#F-521 01/10/84

Memorandum 84-8

Subject: Study F-521 - Community Property in Joint Tenancy Form (Revised Recommendation--staff draft)

During the past year the Commission developed its recommendation relating to community property and joint tenancy. However, we have held up printing the recommendation, and are only submitting the portion relating to severance of a joint tenancy by written declaration to the current legislative session, in order to allow the Commission time for further consideration of several key matters. This memorandum deals with the most important aspect of the recommendation, community property in joint tenancy form.

The Commission's basic policy approach has been that property acquired during marriage in joint tenancy form should be presumed to be community for all purposes during marriage, but upon the death of a spouse it should be treated as joint tenancy and pass to the surviving spouse. However, this approach creates two significant problems: (1) it is likely that the IRS would also treat the property as joint tenancy for income tax basis purposes following the death of a spouse, thereby precluding favorable community property treatment; and (2) if the property passes automatically to the surviving spouse, the spouses lose the opportunity to pass it by will to an exemption equivalent testamentary trust for the surviving spouse and thereby avoid having it subjected to estate taxes.

The staff has examined a number of different approaches to accomplishing the result desired by the Commission, without incurring serious tax disadvantages. None of these approaches, in the staff's opinion, can do this successfully:

(1) Rather than being characterized as community property with right of survivorship, the property could be characterized as community property without right of testamentary disposition. The staff believes property of this type probably would receive community property income tax treatment. However, it is clear that it could not be passed to an exemption equivalent testamentary trust, and thus is unduly restrictive.

(2) The community property could be made not subject to testamentary disposition except to a trust for the benefit of the surviving spouse. While this would seem to satisfy the basic tax concerns, as a practical

matter the staff believes it is too restrictive. There is a problem in describing what sort of trust will satisfy the statutory standard. Also, suppose the surviving spouse does not agree the property should go to a trust, or believes the terms of the trust are too restrictive, and wishes to take the property outright; the proposed solution does not accomodate this situation.

(3) The community property could be made not subject to testamentary disposition except with the consent of the surviving spouse. This looks like a good solution, except that it runs afoul of a different tax law. The ability of the surviving spouse to receive the property or to direct it elsewhere by giving or withholding consent to a testamentary disposition would likely be construed by the IRS to be in effect an exercise or release of a general power of appointment, and therefore taxable as such.

(4) A different technique to the same end would be to provide that the property is not subject to testamentary disposition but make clear that the surviving spouse may disclaim the interest received by intestate succession. This would enable the testator to effectively dispose of the property by will, including a disposition in trust to the surviving spouse, in cases where the survivor agrees with this disposition. However, this solution also appears likely to run afoul of the tax laws. The IRS takes the position that a disclaimer as to an interest in joint tenancy is not effective unless made within 9 months after creation of the joint tenancy, since the interest of the survivor is created when the joint tenancy is created and not when the first joint tenant dies. It seems probable the IRS would apply similar reasoning in the analogous situation of community property in joint tenancy form--the interest of the survivor is created at the time the property is taken in joint tenancy form rather than at the time of death of the first spouse, and therefore a disclaimer made more than 9 months after title is taken is not valid for taxation purposes.

(5) A final approach would be to make the property subject to testamentary disposition just as any other community property, except that the joint tenancy form would confer on the survivor the right to elect to take against the will. Unfortunately, this looks even more like the exercise or release of a general power of appointment by the surviving spouse than the approach outlined above in paragraph (3), and is even more likely to result in being treated as such for tax purposes.

In the staff's opinion, all of the above approaches satisfy the Commission's basic policy objective of assuring community property treatment during marriage, passing the property to the surviving spouse at death, but still allowing flexibility to create a testamentary trust where this is mutually agreeable to the spouses. However, all of the above approaches the staff believes will cause tax or practical problems of one kind or another to such an extent that the staff believes none of the approaches should be pursued.

At this point, we can see only two alternatives: (1) keep existing law, or (2) shift policy objectives somewhat. In favor of keeping existing law is that its uncertainty and ambiguity create flexibility to pass community property in joint form to the survivor or to a trust as the survivor sees fit, simply by creatively shaping the facts to characterize the property as community or true joint tenancy, depending on the desires of the survivor. Against keeping existing law is that it preserves all the problems we are trying to eliminate--confusion over rights during marriage, litigation over rights of creditors and devisees at death, perjury necessary to obtain favorable tax treatment.

The staff believes existing law should be cleaned up, even at the expense of departing from the Commission's policy objectives somewhat. Most of what the Commission wants can be accomplished by providing that property held by married persons in joint tenancy form is presumed to be community for all purposes except that the property is subject to testamentary disposition only by specific devise. This approach was suggested to the staff by Professor Jerry Kasner of University of Santa Clara Law School, and the staff believes it is sound.

It accomplishes nearly all of the Commission's objectives, with favorable tax treatment. First, it ensures that the property will be treated as community during marriage. Second, it ensures that the property will receive community tax basis treatment upon the death of the first spouse. Third, it causes the property to pass to the survivor by intestate succession, unless the decedent has made a specific devise of the property; a general devise is not adequate. Fourth, it gives the decedent flexibility to devise the property to a testamentary trust.

However, it differs from the Commission's basic policy in that it enables the decedent, by making a specific devise, to give the property to a testamentary trust without the consent of the survivor, or even

outright to a third person. But the staff does not believe this is so far removed from the Commission's basic objective to treat the property in the same manner as joint tenancy at death. After all, a joint tenant can give the property by will to a testamentary trust without the consent of the survivor, or even outright to a third person, simply by unilaterally severing the joint tenancy before death. Requiring a specific devise of community property is analogous to requiring a severance in order to devise joint tenancy property. The community property will pass automatically to the survivor unless the decedent specifically identifies the property as intentionally being passed by will, just as joint tenancy property automatically passes to the survivor unless the decedent takes steps to enable testamentary disposition by specifically identifying the property in a severing document. We could even require that the decedent record a prior severance of community property in joint tenancy form in order to make the testamentary disposition effective, if the Commission feels this is necessary.

We are convinced this approach is basically sound and not inconsistent with the Commission's policy. The staff has prepared a revised recommendation along these lines, attached as Exhibit 1. If the Commission approves the draft, the staff believes we should once again distribute this revised recommendation for comment.

Respectfully submitted

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EXHIBIT 1

STAFF DRAFT

968/676

An act to add Article 5 (commencing with Section 5110.510) to Title 8 of Part 5 of Division 4 of, and to repeal Section 4800.1 of, the Civil Code, relating to community property.

Civil Code § 4800.1 (repealed)

SECTION 1. Section 4800.1 of the Civil Code is repealed.

~~4800.1. For the purpose of division of property upon dissolution of marriage or legal separation, property acquired by the parties during marriage in joint tenancy form is presumed to be community property. This presumption is a presumption affecting the burden of proof and may by rebutted by either of the following:~~

~~(a) A clear statement in the deed or other documentary evidence of title by which the property is acquired that the property is separate property and not community property.~~

~~(b) Proof that the parties have made a written agreement that the property is separate property.~~

Comment. The substance of former Section 4800.1 is continued in Section 5110.510 (community property presumption).

315/59

Civil Code §§ 5110.510-5110.590 (added)

SEC. 2. Article 5 (commencing with Section 5110.510) is added to to Title 8 of Part 5 of Division 4 of the Civil Code, to read:

Article 5. Community Property In Joint Tenancy Form

§ 5110.510. Community property presumption

5110.510. (a) Property held by married persons during marriage in joint tenancy form is presumed to be community property.

(b) The presumption established by this section is a presumption affecting the burden of proof and may be rebutted by the following:

(1) A clear statement in the deed or other documentary evidence of title by which the property is acquired that the property is separate property and not community property.

(2) Proof that the married persons have made a written agreement otherwise.

(c) The presumption established by this section may not be rebutted by tracing the contributions to the acquisition of the property to a separate property source. Nothing in this subdivision limits the right of a party to reimbursement for separate property contributions pursuant to Section 4800.2.

Comment. Section 5110.510 creates an exception to the presumption of Section 683 that community property held in joint tenancy form is joint tenancy. Instead, property taken in joint tenancy form during marriage is presumed to be community property. This reverses case law that treated community property in joint tenancy form as either community property or joint tenancy, depending upon the intent of the parties. See, e.g., discussion in Sterling, Joint Tenancy and Community Property in California, 14 Pac. L.J. 927 (1983). Section 5110.510 is consistent with former Section 4800.1 (for purposes of division, property acquired in joint tenancy form during marriage presumed to be community property), and expands the community property presumption for all purposes of characterization, not just for purposes of division at dissolution of marriage. Section 5110.510 does not distinguish between community property and quasi-community property, since both spouses have a current interest in property held in joint tenancy form.

The presumption of Section 5110.510 may be overcome by contrary evidence of the express intention of the parties in the form of a written statement, in the deed or otherwise, negating the community character and affirming the separate character of the property. Subdivision (b). This will help ensure that any transmutation of community property to separate property by the spouses is in fact intentional.

Ownership of property presumed to be community pursuant to this section is qualified by a reimbursement right at dissolution for separate property contributions to its acquisition. Section 4800.2. See also Section 5110.520 (limitation on testamentary disposition).

045/127

§ 5110.520. Limitation on testamentary disposition

5110.510. Notwithstanding Section 6101 of the Probate Code, a will may not dispose of the one-half of community property in joint tenancy form that belongs to the decedent except by specific devise.

Comment. Section 5110.520 imposes a limitation on testamentary disposition of community property in joint tenancy form. Apart from this limitation, the property is community for all purposes and receives community property treatment at death, including tax and creditor treatment and passage without probate (unless probate is elected by the surviving spouse). Prob. Code § 649.1. Because the names of both spouses appear on the property title in this form of tenure, title in the survivor may in the ordinary case be cleared by affidavit in the same manner as joint tenancy, without the need for court confirmation pursuant to Section 650 of the Probate Code.

§ 5110.550. Joint bank accounts

5110.550. This article does not apply to a joint account in a financial institution if Part 1 (commencing with Section 5100) of Division 5 of the Probate Code applies to the account.

Comment. Section 5110.550 makes clear that the Probate Code provisions governing joint accounts prevail over this chapter. See Prob. Code § 5305 (presumption that sums on deposit are community property).

405/793

§ 5110.590. Transitional provisions

5110.590. (a) As used in this section, "operative date" means January 1, 1986.

(b) Subject to subdivision (c) and (d), this article applies to all property acquired by married persons before, on, or after the operative date.

(c) This article does not apply until one year after the operative date to property acquired in joint tenancy form by married persons before the operative date, regardless whether payments on or additions to the property are made after the operative date. During this period the property is governed by the law applicable before the operative date, and to this extent the law applicable before the operative date is preserved.

(d) This article does not apply to any transaction involving the property that occurred before the operative date, including but not limited to inter vivos or testamentary disposition of the property by a married person and division of the property at dissolution of marriage. Such a transaction is governed by the law applicable before the operative date.

Comment. Section 5110.590 makes clear the legislative intent to make this article fully retroactive to the extent practical, consistent with protection of the security of transactions involving the spouses or third persons that occurred before the operative date. Retroactive application is supported by the importance of the state interest served by clarification and modernization of the law of joint tenancy and community property, the generally procedural character of the changes in the law, and the lack of a vested right in joint tenancy property due to the severability of the tenure. In addition, Section 5110.590 provides a one-year grace period after the operative date during which persons who acquired property before the operative date may make any necessary title changes or agreements or other arrangements concerning the property.