gc_logo_small

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Joint Property**

© 2016 Greene Consulting Associates, LLC INTENDED SOLELY FOR USE BY REGISTERED USERS NOT TO BE REPRODUCED OR CIRCULATED

## ABOUT GREENE CONSULTING ASSOCIATES, LLC

Greene Consulting Associates was founded in 1979 and provides consulting and training services solely to the financial services marketplace. Located in Atlanta, Georgia, Greene Consulting has worked with the top providers of investment management and wealth management in both the United States and abroad. Focused on helping firms generate incremental revenue growth through more effective sales and relationship management strategies, Greene Consulting offers customized training programs in Financial Services Sales, a Sales Management program, Presentation Training that integrates proprietary products, and a comprehensive suite of online learning courses related to investments and wealth management entitled SkillMark®.

For more information about Greene Consulting or any of its products and services, write Greene Consulting at Waterstone Building, 4751 Best Road, Suite 450, Atlanta, Georgia 30337. Or, visit the company's website at [www.greeneconsults.com](http://www.greeneconsults.com).

## Introduction

Used prudently, jointly held property can be one of the simplest and most expedient methods of transferring assets at death. In some cases, it is a type of transfer that takes place as an operation of law, which sometimes completely bypasses the probate process. But if its features are ignored or improperly used in the estate planning process, it can significantly undermine the estate plan. It is, therefore, important to have a basic understanding of the features of joint property.

|  |
| --- |
| **Probate Process**  The probate process involves the court’s authentication of the will and supervision of payment of creditors, changing titles to property, and the distribution to heirs. |

|  |
| --- |
| Objectives  At the conclusion of this module, you should be able to:   * Explain the characteristics of different types of jointly held property. * Understand the estate tax implications of jointly held property. * Identify when the use of jointly held property might complement or undermine an estate plan. * Understand the unique characteristics of community property and its implications for non-community-property states. |

## Types of Jointly Owned Property

There are four types of co-ownership of property, which are listed below. For each of them, it is important to have knowledge of the following points:

* The number of permissible owners
* The relationship of owners, if any
* The nature of each person's ownership
* What happens when an owner dies
* Appropriate use of this type of ownership

|  |  |  |  |
| --- | --- | --- | --- |
| **Joint Tenants (with Right of Survivorship)**   * How many owners are allowed? **Two or more.** * What is the relationship of the owners? **None required, but they may be related.** * What is the extent of each person's ownership interest? **Each co-owner has an equal,** undivided interest. If there are two owners, they each own ½. If there are three owners, they each own 1/3.  |  | | --- | | Undivided Interest  An undivided interest is where each co-owner has an ***interest in the entire property***, not just ownership of a piece of the property.  For example, if two individuals own an undivided interest in an acre of land, each owner has an ownership interest in the entire acre, rather than one owning the northern half and the other owning the southern half. Each owner, therefore, has the right to make use of the entire acre, not just a piece of it. |   Even though two or more people own property as JTWROS, the rights of the parties may be limited, thus preventing a tenant from asserting ownership rights over his/her undivided share without the consent of the other joint owners. For example, a check payable to John and Mary as JTWROS may require both owners to endorse the check, and it is unlikely a bank would permit one party acting alone to endorse and claim half of the amount due.   * *What happens when an owner dies?*  **His/her interest passes to the surviving co-owners.** Although the phrase "with right of survivorship" is frequently added, this is merely for clarification and is not required. For example, if there were four owners, each with ¼ interest in the property, then when one dies the other three co-owners would have 1/3 interest in the property. * *When is this appropriate?*  In common law states, it is **most appropriate for married couples** to title their home and checking accounts in this manner. Financial accounts are usually converted to this type of ownership by indicating the letters JTWROS (Joint Tenants with Right of Survivorship). But its use in this manner might require that each spouse own property individually sufficient to optimize their use of the applicable credit amount. However, caution regarding JTWROS is in order for community property states, where it can be more advantageous for spouses to own property as community property or as “community property with right of survivorship” so that 100% of the property can get a step up in basis (rather than 50%) when one spouse dies.   JTWROS can also be useful in passing property to the next generation, such as a surviving spouse titling property in Joint Tenancy with a son or daughter. But this later use makes the most sense when there is only one son or daughter. Where there is more than one child, it could result in unequal distributions unless this is adjusted for in the will. Note that the gift of a cotenancy interest to anyone other than a spouse may have adverse estate tax consequences.   |  | | --- | | Example of Unequal Distributions  Mary was married to John at his death. They have two daughters, Jane and Helen. Following John’s death, Mary titled property JTWROS with herself, Jane, and Helen as cotenants (co-owners).   * When Mary dies, Mary’s 1/3 interest passes equally to Jane and Helen. * Jane and Helen become 50% cotenants in the JTWROS after Mary’s death. * Assume Jane dies next. * Jane’s 50% of the JTWROS passes to Helen. * Helen now owns 100% of the property. |  |  | | --- | | Adverse Estate Tax Consequence  A gift of a cotenancy interest to a child or anyone other than a spouse may incur gift tax, subject to the facts and circumstances of each case. This will be discussed in detail later in this course.  However, the gift of a cotenancy interest to anyone other than a spouse may cause inclusion of the value of the gift in donor’s gross estate. The value included in the donor’s gross estate is generally the date of death value, not the value when the gift occurred. If significant appreciation occurs from the date of the gift to the donor’s death, this has the potential for increasing estate taxes of the deceased donor. Remember that the property itself will not be in donor’s gross estate (the donor’s cotenancy passes by operation of law to the surviving cotenants) but the value of the property will be. In effect, the executor of the donor’s estate may have to find cash to pay estate taxes on an asset that the estate does not own. Additional information on this topic is provided later in this lesson.  This is a high level summary presented to raise awareness and is not intended to address all potential considerations. Consult a CFP® Professional, CPA, or attorney for additional guidance. | |

|  |
| --- |
| **Tenants by the Entirety**   * How many owners are allowed? **Two**. * What is the relationship of the owners? **They must be legally married.** * What is the extent of each person's ownership? **Each spouse has an equal (½) undivided interest in the property.** * What happens when one owner dies? **Full ownership goes to the surviving spouse.** * When is this appropriate? It is appropriate for titling property between spouses where the desire is to transfer ownership to the survivor upon death. Note that this is very similar to Joint Tenancy. That it exists as a distinctive means of titling property simply reflects the fact that it grew out of the common law concept that spouses are treated as one person. |

|  |
| --- |
| **Tenants in Common**   * How many owners are allowed? **Two or more**. * What is the relationship of owners? **None required, but they may be related**. * *What is the extent of each person's ownership?* **Each person holds a percentage interest in the property, the size of which can vary among the co-owners.** Usually, their ownership interest is proportional to their contribution to the purchase of the property. Here too, their interest in the property is undivided. * *What happens when one owner dies?* This type of ownership does not bypass probate, unless it is held in trust. Nor does the owner's interest terminate at death. **While alive, each owner has the right to transfer his/her percentage interest at any time, to whomever they wish, independently of the other owners. In like manner, at death, their interest will be distributed according to the terms of their will.** * *When is it appropriate?* This form of ownership is **most appropriate between non-related parties**, because each owner is able to keep their portion as a part of their estate and pass it on to heirs. It is also appropriate for passing property on to children. For example, by gifting property to children as Tenants in Common, the donor ensures that the interests of the children and their lineal descendants will be kept equitable. If one child dies, his/her interest will pass on to his/her lineal descendants. For this reason, this is also the most common means by which property is titled when it is to be distributed to children through a will. |

|  |
| --- |
| **Community Property**  *Where does Community Property exist?* **Only in 10 states:** Alaska (optional), Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, Wisconsin  SmallUSA   * How many owners are allowed? **Two.** * What is the relationship of owners?  **Applies only to married couples.** * What is the extent of each person's ownership? With some exceptions, **each spouse owns half of all property acquired during marriage**. * What happens when one owner dies? **Community Property is subject to probate.** When one spouse dies, their half interest in the property will be distributed as instructed in the will. * When is this appropriate? In most states, this is not so much a question of appropriateness as it is of state law. In other words, **property acquired by a married couple in most community property states, unless it is a gift or inheritance, or unless it is purchased with assets acquired prior to marriage, becomes Community Property. However, this is not automatic in Alaska, where couples must opt for Community Property treatment.** |

## Summary Grid

The features of each type of joint ownership are summarized in the grid below. This should help in identifying differences and similarities between the different types of ownership.

|  |  |
| --- | --- |
|  | Bar |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| barArrow-1 | **Any number** | **2** | **Any number** | **2** |
| barArrow-2 | **None required** | **Husband and wife** | **None required** | **Husband and wife** |
| barArrow-3 | **Equal** | **Equal** | **Can be unequal** | **Equal** |
| barArrow-4 | **To surviving co-owner(s)** | **To surviving spouse** | **As directed by will** | **As directed by will** |
| barArrow-5 | To avoid probate and leave property with surviving spouse  To avoid probate and pass assets on to an only child | Exclusively to avoid probate and leave property with surviving spouse | For non-related owners, each of whom wishes to dispose of the property independently of the others  For distributions to children where equal treatment is a priority. | Restricted to specific states whereby, in general, half of everything acquired during marriage is owned ½ by each spouse |

## Review Exercise

**Select the correct answer to each question.**

Let’s review some of the similarities and differences between the four types of joint ownership.

**Use the following key to answer the questions 1-3.**

1. Joint Tenants (JTWROS)
2. Tenants by the Entirety
3. Tenants in Common
4. Community Property
5. **For which types of property ownership must the owners be married?**

* A only
* A and B
* A and C
* B and D
* B and C

1. **Which types of ownership will avoid probate when an owner dies, assuming no property is owned by a trust?**

* A only
* B only
* A and B
* C only
* C and D

1. **In which of the types of ownership may the owner’s shares be unequal?**

* A only
* B only
* C only
* D only
* B and C

**For questions 4-7, identify the most appropriate means of titling property to meet the estate planning goals in each situation.**

1. **A will appointment of real estate to three adult children.**

* 100% in Joint Tenancy (JTWROS)
* Approximately 50% in Joint Tenancy (JTWROS)
* 100% as Tenants by the Entirety
* Approximately 50% as Tenants by the Entirety
* 100% as Tenants in Common

1. **A will appointment of a family heirloom to three children that has more emotional significance than monetary value. Under no circumstances does the testator wish for the asset to go outside the immediate family.**

* 100% in Joint Tenancy (JTWROS)
* Approximately 50% in Joint Tenancy (JTWROS)
* 100% as Tenants by the Entirety
* Approximately 50% as Tenants by the Entirety
* 100% as Tenants in Common

1. **An investment by four business associates, each wishing to contribute different amounts.**

* 100% in Joint Tenancy (JTWROS)
* Approximately 50% in Joint Tenancy (JTWROS)
* 100% as Tenants by the Entirety
* Approximately 50% as Tenants by the Entirety
* 100% as Tenants in Common

1. **An investment by four business associates, each wishing to contribute 25% of the purchase price.**

* 100% in Joint Tenancy (JTWROS)
* Approximately 50% in Joint Tenancy (JTWROS)
* 100% as Tenants by the Entirety
* Approximately 50% as Tenants by the Entirety
* 100% as Tenants in Common

The answers to these questions are found on the following page.

## Review Exercise – Answer Key

**Select the correct answer to each question.**

Let’s review some of the similarities and differences between the four types of joint ownership.

**Use the following key to answer the questions 1-3.**

1. Joint Tenants (JTWROS)
2. Tenants by the Entirety
3. Tenants in Common
4. Community Property
5. **For which types of property ownership must the owners be married?**

* A only

**Incorrect.**

* A and B

**Incorrect.**

* A and C

**Incorrect.**

* **B and D**

**Correct.**

* B and C

**Incorrect**.

1. **Which types of ownership will avoid probate when an owner dies, assuming no property is owned by a trust?**

* A only

**Incorrec**t**.**

* B only

**Incorrect.**

* **A and B**

**Correct.**

* C only

**Incorrect.**

* C and D

**Incorrect.**

1. **In which of the types of ownership may the owner’s shares be unequal?**

* A only

**Incorrect.**

* B only

**Incorrect.**

* **C only**

**Correct.**

* D only

**Incorrect.**

* B and C

**Incorrect.**

**For questions 4-7, identify the most appropriate means of titling property to meet the estate planning goals in each situation.**

1. **A will appointment of real estate to three adult children.**

* 100% in Joint Tenancy (JTWROS)

**Incorrect**. Generally, this would not be the best choice because the families of two of the children would ultimately be denied the inheritance.

* Approximately 50% in Joint Tenancy (JTWROS)

**Incorrect** for two reasons. One is that it would not cover the entire amount. Second, the families of two of the children would ultimately be denied the inheritance on the 50% that is so titled.

* 100% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* Approximately 50% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* **100% as Tenants in Common**

**Correct**. This would ensure that if a child predeceased the testator or as each child subsequently died, their portion could go to their family or as they otherwise directed in their wills.

1. **A will appointment of a family heirloom to three children that has more emotional significance than monetary value. Under no circumstances does the testator wish for the asset to go outside the immediate family.**

* **100% in Joint Tenancy (JTWROS)**

**Correct**. This probably makes the most sense in this situation, since the ownership will stay among the three surviving children.

* Approximately 50% in Joint Tenancy (JTWROS)

**Incorrect**. This would only account for 50% of the property, and there is no other appropriate choice for the other 50%.

* 100% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* Approximately 50% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* 100% as Tenants in Common

**Incorrect**. This would not ensure that the heirloom stays in the family. Each child could distribute out their interests as they wished.

1. **An investment by four business associates, each wishing to contribute different amounts.**

* 100% in Joint Tenancy (JTWROS)

**Incorrect**. Joint Tenancy (JTWROS) is not generally appropriate for non-related participants.

* Approximately 50% in Joint Tenancy (JTWROS)

**Incorrect**. Joint Tenancy (JTWROS) is not generally appropriate for non-related participants. Plus, this choice does not address the entirety of the property.

* 100% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* Approximately 50% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* **100% as Tenants in Common**

**Correct**. This is the most appropriate form for non-related participants, because it is doubtful they would want their interests to go to the other participants in the event of their deaths.

1. **An investment by four business associates, each wishing to contribute 25% of the purchase price.**

* 100% in Joint Tenancy (JTWROS)

**Incorrect**. Joint Tenancy (JTWROS) is not generally appropriate for non-related participants, plus it only allows for equal ownership.

* Approximately 50% in Joint Tenancy (JTWROS)

**Incorrect**. Joint Tenancy (JTWROS) is not generally appropriate for non-related participants and it requires that the ownership interests be equal. Plus, this choice does not address the entirety of the property.

* 100% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* Approximately 50% as Tenants by the Entirety

**Incorrect**. Tenants by the Entirety can only be between husband and wife.

* **100% as Tenants in Common**

**Correct**. This is the most appropriate form for non-related participants, because it is doubtful they would want their interests to go to the other participants in the event of their deaths. It is also the only choice that allows the owners to have unequal interests in the property.

## What is the Default Position?

While many people give some thought to titling of real estate, most do not typically think to designate the type of co-ownership they are creating when opening financial accounts. Generally speaking, such ownership is Tenants in Common unless there is a deliberate indication that it is joint with right of survivorship. This is usually indicated by adding the letters JTWROS (Joint Tenants with Right of Survivorship) to the account.

The same is true with wills and trusts, which often distribute assets to multiple owners. Unless the document specifically indicates that the property is to be distributed as Joint Tenants with Right of Survivorship, it is assumed to be Tenants in Common. The importance of this assumption is illustrated below.

**Example**. Mr. Jacobs indicated in his will that his farm was to be distributed to his three children: Jason, Claudia, and Matthew. Matthew died prior to Mr. Jacobs. Upon Mr. Jacobs' death, the executor distributed a 1/3 interest in the farm to Matthew's family. Had he not made that assumption that the property was to be distributed as Tenants in Common, Matthew's family (which included two of Mr. Jacobs' grandchildren) would have been disinherited.

In short, Tenants in Common is the default form of ownership. It requires an extra step to create Joint Tenancy.

## Potential Gift Tax Consequences

If, when creating joint property, any co-owner receives an interest in the property that is greater than his/her contribution to its purchase, then the overage may be considered a gift. This is not a problem if the co-owners are married, due to the unlimited marital deduction. But if they are not married, and the amount of the "gift" is over the annual gift tax exclusion[,](http://www.greeneconsults.com/topclass/) then a taxable gift may take place in the creation of the joint ownership, in which case the person making the gift will need to file a gift tax return.

|  |
| --- |
| **Annual Gift Tax Exclusion**  In 2016, an individual can make gifts of up to $14,000 to any individual with no gift tax consequences; spouses can split gifts for a combined $28,000 to any individual, regardless of the source of the funds. These amounts will be adjusted for inflation in future years, but only as inflation increases the exclusion by thousand dollar increments. |

***Example:*** Bill and his son John are purchasing property as Joint Tenants with Right of Survivorship. The property is valued at $100,000. Bill is contributing $80,000 and his son is contributing $20,000. Per the laws of that state, they each have an enforceable right to half the property, so Bill is essentially giving John an interest in the property that is $30,000 over and beyond John's contribution. Since this is beyond the $14,000 annual gift tax exclusion ($28,000 if Bill and his wife are splitting the gift), a taxable gift results from the transaction.

***What if Bill and his wife had given John $20,000 last year, and John is going to use that prior gift to bring his contribution on the purchase up to $40,000.*** The fact that the source of the funds was a gift in a prior year is immaterial. Since Bill and his wife could split the gift, it was not a taxable gift. The money then became John's to do with as he pleased. With the current transaction, John is now only receiving a gift of $10,000 and a taxable gift does not occur.

Whether or not a gift occurs upon titling the joint property with a non-spouse will depend upon the rights of each tenant under local law. Generally speaking, when adding a non-spouse to a bank account, titled as JTWROS, no gift occurs when adding the non-spouse to the account. This is true because with such accounts the creator of the account is generally free to withdraw the funds and close the account at any time with no recourse by the person who was added to the account. However, whenever the non-spouse withdraws funds from the account for his or her own benefit, then a gift occurs at the time of withdrawal.

When titling property such as real estate or a stock certificate as JTWROS with a non-spouse who did not contribute (or contributed less) to its purchase, then a gift generally takes place at the time of titling. In contrast to a bank account, one party would not be able to own the asset entirely outright without the other party formally surrendering his or her interest. Again, state law will have to be consulted to make that determination, and it is best that the client consult with his or her estate planning attorney or tax advisor before taking such action.

## Estate Tax Consequences

The fact that some forms of joint property escape probate does not necessarily mean that the property escapes estate taxes. Ignoring community property for the moment, just what are the consequences of joint ownership for estate tax purposes?

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Non-Spousal Joint Tenancy (With Right of Survivorship)**  The estate tax consequences of Joint Tenancy depend upon whether or not the joint tenants are married. If they are not married (non-spousal), then when one owner dies the **IRS will presume that the decedent owned 100% of the property**. The only way to keep the full amount from being included on the tax return is to prove that the surviving joint tenant(s) contributed funds for its acquisition. If such evidence can be furnished, then the decedent's interest in the property would be reduced to the percentage of the purchase that was actually supplied by the decedent.  **The burden of proof will be upon the executor.** As is shown in the following example, keeping adequate records of the original purchase and all subsequent improvements is vitally important.  **Example.** *Two brothers, Dan and David, purchase a $100,000 piece of property in 1980 in Joint Tenancy, with Dan contributing $60,000 and David contributing $40,000.*  Assuming adequate records, it is simple to calculate their interests at 60% and 40%. If David were to die today, when the property is worth $500,000, then 40% of its value ($200,000) would be included in his estate. But what happens if in the interim years Dan had made improvements to the property?  *Suppose that prior to David's death, Dan made $50,000 of improvements to the property in 1988. Prior to making those improvements, the property had also appreciated in value to $200,000. Assuming all records were kept, how much would be included in David's estate if he were to die today when the total property is worth $500,000?*  As can be seen in the chart below, just prior to making the improvements in 1988, Dan owned 60% ($120,000) and David owned 40% ($80,000). Once the $50,000 improvement was made, Dan's interest became $120,000 + $50,000; David's interest remains $80,000. Dan's share then increases from 60% to 68% of the property (170,000/250,000 = 68%), while reducing David's interest to 32%. Note: David's interest was still worth $80,000 (32% of $250,000 = $80,000). With these changes, if David were to die today with the total property worth $500,000, then 32% of $500,000 ($160,000) would be included in his estate.   |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Years** | **Contributions** | | **Market Value of Property** | **Percent Interest** | | **Value of Each Share** | | | **Dan** | **David** | **Dan** | **David** | **Dan** | **David** | | 1980 | $60,000 | $40,000 | $100,000 | 60% | 40% | $60,000 | $40,000 | | 1988 | 0 | 0 | 200,000 | 60% | 40% | 120,000 | $80,000 | | 1988 | 50,000 | 0 | 250,000 | 68% | 32% | 170,000 | $80,000 | | TODAY | 0 | 0 | 500,000 | 68% | 32% | 340,000 | 160,000 | |

|  |
| --- |
| **Spousal Joint Tenancy (With Right of Survivorship)**  **For couples married after 1976 and acquiring joint property after that date, ½ of the property is included in the decedent's taxable estate**, regardless of the source of funds with which the purchase was made.  **Be aware** that some courts have ruled that if the couple married prior to 1977 and acquired joint property prior to 1977, then the property is treated just as non-spousal Joint Tenancy. Therefore, a specialist should be consulted when planning involves this situation. |

|  |
| --- |
| **Tenants by the Entirety**  The estate tax consequences are exactly the same as for Spousal Joint Tenancy (see above). |

|  |
| --- |
| **Tenants in Common**  Only the percentage interest that is owned by the decedent is included in his/her estate. In other words, their interest is treated just as if they owned their portion independently of the other owners. |

## Pitfalls of Joint Tenancy

For many people, Joint Tenancy is an effective estate planning tool because:

* It is simple
* It provides survivor benefit
* It avoids probate

But there are factors that must be considered and situations where it is clearly ill advised to use it for estate planning.

Potential Disadvantages for Spouses

When planning for spouses, you must look at factors such as life expectancy, cost basis, and relative size of estates when making decisions about utilizing Joint Tenancy. The two most common situations where Joint Tenancy might be a bad idea are:

|  |
| --- |
| **In taxable estates.**  If the combined assets result in a taxable estate, then good estate planning should allow each spouse to make use of their applicable credit amount and shelter some assets from inclusion in the estate of the surviving spouse. Optimal planning might be curtailed if too much property is in Joint Tenancy. |

|  |
| --- |
| **When it is desirable to have a 100% step-up in basis.**  Sometimes, it is desirable for a surviving spouse to have a 100% step-up in basis on inherited property. With Joint Tenancy, only half of the property will receive a step-up in basis.  **Example**: Robert and Sylvia Thompson bought their home thirty years ago for $200,000. It is titled JTWROS, and today it is worth $1,000,000. Robert is 20 years older than Sylvia and in poor health. Anticipating that he will predecease her, Sylvia plans to sell the home upon his death and move closer to her children. Assuming current market values, when Robert dies, his half of the property will receive a step-up in basis, thereby raising the basis of his half of the home to $500,000. By adding that $500,000 to Sylvia’s basis of $100,000, the new basis becomes $600,000. When she sells the property for $1,000,000, she will have a gain of $400,000 ($1,000,000 - $600,000 basis). Since this is her primary residence, IRS rules state that she may exclude $250,000 of gain for tax purposes, leaving her $150,000 of taxable gain.  **What would happen if Robert owned the property outright?** Because transfers between spouses are not taxable events, Sylvia could transfer her interest with no tax consequence. If it is desirable to keep their estates equalized, Robert might transfer assets to Sylvia that have little or no capital appreciation. When Robert dies, she receives the property from his estate with a full step-up in basis. When she sells the property, there would be no taxable gain. |

Potential Disadvantages for Non-Spouses

For non-spouses, the major pitfalls of Joint Tenancy deal with loss of control and the potential for undermining a previously constructed estate plan. These pitfalls are illustrated by the following examples, and could all be avoided with other estate planning vehicles.

|  |
| --- |
| **Loss of control**  ***Example.*** Mrs. Howard has been widowed for some years. She owns her own home outright and, wishing to avoid probate, she transfers her home in Joint Tenancy with her daughter. Mrs. Howard now wishes to marry, sell the home, and move to another state. Her daughter disapproves of this marriage, and has refused to go along with the sale. |

|  |
| --- |
| **Undermining the estate plan**  As Mrs. Booker became elderly and in need of assistance, she titled most of her property as JTWROS with her youngest daughter, Julie, who lived closer than her other three children. While she thought of it as a convenience, believing her will would distribute everything equally among the children; she had effectively disinherited the other children. Once a close family, a rift developed following Mrs. Booker's death, and for years the other children have not spoken with Julie. |

Read the Agreement Carefully

Because of this risk of Joint Tenancy, many states have laws that spell out the consequences of establishing certain types of joint accounts, such as checking/savings accounts and CDs. But most states leave it to the terms of the account agreement. Generally, such accounts fall into three categories. As can be seen by their description below, it is imperative that they be read carefully to understand the consequences.

* **Joint Tenancy with immediate vesting.** A gift of ½ of the assets occurs when the second person is added to the account, and each is taxed on ½ the income.
* **Revocable account.** Income is reported on the basis of each person's contribution. No gift occurs when the account is opened, but does occur if one person withdraws more than he/she contributed.
* **Convenience account.** One person contributes all the funds, and the other person is simply able to act as their agent in depositing or withdrawing funds. There is no gift when creating the account or when withdrawing funds as agent. Depending upon the terms of the agreement, the agent may or may not inherit the funds upon the death of the other person.

## Origin and Scope of Community Property

Thus far, this course has focused primarily on types of co-ownership derived from "common law," meaning they are derived from property laws of England. But a small number of states derive their property ownership laws from Spanish law, which has particular impact for married couples. These states are known as "community property" states, and include:

|  |  |
| --- | --- |
| Alaska (optional)  Arizona  California  Idaho  Louisiana  Nevada  New Mexico  Texas  Washington  Wisconsin |  |

As can be seen by the map, these states do not cover much of the continental United States. Yet it is important to have some awareness of community property, even if you do not live in a community property state because the impact of community property laws is not confined to these 10 states. Furthermore, other states are considering community property laws, so the list may grow.

## The Nature of Community Property

In a nutshell, here is the key difference between the community property states and common law states:

|  |  |
| --- | --- |
| CA | FL |

With certain exceptions, everything received by a husband and wife while residing in a community property state is considered to be owned 50-50. While this seems consistent with the outcome of most divorce settlement cases in common law states, where assets are frequently split 50-50, such similarity has more to do with the court seeking an equitable solution than with property law. Note: In Alaska, rather than community property being the default position for spouses, the spouses must opt for community property treatment.

Examples of Community Property

All of the following are community property:

* **Salaries earned by either spouse during marriage.**
* **Items purchased with money earned by either spouse during marriage.**
* **Income generated by community property.**
* **In some states, income generated by separate property.** Texas is an example of a state where this is the case.
* **Commingled purchases and accounts.** It is possible to purchase property or open accounts with a combination of community funds and separate funds, and have a representative portion retain its character as separate property. But if the funds have become so commingled that it is no longer possible to distinguish them, then everything becomes community property. This is why good records can be so important.

Exceptions to Community Property

The following are exceptions to community property, whereby each spouse owns property separately from the other spouse, which will be 100% included in the estate of the individual spouse owning it:

* **Property acquired prior to marriage.** However it was titled before marriage, as solely owned or jointly owned, it retains the same status after marriage.
* **Property acquired prior to moving into a community property state.** If a couple moves into a community property state from a non-community property state, then any property acquired prior to the move will generally retain its prior status.
* **Gifts and inheritances to one spouse during marriage.** If the gift or inheritance is specifically to one spouse and not the other, then the property retains its status as gifted or inherited.
* **Compensation for personal injuries during marriage.** Such compensation is generally treated as separate property.
* **Property purchased during marriage with separate property** will itself be separate property.
* **In some states, income generated by separate property.** California is an example of a state where this is the case.

## Estate Implications of Community Property

What happens with community property when one spouse dies? The most important points to remember are the following:

* **Community property is subject to probate.** In this regard, it differs from joint tenancy or tenancy by the entirety. This means it is possible for the decedent's will to appoint the property to someone other than the surviving spouse. State laws vary as to what happens if there is no will; in some states it goes to the surviving spouse while in other states it goes to the decedent's lineal descendants.

|  |
| --- |
| **From Joint Tenancy**  Jointly held property that automatically transfers to the survivor when one owner dies. |

|  |
| --- |
| **Tenancy By The Entirety**  A form of joint ownership that is restricted to husband and wife. Full ownership automatically transfers to the survivor upon death of one spouse. |

* **Half of the community property is included in the estate of the first to die.** But since community property qualifies for the unlimited marital deduction, it can be willed to the surviving spouse or placed in a marital trust and the tax will be deferred.

|  |
| --- |
| **Marital Trust**  A trust for the benefit of a surviving spouse that is included in the surviving spouse's taxable estate. |

* **All debts incurred during marriage regarding community property are community property debts,** and half of them would be claims against the estate of a deceased spouse.
* **The surviving spouse gets a step-up in basis on the entire property** if at least ½ of the whole property is included in the deceased spouse's gross estate.1 This ability to receive a step-up on the entire property may be sufficient reason for spouses to convert separate property (e.g., acquired prior to marriage) into community property. In some states, it is possible for spouses to change separate property into community property, and vice versa, simply by written agreement between them. This ability to get a potential full step-up in basis on the property as a whole is the most valuable estate planning feature of community property, as the following example illustrates.

*1A potential exception to this statement exists if death occurred in 2010 when it was possible to elect out of estate tax treatment.  If the Executor elected out of estate tax treatment, then the ability to receive this step up in basis could be subject to some limitations.*

***Example.*** Howard and Theresa Woods purchased some land in Tennessee as an investment prior to moving to Texas (a community property state). They purchased the property as joint tenants with the right of survivorship, and still desire to pass their interest on to the surviving spouse. Today, they are trying to decide if it would be wise to change this investment into community property, even though that would make it subject to probate. They purchased the property five years ago for $100,000 and it is worth $300,000 today. What planning might they want to consider?

***Answer.*** If they leave the land in joint tenancy, when one spouse dies there will be a step-up in basis on half of the property. If the surviving spouse were to sell the house, the surviving spouse would have a basis of $200,000 and a capital gain of $100,000 upon its sale. Assuming a capital gains tax of 15%, that results in a tax bill of $15,000. But if they converted it to community property, the entire property would receive a step-up in basis, and the survivor would own the property with a basis of $300,000 and no capital gain upon its sale.

Special Circumstances:

* **Life Insurance.** While the laws are complex and vary from state to state, it is generally true that if a person purchases life insurance in a community property state, retains an incident of ownership, remains domiciled in that state and pays all premiums in that state, then the insurance proceeds are community property for the surviving spouse, and only ½ of the policy benefits will be included in the deceased owner's estate.
* **Qualified Employee Benefit Plans.** An employee's spouse may have a community interest in the employee's qualified benefit plan. If the employee's spouse dies first, then the spouse's interest would be included in the gross estate.
* **Divorce.** Upon divorce, community property is divided equally and is owned by each party as tenants in common.

## What if You do not Live in a Community Property State?

Even if you do not live in a community property state, it is important to remember that when married couples move from a community property state, any property they acquired as community property will retain its status as community property. Furthermore, any property that is purchased with community property assets will itself become community property, even though the property purchased is not located in a community property state.

***Example.*** James and Ethyl Gilmore moved from California to Tennessee. Prior to moving, they sold the California home they purchased when they first got married. Although there was an outstanding balance on the mortgage, the difference in the cost of living made it possible for them to pay cash for their new house in Tennessee. Because the house is purchased with community property assets, the Tennessee house will be treated as community property, even though Tennessee is a non-community property state.

In a similar fashion, if a couple moves from a non-community property state into a community property state, the property they acquired prior to the move will retain its character (as separate property, joint tenancy, etc.) and does not automatically become community property.

## Review Exercise

**Select the correct answer to each question.**

Of the following states, which are community property states?

|  |  |  |
| --- | --- | --- |
|  | **Community  Property** | **Non-Community  Property** |
| 1. California |  |  |
| 2. Florida |  |  |
| 3. Wyoming |  |  |
| 4. Arizona |  |  |
| 5. Idaho |  |  |
| 6. Utah |  |  |
| 7. Minnesota |  |  |
| 8. Nevada |  |  |
| 9. Texas |  |  |
| 10. Colorado |  |  |

Of the items indicated below, assume you live in a community property state unless stated otherwise. Indicate if these items are community property or separate property.

|  |  |  |
| --- | --- | --- |
|  | **Community  Property** | **Separate  Property** |
| 1. A motorcycle you owned before marriage. |  |  |
| 2. A painting you inherited during marriage. |  |  |
| 3. A boat owned and registered in your name, which you bought during your marriage with monthly payroll deductions. |  |  |
| 4. A $50,000 settlement you received from an injury you suffered when you and your spouse were walking in your neighborhood. |  |  |
| 5. A Rolex watch you received from your parents as a gift while married. |  |  |
| 6. A $10,000 inheritance you added to the joint checking account with your spouse 25 years ago. |  |  |
| 7. A vacation home you purchased and titled in your name when you and your spouse lived in Kentucky, prior to your moving with your spouse to your current residence in Arizona. |  |  |
| 8. The home you and your spouse purchased in New York, with the proceeds from the sale of your home in California. |  |  |

**The answers to these questions are found on the following page.**

## Review Exercise - Answer Key

**Select the correct answer to each question.**

Of the following states, which are community property states?

|  |  |  |
| --- | --- | --- |
|  | **Community  Property** | **Non-Community  Property** |
| 1. California | **X** |  |
| 2. Florida |  | **X** |
| 3. Wyoming |  | **X** |
| 4. Arizona | **X** |  |
| 5. Idaho | **X** |  |
| 6. Utah |  | **X** |
| 7. Minnesota |  | **X** |
| 8. Nevada | **X** |  |
| 9. Texas | **X** |  |
| 10. Colorado |  | **X** |

**Correct.**

**Incorrect.**

Of the items indicated below, assume you live in a community property state unless stated otherwise. Indicate if these items are community property or separate property.

|  |  |  |
| --- | --- | --- |
|  | **Community  Property** | **Separate  Property** |
| 1. A motorcycle you owned before marriage. |  | **X** |

**Correct**. Separate property acquired before marriage remains separate property.

**Incorrect**. Separate property acquired before marriage remains separate property.

|  |  |  |
| --- | --- | --- |
| 2. A painting you inherited during marriage. |  | **X** |

**Correct**. Inheritances to one spouse during marriage remain separate property.

**Incorrect**. Inheritances to one spouse during marriage remain separate property.

|  |  |  |
| --- | --- | --- |
| 3. A boat owned and registered in your name, which you bought during your marriage with monthly payroll deductions. | **X** |  |

**Correct**. Your salary is community property. Property purchased with community property becomes community property.

**Incorrect**. Your salary is community property. Property purchased with community property becomes community property.

|  |  |  |
| --- | --- | --- |
| 4. A $50,000 settlement you received from an injury you suffered when you and your spouse were walking in your neighborhood. |  | **X** |

**Correct**. Personal injury settlements are generally separate property.

**Incorrect**. Personal injury settlements are generally separate property.

|  |  |  |
| --- | --- | --- |
| 5. A Rolex watch you received from your parents as a gift while married. |  | **X** |

**Correct**. Gifts to one spouse are generally separate property.

**Incorrect**. Gifts to one spouse are generally separate property.

|  |  |  |
| --- | --- | --- |
| 6. A $10,000 inheritance you added to the joint checking account with your spouse 25 years ago. | **X** |  |

**Correct**. Although the contribution was originally separate property, it would be so commingled by now that it would be indistinguishable, and thereby becomes community property.

**Incorrect**. Although the contribution was originally separate property, it would be so commingled by now that it would be indistinguishable, and thereby becomes community property.

|  |  |  |
| --- | --- | --- |
| 7. A vacation home you purchased and titled in your name when you and your spouse lived in Kentucky, prior to your moving with your spouse to your current residence in Arizona. |  | **X** |

**Correct**. The property does not become community property simply by moving to a community property state.

**Incorrect**. The property does not become community property simply by moving to a community property state.

|  |  |  |
| --- | --- | --- |
| 8. The home you and your spouse purchased in New York, with the proceeds from the sale of your home in California. | **X** |  |

**Correct**. Property purchased with community property becomes community property.

**Incorrect**. Property purchased with community property becomes community property.

## Joint Property Summary

The following is a quick review of the key concepts contained in each section of this course.

|  |  |
| --- | --- |
| **Section:** | **Key Points:** |
| **Types of Joint Property** | **Characteristics and appropriate use of each type of joint property:**  **- Joint Tenancy (With Right of Survivorship)  - Tenancy by the Entirety  - Tenants in Common  - Community Property**  **The default position on joint property** |
| **Pitfalls of Joint Tenancy** | **Potential disadvantages for spouses**  **Potential disadvantages for non-spouses**  **Types of joint bank accounts** |
| **Origin and Scope of Community Property** | **Which states are community property**  **Impact of moving from a community property state to a non-community property state and vice versa**  **The primary difference between community property states and common law states**  **Identification of community property and separate property** |
| **Taxation** | **Potential Gift Tax Consequences of Joint Property**  **Estate Tax consequences of each type of Joint Property**  **Probate of community property**  **Impact of Community Property debts on estate settlement**  **Step-up in basis of Community Property** |
| **Special Circumstances Involving Community Property** | **Life Insurance as Community Property**  **Qualified Employee Benefit Plans as Community Property**  **Divorce and Community Property** |

## Conclusion

This concludes the material for this subject. At this time you may return to any sections in which you feel the need for further study