NEET Notes

Making Sense of Estate Planning

February 2017

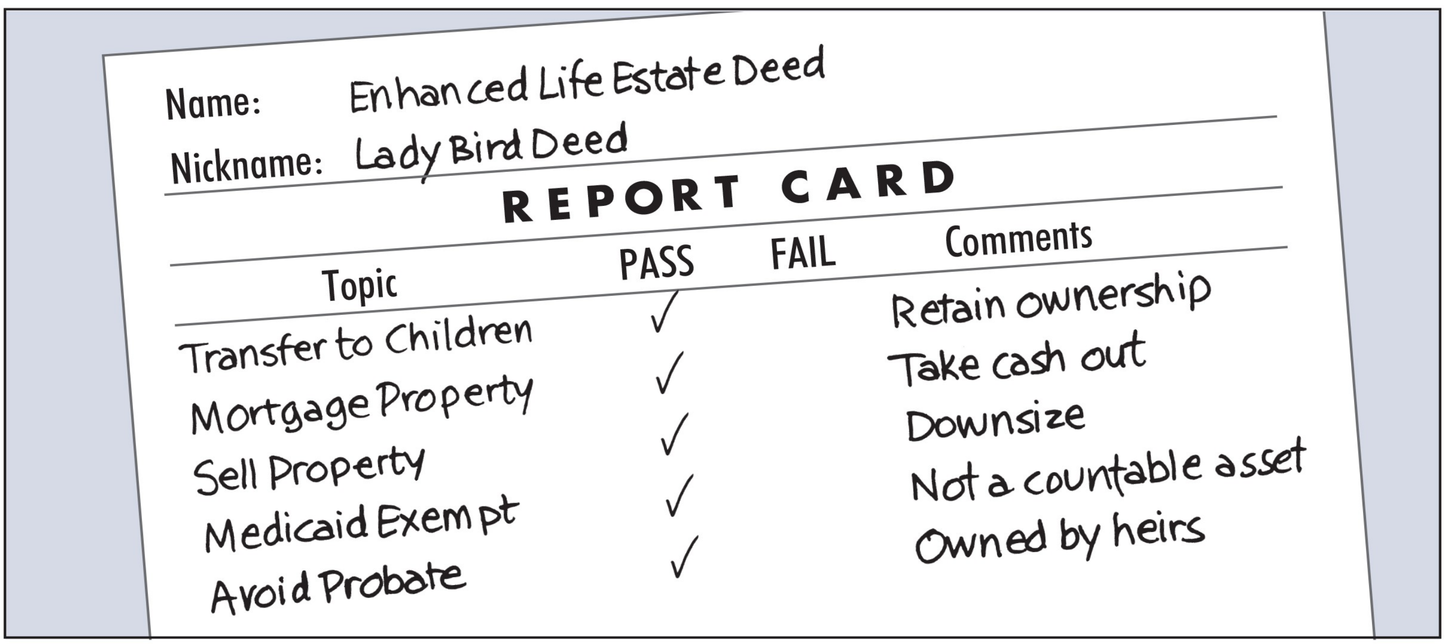
Life Estates and Ladybird Deeds

During the first year of law school, students take some of the more important legal courses: Contracts, Torts, Civil Procedure and Real Property. These are the topics everyone expects you to know about if you are an attorney, even if you never practice in these areas. As a student trying to master various complicated legal concepts, I sometimes thought to myself: “that concept is all well and good, and maybe it was relevant 200 years ago, but will it ever be applicable in today’s world?”

Take Real Property, one of the oldest areas of the law. Back in 11th Century England, when ownership of real property (land) by anyone other than the king was just beginning, what the lucky few landowners usually owned was a life estate interest in property. A life estate meant that you owned the land for as long as you lived, then ownership of the land reverted back to the king. Over time, life estate holders sought the ability to pass their interest in the land to their children, and perhaps even more radical, to sell the land to someone else during their lifetime. Fast forward to today.

When you purchase a house today, you usually purchase ownership of the property until the end of time. Your interest does not last for your lifetime only and then revert to someone else. Because we are all mortal, however, our interest in the land must be cut short at some point. Usually our interest is cut short because we sell the land to someone else during our lifetime, or upon our death, we pass it to our survivors through an estate plan or the state’s intestacy laws. The intestacy laws state to whom the land will pass if you don’t have an estate plan. In Vermont, the intestacy laws would typically have the land pass to your spouse, if married, but if not, then to your children, then to your parents, sibling, or extended family, depending on who is living at the time

Life estates are uncommon today, for good reason. First, if you own a life estate, it would be difficult to mortgage the property because the property typically acts as security for the loan, and if the ownership will terminate when the life estate holder dies, the lender might not get all their money back before the property reverts to the



NEET Notes is a monthly letter to clients and financial professionals that addresses an estate planning term, topic or legislative/regulatory development. The contents are for educational purposes only and do not constitute legal advice. If you have questions, or want to suggest a topic you would like to see addressed in *NEET Notes*, call Adam at 985-8811.

Referrals are an essential part of a successful law firm. If you hear of friends or colleagues in need of estate planning advice, please pass along the enclosed business card or this newsletter. Thank you!

NorthEast Estates and Trusts, PLLC
181 Falls Road, P.O. Box 928
Shelburne, VT 05482

Phone: 802-985-8811
E-mail: abartsch@neetlaw.com
www.neetlaw.com

next owner. Second, life estate holders are not encouraged to improve the land, because upon their death, the improvements pass to the next owner. Third, there are numerous areas of potential conflict between the life estate holder and the owner after the life estate holder's death (known as the remainderman in most cases). Suppose the life estate holder uses the property in a way directly conflicting with what the remainderman wants. For instance, a family theme park as opposed to a serene nature reserve. Conflicts also arise over who covers expenses related to maintaining the land, whether the life estate holder must purchase property insurance, how proceeds of an insured loss are split, etc. Many of these situations have answers from prior similar disputes that have appeared before the courts (case law), but even so, the expectations of the life estate holder and the remainderman might clash repeatedly leading to attorneys and then the courts getting involved.

Despite these drawbacks, there has been a small revival in the use of life estates in a handful of states, including Vermont. This revival comes in a new form, what's called an enhanced life estate deed (ELED), also commonly known as a Ladybird deed.

What an ELED Does: Modern life estates are usually not granted to someone else, as was the case in the early English tradition. Today one grants a life estate to oneself and transfers the remainder interest (a future interest) to someone else, typically one's children. For instance, parents own their residence and want to avoid having it pass through probate after they die. They transfer the residence to their children, but withhold a life estate so that they can continue to own the property (their interest being a life estate) until they both have passed on. Upon the death of the second spouse, the house automatically passes to the remaindermen (their children) without the need for probate.

This example would be a bare-bones approach and might not fully meet the clients' goals. A lot of things can still go wrong in this scenario. For one, if the parents live longer than expected and need to sell the house to raise funds, they would need the remaindermen to sign off on the sale transaction. Or, perhaps the parents decide that not all the children should receive the house, rather only two of the four children should receive an interest in the house. Again, the remaindermen, including those being disinherited, would need to sign off on the change before the change could be made.

What make's life estate deeds particularly powerful in Vermont is that the parents can withhold certain powers alongside the life estate. This is where the "enhanced" part of the ELED comes into play. The parents can, without needing the approval of the remaindermen, mortgage, lease, sell or give away the property, or return the property to themselves (so that they once again wholly own the property, not just a life estate). These powers can be exercised without the remaindermens' consent, so none of the children have a veto power. It's as though the parents own the house outright, but still get the benefit of passing the house to their chosen children without the need for probate, after the death of the second spouse. The conflicts between life estate holder and remaindermen noted above can still exist, but because the transaction is between family members, the uncertainties are far less.

"Can you give me a minute? There are a few key people I want to take along with me."

Other Benefits of ELEDs: As mentioned, the property avoids probate because it passes directly to the children after both parents die. Meanwhile, the parents maintain full control over the property because no one has a veto power over the property being sold or mortgaged. Further the property does not become subject to creditors of the remaindermen, which is one of the chief reasons for not adding a child as a current co-owner on your property deed. If a child is a co-owner and owns a half-share of your property, there is a risk that a creditor of the child can force a partition proceeding in court. If successful, the house might need to be sold so the creditor can receive the child's share of the sale proceeds (equal to the child's ownership interest in the house).

Regarding Medicaid, the ELED has two important benefits. First, the transfer of the future interest to the remaindermen is not a gift under Vermont's Medicaid regulations. By withholding the enhanced powers, the parents are viewed as having a degree of control over the property such that they are not making a current gift to the children. Thus no gifting penalty if the parents later apply for Medicaid, and the house remains an exempt asset. Second, by bypassing probate, the house avoids a Medicaid reimbursement claim. Under current law, Medicaid makes a claim against the estate during the probate proceeding, and if allowed, probate assets such as real property may need to be sold to pay off the Medicaid claim. If the property bypasses probate, Medicaid cannot reach it in most circumstances. Be aware however, that Medicaid laws are changing, in part because Medicaid expenses are a growing part of many states' budgets. As Medicaid costs grow, states are looking for avenues to obtain reimbursement, one of which is known as "expanded estate recovery." In the future, Medicaid might be able to assert a claim against the remainder interest after the parents' deaths, or treat the transfer of the future interest (in the current ELED) as a gift that could generate a gift penalty period.

ELEDs are often used alongside a will to minimize assets needing to pass through probate. But there can be tax issues and a new deed must be recorded. Professional assistance is advised to ensure an ELED is appropriate for your situation and won't cause unexpected harms.