# Price & Farrington's Estate and Tax Planning *Fast*Faxts

February, 2006

*Estate, Tax , Business and Wealth Planning for Advisors and Clients*



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## Best Strategies for Joint Ownership:
## *Real Estate, Bank Accounts, Cars etc.*

*Happy Valentine's Day!*

Holding assets jointly—such as bank accounts, securities or real estate—is common, especially among married couples. Joint ownership can also be used by cohabitants (*See* our October., 2005 *Fast*Faxts) and elderly individuals who want a younger person to be able to pay bills, handle investments, etc. There probably will be income, gift and estate tax consequences. Here are the rules:

***Income tax.*** If income-producing property is held jointly by a married couple filing a joint return, the income tax consequences are straightforward—the couple owes tax on the inome. But what if the married couple files separate returns? Or if the co-owners aren't married and thus can't file a joint return? Typically the income will be taxed 50-50 between the joint owners.

If the funds in a joint account belong to one person, that person's name is listed first on the account, along with his/her Social Security number. If the joint account contains combined funds, each person's share of any income from the property is determined by state law.

*Example*. Billy Bob has put his niece Babette's name as joint owner with right of survivorship on his bank and brokerage accounts so that she can help manage his affairs if it should become necessary. Billy Bob and Babette should make sure Billy Bob's Social Security number is on the account so that each annual Form 1099 reports income taxable to Billy Bob, not to Babette.

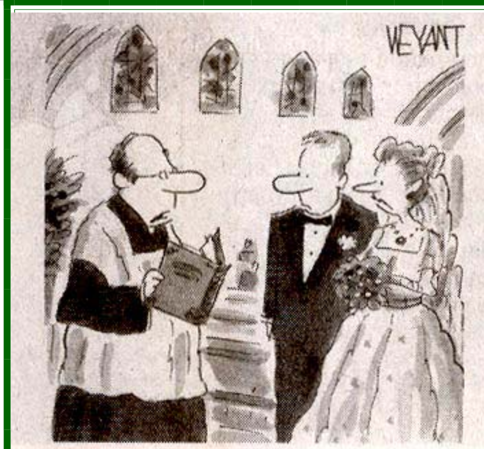
***Gift tax.*** Putting a spouses name on property as joint owner won't trigger gift tax because spousal gifts are untaxed. But the situation is different for nonspouses and non-U.S. citizen spouses. (*See* Sidebar column)

Generally, putting someone's name on an account won't trigger a gift if assets aren't withdrawn by the non-contributing joint tenant. Adding a joint tenant to real estate becomes a taxable gift if the new joint tenant has the right under state law to sever his interest in the joint tenancy and receive half of the property. *Example:* As above, Billy Bob puts Babette's name on his accounts. As long as Babette leaves those accounts alone, no gift has occurred.

*Trap:* Say that Babette takes $20,000 from Billy Bob's bank account. A gift tax return might have to be filed and gift taxes might be owed. Babette should keep careful track of her use of Billy Bob's assets. If she writes a $20,000 check to an assisted-living facility to provide care for Billy Bob, no gift will have occurred.On the other hand, if Babette writes that $20,000 check to buy a pickup truck for herself, that will be a gift from Billy Bob unless she can show that the truck was used solely for Billy Bob's care.

***Caution.*** Joint accounts owned by unmarried couples are potentially a problem. Suppose Bill Smith and Carol Jones are unmarried but living together. Bill earns the income, which goes into a joint account. Every check that Carol writes might be considered a gift if she uses the funds to pay for her personal expenses. That's true even if Bill writes checks to pay for personal items Carol has charged on a credit card. This problem isn't easy to resolve if Carol spends more than $12,000 from the account on herself—that's the annual gift tax exclusion for 2006. It's important to keep careful records of all expenses from joint accounts. Money that is used for common expenses won't be considered a gift.

***Estate taxes.*** Property held as "joint tenants with right of survivorship" (JTWROS) goes automatically to the survivor. This might create estate tax problems.



"The rest is mostly boilerplate."

*Example*. Dan and Cheryl Clark are married and have $4 million in assets. Everything is owned as JTWROS. They are also the beneficiaries of each other's retirement accounts. If Dan dies in 2006, everything will pass to Cheryl, who will now have a $4 million estate.

*Trap.* This arrangment prohibitsd them from leaving anything to other heirs, including their children, upon Dan's death. Thus, they won't be able to use the federal estate tax exclusion amount, set at $2 million for 2006 to 2008. Suppose, in our example, Cheryl dies in 2007 owning the $4 million estate. At $2 million over the exclusion amount, which is taxed at 45%, the federal estate tax bill will be $900,000. That tax could have been avoided with a $2 million bequest at Dan's death in 2006. That bequest might have gone to their children, or to a credit shelter trust structured for the benefit of Cheryl outside of her taxable estate.

*Strategy*. Families with estate tax concerns should modify their use of joint ownership between spouses. Each spouse should have some assets in his and her own name that can be left to other parties or to a trust at the first death, sheltered by the estate tax "applicable exclusion amount".

***Capital gains tax.*** When assets pass from a decedent to heirs, estate tax isn't the only concern. Appreciated assets get a step-up in basis as of the date of death, which can eliminate capital gains taxes.

*Example.* Bob Day lives in Oregon and owns $1 million in stocks and stock funds held outside of retirement plans. His basis in those securities is $200,000. A sale during Bob's life would result in an $800,000 capital gain and a $120,000 tax bill., assuming all the securities qualify for the 15% rate on capital gains.

Assuming no predeath sale, if Bob owns those securities by himself and leaves them to his wife, Susan, she'll have a stepped-up basis of $1 million, which means she could sell them for that amount after his death and owe no capital gains tax.

*Trap.* If Bob holds these stocks as JTWROS with Susan, they will all pass to her at death but only Bob's half of the joint account will get a basis step-up, giving her a $600,000 basis ($500,000 in his half and $100,000, or one-half the original cost basis, in her half). As a result, a sale for $1 million would produce a $400,000 capital gain ($1 million minus her new $600,000 basis) and a $60,000 tax bill, at 15%.

*Strategy.* Highly appreciated asets might be held in sole name rather than jointly, to get a full basis step-up. The rules are different in community property states such as Washington, where if a spouse leaves his/her half of community property to a spouse, the spouse who inherits will get a full basis step-up. Susan would have a $1 million basis on the securities she holds after inheriting Bob's half, owing no cap gains tax on a $1 million sale. ■

**Take a Moment**

***A smile is contagious; be a carrier.***

***The best thing to do behind a friend's back is pat it.***

***The only people you should ever want to get "even" with are those who have helped you.***

***You never saw a fish on the wall with its mouth shut.***

## Sidebar Q&A

### Joint Tenancy Personal Property With Noncitizen Spouses: *Don't Do It.*

***Are joint accounts with noncitizen spouses treated differently?*** Yes, and the consequences can be disastrous.

***What's the big problem?*** Prior to July 14, 1988, if the creation of a joint account with a spouse—noncitizen or not—created a gift, it wasn't taxable because of the unlimited marital deduction for gifts. Congress became concerned that if one spouse created a joint account with, say, $5 million of that spouse's funds, with a noncitizen spouse, and the donor spouse died before the noncitizen spouse, the surviving noncitizen spouse would receive all the moola without any gift taxes having been imposed. The noncitizen spouse could then return to his or her country of origin and the U.S. Treasury would never receive any estate taxes on the $5 million when the noncitizen spouse died in his or her country of origin.

***Isn't that the same thing a citizen spouse could do?*** No, a U.S. citizen surviving spouse is taxable on his or her worldwide holdings,so the loss of revenue is prevented.

***Can you provide an example?***

*Creation of the account.* The propertied spouse deposits $5 mil into a joint account. The joint tenant is a noncitizen spouse who hasn't made any deposit.The Internal Revenue Code treats each joint tenant as owning one half of the account (See IRC 2515A. Though repealed in 1981, this section still applies to these facts under IRC 2523(i)(3).) That means the propertied spouse has made a gift of $2.5 million to the noncitizen spouse.

*"I thought it was legal—I wrote it on a legal pad."*

*Unlimited Marital Deduction.* Normally this $2.5 mil gift wouldn't be a problem under the unlimited marital deduction and no gift tax would be due and none of the propertied spouse's $2 million applicable exclusion amount for 2006 would be used up. But IRC Section 2523(i) provides that *there is no unlimited marital deduction for gifts to noncitizen spouses.* Under IRC 2515A the propertied spouse in our example has made a $2.5 million gift to the noncitizen spouse.

*Section 2503 annual gift tax exclusion.* To partially offset the inability of a propertied spouse to make large gifts to a noncitizen spouse, Section 2523(i) allows an annual gift tax exclusion for gifts to noncitizen spouses of $120,000 in 2006.

***What's the conclusion?*** The creation of a joint personal property account with a noncitizen spouse can be a gift tax disaster. In our example, the propertied spouse has made a taxable gift of $2,380,000 and might not realize it for years, while penalties and interest continue to mount. The moral? *Seeking out the guidance and counsel of an experienced estate planning attorney is a very good idea.* ■