BUYNAK & FAUVER

HOW SHOULD YOU HOLD TITLE TO REAL ESTATE?

(*Real Estate Advisory No. 3)*

This Advisory discusses the impact of how you hold title to real estate. Chances are likely that your home is probably the most valuable asset you own. Yet, most people donøt think about how they should hold title to real estate until the title company asks how they want it listed on the deed when they buy a home or refinance a loan. This choice should be made with knowledge and careful consideration of the various options because of the effect on estate planning and taxes. Letøs look at some common ways to hold title:

Individual Name: You can hold title in your own name, e.g., John Doe, even if you are married. Many married people hold title in their own name individually and the deed commonly states, ñJohn Doe, a married man, as his separate property.ò If a deed is listed this way, it is intended to be a recorded notice that the owner is married but the property is not considered marital property owned jointly with a spouse because it was acquired before the marriage, or after marriage with separate property funds. Does this mean that the spouse has no claim to any portion of the spouseøs separate property assets? The answer is not a simple one, because in community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin) a person can acquire a community interest in their spouseøs separate property if community funds have been used to pay the mortgage, taxes, insurance, or pay for repairs or improvements on the property. At divorce or death, this can cause some complications to straighten out by calculating how much has been contributed by the community to the separate property, unless a premarital or post-marital agreement exists.

There are other possible drawbacks to holding title in your individual name. For example, what happens if you become mentally or physically incapacitated due to an illness or an injury and the property needs to be refinanced or a line of credit opened or increased to pay for your medical expenses? If you are unable to take care of your business affairs, the court will appoint a conservator for you which is a complex and costly process. It is a public process that can be embarrassing, time consuming and difficult to end if you recover from a temporary incapacitation (think about the possibility of a stroke or an auto accident and being in a coma for an extended period of time next time you drive on that dangerous stretch of highway).

You may respond to this dilemma by saying, ñI have a will that designates an executor to take care of my property!ò A will is important, but it only goes into effect after your death, and not if you are incapacitated. Your next response may be, ñI also have a power of attorney!ò Many power of attorney forms (especially those that were prepared long ago) have a limited life of seven years, and most end at incapacity. What is necessary is a *durable power of attorney* which remains valid at your incapacity. If you donøt have this particular kind of power of attorney and you own property in your individual name, you should have one prepared to designate someone to manage the property, pay expenses and sell or borrow on the property if necessary.

What happens to your property when you die and title is in your name individually? If your name is the only name on the title, the property will almost certainly have to go through the probate court system before it can be distributed to your heirs. Since your name is the only one on title and you are not living to sign a deed to transfer title, a court order distributing the property to the beneficiaries named in your will is the general process of transfer, or in the absence of a will, the probate code provides which of your legal heirs will receive your property in an estate administration procedure, and in what percentage. If you have a trust, but never transferred title of your property into your trust name, it may require a probate as well, unless you can bring what is called a *Heggstad* petition to ask the court to transfer title to your trust when it was listed it as a trust asset in your trust document but you never formally changed title. That process generally works, but is an unnecessary cost that you can avoid by reviewing title to real estate assets while you are alive.

Joint Tenancy: Most married couples hold title as John Doe and Mary Doe, as joint tenants. It is generally considered to be a fair process because whichever one of the co-owners that survives the other receives the property. This is a fairly easy and inexpensive way to take care of changing title after the death of one party because all it takes is the recording of an affidavit of death of joint tenant along with a copy of the death certificate. Parents and their adult children often hold title this way, and frequently unmarried couples, including gay and lesbian partners and registered domestic partners choose this form of co-ownership.

Many people don’t realize that one of the parties can sever a joint tenancy ownership of property by deeding their share of the property to another person, and this can be done without the other party’s consent or knowledge. I remember years ago dealing with a situation that ended up in a litigation matter where a father and son owned an apartment building as joint tenants and the son managed, repaired and improved the complex for over 20 years with the understanding that at his father’s death, he would be the sole owner automatically. After dad died, the son discovered that before his death dad had deeded his interest to another son, and now after years of work and investment, the son now owned the property jointly with his brother. A long court battle ensued because the man challenged his father’s capacity when he deeded his interest to the brother, but the end result was that the two brothers had a joint ownership in the apartment. This turned out to be contrary to what he thought was a well thought out retirement plan.

Another problem with owning property in joint tenancy is that when you add a co-owner to the property as a joint tenant, you lose many aspects of property control. Many parents think that by adding their son’s or daughter’s name to the property that it is a way to pass the property on without a probate and this is generally true, but if they later want to sell or refinance the property, it requires all named joint tenants to sign loan documents. If the co-owner disagrees with you about a sale or mortgage on the property, you could end up in court. If your co-owner is incapacitated, the court may get involved to protect your co-owner’s interest in the form of a conservatorship. You also expose the property to your co-owner’s debts and obligations, so by adding your son’s or daughter’s name to the property, you could potentially lose your home to your child’s creditors if he or she is successfully sued. There could also be gift and/or income tax problems if your co-owner is not your spouse.

Moreover, because your will does not control property held in joint tenancy, you could be disinheriting your other family members when your co-owner inherits your share. Often, children from a previous marriage are disinherited when a new spouse is the surviving owner, who can later remarry and hold title to the property with a new spouse. Children from a former marriage left out of the inheritance process may forever have feelings of resentment toward the step-parent who is now living in the family home with the new spouse.

Finally, property held in joint tenancy only receives a step up in the basis equal to one-half of the property value at the death of the first joint tenant. This means that if property was originally acquired many years ago for a cost of $100,000 and it is now worth $1.1 million, the propertyôs basis will be adjusted upward to $600,000 when the first joint tenant dies. Then, if the surviving joint tenant sells the property without replacing it with other property, capital gains taxes must be paid on the difference between the $600,000 adjusted basis and the selling price. If property is held as community property, the surviving spouse receives an increase in the basis to the full market value at the time of the joint ownerôs death. In the above scenario, this would result in an adjusted basis of the property being $1.1 million and capital gains taxes on a sale would be calculated at the increase over the $1.1 million price instead of the $600,000 adjusted basis for joint tenancy owned property. Thus, owning property in joint tenancy could potentially result in thousands of dollars in taxes being paid by a surviving joint tenant when the property is sold rather than little or no capital gains taxes being due if held in one of the joint forms discussed below.

Tenants-In-Common: With this kind of ownership, two or more people own property in the percentage stated in the deed. This commonly looks like this on a deed: ñJohn Doe, as to an undivided one-third interest, Mary Doe as to an undivided one-third interest, Suzy Doe as to a one-sixth interest and Larry Doe as to a one-sixth interest, as all tenants-in-common.ò Each person owns the stated percentage of the property and can sell his share without the other partiesô consent. Also, each ownerôs share is distributed in the manner directed in his or her will. This means that if Larry Doe dies, his beneficiaries will receive a one-sixth interest in the property and they will continue ownership with John, Mary and Suzy. If there is no will, the property will go to the ownerôs heirs as directed by the probate code. In California, this generally means that the surviving spouse receives the property totally unless there are children, at which case the property is shared jointly with the surviving spouse in a proportionate manner set out in the California Probate Code. If there is no surviving spouse or children, then the property is distributed to parents, brothers and sisters, aunts, uncles, grandparents, cousins and on and on. Complications can arise if one of the parties to the tenancy-in-common is involved in a dissolution of their marriage and the spouse claims an interest in the property, even though not listed on title.

Community Property and Community Property With Right of Survivorship: Married couples can own property as husband and wife as community property and they receive some additional benefits by holding title in this manner, including a full step up in basis as discussed above. If a couple designates ownership of property as community property, one spouse will receive the other personôs share at death. Many people think the transfer to the survivor is automatic, but it is not. It requires a spousal property petition to be filed with the court and after reviewing the petition and allowing other heirs an opportunity to contest the petition, the court holds a hearing and issues an order transferring title to the surviving spouse. If property is held as ñJohn Doe and Mary Doe, husband and wife, as community property with right of survivorshipò then no spousal property petition is required and the survivor merely records an affidavit of death with a death certificate and no court hearing is required to transfer the property. For many couples who want the benefits of joint tenancy that avoids probate but want to retain the increase in the basis of the property, this is a good choice in the manner to hold title.

Tenancy-by the Entirety: This form of joint ownership is available between spouses in some states (not California), is similar to joint tenancy with right of survivorship in that when one spouse dies, the survivor receives the total interest in the property, even if a will says otherwise. There are many of the same risks as other joint ownership forms, including unintentional disinheriting and court interference if one party becomes incapacitated and does not have a valid durable power of attorney.

Property Titled in a Revocable Living Trust: When you have a living trust, title to real estate is held in the name of the trustee of your trust. Usually, you and your spouse are the trustees of your trust initially, and your spouse serves as the sole trustee after your death. While you are living, you and your spouse can buy, sell and refinance real estate at will.

If you become incapacitated, the co-trustee (usually your spouse) is able to step in and act for you without a court appointed conservator. If both you and your spouse are incapacitated, the successor trustee named in your trust can manage property expenses and use income or loan proceeds for your benefit while you are living. Your successor is legally obligated to follow the instructions you put in your trust. If you recover, your successor trustee simply steps aside and returns the property to your control. When both you and your spouse have passed away, the successor trustee manages and distributes the property without probate proceedings according to the instructions in your trust, so you donôt have to worry about unintentionally disinheriting someone by changing title to you and one of your beneficiaries.

If your trust provisions provide, your successor trustee can hold income-producing property for years to come and support minor children or even adult children or other beneficiaries until they reach an age where they can manage the property responsibly. Otherwise, children may legally inherit property beginning at age 18, and few people at this age are mature enough to manage rental or commercial property wisely. In fact, most people canôt manage property wisely until they approach their 30ôs, and this is the reason why so many people establish a trust and provide for gradual distribution of property to their children so property ownership can be delayed until they are mature enough to handle the responsibility.

Summary: How you hold title to your real estate holdings should be given careful consideration, as it can result in different tax and estate planning results and can be further complicated in the event of a dissolution of marriage of anyone listed on a deed. Pull out your existing deed and make sure you know the full implications of how you currently hold title. If you are unsatisfied with what you currently have, now is the time to change title.

As always, you should be sure that additional legislation has not been enacted or that court decisions have been rendered that would change the above advisements. This advisory is neither exhaustive nor is it tailored to your specific situation. If you have questions or concerns, you should discuss your individual situation with us or your own attorney.

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This Advisory is one of a series of business, estate planning, real estate and tax advisories prepared by the attorneys at the Buynak & Fauver. Should you have further questions regarding the information provided in this Advisory, please contact the author at the number listed above.

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