

Reprinted from

The New York Times

Real Estate

January 2, 2005

Transferring Title in a Home to the Children

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AGING homeowners often transfer title in their cherished family home to a child or children long before the parents die. That kind of estate planning, which seeks to protect the home from claims for end-of-life medical expenses or nursing-home costs covered by Medicaid, is permitted, with certain restrictions, by Medicaid regulations.

But in most cases, estate-planning experts say, simply deeding a home to children can end up being frustrating for the parents, who lose control over the property, and costly for the children, who could wind up paying significant capital gains taxes when they sell. There is a way, however, for parents to accomplish their estate-planning goals while retaining some control and minimizing the tax the children will ultimately have to pay.

Alexander A. Bove Jr., an estate-planning lawyer in Boston and author of "The Medicaid Planning Handbook" (Little, Brown, 1992), said that under current law, people with insufficient funds may be eligible to have their long-term nursing home care covered by Medicaid. But if the individual owns a home, Medicaid can place a lien on it to recover benefits paid.

As a result, Mr. Bove said, some homeowners try to shield the home from potential Medicaid liens by transferring ownership, usually in the form of a gift, to their children or other loved ones. But under the laws governing Medicaid, such transfers are subject to a three-year "look-back period."

This means that if the transfer takes place less than three years before Medicaid benefits are sought, there is a waiting

period before benefits can begin. The waiting period, Mr. Bove said, is calculated using a formula that takes into consideration how much the asset was worth and how recently the transfer was made.

Deeding a property to children accomplishes two purposes: it immediately shields the property from a future Medicaid lien and it starts the three-year Medicaid clock ticking. But simply deeding the property can have some drawbacks.

Cormac McEnery, an estate-planning lawyer in City Island in the Bronx, said that once a home is deeded outright - or "in fee simple" - to a child or children, the parent loses legal control over it. So if a child has a falling out with the parent, there is nothing the parent can do to redistribute ownership among the remaining "loyal" children.

A standard "fee simple" conveyance of the property as a gift can also have negative tax implications for the children. Mr. McEnery explained that if a parent conveys a home to a child as a gift, the child assumes the parent's tax basis, which is used to determine the taxable capital gain when the home is sold.

So, if the parent bought the home for \$100,000 in 1975 and the child ultimately sold the house for \$500,000 without owning and using it as a primary residence for two years and thus getting a tax break, the taxable gain would be \$400,000 (less any improvements). At the current federal capital gains tax rate of 15 percent, the child would have to pay \$60,000 in federal taxes on a \$400,000 gain and would probably be responsible for state capital gains taxes as well.

But Mr. Bove, the Boston lawyer, said that by including what is known as a "special power of appointment" clause in a deed, a homeowner not only retains control over who will ultimately own the home but also shields the home from potential Medicaid liens, starts the three-year Medicaid look-back clock ticking and eliminates the capital gains tax problem for the children.

With a special power of appointment clause, Mr. Bove said, a homeowner transfers title to the home to whomever he wants - usually the children - while retaining the right to change his mind and redistribute the ownership interest or retitle the property to someone else, either during his lifetime or through his will.

For Medicaid purposes, Mr. Bove said, such a transfer is considered a completed transfer. But for tax purposes, since the parent reserves the right to change his mind and retitle the property to someone else, it is considered an "incomplete transfer," which becomes complete only on the death of the parent. And when that occurs, the children benefit from a stepped-up tax basis - equal to the market value of the property at the time of the parent's death, rather than the original acquisition cost.

Peter Brogan, head of the legal department at the Judicial Title Insurance Agency in Manhattan, said that if the special power of appointment clause is properly drafted, the strategy will pass muster not only for Medicaid and federal and state tax purposes but for title insurance purposes as well.

"The language used in the clause must be precise," Mr. Brogan said. "Always consult an experienced elder-care lawyer