

UNMARRIED COUPLES AND REAL ESTATE OWNERSHIP IN CALIFORNIA

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WHY SHOULD UNMARRIED COUPLES WORRY ABOUT REAL ESTATE CO-OWNERSHIP ISSUES ?

Like a marriage, every non-marital relationship ends with either separation or death. If it ends with separation, the former partners may not remain friendly. If it ends with death, the surviving partner may not be friendly with the deceased partner's heirs. Either way, there may be a property dispute. Non-marital relationships are unlike marriages in that there is no well-developed body of law to govern property rights following separation or death. Resolving property disputes based on non-marital relationships can be expensive, time-consuming and personally destructive. In addition, both the beginning and the end of an unmarried couple's relationship can have income and property tax consequences which can be minimized or even eliminated with planning.

HOW DOES DOMESTIC PARTNER REGISTRATION AFFECT REAL ESTATE CO-OWNERSHIP?

Certain unmarried couples are now permitted to register with the State of California as domestic partners. State registration is available to all same-sex couples, and to straight couples if one of the partners is over 65. Although the full legal effect of state registration is not yet known, certain important consequences have been established. This article will describe those consequences and highlight differences between registered and unregistered unmarried couples that relate to real estate co-ownership.

HOW DOES REAL ESTATE "TITLE" AFFECT UNMARRIED COUPLES?

The "title" or form of ownership of real estate has a major impact on what happens to the property after the death of an owner or in a dispute between co-owners. When you buy real estate, either alone or with another person, you need to decide how title will be held, and your decision will determine what is written on the deed to the property. You will need to make this decision again, and to change the deed, if you choose to share individually-owned property with a new partner. But while the manner of holding title as shown on the deed is important, it is not always the final determinant of how the property is owned. When an owner is involved in a committed relationship, his/her behavior (and that of his/her partner) can change what happens to the property after death or in a breakup, and can override what the deed says. For this reason, it is important to think about title to the property you own, and to plan for death and breakup, whenever there is a major change in your domestic life.

HOW DO UNMARRIED COUPLES HOLD TITLE TO REAL ESTATE?

Unmarried couples who have not registered as domestic partners with the State of California usually hold title to real estate as joint tenants, as tenants in common, or in a living trust. Beginning January 1, 2005, state-registered domestic partners will also be able to hold title as "community property" and "community property with a right of survivorship". Below is a brief summary of the characteristics of these forms of ownership.

- Joint Tenants: Couples that own as joint tenants have a "right of survivorship", meaning that if one owner dies, the other automatically becomes owner of the deceased owner's share. The passage of the deceased owner's interest to the other owner does not require a will or other estate planning document, and does not involve a probate court proceeding. For this reason, holding title as joint tenants provides the least expensive, fastest, and most definitive manner of passing property between co-owners upon death. But joint tenants must hold property in equal shares which means that if the couple wants an unequal allocation of rights or responsibilities either during their relationship, after a breakup, or both, they will need a co-ownership agreement.
- Tenants In Common: Couples that own as tenants in common do not have the right of survivorship, meaning that upon death each owner's interest passes to whoever the deceased owner left it to in a will or, if there is no will, to the deceased owner's legal heir(s). The legal heir will not be the other partner unless the partners are state-registered, so it is important that unregistered unmarried couples who co-own property as tenants in common and who wish to have the property pass to the surviving partner make sure that each partner has a will leaving the property to the other. When a tenant in common owner dies, with or without a will, and regardless of state-registration, his/her interest must go through a probate court procedure which always involves some delay and cost, and can provide an opportunity for relatives to contest a will or argue about succession.
- Living Trust: Unmarried couples can form a living trust to hold title to their property. The principal benefits of this form of ownership are (i) the avoidance of probate court procedures and associated costs and delays, and (ii) the ability to make very specific and nuanced plans for the disposition of property following death. But in order to own property in a living trust, it is necessary to create the trust, and that involves cost.
- Community Property With Survivorship: Community property ownership will only be available for state-registered domestic partners, and only after January 1, 2005. California recognizes two types of community property ownership: (i) with a right of survivorship ("CPRS") and (ii) without a right of survivorship ("CP"). CPRS is similar to joint tenancy in that a deceased partner's share immediately passes to the surviving partner without probate costs or delays. But CPRS differs from joint tenancy in two important respects. First, CPRS may provide more advantageous tax treatment than joint tenancy for the surviving partner, although it is still too early to know definitively. Second, in a breakup, CPRS will be subject to a very well-developed body of domestic relations law which might make dispute resolution faster and less expensive than it would be if the property were held in joint tenancy. Couples wishing to hold title as CPRS must specifically so state on the deed. If the deed says community property but does not mention the right of survivorship, the presumption will be that the property is held as CP rather than CPRS.
- Community Property Without Survivorship: The difference between CP and CPRS is how the property passes after the death of a partner. With CP, each partner may will up to half of his/her community property share to someone other than the other partner. Any portion not willed, or the entire property if there was no will, passes to the surviving partner. Unlike CPRS property, all CP property must go through a probate court procedure regardless of whether the deceased partner had a will, and regardless of whether the property is passing to the surviving partner. For this reason, CPRS is a better option except where one wants a portion of the property to pass to someone other than his/her partner. Also, keep in mind that community property ownership will only be available for state-registered domestic partners, and only after January 1, 2005.

WHAT HAPPENS WHEN THE DEED DOES NOT STATE HOW TITLE IS HELD?

For unmarried couples who are not state-registered domestic partners, co-owned property is presumed to be held as tenants in common. For state-registered domestic partners, property acquired after January 1, 2005 will be presumed to be community property, and property acquired before that date will probably be presumed to be held as tenants in common, although the status of property acquired between the date of domestic partner registration and January 1, 2005 is subject to debate. Each presumption can be overcome when the background facts establish a different intent.

CAN AN UNMARRIED PARTNER CLAIM RIGHTS TO THE OTHER PARTNER'S SEPARATE PROPERTY?

Although the doctrine of "Common Law Marriage" has been abolished in California, there are a variety of legal bases on which a person can claim to have acquired an interest in property that his/her partner owned before the relationship began, or in property that his/her partner acquired independently during the relationship. Historically, these claims were based on promises that one partner made to the other, including promises that are only implied by the partners' behavior. For state-registered domestic partners, community property laws may now provide an additional basis for these types of claims.

WHAT FACTS SUPPORT A CLAIM OF JOINT OWNERSHIP?

- **Contributions**: Even though one partner paid to acquire the property, the other partner has contributed funds for mortgage payments, carrying costs, or improvements.
- **Usage**: Both partners use the property regularly and treat it as if it was jointly owned.
- **Promises**: One partner orally promises the other a share in the property.

- **Behavior**: The partners pool earnings, use joint accounts, regularly purchase together, and share much of what they own. A general pattern can imply joint ownership of all property, including separate purchases.
- **Services**: One partner performs domestic services for the other such as housekeeping, cooking, or home maintenance, or contributes work to improvement of the property.
- **Sacrifice**: One partner relinquishes career or investment opportunities in order to contribute to the relationship.
- **Registration**: Registration as domestic partners will create a presumption of community ownership for property acquired after January 1, 2005, and may imply joint ownership of property acquired earlier.

HOW CAN UNMARRIED COUPLES AVOID PROPERTY DISPUTES?

The key to avoiding property disputes is (i) carefully considering and determining the manner of holding title when you acquire property, (ii) having a will or trust in place, (iii) having a clear and detailed written agreement describing the partners' intentions regarding the property in a breakup, and (iv) reconsidering each of these issues as circumstances change and when you begin a new committed relationship.

DO ALL UNMARRIED COUPLES WHO CO-OWN PROPERTY NEED A CO-OWNERSHIP AGREEMENT?

Some breakups are not amicable and in those cases a co-ownership agreement can avoid significant anguish and cost. A co-ownership agreement is particularly important when one partner has contributed a larger share of a down payment for a co-owned property and/or plans to contribute a larger share for mortgage payments, recurring ownership expenses, or improvements. Absent a co-ownership agreement or other documentation, one partner's excess contribution to a down payment or other costs may be considered a taxable gift creating an obligation to pay gift tax. The same problem can arise when one partner adds the other to title to a property that he/she acquired individu-

ally. A co-ownership agreement is also particularly important when the partners share a home which is owned by one of them. In these cases, ongoing contributions to the home are typically difficult to trace. Beginning on January 1, 2005, a co-ownership agreement between state-registered domestic partners will need to meet legal requirements applicable to pre-marital or post-marital agreements between married couples.

ISN'T CREATING AN UNMARRIED COUPLE AGREEMENT AWKWARD AND COLD?

Planning for separation and death isn't romantic. But the process is easier if you remember that an agreement is equally likely to help either partner, and think of it as something each of you is doing for the other. Also realize that the agreement has nothing to do with your life together, and can be ignored so long as your relationship continues. The pain of preparing the agreement lasts only a few hours. Then you can put it away and never look at it again.

WHAT ARE THE MAJOR ISSUES FOR COUPLES WHO CO-OWN PROPERTY?

- Expenses: Consider acquisition costs (down payment and closing costs), carrying costs (mortgage payments, property taxes, insurance, utilities and minor repairs), and improvement costs (major repairs and enhancements). For each of these cost categories, allocate decision-making and payment responsibility, and determine how contributions will affect sale proceeds.
- Forced Sale: Since it is unlikely you will want to continue co-ownership following separation, either partner should be permitted to force a buyout or sale. If this is not the arrangement, the agreement must describe each partner's rights and responsibilities following separation.
- Sale Proceeds: Clearly allocate rights to sale proceeds even if the property is separately held. The allocation also determines price if one partner buys out the other based upon an appraised value.

- Death: Disputes with a deceased partner's heirs are common, so clarify postmortem intentions even when property is separately held. If either partner might own jointly with the other's heirs, allocate rights and duties between the surviving partner and the heirs, and provide for a forced buyout or sale.
- Occupancy: Decide who will occupy any shared dwelling following separation.

HOW DO MOST UNMARRIED COUPLES RESOLVE THESE ISSUES?

There are infinite ways to structure a property agreement. The examples below illustrate some common patterns. Keep in mind that elements can be mixed and matched to create a hybrid structure that fits your circumstances. Also remember that the primary purpose of an agreement is to avoid disputes upon separation or death, not to dictate behavior during your relationship. You need not rigidly adhere to the costs-sharing "rules" of your agreement so long as your checkbook records, together with the agreement, provide the basis for a retrospective accounting.

- Individual Ownership: This arrangement is common where one partner owns the property before the relationship, or purchases it with separate funds and wants to maintain complete ownership and control. The owning partner holds title and controls sale rights, sale proceeds, succession upon death, and tax deductions. Funds contributed by the non-owning partner to carrying and improvement costs are considered "rent" payments that do not create ownership rights.
- Equal Ownership: This arrangement is common among partners with similar financial strength. Acquisition, carrying and improvement costs, and tax deductions, are shared equally. Either partner may trigger a buyout or sale and proceeds are distributed equally.
- Proportional Ownership: This arrangement is common where one partner has greater savings and income. Acquisition and improvement costs are shared proportionately. For carrying costs, each partner contributes a preset "rent" payment, and amounts over the "rent" payment

are shared proportionately. Sale proceeds are distributed proportionately. Succession following death, and tax deduction allocation, are determined by agreement.

- Equal Ownership With Loan: This arrangement is common where one partner has greater savings (but not necessarily greater income) and the partners wish to distribute ownership risks and benefits. Partner A loans Partner B any amount needed for Partner B to make an equal contribution to acquisition, carrying and improvement costs. The loan can bear interest, be secured by Partner B's share of the property, and be payable during ownership or upon buyout or sale. Sale proceeds are distributed equally except for any amount that Partner B owes Partner A. Tax deduction allocation is determined by agreement. Partner B may also deduct any interest paid to Partner A.
- Capital Accounts: This arrangement is common where partners' relative contributions to the property will vary over time and they wish to distribute the risks and benefits of ownership in proportion to their cumulative contributions. Each partner's contributions to acquisition, carrying and improvement costs is called that partner's "capital account". Sale proceeds are distributed in proportion to the balances of the capital accounts on the date of sale. Succession following death, and tax deduction allocation, are determined by agreement.

HOW DO FORCED BUYOUT AND SALE PROVISIONS WORK?

The property is valued based on one or more appraisals. Either partner may buy out the other (or his/her heirs) by paying the amount the "selling" partner would have received from a sale at appraised value. If neither partner buys, the property is marketed at appraised value, and if it does not sell within a preset offering period (typically 30-60 days), either partner may require a preset price reduction (typically 5-10%). The price reduction system is designed to prevent a partner who is less anxious to sell from insisting on an unrealistic price. Following each price reduction, the partners have another buyout opportunity. If both partners want to buy, the deadlock is resolved through an auction-like procedure.

WHAT IF A PARTNER CONTRIBUTES SERVICES TO THE PROPERTY?

Where one partner plans to perform major repair or improvement work on the property, the agreement should describe how the work will affect buyout or sale proceeds. It is simplest to attach a fixed value to the labor before it is done. This approach avoids disputes regarding the length and quality of time contributed to the project. The fixed value can then be considered a loan, loan repayment, or capital contribution depending on the ownership structure.

ARE SHORT AND SIMPLE AGREEMENTS BEST?

The only part of an agreement that matters is the "key clause", the provision that applies directly to the circumstances that force you to consult the agreement. Unfortunately, you never know what the "key clause" will be when you prepare the agreement. If the "key clause" is missing because you tried to keep the agreement short and simple, the agreement will be useless. As long as an agreement is clear, it can never be too long...only too short.

CAN SELLERS DISCRIMINATE AGAINST UNMARRIED COUPLES?

Discrimination against unmarried couples is prohibited in California, but allowed in most other jurisdictions. Federal law prohibiting housing discrimination based on "family status" has been held inapplicable to unmarried couples. (There have been several unsuccessful legislative attempts to broaden this law to include gay (but not straight) couples.) Federal law does prohibit discrimination against unmarried couples in credit transactions related to home purchases. Of the 47 states that have housing discrimination laws applicable to sellers, 21 prohibit discrimination based on "marital status", but only four of these (including California) have been held to include unmarried couples.

ABOUT THE AUTHORS AND THE FIRM

The firm of Goldstein, Gellman, Melbostad, Gibson & Harris, LLP, formed in 1986, has extensive experience in real estate litigation and transactions, estate planning, probate administration and disputes, taxation, and unmarried couples relationships. The firm and each of the authors can be reached by telephone at 415-673-5600.

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