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

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Estate, Tax, Retirement and Wealth Preservation Planning

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TITLING ASSETS IN JOINT TENANCY:
The Best Advice is Usually "Beware"

Our Best Wishes for a Prosperous New Year!

2002 brought dramatic changes; on June 7 President Bush put his signature to the most sweeping tax bill in twenty years, and on September 11 our lives were permanently impacted. Both events profoundly affect our need to plan and the importance of understanding our options.

In the realm of estate planning, some things remain remarkably constant. People make important decisions with little insight or information regarding the affect those decisions will have on their planning. Even worse, advisors often abet these decisions, with little understanding of the serious consequences. Here's one example:

✓***What is Joint Tenancy?*** Joint Tenancy With Right of Survivoship (JTWROS) is one of the most common legal forms of asset titling, perennially recommended by banks, title companies and financial advisors as a painless, simple way to title real estate and accounts. It is a way two or more co-owners can own property together. When one joint tenant dies, his or her ownership share of the tenancy property is automatically transferred to, and becomes owned by, the surviving joint tenant(s). It is this survivorship feature that raises serious planning issues. Question: should you and your spouse or you and your children hold title to real or personal property as joint tenants? For the following reasons, the answer is often no.

✓***Step-Up in Basis.*** A house titled to "John Jones and Mary Jones, husband and wife, as joint tenants" receives only a 50% basis step-up on the first death vs. a 100% step-up if the asset is titled as community property, no matter who made what contribution to the original purchase. A step-up in basis to fair market value on the first death makes a huge difference in potential capital gains tax liability when the property is sold.

✓***No Control.*** Since the interest of the first joint tenant to die terminates immediately, the survivor owns the entire property by operation of law. The deceased joint tenant cannot leave any part of the property to any other person by will or otherwise. The will is completely preempted – potentially subverting the deceased's planning goals. If the asset is community property, serious ownership problems can develop between a surviving spouse and a surviving joint tenant.

✓***100% Includible.*** One risk for unmarried people owning property in JTWROS is that the property becomes 100% includible for federal estate tax purposes in the estate of the first joint tenant to die-even though he/she has no power to dispose of the property by will or otherwise. The exception is the extent to which the surviving joint tenant(s) can prove their contribution to the purchase price. Unless good records are kept, the full value of the jointly owned property will be subject to death taxes twice. (For marital joint tenancies, just one half of the date-of-death market value of the property is included in the federal taxable estate of the first spouse to die.)

✓***Creditors.*** Creditors of any joint tenant can potentially reach the entire property, e.g. if a joint tenant child injures someone in an accident, the parents' joint tenancy property could be liable for any judgments entered against the child. Even if a creditor cannot seize a non-liable joint tenant's interest, the creditor can attach a liable joint tenant's individual interest , and a court may order the entire property sold to reach the debtor's share. This can get ugly.

✓***Inevitable Probate.*** Joint tenancy only postpones probate. A probate is required on the death of the last joint tenant to die because there is no surviving joint tenant to take title automatically.

✓***An Unintended Gift.*** The IRS takes the position that a taxable gift is made when joint tenancy is created if owners are unmarried and don't pay equally for the property. If a parent, for example, puts up all of the money to purchase property and lists a child as joint tenant, the person putting up the money makes a legal gift of half-ownership of the property. Here's an exception: If a bank account is opened in joint tenancy, with one person making all or most of the deposit, there's no taxable gift until the person who didn't contribute half the original deposit makes a withdrawal of more than his original deposit.

"A raise in my allowance is fine, Dad. But what I'm really after is power of attorney"

✓***No Management.*** Any form of shared ownership can become difficult if one owner becomes mentally or physically incapacitated and no legal authority exists to act on behalf of that owner. Joint tenants should each prepare a durable power of attorney. Otherwise, there's a risk a court proceeding will be required if one owner becomes incapacitated. If the property were held in a living trust with the same owners designated as trustees instead of joint tenants, the disability of one or more of the trustees wouldn't subject the property to court interference.

✓***K.I.S.S.?*** For people who value simplicity (joint tenancy is easy to create) and whose situations don't involve the drawbacks and risks we've discussed, joint tenancy might work fine. Just beware; asset titling is a legal exercise involving both legal and practical consequences which requires the advice of an experienced estate planning attorney, not a title officer, bank clerk or "estate planning advisor". The stakes are simply too high.

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