

# The Perils of Gifting Joint Tenancy Property

A joint tenant is usually the owner of an undivided interest in property with a right of survivorship. As a result, on the death of a joint tenant, his or her interest in the property terminates and the property interest of the surviving joint tenant is automatically increased proportionately without the necessity of a formal transfer, distribution or probate proceeding.

Usually the right of survivorship is a defeasible right: Either tenant or party acting alone may destroy the survivorship rights by severing his or her interest. This can be done by dividing the property between the joint tenants through a judicial partition or by one joint tenant selling his or her interest to a third party (converting the joint tenancy into a tenancy in common).

Despite its widespread use as a method of property ownership, joint tenancy with someone other than your spouse may not yield the intended result in your estate plan. Use joint tenancy with caution and not with the often erroneous assumption that it will

save estate taxes. Let's look at some of the gift and estate tax surprises that may arise when you own joint tenancy property with someone who is not your spouse.

## *Gifts of Joint Tenancy Property*

If you buy real estate with \$500,000 of your own funds and have the title to the property conveyed to yourself and your child in joint tenancy with rights of survivorship, have you made a gift to your child for federal gift tax purposes?

Usually you have, but not always. Whether a gift has been made depends on whether the survivorship rights are defeasible or indefeasible under applicable local law. If you are able to unilaterally sever your interest in the property, then you have made an immediate gift to your child in the amount equal to one-half the value of the property. Otherwise, the conveyance is not a completed gift for federal gift tax purposes. (A special rule applies to joint tenancy interests and

bank accounts held in street name, which is outside the scope of this discussion.)

### ***Adjusted Taxable Gifts***

Usually when you make a gift of property, the value of the property will not be taxed in your gross estate for federal estate tax purposes. Any appreciation in the value of the gifted asset is passed on to the donee free from estate taxes.

However, if the gift does not qualify for the gift tax annual exclusion, it still affects the amount of the federal estate taxes that will be due in your estate. Such a gift is referred to as an adjusted taxable gift when you compute the federal estate tax. The value of all adjusted taxable gifts, determined at the time of the gifts and without appreciation, is added to the value of your gross estate. To prevent the gift from being taxed twice, 100% of your gift and estate tax applicable exclusion amount is available for purposes of determining the federal estate tax due. The estate receives credit for any gift tax you previously paid on the adjusted taxable gifts.

The result of this adding and crediting is usually an increase in the marginal rate of the federal estate tax for the estate. (That is, the

value of the gifts may increase the applicable estate tax top bracket rate from 37% to 39% or from 53% to 55%.) Consequently, while you do not usually pay federal estate taxes on the value of gifts you have made during your lifetime, the gifts may cause your estate to be taxed at a higher marginal rate.

### ***A Trap for the Unwary***

Ownership of joint tenancy property with someone other than your spouse may result in dramatic, unintended estate tax results. Assume you and the other joint tenant acquired your interests in the property from a third party by gift or inheritance — the joint tenancy interest neither of you created. On the death of either of you, only the value of the decedent's fractional share of the property is included in his or her federal gross estate — the result most of us would expect.

However, if either joint tenant created the decedent's joint tenancy interest, the value of the property included in the decedent's gross estate for estate tax purposes depends on the amount of consideration the decedent furnished to acquire the property. If the decedent furnished no consideration, then none of the property value is included in his or her gross estate. If the decedent furnished

100% of the consideration to acquire an interest in the property, 100% of the date-of-death value of the property is included in his or her gross estate. The burden will be on the estate to establish the amount of the survivor's contributions. Therefore, good record keeping is essential.

### ***A Gift May Not Be a Gift***

Let's go back to our first scenario where you purchased real estate and put the title in your name and your child's name as joint tenants. If, under applicable law, when you acquired the property, either you or your child could unilaterally sever your joint interest in the property, then you made a taxable gift to your child of one-half of the value of the property (\$250,000). If the property is worth \$1 million when you die, \$1 million (the entire value of the property determined on your date of death) is included in your gross estate because you furnished all of the consideration.

### ***Wait a Second!***

What happened to your gift of one-half the value of the property to your child? Shouldn't one-half of the value of the property be excluded from your gross estate? There was a

completed gift for federal gift tax purposes, right? Isn't the value of the gifted property being taxed twice now (once as a gift and again as part of the decedent's gross estate)?

Not really. In this case, the gift to your child is ignored. Assuming a federal gift tax return was filed reporting the \$250,000 gift, any gift taxes that were paid will be subtracted from the tentative amount of federal estate taxes due. Furthermore, the gift, by definition, is not an adjusted taxable gift if the gift is included in the decedent's gross estate. Consequently, the gift is not added to the value of the decedent's gross estate. Therefore, at least the transfer of the one-half interest in the real estate is not taxed twice.

However, the result of bringing the gift back into your gross estate can be severe. All appreciation in the value of the gifted portion of the property that you expected to pass to your child free from death taxes has not escaped the federal estate tax at all. Even worse, the value of the property that was passed to your child by right of survivorship may not be available to your estate to pay the increased taxes caused by the inclusion of the property in your gross estate.

### ***Joint Tenancy Property May Not Be Your Best Gifting Option***

Because the federal estate tax consequences of a gift of joint tenancy property depend on whether the decedent furnished consideration to acquire his or her interest in the property, some gifts of joint tenancy property interests are not considered gifts for federal estate tax purposes. Therefore, when a joint tenancy has already been created or is being contemplated by persons other than spouses, take caution to ensure the joint tenancy property interest will have the desired effect for estate tax purposes.

If you have any questions about joint tenancy property you may hold with a child or someone other than your spouse, please give us a call. We can help you determine how it will be treated for gift and estate taxes — while you still have time to take remedial action.