What Is Cost Basis and How Do You Prove It?

Knowing the “cost basis” of your property is important for tax purposes, but proving cost basis can be difficult. Cost basis adjusts at death, so it is a good idea to appraise property when a joint owner dies.

Cost basis is the monetary value of an item for tax purposes. When determining whether a capital gains tax is owed on property, the basis is used to determine whether an asset has increased or decreased in value. For example, if you purchase a house for $150,000, that is the cost basis. The cost basis can be increased by improvements to the property. If there are no improvements and you later sell the house for $250,000, you will have to pay taxes on the $100,000 increase in value. (However, if the property is your principal residence, you can exclude up to $250,000 in gain, or up to $500,000 for a couple.)

When a property owner dies, the cost basis of the property is “stepped up.” This means the current value of the property becomes the basis. For example, suppose you inherit a house that was purchased years ago for $50,000 and it is now worth $250,000. You will receive a step up from the original cost basis from $50,000 to $250,000. If you sell the property right away, you will not owe any capital gains taxes.

When a joint owner dies, half of the value of the property is stepped up. For example, suppose a husband and wife buy property for $200,000, and then the husband dies when the property has a fair market value of $300,000. The new cost

basis of the property for the wife will be $250,000 ($100,000 for the wife's original 50 percent interest and $150,000 for the other half passed to her at the husband's death).

The burden is on the property owner to prove cost basis, and it isn't always easy to prove, especially if it has been awhile since the property was purchased or improvements were made. Homeowners should keep good records of improvements to a house, which means keeping receipts and purchase orders. If a joint owner of property dies, you should get the property appraised to show the value at the time it is "stepped up" in basis. Be sure to save the documentation so you can use it later.

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Woman's Efforts to Change Will Without Professional Assistance Backfire

Just as making a will without the help of a qualified attorney can be dangerous, trying to change an existing will on your own can fail as well. A recent court decision in Minnesota serves as a cautionary reminder to anyone thinking of altering their estate plan on their own.

Esther Sullivan executed a will in 2006, that gave half of her property to a former employee of hers, Tara Jean Johnson. The grandson of Ms. Sullivan, Joseph VanHale, received a lesser

share. Two years later, in 2008, Ms. Sullivan allegedly attempted to change her 2006 will by marking up a photocopy of it and writing her initials next to each change and signing and dating the bottom of each page. She allegedly wrote on top of the 2008 photocopy, "[t]he Will dated January 19, 2006 is void and to be replace[d] with this and all written in changes." Among the changes was that Mr. VanHale would replace Ms. Johnson as the beneficiary of half her estate. In 2010, Ms. Sullivan allegedly attempted to execute another will using a form she downloaded from the Internet. This document named Mr. VanHale as her only beneficiary.

After Ms. Sullivan's death in 2013, the probate court had to decide which of the three wills should be followed. Mr. VanHale contended that the 2010 document was a valid will, while Ms. Johnson argued for the 2006 will. The probate court ruled that the 2008 photocopy and the 2010 downloaded document were invalid because they did not comply with the state's requirements for a valid will, which include that the will must be signed by at least two witnesses. The court held that although Ms. Sullivan probably intended to revoke the 2006 will, she did not do so successfully. Mr. VanHale appealed, arguing that Ms. Sullivan clearly intended to revoke the 2006 will and that the 2010 document was valid.

On August 17, 2015, the Court of Appeals of Minnesota agreed with the lower court that the 2006 will should be the one admitted to probate. The court ruled that only an original will, not a photocopy, can be revoked. The court also agreed with the lower court that the 2010 document had not been validly executed.

If Ms. Sullivan did change her mind and decide that she wanted her grandson to inherit her estate, the fact that she didn't do it properly meant that far from helping her grandson, she cost him a tidy sum in legal fees. People change their minds, and circumstances can change as well – marriage, divorce, the birth of children – and estate plans need to be revised along

with these changes.

To read the court's decision in the case, *In re the Estate of Sullivan* (Minn. Ct. App., No. A14– 2112, Aug. 17, 2015), click here.

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Understanding Tenancy – Co-Owning Property

When two or more individuals own property – whether it's a condominium, a home, or a piece of land – the relationship between the owners is very important. The form of ownership of the property affects how property is transferred to someone else. It is important to make sure you have the right form of ownership for your property.

Tenancy in common allows an owner the greatest flexibility to transfer the property as he or she wants. Each co-tenant in a tenancy in common has an interest in the property and is free to transfer this interest during life or through a will. The co-tenants can have different ownership interests; for example, three owners could own 5 percent, 35 percent and 60 percent of the property, respectively, as tenants in common. Each tenant can sever their relationship with the other tenants by conveying their interest to another party. This third party then becomes a tenant in common with the other owners.

Joint tenants, on the other hand, must have equal ownership

interests in the property. So, three owners would each have a one-third interest in the property. If one of the joint tenants dies, his or her interest immediately ceases to exist and the remaining joint tenants own the entire property. The advantage to joint tenancy is that it avoids having an owner's interest probated upon his death.

A disadvantage to both joint tenancy and tenancy in common, however, is that creditors can attach the tenant's property to satisfy a debt. So, for example, if a co-tenant defaults on debts, his creditors can sue in a "partition proceeding" to have the property interests divided and the property sold, even over the other owners' objections.

A third form of tenancy that is allowed in several states, including Maryland and D.C., **tenancy by the entirety**, avoids this problem, but it is available only to married couples. Tenancy by the entirety is based on the societal value of protecting the family. One tenant cannot convey her interest on her own, unlike with the other tenancies. Upon the death of one spouse, his or her interest automatically passes to the other spouse, as with joint tenancy, and the creditors of one spouse cannot attach the property or force its sale to recover debts unless both spouses consent.

Creditors may place a lien on property held in tenancy by the entirety, but they are out of luck if the debtor dies before the other spouse, who will take ownership of the property free and clear of the debt. This is why both husband and wife are required to sign the mortgage on their property for the mortgage to be valid. Unmarried couples who buy property and subsequently marry each other should re-title the deed as tenants by the entirety to avail themselves of the greater protections this form of tenancy offers.

In most states, if the form of tenancy that the tenants intended is ambiguous, the tenancy will be assumed to be a tenancy in common.

Do You Need a Lawyer to Write a Will?

While you aren't technically required to hire a lawyer to draft a will, failing to do so can lead to costly problems for your family and other heirs.

A will is a legal document that directs who will receive your property when you die. The legal requirements are pretty simple. In order for your will to be valid, you must know what property you have and what it means to leave it to someone, then sign the document and have it witnessed according to the laws of your state. Some states allow you to make a handwritten will, called a "holographic" will. This will does not need to be witnessed, but it is much more likely to be challenged after you die.

Many services have popped up that offer do-it-yourself will software or documents. These might work fine if you have little or no property, small savings or investments, and a traditional family tree, but the rest of the population should not use these programs. When it tested three leading online legal document preparation services, *Consumer Reports* concluded that none of the will-writing products was likely to entirely meet a person's needs unless those needs are extremely simple.

And likely you'll need a lawyer to definitively determine whether or not your needs are indeed simple. Do you have an estate that is taxable under state or federal law? Do you own

significant amounts of tax-deferred retirement plans? Do you know how to fund the revocable trust provided on the computer program? Is there anything about your estate that is unusual, such as having children from a previous marriage or a disabled child? If you have any questions about your estate plan, you need to see a lawyer.

Not hiring a lawyer can lead to problems that drag out your estate administration and cost money and create headaches for your heirs. For examples of what can go wrong if you fail to use a lawyer, click here and here.

Decisions to Make For Your Power of Attorney

A power of attorney may seem like a simple document, but there are several important decisions that need to be made when creating one. From whom to appoint to what powers to grant, care and consideration should be put into each choice.

A power of attorney is one of the most important estate planning documents you can have. It allows a person you appoint – your "attorney-in-fact" or agent – to act in your place for financial or other purposes when and if you ever become incapacitated or if you can't act on your own behalf. It can permit the agent to pay your bills, make investment decisions, take planning steps, and take care of your family when you can't do so yourself. In theory, all the power of attorney should need to say is the following:

I, Joe Blow, hereby appoint Janet Planet to step in for me in the event of my incapacity to handle my financial and legal matters.

Here are some of the decisions you will need to make on your power of attorney:

Whom to appoint. Of course, you need to appoint someone you trust to have your best interests in mind. The person also needs to be organized and responsible and have the time available (or be able to make the time available) to carry out the functions of paying bills, guiding investments and handling any legal matters that may arise. Generally, people appoint family members to this role, but sometimes none of their relatives are appropriate, in which case they may appoint a friend or even an accountant, attorney or clergy person. If there's no one to appoint, despite the benefits of the power of attorney, you may need to resort to a court-appointed conservator in the event of incapacity.

How many agents to appoint. You may appoint one or more agents on your power of attorney. Having multiple agents allows more than one person to share the responsibility and permits them to divvy up tasks, but at the risk of disputes between your agents. If you apoint more than one, make sure that the document permits each agent to act on his or her own. Requiring them to act together could become very cumbersome if all of your agents have to sign every check or other document. Also, if you appoint more than one agent, make sure they get along and communicate. If not, misunderstandings can arise. It is generally better not to name more than two agents, but parents of three children may not want one to be left out.

Alternates. In addition or instead of naming multiple attorneys-in-fact, you can name one or more alternates in case the first person or people you appoint cannot serve. For instance, you may name your spouse as your agent and your children as alternates. If you do name alternates, make sure the document is very clear about when the alternate takes over and what evidence he or she will need to present when using the power of attorney. Otherwise, a bank or other financial institutions might deny access to an account if it's not

certain that the alternate has indeed taken over.

“Springing” or “durable.” The idea behind a power of attorney is that it will be used only when the person who creates it (the “principal” in legal speak) becomes incapacitated. Interestingly, traditionally powers of attorney expired when the principal became incompetent, the theory being that the attorney-in-fact stands in the principal’s shoes and can only do what the principal can do; if the principal is incompetent, then so is the agent. Every state has passed laws providing for “durable” powers of attorney that survive the incapacity of the principal. But when should it take effect? A “springing” power of attorney only takes affect when the principal becomes incapacitated. The problem is that springing powers of attorney create a hurdle for the agent to get over to use the document. When presented with a springing power of attorney, a financial institution will require proof that the incapacity has occurred, often in the form of a letter from a doctor. Obtaining that letter will be one more task the attorney-in-fact will have to carry out, often when already overwhelmed dealing with a parent’s illness while still trying to stay employed and care for children. It can also mean a delay in access to funds needed to pay for care or to maintain a home. In most cases, if you trust someone enough to name him or her as your agent, you also trust him or her not to use the document until the appropriate time. And if this trust is misplaced, then you can always revoke the appointment. A final argument for executing a durable, rather than a springing, power of attorney is that it may be needed when the principal is competent, but unavailable. For instance, a financial or legal matter may come up while the principal is vacationing in Europe. It could be important that the attorney-in-fact can step in and act while the principal is out of the country.

Gifting. Powers of attorney usually go on for several pages listing the various powers the attorney-in-fact may

carry out. This is because financial institutions and tax authorities often look for and demand specific authorization for the tasks the agent is seeking to perform. One of the most important powers is the power to gift. While strictly speaking allowing your agent to make gifts may not always be in your best interest – it is usually better to have more money than less – it may well be what you would want to do if you were competent to act on your own. You may want to support children and grandchildren or to take steps to reduce taxes or qualify for public benefits.

Trust powers. Similar to the power to make gifts, it can be important to authorize the attorney-in-fact to make, amend, and fund trusts on behalf of the principal. Power of attorney forms often permit the funding of preexisting trusts but not their modification or the creation of new trusts. These powers can be extremely important in the context of long-term care planning, asset protection planning or special needs planning for spouses, children, and grandchildren.

Copies and Storage. Once the agents and wording of the power of attorney have been determined, how many originals should you have and where should they go? Most powers of attorney include language saying that a copy should be treated like an original, but this is not always honored by third parties. In addition, an original may be inaccessible for some periods of time. For instance, in transactions involving real estate, an original power of attorney must be recorded with the deed. The power of attorney will be returned, but perhaps not for several months. You have the option to keep originals yourself or give them to your agents. Usually people keep the originals and tell their agents where the documents are located in case they are needed.

One other important consideration is to see if any of the financial institutions with which you have accounts have their own power of attorney forms. If so, make sure you execute their forms as well as a general durable power of attorney

because banks and investment houses have been known to reject powers of attorney that are not their own for spurious reasons.

Executing a power of attorney is not as simple as it first seems. It is important to have a qualified attorney help you.

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