Study FHL-911 June 8, 2000

Memorandum 2000-42

**Estate Planning During Dissolution of Marriage**
**(Comments on Tentative Recommendation)**

Family Code Section 2040 provides for an automatic temporary restraining order (ATRO) on service of the summons in a proceeding for dissolution or annulment of marriage, or legal separation. The ATRO restrains both parties from "in any way disposing of any property." It isn't clear whether this restrains estate planning changes that only affect the disposition of property on death.

In February the Commission approved a tentative recommendation on *Estate Planning During Dissolution of Marriage*. The proposed law would clarify the scope of the ATRO consistent with the following principles:

(1) The restraining order should not restrain the creation, modification, or revocation of a will.
(2) The restraining order should not restrain the revocation of a nonprobate transfer (other than life insurance).
(3) The restraining order should restrain the creation or modification of a nonprobate transfer.

These principles reflect the policy that a person involved in a dissolution proceeding should be free to make estate planning changes, so long as those changes do not affect the property rights of the person's spouse. Changes to a will, severance of joint tenancy, and revocation of a nonprobate transfer (such as a living trust) only affect an expectancy interest, not a property right. Thus, these types of changes should not be restrained. Creation or modification of a nonprobate transfer (such as a pay-on-death account in a financial institution) may result in an unauthorized transfer of community property. Such changes should not be made during dissolution without spousal consent or approval of the court. Arguably, changes affecting a person's separate property should not be restrained. However, characterization of property as community or separate is often a disputed issue in a dissolution proceeding. In order to protect against dissipation of community property assets that have been incorrectly characterized as separate property, the proposed law would restrain both community property and separate property (as does existing law).

We received several letters commenting on the tentative recommendation. The letters are reproduced in the Exhibit as follows:



After considering these comments (which are discussed in detail below), the Commission should decide whether to adopt the tentative recommendation (with or without changes) as its final recommendation.

## GENERAL RESPONSE

In general, the response was favorable. No commentator expressed opposition to the proposed law as a whole or questioned the need for clarification of the effect of the marital dissolution ATRO. To the contrary:

- Ms. Ratzlaff writes: "I have practiced in the area of estate planning for 20 years and agree that this issue needs to be addressed." See Exhibit p. 1.
- Ms. Tesler writes: "I support the proposed clarifications to Family Code Section 2040. The amendments are much needed." See Exhibit p. 4.
- The Executive Committee of the Family Law Section of the State Bar voted unanimously to support the tentative recommendation, and their chair, David Fink, writes: "On behalf of the executive committee, I would like to thank you for your work in this area, which will provide much-needed certainty in this area of the law." See Exhibit p. 5.
- Mr. Oldman writes: "Generally, I believe that clarification is required in this area of law since parties may be in a dissolution action for a number of years and will need to attend to their estate planning requirements in case of a party's failure to survive the process." See Exhibit p. 6.
- Mr. McCown writes: "Having represented a surviving widow in a contested probate matter following the death of her estranged husband while dissolution proceedings were then pending, I can assure you the problems addressed in the … tentative

> recommendation … are both real and utterly perplexing in the present system." See Exhibit p. 11.

The commentators raise concerns about specific elements of the proposed law. These concerns are discussed below.

## CREATION OR MODIFICATION OF A NONPROBATE TRANSFER

Problems can arise where one spouse creates or modifies a nonprobate transfer of community property, without the other spouse's consent. Existing law already provides a judicial remedy for an unauthorized nonprobate transfer of community property — transfer of the nonconsenting spouse's share can be set aside. See Prob. Code §§ 5020-5032. However, this protection may be inadequate in the context of a pending dissolution proceeding. For example, during a dissolution proceeding, suppose that a husband changes the beneficiary designation on a pay-on-death bank account containing community property funds, naming his sister as beneficiary. He then dies. The sister withdraws the funds (including the wife's community property share ) and leaves the state. The bank is immune from liability because it acted according to the terms of the account. The burden is now on the wife to institute legal action in order to recover her money. If the sister cannot be found or is insolvent, recovery may be impossible. This is the type of diversion of marital assets that the ATRO is meant to prevent. For that reason, under the proposed law, the ATRO would restrain the creation or modification of a nonprobate transfer. Most of the concerns raised by commentators focus on that aspect of the proposed law. These concerns are discussed below.

### Living Trust

Mr. Oldman believes that the restraint should not apply to a "living trust" (Exhibit pp. 6-7):

> I have no quarrel with the intent of the language regarding the creation or modification of nonprobate transfers as it applies to bank and brokerage accounts. However, I believe that the blanket prohibition of the creation or modification of nonprobate transfers may have the effect of preventing the creation or modification of living trusts. …
>
> … Since the creation or modification of a living trust will not have the effect of disposing of both halves of a community asset as in the case of a trustee bank account, I do not believe that any

> important policy is served by creating a restriction on the creation or modification of living trusts.

It isn't clear to the staff that a living trust cannot dispose of both halves of community property. One spouse could create a living trust in that spouse's name alone and fund it with community property. On the settlor's death, the trustee could transfer the property to the named beneficiary, without realizing that the property is community in character. Restraint on creation or modification of a living trust during a dissolution proceeding would help avoid this type of misdirection of community property.

In further communication on this point, Mr. Oldman suggested that the ATRO could be crafted so that it would not restrain the creation of a trust, but would restrain the transfer of property to fund the trust. The parties would then be free to create a new trust to indicate their testamentary intentions, without risking an unauthorized transfer of community property. The staff doesn't see this as a good alternative. If a party to a dissolution creates a living trust, does not transfer property to the trust, and then dies, the trust serves no purpose. A trust is only effective for purposes of probate avoidance as to property that has been transferred to the trust. John R. Cohan, Drafting California Revocable Living Trusts § 21.2 (Cal. Cont. Ed. Bar, 3d ed. 1999). Property added to a living trust after death, by a pourover provision in a will, is subject to probate. If Mr. Oldman's concern is that parties should be free to prepare trust documents during the pendancy of the proceeding, for execution and funding as soon as the ATRO is lifted, we might add the following sentence to the Comment:

> Nothing in this section precludes a party from preparing a draft of a living trust to which property could be transferred on termination of the restraining order.

**The staff believes that the ATRO should restrain creation and modification of living trusts.** However, it may be helpful to receive additional input on this issue.

**Separate Property**

The purpose of the proposed law's restraint on creation or modification of a nonprobate transfer is to prevent an unauthorized transfer of community property. One can therefore argue that the restraint should not apply to nonprobate transfers of separate property. However, as a practical matter, characterization of property as community or separate often involves complex

factual and legal questions that must ultimately be decided by the court. For that reason, under the proposed law, the ATRO restrains transfers of both community and separate property. That policy is supported by the Bar Association of San Francisco (see Exhibit p. 8):

> It is always uncertain at the inception of a dissolution case exactly how any of the property held by the parties to the litigation should be characterized, whether community or separate. That is often the major issue in a dissolution case and this issue is often not resolved until the day of trial and the entry of judgment. For this reason, transfers that could dispose of property, whether community or separate, should be prohibited by the ATRO.

Ms. Ratzlaff and Mr. McCown both question the policy of restraining creation or modification of a nonprobate transfer in cases where the property to be affected is clearly separate property. Mr. McCown writes (see Exhibit p. 12):

> My concern with the tentative recommendation is that the withdrawal of any of each spouse's separate property assets from an existing trust by that spouse …, even where the spouses have previously characterized the trust assets and have waived marital rights in the other spouse's separate property assets under Probate Code §§ 140-147 and 21611(c), still would be prohibited under your commission's proposals.

There will be cases where the proper characterization of property as separate is obvious at the outset. However, the staff does not see how to draft a rule that distinguishes between "obvious" cases and "difficult" cases. Clearly, a written agreement providing that an asset is separate property is a strong indication of the asset's character, and we could create an exception for property that is characterized as separate by agreement of the parties or an express waiver of one party's rights. However, the validity of such agreements is not always certain. For example, the California Supreme Court is currently considering whether a prenuptial agreement between professional baseball player Barry Bonds and his former wife is valid, based on the fact that Ms. Bonds did not have independent counsel before signing the agreement.

The Commission previously considered and rejected an exception for property characterized as separate in a written agreement of the parties, because of uncertainty about the enforceability of any particular agreement. This may be overprotective, but the ATRO is clearly intended to be very protective of marital assets. Existing law restrains both community and separate property transactions. The proposed law probably should as well. In cases where an asset

is obviously separate property, it should not be too burdensome to obtain spousal consent or an order of the court authorizing an estate planning change affecting that asset. **The staff recommends against exempting separate property from the ATRO.**

**Modification of Terms Other Than Beneficiary Designation**

Mr. McCown is also concerned that the proposed law would restrain modification of trust terms other than the beneficiary designation (e.g., a change in trustee). See Exhibit p. 12. Because the purpose of the ATRO is to prevent dissipation or concealment of property, one can argue that modification of trust terms that do not directly affect property distribution should not be restrained. This principle could be implemented by limiting the restraint to modification of a beneficiary designation, thus:

> Restraining both parties from creating ~~or modifying~~ a nonprobate transfer or changing the beneficiary of an existing nonprobate transfer without the written consent of the other party or an order of the court. Nothing in this section restrains revocation of a nonprobate transfer, severance of a joint tenancy, or the creation, modification, or revocation of a will.

On the other hand, there may be indirect consequences affecting property distribution that could follow from changes other than a change in beneficiary. **The staff would like to solicit further input from the estate planning community before such a change is made.**

## JOINT TENANCY

Commentators raise two issues regarding severance of joint tenancy: (1) No change to existing law is necessary. (2) More thought should be given to how "severance" applies to joint bank accounts, joint brokerage accounts, and jointly-registered Series EE bonds. These issues are discussed below:

**Adequacy of Existing Law**

The Bar Association of San Francisco comments that existing Family Code Section 2040 "clearly allows for the termination or conversion of a joint tenancy to a tenancy in common." See Exhibit p. 9. The staff disagrees. The question of whether the ATRO restrains severance of joint tenancy is not clear-cut. In fact, the question was recently the subject of appellate litigation. See *Estate of Mitchell*, 76 Cal. App. 4th 1378 (1999). In *Mitchell*, the court considered and rejected many

arguments for the proposition that the ATRO does not restrain severance of a joint tenancy, including the argument implicitly advanced by the Bar Association of San Francisco — that it would be illogical for Section 2040 to simultaneously restrain severance of joint tenancy and warn parties to consider changing title of joint tenancy property in order to avoid unintended consequences if one of them should die during the proceeding. See Fam. Code § 2040(b) (warning required on summons form). As the *Mitchell* court correctly points out, restraint under the ATRO is not absolute — restrained changes can be made after obtaining spousal consent or an order of the court. Thus there is no logical inconsistency in Section 2040. The Legislature could have chosen to warn the parties that they may wish to sever a joint tenancy, while also requiring that a party obtain spousal consent or court order before doing so.

Ultimately, the *Mitchell* court concluded that the ATRO does not restrain severance of a joint tenancy (because severance of a joint tenancy only disposes of an expectancy, not property). The court's reasoning is persuasive. However, there is no guarantee that other courts will reach the same conclusion. **The staff believes that it is helpful for the proposed law to expressly provide that the ATRO does not restrain severance of a joint tenancy.**

**Joint Bank Accounts, Brokerage Accounts, and Series EE bonds**

Mr. Birnberg writes (see Exhibit p. 3):

> My last concern (or inquiry) is how the joint tenancy severance concept applies to joint tenancies that do not require severance, such as joint bank accounts, joint brokerage accounts and joint Series EE bonds. I think further consideration needs to be given to these peculiar types of assets which are commonly thought of as joint tenancies but which have different ownership attributes.

The proposed law provides that "severance of a joint tenancy" is not restrained. Mr. Birnberg is correct that "severance" may not be the best term to describe termination of a right of survivorship in some types of joint tenancy. For example, Probate Code Section 5303 speaks instead of "eliminating" a right of survivorship in a multiple-party account. It would probably be clearer to replace "severance of a joint tenancy" with more common terminology, thus:

> Restraining both parties from creating or modifying a nonprobate transfer without the written consent of the other party or an order of the court. Nothing in this section restrains revocation of a nonprobate transfer, ~~severance of a joint tenancy~~ elimination of

> a right of survivorship between owners of jointly-owned property, or the creation, modification, or revocation of a will.

This language would govern severance of joint tenancy in real property, as well as cancellation or elimination of survivorship rights in personal property joint tenancies. **The staff recommends this change.**

Series EE bonds and securities are both subject to other laws requiring spousal consent in order to eliminate survivorship in cases of spousal joint-ownership. Section 353.51 of Title 31 of the Code of Federal Regulations provides that a request to change the ownership attributes of a jointly-owned Series EE bond must be signed by both co-owners (except that a single co-owner may sign to eliminate that co-owner's rights). Similarly, Probate Code Section 5506 provides that all joint owners must act in order to change the registration of a jointly-owned security. It might be helpful to point out these independent restrictions in the Comment to Section 2040:

> **Comment**. Section 2040 is amended to clarify the scope of the automatic temporary restraining order with respect to estate planning changes. The fact that the restraining order does not restrain revocation of a nonprobate transfer does not mean that such a provision is necessarily subject to revocation by a party. The question of whether a nonprobate transfer is subject to revocation is governed by the terms of the nonprobate transfer and applicable substantive law. See, e.g., Prob. Code § 5506 (action by all surviving joint owners required to cancel beneficiary registration of jointly-owned security); 31 C.F.R. § 353.51 (restricting changes in ownership of jointly-owned Series EE savings bond).

PROBATE PROCEEDING

Mr. McCown suggests that the Probate Court might be an appropriate alternative forum for seeking court approval of a restrained estate planning change. See Exhibit p. 12:

> If the primary goal in this endeavor is to prevent the unjust dissipation and/or concealment of marital assets by either party, you might consider instead a variation of the Petition for Instructions under Probate Code § 17200 *et seq.* wherein the Probate Court, sitting with the full power of the Superior Court, could provide a timely interim and non-Family Court hearing regarding …intended modifications … to assure the Court and the other party to the divorce action that assets are not being concealed or wasted, but still permitting each of the parties the greatest latitude and

> authority to make these important (albeit crucial, in some cases) modifications in their estate plans while the bifurcated divorce action property settlement matter is pending. …
>
> I suggest the Probate Court here only because either party's death (or incapacity) while a dissolution action is pending would likely end up before that Probate Judge or Commissioner (as here in Kern County) for interpretation of the trust and or accounting and reporting to the beneficiaries, in any event. Such a procedure might also lessen the burden on the Family Court Judges to "learn probate" … in order to decide these interim family estate planning procedures themselves. Ultimately, the Family Court could exercise its authority to make "final" determinations of the community v. separate property characterization of assets, as it has for many years in dissolution proceedings.

One advantage of invoking the superior court's probate jurisdiction in these matters would be the possible involvement of judges with greater expertise in estate planning matters, especially in courts with specialized probate departments. However, it seems likely that the critical issue involved in determining whether a particular estate planning change should be permitted will often be a determination of the respective rights of the parties in the property affected by the proposed change — an issue that the judge in the pending dissolution proceeding may be best qualified to decide. Thus, it isn't clear that a separate probate proceeding would expedite matters or result in a better decision. **Unless there is additional support for this proposal, the staff recommends against it.**

## TECHNICAL SUGGESTIONS

Under existing law, Family Code Section 2040(a)(2) restrains the transfer or disposition of property during dissolution of marriage. The second sentence of proposed Section 2040(a)(4) provides: "Nothing in this section restrains revocation of a nonprobate transfer, severance of a joint tenancy, or the creation, modification, or revocation of a will." Mr. Birnberg suggests two technical changes to clarify that the general property restraint in (a)(2) is qualified by the second sentence in (a)(4):

(1) He proposes making the second sentence in (a)(4) a separate subdivision. This would help highlight the fact that the limitation stated in the provision applies to the entire section. **The staff has no objection to making this change.**

(2) He proposes adding a prefatory clause to subdivision (a)(2) expressly stating that it is qualified by the second sentence of subdivision (a)(4) — "Except as provided in paragraph (4) …" This would add to the complexity of an already complex provision, and **the staff is not convinced that the change is necessary**. The second sentence of (a)(4) is quite clear and expressly limits the entire section.

The State Bar Family Law Section Executive Committee believes that it would be helpful if the proposed definition of "nonprobate transfer" were included in the summary of the restraining order that is printed on the reverse of the summons form. See Exhibit p. 5. The printed summary of the effect of the restraining order closely parallels the substantive provisions of Section 2040. It seems likely that a revised summary describing the effect of the ATRO under the proposed law would include the definition of nonprobate transfer. This likelihood would be perhaps be increased if the definition subdivision were moved to follow immediately after provisions detailing the content of the ATRO. **The staff recommends that this change be made.**

## CONCLUSION

The Commentators generally agree that the proposed law would be helpful. Most of the provisions of the proposed law are acceptable to all commentators. Therefore, **the staff recommends preparation of a draft recommendation**, with whatever changes that the Commission finds appropriate. Commentators whose suggestions are not accepted by the Commission would then have another opportunity to offer comments supporting the changes they propose, before the recommendation becomes final.

Respectfully submitted,

Brian Hebert
Staff Counsel

RUTH E. RATZLAFF
Attorney at Law

5151 North Palm, Suite 820
Fresno, California 93704

(559) 226-1540
FAX (559) 228-8493
E-MAIL ratzlaff@psnw.com

March 18, 2000

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739



Honorable Commissioners:

I have reviewed your Tentative Recommendation regarding Estate Planning During Marital Dissolution. I have practiced in the area of estate planning for 20 years and agree that this issue needs to be addressed.

I agree with all of the recommendations as presented except one. I understand why you may tentatively conclude that restraint of modification of a nonprobate transfer of separate property is not unduly burdensome because of the possible need for a judicial determination as to the separate property or community property nature of a particular asset.

I see in my practice, however, a number of elderly couples in second marriages where the separate property brought into the marriage has been kept completely separate. The less affluent spouse may have a catastrophic illness necessitating long-term nursing home care and may be unable to give written consent.

I suppose I shouldn't complain because this looks like the Full Employment for Lawyers Act. And perhaps this class of parties to a dissolution is so small that it is not unduly burdensome to require the well spouse in my illustration to obtain a court order in the dissolution proceeding, or the appointment of a conservator to give consent on behalf of the impaired spouse.

Certainly a couple entering a second marriage has the opportunity to engage in premarital planning to avoid this complication, including preparation of a property agreement and appointment of agents under durable powers of attorney.

I leave to your discretion, of course, the weight you give to my reservation about the language of your tentative recommendation.

Sincerely,

Ruth E. Ratzlaff

LOEB&LOEB LLP

A LIMITED LIABILITY PARTNERSHIP
INCLUDING PROFESSIONAL CORPORATIONS

1000 WILSHIRE BOULEVARD
SUITE 1800
LOS ANGELES, CA 90017-2475

TELEPHONE: 213.688.3400
FACSIMILE: 213.688.3460
www.loeb.com



Direct Dial: 213-688-3408
e-mail: jbirnberg@loeb.com

March 22, 2000

Nathaniel Sterling
Stan Urlich
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, California 94303-4739

Re: Estate Planning During Marital Dissolution, Tentative Recommendation, FHL-911

Dear Nat and Stan:

I have just received the proposed recommendation to clarify the effect of automatic restraining orders on estate planning. While I believe the approach taken is correct, I have some comments and suggestions:

1. I think that you need to consider further the problem of apparently permitting revocation of trusts but not amendment of what are commonly thought of as testamentary provisions. Perhaps you intend that the sequence be to revoke such a trust (unless both spouses' approval is required for revocation) and then to allow each spouse to separately implement his or her estate plan, rather than to allow amendments. This aspect may not require revision of the statutory language but should be included in the Commission's comments.

2. I believe it would be clearer if subdivision (a)(4) were to consist only of the first sentence, with the second sentence being a new subdivision (c) and proposed subdivision (c) renumbered as subdivision (d). My reasoning is based upon a change that I think is needed to subdivision (a)(2), mentioned in the next paragraph.

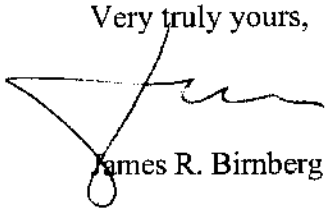
3. I would recommend that you include a prefatory clause to subdivision (a)(2) to limit its application because of the exception in what is now the second sentence of subdivision (a)(4). The proposed clause, taking into consideration the change mentioned in paragraph 3 of this letter, would be "Except as provided in subdivision (c) of this section,..." My reasoning is that the scope of subdivision (a)(2)

seems to be inconsistent with the exception being created for revocation of nonprobate transfers, severance of joint tenancies, and creation, modification or revocation of wills. The addition of this clause would make the provisions clearer.

4. My last concern (or inquiry) is how the joint tenancy severance concept applies to joint tenancies that do not require severance, such as joint bank accounts, joint brokerage accounts and joint Series EE bonds. I think further consideration needs to be given to these peculiar types of assets which are commonly thought of as joint tenancies but which have different ownership attributes.

I hope all of the above comments are helpful to you.

Very truly yours,



James R. Birnberg

JRB:cdw
66666666666
LA220146.1

LAW OFFICES
TESLER, SANDMANN & FISHMAN

PETER B. SANDMANN
A PROFESSIONAL CORPORATION

PAULINE H. TESLER
CERTIFIED FAMILY LAW SPECIALIST
STATE BAR OF CALIFORNIA

ALVIN L. FISHMAN

PLEASE REPLY TO:
☐ SAN FRANCISCO OFFICE
☒ MILL VALLEY OFFICE

April 4, 2000



California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Estate Planning During Marital Dissolution

Dear Commissioner:

I support the proposed clarifications to Family Code Section 2040. The amendments are much needed.

Very truly yours,

Pauline H. Tesler

Pauline H. Tesler

PHT:cf

I:\DOCS\ADMIN\calawrevcomment.wpd



SAN FRANCISCO OFFICE: 250 MONTGOMERY STREET, SUITE 500, SAN FRANCISCO, CA 94104
TELEPHONE: (415) 781-5600 FACSIMILE:(415) 781-4224

MILL VALLEY OFFICE: 163 MILLER AVENUE, SUITE 4, MILL VALLEY, CA 94941
TELEPHONE: (415) 383-5600 FACSIMILE:(415) 383-5675

FAMILY LAW SECTION
THE STATE BAR OF CALIFORNIA



May 4, 2000

California Law Review Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Tentative Recommendation; Estate Planning During Marital Dissolution; Proposed Amendment of Family Code §2040

At its meeting on April 28, 2000, the State Bar Family Law Section Executive Committee voted to unanimously to support the Law Revision Commission's tentative recommendation for the revision of Family Code §2040 to clarify the circumstances under which an estate plan may be revised by a party to a marital dissolution proceeding.

The executive committee was also of the opinion that it would be desirable to include the definition of non-probate transfers contained in the proposed new subparagraph (c) in the language of the automatic restraining order which appears on the reverse of the summons. It was the consensus of the committee that doing so would provide valuable clarification to parties and their counsel.

On behalf of the executive committee, I would like to thank you for your work in this area, which will provide much-needed certainty in this area of the law.

Yours very truly,

David A. Fink,
Chair,
Family Law Section Executive Committee

cc: Christopher Moore
Susan Orloff

LAW OFFICES
OLDMAN, COOLEY & LEIGHTON
A LIMITED LIABILITY PARTNERSHIP
PENTHOUSE SUITE A
16133 VENTURA BOULEVARD
ENCINO, CALIFORNIA 91436-2408
TELEPHONE (818) 986-8080
FAX (818) 789-0947
E-MAIL: info@ocllaw.com

MARSHAL A. OLDMAN
SUSAN J. COOLEY
WALTER M. LEIGHTON
SUSAN R. IZENSTARK

OF COUNSEL
MICHAEL L. TROPE

1000 TOWN CENTER DRIVE
SIXTH FLOOR
OXNARD, CALIFORNIA 93030
TELEPHONE (805) 988-8384
FAX (805) 988-8386



May 22, 2000

moldman@ocllaw.com

Brian Hebert
California Law Revision Commission
3200 5th Avenue
Sacramento, CA 95817

Re: ATRO Proposal

Dear Mr. Hebert:

I have reviewed with interest your analysis and proposal regarding the scope of ATRO's as they affect or restrain the devolution of estates. Generally, I believe that clarification is required in this area of law since parties may be in a dissolution action for a number of years and will need to attend to their estate planning requirements in case of a party's failure to survive the process.

The proposed language properly clarifies that a will does not involve a transfer for ATRO purposes and adopts the holding of the Mitchell decision in regard to the severance of joint tenancy property. Additionally, I have no quarrel with the intent of the language regarding the creation or modification of nonprobate transfers as it applies to bank and brokerage accounts. However, I believe that the blanket prohibition of the creation or modification of nonprobate transfers may have the effect of preventing the creation or modification of living trusts.

A trust may under the language of the proposal be a form of nonprobate transfer that could not be created or modified once an ATRO is served. I do not believe that you intend that living trusts should become any more frozen in place than a party's will; however, I believe that this will result from the current wording of the amendment to Section 2040 of the Family Code.

If a living trust in existence and cannot be modified, a party may be required to maintain distribution of the trust estate for the benefit of the divorcing spouse. I believe that this is not the expectation of most spouses and is inconsistent with a spouse's desire to a change a will to name beneficiaries than the divorcing spouse. The language as proposed in the amendment will place spouses who use living trusts at a disadvantage compared to spouses who have drafted wills as

their key estate planning device. This is contrary to modern estate planning and may have the effect of forcing married couples into probate on the death of at least the surviving spouse. Since the creation or modification of a living trust will not have the effect of disposing of both halves of a community asset as in the case of a trustee bank account, I do not believe that any important policy is served by creating a restriction on the creation or modification of living trusts.

As a clarification of your suggested language, I propose the following:

"(4) Restraining both parties from creating or modifying a nonprobate transfer other than a living trust without the consent of the other party or an order of the court. Nothing in this section restrains revocation of a nonprobate transfer, severance of joint tenancy, or the creation, modification, or revocation of a will or living trust."

Please let me know if you have any questions or comments.

Very truly yours,

MARSHAL A. OLDMAN

MAO:moi

# THE BAR ASSOCIATION OF SAN FRANCISCO



May 30, 2000

**BY FAX**

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

**RE: Estate Planning During Marital Dissolution**

The Board of Directors of the Bar Association of San Francisco approved the comments of its Family Law Section concerning the Commission's tentative recommendations on Estate Planning During Marital Dissolution. Their comments follow.

## 1. Summary

The Family Law Section felt that from their point of view Section 2045 is sufficient as it presently exists and the Family Law Courts have full discretion to make orders affecting the creation, modification, or revocation of nonprobate transfers. The Family Law Section strongly asserts that the ATRO should not prohibit the severance of a joint tenancy, nor should it prohibit the creation, modification or revocation of a will. The distinction should always be whether the intended or proposed transfer affects a mere expectancy or an actual interest in property subject to the jurisdiction of the court in the proceeding. Further, it is always uncertain at the inception of a dissolution case exactly how any of the property held by the parties to the litigation should be characterized, whether community or separate. That is often the major issue in a dissolution case and this issue is often not resolved until the day of trial and the entry of judgment. For this reason, transfers that could dispose of property, whether community or separate, should be prohibited by the ATRO.

## 2. Proposed Revisions to Family Code Section 2040

The Family Law Section discussed this proposed revision and concluded, after much discussion that modification of Family Code



The Merchants Exchange Building, 465 California Street, Suite 1100, San Francisco, CA 94104-1826
(415) 477-2388 • Lawyer Referral Service (415) 989-1616 • www.sfbar.org

Section 2040 could be confusing and not helpful. It is already clear from Family Code Section 2040 that the automatic temporary restraining orders created by the filing of a petition for dissolution of marriage and the issuance of a summons, once served, clearly allow for the creation of a new will and the modification of a deed from join tenancy to community property. Life insurance transfers or modifications are prohibited. For these reasons the Family Law Section considered the proposed revision to Family Code Section 2040(4) and advised that the first sentence should be deleted. The second sentence is approved.

3. **Estate Planning During Marital Dissolution**

As presently constituted, Family Code Section 2040(3) clearly allows for the termination or conversion of a joint tenancy to a tenancy in common. In fact, the summons itself contains a caveat preceded by the word "WARNING" which sufficiently puts litigants on notice that they should convert joint tenancies to real property into community property.

The recommendations of the California Law Revision Commission regarding more clarity in regard to other types of estate planning changes, such as creation, modification, or revocation of a trust, are well taken. It is the consensus of the Family Law Section that any estate planning change which affects an immediate interest to property, as opposed to a mere expectancy of an interest in property, is already prohibited by the automatic temporary restraining orders. Language could be added to Family Code Section 2040 which makes clearer what changes are allowed and what changes do not violate the ATRO. The Family Law Section agrees that it would be a great waste of judicial resources to require parties engaged in dissolution proceedings to seek a court order before making any estate planning changes.

4. **Creation and Modification of Nonprobate Transfers of Property**

It is the consensus of the Family Law Section that the tentative recommendations of the California Law Revision Commission are well taken in this regard. Both the creation and modification of nonprobate transfers of property, whether community or separate, should be prohibited by the ATRO.

5. **Revocation of Nonprobate Transfer**

The revocation of a revocable nonprobate transfer, insofar as it terminates only a mere expectancy, should not be prohibited by the ATRO. The Family Law

Section agrees with the recommendations of the Law Revision Commission in this regard.

6. **Life Insurance Changes**

The Family Law Section agrees that the existing restraint on the cancellation or modification of insurance policies should be maintained.

7. **Special Circumstances and Proposed Legislation**

a) **Creation, Modification, or Revocation of a Will:** The Family Law Section believes that parties engaged in dissolution proceedings should modify their wills in accordance with their changed circumstances.

b) **Revocation of Intervivos Trusts:** This should not be restrained because it does not affect the characterization of property just before it was placed in trust. Hypothecation or disposal of such property is already restrained by the ATRO.

Thank you for the opportunity to comment.

Very truly yours,

Fred W. Alvarez
President

# LAW OFFICES OF BARRY L. MCCOWN

"OLD CHURCH PLAZA"
1200 TRUXTUN AVENUE, SUITE 110
P.O. BOX 1430
BAKERSFIELD, CALIFORNIA 93302-1430

(661) 322-8023 FAX (661) 322-4580


May 30, 2000



California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, California 94303-4739

Re: Estate Planning During Marital Dissolution
Comments on Tentative Recommendation (Feb. 2000)

Transmitted via facsimile copier and United States Postal Service

Honorable Chair and Commission Members:

I applaud your efforts to identify a problem and provide reasonable alternative solutions in the area identified above. Having represented a surviving widow in a contested probate matter following the death of her estranged husband while dissolution proceedings were then pending, I can assure you the problems addressed in the Commission's February 2000 Tentative Recommendation (hereinafter, the "TR") are both real and utterly perplexing in the present system. In effect, I found myself, as a "probate" attorney, trying the divorce during the administration of the decedent's intestate estate. An attempt by the staff of the late Barney Gill, a Certified Family Law Specialist and reverently referred to by local Bakersfield Family Lawyers as the "Dean of Divorce," to execute a "death bed" Will for their client went for naught, leaving my client to claim her intestate interests in both community and separate property. We were also successful in obtaining the award of some 12 months of "Family Allowances" and other financial protections under the Probate Code, which benefits collectively absorbed nearly 70 % of the decedent's property.

Restraining all such testamentary and nontestamentary changes while an action for dissolution of the marriage is pending is likely to frustrate the intentions of at least one of the parties and often may result in the unintended inflation of the other party's property interests, whether from separate or community sources. I was concerned enough to write an article on this subject, especially in light of the significant reliance by attorneys (and the non-attorney "trust mills" which still abound in this state) on the use of the Revocable Inter Vivos (i.e. "Living") Trust. I enclose by attachment a copy of the article entitled "**Trust Drafting With a View to Divorce**," which was published in the January 1999 issue of the Kern County Bar Association's newsletter, the *Res Ipsa Loquitur*.




Certified Legal Specialist in the combined areas of
***Taxation Law*** and ***Estate Planning, Trust & Probate Law***
State Bar of California Board of Legal Specialization

I am most concerned with the blanket prohibition, recommended by the Commission's TR (at pages 4-5), against all forms of "Revocation of Nonprobate Transfer" and "Modification of a Nonprobate Transfer." In my planning with married persons, I try to accommodate my clients' requests to use a single trust instrument for the initial revocable trust structure for the family. (Other specific and often irrevocable trusts for specific tax planning goals, such as the Qualified Personal Residence Trust, may follow, of course, but the initial planning usually involves a "central" trust repository for the substantial bulk of the clients' marital assets.) Many of our "Living Trusts" therefore hold both community and (increasingly common) separate property of the spouses, with each category of property (e.g. "community property," "husband's separate property" and "wife's separate property") initially held in a separate share thereunder, but with both spouses together serving as the co-trustees of all such property, regardless of characterization. We do repose particular rights over separate property in one spouse or the other alone, such as the right to revoke or amend the trust as to the spouse's own separate property, in part to prevent unintended or premature taxable "transfers" of any of those separate property interests. As our clients move between marriages, whether brought on by divorce or death of a former spouse, we find more requests each year for these multiple-characterization trusts, the true "family pot."

My concern with the TR is that ***the withdrawal of any of each spouse's separate property assets from an existing trust*** by that spouse or his or her authorized agent or personal representative (if the spouse is then incapacitated or deceased), even where the spouses have previously characterized the trust assets and have waived marital rights in the other spouse's separate property assets under Probate Code §§ 140-147 and 21611(c), still would be prohibited under your commission's proposals. Furthermore, ***any modification of rights***, such as the renaming of (successor) trustees or other fiduciaries, including Custodians under CUTMA for minor beneficiaries' interests, or a Special Trustee for valuation of assets under a closely held business' Buy-Sell Agreement, or the designation by either spouse of a new "Trust Protector" for their share of the trust, would likewise still be prohibited until the assets of the trust(s) are (often many years) later characterized by the Family Court for purposes of the all-important Marital Settlement Agreement and Order.

If the primary goal in this endeavor is to prevent the unjust dissipation and/or concealment of marital assets by either party, you might consider instead a variation of the Petition for Instructions under Probate Code § 17200 et seq. wherein the Probate Court, sitting with the full power of the Superior Court, could provide a timely interim and non-Family Court hearing regarding these intended modifications by either party (or at least by the Respondent who is "surprised" by service of the subpoena to divorce court) to assure the Court and the other party to the divorce action that assets are not being concealed or wasted, but still permitting each of the parties the greatest latitude and authority to make these important (albeit crucial, in some cases) modifications in their estate plans while the bifurcated divorce action property settlement matter is pending. See Probate Code

§§ 7251 and 7252.

I suggest the Probate Court here only because either party's death (or incapacity) while a dissolution action is pending would likely end up before that Probate Judge or Commissioner (as here in Kern County) for interpretation of the trust and or accounting and reporting to the beneficiaries, in any event. Such a procedure might also lessen the burden on the Family Court Judges to "learn probate" (and especially the Trust Law at Division 9 of the Probate Code) in order to decide these interim family ***estate planning*** procedures themselves. Ultimately, the Family Court could exercise its authority to make "final" determinations of the community v. separate property characterization of assets, as it has for many years in dissolution proceedings.

I hope these thoughts are helpful to you. If you or any of your staff should have any questions regarding these suggestions, please call me.

Very truly yours,

Barry L. McCown

/sjp
enclosure

*Law Offices of Barry L. McCown*
*(661) 322-8023*

# Trust Drafting With a View to Divorce

by

Barry L. McCown, Esq., C.P.A.

There appears to be an almost universal lack of knowledge in the estate planning community, especially among small and solo "general practice" attorneys, regarding the utter prohibition upon asset transfers by either party to a divorce action under the property restraint provisions of the temporary restraining orders in family law (See California Judicial Council Form 1285.05).

It is my understanding that generally the property restraints are enforceable against both petitioner and respondent and include restraints against "transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, real or personal, whether community, quasi-community, or separate, except in the usual course of business or for the necessities of life." Further, "both parties are restrained and enjoined from cashing, borrowing against, canceling, transferring, disposing of, or changing the beneficiaries of any insurance or other coverage including life, health, automobile, and disability held for the benefit of the parties or their minor child or children."

For the last several years I have been utilizing computer software for the design and initial creation of many of the more complex trusts and wills we draft in our office. One such drafting system includes the following "standard" provision regarding the dissolution of the marriage of the joint or co-settlors of a living trust. Assuming the trust is comprised of the couple's community property (held in the main or so-called "Joint Trust"), and also includes the separate property of either (or both) spouse(s) (held in a Husband's Separate Trust or Wife's Separate Trust, respectively, under the same trust instrument), the parties could provide the following directive in the event either later seeks to dissolve their marriage:

> **"If the Settlors become divorced, then: (i) the Joint (or Community Property) Trust shall be divided into two equal shares, with one share distributed to Wife (or Wife's Separate Trust) and one share to Husband (or Husband's Separate Trust); and, (ii) Wife shall be deemed to have predeceased Husband in the disposition of Husband's Separate Trust, and Wife shall cease to be a Trustee or beneficiary of Husband's Separate Trust or to have any power thereunder; and (iii) Husband shall be deemed to have predeceased Wife in the disposition of Wife's Separate Trust, and Husband shall cease to be a Trustee or beneficiary of Wife's Separate Trust or to have any power thereunder."**

The language of the above-referenced "general" divorce provision leads me to wonder whether the mere **termination** of the trust and **restoration** of the parties' respective properties (e.g., an undivided one-half interest in the community or "joint trust" assets, plus the respective spouse's separate property trust assets) might not violate the terms of those family law property restraints (TRO's). I know of no other trust drafting system which even

contemplates this subject matter (i.e., what to do with the property in the Living Trust during the pendency of the Settlors' divorce from one another).

Certified Family Law Specialists likely can appreciate these problems far better than I. However, as a California Legal Specialist in the combined fields of Taxation Law and Estate Planning, Trust and Probate Law, as certified (and recertified in each) by the State Bar of California's Board of Legal Specialization, I am keenly interested in fashioning for my clients a provision which restores to or confirms each party's control over his or her share of the community trust assets and separate property assets and permits, to the extent possible, the maximum planning flexibility with respect to amended beneficiary and trustee designations for each spouse.

A fair reading of the TRO would seem to enjoin all such transactions, and perhaps could be read to prevent either spouse from initiating any changes regarding the administration and distribution of his or her separate trust property, contrary to the "revocable" (i.e., always amendable and the property may always be withdrawn from trust) feature of these instruments and the presumption of the California Trust Law. (See Probate Code section 15400, which provides that, "Unless a trust is expressly made irrevocable by the trust instrument, the trust is revocable by the settlor.") As we all know, it is often months or years before the court approves the parties' Marital Settlement Agreement (MSA) dividing their properties, including those trust assets. In the meantime, are the parties prohibited from redirecting their future beneficial interests in their trust assets, and does it make any difference whether such trusts are made up of separate or community property assets?

Would a mere codicil to or re-execution of a Will by either spouse be deemed a violation of these orders, thereby subjecting either party to court sanction, including jail time? Further, assuming either spouse wishes to simply change the beneficiary designations on his or her share of the trust, is this going to be deemed a violation of the TRO? (Is it a disposition of the property if it remains in trust?)

Keep in mind that not all life insurance proceeds are paid directly to a beneficiary and, at least with respect to children, they are more likely to be collected in trust for the benefit of the child(ren). If that is the case and either party amends his or her share of the trust or makes any other change to the beneficiaries under the trust, even to extend the trust term from age 30 to, say, age forty for each beneficiary and without changing the shares of any beneficiary, might this also be considered a violation of the TRO during the pendency of the divorce? How about a change in the successor Trustee nominations (i.e., future trustees who might be asked to act in such capacity) under an instrument permitting the Trustee discretion to "sprinkle" income among a class of beneficiaries? Is this a disposition or change in the property that might be deemed in violation of the TRO? (This ability in successive trustees to "sprinkle" or allocate trust income or principal among multiple beneficiaries on a needs basis or to accomplish creditor protection under the trust is a highly desirable estate planning/tax saving feature of a so-called "dynastic" estate plan and certain irrevocable trusts.)