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03/07/91

Memorandum 91-19

Subject: Donative Transfers of Community Property (Consultant's Background Study)

The Commission retained Professor Jerry Kasner of University of Santa Clara Law School to prepare a background study of issues raised by the case of MacDonald v. MacDonald, 51 Cal. 3d 262 (1990). The MacDonald case held that where a husband made a beneficiary designation of his community property IRA and the wife gave her written consent to the designation, the consent was not an effective disposition of the wife's community property interest when challenged by the wife's executor after her death.

This decision has caused much consternation among the family law and estate planning bar for obvious reasons. The Commission has received many phone calls from persons wondering whether anything is being done about the situation; the staff has assured them that the Commission has a consultant working on it and is planning to address this as a priority matter soon.

Professor Kasner has now delivered his study, ahead of schedule. A copy of the study, "Donative and Interspousal Transfers of Community Property in California: Where We Are (Or Should Be) After MacDonald", is attached. An outline follows:

I. Introduction
II. Interspousal Transfers - Gifts or Transmutations?
III. Transmutation Rules in Other Community Property States
IV. Recommendations for Change in the Statutory Transmutation Rule
V. Recommendations for Change
VI. Proposed Statutory Language for Transmutations
VII. Gifts of Community Property to Third Persons
VIII. Community Property Interests in Life Insurance
IX. Other Death Benefits, With Particular Emphasis on the Terminable Interest Rule and Federal Pre-Emption
X. Other Will Substitutes
XI. Spousal Consents to Death Transfers - Conclusions and Recommendations
XII. Recommended Statutory Changes
XIII. Conclusion

At the April meeting Professor Kasner will summarize his study and recommendations for the Commission. We hope interested persons will be prepared at that time to offer comments to the Commission, so that the Commission can begin to make initial policy decisions. This is an important project; our goal is to have legislation ready for introduction in the 1992 legislative session.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

DONATIVE AND INTERSPOUSAL TRANSFERS OF COMMUNITY PROPERTY IN CALIFORNIA: WHERE WE ARE (OR SHOULD BE) AFTER MACDONALD*

by

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MARCH 1991

This report was prepared for the California Law Revision Commission by Professor Jerry Kasner. No part of this report may be published without prior written consent of the Commission.

The Commission assumes no responsibility for any statement made in this report, and no statement in this report is to be attributed to the Commission. The Commission's action will be reflected in its own recommendation which will be separate and distinct from this report. The Commission should not be considered as having made a recommendation on a particular subject until the final recommendation of the Commission on that subject has been submitted to the Legislature.

Copies of this report are furnished to interested persons solely for the purpose of giving the Commission the benefit of the views of such persons, and the report should not be used for any other purpose at this time.

CALIFORNIA LAW REVISION COMMISSION
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DONATIVE AND INTERSPOUSAL TRANSFERS OF COMMUNITY PROPERTY IN CALIFORNIA: WHERE WE ARE (OR SHOULD BE) AFTER MacDONALD

JERRY A. KASNER, 1991

I. INTRODUCTION

In 1984, the California legislature decided that it was far too easy for a spouse to transform, reclassify, or "transmute" community and separate property. Cases permitting transmutation by an oral agreement, a so-called "understanding" between the spouses, and even by the conduct of one or both spouses, resulted in substantial litigation in which self-serving and often unsubstantiated statements of one or both parties were the basis of substantial alteration of property rights. What was even worse, in the eyes of many, was the effect these rules would have on creditors. It was time for a change.

The change was the adoption of Statutes of California 1984, Chapter 1733, dealing with transmutation. The first of four new statutes, California Civil Code Section 5110.710, provides that married persons, by agreement or transfer, and without consideration, may transmute community property to the separate property of either, transmute the separate property of either spouse to community, or transmute separate property of one spouse to separate property of the other. Other than clarification, this was not a major change in the law. It is generally consistent with statutes and case law relating to marital property agreements.

The second new statute was California Civil Code Section 5110.720, which indicates a transmutation may be a fraudulent transfer. While there is case authority to support this conclusion, this was an important clarification.

The third statutory provision, California Civil Code Section 5110.730, completely changed California community property law. Under its terms, effective for transfers on or after January 1, 1985, a transmutation is not valid unless it is made in writing by an express declaration that is "made, joined in, consented to, or accepted by the spouse whose interest is adversely affected. (emphasis added)". California Civil Code Section 5110.730(a). Further, if real property is involved, the transfer is not effective as to a third party without notice unless recorded. California Civil Code Section 5110.730(a). There is an exception for personal use property, such as wearing apparel, jewelry, or "other tangible articles of a personal nature" used solely or principally by the donee spouse and "not substantial in value taking into account the circumstances of the marriage." California Civil Code Section 5110.730(c). Finally, the statue does not apply when commingling is involved. California Civil Code Section 5110.730(d).

Under the law prior to 1985, husband and wife could enter into any transaction with each other, including a transmutation of property, and the transmutation could be written or oral. This rule stems from the original Act of 1850, which indicated the spouses could contractually change their rights in property under the system by either antenuptial or postnup-

tial contracts. 1849-50 Cal. Stat. 254. In the case of oral transmutation, the courts required that the agreement be executed, not executory, but generally otherwise ignored other requirements of a valid contract, such as consideration. Kennedy v Kennedy, 220 Cal 134, 136-137; 30 P. 2d 398, 390 (1934) ;Estate of Raphael, 91 Cal. App. 2d 931, 935-940; 206 P. 2d 391, 393-396, (1949). Thus, as Professor Reppy has concluded, the pre-1985 law relating to so-called transmutation "contracts" did not require such contracts to be in writing, comply with the statute of frauds, supply consideration other than mutual promises, or specifically identify existing property. W. Reppy, Community Property in California, 29-39 (2nd ed. 1988). In fact, the courts had essentially abandoned the contract theory as essentially to effect transmutations, holding they could be implied by the conduct of the parties. Estate of Nelson, 224 Cal. App. 2d 138, 143-144; 36 Cal Rptr. 352, 355 (1964). Also, a transmutation could apply to property not yet in existence, such a future earnings. Wren v Wren, 100 Cal. 276, 279-280; 34 P. 775, 766 (1893).

In its first decision dealing with the written transmutation statute, the California Supreme Court has concluded that a writing is not an "express declaration" sufficient to effect a transmutation unless "it contains language which expressly states that a change in characterization or ownership of the property is being made." Under the facts of the case, Estate of MacDonald v. MacDonald, 51 Cal. 3d 262; 51 Cal. 3d 452A;

272 Cal. Rptr. 153; 794 P. 2d 911 a husband received a distribution from his pension plan , which was conceded to be community property, and deposited these funds into individual retirement accounts (hereinafter IRAs). The IRA accounts were established through the use of forms characterized as adoption agreements, which included a provision for designation of a beneficiary who would succeed to the account on the death of the owner/participant. Also included was a form for the consent of the owner's spouse to the beneficiary designation.

The instructions made available for the adoption form indicated that if the participant's spouse was not named the sole primary beneficiary, the spouse would have to sign the consent. The husband named as beneficiary a living trust which provided income for wife for life, remainder to his children from a prior marriage. His wife signed the consent which read: "Being the participant's spouse, I hereby consent to the above designation."

The wife left a will which bequeathed the residue of her estate to her four children. She was terminally ill when the consent was signed, and contemporaneously with that action, the husband and wife divided their other property into separate estates. She sold her half, and placed the proceeds into a separate account. When she died approximately six months later, the executrix of her estate sought to assert a community claim against the IRA accounts.

The trial court held that the signature of the deceased wife to the consent form constituted a waiver or transmutation of her community rights in the IRAs, which in effect resulted in a transfer of those rights to the husband. Thus the wife's community interest in the IRAs was transmuted into the separate property of the husband. This determination was reversed on appeal, MacDonald v. MacDonald, 213 Cal. App. 3d 456; 261 Cal. Rptr. 653 (1989); and the Supreme Court agreed with the appellate court.

The Supreme Court found there was no substantial evidence of an intent of the wife to transmute her interest in community property to separate property of the husband. Even if there was such evidence, the intent of the legislature in adopting California Civil Code Section 5110.730(a) was to overturn the easy transmutation rule under prior law, and now require, according to the Supreme Court in MacDonald, an "express declaration...that the characterization or ownership of the property is being changed." The court found that the consent contained no language which expressly characterized the property or indicated an alteration of ownership of the funds.

In attempting to define exactly what language would be sufficient to satisfy the requirement of an express declaration, the majority of the court held that there was no requirement that the word "transmutation" or other specific language would be used, although Justice Mosk, in a concurring

opinion, argued the writing requires an express declaration of transmutation. MacDonald, supra, 51 Cal. 3d at 274. The opinion concedes the statute itself is vague, and does not indicate what language the writing itself should contain. It suggests that words of gift, i.e., "I give to the account holder any interest I have in the funds..." would be sufficient.

The statement of the court that language of gift would probably be sufficient to effect a transmutation is not in accordance with some case authority. Note that in Estate of Walsh, 66 Cal. App. 2d 704, 707; 152 P. 2d 750, 752 (1944), oral testimony that a transfer of jewelry paid for with community funds from husband to wife as a gift was not sufficient to transmute it into her separate property See also Wall v Wall, 30 Cal. App. 3d 1042; 106 Cal Rptr 690 (1973).

In the MacDonald opinion, the Supreme Court cited the decision in Estate of Blair, 199 Cal. App. 3d 161, 168; 244 Cal. Rptr. 627, 631 (1988) holding that joint tenancy property had not been transmuted into community despite its listing by the wife as community property in her petition for legal separation and the husband's signature on a deposition in which he stated he "believed" it was community property. This citation reinforced the Supreme Court's conclusion in MacDonald that a transmutation or community or separate property requires a formal written statement to that effect.

While the Supreme Court sought to limit its review in MacDonald, it appeared, at least in footnotes, to give tacit approval to some other issues in the case resolved by the District Court of Appeals, or possibly to ignore these other issues altogether. Since the IRA funds were derived from pensions, the surviving husband sought to invoke the "terminable interest rule", which held that where the spouse who was not the participant in a pension or retirement plan predeceases, the rights in that plan automatically pass to the participant spouse, and the community interest of the deceased spouse terminates. The trial court rejected this argument, finding that the IRA accounts were not pension benefits. The appeals court went further, holding that the terminable interest rule has been abolished for all purposes retroactively in California by the adoption of California Civil Code Section 4800.8, citing Estate of Austin, 206 Cal. App. 3d 1249, 1252; 254 Cal. Rptr. 372, 373 (1988). The court also expressed doubt the rule ever applied to private pension plans, at least where the participant can designate the death beneficiary, citing Bowman v. Bowman, 171 Cal. App. 3d 148, 151; 217 Cal. Rptr. 174, 175 (1985).

Many commentators believe that both the appellate court and the Supreme Court failed to consider what may be the most important aspect of the MacDonald decision - assuming the consent of the wife to the beneficiary designation for the IRA accounts was not a waiver of transmutation of her community property rights, was it not in any case sufficient to

constitute a consent to a gift or transfer of these accounts, effective upon the death of the husband? If husband had predeceased wife, could she have revoked the consent? Since she died first, is the consent irrevocable at her death, or is it possible, as in MacDonald, that her personal representative could revoke the consent after her death?

This issue was not squarely faced in the lower court, and was raised for the first time in the Supreme Court. According to footnote 3 of the opinion, the respondent sought to argue that the beneficiary consent was in fact a form of "will substitute" dealing with disposition of the IRA accounts. The footnote indicates there was no evidence to support that contention, and in any case, the issue was raised for the first time on appeal, which is not permitted under California Rules of Court, Rule 29(b). Of perhaps greater significance, footnote 8 indicates the court was asked to consider whether or not wife's consent to the beneficiary designation was a consent to a gift by the husband as required by California Civil Code Section 5125(b). The footnote infers that this would simply be a way of circumventing the written transmutation rule, but in any case, indicates the court was limiting its review to the transmutation issue.

The final decision in MacDonald was probably correct on the only issue specifically decided by the Supreme Court, transmutation. The consent form signed by the wife really only evidenced an agreement to the designation of a death beneficiary undertaken as part of estate planning motivated to

a large extent by her terminal illness. It is difficult to find any written expression of an intent to transfer (transmute) property rights from wife to husband on the facts presented. However, the strict interpretation of California Civil Code Section 5110.730, although probably justified by the language of the statute, imposes an almost impossible burden upon spouses to alter and clarify their property rights in an informal manner, or to make gifts to each other without the necessity of hiring a lawyer to draft an "express written declaration" for them. Most laypersons probably believe a "transmutation" is some form of religious experience, and would be amazed to learn that they have to use that or similar language to make property transfers to each other.

There are other problems with the California Civil Code Section 5110.730 which were not before the court. Must this "express written declaration" be actually signed by one or both spouses? The statute indicates that it must be "made by, joined in, consented to , or accepted by" the spouse "adversely affected." What does that really mean? Who is adversely affected if the spouses are transmuting community property into joint tenancy property? If the agreement converts property from joint community property to a tenancy in common, do both spouses have to agree, consent, or accept it?

The abrogation of the terminable interest rule, while probably highly desirable, should not be done by default

through application of California Civil Code Section 4800.8, which clearly falls within the marital dissolution provisions of the Civil Code, to transfers at death. Further, the issue of retroactivity is a serious one, and may raise issues such as those presented by adoption of Civil Codes Sections 4800.1 and 4800.2. Legislative clarification is needed.

Finally, the MacDonald case illustrates the lack of statutory or judicial authority as to the impact of the spousal consent rules as they pertain to gifts intended to take effect at death, or nonprobate transfers of property. In this area, life insurance policies and death benefits present a series of special problems which should be addressed.

II. INTERSPOUSAL TRANSFERS - GIFTS OR TRANSMUTATIONS?

California Civil Code Section 5125(b) expressly provides that a spouse may not make a gift of community property, or dispose of it without a valuable consideration, without the express written consent of the other spouse. Does this rule apply where the transfer is from one spouse to another? At least in footnote 8 to the MacDonald decision, the Supreme Court seems to say it does not, as it might function to circumvent the requirements for a written transmutation.

It appears there are two ways in which a transmutation or community or separate property can occur - either by an agreement between the spouses altering their property rights, or by a gift or other transfer of property from one spouse to

another. These are the two methods expressly recognized by the Uniform Marital Property Act, Section 7(b), 9A Uniform Laws Annotated, Master Edition, Section 7(b) (1987). A transmutation could probably also result from application of the estoppel doctrine under some circumstances. (cite?) Since 1872, California law has permitted husbands and wives to deal with each other with virtually no limitations, and clearly permits them to agree to change, i.e., "transmute", the character of their property by agreement from community to separate or vice versa. Title Insurance and Trust v. Ingersoll, 153 Cal. 1: 94 P 94 (1908); Fay v Fay, 165 Cal. 469, 132 P. 1040 (1913), Tompkins v. Bishop, 94 Cal. App. 2d 546, 211 P. 2d 14 (1949).

Until 1985, California law upheld oral marital agreements that transmuted the character of both real and personal property. Since consideration is conclusively presumed to exist in marital agreements, the practical effect is to permit "gifts" of property from one spouse to the other without satisfying the requirements of either California Civil Code Sections 5125 and 5127.

Why should the rules for interspousal gifts be different that the general rule for community property gifts? On the face of it, California Civil Code Section 5125(b) would be inappropriate when applied to a transfer of community property by gift from one spouse to the other, since the consent would be coming from the donee, not the donor. This may be a reason

the courts have not applied the written consent rule where interspousal transfers are involved. See Logan v. Thorne, 205 Cal. 26, 28; 269 P. 2d 626, 627 (1928)and the discussion at Hogoboom & King, California Prac. Guide: Fam. Law. 1 (TRG 1990), Section 8.118 -8.124. What is more likely is that neither the legislature or courts really think of interspousal transfers as gifts in the management and control sense, which is the general subject of California Civil Code Section 5125.

The balance of this discussion, and proposed legislative changes, will assume a distinction between management and control issues which govern gifts in general, and contract or transfer issues which control interspousal gifts and transmutations. However, a key issue will be the extent to which a consent by a spouse to a gift by the other spouse to a third party also results in a transmutation of the property in question.

In its comment on the proposed adoption of California Civil Code Section 5110.730 in 1983, the California Law Revision Commission noted that the new law would overrule existing case law that permitted oral transmutations of personal property, with the exceptions noted for certain gifts not of substantial value. Recommendation Relating to Marital Property Presumptions and Transmutations, 17 CAL. L. Revision Comm'n Reports 205, 224-225 (1984). The recommendation also states, supra at p. 214, that "California should continue to recognize informal transmutations for certain personal property gifts between the spouses, but should require a writing for a

transmutation of real property or other personal property. (emphasis added.)" Compare this to the statement in Hogoboom & King, supra Sec. 8.118: "However, presumably true gifts can still be proved by evidence of the ordinary elements of a gift - delivery and donative intent." In view of the fact that any gift between spouses results in a transmutation, and the legislative history indicates an intent to exempt only certain interspousal gifts from California Civil Code Section 5110.730, it appears an express written declaration will be required to make an interspousal gift of real or personal property.

III. TRANSMUTATION RULES IN OTHER COMMUNITY PROPERTY STATES

Other community property jurisdictions have used both the gift theory and the agreement theory to support transmutations of property. In Texas, there appears to be no statute directly in point. However, Texas Const. Art. XVI, as amended in 1980, grants to spouses broad authority to enter into premarital and marital property agreements altering their property rights. The Texas cases generally recognize transmutation by gift, such as deeds from one spouse to the other, or acts of one spouse indicating he or she consents or acquiesces to a gift to the other spouse.

When interspousal gifts are involved, Texas seems to permit informal or "easy" transmutations. See Bruce v. Koch 40 S.W. 626 (1897); Wofford v. Lane, 167 S.W. 180 (1914); Cauble v. Bever-Electra Refining Co., 274 S.W. 120 (1925);

Hamilton v. Charles Maund Oldsmobile-Cadillac Co. 347 S.W. 2d 944 (1961); all of which deal with interspousal gifts, and none of which indicate an instrument in writing is a necessary element. In Wohlenberg v. Wohlenberg, 485 S.W. 2d 342 (1972), dealing with alleged gifts through deposits in bank accounts, there was no written declaration, and the case was decided on other facts, including testimony of the spouse. Delivery was sufficient to find a completed gift from husband to wife in Armstrong v. Turbeville, 216 S.W. 1101 (1919). Most Texas cases hold that conveyance or delivery will be sufficient to establish a gift if other competent evidence, including testimony as to statements made, support this conclusion. In Robbins v.Robbins, 125 S.W. 2d 666 (1939), the informal consent and acquiescence of the husband in the acquisition by wife of real property in her own name was enough to establish an intent to make a gift to her. See also McFadden v McFadden, 213 S.W. 2d 71 (1948), Babb v McGee, 507 S.W. 2d 821 (1974). In these decisions, the courts held the character of property transferred inter vivos from one spouse to the other is determined by the nature of the consideration given for it, and surrounding circumstances could be used to show the transfer was a gift.

New Mexico follows California and most other community property states in recognizing a variety of interspousal transactions. N. M. Stat. Ann. Sec 40-2-2 (1978). Interspousal conveyances, at least from husband to wife, raise a rebuttable presumption of a gift and transmutation. Overton v. Benton,

291 P. 2d 636 (1955). In a 1980 New Mexico case, Estate of Fletcher v. Jackson, 613 P. 2d 714 721 (1980), the court held an agreement between spouses to transmute from community to joint tenancy does not have to be in writing in all cases. The court indicated that Section 40-2-2, permitting spouses to enter into any engagement or transaction with each other, did not expressly require a writing, but that the transmutation had to be established by clear, strong, and convincing proof - more than a mere preponderance of evidence, quoting In re Trimble's Estate, 253 P. 2d 805 (1953). But this did not require an express written instrument. Note that the above conclusion was reached despite a New Mexico statute which provides that separate property means property designated as separate property by a written agreement between the spouses. N. M. Stat. Ann. Section 40-3-8(A)(5) (1978) See Community Property - Transmutation of Community Property: A Preference for Joint Tenancy in New Mexico? 11 N M. L. Rev. 421 (1980-81).

Nevada follows the written agreement rule, Nevada Revised Statutes, Section 123.220. However, the cases refer to a presumption of gift in the case of transfers of community property from husband to wife, apparently without a specific written agreement. But in a recent case Verheyden v. Verheyden, 757 P. 2d 1328, 1331 (1988), the court indicated that mere oral expression that one spouse is making a gift to the other does not satisfy the requirement of clear and convincing proof necessary to overcome the community

presumption. There is also a presumption in Nevada that a transfer of title to separate property from husband to wife is a gift, but it is rebuttable. Todkill v. Todkill, 495 P. 2d 629 (1972). See also Peters v Peters, 557 P. 2d 713 (1976). In Campbell v. Campbell, 705 P. 2d 154 (1985), where wife made a downpayment from separate funds on a house held in joint tenancy, that was presumed to be a gift, without any express written instrument. See also Graham v. Graham, 760 P. 2d 772. Use of separate funds of a wife to pay for improvements on a home which was the separate property of the husband was presumed to be a gift in Hopper v. Hopper, 392 P. 2d 629 (1964).

Idaho has a presumption property conveyed from one spouse to the other is separate property, Idaho Code Section 32-096, and also has a provision for marriage settlement agreements, which must be formally executed. Idaho Code Sections 32.916, 32-919. Case law indicates these formalities must be followed to transmute property. Stockdale v. Stockdale, 643 P. 2d 82 (1982).

Washington has a similar provision for marital agreements covering conveyances between husband and wife for real estate, and agreements as to the status of property, which must be executed with due formality. Wash. Rev. Code Ann. Sections 26.16.050 and 26.16.120. However, case law indicates transmutation can be effected by deed or an agreement between the parties. Character of property cannot be changed by oral agreement alone; in effect, the statute of fraud applies.

Rogers v. Joughlin, 277 P. 988 (1929), the statute of frauds applies. Churchill v. Stephenson, 45 P. 28 (1886). However, gift cases seem to require less. As in most community property states, a conveyance from one spouse to another will raise a presumption of gift. Denny v Schwabacher, 104 P. 137 (1909). In 1895, The Washington Supreme Court held that where a third party conveyed title to real property to a wife, and extrinsic evidence indicated her husband had intended it to be a wedding anniversary present, it was presumed to be the separate property of the wife. Nixon v Post, 43 P. 23 (1895). However, in In re Parker's Estate, 196 P. 632, 633 (1921), a husband's direction that title to newly purchased real estate be placed in the name of the wife alone was held to be an invalid oral gift, and the court noted that oral agreements were void.

Arizona cases recognize transmutation by conveyance plus contemporaneous conduct. In re Sims Estate, 475 P. 2d 505 (1970); Jones v. Rigdon, 257 P. 639 (1927); Noble v Noble 546 P. 2d 358 (1976). However, cases again seem to permit some transmutation with little formality. In Jones v. Rigdon, the court made the following interesting comments: "Ordinary, such a gift is evidenced by a conveyance from one to the other, but that is not the only method by which it is established. The fact husband causes or permits a conveyance to be made to his wife tends to show it was the intention of the parties the property should be her separate estate....And

extrinsic evidence, including the testimony of witnesses, is admissible on this point."

The version of the Uniform Marital Property Act adopted in Wisconsin permits variation of property rights by a "marital property agreement." Wis. Stat. Ann. Section 766.17 (1990). The law also provides that spouses may reclassify their property by gift, conveyance signed by both spouses, marital property agreement, written consent, or in some cases, by unilateral statements. A marital property agreement must be signed by both spouses, is enforcable without consideration, and includes definition of rights in property. Wis. Stat. Ann. Section 766.58 (1990). This covers agreements both before and during marriage. The written consent provision applies specifically to life insurance. Wis. Stat Ann. Section 766.61(3)(e) (1990). The unilateral statement refers to preservation of income from separate property. Wis. Stat. Ann. Section 766.59 (1990). Legislative Counsel Notes indicate Wisconsin rejected broader language in the uniform law that written consent could be a substitute for a marital property agreement.

It is possible to conclude from the statutes and cases in other community property jurisdictions that while there is some requirement of a writing for transmutation under many circumstances, the courts seem to discount it where the evidence indicates an intent to transfer i.e., transmute, and and acceptance. Also, the writing which is sufficient in many cases is of a relatively informal character, and certainly is

not required to include an "express declaration" to result in a transmutation of the property. California, once considered to have the "easiest" transmutation rules, now has the most difficult. For an excellent summary of the treatment of interspousal transfers during marriage in community property states, see W. S. McClanahan, Community Property in the United States, (1982).

IV. RECOMMENDATIONS FOR CHANGE IN THE STATUTORY TRANSMUTATION RULE

The adoption of the written transmutation rules in 1985, as interpreted by the MacDonald case, signaled the end of easy transmutations, and as a necessary consequence, ended reliance on extrinsic evidence of gift or intent to transfer which had previously prevailed in California and is applied in a variety of circumstances in other community property states.

The implications of the adoption of California Civil Code Section 5110.730 may not have been fully appreciated when it was proposed and adopted. The legislative history focuses on the necessity of eliminating the use of oral evidence to prove interspousal agreements. It does not address the issues of informal interspousal transfers and gifts. For example, rules relating to the use of separate funds to maintain or improve community property, formerly rather easily classified as "gifts to the community" in the absence of evidence to the contrary, now require evidence of an intent to recharacterize the funds so used. Otherwise, there is a right of reimburse-

ment, or possibly a separate interest in the community property which is the subject of the improvement. Consider cases like Estate of Armstrong, 241 Cal. App. 2d 1, 50 Cal. Rptr. 339 (1966), where a wife used community funds to pay off a lien on her husband's separate property. The court presumed she made a gift of her community interest in the funds to him, thereby "transmuting" those community funds into his separate property. See also Estate of LaBelle, 93 Cal. App. 2d 538, 209 P. 2d 432 (1949) where the wife was aware her husband was using community funds to improve his separate property, and took no action. A gift was presumed.

Under the facts of either Armstrong or LaBelle, there appears to be no express written declaration which would include, in the language of the MacDonald opinion, "... language which expressly states that the characterization of the property is being changed." Estate of MacDonald, 51 Cal. 3d at 272. In fact, there was no written documentation of any kind in the LaBelle case. Did the legislature really mean to limit informal interspousal transfers to that extent? If so, the resulting right of reimbursement, or in some cases right to apportionment of interests in the property itself, may result in more litigation rather than less. See In re Marriage of Warren, 28 Cal. App. 3d 777, 104 Cal. Rptr. 860 (1972), defining a right of reimbursement where no gift was made, and In re Marriage of Gowdy, 178 Cal. App. 3d 1228, 224 Cal. Rptr. 400 (1986), finding that where there was no gift, the use of community funds to pay encumbrances on husband's separate property gave the community a proportionate interest

in that property. These issues will now be frequently litigated under the transmutation statute. If one spouse can prove he or she used separate funds to improve community property, there is no "informal" transmutation resulting from an implied gift. The same applies to the use of community funds by one spouse to improve or maintain the separate property of the other spouse.

Further, the written transmutation rule will directly conflict with the various title presumptions. For example, if community funds are used to acquire a personal residence, and title is taken an joint tenants, MacDonald suggests the joint tenancy title is invalid unless an express written declaration recharacterizing the community as joint tenancy property is found. This result is indicated by the decision in Estate of Blair, 199 Ca. App. 3d 161, 244 Cal Rptr. 627 (1988), involving the opposite issue, transmutation from joint tenancy to community.

In many cases, the only written declaration as to the status of property in such cases is the joint tenancy deed itself. Since this is not signed by the grantee spouses, does it meet the written declaration requirement? This fact pattern may explain the fact the language of California Civil Code Section 5110.730 does not expressly require either spouse to sign the written declaration, only join in, consent to, or accept it. Professor Reppy suggests that "consented to or accepted by" does not require a signature by the spouse adversely affected, as where a deed characterizing property as

the separate property of the wife is prepared at the instance of the husband, resulting in a transmutation of community funds used to pay for the property into the separate property of the wife. W. Reppy, Community Property Law In California, 52 (2nd ed. 1988). He also argues that acceptance of a deed changing the character of the property is a transmutation under the statute. On the other hand, the Legislative Committee Comment on California Civil Code Section 5110.730 indicates that in the case of transmutation of real property, the new provision brings the law into line with the statute of frauds under California Civil Code Sections 1091 and 1624. Communication of Law Revision Commission Concerning Assembly Bill 2274, 18 Cal. L. Revision Comm'n Reports, 67, 68 (1986). Both of those provisions require the writing to be signed by the transferor or party to be charged.

The mere fact a deed or document of title is mailed to the spouses, who probably do not even bother to look at it, is hardly evidence they accepted it or consented to it, even if it contains language which could be construed as an "express declaration" meeting the transmutation requirements. Consent or acceptance requires some affirmative action by one or both spouses. Again, the problems of proof here may be greater than under the "easy" transmutation rules.

It is clearly possible the express written declaration rule will invalidate many title documents where the spouses have not executed documents creating the title or consenting

to it. In discussing the express declaration required to create a joint tenancy, the Supreme Court in MacDonald, 51 Cal. 3d at 271, noted that under California Civil Code Section 683, the actual form of express declaration is set forth in the statute. Section 683(a) refers to a title created by a transfer, as when husband and wife holding title as community property transfer to a joint interest "when expressly declared in the transfer to be a joint tenancy." It also indicates a joint tenancy in personal property may be created by written transfer, instrument, or agreement.

Is Section 683 really consistent with Section 5110.730? It is if we assume that under both sections, each spouse must consent to, join in, make, or agree to the transfer. If one spouse, acting in his or her management capacity, purchases securities with community funds and instructs a broker or transfer agent to title the securities in the names of husband and wife as joint tenants with right or survivorship, is this valid, given the fact the other spouse took no part in this action? If not, there are in existence a large number of invalid joint tenancies in real and personal property.

California Civil Code Section 5110.730 may also may be in conflict with California Civil Code Sec 4800.1, which provides that for marital dissolution purposes, titles held in joint tenancy , tenancy by the entirety, or tenancy in common are presumed to be community property absent a contrary statement in the document of conveyance or a written agreement the property is separate. In effect, California Civil Section

4800.1 creates an automatic transmutation for purposes of marital dissolution where separate funds are used to acquire property in joint tenancy or other forms of joint title, with no requirement of an express written declaration. However, if the document creating the joint tenancy or tenancy in common does not contain an express declaration relative to the characterization, it may be the joint form of title was invalid to begin with. If so, California Civil Code Section 4800.1 would not become operative.

Further, the presumption in California Probate Code Section 5305 that various forms of joint accounts between husband and wife are presumptively community property is inconsistent with a requirement that an express declaration of transmutation is required when the account is created or funds are added to it. Note that the community presumption can be overcome by a tracing of separate funds, absent a written agreement expressing a clear intent the funds will be community property. The community property presumption can also be overcome by a separate written agreement providing the sums are not community property. These exceptions are reasonably consistent with the requirements of Section California Civil Code 5110.730, but the basic community presumption is not.

The transmutation statute should be clarified as to the form of the declaration required for a transmutation, and coordinated with all other presumptions, including the title

presumption set forth above. As illustrated by the law of various other jurisdictions, where transmutations have not been as "easy" as in California, there seems to be at least some distinction between marital property agreements and interspousal gifts.

If, as Professor Reppy and language in the dissenting opinion in MacDonald indicate, the real intent of the legislature in adopting the changes in transmutation was to adopt a statute of frauds in this area, why not simply do so? Since extrinsic evidence can be used under the statute of frauds, this would make transmutations easier than under the strict express declaration requirements of present law. This could in turn increase litigation. On the other hand, requiring some writing to support the alleged transmutation seems to eliminate the principal evil of the prior system, i.e., accepting oral testimony as the only basis for establishing a transmutation. Further, the litigation that is likely to result from the express declaration test of Mac Donald, (where titles and presumptions may have to be ignored, and the tracing required whenever funds of one classification are used to acquire, maintain, or improve property of a different classification) will not discourage legal disputes which must be resolved by the courts.

Should the statute require the use of the word "transmutation"? This is a term of art that would rarely be employed by lay persons, and would as a practical matter limit transmutations to agreements prepared by attorneys. It is

doubtful the legislature intended to narrow the scope to that degree. Would the use of "gift" language be sufficient? It should be, as it conforms to the general understanding that when one person makes a gift to another, he or she is transferring an interest in that property to the other person. MacDonald certainly supports that position, but in view of case law to the contrary, it should be spelled out in the statute.

In the case of joint titles, there should at least be a written document in which both spouses have agreed to the use of that title. If title is simply conveyed to a husband and wife as joint tenants or tenants in common, or even as community property, there is no express written declaration which satisfies the statute. This is likely to be a controversial area, since joint forms of title can be so easily created without the involvement or both, or in some cases either spouse. However, this would allay much of the criticism of California Civil Code Sections 4800.1 and 4800.2. It at least guarantees the creation of joint titles is a conscious act of both spouses, whether or not they really understand the legal consequences of that form of title.

What is the status of such writings as signatures on checks or deposit slips? Endorsements on checks deposited in joint accounts? Tags on birthday presents reading "Mary, with love, from Bill"? It is doubtful these writings would meet the express declaration requirement in MacDonald See W.

Reppy, Tricky Transmutation Law in California, Vol. 2. No. 8, Community Property Alert, Nov. 1990. Where the language is unclear, as in the above situations, or in the case of so-called "waivers" or consents, as in MacDonald, extrinsic evidence of intent to transfer should be permitted. The requirement of some written evidence of a transfer should reduce, but will not eliminate, the problems of uncertainty and easy transmutation discussed in MacDonald. The threshold requirement would be a written instrument which could be construed to alter the property rights of the party who signs. In addition, there would have to be evidence of an intent to transfer or transmute, which could be oral. If there is an express written declaration, as required under MacDonald, there is a transmutation which would not be subject to attack absent fraud, breach of fiduciary duty, etc. In the absence of an express declaration, the burden of proof would be on the party seeking to establish the transmutation.

Basically, whenever a deed or document of title is executed by one spouse in favor of the other, there is a reason to at least infer, if not presume, that a gift has been made. Dunn v. Mullan, 211 Cal. 583, 296 P. 604 (1931); Marriage of Frapwell, 49 Cal. App. 3d 597, 122 Cal. Rptr. 718 (1975). As noted above, the presumption has been frequently applied in most other community property states, despite their requirement of a writing to support a transmutation by agreement. It should not matter whether the form of transfer recites it is a gift. Professor Reppy suggests that a formal

conveyance from one spouse to the other should raise a presumption of transmutation by gift. W. Reppy, Debt Collection from Married Californians: Problems Caused by Transmutations, Single-Spouse Management, and Invalid Marriage, 18 San Diego L. Rev. 143, 162-168 (1981). This may go too far, since interspousal transfers occur for a variety of reasons, such as to facilitate financing, or to simplify management, which would not indicate an intent to transmute the property by gift or otherwise. In Bruch, Management Powers and Duties Under California's Community Property Laws: Recommendations for Reform, 34 HASTINGS L. J. 227 (1982), the author convincingly argues that in the modern era of equal management, interspousal transfers may be commonplace for a variety of reasons, and should give rise to no presumptions. However, such a gift presumption would tend to discourage litigation, and still leave the door open to use of extrinsic evidence to rebut the presumption.

The present law requires the signature of the spouse who is adversely affected, or at least requires that spouse join in, consent to, or accept the declaration. In many cases, such as transmutation from community to joint tenancy or tenancy in common, it does not appear either party may be adversely affected. The language of the statute should be clarified to require the signature of both spouses where the pre-existing rights of both spouses in the property are being altered by the transmutation, but should not require the

signature or written consent of a spouse who had no interest in the property prior to the transmutation.

Would easing the "express written declaration" requirement of California Civil Code Section 5110.730 be contrary to the legislative intent in adopting it? Reference to the report of the Law Revision Commission Report recommending the change in 1983, 17 Cal. L. Revision . Comm'n. Reports, p. 213-214 (1984), indicates the following:

> (a) The convenience and practice of informality recognized by the rules permitting oral transmutations must be balanced against the danger of fraud and increased litigation caused by it. The public expects there to be formality and written documentation or real property transactions, just as it expects there to be formality in dealings with personal property involving documentary evidence of title, such as automobiles, banks accounts, and shares of stock. Most people would find an oral transfer of such property, even between spouses, to be suspect and probably fraudulent, either as to creditors or between each other."

Assuming this was the basis of legislative action, the report suggests formality of transfer is an element, as well as transfer of title. This in turn supports the strict interpretation of the statute in the MacDonald opinion. However, it is difficult for the author to understand why the rules for interspousal transfers should be more difficult than those which pertain to contracts under the statute of frauds.

All California Civil Code Section 1624 requires to satisfy the statute of frauds is that certain contracts, "or some note or memorandum thereof, is in writing and subscribed by the part to be charged or by his agent." This is far short

of an "express declaration in writing" as that term is defined by the California Supreme Court in MacDonald. The statute of frauds does not require the contract itself to be in writing; if there is the required note or memorandum, an oral contract is enforcable. See generally, Witkin, Summary of California Law (9th ed. 1990) Contracts, Section 269. The writing may be informal and consist of one or more actual writings. Witkin, supra, Section 270. Nor is there any requirement that the writing be intended as a memorandum of the terms of a contract. Witkin, supra, Section 271.

The extent to which the writing must identify the property in question or set forth the essential terms of the contract is not clear. See generally, the discussion in Witkin, supra, Sections 272-276. If the "written memorandum" test were applied to interspousal transfers, issues are certain to arise as to the sufficiency of the writing, the description of the property being transferred, and even the fact of the transfer itself. While case law interpreting the statute of frauds would be helpful in resolving these issues, the fact it is geared to certain specific contractual arrangements such as real property transfers, employment agreements, and sales of goods, will make many judicial decisions irrelevant, particularly since interspousal transfers and agreements may be without consideration. The statute of frauds is simply not geared to gift transfers. Nor is it clear whether or not it covers agreements between spouses which would otherwise fall within its scope.

It should be noted the other statute of frauds in California is California Civil Code Section 1091, limiting transfers of most estates in real property to instruments in writing signed by the transferor or his or her agent. This rule would apply to deeds of gift as well as contractual conveyances. Note in this respect California Civil Code Section 5110.730 seems to require less, if we assume a transmutation of real property could be based on a "consent" or "acceptance", which would not necessarily be executed by the transferor spouse. This is another reason to amend the transmutation statute to require the signature of the transferor spouse.

Marital agreements are covered generally by Title 11 of the California Civil Code, Chapter 1, Sections 5200 through 5203 and Chapter 2, and Sections 5300 through 5317, adopting the Uniform PreMarital Agreement Act. To the extent premarital agreements cover property rights, as they do in California Civil Code Section 5312(1), the only real distinction between between premarital agreements and other marital property agreements are the disclosure requirements in Section 5315 under which one spouse may be required to furnish financial information to the other. However, these express disclosure requirements for premarital property agreements may be motivated by the fact the parties deal generally at arm's length in premarital agreements, when they are not in a confidential relationship, as illustrated by In re Marriage of

Dawley, 17 Cal. 3d 342, 551 P. 2d 323, 131 Cal. Rptr. 3 (1976). Under California Civil Code Section 5103, any interspousal agreements made after marriage are covered by a strict confidential relationship rule, which imposes a higher standard than premarital agreements.

There appears no reason why a premarital or marital property agreement which transmutes property rights will not also meet the requirements of California Civil Code Section 5110.730, as they would presumably contain express declarations and must be in writing. However, some clarification of this relationship would be helpful.

To what extent does California law impose a general requirement of a writing to gifts? There are few statutes pertaining to gifts in California. California Civil Code Section 1146 defines a gift as a voluntary transfer of personal property made without consideration. Section 1147 indicates verbal gifts are not valid unless the means of obtaining possession or control of the thing is given, and if it is capable of delivery, there must be actual or symbolic delivery. This leads Witkin to conclude that there cannot be an oral gift of a chose in action, and something such as a written assignment or delivery of a chose evidenced by a writing, such as a savings account passbook, would be necessary. 4 Witkin, Summary of California Law, Section 110 (9th ed. 1987). In the case of stock certificates, endorsement by the donor is not essential. Crane v Reardon, 217 Cal. 531, 20 P. 2d 49 (1933). Estate of Walsh, 66 Cal. App. 2d 2d 704,

152 P. 2d 750 (1944), held that where the husband bought jewelry with community funds for his wife on special occasions, there was evidence of delivery but not intent to make a gift, and held that in the absence of a written transfer, the property was still presumed to be community.

Gifts of real property are not covered by these statutes. However, since any conveyance of an interest in real property, other than an estate at will or a term of less than one year must be in writing, as already discussed, that should control gift transfers.

V. RECOMMENDATIONS FOR CHANGE

The following recommendations attempt to better balance the clear legislative intent to eliminate California's "easy" oral transmutation rule and the resulting impact on litigation and creditors' claims with the harsh consequences of California Civil Code Section 5110.730 as interpreted by MacDonald. They are based on a general assumption that it should be no more difficult for husbands and wives to enter into agreements with each other or transfer property to each other than unmarried persons, while at the same time recognizing that the nature of the marriage relationship makes it difficult to prove such transactions have occurred without some formality. They conclude that a requirement of some written evidence of the transmutation, whether by agreement or gift, is the best way to accomplish these goals.

The statutory language relating to premarital agreements and marital property agreements should be coordinated and cross-referenced, and should be brought under the statute of frauds. In addition, the transmutation rules should, in the case of such agreements, eliminate the present language of California Civil Code Section 5110.730 and substitute an express reference to such agreements.

In line with the distinction noted in many other states, California Civil Code Section 5110.730 should include within the specific scope of transmutation any transfer of property from one spouse to another, including gifts, and require a writing signed by the spouse who is transferring or is "adversely affected" by the transfer, so long as that writing would satisfy the statute of frauds. This would cover both sales and gifts of property from one spouse to the other where there is no formal agreement.

The result of these statutory changes would be a less formal transmutation statute, expressly covering premarital agreements, marital property agreements, and interspousal transfers, requiring a writing, but not an express declaration, and bringing into play a well developed body of law under the statute of frauds to limit the extent to which extrinsic evidence could be used to prove the effect of the writing. Also, the law should clearly require both spouses, in the case of agreements, or transferor spouse in the case of gifts or other transfers, to actually sign the writing, which is not clear under the present law.

To discourage litigation, which obviously was a legislative concern in adopting the new transmutation rules, the following presumptions affecting the burden of proof should be considered:

(1) Where one spouse executes a deed or document of title naming the other spouse as sole owner of the property, or sole owner of an interest in the property, such as a life estate or tenancy in common, a transmutation by gift should be presumed. As the cases indicate, that would have been the presumption prior to the adoption of California Civil Code Section 5110.730. W. Reppy, supra, 18 San Diego L. Rev. at 162. It also satisfies the legislative intent by requiring written documentation. However, since not all interspousal title transfers are intended to result in transmutations, extrinsic evidence should be admitted to overcome the presumption.

(2) Any writing which uses the words "gift" or "give" in connection with the delivery of property from one spouse to another, signed by the transferor, should raise a presumption of gift and transmutation. The MacDonald opinion assumes this would be sufficient, and despite case law to the contrary, it makes sense.

Would the proposed changes have a dramatic impact on the rights or creditors to reach marital and separate property? In his article, Professor Reppy concluded that informal or "easy" transmutations under the pre-1985 law were probably

binding on creditors, absent actual or constructive fraud. W. Reppy, supra, 18 San Diego L. Rev. 143. He suggested that a requirement of a writing and even recordation of the writing should be required to bind creditors. The 1985 changes did not go that far. However, the "express declaration in writing" rule generally has the same effect. Also, California Civil Code Section 5110.730(b) specifically provides that a transmutation of real property is not effective as to third parties without notice thereof unless recorded. Creditors are further protected by California Civil Section 5110.720 from a transmutation of property which would be a fraudulent transfer under any applicable law. Consider in particular California Civil Code Section 3440, under which transfers of personal property not accompanied by delivery followed by "actual and continued change of possession" of the property transferred is conclusively presumed fraudulent in the case of the transferor's creditors. Several cases have applied this rule to interspousal transfers, Murphy v. Mulgrew, 102 Cal 547 (1894), 36 P. 857;, Pfunder v. Goodwin, 83 Cal. App. 257, 257 P. 119 91927); 551, and on the federal level, Allen v. Meyer, 195 F. 2d 940 (9th Cir. 1952). As Professor Bruch discusses in her article, supra, the lack of formalities of delivery of possession in a marriage makes it extremely difficult to establish a transmutation has occurred. At least the requirement of a writing to establish the fact of such a transfer puts the debtor in no worse position.

The revised transmutation rules proposed here might have some adverse affect on creditors, since they would require less than an express declaration. However, the impact would be minimal. The so-called abuse under the pre-1985 easy transmutation rules was the use of oral testimony, often totally unsubstantiated, to establish a transmutation or real or personal property from community to separate or separate to community to the detriment of creditors. Under present law, even the "express written declaration" which will be required for an effective transmutation will, in the case of real property, not affect third persons, which presumably includes creditors, unless recorded. The adoption of a more lenient statute of frauds test will not change that result, unless California Civil Code Section 5110.730(b) is repealed or amended, and that is not part of these proposals. It is true that a recorded conveyance of real property from one spouse to the other, or into or out of any form of joint ownership, could be characterized as a transmutation with the aid of extrinsic evidence. But the change in the form of title should be sufficient notice to creditors, without an additional requirement of an express declaration in writing.

In the case of personal property, the substitution of a writing sufficient to satisfy the statute of frauds for the express written declaration does not alter the application of California Civil Code Section 3440. However, if there is clearly a delivery and change of possession of personal property, the requirement of an express written declaration

would give a creditor of the transferor the ability to establish there was no transmutation, while a writing short of an express declaration permits the introduction of extrinsic evidence. For example, if husband makes an assignment in blank of a stock certificate which is community property and delivers the certificate to his wife, and she in turn places it in a safe deposit box which she maintains in her name alone, husband's signature on the certificate might be a sufficient writing to permit extrinsic evidence of delivery and change of possession, and a completed gift and transmutation to the separate property of wife. A creditor would then have to prove there was no intent to transfer, i.e., husband wanted wife to assume full management of the securities in question, but did not intend to make a gift. Obviously, there would be no express declaration in writing to effectuate a transmutation under present law. On the other hand, the requirement of change of possession and delivery in the context of a marriage is so unrealistic that California Civil Code Section 3440 gives creditors more protection than they are entitled to in any case. The issue is more complicated where the gift is conversion of separate personal property of one spouse to community property, since such elements as delivery are often lacking. For example, if a husband "transmutes" an inherited work of art into community property, it will in all probability continue to hang on the wall of the family home. In this case, the requirement of some writing does afford protection to creditors.

In the case of premarital and marital property agreements between the spouses, the changes proposed below only seek to clarify their relationship to the transmutation statute. In virtually every case, any transmutation which results from the provisions of such agreements would constitute express declarations in writing signed by both spouses. Creditors and any other persons should be in no better or worse position under the proposed changes then under present law.

VI. PROPOSED STATUTORY LANGUAGE FOR TRANSMUTATIONS

Section 1624 of the California Civil Code should be amended by adding a new subdivision (h) as follows:

> "(h) Marital agreements, including marital property agreements and premarital agreements as defined in Title 11 of this Code."

Comment: This will bring all marital agreements under the statute of frauds, regardless of what they cover.

Section 5201(a) of the California Civil Code would be amended to read as follows:

> "(a) The property rights of husband and wife prescribed by statute may be altered by a premarital agreement which meets the requirements of Chapter 2 of this Title or other marital property agreement."

Comment: This change is intended only to cross reference the Uniform Premarital Agreement Act for clarification.

A new Section 5204 would be added to the California Civil Code to read as follows:

> "A "marital property agreement" means an agreement in writing and signed by both parties, with or without consideration, which

> relates to the rights and obligations of the parties in any of the property of either or both of them whenever and wherever acquired or located."

Comment: This follows the language of California Civil Code Section 5312(a)(1) relating to premarital agreements. There is no reason not to conform these provisions.

A new Section 5205 would be added to the California Civil Code, to read as follows:

> For purposes of marital property agreements, "property" means an interest, present or future, legal or equitable, tangible or intangible, vested or contingent, in real or personal property, including present or future income from the property and present and future earnings of the spouses.

Comment: This definition of property is based on the premarital agreement language in California Civil Code Section 5310(b), but is broadened to specifically cover intangible property and future earnings. This will provides additional flexibility in planning by the spouses, particularly as to future income, although the tax consequences of such agreements are unclear.

A new Section 5206 would be added to the California Civil Code, to read as follows:

> "A marital property agreement may be amended or revoked only be a written agreement signed by the parties. The amended agreement or revocation is enforceable without consideration."

Comment: This is the language relating to premarital agreements used in California Civil Code Section 5314.

A new California Civil Code Section 5206 would be added, to read as follows:

> Premarital agreements and marital property agreements may alter or transmute the property rights of the parties as provided in California Civil Code Section 5110.710, subject to the provisions of Sections 5110.720 to 5110.740, inclusive.

Comment: It must be clear which statute controls transmutations. While marital agreements can transmute property, they should be subject to the additional requirements of the specific transmutation provisions.

California Civil Code Section 5203 would be amended as follows:

> "Nothing in this chapter or Chapter 2 of this title affects the validity or effect of premarital agreements made before January 1, 1986, and the validity and effect of those agreements shall continue to be determined by the law applicable to the agreements prior to January 1, 1986.

Comment: This simply restates the present section, but adds the missing reference to Chapter 2. Note that a similar provision should probably be added for the changes made to both premarital and marital property agreements under these changes.

California Civil Code Section 5110.710 would be amended to add paragraph (d), as follows:

> "(d) As used herein, "property" means an interest, present or future, tangible or intangible, vested or contingent, in real or personal property, including present or future income from property and present or future earnings."

Comment: This broadens the definition of property for reasons outlined above.

California Civil Code Section 5110.730(a) would be amended to read as follows:

> "(a) A transmutation of real or personal property is not valid unless (i) pursuant to a premarital agreement or a marital property agreement described in Title 11, or (ii) pursuant to an instrument, note or memorandum in writing evidencing an intent to transfer, to consent to the transfer of , or to waive a property right, signed by the transferor spouse or spouse whose property interests would be adversely affected by the transmutation. For purposes of determining the nature and effect of such written instruments, notes or memoranda, extrinsic evidence may be admitted to the extent not inconsistent with the express written provisions. If the writing is a deed or other document of title executed by one spouse naming the other spouse as sole owner of the subject property, co-owner of the property with a person or persons other than the grantor, or owner of a limited interest in the property, such as a life estate, this is presumed to be a transfer to the transferee spouse which transmutes the property or interest in property to the transferee's separate property. The transfer of real or personal property from one spouse to the other accompanied by a writing signed by the transferor in which the transferor indicates an intent to make a gift to the donee spouse shall be presumed a gift which transmutes the property to the separate property of the transferee spouse. These are presumptions affecting the burden of proof.

Comment: This language would overrule MacDonald by eliminating the "express declaration" language, expressly cover premarital and marital property agreements, require the writing to be signed by both spouses, if pursuant to an agreement, or the spouse being divested of property rights, if a gift or other transfer, and subject all writings to a

statute of frauds test. Since extrinsic evidence can be admitted if the written instrument is not clear on its face, the statute includes presumptions in favor of transmutation where there is an express title transfer or asset transfer accompanied by a writing which indicates an intent to make a gift. Note that this proposed statute is still inconsistent with the joint title presumptions discussed above, and if it is determined those presumptions should be preserved, that should be added, possibly with language such as the following:

> Notwithstanding the foregoing provisions, if title to property is held in a form of ownership specified in Civil Code Sections 4800.1 or 4800.2, or in an account specified in Probate Code Section 5305, the rules and presumptions of those provisions will be fully applicable. Further, if title to real or personal property is held in joint tenancy in accordance with Civil Code Section 683, it shall pass by right of survivorship to a surviving joint tenant or joint tenants.

The issue of retroactivity is a difficult one, and must be addressed. Since this statute does potentially vary the requirements for a contract or agreement between spouses, it should not be retroactive. A strong argument could be made that this change only clarifies pre-existing law, and that since it imposes a more relaxed standard than the express declaration in writing required under present law, it would not interfere with existing contacts which meet the more stringent standard. However, it could also have the effect of making an informal transfer that would not meet the express declaration requirements into a completed transmutation, and

that could be construed as an interference with existing property rights.

In the course of preparation of that part of this study pertaining to marital property agreements, the provisions of California Probate Code Section 140-147 relating to waiver or rights by a surviving spouse were also reviewed. Although not directly in point as to transmutation, it is clear such waivers can result in a transmutation at death to the extent the waiver changes property rights. In general, these provisions add an additional requirement to waivers or agreements by requiring representation by independent legal counsel under several circumstances. This is of course inconsistent with the requirements for a marital property agreement or a transmutation under California Civil Code Section 5110.730. However, in the case of premarital agreements, California Probate Code Section 147(c) provides that the law relating to such agreements will control over the Probate Code provisions. Again for purposes of clarification, it may be wise to add some language to California Civil Code Section 5110.730 along the following lines:

> To the extent property rights which are the subject of transmutation under these provisions include rights of a surviving spouse described in Probate Code Sections 141, the validity of any agreement, transfer or waiver of such rights shall be determined under the provisions of Probate Code Sections 140-147.

VII. GIFTS OF COMMUNITY PROPERTY TO THIRD PERSONS

California was probably the first community property state to provide by statute that a husband could not make a gift of community property without the consent of his wife. 1891 Cal. Stat. 425, ch. CCXX, Section. 1. This rule was the outgrowth of the Spanish rule that in exercising management and control over the community property, the husband was acting in effect as a business manager. Viewed from that perspective, a transfer for inadequate consideration would not be in the bests interests of the community, and was probably invalid, at least if material. DeFuniak & Vaughn, Principles of Community Property (2nd ed 1971).

With the advent of equal management and control of community property, generally effective January 1, 1975, California Civil Code Section 5125(b) provided that "A spouse may not make a gift of community personal property or dispose of community personal property without a valuable consideration." This version of the law seems to make such gifts absolutely void regardless of whether or not both spouses consented or joined in the gift, and regardless of the existence of a written consent or agreement. Prior to January 1, 1975, the law provided that a gift required the written consent of both spouses. The obvious defect in the statutory language was remedied in 1978 by adding to California Civil Code Section 5125(b) the words "without the written consent of the other spouse."

Note the statutes do not contain similar language for community real property, apparently on the assumption that the language of California Civil Code Section 5127 providing for the joinder of the spouses in any written conveyance or encumbrance of community real property provides the necessary protection. The rights of the nonconsenting spouse have certainly been fully protected where a gift of real property is concerned. For example, in Gantner v. Johnson, 274 Cal. App. 2d 869, 876, 79 Cal. Rptr. 381, 386 (1969), the court held the nonconsenting spouse could set aside the gift of real property in its entirety during her lifetime, regardless of the language of California Civil Code Section 5127 indicating she should have taken some action within a year after the conveyance by her husband was recorded.

California Civil Code Section 5125.1 creates a cause of action by one spouse against the other for breach of the duty imposed either by Sections 5125 or 5127 with respect to management and control of the community, which would include making gifts without the consent of both spouses. This action can be brought independently of any action for dissolution of the marriage, legal separation, or annulment of the marriage. What is not clear is the form of relief, i.e., if the nonconsenting spouse obtains a money judgment against the other spouse, how is it paid? Does it come out of the donor's "share" of community property? Does it constitute separate property of the nonconsenting spouse?

Although there is no de minimus rule permitting gifts by one spouse without the consent of the other in the statutes, case law seems to recognize small gifts are not subject to the rule. See Modern Woodmen of America v Gray, 113 Cal App 929, 299 P. 754 (1931). Compare this with the de minimus transmutation rule of California Civil Code Section 5110.730(c), under which an express written declaration is not required for gifts between the spouses of clothing, wearing apparel, jewelry or other tangible articles of a personal nature for use by he donee spouse and not substantial in value taking into account the circumstances of the marriage.

If one spouse makes a gift of community property without the consent of the other, the courts have variously described this as at a minimum a breach of the donor spouse's fiduciary duties and at worst a fraud against the other spouse. Fields v. Michael, 91 Cal. App. 2d 443, 204 .P. 2d 402 (1949). In either case, the nonconsenting spouse may either seek to set aside the gift, and recover the property, or seek reimbursement from the donor spouse. Fields, supra, Trimble v. Trimble, 219 Cal. 340, 26 P. 2d 477 (1933). Prior to the adoption of California Civil Code Section 5125.1 in 1986, it was only possible for the nonconsenting spouse to seek reimbursement from the other spouse when the community terminated by reason of dissolution or death.

Despite language in the cases referring to gifts made without the consent of both spouses as fraudulent or void transfers, the present state of the law is that such gifts are

only voidable, and only voidable by the nonconsenting spouse. Spreckels v. Spreckels, 172 Cal. 775, 158 P. 2d 537 (1916). As a result, after the marriage has terminated, the nonconsenting spouse can seek to set aside only one-half of the invalid transfer. Where the marriage is ended by dissolution, California Civil Code Section 4800(b)(2) also permits, as an award or offset against the property division, any sum the court determines was "deliberately misappropriated" by one spouse to the detriment of the other, which could be construed to include unauthorized gifts.

Until the marriage is dissolved by dissolution or death, the right to set aside the gift in its entirety can still be pursued by the nonconsenting spouse. See Britton v. Hammell, 4 Cal. 2d 690, 52 P. 2d 221 (1936); In re Marriage of Stephenson, 162 Cal. App. 3d 1057, 209 Cal. Rptr. 383 (1984).

The preceding discussion focuses on gifts and lifetime transfers which are complete during the lifetime of the donor or donors. Where the purported "transfer" is incomplete, i.e., revocable, will the same rules apply?

At common law, a gift causa mortis was a transfer that takes effect at death. In Odone v Marzocchi, 34 Cal. 2d 431, 212 P. 2d 233 (1949), a spouse transferred cash to a friend just before spouse entered the hospital, with instructions to pay her bills and return the money to her if she survived, otherwise keep it. She died eight days later, and husband sought to set aside the entire transfer. The court held it

was a valid gift causa mortis and husband could recover only one-half. At common law, the gift was complete when made, subject to a condition subsequent, death. This distinction may be very important, since under California law, the statutory language defining a "gift in view of death", discussed below, indicates the gift only takes "effect" at death, and is treated as a legacy for purposes of creditors claims.

The California Supreme Court developed the concept of an "inchoate gift" to characterize such transfers in Travelers Insurance Co. v. Fancher, 219 Cal. 351, 26 P. 2d 482 (1933). On the same day, the court also decided Trimble v. Trimble, 219 Cal. 340, 26 P. 2d 477 (1933), which involved deathbed gifts of community property by deed. Although the concept of a gift in view of death was not discussed in either case, the Trimble facts sound like one.

California Civil Code Section 1149 defines a "gift in view of death" as one made in contemplation, fear, or peril of death, including a gift made during the last illness of the giver. California Civil Code Section 1149. A gift in view of death may be revoked by the giver at any time, and is revoked by recovery from illness or escape from peril, or the occurrence of any event which would revoke the giver's will at the same time. California Civil Code Section 1151. However, if the property has been delivered, a bona fide purchaser is protected. The gift is viewed as a legacy insofar as

creditors of the donor are concerned. — California Civil Code Section 1153.

The California Law Revision is presently considering changes in the statutes pertaining to gifts in view of death. See CAL. L. Revision Comm'n Staff Memoranda 90-54 (March 20, 1990), 90-139 (November 15, 1990), Gifts in View of Death. If recommended, these changes should include consideration of the issues raised by this study and the impact of the MacDonald decision. The same applies to proposed changes in the California Probate Code involving nonprobate transfers of community property, CAL L. Revision Comm'n Staff Memorandum 90-109 (July 12, 1990).

Under existing Civil Code Sec 1146, a gift in view of death is a gift only of personal property made in contemplation, fear, or peril of death, which is intended to take effect only if the giver dies. If the giver recovers or escapes the peril, the gift is revoked. California Civil Code Section 1149. It can also be revoked during the lifetime of the giver. Memorandum 90-54, supra, page 7, indicates "A gift in view of death of community or quasi-community property is subject to the rights of the giver's spouse. See California Civil Code Section 5125, California Probate Code Section 101-102." If California Civil Code Sec 5125 applied, both spouses would have to consent to a gift in view of death for it to be effective at all.

The determination of whether the transfer is complete during life or only at death may be critical in deciding the impact of the consent of the spouse. If the consent is given, and the transfer is legally complete, it would seem under existing law the consent cannot be withdrawn, and that the consenting spouse cannot make a testamentary disposition of his or her community interest in the property. The question is whether or not the gift in view of death is a completed transfer subject to a condition subsequent, death. Under the California statute, this is by no means clear. The statute indicates it "takes effect" at death and is treated as a legacy for purposes of creditors claims. This does not sound like a completed transfer subject to a condition subsequent. On the other hand, the statute indicates the transfer can be revoked - it would seem the concept of revocation applies only to recall something which has already been transferred. However, whether such transfers are complete or incomplete, they really takes effect only at death, and insofar as community property transfers are concerned, should be treated in the same manner as other transfers which take effect at death.

Where the subject matter of a gift is community property, it must be determined whether or not it is complete when made or only takes effect at death. If the gift is complete when made, and both spouses consent, neither spouse can set it aside. If the gift only takes effect at death, even

consenting spouses should retain their community interests for all purposes, as there is no complete transfer.

A more modern version of the gift or transfer taking effect at death is a revocable transfer of property which becomes a completed gift at death if not revoked, sometimes called an "inchoate gift" or a nontestamentary disposition. These transfers include revocable trusts, as illustrated in S. Katz, 382 F. 2d 723 (9th Cir. 1967); revocable beneficiary designations under life insurance policies, described in Travelers' Insurance Co. v Fancher, supra, and Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 243 P. 431 (1926); revocable beneficiary designations under employee benefits plans, such as pension plans, profit sharing plans, and deferred compensation plans, as illustrated by the MacDonald decision; Totten trusts, i.e., bank accounts held by one person in trust for another, where the creator/trustee of the account can revoke the transfer during his or her life by withdrawing funds from the account, but the funds pass to the beneficiary at the trustee's death; and various "pay on death" or "transfer at death" forms of holding title to bank accounts and other property. See Estate of Wilson, 183 Cal. App. 3d 67, 227 Cal Rptr 794 (1986). In Travelers Insurance, Blethen, and Wilson, the courts held that some of these forms of nonprobate transfers were gifts intended to take effect at death. As a result, after the death of the transferor, they could only be set aside as to one-half by a spouse who did not consent to the transfer.

If the transfer is not complete until death, i.e., is not a transfer subject to a condition subsequent, how does the consent of of one spouse to a transfer of community property by the other spouse affect the consenting spouse's community property rights while both spouses are alive? Since there has been no transmutation, there should be no effect. Each spouse retains his or her community rights. The transferor spouse can revoke the transfer, and the consenting spouse should be able to revoke his or her consent.

However, if the consenting spouse survives the other spouse, does the consenting spouse have a right to set aside the transfer as to his or her community interest? In this situation, even though the transfer takes effect at death, it can be argued the other spouse gave his or her written consent to the transfer, and the gift is complete at the death of the transferor spouse. The consent should therefore be irrevocable, as it would have been if the transfer occurred during the lifetime of both spouses. In fact, California Civil Code Section 5125(b) should require this result - the deceased spouse did dispose of or make a gift of community property with the written consent of the other spouse. In the Mac Donald case, had the husband died first, there should have been no legal basis for the wife to revoke her consent to the beneficiary designations under the IRA accounts.

If the consenting spouse predeceases the other spouse, can the estate of the deceased spouse seek to set aside his or

her community interest in the transfer? If the deceased spouse could have revoked his or her consent while alive, it can be argued that his or her estate can exercise the same power. Or is the consent to the transfer in fact a gift by the deceased spouse, which becomes complete and irrevocable at his or her death? If the personal representative of the consenting spouse can revoke his or her consent, as was permitted in MacDonald, the personal representative of the transferor spouse should have the same right to revoke the gift, at least as to that spouse's community interest, if he or she dies first. Otherwise, equal treatment of the spouses is being denied. If MacDonald is carried to that illogical conclusion, there can never be a transfer of community property which is effective at death of the first spouse.

On the other hand, it can be argued that since the transfer in question here is an inchoate or revocable gift, it only becomes complete when the donor spouse, i.e., the one who makes the transfer, dies, and is not complete to any extent when the consenting spouse is the first to die. Under this argument, the consent can be revoked during the lifetime of the donor spouse, and the right would extend to the personal representative of the predeceased consenting spouse. To follow this view, one must assume, as the courts appeared to assume in MacDonald, that the consent was conditional, i.e., based on the assumption that the donor spouse is the first to die. It also assumes that the consenting spouse intended the

consent be revoked and the community property interest pass under his or her will if he or she is the first to die.

If the consenting spouse dies first, can the other spouse revoke the gift? Assuming the consenting spouse is deemed to have made a gift which is complete at death, a doubtful presumption under MacDonald, the other spouse should also be precluded from setting it aside as to his or her community interest. If the transferor spouse can revoke the gift, as would certainly be possible if separate property is involved, how could that revocation affect the community interest of the predeceased consenting spouse? If we assume the consenting spouse knew what he or she was doing when that spouse consented to the gift, then we should assume, as the courts failed to do in MacDonald, that he or she wanted the property to pass to the designated donee or beneficiary, and once the consenting spouse is dead, the designation should be irrevocable insofar as his or her community interest in the subject matter of the transfer is involved.

It is clear that the courts have treated a gift intended to take effect at death in the same manner as a gift which is complete during the donor's lifetime - if the other spouse does not expressly consent to the transfer, he or she is entitled to set it aside. However, since these transfers only take effect at death, the other spouse can only set it aside as to his or her one-half community interest. Where the other spouse has consented to the transfer, the answer is less clear. If the gift is not complete until death, it appears

either spouse should be able to revoke it. But if either spouse dies, and the gift is complete to any extent, it seems the other spouse should have no power to set it aside, even though it is deemed to take effect at death. However, this conclusion is clearly inconsistent with the contract rights under life insurance policies, death benefits, and other forms of beneficiary designations which give one spouse, generally the owner of the life insurance policy or the participant in the death benefit plan, the right to change beneficiaries, or revoke a beneficiary designation. If a husband has the power to name a beneficiary of a life insurance policy which is community property, and does so with the written consent of his wife, the death of the wife would not preclude the surviving husband from changing the beneficiary under the terms of the policy.

CAL L. Revision Comm'n Memorandum 89-106, Disposition of Community Property (Donative Transfers and Revocation of Consent), November 3, 1989, suggests the revocability or irrevocability of a consent may depend on whether or not the gift is complete, i.e., there has been a delivery. There are problems with that approach. A gift in view of death may involve a completed transfer, subject to revocation. A beneficiary designation involves no transfer at all. A Totten trust technically does involve a transfer, "A in trust for B", but it is clearly revocable. The Memorandum goes on to treat all these transfers the same, i.e., regardless of the

technical form, the transfer is not really effective until death. That seems by far the best approach.

Commentators have suggested that MacDonald applies literally to will substitutes and possibly even to wills, on the theory that the transfer at death may have the effect of converting community property into the separate property of one spouse, or separate property of one spouse into the separate property of the other spouse. See Reppy, Tricky Transmutation Law in California, Community Property Alert, November 1990 at 1.It is true that some California cases have indicated there is a "transmutation at death", see in particular the insurance cases cited below. The issue the Supreme Court decided in MacDonald was whether the consent transmuted the IRA accounts into the separate property of the surviving spouse. The beneficiary named was not the surviving spouse, rather a trust created by the surviving spouse. If this broad reading of Civil Code Sec 5110.710 were followed, no transfer at death would be effective unless it met the specific requirements of the transmutation statutes. The issue in MacDonald was whether Mrs. MacDonald made a lifetime transfer of her interest in the IRA accounts, not a transfer effective at her death. In fact, the real weakness in both MacDonald opinions is the failure to recognize that is exactly what Mrs. MacDonald did - make a testamentary transfer of her interests in the accounts through the medium of her signature to the consent, which is a satisfactory form of will substitute. It seems unlikely the legislature intended to

extend the transmutation statute to transmutations which take effect at death, and it is doubtful MacDonald stretches that far.

If Mrs. MacDonald's action is correctly interpreted as a testamentary act under the various theories just discussed - inchoate gift, or gift which takes effect on death; nonprobate transfer; or gift in view of death; then the issues that should have been considered become clear. Could she revoke the consent during her lifetime? The answer generally would be "yes", just as she could generally revoke a will, revocable trust, or beneficiary designation. Can it be revoked after her death by her successors or personal representative? Not unless the law is that all testamentary and nonprobate transfers of property can be revoked after the death of the testator or transferor. The Supreme Court must be criticized for the cavalier way in which this issue was treated in footnotes 4 and 5 of its opinion. Footnote 4 suggests, without any real support other than a lack of evidence, that Mrs. MacDonald had no idea of the nature and extent of her rights in the IRA accounts, and footnote 5 rejects the idea that her consent was a will substitute on the same theory - there was no evidence she knew it was a will substitute. Note the criticism of these statements in the dissenting opinion, MacDonald, supra at 267, pointing out that Mrs. MacDonald was an "intelligent and financially sophisticated woman" and suggesting a sexist overtone to the argument that she executed the consent without really knowing what she was doing.

Assuming a spouse revokes a consent during his or her lifetime, than his or her community interest will be distributed at death as if the consent had not been given. Should there be a requirement of notice of revocation to the other spouse? Since there is generally no requirement that the spouse who names the beneficiary or makes the nonprobate transfer notify the other spouse of his or her action, no notice should be necessary either way.

The spouse who names the beneficiary can revoke the beneficiary designation or the nonprobate transfer of community property. If this is done while both spouses are alive, it would clearly revoke any consent of the other spouse. But if it is done after the death of the consenting spouse, one of three possible results will follow:

(1) By consenting to the original beneficiary designation or transfer, the predeceased spouse waived, transferred, or transmuted his or her community interest to or in favor of the surviving spouse. The new beneficiary or transferee will receive the entire benefit, including the community interest of the predeceased spouse.

(2) Naming a new beneficiary or transferee revokes the consent of the predeceased spouse; the new beneficiary or transferee will receive only the community interest of the surviving spouse; the community interest of the predeceased spouse will pass as it would have if included in his or her probate estate.

(3) Naming a new beneficiary or trustee automatically revokes the consent of the predeceased spouse; the community interest of the predeceased spouse will pass in accordance with the beneficiary designation or transfer to which the predeceased spouse consented.

The first alternative is in reality what the Supreme Court rejected in the MacDonald case, it assumes a waiver or transmutation. Absent proof of a lifetime transfer of the consenting spouse's community interest in the property to the other spouse, this alternative does not produce a reasonable result.

The second alternative is more attractive, but also defective. It assumes, as the majority of both courts apparently did in the MacDonald case, that the consenting spouse does not really intend to transfer his or her community interest in the property to the designated beneficiary or transferee. If we assume the transferor spouse intends to transfer his or her community interest in the property to the transferee or beneficiary, then, in this era of equal rights and responsibilities, we should assume the consenting spouse also intends to transfer his or her community interest to the same person. If not, then all forms of consent are meaningless.

The third alternative puts the spouses in exactly the same position they would occupy if they each executed a will or revocable trust transferring their respective property

interests to the same beneficiary. While both are alive, either can revoke the transfer as to his or her community interest. In fact, the consenting spouse occupies a somewhat better position then he or she would by executing a will or revocable trust, since the consent would be automatically revoked if the other spouse seeks to change the beneficiary. This distinction is mandated by the nature of the contractual right of only one spouse to name the beneficiary or transferee. On the death of either spouse, his or her community interest will be distributed on the basis of the beneficiary designation which he or she made or to which he or she consented, or in the absence of a consent, the spouse who is not empowered to name a beneficiary can make a testamentary disposition of his or her community interest.

However, where the spouse who designates the beneficiary or transferee is the first to die, the equality argument advanced above fails. If we assume the consent has any validity at all, it must be effective to transfer the consenting spouse's community interest in the property if the other spouse is the first to die. Thus the inequality - if the transferor spouse is the first to die, the consenting spouse is bound, if the consenting spouse is the first to die, the transferor spouse is free to revoke the transfer as to his or her community interest.

Given the contractual nature of life insurance and other assets which may the subject to nonprobate transfers, there appears to be no way to eliminate this inequality without

either (a) permitting each spouse to designate a transferee or beneficiary as to his or her community interest, contrary to the contractual requirements of the property rights, or (b) deciding that spousal consents to such designations are meaningless. A possible alternative would be to provide that if the consenting spouse if the first to die, and the surviving spouse thereafter changes the beneficiary, the consent is revoked post mortem, and instead of passing to the beneficiary who was named in the consent, the predeceased spouse's community interest will pass under that spouse's will or by intestate succession. The trouble with this approach is it assumes the consenting spouse would not have agreed to the beneficiary designation unless the community interest of the other spouse would pass to the same beneficiary. This is subject to the same criticism as the conclusion in MacDonald, i.e., that Mrs. MacDonald did not really intend to pass her community interests in the IRAs to the trust created by her husband, even though she signed a consent to that effect. It is dangerous to assume the deceased spouse would necessarily revoke the consent and instead shift his or her interest in the benefit to heirs at law or beneficiaries under his or her will simply because the surviving spouse decided to change the beneficiary as to his or her community interest.

VIII. COMMUNITY PROPERTY INTERESTS IN LIFE INSURANCE

Before considering specific recommendations as to spousal consents to transfers of community property which take effect at death, it is necessary to review the unique characteristics of some of the property rights which may be the subject of such transfers, such as life insurance.

While it seems clear that life insurance policies, like any other property, will be community property if acquired during marriage, from community funds, etc., there is little actual authority on the community or separate status of the policy itself. In connection with California inheritance tax, a California decision held the policy itself was community property. In Re Mendenhall's Estate, 182 Cal. App. 2d 441, 6 Cal. Rptr. 45 (1960). Where the insurance was on the life of the husband, and wife died first, her community interest in the policy was subject to inheritance tax. A similar result was reached for federal estate tax purposes in U.S. v. Stewart, 270 F. 2d 894 (9th Cir. 1959), reversing 158 F. Supp. 25 (N.D. Cal. 1957); and Scott v. Comm., 374 F. 2d 154 (9th Cir., 1967).

The issue of community rights in the policy arose forcefully in Prudential Insurance Co. v. Harrison, 106 F. Supp 419,(S.D. Cal. 1952) and Manufacturer's Life v. Moore, 116 F. Supp 171 (S. D. Cal. 1953). Both cases involved claimants who killed their spouses and were beneficiaries of life insurance policies on the lives of the victims paid for

with community funds. In both cases, while finding the killers were precluded from profiting from their wrongful acts, the courts held the surviving spouses nevertheless had a one-half community interests in the policies. In Harrison, the spouse was allowed to collect one-half of the proceeds, while in Moore, the spouse was limited to one-half of the cash surrender value.

The community rights of spouses issue has also arisen in the context of simultaneous death. The statutory presumption is that where the insured and beneficiary die simultaneously, the beneficiary is presumed to have died first. See California Probate Code Section 224. But where the insured and beneficiary are spouses, and the policy is community, the proceeds are distributed as community property, even though it is presumed the beneficiary spouse died first. In re Castagnola's Estate, 68 Cal. App. 732, 230 P. 188 (1924); Estate of Wedemeyer, 109 Cal. App. 2d 67, 240 P. 2d 8 (1952). Note that this rule under Probate Code Section 224 will not apply if there is an alternate beneficiary other than the estate or personal representatives of the insured.

While the characterization of an insurance policy as community property for purposes of marital dissolution is clearly required in many cases, there are some disturbing decisions involving employee group life insurance. In re Marriage of Lorenz, 146 Cal. App. 3d 464, 467, 194 Cal. Rptr. 237, 238 (1983), held that an employee's rights under an employer sponsored group term life insurance policy were not

subject to division as part of a marital dissolution. Disagreeing with this decision, another court in In re Marriage of Gonzales, 168 Cal. App. 3d 1021, 1024, 214 Cal. Rptr. 634, 636 (1985), suggested that the court in Lorenz excluded employee group term life insurance from the division on the grounds that it had no ascertainable value, not on the grounds it was not community property. See also Bowman v Bowman, 171 Cal. App. 3d 148, 217 Cal. Rptr. 174 (1985), generally following Gonzales. Still another court has excluded such insurance from the division on basically the same no value theory, although limiting its result to situations where the employee was still insurable. Estate of Logan, 191 Cal. App. 3d 319, 325, 236 Cal Rptr. 368, 372 (1987).

Although the group life insurance decisions above deal with marital dissolution, a finding that such insurance, or for that matter any form of term insurance which has no cash value is not community property has serious implications where the noninsured spouse is the first to die. If the policies are not community property, at least prior to the death of the insured spouse, then the predeceased spouse would have no power to make a testamentary or nonprobate transfer of an interest in the proceeds of the policy. This is an incorrect result. Since Marriage of Brown, 15 Cal. 3d 838, 544 P. 2d 561, 126 Cal. Rptr. 633 (1976), the fact a property right is not vested, contingent, or may have no value is not an acceptable reason to exclude it from community characterization. Term life insurance fits this test as well

as any other form of property, including stock options. See Marriage of Nelson, 177 Cal. App. 3d 150, 222 Cal. Rptr. 790G (1986); Marriage of Hug, 154 Cal. App. 3d 780, 201 Cal. Rptr. 676 (1984).

However, even if term life insurance is characterized as community property, there is a real problem where the noninsured spouse is the first to die. What is the extent of the deceased spouse's community interest in the policy? If it is based on the cash value or related interpolated terminal reserve value, it is zero, since term life insurance by definition only provides protection for the policy period and accumulates no reserve or residual value. If the noninsured spouse should attempt to make a testamentary disposition of that interest, it is worthless. This was clearly a major issue considered by the court in Logan, supra, arguing that the only real interest of the community in such insurance is if the insured dies while premiums paid during marriage are providing the insurance coverage. If this position is adopted, it apparently overrules the decision in Modern Woodmen of America v. Gray 113 Cal. App. 729, 733, 299 .P 754, 755 (1931), holding that at least in the case of the death of the insured, community and separate interests in life insurance should be based on apportionment of all premiums paid while the policy is in effect.

A legislative solution to the problem of term insurance, where the noninsured spouse is the first to die, is to provide

that the community interest of the deceased spouse should be equal to the cash surrender or interpolated terminable reserve value of the policy unless the insured dies while premiums paid with community funds are providing coverage, in which case the proceeds are to be allocated on the basis of the total premiums paid with separate and community funds. This is an attempt to retain the apportionment theory of Modern Woodmen while recognizing the lack of any real value in the community interest of the predeceased spouse. Another solution is the continue the apportionment rule after death, as in the Scott case, discussed in the following paragraphs. Still another solution, which is not recommended, is to follow the "no value - no community property" rule as in Logan.

A case which dealt with some of these issues in the tax context is Scott v. Comm., 374 F.2d 154 (9th Cir. 1967), rev'g 43 T.C. 920. 1965) Mrs. Scott predeceased her husband and left her entire estate to their two sons. There were two insurance policies on the life of the husband, purchased with community funds. The parties agreed that one-half of the policy was part of her estate, and one-half of its cash surrender value was subject to federal estate tax. Mr. Scott subsequently changed the beneficiaries to the two sons, and continued premium payments on the policy until his death. Mr. Scott's estate included one-half of the proceeds of the insurance. The IRS sought to include all of the proceeds less the one-half cash surrender value which had previously included in the estate of Mrs. Scott.

Interpreting California law, the appellate court rejected the IRS contention that Mrs. Scott's community interest in the policy was limited to one-half of the cash surrender value at her death. It held that upon Mrs. Scott's death, her sons became tenants in common in the policies with their father. When he continued to pay the premiums, admittedly with separate funds, he increased his proportionate interest in the policies and decreased the interest of his sons. When he died, a proportionate share of the proceeds would be included in his estate, based upon the proportion of premiums paid with community or separate funds. Thus the Ninth Circuit applied apportionment based on premium payments to post death premium payments. Since the community is terminated by death, it is difficult to see how the estate of the predeceased spouse could protect his or her interest in the policy other than by continuation of premium payments to preserve the proportionate interest in the tenancy in common. protect the deceased spouse's proportionate share of the tenancy in common unless the estate or successors continue to pay a portion of the premiums.

The reference to tenants in common in the Scott case is a reasonable way to determine property interests in life insurance policies where the noninsured spouse is the first to die. However, it is likely insurance companies will resist attempts by executors and successors of the noninsured spouse to assert rights in the policies which are reserved to the owner. To define the interest in terms of cash surrender

value is more realistic, and would permit the owner of the policy to assert all other policy rights and pay additional premiums. In effect, the interest of the deceased spouse would be limited to the cash surrender value at his or her death, and would no longer include a share of the proceeds on the subsequent death of the insured spouse.

However, if the community interest of a predeceased noninsured spouse in a life insurance policy is limited to the cash surrender value at his or her death, the estate or successors are denied participation in the interest or growth factor attributable to that value after death. In most modern cash value or universal life insurance policies, there is an investment element which will continue to grow. However, attempting to define that element in legislation is almost impossible.

There is much more authority on the classification of the insurance proceeds as community property, in cases involving group life insurance, Polk v. Polk, 228 Cal. App. 2d 763, 39 Cal. Rptr. 824 (1964), annuity proceeds, Penn Mutual Life v. Fields, 81 F. Supp. 54 (S.D. Cal. 1948); fraternal benefit society policies, Modern Woodmen of America v. Gray, 113 Cal. App. 729, 299 P. 754 (1931); employee plan proceeds, Gettman v. Los Angeles, 87 Cal. App. 2d 862, 197 P. 2d 817 (1948), and a variety of other life insurance policies, as illustrated by Tyre v. Aetna Life, 54 Cal. App. 2d 399, 353 P. 2d 725 (1960), Travelers Insurance Co. v. Fancher, 219 Cal. 351, 26 P. 2d 482

(1933). The basic rule - if premiums or contributions come from community sources, at least a portion of the proceeds will be community property.

Where the insured spouse names the other spouse as beneficiary of a community property life insurance policy, the "inchoate gift" rule discussed above comes into play, and cases have held that the insured spouse had made an inchoate gift to the other spouse of the insured spouse's community interest in the plan, which becomes complete on death. Thus the proceeds are the separate property of the surviving spouse. Estate of Miller, 23 Cal. App. 2d 16 (1937). This inchoate gift-separate property result should be considered in the context of cases which have forced the surviving spouse to elect between rights as beneficiary under such policies and community property rights. In Mazman v. Brown, 12 Cal. App. 2d 272, 276, 55 P. 2d 539, 541 (1936), husband named wife as beneficiary as to one-third of the policy proceeds and his parents as beneficiary as to the other two-thirds. The court held the wife could not claim one-third of the proceeds as separate property and still assert a community claim as to one-half of the remaining two-thirds. In Tyre, supra, husband insured elected a life income benefit for wife, with a remainder to a child. The court held the wife could set this aside and claim her community half, but could not then also assert any claim as beneficiary.

Are the forced election decisions inconsistent with the inchoate gift theory, on the grounds that if the proceeds

payable to the surviving spouse are automatically separate property, they are not subject to the election? There is no real inconsistency - the inchoate gift theory assumes the transmutation from community to separate property is contingent on death. If so, and a gift causa mortis approach is followed, the decedent is doing no more or less here than he or she would with a forced election under a testamentary document - i.e., a forced election bequest in a will also converts decedent's share of community to separate property on death, but this is contingent on an election.

However, if the insurance proceeds really become separate property on death, there would be a difference insofar as creditors are concerned. The liability of separate and community property for the debts of either spouse is covered generally in California Civil Code Sections 5120.110 through 5120.160, and in general, the separate property of one spouse may not be applied to pay debts incurred by the other spouse. See California Civil Code Section 5120.130(b)(1). Further, California Probate Code Section 980, dealing with the allocation of debts between the estate of a deceased spouse and a surviving spouse, bases that allocation of ratios of community and separate property. If the death of an insured spouse automatically converts a community property asset into the separate property of the surviving spouse, that property arguably cannot be reached to pay debts of the deceased spouse or be the basis for allocation of such debts. This appears unlikely.

Interests in community property passing at death from one spouse to the other, or for that matter, passing to third persons, should be no different than other assets which pass as the result of a testamentary or nontestamentary disposition - they should retain their community character until the transfer is complete, and there is no "transmutation" or automatic conversion to separate property. However, there is authority to the contrary, at least in the case of joint tenancies, where surviving joint tenants take free and clear of the claims against the deceased joint tenant. See Zeigler v. Bonnell, 52 Cal. App. 2d 217, 200, 126 P. 2d 118 (1942).

Assuming both the insurance policy and proceeds are community property, what are the rights of the spouses in the policy while both spouses are alive? If one spouse, generally the insured spouse, is designated as the owner, he or she will of course be able to exercise all rights under the terms of the policy, borrow against it, cash it in, select settlement options, assign it, and name the beneficiary. To the extent the policy rights fall into the category of management, it seems clear the spouse who is owner can exercise those rights without the consent of the other spouse under the equal management and control provisions of California Civil Code Sections 5125 and 5127. This would include the right to cash it in, borrow against it, select dividend options, convert it into another form of contract, etc.

However, as to any assignment of a community property life insurance policy that is a gift, even though the policy rights of the owner will permit this, the other spouse who did not consent in writing should certainly be able to set the transfer aside under the authority of California Civil Code Section 5125(b). Similarly, to the extent the owner spouse elects a beneficiary other than the surviving spouse, unless he or she has consented (in writing?) the surviving spouse is able to set that beneficiary designation aside. This right to set aside is absolute during the joint lifetimes of the spouses. Benson v. Los Angeles, 60 Cal. 2d 355, 384 P. 2d 649 (1963).

As the foregoing indicates, the assignment of a life insurance policy or its proceeds, or designation of a beneficiary, is regarded much like a lifetime gift of community property, even though the transfer may not take effect until death. This conclusion is reinforced by the fact that after the death of the insured spouse, this right to set aside is limited to one-half of the proceeds. NY Life v Bank of Italy, 60 Cal. App. 602, 214 P. 61 (1923), Fancher, Gettman, and Fields supra. Further, where the surviving spouse is named beneficiary as to part of the proceeds, the forced election rule already discussed may apply, and the prior death of the noninsured spouse does not change his or her community interest in the policy or its proceeds.

Similar results should follow as to selection of settlement options - if, as in the Tyre case, the owner

selects a settlement or payment option that confers upon the surviving spouse less than one half of the proceeds payable in cash, the surviving spouse should be able to set that aside, subject to a possible election.

Assuming a life insurance is wholly or partially community property, and the beneficiary designation is treated in the same manner as other lifetime transfers which take effect at death, what if the noninsured spouse consents to the designation of a beneficiary other than himself or herself? The courts seem to assume, without prolonged discussion, that the consent of the noninsured spouse will have the effect of waiving his or her community claim against the proceeds of the insurance. Although the case involved employee death benefits rather than life insurance, consider the following language from Benson v. Los Angeles, 60 Cal. 2d 355, 363, 384 P. 2d 649, 653, 33 Cal. Rptr. 257, 261(1963): "In the case of insurance any change in the beneficiary away from the wife without her consent, and without a valuable consideration other than substitution of beneficiaries, is voidable in its entirety by her during her husband's lifetime." Note there was no consent in the Benson case, and no cases have been found which specifically deal with consents to life insurance beneficiary designations.

The language in Benson is a logical extension of the inchoate gift rule - if the beneficiary designation is donative (not for consideration), it is a gift, and can be set

aside by a nonconsenting spouse, but not by a consenting spouse. However, what is the significance of the fact this inchoate gift can be revoked by the spouse who is designated owner of the policy?

Applying the general rule of equal management, if one spouse as owner of the policy can revoke the gift, why shouldn't the other spouse be able to revoke it? But if this policy is adopted, the consenting spouse would be able to completely revoke his or her consent, which is inconsistent with the idea that the consenting spouse has waived his or her community rights.

Since the gift is inchoate, would it make more sense to argue that both spouses are bound by the beneficiary designation, and it cannot be revoked unless both agree? This is contrary to the express terms of the contract, but it may be consistent with reasonable enforcement of community rights. As a policy matter, enforcing a rule that requires the consent of both spouses to take any action may produce unfair results, particularly where there is marital discord.

Where the noninsured spouse is the first to die, and did not consent to a beneficiary designation for the life insurance, the personal representative of the deceased spouse's estate, or his or her successor in interest, apparently has the right, and probably the duty, to claim a one-half interest in the insurance policy for the estate. But what exactly does the estate have? Can the executor name a

beneficiary for the decedent's community interest in the policy? Could the executor borrow against it or cash it in? If premium payments are discontinued, and the policy may lapse, do the estate representatives have a duty to pay premiums to preserve an estate asset? What if it is term insurance?

Where the policy in question has a cash surrender value, it is well established, at least for federal estate tax purposes, that the estate of the predeceased noninsured spouse will include one-half of the interpolated terminal reserve value assigned to the policy by the insurance company, roughly equivalent to the cash surrender value in most cases, assuming the premiums are paid with community funds. See U.S. v Stewart, 270 F.2d 894 (9th Cir., 1959).

The exercise of any such rights over the insurance policy other than the continuation of premium payments would be inconsistent with the contract rights under the policy, assuming the surviving spouse is the owner. Arguably, the only thing that would pass to the heirs or beneficiaries of the deceased spouse is either the right to one-half of the cash surrender value at the date of death of the first spouse, or the right to collect one-half of the proceeds of the policy when the insured dies.

It also seems clear that if husband seeks to change the beneficiary after the death of his wife, he could only do so as to half of the proceeds. If he sought to borrow against

the policy, could he only borrow up to half of the amount available? Could he cash it in? Change settlement options?

The status of a community interest of the predeceased noninsured spouse in life insurance was discussed in Estate of Leuthold, 324 P. 2d 1103, 1109 (1958), holding that for Washington inheritance tax purposes, the death of the noninsured spouse was a taxable event, and her estate included one-half of the cash surrender value of the policies. Compare Warthan v. Haynes, 272 S.W. 2d 140 (1954) and the decisions cited therein, holding that under Texas law, the estate of the predeceased noninsured spouse had no claim to the policies, and the surviving insured spouse would have a right to change the beneficiary as to the entire proceeds. Clearly, California would not follow the Texas line of cases.

Where the deceased noninsured spouse did consent to a beneficiary designation, can that consent be set aside after his or her death? Possibly the most significant aspect of the MacDonald is that the spouse consented to the beneficiary designation made by her husband, and that after her death, the executor of her estate was permitted to set aside that consent and claim a community interest in the plan. This point was never squarely faced by the California Supreme Court, although certain language in footnotes indicates they did not consider it terribly important. In footnote 5, the opinion declines to treat the consent to beneficiary designation as a will substitute, and holds the consent was not a testamentary disposition. The court notes that the issue was raised for

the first time on appeal to the Supreme Court. MacDonald, supra, 51 Cal. 3d. at 267. In footnote 8, the court also rejected an argument that the consent was a written consent to a gift of community property under California Civil Code Section 5125(b). Again, the Supreme Court appears to reject this contention, but also points out it was not properly raised on procedural grounds. Id at 272.

In footnote 3 to his strong dissenting opinion in MacDonald, Justice Arabian notes a statement by counsel which infers Mrs. MacDonald only signed the consent because her husband requested it, and his dissenting opinion suggests the majority opinion negated Mrs. MacDonald's testamentary intent. Id at 281. It should be noted that the facts of the case indicate that after Mrs. MacDonald became aware she was terminally ill, the parties restructured all of their property into separate shares to facilitate their estate plans. While there was no evidence this restructuring included the IRA accounts, it does suggest Mrs. MacDonald was in full agreement with the disposition of those accounts.

The MacDonald case did not involve life insurance. However, on issues relating to beneficiary designations, there are clear parallels between life insurance policies and other forms of death benefits or contractual rights which provide for a nonprobate transfer through the designation of beneficiaries by one or both spouses. There are also differences, which will be explored in the next section.

IX. OTHER DEATH BENEFITS, WITH PARTICULAR EMPHASIS ON THE TERMINABLE INTEREST RULE AND FEDERAL PRE-EMPTION

While the foregoing discussion focused on life insurance and death benefits thereunder, many of same principals apply to death benefits arising under other arrangements, such as employee death benefits, self-employed retirement plans, (herein called Keough plans), deferred compensation plans, death benefit plans, and IRA accounts. As pointed out in Memorandum 89-106, both the contractual requirements of such plans, and in some cases applicable state and federal law, tend to vest complete management of these plans in the employee, self employed person, or transferor to the IRAs. Other than issues of federal pre-emption or the terminable interest rule, which will be discussed subsequently, this does not materially differ from the control exercised by the spouse designated as owner of the life insurance policy.

However, in the case of employee benefit plans, the right to designate a death beneficiary may be limited by the terms of the plan. The district court of appeals in MacDonald made it clear that since Mr. MacDonald had transferred the funds from his pension plan to IRA accounts, totally within the control of Mr. MacDonald, general community property principals could be applied without interference with contractual rights. Note the Supreme Court did not discuss this point. If, for example, the employee under a death benefit plan sponsored by an employer has no right to designate a death beneficiary, neither would his or her

spouse. In fact, it is not clear such a benefit is even properly classified as community property even though earned during marriage, as it may be only an expectancy, despite the limitations of that doctrine expressed by the Supreme Court in Brown. In this case, the beneficiary is designated under the provisions of the plan itself.

The death benefit plan maintained by IBM for the surviving spouse or children of employees, discussed in various federal tax cases is an excellent illustration of the issues which arise in attempting to define property rights. Under the provisions of this plan, if an employee of IBM dies while employed by the company, a specified death benefit will be paid to his or her surviving spouse, if any, otherwise to certain surviving issue. The employee has no control over this plan and no right to designate a beneficiary. In the federal estate tax area, the Internal Revenue Service has been faced with the issue of whether or not the benefits under such a plan are property owned by the decedent, subject to inclusion in his or her estate. The Second Circuit held they were not in Estate of Schelberg, 612 F. 2d 25 (2nd. Cir. 1979). A federal district court did subject the plan benefits (1983), but this was based on specific provisions of Section 2039 of the Internal Revenue Code, not on a general argument that the death benefit was property owned by the decedent. Further, an attempt by the Internal Revenue Service to argue that employment by a company which maintains such a plan is a gift of the death benefit to the beneficiary was rejected by

the Tax Court in Estate of DiMarco, 87 T.C. 653 (1987), again based on the argument that the employee never had any property interest in the death benefit to give away.

Are such death benefit plans property, and if so, are they community property to the extent the right to the benefit is earned during the marriage? In re Marriage of Brown, supra, adopted a broad concept of contingent property rights, which includes retirement and related benefits which are not vested and may be subject to forfeiture. However, the subject matter in Brown was benefits which could be received by the employee while alive. If the right to the benefit only comes into existence after death, how can it be community property?

It may be that the death benefit under such a plan is tied, directly or indirectly, to retirement or other benefits which could be enjoyed by the employee while alive. In fact, that is the basis for seeking to include the benefit in the taxable estate of a deceased employee under Internal Revenue Code Section 2039. Unless the death benefit is treated as something separate from the other rights, it could be community property by reason of its relationship to other employee benefits.

Since the usual contractual death beneficiary under such plans is the surviving spouse, the issues addressed in this study will not arise where the employee dies first. If the other spouse is the first to die, will his or her personal representative have any claim to benefits under such a plan?

If so, this would result in direct interference with contractual rights under the plan, which as noted above the District Court was careful to distinguish in its MacDonald decision. California Civil Code Section 4800.8 addresses court orders relating to rights under retirement plans to assure each party receives his or her community rights in such plans, including death benefits and survivor benefits. It also covers the division of retirement benefits paid on or after the death or either party. But it does not by its terms purport to overrule contractual provisions of the plan. In fact, it specifically authorizes the court to order a party to elect a survivor benefit "in any case in which a retirement plan provides for such an election." California Civil Code Section 4800.8(b). Also, it appears the section does not apply to death benefits unless they arise under a retirement plan.

The above discussion suggests that community property rights to designate beneficiaries for death benefits under any plan should be subject to contractual limitations under the plan itself. In other words, new legislation intended to clarify the rights of spouses to designate beneficiaries, consent to such designations, and revoke such consents should be limited to situations where the identity of the beneficiary is not determined under the terms of the plan itself. Clearly, this can lead to inequitable results. An employee who has "earned" a substantial death benefit during marriage payable only to a surviving spouse can divest the spouse of

that benefit by divorce. Further, if the spouse is the first to die, he or she cannot dispose of any part of the benefit even though it was clearly earned during the marriage. But short of direct interference with contract rights, it seems there is no satisfactory solution.

The California Supreme Court was faced with the problem of contractual limitations on beneficiaries under pension plans in Benson v. City of Los Angeles, 60 Cal. 2d 355, 384 P. 2d 649, 33 Cal. Rptr. 257 (1963), and what resulted was at least one element of the so-called "terminable interest" doctrine. Husband and wife divorced, but their property rights were never adjudicated. Husband remarried, and under the provisions of a municipal pension plan provided by his employer, in which his former wife clearly had a community interest, a death benefit was payable to his "widow." While conceding the pension was community property, the court held that the first wife had no "vested" interest in it, and her community interest in it terminated when he died. It should be noted the court emphasized this was a retirement plan for public employees, and there was a public purpose in making provision for a widow. The court made it clear it was not extending this rule to situations in which the employee spouse could designate a beneficiary.

Authorities have argued over whether or not the effect of Benson was to covert the pension into the separate property of the husband. See, in general, Culhane, Toward Pension

Equality: A "Death Blow" to California's Terminable Interest Doctrine. Vol. 12 Community Property Journal 199, 202-204 (1985). Other courts seem to have established an distinction between right to payment during lifetime, which would fall under the general community property rules, and death benefits, which may be mandated by the form of the pension agreement. See Phillipson v. Board of Administration of Public Retirement System 3 Cal. 3d 32, 473 P. 2d 765, 89 Cal. Rptr. 61 (1970)

Some years later, the Supreme Court extended the terminable interest rule to hold that the community interest of a nonemployee spouse in a public retirement plan was not subject to testamentary disposition by that spouse if he or she was the first to die. Waite v. Waite, 6 Cal. 3rd 461, 492 P. 2d 13, 99 Cal. Rptr. 325 (1972). This was the clearest expression of the rule as it applied to transfers at the prior death of the nonparticipant spouse.

Later cases extended the doctrine to private retirement plans. In re Marriage of Bruegel 47 Cal. App. 3d 201, 120 cal. Rptr. 597 (1975) held that it was actuarially correct to divide community interests in a private noncontributory pension plan at divorce, but nothing could be done to mandate a death benefit payment to the nonparticipant spouse. However, this decision was specifically overruled by the Supreme Court in Marriage of Brown, supra. Estate of Allen, 108 Cal. App. 3d 614, 166 Cal. Rptr. 653 (1980) and Marriage of Peterson, 41

Cal. App. 3d 642, 115 Cal. Rptr. 184 (1974) both support the terminable interest rule.

Two decisions which predate the terminable interest rule distinguished the situation where the participant could name a beneficiary for the death benefit, holding the nonparticipant spouse had an enforcable community interest. Cheney v. City and County of San Francisco, 7 Cal. 2d 565, 61 P. 2d 754 (1936); Gettman v Los Department of Water and Power, 87 Cal. App. 2d 862, 197 P. 2d 817 (1948). Whether the later terminable interest decisions overruled these earlier cases is not clear.

Judicial resistance to the terminable interest doctrine started to appear. One court refused to apply the doctrine to a public retirement plan to the extent the husband made direct contributions of community property to it. Chirmside v. Bd. of Adm., 143 Cal. App. 3d 205, 191 Cal. Rptr. 605 (1983). another decision rejected application of the terminable interest doctrine to any private pension plan. Bowman v. Bowman, 171 Cal. App. 3d 148, 217 Cal. Rptr. 174 (1985).

The legislature stepped in to the picture in 1986 by passing California Civil Code Section 4800.8, which extends the power of the court to divide up pension and employee benefits at divorce. However, for purposes of this discussion, the following uncodified language in 1986 California Statutes chapter 686, is very significant: "It is the intent of the legislature to abolish the terminable

interest rule set forth in Waite v Waite, 6 Cal. 3d 461 and Benson v City of Los angeles, 60 Cal. 2d 355, in order that retirement benefits shall be divided in accordance with Section 4800..." 19866 Cal. Stat. chap. 686, 506.

There appear to be two different legislative intentions specified in this language. First, it seeks to abolish the terminable interest doctrine as delineated in Waite and Benson, which were not divorce cases. Second, it does abolish the rule as it applied in divorce cases. Does it apply where there is no divorce, and the issue is the right of the nonemployee spouse to make a testamentary disposition of his or her community interest in the death benefit? The first expression of intention is certainly broad enough to accomplish this.

Four recent California Appellate court cases have upheld the retroactive abolition of the terminable interest rule. One of these, Marriage of Taylor, 189 Cal. App. 3d 435, 234 Cal. Rptr. 486 (1987) so held in the case of a divorce. However, Estate of Austin, 206 Cal. App. 3d 1249, 254 Cal. Rptr. 372 (1988); Estate of MacDonald, 213 Cal. App. 3d 456, 261 Cal. Rptr. 653 (9189); and have held the rule has also been abolished for the purposes of transfers at death. In Marriage of Powers, 218 Cal. App. 3d 626, 639, 267 Cal. Rptr. 350, 356 (1990), a marriage dissolved in 1979, and the trial court reserved jurisdiction over the community property pension plan. The court held the terminable interest had been abolished for all purposes retroactively, and that this would

extend to any unresolved community interest of a former spouse in a pension plan.

The district court decision in MacDonald was careful to note that the community interest in the pension plan in question had been terminated, and contains the following statement: "No interference with contractual rights between an employer - private or public - and its employee could have occurred." MacDonald supra, 261 Cal Rptr. at 657. Note the Supreme Court did not discuss the terminable interest issue in its opinion or the footnotes.

It is technically arguable that the adoption of California Civil Code Section 4800.8 did not abolish the terminable interest rule for all purposes. On the other hand, it is also technically arguable that the rule had either been abolished or weakened to the point of extinction by case law even prior to adoption of Section 4800.8. As Professor Reppy points out, the technical basis for application of the rule at death was in effect eliminated when Waite was "legislatively jettisoned." Reppy, Update on the Terminable Interest Doctrine: Abolished in California; Adopted and Expanded in Arizona. Community Property Journal, July 1987, at 1. The conclusion is inescapable that the terminable interest rule should be finally laid to rest for all purposes.

Unfortunately, such doctrines do not die so easily. As pointed out above, the doctrine arose when applied to so-called "widow's" pensions. Simply abolishing the rule does

not answer the question of what do do when in fact it is a widow's pension, or any other death benefit which mandates payment only to specified persons, and does not permit an employee or participant to designate a beneficiary.

For all of its strong language about abolition of the terminable interest rule, California Civil Code Section 4800.8 appears to hedge its bets. In the case of a marital dissolution, it orders the court to do one of the following:

> "(a) Order the division of any retirement benefits payable on or after the death of either party in a manner consistent with Section 4800."
>
> "(b) Order a party to select a survivor benefit annuity or other similar election for the benefit of the other party, as specified by the court, in any case where the retirement plan provides for such an election. (emphasis added)."

How will a court apply this direction where the death benefit under the plan must be paid to a surviving spouse? Will it attempt to change the terms of the plan itself, by, as some have suggested, extending "surviving spouse" to include an former spouse? Seeing constitutional and other dangers in this approach, will it seek to impose a lien or constructive trust on the death benefit when paid? And what if, as in the case of the IBM plan, there is a provision that absent a surviving spouse, the benefit will be paid to children of the employee? Will the children be forced to pay over the community share to the former spouse?

Perhaps an example will best illustrate why something as simple as abolishing the terminable interest rule is not so

simple after all. Husband and wife have been married and living in California for 30 years, during which husband has been employed by a company that provides a death benefit payable to the surviving spouse of any employee who dies while working for the company. Wife dies in 1990. Under her will, her entire estate passes to her children. Husband remarries in 1991, and dies shortly thereafter. Who will receive the death benefit? Will part of it pass to the children under the will of the wife? If so, how much? Since this is a nonvested property right, contingent on the continued employment of husband by the company, the community interest of the wife would probably have to be valued under rules similar to those used in the case of nonvested pension benefits on divorce. Assuming there is an interest in the plan which passes under the will of the wife, can the employer be compelled to pay it directly to the children, in derogation of the terms of the plan, or will the children have to seek collection from the widow?

A Texas decision, Valdez v Ramirez, 574 S.W. 2d 748 (1978), which involved a federal pre-emption issue, does deal specifically with this problem. The wife was a civil service employee of the federal government, and covered under a pension plan which provided only for retirement payments to the employee, or in the event of his or her death, to the surviving spouse of the employee and/or, under certain circumstances, children of the employee. There was no provision for payment outside the immediate family. She

elected a joint and survivor annuity for herself and her husband. Her husband predeceased her, and under his will, his community property passed to his two adult children. The Texas Supreme Court held that they had no claim against the annuity. It held that payment to the children would be contrary to the terms of the Civil Service Act and also contrary to her election of a joint and survivor annuity.

Valdez was subsequently distinguished by the Texas Supreme Court in Allard v. French, 754 S.W. 2d 111 (1988), where the pension in question was a private retirement plan under which the employee had options as to retirement payments, and did not elect a joint and survivor annuity. In this decision, the court noted that in Valdez it would have been "contrary to the entire contract, policy, and plan of the Federal Retirement Act" to allocate benefits to the heirs of the predeceased nonemployee spouse. Allard, supra, 754 S. W. 2d at 114. In Allard, the court held that one-half of the retirement account was part of the estate of the predeceased nonparticipant spouse.

Although federal pre-emption or lack of it issue was clearly an element in both of these decisions, the Texas Supreme Court did focus on the terms of the plan or contract itself, and it is not clear what the result would have been if, for example, the plan in Allard had mandated a death benefit only to a surviving spouse. However, both of these cases noted that certain assets, including these pension claims, are subject to different management and control

provisions under which the participant spouse has sole management and control. As a result, the nonparticipant spouse could not object to the selection of a joint and survivor annuity option in Valdez or the failure to select that option in Allard. A similar conclusion was reached in O'Hara v. Public Employees Retirement Board, 764 P. 2d 489, 490 (1988), in which the Nevada Supreme Court held that "An employee spouse may select among retirement options so long as the community property interest of the nonemployee spouse is not defeated."

The issue of federal pre-emption of death benefits from qualified retirement plans must be considered in light of the various federal laws governing such plans, in particular the Retirement Equity Act of 1984, Pub Law No. 98-397, 98 Stat. 1426 (1984). In general, and regardless of any plan provisions or state law to the contrary, most such plans are required to pay benefits for a deceased participant who had not yet retired or achieved what is referred to as his or her annuity starting date in the form of a survivor annuity to his or her surviving spouse. Internal Revenue Code Section 401(a)(11)(A). Where the participant dies after his or her annuity starting date, generally the date of retirement, the form of the benefit must be in the form of a joint and survivor annuity with his or her spouse. Internal Revenue Code Section 401(a)(11). The nature, extent, and amount of the required annuity payments will depend upon what kind of plan is involved.

The law does provide for a waiver of the joint and survivor annuity or survivor annuity under Internal Revenue Code Section 417(a). In general, this requires a written election by the participant in which his or her spouse joins, which must designate the beneficiary and the form of benefit, which cannot be changed unless the spouse signs a general consent, which permits the participant to change the beneficiary and form of payment without any further consent by the other spouse. There are a variety of other technical requirements for these elections and consents set forth in Internal Revenue Code Section 417.

Do the federal rules raise any concern that federal law has so far pre-exmpted state law with respect to qualified retirement plans that such plans are no longer community property? Given the long history of this issue in connection with federal laws regarding pensions, as evidenced by Hisquierdo v. Hisquierdo, 439 U.S. 572 (1979), and McCarty v. McCarty, 453 U.S. 210 (1981), this is always an area of concern. However, while there is no real authority in point, most practitioners believe that mandating forms of retirement benefits, particularly under private pension plans, does not recharacterize the community or separate status of the benefits. What is of greater concern is the fact that federal law does not clearly define the status of the benefits where the nonparticipant spouse is the first to die and has a community interest in the plan. The Employee Benefits Committee of the American College of Trusts and Estates

Counsel is presently seeking clarifying legislation in this area.

Since federal pre-emption may come into play, should new legislation attempt to adopt parallel provisions to those in the Internal Revenue Code? In this respect, the recent study of the the California Law Revision Commission dealing with repeal of California Civil Code Section 704, Passage on Death of Ownership of U.S. Savings Bonds, is instructive. It was suggested the section be replaced with a codified statement of applicable federal law or related federal material. The staff disagreed with this approach in CAL L. Revision Comm'n Staff Memorandum 90-91, for various reasons, including the possibility federal law will not be correctly stated, is frequently amended, and will control in any case. Those reasons are equally valid here. Add to them the fact federal law does not pre-empt beneficiary designations in all cases, such as the situation in MacDonald, or may not cover 100% of the death benefit. Finally, as discussed above, it is doubtful the federal rules will go so far as to actually change the community character of the death benefit, whereas comparable state law might be construed as changing its community status. In other words, if a state statute specifically limits the right of a participant in a pension plan to name a death beneficiary, the community characterization of that benefit under state law might be questioned.

Assuming the terminable interest rules have either already been or should be abolished, is this action retroactive? Three California appellate courts have had no difficulty in doing this. The issue is discussed extensively in Reppy, Update on the Terminable Interest Doctrine: Abolished in California, Adopted and Expanded in Arizona Community Property Journal, July 1987 at 1. Most of this discussion focuses on the impact of unequal property divisions on marital dissolution, which is not the issue here. However, the article appears to conclude that retroactivity is not an issue where what is involved is the division of property at divorce, leaving open the larger issue discussed in Marriage of Buol , 39 Cal. 3d 751, 705 P. 2d 354, 218 Cal. Rptr. 31 (1985) and other cases involving Civil Code Sec 4800.1 and 4800.2, holding the imposition of new rules governing interspousal agreements could not be applied retroactively. As discussed in connection with proposed changes in the transmutation rules above, an attempt to change the provisions of death benefit plans to alter the distributions of death benefits would directly interfere with the provisions of those plans. This should be avoided.

The "abolition" of the terminable interest rule as it applies to property interests in death benefits aside from marital dissolution cases could be deemed alteration of property rights of the spouses. But does it deprive spouses of vested rights? Does it impair contract obligations? The terminable interest rule was not based on a contract or

agreement between the spouses. Further, it arose through case law, and as many of the cases cited above indicate, the extent of its application was never really clear nor was the extension of the rule to transfers at death. As a result, abolition of the rule may fall into the scope of Addision v. Addision, 62 Cal. 2d 558, 568, 43 Cal. Rptr. 97, 103, (1965), holding that the California quasi-community property law as applied in marital dissolution cases did not interfere with vested property rights. That case did not extend to the transfer of quasi-community property at death. Application of the rules at death was the subject of Pauley v. Bank of America 159 Cal, App. 2d 500, 324 P. 2d 35 (1958), which in turn discussed the decision in Thornton v. Thornton, 1 Cal. 2d 1, 33 P. 2d 1 (1934). In effect, these cases hold that legislation could control succession at death to property owned by the decedent. thus leading to the California rule of California Probate Code Section 66 that property acquired by a spouse can be characterized as quasi-community only if the acquiring spouse is the first to die.

If the California terminable interest rule could be clearly interpreted as holding the nonparticipant spouse has no community interest in a pension or death benefit plan, and if new legislation specifically confers upon that spouse a testamentary power over it, a Constitutional issue may arise. In his article, Professor Reppy suggests that under the terminable interest rule, the benefits paid after death, which he characterizes as the future interest, are the separate

property of the participant spouse. If so, a statute giving the other spouse who predeceases testamentary power over such benefits would amount to permitting a nonacquiring spouse to dispose of separate property of the acquiring spouse, which goes way beyond California Probate Code Section 66. He also suggests that whether this future interest is vested or contingent would not be relevant to the issue of constitutional protection.

The Internal Revenue Service has issued a private letter ruling discussing in a general way the terminable interest rule and the possible impact of federal tax law. While private letter rulings may not be cited as precedent or authority, this one is useful as a commentary in this area. PLR 8943006 involved a nonparticipant spouse's community interest in a pension plan, and held that upon her death, it was included in her taxable estate for federal estate tax purposes although the Internal Revenue Service concluded that under state law, her interest terminated at her death by operation of law and passed to the surviving spouse. In reaching this conclusion, the ruling discusses the terminable interest rule as applied in an unreported California federal district court decision, Ablamis v. Roper, Civil No. 80 20353 RPA (DC ND Cal 1989), presently on appeal to the Ninth Circuit. In that decision, the court concluded that the terminable interest rule had not been abolished for purposes of transfers at death, and in any case , pre-emption under federal law in apply requires the same result. The ruling

also discusses Allard v. French supra, and noted that while the Texas court held the terminable interest rule was inapplicable under state law, the case failed to discuss federal pre-emption issues, as pointed out in the dissenting opinion in that case.

It is submitted the result in the ruling is correct in that it acknowledges the deceased spouse's interest in the death benefit is community property which does not magically disappear at death and magically reappear as the separate property of the surviving spouse. Rather, the decedent's community interest passes to the surviving spouse by reason of operation of state or federal law, or the terms of the plan itself. to the extent the legislature can control the distribution of community property at death, it can mandate a provision for testamentary or nonprobate transfer of this community asset as well as any other.

Based on all of the foregoing, it appears retroactive legislation permitting the nonparticipant spouse to make a testamentary disposition of death benefits is probably not subject to Constitutional attack, but this is by no means certain. This conclusion is based on the fact the terminable interest rule evolved through case law, the extent of its application has never been clear, and the decisions applying the rule do not specifically hold the death benefit is something other than community property, or that it automatically loses its community identity on death. Now four California decisions have found the repeal of the rule at the

time Civil code Sec 4800.8 was adopted is retroactive, and the the California Supreme Court did not consider the issue in MacDonald. Further, even adopting the view that the pension or retirement benefit is community property while both spouses are alive, but the death benefit arising from that plan automatically becomes separate property at death of either spouse would seem to permit the legislature to repeal the automatic transmutation at death rule. However, where the plan specifically provides for the identity of the payee, as a surviving spouse or children, the adoption of legislation which automatically rewrites the plan to change the beneficiary designation and allow a deceased spouse to transfer a community interest in the benefit may be an interference with contract rights.

One answer is to adopt legislation which does not attempt to resolve the issue of retroactivity nor resolve the issue of changing the identity of a beneficiary designated by the plan. The legislature may well decide to leave these issues to the courts. On this basis, new legislation could only confirm the right of the nonparticipant spouse to make a testamentary disposition or consent to a nonprobate transfer of his or her community interest in a retirement plan or death benefit to the extent not inconsistent with the provisions of the plan or any applicable state or federal law. If the terminable interest rule has already been abolished for all purposes, this acknowledges that abolition and permits the nonparticipant spouse to act upon it. It does not specifically

authorize the spouse to make a disposition contrary to the provisions of the plan, or to alter any provisions of public retirement plans which specify the identity of the death beneficiary. It acknowledges the possibility of federal pre-emption. To cover the issue of retroactivity, without attempting to resolve it, the statute should not be specifically retroactive, but should be effective for deaths occurring after the effective date of the legislation, as is typical in other California Probate Code provisions.

X. OTHER WILL SUBSTITUTES

There are a variety of other forms of will substitutes which will give rise to similar issues - Totten trusts, joint bank account, agreements for purchase of business interests on the death of shareholders and partners, etc. They will all involve issues similar to those which arise with life insurance and death benefits. Unfortunately, they also are all made suspect insofar as spousal consents are concerned because of MacDonald. For example, that decision raises the danger that a spousal consent to a sale of community property stock under a corporate buy-sell agreement could be rescinded upon his or her death if his or her personal representative argues that the price is inadequate, and deprives the beneficiaries of his or her estate of its real value.

The Law Revision Commission is presently considering in Study L-3025 the use of transfer-on-death designations for motor vehicles and vessels in California. CAL L. Revision

Comm'n Staff Memorandum 90-141, TOD Registration of Vehicles and Vessels, November 20, 1990. The question has been raised as to the community property considerations where such transfers are permitted. The answer is to specifically bring all nonprobate transfers under the same rules, and the best place to do that is in revised nonprobate transfer provisions. Given the number of Vehicle code Sections that are affected by this proposal, possibly the best answer would to specifically bring all transfers at death of motor vehicles and vessels under the scope of California Probate Code Sections 5000-5003.

XI. SPOUSAL CONSENTS TO DEATH TRANSFERS - CONCLUSIONS AND RECOMMENDATIONS

The effect of spousal consents to death beneficiary designations and other forms of will substitutes involving community property should be determine under gift rules, not transmutation rules. While MacDonald was probably correct in its determination that the spousal consent did not result in a transmutation of the IRA accounts to separate property, it was incorrect in its failure to recognize the effectiveness of the consent as it applied to a gift which took effect at death. although the Supreme Court attempted to limit its review of MacDonald to the transmutation issue, it contains language in in footnotes 4 and 5 which discount the effectiveness of the spousal consent in general and the effectiveness of the consent as a will substitute in particular. MacDonald, supra, 51 Cal. 3d at 267.

One of the most effective forms of a will substitute for transfer of community property is the revocable living trust. It involves a lifetime transfer of property in a form which can be revoked by at least one spouse. Upon the death of either spouse, it disposes of his or her community interest in trust assets.

Former California Civil Code Section 5113.5, which was replaced July 1, 1987, provided that the assets in a trust would retain their community status if the trust was revocable during the joint lives of the spouses, specifically provided that assets in the trust would retain community status, limited trustee management powers to those the spouses would have in the community property, and provided the trust could not be altered or amended unless both spouses agreed.

Effective July 1, 1987, this section was replaced by present California Civil Code Section 5110.150, which similarly provides assets held in a trust will retain community status if the trust is revocable during the marriage and the power to modify the trust as to the rights and interests in that property during the marriage requires the joinder or consent of both spouses. Unless the trust specifically provides otherwise, it can be revoked by either spouse acting alone. The management powers of the trustee are somewhat broader than the prior statute, and there is no requirement of a specific provision that assets in the trust will retain their community status. All assets withdrawn from the trust retain community status.

The thrust of the statutory history of the revocable living trust is to define community property rights while both spouses are alive, not to deal with the dispositive provisions of the trust after death of one spouse. Since the other forms of will substitutes focus on transfers at death rather than lifetime management, such trust may be distinguished from other forms of will substitutes. However, these statutes, and the Ninth Circuit decision in Katz v. U.S., 382 F. 2d 723 (1967), do focus on the question of whether or not the consent to the terms of a trust result in a transmutation or waiver of community property rights, and hold they do not. Further, based on the statutes and case law, it is generally assumed that consent to the terms of the trust will not alter the property rights in the trust until death, unless there is a specific transmutation of the property. This was the specific issue in the Katz case, where the court found no transmutation or conveyance of community property to husband resulting from wife's consent to the establishment of the trust.

The statutory history of the revocable trust does suggest the following as a possible alternative approaches to beneficiary designations for life insurance, death benefits, and other forms of will substitutes:

(1) Require the consent of both spouses to select a beneficiary. This approach is suggested in Bruch, Management Powers and Duties Under California's Community Property Laws: Recommendations for Reform. 34 HASTINGS L. J. 227 (1982).

However, this would be expressly contrary to the provisions of the policy or plan, and does not address the issue of revocability of the beneficiary designation.

(2) While both spouses are alive, either the spouse who names the beneficiary or the consenting spouse can revoke the beneficiary designation. This ignores the provisions of the policies or death benefit plans, and would force the insurer or plan administrator to recognize the existence of a community interest in the plans or benefit, and to honor a notice received from someone who is not a party to the contract.

In the case of life insurance policies, the Wisconsin version of the Uniform Marital Property Act, WIS. STAT. ANN. Section 766.61 (West Supp. 1990) to some extent follows the second alternative with the following provisions:

> "766.61(e) A written consent in which a spouse consents to the designation of another person as beneficiary of the proceeds of a policy...is effective, to the extent the written consent provides, to relinquish or reclassify all or a portion of that spouse's... ownership interest or proceeds of the policy without regard to the classification of property used by a spouse or another person to pay premiums on that policy. Unless the written consent expressly provides otherwise, a revocation of a written consent is effective no earlier than the date on which it is signed by the revoking spouse and does not operate to reclassify any property which was reclassified or in which the revoking spouse relinquished an interest from the date of the consent to the date of revocation.
>
> "(f) Designation of a trust as the beneficiary of the proceeds of a policy with a marital property component does not by itself reclassify that component."

These provisions, last amended in 1985, are confusing. They permit the use of a consent to transmute a marital property interest in a policy, but also indicate the consent to a beneficiary designation is revocable. However, if revoked, this does not change the transmutation of interests. It would seem two things are being confused here - a consent which operates as a waiver or transfer of a community or separate interest in the policy, i.e., a transmutation, and a procedure for consenting to and revoking a consent to a beneficiary designation.

To afford at least some protection to the insurance companies, Section 766.61(b) makes it clear that a policy issuer can rely on its own records. and if it takes action based on the policy provisions and its records, cannot be held liable. The classification of the policy as marital property has no effect on the policy issuer's duties. However, Section 766.61(c) provides that if the policy issuer receives notice of a claim against the policy at least 5 days before taking action, and documentation of that claim within 14 days thereafter, it can hold up action until he claim is resolved.

The type of documentation covered in the statute includes a decree, marital property agreement, written directive signed by the beneficiary and surviving spouse, a consent as discussed above, or proof that legal action has been commenced.

The Wisconsin statute seems to apply an inchoate gift

rule, and also is a transmutation statute, since it results in reclassification of the policy or premiums. However, it is a revocable gift or transmutation, except to the extent policy interests accrue between the date of consent and date it is revoked. This approach has a good deal to recommend it. The most questionable aspect is the extent of the transmutation. For example, if only a consent to a beneficiary designation is involved, it is difficult to see the policy behind classifying this as a transmutation rather than simply a gift which becomes complete at death. An actual transmutation of the policy or premiums should be handled under the usual transmutation rules. On the other hand, the revocability provision is in accord with the rights of the other spouse to change his or her mind and change beneficiary designations, settlement options, etc. It does lack a requirement of notice of revocation, both to the insurer and the other spouse, which seems a reasonable requirement. Also, thought should be given to automatic revocation in the event the owner of the policy seeks to change a beneficiary or exercises other rights under the policy.

Section 12(c)(5) of the Uniform Marital Property Act, from which the Wisconsin version is derived, also applies a transmutation by consent in the case of life insurance as follows:

"Written consent by a spouse to the designation of another person as the beneficiary of the proceeds of a policy is effective to relinquish that spouse's interest in the

ownership interest and proceeds of the policy without regard to the classification of property used by a spouse or another to pay premiums on that policy...." 9A Uniform Laws Annotated, Master edition, Section 12(c)(5), (1987).

Looking at the confusing language in the Wisconsin statutes, which attempts to permit a transmutation in connection with a beneficiary designation, and the issue in the MacDonald case arguing a consent is a transmutation, it is submitted that the designation of a beneficiary, or the exercise of other rights or options under a policy or plan, or any spousal consent to the exercise of such rights, should not result in a transmutation of either spouse's community interest in the plan unless there is an express written document of transmutation.

A third approach to the consent issue is to provide that any attempt by one spouse to change the beneficiary designation or other options under the plan or policy requires the written consent of the other spouse. This is subject to the same objections as requiring both spouses to consent to any beneficiary designation, and further, overlooks the problems created by marital disharmony. This is not a good solution.

Following the lead in the revocable trust area, the exercise of rights in insurance policies, pension and Keough plans, IRA accounts, and other assets which may pass by contractual designation while both spouses are alive should

fall within the basic management and control rules, with or without the consent of the spouse who does not have the management or control under the terms of the policy or plan. The Wisconsin statute illustrates the problems of conferring such rights to a spouse who is not the owner of the insurance policy. To the extent a spouse believes his or her community rights in such property is being mishandled, or is in jeopardy, he or she can seek relief from the courts under California Civil Code Section 5125.1, or in the case of pension plans, seek relief under California Civil Code Sections 4363 through 4363.2.

The statutes should make it clear that consents or waivers only as to death beneficiary designations should not be deemed transmutations of community or separate interests in such policies or plans, absent specific compliance with California Civil Code Section 5110.730. Such consents, effective only if in writing, should be revocable while both spouses are alive, much like revocable living trusts. However, if the spouse who is the owner of the policy or exercises control over the plan or other will substitute changes a beneficiary without obtaining a new consent from the other spouse, the consent is automatically revoked. The designation of a beneficiary or the exercise of any other rights under a plan or policy by one spouse without the written consent of the other spouse will have no affect on the community property interest of the other spouse in the plan or policy. This is merely a restatement of existing law. And as

under existing law, upon the death of either spouse, his or her one-half community interest in the plan or policy would be fully vested, but subject to a forced election.

It has been suggested that each spouse has the power to make a nonprobate transfer of his or her community interest in assets which normally pass outside a will, such as life insurance policies or death benefits. However, it is extremely unlikely any insurance company, trustee, or pension plan administrator will accept a beneficiary designation other than from the owner of the life insurance policy or participant in the plan.

Present and proposed legislation on nonprobate transfers of community property should make it clear that each spouse has the power to dispose of his or her community interest in such assets either:

(1) By a nonprobate transfer at death, if the transferor is authorized to do so by a written instrument described in Section 5000.

(2) By a testamentary disposition or succession, if the transferor is not authorized to make a nonprobate transfer at death under a written instrument.

To the extent one spouse makes an <u>irrevocable</u> lifetime transfer of an interest in a plan or policy without full consideration, the statutes should clearly provide, in accordance with existing law, that the other spouse can set that aside entirely. To the extent the action taken is

revocable, as naming a beneficiary, the other spouse cannot set it aside, but retains testamentary power over his or her full community interest. In other words, a beneficiary designation by one spouse cannot apply to the community interest of the other spouse without his or her written consent.

The statutes should also provide that to the extent one spouse irrevocably designates a beneficiary or irrevocably assigns any interest in a plan or policy with the written consent of the other spouse, neither spouse can set aside that transfer or assert a community interest in the death benefit. This is a completed gift with consent, and even if the benefits are not received until death, neither spouse should be able to set it aside. However, this is not to be construed as a transmutation of the consenting spouse's community interest in the plan to separate property of the other spouse - if the transfer is to the other spouse rather than a third party, there must be written evidence that the consent was intended to operate as a transmutation.

If one spouse designates a beneficiary of any death benefit or transfers any other interest in a plan or policy which he or she can revoke, and the other spouse consents to the designation, the gift should be deemed complete on the death of either spouse, as to that spouse's community interest. However, if the surviving spouse revokes or alters the beneficiary designation, such a change will be ineffective as to the community interest of the predeceased consenting

spouse, which will pass in accordance with the beneficiary designation to which he or she consented.

If the spouse making the transfer revokes it or alters it without the written consent of the other spouse, the consent of the other spouse is ineffective. Also, the consenting spouse may, during the lifetime of the other spouse, withdraw his or her consent. In either case, the property will be distributed as if no consent was obtained.

XII. RECOMMENDED STATUTORY CHANGES

Probate Code Section 5000(a) would be adopted as follows:

> 5000. (a) A provision for a nonprobate transfer on death in an insurance policy, contract of employment, bond, mortgage, promissory note, certified or uncertified security, account agreement, custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature or any other written instrument effective as a contract, gift, conveyance or trust is not invalid because the instrument does not comply with the requirements for execution of a will.

Comment: This language, borrowed from Uniform Probate Code Sec. 6-201, would clarify the application of the law to partnership agreements, stock redemption plans, buy-sell agreements, powers of appointment, etc. Otherwise, it follows proposed legislation already developed by the Law Revision Commission staff.

Probate Code Section 5001, would be adopted as follows:

> Property subject to nonprobate transfer
>
> 5001. Except as otherwise provided by statute, a provision for a nonprobate transfer on death in a written instrument described in Section 5000 may dispose of the following property:
>
> (a) The transferor's separate property.
>
> (b) The one-half of the community property that belongs to the transferor under Section 100, if the written instrument authorizes the transferor to make a nonprobate transfer.
>
> (c) The one-half of the transferor's community property that belongs to the transferor under Section 101, if the written instrument authorizes the transferor to make a nonprobate transfer.
>
> (d) In the event the surviving spouse of the transferor has executed a written consent to a nonprobate transfer, then subject to the provisions of Section 5003, the transferor may dispose of the surviving spouse's community or quasi-community interest in the property subject to the nonprobate transfer, if the written instrument authorizes the transferor to make a nonprobate transfer.

Comment: The first three subdivisions follow the recommendations of the Law Revision Commission staff. Subdivision (d) specifically authorizes a spousal consent to the nonprobate transfer.

California Probate Code Sec 5002 would be added as follows:

> Testamentary power of spouse who is not authorized to make a nonprobate transfer over community property subject to nonprobate transfer.
>
> To the extent the written instrument described in Section 5000 does not authorize a spouse to make a nonprobate transfer as described in Section 5001, such spouse's community interest in the property subject to the nonprobate

transfer shall be disposed of in accordance with Sections 6101 or Sections 6400 through 6414, inclusive. This provision shall apply regardless of which spouse is the first to die, but shall not apply to the extent a spouse has executed a written consent to a nonprobate transfer pursuant to section 5001(d).

Comment: The intent here is to clarify the right of the nonconsenting spouse to make a testamentary disposition of his or her community interest in property subject to nonprobate transfer unless he or she has executed written consent.

California Probate Code Section 5003 would be added as follows:

Effect of written consent to nonprobate transfers

(a) A written consent by a spouse to a nonprobate transfer pursuant to Cal Probate Code Sec 5000 shall not be deemed a relinquishment or transmutation of such spouse's community or separate interest in the property subject to the nonprobate transfer unless such consent meets the requirements of Civil Code Section 5110.720.

Comment: This codifies the result in MacDonald

(b) Unless the written consent described in Paragraph (a) provides otherwise, it can be revoked in writing only during the lifetime of the consenting spouse, and is effective only with respect to the beneficiary or transferee named in it. Any revocation is effective no earlier than the date executed by the consenting spouse.

Comment: While this provision specifically reserves the right of the consenting spouse to revoke a consent, it limits the period of revocation to the lifetime of that spouse.

(c) Any change of beneficiary or transferee with respect to a nonprobate transfer described in Probate Code Sec 5000 or during the joint lifetimes of the spouses shall automatically revoke entirely a written consent described in

Paragraph (a) unless the consent expressly provides otherwise; provided, however, that in the event of the death of the consenting spouse, any subsequent change in beneficiary or transferee, or exercise of other rights over the property subject to the nonprobate transfer by the surviving spouse shall not be effective as to the community interest of the deceased spouse in such property, which shall be transferred in accordance with the provisions of the nonprobate transfer to which the predeceased spouse consented.

Alternative

(c) Any change of beneficiary or transferee with respect to a nonprobate transfer described in Probate Code Sec 5000 shall revoke entirely a written consent described in Paragraph (a) unless the consent expressly provides otherwise, and the consenting spouse's community interest in such property shall be disposed of in accordance with Sections 6101 or 6400 through 6414, inclusive.

Comment: The first alternative makes it clear the spouse authorized to make a nonprobate transfer can change the beneficiary or transferee at any time. If this is done while both spouses are alive, it revokes the consent. If done after the death of the consenting spouse, the beneficiary or transferee to whom he or she consenting will take his or her community interest, This is based on the assumption the spouse intended his or her community interest to pass to that person.

The second alternative assumes that if the beneficiary is changed after the death of the consenting spouse, the consent is again automatically revoked, but in this case, the community property interest of the consenting spouse passes by testamentary disposition.

(d) Unless the written consent described in Paragraph (a) provides otherwise, such consent

cannot be revoked after the death of the consenting spouse, either before or after the death of the other spouse, and the community interest of the deceased consenting spouse, shall be distributed to the beneficiary or beneficiaries to whom the consent applies.

Comment: This is intended to clearly reverse the result in MacDonald insofar as a post mortem revocation of the consent was permitted. If the alternative to proposed Sec 5003(c) is adopted, this provision should end with "either before or after the death of the other spouse."

A new provision to the proposed statutory changes relating to gifts in view of death would be added as follows:

Gift in view of death of community property.

A gift in view of death of property in which the spouse of the giver has a community interest is effective only as to the giver's community interest in such property, provided, however, in th event the spouse of the giver consents in writing to the gift, it shall, unless either the gift or consent are revoked by either spouse, be effective as to the consenting spouse's community interest in the property. A revocation of the gift shall automatically revoke the consent for all purposes; a revocation of the written consent, if made during the lifetime of both spouses, shall revoke the gift only as to the community interest of the consenting spouse; an attempt to revoke the consent after the death of either spouse shall be ineffective.

Comment: This provision is not as extensive as those suggested for nonprobate transfers because the gift in view of death is much less likely to occur, the subject matter is limited, and the time frame for revocation is much shorter.

Possible statutory provisions defining rights in community property life insurance could include the following:

If a noninsured spouse predeceases an insured spouse, the community or separate interest of the deceased spouse in the insurance policy shall, in the absence of a written agreement or written consent to the contrary, be a dollar amount equal to a fraction of the interpolated terminable reserve plus prepaid premiums for the policy on the date of death of the predeceased spouse; such fraction to be determined on the basis of the total separate and community funds used to pay premiums during the entire period the policy is in effect. To the extent the source of premium payments cannot be traced, it shall be presumed all premiums paid during the marriage were paid with community funds.

Possible addition:

(a) If the insurance policy has no interpolated terminable reserve value, then in the event, and only in the event, the insured spouse dies during a period the prepaid premiums providing the insurance coverage at the date of the death of the insured were paid with community funds during the marriage, the community interest of the predeceased insured spouse shall be determined in accordance with paragraph (b) following.

(b) If the noninsured spouse survives the insured spouse, the community or separate interest of the surviving spouse in the insurance policy, shall, in the absence of a written agreement or consent to the contrary, be a dollar amount equal to a fraction of the proceeds of the policy; such fraction to be determined on the basis of the total separate and community funds used to pay premiums during the entire period the policy is in effect. To the extent the source of premium payments cannot be traced, it shall be presumed all premiums paid during marriage were paid with community funds.

Comment: The intent of the above changes would be to clarify the extent of an noninsured spouse's community interest in a life insurance policy. The first generally follows the approach used by the Internal Revenue Service in valuing a community interest in life insurance where the noninsured

spouse is the first to die. The interpolated terminal reserve is believed to better reflect the true economic value of the policy than its cash surrender value, although the two values are often close. The possible addition is intended to cover term insurance with no cash surrender, i.e., interpolated terminable reserve value, but to follow the suggestion in Logan that if the insured actually dies while the coverage is being provided by community property premiums paid prior to death, the other spouse should have full community rights in the proceeds. The last part of the proposed statute simply restates existing apportionment rules.

This proposed legislation does not deal with all of the problems raised in the discussion of life insurance. It does not indicate how the interest of the predeceased spouse can be protected after death, as where the owner of the policy decides to cash it in or borrow against it. It does not resolve the issue raised by the Scott decision, i. e., will the decedent's interest in the policy grow in the future to reflect its investment value, and will it be translated into a share of the proceeds when the insured dies? All that is proposed at this point is legislation which will better define the extent of the deceased spouse's community interest in insurance on the life of the other spouse.

The following statutory change relating to the rights of nonparticipant spouses to dispose of interests in retirement plans and death benefits could be considered:.

> A predeceased spouse may dispose of his or her community interest in any contract of employment, compensation plan, pension plan, individual retirement plan, employee benefit plan, or self-employed retirement plan in which the surviving spouse is the employee, participant or owner pursuant to the provisions of Probate Code Section 5000-5003, 6101, or 6400 through 6414 to the extent such a testamentary disposition or consent to a nonprobate transfer is not inconsistent with the provisions of such contract or plan , or the provisions of any state or federal law applicable to such contract or plan.

Comment: This statute assumes the repeal or abolition of the terminable interest rule and permits the nonparticipant spouse to act on it, but not if such action is in conflict with the plan or applicable law.

Because of the possibility of a waiver of rights of a surviving spouse to survivor benefits under Internal Revenue Code Section 417, supra, thought should be given to a new statute relating to the effect of waivers of rights to survivor benefits under federal law, such as

> A waiver of a right to a survivor benefit or other benefit under provisions of the Internal Revenue Code will not be characterized as a transmutation of the community property rights of the spouse or spouses executing the waiver.

Comment: The execution of waivers of rights to joint and survivor annuities or survivor benefits under the provisions of the Retirement Equity Act of 1984 should not be construed as a transmutation of community property rights.

The provisions of California Probate Code Sections 140-147, previously discussed, cover the waiver of property rights by a surviving spouse. Professor Paul Goda, S.J., of the

Santa University law school, has pointed out to the author that the scope of these provisions should extend to nonprobate transfers. Based on his suggestion, the following is a proposed addition to Probate Code Sec 141(a):

> (10) Any property right which may be subject to a nonprobate transfer pursuant to Sections 5000 through 5003 of the Probate Code.

No specific reference has been made herein to quasi-community property subject to testamentary disposition by the acquiring spouse. Obviously, the definition under California Probate Code Section 66 is the one applicable. To the extent the insurance policy, death benefit, or other property which could be the subject of nonprobate transfer is quasi-community property under this definition, it must have been acquired by the first spouse to die. If clauses were added to all of the proposed statutes to cover quasi-community property, the statutory language would be even more confusing. Possibly this could be handled by one statute, specifying that for purposes of these provisions, quasi-community as defined under California Probate Code Section 66 shall be treated in the same manner as community property <u>where the acquiring spouse is the first to die.</u> This way, a consent to a beneficiary designation would be covered by these provisions if the acquiring spouse predeceases, but would be meaningless if the consenting spouse is the first to die.

XIII. CONCLUSION

The decisions in the MacDonald case encompassed a variety of issues relating to lifetime and deathtime transfers of community property, and made the need for statutory clarification apparent. The requirements for transmutation and recharacterization of property rights had been addressed by the legislature in the 1985 additions to the transmutation rule, but it is now clear further clarification is needed. The rights of spouses to make testamentary dispositions of community and quasi-community-community property in the traditional manner by will are well established. However, the increasing frequency of nonprobate transfers at death by contract or otherwise requires legislative action to define the community and quasi-community rights of the spouses, particularly where only one spouse has the right to make the disposition under the terms of the contract or plan. Finally, the nature and extent of community property rights in such assets as life insurance policies and death benefits should be more clearly defined. In all of this, the emphasis should be to assure, to the extent possible, equal rights of the spouses in all forms of community property, regardless of its unusual characteristics, including equal rights to transfer it by gift or at death.