

The Benefits and Drawbacks of Reserving a Life Estate

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Your home is often your most important asset. Many families want to protect this asset from the high cost of nursing home care. When nursing home care is not imminent, a common planning technique is to deed the home to a loved one, typically your adult child(ren), and reserve a life estate for yourself. This transfers ownership to your child(ren) (remainderpersons) while giving you (the life estate holder) the right to live in the home for the rest of your life. If you make it through the five-year Medicaid (MassHealth in Massachusetts) lookback period and retain ownership in the house until your death, then the house value is protected from having to pay for your nursing home costs.

Sounds like reserving a life estate is a good idea...or is it? Let's look at the benefits:

Living Rent-Free

The life estate provides you with an absolute legal right to use the house, rent-free, for the rest of your life. When you pass away, the right of occupancy passes to the remainderpersons (your child(ren) or whomever you transferred ownership to).

Collect Rental Income

Another clear-cut advantage is that the life estate tenant is

entitled to all the net rent. For example, if you move to another living situation such as an assisted living community, you can benefit from renting out the property and receive all the net rent without sharing it with anyone.

Avoid Probate

Once you as the life estate holder passes, title passes by operation of law to the remainderpersons. With respect to the property, probate is avoided, and no court proceedings are necessary. Your family saves thousands of dollars in legal expenses and court costs.

Home is Protected from Nursing Home Expenses

Once you make it through the five-year lookback period, MassHealth cannot recover against the home – if you continue to hold onto the property until the time of your death. Since probate is avoided, the property is not considered an estate asset subject to MassHealth recovery. This means that if MassHealth has a claim against your estate for nursing home expenses, the Commonwealth will only be able to seek reimbursement from your other probate estate assets, if any.

Of course, there are other elements of reserving a life estate that may not be seen as benefits and more like disadvantages. Here are some limitations to consider:

Loss of control

A significant issue with reserving a life estate is the loss of control. You cannot sell or mortgage the home without the consent of the remainderpersons (your child(ren) or beneficiaries). This includes obtaining a reverse mortgage to provide needed cash flow in your retirement years. The remainderpersons, however, can mortgage the home, refinance, or even sell it (subject to your life estate) without you having any say.

You are still responsible

As the life tenant, you are still responsible for all household expenses, including but not limited to, property taxes, water/sewage charges, condo fees (if applicable), special assessment fees.

Your net proceeds are limited if the home is sold during your lifetime

If the home is ever sold during your lifetime, you are only entitled to receive the proceeds attributable to the Life Estate value and nothing else. Currently, there is a no clarity regarding how the value of your life estate will be calculated. The IRS uses one method, and MassHealth uses another. This can cause major issues should you want to become eligible for MassHealth long-term care benefits.

The home is subject to a remainderpersons' creditors

If one of your children/remainderpersons files for Chapter 7 bankruptcy, gets sued, gets divorced, your home may be reachable by these creditors who could try to force the sale of the home. Also, if your child(ren)/remainderpersons predeceases you, you can suddenly own the home with someone you did not expect to.

No changes

Once you sign the deed transfer reserving a life estate for yourself, you cannot undo the transfer or change the beneficiaries. On the other hand, setting up an irrevocable trust would permit you to change the beneficiaries by reserving and exercising a Special Power of Appointment in the trust.

Deciding whether to reserve a life estate takes careful consideration and knowledge of both the pros and cons. If your goal is to protect your home from nursing home costs, working

with an experienced elder law attorney is essential.

The information contained in this article is not intended to make you an expert on estate planning nor is this article intended to replace the need for the advice of a professional. Rather, this article is simply intended to provide a basic understanding of why estate planning is important for everybody and a basic understanding of some of the more common estate planning tools. This article does not constitute legal advice.