#L-3040 jd162
03/22/90

Memorandum 90-60

Subject: Study L-3040 - Community Property Presumption for Joint Tenancy Upon Death

The attached letter from Valerie J. Merritt identifies a matter that the staff believes merits priority consideration by the Commission.

As you know, under federal income tax law, community property is given a very favorable tax treatment upon the death of one of the spouses. The surviving spouse is given a stepped up basis for capital gains purposes on the entire property, both the one-half share of the deceased spouse and the one-half share of the surviving spouse. By way of contrast, if the property is joint tenancy property, the surviving spouse is given a stepped up basis only on the one-half interest of the deceased spouse.

In the past, it was common for the surviving spouse to petition the court for an order that property passing to the surviving spouse from the deceased spouse was community property, notwithstanding that the title was held in joint tenancy. Valerie Merritt reports in the attached letter that this apparently is now precluded by legislation enacted upon recommendation of the Law Revision Commission. She refers to the legislation requiring that transmutation agreements entered into on or after January 1, 1985, be in writing. She believes that in order to show "joint tenancy for convenience only," one must prove a transmutation from separate to community property. If this is true, the transmutation legislation enacted upon Commission recommendation will have a very significant adverse tax effect. The Commission was not aware of this possible effect at the time the legislation was recommended.

Extension to death cases of presumption that property held in joint tenancy title is community property

The staff believes that a review of this matter should be given top priority. One obvious possibility would be to extend to death cases the presumption that property taken in joint tenancy title by

married persons is community property. The staff can make a study to determine whether the presumption should be so extended and the ramifications of such an extension. Empirical studies have established that married persons who put community property in joint tenancy title do so only to avoid the need for probate and do not intend to change the nature of the property from community property to separate property. Accordingly, not only does the interpretation being given the transmutation legislation have serious tax consequences, but also it is contrary to the usual intent and understanding of the parties. At least one recent law review article, and perhaps others, have urged that the existing community property presumption for property held in joint tenancy title be extended to cover death cases as well as marriage dissolution cases. However, the staff believes that further study should be given to this possibility before a decision is made.

Make clear that transmutation statute does not preclude evidence to show that taking title in joint tenancy was not intended to change character of community property

The staff is not sure that the transmutation statute has the effect that is suggested by Ms. Merritt. Does the statute change the rule in Estate of Levine, which states:

> For the purpose of determining the character of real property upon the death of a spouse, there is a rebuttable presumption that the character of the property is as set forth in the deed. . . . The burden is on the party seeking to rebut the presumption to establish that the property is held in some other way; this may be done by a showing that the character of the property was changed or affected by an agreement or common understanding between the spouses. Such an agreement may be oral or written, or may be inferred from the conduct and declarations of the spouses. However, there *must* be an agreement of some sort; the presumption may *not* be overcome by testimony about the hidden intention of one spouse, undisclosed to the other spouse at the time of the conveyance.

We do not see that the transmutation statute changes rules of the Levine case that determine whether the taking of title in joint tenancy changes the character of the property from community to separate. Does the transmutation statute apply at all where the claim is that the character of the property remained unchanged, despite the taking of title in joint tenancy. The staff believes that the transmutation statute applies only where the claim is that the character of the

property was transmuted (changed) from community to separate or from separate to community.

The Levine case indicates that the presumption of separate property arising from taking title in joint tenancy can be rebutted by "a showing that the character of the property was . . . affected by an agreement or common understanding between the spouses. Such an agreement may be oral or written or may be inferred from the conduct and declarations of the spouses." Hence, if the parties have an understanding that the taking of title in joint tenancy was not to change the community property nature of the property but was for convenience only (to avoid probate), this would be a sufficient showing of lack of intent to make a change in the character of the property. The transmutation statute would not be involved at all, since that statute requires only a written transmutation agreement in order to find a transmutation. Perhaps there is a need to clarify the transmutation statute to make clear that it covers only what is needed in order to make a transmutation and does not limit what is needed to establish that no change in the character of the property was made.

Does Commission wish to study this matter?

The staff does not recommend any particular approach to deal with this matter at this time. However, we believe that the adverse tax consequence that apparently has resulted from the Commission recommended transmutation statute merits priority consideration. Does the Commission agree? If so, the staff will investigate the extent to which a tax problem exists, whether legislation is desirable to deal with the problem, and if so the nature of the needed legislation.

Respectfully submitted,

John H. DeMoully
Executive Secretary

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REFER TO FILE NO.

March 19, 1990

CAL LAW REV. COMM'N

MAR 21 1990

RECEIVED

John H. DeMoully, Executive Secretary
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Palo Alto, California 94303-4739

Re: Letter Dated March 15, 1990

Dear John:

I am in receipt of your letter of March 15, 1990, and I am afraid that I must disagree with your conclusions.

California law has been clear for decades that joint tenancy title is by its nature incompatible with community property. Siberell v. Siberell, 214 Cal. 767, 773, 7 P.2d 1003 (1932) (copy enclosed). Civil Code §4800.1 was enacted to create a contrary presumption for purposes of dissolution of marriage proceedings only.

The Levine case is consistent with that body of case law. The Court holds the initial presumption that the title is as stated in the deed, and if that presumption is not rebutted, the property is not community property. The Court was willing to allow evidence of an agreement of the parties that "the character of the property was changed," in other words, an agreement of transmutation from separate to community property. In this particular case, the transmutation agreement could not be proven.

As you well know, the Commission recommended and the Legislature enacted legislation requiring that transmutation agreements entered into on or after January 1, 1985, be in writing. Prior oral transmutation agreements, if they can be proved, are still valid. In order to show "joint tenancy for convenience only," one must prove a transmutation from separate to community property. Increasingly, the only such proof will be a written transmutation agreement. I understand that the Orange County probate court now requires allegations adequate to prove transmutation before it will find property held in joint tenancy title to be community property. I would not be surprised if

other courts do the same. I do know the local Internal Revenue Service District Office is asking for copies of written agreements in such circumstances.

I personally believe that "joint tenancy for convenience only" is a misnomer, used primarily to create a post-death transmutation when none was intended during lifetime. While I also personally abhor the knee-jerk response that leads to the creation of so many joint tenancies during lifetime where the parties might be better served by community property ownership, I believe we must have title designations which mean what they say. Hence, the presumption is that the form of title controls, as in the Levine case. It will become increasingly hard to rebut the presumption as time passes from the January 1, 1985 effective date of the new transmutation statutes.

I too believe we should keep in mind the well-established principles of law recognized in the Levine case; however, I believe that case does not stand for the proposition that joint tenancy property may actually be community property in a death case. I believe the law of California continues to be that joint tenancy property is separate property for all purposes other than division of property upon dissolution of marriage.

Since you circulated your letter of March 15, 1990, to all of the members of the Commission, I would appreciate it if you would circulate my response to the same broad audience.

Sincerely,

Valerie J. Merritt

Valerie J. Merritt
of KINDEL & ANDERSON

VJM:plh
Enclosure
As indicated above

cc: James V. Quillinan, Esquire (w/enclosures)