

How do you own your property?



Knowing how you own your property is one of the first steps in estate planning. Forms of property ownership can affect how and when property passes to your spouse, your children, and others with an interest in your estate.

Classes of Property

Property is divided into two classes: real and personal. *Real property* consists of land and certain kinds of interests in land. Real property includes standing timber and structures erected on the land, such as a house, fence or garage. *Personal property* is everything that is not real property, such as cash, household items, goods, cars, jewelry, bank accounts, stocks, and bonds.

Making an Inventory

Before you see an attorney about writing your will, make a list of the real and personal property that will pass to your heirs upon your death. In making your list, you need to know what property can be passed on to others under the terms of your will. You may own interests in property that you cannot give away under your will because the law has already determined who will own the property at your death. Whether you can give away property under the terms of your will depends upon the answers to two questions:

- Who holds title to the property?
- What rights do you have in the property?

Who holds title to the property?

Holding title means you have rights of ownership. Ownership or title is shown on a deed, certificate, bill of sale, contract, will, or other document. For real property, the document of title must be registered with the register of deeds in the county where the property is located. Ownership of personal property may be shown by documents such as automobile titles, receipts, contracts, bills of sale, bank records, and stock certificates. Without these

documents, ownership of personal property may be difficult to prove. In some cases, possession of untitled personal property is proof of ownership.

You may hold title to property by yourself or with other people. If your name is the only name on the document of title, you are the *sole owner* of the property. If your name and someone else's name appear on the document of title, your ownership rights may be limited by the rights of the other owner. The document of title determines the ownership rights of each owner.

The document of title may create *consecutive interests* in the same property. This means that certain rights of an owner begin after the rights of another owner have ended. Or the document of title may create *concurrent interests*, where the rights of each owner occur at the same time. Consecutive interests and concurrent interests may take various forms, giving different property rights to the owners.

What are your property rights?

Sole ownership. This is the simplest form of property ownership. One person has all present and future power to use, control, sell, or otherwise dispose of the property. If you are sole owner, you may transfer the entire property under the terms of your will. If you do not have a will, your property will be transferred to the people who are entitled to take your property under North Carolina law. For more information, see estate planning note *Where There Is a Will There Is a Way* (AG-688-02).

Consecutive interest. You may own a consecutive interest in property. This means your interest arises either before or after the interest of someone else. A *life estate* and a *remainder* are examples of consecutive interests. If you own a life estate, you are called the *life tenant*. You have the right to possess and

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use the property for the life of a specified person. Usually, a life estate is measured by the life of the life tenant, but it may be measured by the life of someone else. If so, the life tenant's interest ends upon the death of that person. Upon your death (or the death of a specified person), ownership passes to the person or persons who own the remainder. They are called *remaindermen*.

Usually, the life tenant has the following rights and duties, unless the document creating the life estate shows a contrary intent.

- A life tenant may sell his estate for a lifetime. The purchaser buys not the underlying property, but the right to use and possess it for the lifetime of the specified person.
- The life tenant has the right to plant, harvest, and sell annual crops.
- The life tenant is entitled to cut and use a reasonable amount of timber for fuel or to repair buildings, fences, and the like. The life tenant may not cut timber from the land merely for his or her own profit. An exception exists for timberland held as part of a trade or business investment under a forest management plan adopted before the life estate was created. In that case, the life tenant may be obligated to hold part of the sale proceeds for the benefit of the remaindermen. Good practice is to provide written authorization in the legal document creating the life estate that allows the life tenant to cut mature, over-mature, diseased, insect-infested, or dead and dying trees.
- If the property produces income, such as a farm or an apartment building, the life tenant may collect the rents and profits from the property.
- The life tenant is responsible for taking care of the property and for making ordinary repairs.
- The life tenant must pay property taxes and local assessments. If the property is mortgaged when it comes to the life tenant, the life tenant is responsible for paying the annual interest on the debt, but not the principal.
- The entire property itself may not be sold unless the life tenant and all the remaindermen join in the sale. If the property is unproductive, the life tenant may get permission from the court to sell the land. However, he must reinvest the funds for both the benefit of the life tenant and the remaindermen.
- The life tenant may not give away the property under the terms of his or her will if his or her life was the measuring life.

The following words in a will or deed create a life estate: "to my wife for so long as she lives, remainder to my sister, Jane." The wife has the right to possess and use the property for her lifetime, and upon her death, the property passes to Jane as the sole owner.

Although it is easy to create a life estate, it has serious legal consequences. Carefully consider the burdens and restrictions you may be placing on the life tenant. Check the tax consequences of conveying a life estate, or a remainder

interest. Consult an attorney and a tax advisor for additional details.

Concurrent interests. You and others may own concurrent interests in the same property. *Concurrent joint ownership* means your rights and the rights of other owners occur at the same time. Your rights in the property depend upon the form of joint ownership. Concurrent joint ownership of property in North Carolina may take three forms: *tenancy in common*, *tenancy by the entirety* and *joint tenancy* (with or without a *right of survivorship*). Of the three forms, only tenancy in common always permits your interest in the property to pass on to your heirs via your will.

Tenancy in common. A tenancy in common means that two or more people own undivided fractional interests in the same property. For example, if three people own the property equally as tenants in common, each owns an undivided one-third interest in the property. Each co-owner has the right to use and possess the entire property, as long as other co-owners are not excluded. None of the co-owners may take any action with respect to the entire property without the written permission of the others. Together, they may sell, lease, mortgage, manage, or collect income from the entire property. Ownership shares in a tenancy in common may be unequal. In the example above, one person could have a one-half interest in the property, another could have one-eighth interest, while the third owner could have a three-eighth interest.

Generally, each may sell his or her undivided interest in the property without the permission of the other co-owners. The purchaser buys an undivided interest in the property, and the remaining tenants in common have a new co-owner. One owner may also use his or her share as security for a debt, although that owner may not mortgage the entire property without all other co-owners joining him or her. A *judgment creditor* of a co-owner (a person who sued the co-owner successfully and was granted a judgment for money due) may execute on the judgment, forcing the sale of the co-owner's share.

Each co-owner may ask the court to order a partition and sale. The court may divide the property and give each co-owner his or her proportionate interest. Or the court may order a sale of the whole property and divide the money among the co-owners.

When a co-owner dies, ownership of his interest is controlled by his will or by the laws that determine who gets his property if he dies without a will. His beneficiaries or heirs inherit undivided interests in his share of the property. Without proper planning, family property handed down through the generations may become unmarketable because there are too many owners. Example 1 illustrates this problem.

The value of each co-owner's undivided interest is included in her gross estate for federal estate tax purposes and may be subject to federal and state estate taxes. One method of determining the value of the interest is to divide the fair market value of the entire property by the co-owner's

EXAMPLE 1

Brothers, Bob and Jim, own a farm as tenants in common. Each owns a 50 percent undivided interest. Jim dies, leaving his share equally to his 5 children. Bob still owns a 50 percent undivided interest, but his nieces and nephews are his new co-owners. Each owns a 10 percent undivided interest in the property. Bob dies, leaving his undivided interest to his 10 children. Each of his children owns a 5 percent undivided interest. There are now 15 owners to the farm. To sell the entire farm, the 15 cousins must agree to the sale. Any cousin may choose to sell his or her individual interest. What happens if the 15 cousins pass the property on to their children? If each has 5 children, the number of co-owners increases to 75. It may become difficult to sell the entire farm with clear title.

fractional interest. For example, if Jane owns a 25 percent undivided interest in property with a fair market value of \$100,000, the value of her interest for estate tax purposes may be \$25,000. However, Jane's estate may make a strong argument that the value of her interest is less than \$25,000. A fractional interest in property is less marketable and less desirable than an entire interest.

Tenancy by the entirety. Generally, a husband and wife own real property as tenants by the entirety. If the document of title conveys the land to a husband and wife, North Carolina law presumes that a tenancy by the entirety is created, unless a contrary intention is shown. In most circumstances, the deed does not need to state that a tenancy by the entirety is created. However, if you plan to give your spouse an interest in property that you own as tenants in common with someone else, check with your attorney. If you and your co-owner are partitioning the property and you plan to give your spouse an interest in your share of the property, you need specific language in the deed to create a tenancy by the entirety.

Only a husband and wife may own real property as tenants by the entirety. Under the law, each spouse owns the entire interest in the property. However, neither spouse may sell, lease, or mortgage the property without the written consent of the other. This rule is based on the legal fiction that a husband and a wife are the same person. Divorce automatically ends a tenancy by the entirety, converting it to tenancy in common in which each ex-spouse owns a one-half, undivided interest. Property acquired by a couple prior to marriage will generally be held as a tenancy in common. A subsequent marriage does not convert the ownership to a tenancy by the entireties.

In North Carolina, a husband and wife have equal rights to the control, use, possession, rents, and profits of real property that they own as tenants by the entirety. If they file separate income tax returns, each spouse must report one half of the income or loss from the property. Creditors cannot take property held as tenants by the entirety for payment of a debt that is owed by only one spouse.

Upon the death of one spouse, the surviving spouse automatically owns the property. The property is not transferred by the will of the deceased spouse and is not probated in the

deceased spouse's estate. If both spouses die at the same time, the property is split equally and half of the property probated in the estate of each spouse.

One-half the fair market value of the property is included in the deceased spouse's gross estate for estate tax purposes. No tax liability results because property passing to the surviving spouse is exempt from federal and state estate taxes. If the property was acquired before 1977, however, the amount included in the deceased spouse's gross estate may be the amount the spouse contributed toward acquiring the property. Ask your attorney or tax advisor for details.

Tenancy by the entirety is a popular way for husbands and wives to co-own real property. It simplifies the transfer of ownership at death. However, some husbands and wives may find there are estate tax reasons for owning the property differently. A companion publication discusses this: *Federal and North Carolina Gift and Estate Taxes* (AG-688-03). To find out which form of ownership is right for your family, consult an accountant or attorney.

Joint tenancy with right of survivorship: Two or more persons may own equal shares in property as joint tenants with right of survivorship. Bank accounts, certificates of deposit, and stock certificates are the most common types of personal property owned in this manner. Real property may also be owned jointly with a right of survivorship.

This form of ownership arises only by express agreement. The document creating the joint tenancy must expressly provide for the right of survivorship. For example, if you and your spouse open a joint bank account, you must choose whether you will own the account with or without a *right of survivorship*. Under the law of North Carolina, if you agree to a joint tenancy in either real or personal property but neglect to indicate whether it is owned with or without a right of survivorship, it is presumed to be *without* right of survivorship.

Upon the death of a joint tenant, in a joint tenancy with right of survivorship, the property automatically passes to the surviving joint tenant or tenants. The deceased joint tenant's will does not control who gets the property. Example 2 illustrates such a situation. Note: Property held without right of survivorship passes at death in the same manner as property held as tenants in common.

EXAMPLE 2

Mary is a widow with three children. Mary is afraid she may become ill and forget to pay her bills. She wants to give her youngest child, Jane, legal authority to write checks and make deposits on her account. She and Jane open a joint account, the signature card for which states that it is "with a right of survivorship." Mary sells her house and her farm and deposits the sale proceeds in her bank account. In her will, Jane leaves her property equally to her three children. When Mary dies, Jane becomes sole owner of the funds. Jane likely has no legal obligation to share the money with her brother and sister. This is the type of situation, however, that often leads to litigation because it raises such issues as overreaching by Jane and Mary's competence to enter the joint tenancy agreement. Mary's will does not control who owns the money in the account.

If the co-owners are husband and wife, one-half of the value of the property is included in a deceased spouse's gross estate for tax purposes. No tax liability occurs because property passing to the surviving spouse is exempt from federal estate tax and North Carolina inheritance tax. If the property was acquired before 1977, however, the amount included in the deceased spouse's gross estate may be the amount of that spouse's contributions. Ask your attorney or tax advisor for details.

If the co-owners are not husband and wife, the value of the entire property is included in the deceased co-owner's gross estate except to the extent of the surviving owner's contributions. See Example 3.

EXAMPLE 3

Joe and Mike open a joint bank account with a right of survivorship. Joe deposits \$500, and Mike deposits \$1,000. Joe dies. The entire \$1,500 will be included in Joe's gross estate for tax purposes if his executor fails to prove that Mike contributed \$1,000. If Joe's executor can prove Mike's \$1,000 contribution, only \$500 will be included in Joe's gross estate.

There are special survivorship accounts available in North Carolina for which a beneficiary may be designated. These accounts offer several advantages. Check with your bank for details.

Conclusion

The way you own your property will affect how it is distributed after your death. Automatic survivorship rules take precedence over what you have written in your will. A carefully designed estate plan can be undermined if you do not consider the forms of property ownership. It is often advisable to change the form of ownership to achieve your estate planning goals. To help your attorney and tax advisor develop your estate plan, make a list of your property. Provide copies of titles and deeds to help your attorney determine the form of ownership. Knowing how you own your property is essential when you begin to develop an appropriate estate plan for you and your family.

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