

Memorandum 2022-40

Miscellaneous Estate Planning Issues (Discussion of Issues)

In Memorandum 2022-3, the Commission¹ considered its work priorities for 2022. That memorandum discussed two narrow estate planning issues that had come up in the Commission's work on the revocable transfer on death deed ("RTODD") but were deferred for later study.² The memorandum recommended that those topics might be appropriate for work in 2022, if resources were available.³ The Commission approved that recommendation.⁴ This memorandum begins that work.

Unless otherwise indicated, all statutory references below are to the Probate Code.

SOURCE OF SUBSTITUTE PECUNIARY GIFT UNDER SECTION 21134

Background

In general, if an "instrument"⁵ makes a "specific gift"⁶ of property on death, and the deceased transferor no longer owns the property at the time of death, the gift fails.⁷ This is known as "ademption by extinction" of the specific gift.⁸ The rationale for this rule has been explained as follows:

Ademption of a specific [gift] is the extinction or withdrawal of a [gift] in consequence of some act of the testator equivalent to its

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. Memorandum 2022-3, pp. 21-22.

3. *Id.* at 46.

4. Minutes (Jan. 2022), p. 3.

5. "'Instrument' means a will, a document establishing or modifying a trust, a deed, or any other writing that designates a beneficiary or makes a donative transfer of property." Section 45.

6. "A specific gift is a transfer of specifically identifiable property." Section 21117(a). This is distinguished from a "general gift." "A general gift is a transfer from the general assets of the transferor that does not give specific property." Section 21117(b).

7. See 14 Witkin, Summary 11th Wills § 272 (2022).

8. *Id.*

revocation, or clearly indicative of an intention to revoke. The ademption is effected by the extinction of the thing or fund bequeathed, or by a disposition of it subsequent to the will, which prevents its passing by the will, from which an intention that the [gift] should fail is presumed.⁹

For example, if a person's estate plan would make a gift of a specific asset (e.g., an expensive car), which the person later sells, there is a presumption that the sale was intended to negate the gift.

Section 21134 provides an exception to the general ademption rule for cases where the sale or other loss¹⁰ of a specific asset occurs while the owner lacks decision-making capacity and is under the protection of a conservator, attorney-in-fact, or trustee (a "protected person").

In that situation, one cannot infer anything about the protected person's intentions from the fact that the property was sold. The protected person was not responsible for the sale of the property, may not have known or understood that it occurred, and likely did not have the legal capacity to change their estate plan to make a substitute gift. For that reason, Section 21134 limits ademption of the specific gift by instead providing the beneficiary with a substitute pecuniary gift (e.g., the monetary value of the expensive car that was sold).

Notably, Section 21134 provides that the substitute pecuniary gift is deemed to be a "general gift." The implication of that is discussed below.

The Issue

When the Commission was studying the RTODD statute, a question arose about whether and how Section 21134 would apply to an RTODD. The staff concluded that an RTODD is an instrument that makes a specific gift. Thus, Section 21134 should apply. However, it was not entirely clear *how* that section would operate when applied to an instrument like an RTODD, which only affects a single asset (other examples of single-asset instruments include a transfer-on-death registration of a motor vehicle,¹¹ boat,¹² mobilehome,¹³ or securities¹⁴).

9. See *Brown v. Labow* (2007) 157 Cal.App.4th 795, 807 (*quoting* *Estate of Mason* (1965) 62 Cal.2d 213, 215).

10. Section 21134 applies to property that was sold, encumbered, condemned through eminent domain, or destroyed. The manner in which the property was lost is not relevant to the issues discussed in this memorandum. To simplify the discussion, the remainder of this memorandum refers only to the sale of property.

11. Veh. Code § 4150.7.

12. Veh. Code § 9852.7.

13. Health & Safety Code § 18080.2.

14. Sections 5500-5512.

Specifically, if Section 21134 is applied to an instrument that only affects a single asset, *what would be the source of the money used to fund the substitute pecuniary gift?* That question is not answered in the statute; nor did the staff find an answer in caselaw or secondary sources. It would be helpful to provide an answer in the statute, to avoid confusion and ensure consistency of treatment.

In crafting an appropriate rule, the staff sees three relevant policy considerations. They are discussed below.

Funds Should be Drawn from Decedent's Estate Generally

As noted above, the uncertainty about the operation of Section 21134 is most acute in the context of an instrument that only transfers a single asset (like an RTODD). In that case, the affected instrument does not govern any other property, from which a substitute gift could be drawn. Necessarily, the gift will come from property that is governed by some *other* instrument (or by intestate succession, if there is no governing instrument).

That would seem to require that the funds be drawn from the decedent's probate or trust estate. Wills and trusts are the only broad multi-asset testamentary instruments.

That result seems reasonable, because it would approximate the decedent's presumed intentions. For example, suppose that the transferor executed an RTODD to transfer a specified parcel of real property to a designated beneficiary. Later, while the transferor was subject to a conservatorship, the conservator sold the property that was to be transferred by the RTODD. The proceeds of sale were then deposited into the transferor's bank account. If, after the decedent's death, an equivalent amount were withdrawn from the transferor's probate estate and provided to the RTODD beneficiary, that would seem to restore the status quo ante. The RTODD beneficiary receives a substitute gift and the probate estate does not receive a windfall.

For those reasons, the staff believes that the decedent's general estate should be the source of a substitute gift made under Section 21134.

Substitute Gift Should be Subject to the General Rules of Abatement

Section 21134 expressly provides that the substitute pecuniary gift is a "general gift." That designation is critical in the statutory order of "abatement," which governs the order in which different classes of gifts are consumed ("abated") to pay the estate's obligations:

21402. (a) Shares of beneficiaries abate in the following order:
- (1) Property not disposed of by the instrument.
 - (2) Residuary gifts.
 - (3) General gifts to persons other than the transferor's relatives.
 - (4) General gifts to the transferor's relatives.
 - (5) Specific gifts to persons other than the transferor's relatives.
 - (6) Specific gifts to the transferor's relatives.
- ...

Within each class, gifts abate pro rata.¹⁵

What would that mean in practical terms? Any substitute pecuniary gift created pursuant to Section 21134 could be consumed to pay the decedent's debts and costs of estate administration. As a general gift, it would be consumed before any specific gifts. Also, if the beneficiary of the substitute pecuniary gift was not a relative of the decedent, the gift would abate before general gifts to relatives.

The proposed law should not disturb that existing law and policy.

Require Exhaustion of Probate Estate Before Reaching Other Assets

There is one other factor that should be considered. The Probate Code already includes at least two rules that require the exhaustion of the *probate* estate before any estate obligations can be charged against *nonprobate* assets:

- (1) Property governed by a trust is liable for the trustor's debts and expenses of administration, but only "to the extent that the deceased settlor's probate estate is inadequate to satisfy those claims and expenses."¹⁶ In other words, it appears that the probate estate must be exhausted before the trust estate will have any liability.
- (2) Section 9653 authorizes a decedent's personal representative to claw certain assets back into the probate estate for the payment of creditor claims, but only "if the personal representative has insufficient assets to pay creditors...." As with trusts, the specified assets are only liable after the probate estate has been exhausted.

That treatment seems to be justified by the fact that a decedent's probate estate is the default repository for property that is not transferred by other instruments. Thus, the probate estate serves to collect the "residue" of the decedent's property. The decedent may not have had any specific intentions for the disposition of such property. This is especially true if a decedent dies intestate (i.e., with no will).

15. Section 21403.

16. Section 19001(a).

By contrast, when a decedent acts during life to transfer property to a trust or dispose of it by an RTODD or other single-asset instrument, the decedent is taking an affirmative step that is clearly the product of specific intention.

Given that, it makes sense to deplete the general probate estate before depleting assets that are subject to more specific instruments.

The staff believes that approach should also be followed in crafting proposed legislation on this matter — the law should require that the probate estate be exhausted before looking to the trust estate to fund a substitute gift under Section 21134.

Proposed Reform

Consistent with the recommendations made above, the staff recommends that Section 21134 be revised as follows (revision shown in underscore):

21134. (a) Except as otherwise provided in this section, if, after the execution of the instrument of gift, specifically given property is sold, or encumbered by a deed of trust, mortgage, or other instrument, by a conservator, by an agent acting within the authority of a durable power of attorney for an incapacitated principal, or by a trustee acting for an incapacitated settlor of a trust established by the settlor as a revocable trust, the transferee of the specific gift has the right to a general pecuniary gift equal to the net sale price of the property unreduced by the payoff of any such encumbrance, or the amount of the unpaid encumbrance on the property as well as the property itself.

(b) Except as otherwise provided in this section, if an eminent domain award for the taking of specifically given property is paid to a conservator, to an agent acting within the authority of a durable power of attorney for an incapacitated principal, or to a trustee acting for an incapacitated settlor of a trust established by the settlor as a revocable trust, or if the proceeds on fire or casualty insurance on, or recovery for injury to, specifically gifted property are paid to a conservator, to an agent acting within the authority of a durable power of attorney for an incapacitated principal, or to a trustee acting for an incapacitated settlor of a trust established by the settlor as a revocable trust, the recipient of the specific gift has the right to a general pecuniary gift equal to the eminent domain award or the insurance proceeds or recovery unreduced by the payoff of any encumbrance placed on the property by the conservator, agent, or trustee, after the execution of the instrument of gift.

(c) For the purpose of the references in this section to a conservator, this section does not apply if, after the sale, mortgage, condemnation, fire, or casualty, or recovery, the conservatorship is terminated and the transferor survives the termination by one year.

(d) For the purpose of the references in this section to an agent acting with the authority of a durable power of attorney for an incapacitated principal, or to a trustee acting for an incapacitated settlor of a trust established by the settlor as a revocable trust, (1) “incapacitated principal” or “incapacitated settlor” means a principal or settlor who is an incapacitated person, (2) no adjudication of incapacity before death is necessary, and (3) the acts of an agent within the authority of a durable power of attorney are presumed to be for an incapacitated principal. However, there shall be no presumption of a settlor’s incapacity concerning the acts of a trustee.

(e) The right of the transferee of the specific gift under this section shall be reduced by any right the transferee has under Section 21133.

(f) A general pecuniary gift provided pursuant to this section shall be treated as a general gift made by the decedent in a will. If the probate estate has insufficient assets to fully fund the gift, the remainder shall be treated as a general gift made by the decedent in a trust.

The staff invites comment on the wording of proposed subdivision (f). The staff considered framing the rule to provide that the substitute gift be treated as a *debt* to be charged against the probate or trust estate, but that would elevate the gift in priority over specific gifts (which can abate to satisfy decedent’s debts). That seemed at odds with the existing designation of the substitute gift as a general gift.

After considering the issues discussed above, the Commission should decide whether it wishes to proceed with such a reform, with or without changes.

EFFECT OF USE RESTRICTION ON TRANSFER OF TITLE

The second topic addressed in this memorandum involves the effect of a property use restriction on the transfer of title.

This issue came up when discussing the effect of a use restriction on property transferred by RTODD. For example, suppose that the RTODD purports to transfer title to property that is subject to an age restriction (e.g., the property can only be occupied by a person 55 or older). What result?

The Commission concluded that the use restriction would not prevent the transfer of title, but that the property would still be burdened by the restriction after the transfer. Consequently, a beneficiary below age 55 would acquire title, but could not occupy the property. The beneficiary would still be free to rent or sell the property, thus realizing the pecuniary value of the gift.

The Commission’s “follow-up” recommendation on the RTODD statute expressly addressed this issue, and noted that the same issue could exist for any

kind of at-death transfer of property.¹⁷ The Commission recommended (and the Legislature enacted) the following language:

An enforceable restriction on the use of the transferred property does not affect the transfer of title to the property by a revocable transfer on death deed.¹⁸

The Commission’s Comment to that reform explained its purpose:

Comment. Section 5652 is amended to achieve the following results:

... To make clear that a use restriction does not affect the transfer of title by a revocable transfer on death deed. A beneficiary who receives use-restricted property takes title subject to the restriction, but remains free to convey or encumber the property.¹⁹

The Commission also decided that it would later consider whether some sort of global equivalent of the language above should be enacted in the Probate Code. That is the question presented here.

Division 11 of the Probate Code addresses the “Construction of Wills, Trusts, and Other Instruments.” That would seem to be the appropriate location for a code-wide rule of construction such as the one discussed here. To address the issue discussed above, the following provision could be added to the “general provisions” chapter in Division 11:

21119. An enforceable restriction on the use of property does not affect the transfer of title to that property.

Comment. Section 21119 is added to make clear that an enforceable use restriction does not affect a transfer of title to the burdened property. A beneficiary who receives use-restricted property takes title subject to the restriction, but remains free to convey or encumber the property.

The staff does not see any practical or policy problem with such a rule, but invites expert input on that point.

17. *Revocable Transfer on Death Deed: Follow-Up Study*, 46 Cal. L. Revision Comm’n Reports 135, 158-59 (2019).

18. Section 5652(b); 2021 Cal. Stat. ch. 215, § 15.

19. *Revocable Transfer on Death Deed: Follow-Up Study*, *supra* note 17, 197.

After considering this memorandum and any public input, the Commission should decide whether to proceed with the reform described above, with or without changes.

Respectfully submitted,

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