#L-3048 ns95
07/12/90

Memorandum 90-109

Subject: Study L-3048 - Nonprobate Transfers of Community Property (Draft of Tentative Recommendation)

It is fundamental to community property law that a spouse may dispose of the spouse's one-half interest in community property and quasi-community property by will. See Prob. Code §§ 100 (community property) and 101 (quasi-community property); 6101 (property disposed of by will). Case law also makes clear that a spouse may make a nonprobate transfer effective at death of the spouse's one-half interest in community property and quasi-community property. See, e.g., Tyre v. Aetna Life Ins. Co., 54 Cal. 2d 399, 6 Cal. Rptr. 13, 353 P.2d 725 (1960) (beneficiary designation in community property life insurance policy); Estate of Wilson, 183 Cal. App. 3d 67, 227 Cal. Rptr. 794 (1986) (Totten Trust account for benefit of third party).

We have become convinced that the ability to make a nonprobate transfer of community property should be clearly stated in the statute. As shown by our correspondence with Gregory Wilcox of Oakland (Exhibit 1), existing law requires both a close reading of the statutes and a knowledge of the cases to yield the conclusion that a decedent may make a nonprobate transfer of the decedent's one-half interest in the community property.

So fundamental a proposition should not be so obscure in the law. The staff would statutorily clarify the matter. Attached to this memorandum is a staff draft of a tentative recommendation to do this. If the Commission approves the draft, we will distribute it to persons on both our probate and family law mailing lists for comment.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

GREGORY WILCOX
ATTORNEY AT LAW

506 FIFTEENTH STREET, SUITE 700
OAKLAND, CALIFORNIA 94612-1486
(415) 451-2600

May 31, 1990

Nathaniel Sterling
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94303-4739

Re: Disposition of community property by beneficiary designation

Dear Mr. Sterling:

This will respond to your suggestion last Wednesday that I put my telephone comments in writing. As you remember, I pointed out that there is a question about the ability of a person to dispose of his or her community property by using a beneficiary designation. Here is the argument.

From 1923 to 1985, Probate Code Section 201 provided,"Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse, subject to the provisions of sections 202 and 203."

Although one might think that the term, "testamentary disposition," meant "by will," several court cases stretched the meaning of "testamentary" to allow other types of dispositions that were somehow "testamentary" in nature. For example, Justice Traynor in Tyre v. Aetna Life Insurance Co. (1960) 54 Cal. 2d 399, 6 Cal. Rptr. 13, stated,"Section 201 of the Probate Code gives the husband testamentary control over only one-half of the community property, and the word 'testamentary' as used in that section is not limited to formal testaments." As a result, the court allowed the surviving spouse to claim her one-half community property interest from an insurance policy.

Recently the court in Estate of Wilson (1986) 183 Cal. Rptr. 3d 67, 227 Cal. Rptr. 794, also seems to have accepted Totten trusts as a "testamentary disposition" under former Probate Code Section 201. The Wilson court said, "At the donor's death the Totten trust becomes a testamentary disposition of the assets contained within it." (Id., at p. 72.)

Probate Code Section 201 was repealed as of January 1, 1985, and replaced by new Sections 100, 6101, and 6401. New Section 6101 states in pertinent part, "A will may dispose of the following property: (b) The one-half of the community property that belongs to the testator under Section 100." And then new

Section 6400 says that "any part of the estate not effectively disposed of by will passes to the decedent's heirs as prescribed in this part [decedent's half of community property to surviving spouse under Section 6401]."

Now it may be possible to argue, as the courts have held for years, that a "testamentary disposition" includes Totten trust and insurance policy beneficiary designations. However, it is really hard to argue that the new statutes' repeated use of the word, "will," is equally elastic. One would like to argue that "will" really means "testamentary disposition," but Probate Code's Section 88 definition of "Will" makes this hard to advance with a straight face. Alternatively, one would like to argue that the language in Section 6101 is merely permissive, but not all encompassing. After all, it only says that "a will may dispose . . .." However, Sections 6400 and 6401 slow this argument down because they quite clearly give the surviving spouse all community property "not effectively disposed of by will . . .."

There doesn't seem to be any case law on this issue, except a footnote in Estate of Wilson, supra. It says that "the relevant language of section 201, however, continues in substance in the new sections 100, 6101, 6401." This footnote does support an argument that beneficiary designations can be used to make a disposition of community assets, but it is pretty blatant dicta, and dicta without much sign of thought at that.

The Official Comments of the Law Revision Commission are little help either. The Comment to Sections 6101 merely says,"Subdivision (b) continues a portion of former Sections 21 and 201." Likewise, the Comments to Sections 6400 and 6401 fail to illuminate this issue.

The startling conclusion of this odyssey through the code and comments is that a person may no longer be able to give away even half of his or her community property by using a beneficiary designation. Under the new code provisions, there is a good argument that the Totten trusts in the Wilson case would have had to have been turned over to the surviving spouse in toto, because they were not "effectively disposed of by will."

The Wilson court may have "resolved" this problem by calling it another problem. In dealing with the Totten trusts, it says:

> A general rule emerges from these cases. If a spouse, after the death of the decedent, proves a lack of consent to a gift, it will be avoided to the extent of the nonconsenting spouse's one-half interest in community property transferred, [citing cases]. Id., at p.72.

In other words, the Wilson court treats the Totten trust as a lifetime gift, and makes it subject to the accepted rule that a surviving spouse may avoid half the gift after death.

In my view, this is way off the point. It is standard hornbook law that a spouse can recover one-half of an unconsented lifetime gift of community property after death. Witkin, Summary of California Law, Ninth Edition, Volume 11, "Community Property," Section 114, page 511. However, it didn't seem to bother the court at all that a beneficiary designation in a Totten trust or life insurance policy is not a lifetime gift. Indeed, it has to be found to be a "testamentary disposition" to be eligible under the language in Section 201.

There is an argument that the "logic" of the Wilson court, if taken seriously, has solved the problem for all beneficiary designations. It does this by the expedient of treating them as lifetime "gifts," even though they are entirely revocable and take effect only at death. If such beneficiary designations are gifts they do not have to satisfy the "testamentary disposition" rule of Probate Code Section 201, or the "by Will" language of the successor statutes. These provisions are simply inapplicable because the transfers are lifetime gifts. As such, the surviving spouse may move to avoid the "gift" at death as to his or her community property one-half.

One should note, however, that even the Wilson court felt compelled to find that "the Totten trust becomes a testamentary disposition of the assets contained within it," Id., at p.72, therefore satisfying old Probate Code Section 201. Could it have similarly found that a Totten trust amounts to a disposition "by Will" if the new Probate Code provisions applied?

This problem in the language of the new Probate Code Sections has always bothered me as an abstract matter. Recently it has come up in concrete form. I am representing a company in its dealings with former employees. The company has been in bankruptcy and has not been able to pay the health benefits to its former employees at the time they incurred the medical expenses. Now that it has raised some money, some employees have died. To whom does it owe the money? A year ago, in an effort to simply this problem, the company asked its former employees to sign beneficiary designation forms for future lump sum payments of unpaid health benefits. It carefully asked them to have their spouses sign a consent on the form if the beneficiary were to be other than the spouse. Of course, a number of the former employees named a third party and did not get their spouse's consent.

So, where does the money go? Must the surviving spouse allow the deceased former employee to leave at least his one-

half community property interest to a third party by beneficiary designation (as permitted in Wilson, and afterward under the logic of Wilson)? Or can the surviving spouse get all of it, because it wasn't given away in a "will"? Or can the surviving spouse get all because the designation form warned the employee that the designation would be ineffective unless he got his spouse's consent? Did the form have a right to give such a warning? Did it have the right to deprive the employee of his right to give away his one half by beneficiary designation (assuming he had such a right).

I don't know what to tell my client except to interplead the amount owning and let the surviving spouses and third parties fight it out. There will, however, be no law made since the amounts involved are not enough to justify an appeal.

I don't think that these issues are obscure. They seem destined to come up with every self help estate plan in which decedents try to give away community property in a Totten trust, POD account, joint tenancy account, IRA, or life insurance policy. I've read and reread the new Multi-Party Accounts Law, and the Official Comments, and I don't see the problem solved there even with regard to deposits at financial institutions. It appears that every conceivable variation has been foreseen and covered. However, I do not see how an attempted death transfer of community property funds to a third party is regulated. Probate Code Section 5305(d) says that "a multiple-party account created with community property does not in any way alter community property rights." The comment more clearly points out that one spouse cannot "change the community property interest of the other spouse" by the simple expedient of taking community funds from joint ownership and putting them in his own name. Fine, but what are the "community property rights" and what is the "community property interest"? Do such rights and interests include the ability to give away his or her one-half share by beneficiary designation of a third party, as well as by will?

I genuinely hope I've made some mistake on this, because otherwise there are a lot of beneficiary designations floating around just waiting to cause lawsuits. Perhaps you will feel that the Wilson case takes care of the matter. I look forward to hearing from you.

Very truly yours,

GREGORY WILCOX

pc: James V. Quillinan
Diemer, Schneider, Luce & Quillinan
444 Castro Street, Suite 900
Mountain View, CA 94041

STATE OF CALIFORNIA GEORGE DEUKMEJIAN, Governor

CALIFORNIA LAW REVISION COMMISSION
4000 MIDDLEFIELD ROAD, SUITE D-2
PALO ALTO, CA 94303-4739
(415) 494-1335

June 6, 1990

Gregory Wilcox
Attorney at Law
506 Fifteenth Street, Suite 700
Oakland, CA 94612-1486

Re: Your letter of May 31 concerning disposition of community property by beneficiary designation

Dear Mr. Wilcox:

Your letter to Mr. Sterling has been referred to me for review. I think that the problem that you identify in your letter is dealt with in Section 6400 of the Probate Code. That section provides that any part of the "estate" of a decedent not effectively disposed of by will passes to the decedent's heirs as prescribed in this part. You need to consider the meaning of "estate" as used in Section 6400. I believe that the word "estate" is frequently used in the Probate Code to mean the probate estate. See, for example, Sections 7050, 8000, 8800, 8850 (proceedings concerning the administration of the decedent's estate). The phrase "estate" of the decedent does not include, for example, property passing by a right of survivorship under a joint tenancy, nor does it include (I believe) property passing pursuant to some other form of nonprobate transfer that becomes operative on the death of the decedent. Hence, the application of Section 6400 is limited to the probate estate and this limitation limits the applicability of the remaining sections in Part 2 (commencing with Section 6400).

This conclusion is reinforced by an examination of Section 160, which deals with nonprobate transfers. This section recognizes the validity of nonprobate transfers and provides in substance that a nonprobate transfer provision is not invalidated by any other provision of the Probate Code. This is consistent with the view that Section 6400 relates only to the probate estate (which excludes the estate passing outside probate by virtue of a nonprobate transfer provision).

I do not believe that it would be a satisfactory solution to substitute "testamentary disposition" since the Probate Code treats a nonprobate transfer as a nontestamentary disposition.

I do not believe any revision of the Probate Code is necessary. I am willing to reconsider this view, however. I look forward to hearing from you on this matter. Do you have any revisions of the Probate Code that you believe are needed to clarify this matter?

The Probate Code provisions do not deal with the consent required for one spouse to make a gift of community property. See Civil Code 5125(b). That is a matter that is the subject of considerable concern in light of recent cases, and legislation may be necessary to deal with what constitutes "written consent" to a gift and whether written consent may be given to a nonprobate transfer that does not take effect until death, such as an insurance designation or pay-on-death beneficiary designation. The Commission plans to consider the problem of when consent is required and what constitutes "written consent."

I believe that the person holding the property of the decedent has the right to prescribe the conditions that must be satisfied in order that the holder of the property be required to transfer the property to a third person on the death of the decedent. For example, the depositor must comply with the conditions prescribed by the financial institution if an effective pay-on-death beneficiary designation is to be made. Hence, I believe that the company form could require the signature of the spouse for an effective beneficiary designation, and if that was the case the lack of the signature would make the beneficiary designation ineffective. I think this conclusion is consistent with Section 160 of the Probate Code. I do not know, however, whether the form involved actually provided that the beneficiary designation was ineffective unless the signature of the spouse was obtained.

Sincerely,

John H. DeMoully
Executive Secretary

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GREGORY WILCOX
ATTORNEY AT LAW

506 FIFTEENTH STREET, SUITE 700
OAKLAND, CALIFORNIA 94612-1486
(415) 451-2600

July 6, 1990

John H. DeMoully
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94303-4739

Re: Disposition of community property by beneficiary designation

Dear Mr. DeMoully:

Thank you for your thoughtful letter in response to mine of May 31. I received the second copy of our letter last week.

Your comments distinguishing testamentary probate estate transfers from nontestamentary nonprobate transfers make a lot of sense to me. As a result, the addition of the alternative "or other testamentary disposition" to Probate Code §6101 would indeed muddy the water.

Nevertheless, I gather from your comments that you agree with my opinion that a spouse can, or ought to be able to, give away his or her one half of community property through beneficiary designations. I was interested, however, that you came to the conclusion that no revision of the Probate Code was necessary. It seems to me that the right to unilateral control of community property by the use of beneficiary designations is still unclear even after the analysis in the first page of your letter.

The matter you raise at the top of the second page, spousal consent, I take to be the different but related question of what kind of consent is required to achieve 100 percent nonprobate transfers. This was the issue in the McDonald case to which you undoubtedly refer.

I would like to take you up on the former question, and your invitation to suggest clarifying language. It seems to me that the right of a spouse to use beneficiary designations to dispose of his or her half of community property could be easily rescued from reliance on the tortured logic of Estate of Wilson. In particular, Probate Code §6101 could be amended to read, "A will, pay-on-death provision pursuant to Probate Code §160, or survivorship provision pursuant to Probate Code §5302, may dispose of the following property: . . . ."

Additional clarifying language should also be added to Probate Code §160 itself. This is needed to negate any suggestion that the new §6101 language constitutes a statutory repeal of the item-by-item community property theory in the Wilson decision. I note that the creditor interests were successful in inserting protection for themselves in Probate Code §160(b). Similar language could protect spouses and also clarify a spouse's right to make beneficiary designation transfers of no more than one half of his or her community property. The subsection could be amended to read, "Nothing in this section limits the rights of creditors under any other law, nor the community property rights of a spouse to claim his or her one half interest in community property paid or to be paid under an instrument described in this section."

I look forward to the Commission's position on the issue of the consent required for gift, or gift at death, transfers. Do you suppose I could be put on the mailing list for review of Commission proposals?

Thank you again for your time and attention.

Very truly yours,

GREGORY WILCOX

pc: James V. Quillinan
Diemer, Schneider, Luce & Quillinan
444 Castro Street, Suite 900
Mountain View, CA 94041

TENTATIVE RECOMMENDATION

relating to

NONPROBATE TRANSFERS OF COMMUNITY PROPERTY

A married person may dispose of the person's one-half interest in community property[1] and quasi-community property[2] by will or by nontestamentary transfer effective at death. While the ability of the married person to will the property is statutory,[3] existing law on nonprobate transfers requires both a close reading of the statutes and a knowledge of the cases.[4]

So fundamental a principal that a married person may make a nonprobate transfer of the person's one-half interest in community and quasi-community property interests should not be obscure, but should be clearly stated in the statute. The Commission recommends the following legislation to clarify the matter.

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DIVISION 5. NONPROBATE TRANSFERS

PART 1. PROVISIONS RELATING TO EFFECT OF DEATH

Prob. Code § 5000 (unchanged). Nonprobate transfers at death

5000. (a) A provision for a nonprobate transfer on death in an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or uncertificated security, account agreement,

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1. Prob. Code § 100.

2. Prob. Code § 101.

3. Prob. Code § 6101.

4. See, e.g., Tyre v. Aetna Life Ins. Co., 54 Cal. 2d 399, 6 Cal. Rptr. 13, 353 P.2d 725 (1960) (beneficiary designation in community property life insurance policy); Estate of Wilson, 183 Cal. App. 3d 67, 227 Cal. Rptr. 794 (1986) (Totten Trust account for benefit of third party).

custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature is not invalid because the instrument does not comply with the requirements for execution of a will, and this code does not invalidate the instrument.

(b) Included within subdivision (a) are the following:

(1) A written provision that money or other benefits due to, controlled by, or owned by a decedent before death shall be paid after the decedent's death to a person whom the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later.

(2) A written provision that money due or to become due under the instrument shall cease to be payable in event of the death of the promisee or the promisor before payment or demand.

(3) A written provision that any property controlled by or owned by the decedent before death that is the subject of the instrument shall pass to a person whom the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later.

(c) Nothing in this section limits the rights of creditors under any other law.

Comment. Section 5000 is existing law, effective July 1, 1991, under 1990 Cal. Stats. ch. 79 (AB 759). For the version in effect until July 1, 1991, see Section 160. No change in this section is proposed; it is set out here for the convenience of those reviewing this tentative recommendation.

Prob. Code § 5001 (added). Property subject to nonprobate transfer

5001. Except as otherwise provided by statute, a provision for a nonprobate transfer on death in a written instrument described in Section 5000 may dispose of the following property:

(a) The transferor's separate property.

(b) The one-half of the community property that belongs to the transferor under Section 100.

(c) The one-half of the transferor's quasi-community property that belongs to the transferor under Section 101.

Comment. Section 5001 parallels Section 6101 (property which may

be disposed of by will). It codifies case law that a married person may make a nontestamentary transfer of the married person's one-half interest in community property effective on death. See, e.g., Tyre v. Aetna Life Ins. Co., 54 Cal. 2d 399, 6 Cal. Rptr. 13, 353 P.2d 725 (1960) (beneficiary designation in community property life insurance policy); Estate of Wilson, 183 Cal. App. 3d 67, 227 Cal. Rptr. 794 (1986) (Totten Trust account for benefit of third party). Nothing in this section validates a married person's purported disposition of the surviving spouse's one-half interest in community property without the consent of the surviving spouse. Civil Code § 5125.

Section 5001 does not deal with the formal requirements for an effective nonprobate transfer. This may be the subject of a controlling statute or regulation, or may be a matter of contract between the transferor and the person having control of the property. Nor does Section 5001 authorize a disposition of community or other property by nonprobate transfer to the extent statutes governing the property provide otherwise. See the introductory proviso to the section.

Property effectively disposed of by nonprobate transfer is not part of the decedent's probate estate and does not pass by intestate succession under Section 6400 (property subject to intestacy provisions). Section 5001 does not address the issue whether a will may override a nonprobate transfer or vice versa. This is governed by law other than this section. See, e.g., Section 5302(e) (survivorship right, beneficiary designation, or P.O.D designation in multiple-party account cannot be changed by will).

Relevant definitions include Sections 28 ("community property"), 45 ("instrument"), 66 ("quasi-community property"), and 81 ("transferor").