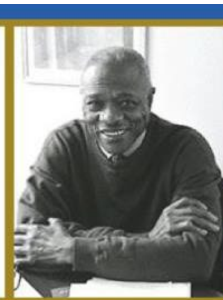




GRIMALDI YEUNG LAW GROUP

652 Fourth Avenue, Brooklyn, NY 11232
45 Rockefeller Plaza, 20th Floor, New York, NY 10111 | (718) 238-6960 | Fax (718) 238-3091 | www.gylawny.com


# Understanding the Step-Up in Basis and Life Estates After Someone Passes

When a loved one passes away, dealing with the estate can bring up many questions, especially when real estate property is involved. Often the inherited property was purchased many years prior and has appreciated during the decedent's life. One of the most important (but often misunderstood) tax rules is the cost basis of this inherited property.

**What's a "Step-Up in Basis"?**

When you inherit property—like a house, land, or investments which have appreciated in value, the IRS allows you to "step up" the value of that asset to its **fair market value at the time of the original owner's death**. This is the value called "cost basis", that is used to calculate any capital tax gained owed on a future profit from a sale.

**Real-life example:**

Let's say your parents bought a house for $100,000 years ago. At the time one passed away, the house was worth $400,000. If you sell it shortly after inheriting it, you only pay capital gains tax on any profit received on sale **above $400,000**, date of death value, not the original $100,000 he paid. That's a huge tax break!

**What Is a Life Estate?**

Often an individual may wish to gift real estate or appreciated property in life, but does not want to forfeit the chance to "step-up" the cost value possible when the property passes at death. The technique to use is a gift with a "life estate". Gifting property subject to a life estate gives two or more people each an ownership interest in a property, but for different periods. The person holding the life estate – the life tenant – possesses the property during their life. The gifted owner – the remainderman, who has a current ownership interest, and continues to have the full title to the property, but will not take possession until the death of the life estate holder.

The life tenant retains full control of the property during their lifetime. They also have the legal responsibility to maintain the property and the right to use it, rent it out, and make improvements to it.

## Advantages of a Life Estate Deed

Life estates can be an excellent planning technique in many circumstances. For example:

- If a parent passes ownership of their homes to their children while retaining a life estate, they have absolute possession of the property during their lives
- By executing a life estate deed, the property would avoid probate at the parents' deaths as it passes to the remainder person at their death
- A life estate deed also protects the property from a Medicaid lien as it's ownership is no longer in the Medicaid recipient's name
- The transferred property receives a step-up in tax basis.

Therefore, life estates can prove to be an excellent tool for both estate tax planning and Medicaid planning.

## Qualifying for Medicaid After House Transfer

Giving away an interest in property would disqualify you from receiving assistance from Medicaid should you require long-term care within five years of the transfer. A transfer of a home is a Medicaid disqualifying transfer and will result in a penalty calculation and a delay in eligibility. Even a gift deed with a life estate creates Medicaid ineligibility.

In addition, if the remaindermen were to sell the property while the life tenant is in a nursing home receiving Medicaid benefits, the Medicaid program would have a claim against the Medicaid recipient's share of the proceeds for payments made to them. (The share of the proceeds allocated to your children would be protected.)

## Other Ways to Retain and Interest in Property and Secure a Step-Up in Cost Basis for Capital Gains Savings

Using a Trust as an alternative to Life Estate Deed is an additional way to receive a step-up in basis at death. Any Trust, Revocable or Irrevocable can hold title to properties such as the family home. A deed can be signed transferring the title to a Trust and the Trust can outline and describe who and how the Trust beneficiaries may use and enjoy the property, similar to the life tenancy. A Trust can be very descriptive and detailed in describing the use of the property not available in a gift deed. A Trust can protect the life tenant's rights, describe the care and maintenance and establish who will receive the title at the end of the Trust's term. It can be very comprehensive. NOTE: Only an Irrevocable Trust can provide the additional Medicaid asset protection and must be carefully drafted to remove title from the potential Medicaid recipient's control and cannot revert back to the original owner.

## How to Analyze Whether a Life Estate is Part of the Inherited Real Estate

If you're an heir or executor dealing with inherited property, here are a few steps to take:

1. **Review the deed** – Was the deed transfer an outright gift, or did the person keep any rights to use the property, for example a life estate.

2. **Gather evidence** – Receipts, utility bills, or notes showing continued use/control of property.
3. **Consult with a tax professional** – These situations can be complex, and getting proper advice can save you in taxes.
4. **Consider filing IRS Form 706 Estate Tax Return as Part of the Gift/Life Estate Plan** – Even if not required, this tax reporting can help support that the decedent held an interest in the inherited property at death of the life tenant in the deed.

**Final Thoughts**

Inheritance law and tax rules can feel overwhelming, but knowing how concepts like the "step-up in basis" and "life estates" can provide tax savings and be very useful. If a loved one left you property and they continued to use it until their death—even after putting your name on the deed—you can still qualify for valuable tax benefits.

**Consult With Our Firm's Estate Planning Attorneys**

As with most planning tools, a life estate can prove useful and have several valuable benefits, but it might not be right for everyone. In many cases, the potential problems can outweigh the benefits. As the law in this area is complex, it's important to talk to our firm's attorneys who have extensive knowledge in this area and are willing to help you analyze the best way to gift your appreciated and valuable asset to secure the best tax advantages, and to integrate this gift into your long range probate-avoiding and asset protection plans including future Medicaid eligibility.