Community Property with RIGHT OF SURVIVORSHIP

Community Property With Right Of Survivorship (section 682.1 of the Civil Code) is a relatively new way for married couples to hold title to property in California. It combines the best features of Joint Tenancy and Community Property and enables property that was deeded after July 1, 2001 to pass to the surviving spouse without having to go through estate administration, otherwise known as probate.

Historically, the benefit of holding title as Community Property has been a double adjustment in the income tax valuation of inherited assets to reflect the new fair market value at the time of death of a spouse. The following is an example of how the taxable profit from selling a property can be affected by holding title as Community Property, Joint Tenancy or Community Property with Right to Survivorship.

BOB & TINA bought a home in 1989 for $100,000. Five years later, they moved out, converting it into a rental. After many years, the rental property has depreciated down to a basis of $40,000 while the value has risen substantially. If it sells for $300,000 (after commission and costs of sale), the story has three possible endings, depending on when it is sold and how they hold title.

TAXED TO THE MAX

Bob gets terminally ill. During this time, Tina sells the property. The profit, $300,000 - $40,000 (basis) = $260,000, is taxable.

LOWER TAXES, HIGHER FEE

Bob passes away. Tina sells the property immediately thereafter. The amount of taxable profit depends on how they held title. If Held as Joint Tenants, the basis in inherited property is adjusted to the date of death value. This would apply to the half of the property Tina inherited from Bob. The other half that she already owned was valued at $20,000 (half of $40,000) and stays the same. Bob's half (now owned by Tina) is adjusted to $150,000. Tina's new basis - her $20K + Bob's $150k, is now $170,000. When she sells for $300,000, only the difference of $130,000 is taxable. Under Joint Tenancy, the property automatically passes to Tina, without passing through probate, thus avoiding the delay and expense associated with the process. Unfortunately, under Joint Tenancy, only the deceased spouse's one-half interest obtains an adjusted tax basis, which is equal to one-half the fair market value of the property at the time of death.

If Held as Community Property: Each spouse owns the entire property, so Federal Tax Law says that the basis is adjusted to the date of death value for the entire property. Tina's basis is now $300,000. When she sells for $300,000, nothing is taxable. However, a drawback of vesting title as Community Property is the legal expense often required to process the estate through probate. Probate fees typically equal about 5% of the gross value of the estate. Probate usually takes about a year, but can easily last twice that. During that time, hearings are held before assets are sold or money is paid out to the family.

NO TAXES, NO FEE

If Held as Community Property with Right of Survivorship, upon the death of either spouse, property automatically passes to the surviving spouse without probate, and the property receives a 100% adjustment basis for tax purposes. This allows the inheriting spouse to avoid probate and sell immediately, if desired, with no taxable proceeds from the sale.

IS THERE A DOWNSIDE TO AVOIDING PROBATE?

In general, probate costs time and money. While in the past, it offered some protections, a law that went into effect on January 1, 1991 changed all that, largely eliminating the risk associated with avoiding probate. In essence, any claim against a decedent must now be filed within one year of his or her death, or it is forever lost. This rule applies whether the estate was probated, or probate was avoided through a Living Trust, Joint Tenancy, Community Property With Right Of Survivorship, or any other means. For the complete text, see California Code of Civil Procedure, Section 331.2. You've learned that how you hold title can greatly affect the outcome of the sale of a properly in foreseen or unforeseen circumstances. Contact your tax advisor for assistance in determining the best way to hold title for your unique situation.