Study L-4100 January 26, 2017

Memorandum 2017-7

Nonprobate Transfers: Creditor Claims and Family Protections (Reactivation of Study)

In 2010, the Commission[1] received a background report from its former Executive Secretary Nathaniel Sterling entitled *Liability of Nonprobate Transfer for Creditor Claims and Family Protections* (hereafter, "NPT Report").[2] Shortly thereafter, the Commission circulated the NPT Report for public comment,[3] but received no comments. The Commission had a full workload at that time, but sought to initiate study of this topic in 2013.[4] Shortly thereafter, work on this topic was suspended to permit staff to address some late-arising issues in a nearly-complete study.[5] Work on this issue has not progressed since then.

In December 2016, in conjunction with its annual consideration of New Topics and Priorities, the Commission directed the staff to reactivate the study on nonprobate transfer liability in 2017. This memorandum reactivates the study.

Given the time that has elapsed since the NPT Report was before the Commission, this memorandum provides a summary of that report, to reintroduce the issue to Commissioners and stakeholders. This memorandum also identifies a few recent changes to California law on nonprobate transfer liability.

Before getting to those substantive issues, this memorandum provides a brief discussion of stakeholder outreach for the study.

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. The NPT Report is available at http://www.clrc.ca.gov/pub/BKST/BKST-L4100-NPT-Creditors.pdf.
3. See Memorandum 2010-27; Minutes (June 2010), p. 7.
4. See Memorandum 2013-25.
5. See Memorandum 2013-54, pp. 12-13.

Except as otherwise indicated, all statutory references in this memorandum are to the Probate Code.

STAKEHOLDER OUTREACH

The Commission has indicated that it wants the staff to provide information about the stakeholders contacted when any new study is initiated. Specifically, in 2014, the Commission gave staff the following direction:

> When inviting stakeholder participation in a new study, the staff should provide Commissioners with a list of the groups and individuals that were invited to participate.[6]

The nonprobate transfer liability study was commenced before the Commission requested that the staff provide this stakeholder outreach information. In an effort to comply with this direction, this memorandum identifies the stakeholders that have been invited to comment and participate previously.

Memorandum 2010-27 indicates that the NPT Report was circulated to the Commission's regular estate planning mailing list.[7] The Commission's estate planning mailing list includes a number of estate planning attorneys, as well as other persons interested in estate planning policy, and has served well to notify interested persons of the Commission's prior work in the Probate Code. In addition, the staff committed to circulating the NPT Study to other stakeholders, such as the Executive Committee of the Trusts and Estates Section of the State Bar, debt collection groups, family protection groups, legal scholars, the California Judges Association, the Judicial Council, the Assembly and Senate Committees on Judiciary, and the Governor's Office.[8]

The staff proposes to use the Commission's regular estate planning mailing list as the primary distribution list for this study.[9] However, the staff recognizes that this study topic may also be of interest to persons on the Commission's existing debtor-creditor relations mailing list.[10] The staff will send a note to the

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6. See Minutes (Oct. 2014), p. 3.
7. See Memorandum 2010-27, p. 6.
8. *Id*.
9. The Commission's estate planning mailing list includes approximately 295 subscribers. The list includes persons affiliated with the following groups: Judicial Council, State Assembly, State Senate, California Department of Justice, law firms with estate planning practice, and the Uniform Law Commission.
10. The Commission's debtor-creditor relations mailing list includes approximately 85 subscribers. The list includes persons affiliated with the following groups: Judicial Council, State

debtor-creditor list notifying them of this study and inviting them to receive future updates.

The staff welcomes any suggestions of additional stakeholders who should be contacted about this study.

SCOPE OF STUDY

As indicated above, the foundation for this study is the NPT Report, which the Commission received from its former Executive Director, Nathaniel Sterling. Mr. Sterling prepared this report on a pro bono basis and the staff greatly appreciates the thorough analysis of nonprobate transfer liability that Mr. Sterling conducted.

The NPT Report is not attached to this memorandum. Commissioners will be provided with hard copies of the report. For stakeholders, the report is available for download on the Commission's website.[11]

Nonprobate Transfers, Generally

To understand the scope of this study, it is helpful to first consider what constitutes a nonprobate transfer.

Generally, the NPT Report treats as a nonprobate transfer any transfer of property that is owned or controlled by the decedent after the decedent's death without probate administration. More specifically, in the NPT Report, nonprobate transfers include:

- Transfers of property to beneficiaries under the terms of the decedent's revocable trust.
- Transfers of the decedent's property according to a beneficiary designation made by the decedent (e.g., pay-on-death bank account or vehicle registered in transfer on death form).
- Receipt of property to which a beneficiary is entitled by reason of the decedent's death (e.g., life insurance[12] or survivors' benefits).

Assembly, State Senate, California Bankers Association, California Land Title Association, law firms with debt collection practice, individual California counties, and the Uniform Law Commission.

11. The NPT Report is available for download from the Commission's website under the Reports/Background Studies menu, or directly from this link: http://www.clrc.ca.gov/pub/BKST/BKST-L4100-NPT-Creditors.pdf.

12. In some instances, the insured's life insurance may include an investment component that the insured can take advantage of during life. See, e.g., http://www.investopedia.com/articles/personal-finance/121914/life-insurance-policies-how-payouts-work.asp. Those forms of life

- Transfers of property without probate administration under statutorily defined procedures (e.g., affidavit procedures for personal or real property of small value).
- Transfers of property based on the joint character of ownership (e.g., joint tenancy or community property).

In some instances, a decedent may control the disposition of property that was owned by someone else (e.g., where the decedent has a general power of appointment over someone else's property). Similarly, a decedent may control the disposition of property that the decedent earned or purchased, but cannot realize its full value (e.g., life insurance[13]).

Description of Issue

The primary question in this study is:

> Does the law governing whether nonprobate transfers are liable for a decedent's obligations need to be revised?

Mr. Sterling, in the NPT Report, concludes that the answer to this question is yes. The report indicates that the ad hoc development of nonprobate transfer law has not adequately incorporated the public policies requiring payment of a decedent's just debts and protection of a decedent's dependents.[14]

Previously, the Commission opted to take an incremental approach in this study. In particular, the Commission decided to focus initially on assessing the scope of liability of a nonprobate transfer for creditor claims and family protections, without proposing a comprehensive procedure for enforcement of that liability.[15]

Purpose of Probate

The public policies requiring the payment of a decedent's debts and the protection of a decedent's dependents have traditionally been imposed through the probate process. As indicated in the NPT Report,

> The probate system reflects policy choices and mechanics worked out over many years in fine detail. With respect to creditors of the decedent, for example, the probate system provides notice to creditors, a claims resolution mechanism, and a process for

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insurance are beyond the scope of this memorandum, which focuses on life insurance that pays the insured's named beneficiaries on the insured's death.

13. See *supra* note 12.
14. See NPT Report, p. 151.
15. See Memorandum 2012-45, pp. 12-13; Minutes (Dec. 2012), p. 2.

> satisfying allowed claims. The probate system establishes a policy-based order of abatement to satisfy claims, and a hierarchy of priorities in case the decedent's estate is insolvent.
>
> Likewise the probate system provides for the decedent's dependents in the form of temporary possession of the family dwelling and exempt property, a probate homestead, a family allowance, and a small estate set-aside.
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> The effort to disentangle these types of issues with respect to nonprobate transfers and to provide rational treatment of them is just beginning. The California trust law now addresses the matter directly.[16]

It is perhaps unsurprising that the issues of family protection and creditor payment have been addressed for trust law. Given the popularity of the revocable trust and the trust's ability to address many different forms of property in a single instrument, the revocable trust is the nonprobate instrument best suited to functioning on its own as a will substitute[17] and, when all the decedent's property is placed in trust, will allow for probate to be avoided altogether. Regarding trust liability, the Probate Code provides an optional creditor claims procedure for trusts and establishes the liability of trust property for a decedent's debts when the probate estate is inadequate.[18]

Aside from the revocable trust, a nonprobate instrument typically addresses only a single type of property (e.g., transfer on death security registration or revocable transfer on death deed). Given the variety of nonprobate instruments and other nonprobate transfers, however, it is possible that a decedent could dispose of all property outside of probate, without use of a trust. In these situations, there may be a patchwork of laws governing whether the individual nonprobate transfers are liable for the decedent's debts or family protections.

CHANGES IN CALIFORNIA LAW SINCE PREPARATION OF NPT REPORT

The NPT Report was prepared in 2010. Since then, the law governing nonprobate transfer liability has changed in some significant ways.

The staff has not comprehensively reviewed the analysis provided in the NPT Report to identify changes in the law. However, the staff is aware of three

16. NPT Report, p. 8.
17. See *id*. at 94.
18. §§ 19000-19403.

changes in California law related to nonprobate transfer liability in recent years. Those changes include:

- Enactment of Uniform Voidable Transactions Act.[19]
- Enactment of Revocable Transfer on Death Deeds.[20]
- Changes to Scope of Medi-Cal Recovery.[21]

Each of these changes is discussed, as relevant, below. **The staff welcomes stakeholder input regarding noteworthy court decisions and changes to California laws that relate to this study.**

LIABILITY OF NONPROBATE TRANSFERS UNDER CALIFORNIA LAW

Nonprobate Transfer Liability, Generally

California law does not provide a singular rule governing the liability of nonprobate transfers.

California law does, however, include a general provision specifying that the authorization of transfers by nonprobate means does not limit "the rights of creditors under any other law."[22] This provision expressly disclaims limiting creditor rights, but does not purport to affirmatively establish creditor rights over nonprobate transfers. Rules that may govern the liability of nonprobate transfers are found primarily in the Probate Code, the Code of Civil Procedure, and the Civil Code.

Traditionally, a decedent's debts were addressed in probate, while the enforcement of money judgments during the decedent's life would be governed by the Code of Civil Procedure.[23] Some of the confusion about the liability of nonprobate transfers relates to whether (and, if so, how) rules governing the liability for money judgments (e.g., exemptions from money judgments, fraudulent transfer rules) generally apply in the nonprobate context. California law provides that the Probate Code governs claims against the decedent's "estate," without specifying whether the reference to the decedent's "estate" is

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19. 2015 Cal. Stat. ch. 44 (SB 161 (Vidak)); see also Civ. Code §§ 3439-3439.14.
20. 2015 Cal. Stat. ch. 293 (AB 139 (Gatto)); see also *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm'n Reports 103 (2006).
21. See 2016 Cal. Stat. ch. 30 (SB 833 (Committee on Budget and Fiscal Review)).
22. See § 5000(c).
23. See generally NPT Report, pp 27-29.

meant as the "probate estate."[24] The exemptions from money judgments set out in the Code of Civil Procedure would appear, by their terms to apply to certain types of nonprobate transfers (e.g., life insurance), however the NPT Report suggests that the "application of exemptions to nonprobate transfer liability is even sketchier than that governing proceedings in probate."[25] The NPT Report suggests that a court may apply exemptions to a nonprobate transfer based on a technical argument, i.e., that the silence of the law as to their application means that general principles, like tracing, could be the basis for a court to "extend a decedent's exemption to a nonprobate transfer."[26]

Liability of Specific Nonprobate Transfers

As a general matter, for a specific type of nonprobate transfer, the transfer falls into one of the following categories of liability:

(1) Liable for a decedent's debts;
(2) Liable for a decedent's debts, if probate estate inadequate;
(3) Not liable for a decedent's debts; or
(4) Not subject to a clear rule of liability.

Each of these categories is discussed in turn below.

The discussion of liability for the decedent's debts in this section focuses only on the decedent's *unsecured* debts.[27]

This discussion assumes, where applicable, that any beneficiary designation on a nonprobate instrument does not name the decedent's estate as the beneficiary. Where the decedent has named the estate as the beneficiary, the property would presumably pass through probate and, thus, be treated in accordance with the rules of probate administration.

Liable

Certain types of nonprobate transfer are generally liable for a decedent's debts under California law. Such liable nonprobate transfers include:

- Statutory Alternatives to Probate.

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24. See Code Civ. Proc. § 686.020; Prob. Code § 9300.
25. NPT Report, p. 97.
26. *Id*. at 98.
27. See *id*. at 20 ("A secured creditor ordinarily does not have a collection problem. Property passes from a decedent to a beneficiary, whether by probate or nonprobate transfer, subject to liens and encumbrances on the property.").

- Revocable Transfer on Death Deeds.
- Nonprobate Transfers of Community Property.

Each of these is discussed in turn below.

Statutory Alternatives to Probate

Generally, the situations in which the nonprobate transfer is liable are optional statutory transfer procedures that can be pursued at the election of the successor to the decedent's property.[28]

The Probate Code provides several statutory options for persons to claim a decedent's property without probate, typically limited to small estates or property of small value. These options include:

- Vehicle or Vessel Claimed with an Affidavit for Transfer Without Probate.[29]
- Small Estate Set-Aside.[30]
- Summary Disposition of Small Estates.[31]
- Affidavit Procedure for Collection or Transfer of Personal Property.[32]
- Court Order Determining Succession to Property.[33]
- Affidavit Procedure for Real Property of Small Value.[34]
- Passage of Property to Surviving Spouse without Administration.[35]

Typically, the recipients of the property under these procedures are liable for the decedent's debts, but that liability is limited to the value of property received.[36]

Revocable Transfer on Death Deeds

In 2015, the Legislature enacted the Commission's recommendation on revocable transfer on death deeds (hereafter, "RTODD").[37] This bill authorizes a

28. See, e.g., NPT Report, pp. 12, 18-19.
29. *Id*. at 18.
30. *Id*. at 33.
31. *Id*. at 34.
32. *Id*. at 39-41.
33. *Id*. at 41.
34. *Id*. at 41-42.
35. *Id*. at 42-43.
36. *Id*. at 12, 18, 33, 34, 39-43. The surviving spouse's liability may not be limited to the value of decedent's property, given the community property rules. See *id*. at 13 ("Because the one-half interest of each spouse remains liable, the [decedent's] liability could be satified disproportionately from … property of the surviving spouse.").

new nonprobate transfer instrument and includes special provisions regarding liability for a decedent's debts.[38]

The RTODD law imposes liability on the beneficiary receiving property under an RTODD.[39] The law limits the liability to the fair market value of the property and any income received from the property.[40] The RTODD law also specifies how the liability can be enforced.[41]

Nonprobate Transfers of Community Property

California's laws on community property specify that "each spouse's interest in community property is liable for the debts of either spouse."[42] This liability survives the death of a spouse.[43]

The NPT Report notes that "[t]ransfer of the decedent's community property interest by means of a nonprobate transfer does not appear to change these rules."[44]

It is not clear, however, whether these liability rules govern community property in joint tenancy form or community property with right of survivorship.[45] These forms of ownership may instead be governed by the rule of nonliability applicable to joint tenancy property, which is discussed further below.

Liable, If Probate Estate Inadequate

Certain types of nonprobate transfer are expressly liable for a decedent's debts under California law, but only when the probate estate is inadequate. Such nonprobate transfers include:

- Property in a Revocable Trust.[46]

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37. 2015 Cal. Stat. ch. 293 (AB 139 (Gatto)); see also *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm'n Reports 103 (2006).
38. See §§ 5670-5676.
39. § 5672.
40. § 5674.
41. §§ 5672, 5676.
42. NPT Report, p. 12, *citing* Fam. Code § 910.
43. *Id*. at 12-13, *citing* Marriage of Barnes, 83 Cal. App. 3d 142, 147 Cal. Rptr. 710 (1978).
44. *Id*. at 13.
45. *Id*. at 13-14; see also discussion of "Joint Tenancy" *infra*. Civil Code Section 682.1 provides that community property with right of survivorship "shall, upon the death of one of the spouses, pass to the survivor, without administration, pursuant to the terms of the instrument, subject to the same procedures, as property held in joint tenancy."
46. NPT Report, pp. 17, 44-45.

- Vehicle, Vessel or Mobile Home Registered in Transfer on Death Form.[47]
- General Power of Appointment.[48]

These are discussed in turn below.

Property in a Revocable Trust

As noted above, California law provides for the liability of the property contained in a revocable trust to the extent that the probate estate is inadequate.[49] This law has been in effect since 1992.[50] The NPT Report indicates that this is the "newest and most significant of the California statutes attempting to allocate a decedent's debts to a nonprobate transfer."[51]

> The basic liability rule – the decedent's trust estate is liable only to the extent the probate estate is inadequate – embodies two significant public policies:
> (1) The trust estate is subject to the decedent's creditors – fraudulent intent is irrelevant.
> (2) The trust estate is only secondarily liable – it is a protected form of nonprobate transfer.[52]

The law also provides that, if there has been no probate or trust claim proceeding, a trust distributee is personally liable for a pro rata share of the decedent's debts, to the extent that the remaining trust estate is inadequate to pay those debts.[53]

Although the liability rules for trusts appear to be sufficiently clear, the NPT Report indicates that the statutory trust law could benefit from clarifying how this liability can be enforced in practice.[54]

Transfer on Death Registration of Vehicle, Vessel, or Mobile Home

California law authorizes a transfer on death registration for a vehicle, vessel, or mobile home (hereafter, collectively, "vehicle").[55] A transfer on death pursuant to such a registration is expressly subject to Probate Code Section 9653,

47. *Id*. at 18, 36-38.
48. *Id*. at 14, 32-33.
49. § 19001.
50. NPT Report, p. 44.
51. *Id*. at 44.
52. *Id*. at. 48-49.
53. *Id*. at 52, *citing* §§ 19400, 19402.
54. See *id*. at 49-51, 52-53.
55. See *id*. at 18, *citing* Veh. Code §§ 5910.5, 9916.5; Health & Safety Code § 18102.2.

which permits a personal representative to recover the vehicle for the benefit of the decedent's creditors if the probate estate is inadequate.[56]

General Power of Appointment

California law provides that a creditor of a decedent "may reach property over which the decedent held a general power of appointment if the decedent's estate is inadequate to cover claims of creditors and expenses of probate."[57] However, if the estate is inadequate, the liability is allocated proportionally between this property and the other estate property:

> [O]nce it is determined that the estate is inadequate, the property is liable 'to the same extent' as it would be if it were owned by the decedent. … That treatment should be contrasted with other liability schemes that make property liable only to the extent the estate is inadequate.[58]

Not Liable

Certain types of nonprobate transfer are typically *not* liable for a decedent's debts.[59] Such nonprobate transfers include:

- Joint Tenancy
- Social Security
- United States Savings Bond

These are discussed in turn below.

Joint Tenancy

Joint tenancy is a form of property ownership, in which the tenants hold equal and undivided interests during life.[60]

During the decedent's life, "the decedent may sever the joint tenancy and the decedent's tenancy in common interest is part of the decedent's estate."[61] In addition, during the decedent's life, "an unsecured creditor may reduce the claim to judgment and levy on the property."[62]

56. See § 9653; see also Veh. Code §§ 5910.5(h), 9916.5(h); Health & Safety Code § 18102.2(h).
57. NPT Report, p. 32, *citing* § 682.
58. *Id*. at 32.
59. This general rule of nonliability may be limited. For instance, if the nonprobate transfer was a voidable transaction, the nonprobate transfer will, at least in some cases, be liable for the decedent's debts. See, e.g., NPT Report, pp. 15 (joint tenancy), 17 (U.S. Savings Bond).
60. NPT Report, p. 14.
61. *Id*. at 89.
62. *Id*. at 89.

However, upon the death of the decedent, the decedent tenant's share passes equally to the surviving joint tenants, by right of survivorship.[63] Generally, the surviving joint tenants receive the property free of claims of the decedent's creditors, including a lien or encumbrance against the decedent's interest.[64]

Joint tenancy is traditionally and most commonly associated with real property. These liability rules appear to have developed in that context. Real property that is community property can be held in joint tenancy form or as community property with right of survivorship. For property held in either of those forms, it is unclear whether the liability rules for community property or for joint tenancy apply.[65]

In addition, there are forms of personal property held in joint tenancy.[66] Whether the liability principles of joint tenancy apply to these forms is not quite clear.[67]

Social Security

Funeral and survivors' benefits from social security are exempt from creditor claims under federal law.[68]

United States Savings Bond

A United States Savings Bond may be reached by the decedent's creditor only if the transfer is fraudulent.[69]

Liability Unclear

For certain types of nonprobate transfer, the law does not include a clear statement establishing or precluding liability for a decedent's debts. Such nonprobate transfers include:

- Multiple Party Accounts.[70]
- Transfer on Death (hereafter, "TOD") Security Registration.[71]

63. *Id*. at 14, 15.
64. See *id.* at 14-15.
65. See *id*. at 13-14.
66. See, e.g., *id*. at 14 (joint safe deposit box), 18 (vehicle, vessel, or mobile home registered in joint tenancy).
67. See, e.g., *id*. at 14 (whether contents of joint safe deposit box pass by joint tenancy depends on the contents of the box).
68. See *id*. at 17; *citing* 42 U.S.C. § 407.
69. See *id*. at 17, *citing* Katz v. Driscoll, 86 Cal. App. 2d 313, 194 P.2d 822 (1948).
70. See *id*. at 16.
71. See *id*. at 17.

- Public Retirement Benefits
- Worker's Compensation Benefits
- Life Insurance.[72]
- Private Retirement Benefits.[73]
- Payment to Beneficiary for Partnership Interest.[74]

The most significant of these transfers are discussed in turn below.

Multiple Party Accounts

California law authorizes multiple party accounts. Such accounts can take the following forms: a Totten Trust account, an account with a pay on death beneficiary designation, and a joint account.[75] These accounts can provide for a nonprobate transfer of the funds in the account on the death of an accountholder.[76] The NPT Report indicates that "[t]he rights of creditors are not spelled out by statute and are far from clear."[77]

TOD Security Registration

California law permits a security to be registered with a TOD beneficiary designation.[78] The TOD Security Registration statute states that it "does not limit the rights" of a creditor of the security owner "under other laws of this state,"[79] but the statute is otherwise silent on the rights of creditors.[80]

Public Retirement Benefits & Worker's Compensation Benefits

Public retirement plan and worker's compensation benefits are fully exempt under California's Enforcement of Money Judgments law.[81] However, the NPT Report suggests that the application of the exemptions to nonprobate transfer liability is somewhat unclear.[82]

The NPT Report also notes that federal law broadly immunizes a retirement plan covered by the Employee Retirement Income Security Act ("ERISA").[83]

72. See *id.* at 15.
73. See *id*. at 16.
74. See *id*. at 16.
75. See § 5132; see also NPT Report, p. 16.
76. See § 5203.
77. NPT Report, p. 16.
78. See generally §§ 5500-5512; see also NPT Report, p. 17.
79. § 5509.
80. NPT Report, p. 17.
81. See *id*. at 16, 18; see also Code Civ. Proc. §§ 704.110, 704.160.
82. NPT Report, p. 97.
83. *Id*. at 100.

Life Insurance & Private Retirement Benefits

Under California's Enforcement of Money Judgments law, life insurance policies and proceeds and private retirement benefits are both subject to an exemption.[84] In each case, the exemption is limited to the amount reasonably necessary for the support of the judgment debtor and the spouse and dependents of the judgment debtor.[85]

As with the exemptions discussed above for retirement and worker's compensation benefits, the application of these exemptions to nonprobate transfer liability is somewhat unclear.[86]

However, for life insurance, case law indicates that a decedent's creditor can obtain proceeds of a fraudulently transferred policy in excess of the exemption.[87]

For private retirement benefits, as with public retirement benefits, ERISA plans are protected by federal law.[88]

Voidable Transactions

The NPT Report discusses a claim that the transfer was a fraud against creditors, under the Uniform Fraudulent Transfers Act, as the "classic approach for a creditor to reach property that passes outside the probate estate."[89]

Changes to the Uniform Law

In 2015, California enacted the Uniform Voidable Transactions Act to replace its prior enactment of the Uniform Fraudulent Transfers Act.[90] The Uniform Voidable Transactions Act is a revision and renaming of the former Uniform Fraudulent Transfers Act.[91] The Uniform Law Commission characterized the changes as "address[ing] a small number of narrowly-defined issues."[92]

As yet, the staff has not reviewed the amendments in detail. Going forward, the staff will be looking more closely at the changes made in the Uniform

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84. *Id*. at 15, 16.
85. Code Civ. Proc. §§ 704.100(c), 704.115(e).
86. NPT Report, p. 97.
87. See *id*. at 15, *citing* Headen v. Miller, 141 Cal. App. 3d 169, 190 Cal. Rptr. 198 (1983).
88. *Id*. at 100.
89. NPT Report, pp. 22-24.
90. 2015 Cal. Stat. ch. 44 (SB 161 (Vidak)); see also Civ. Code §§ 3439-3439.14.
91. See Uniform Voidable Transactions Act, *available at* http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2014_AUVTA_Final%20Act_2016mar8.pdf.
92. See *id*. at Prefatory Note (2014 Amendments).

Voidable Transactions Act to determine whether these changes have implications for nonprobate transfer liability.

Transactions Deemed Voidable

The Uniform Voidable Transactions Act effectively deems three types of personal[93] transactions as voidable:

(1) Transfers made or obligations incurred with actual intent to hinder, delay, or defraud any creditor of the debtor.

(2) Transfers made or obligations incurred without receiving reasonably equivalent value if the debtor intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

(3) Transfers made or obligations incurred without receiving a reasonably equivalent value in exchange and the debtor was insolvent or became insolvent as a result of the transfer or obligation. Such transactions are only voidable as to creditors at the time of the transfer was made or obligation was incurred. [94]

The application of these principles to nonprobate transfers is not entirely clear. The NPT Report suggests that clarification of the interrelationship between nonprobate transfer liability and voidable transactions law would be beneficial.[95]

Recovery of Voidable Transaction

Probate Code Section 9653 authorizes the personal representative to recover property transferred by voidable transaction where the probate estate is inadequate to pay the creditors.[96] This section also permits recovery of a gift causa mortis (gift made in view of impending death) and a vehicle registered in TOD form.[97]

The NPT Report states that:

> Section 9653 is not the exclusive procedure by which a creditor may reach fraudulently transferred property. A creditor may pursue a fraudulent transfer remedy directly, without the intermediary of the personal representative. Probate Code Section 850 (conveyance or transfer of property claimed to belong to decedent or other person) is also available.

93. The Uniform Voidable Transactions Act also contains a provision related to voidable business-related transactions. See Civ. Code § 3439.04(a)(2)(A).
94. Civ. Code §§ 3439.04, 3439.05.
95. NPT Report, p. 24.
96. See *id*. at 36-38.
97. § 9653.

Special Rules for Particular Creditor Claims

There are specialized bodies of law addressing two types of creditor claims: federal estate tax claims and Medi-Cal estate recovery claims. Each of these is discussed briefly, in turn, below.

Federal Estate Tax Claims

The NPT Report discusses federal estate tax law, which is addressed more fully below.[98]

California law includes an estate tax proration system to implement the allocation of federal estate tax liability among beneficiaries and seize property, as needed.[99]

The NPT Report indicates that California's estate tax apportionment scheme may be a useful model for a nonprobate transfer liability system to discharge debts in the absence of a probate or trust proceeding.[100]

Medi-Cal Estate Recovery Claims

The NPT Report discusses the statutory scheme governing reimbursement of Medi-Cal assistance provided to a decedent.[101] Generally, federal law requires the state to seek recovery of certain expenses and permits the state to seek recovery of certain other expenses.[102]

In 2016, California made significant changes to the scope of recovery for Medi-Cal reimbursement.[103]

In particular, California limited the property from which Medi-Cal reimbursement could be sought to the property that federal law requires be subject to reimbursement. This change appears to exclude nonprobate-transferred property from the scope of Medi-Cal reimbursement.[104]

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98. See generally NPT Report, pp. 62-66; see also discussion of "Federal Estate Tax" *infra*.
99. NPT Report, pp. 53-54.
100. *Id*. at 55, 66, 155.
101. *Id*. at 57-61.
102. See, e.g., 42 U.S.C. § 1396p(b).
103. See 2016 Cal. Stat. ch. 30 (SB 833 (Committee on Budget and Fiscal Review)).
104. See Welf. & Inst. Code § 14009.5(a)(2) (expressing intent to limit the definition of estate for purposes of Medi-Cal recovery "to include only the real and personal property and other assets required to be collected under federal law."); 42 U.S.C. § 1396p(b)(4) (estate "(A) shall include all real and personal property and other assets included within the individual's estate, as defined for purposes of State probate law; and (B) may include, at the option of the State (and shall include, in the case of an individual to whom paragraph (1)(C)(i) applies), any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest), including such assets conveyed to a survivor, heir, or assign

In addition, California sought to "prohibit the recovery from the estate of a deceased Medi-Cal member who is survived by a spouse or registered domestic partner."[105] Under the prior law, Medi-Cal recovery could not be pursued until after the death of the surviving spouse (assuming no other specified dependents).[106]

These recent changes give further support to the recommendation in the report to exclude Medi-Cal estate recovery from any comprehensive statute on nonprobate transfer liability.[107] The report bases this recommendation on the fact that Medi-Cal recovery is largely a creature of federal law and is circumscribed by federal law.[108] However, as discussed above, California has also recently revised the scope of Medi-Cal liability for nonprobate transfers under state law. It would be inappropriate to make changes to the scope of Medi-Cal liability for nonprobate assets, given the recent legislation directly addressing this point.

Law in Other Jurisdictions

There are several examples of laws in other jurisdictions that impose liability on nonprobate transfers. The NPT Report discusses four such laws:

(1) Federal Estate Tax
(2) Missouri Statute
(3) Washington Statute
(4) Uniform Law

Each of these provisions is discussed briefly below.

Federal Estate Tax

Federal estate tax is based on the decedent's gross estate, which includes all of a decedent's probate and nonprobate property.[109] Specifically, the following types of property are subject to liability for federal estate tax:

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of the deceased individual through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement.")

105. See Welf. & Inst. Code § 14009.5(a)(4).

106. See Welf. & Inst. Code § 14009.5 (as amended by 1995 Cal. Stat. ch. 548, §2); see also Cal. Dep't of Health Care Servs., Changes to Estate Recovery effective January 1, 2017 due to Legislation SB 833, *available at* http://www.dhcs.ca.gov/services/Documents/Changes_to_Estate_Recovery_effective_January_1.pdf.

107. NPT Report, p. 61.

108. *Id*.

109. *Id*. at 62.

- A transfer that takes effect at death.
- A revocable transfer, including the decedent's revocable inter vivos trust.
- A decedent's interest in joint tenancy property.
- Life insurance proceeds.[110]

Federal law requires that the tax be apportioned among *all* recipients of a decedent's property in proportion to the value of property received.[111] California law provides a special procedure for apportioning the estate tax appropriately among probate and nonprobate property.[112]

Federal law on estate tax provides the Internal Revenue Service with enforcement authority to recover unpaid estate taxes and allows transferees who pay more than their share to seek reimbursement from other recipients of the decedent's property.[113]

Given that this scheme ultimately relies on the federal tax lien authority, the NPT Report concludes that the federal estate tax scheme is "not an appropriate mechanism for dealing with private debts and family protections."[114]

Missouri

Missouri law provides for liability of transferees of "recoverable" nonprobate transfers for a decedent's debts and family protections, to the extent that the decedent's probate estate is insufficient.[115] This liability is enforced in an action for accounting by the decedent's personal representative.[116]

The NPT Report indicates that the nonprobate transfers covered by the Missouri law include "a transfer of property taking effect upon the death of the owner pursuant to a beneficiary designation, plus 'any other transfer of a decedent's property other than from the administration of the decedent's probate estate that was subject to satisfaction of the decedent's debts immediately prior to the decedent's death, but only to the extent of the decedent's contribution to the value of such property.'"[117] The NPT Report states that trust beneficiaries and

110. *Id*. at 62-63, *citing* 26 U.S.C. §§ 2037, 2038, 2040, and 2042.
111. *Id*. at 63.
112. *Id*. at. 63; see also *id*. at 53-55.
113. *Id*. at 64-66.
114. *Id*. at 66.
115. *Id*. at 66-67.
116. *Id*. at 66.
117. *Id*. at 85, *quoting* Mo. Rev. Stat. § 461.300(10)(4).

surviving joint tenants would be subject to liability under this provision.[118] The NPT Report does not discuss, however, whether certain nonprobate transfers, including life insurance and retirement benefits, would be "recoverable transfers" within the scope of this law.

The NPT Report indicates that the Missouri scheme may help to provide procedural details for a system premised on personal representative enforcement of nonprobate transfer liability.[119]

Washington

Washington law provides two separate procedures to be used for nonprobate liability; one procedure for use in a probate proceeding and one where there is no probate.[120]

Where there is a probate, Washington law requires the beneficiary of a nonprobate transfer to account to the personal representative for liabilities, claims, estate taxes, and a share of administration expenses. The law exempts recipients from accounting for life insurance, retirement, and pension benefits under this rule.[121]

Where there is no probate, Washington law provides for a person (or group of persons) who, by reason of the decedent's death, is entitled to receive substantially all of the decedent's property to give notice to creditors. This notice process is akin to probate in that it forces creditors to file a claim in a timely fashion or be barred from recovery.[122]

The NPT Report notes that the nonprobate notice claim process under Washington law is similar to California's trust claim process, but Washington makes this process available to a broader range of nonprobate beneficiaries.[123]

Uniform Law

In 1989, the Uniform Law Commission prepared the Uniform Nonprobate Transfers on Death Act, which addresses the liability of nonprobate assets for a

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118. *Id*. at 66.
119. *Id*. at 67.
120. See *id*. at 67-69.
121. *Id*. at 67-68.
122. *Id*. at 68.
123. *Id*. at 69.

decedent's debts and family protections.[124] This Act has been incorporated into the Uniform Probate Code.[125]

The NPT Report identifies six jurisdictions that have enacted the relevant provision (Section 102 of the Uniform Nonprobate Transfers on Death Act or Section 6-102 of the Uniform Probate Code, hereafter, "Section 102").[126] In the staff's research, we have found that at least two additional jurisdictions, the District of Columbia and Montana, have adopted this provision.[127]

The NPT Report analyzes Section 102 in considerable detail, but, for this memorandum, only certain key features of the provision are noted.[128]

Section 102 provides for the liability of a nonprobate transfer for the decedent's debts and family protections, to the extent that the decedent's probate estate is insufficient.[129] The liability of an individual nonprobate transfer is limited to the value of the property.[130]

Section 102 also establishes a default order of abatement for nonprobate transfers (once the probate estate is exhausted, debts are first paid from the trust, then from other nonprobate-transferred property, absent other direction from the decedent).[131]

Finally, certain types of property are not covered by Section 102,[132] including:

(1) Property over which the decedent held a general power of appointment.
(2) Real property transferred by right of survivorship under joint tenancy.
(3) Property in a joint ownership form that, prior to the death of the decedent, was owned by the decedent's co-tenant (i.e., the liability

124. *Id*. at 69-81.
125. See Article VI of the Uniform Probate Code (Nonprobate Transfers on Death). See, in particular, Section 6-102 (Liability of Nonprobate Transferees for Creditor Claims and Statutory Allowances). The Uniform Probate Code is available at:
http://www.uniformlaws.org/shared/docs/probate%20code/UPC_Final_2016aug1.pdf.
126. NPT Report, p. 69 (The six jurisdictions are Arizona, Colorado, Idaho, Indiana, New Mexico, and the Virgin Islands.).
127. See D.C. Code § 19-601.02 (2016); Mont. Code § 76-2-228 (2015).
It is, perhaps, worth noting that prior versions of the Uniform Probate Code contained provisions regarding the liability for creditor claims and family protections for specific types of nonprobate instruments. A number of state statutes include such provisions. See, e.g., N.D. Cent. Code § 30.1-31-12; Neb. Rev. Stat. § 30-2726; S.C. Code Ann. § 62-6-205.
128. See generally NPT Report, pp. 69-81.
129. See *id*. at 69.
130. *Id*.
131. *Id*.
132. *Id*. at 70-73.

of the recipient of a bank account held in joint tenancy is limited to the decedent's share of the funds in the account, not the full account).

(4) Property that would be exempt from a creditor's claim under the state's enforcement of money judgments law.

The NPT Report identifies several concerns about the provision that may need to be addressed if this provision is used as a model in the Commission's work.[133]

Policy Issues

The NPT Report identifies a host of different issues that may need to be addressed to comprehensively address the issue of liability of nonprobate transfers for a decedent's debts. These issues include, among other things:[134]

- Providing a definition of nonprobate transfer.
- Reevaluating the nonliability of joint tenancy property.
- Determining the priority, if any, of nonprobate transfers (i.e., are such assets only liable to the extent that the probate estate is insolvent?).
- Clarifying whether and how the general probate abatement scheme applies to nonprobate transfers.
- Reconciling the exemptions from money judgments with the family protection provisions in the Probate Code.
- Clarifying how exemptions work for property transferred by nonprobate means.
- Assessing whether and how to prioritize among creditors who seek to hold nonprobate transfers liable for debts.
- Developing a scheme for enforcement of liability against and collection of nonprobate transfers.

Family Protections

Finally, the NPT Report discusses the family protection provisions in the Probate Code. These provisions allow a surviving spouse or children to receive (either temporarily or permanently) certain property of the decedent. In this memorandum, the focus is on the family protections that seem to be either impliedly or expressly need-based.[135]

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133. See, e.g., *id*. at 71 (recommending expressly identifying property excluded from the provision), 72 (same), 76 (recommending clarifying scheme for abatement of property within a trust).

134. See generally *id*. at 82-137.

135. The NPT Report discusses the Small Estate Set-Aside as a nonprobate transfer mechanism, as well as a family protection. This memorandum addresses the Small Estate Set-Aside as a

As a general matter, the preceding discussion on the liability of nonprobate transfers does not apply to family protections. Many of the statutory family protections appear to only apply in a probate proceeding.[136]

Temporary Family Protections

Certain family protections in the Probate Code seem implicitly designed to limit the financial hardships and difficulties faced by the surviving spouse and dependent children temporarily, in the immediate aftermath of the decedent's death. For instance, the Probate Code provides for the surviving spouse and children to retain possession of certain property and receive an allowance during the course of probate administration.[137] These provisions would presumably limit the upheaval during an already difficult time.

Long-Term Family Protections

Other Probate Code provisions offer more long-term assistance to the family, when needed. Specifically, the code authorizes the probate court to set aside certain property for the surviving spouse and children.[138] Depending on the character of the property, the set-aside property may be either permanently[139] or temporarily[140] relieved from liability for the decedent's debts.

Family Protections More Broadly

The NPT Report focuses primarily on family protection provisions that would operate during probate. Thus, unless a nonprobate transfer is somehow pulled

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nonprobate transfer mechanism. See discussion of "Statutory Alternatives to Probate" *supra*. It is worth noting that the recipient spouse or child of such a set-aside would be subject to personal liability for the decedent's debts.

The NPT Report also discusses the Omitted Spouse/Child will and trust reformation devices as family protections. The report notes that these provisions, providing an intestate share to an omitted spouse or child, are intended to apply only to unintended disinheritance. This seems to be a significant difference, as these provisions would not apply in situations where the decedent intentionally disinherited a spouse or child, regardless of whether the spouse or child has a need for the inheritance. See NPT Report, pp. 148-150.

136. See, e.g., NPT Report, pp. 141-142 (surviving spouse and children have right to temporary possession of the family dwelling and exempt property "[u]ntil the [probate] inventory is filed and for a period of 60 days thereafter, or for such other period as may be ordered by the court for good cause on petition therefor").

137. See *id*. at 137 (family dwelling and exempt property), 138 (family allowance).

138. See *id*. at 137 (exempt property), 138 (probate homestead and small estate).

139. *Id*. at 137 (for the decedent's exempt property, "[i]t appears this is a permanent award, notwithstanding claims of other beneficiaries or creditors.").

140. *Id*. at 138 (probate homestead "is a burden on the property for a limited period, not exceeding the life of the surviving spouse and the minority of the children.").

back into a probate proceeding, these family protections would not appear to apply.

However, certain nonprobate transfers may themselves provide something akin to family protection, by providing property to the family. For instance, a few forms of nonprobate transfer are necessarily transfers to a surviving spouse or children.[141] Further, the exemptions from liability applicable to certain types of nonprobate property have also been justified as a form of family protection.[142]

NEXT STEPS

This memorandum was intended to provide a summary of the general "lay of land" of nonprobate transfer liability, as detailed in the NPT Report. In the next memorandum, the staff will begin analyzing possible approaches for addressing the issue of nonprobate transfer liability.

Respectfully submitted,

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141. See *id*. at 11-14 (community property), 17 (social security benefits).
142. See *id*. at 99 (life insurance), 100 (retirement accounts).