SHOULD I HOLD TITLE TO MY PROPERTY IN JOINT TENANCY?

What is joint tenancy?

Joint tenancy is a form of holding title to property. Other forms of holding title include "tenants in common," "husband and wife," "community property," and "community property with right of survivorship." Title may also be held by a trustee in trust.

Joint tenancy has a characteristic known as the right of survivorship. This means that if one joint tenant dies, the surviving joint tenant(s) receives the deceased joint tenant's interest. For example, if Bob and Sue hold title to a duplex as joint tenants, and Bob dies, Sue then becomes the owner of the entire interest. If the property is a bank account, Sue need only provide the bank with a certified copy of Bob';s death certificate, and the bank will place the account solely in Sue's name. If the property was real property (for example, a duplex), Sue need only record an "Affidavit of Death of Joint Tenant" with the County Recorder in the county where the real property is located, and title to the property will vest solely in Sue.

To establish title in joint tenancy, title to the account or real property should be titled as follows: "Bob and Sue as joint tenants"; or "Bob and Sue as joint tenants with right of survivorship"; or "Bob *or* Sue." Note that use of the word "or" creates a joint tenancy. Conversely, if title was simply "Bob and Sue." the title established would be tenants in common.

What are the benefits of joint tenancy?

The primary benefit of joint tenancy is the right of survivorship. Upon death of a joint tenant, the surviving joint tenant succeeds to the entire interest in the property by the simple act of providing a death certificate (in the case of a bank account) or an affidavit of death of joint tenant (in the case of real property). Thus, the property interest of the decedent passes to the surviving joint tenant without the necessity of any type of probate proceeding or other administrative proceeding.

This should be compared to situations where title is held as "tenants in common" or "husband and wife." In the latter instances, the law treats the deceased owner's interest as an "undivided interest." For example, if Bob and Sue hold title as "tenants in common," then in the event of Bob's death, his undivided one-half interest will not necessarily pass to Sue, the surviving tenant in common. Instead, Bob's interest will pass to the beneficiary(ies) that he designates in a will, and only after a probate proceeding has been conducted or, in the event Bob dies without a will, his undivided one-half interest will pass to his "heirs at law," and only after a probate proceeding has been administered.[1]

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[1] "Heirs at law" generally depends on what members of the decedent's family survive him or her. A person without a will is said to have died "intestate." A person who dies with a valid will is said to have died "testate." Where a person dies intestate, his or her property passes to his or her relatives who survive him or her in accordance with a scheme established by the state where the decedent passed away.

What is probate?

Probate is an administrative court proceeding which is required before property of a decedent can be distributed to the persons named in the decedent's will or if the person died without a will, before the persons designated by law as the decedent's "heirs" may receive the property. Probate proceedings are a public record (i.e., the decedent's will and a description and value of the decedent's property are a matter of public record). The proceeding generally takes at least 6 months to complete (and usually longer), and an attorney is generally necessary to assist the decedent's representative (referred to as an executor or an administrator) in conducting and completing a probate proceeding.

In probate, the attorney and the representative of the estate are entitled to a fee based on the gross value of the decedent's property. For example, if the decedent died with a modest home valued at $300,000.00 with a mortgage of $150,000.00 and a bank account of $200,000.00, the attorney's fee and the representative's fee would each be $13,000.00. Thus, the total fees would be $26,000.00 to probate such an estate to ensure that the beneficiaries under the will or the heirs at law of the decedent received the decedent's property. In addition, a substantial filing fee is required by the court in connection with the probate proceeding.

Many people are aware of and wish to avoid probate costs. Holding title in joint tenancy is one way to avoid those expenses.

Are there any drawbacks to holding title in joint tenancy?

a. Income Tax Considerations.

There are numerous pitfalls to holding title in joint tenancy. One deficiency of joint tenancy concerns the concept of "basis." To illustrate, assume that Bob and Sue are married and in 1975 purchased a duplex at a cost of $75,000.00. For income tax purposes, Bob and Sue's "basis" is their cost, i.e., $75,000.00. Assume that in 2014, the duplex is now worth $275,000.00. Should Bob and Sue decide to sell the duplex, for income tax purposes, they would incur a gain of $200,000.00 (i.e., $275,000.00 sales price less $75,000.00 basis equals $200,000.00 gain). The income capital gains tax payable by Bob and Sue would be approximately fifteen percent (15%) of $200,000.00 to the federal government and approximately ten percent (10%) of the gain to the state of California. Thus, the income tax payable would be approximately $50,000.00.

Assume that before the duplex is sold, Bob dies. If Bob and Sue held title in joint tenancy, Sue will succeed to Bob's interest after filing an affidavit with the County Recorder in the county where the duplex is located. As a result of Bob's death, what happens to the "basis" in the property? The law treats Sue as inheriting Bob's interest and as to Bob's interest, Sue receives a "stepped-up" basis in Bob's one half of the property. Assuming the property was worth $275,000.00 on the date of death, Bob's one half of the property gets a new basis equivalent to one half of the date of death value, i.e., $137,500.00. Sue's basis in her one-half interest in the property remains at one half of the original cost, i.e., $37,500.00. Therefore, after Bob's death, Sue's basis in the entire property is a total of $175,000.00. If

Sue then sells the property, she will incur a taxable gain of $100,000.00, i.e., $275,000.00 fair market value less $175,000.00 basis equals $100,000.00. On a gain of $100,000.00, Sue will pay approximately $25,000.00 in income taxes.

In California, a community property state, married couples who hold title as "community property," receive a significant benefit on the date of death of the first spouse to die. The benefit is that the surviving spouse receives a "stepped-up" basis on both the deceased spouse's interest in the property and on the surviving spouse's interest in the property. Thus, in the example above, upon Bob's death, Sue receives a new "stepped-up" basis in the property equivalent to $275,000.00 on the date of Bob's death. In other words, she receives a stepped-up basis as to Bob's one half and as to her one half. Should Sue now decide to sell the property for the fair market value of $275,000.00, she will incur no gain on the transaction and no income tax will be payable. The advantage of the full stepped-up basis upon the death of the first spouse to die is generally very significant when the property in question has substantially appreciated since the date of original acquisition.

The income tax basis "trap" also arises where an owner transfers or "gifts" an interest in the property to others, as joint tenants. Many people attempt to avoid probate by transferring their property to their children during their lifetime. Using the above example, assume that Bob and Sue held title in joint tenancy, and that after Bob passed away, Sue's basis in the duplex is now $175,000.00 and the property is worth $275,000.00.

Bob and Sue have three children. Sue executes a deed transferring the property to her three children. Sue now knows that if she passes away, her three children will succeed to her interest without the necessity of probate. What is the children's basis in the property after Sue passes away? The answer is that the children receive Sue's basis and do not receive a "stepped-up basis" upon Sue's death. When an owner gifts property to others during that person's lifetime, the donees receive a "carry-over" basis, i.e., they receive the same basis as the donor, i.e., the person making the gift. In our example, the children receive Sue's basis of $175,000.00. After Sue passes away, if the children sell the property, they will have a gain of $100,000.00 and must pay income taxes of approximately $25,000.00.

If, instead, Sue had left the duplex to her children by way of a will, or through the mechanism of a living trust, her children would have received a full "stepped-up" basis upon her death. Then, when the children sold the duplex, there would have been no income taxes payable. By leaving the property to her children through a will, probate fees would have been incurred, but income taxes avoided. If Sue had left the property to her children utilizing a living trust, both probate fees and income taxes would have been avoided.

b. Gift and Estate Tax Considerations.

Another drawback to gifting or transferring property to others concerns the concept of gift and estate taxes. In the example above, where Sue gifted the property to her children, she must understand that she has, in fact, transferred ownership and, therefore, has made a gift to her children. Since there are

three children, she has effectively gifted each of them a one-third interest in the property. Assuming the property is worth $275,000.00 at the time of the transfer, and then Sue has effectively made a gift of $91,666.00 to each child.

Under our gift and estate tax laws, a person may gift up to $14,000.00 in property each year to any person without any tax consequence. Thus, with respect to each of her children, Sue has made a "taxable" gift of $77,666 to each of her children. By law, Sue is required to file a "gift tax return" with the IRS. All persons have an estate and gift tax "credit" amount. By making this transfer, Sue has used up $233,000.00 of her "credit"; (i.e. $77,666 x 3).

Many people who effect a transfer like the one in the example above, are not aware of the requirement that a gift tax return be filed and are not aware that a portion of their estate and gift tax credit has been used up.

c. Consequences of Ownership Rights.

Another overlooked consequence of the transfer or gift of an interest in property, particularly real property, concerns ownership rights to the property. If Sue has gifted an interest in the duplex to her three children, the result is that the three children and Sue become co-owners of the duplex. By law, co-owners of real property have certain absolute rights. For example, a co-owner who owns any interest in real property (i.e., whether it be a one percent (1%) interest or a ninety-nine percent (99%) interest) has the same right of possession to the real property as any other co-owner. Thus, an owner of any interest in real property has the right to occupy the entire property as does each of the other co-owners. Once a person acquires an ownership interest in real property, none of the other owners may prevent that owner from occupying the property.

d. Creditor Issues.

Last, transferring or gifting an interest in property to another creates a risk that a creditor of the new owner may acquire an interest in the property. Once again, using the example above, assume that Sue has gifted an interest in the duplex to her three children and assume that one of her children has issues concerning his or her financial irresponsibility, i.e., one of her children is a spendthrift, and assume further that a creditor of the spendthrift child has obtained a judgment against the spendthrift child for money owed to the creditor. Since the spendthrift child now owns an interest in the duplex, the creditor need only record its judgment in the county where the duplex is located and the creditor will now have a lien against the duplex. This lien will affect the ability of the other co-owners of the duplex to sell the duplex or borrow money against the duplex from a bank or other lender. In effect, the judgment creditor's lien against the spendthrift child will render the property unmarketable until the judgment that the creditor has obtained is paid off and the lien removed.

What are the alternatives to joint tenancy?

One alternative to joint tenancy that is available to spouses is a relatively new form of title known as "community property with right of survivorship." This form of title has only been available since 2001. It is only available to spouses where the property in question is in fact the community property of the spouses. "Community property with right of survivorship" gives the couple the benefit of the right of survivorship like joint tenancy but also gives the surviving spouse, in the event of the death of a spouse, a "stepped-up" basis on both the deceased spouse's interest in the property and the surviving spouse's interest in the property.

For non-spouses, the alternative form of ownership is "tenants in common." Legally, tenants in common each hold an undivided interest in the property. If there are three tenants in common, then each owner holds an undivided one-third interest. An owner's one-third interest will pass to the person designated by that owner in a will and if no will, by law to that owner's "heirs at law." In both cases, a probate proceeding will be necessary before title to the property will actually pass to the successor(s) of the decedent.

Generally speaking, the best form of ownership is that of a revocable living trust. A revocable living trust is similar to a will. It provides what will happen to a person's property upon death. An advantage of the living trust over a will is that the property in a living trust will pass to the decedent's beneficiaries or heirs without the necessity of probate and the expense of probate. Further, the beneficiaries who receive property from a decedent through a living trust receive a full "stepped up" basis in the property for income tax purposes.

Conclusion.

Historically, joint tenancy was commonly chosen by spouses and others as the preferred form of holding title to property. Typically, this form of holding title was selected without consideration of its numerous drawbacks and primarily as a probate avoidance device. The importance of the form of title to real property in overall estate and income tax planning is overlooked far more than it is considered.

The best course of action is to develop a relationship with an experienced estate planning attorney. An experienced estate planning attorney is indispensable to a person or couple who seek(s) to achieve an overall estate plan that will minimize taxes, avoid probate costs, and facilitate a transfer of property to intended beneficiaries and heirs with the least amount of delay and expense.