Should I transfer my home to my children?

This question is asked frequently by older persons concerned that their home might be lost in the event illness requires nursing home placement or when concerns are raised about inheritance taxes. Deciding the best course of action requires some careful consideration and decisiveness on the part of the homeowner.

Initial determinations - To begin consideration of this question, a determination must be made of the present **value** of the home. Many people can make an educated guess of the value of their home based upon the selling price of similar homes in the neighborhood. If this determination is not easy to make, a appraisal can be done or, to calculate the value which will be used by the state, you can use the new Erie County Assessment figure effective on January 1, 2013. This number which is the presumptive fair market value beginning in 2013 will need to be adjusted as time goes on. The state calculates a number which has to be multiplied by the assessed value to determine the fair market value. This multiplier, called the common level ratio, changes each year on July 1, and that ratio is 1.04, until June 30, 2015 so please consult the office if you are making the calculation after June 30, 2015 to get the updated number. The assessment office information is available on the Internet.

Once this calculation is made, the **basis** of the property must be determined. The basis of any property is the price paid for it, increased by the cost of any permanent improvements made during your period of ownership. If you acquired the property by gift, your basis is the same as the donor's basis, increased by the permanent improvements made after your acquisition of title. If you inherited the property, the basis is the value of the property used for purposes of estate settlement, increased by the cost of any permanent improvements made after you inherited the property.

Three choices - Once you have determined the basis and the present value of the residence, you need to understand that there are only three (3) things you can do with the residence at this point: keep it, sell it or give it away. So you need to consider the pro's and con's of each of these potential actions in order to decide what to do.

Keep it

Pro's

1. The owner retains his or her place of residence and does not have to face the possibility of moving to a new or unfamiliar environment.

2. Although there will be some inheritance tax upon the death of the present owner, the amount of the inheritance tax is usually much less than the income tax to be paid by the person to whom the house is given when he or she sells it.

Con's

1. Upon the death of the owner (or the last to die of a married couple) there will be an inheritance tax on the property. To make a rough determination of the amount of tax which will be due, multiply the present value by 4.5% if the heirs of the house are the children or

grandchildren of the owner. Multiply by 12% if the heirs will be siblings or by 15% for unrelated parties. There is no inheritance tax if the property is to be inherited by a church or charitable organization.

2. If the owner of the house becomes unable to take care of himself and requires nursing home placement, there is no lien placed against the property and the state does not take it or require it to be sold. However, unless there is nursing home insurance or significant other income or assets which will cover the cost of nursing home placement (currently estimated at $293.15 [1] per day), the likelihood is that, at some point, the owner will expend all available resources and require public assistance. Should that occur, the state will cover the costs of care, but upon death, the state will place a claim against the estate of the decedent for the amount so expended. This may require the sale of the residence to cover the cost of the care. The claim applies only to assets in the estate; generally speaking, if the house is jointly owned with another living person, the state cannot collect on the claim.

Sell it

Pro's

1. The federal income tax laws allow the exclusion of the first $250,000 *of the gain* on the sale of a principal residence. ($500,000 for a married couple.) The Pennsylvania Personal Income Tax also contains an exclusion, and if the property was purchased before the date on which the tax law became effective (June 1, 1971), a portion of the gain can also be excluded on the basis that it occurred before that date. With these exclusions, many people can exclude all of the gain on sale from income tax.

2. The proceeds of the sale can usually be given to the intended heirs without the payment of any federal gift tax, thereby transferring the accumulated wealth of the family from one generation to the next and keeping the government out of the picture.

However, you should be aware that if Medical Assistance is applied for by the donor (giver) of this money, the applicant must report any gifts and the amounts given within the five years preceding the application. Present regulations require the value of the gift to be divided by $293.15 to determine the number of days that the person who made the gift is ineligible for medical assistance benefits. The period of ineligibility begins as of the date the person is otherwise eligible for medical assistance benefits, in other words, when you have spent all you have. Thus at the very time you need the medical assistance, you are ineligible to receive it.

If you do spend all your resources and apply for Medical Assistance, but are denied those benefits due to the transfer of proceeds from the sale of the house, your children may be liable to cover the cost of your care. There are some techniques, including giving the house back which can avoid or mitigate these penalties.

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[1] This number will change although the date of the change cannot be estimated. The last change date was January 1, 2015.

Con's

The most obvious con in this case is that the older person has to live somewhere and may need to use the proceeds of the sale of the house to meet the expenses of rental of suitable accommodations. However in many cases, periodic income from Social Security and pensions is sufficient to meet these day-to-day needs.

Give it away

Pro's

1. Giving the property to the intended heir(s) allows for an immediate transfer of the property and the responsibilities that go along with it. The donee becomes liable for maintenance, taxes and insurance.

2. There will be no inheritance tax on the property provided the donor lives for a period of one (1) year after the date of the transfer and no Federal Estate Tax provided the donor's estate contains less than a little over $5 million or more than three (3) years has elapsed since the date of the gift.

Con's

1. Such a gift may be illegal. A poorly written federal statute passed during the summer of 1996 makes it illegal to "*knowingly and willfully [sic] dispose of assets in order for an individual to become eligible for medical assistance...if disposing of the assets results in the imposition of a period of ineligibility for such assistance*". No regulations have been issued to clarify the meaning of this clause, although reference to "a period of ineligibility" is generally thought to mean that period during which a person would be ineligible for benefits as described above. Although the law provides substantial penalties to the donor, the donee and the attorney who prepares the papers to facilitate the transfer, the federal government has declined to enforce these provisions.

2. The gift of more than $500 in value within five (5) years of the date of application for Medical Assistance benefits of will create a period of ineligibility effective as of the date the donor would otherwise qualify for Medical Assistance benefits. The length of the period of ineligibility is measured in days and will be determined by dividing the fair market value of the property by the cost of nursing home care for one day, currently $293.15. Further, this period of ineligability will not begin until the Donor has used all other funds and this may effectively preclude needed care.

3. Giving the house away and reserving the right to live there for the rest of your life will result in the imposition of inheritance tax on the full value of the property at the date of death. Under some narrow circumstances the property can be given away but the donor can reserve the right to live there for the rest of their lives and the right to sell the property. This is a narrow

exception and only applicable under special circumstances.

4. If the person to whom the house is given dies, or is involved in a divorce, lawsuit or accident there is some danger that the property will be taken to settle up on these matters, leaving the donor out in the cold. There seems to be a feeling that "That won't happen in my family" but no family is immune from these sorts of problems.

5. After the death of the donor or after the donor has moved out of the house, the person to whom it is given usually sells the property. Even when the donee *intends* to reside in the property himself, the fact of the matter is that the house is usually sold. When it is, there will be a tax on the long term capital gain, which is the difference between the basis (calculated as set forth above) and the selling price. Under recent tax law changes, the tax on this difference is subject to the capital gains tax, which is currently 15% for federal tax and slightly less than 3% for state tax. In many cases the resulting tax is more than the inheritance tax at 4.5% or 12 or 15% on the fair market value of the property.

6. The children of the donor may become legally responsible to pay for his or her care, even if they did not receive the house, under Act 43 of 2005. The rules are changing rapidly in this area, so please call for an appointment to get the latest update.

Is joint ownership the answer?

One variation on the above that often is discussed is the possibility of putting the property into joint name with one or more parties. This can, of course, be done and when it is the above considerations all apply to the various fractional shares. For example, if a father puts his house into joint name with his son, and later dies, still owning the remaining one-half, there will be inheritance tax on one-half the value at the date of death and the son's basis in the property is 1/2 his father's basis plus 1/2 the value at the date of death. The gift of the 1/2 will likely require the filing of a gift tax return and will give rise to the "look-back" rules discussed above if the father applies for medical assistance.

These are by no means the only considerations to be applied in the determination of whether to transfer the house. Other factors which must play into the determination are the health of the parties, the level of cooperation of the family members and the mental state of the older family member who is contemplating the transfer.

There are no easy answers and there is no one right answer to the question. This brochure only touches the tip of the iceberg and covers the matter in a general, non-specific manner. Specific questions and situations may lead to different conclusions. In order to come to the decision which is correct for you, a consultation with STEADMAN LAW OFFICE will be helpful.

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