Should I Create a Life Estate?

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What Is a Life Estate?

Life estates are most commonly used with real estate and are created by the owner of the property. If you own your home, you are considered the life estate tenant. As the life estate tenant, you may convey your property to another individual(s) and retain a lifetime right to use and occupancy of the property. Upon your death, full ownership of the property automatically transfers to the individual(s) who have the remainder interest in the property.

How Do I Create a Life Estate?

Creating a life estate is generally straightforward. As the owner, you simply transfer title to the property to another person(s) via a quit claim deed wherein the deed language defines your right to use, possess and control the property during your lifetime. For example, the deed may contain a clause reading: “Reserving unto the Grantor a Life Estate in the Property conveyed hereby.”

As with most things in life, there are advantages and disadvantages to creating a life estate. Analyzing the pros and cons relative to your circumstances is essential before completing any property transfer.

What Are the Pros of Creating a Life Estate?

Principally, probate avoidance and medical assistance planning are the central advantages of creating a life estate.

Upon your death, as the life estate holder, the title to the property is transferred to the individual(s) who you have designated as holding the remainder interest in the property. Most importantly, this transfer occurs automatically and without the need for probate. Those who hold the remainder interest will only need to record an affidavit of survivorship to complete the transfer of title. This allows a smooth transition of ownership following your death. Most commonly, if transferring the property to family members, there can be no issue as to who will own the property as the initial life estate deed clearly defines the designation.

The transfer of the property to the person(s) who are deeded the property is considered a completed gift/transfer. In New York, there exists detailed regulations that specify the value of the property transferred and the value of the retained life estate of which the decedent held. The value of the life estate is significant in instances where the property is sold prior to the death of the person holding the life estate. The value of the life estate is also important to determine the amount that can be claimed as a lien against the property if the life tenant receives medical assistance prior to death. *See below for more details*.

The value of a life estate is calculated by taking the value of the property and multiplying it by the life estate factor/rate. The value of the remainder is found by taking the resulting life estate value and deducting it from the value of the property. The remainder rate is the value that determines the divestment subject to penalty.

Why is this important to consider? For example, if you are 85 years old and deed away your property to your children that is worth $200,000, the value of the life estate to the life estate tenant is approximately $70,718.00 and the value of the remainder is $129,282.00 (click here to contact for details on Life Estate and Remainder Interest table). If you require Medicaid within five years of recording the life estate deed, this results in a $129,282.00 transfer penalty. If this is done outside of the five-year look-back period, there will be no penalty.

Depending on your circumstances, medical assistance planning can best be achieved via creation of a life estate. But it may not be the only option. For example, property can be titled in fee simple or have multiple owners with rights of survivorship. Again, seeking the guidance of legal and tax professionals to analyze the pros and cons relative to your situation is crucial before taking any affirmative steps.

What Are the Cons of Creating a Life Estate?
Understanding the downfalls of creating a life estate will allow you to efficiently plan for both your present and your family's future. The following list of potential adverse consequences for creating a life estate is not dispositive but will highlight common issues for consideration.

If you wish to sell your property but previously transferred your property to your children and retained a life estate, your children must agree to the sale. By selling your property you are extinguishing their remainder interest. This is common when people get older and wish to downsize. This exemplifies the importance of efficiently choosing who you transfer your property to. In the event you wish to downsize and purchase another property, there is always the option of creating another life estate to benefit your children.

In the event any of your children whom you have conveyed your property to suffer from financial difficulties and have a judgment or lien against them, it is possible those hardships can become a lien on your property. In essence, your child's financial problems become yours. This can extend to marital issues that end in divorce because their remainder interest may figure into your child's property settlement.

As detailed above, when you create a life estate, a gift is automatically made to your children in the form of a remainder interest. This gift disqualifies you for medical assistance such as nursing home bills for the then applicable five-year look back period. Sufficient cash assets must be reserved to pay for nursing home care during that time.

If you are receiving medical or nursing home care and the property is sold, it will be required that you use a portion of the sale proceeds to pay for your nursing expenses. The percentage is determined by the regulations as described above. Further, if you are receiving medical assistance upon your death and your medical bills are not fully paid, a lien can be placed against your property that is equal to the value of your interest in the property on the date of your death.

As this list is not exhaustive, disadvantages may include taxable gain considerations, sale of your property during your lifetime and the elimination of a step-up basis for your children, difficulties surrounding the probate of predeceased child and the restructuring of a remainder interest, and disagreements concerning the maintenance and improvements of the property during your lifetime. If you or someone you know is interested in speaking to a trust & estates professional, please contact one of our qualified trust & estates practice team members at Lippes Mathias. Click here to view our team.

Conclusion

By creating a life estate, you are giving up control of your property and the individual(s) who you designate as holder(s) of the remainder interest will see the benefit. An informed decision after discussing the above factors is the only way to efficiently plan and protect your present and your family's future.