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Life Estate: A Useful Estate Planning Tool

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A life estate is a type of ownership interest in property allowing a person to have possession of real property (typically land, or a home or other buildings on the land) during their lifetime. Then, after death, another person or entity (such as a charity or non-profit organization) gains full ownership of the property.

*This MontGuide answers questions Montanans have asked about **life estates**. It examines drawbacks of a life estate if a family's circumstances change. It features four families who could use a life estate as a tool to achieve different estate planning goals. Finally, the MontGuide poses questions to consider before deciding to use a life estate as an estate planning tool.*

What makes a life estate?

A life estate exists during the life of a specific person or persons (**joint life estate**). This person is known as the **life tenant(s)**. The life tenant keeps the use and the possession of the property held in the life estate for the duration of the person's life. The party who owns the property is known as the **remainderman**. Although the remainderman is the owner of the property, the remainderman cannot have possession until the life tenant dies. The life tenant has exclusive possession rights to the property, including the right to exclude others from using it.

A person can create a life estate with a deed or a will. Typically, the wording is like the following, "I, John Smith, convey my real property to Sara Smith for life." While the wording seems simple, the person setting up a life estate should outline in writing the rights and responsibilities of the life tenant and remainderman.

What are the *rights* of a life tenant?

The typical **rights** of a life tenant include:

- Residing on the property;
- Renting or leasing the property to a third party and collecting the payments;
- Making profits from the land including farming, ranching, or timber harvesting (unless previously granted to a third party); and,

- Receiving a part of proceeds from a sale of the life estate property (assuming the life tenant was granted permission to sell).

What are the *responsibilities* of a life tenant?

The typical **responsibilities** and **obligations** of a life tenant include (unless the life estate deed states otherwise):

- Maintaining the property and avoiding waste to the property. (Waste is an unreasonable or improper use of land such as over-harvesting trees and selling them for lumber);
- Paying property taxes and insurance;
- Paying any other fees, dues, or utilities;
- Paying interest costs on a mortgage. The remainderman makes payments on the principal of the mortgage.

However, the life tenant and remainderman can change any of these rights and responsibilities upon signing a written agreement between them.

Montana attorneys have expressed concern about life estate deeds written so generally that disputes arise between the life tenant and remainderman because of differing expectations. A life estate deed outlining the specific rights and responsibilities of the life tenant and remainderman may avoid a costly court case.

What is a "retained life estate" in a home?

Parents who make a gift of the home to their children but keep the right to live in the home until they die have a retained life estate. If you transfer your home to your adult children, while reserving a life estate for yourself, they become **owners** of the property as remaindermen and you become the life tenant.

This means creditors may be able to place a lien against your home for your adult children's debts. However, when you have a retained life estate, the creditors of a child cannot force the sale of your property in the life estate to satisfy your child's debt. The creditors will have to wait until you die to enforce their claim against your child.

Is the value of a life estate included in the life tenant's estate for federal estate tax calculation purposes?

Yes. The full value of the property is taxable in the estate of the life tenant at death for federal estate tax purposes. But this is not a concern for 99 percent of Montanans because the federal estate tax exclusion during 2021 is \$11,700,000 for a single person; \$23,400,000 for married couples.

Under current law assets passing to heirs receive a “stepped-up” basis which, in IRS language, means “fair market value.” Having the property pass to your heirs at a stepped-up basis is an advantage to them. For example, if at your death the value of land in a life estate is \$300,000, and your heirs sell it for \$300,000, there is no capital gain and, consequently, no federal or state income tax due.

How is a life estate transferred to the remainderman at the death of a life tenant?

The Montana legislature has provided a way to update the public record ownership of real property on the death of a life tenant without probate. The remainderman can file a document with the Clerk and Recorder in the county where the property is located and indicate the life tenant is deceased. The document typically includes the following information:

- a statement of the death of the holder of the life estate interest and therefore the life tenant's interest in the property has ended;
- identity of the remainderman;
- date of death; and
- a legal description of the real property held in the life estate.

Before a County Clerk and Recorder will accept the document, the remainderman must sign the document and acknowledge it in front of a notary public.

The remainderman must also present a completed **Montana Realty Transfer Certificate**. [Form 488](#) is available from the local Department of Revenue. The form is also available at any Montana County Clerk and Recorder's office or online www.revenue.mt.gov. Search “Realty Transfer Certificate.”

The **Realty Transfer Certificate** has a **Water Right Disclosure**. The Montana Legislature requires owners of property to know the status of their water rights. Do any water rights exist on the property? Are water rights transferred with or withheld from the property? The remainderman presents both the Acknowledged Statement and Form 488 to the Clerk and Recorder in the county where the life estate property is located.

After the Clerk and Recorder records the Acknowledged Statement, the public record reflects title to the property is now in the name of the remainderman. The County Treasurer's office will send future real estate tax bills to the remainderman.

May a life tenant sell a life estate?

Life estates are marketable. This means a life tenant may sell the life estate, but only for the interest owned. A typical example could be a parent who needs the money from the sale of a life estate to pay for long-term care. The IRS has a table for calculating the value of a life estate based on the age of the life tenant.

What types of families could benefit from the use of a life estate?

Farm and ranch families may find a life estate is useful for ensuring real property passes to specific children, but only after the death of the surviving parent (**Family Situation #1**).

Remarried couples, with children from a prior marriage, could use a life estate to provide a home for the surviving spouse during their lifetime, while ensuring the home passes to specific children when the second spouse dies (**Family Situation #2**).

Couples who want certain real properties to eventually pass to a charity or nonprofit, but only after the passing of the surviving spouse, may find a joint life estate could accomplish their goal (**Family Situation #3**).

Parents and their adult children who want to protect a home's value from costs of a nursing home, assisted living, or home care may find a life estate is not as valuable of a tool as they thought (**Family Situation #4**).

Family situation #1: A life estate for a farm/ranch family.

Jake and Ann are in their 70s. They have two adult children. Their older son, John, has been involved in the farming operation for 20 years. Their other son, Sam is a high school teacher in Wyoming. Sam plans to make teaching a lifetime career. Sam has informed his parents and brother he has no desire to return to Montana or to the farm except for family visits.

Jake and Ann's farm assets are worth about \$1,000,000. They have reached 90 percent equity in their land, buildings, machinery, and equipment. Jake has the farm assets in his name as sole owner. Jake and Ann also hold non-farm financial assets titled as joint tenants with right of survivorship.

Neither Jake nor Ann have a written will, nor have they utilized payable on death beneficiary designations (PODs) on their financial accounts or transfer on death registrations (TODs) on their mutual funds to pass these assets to their two sons without probate. For further information about non-probate transfers, request the [Nonprobate Transfers MontGuide](#) from your local MSU Extension office or download here: <http://store.msuextension.org/publications/FamilyFinancialManagement/MT199509HR.pdf>

Jake and Ann prefer to live on the farm until their deaths. They realize the time may come when a move to town may be necessary, but they will “cross that bridge” when they come to it. They have agreed they want their son John to inherit all the

farm assets because of his involvement and dedication to the operation of the farm over the past 20 years. They have decided they want the non-farm assets to pass to Sam.

After visiting with an estate planning attorney, Jake and Ann realized each needs to write a will to carry out their goals. The attorney suggested a provision in Jake's will specify he is leaving the farm to their son John, subject to a life estate for Ann. This means if Jake dies before Ann, she receives the farm assets in a life estate.

The life estate allows Ann to live on the farm until her death, as if she owned the property outright. During the probate process for Jake, Ann, as the personal representative, files a life estate deed outlining the rights and responsibilities of the life tenant and remainderman written by their attorney.

During the time Ann has a life estate in the farm, she pays the interest payments on the mortgage, property taxes and upkeep on the home. Their son, John, pays the principal on the mortgage. Ann receives farm income through a lease with the remainderman, John.

Because of the existence of the life estate, Ann cannot gift the farm to anyone else or to any other entity, including a charitable or nonprofit organization, unless John agrees. Upon Ann's death, the farm assets pass to their son, John, because Jake named John as the remainderman in his will.

After Jake's death, if Ann decides she would like to write a new will leaving the farm to Sam instead of John or to a nonprofit, the life estate deed prohibits her from doing so. The farm is not hers to give away during her lifetime or at her death. Ann only owns a life estate in the farm and, as such, she is a life tenant. The life estate ends at her death and the farm passes to John, the remainderman named in Jake's will.

After the first meeting with the estate planning attorney, Jake and Ann made a list of questions to ask during their next meeting (See pages 4–5). They are concerned about these issues and believe they need answers before they determine if a life estate is their best estate planning tool.

Family situation #2: A life estate for remarried couples with children from former marriages.

Ken and Sue were recently married. Sue has two adult daughters from an earlier marriage while Ken has one adult daughter. After their marriage, Sue sold her home and moved into the home Ken built for his first wife who is deceased.

Eventually, Ken would like the home to pass to his daughter, since she feels a sentimental attachment to it and lives nearby. Sue is reluctant about Ken's idea but understands his desire to have his only daughter inherit the home he built.

Ken has a concern that if he wills the home outright to his wife, Sue could change her mind about his daughter inheriting the home. Sue could decide to leave the home to her two daughters. Or, she could sell the home and use the proceeds to buy another

home. Ken has similar thoughts about leaving the home outright to his daughter. He is concerned she may not allow Sue to live in the home after his death.

Ken and Sue discussed their worries with an estate planning attorney. The attorney said she could draft a will or a transfer on death deed with a provision to place the home in a life estate for Sue if Ken dies first. The life estate, with Sue as the life tenant, would allow her to live in the home until she dies. Upon Sue's death, the home passes to Ken's daughter, the remainderman.

During the time Sue has a life estate in the home, she pays for the upkeep and property taxes. She cannot give the home to anyone else or any other entity, such as a charity or nonprofit, unless Ken's daughter as remainderman agrees.

Even if Sue decides to write a will after Ken's death with a section leaving the home to her two daughters, this provision would be invalid. As a life tenant, Sue only has use and possession of the home during her life. Sue's interest in the life estate ends upon her death. Thus, at the time her will takes effect, she does not have any interest in the home to will to anyone. After her death, the home belongs to the remainderman, Ken's daughter.

While Ken and Sue believe a life estate could meet their goals at the present time, they have concerns about potential future events.

- What if Ken's daughter dies before Sue? The attorney recommended that Ken consider whom he wants to receive the home if this should happen. Once Ken reaches a decision the attorney could name a successor remainderman in his will to receive the home in the event his daughter dies before Sue.
- What if Sue remarries? Ken believes he needs time to consider whether he would want another man living in the home he built.

Family situation #3: A life estate for a couple who wants to donate property to a charity or nonprofit.

Jim and Sally have been married for more than 45 years. They met while attending Montana State College, now known as Montana State University (MSU). Jim and Sally have no children. Their nieces and nephews are financially established.

Jim and Sally have decided because MSU has played a significant role in their lives, they want to donate their ranch to the MSU College of Agriculture, but only after they die. They want MSU to use the ranch in whatever way the college considers most beneficial, including using the proceeds from the sale of the ranch to fund teaching, research, and Extension programs.

Their attorney suggested they could gift the ranch to the College of Agriculture through the MSU Alumni Foundation while they are alive but keep a joint life estate. This tool will enable Jim and Sally to take state and federal income tax deductions now while enjoying their remaining years on the ranch. After

one spouse dies, the life estate allows the survivor to stay on the ranch until death.

Jim and Sally find comfort in knowing the MSU College of Agriculture will benefit from their property after they both die. The attorney cautioned Jim and Sally that after making the gift, they cannot change the life estate document without consent of the remainderman, which in this case is the MSU Alumni Foundation. Nor, can Jim and Sally change their minds about whether the MSU Alumni Foundation is to receive the ranch for the benefit of the College of Agriculture.

Family situation #4: A life estate for families who are concerned about long-term care costs and Medicaid eligibility.

With the average cost of nursing home care in Montana reaching over \$92,000 annually, no wonder parents without long-term care insurance are searching for ways to protect the assets they have worked a lifetime to accumulate. Some Montanans have heard a life estate can prevent Medicaid from “taking” their property.

Typically, the thinking is this: if the parents do not own the property, then they would qualify for Medicaid if they went into a nursing home because they would not have assets. However, the reality is closer to this.

Example 1: Dorothy and Fred signed a quitclaim deed transferring their home to their adult children for an amount less than the market value of the home, such as one dollar. The quitclaim deed included a provision saying the parents “retain the right to use and occupy the property during their lifetimes.” This wording sets up a joint life estate for Dorothy and Fred and makes their children the remaindermen

Because the children did not pay the market value for the home, the parents have made a gift of the difference between the market value and one dollar. The transfer of the property by the parents to the children is a gift under Medicaid eligibility rules. If the gift occurs within the five years prior to the parent applying for Medicaid benefits, the parent will be **ineligible** for Medicaid benefits for a certain number of months (or years) based on the value of the gifts. This is because of the federal **5-year look back rule** on gifts.

In addition to impacting Medicaid eligibility, a life estate will still be subject to a lien for payments the life tenant received from Medicaid and Medicaid will be able to recover these amounts from a person’s estate.

While Medicaid rules prevent the state from forcing a life tenant parent to sell the life estate, Medicaid can place a lien on the life estate for medical payments made on behalf of the first parent to receive Medicaid assistance. A lien is a claim against

the life estate preventing the life tenant from being able to sell the life estate without Medicaid knowing and being able to collect the owed amount. If the life estate sells during either parent’s lifetime, the Medicaid lien is paid from the parents’ share of the sale proceeds.

Upon the death of both parents, Medicaid can collect the amount it paid out on behalf of the person from his or her estate. However, Medicaid cannot recover from the estate if the survivor is a recipient’s spouse, child under the age of 21, or a blind or disabled child. Montana has regulations for hardship exemptions that may prevent Medicaid from recovering certain estate assets.

Example 2: Etta is considering the transfer of her \$200,000 home to her daughter and keeping a life estate. If Etta needed nursing home care and applied for Medicaid after making the gift to her daughter, she would have a period of ineligibility of a certain amount of time. ($\$200,000 \div \252.18 daily cost of nursing home care = 793.08 days \div 30 days in a month = 26.44 months \div 12 = 2.2 years). If Etta enters a nursing home and applies for Medicaid, she will need to have resources to cover her nursing home costs for a little over two years before Medicaid will begin paying for nursing home costs.

Legal consequences

Before granting or keeping a life estate interest either through your estate plan or by a separate agreement, discuss the legal consequences with an attorney. Consider assets, family situation, and personal preferences carefully to ensure a life estate fits with your overall estate plan.

Ask the following questions of an estate planning attorney. Decide what items you want to incorporate in an agreement during the formation of a life estate.

- What happens if the life tenant becomes incapacitated and needs to move into a long-term care facility?
- Can the life tenant rent the property to a third party and collect payments? What are the consequences of this action?
- Who pays for regular maintenance costs on the property?
- What maintenance must the life tenant perform on the property?
- What if the life tenant does not have enough money to pay interest on the mortgage or upkeep of the home?
- What if the remainderman misses making a principal payment on the mortgage?
- Who pays for major improvements--the life tenant or the remainderman?
- Who makes decisions about major improvements--the life tenant or the remainderman?
- What type of insurance is the life tenant required to buy?
- Is the remainderman permitted to inspect the property or

otherwise enter the property during the lifetime of the life tenant? If so, when, and how is entry allowed?

- Who pays property taxes and other fees?
- Can a life estate be flexible enough to adapt to potentially changed family circumstances?

Summary

A life estate is a legal tool that may meet the estate planning goals of a wide variety of individuals. A life estate allows the life tenant to have the income from and use of the property for the duration of life. The remainderman receives full ownership of the property when the life tenant dies.

To determine whether a life estate is the proper legal tool for your situation, discuss your goals with an estate planning attorney. The attorney may recommend other alternatives such as a testamentary or Clayton QTIP election trust. Testamentary or QTIP trusts are legal tools that could also achieve the goals of the four family situations in this MontGuide.

References

Montana Medicaid Manual, Combined Medicaid 404-3, Asset Transfers Involving Life Estates, downloaded October 15, 2020 <https://dphhs.mt.gov/Portals/85/hcsd/documents/mamanual/CMA404-3July012016.pdf>

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Acknowledgement

Representatives from the Business, Estates, Trusts, Tax and Real Property Section of the State Bar of Montana have reviewed this MontGuide and recommend its reading by Montanans interested in learning about life estates.

Disclaimer

This publication is not a substitute for legal advice. Rather, the MontGuide helps families become better acquainted with life estates as an estate planning tool. Future changes in laws are not predictable, and statements within this fact sheet are based solely upon those laws in force on the date of the publication.

