

When to Look a Gift Horse in the Mouth (You, Your Home, Your Children)

BY TOM MARTIN

A long time ago, the citizens of ancient Troy would have saved themselves a lot of grief if they had first checked to see if the “gift” from the Greeks was really one at all. The same is true for gifts from family members who have the best of intentions.

FATAL MISTAKE

Sometimes looks can be deceiving.

Let’s say you own your home free and clear and would like to leave it to your two children. You’ve heard people talk about the need to avoid “probate” and you figure the best and cheapest way to avoid it is to simply add your kids to the title as joint tenants with rights of survivorship.

That way, when you pass, your home will go directly to your kids without the need for probate. Pretty good solution, and with no need to pay an attorney for expensive advice, right? Wrong.

You see, although joint tenancy helps your kids avoid the time and expense of probate, it burdens them with unintended tax consequences.

MURPHY’S LAW

“What tax consequences?” you might ask.

Well, when you add your kids onto the title to your home, they step into your shoes as far as the IRS is concerned.

Let’s say you purchased your home some time ago for \$50,000 and your home is now worth \$500,000.

If you decided to sell your house today, you would potentially pay capital gains tax on the difference between the purchase price and the sales price, or \$450,000. By adding your kids to the title, if they sold the house after you passed, they would also owe taxes on \$450,000.

It gets worse.

If you sold your own home in which you have lived for 2 years or more, you could make up to \$250,000 in profit

if you’re a single owner or twice that if you’re married, and not owe any capital gains taxes. But, your kids likely don’t get that tax break.

The amount of capital gains tax they would owe depends on their tax bracket and can range from 5% to 15%. Bottom line: your kids could get stuck with a tax bill of up to \$67,500. Yes, \$67,500.

WHAT TO DO?

By creating a living trust, you can ensure your kids will avoid probate and not have to pay steep capital gains taxes on your home.

If they sell the house for \$550,000 a year after they inherit it, they will only owe taxes on the increase since they inherited it, or \$50,000. Their likely tax bill: between \$2,500 and \$7,500. That’s a potential capital gains savings of \$60,000! ♦

