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Effects of Transferring Real Property While Retaining a Life Estate

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We have discussed the option of preparing a new deed to transfer ownership of your real property while retaining or reserving to yourself a "life estate" in the premises. You would be known as the "grantor" and the person or persons to whom you are transferring the property would be known as "grantee(s)" and "remaindermen."

This "life estate deed" is a distinctly different option than conveying ownership of your real property into an Irrevocable Trust and retaining a life estate interest within the terms of the Trust Agreement. An Irrevocable Trust is more complex and expensive though offers more benefits and is often a reasonable and sometimes necessary alternative. We can discuss the differences in more detail at your convenience.

The transfer ownership of your real property while retaining a "life estate" would result in the following:

1. You, as the person retaining the "life estate," will continue to be responsible for all expenses related to the property. Tax bills will continue to come to you at the property address unless you wish otherwise.

2. The life estate entitles you to occupy the property during your lifetime. Thus, if it is your residence which is transferred, you are assured that you will have a place to live for the rest of your life.

3. Your grantee(s) will be receiving a “remainder” interest in the property, which will vest in them upon recording the deed.

4. You can terminate your life estate at a later date, if you choose to do so. This would require that another deed be prepared and recorded, terminating your life estate. You (or your agent if authorized under a power of attorney) would have to sign this deed.

5. If the property is sold during your lifetime, you would have to agree to such sale, and you, together with the remaindermen, would have to sign a deed to the buyers. (If you were not able to sign a deed, another person could sign for you, using a Power of Attorney.) Some of the practical difficulties involved in such a sale during your lifetime would be alleviated if the property were instead owned by an Irrevocable Trust.

6. If the property is sold before your death, because you have retained a life estate in the property, you would be entitled to a percentage of the proceeds of the sale. This percentage is determined by your age at the time of sale and government tables which set forth the value of life estates and remainder interests at various ages.

7. It is important for you to know that if the property is sold during your lifetime and you are in a skilled nursing home, your portion of the sale proceeds would be considered an available asset and would affect your continuing eligibility for Medicaid. This is not the case if the property were instead owned by an Irrevocable Trust.

8. Further, if the property is sold during your lifetime and a capital gain (profit) is realized, your grantee(s) would not be entitled to the same forgiveness of gains as you would be; consequently, the grantee(s) might face an income tax liability. Again, this is not the case if the property were instead owned by an Irrevocable Trust. (There is a way around this – by your grantee(s) deeding the property back to you; but, if this were done, the entire value of the property would become an “available asset” affecting your Medicaid eligibility.)

9. If at any time you terminate your life estate (by a new deed as noted above in No. 4), you will be seen as making a transfer of the value of your life estate to the grantee(s), as would be the case in a sale of the property (No. 6 above). Such a transfer might affect your continuing or future eligibility for Medicaid.

10. If the property is not sold during your lifetime, and you retain your life estate until you die, the following occurs:

(a) The grantee(s) get a “stepped-up” tax basis in the property. Specifically, if and when the remaindermen sell the property following your death, they would not have to pay a capital gains tax on any increase in value on the property that occurred during your lifetime. Rather, the tax basis in the property would be the value of the property on the date of your death.

(b) If you had been in a nursing home and had been receiving Medicaid assistance, upon your death (and under current New York State Law) Medicaid would have no claim against the property or the proceeds from the sale of the property after your death.

11. For the above reasons, it may be financially more advantageous if you and your grantee(s) do not sell the property prior to your death. If the property must be sold prior to your death, we should meet and undertake additional planning at that time.

12. By deeding your property to your grantee(s), you will be making a gift. However, because of the special language in the deed whereby you would reserve your right to change the original remainder interests (remove and substitute grantees; see 14 below), the gift is not completed until your death (or until you terminate your life estate and your power to appoint the remainder interests). Consequently, no gift tax return need be filed upon recording the deed.

13. If you have exemptions from your real estate taxes (for example, a Veteran's exemption, a senior citizen exemption or a STAR exemption), you will continue to be eligible for these exemptions – because you are, for property tax purposes, still considered to be the owner of the property. Of course, upon your death, or if you terminate your life estate or permanently vacate the property because you need placement in a skilled nursing or assisted-living facility, all your personal real property tax exemptions will be terminated.

14. You are also reserving in the deed a "Limited Power of Appointment" over the remainder of the property during your lifetime. This means that, with certain limitations, you will have the right to change the names of the eventual owners – the grantee(s)/remaindermen of the property. This Limited Power of Appointment must expressly exclude your ability to transfer title back to yourself, your estate, your creditors or someone for whom you have a legal support obligation. This would have to be done with a new deed. This right is reserved to make the document flexible because sometimes circumstances change so that you may wish to add a name or to delete the name of an original grantee (because of a grantee's pending divorce or bankruptcy, for example).

15. If you choose to make a transfer of ownership with reservation of life estate, you should notify your homeowner's insurer of the change in title so that any claim benefits are paid to the proper party/owner and are not unintentionally exposed to your creditors.

16. You may have title insurance on your property (different from hazard/homeowner/property insurance) to cover such matters as unmarketability of title, liens, encumbrances on the title, boundary line issues, etc. You may want to check with your title insurance company to see if you would still be covered under the policy after the contemplated life estate deed transfer. This is more likely a concern in the event you

were to transfer the property to an entity such as an Irrevocable Trust or Limited Liability Company.

17. Finally, and very importantly, if you ever apply for Medicaid assistance for skilled nursing home expenses, you will be asked whether you have made any "uncompensated transfers" within the 60 months previous to your Medicaid application date. The deeding of your property to the grantee(s) is such an "uncompensated transfer." If a Medicaid application is not made within 60 months following the recording of a deed, the transfer need not be reported to the Medicaid authority.

18. If you apply for skilled nursing home Medicaid before the 60 months expire, you will have to report the transfer of your property, and your Medicaid eligibility will be affected. The remainder interest may have to be re-transferred to you so that you end up in full title to the property once again. If within 60 months of the date of recording your deed you consider applying for skilled nursing home Medicaid, you should consult with our office to obtain advice about the application of the rules we have outlined and to determine when it would be safe to apply for benefits under the Medicaid program.

Please review these ramifications with interested family members and contact me regarding any questions or concerns you or your proposed grantee(s) may have.