THE HERITAGE LAW CENTER

TRUSTS • ESTATES • FAMILIES

# BBA Practice Fundamentals

## Estate Planning with Real Estate

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# Why Real Estate is Important to Estate Plan

- Emotional significance to family
- Large asset in most estates
- Can have large gain – tax implications
- Client may have multiple properties

# Common Ownership Types

- Individual Ownership
  - Need to consider lifetime assistance needs (DPA) and eventual transfer plan
- Joint Tenants
  - when one owner dies, full ownership transfers automatically to the survivor -- can cause unintended distribution issues
  - co-owner's creditors can attach to property
- Tenants in Common
  - each owner's share considered separate property
  - Each ownership interest will be distributed as directed in his or her will
- Tenants by the Entirety
  - available only between spouses
  - Both spouses must agree to conveyance
  - Creditors of one spouse can not attach

# Common Ownership Types

- Life Estates
  - Ownership split between Life Tenant and Remaindermen
  - life tenant has full control during life over everything but selling or mortgaging, also has the legal responsibility to maintain the property.
  - In the event of a sale, the remaindermen would receive a portion of the proceeds based on tables that factor in the life tenant's age and current interest rates.
  - Avoids probate and gets stepped up basis

- Trusts
  - In many trusts Grantor retains RE in estate for tax purposes, heirs get step up
  - Trust assets avoid probate and are handled privately by successor Trustee
  - Can be set up to provide creditor protection for heirs
  - Can provide for special circumstances, such as disabled child, minors, spendthrifts, etc

- LLCs
  - Often used for rental or investment property
  - LLC protects the personal assets of the members against claims related to the property.
  - LLC should get commercial insurance to protect the property itself from being subject to claims made directly against the LLC.
  - Ownership interests can be transferred without public record, BUT beware of due on sale clauses – DE and RI statutes more clear
  - Fractional interests can be gifted easily BUT MA LLCs may have issue with fractional interest discounting
  - Must follow corporate formalities and file annual report
  - Can reduce MA estate taxes for out-of-state clients

# Post-Mortem Transfers

- Intestacy laws serve as a base line
- RE devised by Will = Probated <u>where the RE is located</u>
  - Subject to creditor claims
  - May need License to Sell if powers not included in the Will
  - Estate Tax Affidavit filed to clear title
  - Heirs receive asset with stepped up basis
- Life Estates
  - Remaindermen become owner of RE automatically upon death of life tenant
  - Probate is avoided and heirs get stepped up basis
  - If Medicaid lien on RE, disappears at death of life tenant

- Trust-owned RE
  - Trustee automatically authorized to manage or dispose of RE per terms of Trust
  - RE is stepped up to date of death if included in Grantor’s estate
  - Assets in Trust avoid probate
  - Creditor protection for heirs possible with third party Trustee
  - Right of refusal often used where multiple beneficiaries involved

# Life-Time Transfers

- Sale for Fair Market Value
  - Can exclude up to $250,000 of your capital gain from tax. For married couples filing jointly, the exclusion is $500,000.
  - must have owned and lived in your home as your principal residence an aggregate of at least two of the five years before the sale. You can claim the exclusion once every two years.

- Gifting
  - Adding name to deed ($1 Deeds) = Gift of 50% of RE
  - annual $14,000 (individual) gift tax exemption plus a lifetime gift and estate tax exemption of $5.25 million
  - Recipient gets no step up on gifted portion – carry over basis
  - Client removes asset from estate BUT loses control over what they do with asset
  - If recipient dies, assets distributed by THEIR estate plan and if divorced or sued, assets are available to THEIR creditors

# Tax Considerations

- Capital Gains
  - **Basis** = what you paid for a property plus capital improvements
  - **Gain** = the difference between what you paid for the RE and what you sold it for or FMV at transfer
  - **Step-up** in **basis** is the readjustment of the value of an appreciated asset for tax purposes upon inheritance, value of the asset is FMV at date of death of owner, not the value at which they purchased the asset.
    - Inherited RE gets stepped up basis
    - Jointly held property can have half stepped up basis after death of first owner
  - **Carry over basis**: recipient gets the same basis the giftor had

# Tax Considerations

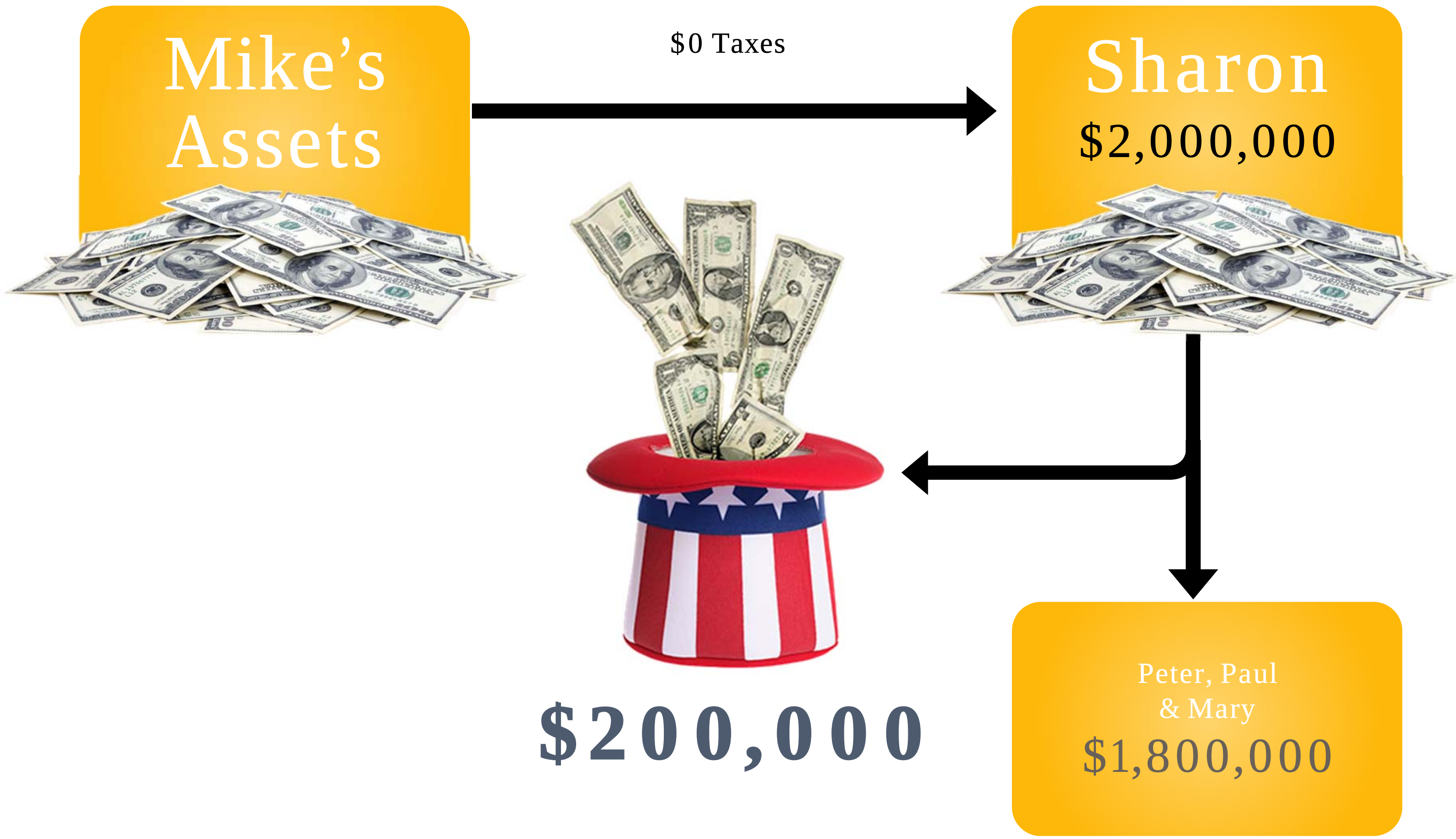
- Gift Taxes
  - annual $14,000 (individual) gift tax exemption plus a lifetime gift and estate tax exemption of $5.45 million
  - BUT annual exclusion is just a filing threshold, no taxes imposed if under Fed exemption
  - No MA gift taxes
  - Gift loses step up opportunity, but may be worthwhile to reduce estate with RE that is not highly appreciated

## Tax Considerations

- Estate Taxes

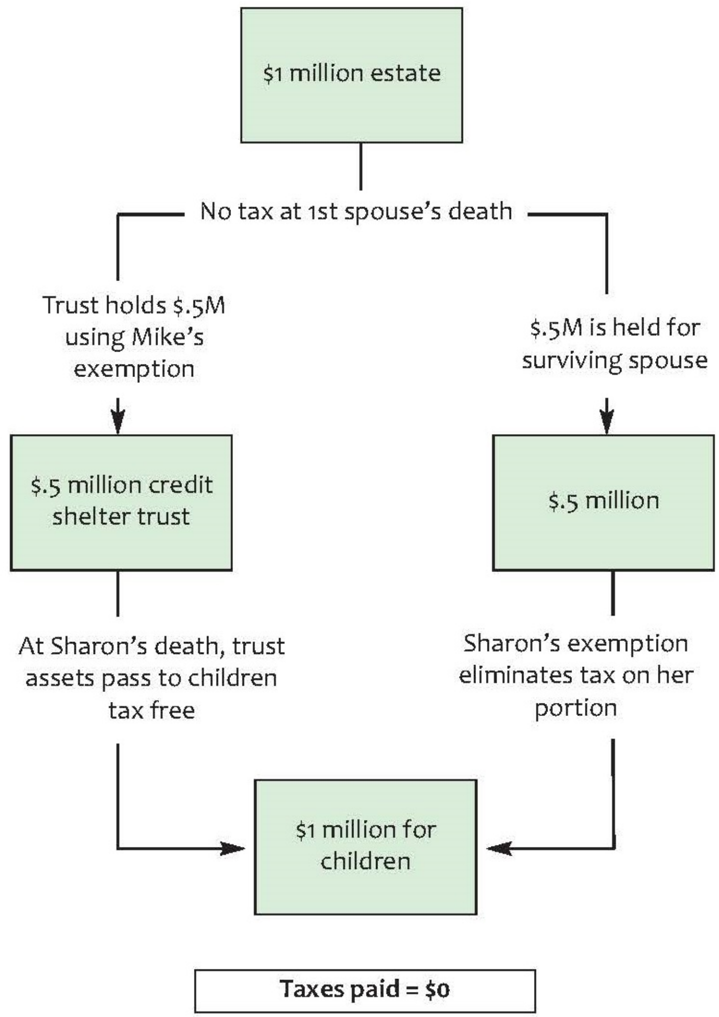
| Year | Massachusetts | Federal |
|---|---|---|
| 2012 | $1,000,000 | $5,120,000 |
| 2013 | $1,000,000 | $5,250,000 |
| 2014 | $1,000,000 | $5,340,000 |
| 2015 | $1,000,000 | $5,430,000 |
| 2016 | $1,000,000 | $5,450,000 |

# The Estate Tax Dilemma



# Avoiding Estate Taxes with Credit Shelter Trust

We use Mike's Exemption




Plus Sharon's Exemption

# Avoiding Estate Taxes with QPRTs

- QPRTs
  - With a Qualified Personal Residence Trust, or "QPRT“ client transfers residential property to an irrevocable trust while continuing to use the residence rent-free for a term that they are likely to survive.
  - During the fixed term, they continue to pay expenses and deduct real estate taxes
  - When the fixed term ends, the residence may be held in further trust for the named beneficiaries or distributed outright to them.
  - Client can continue to use the rent the property – must have proper lease
  - Initial transfer is a taxable gift but the value of the gift is reduced by the value of the retained right to live in the residence for the fixed term. Thus, the amount of the taxable gift will be substantially less than the fair market value of the residence.
  - Reduces estate tax exposure BUT client must survive term, loses ownership rights and no step up for beneficiaries

# Asset Protection from Creditors

- Homestead Protection
  - protects the equity in your residence in the event a lawsuit is brought against you
  - MA home owners automatically provided with protection up to $125,000
  - recording a homestead declaration increases protection up to $500,000
  - individuals over the age of 62 (elderly) or legally disabled can each file increasing protection to $1 million
  - Does not protect from state agencies

# Asset Protection from Medicaid (MassHealth)

- Federal and Massachusetts program that pays for nursing home care
- Must meet strict asset and income guidelines: $2,000 per Applicant or $121,220 for couple with community spouse
- Primary residence not considered in asset limit ($828,000 equity cap ) but other RE is
- Lien will accrue on residence for amount paid by MassHealth, paid when house is sold or transferred

# The “Look-Back Period”

## Medicaid Transfer Rules

- DMA will look back 60 months (5 years) for <u>all</u> transfers
  (prior law: DMA would look back 36 months for transfers made from the Applicant to an individual)

- <u>Community Based Programs DO NOT Penalize for Transfers</u>

# Transfer Options – Irrevocable Trusts

## Irrevocable Trusts

- Avoids probate – assets managed privately by your Trustee
- Can structure inheritances (percentages over time) or create additional control mechanisms
- Can offer creditor protection to your heirs – divorce, creditor claims, bankruptcy etc.
- Can be used to plan for special circumstances such a child with dependency issues, spendthrift or disabilities
- **Can protect assets from Long Term Care costs if drafted correctly BUT currently being challenged**

# Transfer Options – Irrevocable Trusts

- Must not have access to trust principal, but generally you do have access to income (this makes the income available should the person need long term care, but also allows them to use this to help with their expenses)
- Since there is no access to principal you want to make sure you are transferring assets you do not need immediately
- Need to name 3rd party as Trustee, can be a beneficiary
- 5 Year Wait period for Nursing Home Care

# Transfer Options

- Life Estates
  - Lien still accrues against property BUT lien canceled after life tenant dies
  - If house is sold prior to life tenant death, lien gets paid and proceeds allocated to life tenant could disrupt eligibility
  - Often requires remaindermen to assist in management while life tenant is in nursing home

- Long-term care insurance
  - Policy meeting state requirements avoids lien on residence
  - Must cover nursing-home care for at least 730 days;
  - pay at least $125 per day for nursing-home care; and
  - not require an elimination period (days that services must be provided before your policy will begin to pay) of more than 365 days, or in lieu of a waiting period, a deductible of more than $54,750.

## Thank You!

Questions?

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