

New Dimensions in Estate & Trust Planning

*An Article to Benefit Clients & Friends
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THE PITFALLS OF JOINT OWNERSHIP

The Accidental Estate Plan

Joint ownership is the most common form of estate planning: it is simple, easy, and it often occurs without any consideration for the estate planning consequences. Many married couples own all of their property jointly, perhaps more by underlying assumption than by a plan that considers the benefits and risks of joint ownership based on specific goals. Married couples seem to like the idea of joint ownership as symbolic of the commitment to each other, to like goals, and to share equally in their successes and in their failures. Not only do couples use joint ownership as appropriate for their future together, but also many bank officers, brokers and agents make the very same assumption without ANY regard for unexpected and preventable catastrophes.

What is Joint Ownership?

Joint ownership is often an arrangement between husband and wife, but can exist between any people who own an asset together.

Real property, as well as intangible personal property, may be owned jointly. Intangible property includes, but is not limited to, bank accounts, brokerage and investment accounts, stocks, bonds, mutual funds, promissory notes and vehicles. Joint ownership may be with or without the right of survivorship and should be so specified, consistent with the result you intend on death.

Where assets are owned with a right of survivorship, jointly owned property automatically transfers to the other co-owner at death, thus avoiding probate. Without a right of survivorship, the fractional interest owned by the deceased becomes a probate asset of the deceased's estate, and the joint owner continues the use of his or her property interest.

When compared to the other alternatives in estate planning, joint ownership may prove to be the worst estate planning method of all. Why?

Pitfall #1: Disability

All joint owners need to sign to transfer real property. While this requirement is sensible, it can lead to great expense and delay at the incapacity of one owner. For example: Bob and Mary, husband and wife, own all of their assets jointly with the right of survivorship. This means both Bob and Mary need to sign a deed to sell the property. Suppose Mary were to be incapacitated through a disease like Alzheimer's. She would be legally required to sign but prohibited from doing so by lack of capacity. Bob would be forced to open an expensive and tedious court Guardianship (also called *Conservatorship*) proceeding to acquire the legal right to sign on Mary's behalf. He would then be subject to burdensome bond requirements and annual court accountings.

Pitfall #2: Death and (Estate) Taxes

Although most people who choose to title assets jointly do so to **avoid** probate, joint ownership merely **POSTPONES** probate until the second death. Using Bob and Mary again as an example, suppose that at Bob's passing, all of the assets pass to Mary automatically and avoid probate at Bob's death. Now Mary owns all of the assets in her name solely. At her death, **all** of their assets will be subject to probate proceedings to transfer ownership of her assets to her heirs.

If Bob and Mary have an estate larger than one of their federal estate tax exemptions (\$3.5M in 2009), then the joint ownership of all of their assets may subject their family to federal estate taxes that could **easily** have been avoided. This can occur when Bob (the spouse who dies first) does not have any individually owned assets to fund his exemption amount (\$3.5M in 2009). Joint ownership takes assets away from Bob immediately at his death and transfers them to Mary. Bob's exemption is wasted because he has no assets on his side of the ledger on which to apply his exemption. When Mary dies, Mary's exemption may well be insufficient to protect both her share of the

assets and those received from Bob. For instance, if Mary dies with an estate larger than her allowed exemption, the remaining amount will be subject to estate tax (rates range from 37%-55%). As a result, the children, Sally and Sam, could pay unnecessary Estate Taxes, which will be due within nine (9) months of Mary's date of death.

Tax planning provisions are now more critical than ever to include in estate plans because the fate of the estate tax "repeal" is totally unreliable. The "repeal," as currently set forth, applies **ONLY** to a one-year time frame – the year 2010. **After the one year, the estate tax is back and the exemption is \$1 million.**

Moreover, if Bob and Mary owned property jointly in Virginia (a separate property state), and Bob passed, Mary only gets a "step-up" in basis (cost basis stepped up to the fair market value on Bob's date of death) on Bob's one-half interest. If she were to sell the property, she may have to pay unnecessary capital gains on the 50% of the property that did not receive the step up in basis.

Meanwhile, Mary may remarry. Most likely, she and her new husband, Tom, will own their property jointly since she did so before without any problem. If Mary dies before Tom, her assets will automatically pass to Tom, and she will have unintentionally **DISINHERITED** her children. This may be good news for Tom and Tom's children but catastrophic for Bob and Mary's children!

Pitfall #3: Strange Bedfellows

When an owner adds another person to a title, he ties himself to the new owner's personal and financial liabilities. Continuing the previous example, assume Mary chooses not to remarry after all and instead decides to put her children's names on each of her assets so they will pass to her children at her death. Once Mary, Sally and Sam's names appear on the assets, each will hold a one-third interest as joint owners. All three now equally own one

third interest in the entire asset. As a result, Mary has subjected her assets to her children's lawsuits! Her home, for example, could be taken from her if her children are sued due to an automobile accident or other matter. Her financial security is tied to her children's creditors, marriages, and life decisions.

Mary's ownership with Sally and Sam is now an equal ownership three ways. Because of the joint ownership, Sally and Sam can use or sell their one-third interest as they see fit, without Mary's knowledge, much less her permission. They could even force a partition suit to sell the real estate. The children receive their one-third share all at once even if they are not able to manage it. The children's creditors can attach their respective interest as well. If Mary, Sally or Sam became disabled, their individual share may become subject to and administered by the court through a conservatorship. If Sally or Sam dies, their respective spouse may have a claim against their share. The moral of this story is DO NOT own assets jointly with children!

Pitfall #4: Gift Taxes

Once Mary adds Sally and Sam's names on the assets, each holds a one-third interest as a joint owner. Unbeknownst to Mary, she made gifts of a one-third interest each to Sally and Sam in assets that she may later need. Even though Mary may be the only one who actually

uses the asset, she has made a completed gift to the children, which is subject to Federal Gift Taxes. These Gift Taxes need to be reported on a Federal Return and can trigger more Estate Taxes to be due upon her death.

How to Avoid the Pitfalls of Joint Ownership

In short, use little, if any, joint ownership in your estate plan. Joint ownership defeats estate tax planning efforts and can create significant tax liabilities that could have been prevented. A husband and wife should set up a revocable living trust with tax planning provisions and have their assets retitled into the trust. They, then, can include tax planning and remarriage protection provisions in the trust. This will insure their true estate planning objectives are achieved.

To successfully use both Bob and Mary's exemptions, it is important to have the proper tax planning in place in the living trust prior to the first spouse's death and the ownership of assets coordinated with the tax plan in the trust, free of joint ownership.

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