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# Ways Clients Can Help Their Children Buy A House

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Home ownership is part of the American dream and some clients may want to help a child purchase a home. If they are ready to provide some financial support, there are a number of options available. Determining the best option for them typically depends upon a number of factors, chief among them: how much financial help they are willing and able to provide and what level of control and involvement they want to retain. The most common approaches are described below, presented in order of how much control they retain (from least to most).

**Option 1—Outright Gift:**
You make a cash gift to your child for a home purchase.

Option 1 is the simplest and easiest to implement. You make a gift, and then have no ongoing involvement or responsibility with respect to your child's home. Once you gift the funds, it is up to your child to determine how and why to use them, and even whether to purchase a home at all. Later, the child may sell or gift the home as desired, even if you disagree with the choice.  If your gift exceeds the annual gift tax exclusion ($16,000 in 2022), you must file a gift tax return to report the gift. No gift tax is due unless you have already used your full lifetime gift tax exemption ($12,060,000 in 2022).

**Option 2—Loan:**
You loan money to your child for a home purchase.

Option 2 allows you to support your child without making a gift, and with the expectation of repayment. Your loan can be secured (a mortgage on the home your child buys) or unsecured, and is documented with a promissory note (your child's enforceable written promise to pay you back).

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You don't have any ownership or responsibility for the home, nor do you participate in the appreciation in the home's value; however, you have some control because your initial investment is due back to you. This obligation means that your child can't gift the funds received to someone else (like a disapproved spouse), or sell the home and use the funds you loaned them for some other endeavor unless you agree. If you subsequently choose to do so, you can forgive the loan, making a gift during your lifetime or at death through your estate plan. To avoid any gift tax consequences, your loan must bear interest of at least the IRS minimum interest rate (known as the "applicable federal rate") for the term of the loan, and the child must actually pay you that interest, which is taxable income to you for income tax purposes (and may be deductible by your child as mortgage interest if properly structured). If your child does not make the required interest payments, there is a risk that the IRS will treat the entire arrangement as a gift from you to your child.

**Option 3—Gift Or Loan In Trust:**
You create an irrevocable trust for your child and make a gift (Option 1) or loan (Option 2) to that trust rather than to your child directly.

By making the gift or loan to an irrevocable trust, you have more control over how the gifted funds are used in the future. Irrevocable trusts can be structured in a variety of ways that give your child as much or as little control as you desire, and are meant to address a variety of concerns and issues. For example, if you want your child to have a place to live but don't believe they are able to manage financial

assets, you can choose a trustee other than your child. The trustee, as owner, handles payments relating to ownership of the home, decisions about when to sell the home and how to reinvest the sale proceeds for your child, etc.

If it is important to you that your gift (or the home purchased with gifted funds) remains your child's separate property, but you otherwise trust the child to own and manage the home, an irrevocable trust can act as a built-in premarital agreement, ensuring that the home it owns is your married child's separate property which cannot be gifted to a spouse or claimed by a divorcing spouse. An irrevocable trust can also provide creditor protection for your child in the event of a personal liability. Importantly, an irrevocable trust can also provide income tax benefits (e.g., eliminating taxable income to you on interest payments made on a loan (Option 2)) and multi-generational transfer tax benefits (e.g., protecting your gift, and the purchased home, from future gift or estate tax).

While an irrevocable trust can provide significant benefits, it does add a bit of complexity both at the outset, and over the long-term as the trust structure remains in place. Unless the irrevocable trust owns other assets that can be used to maintain the home, it is important to have a plan in place to cover the ongoing costs of maintenance and ownership. Also, if your child hopes to obtain a conventional mortgage for a home purchase (in addition to whatever gift or loan you make), this option may not be available because banks are often reluctant to lend to irrevocable trusts (or if they do, may offer less favorable terms and require a personal guarantee).

**Option 4—Joint Purchase:**
You acquire an ownership interest in your child's home, in accordance with your percentage contribution to the purchase price.

Like Option 2, Option 4 allows you to support your child's home ownership without making a gift. As the home appreciates, you share in the appreciation with your child, according to your ownership interests. This might be a good thing (if you need that value for retirement or other activities yourself), or may be a disadvantage if you intend to ultimately gift your interest to your child (because your ultimate gift is of your interest in the appreciated home value, rather than your initial investment, and gift or estate tax may be due as a result). If your child plans to obtain a mortgage and you are willing to sign on as a co-borrower, your good credit may help your child qualify for more attractive mortgage rates or terms, though you become liable if your child does not make required mortgage payments. You retain some control through your ownership interest, and while you may ultimately choose to gift your interest to your child, you are not required to do so.

Co-ownership can be messy, however. You and your child may later disagree about who is responsible to pay expenses of home ownership (including property taxes, insurance, maintenance, improvements and utilities), when to sell the home, or what happens if one of you wants to transfer your interest in the home to someone else. Having a clear agreement on these points up front, preferably in writing, is advisable. Updating your estate plan to address a co-owned home is also important. For example, parents typically co-own homes with their children as "tenants-in-common," which means each owner's interest passes at death according to the owner's estate plan. Ensuring that the estate plan addresses whether the child who lives in the home inherits it or has the opportunity to purchase it is important. If you have other children, it is also important to address whether and how your other children are "equalized" for the gift, receiving approximately the same amounts from you overall, and how the home is valued for purposes of that equalization. For example, a partial interest in property is typically "discounted" in valuation due to your inability as a partial owner to control the property or easily sell your interest, but for equalization this notion of a discount sometimes causes tension between children as they perceive it to favor the child who co-owns the house with you.

**Option 5—You Own A Home Where Your Child Lives:**
You purchase a home and allow your child to live there.

If you want your child to have a home to live in, but are not comfortable with Options 1-4 and wish to retain complete control, you can purchase a home and allow your child to live there. As owner, you have full responsibility for, and control over, the home. You also have the ability to set terms and conditions applicable to your child's use and occupancy of the home – for example, do they pay rent? Who else may live in the home with them? Are they responsible for maintenance, repairs and utilities? Whether you are making a gift to your child if you allow them to live in your home without payment of full fair market value rent is a gray area. It has long been recognized that the rent-free use of property is a gift (which is why, in Option 2, you make a gift if you do not charge interest on a loan you make to your child). However, there is a commonly understood exception for personal and family consumption that is not well defined, and it is important to consult with your advisors in this regard.

As with Option 4, it is critical that your estate plan address whether your child can continue to live in the home following your passing, and if so, the terms under which he or she can

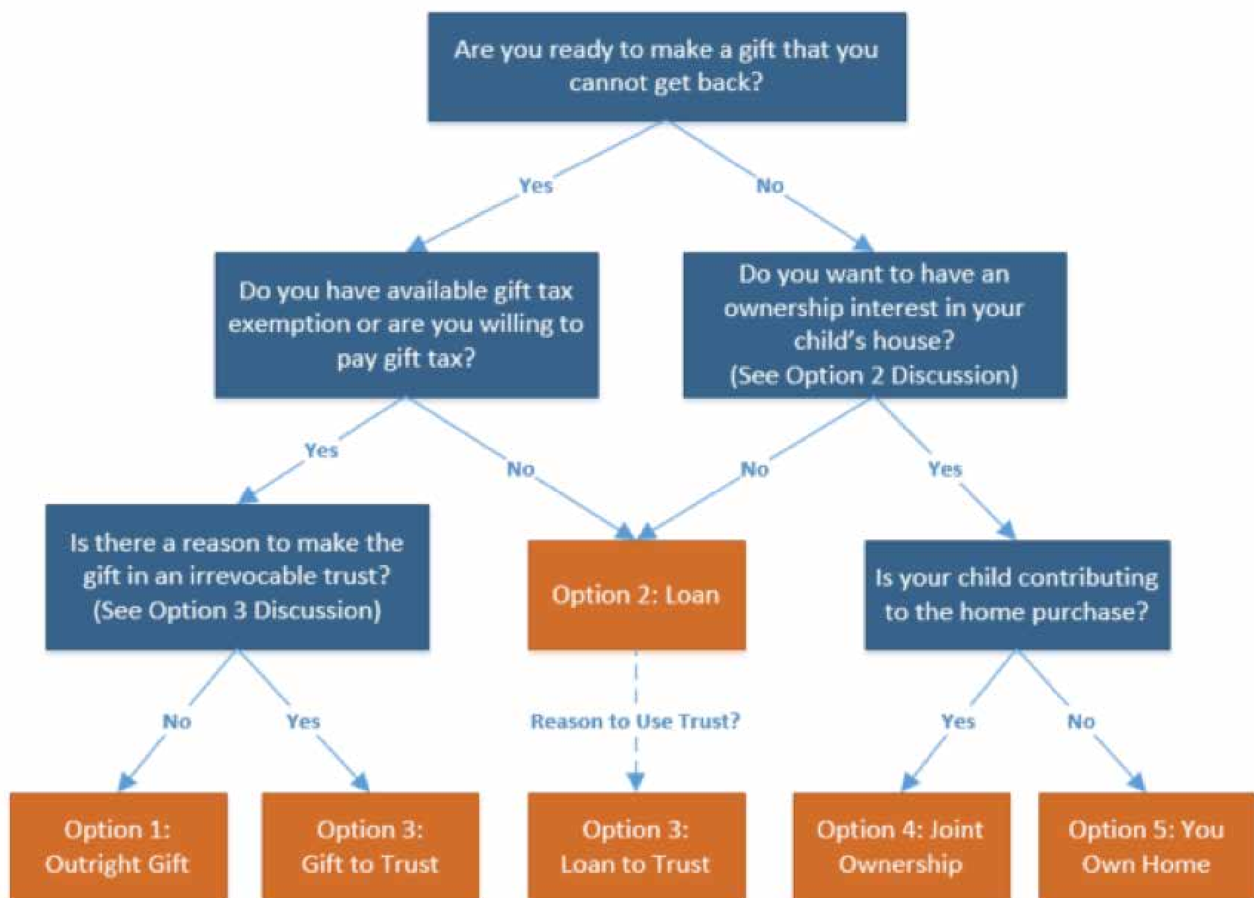
reside there (e.g., will the child inherit the home? be given the option to purchase it?). Ideally, you will communicate those decisions with your child so that they are not surprised to learn about any benefits, requirements or restrictions when you are gone.

**Privacy, Property Tax And Your Child's Estate Plan**
In California, there are unique issues that arise when helping a child buy a house.

First, property ownership records are public and easy to search. If it is important to you or your child to maintain privacy and public connection to the property, planning up front for this is important.

Second, California property taxes are generally based upon a home's purchase price (with limited annual adjustments) rather than fair market value. However, when a change in ownership occurs, the property tax base is adjusted to fair market value unless an exclusion applies. Prior to Proposition 19 (which became effective in 2021), there were exclusions that could prevent this adjustment whenever a parent transferred a home to their child. Now, choosing Option 4 or Option 5 often results in partial or full property tax reassessment if your interest in the home is ultimately given or sold to your child. If the home has significantly appreciated since purchase, this means a steep increase in annual property taxes, which may impact the child's ability to retain the home on an ongoing basis. This negative result can sometimes be avoided with careful up-front planning before the home is acquired.

Finally, without appropriate planning, your child's death could result in a probate (which brings avoidable expense and delay), the transfer of the home to unintentional beneficiaries (if the child does not have their own will or trust), the need for court-appointed guardians (if the child's interest passes to their minor children without other planning), or other unintended results. For these reasons, your child should complete or update their own estate plan when the home is purchased. FA

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