

Taking advantage of community property



By Faith Read Xenos, CFP

In today's society, few people settle down in one spot for good. As a result of the varying state laws, moving between states can change the nature of the property that you own, which in turn can affect your estate plan. The laws surrounding the concept of community property offer a prime example of how your property rights can be affected, depending on where you live currently, where you lived previously, and where you may move in the future. Currently nine states have some form of community property law: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. While the laws of these states vary greatly, they have several things in common.

What Is Community Property?

Each spouse owns a present, equal and undivided interest in the community property. Generally, property acquired during marriage, regardless of how it is titled, is community property. This includes property acquired through the personal efforts of either spouse, as well as income generated from sales proceeds from community property. Community property does not, however, include property received by gift or inheritance.

When moving from a community property jurisdiction to a common law jurisdiction, the property retains its community character, although enforcement by a common law jurisdiction is, at best, difficult. Courts outside community property jurisdictions have not always adhered to the community property concept.

Property Rights

The main difference between separate and community property states relates to how property acquired during marriage is divided. This classification affects lifetime ownership rights, as well as rights in the property at death.

When moving from a separate property to a community property state, spouses will acquire rights in each other's property that they never would have had if they had remained in a separate property state. All community property states provide for some mechanism to classify or reclassify a couple's property by agreement.

Accordingly, it is possible to keep separate property separate, even if moving into a community property state. This can generally be done by agreement of the parties. It is often easy to involuntarily convert separate property to community property, however, so take care.

The same classification issues arise when moving from a community property state to a separate property state. Again, property can retain its character as community property or it can end up being converted to separate property.

Taxation

Aside from the rights that spouses may gain or lose when moving between states, there are important tax considerations. When moving from a community property state to a separate property state, certain tax advantages can be lost.

Virtually all property that an individual owns upon death receives a step-up in basis to its value at the date of death. When a husband and wife own property in joint tenancy, upon the death of the first spouse, only one-half of the property receives a step-up in basis. However, when the property is community property, regardless of how it is titled, the entire asset receives a step-up in basis!

The impact here can be significant, especially if it is likely that the asset will be sold prior to the death of the surviving spouse. As a result, it can be tax smart for couples who move from community

property to separate property states to take the necessary action to preserve the community character of assets.

For example, if you and your spouse move from a community property state and purchase real estate in a new, separate property state, consider reflecting the community character of the assets in the deed. This can be done by reciting that you take title as "husband and wife," with an additional recital that you hold your property as community property to be governed under the laws of your former state of domicile. While it is not clear that this approach will work to allow for the "double" step-up in basis upon the death of the first spouse, it certainly bolsters the argument.

Another potential way to preserve the community character of assets is to fund a revocable joint trust with community property prior to moving out of your community property state and selecting the laws of the community property state as the governing law.

How Will State Property Laws Affect You?

Moving between states can have a great impact on your and your spouse's property rights, as well as on the taxation of property upon your deaths. If you are considering a move, it is essential that you determine the impact the new state property laws will have on you and your spouse and your current estate plan.

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