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Joint tenancy should be used with extreme caution. It can subject a co-owner to unnecessary taxes and liability for the other co-owner's debts. It can also deprive heirs of bequeathed property and, in California, leave the joint tenant without right of survivorship. Shown here are tips and traps for consulting effectively regarding the use of the joint tenant form of title.

By Sandra Sickler

Many persons, particularly elderly parents and single persons, put the names of someone other than themselves on their bank accounts, real property, and other assets for convenience without realizing the true consequences. Joint tenancy has several traps that can seriously damage an estate plan, create unnecessary taxes, and even cause the true owner to lose the asset. This article, based on California law, discusses several joint tenancy traps for the unwary.

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Joint Tenancy Property Passes to the Surviving Joint Tenant, Regardless of Your Will

The most widely known aspect of joint tenancy is the right of survivorship. This means that when one co-owner dies, his or her interest in an asset held in joint tenancy passes to the surviving co-owner without probate. The joint tenant form of title should only be used when each co-owner wants his/her interest to pass to the surviving co-owner. If a co-owner intends that his or her interest in a particular asset go to someone other than the surviving co-owner, the joint tenancy form of ownership will thwart that desire.

A young lady whose elderly uncle placed her name on a $100,000 certificate of deposit (CD) as a joint tenant with him recently retained the writer in a probate proceeding. The uncle also left a will that divided his estate among several beneficiaries, including the niece. After the uncle's death the executor of his estate attempted to claim the $100,000 CD as part of the estate and to divide it among all beneficiaries named in the uncle's will. Although the attorney who wrote the will and a business associate of the uncle testified in court that the uncle intended to divide his entire estate, including the $100,000 CD, among all of the beneficiaries named in his will, the court held that since the uncle had put the name of the niece on the certificate as a joint tenant, the entire $100,000 belonged to her. This meant that the niece received the $100,000 CD *in addition* to the share of the uncle's probate estate that was specified for her in the will. *It is essential that assets be held in joint tenancy only with the person to whom you want them to pass upon your death.*

Exposure of Your Assets to Claims by Creditors of Your Joint Owner

By placing another person's name (your child, for example) on your assets, you expose your assets to the claims of your child's creditors. If the child files bankruptcy, you may have to purchase back one-half of your own property at the current fair market value. If a judgment is recorded against your child, it will place a lien against your property, and the judgment creditor could force you to buy one-half of your property for the current fair market value or to sell it and give them up to one-half of the proceeds to satisfy the judgment. Bank accounts in joint tenancy are particularly susceptible to seizure if your child has delinquent tax problems. The Internal Revenue Service (IRS) may seize your bank account to pay your child's taxes. Although it may be possible to convince the IRS or other creditors that the asset belongs only to you, this will be accomplished only after much aggravation, expense, and inconvenience.

Joint Tenancy Can Significantly Increase Estate Taxes

Joint tenancy avoids probate, but it does *not* avoid estate taxes. The IRS treats the first owner to die as the *only* owner of assets held in joint tenancy.[1] To avoid having the entire asset included in the taxable estate of the first owner to die, the surviving owner must produce clear proof that a portion of the property originally belonged to him or her. Otherwise, the tax treatment can lead to very unfair and unnecessary taxation if the deceased owner's total estate is more than $650,000.

Joint Tenancy Between Husband and Wife Can Deprive the Surviving Spouse of Significant Income Tax Advantages

When one owner of joint tenancy property dies, only that owner's share of the property receives a stepped-up basis. In other words, when the surviving owner sells the property, one-half of the appreciation that accrued between the time the property was purchased and the date of the first owner's death will be taxed as gain.[2]

A husband and wife can hold title as community property. Community property receives *a full step-up in basis* when either spouse dies.[3] This means that all of the appreciation that accrued between the original purchase and the first spouse's death will go untaxed. For assets that have significantly appreciated, this can result in very significant tax savings to the surviving spouse when he or she sells the property. If the surviving spouse chooses to rent the property and claim a depreciation deduction, that deduction is calculated on the stepped-up basis as the full fair market value on the date of the first spouse's death. On highly appreciated assets, this is a tremendous tax advantage.

A word of caution is appropriate here. The full change in basis at the first spouse's death can go either up or down. If the property has *appreciated* in the spouses' hands, the basis takes a full step-up at the first spouse's death. Likewise, if the property has *depreciated* in the spouses' hands, the basis takes a full step-down to the fair market value as of the date of the first spouse's death. It may be advisable for spouses to hold depreciating assets in joint tenancy rather than as community property.

Possible Loss of Income Tax Advantages That Would Otherwise Be Available

The Internal Revenue Code (the Code) provides homeowners the opportunity to avoid paying tax on up to $250,000 (for a single person) or $500,000 (for a married couple) on the gain from the sale of their home.[4]

If you place your child's name (or the name of anyone else) on your home, you are setting yourself up for losing at least a portion of this tax advantage. For example, suppose you paid $50,000 for your home years ago. When your spouse dies you place your child's name on the property as a joint tenant to avoid probate upon your death. You later sell the home for $250,000. Ignoring the costs of sale to keep the example simple, you have a gain of $200,000.

Since you own one-half of the property and your child owns one-half of the property, one-half of the gain belongs to you and one-half belongs to your child. Since you have been living on the property, your one-half of the gain is income tax–free. However, if your child does not meet the requirement of residency in the house, your child's gain is taxable.

California Law Provides for One Joint Tenant to Defeat the Other Joint Tenant's Right of Survivorship in Real Property Without the Consent of the Other Joint Tenant

Some people believe that joint tenancy provides security for the right of survivorship. This is not so for California real property. If real property (vacant land or land improved with a building) is held in joint tenancy, one co-owner can defeat the other co-owner's right of survivorship by signing and recording a written instrument that shows intent to defeat the right of survivorship.[5] The person who wishes to defeat the right of survivorship must record the written instrument in the county where the property is located. If the written instrument that severs the right of survivorship is signed three days or less before the person who signs it dies, the instrument may be recorded up to seven days after he or she dies. It will then be effective to avoid the surviving co-owner's right of survivorship in the property. This could leave the surviving co-owner with strangers as co-owners instead of in complete ownership of the real property.

Conclusion

Co-owners have choices regarding how they hold title to their assets. In California, title can be held by more than one person as tenants in common, joint tenancy, or community property. Only a husband and wife can hold community property. Each form of holding title has certain advantages and disadvantages. With appropriate planning, many of the traps of joint tenancy that have been discussed in this article can be avoided without losing the perceived advantages of joint tenancy. The advice of a knowledgeable attorney regarding what names should be placed on title to your assets and how title should be held between co-owners can save significant taxes and avoid much frustration and grief on the sale or other disposition of assets.

Endnotes

1. *See* I.R.C. § 2040.
2. *See* I.R.C. § 1014.
3. *See* I.R.C. § 1014(b)(6).
4. *See* I.R.C. § 121.
5. *See* Cal. Civil Code § 683.2.