

# So you want to give your house away to your children...



Closing Thoughts

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Should you? This is a simple question, but the answer usually is not.

Before deciding to give your house away you should consider the serious consequences of gifting a house and the problems that might arise. You should work with a lawyer who has experience in this area to see if such a plan makes sense for you.

When a prospective client calls my firm and asks about these matters, the question we get is often, “How much will it cost for a deed to my children?” We usually speak to them for a few minutes and ask them to come in to our office to discuss the issues involved. We will want to know why the person wants to make the gift.

If the only reason for making the gift is to avoid probate, there are often better ways to reach that goal. Sometimes the caller may be experiencing financial difficulties, and has heard that it is a good idea to give the property away to protect it from creditors. There are a number of very bad consequences that can result from such a plan, and I will not attempt to outline them here.

Most people who approach us with this question are looking at the transfer as part of their estate plan and want to see the house go to their children sooner rather than later. Sometimes the person has very limited income, perhaps due to the death of a spouse, and they feel they cannot continue to carry the expense of the house. Sometimes this concern can be addressed by a reverse mortgage, but some people are not financially situated to carry the costs of a home even if

this is done.

Sometimes a child is already living with a parent, who thinks the child should have the house as long as they are going to be serving as a caretaker in their old age. Increasingly, callers have heard a few things about how the Medicaid system works, or watched their parents or friends spend all their assets on nursing home care, and feel strongly that they should be able to leave something to their children after a lifetime of work.

Although gifts of homes to children in many cases do not give rise to problems, there are cases where bad things happen. For example, if a house is gifted to a child without the parent taking any steps to protect themselves, the child—or, if the child predeceases the parent or becomes divorced, then the daughter- or son-in-law—might decide they want to liquidate the asset and move to evict the parent from the house. The parent may not have good legal grounds upon which to oppose the eviction.

Risks can also arise if a child encounters financial problems and a creditor or bankruptcy trustee seeks to have the home sold to pay debts. A home gifted to a child who suffers a divorce may also be at risk. These cases do happen, though I think they are the exception. Any parent considering gifting a home to a child should learn about these risks, and whether any steps are possible to reduce them.

One technique that can reduce some of the risks is for the parent to retain a “life estate” in the property when giving it away, although doing so may have some negative features depending on the circumstances of the parent and their goals. Anyone holding a life estate has the right to occupy the property during their lives, and to rent the property and receive the net income after paying for maintenance, taxes, and insurance. Another technique, though a more complicated and costly arrangement, is for the parent to establish a trust to hold title to the property during their lifetime.

If you give your home away and within five years apply for Title 19 Medicaid benefits, you will be deemed ineligible for benefits unless the gift falls within certain permitted transfers. One option for retaining eligibility is to have your children give the house back to

you, but keep in mind that they will be under no legal obligation to do so. Even if they wish to return the house, they may be unable to do so. A house cannot be transferred back to you if your child has died, the house has gone to a spouse, the house is tied up in a divorce, or a creditor has placed a lien on the property.

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Children receiving the gift of a home should be aware that they may face penalties if their parent is deemed ineligible for Medicaid because of a penalty imposed by the Department of Social Services due to a gift made to them within five years of an application for benefits. The state or the nursing home may have the legal right to sue the child for the amounts expended for the care of the parent.

Gifting a house during life can result in unanticipated, and often avoidable, capital gains taxes. That is because children receiving a lifetime gift from a parent generally also get the tax basis in the property that was held by the parent. Tax basis, generally speaking, is what was paid for the property plus capital improvements.

So if Dad owns a home that he bought in 1960 and for \$15,000, and he gifts it during his life to his children, they obtain Dad’s tax basis in the property. When they sell the property, say for \$250,000, the difference between the basis and sales proceeds of \$235,000 will be exposed to capital gain taxes of roughly \$47,000, assuming a 20 percent combined federal and state rate.

Now if Dad retained title until his death, or had gifted it during life but retained a life estate in the property, the property would pass through his estate and the children should get a stepped up tax basis equal to the date of death value. So if the children sell the property shortly after Dad’s death, no capital gain tax should be due.

If you decide to make such a gift after considering all the factors, you should review your insurance coverage with your insurance agent. Find out whether the gift might violate your mortgage or whether it will have an adverse impact on any tax reduction programs the property benefits from, such as open space or farmland designations. Consider whether steps need to be taken to preserve rights under title insurance policies. In many if not all cases, these issues can be dealt with in a satisfactory way. But failing to pay attention to them can have unintended—that is, painful—consequences.

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