

A Review of Ownership Regimes in the U.S. for Married Couples

U.S. states generally use one of two property law systems that govern the ownership of property in a marriage. Known as community property and common law property, these legal systems offer different criteria for determining which property is owned jointly by both spouses, and which property is owned separately by one or the other.

- In community property states, subject to certain limited exceptions, spouses are afforded equal rights in property acquired during the marriage, regardless of the title to that property.
- Common law property states generally recognize ownership based on how assets are titled.

The differences between the two systems have significant implications in tax and estate planning matters and in the division of property in divorce. While all married couples should understand these implications, it is particularly important for those with significant assets, for those moving from a state with one of the regimes to the other, and/or for those who want to review or arrange their estate plan.

Community Property States

In the nine community property states, spouses have an undivided one-half interest in most property acquired during the marriage, regardless of how it is titled. The general exceptions are for property that is:

- Acquired before marriage
- Given to either spouse
- Inherited by either spouse
- Acquired with the separate property or separate credit of one of the spouses (i.e., acquired by a spouse using property that was a gift to, inherited by or already owned by that spouse before the marriage and any appreciation on those assets).

- Excluded by a prenuptial or other agreement.
- Acquired when legally separated and not living together.

States with community property regimes include:

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin

Additionally, Alaska, Florida, Tennessee, South Dakota, and Kentucky have adopted elective community property systems that permit spouses to elect to treat certain property as community property.



It should be noted that if separate property is commingled with community property, the burden may be on the owner of the separate property to prove what portion of such property is his or her separate property, which requires tracing the separate property contributions and the appreciation on those contributions. Tracing can be a difficult and costly endeavor.

Divorce Considerations

DIVISION OF A CLOSELY HELD BUSINESS

Like any other asset, the court can determine whether any part of a business owned by a spouse is considered community property, even if it was purchased with separate property. That determination may be based on factors including the date of establishment, the source of initial investments in the business, the contributions of the two spouses and the compensation received by the community for such efforts, and the skill set needed to operate the business going forward.

REAL PROPERTY

There is a general presumption that property acquired during marriage or owned by a married person during marriage is community property, and the party asserting separate property characterization may have the burden to trace the asset to a separate property source. The presumption is not necessarily overcome by the fact that record title to the property is in the name of one spouse alone.

If a spouse purchases real property with his or her separate assets, and community property is used for improvements or mortgage payments, the community is entitled to reimbursement of those funds, although the value of the right to

reimbursement, and whether any increase in value of the separate property is included, varies among the community property states.

Likewise, if a married couple purchases real property with community property and separate property is used for improvements or mortgage payments, the spouse making those contributions may be entitled to reimbursement, although some states presume a gift to the community and require proof of an agreement to the contrary in order to reimburse. In the case of mortgage payments, this can translate into an ownership interest in the property equal to the percentage of total value created by those payments.

Estate Planning Considerations

LIVING TRUSTS

Married couples in community property states frequently establish joint revocable trusts as part of their estate plans. Since each spouse has an undivided one-half interest in community property, separate revocable trusts may be less practical, as community property cannot always be “split” and then held in separate trusts for each spouse. Married couples can, however, establish a joint trust to hold community property assets and attach property schedules specifying the character of any separate property held by such trust, or if they wish, create separate trusts for any individually owned property.

GIFTING

If a spouse makes a gift of community property to a beneficiary, it is generally deemed to come 50% from one spouse and 50% from the other spouse. If he or she makes a gift of separate property to a beneficiary, it is considered to be 100% from that individual. This becomes an important consideration if one spouse has more federal gift tax exemption than the other (currently \$15 million in 2026), or the married couple wishes to create a spousal lifetime access trust. It can be advantageous to make gifts from the separate property of the spouse with the greater remaining exemption. It's advisable to consult an attorney to determine the character of the assets and to help transmute community property into separate property for the purpose of making gifts.

AT DEATH

Each spouse may dispose of their share of community property as he or she desires. However, if retirement funds and insurance policies are purchased with community property, there can be complications if someone other than the other spouse is chosen as a beneficiary. An estate planning attorney should be consulted to determine whether or not the surviving spouse has right to those policies regardless of the beneficiary designation.

Common Law Property States

For those states that have not adopted a community property framework, the common law property system applies. Generally, in states that follow common law with respect to ownership of marital property, spousal ownership of property may be determined by how title to the asset is held. Thus, married couples who wish ownership of their property to be determined differently have several options. These include maintaining separate accounts for individually owned assets and/or titling any assets gained over the course of the marriage to make their intention clear.

Titling of Assets in Common Law Property States

In most common law states, individuals have two joint ownership options:

- They can title property as **tenants in common**, where each person owns a distinct percentage in the property, equal or otherwise. Each tenant in common may transfer their interest during lifetime or upon death to whomever he/she wishes without the consent of the co-tenant.
- Those with property titled as **joint tenants with rights of survivorship** hold an undivided interest in the whole property. When the owner of that that interest dies, it passes directly to the

survivor and not through probate. Should one joint tenant transfer their interest without the agreement of the other before death, the survivorship aspect of the tenancy is terminated, and the ownership of the property is converted into a tenancy in common.

In certain states, there is a third option available only to married couples. **Tenancy by the entirety** is a category of joint tenancy that is most commonly applied to interests in real property. This type of joint interest may only be severed by consent of both spouses and the interest of a deceased spouse passes to the survivor by operation of law, avoiding probate. Because the consent of both spouses is required in order to divide their interests in

assets held as tenants by the entirety, this form of titling often offers greater creditor protection than other joint forms of ownership.

As the treatment of property in common law jurisdictions is state specific, it is important to keep in mind the different presumptions which may apply based on a couple's home state.

Divorce Considerations

Regardless of how title is held, property acquired during the marriage may be considered "marital property" in common law states subject to equitable distribution in a divorce. Equitable distribution does not necessarily mean that each party will receive 50%, as the goal is to achieve a fair division between the spouses. Courts vary by state, and even locally within the state, but equitable distribution factors can include the length of time that the parties were married, contributions of the spouses and income during and after the marriage. Common law states also differ in how they treat the growth of separate property. Some will consider the growth as marital property subject to equitable division, and some will not.

Estate Planning Considerations

WILLS AND LIVING TRUSTS

Spouses in common law jurisdictions can use wills and revocable living trusts that dispose of assets that are held in their sole name and which do not pass by beneficiary designation or by operation of law. (For

example, a retirement account passes by beneficiary designation and an ownership interest in a joint account with rights of survivorship passes by operation of law.) Separate revocable trusts, as opposed to joint revocable trusts, are more frequently used in common law property states. Spouses can also convey their respective half of any jointly held assets, such as real property, into their own revocable trust.

GIFTING

Married couples can independently gift property that is not held jointly, or they can treat joint gifts to third parties as made one-half by each spouse by electing to split gifts on a timely filed federal gift tax return. In either case, the spouses should consult with their tax advisor to determine what, if any, reporting needs to be made to the IRS in relation to the gift (i.e. Form 709, United States Gift and Generation-Skipping Transfer Tax Return).

AT DEATH

The deceased spouse's taxable estate (as opposed to the probate estate) will generally include:

- All assets held solely in his or her name;
- 50% of assets held as joint tenants with rights of survivorship or as tenants by the entirety with the surviving spouse; and
- The applicable ownership percentage of any assets held as tenants in common.

Different rules may apply if the deceased spouse held assets in survivorship with someone other than the surviving spouse.



Step-Up in Basis

Even though each spouse has a one-half interest in community property, the full amount receives a basis step up to fair market value when either dies. If the surviving spouse sells any portion of his or her share of community property, they only pay tax on capital gains accrued after the date of the deceased spouse's death. In a common law property state, however, only the assets included in the deceased spouse's taxable estate receive that step-up in basis. If a married couple owns community property in joint tenancy, they will want to confirm whether their state law presumes the property is community or whether each spouse has a one-half separate property interest and, if the latter, they should consider whether it is better to instead hold it as community property and potentially transfer it to the joint trust, or to hold it as community property with right of survivorship.

OWNERSHIP REGIMES

Here's a sample calculation to illustrate the concept. Assume a married couple purchased property together, the property appreciated, then one spouse died.

Community Property	
Real Property Value at Purchase	\$100,000
Current Value of Real Property	\$5,000,000
Gain	\$4,900,000
SPOUSE 1 DIES	
Basis of Property Now Owned 100% by Survivor	\$5,000,000
Spouse 2 Sells Property	\$5,000,000
Gain	\$0

Common Law Property	
Real Property Value at Purchase (JTWROS)	\$100,000
Current Value of Real Property	\$5,000,000
Gain	\$4,900,000
SPOUSE 1 DIES	
Basis of Property Now Owned 100% by Survivor	
Spouse 1 Basis (Stepped Up)	\$2,500,000
Spouse 2 Basis (1/2 original)	\$50,000
Spouse 2 Sells Property	\$5,000,000
Gain	\$2,450,000

Considerations When Changing Domiciles

Domicile is generally the place a married couple has their true, fixed and permanent home and principal establishment and to which, whenever absent, they intend to return. If you are a resident of California, and temporarily move to Tennessee, for example, California will remain your domicile. Generally, ownership of real property will be governed by the state in which it is located. For other types of property, the characterization as community or separate property may be determined by how the property is treated by the couple after the move. Where a married couple lives at the time property is acquired will impact the attributes of ownership:

Moving From a Community Property State to a Common Law State

Generally, property that is acquired in a community property state is not automatically converted into separate property when the couple moves to a common law state. Married couples moving from a community property state to a common law state should discuss the characterization of their property with their estate planning attorneys. Maintaining the status of community property may allow couples to avail themselves of the favorable basis step-up at death, but it could also subject the property to the community property rules for division in the event of a divorce or death.

Moving From a Common Law State to a Community Property State

If a married couple acquires property while living in a common law state that would be considered community property in a community property state, then subsequently moves to a community property state, a number of states will treat that property as community property. Such property is referred to as “quasi-community property.”

Summary

While the process of getting married is similar in all states, the property ownership rights of the spouses is mostly dependent on the regime applicable in state of domicile. It is important for married couples or married couples-to-be to work with their legal and tax advisors in order to understand the implications of state law, the differences among the various property ownership titling options, and the necessity or opportunity of planning in advance of getting married, moving out of state, or making a significant investment.

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Many estate techniques share the common risk of the loss of control of the assets once the gift of the assets is complete. The strategies set forth herein are shown for educational purposes only, are not tailored to any specific client, and do not constitute a recommendation to employ any strategy identified. To that end, they do not capture all possible outcomes but are based on limited set of assumptions. If the assumptions upon which they are based are not realized, the efficacy of the strategy may be materially different from that which is reflected in the illustration. Accordingly, clients must consult their tax advisor when considering the utility and appropriateness of any strategies identified herein.

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