

What Is A Life Estate?

Legal View

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A life estate is created when an owner of real property transfers his or her interest in such property to one or more persons, while retaining the right to occupy and use the property during their life time. The person transferring ownership is called the “grantor” and can become a “life tenant,” or designate someone else as the life tenant. The person ultimately receiving ownership of the property, the “grantee,” is called the “remainderman.” When the life tenancy ends all interest and possessory rights pass to the remainderman. In a previous article, the use of a Beneficiary Deed was discussed which also transfers real estate to designated beneficiaries on death, but in that case, the grantor may change the beneficiaries during his lifetime and the beneficiaries have no immediate interest. In a life estate, the grantor relinquishes all control over what happens to the property, and cannot later transfer, sell or mortgage the property without the consent and cooperation of the life tenant and the remainderman. Both types of conveyances serve to “avoid probate” and give the beneficiaries a “stepped up” tax basis using the value of the property at the time of the grantor’s death along with other calculations for computing capital gains tax. However, as with a beneficiary deed, a life estate can have unintended consequences.

What Could Go Wrong?

The main problem is that once control is relinquished by the grantor, third parties who have claims against the remainderman, may be able to assert such claims against the property despite the retention of the life estate. Once the life estate deed is signed, the grantor gives up all control over what happens to the property in the event of the death or disability of the remainderman, or if the remainderman is embroiled in a divorce or other creditor problems when the life tenant dies. A “future interest” can be created for the remainderman when the life estate is created, which in turn creates an asset capable of being valued and attached by creditors, divorcing spouses and bankruptcy trustees even before the life tenant passes. In such case, when the property transfers automatically to the remainderman it may be subject to a potential creditor’s claim.

Another problem may arise when an unexpectedly long passage of time occurs based on the life tenant’s lifespan. The life estate title transfer may not take place until *long after* the life tenant has left the property, possibly to live out their final days in a nursing home. In such case, the property may be unmarketable and languish in dis-repair unless the life tenant and the remainderman agree to terminate the life estate and each is mentally competent to do so.

Is a Life Estate Worthwhile?

The creation of a life estate may be beneficial although they are becoming used less frequently since the advent of the Beneficiary Deed. It really depends on what needs to be accomplished. A life estate can help avoid a Medicaid claim if it is created at least 5 years before the Grantor applies for Medicaid. It can also allow another person such as the grantor’s spouse to

live in and receive the benefits of a property, and still pass the property onto another heir as the remainderman.

If the goal is to retain control with an eye toward the possible avoidance of probate, a life estate will not serve that purpose. Preparation of a will or trust or beneficiary deed can provide more flexibility and cover more unknown or unexpected contingencies. Although financial assistance through Medicaid could also be impacted the use of a life estate, it should be explored before competency issues arise for the grantor. Life estates provide little flexibility to make changes later or allow the appointment of someone who can make changes if needed.

Although life estates may seem similar to beneficiary deeds, the final outcome for each can be very different. Estate planning is best when considering all options, including wills, trusts and even the often (unnecessarily) dreaded probate court.

Do you have a legal question? Send your inquiry to attorney Jeff@klfpc.com. Appointments are available in both Black Hawk and Denver offices.

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