

# Life Estate Deed: Pitfalls and Considerations

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Clients commonly seek the advice of an elder law attorney so that they can protect and preserve their assets for their loved ones. Often, a client's largest asset is his or her home. There are a variety of estate planning tools available to accomplish the client's goal of protecting his or his home while ensuring that it is left to his or her loved ones. One such tool is a life estate deed. Although a life estate deed has its benefits, the attorney must also consider its drawbacks in relation to the client's personal circumstances before determining if it is the best plan for the client.



Deidre M. Baker

often wary of the cost in preparing a trust document or may be intimidated by its language.

In addition, the life tenant has the right to collect all rental income during his or her life, akin to a Medicaid trust. The life tenant also enjoys the absolute right to reside in the property for the remainder of his or her life. The life estate also ensures that the life tenant retains any and all STAR exclusions and veterans' exemption for real estate tax purposes. Furthermore, the

remainderman receives a stepped-up basis in the value of the property at the death of the life tenant, obviating the concern for capital gains taxes upon sale or transfer.

#### What is a Life Estate Deed?

A "life estate" refers to a present ownership interest in a piece of real property for the duration of an individual's life. The owner of the life estate is sometimes referred to as a "life tenant." The life tenant retains the ability to remain in the property for the remainder of his or her life.

The creation of a life estate is a relatively straightforward process. The property is conveyed by the grantor(s) to at least one other party by deed and includes special language allowing the grantor to retain a life estate in the property. The life estate deed establishes two forms of ownership for the same property: the life estate and the "remainderman's" interest. The remainderman has a future interest in the property. The remainderman will acquire full ownership of the property upon the termination of the life estate which typically occurs upon the death of the life tenant.

The life estate has a financial value that is calculated based on the life tenant's life expectancy and the fair market value or sale price of the property. As the life tenant's age increases, the value of the life estate decreases, and the remainderman's interest increases. Upon the death of the life tenant, the life estate is extinguished and the remainderman owns a fee simple interest in the property.

It is important to note that a life estate is more than a mere right to occupy the premises. While the life estate is not a form of fee ownership, the life tenant is the owner of the property and is entitled to all of the rights and obligations associated with ownership.<sup>1</sup> Courts have traditionally held that the life tenant, for example, is required to make necessary repairs, pay taxes, and prevent waste in the property.<sup>2</sup>

#### Benefits of a Life Estate Deed

There are several reasons why a life estate deed is an attractive estate planning vehicle for many people. First, the cost of preparing and filing a life estate deed is less expensive than executing a Medicaid trust, for example. Often, clients find life estate deeds to be cost-effective and ready faster than a Medicaid trust. While trusts can take weeks to prepare, review, and finalize, a deed and the supporting documents can take an estate lawyer a mere few hours to prepare.

Another benefit of a life estate deed is that it allows the property to pass outside the probate process. The remainderman automatically takes full legal ownership of the property upon the death of the life tenant. The property can be sold or transferred without waiting for the appointment of an estate representative. This same goal can be achieved with a Medicaid trust, but clients are

#### Drawbacks to a Life Estate Deed

While there are obvious benefits to a life estate deed, clients can also experience unforeseen pitfalls when these deeds are executed. Many individuals use life estate deeds to avoid probate and reduce the costs of administering the estate at death. Unfortunately, when someone uses a life estate deed, they risk losing control over the distribution of their property when things turn out differently than expected.

Most important, a life estate deed makes the grantor's financial interest in the property vulnerable to adverse circumstances of the remaindermen who often are the children of the life tenant. For example, if one of the remaindermen goes through a divorce, files bankruptcy, or has creditor issues, it is possible that a lien could be filed against their interest in the life tenant's property.

Another downside of a life estate deed often not considered at the time of transfer is that all of the owners, including the remaindermen, must agree to a future sale. Upon the creation of the life estate, the life tenant loses the right to solely control when and if the property is sold. If one of the remaindermen refuses to sign the deed or participate in the sale, the life tenant will be required to initiate a partition action in order to force a sale. Not only can this create family discord, but it could result in delays, additional legal proceedings, and potentially losing a prospective buyer who does not want to wait for the proceedings to be finalized.

In addition, there are potential tax consequences that may have not been considered at the time of the transfer. For example, if the home is sold during the life of the life tenant, he or she may not qualify for the full \$250,000 capital gains tax exclusion (\$500,000 if married and filing jointly). Rather, the life tenant would be entitled to a partial qualification relative to the value of the life estate. Additionally, the remaindermen are entitled to no tax exemptions, making the property as a whole more vulnerable to capital gains tax liability.<sup>3</sup>

Another common issue encountered with life estate deeds which is sometimes overlooked, is the impact that the deed transfer can have on the life tenant should he or she need long-term care in the future. In the event that a life tenant requires nursing home care within five years of establishing the life estate, Medicaid will consider the conveyance to the remaindermen as an uncompensated transfer and impose a penalty period. During the length of the penalty period, Medicaid will not finance the cost of the nursing home

## Hon. Norman St. George, Administrative Judge of Nassau County, Receives Prestigious Norman F. Lent Memorial Award



(L-R) Hon. Norman St. George and F. Scott Carrigan, President of the Criminal Courts Bar Association of Nassau County

Hon. Norman St. George, Administrative Judge of Nassau County, was honored with the *Norman F. Lent Memorial Award* presented by the Criminal Courts Bar Association of Nassau County. The prestigious award was presented by the organizations President, F. Scott Carrigan, at the Association's Annual Dinner Dance on Thursday, January 23 at the Fox Hollow in Woodbury.

The award is presented each year to an individual who through actions and deeds has consistently maintained the highest standards of the legal profession. Judge St. George was recognized for his extraordinary and efficient leadership of the Nassau County Courts, his fairness, compassion, and judicial temperament.

As Administrative Judge of Nassau County, Judge St. George oversees the operations of all the courts in Nassau County, with direct supervision of nearly 90 judges and more than 900 non-judicial employees.

## DEED ...

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care, resulting in a large nursing home bill for the family. Additionally, if the property is sold within five years of the life tenant requiring nursing home care, Medicaid will treat the life tenant's share of the proceeds as an available asset. This can impact Medicaid eligibility for the life tenant and require that some of the proceeds be spent on nursing home care.<sup>4</sup>

### Alternative to Life Estate Deed

An alternative to the life estate deed is to transfer a client's property to a Medicaid trust. A Medicaid trust can be drafted to allow for all the benefits that a life estate deed provides, such as a stepped-up basis in the value of the property, while also avoiding the potential risks associated with a life estate deed. For example, property owned by a Medicaid trust, rather than the life tenant and remaindermen, is protected from potential creditors of a beneficiary and can make Medicaid eligibility simpler. Furthermore, the trustee of a Medicaid trust is in full control of the property and does not require the approval of others to sell the property.

A Medicaid trust, also referred to as an irrevocable trust, is commonly thought of as an instrument that is inflexible or rigid. During consultations, clients often refer to loss of control as a main deterrent to moving forward with this type of estate plan, however, this is a common misconception. A Medicaid trust may enable individuals to retain a significant degree of control over assets during their lifetime, while providing for protection from creditors, such as Medicaid, and reducing tax liability for his or her heirs at death. Putting assets into an

*A Medicaid trust may enable individuals to retain a significant degree of control over assets during their lifetime, while providing for protection from creditors*

irrevocable trust also may help to reduce the risk that a child's creditor or ex-wife will take the assets while the couple is alive.

As with all estate planning, a client's specific circumstances must be evaluated to determine what plan best suits him or her. Some important considerations for determining which estate plan makes sense for a client includes the client's finances, the client's family dynamics, and whether the client will require long-term care in the future. Depending on these factors, a life estate deed may not always be the best option for the client.

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1. *Matter of Heintz*, NYLJ (May 21, 1996) at 35.
2. *Matter of Gaffers*, 254 A.D. 448 (3d Dept. 1938).
3. See I.R.S. Publication 523 (2018), *Selling Your Home*, found at <https://www.irs.gov/publications/P523>.
4. See NYSDOH Administrative Directive, *Deficit Reduction Act of 2005 - Long-Term Care Medicaid Eligibility Changes*, 06 OMM/ADM-5 (July 2006), available at <https://on.ny.gov/2ubYT9z>.

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than his or her spouse as the beneficiary, and the policy proceeds will not be included in the net estate.

### Computing the Elective Share

While statutorily straightforward, computing the value of the surviving spouse's elective share and how much the surviving spouse is entitled to can prove complicated at times.

*Example 1:* Husband dies with no will, owning real property as tenants by the entirety with spouse, date of death value is \$450,000; an individual account worth \$24,000 at death; and a brokerage account, transfer on death to his brother, worth \$625,000. Funeral expenses were \$2,500, and estate administration expenses \$6,000.

The net estate value will be \$841,500 (half value of real property + brokerage account value - funeral and estate administration expenses). Note that the total value of the individual account is excluded from the calculation. This is because the individual account vests in the surviving spouse and is not an asset of the estate since it falls under the Exemption for the Benefit of the Family, as a cash exemption.<sup>17</sup>

One-third of the net estate is \$280,500, which is the elective share amount. This amount is then reduced by the assets already passing to the surviving spouse (half value of real property), providing a net elective share amount of \$55,500 due to the surviving spouse. The decedent's brother would be required to pay \$55,000 to the surviving spouse.

*Example 2:* Wife dies with a will, owning real property owned individually worth \$1.1 million at death with an outstanding mortgage of \$300,000, bequeathed to her daughter; life insurance with a death benefit of \$800,000 payable to the surviving spouse; jewelry val-

ued at \$15,000 at death, bequeathed to her daughter; a transfer-on-death account to her brother, worth \$82,000 at death; and a residuary estate consisting of various accounts at financial institutions, worth \$825,000 at death, with two-thirds left to her daughter and one-third to the surviving spouse. Estate administration expenses were \$12,000 and valid debts were \$20,000.

The value of the net estate is \$1,665,000 (total value of real property - value of outstanding mortgage + jewelry + TOD account + residuary estate - \$25,000 cash exemption - outstanding debts - estate expenses). Here, note that the total value of the life insurance death benefit is excluded from these calculations, and that \$25,000 cash value from the residuary estate is also excluded under EPTL §5.3.1(a)(6).

One-third of the net estate is \$555,000, which is the elective share amount. Again, this amount is reduced by the value of the assets already passing to the surviving spouse, which is one-third of the residuary estate, \$266,666.67. The net elective share payable to the surviving spouse would be \$288,333.33. This amount would be payable ratably between the decedent's daughter and her brother.

The actual value of the elective share must be calculated before the surviving spouse determines whether to exercise his or her right of election. The value of the assets received under a will may be higher than the amount that would be received pursuing the elective share. If it is determined that the surviving spouse would receive more under a will, then he or she may request that the court issue an order cancelling the election. The court may only grant such order, however, if there is no prejudice shown to the creditors and other parties interested in the estate.<sup>18</sup>

### Exercising the Right of Election

The right of election is personal to the surviving spouse, with few exceptions. When

authorized by the court having jurisdiction, the right can be exercised by the guardian of the property of an infant spouse; the committee of an incompetent spouse; the conservator of a conservatee spouse; the guardian ad litem for the surviving spouse; and a guardian authorized under Article 81 of the Mental Hygiene Law.<sup>19</sup>

The surviving spouse or such authorized person must file the notice of election with the court within six months from the date of issuance of letters testamentary or administration, but not later than two years after the date of decedent's death.<sup>20</sup> The notice must be served by mail on the personal representative of the estate, or the named executor if the will has not yet been admitted to probate.<sup>21</sup> The surviving spouse can request an extension of time to file, in six-month increments, so long as the original time to make the election has not expired.<sup>22</sup> If the original time to file has passed, then the surviving spouse may submit an application for relief from the default and for the extension provided there is reasonable cause.<sup>23</sup>

Once the notice of election has been filed, a petition to determine the validity of the right of election under Section 1421 of the Surrogate's Court Procedure Act will likely be filed by the personal representative of the estate, along with an order to show cause as to why the determination should not be made that the surviving spouse is a valid spouse and entitled to the elective share. If there is any property not in the hands of the estate representative, the value of which is required to satisfy the elective share, the petition can also request an order restraining the party holding the property from transferring said property. Process needs to issue to all persons interested in the question being posed.<sup>24</sup> For example, if a joint account with Son is held by Chase bank, the order to show cause will enjoin Chase bank from transferring the account and process will issue to both Son and Chase bank.

## Conclusion

New York's right of election statute was enacted to provide a surviving spouse, typically the surviving homemaker wife, at the time, with some means of financial support when the deceased husband disinherited his wife. Although times have changed, the public policy behind the legislation has not.

There are many factors that go into determining whether or not a surviving spouse should exercise his or her right of election. Careful attention should be paid to this statute anytime a surviving spouse is left less than the full estate.

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1. EPTL § 5-1.1-A.
2. *Id.*
3. EPTL § 5-1.1-A(a)(4).
4. EPTL § 5-3.1.
5. EPTL § 5-1.2.
6. The slayer rule stands for the proposition that a person cannot profit from his or her fraud or crime. See *Riggs v Palmer*, 115 N.Y. 506 (1889).
7. In order for a waiver to be valid it must be in writing and "acknowledged or proved in the manner required by the laws of this state for the recording of a conveyance of real property." See EPTL § 5-1.1-A(e).
8. EPTL § 5-1.1-A(b)(1)(A).
9. EPTL § 5-1.1-A(b)(1)(B).
10. EPTL § 5-1.1-A(b)(1)(C).
11. EPTL § 5-1.1-A(b)(1)(D).
12. EPTL § 5-1.1-A(b)(1)(E).
13. EPTL § 5-1.1-A(b)(1)(F).
14. EPTL § 5-1.1-A(b)(1)(G).
15. EPTL § 5-1.1-A(b)(1)(H).
16. EPTL § 5-1.1-A(b)(1)(I).
17. EPTL § 5.3.1(a)(6).
18. EPTL § 5-1.1-A(c)(5).
19. EPTL § 5-1.1-A(c)(3)(A)-(E).
20. EPTL § 5-1.1-A(d)(1).
21. *Id.*
22. EPTL § 5-1.1-A(d)(2).
23. *Id.*
24. See SCPA § 1421.