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Life Estate Deeds

Top 5 Questions & Answers

If you own real estate in Maryland, it is important to consider and make informed decisions about these types of assets. A life estate deed can be a valuable tool to help you legally pass your real property assets to your heirs, potentially avoid the probate process, while also preserving tax benefits. This type of deed may be used during the estate planning process or the Medicaid planning process. In this article, we will provide an overview of life estate deeds in Maryland.



1. What is a Life Estate Deed?

A life estate deed is a type of deed in Maryland which allows you to retain ownership and possession of your real estate, while living. With this type of Deed, you will also designate a beneficiary (or more than one, if you would like to do so), referred to as a Remainderman, to receive the property upon your death. This type of instrument helps avoid the probate process for real estate assets. There are two different types of life estate deeds in Maryland, which we discuss below.

2. Who are the Parties in a Life Estate Deed?

There are two types of parties in a life estate deed: The current owner of the property is called the "Grantor" and retains a life interest in the real property. Once the Deed is signed, they are identified as the "Life Tenant," meaning that they retain an exclusive right of enjoyment to the property while they are alive, whether or not they actually reside in the property itself. The second party to the Deed is called the "Remainderman," who will become the owner of the property by operation of law upon the death of the Life Tenant.

3. What is a Life Estate Deed with Full Powers?

The first type of life estate deed in Maryland is created with full powers. This legal instrument allows you to retain authority over your real property and is primarily used to bypass the probate process and transfer the real estate to your beneficiaries directly. The powers retained in this type of Deed include the ability to remain living in the property, sell, refinance, transfer or mortgage the property, and basically exercise absolute ownership and control over the property while living. With a Life Estate With Powers, if the Grantor/Life Tenant wishes to transfer or sell the property, they can do so without the consent of the remainderman.

It is important to note that this type of Life Estate Deed does not provide protection for Maryland Long Term Care Medical Assistance ("Medicaid") purposes, as the grantor/life tenant retains full control of the real property. Thus, it does not constitute a gift or a transfer for less than fair market value and does not protect the property from the five-year look-back period. This type of Deed could actually trigger Medicaid eligibility issues by virtue of its titling, as the property must be in the name of the applicant so that Medicaid can file a lien against the property after benefits have been paid out for six months. A Life Estate Deed avoids this right and frustrates Medicaid's ability to file such a lien, and when the Life Tenant dies, the Remainderman becomes the owner of the property by operation of law.

4. What is a Life Estate Deed Without Powers?

This type of deed is most commonly used in conjunction with Medicaid Planning and should be considered with the guidance of an elder law attorney. With this type of Deed, you are listing the remainderman as a beneficiary of the real property and you are not retaining the right to sell, mortgage, or reconvey the property. Instead, to perform such actions, the grantor/life tenant will need to work with the remainderman to make such decisions. Thus, this type of transaction should only be considered if the life tenant/grantor is comfortable working with the remainderman to resolve these issues down the road. This type of deed is most desirable during planning for long term care, as a method to transfer real property safely and to avoid an assessment of a gift penalty. In this case, transferring property by virtue of a life estate deed without powers is considered a gift.

With this type of Deed, it is also possible that the Remainderman could die before the life tenant, and their interest will impact the planning involved. If there are multiple remaindermen, it must be clear how their interests are owned and whether or not that interest is controlled by their respective estates. Do they own the interest as joint tenants with rights of survivorship, thereby bypassing the estate of the first to die, or do they own it as tenants in common, with each interest passing through their respective estates and thus subject to the rights and claims of their respective creditors? An analysis of these options and any creditor issues should be discussed with an estate planning attorney prior to drafting the appropriate life estate deed.

5. What About Capital Gains?

The Life Tenant of a Life Estate Deed can avoid capital gains tax on the sale of a principal residence by virtue of a tax exclusion. This same exclusion will not apply to the Remainderman unless the property is also their primary residence. If the property is going to be sold later, you should discuss these implications with your estate planning attorney as a retitling might be a good option to take advantage of applicable tax exclusions.

An additional benefit of Life Estate Deeds is that there is a step up in cost basis after the death of the Grantor/Life Tenant. When the remainderman decides to sell the property in the future, the cost basis will be determined as of the date of death of the Grantor/Life Tenant, not the amount for which it was originally purchased. If the property has greatly appreciated, this could save tens of thousands of dollars in capital gains taxes. In order to take advantage of this tax benefit, the property would need to be appraised upon the death of the Grantor/Life Tenant to set that value in order to be eligible for that capital gains tax benefit in the future.

Additional Benefits

One of the biggest benefits of this type of life estate Deed for Medicaid purposes is that after five years have passed from the date of transfer, the property is fully protected from the assessment of a gift penalty period, as it would not be subject to the five-year look-back. If an application for Medicaid is needed before this amount of time has passed, then the transfer would trigger a waiting period based on the value of the gift transferred, measured by using the actuarial life expectancy of the grantor pursuant to the appropriate life tables when the Medicaid application is submitted. Consulting with an elder law attorney prior to submitting such an application with this in mind is critical.

If you are considering establishing a life estate deed, it's also a great time to get guidance from your attorney about other assets that you wish to pass on to your heirs. There may be additional tax considerations or legal instruments to ensure that your wishes are carried out.

Summary

While a comprehensive estate plan is the best way to prepare for any eventuality, a life estate deed can be a valuable tool to address real estate assets in Maryland.

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