

## **Calculation of Gain or Loss On Sale of Life Estate**

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Losses are generally not realized on the sale of personal assets. In order to calculate gain, the value of the life estate and remainder interest must first be determined using tables prescribed by the Internal Revenue Service (Table S). See IRS Publication No. 1457. In order to use the tables, you need the current IRC § 7520 rate and the age of the life tenant. The IRC § 7520 rate is published by the IRS on a monthly basis by way of a Revenue Ruling.

Under IRC § 121, gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 or more years. A taxpayer who meets the ownership and use requirements may apply the IRC §121 exclusion to gain from the sale or exchange of an interest in the taxpayer's principal residence that is less than the taxpayer's entire interest if the interest sold or exchanged includes an interest in the dwelling unit. Section 1.121-4(e)(1)(i) of the Regulations.

Generally, the life tenant meets the use and ownership test of IRC § 121 and thus can exclude the gain allocated to her. However, under most fact patterns, the remainderman fail the test and must realize the gain allocated to them.

#### **Fact Pattern:**

Mother transfers title to her two children in October of 2005 while retaining a life estate and limited power of appointment. In September 2006, Mother and children decide to sell the primary residence against the advice of counsel. At the time of the sale the Mother is 87 years of age and the IRC § 7520 rate is 6.0%

**STATEMENT OF SALE**

**CLOSING DATE:** September 2006

**PARTIES:** Life Tenant, Child A and Child B

**PREMISES:** Principal Residence

**CONTRACT PRICE:** \$365,000.00

**SELLER'S CREDITS**

State, County and Town Taxes ( $\$680.71/365=\$1.87/\text{day} * 108 \text{ days}$ ) \$202.00

School Taxes ( $\$723.61/365=\$1.99/\text{day} * 289 \text{ days}$ ) \$575.00

Fuel Oil (206.50 gallons \* \$2.38/gallon) \$491.10

**TOTAL CREDITS TO SELLER** \$1,268.10

**PURCHASER'S CREDITS**

Contract Deposit \$36,500.00

Property Disclosure Credit \$500.00

**TOTAL CREDITS TO PURCHASER** \$37,000.00

**AMOUNT DUE SELLER AT CLOSING** \$329,268.10

**Less Amounts Paid At Closing:**

1. Coldwell Banker \$9,125.00

2. Re/Max \$9,125.00

3. New Age Title Agency, Inc. \$1,685.00

4. Other Fees \$1,975.00

**NET AMOUNT DUE SELLER** \$307,358.10

# **CALCULATION OF CAPITAL GAIN AND DISTRIBUTION OF NET PROCEEDS**

September 2006 § 7520 Rate: 6.0%  
Client's Closest Age: 87

Value of a Life Estate: 25.38%  
Value of a Remainder Interest: 74.62%

**NET AMOUNT TO BE APPORTIONED BETWEEN SELLERS (INCLUDES ESCROW) \$343,858.10**

## **AMOUNT DISBURSED TO SELLERS AS FOLLOWS:**

### **LIFE TENANT**

Sales Proceeds (\$343,858.10 \* .2538) \$87,271.18

Net Amount Distributed to Life Tenant **\$87,271.18**

### **CHILD A**

Sales Proceeds (\$343,858.10 \* .7462=\$256,586.92/2) \$128,293.46

Net Amount Distributed to Child A **\$128,293.46**

### **CHILD B**

Sales Proceeds (\$343,858.10 \* .7462=\$256,586.92/2) \$128,293.46

Net Amount Distributed to Child B **\$128,293.46**

### ESTIMATED CAPITAL GAIN CALCULATION

Sales Price	\$365,000.00
Less: Expense of Sale	(\$21,910.00)
Less: Adjusted Cost Basis	<u>(\$215,000.00)</u>
Estimated Capital Gain	\$128,090.00

### ESTMIATED CAPITAL GAIN APPORTIONED AS FOLLOWS:

Life Tenant ( $\$128,090 * .2538$ )	\$32,509.25
Child A ( $\$128,090 * .7462 = \$95,580.76/2$ )	\$47,790.38
Child B ( $\$128,090 * .7462 = \$95,580.76/2$ )	\$47,790.38

Consideration should be given to coordinating with the accountant of the various parties to compute pro form individual income tax returns using the projected capital gains figures in order to calculate the tax impact on the parties individual income tax profiles. Estimated taxes should be paid to both the IRS and New York State at the closing table to avoid (i) a large tax payment to the IRS the following year, (ii) underpayment penalties and (iv) accusations by the parties against the attorney that they were never told they had to pay taxes and thus, spent the money.

***Query:*** Will the Department of Social Services accept the calculation of the gross proceeds attributable to the life tenant?