

The Estate Planning Advisor

Should We Give the House to Our Kids?

By Richard J. Shapiro, J.D.

Virtually everyone wants to protect their assets in the face of potentially ruinous long-term care costs. Since a primary residence is often a client's most significant asset, we are often asked to prepare a deed to "put the house in the kids' names."

Transferring a home directly to the children, however, is almost always a colossal mistake. In making the transfer, the parents will lose their property tax exemptions, and if the house is sold, they will also lose the capital gains exemption available only to a homeowner. For example, assume a married couple deeded their home to their children in 2006. The home cost \$50,000 when purchased in 1975. The children then sell the home for \$350,000 in 2009. Since the sellers (the children) do not live in the home, the homeowner's exclusion is unavailable and the \$300,000 of "gain" from the sale would be fully taxable to the children. With state and federal capital gains rates of about 20%, the children would pay a tax of approximately \$60,000 that would have been completely avoided had the parents remained on the deed.

Such a lifetime transfer also results in the loss of the "step-up" in tax basis for assets that are inherited at death. Under the above facts, had the children inherited the home after the parents' deaths at a value of \$350,000 and then sold it for that same amount, no capital gains tax would be owed. A lifetime transfer, however, forfeits the step-up in basis, causing the imposition of the capital gains tax on the full amount of the gain.

Even without the negative tax consequences, a lifetime transfer of the home is of dubious benefit. Once the transfer is made, the parents lose all control over the home, and can even be evicted by their children! Also, if one of the children were to get divorced, file for bankruptcy, or have a judgment entered against them, that child's share of the equity in the house might well be forfeited to their ex-spouse or their creditors.

Of course, keeping the house in the parents' names does nothing to satisfy the stated goal of asset protection. Fortunately, there are far better alternatives to the outright gift. One common strategy is a deed with a retained "life estate." In this type of deed, the parents retain "life rights" in the home, with the children (or a trust for their benefit) receiving the "remainder interest." The value of the remainder interest is determined by a government table and is based on the parents' life expectancy. Under current rules, the five-year Medicaid "look back" period for the gift of the remainder interest begins as of the date of the deed. If neither parent requires long-term care within five years from the date of the transfer, then the value of the remainder interest is no longer considered an asset of the parents if either one requires long-term care and seeks Medicaid eligibility. And, *so long as the home is not sold while the parent receives Medicaid benefits*, there will be no lien attaching to the home upon the parent's death.

While a life estate deed is better than an outright gift, in general the most effective strategy is to transfer the home to an irrevocable trust. Like a life estate transfer, a home transferred to an irrevocable trust will be "Medicaid exempt" once the five year look back

period has run. The trust, however, has a number of advantages over the life estate deed, including the ability for the parents to change the ultimate recipients of the property, and complete protection from a Medicaid lien if the home is later sold while a parent is receiving Medicaid.

While irrevocable trusts are frequently a better choice than the life estate deed, either planning tool (i) permits the parents to retain property tax exemptions, (ii) retains the capital gains tax exclusion if the house is sold during the parents' lifetime and (iii) ensures that the home will receive a "step up" in tax basis to the date of death value upon the parents' deaths.

Richard J. Shapiro is a partner with the Middletown law firm of Blustein, Shapiro & Rich, LLP. Mr. Shapiro is a member of the National Network of Estate Planning Attorneys, the National Academy of Elder Law Attorneys, the New York State Bar Association (Trusts and Estates and Elder Law Sections), and the Hudson Valley Estate Planning Council. He can be reached at (845) 692-0011 or at rshapiro@mid-hudsonlaw.com. The information in this article is for general information purposes only and is not, nor is it intended to be, legal advice, including legal advice for Internal Revenue Code purposes as described in IRS Circular 230.