The Pitfalls of Joint Tenancy as an Estate Planning Tool - Pt. I

Under the law, real property held in a form of title called “joint tenancy” avoids the court probate system when one of the joint tenants passes away. I have heard of many people who try to simplify their estate planning and avoid court probate charges by simply having a new deed drawn up to add someone to their real estate as a joint tenant. In this article, I would like to share with you some of the big disadvantages of giving a person joint tenancy status on your real estate.

If you add someone as a joint tenant, they now add your property to their list of assets. This means that they can borrow money against the property, or worst, the property can be sold to settle a liability or debt of the person you added to your property. To explain this better, let us say you add your daughter as a joint tenant on your home. She later is found to be at fault in a bad car accident and her damages to the other party exceed her car insurance liability limits. In this case, the other party may be able to force her and you to sell your property to pay for the damages. Or your daughter has a business and the business is sued. In this case as well your property could be used to pay off any judgments against her. As another example, your daughter gets married to a person who is not only a financial liability but who could also influence her to take advantage of “their property” (formerly your property, which she now owns too). If they decide to move into your house, you cannot stop them, because half of the house belongs to her !

I have seen people who regretted adding someone as a joint tenant, because people change and situations change. This brings me to another disadvantage of joint tenancy people don't always carefully consider. That is the fact that you cannot just draw up a new deed to undo a joint tenancy. You must have written consent from the joint tenant to take them off of your property ! If they don't agree to give you back complete control of your property, there is no way to get them off of your property without a very complicated court proceeding in which the odds are strongly against you. You lose control when you add a joint tenant and you cannot just go back and undo it by making out a new deed.

If you are thinking about using joint tenancy as means of avoiding the court probate charges, you really should carefully consider the risk you are taking -- that of losing your property. As an alternative, you should consider obtaining a living trust. Like joint tenancy, a living trust can offer you a simple and cost efficient way to transfer property. Unlike joint tenancy, a living trust does not subject your property to the claims of your beneficiaries or their creditors. They do not gain a present interest in your estate and you keep total control of your property until your use for it ceases.

Another major disadvantage of adding someone to your property as a joint tenant is increased income tax liability when the property is sold. Under IRS rules, when someone inherits your property, their tax “basis” in the property becomes the value of the property on the date of your death. To illustrate, let's imagine that you paid $100,000 for your home 20 years ago. Further imagine that on your death your daughter inherits your house, now valued at $500,000. If your daughter sells your house two years after you pass away when it is valued at $600,000, taxes would be due only on the $100,000 difference in value between the date of your death and the date of sale. On the other hand, the result would be very different if you have made your daughter a joint tenant on your property. Under IRS rules, your daughter can only get the date of death value on your half of the property. Therefore, when she sells the property for $600,000 she pays taxes on $300,000 ($50,000 on your half and $250,000 on her half) !

Fully explaining this tax issue is a job better left to an accountant or CPA; however, for estate planning purposes it is enough to know that adding someone as a joint tenant could have costly tax consequences for them down the road. A living trust can help avoid the payment of excess income taxes on transferred property. If your daughter had inherited your property through your living trust, you could have achieved your goal of transferring your property quickly and in a cost-effective manner. In the above example, your daughter would only have to pay taxes on the $100,000 gain between the date of your passing and the date of the sale. Finally, as pointed out previously, you could maintain full control of your property during your lifetime. Therefore, before you give someone a present interest in your property through joint tenancy, you should seriously consider the advantages of a living trust.