Why you should think twice about joint tenancy?
Placing your home in joint tenancy or in community property with a right of survivorship with your spouse, automatically passes the propertry upon your death avoiding probate. However, there are capital gains to consider and other potential problems with these devices besides avoiding probate.

A surviving joint tenant or spouse who had provided no financial contribution toward the acquisition of an appreciated asset like a home often ends up with a new adjusted basis equal to its value as of the date of death for capital gains and depreciation purposes which is beneficial but spouses typically do provide contribute financially toward the acquisition of assets like a home.

A surviving joint tenant spouse who had provided a financial contribution on assets that had appreciated in value often ends up without a new adjusted basis that is less than what surviving joint tenant spouse would receive if the spouses held property as community property. Upon a death of a spouse, if spouses hold property as joint tenants or tenants in common, the property is treated as the separate property of each spouse and only the decedents' half of the property receives the stepped-up basis. Upon a death of a spouse, if spouses hold property as community property, the surviving spouse's half interest in community property, as well as the decedent's half, both get a so called “stepped-up” basis. Where property has appreciated at the time of the first spouse's death, this step-up of both halves of community property provides potentially advantages to the surviving spouse over jointly held property. A higher basis translates to a smaller gain should the spouse sell the property, and if the asset is depreciable, larger depreciation deductions will result. Since assets generally appreciate over time, there usually is a tax incentive for most spouses to classify assets as community property. Even though Federal tax laws allows each individual taxpayer to exclude up to $250,000 of gain from the sale of a home, if certain ownership and occupancy requirements are met, i.e. lived in the home for two years of the last five years before sale, many California residences have appreciated beyond the $250,000 exclusion. If an individual is unable to exclude all or part of the gain, then the gain is taxable as a capital gain in the year of sale.

The following examples illustrate the potential advantage that an appreciated asset classified as community property would have over an asset held in joint tenancy when that asset passes to a surviving spouse.

Example 1. Husband and wife own a house with a basis of $20,000 that is considered to be community property. Husband dies leaving his community interest in the house to his spouse. The house is valued at $150,000 for estate tax purposes. The basis in the house is stepped up from $20,000 to $150,000 and one-half of the value of the house would be included in the husband's estate. A marital deduction is allowed for the portion of the house included in the husband's estate since the husband's community interest in the house passes to his wife. The result is no increase in the husband's taxable estate.

Example 2. Assume the same facts as in Example 1 except that the house is held in joint tenancy instead of as community property. The wife's basis in the house would be $85,000, computed as follows: $10,000, which is the wife's one-half share of the original basis of the house, plus $75,000, which is the husband's stepped up basis in his one-half share. Since the surviving spouse will receive full ownership in the house, including one-half the value of the house in the husband's estate would be neutralized by an offsetting marital deduction.

If the property is the separate property (solely owned) of the first spouse to die, there would be a full income tax basis adjustment upon the death of the first spouse. This result is the same as if the property were community property. On the other hand, if the property is the separate property of the surviving spouse, there would be no income-tax basis adjustment upon the death of the first spouse.

Joint tenancy is also problematic because it can negatively impact your ability to refinance or sell your home. Deeding your home to another person as joint tenants makes that person is an owner. If you want to refinance or sell the property, it requires a court partition action if the other joint tenant refuses. Further, if you do sell, the other joint tenant may not be eligible for capital gains exclusion if the other joint tenant did not own the home and live in it for two of the five years prior to the sale. If so, if there was for example $250,000 of gain on the sale, the other joint tenant would pay taxes on ½ that gain. Joint tenancy also does not provide for children from prior marriages because the surviving tenant spouse inherits all of joint tenancy property.

If a joint tenancy doesn’t accomplish your objectives or could result in adverse taxes consequences to your heirs, put your home in a revocable trust to avoid probate.

What is community property with a right of survivorship?
Community property with a right of survivorship vests the surviving spouse with outright ownership of the decedent’s one-half community property interest just like joint tenancy with the relative tax advantages of holding title as community property. If a joint tenancy accomplishes your objectives, community property with a right of survivorship might be even better because it not only avoids probate but can provide a step-up in basis.

If a married couple combined estates is less than the applicable exclusion amount , there is usually no need for estate tax planning. Even in a estate with a need to avoid estate taxes, a community property with a right of survivorship deed may preferred to transfer to the surviving spouse the personal residence.

However, holding title as community property with right of survivorship is not always superior to holding title in joint tenancy between spouses because certain creditor’s claims (e.g. not consensual secured loans) against the deceased spouse are cut off. Upon death of a joint tenant, the jointly held property will then pass to surviving spouse not subject to these creditor’s claims unlike title to property held in community with right of survivorship property.

Further, if you own property which you acquired prior to marriage or by gift or inheritance during marriage, that is your separate property. If you deed your separate property into community property, you will be transmuting or changing your separate property interest in which you own 100% into a community interest in which you have only a one half interest with the same control problems as a joint tenancy.

A community property with a right of survivorship deed is available on this site for download subject to this website's general disclaimer and the other specific limitations discussed below. The deed must be completed with a legal description included on it or attached as an Exhibit, signed by each spouse on title to the property, notarized, and recorded with the County Recorder's Office for your property. A Preliminary Change of Ownership Report should be presented with the deed to the Recorder's Office and box A in Part 1 should be checked to indicate that this deed is exempt from property tax re-assessment as a exempt spousal transfer. The Preliminary Change of Ownership Report should be obtainable from your local County Recorder's or Assessor's office.
If a community property with a right of survivorship deed doesn't accomplish your objectives, you can transfer your home in a revocable trust to avoid probate.