

Joint Tenancy

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JOINT TENANCY

Joint tenancy is a type of ownership by two or more persons of the same property, real or personal. The individuals, called joint tenants, share equal ownership of the property and have the equal, undivided right to keep or dispose of the property. Joint tenancy with right of survivorship (JT/WROS) means that upon the death of one joint owner, title passes by “operation of law” to the surviving owner, who receives sole ownership of the asset, thus avoiding probate. Even if a joint tenant intends to have his or her share pass to loved ones, the property is not controlled by the instructions in the owner’s will or trust. Although fraught with problems, joint ownership remains a popular planning device used by many families. However, for most people, the disadvantages of joint tenancy exceed any advantages.



HUSBAND AND WIFE AS JOINT OWNERS: PROBATE POSTPONEMENT

If you are married, you may have already encountered joint tenancy. Many married couples own property as joint tenants, whether it be their family home, an investment account, or bank accounts. Let’s take a look at a common scenario: Bob and Mary, husband and wife, own their family home as joint tenants. Why? Because that’s what their real estate agent likely advised them to do. After Bob dies, Mary automatically becomes the sole owner of their home and there is no probate. That is the good news.

But what happens when Mary dies? At that point there will be a probate. There must be a court process to transfer Mary’s ownership to her heirs. Why? Because Mary’s signature is no longer available. We can’t transfer real estate without someone with legal authority signing the deed to transfer the property.

So the first important lesson about joint tenancy is that it does not really avoid probate; it only postpones it. Sure, upon the death of the first joint tenant, title will automatically pass to the surviving joint tenant, and it does avoid probate at that time. However, upon the death of the surviving spouse, there will be a probate unless the surviving spouse creates a new joint tenancy or places his or her assets in a living trust.

An All Too Common Scenario

Here is an all too common scenario filled with traps for the unwary or ill-advised. Let's say that instead of dying as in our previous example, Mary lives. Now, as a widow, she owns the family home in her name alone. Holding the home in joint tenancy seemed to work well when she owned it with Bob because there was no probate at his death. So Mary decides to add her son Sam as a joint tenant on the family home. Debbie, her daughter-in-law is a paralegal and she confirms that holding the property in joint tenancy will avoid probate. Debbie will even prepare the deed, so there is no need to consult with an attorney or pay any legal fees.

What if Son Divorces?

What happens if son Sam gets into a nasty divorce? Unfortunately Mary's home could get dragged into the proceedings and the property will be tied up until things get sorted out.

What happens if Sam get into a car accident and someone then obtains a judgment against him? The judgment holder could force a sale of the property to satisfy the judgment.

So our next important lesson about holding property jointly is that if the other joint owner ends up in a divorce or a lawsuit this will expose the asset to the other joint owner's debts.

What if Mary or Sam Become Incapacitated?

Let's turn to another scenario: Imagine that either Mary or Sam become incapacitated. Recall, that often when families do "joint tenancy" planning, they have not consulted with an attorney. This means they likely do not have certain legal documents, such as a living trust or a power of attorney for financial matters in place to assist them in handling legal and financial affairs for their loved one upon incapacity.

If Mary became incapacitated and Sam needed to sell the property in order to put her into a full-time nursing home, he wouldn't be able to do so without first going to court. The court would appoint a conservator (whomever the court thought was best for the job, not necessarily Sam), and then the conservator could decide if the property should be sold.

So if either joint tenant becomes incapacitated and the proper legal documents are not in place, the joint tenancy property may be tied up in a guardianship or conservatorship proceeding at a time when the family desperately needs the cash.

Mary Changes Her Mind: Trouble With the Other Joint Owner

Now let's look at a different scenario. What if, at some point after she has added Sam as a joint owner, Mary decides she wants to change her estate plan and provide shares for her three grandchildren in addition to her two children? Mary meets with an attorney and determines a revocable living trust will best meet her needs and that title to her property will need to be changed to the name of her new living trust.

When Mary asks Sam to sign over the deed, what happens if Sam refuses? Although he is provided for in the new trust, it still means his share is being reduced and he won't be getting the entire property. What can Mary do? If she cannot prevail upon Sam to sign the deed, she will need to initiate a court action against her son.

It's always easy to add a joint tenant onto a deed. However, getting him or her off the deed if you change your mind is not always as easy.

What if Mary Remarries Instead? Unintended Disinheritance

What happens if Mary remarries instead and wants to add her new husband Nate to the deed as her joint tenant? If Mary dies first, then Nate owns the house. Even if Mary tells Nate that the house is eventually to go to her children, Nate is under no legal obligation to give anything to Mary's children, Sam and Sarah. This is true even if Mary's will expressly states that all her assets are to be equally divided among her two children. Because legal title controls, not the will, it doesn't make any difference what her will says. If it is Mary's intent to leave her property to her children, she should not add Nate as a joint tenant because she has no way of ensuring the property will pass to whom she wants.

It is easy to see how joint tenancy can have the unintended consequence of disinheriting children if a surviving spouse remarries after the death of the first spouse and puts her new spouse on as a joint tenant on the family home. If she then predeceases her new spouse, her children from her first marriage will not receive anything.

TAX ISSUES

But this scenario isn't the only problem we see with joint ownership. There are also tax consequences! Let's look at the tax consequences of what happens if Mary dies with son Sam on title to the property as the other joint tenant.

Tax Issues: Gift Tax Consequences

Avoiding probate is generally the most significant benefit of holding property in joint tenancy. However, gift tax consequences are often overlooked. When a parent places a child on title to property as a joint tenant, the parent is typically unaware that he or she has made a gift of one-half of the value of the property to the child. If the value of that gift exceeds the annual gift-tax exclusion amount, \$12,000 in 2008 (\$13,000 in 2009), it is a taxable gift requiring the filing of a gift tax return. In some cases, a gift tax may have to be paid.

Tax Issues: Income Tax Consequences

Another problem with joint tenancy is that the surviving joint tenant will not receive the full step-up in cost basis he or she would receive if he or she inherited the property instead (or held title to the property as community property in a community property states). Here is an example: Mary and Sam jointly buy a house as joint tenants for \$50,000 and today it's worth \$650,000. Upon Mary's death,

only her half of the property receives a step up in cost basis. So if Sam sells the house for \$650,000, Sam has a \$300,000 gain on the sale which is subject to capital gains tax.

What happens if Mary “gives” the property during her lifetime to son Sam, who then sells it for \$650,000? Because Mary transferred title to Sam while she was living, the house retains Mary’s old cost basis of \$50,000. That means Sam now has a \$600,000 capital gain on the sale which is subject to capital gains tax.

Let’s look at what happens if, instead, Mary leaves her home to Sam as an inheritance — either through a will or a living trust. Sam sells the house for the same \$650,000. But, because he received the house as an inheritance after Mary died instead of as a gift while Mary was living, the property receives a new stepped-up cost basis. The basis is now the fair market value on the date of Mary’s death — \$650,000. So now when Sam sells the house, there is no gain on the sale and no capital gains tax to pay.

Tax Issues: Property Tax Consequences

Let’s assume that Mary had a will dividing her property equally among her two children, Sarah and Sam, and that is the way she wanted it. But, what Mary didn’t realize is that because the family home was titled in joint tenancy with Sam, her daughter Sarah is not legally entitled to any of the property. It is all Sam’s and he is under no legal obligation to share any of it with his sister.

Even if Sam decides that he will honor his mother’s wishes and agrees to give his sister one-half of the property, this could trigger some unpleasant tax consequences. There could be gift tax consequences if Sam ends up giving Sarah more than the annual exclusion amount (\$12,000 in 2008, and \$13,000 in 2009). Moreover, at least in California, there will be property tax consequences. A transfer between siblings will trigger a property tax reassessment for one-half of the property, which could be problem if the children had intended to keep the property.

Federal Estate Tax Consequences

Although title to the property passes by operation of law to the surviving joint owner, the value of the owner’s interest in the property is still included in his or her estate for federal estate tax purposes. Because individuals using joint tenancy often have not consulted with an attorney, they may be completely unaware of their federal estate tax liability and may not have made adequate provision for payment. It’s also possible that an owner’s beneficiaries may pay federal estate taxes on property they do not receive.

ADVANTAGES OF JOINT TENANCY

So why would anyone ever hold property in joint tenancy? First, joint tenancies are easily understood, so there is a perceived advantage due to its simplicity. Also, joint tenancy can be used to avoid probate, because the property does pass by operation of law without a court proceeding at the first joint tenant’s death. Finally, joint

tenancies often represent a relationship commitment and people who care about each other may want to hold property jointly and don't know of a better alternative.

IN SUMMARY

1. Joint tenancy ownership does not really avoid probate, it only postpones it.
2. The original joint tenant could end up in a lawsuit if the other joint tenant is sued over an accident that involves the jointly owned asset. The asset is exposed to the other owner's debts and the property could be seized as settlement. Your joint tenant's divorcing spouse may also make a claim to the property.
3. If a co-owner becomes incapacitated, a court may get involved. This would limit the control the other owner has over the joint tenancy property.
4. It's always easy to add a joint tenant onto a deed. However, getting the joint tenant off the deed if there is a change of mind is not always as easy. If the co-owner doesn't agree, the joint tenants could end up in court.
5. If the original owner dies first, there is no way of controlling what ultimately happens to the asset and there could be an unintentional disinheritance of the original owner's family.
6. Tax consequences! Lots of them. The consequences will vary widely depending on a number of factors. Suffice it to say, putting a family member on title as a joint tenant is not as easy as it sounds and it can have many consequences reaching far beyond what the parties intended.
7. The disadvantages of joint tenancy usually far outweigh any advantages, so careful consideration should be taken before holding title to property in joint tenancy.

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