The Deed with Life Estate

A Smart Way to Preserve Your Home from Long Term Care Expenses

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It is likely that your home is the single largest asset you own. As a means of attempting to protect that home from long-term-care expenses, while also avoiding probate, you may want to transfer it to one or more of your children.

On its face, this appears to be a relatively simple and straight forward transfer or conveyance. However, there are many issues that must be discussed and resolved prior to that transfer, to maximize your intent as well as maintain all income tax, estate tax and gift tax benefits to the greatest extent possible.

A life interest is merely a form of ownership where the person transferring the property, usually the parent, retains the right to use, occupy, enjoy the property and live in the residence. The transfer usually occurs to your children, who receive what is commonly known as a future interest in the property. This special form of "dual" ownership is not a joint ownership, nor will you have made a completed gift of your entire real estate to your children. However, you will not be able to sell, mortgage, refinance, or in any way encumber the property without the consent of your children. And likewise, your children may not transfer or sell the property without your signature.

The procedure to complete this transaction involves a deed from the grantor to the grantee, (from you to your children), which must be recorded with the appropriate Registry of Deeds. Once the recording of the deed is effective, your children own an interest in the property as well as you.

The additional benefits to this type of transaction are threefold:

• The first benefit is that the property will not have to be probated upon your death. Keeping in mind that you and your children each own an interest in the real estate, your interest terminates upon death. At that point in time, your children, who own the future interest, become the owners of the property as a matter of law without the need to probate your estate.

However, the value of the real estate is included in your taxable estate for estate tax purposes, even if there is no need to probate your estate. This normally works to the advantage of your children, because they receive what is known as the step-up in basis of the real estate under current law. The benefit is that they inherit the property at the date of death value, not the value as of the date of the transfer, nor the date upon which you acquired the property. If your total assets exceed the estate tax credit for estate tax purposes, then the value of the estate, together with the real estate, will cause an estate tax to be due.

In Massachusetts, as in many other states, when a person dies owning any interest in real estate, there is an automatic lien attached to his or her real estate, which must be released by the filing of an estate tax return within nine months of date of death, or an affidavit, when no tax return is due. This usually is a mere formality if there is no tax due, but it is a necessity to clear the title of the property for your children. In some jurisdictions, such as Connecticut, a gift tax may be due upon the transfer of the real estate.

• Secondly, the transfer of your real estate to your children triggers the waiting period for Medicaid eligibility. Without providing all details relative to the rules and regulations of the Division of Medical Assistance, (which administers the Medicaid program in Massachusetts,) suffice it to say that this transfer will 'start the clock ticking' on the transfer period, which is now five years.

Subsequent to the possible five-year period for ineligibility for obtaining Medicaid benefits, your property should be exempt from any requirement to sell it. However, the state may place a lien on it, but this lien is normally extinguished upon your death as long as the property is not sold during your lifetime, relative to your Medicaid application.

Naturally, this rule is subject to change, and if it does, you may wish to revise the plan of utilizing this type of transfer. In some jurisdictions, the transfer-waiting period may be extended if the proposed rules are enacted as to this disqualification period.

• The third benefit is that when you are reserving the life estate, you will be entitled to obtain an abatement for real estate taxes if you otherwise qualify for an abatement within your city or town. There is an income as well as an asset test in order to qualify for this exemption, but it is preserved so long as the person living in the house (you) reserve the life estate.

Naturally, whenever there is a benefit there is also a detriment or down side. In the event that the future interest holder (your child) dies, becomes disabled, gets divorced, has tax liens against him or her, or incurs significant liability, then his or her interest in the property may be attached by the creditor having such claim. Also, in the event that your child should die, then his or her will, if not revised, may leave these future interests in the real estate to his or her spouse and/or children.

In a similar manner, your child may die without a will, which causes substantial adverse consequences in many cases. Also, if the property is sold during the lifetime of both parties, there may be a capital gains tax assessed against your children for their share of the gain, which they receive as a result of the sale. You should usually be entitled to the exemption for the exclusion of being taxed on the capital gain on the sale of a principal residence however.

While this article is not intended to be a complete and total explanation of the technique of a life interest, hopefully it will cause awareness to this often-beneficial means of transferring your real estate to the next generation as a means to protect your home from long-term care expenses. As always, with these types of transfers, it is best to consult a professional who has the expertise in both legal and tax areas prior to making your final decision to transfer your real estate.❖

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