

Families rarely sit around the kitchen table talking about basis, step up, or lifetime exemptions. They talk about helping a child buy a first home, making sure a surviving spouse is secure, or keeping the house out of the nursing home's reach. The tax rules sit underneath all of that, quietly shaping which choices actually help your family and which end up backfiring.

I have watched more than a few clients spend years carefully "gifting things away," only for the family to face higher capital gains tax or a Medicaid penalty period later. I have also seen the opposite problem: people so afraid of doing the wrong thing that they do nothing, and their heirs slog through probate or fight over unclear intentions.

Gifting versus inheriting is not just a tax question. It is also about control, timing, creditor risk, and practical family dynamics. Taxes, however, deserve a clear explanation, because bad assumptions here are one of the most common inheritance mistakes.

Gifts vs inheriting: the core tax difference

For most middle and even upper middle class families in the United States, the main tax issue is not estate tax. It is capital gains tax tied to the cost basis of assets.

When you **gift** an asset during life, the recipient usually takes your **carryover basis**. If you bought a house for 150,000 and it is worth 450,000 when you sign the deed over to your daughter, her basis is still 150,000. When she later sells, she may have 300,000 of taxable gain, minus any improvements and eligible exclusions.

When someone **inherits** that same property at your death, the basis usually "steps up" to fair market value on the date of death. Using the same numbers, if the property is worth 450,000 when your heirs receive it, their basis is 450,000. If they sell it soon after at roughly that price, there may be little or no capital gain.

That step up is often the single biggest tax benefit of inheriting rather than receiving a lifetime gift.

Here is where people get tripped up. They focus on avoiding "death taxes" that in practice will never apply to them, and overlook the very real capital gains cost of gifting highly appreciated property during life.

How much can you inherit from your parents without paying taxes?

For federal estate tax purposes, the exemption is very high compared with most family balances. As of 2024, the federal estate and gift tax exemption is in the ballpark of 13 million per person, or roughly 26 million for a married couple with proper planning. That means most children can inherit quite a bit from their parents without paying federal estate tax.

However, three points often confuse people:

First, that exemption is scheduled to drop roughly in half in 2026, unless Congress changes the law.

Second, states can impose their own estate or inheritance taxes with much lower thresholds. Depending on where you and your parents live, state rules may be more relevant than federal ones.

Third, while inheritances are usually not subject to income tax, **future gains** on inherited assets can be. That is where basis and step up matter.

In other words, for many families the better question is not "How much can you inherit from your parents without paying taxes?" but rather "How do we structure things so we get a step up in basis and minimize income tax on later sales?"

When gifting during life makes sense

Lifetime gifts are not the villain. There are many good reasons to transfer wealth before death, especially to adult children. The best way to gift money to an adult child depends on your goals, their situation, and the tax rules in play.

You might be trying to help a child with a down payment, even out prior support among siblings, fund education, or gradually transfer a family business. Sometimes, you are also trying to remove assets from your taxable estate or from possible creditors.

For cash or assets that have not appreciated much, gifting can make a lot of sense. The federal annual gift tax exclusion allows you to give up to a certain amount per recipient each year (17,000 per person in 2023, 18,000 per person in 2024), without filing a gift tax return. You can give more, but larger gifts simply chip away at your lifetime exemption.

If you are asking yourself, "What is the best way to gift money to an adult child?", a few strategies commonly come up in practice:

You might give cash directly under the annual exclusion, so there is no paperwork and no tax to the child. You might pay tuition or medical bills directly to the institution. Direct payments for qualified education or medical expenses are not subject to gift tax and do not use up your annual exclusion. Or you might fund a 529 college savings plan, where the growth can be tax free if used for qualified education.

All of those share one trait. They generally do not involve significant cost basis issues, because you are gifting cash or assets that will not trigger large capital gains right away.

Where people get into trouble is when they gift away their house, rental properties, or long held stock with large built in gains. At that point, the loss of the step up in basis can easily outweigh any modest estate tax or probate savings.

Is it better to leave a house in a will or trust?

Clients almost always ask some version of this. "What is the best way to leave your house to your children?" and "Is it better to leave a house in a will or trust?" sound like different questions, but they both aim at the same concerns: taxes, probate, control, and protection from nursing home costs.

From a pure tax perspective, whether your children receive the house through a will or a revocable living trust, the step up in basis is generally the same. The key is that they **inherit** at your death rather than receive the property as a lifetime gift.

The real differences between a will and a trust are procedural and practical:

A house that passes through a **will** is subject to probate. In many states, that means delays, public records, court oversight, and higher legal and court costs. It can be perfectly workable, but it is not always efficient.

A house inside a properly funded **revocable living trust** usually avoids probate. The successor trustee can follow the instructions in the trust document and transfer or sell the property with less court involvement.

If you are wondering which bank accounts avoid probate, the same concept applies. Accounts with pay on death (POD) or transfer on death (TOD) designations, joint accounts with rights of survivorship, or accounts titled in a revocable trust generally avoid probate. Accounts in your sole name without any of those features typically pass through your will and the probate process.

So, is it better to leave a house in a will or trust? For many families, placing the home in a revocable trust gives a cleaner transition on your death, without sacrificing the step up in basis. There are exceptions, particularly if you have complex creditor concerns, a blended family, or beneficiaries who need long term management. That is where a tailored conversation with an estate planning attorney near you matters.

The nursing home question: can Medicaid take the house?

Few topics generate more anxiety than long term care and the risk of losing a home. I hear all kinds of half true statements about “Medicaid loopholes” and “5 year rules.” Clarifying those is essential before deciding whether to gift the house, put it in a trust, or leave it to be inherited.

First, Medicaid is means tested. To qualify for long term care Medicaid, your assets and income usually must be below certain limits. Your primary residence may be treated differently from other assets while you are alive, but after your death, your state may pursue “estate recovery” and seek reimbursement from your estate.

That leads straight to the question: “Can a nursing home take your house if it is in a trust?” The answer depends on **what kind of trust**, when it was created, and your state’s specific rules.

A simple revocable living trust usually provides **no** protection for Medicaid purposes. Since you retain the right to revoke or change it, the law typically treats those assets as still yours. They are counted for eligibility, and they remain exposed for estate recovery.

Irrevocable trusts are a different animal. That is where the well known “5 year rule for irrevocable trusts” and the “Medicaid 5 year lookback” come in. If you transfer assets, including your house, into a properly drafted irrevocable Medicaid trust and then apply for Medicaid within 5 years, the transfer can trigger a penalty period. During that penalty period, Medicaid will not pay for your long term care, [probate attorney orange county](#) which can be financially devastating.

So when people ask “How to avoid Medicaid 5 year lookback” or about a “Medicaid loophole,” what they are really asking is how to do legal planning **more than 5 years before** needing care and in a way that meets very specific requirements. There is no magical loophole that safely hides assets at the last minute without consequences. There is, however, careful early planning where an irrevocable trust can make sense.

That leads straight to some hard tradeoffs.

The downside of putting your house in an irrevocable trust

Irrevocable trusts can be powerful. They can protect assets from your future creditors, including potentially long term care costs, and they can remove appreciation from your taxable estate. But they are not free.

When people ask, “What are the only three reasons you should have an irrevocable trust?” I usually give them this framework, understanding there are always nuances:

You want to protect assets from future creditors or lawsuits, including potential long term care costs, in a way that fits Medicaid rules and your state law. You want to achieve a specific tax result, such as removing life insurance proceeds or appreciating assets from your taxable estate while still preserving some or all of the step up in basis. Or you want to lock in a structure for beneficiaries who cannot or should not control the assets directly, such as a child with special needs, an heir with addiction issues, or a blended family where you want to provide for a surviving spouse but protect children from a prior marriage.

The downside of putting your house in an irrevocable trust is loss of control. You are usually giving up the right to change your mind easily, sell or refinance without trustee cooperation, or reclaim the property directly. Depending

on how the trust is drafted, there may be complications for mortgage lenders, title companies, and even property tax exemptions.

There is also confusion around “What is the 7 year rule for trusts?” That phrase often comes from the United Kingdom’s inheritance tax rules, not from U.S. Medicaid. In the U.S., the more relevant timing concept for Medicaid is the 5 year lookback, not 7 years. For U.S. Federal estate and gift tax, there is no generic 7 year rule for trusts, though there are various 3 year and other specific timing rules for certain transfers.

The “5 year rule for irrevocable trusts” people talk about is usually just shorthand for the Medicaid lookback. Create and fund the right kind of trust at least 5 years before you need nursing home care, and those assets might be shielded. Do it closer in time, and you may be penalized.

Because of these tradeoffs, an irrevocable trust is not a casual decision, and it should be part of comprehensive estate planning, not something pulled from a generic online form.

Gifts vs inheriting: practical tax comparison

It often helps clients to see the main tradeoffs side by side. Keeping in mind that state laws and personal circumstances matter, here is a general comparison that comes up again and again in practice.

1. Lifetime gifts of appreciated assets transfer your low basis to the recipient, which can increase their future capital gains tax. Inherited assets typically receive a step up in basis to date of death value, reducing or eliminating those gains.
2. Lifetime gifts can reduce the size of your taxable estate and may provide Medicaid planning benefits if structured correctly and done early. Inheritances keep assets under your control while you are alive, but they remain in your estate for tax and sometimes for Medicaid estate recovery.
3. Gifting can help family members when they need it most, such as funding a business or buying a home, but may create resentment if not coordinated among siblings or clearly communicated. Inheriting at death can be more equal and orderly, but does not provide help during your lifetime.
4. Gifting certain assets, like cash or recently purchased property, usually has minimal capital gains impact. Gifting highly appreciated stock, a long held rental, or the family home often has large basis consequences.
5. For very large estates that are likely to exceed federal or state estate tax thresholds, strategic lifetime gifts may be essential. For most families, protecting the step up in basis is usually tax priority number one.

An experienced estate planning attorney near you will plug your actual numbers into this analysis. It is one thing to say, “Gifting the house costs your children the step up.” It is another to show that the difference in capital gains tax could be, say, 60,000 to 120,000 based on realistic sale values.

Who should you avoid naming as a beneficiary?

Beneficiary designations can quietly undo or enhance your broader planning. Clients often ask, “Who should I not name as a beneficiary?” The answer depends on context, but a few recurring patterns show up.

It is generally risky to name **minor children** directly as beneficiaries of life insurance, retirement accounts, or bank accounts. A court will likely need to appoint a guardian or conservator to manage the funds, which can be expensive and clumsy. Using a trust for minor beneficiaries often makes more sense.

It is usually a mistake to name a beneficiary who receives means tested government benefits, such as certain disability benefits, without considering a special needs trust. A direct inheritance might disqualify them from

essential services.

Ex spouses, casual acquaintances, and financially unstable friends sometimes linger on outdated beneficiary forms. Reviewing those regularly is part of comprehensive estate planning. If you name someone who is deep in debt or facing lawsuits, their creditors may capture the inheritance you intended for them.

On the flip side, one of the most common inheritance mistakes is relying on your will to control assets that **do not** pass through your will at all. Retirement accounts, life insurance, and some bank accounts pass by beneficiary designation, not by the terms in your will. That leads straight to another issue.

What should not be included in a will?

A will is not a catchall. Several types of instructions either do not belong in a will or should be handled elsewhere as well.

You should not rely on your will alone to distribute retirement accounts like IRAs and 401(k)s or life insurance proceeds. Beneficiary designations control those, and conflicts between your will and those forms usually resolve in favor of the designation, not the will.

You should not put overly detailed instructions about medical care in your will. By the time a will is read, your medical decisions have long since been made. Separate health care directives, living wills, and powers of attorney handle those issues.

You should avoid trying to use a will to change property that already passes by joint ownership with rights of survivorship. For example, if you own a house jointly with a child as joint tenants, your will cannot easily redirect that house to someone else at death.

What is comprehensive estate planning, in part, is recognizing which document controls which asset, and making sure they all match your intentions. A will is important, but it is only one piece of the puzzle.

The 5 by 5 rule in estate planning

Every so often, particularly with older irrevocable trusts or life insurance trusts, clients encounter the phrase “5 by 5 rule.” It usually refers to a power in a trust that allows a beneficiary to withdraw the greater of 5,000 or 5 percent of the trust assets each year.

This 5 by 5 rule has two main purposes. First, it can provide a beneficiary with limited access to trust funds, which can be helpful if they need occasional financial support. Second, it can help keep the trust assets from being treated as fully owned by the beneficiary for certain tax and creditor purposes, while still giving them a modest withdrawal right.

This is a technical area, but it matters when you are evaluating older trusts, life insurance planning, or how to give children controlled access to funds without blowing up your protection objectives.

Probate, bank accounts, and avoiding messy transitions

People often underestimate how disruptive a badly handled transition at death can be. Accounts get frozen, bills go unpaid, and siblings argue over who was “supposed” to get what.

A common question is which bank accounts avoid probate. In practice, these usually fall into several categories: accounts with pay on death or transfer on death designations, joint accounts with survivorship rights, and accounts held in a revocable trust. Structuring accounts this way can significantly streamline administration.

That said, there is a trap: overusing joint accounts with one child “for convenience,” expecting them to share later. That is one of the most common inheritance mistakes I see. The law often treats that account as belonging to the surviving joint owner, regardless of what you “meant.” Better options might be a power of attorney during life and clear beneficiary or trust provisions at death.

What is comprehensive estate planning?

People sometimes ask, “Do I really need anything more than a simple will?” and “What is comprehensive estate planning?” The difference is less about how thick the binder is and more about how well the plan fits your actual life.

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Will and Testament of
**LAST WILL
AND
TESTAMENT**



Comprehensive planning usually covers several coordinated pieces:

Your will, which names an executor and handles property that does not pass through other mechanisms. A revocable living trust, if avoiding probate, providing continuity, or managing assets for beneficiaries makes sense. Powers of attorney for finances and health care, so someone you trust can act if you are incapacitated. Beneficiary designations reviewed and aligned with your broader plan. Real property titled in a way that reflects your goals about probate, tax basis, and protection. And, where appropriate, carefully crafted irrevocable trusts for tax or asset protection objectives, including Medicaid and special needs planning.

Crucially, comprehensive planning also includes **communication**. Your executor and key family members should know where documents are, who your advisors are, and what your general intentions are, even if they do not know every dollar amount.

How much does it cost to have an estate planning attorney?

Costs vary by region, complexity, and how the attorney structures fees. In my experience, people tend to underestimate the value of getting this right and overestimate the cost.

For a straightforward plan using a will, powers of attorney, and basic beneficiary review, fees in many parts of the country might range from several hundred dollars to a few thousand dollars. More complex plans, including multiple trusts, business succession planning, or advanced tax strategies, can be significantly more.

The better question is often how the cost compares to the potential savings or avoided problems. Fixing a poorly drafted will after death is usually impossible. Cleaning up an unclear beneficiary designation or unplanned Medicaid penalty can cost far more than the original planning would have.

When you speak with an estate planning attorney near you, ask openly about fees, flat versus hourly arrangements, and what is included. Also ask about ongoing updates, because tax laws, like the estate tax exemption, do change.

A short checklist before you gift or retitle your house

Before you sign a deed, add a child to a bank account, or move your home into an irrevocable trust, pause and work through a few key questions.

1. Does this transfer help or hurt from a capital gains standpoint, given the step up in basis your heirs would otherwise receive at your death?
2. Are you mixing Medicaid planning with tax and inheritance planning, and if so, have you realistically considered the 5 year lookback and your own health horizon?
3. Will this change create tension among your children or other heirs, either because it favors one person or because it complicates your estate administration?
4. Are you giving up control or flexibility that you might need later, especially if your own housing or financial needs change?
5. Have you run this plan by an experienced estate planning attorney who understands your state's specific rules on probate, Medicaid, and property transfers?

That short pause, paired with good advice, is often what separates families who look back on their planning with relief from those who quietly curse that "quick deed" or "simple change" for years.

Tax rules around gifting and inheriting are technical, but the consequences are personal. Whether you are trying to help an adult child now, shield assets from long term care costs, or simply make things easier for your heirs, taking the time to understand these differences, and to build a comprehensive plan around them, is almost always worth it.

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