HIS, HER OR THEIR PROPERTY: A PRIMER ON MARITAL PROPERTY LAW IN THE COMMUNITY PROPERTY STATES

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I. INTRODUCTION

Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington are the traditional "community property states." Unlike most of the other states (collectively referred to in this outline as the "common law states"), the marital property laws of most of those states have their historical and legal origins in French, Spanish and/or Mexican law. Oklahoma briefly experimented with community property laws in the 1940s, and Wisconsin enacted the Uniform Marital Property Act in the 1980s. This uniform act codifies many basic community property principles. Alaska has an elective community property system. Tennessee passed its Community Property Trust Act in 2010 which allows married couples to convert their property to "community property" by conveying their property into a community property trust arrangement. Puerto Rico is also a community property jurisdiction. For a historical perspective of the community property regimes, see W.S. McLanahan, *Community Property Law in the United States* (1982); and William Q. DeFuniak and Michael J. Vaughan, *Principles of Communit y Property* (2nd Edition 1971).

A. Purpose

The purpose of this paper is to provide, within the time parameters of the presentation, a basic overview of the marital property laws of the community property states. The fundamental differences that exist between common law states and community property states will be examined. The principles that the community property states share will be explained, and areas of law where the community property states differ, as well as key transfer and income tax consequences applicable to community property ownership, will also be addressed. Finally, some of the questions an estate planning lawyer in a common law state may ask about community property will be identified. Note: *Unless specifically indicated, this paper also assumes that the spouses have not entered into a premarital or postmarital agreement that might change the otherwise applicable default rule.*

B. Intentions

This paper is not intended to be a comprehensive study of community property laws. It is also not intended to answer questions dependent on a particular state's law (although efforts have been made to stay current on relevant state law). Accordingly, an examination of the current laws of each particular community property state would be needed in order to resolve a particular issue. Sometimes the complicated application of the laws of two states is required. However, it is hoped this paper can help the estate planning lawyer "spot the issue." Of course, any real issue should be resolved after consulting with experienced counsel licensed in the actual states where the parties are domiciled or the property in question is located. However, in order to describe what is the "collective" view of the community property states or their "divergent" views, the author has relied primarily on William Reppy and Cynthia A. Samuel, *Community Property in the United States* (7th Edition 2009) and Jeffrey Schoenblum, *Multistate and Multinational Estate Planning* (2010 Edition) and recommends these two sources to those who desire more information.

C. Definition of Marriage

Also, it is not the intent of the author to address whether or not a couple (opposite sex or same sex) is married. The validity of a marriage, whether ceremonial or common law (yes, some community property states recognize common law marriages), is typically a matter of the law of the state where the couple is domiciled, but the state of domicile usually recognizes a marriage as valid, if valid where the ceremony was performed or where the couple was domiciled when married. Similarly, this paper does not address whether domestic partners or parties to a civil union (or any other similar relationship) assume or should assume the status of "married" for marital property purposes. Again, that determination is a matter of a particular state's law. Accordingly, this paper assumes that the couple in question has that status under applicable law. For discussion purposes, terms like "spouse" and "marriage" are used to refer to the individuals who have that status for marital property purposes, and the relationship resulting from that status. Note: *As expected, the United States Supreme Court's decision in United States v. Windsor, 570 U.S. 12, 133 S. Ct. 2675 (2013), has been a real "game changer." Following its lead, an increasing number of states are recognizing same sex marriages. In addition, for federal tax purposes, in Revenue Ruling 2013-17, the IRS has ruled it would follow the "place of celebration" rule, if a couple moves to a state that does not recognize same sex marriages.*

II. COMMON LAW v. COMMUNITY PROPERTY LAW

In states where marital property concepts trace their origins to the common law of England, the *common law states,* the assets of a marriage are typically defined as one spouse's property or the other spouse's property. The spouses may own some assets as tenants in common, joint tenants or tenants by the entirety. In the event of divorce, some assets may be treated as *marital assets* and subject to equitable division by the divorce court.

A. Comparing Community Property States

On the other hand, in *community property states*, where marital property concepts trace their origins to the civil law of continental Europe, (like Spain and France), marital assets are typically classified as the one spouse's separate property, the other spouse's separate property and their community property. The spouses may also co-own property as tenants in common or joint tenants, each spouse owning an undivided one-half interest in the property as his or her separate property. Being a unique common law concept, tenancy by the entirety is not a form of ownership typically recognized in a traditional community property state.

B. <u>An Inherent Part of Property Law</u>

In community property states, marital property principles are an inherent part of the state's property law. They are not just family law concepts relevant in divorce proceedings. In other words, the status of an asset as being her separate, his separate or their community is important during the couple's marriage and upon its termination by reason of divorce or the death of the first spouse. Even the rights of third parties, like creditors of the spouses, purchasers from the spouses, and even a spouse's business partners, can be affected by the state's marital property laws.

C. <u>Blended Systems</u>

Notwithstanding the uniqueness of a "civil law" based marital property system, the marital property law in the community property states today is actually a blend of both community property concepts and common law principles. For example, community property states have adopted the common law concept of equitable election to create what was historically referred to as the "widow's election" – now the "surviving spouse's election." See II.E, infra. Some common law states have incorporated some traditional community property principles into their laws (e.g., "marital property" in the event of divorce).

Still, the fundamentals of both systems can cause different results even in situations where the marital property concept involved is not apparent. For example, the law in a common law state may define the spouse of a devisee in a will as a "disqualified" attesting witness in part due to the common law's "fictional unity" of the spouses. The law in a community property state may not disqualify the devisee's spouse as an attesting witness since the attesting spouse would not have an ownership in the devisee's inheritance because it would be the devisee's separate property.

D. <u>Record Legal Title</u>

The significance of how title to property is held, whether in her name, his name or their names, differs in common law and community property states.

i. Common Law States

In a common law state, the record, legal title of an asset is likely to be determinative of its ownership. Property titled in one spouse's name is presumptively that spouse's property. Additional facts may establish that the other spouse may have an ownership interest through the imposition of a resulting trust (i.e., other spouse contributed to the purchase of the asset) or constructive trust (i.e., the spouse committed fraud in the asset's acquisition).

ii. Community Property States

In a community property state, title is not determinative of ownership. An asset titled in one spouse's name may be that spouse's separate property or the couple's community property. Property titled in both spouses' names may be community property or the spouses may be tenants in common or joint tenants, each owning an undivided one-half interest as separate property. It is even possible that an asset may be part separate property of each spouse and part their community property, whether title is in one spouse's name or in both of their names. In these situations, a unique "tenancy" is said to exist between the marital estates.

E. <u>Overview of First Spouse's Death</u>

At the death of the first spouse, assets with valid *survivorship rights* pass nonprobate to the surviving party in both common law and most community property states. Since "joint tenancy" is a common law concept, the process of creating "rights of survivorship" in the community property states has had an interesting history and the law will vary from state to state. *See* Schoenblum, at 10-74. So, the focus here is on the probate estate.

i. Elective Shares

In a common law state, the deceased spouse's *probate* estate passes intestate or testate to the deceased spouse's heirs and/or devisees, and the surviving spouse may have a right to an "elective" or "statutory" share of the decedent's probate estate. In such a situation, the spouse may be put to an "election" (i.e., accept what was left to the surviving spouse in the decedent's will or claim the "elective" or "statutory" share).

ii. Retained Ownership

Elective/statutory rights trace their origins to the common law concepts of dower and curtesy. Thus, elective share rights are not granted to surviving spouses in community property states. At the death of the first spouse, the surviving spouse *retains* (not inherits or acquires) the survivor's one-half interest in the couple's community property, as well as the surviving spouse's separate property.

iii. The Spouses' Respective Interests

While there has been some academic discussion concerning the nature of the surviving spouse's interest in what had been their community property prior to the first spouse's death, the rule in most (if not all) of the community property states is that the surviving spouse continues to own an undivided one-half interest in each and every former community asset upon the first spouse's death. It is not merely a claim to 50% of the value of the community estate as it existed when the first spouse died – the "value approach." *See* Jesse Dukeminier, Stanley Johanson, James Lindgren and Robert Sitkoff, *Wills, Trusts and Estates* (Aspen 2005). Accordingly, the decedent's undivided one-half interest is what passes under the deceased spouse's will or by intestate succession. Adopting the "value approach" would, in effect, convert the community property system into an elective share system. However, the deceased spouse can attempt to incorporate the "value approach" into the post-death administration by putting the surviving spouse to an election in the deceased spouse's will. *See* II, E, vi, *infra*.

iv. Testamentary Power

Accordingly, in a community property state, the deceased spouse's *probate* estate consists of the decedent's separate property and one-half interest in the community property and passes intestate or testate to the decedent's heirs and/or devisees, which may or may not include the surviving spouse. If the deceased spouse devises that spouse's one-half interest to a third party (or if the decedent's interest passes by intestacy to a third party), the surviving spouse and the third party become tenants in common. The deceased spouse's testamentary power over the decedent's one-half of the community has been a foundational principle of community property jurisdictions.

v. Statutory Rights

The surviving spouse in a community property state may be able to exercise other rights based on the status of being the surviving spouse. These rights may include a "homestead" right of occupancy or some type of "allowance." *See* Schoenblum, at 10-77.

vi. "Surviving Spouse's Election"

In a common law state, the surviving spouse may be required to elect between (i) what the decedent devised to the surviving spouse or (ii) the surviving spouse's statutory share – the "surviving spouse's election." In a community property state, the term "surviving spouse's election" is typically the application of the common law concept of equitable election; if a devisee accepts the benefits under a will, the devisee must suffer the detriments of the will. Thus, if the deceased spouse specifically devises a community asset to a third party while devising other assets to the surviving spouse, the surviving spouse has an election; the surviving spouse can allow the community asset, including the surviving spouse's one-half interest, to pass to the third party in order to receive what was devised to the surviving spouse, an election which can have adverse income tax and transfer tax consequences. Depending on the circumstances, acceptance of benefits under the will may also force a surviving spouse to waive the statutory rights described in II, E, v, *supra*, or to even accept the deceased spouse's "value approach" described in II, E, iii, *supra*.

III. COMMON DENOMINATORS IN COMMUNITY PROPERTY STATES

While the community property laws of the traditional community property states differ significantly, they all share the fundamental premise of a marital partnership resulting in the personal earnings of each spouse being owned equally by both spouses.

A. Community Property Defined

Accordingly, absent an agreement of the parties or other special situation, community property generally includes all personal earnings of both spouses acquired during the marriage (whether in the form of wages, salaries, etc.), along with the rents, profits and other fruits of those earnings (i.e., income and gain generated by community property). For example, property purchased with community property during the marriage is also community property.

B. Separate Property Defined

In a community property state, any assets not determined to be community property are the separate property of one spouse or the other spouse. Jointly held property may be the separate property of both spouses. The traditional definition of separate property is that property of either spouse which was owned prior to the marriage and that property which was acquired by a spouse during the marriage by gift, devise or descent.

C. The Community Presumption

There generally exists a presumption that any property owned by either spouse or both spouses during or upon termination of the marriage is community property. This presumption places the burden of proof on the party asserting that a particular asset is separate property to show why it is separate property.

D. Commingling

Where separate property and community property have been "mixed," the party trying to establish what part is separate and what part is community typically has a difficult time "tracing" the separate property portion back to its original separate source. A "commingling" occurs if the burden of proof is not met, and consequently the asset is deemed to be community property. *See* Part V.C., *infra.*

E. Nature of Community Property

Community property is a form of co-ownership of property that can only exist between spouses. Each spouse owns an undivided one-half interest in each community asset, whether record title is in one spouse's name or both spouses' names. It is a concept more closely related to a tenancy in common than a joint tenancy because each spouse generally has the power by will to dispose of his or her one-half interest at death (although the express creation of survivorship rights is now permitted in most states). However, during the marriage, a spouse acting unilaterally may not be able to either demand a partition of a community asset or assign/convey his/her one-half interest to a third party.

F. New Tax Basis at Death

One significant tax advantage of community property ownership is that each item of community property generally receives a "step-up" in tax basis equal to its value for estate tax purposes upon the death of the first spouse. *See* I.R.C. § 1014(b)(6). Of course, the disadvantage is that if an asset's value for estate tax purposes is less than its cost basis, then both halves receive a "step-down" in basis.

G. Common Law Concepts

The laws in traditional community property states typically do not include the common law concepts of dower, curtesy and tenancies by the entirety. However, spouses can own separate property as tenants in common or as joint tenants with rights of survivorship. The concepts of constructive trust and resulting trust are also recognized.

H. Shift of Situs

Generally, investing community property in personal property having "situs" in a common law state (or depositing community funds in an account in a common law state) does not affect the investment's community property character. Since it is personal property, the law of the couple's domicile ordinarily controls. *See* Schoenblum, at 10-88. The ownership of a real property in the common law state purchased with community property is governed by the law of the situs, but the situs state will typically recognize both spouses' ownership interests. But, the real question is whether the real property purchased with community property in the common law state is actually community property, or do the spouses simply own the property as tenants in common or joint tenants? Surprisingly, there is little case law on point. One noted authority states, ". . . the common law jurisdiction will respect the interest of the spouses in that property, even though the exact community nature is not recognized by that jurisdiction." Gerald Treacy, *Tax Management Estates, Gifts and Trusts Portfolio,* 802-2nd, Community Property: General Considerations (BNA). At least one case has held it is "community property" in the bankruptcy context. See *In re Eisner*, 2007 WL 2479654 (Bankr., E.D. Tex). *See* Schoenblum, at 10-83.

IV. ILLUSTRATIVE DIFFERENCES AMONG THE COMMUNITY PROPERTY STATES

While the traditional community property states share many concepts within their respective community property systems, there exist significant differences among the states. Accordingly, a good understanding of the community property law of Texas or California, for example, may not equate to even minimal knowledge of the community property laws of another community property state. These differences include:

A. Income From Separate Property

Income generated during the marriage by separate property, such as rent, dividends or interest, is separate in most community property states. However, absent an effective agreement of the spouses, income generated by separate property has historically been considered to be community property in Texas, Idaho and Louisiana (Wisconsin).

B. Rebutting the Community Presumption

In some community property states, the party asserting that an asset is separate must prove its separate character by a "preponderance of the evidence." Another state may require "clear and convincing evidence." In other words, proof standards differ from state to state.

C. Extended Acquisitions

When property is acquired before marriage but part of the purchase price is paid during the marriage with community funds, some of the traditional community property states apply the "inception of title rule." Others follow the "time of vesting rule" or "pro rata apportionment." *See* Reppy and Samuel at 86. Within a particular state there may also be exceptions to the general rule. *See* Schoenblum, at 10-62. For example, in Texas, the general rule is "inception of title," but to determine the marital character of an employee's interest in a retirement plan, the "pro rata" approach is used.

D. Appreciation in Value

In most situations, appreciation in value does not affect the separate character of the asset, but the circumstances may dictate that the "community" is entitled to "reimbursement" (i.e., one spouse has a claim against the other spouse) when the marriage terminates if community property or community effort contributed to the separate property's appreciation in value. But when certain separate property assets (e.g., closely-held business interests) appreciate in value during the marriage, the appreciation may be considered to belong to the "community" in some jurisdictions. *See* Part VI.C, VII.F, *infra*.

E. Management and Liability

Whether a spouse has the authority to unilaterally manage (or sell, give or encumber) a community asset, or whether joinder of both spouses is required, depends on the laws of each individual state, and these laws vary significantly. *See* Schoenblum, at 10-56. Likewise, which assets are liable for which debts incurred by one or both spouses also depends on individual state laws, and these also vary considerably from state to state. *See* Schoenblum, at 10-73. *See* also VII, G., *infra*.

F. Division at Divorce

The divorce laws of some community property states require an "equal" division of the community property. The divorce laws in the other community property states authorize an "equitable" division of the community property by the divorce court. Even the treatment of separate property varies from state to state. *See* Schoenblum, at 10-55.

G. Intestate Succession

If a spouse dies intestate in some community property states, the deceased spouse's one-half of the community property passes to the surviving spouse. The rule is different in other community property states. For example, in Texas, the result depends on the identity of the deceased spouse's descendants, if any.

V. BASIC CHARACTERIZATION AS COMMUNITY OR SEPARATE

Historically, a civil law country, like Spain, might have determined the marital character of an asset acquired during the marriage using a rather simplistic approach – the "onerous/lucrative" acquisition test. If the asset was acquired as a "windfall" (by gift, devise or descent or not in exchange for good and valuable consideration), it was a lucrative acquisition and the acquiring spouse's separate property. If the asset was acquired in exchange for consideration (time, talent, labor or property), it was an onerous acquisition and the community property of both spouses.

A. Complex and Different Rules

While there still exists some references to the "onerous/lucrative" test, characterization in the community property states today is much more complex and differs from state to state. For example, Texas' foundational principles include the rule of implied exclusion (if the asset doesn't fit the definition of separate property, it is community property), the inception of title rule (status is determined based on facts existing at the origin of a right to the property, not necessarily when "title" is acquired), and the traceable mutation rule (an asset acquired in exchange for separate property is separate and an asset acquired in exchange for community property is community property).

B. Community Presumption

While each community property state has its own unique set of characterization rules, they all share the rule that an asset is presumed to be community property until it is proven to be separate. As explained earlier, the states, however, differ on the degree of proof required to overcome the community presumption. They even differ in defining the presumption. Reppy and Samuel describe four different approaches to defining the community presumption. They are:

i. "The 'acquisition' formula: 'Property acquired during marriage by either husband or wife, or both, is presumed to be community property.' N.M. Stat. Ann § 40-3-12(A). . . ."

ii. "The 'long marriage' exception to the 'acquisition' formula: All property possessed by the spouses or one of them after they have been married for many years is presumed to have been acquired during marriage and hence presumed to be community. *Estate of Caswell*, 288 P. 102 (Cal. App. 1930)."

iii. "The 'possession' formula: 'Property possessed by either spouse during or on dissolution of marriage is presumed to be community property.' Tex. Fam. Code § 3.003(a). This was the approach taken in *Lynam. Accord, State ex. Rel. Marshall v. Superior Court*, 206 p. 362 (Wash. 1922); *Malich v. Malich*, 204, p. 1020 (Ariz. 1922); La. Civ. Code art 2340."

iv. "The 'unlimited' presumption: 'All property of spouses is presumed to be marital property.' Wis. Stat. § 766.31(2)."

See Reppy and Samuel, *supra*, at 65, 66.

C. Mixing Community and Separate

If during a marriage the spouses acquire property for one lump-sum payment that is traceable to both community funds and separate funds of the spouses, a form of co-ownership between the community and separate estates may result. *See* Reppy and Samuel, *supra*, at 85. In other words, characterization frequently requires "tracing" to avoid "commingling." The key is being able to prove the source of the consideration used to acquire property. Bank and investment accounts are frequently commingled due to community and separate funds being invested in the account. State law may give the owner of the "lost" separate property a claim for reimbursement when the marriage terminates.

D. Partial Consideration Prior to Marriage

A foundational rule in all community property states is that property owned before marriage is separate property, and because of this rule, Reppy and Samuel address a unique community property problem: "Where consideration is not paid in one lump sum but is given over a period of time beginning prior to marriage, . . ." they offer these alternative approaches to solving the problem:

i. "*Inception-of-title* (sometimes called inception-of-right) . . . This rule focuses on the initiation of the transaction. Take the case of an installment purchase contract made by H. If he entered into the contract before marriage, he has a separate inception of title. He later marries, makes payments with community funds and receives deed or title. The property is his separate property even if all monies paid out were community, because his contract right was separate. The community will have a claim for reimbursement against *H*. . . ."

ii. "*Time-of-vesting* (sometimes called time-of-receipt) . . . Under this rule the focus is on the closing of the transaction when title is deeded over or, if that is delayed, when the buyer is entitled to demand a deed. In most installment contracts, this is when the last payment is made. Even if *W* or *H* initiated the contract when single or with separate funds during the marriage, the fact that title passed during marriage makes ownership presumptively community. To establish separate ownership, a spouse would have to prove that the entire consideration paid was separate money. If only part of the consideration was separate, the spouse making the contribution has no ownership interest but only a claim for reimbursement. . . . "

iii. *"Pro rata* (also sometimes called the "tracing theory"). . . . It provides for concurrent ownership by community and separate estates, just as where a lump-sum purchase price is partly community, partly separate. Focus is on the overall percent of consideration paid over time by the community and by a spouse separately."

See Reppy and Samuel, *supra*, at 85-86.

E. Life Insurance Policies

A life insurance policy, or its proceeds, can be a significant asset of the marriage.

i. If a state, like Texas, uses the ***inception of title*** rule to characterize the policy, and if the policy was owned by the insured prior to marriage (or the initial premium was paid during the marriage with separate property), the policy is the insured spouse's separate property, and the "community estate" is reimbursed on the basis of community premiums paid toward the separate policy when the marriage terminates.

ii. But, as Reppy and Samuel explain for those states where a ***pro rata approach*** is taken: ". . . to characterize a policy or its proceeds, little problem exists with the 'investment portion' of whole life policies. The cash surrender value at the time of dissolution should be subjected to a 'money apportionment' taking into account the rate of increase and the period of time the company has had to invest the portion of premiums used for that purpose. The rest of the premiums in whole life policies and all the premiums of 'term' policies purchase death benefits and do not build up a cash surrender value. . . . "

iii. In other states, the source of the last premium may dictate the ownership of the proceeds payable at the insured's death.

See Reppy and Samuel, *supra*, at 103, 104.

VI. SPECIAL CHARACTERIZATION RULES

Certain types of transactions and certain types of assets can complicate characterization even more. Again, the laws of the various community property states can vary significantly in their application under these circumstances.

For example, as discussed earlier, if the wife owned a life insurance policy on her life prior to marriage and during the marriage she continued to pay the premiums out of a joint account where she and her husband deposited their respective paychecks, is the policy her separate property or their community property? In some community property states, it may be both her separate and their community property in proportion to total premiums paid before and during the marriage. In other community property states, it may be her separate property since the initial premium was paid before marriage.

A. Credit Acquisitions During Marriage

In Texas, credit acquisitions during a marriage are generally treated as community property unless there is clear and convincing evidence that the creditor agreed to look solely to the separate estate of the contracting spouse for satisfaction. But as Reppy and Samuel explain: "Elsewhere things get confusing." Proceeds of unsecured loans given on personal credit of H or W are presumed community property. *Jones v. Edwards*, 245 p. 292 (Nev. 1926). In California and probably Arizona and Washington, the presumption is rebutted by showing that the lender's state of mind was such that he made the loan primarily because of the existence of separate property of the borrower which made repayment likely. *Gudelj v. Gudelj*, 259 P.2d 656 (Cal. 1953); *In re Finn's Estate*, 179 P. 103 (Wash. 1919); *Finley v. Finley*, 287 P.2d 475 (Wash. 1955). Conversely, in these states, if the borrower pledges separate property as security, proceeds are presumed separate. *Marriage of Grinius*, 212 Cal. Rptr. 803 (Ct. App. 1985) (this case also says that to overcome the community presumption, it must be shown that the lender intended to rely solely, not just primarily, on a spouse's separate property). However, if by local law the lender can go beyond the security to collect payment in event of default, and if it is shown that, despite the separate security, the loan was given primarily because the spouse's signature on the promissory note obligated community property in addition to separate, a court will likely hold the loan proceeds community-owned." Reppy and Samuel, *supra*, at 134, 135. *See* also Schoenblum, at 10-64.

B. <u>Retirement Benefits</u>

A married participant's interest in a retirement plan is perhaps the most difficult type of property interest to characterize as community or separate property. *See* Schoenblum, at 10-79. In this situation, a number of factors become relevant. Is the plan governmental or private? Is it a "defined benefit" or "defined contribution"? Is the plan governed by ERISA? Has the participant retired and perhaps "rolled over" the benefits into an IRA? Is income from separate property community or separate property in the state where the participant is domiciled?

i. Characterization

Generally, contributions to the plan during the marriage are a form of compensation and the community property of the participant and the participant's spouse. However, when the participant began employment prior to the marriage, the states take differing approaches to determine the separate or community nature of the participant's interest in the retirement plan, but all tend to adopt some type of "apportionment" approach. In a defined benefit plan it is usually based on timing, comparing time employed prior to and during the marriage. In a defined contribution, plan, the participant's account record is examined and consideration is given to the timing and amount of each contribution to the plan.

ii. Federal Preemption

Characterization is usually more of a divorce issue than an estate planning or estate administration issue. Upon the death of the non-participant spouse, that spouse's community interest may simply "terminate" in some states, or if it doesn't terminate, it may be non-assignable under *Boggs v. Boggs*, 520 U.S. 883 (1997), which held federal law preempts state law and prohibits the surviving spouse from devising her interest in a federally regulated ERISA plan. *Boggs v. Boggs* does not apply if the participant in an ERSA plan dies first, but ERISA may preempt state law and require at least some portion of the plan to be paid to the participant's spouse, regardless of the community or separate nature of the plan, unless both spouses agree to a different disposition. The federal preemption rules do not apply to IRAs.

C. <u>Closely-Held Business Interests</u>

A spouse's ownership interest in a business entity (e.g., shares of stock in a corporation, a partner's interest in a partnership or a member's interest in a limited liability company) may be separate or community property depending upon the facts and circumstances of the interest's acquisition. Absent extraordinary circumstances, the entity's assets typically belong to the entity and are neither community nor separate property, and until distributed to its owners, the entity's profits belong to the entity and are neither community nor separate property.

i. Compare Sole Proprietorships

Since a sole proprietorship is not a legal entity, its assets belong to the owner, and the owner's interest in each individual asset may be the owner's separate property or community property. Generally, each asset associated with the business is presumptively community property, placing the burden on the owner to prove which assets are separate property.

ii. Enhanced Value of an Entity

If the owner's interest in a business entity is community property, any increased value of the interest accrues to the benefit of both spouses. If the owner's interest is the owner's separate property, any increased value generally accrues only to the benefit of the owner spouse.

iii. Effect of Spouse's Efforts

However, if the increased value of the entity is attributable to the "time, talent and labor" of the owner, the issue is raised: Shouldn't these "community" efforts accrue to the benefit of both spouses? A foundational premise of any community property state is that what is acquired during the marriage by personal effort belongs to both spouses (e.g., the couple's wages, salaries and other forms of compensation, like contributions to retirement plans) and is community property.

If the owner spouse's personal efforts contribute to the success of the entity, causing its value to increase, shouldn't that increased value accrue to the benefit of both spouses? The inception of title rule suggests the owner's interest (even if the increase in value is due to the owner's time, talent and labor) remains separate property, but that the other spouse may have a claim for reimbursement. Other states may credit the other spouse with a community ownership interest. *See* Schoenblum, at 10-66.

iv. Payments to Owner by Entity

Compensation paid by the entity for personal services rendered, whether current or deferred, and whether in the form of salary, bonuses or fringe benefits, is community property. But payments by the entity for use of the owner's capital investment, such as ordinary dividends, are community property in some, but separate property in the other community property states. Distributions upon liquidation of the entity may be separate or community, depending upon the exact nature of the distribution and the character of the ownership interest.

D. <u>Examples</u>

i. Illustration No. 1

After the wedding, Pat and Kris bought a home. In order to raise the cash necessary for the down payment, each contributed $5,000 from non-interest bearing checking accounts owned by each prior to marriage (there were no deposits in either account during the marriage), and they withdrew $10,000 from their joint checking account where they have deposited their paychecks since they were married. They also borrowed $80,000 for the balance of the purchase price from a local bank, signing a ten-year note secured by the home. The note was eventually paid, and the bank's lien was released. The home is now valued at $400,000. Is the home separate property of each or their community property?

In Texas, the home would be characterized as part Pat's separate property, part Kris' separate property and part their community property. Each spouse would own an undivided 5% interest as separate property (assuming the community presumption is rebutted), and they would own an undivided 90% interest as community property (10% due to the community down payment and 80% due to the borrowed $80,000).

ii. Illustration No. 2

During the marriage, Pat purchased a weekend home on a nearby lake. As a down payment, Pat used $10,000 he inherited when an uncle had died and borrowed $90,000 from the bank for the balance of the purchase price. Pat alone signed the note and secured the note with a lien on the lake house. Shortly after closing, Pat's mother gave to Pat $90,000 so Pat could pay off the note before making a monthly payment of principal and interest on the loan. The lien was released and the weekend home is now valued at $200,000.

Is the weekend home Pat's separate property or the community property of Pat and Kris? In Texas, it is 10% Pat's separate property (assuming the community property presumption is rebutted) and 90% the community property of Pat and Kris because the consideration paid for the weekend home was from both the $10,000 down payment, and the $90,000 borrowed from the bank. Even though only Pat borrowed the money (Kris had no personal liability), the borrowed $90,000 is also presumed to be community property. The fact that the note was paid with separate funds is likely to be found to be irrelevant for characterization purposes, but Pat may have a separate claim for reimbursement.

iii. Illustration No. 3

Prior to the marriage, Kris participated in an employer's ERISA-regulated 401(k) plan. On the day they married, the value of the plan was $1,000,000. So far during the marriage the employer has contributed another $500,000, and the current value is $3,000,000. Is Kris' interest in the plan Kris' separate property or their community property?

With a defined contribution plan, Texas law presumes that Kris' interest in the plan is community property, placing the burden of proof on Kris to prove which part of the $3,000,000 of current investments were either (i) part of the plan on the day before the marriage, or (ii) are investments traceable to what was part of the plan immediately prior to the marriage. If Kris is unable to meet the required burden of proof, Kris' interest in the plan is community property.

iv. Illustration No. 4

Refer to Illustration No. iii, and assume Pat dies first. Can Pat devise whatever was Pat's one-half community interest in Kris' plan (perhaps $1,500,000 if Kris cannot rebut the community presumption) to Pat's children by a prior marriage? Even though Pat had a community property interest in Kris' plan, Pat cannot devise that interest to the children because the United States Supreme Court has ruled that federal law preempts state law and federal law prohibits the non-participant spouse from devising that spouse's community interest to anyone other than the participant spouse (Pat's interest in some states may simply cease to exist under the terminable interest rule).

v. Illustration No. 5

Refer to Illustration No. iii, and assume Pat divorces Kris. Could a divorce court award to Pat all or any part of the community property interest in the plan (perhaps $3,000,000 if Kris cannot rebut the community property presumption)? It is possible; federal law permits a state divorce court to award to the other spouse an interest in the ERISA retirement plan of the participant spouse by way of a Qualified Domestic Relations Order (QDRO).

vi. Illustration No. 6

Assume Pat inherited all of the stock in Pat's family's corporation during the marriage. At that time, the business was valued at $10,000,000. Since then Pat has served as the corporation's chair of the board and chief executive officer, and the business is now valued at $100,000,000. The success of the business and its increase in value are due in large part to Pat's energy and expertise. Is the stock Pat's separate property or their community property, or part separate and community property?

In Texas, absent exceptional circumstances, it is likely that the stock is still Pat's separate property. Kris might have a claim for reimbursement, if Pat did not receive reasonable compensation for Pat's "time, talent and labor." On rare occasions, Texas courts have found that the entity was the alter ego of the owner and operated as a sham, allowing the other spouse to pierce the "corporate veil" and the corporation's assets are presumptively community property.

VII. ATTRIBUTES OF OWNERSHIP

The community property states have statutes defining community and separate property with varying amounts of detail concerning the relative rights of the spouses in such assets. However, the spouses may, in effect, "opt out" of the statutory default set of rules in a premarital or marital agreement. Further, the character of property can also be changed by other means, like "exchanges" and "gifts" between the spouses. "Transmutation" is a generic term that describes contractual and donative transactions between spouses which change the character of property from separate to community and community to separate. *See* Reppy and Samuel, *supra*, at 25.

Absent such an agreement, there exist other "default" rules addressing issues other than characterization.

A. <u>Equal Ownership, Equal Management</u>?

Despite its "partnership" theory of equal ownership, the husband historically had been the dominant figure in the partnership because of the wife's "disabilities of coverture." Today, the community property states share a bifurcated system of joint and several management of community property by both spouses, but the details differ.

i. The Texas Rule

In Texas, certain community assets (typically those assets held in one spouse's name) are subject to that spouse's "sole management, control and disposition" and other assets (typically held in both spouses' names) are subject to the couple's "joint management, control and disposition."

ii. The Equal Management Rule

Reppy and Samuel explain that, in the other states, the basic rule is equal management based on concurrently possessed power to act unilaterally when personal property is involved. If real estate, both spouses must join in an alienation, but day-to-day management is subject to the same "equal management" concept described for personal property. There are, of course, exceptions. *See* Reppy and Samuel, *supra*, Chp. 14.

B. <u>A Spouse's Fiduciary (or Fiduciary-Like) Role</u>

Since equality of the interests of the spouses is a fundamental principle of community property law which all community property jurisdictions recognize, the problem of how the non-managing spouse can have an ownership interest equal to that of the managing spouse has proven to be problematic, and the solution varies from state to state. Most community property states view the spouses as equal owners with the managing spouse acting as an agent of the other spouse. In Texas, the managing spouse is considered to be a trustee for the other spouse. In any event, some sort of fiduciary relationship is typically found to exist between the managing spouse and non-managing spouse. *See* Reppy and Samuel, *supra*, at 18.

C. <u>Protection of Third Parties</u>

Typically, a third party, such as a good faith purchaser, can rely on the apparent authority of a spouse to act unilaterally if the property is in that spouse's possession and "untitled" or is titled in that spouse's name only. *See* Reppy and Samuel, *supra*, at 258-264.

D. <u>Mismanagement of the Community by a Spouse</u>

The duty of care owing by one spouse to the other during the marriage when exercising a unilateral power of management varies from state to state, but a breach of that duty can result in a cause of action for damages by the other spouse when the marriage terminates by reason of divorce or death. This issue is typically raised when one spouse makes a unilateral gift to a third party. Some states permit "reasonable" gifts, but others require "joinder" of both spouses. If the marriage terminates by reason of the first spouse's death, the personal representative may be the party bringing the cause of action against the surviving spouse or defending a cause of action brought by the surviving spouse. *See* Schoenblum, at 10-58.

E. <u>Constructive Trust</u>

Many claims of "wrongful management" involve unilateral gifts of community property by one spouse to third parties, such as children by a prior marriage or paramours of the donor spouse. If the "wronged" spouse cannot be made whole by the awarding of damages, a court may impose a constructive trust on the donee to avoid unjust enrichment of the donee.

F. Reimbursement

A spouse's expenditure of community funds to improve the spouse's separate property or to pay an indebtedness secured by separate property is generally not considered a breach of duty that can result in money damages. Reimbursement is the generally accepted approach to a situation when the funds of one marital estate are expended to benefit another marital estate. However, the states disagree as to what the measure should be and use a variety of factors to determine the amount to be reimbursed. Texas has expanded the concept to situations where a spouse's "time, toil and effort" have enhanced the value of a separately owned business entity.

G. Liabilities to Third Parties

The determination of which assets of the marriage are liable for which debts depends on a number of factors, including which state's law applies. In addition, the factors may include (i) when the debt was incurred, (ii) what type of debt is involved, and (iii) the personal involvement of each spouse.

Obviously, if both spouses have joint and several liability, the entire non-exempt marital estate is available to the creditors. If only one spouse has personal liability, the results differ from state to state.

i. The Management System

In some states, the creditors' rights depend in large part on which property the debtor spouse manages. Any property subject to a spouse's sole or joint management can be seized by the creditors. Some community property states have adopted this approach, but the details vary from state to state. For example, in Texas, if it is a tort debt, all non-exempt community assets can be reached by the creditor.

ii. Community Debt v. Separate Debt

In some states, a debt is classified as "community" or "separate" when the creditor asserts the claim. If "community," generally all non-exempt community property can be seized.

Of course, the details, whether using the management approach or the community debt approach, vary significantly from state to state.

For a more complete discussion, see Reppy and Samuel, *supra*, Chp. 17.

VIII. TRANSFER TAX CONSEQUENCES

The transfer of community property or separate property to someone other than one of the spouses can have transfer tax consequences. A gift by one spouse of community or separate property to the other spouse will likely qualify for the marital deduction and not be treated as a taxable gift, regardless of the value of the donor's interest in the subject of the gift. For an insight into the IRS' position on a number of community property issues, including income tax reporting issues, see the Internal Revenue Manual, http://www.irs.gov/irm/part25/irm_25-018-001.html.

A. Gifts to Third Parties

i. Nature of the Gift

An inter vivos gift of community property to a third party is considered to be a gift by both spouses, whether the property was titled in both spouses' names or in the name of one spouse. Each spouse has made a gift to the donee of an undivided one-half interest. There is no need to "split" the gift. If a spouse makes a gift of separate property, the spouses can agree to "split" the gift on their respective gift tax returns. An agreement by both spouses to "split" a gift by one spouse creates joint and several liability for any gift tax owing. (Note, *see* Part VII.B, *supra*, if a gift of community property to a third party by one spouse is a breach of duty owing to the other spouse).

ii. Reporting Requirements

If only gifts of community property are made by the couple, the filing of gift tax returns is not necessary if the value of the gifts to each donee is less than twice the amount of the annual exclusion amount in the year of the gifts. At the spouse's death, only the value of the decedent's taxable gifts (i.e., one-half of a community property gift or the full value of a separate property gift) is added to the taxable estate as a post-1976 taxable gift.

B. Death of First Spouse

The gross estate of the deceased spouse generally includes the decedent's separate property and the decedent's undivided one-half interest in the community property, whether the community property is held in both spouses' names or in the decedent's name, or in the name of the surviving spouse. Since the surviving spouse retains, not inherits, the survivor's one-half interest, it generally is not subject to the transfer tax, *but the surviving spouse's one-half interest receives the same adjustment in basis* *as the deceased spouse's interest under IRC § 1014(b)(6). See* Part III.F, *supra*.

C. Marital Deduction

Transfers of both the decedent's separate property and one-half of the community can qualify for the marital deduction if they pass to or for the benefit of the surviving spouse, typically outright to the surviving spouse or into a QTIP trust.

D. Other Deductions

The state's community property principles are used to determine what part of any debts and administration expenses can be claimed as deductions on the estate tax return. Only that portion of a debt or administrative expense which is properly payable under state law out of the assets included in the gross estate can be deducted on the estate tax return. For example, if a particular debt of the deceased spouse is properly payable under state law out of both halves of the community, only one-half of the debt is deductible. If properly payable out of the decedent's separate property (or deceased spouse's one-half of the community), it is fully deductible.

E. Tax Trap for the Surviving Spouse

If the surviving spouse allows his/her one-half of a community life insurance policy or a payable on death ("POD") account to pass to the children (or other third party) upon the decedent's death, the surviving spouse may have made a taxable gift. Similarly, if the surviving spouse allows his/her one-half of a community asset to be devised to a third party, the surviving spouse may have made a taxable gift to the third party. On the other hand, if the surviving spouse is also a beneficiary under the will, an election to accept the benefits in exchange for half of the community passing to a third party is a taxable event subject to possible income tax or gift tax consequences. *See* Schoenblum, at 10-75.

F. Surviving Spouse's Retained Life Estate

If community property is placed in a trust in which a spouse has a lifetime income interest, one-half of the trust estate may be included in the spouse/beneficiary's gross estate at such spouse's death. This typically occurs when an insured spouse transfers the community property life insurance policy into an irrevocable life insurance trust for the benefit of the other spouse for life, remainder to the children. Even if the insured spouse lives for more than three years and the proceeds are excluded from the insured's gross estate, one-half of the value of the trust estate may be included in the surviving spouse's gross estate. (This result may be avoided by converting the policy into the insured's separate property prior to transferring it into the trust.)

G. Unique Planning Opportunities

Obviously, the community property system makes it easier for both spouses to take advantage of estate "equalization" planning and the unified credit of each spouse since each spouse has an undivided one-half interest in their community property. In addition, spouses in community property states may be able to take advantage of unique valuation opportunities.

i. *Bright* Case

In one key valuation case, *Estate of Bright v. U.S.*, 658 F.2d 999 (5th Cir. 1981), the court explained the proper method of valuing the deceased spouse's community interest in the stock in a family corporation (their community property stock represented "majority control"). Rather than determining the value of the controlling block of community property stock and then dividing by two, the court explained that only the deceased spouse's one-half interest is included in the gross estate and it is that undivided one-half interest which is valued. Since that one-half interest represents a minority interest, it is even entitled a "minority discount."

ii. Other Discounts

Using the same rationale, the deceased spouse's one-half interest in community property real estate may be entitled to a fractional interest discount. [*See* Williams Estate, T.C. Memo 1998-99.] In *Bonner v. United States*, 84 F.3d 196 (5th Cir. 1996), the 5th Circuit allowed the estate of the surviving spouse to take a fractional interest discount for the survivor's one-half interest in real estate and for the other one-half of the real estate which was held in the QTIP trust created when the deceased spouse died.

IX. CHANGE OF DOMICILE

When a married couple moves from a community property state to a common law state, the change of domicile complicates their relative marital property rights. A few general rules do exist, including the law of the situs governs interests in land. *Restatement (Second) of Conflict of Laws*, § 234. A change of domicile does not generally change the marital character of real property. Gerald Treacy, *Tax Management Estates, Gifts and Trusts Portfolio*, 802-2nd, Community Property: General Considerations (BNS). *See also Restatement* (Second) Conflict of Laws § 234 (1971). However, the attributes of ownership associated with the community property acquired by the couple while domiciled in a community property state do not necessarily stay the same after they move to another state.

A. <u>General Conflicts Principles</u>

Traditionally, the law of the state in which real property is located determines its ownership, and the law of the marital domicile determines the ownership of personal property. A married couple's move between a community property and common law state should not affect the ownership of the assets already acquired. Susan Gary, Jerome Borison, Naomi Cahn and Paula Monopoli, *Contemporary Approaches to Trusts and Estates*, pps. 660, 661 (Wolters Kluwer 2011) *See*, also, Kenneth W. Kingma, *Propertry Division at Divorce or Death for Married Couples Migrating Between Common Law and Community Property States*, 35 ACTEC J. 74 (2009).

B. <u>Unique Features</u>

While they were domiciled in the community property state, not only did the couple have equal, undivided ownership interests, but the community property state's unique set of rules governing management and liabilities related to the property attached. Upon the termination of the marriage, the community property state's unique set of rules would have governed the dissolution of this unique type of marital partnership.

C. <u>Attributes of Ownership</u>

To be sure, the property that was originally community property, whether held in his name, her name or their names, and whether it was real or personal property, is still owned in equal, undivided interests by the spouses after they move. But to assume that the same "attributes" of ownership that attached while they were domiciled in the community property state (i.e., management, liabilities, effect of dissolution) still apply once their domicile changes is problematic (even if it is a move from one community property state to another community property state). Surprisingly, there are relatively few cases addressing the attributes of ownership, and even among those, the results are not always consistent.

D. <u>Real Property</u>

If a tract of land was community property held in one spouse's name in a community property state, after the change of domicile the other spouse still owns an undivided one-half interest, even though title is in one spouse's name, but do the community property state's rules of management and liability still apply? If they later divorce, does the common law state divide the property using its own rules or the community property state's rules? If the marriage ends in death while they live in the common law state, the disposition of the deceased spouse's interest in the real property is clearly governed by the law of the situs, but there still exists numerous ancillary issues, the resolution of which will depend on which state's law applies, the law of situs or the law of domicile.

E. Personal Property

The effect on the characterization of personal property when the couple moves from a community property state to a common law state appears to depend in part upon the law of the state of the current domicile. The approach taken by some states preserves the community character of any "movables." The law in other common law states converts the "movables" into some form of common law ownership. Other states have adopted the Uniform Disposition of Community Property Rights at Death Act (1971) ("the Uniform Act"), which causes what was community property, or is traceable to what was community property, to be treated as though it were still community property at the death of the first spouse. The Act does not preserve the property's community character. *See* Schoenblum, at 10-100.

F. IRC § 1014(b)(6)

The most significant estate planning consequence of the approach taken by the common law state may be whether both spouse's respective interests in the personal property will receive an adjusted basis under IRC § 1014(b)(6) at the first spouse's death. In states that preserve the community character of the assets, IRC § 1014(b)(6) appears to apply. The result is not clear in a state that has enacted the Uniform Act. While there is some authority that the IRS will allow the "step up" for the surviving spouse, there is no definitive answer and leading authorities are divided in their opinions. See Jeremy Ware, Section 1014(b)(6) and the Boundaries of Community Property, 3 Nov. L.J. 704, 713 (2005) (where the author also discusses steps a couple may attempt to utilize in order to preserve the community character of their personal property. *Supra*, p. 719).

Whether the surviving spouse's one-half of the real property located in the community property state receives the § 1014(b)(6) adjustment in basis depends on whether it is still "community property" under IRC § 1014(b)(6) and on the law of the situs state. In *Hammonds v. Commissioner of Internal Revenue*, 106 F.2d 420, 424 (10th Cir., 1939), the court noted that, in community property states, marital rights in lands are generally regulated by the law of the situs regardless of the domicile of the couple.

G. Surviving Spouse's Rights

Upon the first spouse's death, the change of domicile may have granted the surviving spouse even greater rights than the spouse would have had if they were still domiciled in the community property state. The surviving spouse may not only retain the survivor's one-half interest in what was community property before the change in domicile, but also claim a "statutory share" in the estate of the deceased spouse under the law of the domicile. The laws of the common law states even vary on the resolution of this issue. Schoenblum, at 10-97. The Uniform Act recognizes this principle; however, the community property may not be subject to the surviving spouse's elective share. *See* Gary, et al., at 661.

X. SO, YOUR CLIENT SAYS . . .

The lawyer in a common law state needs at least a basic understanding of community property principles, not because the lawyer intends to practice law in a community property state, but because (i) a client may be moving to a community property state, (ii) a client may own property in a community property state, or (iii) the "objects of the client's bounty" may reside in a community property state. For example, the client may say:

A. "<u>My Daughter Lives in Texas</u>"

Whether or not the client trusts the son-in-law, steps can be taken to hopefully enable the daughter to maintain the separate character of any inter vivos or testamentary gifts.

i. Segregated Accounts

At a minimum, the daughter should be advised to "keep her separate, separate" by opening bank and brokerage accounts in her individual name (perhaps with a designation "separate account") and to only deposit into the account her separate property. Contemporaneous business records showing the source of any and all separate deposits should be retained in the event proof of separate character of the account is later needed.

ii. Avoid Inadvertent Commingling

In a state like Texas, where income from separate property is community property, any interest (or other income generated by the account) should be paid into a different account in her name (perhaps with a designation of "special community account") in order to avoid a "commingling" of community and separate funds in the separate account. If an account is "commingled," it becomes community property.

iii. Separate Investments

Any investment given to her, purchased with funds in her "separate account" or certificates issued out of her separate account, should be held in her name only. Further, real estate conveyed to her should be conveyed to her "as her separate property." Again, contemporaneous business records can serve as evidence of the nature of the transaction and the separate character of the asset and should be retained.

iv. Family Entities

If the daughter is to be a partner in a family partnership, a member in a family-oriented limited liability company or a shareholder in a closely-held corporation, her interest should be given to her as a gift (or purchased with traceable separate property) and held in her name only (perhaps "as her separate property"). Again, contemporaneous business records of the nature of the transaction should be retained. If she expends any "time, talent or labor" in the management of the entity, paying her a reasonable compensation for those personal services should be considered to hopefully avoid a later reimbursement claim by her husband.

v. Asset Protection Trusts

Any and all of the inter vivos or testamentary gifts could be placed in an asset protection trust for the daughter's benefit during her lifetime. The spendthrift provisions will help not only insulate the daughter's interest from the claims of her creditors, but also any community property claims of the son-in-law. Including a statement in the trust agreement that it is the settlor's intent that any and all interests of the daughter, as well as any and all distributions to her out of the trust, are her separate property may not be conclusive, but may prove to be persuasive in future litigation. Limiting distributions of income and/or principal to an ascertainable standard (health, education, maintenance or support) is especially important if the daughter is going to be the trustee or is going to be given general power of appointment. If a third party is going to serve as trustee, income distributions to her could be at the discretion of the trustee or pursuant to an ascertainable standard. Caution should be exercised in granting any other powers to the daughter over the trustee or the trust estate. Carefully planning and drafting the terms of the trust could prove to be persuasive in maintaining her interests in the trust, as well as distributions out of the trust, as her separate property.

vi. Local Counsel

Texas counsel can be retained to advise the daughter on what other planning tools are available to her in order to insulate "her estate" from any possible community property claims of the son-in-law (or his successors or creditors) and/or to review the client's planning to ensure that what can be done has been done to insulate the daughter's inheritance from any possible claims of the son-in-law (or his successors or creditors). Finally, Texas counsel's fees should be paid by the daughter with her separate property or by the client to avoid any claim by the son-in-law that the daughter misused their community property to his detriment.

B. <u>"I Just Bought a Second Home in Texas"</u>

Generally, the law of the situs governs the ownership of real property. *Restatement (Second) Conflict of Laws*, § 234(1) (1971). This general rule does not mean that the property is community property just because it is located in a community property state. The situs courts usually, but not always, apply their own local rules. *Restatement (Second) Conflict of Laws*, § 234(2).

i. The Situs Rules

Traditionally, the situs state looks to the source of assets with which the land was acquired and then attaches the same character to the real property. Schoenblum, at 10-83. Thus, real property purchased in a community property state with funds earned in a common law state will be characterized as separate real estate because the out-of-state earnings are not community property. Karen Boxx, "Community Property Across State Line Square Pegs and Round Holes," *Probate Property*, p. 9, (19 Prob. & Prop.) (2005). Accordingly, whether title is held in the client's name or in the names of the client and the client's spouse, it is not likely to be found to be community property.

ii. Title in One Spouses' Name

If title is held in one spouse's name and the other spouse contributed to its purchase (without donative intent), common law principles, like the purchase money resulting trust (after considering its gift exception), would likely be used to recognize that spouse's ownership interest in proportion to the relative amounts contributed, but the Texas real estate would not be community property.

iii. Title in Both Spouses' Names

If the second home was purchased with one spouse's property but title was placed in both spouses' names (presumed donative intent), the couple would likely be found to be tenants in common, unless the husband could prove he did not have donative intent when the property was purchased and title placed in both spouses' names. Incidentally, Texas law presumes co-owners are tenants in common, not joint tenants, but survivorship rights can be created by a written agreement of the co-owners.

C. "I Am Moving to Texas"

Once a couple establishes their domicile in a community property state, that state's law governs their marital rights. However, any property they may have acquired while residing in the common law state can (but not necessarily will) remain his, hers or their property as originally determined by the law of the common law state. Louis Mezzallo, *Tax Management, The Mobile Client: Tax, Community Property and Other Considerations*, 803 (BNA).

i. Existing Assets

Once they establish their new domicile, each traceable asset acquired while domiciled in the common law state will remain as his or her property or they will each own an undivided one-half interest in the property, *assuming the recently attached community property presumption can be overcome by clear and convincing evidence.*

ii. Future Acquisitions

However, their respective salaries and other forms of compensation will be community property. The income being generated by their respective separate properties will be community property. Any other assets purchased by either spouse while domiciled in Texas will be presumed community property unless proven to be separate property (i.e., traceable to his or her separate property).

iii. Unilateral Gifts and Debts

Any unilateral gifts of community property to a child, a child by a prior marriage or other third party may later be found by a probate or divorce court to have been a "fraud on the community" and a breach of a duty owing by the donor spouse to the other spouse. Further, if a spouse incurs a tort debt, the creditor may be able to enforce any resulting judgment against any and all community property, even if the other spouse did not have personal liability for the debts, and the creditor will take advantage of the community presumption.

iv. Divorce

Generally, community property is subject to an equitable division by the divorce court and separate property is not. However, any separate property that had been acquired while they were residing in the common law state but what would have been community property had they been living in Texas ("quasi-community property") will be treated as if it were community property and subject to an equitable division by the divorce court.

v. Alimony

While contractual alimony can be incorporated into a divorce decree, absent such an agreement, the Texas divorce court cannot award alimony to a spouse. Alimony is contrary to Texas public policy. A limited form of alimony, "maintenance," is available in limited situations.

vi. Death of First Spouse

Upon the first spouse's death, the deceased spouse will only have testamentary power over the decedent's separate property and one-half of the community property. The surviving spouse will retain the survivor's separate property and one-half of the community, but will no longer have any elective/statutory share rights. Unlike some states, Texas does not recognize *quasi-community property* at death.

vii. Compare Other States

Some other community property states grant to the surviving spouse an interest in the deceased spouse's *quasi-community property*, which is actually the decedent's separate property. "Quasi-community property is generally defined as marital property acquired while domiciled in a common law state that would have been characterized as community property if the married couple had been domiciled in a community property state." Kenneth W. Kingma, *Property Division at Divorce or Death for Married Couples Migrating Between Common Law and Community Property States*, 35 ACTEC J. 74, 82 (2009). *See* Gary, Borison, Cahn and Monopoli, at 661. Generally, the surviving spouse is entitled to an undivided one-half interest in such property, and the remaining one-half interest is subject to testamentary disposition by the deceased spouse. In the event the decedent leaves an incomplete testamentary plan, or dies intestate, all of the decedent's quasi-community property not otherwise disposed of is distributed in the same manner as community property under the laws of intestacy. If the non-owner spouse dies first, however, this spouse possesses no rights in the quasi-community property of the surviving spouse, and the survivor retains this property, free and clear of any claim of the deceased spouse's estate.

viii. Local Counsel

Obviously, the client would be well advised to consult with Texas counsel as soon as they move (perhaps even before they move). Existing estate planning documents need to be reviewed within the context of Texas law. The need for any community property-specific planning should be considered. As should be obvious, joint representation of both spouses is even more problematic in a community property state.

ix. To He_ _ (Double Hockey Sticks) . . . With This!

In view of all of these new complications, the client may wish to "opt out" of the Texas' community property regime, a result that can be accomplished in a marital agreement crafted using Texas law. The couple can agree to create a "community free" Texas marriage where all property is the separate property of one spouse or both spouses.