Study FHL-911 August 11, 2000

Memorandum 2000-60

Estate Planning During Dissolution of Marriage (Draft of Recommendation)

This memorandum supersedes Memorandum 2000-51 and its supplements, which were not considered by the Commission.

At its June meeting, the Commission considered public comments on its tentative recommendation relating to *Estate Planning During Marital Dissolution*, which would clarify the effect of the automatic temporary restraining order (ATRO) that is in effect during a proceeding for dissolution or annulment of marriage. The Commission instructed the staff to prepare a staff draft recommendation based on the tentative recommendation. That draft is attached. Three comment letters are also attached as an Exhibit.

COMMENTS ON STAFF DRAFT RECOMMENDATION

We received several comments regarding the staff draft recommendation (which was originally attached to superseded Memorandum 2000-51). These comments are discussed below.

Creation of Unfunded Living Trust

Mr. Oldman has suggested that the ATRO should restrain the transfer of property to fund a living trust, but should not restrain the creation of an *unfunded* living trust. So long as the trust remains unfunded, there is no risk of an unauthorized transfer of community property by operation of the trust. A party who creates an unfunded living trust during a dissolution proceeding could then execute a will with a pour-over provision to fund the trust. The property would be transferred to the trust on the testator's death. Considering that property poured from a will into a trust would be subject to probate, the staff was unsure why anyone would choose such an arrangement (since probate avoidance is one of the principal advantages of living trusts). Mr. Oldman and Mr. Birnberg have written to explain the advantages of such a plan. They make three points:

Gradual Funding of Trust as Assets Released

Mr. Oldman notes that an unfunded living trust created during a dissolution proceeding could be funded gradually, with property that is released from the jurisdiction of the family court by agreement of the parties (see Exhibit p. 1):

> It is my understanding that the parties will often agree that property may be released from the jurisdiction of the family court while the matter is pending. If a trust may be established in the meantime, it may be funded upon release of the assets. This may be especially important where the parties remarry after dissolution but while the marital estate is still being divided. In some cases, years may pass while a portion of the estate is in the process of division and the ATRO may still be in effect.

Of course, in a proceeding that stretches on for years, a party should be able to obtain spousal consent or a court order authorizing creation of a trust. Still, there may be cases of shorter duration where it would be useful to create an unfunded trust as an eventual repository for property released from the ATRO.

Greater Efficiency in Estate Planning

Mr. Oldman observes that modern estate planning typically employs one or more living trusts. If the only estate planning instrument that a party can create during a dissolution proceeding is a will, many parties will execute a will during the proceeding and then replace it with a more sophisticated plan (involving a trust) once the ATRO terminates. This would require the parties to engage in estate planning twice, imposing unnecessary costs (see Exhibit pp. 1-2):

> Allowing the parties to engage in proper estate planning in the beginning will not increase the risks of estate dissipation while allowing the parties to proceed with a new estate plan in accordance with modern techniques and expectations.

Mr. Birnberg makes a similar observation (see Exhibit p. 5):

> 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.

Privacy

Finally, Mr. Oldman is concerned that requiring court permission to create a living trust during a dissolution proceeding would compromise the privacy and confidentiality one expects with regard to the contents of a trust (see Exhibit p. 2):

> If a motion is required in order to obtain permission to create a trust while an ATRO is in effect, the other spouse will be notified of the intent to create a trust and probably will also be informed of its terms. In fact, the need to file a motion may make the entire trust instrument a matter of public record. This is not true of a will made during dissolution proceedings. Any party being required to obtain court permission to create a trust will be placed at a relative disadvantage compared to the creation of a will. Once again, this is contrary to normal estate planning procedures and expectations.

Discussion

Mr. Oldman and Mr. Birnberg demonstrate that there are good reasons to create an unfunded living trust during a dissolution proceeding. **The staff is concerned about adding to the complexity of the proposed law, but believes that the suggested change may be appropriate.** Mr. Oldman's suggestion could be implemented by revising the proposed amendment to Family Code Section 2040(b) to read as follows:

> (b) Nothing in this section restrains any of the following:
> (1) Creation, modification, or revocation of a will.
> (2) Revocation of a nonprobate transfer.
> (3) Elimination of a right of survivorship to property that is owned jointly by the parties.
> (4) The creation of an unfunded living trust.
>
> **Comment**. … Subdivision (b)(4) provides that the ATRO does not restrain creation of an unfunded living trust. However, the transfer of property to fund a living trust would be restrained under subdivision (a)(2). An unfunded living trust created during a dissolution proceeding could serve as a receptacle for property subject to a pour-over provision in a will. Such a trust could also be funded by property that has been released from restraint by the ATRO.

If the Commission approves the staff draft recommendation, it should also decide whether this would be an appropriate change.

Disadvantage to Respondent

The automatic temporary restraining order (ATRO) in effect during a proceeding for dissolution of marriage takes effect on service of the summons. This means that a petitioner can take actions restrained by the ATRO *before* service of the summons and thereby avoid the restraint. A respondent who is surprised by service cannot. The Probate, Trust, and Estate Planning Legislative Committee of the Beverly Hills Bar Association ("the Committee") believes that this is a problem, but does not offer any specific suggestion for how the problem might be solved. See Exhibit p. 3.

The Commission previously considered whether the potential unfairness to the respondent could be minimized by some sort of retroactive limitation on the petitioner's actions (e.g., voiding actions of the types restrained by the ATRO that were taken during some fixed period before service of the summons). Retroactive limitation would be analogous to the rule in bankruptcy that allows a trustee to void transfers from a debtor to the debtor's creditors that occurred within 90 days of filing the petition. See 11 U.S.C. § 547(b). The Commission rejected the idea of retroactive limitation as creating too many problems. **The staff sees no simple solution to the problem of unfairness to a surprised respondent.**

Proposed Exemptions from Scope of ATRO

The Committee also lists a number of transactions that it believes should not be restrained by the ATRO. These are discussed below (see Exhibit pp. 3-4):

Changing the Beneficiary of a Living Trust

The Committee suggests that the ATRO should not restrain a change in beneficiary of a living trust. However, one of the principles underlying the proposed law is that the ATRO should restrain estate planning changes that could potentially result in an unauthorized transfer of community property. A change of beneficiary of a living trust has such potential. If one spouse changes the beneficiary of a trust containing community property and then dies, the property may be transferred to the new beneficiary without the surviving spouse's consent. **The staff recommends against this change.**

Designating Personal Representative as Beneficiary

The Committee suggests that the ATRO should not restrain changing the beneficiary of a nonprobate transfer to the personal representative of the party's estate. The risk of such a change resulting in an unauthorized transfer of community property would be small, because the property would be subject to

probate administration. In the process of administration, the character of the property could be determined and the transfer could be set aside to the extent that it affects the other spouse's community property. However, a party could achieve much the same result simply by revoking the nonprobate transfer (revocation would not be restrained under the proposed law). On revocation of the nonprobate transfer, the party's share of the property would be part of the party's estate, subject to disposition by will. **The staff recommends against this change.**

Designating Trustee as Beneficiary

The Committee suggests that the ATRO should not restrain changing the beneficiary of a nonprobate transfer to the trustee of the party's living trust. However, such a change could potentially result in an unauthorized transfer of community property. For example, suppose that Husband and Wife agree that Wife will establish a pay-on-death account, funded with community property, naming Husband's child from a former marriage as beneficiary. At that time Wife also creates a living trust, funded with her separate property, naming her sister as beneficiary. During a subsequent dissolution proceeding, Wife changes the beneficiary of the POD account to be the trustee of her living trust. On wife's death, the POD account is paid to the trustee who then conveys the property, according to the terms of the trust, to Wife's sister. **The staff recommends against this change.**

Revocation or Cancellation of Community Property Agreement

Under existing law, spouses may agree to divide community property on death asset-by-asset, rather than sharing ownership of each asset equally. Prob. Code § 100(b). The Committee points out that such an agreement can be used to minimize taxes by allocating taxable assets to the estate of the surviving spouse. Such an arrangement may not make sense in the context of dissolution. The Committee believes that revocation or cancellation of such an agreement should not be restrained by the ATRO.

The Committee makes a good point. Revocation of such an agreement should not affect the present property interests of either spouse. The planned division of assets would fail (as the parties anticipated that it might, given the agreement's revocability), but the parties present ownership rights and overall shares of community property on death would not be affected. For this reason, **the staff agrees that the ATRO should not restrain revocation of such an agreement.**

However, it doesn't appear that any change to the proposed law is required in order to implement the Committee's suggestion. Under the proposed law, the ATRO does not restrain revocation of a "nonprobate transfer," which it defines as follows:

> "Nonprobate transfer" means an instrument, other than a will, that makes a transfer of property on death, including a revocable trust, pay-on-death account in a financial institution, Totten trust, transfer-on-death registration of personal property, or other instrument of a type described in Section 5000 of the Probate Code."

An agreement specifying how community property assets are to be divided on the death of a spouse could be understood as an instrument making a transfer of property on death, i.e., a nonprobate transfer. The fact that Probate Code Section 5000 includes a "marital property agreement" in its list of instruments that can constitute a nonprobate transfer supports this interpretation. The effect of the ATRO on such an agreement could be clarified by adding language to the Comment, along the following lines:

> **Comment.** …Subdivision (d) defines "nonprobate transfer" for the purposes of this section. The definition expressly incorporates instruments described in Probate Code Section 5000, including a "marital property agreement." Thus, an agreement between spouses as to how to divide community property between them on either of their deaths is a nonprobate transfer for the purposes of this section. See Prob. Code § 100(b) (agreement as to division of community property on death of spouse).

Modification of a Power of Appointment

The Committee suggests that the ATRO should not restrain modification of a power of appointment. However, modification of a power of appointment could easily result in an unauthorized transfer of community property. For example, before a dissolution proceeding is anticipated, Husband creates a power of appointment in a trust funded with community property (with Wife's consent). After commencement of the dissolution proceeding, Husband modifies the power of appointment, changing the donee to a person more likely to distribute property to his preferred heirs and enlarging the scope of community property subject to the power. This change would directly affect the disposition of Wife's share of the community property. **The staff recommends against making this change.**

Execution of a Disclaimer

The Committee suggests that the ATRO should not restrain execution of a disclaimer. Pursuant to Probate Code Section 260 *et seq.*, a person may disclaim an interest in property which he or she would otherwise receive as beneficiary of a will or nonprobate transfer. Execution of a disclaimer by one spouse would not affect the present property interests of the other spouse. For that reason, **the staff agrees that the ATRO should not restrain execution of a disclaimer.** At the risk of making the ATRO harder to understand by pro se litigants, we could add the suggested exemption by amending proposed Family Code Section 2040(b) as follows:

> 2040. …(b) Notwithstanding subdivision (a), nothing in this section restrains any of the following:
>
> …
>
> (6) Execution and filing of a disclaimer pursuant to Part 8 (commencing with Section 260) of Division 2 of the Probate Code .

Proposed Law Does Not Prevent Modification of Nonprobate Transfer

Mr. Birnberg sees a conceptual gap in 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). See Exhibit p. 5.

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.

Community Property Rights in Multiple Party Account

Mr. Birnberg also sees a problem with the discussion of multiple party accounts (see Exhibit pp. 5-6):

> 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 *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 discussed previously, it may be difficult as a *practical* matter for the spouse to recover community property once it has transferred, regardless of his or her 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 to provide an 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.

ALTERNATIVE APPROACH: NO RESTRAINT ON CREATION OR MODIFICATION OF NONPROBATE TRANSFERS

To date, nearly all of the negative comments we have received regarding the proposed law relate to the proposed restraint on creation and modification of nonprobate transfers. In light of these objections, the Commission should perhaps reconsider whether the restraint is justified. To that end, the purpose of the restraint, objections to the restraint, and an alternative approach that does not include the restraint, are discussed below.

Purpose of the Restraint

The restraint on creation and modification of nonprobate transfers is intended to prevent one spouse from creating or modifying a nonprobate transfer in such a way as to transfer community property to a third party without the other spouse's consent. If such a change were made and the transferring spouse were to die during the dissolution proceeding, the transfer might be completed before the surviving spouse could act to prevent it. For example, during a dissolution proceeding Husband changes the beneficiary of a pay-on-death bank account containing community funds, without informing Wife. Husband then dies and the funds are paid to the new beneficiary, contrary to Wife's expectations.

Existing law provides a remedy that should be adequate in most cases — where a nonprobate transfer of community property is made without spousal consent, the transfer is ineffective as to the nonconsenting spouse's share and may be set aside. Prob. Code § 5020-5032. However, this remedy could prove inadequate if the recipient of the transferred property cannot be located, is outside the jurisdiction of the court, or has dissipated or concealed the property. Such practical problems could perhaps be overcome in two ways:

(1) A spouse who learns of an unauthorized nonprobate transfer of community property before the transferor's death can petition the court for an order restraining the property holder (e.g., a bank) from transferring the property. See Fam. Code § 2045(a) (restraint of third parties).

(2) If community property is transferred without the spouse's consent, the court might award some other community asset to the injured spouse as compensation (assuming that other assets exist).

Thus, the problem addressed by the restraint is actually quite narrow. It will only arise where each of the following is true:

- One spouse creates or modifies a nonprobate transfer without spousal consent.
- The transferring spouse dies during the proceeding and the property is transferred.
- The transferee cannot be found, is not within the jurisdiction of the court, or has dissipated or concealed the property.
- The decedent's other assets are insufficient to serve as an offset to compensate the nonconsenting spouse for the loss of the transferred property.

This is an unlikely combination of events. Nonetheless, it would be unjust if it were to occur.

Objections to the Restraint

Commentators have raised the following objections to the restraint on creation and modification of nonprobate transfers:

Creation of Unfunded Living Trust Should Not Be Restrained

Creation of an unfunded living trust should not be restrained. An unfunded trust cannot result in an unauthorized transfer of community property. See discussion above.

Desire to Avoid Probate Thwarted

If creation and modification of a nonprobate transfer are restrained, but revocation of a nonprobate transfer and creation of a will are not restrained (as in the Staff Draft Recommendation), the tendency will be for parties to revoke nonprobate transfers and replace them with wills, in order to avoid an unintended transfer if the party dies during the proceeding. If a party does die during the proceeding, the party's estate will be subject to probate, which may be contrary to the decedent's desire to avoid probate.

Additional Cost

A party who replaces a nonprobate estate plan with a will and survives a dissolution proceeding will probably wish to change his or her estate plan once again, to replace the interim will-based plan with a plan using nonprobate transfers. Such a party incurs the cost of estate planning twice. See discussion above.

Privacy of Trust Compromised

The contents of a trust are confidential. If court permission is required to create or modify a trust, the contents of the trust may become part of the public record. See discussion above.

Separate Property Restrained

The restraint should not apply to separate property. A transfer of separate property cannot result in an unauthorized transfer of community property. However, as has been discussed in prior memoranda, it may be difficult for the parties to properly characterize property as separate or community. Such characterization involves a complex application of law to facts that is probably best left to the court.

Unfair Advantage to Petitioner

Because the ATRO takes effect on the service of the summons, a petitioner can make any desired estate planning changes before the summons is served. A respondent who is surprised by service of summons cannot. In such cases, the respondent is restrained in a way that the petitioner is not. See discussion above.

Alternative Approach

The draft recommendation could be revised so that creation and modification of a nonprobate transfer are not restrained. This could be done by revising the proposed amendment of Family Code Section 2040 to read as follows:

> 2040. (a) In addition to the contents required by Section 412.20 of the Code of Civil Procedure, the summons shall contain a temporary restraining order:
>
> (1) Restraining both parties from removing the minor child or children of the parties, if any, from the state without the prior written consent of the other party or an order of the court.
>
> (2) Restraining both parties from transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, real or personal, whether community, quasi-community, or separate, without the written consent of the other party or an order of the court, except in the usual course of business or for the necessities of life and requiring each party to notify the other party of any proposed extraordinary expenditures at least five business days before incurring those expenditures and to account to the court for all extraordinary expenditures made after service of the summons on that party.
>
> Notwithstanding the foregoing, nothing in the restraining order shall preclude a party from using community property, quasi-community property, or the party's own separate property to pay reasonable attorney's fees and costs in order to retain legal counsel in the proceeding. A party who uses community property or quasi-community property to pay his or her attorney's retainer for fees and costs under this provision shall account to the community for the use of the property. A party who uses other property that is subsequently determined to be the separate property of the other party to pay his or her attorney's retainer for fees and costs under this provision shall account to the other party for the use of the property.
>
> (3) Restraining both parties 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 and their child or children for whom support may be ordered.

(b) Nothing in this section restrains any of the following:

(1) Creation, modification, or revocation of a will or nonprobate transfer.

(2) Elimination of a right of survivorship to property that is owned jointly by the parties.

(c) In all actions filed on and after January 1, 1995, the summons shall contain the following notice:

"WARNING: California law provides that, for purposes of division of property upon dissolution of marriage or legal separation, property acquired by the parties during marriage in joint form is presumed to be community property. If either party to this action should die before the jointly held community property is divided, the language of how title is held in the deed (i.e., joint tenancy, tenants in common, or community property) will be controlling and not the community property presumption. You should consult your attorney if you want the community property presumption to be written into the recorded title to the property."

(d) For the purposes of this section:

(1) "Nonprobate transfer" means an instrument, other than a will, that makes a transfer of property on death, including a revocable trust, pay-on-death account in a financial institution, Totten trust, transfer-on-death registration of personal property, or other instrument of a type described in Section 5000 of the Probate Code.

(2) "Nonprobate transfer" does not include a provision for the transfer of property on death in an insurance policy or other coverage held for the benefit of the parties and their child or children for whom support may be ordered, to the extent that the provision is subject to paragraph (3) of subdivision (a).

Comment. Section 2040 is amended to clarify that the automatic temporary restraining order does not restrain estate planning changes. This is consistent with *Estate of Mitchell*, 76 Cal. App. 4th 1378, 91 Cal. Rptr. 2d 192 (1999) (restraining order does not restrain severance of joint tenancy). The fact that the restraining order does not restrain modification or revocation of a nonprobate transfer does not mean that such a transfer is necessarily subject to modification or revocation by one party without the consent of the other party. The question of whether a nonprobate transfer is subject to unilateral modification or 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). Also, a party must obtain

spousal consent before creating or modifying a nonprobate transfer of community property. See Prob. Code §§ 5020-5032.

While subdivision (b) provides that creation of a nonprobate transfer is not restrained, a transfer of property to fund a nonprobate transfer is subject to the general restraint on transfer of property provided in subdivision (a)(2). Thus, a party may create a living trust but cannot transfer property to the trust without written spousal consent or an order of the court. An unfunded living trust created during a dissolution proceeding could serve as a receptacle for property subject to a pour-over provision in a will. Such a trust could also be funded by property that has been released from restraint by the ATRO.

This approach is substantially simpler than that in the staff draft recommendation, and avoids all of the concerns discussed above. **The staff sees considerable merit in this approach**, but would like to receive input from family and estate planning practitioners on which approach is preferable.

Transfers Restrained Under Alternative Approach

As stated in the last paragraph of the proposed Comment (above), transfer of property to fund a nonprobate transfer would still be restrained under the alternative approach. If transfers of property to fund a nonprobate transfer were not restrained, a spouse might transfer community property outside the court's jurisdiction to fund a trust in some other state or country (e.g., an "asset protection trust" in the Cook Islands). This is exactly the sort of dissipation of marital assets that the ATRO is intended to prevent. The staff recognizes that this will hamper estate planning to some extent and is interested in hearing input on the merits of this limitation.

Respectfully submitted,

Brian Hebert
Staff Counsel

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July 3, 2000

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

Re: ATRO Proposal

Dear Mr. Hebert:

Thank you for sending me the tentative recommendation regarding the proposed ATRO legislation.

In regard to the question of being able to establish rather than establish and fund a living trust, I believe that the creation of an unfunded living trust will be a benefit to litigants in dissolution proceedings for the following reasons:

1. While a probate may not be avoided to the extent that the trust remains unfunded, the creation of a trust will allow the parties to fund their respective trusts as assets are released from the dissolution proceeding. It is my understanding that the parties will often agree that property may be released from the jurisdiction of the family court while the matter is pending. If a trust may be established in the meantime, it may be funded upon release of the assets. This may be especially important where the parties remarry after dissolution but while the marital estate is still being divided. In some cases, years may pass while a portion of the estate is in the process of division and the ATRO may still be in effect.

2. Modern estate planning almost invariably employs the creation of one or more living trusts. While many of the same objectives may be achieved by a will, a trust will normally be created after the completion of the estate planning process. Requiring litigants to be satisfied with a will during dissolution may force them to engage twice in estate planning and will be ultimately wasteful to the parties. Allowing the parties to engage in proper estate planning in the

beginning, will not increase the risks of estate dissipation while allowing the parties to proceed with a new estate plan in accordance with modern techniques and expectations.

3. As with a will, the creation of a living trust is normally a private and confidential matter. If a motion is required in order to obtain permission to create a trust while an ATRO is in effect, the other spouse will be notified of the intent to create a trust and probably will also be informed of its terms. In fact, the need to file a motion may make the entire trust instrument a matter of public record. This is not true of a will made during dissolution proceedings. Any party being required to obtain court permission to create a trust will be placed at a relative disadvantage compared to the creation of a will. Once again, this is contrary to normal estate planning procedures and expectations.

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

Very truly yours,

MARSHAL A. OLDMAN

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Reply To:

July 7, 2000

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

Re: Estate Planning during Marital Dissolution February, 2000

Gentlemen:

We have reviewed the proposal of the Law Revision Commission regarding estate planning during the marital dissolution. In general we agree with the approach of the Law Revision Commission but believe that the approach falls short in one respect. As pointed out in the preamble to the recommendation, it is clear that the non-petitioning, respondent spouse, is at a disadvantage. We believe that neither spouse should be forced to go to court to accomplish the following changes to his or her estate plan:

A. Changing the beneficiary designation of a living trust.

B. Changing the beneficiary on any non-probate transfer to the personal representative of the party's estate or the trustees of the party's living trust.

C. Revoking or canceling a community property agreement. Community property can now be treated in the aggregate. We are frequently seeing community property agreements that allocate assets between two community halves rather than splitting each asset down the middle. The "creative planning" in some of these agreements consists of allocating the taxable assets, i.e. retirement plans, to the estate of the surviving spouse, thereby allowing optimal funding of the by-pass trust. This can be detrimental to the interest of the surviving spouse.

D. Modification of a power of appointment or execution of a disclaimer.

These actions can be undertaken without any fear that the Family Law court would lose jurisdiction. We believe they are consistent with the Law Revision Commission's existing recommendation and would generally have the same result. Assets would not automatically be removed from the party's estate, nor from the court's jurisdiction, but would still be subject to the party's disposition at death. Further, there is no reason why a disposition should not be allowed to take place by a trust instead of a will.

Respectfully submitted,

BEVERLY HILLS BAR ASSOCIATION
Probate, Trust and Estate
Planning Legislative Committee

By: _____
Kenneth G. Petrulis, Chair

KGP/ct

cc: Marc Sallus
Gary Edelstone

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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 losses 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

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ESTATE PLANNING DURING MARITAL DISSOLUTION

Existing law imposes an automatic temporary restraining order (ATRO) on both parties in a proceeding for dissolution or annulment of marriage, or legal separation (hereinafter "dissolution"). Except as necessary to pay attorney's fees or ordinary expenses, the ATRO restrains the parties from "transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, real or personal, whether community, quasi-community, or separate, without the written consent of the other party or an order of the court."[1] The extent to which the ATRO restrains estate planning changes during a dissolution proceeding is not clear. The Commission has been informed that different trial courts interpret the ATRO differently — some interpret the ATRO as restraining estate planning changes while others do not.[2]

In a recent decision, *Estate of Mitchell*, the court held that revocation of a joint tenancy is not restrained by the ATRO, because unilateral severance does not involve a transfer and because severance only disposes of an expectancy, not property.[3] This is a reasonable interpretation of Family Code Section 2040. However, the opinion does not consider other types of estate planning changes, such as creation, modification, or revocation of a trust. The applicability of the ATRO to these other types of changes should also be clarified.

PROBLEMS WITH EXISTING LAW

Uncertainty

Uncertainty as to whether the ATRO restrains estate planning changes can create a trap for unwary parties and inexperienced practitioners. For example, if a party makes an estate planning change during a dissolution proceeding without first obtaining spousal consent or the permission of the court, and the court interprets

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1. See Fam. Code § 2040(a)(2).

2. This uncertainty is reflected in a standard family practice treatise and in a recent publication of the California State Bar Family Law Section. See W. Hogoboom & D. King, California Practice Guide: Family Law ¶ 1:394.1 (1999) (cautioning that severance of a joint tenancy "may well" violate the ATRO); Moore, Selected Estate Planning Issues for Family Lawyers, Family Law News, California State Bar Family Law Section, Winter 1996, at 12-13 (discussing uncertainty as to whether ATRO applies to severance of joint tenancy and revocation of trust).

Courts in other states have interpreted similar provisions restraining the disposal of property during a marital dissolution proceeding, with varying results. See, e.g., Lindsey v. Lindsey, 492 A.2d 396 (Pa. Super. 1985) (change of beneficiary designation on life insurance policies not conveyance of asset because beneficiary designation vests nothing in beneficiary during lifetime of insured — beneficiary has mere expectancy); Lonergan v. Strom, 700 P.2d 893 (Ariz. 1985) (severance of joint tenancy by means of straw transfer violated ATRO, but did not violate purpose of ATRO — to protect marital estate from dissipation or removal beyond reach of divorce court); Willoughby v. Willoughby 758 F. Supp. 646 (DC Kan. 1990) (change of life insurance beneficiary was disposition of property in violation of restraining order). See generally Chapus, *Divorce and Separation: Effect of Court Order Prohibiting Sale or Transfer of Property on Party's Right to Change Beneficiary of Insurance Policy*, 68 A.L.R.4th 929 (Westlaw 1999).

3. Estate of Mitchell, 76 Cal. App. 4th 1378, 91 Cal. Rptr. 2d 192 (1999).

the ATRO as restraining such a change, the change may be ineffective and the party may be held in contempt.[4]

Unintended Transfers

A change in a person's life as significant as dissolution of marriage will often lead to changes in that person's testamentary intentions. If the ATRO prevents a person from making an intended estate planning change and the person dies during the dissolution proceeding, the person's estate will pass in an unintended way. For example, suppose a husband and wife convey their community property into a trust that names the survivor of them as beneficiary and is unilaterally revocable by either. The wife later files for dissolution of marriage and decides to revoke the trust and execute a will devising her share of the community property to her children. Before she can obtain a court order permitting the estate planning changes, she dies, and contrary to her wishes, her husband receives the entire property.

Inefficiency

It appears that a principal purpose of the ATRO provision is to conserve judicial resources by making automatic those types of restraints that are commonly sought and granted in dissolution proceedings.[5] However, if parties to a dissolution routinely wish to make estate planning changes during the proceeding, then judicial efficiency is not served by an automatic restraint of such changes. In fact, estate planning changes during dissolution of marriage appear to be commonplace. In one appellate decision, the court suggests that family law attorneys risk malpractice liability if they do not advise their clients of the need to make estate planning changes during a dissolution proceeding in order to avoid an unintended transfer if the client dies during the proceeding.[6] Similar advice is provided in standard family law practice treatises.[7] Considering that careful attorneys will seek

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4. See Civ. Code § 2224 ("One who gains a thing by … wrongful act, is … an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it."); Code Civ. Proc. § 1209(a)(5) (contempt includes disobedience of lawful court order).

5. See, e.g., Assembly Committee on Judiciary analysis of Assembly Bill 1905, May 4, 1989, at 6:

> Proponents state that the restraining orders contained in this proposal are granted routinely by courts following the filing of an Order to Show Cause (OSC). One of the elements presently contributing to court congestion in family law courts is the routine filing of such OSC's simply to obtain these standard orders, with the attendant court time necessary for perfunctory hearings or, as is usual, signing in chambers. One or both parties usually seek at least one of these restraining orders soon after filing the family law action.
>
> This proposal would save court time without diminishing the parties' right to a hearing. Either party always would have the option of filing a motion to request that the orders be dissolved.

6. See Estate of Blair, 199 Cal. App. 3d 161, 169, 244 Cal. Rptr. 627, 631 (1988).

7. See W. Hogoboom & D. King, California Practice Guide: Family Law ¶¶ 1:367-369, 390 (suggesting that it is the duty of family law attorneys to promptly inquire whether their clients wish to sever joint tenancy in order to avoid unintended transfer if client dies during proceeding); K. Kirkland et al., California Family Law Practice and Procedure § 20.12[4][a][iv] (2d ed. 1999) (suggesting that clients should be advised to sever joint tenancy on commencing family law proceeding in order to avoid possible

spousal consent or an order of the court before taking such actions, the court will be required to hear numerous requests that would be granted in many cases — an apparent waste of judicial resources.

Disproportionate Effect on Respondent Spouse

The ATRO takes effect on service of the summons in a proceeding for dissolution of marriage.[8] A petitioner can effectively avoid the ATRO by making any desired estate planning changes before filing. A respondent who is unaware of a pending summons cannot avoid the ATRO in this way. The problems associated with the ATRO provision disproportionately affect respondents.

PROPER SCOPE OF RESTRAINING ORDER

As a general matter, it is inequitable and inefficient to require that a party to a dissolution proceeding obtain spousal consent or an order of the court before making estate planning changes that do not affect the rights of the other spouse. Such a restraint also exceeds the proper purpose of the ATRO — protecting marital assets from dissipation or concealment. As stated in an Arizona case interpreting a similar ATRO provision:

> In our opinion, it is not the purpose of [the ATRO] to freeze each party's estate plan as of the date of the filing of the petition for dissolution and thus insure that it will be effectuated without alteration in the event one of the parties dies before entry of a final decree. The statutory intent is to forbid actions by either party that would dissipate the property of the marital estate or place it beyond the court's adjudicatory power in the dissolution proceeding.[9]

Whether different types of estate planning changes might adversely affect the property interests of the other spouse is discussed below.

Transaction Involving a Will

The beneficiary of a will has no vested property interest in the will during the testator's life. Thus, a decision by one spouse to create, modify, or revoke a will during a dissolution proceeding does not affect the rights of the other spouse and should not be automatically restrained. This is consistent with the holding in *Estate of Mitchell*, that the ATRO does not restrain termination of an expectancy.[10]

Of course, spouses may agree by contract to make a particular testamentary disposition by will. In such a case, the contract itself serves to restrain

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unintended transfer to other spouse). Although these examples focus on joint tenancy survivorship, the same concerns are raised by other instruments that transfer property on death.

8. See Fam. Code § 233(a).
9. Lonergan v. Strom, 700 P.2d 893, 898 (Ariz. 1985).
10. See *supra* note 3.

modification or revocation of the agreed-upon will provision.[11] It is not necessary that all estate planning changes involving wills be automatically restrained during dissolution proceedings in order to protect these contractual agreements.

Revocation of Nonprobate Transfer

Many people choose to use a "nonprobate transfer" (such as a revocable trust, joint tenancy title, or a pay-on-death (P.O.D.) account in a financial institution), in order to pass property on death outside of the probate process. Revocation of a revocable nonprobate transfer is similar to revocation of a will in that it terminates a mere expectancy.[12] There does not appear to be any reason to automatically restrain the revocation of a nonprobate transfer during a dissolution proceeding.[13] Again, this is consistent with the holding in *Estate of Mitchell.*[14]

Modification of a Nonprobate Transfer

Modification of a nonprobate transfer during a dissolution proceeding can result in an unauthorized transfer of community property. This is because a nonprobate transfer, unlike a will, can be used to dispose of both spouses' shares of the community property, so long as both spouses have consented to the transfer.[15]

If, during a dissolution proceeding, one party modifies an instrument making a nonprobate transfer of community property without the consent of the party's spouse, the spouse's share of the property may be transferred contrary to the spouse's wishes. For example, suppose that a husband, with his wife's consent, deposits community funds in a P.O.D. account, naming their children as beneficiaries. Later, during a proceeding to dissolve their marriage, the husband changes the account to name his brother as beneficiary, without his wife's consent. The husband then dies and his brother withdraws all of the funds, including the wife's share of the community property.[16] This is exactly the sort of dissipation of marital assets that the ATRO is intended to prevent. Thus, modification of a

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11. See, e.g., Redke v. Silvertrust, 6 Cal. 3d 94, 490 P.2d 805, 98 Cal. Rptr. 293 (1971) (enforcing oral agreement to maintain particular testamentary provision).

12. See, e.g., *In re* Marriage of Hilke, 4 Cal. 4th 215, 222, 841 P.2d 891, 895, 14 Cal. Rptr. 2d 371, 375 (1992) ("severance of a joint tenancy — by eliminating the survivorship characteristic of the joint tenancy form of ownership — theoretically affects the expectancy interest of the other joint tenant, but does not involve a diminution of his or her present vested interest").

13. Life insurance presents a special case and is discussed separately. See *infra* text accompanying notes 19-20.

14. See *supra* note 3.

15. See Prob. Code §§ 5020 (spousal consent required for nonprobate transfer of community property), 6101 (will may only dispose of testator's half of community property).

16. See Prob. Code §§ 5403 (P.O.D. account paid to P.O.D. payee on proof of death of original payee), 5405 (payment pursuant to Section 5403 discharges financial institution of all claims regardless of whether payment was consistent with beneficial ownership of account).

nonprobate transfer, in a manner that will affect the disposition of community property, should be restrained by the ATRO.[17]

Modification of a nonprobate transfer of separate property does not present the same risk. However, characterization of property as community or separate often involves a complex legal and factual determination that is probably best left to the courts. For this reason, the restraint on modification of a nonprobate transfer should apply to both community and separate property. This is consistent with existing law, which restrains transactions involving either community or separate property.[18]

Creation of a Nonprobate Transfer

Creation of a nonprobate transfer can also pose a risk of unauthorized transfer of community property. For example, one spouse may use community funds to establish a P.O.D. account, without the consent of the other spouse, naming a third party as P.O.D. payee. On the account holder's death, the funds, including the nonconsenting spouse's share, would be paid to the third party. Thus, for the same reasons that modification of a nonprobate transfer should be restrained, creation of a nonprobate transfer should also be restrained.

Life Insurance

Under existing law, the ATRO expressly restrains cancellation or modification of any type of insurance during a dissolution proceeding.[19] This preserves the status quo in important ways, such as preventing the cancellation of health insurance coverage of a spouse. It also helps avoid the problem of an unauthorized transfer of community property to a third party. Finally, it preserves an asset that the court can use in fashioning a support order — it is fairly common for the court to order the obligor spouse to maintain life insurance for the benefit of the supported spouse, to provide support in the event of the obligor's death.[20] The court's ability to make such an order might be compromised if the policy were canceled. For all of these reasons, the existing restraint on cancellation or modification of insurance policies should be maintained.

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17. Modifications that would be restrained as affecting the disposition of property include a change of beneficiary or of a power of appointment. Modifications that would not be restrained include naming a new trustee or successor trustee (so long as the change does not affect the trustee's powers or duties with respect to disposition of trust property).

    Note that a rule permitting revocation of a nonprobate transfer, but requiring spousal consent or a court order in order to modify a nonprobate transfer, is consistent with the rule governing a trust containing community property — either spouse can unilaterally revoke such a trust, but the consent of both spouses is required in order to modify it. See Fam. Code § 761.

18. See Fam. Code § 2040(a)(2).

19. See Fam. Code § 2040(a)(3).

20. See Fam. Code § 4360 (support order may include amount sufficient to maintain insurance on life of support obligor, for benefit of supported spouse).

RECOMMENDATION

The Commission recommends that Family Code Section 2040 be amended to clarify the scope of the ATRO, consistent with the following principles:

(1) The ATRO should not restrain the creation, modification, or revocation of a will.

(2) The ATRO should restrain the creation of a nonprobate transfer.

(3) The ATRO should restrain modification of a nonprobate transfer if the modification will affect the disposition of property.

(4) The ATRO should not restrain the revocation of a nonprobate transfer (other than life insurance).[21]

21. See proposed Fam. Code § 2040(c) ("nonprobate transfer" defined).

PROPOSED LEGISLATION

Fam. Code § 2040 (amended). Automatic temporary restraining order

SECTION 1. Section 2040 of the Family Code is amended to read:

2040. (a) In addition to the contents required by Section 412.20 of the Code of Civil Procedure, the summons shall contain a temporary restraining order:

(1) Restraining both parties from removing the minor child or children of the parties, if any, from the state without the prior written consent of the other party or an order of the court.

(2) Restraining both parties from transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, real or personal, whether community, quasi-community, or separate, without the written consent of the other party or an order of the court, except in the usual course of business or for the necessities of life and requiring each party to notify the other party of any proposed extraordinary expenditures at least five business days before incurring those expenditures and to account to the court for all extraordinary expenditures made after service of the summons on that party.

Notwithstanding the foregoing, nothing in the restraining order shall preclude a party from using community property, quasi-community property, or the party's own separate property to pay reasonable attorney's fees and costs in order to retain legal counsel in the proceeding. A party who uses community property or quasi-community property to pay his or her attorney's retainer for fees and costs under this provision shall account to the community for the use of the property. A party who uses other property that is subsequently determined to be the separate property of the other party to pay his or her attorney's retainer for fees and costs under this provision shall account to the other party for the use of the property.

(3) Restraining both parties 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 and their child or children for whom support may be ordered.

(4) Restraining both parties from creating a nonprobate transfer or modifying a nonprobate transfer in a manner that affects the disposition of property subject to the transfer, without the written consent of the other party or an order of the court.

(b) Nothing in this section restrains any of the following:

(1) Creation, modification, or revocation of a will.

(2) Revocation of a nonprobate transfer.

(3) Elimination of a right of survivorship to property that is owned jointly by the parties.

(c) In all actions filed on and after January 1, 1995, the summons shall contain the following notice:

"WARNING: California law provides that, for purposes of division of property upon dissolution of marriage or legal separation, property acquired by

the parties during marriage in joint form is presumed to be community property. If either party to this action should die before the jointly held community property is divided, the language of how title is held in the deed (i.e., joint tenancy, tenants in common, or community property) will be controlling and not the community property presumption. You should consult your attorney if you want the community property presumption to be written into the recorded title to the property."

(d) For the purposes of this section:

(1) "Nonprobate transfer" means an instrument, other than a will, that makes a transfer of property on death, including a revocable trust, pay-on-death account in a financial institution, Totten trust, transfer-on-death registration of personal property, or other instrument of a type described in Section 5000 of the Probate Code.

(2) "Nonprobate transfer" does not include a provision for the transfer of property on death in an insurance policy or other coverage held for the benefit of the parties and their child or children for whom support may be ordered, to the extent that the provision is subject to paragraph (3) of subdivision (a).

Comment. Section 2040 is amended to clarify the scope of the automatic temporary restraining order with respect to estate planning changes.

Subdivision (a)(4) restrains modification of a nonprobate transfer "in a manner that affects the disposition of property subject to the transfer." Modifications that are restrained as affecting the disposition of property include a change of beneficiary or power of appointment. Modifications that are not restrained include naming a new trustee or successor trustee (so long as the change does not affect the trustee's powers or duties with respect to disposition of trust property).

Subdivision (b) provides that the restraining order does not restrain elimination of a right of survivorship between owners of jointly owned property. This codifies *Estate of Mitchell*, 76 Cal. App. 4th 1378, 91 Cal. Rptr. 2d 192 (1999) (restraining order does not restrain severance of joint tenancy). The fact that the restraining order does not restrain revocation of a nonprobate transfer does not mean that such a transfer is necessarily subject to revocation by one party without the consent of the other party. The question of whether a nonprobate transfer is subject to unilateral 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).