

# Life Estate: A Useful Estate Planning Tool

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**If your estate-planning goals include allowing someone to possess your property during his/her lifetime before the estate passes on to another person or organization, then a life estate might be just the tool you need.**



## MontGuide

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### **A LIFE ESTATE IS A LEGAL ARRANGEMENT THAT**

allows one person to have possession of property (typically land, a home or buildings on the land) during his or her lifetime and, after his or her death, for another person or entity to gain ownership of the property.

A life estate is limited to the life of a specific person or persons (joint life estate). This specific person is known as the life tenant. The *life tenant* retains the use and/or the possession of the property held in the life estate for the duration of his or her life. Individuals who receive the real property upon the death of the life tenant are known as remaindermen.

This Montguide explores how three couples use life estates as tools to achieve different estate planning objectives and the potential drawbacks that can occur when family circumstances change.

Farm couples may find a life estate is useful for helping them ensure that real property passes to specific children, but only after the death of the surviving parent.

Remarried couples, with children from a prior marriage, may find that a life estate could provide for the surviving spouse during his or her lifetime, while ensuring the property passes to specific children when the second parent dies.

Couples who want certain real properties to eventually pass to a charity, after the passing of the surviving spouse, may find that a joint life estate could accomplish their goal.

#### **Farm couples**

Jake and Ann are an older couple with two adult children. Their older son, John, has been involved in the farming operation with Jake and Ann for many years. Their other

son, Sam is a high school teacher in Wyoming and has indicated that he plans to make teaching a lifetime career.

Jake and Ann's farm assets are worth approximately \$900,000. They have attained 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 several non-farm personal property assets as joint tenants with right of survivorship. These include stocks, U. S. savings bonds and certificates of deposit. Neither Jake nor Ann has a written will.

Jake and Ann would prefer to live on the farm until their deaths. They realize the time may come when they must move to town, but they will cross that bridge when they come to it. They decided they want John to inherit all of the farm assets because of his involvement and dedication to the operation over the years. They want the non-farm assets to pass to Sam.

After visiting with an attorney, whose practice focuses on estate planning, Jake and Ann realized they both need a written will to accomplish their objectives. The attorney suggested that one section of Jake's will indicate that he is leaving the farm to their son John, subject to a life estate for Ann. If Jake should die before Ann, the farm assets will be placed in a life estate for Ann. Upon her later death, the farm assets pass to their son, John, because he was named the remainderman in Jake's will. The life estate allows Ann to live on the farm until her death, almost as if she owned the property outright. She could also receive the farm income through a lease with their son, John.

During the time Ann has a life estate in the farm, she is responsible for the interest payment on the mortgage, property taxes and upkeep on the home. John pays the

principal on the mortgage. Ann cannot gift the farm to anyone else or to any other entity, including a charitable organization. After Jake's death, if Ann decides she would like to write a new will leaving the farm to Sam, the inflexibility of a life estate prohibits her from doing so. The farm is not hers to give away during her lifetime or at her death. Ann owns a life estate in the farm and, as such, she is only a life tenant. Her ownership interest terminates at her death. Upon Ann's death, the farm must pass to John, the remainderman named in Jake's will.

One of the disadvantages of a life estate for Jake and Ann is that it cannot be adjusted for changing family circumstances.

- What if Ann becomes incapacitated and needs to move to a nursing home?
- What if John decides he wants to change professions and no longer wants to farm?
- What if Sam decides he wants to come back to the farm?

Jake and Ann are concerned about these issues and feel they need more time to consider alternatives.

### **Remarried Couples**

Ken and Sue were recently married. Sue has two daughters from a prior marriage and Ken has one daughter from his prior marriage. After their marriage, Sue sold her home and moved into the house Ken built before his first wife passed away.

Eventually, Ken would like the house to pass to his daughter, since she is sentimentally attached to it and still lives nearby. Sue is somewhat reluctant about this idea but understands Ken's desire to have his only daughter inherit the house.

Ken is concerned that if he wills the house outright to his wife, Sue could change her mind about his daughter inheriting the house at Sue's death. But, if he wills the house to his daughter, he is concerned that she might not allow Sue to continue living in the home after his death.

Ken discussed his concerns with an attorney whose practice deals primarily with estate planning. The attorney indicated he could draft a will that places the house in a life estate for Sue after Ken dies. The life estate, with Sue as the life tenant, would allow her to live

in the house until she passes away. Upon Sue's death, the remainder interest in the house passes to Ken's daughter because she was named as the remainderman in Ken's will.

During the time Sue has a life estate in the house, she is responsible for the upkeep and property taxes. She cannot give the house to anyone else or any other entity, such as a charity. Even if she decides to write a new will after Ken's death in order to leave the house to her two daughters, she cannot do so because she only has use and possession during her life. Because Sue only has a life estate in the house, upon her death, the house belongs to the remainderman, Ken's daughter.

While Ken and Sue believe a life estate could meet their objectives at the present time, they have concerns. What if Ken's daughter dies before Sue? The attorney advised Ken to consider who he wants to receive the house if this should happen. Ken and Sue are concerned that a life estate may not be flexible enough to adapt to changing family circumstances.

### **Donating Property to a Charity**

Jim and Sally have been married for more than 45 years. They met while attending Montana State University (MSU), or Montana State College as it was known back then. Jim and Sally have no children.

They have decided that because MSU has played such an important role in their lives, they want to donate their ranch to the College of Agriculture, but only after they both pass away. They want MSU to use the ranch in whatever way it considers most beneficial, including using the proceeds from the sale of the ranch to fund teaching, research or Extension programs.

The attorney suggested that they could gift the ranch to the College of Agriculture while they are alive, but retain a joint life estate. This will enable Jim and Sally to take income tax deductions now, enjoy their remaining years on the ranch, and know that the MSU College of Agriculture will own the property after they both die. The joint life estate would also qualify for gift and estate tax deductions. The attorney cautioned Jim and Sally that the life estate document could not be changed after the gift is made. They cannot change their minds about what organization is to receive the ranch once the gift is made.

## Summary

A life estate is a legal tool that may meet the estate planning objectives of a wide variety of individuals. A life estate allows the life tenant to retain the income from and use of the property for the duration of his or her life with the remaindermen receiving full ownership of the property when the life tenant dies.

To determine whether a life estate is the appropriate legal tool for your situation, discuss your estate planning objectives with an attorney whose practice is primarily in the estate planning area. Because of the inflexibility of a life estate, the attorney may recommend other alternatives such as a bypass or trust. A bypass trust is a legal tool that could be used to achieve the goals of the three couples mentioned in this MontGuide. For more information request:

- *Using a Bypass Trust to Provide Children from Remarried, Step, and Blended Families (MT201407HR)*
- *Transferring Your Farm or Ranch to the Next Generation (EB0149)*

An interactive website illustrating the distribution of a deceased person's estate including a brand (if there is no written will), can be found at [www.montana.edu/dyingwithoutawill](http://www.montana.edu/dyingwithoutawill). Montanans with slow internet service may find a CD containing the same information to be more usable. Request a copy from your local county Extension office or send your request to:

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## Acknowledgement

This MontGuide has been reviewed by representatives of the Business, Estates, Trusts, Tax and Real Property Section of the State Bar of Montana who recommend its reading by Montanans who are interested in life estates.

## Disclaimer

This publication is not intended to be a substitute for legal advice. Rather, it is designed to help families become better acquainted with some of the devices used in estate planning and to create an awareness of the need for such planning. Future changes in laws cannot be predicted, and statements within this fact sheet are based solely upon those laws in force on the date of the publication.



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