ESTATE PLANNING ISSUES

WHAT ABOUT A LIFE ESTATE IN FAMILY RESIDENCES:

"SHOULD I ADD MY KIDS TO THE DEED TO MY HOUSE?"

ALWAYS WORTH ANOTHER LOOK

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Over 16 years ago I wrote an article in the Southern Indiana Estate Planning Council's publication on the question, "Should I add my kids to the deed to my house?" that attorneys are still hearing. I also have recently drafted several Warranty Deeds where the parents/owners transferred fee simple title to the kids while retaining a life estate, or right to possess the property until death of the survivor. So it seems appropriate to take the time to advise again on the pros and cons of such a transaction as part of one's estate planning or as I like to describe as, transitional planning. Now I want to take another look at this question along with the question of holding title as a tenant-in-common or with rights-of-survivorship with one's adult children. Any of these questions assumes the desire to avoid the costs and time of "probate, courts and lawyers" when people die since the property will automatically go to their heirs (by operation of law), and this is partly the case. People also think doing these things saves cost in the long run for several other reasons relating to taxes, estate planning or long term care (Medicaid) planning. So attorneys are consistently being asked to "just do a deed with my kids' names on it." Simply redoing a deed is easy, but unintended consequences can result that are often not so easy to fix.

There are basically three common ways to put your child's name on a real estate deed:

first, by adding them as a "joint tenant" which gives them rights of survivorship; second, by adding them as a "tenant in common," which gives each child an undivided ownership percentage in the house, but no survivorship rights; and lastly, by deeding the children the title to the property and withholding a "life estate." A "life estate" is created when the parents deed the house to the kids, but retain a life estate in the property, allowing the parents to possess, or profit from, the house until they die. The parents become "life tenants" and the kids become owners of house as "remaindermen." The life tenant can move out and still retain the rights to the profits of the property during his or her life (not just while he or she lives on the property).

Putting the kids' names on the deed is a tempting planning technique because it is simple and inexpensive and it is viewed as taking the place of a Last Will and Testament. As a result, it is very common for subsequent attorneys to have to deal with these as situations change. Parents believe they are giving up the headaches of ownership to the kids, but they are giving up much more than control; they are limiting their future options by these methods. Another result of deeding to the kids and retaining a life estate is it gives the kids more involvement in the property. But these issues are just part of the problem. Once the property is put in the names of several parties, both the parent(s) and the kids still retain some amount of control as either "joint tenants," "tenants in common" or "holders of a life estate," or as "remaindermen" (those receiving the property after the life tenant *dies*). Some such co-owners do not know the difference between "tenancy in common" and "joint tenancy," and their heirs lose out on any sale proceeds because they were not "tenants in common" owners. Other co-owners do not think about having equal legal rights with other co-owners who can share in all of the property.

Furthermore, to change such forms of ownership of property, *all* parties must re-sign a transferring deed, which may be difficult since they may not *all* agree, one may be incapacitated,

or one may have died. These circumstances can be overcome but at a cost of money and time. The bottom line is that the method you use can have different consequences on the ultimate outcome.

Another common problem with people putting the names of their children on their deed as "joint tenants with rights of survivorship," is that it only assures that the surviving parent's *last* living child will receive the property outright and the deceased children's heirs receive nothing. This form of ownership does avoid "probate, courts and lawyers" and is one method to pass the parents' property to their heirs. But only the last surviving child receives the property, and this may not be the parents' true desired result since it could leave their deceased children's heirs out entirely.

Some people choose to add their kids' names to their deeds to remove the property from their estate in anticipation they may need to go into a nursing home. Under Indiana Medicaid Law, property held as "joint tenants with rights of survivorship" is not considered to be an "available" asset for calculation of Medicaid eligibility, and, therefore, the jointly held property does not need to be "spent down" prior to applying for Medicaid. Generally speaking, a person may make gifts more than sixty (60) months prior to applying for Medicaid, and these gifts will not affect his or her Medicaid eligibility under Indiana law. With fiscal problems at all levels of government, the chances of a retroactive extension of the 60 month rule is not only likely but probable.

Be careful not to execute documents too quickly without considering all the ramifications, most importantly income tax concerns is a key one. By adding someone to the deed, you, the parent, are making a gift to that person, and the child or "donee" then takes the tax basis (the price for which the property was purchased plus capital improvements) of that portion of the property interest the child is receiving. Thus, a later sale of the property would have additional tax

ramifications as generally described below. Conversely, if the kids receive the interest after you pass away, they get a "stepped-up basis" for income tax purposes to the fair market value at the time of death. If they sell it after your death for the date-of-death value, they will pay no capital gains tax. Of course, if they sell it later when the fair market value has gone up above the "date of death value," they will pay capital gains on that appreciation.

If you as the parent put an only child on the deed and you die, the child will receive a "stepped-up basis" for the one-half interest that you owned upon death. But the one-half interest the child received from you during your life would have a tax basis equal to the same tax basis you had, which is usually lower. Thus, your child would have capital gains tax on that portion.

For example, assume the parent bought a home for $20,000 that is now worth $100,000. The parent puts a child on the deed. The tax basis for the child would be $10,000 (one-half of $20,000). If the parent were then to die and the child sells the property, the child will pay no capital gains tax on $50,000, (the one-half interest he or she receives as inheritance), but will pay capital gains tax on the one-half ownership interest he or she received **before** the death of the parent, or $40,000 ($50,000 minus $10,000) at the rate of fifteen percent (15%) or $6,000.00 ($40,000 x 15%). That is $6,000.00 that the child would not have had to pay if the deed had not been put in the child's name before the parent's death.

If the child makes the home his or her principal residence and lives there for two out of the last five years and then sells the house, he or she will get the same tax savings as the parent on up to $250,000 for individuals and $500,000 for married couples on any capital gain on the sale.

Another tax aspect to consider is gift tax. If the value of the property interest transferred to your children is more than $12,000 each, a gift tax could be due on the value in excess of $12,000. However, this gift tax could be avoided if you use a portion of your "lifetime exclusion"

(currently $1.0 million). So really no gift tax would be due unless you have a very large piece of property or have other significant assets.

Other issues or questions to be considered before you add your children to your deed are: do my real estate taxes on the property go up because I lose my veterans, old age, homestead, and/or mortgage exemptions; does my mortgage lender need to approve this type of transaction; does this affect tax treatment of my selling my principal residence tax-free (up to $250,000 if single or $500,000 if married of capital gain is tax-free); and does it achieve my overall estate planning goals of who gets what and how much? Lastly, am I exposing my house to potential creditors of my children?

Thus, the questions "Should I put my kids on my deed?" and "What method do I use to put my kids name on the deed" are clearly not easy ones and should be carefully considered before taking any actions. It is important to ask, what am I trying to accomplish and does the means to that accomplishment have any unintended results I want to avoid?

Once the transaction is complete there are several respective duties of the parties. The Life Tenets have the right to possess and receive all profits from the property, but are responsible for all expenses attributable to the use of the property, including but not limited to real estate taxes, homeowner's insurance (showing the respective interest of the owners on the Certicate of Insurance preferably), and maintenance, but not capital improvements or additions to the property. Normal wear and tear are excepted from maintenance as a normal and expected depreciation of the property when the kids get it upon the survivor's passing, commonly called "Remaindermen." The value of the whole property is calculated using life expectancy tables used by the Indiana Department of Revenue to calculate a percentage assigned to the Life Tenet and to the Remaindermen. This percentage would be used to determine value if there were a fire or

condemnation action and the property interests of each party to the warranty deed had to be determined. Lastly, the Tenet could not cause damage to the property that would amount legally to "waste." If so, the Remaindermen could institute a law suit to enjoin or stop such waste. If the parties could not agree on any issue, each would have to right to bring a partition law suit and the Court would then either equally divide the subject property, or order it sold a public auction to the highest bidder. If the Remaindermen wanted to sell their interest, it would be subject to the Life Tenet's interest, so probably not a significant value or market because it is essentially a minority interest, with few practical methods to enforce one's rights short of taking court action and incurring attorney's fees.

Thus you can see that before one were to act in this manner, sound legal counseling would help alleviate unintended results or problems for not knowing what may or may not happen.

Sound legal and accounting and tax advice are always recommended before real estate deeds are executed.

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