply to real estate brokers and agents.**

## **Real estate agents or brokers fall under its guidelines when:**

- (1) Buyers are referred to a particular lender**
- (2) There is a referral to a particular title company**
- (3) a particular attorney**
- (4) or other provider of settlement services.**
- (5) advertising of a part of financial terms requires all terms be disclosed.**
- (6) It permits controlled business arrangements (CBA (package deal) as long as consumer clearly understands.**
- (7) Computerized Loan Organization (CLO) – Real estate companies offering loans.**

### **Special information booklets**

**Good faith estimate of settlement costs must be furnished within 3 business days of a loan application**

**NO KICKBACKS ALLOWED**

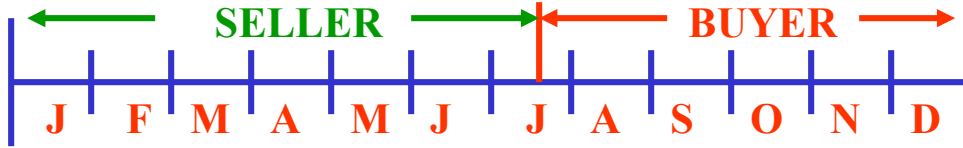
# Settlement/Transfer Of Ownership

## PRORATION

CLOSING DATE 7/15/04

**PAYMENT IN ARREARS – ACCRUED –  
PRORATION - TAXES**

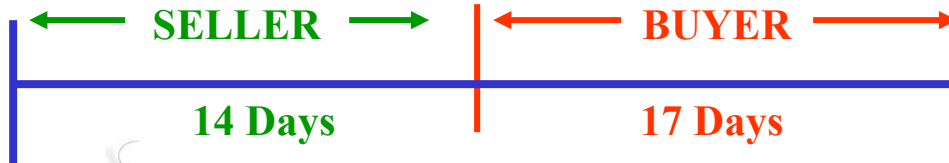
TAXES \$1460/YR \$4/DAY



$$196 \times \$4 = \$784 \text{ OWED}$$

**PAYMENT IN ADVANCE –  
PREPAID - RENT**

JULY RENT \$465 \$15/DAY



$$17 \times \$15 = \$255 \text{ OWED}$$



JANUARY	31	↑ 196 DAYS ↓
FEBRUARY	28	
MARCH	31	
APRIL	30	
MAY	31	
JUNE	30	
JULY	31	
AUGUST	31	
SEPTEMBER	30	
OCTOBER	31	
NOVEMBER	30	
DECEMBER	31	

### Banking Method

All months have 30 days

### Actual Days

Each months actual days are used

# SETTLEMENT SHEET

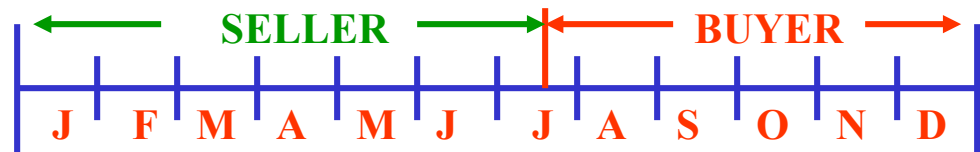
(HUD Form – 1)

ITEM	SELLER		BUYER		OTHER	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
SELL PRICE \$100,000		\$100,000	\$100,000			
TAXES \$1460/YR	\$784			\$784		
COMMISSION 6%	\$6,000					\$6,000
NEW LOAN \$40,000				\$40,000	\$40,000	
LOAN PAYOFF \$80,000	\$80,000					\$80,000
EARN MONEY \$1,000				\$1,000	\$1,000	
TITLE INS \$400	\$400					\$400
RENT \$465/MO	\$255			\$255		
CLOSING FEE \$250	\$125		\$125			\$250
<b>SUB TOTAL</b>	<b>\$87,549</b>	<b>\$100,000</b>	<b>\$100,125</b>	<b>\$42,024</b>		
<b>SELLER FUNDS</b>	<b>\$12,451</b>					
<b>BUYER FUNDS</b>				<b>\$58,101</b>		

DEBIT - \$\$\$\$ OUT

CREDIT - \$\$\$\$ IN

CLOSING DATE 7/15/04



USE 365 DAYS





**General Warranty**  
Seisin  
Encumbrances  
Quiet Enjoyment  
Further Assurance  
Warranty Forever

**Special Warranty**  
Grantor Received Title  
Unencumbered By Grantor  
Defend Title

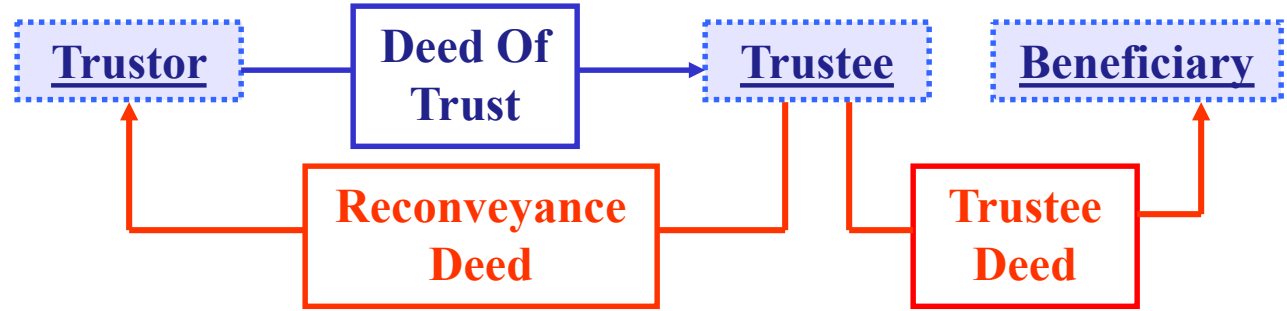
**Bargain & Sale**  
No Express Warranties  
Implication That Grantor Holds Title

**Quit Claim**  
No Warranties  
Used To Clear Cloud On Title

**Executor's Administrator's & Sheriff's Deed**  
Court Ordered Deeds

**Deed In Trust From Trustor To Trustee**

**Reconveyance Deed From Trustee To Trustor**



**Trustee Deed From Trustee To 3rd Party**



# Sales Contracts - Continued

Liquidated Damages Buyer forfeits earnest money on default as damages

Specific Performance Buyer is obligated to buy – Seller is obligated to sell by court order.

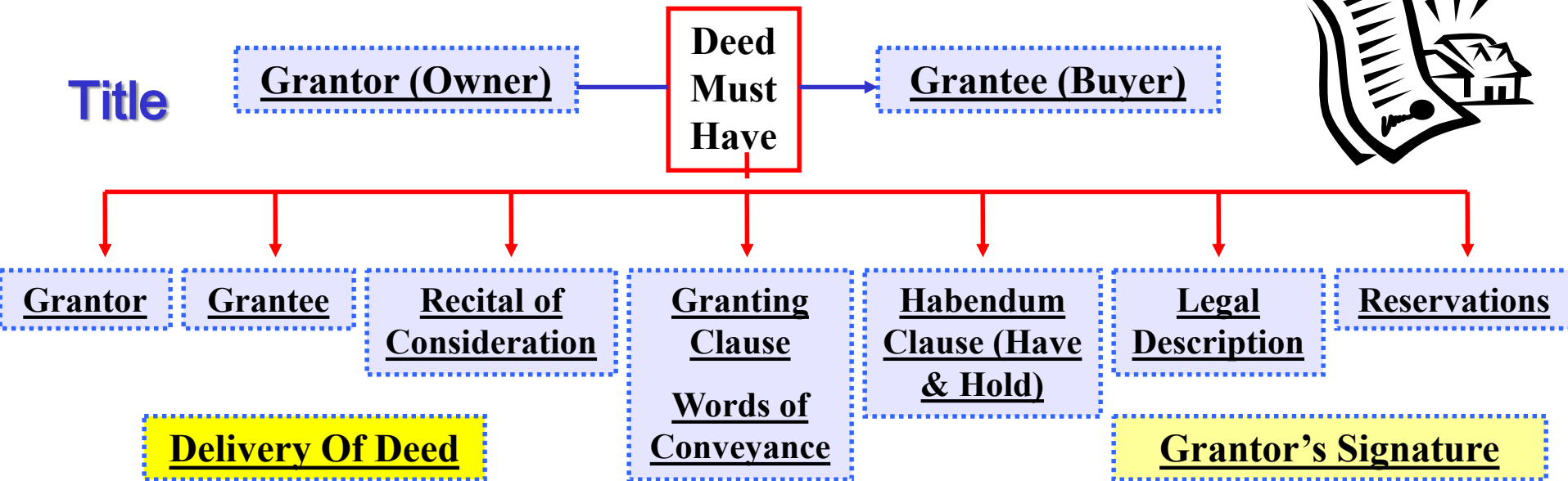
Equitable Title Buyer is considered to have equitable title (an interest) in the property.

Additional Provisions Identify personal property that stays and real property that goes

Contingencies Additional provisions that must be met before a contract is enforceable.  
Lender, etc.

Option A unilateral (one promise) contract where the owner (optionor) gives prospective buyer (optionee) right to buy the property for a certain future time period for an agreed upon price.

Land Contract Contract for deed – **Seller (Vendor)** agrees to accept a down payment and payments for the property but **retains legal title**. **Buyer (Vendee)** takes possession, pays taxes & insurance but only gets **equitable title**. Vendee gets legal title when Vendor is paid in full.



## OTHER SETTLEMENT DOCUMENTS

Mortgage   A pledge of property to the lender for security for the payment of the debt.

Note   The evidence of the debt and states the terms of repayment

### Affidavit

Seller affirms that from the time the sales contract was accepted until the date of closing, nothing has been done to burden the title that would not be revealed in the title search.



**Bill of Sale** To shows the transfer of personal property

**Payoff Statement** Indicates the payoff of the seller's existing note. (estoppel certificate)

**Insurance policy** Buyer must show payment of homeowner's insurance.

**Other Documents**

## TRANSFER TAX

**Most states impose a transfer tax. The transfer tax may be paid by the purchase of tax stamps or payment of a transfer fee.**

### Characteristics of Real Property

- 1. Ways of holding and conveying title, and characteristics of the different approaches to tenancy ( joint tenancy, tenancy in common, tenancy by entirety, severalty)**
- 2. Rights of home ownership (homestead)**
- 3. Rights of others related to property (adverse possession, adjoining owners, encroachments)**
- 4. Nature and types of common interest ownership (condominiums, planned unit development, cooperatives, townhouses, time-share)**
- 5. Eminent domain proceedings (condemnation)**

# Limits To The Rights Of Ownership

## Adverse Possession

**If a party uses someone else's property for a statutory period and that use is open, notorious, hostile and continuous, the party may acquire title to the property through adverse possession, The rights of the party in possession are squatter's rights. More than one person may be in possession over the statutory time and it is still considered to meet the requirements through "tacking."**

## Encroachment

**An unauthorized intrusion of an improvement onto the real property of another.**

CENTER-LINE OF 21ST. YE. SOUTH

HENEN LAND SURVEYING  
2822 1ST AVE. SOUTH,  
GREAT FALLS, MT. 59401  
(406) 453-7820

OFFICE ENCROACHES  
+ 0.50' ONTO 21 AVE.

CENTER-LINE OF THE ABANDONED 10TH STREET SOUTH

LOT 1, BLK. 32

GARAGE FROM LOT 1,  
ENCROACHES + 6.50'  
AS SHOWN.

S 90°00'00" W  
75.00'

S 0°00'01" E

40.52'

48.40'

48.40'

40.52'

OFFICE

40.52'

LOT 5

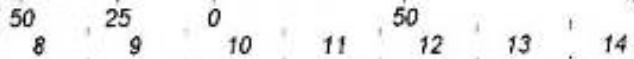
LOT 6

N 0°00'00" W  
135.00'

LEGEND.

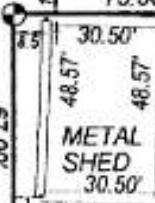
- = FOUND 1/2" REBAR WITH Y.P.C. "M HENEN 9523 L.S."
- ⊙ = SET 1/2" DIA. X 30" REBAR WITH Y.P.C. "M HENEN 9523 L.S."
- △ = SET 8" SPIKE
- = PROPERTY LINE, OUTER BOUNDARY.
- - - = EXISTING FENCE LINE

SCALE: 1" = 50'



S 90°00'00" W  
75.00'

S 0°00'00" E  
135.00'



LOT 2, BLK. 32  
AMENDED PLAT OF  
LOTS 1 - 4, & 28,  
BLK. 32.

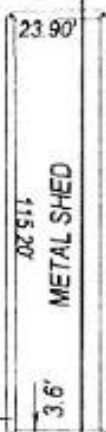
N 90°00'00" W  
40.00'

ABANDONED ALLEY

S 90°00'00" W  
200.00'

BLOCK 32, OF THE REVISED PLAT OF HIGHLAND HEIGHTS ADDITION TO GREAT FALLS, MONT.

LOT 28, BLK. 32 OF THE  
AMENDED PLAT OF LOTS 1 - 4  
& 28, BLK. 32



27 26 25 24 23 22 21 20 19 18 17 16 15

25'  
TYP.

N 90°00'00" E  
390.00'

CENTER-LINE OF 22ND. AVE. SOUTH