

Third Supplement to Memorandum 2000-51

Estate Planning During Dissolution of Marriage: Comments of James R. Birnberg

We have received an emailed letter from James R. Birnberg, commenting on the staff draft recommendation. The letter is attached. This memorandum raises a general question about the proposed law and then discusses Mr. Birnberg's comments.

Restraint on Creation and Modification of Nonprobate Transfer Revisited

Nearly all of the negative comments we have received regarding the proposed law relate to the restraint on creation and modification of nonprobate transfers. Before making the recommendation final, the staff would like to revisit the decision to restrain creation and modification.

The problem that the restraint is intended to address is a narrow one: the possibility that one spouse will create or modify a nonprobate transfer in such a way as to transfer the other spouse's share of community property to a third party, without obtaining the other spouse's consent, and then die during the dissolution proceeding. This would be a serious problem when it occurs, but probably wouldn't occur very often.

Existing law provides a remedy for an unauthorized transfer of community property — the nonconsenting spouse may have the transfer set aside as to his or her share of the community property. Prob. Code § 5021. This remedy should be adequate in most cases. However, it would be inadequate where the person who received the property cannot be located, is outside the court's jurisdiction, or is insolvent.

Thus, the real problem we are addressing with the restraint is an unauthorized nonprobate transfer of community property, where the recipient absconds or there is some other practical obstacle to obtaining relief through the existing legal remedy. This problem could perhaps be avoided by issuance of a court order restraining the person holding the property (e.g., a bank) from transferring the property pursuant to the nonprobate transfer. Any party can petition the court for such an order under Family Code Section 2045(a). For

example, if Husband believes that Wife has improperly changed the beneficiary designation on a POD account during the dissolution proceeding, Husband can apply for a court order restraining the bank from paying on the account in the event of Wife's death. Of course, this places the burden on the innocent spouse to keep track of all marital property held by third parties and seek restraining orders where appropriate.

In light of the negative commentary, the narrowness of the problem we are trying to address, and the complication of the proposed law that results from the restraint on creation and modification, the staff believes it may make sense to deliberate further on this point. Staff could circulate a revised draft recommendation that does not restrain creation and modification of nonprobate transfers, with Comment language discussing remedies available to address unauthorized transfers of community property. Public comment could be sought from the Family Law and Estate Planning community on the merits of the alternative approach. The Commission could then revisit the matter at its October meeting. This would still leave sufficient time to seek implementing legislation for next year.

Unfunded Living Trust

In response to our request for comments on the benefit of creating an unfunded living trust during a dissolution proceeding, Mr. Birnberg comments:

I can understand why the spouse would want to be able to create what otherwise would be an unfunded revocable trust. If the estate planning spouse wants to do any sort of sophisticated estate planning it would have to be included as part of a will, which would have to be recited as part of a court order on distribution. Use of an unfunded revocable trust would permit a less complicated probate estate. In addition, the spouse would not have to redo the estate plan after the ATRO terminated but would merely have to fund the trust.

Mr. Birnberg's comment supports the idea that creation of an unfunded living trust should not be restrained (as discussed in the First Supplement to Memorandum 2000-51).

Proposed Law Would Not Prevent Modification of Nonprobate Transfer

Mr. Birnberg sees a conceptual gap in the draft recommendation. Under the proposed law, the ATRO would restrain modification of a nonprobate transfer, but would not restrain revocation of the nonprobate transfer and creation or

modification of a will to dispose of the asset. Thus, the ATRO does not prevent the modification, it simply makes it more complicated (by requiring two steps rather than one).

In a sense, Mr. Birnberg is correct. A person could, through revocation of a nonprobate transfer and modification of a will, achieve much the same disposition of property as could be achieved by modifying the nonprobate transfer. However, there would be one important difference: the transfer would be by will rather than by nonprobate transfer. This means that the transfer would, in many cases, be subject to judicial supervision through probate administration. This should substantially reduce the risk that community property will be transferred to a third person without the other spouse's consent. In most cases, a nonprobate transfer is not subject to judicial supervision, increasing the risk of an unauthorized transfer of community property. For example, before dissolution and with Wife's consent, Husband deposits community funds into a pay-on-death account in a financial institution and names Wife as the beneficiary. After the dissolution proceeding commences, Husband wishes to change the account to name his friend as beneficiary. If he is allowed to do so and then dies, the account could pay the friend before Wife even learns of the change. If instead, Husband revokes the POD designation and devises the property to his friend in his will, Wife's share of the community property would not be transferred to the friend (because it would not be part of Husband's estate).

The staff will see if the staff draft recommendation can be revised to more clearly explain the justification for restraining modification of a nonprobate transfer but not restraining revocation and subsequent disposition of the asset by will.

Community Property Rights in Multiple Party Account

Mr. Birnberg also sees a problem with the discussion of multiple party accounts:

I further think that the discussion of third-party accounts presupposes that the non-consenting spouse loses rights if the other spouse changes a joint or POD account. I am not sure that is correct under Probate Code Section 5305 and the Law Revision Comments to that section. Therefore, it may be perfectly reasonable to permit creations or modifications of non-probate transfer assets, with the provision that the non-consenting spouse has to be provided with

an offsetting adjustment in the community property divided in the dissolution proceeding.

In relevant part, Probate Code Section 5305 provides that contributions to a joint account between spouses are presumed to be community property and that creation of a multiple party account with community property funds does not alter community property rights to those funds.

Mr. Birnberg is correct that a party does not lose community property *rights* to community funds in a multiple party account if the funds are transferred to a third person without the party's consent. This is clear from Probate Code Section 5305 and also from Sections 5020-5032 (requiring spousal consent to a nonprobate transfer of community property). However, as a *practical* matter, it may be difficult for the spouse to recover his or her community property once it has transferred, regardless of the spouse's legal right to the property.

Mr. Birnberg suggests that compensation for an unauthorized transfer of community property could be had as an offset in the division of community property in the dissolution proceeding. This is sensible, but will only work if the remaining property is sufficiently large for the offset. Also, if one party dies during the proceeding but before dissolution of marital status, the dissolution proceeding is abated and there will never be a division of community property for the purpose of dissolution. In this case, the offset would need to be drawn from property transferred on death.

Respectfully submitted,

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July 18, 2000
VIA E-MAIL & U.S. MAIL

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Re: Memorandum 2000-51
Study FHL-911

Dear Mr. Hebert:

Thank you for your letter of June 30, 2000. I was out of town until yesterday and hope this response gets to you in time for the July 20, 2000 meeting.

First, on the short two page memorandum, I can understand why the spouse would want to be able to create what otherwise would be an unfunded revocable trust. If the estate planning spouse wants to do any sort of sophisticated estate planning it would have to be included as part of a Will, which would have to be recited as part of a court order on distribution. Use of an unfunded revocable trust would permit a less complicated probate estate. In addition, the spouse would not have to redo the estate plan after the ATRO terminated but would merely have to fund the trust.

Second, I think there are conceptual gaps in the proposed legislation, which are illustrated in some of the Staff Draft Recommendation itself. If the spouse can dispose of the assets by Will and can terminate a non-probate transfer but not modify it, is not the modification in fact made by revoking the non-probate transfer and amending the Will to provide for the same disposition of the asset? The proposal seems to me therefore merely to make the transaction harder but not to prevent it. I further think that the discussion of third-party accounts presupposes that the non-consenting spouse loses rights if the other spouse changes a joint or POD account. I am not sure that is correct under Probate Code Section 5305 and the Law Revision Comments to that section. Therefore, it may be perfectly reasonable to permit creations or modifications of non-probate transfer assets, with the provision that the non-consenting spouse has to be

provided with an offsetting adjustment in the community property divided in the dissolution proceeding.

I hope these comments are helpful.

Very truly yours,

James R. Birnberg