FAMILY FINANCE

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Benefits of a Life Estate After Death

Q: My mother put her house in six names — myself and five siblings. She was a life tenant. She passed away, and we sold the house for $785,000. It was in our names already, so I'm guessing that it's not considered an inheritance. Do we owe a capital gains tax? If so, do we owe taxes on the difference between the sale price and the value of the house at the time it was put in our names? — E.M., Hicksville

A: Under the circumstances you've described, this house is considered an inheritance, and you and your siblings don't owe taxes on the sale.

Lynn Brenner

Your mother did what lawyers call "a transfer with retained life estate." She put the house in your names, but she retained the right to live there for the rest of her life. As a result, for tax purposes the house is treated as an inheritance even though it was already in your names when she died; as far as the IRS is concerned, receiving a house in a transfer with retained life estate is the same as inheriting it.

On the downside, this means that the full value of the house is included in your mother's taxable estate. (But no tax is actually due unless her total estate was worth more than $1 million.) On the upside, it means that you and your siblings will only owe taxes on the $785,000 sale price to the extent that it exceeds the value of the house when your mother died. If the house was worth $700,000 at her death, for example, you would owe taxes only on $85,000 of appreciation.

This favorable tax treatment for heirs is one argument in favor of keeping a life estate. Had your mother not retained a life estate when she put the house in your names, the IRS would treat the transfer as a gift. The result: The value of the house would not be included in her estate, but you and your siblings would have had to pay taxes on the difference between $785,000 and your mother's investment in the house: her original purchase price plus capital improvements.

Q: I plan to buy a home for my son and his wife when they move to Florida. They have their own home in Maryland, and I also have a home in Maryland. I'm on Long Island taking care of an elderly parent.

I plan to live in Florida with my son and daughter-in-law. We've talked it over and agree this is the thing to do. Now, I want to protect myself. Their eight-year marriage appears to be very solid, but I'd like to prepare for the unexpected. My savings and the proceeds from the sale of my small home are all I have. Should I see a lawyer and have an agreement drawn up? It could say that if they divorce, or if my son dies, or if both my son and his wife die before I do, the home or its value should be returned to me, and that as long as I'm alive, I'll have a place to live. What's the proper thing to do? — R.K., Melville

A: All three of you need a legal agreement, which should be drawn up by a lawyer who practices in Florida, since that's where you'll buy the house.

You could put the house in your son's name and retain a life estate. (See the explanation above.) But it's simpler to keep it in your own name, says Jeff Zankel, a partner at Lamb & Barnosky in Melville. That way, no matter what happens, you and your savings are protected. Your son and daughter-in-law should protect themselves, too, by keeping a record of any financial contribution they make to the purchase and improvement of the house.

This isn't just a question of being prepared for death or divorce. What happens if the three of you will decide that living together isn't working out? If you drive each other crazy, a legal agreement and good records will help you change your living arrangements as amicably as possible.

Send questions to Family Finance, Business Desk, Newsday, 235 Pinelawn Rd., Melville, NY 11747-4250, or e-mail to Bfamfin@aol.com. Include your age, income and a list of major assets. Letters and e-mails can't be answered personally.