

Holding Title... Life, Death and Taxes... (Part One)

By Jim Nations, Esq.

“How should I take ownership of the property I am buying?”¹ There are very different outcomes that can be achieved from selecting the method by which you hold title. Your choice of title will have serious consequences which may affect how vulnerable your real estate is to creditors (yours and others!), to future ex-spouses, investment partners, probate court, the Federal and California tax codes, and unwanted inheritance claims from relatives and the IRS!

This article will overview the most common ways to hold title; things you should be considering in making your choice of title; and some less common methods that may have great financial benefit to you and your heirs.

Because real estate keeps becoming more valuable, the question of how parties take ownership of their real property has gained greater importance. The form of ownership taken - the vesting of title - will determine future rights and obligations of the parties to the property. These rights involve such matters as: real property taxes, income taxes, inheritance and gift taxes, transferability of title and exposure of the property to creditors' claims. Also, how title is vested can have significant probate implications in the event of death.

During Life....

Four of the more common methods used are summarized below. These may be used, sometimes in conjunction with other strategies and techniques, to achieve your desired outcomes.

	TENANCY IN COMMON	JOINT TENANCY (w/ Right of Survivorship)	COMMUNITY PROPERTY	COMMUNITY PROPERTY (w/ Right of Survivorship)
Who can take title?	Any number of persons (may be husband and wife).	Any number of persons (may be husband and wife).	Only husband and wife.	Only husband and wife. Interest acquired after July 1, 2001
How is ownership divided?	Ownership may be divided into any number of interests, equal or unequal.	Ownership interest may not be divided.	Ownership interests are equal.	Ownership interests are equal.
Who holds the title?	Each co-owner has a separate legal title to his undivided interest.	There is only one title to the whole property.	Title in the "community" (similar to title being in a partnership).	Title in the "community" (similar to title being in a partnership).
Who has possession?	Equal right of possession.	Equal right of possession.	Equal right of possession.	Equal right of possession.
How do owners convey their interest?	Each co-owner's interest may be	Conveyance by one co-owner	Both co-owners must join in	Both co-owners must join in

¹ This important question is one California real property purchasers ask their real estate, escrow and title professionals every day. Unfortunately, though these professionals may identify the many methods of owning property, they may not recommend a specific form of ownership, as doing so would constitute practicing law.

interest?	conveyed separately by its owner.	without the others breaks the joint tenancy, and owners then become tenants in common.	conveyance of real property. Separate interest cannot be conveyed.	conveyance of real property. Separate interest cannot be conveyed.
Purchaser's status	Purchaser becomes a tenant in common with the other co-owners.	Purchaser becomes a tenant in common with the other co-owners.	Purchaser can only acquire whole title of community; cannot acquire a part of it.	Purchaser can only acquire whole title of community; cannot acquire a part of it.
What happens in case of death?	On co-owner's death, his interest passes by will to his devisees* or heirs. No survivorship right.	On co-owner's death, his interest ends and cannot be willed. Survivor owns the property by survivorship.	On co-owner's death, it goes to survivor in severalty. It goes by will to decedent's devisee* or by succession to survivor.	
What is the successor's status?	Devisees* or heirs become tenants in common.	Last survivor owns property in severalty.	If passing by will, tenancy in common between devisee* and survivor results.	
What is a creditor's interest?	Co-owner's interest may be sold on execution sale to satisfy his creditor. Creditor becomes a tenant in common.	Co-owner's interest may be sold on execution sale to satisfy creditor. Joint tenancy is broken. Creditor becomes tenant in common.	Co-owner's interest cannot be seized and sold separately. The whole property may be sold to satisfy debts of either husband or wife.	
What is the presumption of law?	Favored in doubtful cases except husband and wife (see community property).	Must be expressly stated and properly formed. Not favored.	Strong presumption that property acquired by husband and wife is community.	

*Note: A devisee is a person who receives real estate from another by will.

During the life of the owners, each of these forms of ownership provide for equal right of possession and use. The asset is subject to the debts of the co-owner, but in the case of Common and Joint tenancy, only the co-owner's interest can be executed upon; whereas in the case of the two forms of Community property the whole property may be sold to satisfy the debts of either husband or wife. To protect properties from creditors (during life and after death) one should consider corporate and LLC structures as well as irrevocable trusts (See Trust Me! below.)

Upon Death....and Taxes....

1. Tenants in Common

This form is used more for investment ownership in property. It is often used by domestic partners who are unable to avail themselves to the protections and tax advantages of community property ownership. Each shares ownership of the whole property, but when one partner dies, the deceased's share passes according to the owner's will².

2. Joint Tenants (with right of survivorship)

Each owner owns an equal, undivided interest in the property and with the right of survivorship. When one owner dies, the title automatically goes to the survivor or survivors. This title is used frequently for married and unmarried couples, but may result in unintended results, particularly if there are children from previous marriages that need to be considered for inheritance purposes. Also, joint tenancy is often not recommended for assets that can increase in value, such as a real estate, because the surviving joint tenant will not receive a "stepped up cost basis" to fair market value at the date of death of the other joint tenant. (See Cost Basis below.)

3. Community Property

This is the most common form used by California married couples to hold title to their real estate. Each partner owns an equal, undivided interest in the whole property. When one spouse dies, the surviving spouse gets ½ interest in the title to the whole property automatically, and up to ½ goes by will or succession which may go to the surviving spouse, or to others, depending on the deceased's will or trust. If by will, this process is subject to probate.

4. Community Property with Right of Survivorship

A similar form of ownership is called "community property with right of survivorship," which allows the property to be transferred to the surviving joint tenant without going through probate. This form of ownership allows a 100 percent step up in basis. Beginning July 1, 2001 married couples can hold title to property as community property with right of survivorship. The California Legislature enacted this law to allow married couples to transfer their community property to the survivor without the need for probate, while at the same time giving the surviving spouse a full step-up in basis in the property. Historically, spouses in California have been told that to avoid probate, they should hold their property in joint tenancy. However, in doing so, they potentially lost the ability to receive a full 100 percent step-up in basis in the asset on the death of the first spouse. Civil Code Sec. 682.1 was enacted to give the spouses the benefit of avoiding probate while receiving a full step up in basis on the first death.

Spouses who currently hold title to community property as joint tenants should consider re-titling their property pursuant to the new statute. Where the property is the separate property of one spouse, re-titling of the property pursuant to the new statute would cause a transmutation of the property into community property and the client should only consider this option if they want the transmutation to happen. Obviously, any clients purchasing a new property with community funds should title the property pursuant to the new statute. There do not appear to be any disadvantages if a client titles the asset pursuant to the new statute. Hypothetically, there would be a disadvantage if you expect the property to be worth less on the first spouse's death than the cost value of the property.

5. Individual Ownership

One person owns the entire property, which upon death, passes through probate, according to the instructions in their will or by intestate succession, if no will exists. devisees take the property with "stepped up" basis. **(Part Two - continued next month.)**

² For a full discussion on Tenants in Common please see "TIC...TIC...TIC....." AON June 2004

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