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LAW LETTER

Estate Planning

Wills and Specific Devises

Anyone making or changing a will (a *testator* if a man or a *testatrix* if a woman; hereinafter, *testator* refers to either sex) should understand the consequences of placing a specific devise in a will. Even though the motive behind the bequest is admirable, the legal consequences may be disastrous. The testator's intent may be frustrated and the scheme for the division of property altered.

A *specific devise* is the leaving of specifically identified property belonging to the testator to a particular individual (beneficiary). The testator may want a certain person to receive a family heirloom or a friend to have a certain gun or boat. Perhaps the parents want a particular child to take the house.

Two problems can surface with specific devises when (1) the property disappears before the testator's death or (2) a debt (lien) exists against the property at the testator's death. First, if the property is no longer a part of the estate when the testator dies, the law says the bequest or devise has been *adeemed*. Depending on why the property is absent, the ademption either can be an ademption-by-satisfaction or an ademption-by-extinction.

Ademption-by-satisfaction occurs when the testator, after the will has been made, advances all or an equivalent amount to the devisee (beneficiary) with the intent that the gift satisfy the specific devise.

To eliminate problems, the testator's intent must be expressed **in the will** in clear and unambiguous terms. Any attempts by the testator to express the intent in conjunction with the subsequent gift or gifts are ineffective.

The form books suggest the following language in the will if the testator **wants** a subsequent, lifetime gift to be considered ademption-by-satisfaction:

"The specific devise (or devises) that I made to the named beneficiaries in this will are to be reduced and considered adeemed by any lifetime gifts or other inter vivos transfers that I make to be named beneficiaries after the date of execution of this will."

Ademption-by-extinction, on the other hand, occurs when the specifically devised asset has disappeared, has been disposed of or otherwise alienated by the testator. Again, the primary factor in determining ademption-by-extinction depends on the testator's intent as expressed in the will.

Several Texas cases have considered the application of ademption-by-extinction to stock mutations, stock splits and real estate sales. Basically, they held that when a stock mutation occurs because of a business reorganization, ademption-by-extinction does not apply to specifically devised shares of stock that were exchanged for new stocks. Likewise, stock splits do not result in ademption unless a contrary intent is expressed in the will.

The sale of specifically devised real estate does not necessarily cause ademption either. Instead, the devise follows the proceeds **when the will so states** and the proceeds can be traced. When the will does not state that the specific devise should follow the proceeds, however, the proceeds become a part of the residuary estate and pass by way of the general devise. Consequently, testators should state in the will whether the recipient of a specific devise retains the right to the proceeds. Second, if the property is subject to a debt or lien when the testator dies, the debt must be retired by the estate unless the testator stipulates otherwise in the will. Debt retirement on specifically devised property can cause an unequal distribution of the estate. Here is how it works.

Depending on the wording of the will, a testator can divide the assets of the estate into three groups—those subject to specific devises, demonstrative devises and general devises.

Demonstrative devises are testamentary transfers of a certain number of articles in a particular class or a certain amount of money out of a fund. The devise of $10,000 or 100 shares of stock or ten head of cattle are good examples.

Demonstrative devises are less common than specific devises. However, similar to specific devises, an existing debt or lien against a demonstrative devise must be retired by the testator's estate.

General devises are the assets not specifically or demonstratively given away in the will. They are sometimes referred to as the remaining or residuary assets.

In a will, the testator makes specific and demonstrative devises. Then, the testator leaves "all the rest of my estate, real, personal or mixed" to a certain beneficiary or beneficiaries. This is the general devise.

The primary effect of a general

devise (property classed as residuary assets) is that any debts, including liens on the specific and demonstrative devises, must be retired by using these assets. This rule can cause an ill-fated result in the division of an estate, as the following example shows.

A husband and wife have two children. Both children are college graduates starting their careers. One child works in New York, the other locally.

The couple structured their wills so that their home (which has a $30,000 mortgage against it) is left to the child employed locally. The rest of the estate goes to the child in New York.

In this case, the house is a specific devise and "the rest of the estate" a general devise. If the couple suddenly dies, the local child would receive the house, and the other child's share of the (residuary) estate would be reduced by $30,000 to retire the mortgage debt. Depending on the size of the couple's estate, this could cause an unequal distribution between the two children. The testators should address the issue of debt retirement in the will.

The issue of ademption also should be considered in the event of a "loan" to one of the children. Otherwise, an unequal distribution could occur.

Again consider the couple with the two children. The parents structure their wills for the two children "to share and share alike." There are no specific devises.

The child living locally finds a terrific buy on a home. The child can afford the monthly payments but not the down payment. The parents are considering "funding" the $20,000 down payment several ways. However, they want to avoid an unequal distribution of the estate and potential conflicts between the children.

Simply giving the money to the child is one consideration. However, ademption-by-satisfaction would not apply because there is no specific devise. Giving the $20,000 as a gift would reduce the parents' estate by $20,000 and thus reduce the other child's half by $10,000.

By amending the will, however, the gift concept may work. The parents could acknowledge the $20,000 gift and stipulate that it **should be considered** an ademption (or reduction) in any amount of the estate going to the recipient. Also, the parents should instruct in the will that the $20,000 should be added back or reconstituted to the estate before division so that the second child's portion is not reduced by $10,000.

Actually making a bona fide loan to the child is another possibility. If pursued, a promissory note should be drafted by an attorney and signed by the child. According to the Internal Revenue Code, the parents must charge a minimum interest rate on the intra-family loan, which is currently around 7 percent.

If the loan was not fully paid before the parents' death, the unpaid balance would be considered an asset of the estate and not forgiven. Basically, the first child would owe the second for one-half the unpaid balance. Obviously, if not paid, a lawsuit for collection could create hostility between the two.

In this case, the parents again should address the loan in their wills. A possible solution requires the unpaid balance of the note to be treated as an asset of the estate. Next, the unpaid balance is forgiven and considered adeemed and deducted from the half of the estate going to that child.

This solution allows the first child to obtain the down payment without diminishing the other child's estate share.

Obviously, anyone making or revising a will must understand the problems associated with specific devises and take steps to offset any adverse effects.

For more information on wills and estates, order *Texas Wills*, publication 449 for $5.

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