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Transferring the Home

Occasionally clients inquire about transferring their homes to their child or children. Sometimes this question is inspired by friends who have made such a transfer. Generally, people have two very different reasons for transferring a home: Medicaid planning and estate tax planning.

Medicaid Planning: Some clients wish to ensure that the value of their homes will be protected in the event they require long term care. In virtually every case, the transfer of the house to an irrevocable trust will be a better alternative than an outright gift of the house to the children. First, an outright gift of a house is subject to the uncertainties that can occur in the lives of the recipients. If, for instance, a child who is the recipient of the parent's home has credit problems, or is found liable in an unanticipated lawsuit, or divorces, or dies before the parent, the property may wind up in the hands of someone other than those whom the client would have intended. Another drawback to outright gifting of a house is the capital gains tax consequence and the potential loss of the step-up in basis [See article on Capital Gains Tax also in this issue]. If the house is transferred instead to a Medicaid trust, the transfer to the children will not be complete until after the death of the parent. This will eliminate the capital gains tax issue and ensure that the house winds up in the hands of the intended beneficiaries. Note: we have discussed in recent issues of **A Step Ahead** that a transfer of the house, either to a trust or to the children, will result in a period of ineligibility for Medicaid benefits that could be as long as sixty (60) months.

Estate Tax Planning: Estate tax is the highest tax our government currently imposes (as high as 45%). A client whose estate is in excess of \$2,000,000 faces the prospect of having that excess exposed to both federal and state estate tax. Transferring assets out of the estate during lifetime, by the implementation of gifting strategies, will minimize or eliminate the estate tax. But a direct gift of the house to the child or children does not accomplish that result. One gifting strategy is to implement a Qualified Personal Residence Trust (QPRT) which enables a house to be

transferred at a discount of its value. Under the terms of the QPRT, the client retains the right to remain in the house for a specified period of years or for life. At the end of the term, the Trust terminates and the beneficiaries named in the Trust become the owners of the property. Because the child or children do not immediately benefit from the “gift,” its value to them is less than the actual value of the property. This is important because the value of the gift for gift tax purposes is based upon its value to the beneficiaries, not the value as of the date of the transfer. Thus, a valuable asset in an otherwise taxable estate can be gifted at a fraction of its value. The longer the term of the Trust, the longer the beneficiaries must wait to benefit from the ownership of the property, the greater the discount for gift tax purposes. However, the anticipated benefit of a lengthy term must be tempered by the fact that the value of the property will still be included in the estate of the client if the client dies before the completion of the term. Also, after the term expires, the step-up in basis will be lost, resulting in a capital gains tax if the property is sold at a profit. This still results in a net benefit to the family since the estate tax rate is much greater than the capital gains tax rate. In contrast, if the property is transferred to the beneficiaries after the death of the client, the capital gains tax is eliminated provided that the property is sold soon after the client’s death.

If either of these strategies is pertinent to your situation, do not try to implement this planning on your own. Consult with a qualified attorney who can assist you.

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