#F-3050/L-3050

ns82
03/19/91

Memorandum 91-32

Subject: Study F-3050/L-3050 - Donative Transfers of Community Property (Policy Issues)

Background

At the April 1991 meeting the Commission began its review of issues raised by Estate of MacDonald, 51 Cal. 3d 262 (1990). After receiving the background study prepared by its consultant Professor Kasner, and after hearing the remarks of other interested persons present at the meeting, the Commission decided to proceed with issues related to beneficiary designations for donative transfers of community property with the objective of legislation for the 1992 session. Other issues raised in the background study and at the meeting, such as revision of the transmutation statute, should be addressed when time permits, after giving priority to the beneficiary designation problems.

This memorandum presents in relatively concise form policy issues raised in Professor Kasner's study and by the staff that the Commission will need to resolve in developing a recommendation to govern the nonprobate transfer problems. Staff recommendations appear in underscore. An outline of the memorandum discussion follows:

Background
Terminology
Overriding Principles
Community Property Gift Limitations
Form of Consent to Donative Transfer
Rights in Property During Marriage
    Where donative transfer is made without consent
    Where donative transfer is made with consent
Rights in Property After Death of Donor Spouse
Rights in Property After Death of Consenting Spouse
    Revocability by estate of consenting spouse
    Revocability by surviving donor spouse
Special Problems
    Gifts in view of impending death
    Life insurance
    Retirement plans and death benefits
    Quasi-community property

Terminology

This memorandum ordinarily refers to a spouse who makes a beneficiary designation affecting community property as the "donor spouse" and the other spouse as either the "consenting spouse" or the "nonconsenting spouse". In some cases both spouses join in a transaction, so this terminology is somewhat artificial. However, as a general rule there is no need to distinguish between the case where one spouse gives and the other consents to the gift, and the case where both spouses join in the gift.

This memorandum also uses the terms "donative transfer", "nonprobate transfer", and "beneficiary designation" somewhat interchangeably. They all refer to a transfer in the nature of a gift that is intended to take effect at death of one or both of the spouses. The terms would include such items as transfers at death in life insurance policies, bank accounts, pension plans, trusts, and the like.

A number of the key issues addressed in this memorandum involve the donor spouse making a change in beneficiaries or revoking a beneficiary designation after the consent of the consenting spouse. A reference in this memorandum to a change in beneficiaries is intended to apply as well to other changes by the donor spouse such as election of a different benefit or payment option.

Overriding Principles

Issues relating to the effect of a donative transfer and consent or lack of it on community property rights and dispositions arise in the context of an attempt to ascertain the presumptive intent of the parties. Where the intent of the parties is clearly stated in writing, this would control over any other principles that we develop. This concept should be stated expressly and should be emphasized throughout the statute.

Likewise, where the terms of a nonprobate instrument limit or preclude changes in beneficiaries, etc., these terms would generally control over contrary provisions relating to spousal community property rights.

Community Property Gift Limitations

Although either spouse has management and control of community property, by statute neither may make a gift of the community property without the written consent of the other. Civil Code § 5125(b). This statute has been applied to gifts intended to take effect at death as well as to gifts intended to take effect immediately. A nonprobate transfer of community property is in effect a donative transfer or gift designed to take effect at the death of a spouse. As such, it is subject to the spousal consent requirement. Professor Kasner does not suggest that this requirement be altered, and the staff does not recommend it. It represents a fundamental protection to the community property rights of the spouses under California law.

The staff believes that in connection with clarification of the rules governing donative transfers of community property, the law should also be codified that the gift statute applies.

Form of Consent to Donative Transfer

One issue that should be addressed is the form of writing necessary to satisfy the requirement of consent to a donative transfer of community property. The MacDonald case holds that the following signed writing is not a transmutation of property rights between the spouses:

> If participant's spouse is not designated as the sole primary beneficiary, spouse must sign consent. Consent of Spouse: Being the participant's spouse, I hereby consent to the above designation.

Whether it would be a sufficient writing to amount to consent to a gift, on the other hand, is not clear. The MacDonald court declined to address this issue since it was raised for the first time on appeal. But the court states in unclear dictum in a footnote that the gift statute may not be used to avoid transmutation requirements. Estate of MacDonald, 51 Cal. 3d 262, 272 n.8 (1990).

The dictum is confusing because transmutation of property from community to separate is different from an agreement that community property may pass to a third person at death of a spouse. Different requirements and standards are appropriate in these situations. The staff agrees completely with Professor Kasner's conclusion that:

> The effect of spousal consents to death beneficiary designations and other forms of will substitutes involving community property should be determined 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 that took effect at death.

Professor Kasner recommends, and the staff agrees, that the statute should state clearly that, while the gift statute applies to a donative transfer of community property, the transmutation statute does not; the consent is to be judged by gift standards and not by transmutation standards.

However, the gift standards are not completely adequate. Civil Code Section 5125(b) precludes a spouse from making a donative transfer "without the written consent of the other spouse". The MacDonald case is unique among the reported cases in that the consenting spouse actually gave a written consent to the beneficiary designation on the IRAs. The other cases invalidating donative transfers involve arguments that despite the failure of the other spouse to give written consent, either consent should not be required or oral consent should be sufficient or there was a transmutation or an estoppel or a waiver of rights or a ratification of the gift. Professor Bruch, in her study for the Commission on this matter, observes that "A court faced with an objection to customary transfers might find a ratification of the gift or sale or an implied waiver of the writing requirement, but there seems no sound reason to require such doctrinal machinations."

The courts in the cases, however, have been relatively unsympathetic to arguments that failure of written consent should be excused, in light of the clear statutory requirement. This is true even though in many cases there is evidence that the other spouse was aware of the transfers and did not object. Marriage of Stephenson, 162 Cal. App. 3d 1057 (1984), for example, involved a number of community property savings accounts opened for the couples' minor children under the Uniform Gifts to Minors Act, with the husband named as custodian. The evidence showed that the accounts were opened with the knowledge, consent, approval, and participation of both spouses, but there was no evidence of the wife's written consent. The court found no waiver or

estoppel due to the absence of detrimental reliance by the children or potential unjust enrichment of the wife, and held the gifts were voidable.

Section 5125(b) is inflexible and in need of revision. Possible improvements include that small or moderate gifts be allowed without written consent and that unwritten consent be permitted, with the burden of proof of unwritten consent on the donor spouse.

Rights in Property During Marriage

Where donative transfer is made without consent. If the donative transfer of community property is made by one spouse acting alone without the consent of the other spouse, the gift statute is violated and standard community property rules apply. The nonconsenting spouse may revoke the gift in its entirety during the marriage, and may revoke as to the spouse's one-half interest at termination of the marriage by dissolution or death. The staff believes it would be useful to codify these case law rules as part of comprehensive legislation on the subject.

Where donative transfer is made with consent. If the donative transfer of community property is joined in or consented to by both spouses, what is the legal effect of the transfer on their rights in the property while the marriage remains intact? The donative transfer, unlike an outright gift, is intended to take effect at the death of one or both spouses. Is it revocable, meanwhile? If a gift is made by one spouse acting alone, the gift is not revocable by that spouse, only by the nonconsenting spouse. By implication, if the gift has been joined in or consented to by both spouses, it would be revocable by neither.

Professor Kasner believes that these results are inappropriate in the context of a donative transfer. He states that a person who consents to a donative transfer during the marriage should be able to revoke the consent just as the person generally could revoke a will, revocable trust, or beneficiary designation. He would establish the rule that if the gift is not intended to take effect until death, it should be revocable by either spouse until that time. This would be

consistent with the principle that a consent to a gift is not a transmutation of the consenting spouse's interest in community property to the donor spouse's separate property.

There are problems with revocation during marriage. The right should not extend to any transfer that by its terms is irrevocable, such as an irrevocable trust. If the nonprobate transfer was made as part of a mutual estate plan of the spouses, does revocation by either spouse amount to a breach of contract that allows changes by the other spouse? Suppose changes by the other spouse are not possible because irrevocable dispositions have already been made pursuant to the mutual estate plan or because the other spouse now lacks legal capacity or is simply unaware of the changes made by the revoking spouse?

These concerns also point up practical problems in allowing either spouse to revoke at will. Must the revocation be in writing? When is it effective, and how will the time of execution be proved? Must it be delivered to be effective? To whom? If to the other spouse or the named beneficiary, suppose they claim nonreceipt of the revocation? If to a third party fiduciary such as a bank, trustee, or custodian, shouldn't the other spouse receive notice? What is the effect of revocation on a third party fiduciary--may it still pay out to the named beneficiary or must it return the property to either or both spouses, or must it hold the property until it receives a court order directing disposition of the property?

Can the consenting spouse revoke a previously given consent by will? If so, is it sufficient to dispose of the consenting spouse's share of the community property, or must there be a specific devise of the property that is the subject of the previously-consented-to donative transfer? If the consenting spouse may revoke by will, shouldn't the donor spouse be able to do the same? But this conflicts with the basic concept of the nonprobate transfer that passes by its terms outside the probate estate.

The Commission will need to grapple with all these subsidiary issues, if it adopts the liberal revocation approach suggested by Professor Kasner. Alternatively, the Commission may want to consider the possibility of providing that once both spouses have agreed to a beneficiary designation, the designation may not be changed during the

marriage without the consent of both spouses. The staff believes this approach deserves serious consideration both because it resolves many practical problems and because it ensures that a mutual estate plan remains mutual.

Rights in Property After Death of Donor Spouse

Suppose the donor spouse dies before the consenting spouse. Both spouses agreed to a donative transfer on the death of the donor spouse, nothing has intervened to cause any changes, and the property should pass as consented to. This is no different from an outright gift that is consented to in writing by a spouse, and there is no occasion here for revocation. This fundamental principle should be codified for completeness.

On the other hand, if the donor spouse dies without having obtained the consent of the surviving spouse, Professor Kasner recommends that the surviving spouse may rescind as to the surviving spouse's one-half interest in the community property. This is consistent with basic community property principles, and the staff agrees it should be codified.

Rights in Property After Death of Consenting Spouse

In the facts of MacDonald, the husband made a transfer of community property to an IRA payable on his death to a trust for the benefit of his children. The wife consented to this donative transfer of the community property, but died before the death of the husband and thus before the community funds had actually passed to a third party beneficiary. Should the wife's estate be entitled to one-half of those community funds? If not, does the husband continue to have full control of the property, including the right to change beneficiaries or use it for other purposes?

Revocability by estate of consenting spouse. With respect to the first question, Professor Kasner argues that the consenting spouse's consent in effect is itself a donative transfer of the spouse's interest in the community property. As such it should become an irrevocable completed transfer at the consenting spouse's death. This analysis makes sense to the staff. To allow the deceased spouse's

personal representative or successors to revoke the spouse's consent to a donative transfer is in effect to allow beneficiaries disfavored by the spouse's decision during lifetime to alter the spouse's community property disposition in favor of themselves after the spouse's death.

Revocability by surviving donor spouse. Assuming the estate of the deceased consenting spouse may not revoke, what are the rights of the surviving donor spouse? Professor Kasner suggests three possible resolutions of this issue:

(1) The consent of the wife was in effect a waiver or transmutation of rights to the husband who now has full power to revoke or otherwise deal with the community property. This was the argument rejected in MacDonald, at least without an express declaration of the wife's intent to do this.

(2) The death of the wife does not affect her expressed donative intent to pass her share of the community property by nonprobate transfer to the named beneficiaries. Her death seals her part of the transfer. Any subsequent actions by the husband can only affect his interest in the community property.

(3) Any changes in condition after the death of the wife that would cause the husband to change beneficiary designations or otherwise deal with the property are ones of which the wife was unaware. If any changes occur, then her interest in the community property should pass with the rest of her estate to her intended beneficiaries.

The first alternative was supported by Professor Halbach at the April Commission meeting, on the theory that by consenting to the husband's beneficiary designation the wife understands that circumstances change and that the husband may change beneficiaries, and she agrees with that concept and reposes trust in him or she would not have consented to the gift of her community property interest in the first place. The second alternative is supported by Professor Kasner on the theory that that is the best indication we have of the decedent's intent and it should be effectuated. The third alternative is supported by the argument that such a resolution is most likely to conform to the wife's probable intent were she to have a say in the matter.

There are two additional alternatives the Commission might consider:

(4) The husband may not change beneficiary designations at all after the wife's death. The two agreed on a mutual estate plan, and the husband should not be able to alter it after the wife is out of the picture.

(5) The husband may change beneficiary designations with the consent of the deceased wife's legal representative. This would protect the interests of the wife's beneficiaries while building some flexibility into the situation.

Special Problems

Professor Kasner addresses special problems for certain nonprobate transfers.

Gifts in view of impending death. Professor Kasner suggests special rules for gifts in view of impending death. The staff believes the Commission should defer this matter while it works on the general rules governing nonprobate transfers. When it has completed this task it can revisit this issue and see whether or not the general rules should apply in light of the unique circumstances pointed out by Professor Kasner.

Life insurance. Professor Kasner proposes a statutory definition of the community property interest of the noninsured spouse in life insurance. This is a collateral issue that the staff recommends the Commission address on a lower-priority basis.

Retirement plans and death benefits. Professor Kasner proposes a statutory provision that a nonemployee spouse may make a testamentary or nonprobate disposition of the nonemployee spouse's interest in the employee spouse's pension plan, to the extent not inconsistent with the provisions of the plan or with state or federal law. That's not saying much, but the staff agrees with Professor Kasner that we ought to stay out of the thicket of federal preemption and the status of the terminable interest rule at this time.

In this connection Professor Kasner would make clear that a waiver of a right to a joint and survivor annuity or survivor's benefits under the Retirement Equity Act of 1984 is not a transmutation of the

nonemployee spouse's community interest in the pension plan. However, a married person should be able to waive property rights in these and other nonprobate transfers by complying with the waiver provisions in the Probate Code. The staff agrees that these principles should be clarified.

Quasi-community property. Professor Kasner does not focus on treatment of quasi-community property rights for fear of further complicating an already-complex area. He does have suggestions for how to deal with quasi-community property, and the staff believes it will be worth looking at these later after we have worked out our basic approach with respect to community property.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary