WAYS TO HOLD TITLE IN CALIFORNIA

Sole Ownership

This is generally the way most single (not currently married) people hold title. An example would be, *"John Doe, a single man"*. It can also be used to designate property held by a married person where the owner's spouse has no ownership interest in the property, such as, "*Jane Doe, a married woman as her sole and separate property"*. The latter is typically used when one spouse has his/her own separate assets before getting married, is using those funds to make the down payment and monthly payments, and wants to make sure their spouse doesn't acquire a community property interest in the home. This method is also occasionally used when one spouse has good credit and the other does not. Sometimes, lenders will give buyers a reduced interest rate by having the "good credit" spouse take title to the property as a sole owner, and having the "bad credit" spouse Quitclaim (give up) all their rights to the home.

Myth: When the "good credit" spouse takes title as a sole owner, the "bad credit" spouse won't get any equity from the home at the time of divorce.

Fact: Family law courts will look at all evidence to determine the true intention of the parties. Assuming both spouses admit the real reason for separate ownership was to get a lower interest rate, the home will likely be considered community property at purchase.

Tenancy in Common

This is generally how two or more people, who are not married to each other, take title. Tenancy in common can still be used by married people nonetheless. This form of title also has the fewest restrictions, and even permits unequal ownership percentages. An example would be: *"John Doe, a single man, an undivided 1/3 interest, and Jane Snow, a married woman as hers sole and separate property, an undivided 2/3 interest, as tenants in common"*. In this example, John and Jane may be purchasing an investment property, Jane is contributing 2/3 of the down payment from her separate (non-community property funds), and she doesn't want her husband to acquire any interest in the property.

Myth: When one tenant in common dies, the other tenant(s) in common automatically inherit the property.

Fact: The <u>heirs</u> of the tenant in common who dies will eventually inherit the property, but only after going through an expensive and time consuming procedure called probate. For this reason, tenancy in common is usually a <u>bad</u> way to hold title.

Joint Tenancy

This form of title is used when two or more people want to ensure that, upon their death, their interest in the property goes to the surviving joint tenant(s). The owners can be married to each other, or married to other people. To take title as joint tenants, all owners must take title at the <u>same</u> time, and also have <u>equal</u> ownership interests. For example, *"John Doe and Jane Doe, husband and wife, as joint tenants with right of survivorship.* Joint tenancy does achieve one important purpose, in that it avoids the expense and delay of probate proceedings. The disadvantage thus becomes obvious: what if a joint tenant does <u>not</u> want their interest to go to the surviving joint tenant? In this case, Jane may have children from a previous marriage, and may want her children to own at least some part of the property after her death.

Myth: Parents should put their adult children on the title to their homes as joint tenants to avoid probate when the parents die.

Fact: Adding adult children (or anyone else for that matter) to your title is dangerous. Joint tenancy is laden with numerous complex problems, the three most common of which are:

1) You could lose your home if any of your children get sued. For example, your daughter is a shop-a-holic, and racks up more credit card bills than she can repay. So, she files bankruptcy, and now her 1/3 interest in what you thought was your home becomes subject to her creditors in the bankruptcy estate. If you think your children aren't that irresponsible, assume instead your son owns a plumbing business as a sole proprietor. One of his workers forgets to tighten a valve properly, and floods out an apartment building to the tune of $700,000 in water damage. His business liability insurance has a policy limit of only $500,000, so where do you think the apartment building's insurance carrier is going to recover its loss of $200,000? You guessed it, your home.

2**) You could lose your home if any of your children get divorced.** Remember that community property thing? When your not-so-wonderful son-in-law decides your daughter isn't right for him anymore, he files for divorce and claims that your daughter's 1/3 interest in your home is really his community property. Even though you may not lose your home, you'll probably end up writing dear son-in-law a sizeable check to make him go away.

3) Gift Tax / Estate Tax problems. If you put your children on your home's title as joint tenants, you have just given each of them an equal ownership interest in your home. Say your home has $200,000 in equity, and you and your spouse add three adult children to the home's title, all as joint tenants. With five owners, each owns 1/5, or $40,000 of that equity. The Internal Revenue Service assumes you and your spouse just made a "gift" of $120,000 to your three children, and will require the two of you file a Gift Tax Return (time consuming and costly). Further, this "gift" to your children will reduce your Estate Tax exemption when you die.

Myth: So long as only married couples hold title together as joint tenants, everything is OK.

Fact: Over time, real estate will appreciate, and joint tenancy can cost you big dollars in needless **capital gains taxes**.

Assume that you and your spouse get married in 2010, buy a home for $500,000, take title as joint tenants, and live happily for 15 years. During that time, your home has appreciated $900,000 to $1.4 million (remember, this is California). When one spouse dies, the surviving spouse will inherit the half of the house they don't already own on a "stepped up" cost basis, meaning they are considered by the IRS as having purchased that half of the property 15 years ago for $700,000 (1/2 of the current $1.4 million value). Unfortunately, the surviving spouse's half still has a basis of $250,000 (1/2 of the original $500,000 purchase price). When the surviving spouse sells the property four years later for its new market value of $1.6 million, he or she will have a capital gain of $650,000 ($1,600,000 less the combined basis of $700,000 + $250,000). Even with the $250,000 personal residence exemption (which Congress might not increase), the surviving spouse will have to pay capital gains tax on the difference of $400,000 ($650,000 gain less the $250,000 exemption = $400,000). At a 15% tax rate, that's a whopping $60,000 in federal capital gains tax alone that could have been avoided by holding title as Community Property instead (see the next section).

Community Property

Community Property is the most favorable form of title, from a tax perspective, for a husband and wife to own property. Example, *"John Doe and Jane Doe, husband and wife, as community property"*. Traditionally, only a husband and wife could hold title as community property, but this has now been expanded to registered domestic partners as well. Assume the same example above, where John and Jane purchased their home 15 years ago for $500,000. However, instead of taking title as joint tenants, they instead take title as community property. When one spouse dies, both halves of the property are "stepped up", meaning the surviving spouse inherits the entire property with a basis of its current market value ($1.4 million). When he or she sells the house four years later for the same $1.6 million, there is only a $200,000 capital gain. Since the surviving spouse has a $250,000 personal residence exemption, there are no capital gains taxes! Imagine, a $60,000 tax savings just by telling the escrow officer you wanted to hold title as community property instead of as joint tenants. The sad thing is, there are still plenty of escrow officers "advising" married people to take title as joint tenants.

The only disadvantage of a husband and wife holding title as community property is probate. When the first spouse dies, the property does have to go through a somewhat simplified probate procedure. While faster and less costly than traditional probate, this too can be avoided (if you read the next section).

Community Property with Right of Survivorship

This relatively new form of title, created in 2001, provides the tax benefits of holding title as community property along with the survivorship features of joint tenancy. When one spouse dies, the other inherits the entire property on a stepped up cost basis and completely avoids probate. Assuming that both spouses want each other to inherit their home, and assuming neither had the foresight to put their home into a living trust (see below), then Community Property with Right of Survivorship is the best way for most married people to hold title.

Myth: If a husband and wife held title as Community Property, then in 2001 they automatically began holding title as Community Property with Right of Survivorship.

Fact: Title to real property never changes automatically. The spouses must record a new grant deed stating whatever form they want title changed to. An attorney can usually perform this simple task for a minimal charge. A title or escrow company could also do the same (just don't ask them for advice).

Living Trusts

A living trust (also known as a "revocable" trust) is only one part of a comprehensive estate plan. For now, let's focus only on the issue of holding title to real property in the name of a living trust.

When property is held in a living (or any other) trust, it stays in that trust despite the death of any individual. For example the deed might read: *"John Doe and Jane Doe, as Trustees of the John and Jane Doe Family Trust"*. You guessed it; the spouses are the trustees (managers) of their own trust. When one spouse dies, the surviving spouse becomes the only trustee and has full authority to sell or mortgage the property. There is no probate, because the property stays in the trust. When the second spouse dies, the successor trustee (usually a child or close relative of John and Jane) assumes trustee (management) responsibilities. There is no probate, because the property is still in the trust. From there, the successor trustee will then transfer the property to the beneficiaries that John and Jane specified in their trust, also without probate. Most importantly, John and Jane were never exposed to any risk of losing their property by having their children on the title while they were still alive.

Every competently drafted living trust specifies that the property is to be considered community property for tax purposes, so capital gains taxes are reduced or eliminated. Further, Estate Taxes are reduced or eliminated as well. The end result of holding title to property in a living trust: no probate, tax savings, and privacy.

While living trusts are typically set up for married couples, they can also be established for single people, or any group of people who choose to own property together. For most people, the only reason they don’t have a living trust is because they didn’t take the time to learn about its benefits.

Other forms of holding title

As you can imagine, there are numerous other forms of holding title to real estate in California. These include, but are not limited to, Corporations, Limited Liability Companies, and Partnerships. These forms of title are typically used for investment properties, have specific legal and tax consequences. For more information on other forms of holding title, please consult two licensed professionals:

1) An attorney at law (for legal advice); and

2) A tax professional (for tax advice). Make sure they are either a Certified Public Accountant or an Enrolled Agent.

We hope you’ve found the above information helpful.