MARITAL PROPERTY CHARACTER OF PROPERTY AFTER A CHANGE OF DOMICILE OR SHIFT IN SITUS

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I. INTRODUCTION

Texas, Arizona, California, Idaho, Louisiana, Nevada, New Mexico and Washington are considered by many to be 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 these states have their historical and legal origins in civil law jurisdictions, like France, Spain and Mexico. Washington and Idaho have a different history. Oklahoma briefly had community property in the 1940s, and Wisconsin enacted the Uniform Marital Property Act in the 1980s. This uniform act codifies many basic community property principles and places Wisconsin in the community property category. Puerto Rico and Guam are also community property jurisdictions. 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 Community Property* (2nd Ed. 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, specifically Texas. 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 Texas may ask when clients (or their investments) are migrating to and from Texas will be addressed. Note: *While the laws of the 50 states may be becoming more similar though enactments of the Uniform Probate Code and Uniform Trust Code and the ALI's Restatements, fundamental differences still exist. No attempt is made here to address even the key differences among the common law states. Further, unless specifically indicated, this paper also assumes that the spouses have not entered into a premarital or post-marital agreement that might change the otherwise applicable default rule.*

B. Intentions

This paper is not intended to be a comprehensive study of marital property laws. It is also not intended to answer questions dependent on a particular state's law. Accordingly, an examination of the current laws of a 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 or views of the community property states or their "divergent" views, the author has relied primarily on William Reppy, Cynthia A. Samuel and Sally Brown Richardson, *Community Property in the United States* (Carolina Press, 8th Ed. 2015) and Jeffrey Schoenblum, *Multistate and Multinational Estate Planning* (Wolters Kluwer, 2014 Ed.) and recommends these two sources to those who desire more information.

In order to understand the IRS's perspective, the reader can refer to IRS Manual 25.18.1 (June 6, 2017), *Basic Principles of Community Property Law* (the "IRM").

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, informal or common law (yes, some community property states recognize common law/informal 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 the status of a married couple under applicable state law, generally the law of the couple's domicile. If the spouses have different domiciles, the interests of the spouses are typically determined by the law of the state which has the most significant relationship to the spouses and the property. The IRM points out that earned wages by a spouse domiciled in a community property state would be community property, but the earned wages by the spouse domiciled in a common law state would not. *See* IRM at 25.18.1.3.b and IRM at 25.18.1.3.1.

For discussion purposes, terms like "spouse" and "marriage" are used to refer to an individual who has that status under state law for marital property purposes, and the relationship resulting from that status.

D. Windsor and Obergefell

The United States Supreme Court's decision in *United States v. Windsor*, 133 S. Ct. 2675 (2013) overruled the Defense of Marriage Act, requiring same-sex marriages to be recognized under federal law. Following its lead, an increasing number of states began recognizing same sex marriages as valid. In addition, for federal tax purposes, in Revenue Ruling 2013-17, the IRS ruled it would follow the "place of celebration" rule if a couple moved to a state that did not recognize same sex marriages. Two years later, the Supreme Court announced its decision in *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015), holding that the Fourteenth

Amendment requires the states to license same-sex marriages and to recognize same-sex marriages lawfully performed and licensed in another state.

E. Elective Community Property States

In 1998, Alaska created an elective community property system. Tennessee passed its Community Property Trust Act in 2010 which allows married couples to convert their property into "community property" by conveying their property into a community property trust arrangement. In 2016, South Dakota created an elective system by use of a "special spousal trust." Their statutes invite non-residents to establish community property trusts in these states. Other states, like North Carolina and Florida, are currently, or have, considered legislation that would allow their residents to "opt in" to a community property-type system.

These states have adopted or are considering adopting elective community property systems in large part hoping that newly created community property will be recognized as community property under I.R.C. § 1014(b)(6) and receive a "step-up" in basis equal to its fair market value on the death of fist spouse to die even though only the decedent's one-half interest is included in the deceased spouse's gross estate for federal transfer tax purposes. *See* III, F, *infra*. Steve Akers, *ACTEC 2017 Annual Meeting Musings*, p. 31 (March 2017) reported:

> The community property characterization of assets under the Alaska, Tennessee, or South Dakota laws will probably also be recognized under § 1014(b)(6). . . . (but the IRS has not confirmed that § 1014(b)(6) applies). . . . IRS Publication No. 555, "Community Property" (revised February 2016) states that the Publication does not address the taxation of "income or property subject to the 'community property' election under Alaska state laws." IRS Manual 25.18 states that the classification of property under the Alaska Act should be governed by the U.S. Supreme Court decision in *Commissioner v. Harmon*, 323 U.S. 44 (1944) "for income tax reporting purposes."

The June 2017 version of the IRM at 25.18.1.2.2 specifically refers to Alaska's optional community property system and states:

> The U.S. Supreme Court ruled that a similar statute allowing spouses to elect a community system under Oklahoma law (now repealed) would not be recognized for federal income tax reporting purposes. *Commissioner v. Harmon*, 323 U.S. 44 (1944). The *Harmon* decision should also apply to the Alaska system for income reporting purposes.

It’s not unreasonable to extrapolate from the IRM that, while only one-half of the property would be included in the deceased spouse’s gross estate, the IRS would not accept that the surviving spouse would receive a “step-up” in income tax basis upon the death of a spouse.

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 division by the divorce court.

A. Comparing Community Property States

In *community property states*, marital assets are typically classified as the one spouse’s separate property, the other spouse’s separate property or 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. An Inherent Part of Property Law

In traditional community property states, marital property principles are an inherent part of the state’s property law. They are not just family law concepts relevant just in divorce proceedings. In other words, the status of an asset as being separate or 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. Blended Systems

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 civil 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.F, 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. Record Legal Title

The significance of how title to property is held, whether in one spouse's name, the other spouse's name or both 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 a key factor to determine 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 a wrong in the asset's acquisition).

ii. Community Property States

In a community property state, title is not typically 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. For example, in Texas, *see* Tex. Fam. Code § 3.006.

E. Income Tax Reporting

While state law generally determines a taxpayer's property rights, federal law governs how it is taxed. For income tax purposes, if the spouses file separate returns, each spouse reports one-half of the total community income, including earned wages, regardless of which spouse acquired the income. *Poe v. Seaborn*, 282 U.S. 101 (1930). A spouse must, of course, report 100% of his or her "separate income." If the couple filed "jointly," they are jointly and severally liable for the tax on all of the income whether it is community or separate property. *See* IRM at 25.18.1.2.3.

F. Overview of First Spouse's Death

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, *supra*, at 10:21[A][18,19]. 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 definitive rule in some 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. Texas falls within this category. *See Wassmer v. Hopper*, 463 S.W.3d 513 (Tex. App.—El Paso, no pet.). 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, Robert Sitkoff and James Lindgren, *Wills, Trusts and Estates*, 8^{th} Ed. 2009 at pages 469-471. 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* Reppy, Samuel and Richardson, *supra*, at pgs. 375-377.

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. *See* Reppy, Samuel and Richardson, *supra*, Chpt. 19.

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, *supra,* at 10:21[A][20].

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, F, v, *supra*, or to even accept the deceased spouse's "value approach" described in II, F, iii, *supra*. *See* Reppy, Samuel and Richardson, *supra*, at p. 380. *See* also Schoenblum, *supra*, 10:21[A][18].

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. *See* Reppy, Samuel and Richardson, *supra*, Chpts. 1-6.

A. 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. In some states, the community presumption is said to attach to property that is acquired during the marriage. However, when the characterization issue arises as to an asset acquired prior to marriage, evidence is needed to prove that, in fact, the asset was brought into the marriage. *See* Tex. Fam. Code § 3.003.

B. Community Property Defined

Accordingly, absent an agreement of the parties or other special situation, community property generally includes all personal earnings of both spouses earned 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). Property purchased with community property during the marriage is also community property. *See* Tex. Fam. Code § 3.002.

C. Separate Property Defined

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. Today, separate property can be acquired in other ways. *See* V and VI, *infra*. Jointly held property may be the separate property of both spouses. *See* Tex. Fam. Code § 3.001.

D. 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.

E. 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 in order to overcome the community presumption. A "commingling" occurs if the burden of proof is not met, and consequently the asset is deemed to be community property. *See* Reppy, Samuel and Richardson, *supra,* Chpt 10. and V.C., *infra.*

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. *See* IRS Publication No. 555, "Community Property" (revised February 2016).

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 should control. *See* Schoenblum, *supra,* at 10:21[C]. The IRM at 25.18.1.3.6 is in accord, citing *Reeves* *v. Schulmeier*, 303 F.2d 802, 806 (5th Cir. 1962); *Peters v. Haley,* 762 So. 2d 695 (Ct. App. La. 2000), writ denied, 766 So. 2d 547 (La. 2000).

Similarly, residents of common law states cannot convert personal property into community property by simply investing personal property in a personal property investment that has a community property state situs. If the investment by a common law resident is in real property in Texas, *see* IX, H, *infra*, and X, B, *infra.*

The ownership of a real property in the common law state purchased with community property has been governed historically by the law of the situs, and the situs state has typically recognized 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).

On the other hand, at least one case has held it is "community property" in the bankruptcy context. *See Countryman v. Estate of Eisner (In re Eisner),* No. 05-44474, 2007 WL 2479654 (Bankr. E.D. Tex. Aug. 28, 2007). The court, referring to Restatement (Second) of Conflicts of Laws § 259, stated community property does not lose its character by being invested in real property that is not in a community property state. That court cites *Sillero v. Sillero*, 2005 WL 15294422 (Tex. App.—Houston [14th Dist.] 2005), as its Texas authority. But there, a Texas divorce court was dividing the marital estate of Texas residents and the appellate court held that a Texas divorce court could consider the existence of foreign realty when dividing the parties' community property, even though the court lacked in rem jurisdiction over the foreign realty. It should also be noted that Section 259 addresses the removal of "movables" to another state.

The IRM at 25.18.1.3.6 agrees with Treacy, citing *Woods v. Naimy*, 69 F.2d 892, 894 (9th Cir. 1934); *Peters v. Haley*, 762 So. 2d 695 (Ct. App. La. 2000), writ denied, 766 So. 2d 547 (La. 2000). It also points out that the situs court may apply community property principles to property acquired in the situs state to real property acquired in the situs state with community funds in an action "solely between the spouses" because the situs court would have personal jurisdiction of the parties.

Reinstatement (Second) of Conflict of Laws § 259 Comments states: So, if land in a common law state is purchased with funds that are held in community because acquired while the spouses were domiciled in a community property state, the courts of the situs would usually hold that the spouses – at least as between themselves – have the same marital property interests in the land as they formerly had in the funds." It does not state that the land is community property, but that both spouses still own the same ownership interests in the land as in the funds.

I. Texas Couple Buys Oklahoma Land

The ownership of real property purchased by a Texas couple in another state is determined by the law of the state where the real property is located. If that state does not recognize community property, it can't be community property. However, under the "source of payment" rule, the law of the situs recognizes the equitable ownership interest of the spouse who contributed to the purchase of the property even if title is only in the purchasing spouse's name (e.g., a husband uses community property to purchases a ranch in Oklahoma and has title placed in his name). If necessary to maintain that interest in litigation, the typical remedy of the other spouse is the imposition of the common law resulting trust or constructive trust. *See Edwards v. Edwards*, 233 P. 477 (Okla. 1925) and *Johanson's Texas Estates Code Annotated* (2018) comments, Section 201.003.

J. Federal Preemption

Normally state law determines property ownership and the attributes of ownership of property – the "rights to property." There are, however, situations where state and federal law are inconsistent, and where these conflicts occur, federal law usually prevails. For example, in *Free v. Bland*, 369 U.S. 663 (1962), the court ruled that a state law which, at the time, prohibited a married couple from owning community property with rights of survivorship was preempted by federal law because the property was a U.S. savings bond. In *Hisquierdo v. Hisquierdo*, 99 S. Ct. 802 (1979), a state divorce court was found to be without authority to divide at divorce what was under state law the spouses' divisible community property – one spouse's railroad retirement benefits. According to the Family Law Section of the State Bar of Texas, other property interests under state law but not divisible on divorce due to federal preemption include:

1. Fleet reserve pay: *Sprott v. Sprott*, 576 S.W.2d 653 (Tex. Civ. App.—Beaumont 1978, writ dism'd)
2. Military readjustment benefits: *Perez v. Perez*, 587 S.W.2d 671 (Tex. 1979)
3. Railroad retirement benefits: *Eichelberger v. Eichelberger*, 582 S.W.2d 395 (Tex. 1979)
4. Social Security benefits: *Richard v. Richard*, 659 S.W.2d 746 (Tex. App.—Tyler 1983, no writ)
5. Veterans Administration benefits: *Ex Parte Johnson*, 591 S.W.2d 453 (Tex. 1979)
6. National Service life insurance: *Wissner v. Wissner*, 338 U.S. 655 (1950)

K. ERISA Benefits

A community property interest in a qualified retirement plan may be divisible by a state divorce court if the non-participant spouse obtains a *qualified domestic relations order*. 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 is non-assignable under *Boggs v. Boggs*, 520 U.S. 833 (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 (generally 100%) 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 in an ERISA waiver. *The federal preemption rules do not apply to even "rollover" IRAs*.

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 these states. Accordingly, a good understanding of the community property law of Texas or California, for example, may not equate to 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 – sometimes referred to as the "American rule." However, absent an effective agreement of the spouses, income generated by separate property has historically been considered to be community property in some states (Texas, Idaho and Louisiana) – sometimes referred to as the "civil law" or "Spanish" rule. *See* Reppy, Samuel and Richardson, *supra*, Chpt. 11. The key Texas case is *Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925).

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. *See* Reppy, Samuel and Richardson, *supra*, Chpt. 10. Texas requires "clear and convincing evidence." Tex. Fam. Code § 3.003.

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, Samuel and Richardson, *supra*, at Chpt. 6. The community property states may have different exceptions to the general rule. For example, in Texas, the general rule is "inception of title," but to determine the marital character of an employee's interest in a defined benefit retirement plan, the "pro rata" approach is used. *See* Tex. Fam. Code § 3.007.

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* Reppy, Samuel and Richardson, *supra,* Chpt. 11, and Schoenblum, *supra,* § 10.21[A][10][11]. But, in Texas, *see Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984).

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, *supra*, at 10:21[A][3]. 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, *supra,* at 10:21[A][17] and Reppy, Samuel and Richardson, *supra,* Chpt. 17. *See* also VII, G., *infra*. In Texas, *see* Tex. Fam. Code § 3.101-3.104 and 3.201-3.203.

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* Reppy, Samuel and Richardson, *supra,* Chpt. 18. In Texas, *see* Tex. Fam. Code § 7.001-7.009 ("equitable" division).

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. *See* Schoenblum, *supra*, at 10:21[A][18]. For example, in Texas, the result depends on the identity of the deceased spouse's descendants, if any. Tex. Est. Code § 201.003. In any event, the surviving spouse retains the survivor's half of the community. *See* II, F, *supra*.

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. *See* Reppy, Samuel and Richardson, *supra*, Chpts. 3, 4, 5, 6.

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). *See Arnold v. Leonard*, *supra*; *Welder v. Lambert*, 91 Tex. 510 (Tex. 1898); and *Rose v. Houston*, 11 Tex. 323 (1854).

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, Samuel and Richardson 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 and short marriage exceptions to the “acquisition” formula.

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, Samuel and Richardson, *supra*, at 65, 66.

C. <u>Mixing Community and Separate</u>

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, Samuel and Richardson, *supra*, at 91. 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. <u>Partial Consideration Prior to Marriage</u>

A foundational rule in all community property states is that property owned before marriage is separate property, and because of this rule, Reppy, Samuel and Richardson address a unique community property problem: “Where consideration is not paid in one lump sum but is given over a period of time <u>beginning prior to marriage,</u> . . .” 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*. . . ." In Texas, *see Welder v. Lambert*, *supra*, and Tex. Fam. Code § 3.401-3.410.

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, Samuel and Richardson, *supra*, at 91-92.

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, in most situations, 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. *McCurdy v. McCurdy*, 375 S.W. 2d (Tex. App.—Waco 1963).

ii. But, as Reppy, Samuel and Richardson 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, Samuel and Richardson, *supra*, at 109-112.

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 only to the separate property of the acquiring spouse for repayment. *Broussard v. Tian*, 294 S.W.2d 405 (Tex. 1956). But Reppy, Samuel and Richardson at page 138 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. *In re marriage of Grinius*, 212 Cal. Rptr. 803 (Cal. 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, Samuel and Richardson, *supra*, Chpt. 8. *See also* Schoenblum, *supra*, at 10:21[A][9].

B. Retirement Benefits

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, *supra*, at 10:21[A][22]. 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? *See* Reppy, Samuel and Richardson, *supra*, pgs. 126-134, 461-483.

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 participation 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, consideration is given to the timing and amount of each contribution to the plan. In Texas, *see* Tex. Fam. Code § 3.007.

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. 833 (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. Closely-Held Business Interests

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. *See* Reppy, Samuel and Richardson, *supra*, Chpts. 9, 11. In Texas, *see Jensen, supra.*

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. In

Texas, *see Jensen, supra,* and Tex. Fam. Code §§ 3.401-3.410. Other states may credit the other spouse with a community ownership interest. *See* Schoenblum, *supra*, at 10:21[A][11].

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 Texas, Idaho and Louisiana, but separate property in the other community property states. *See* IV, A, *supra*. *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.

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 term that typically describes transactions between spouses which change the character of property from separate to community and community to separate. In Texas, *see* Tex. Fam. Code §§ 4.201-4.206; generally, *see* Reppy, Samuel and Richardson, *supra*, Chpt. 3.

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 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." *See* Tex. Fam. Code § 3.102.

ii. The Equal Management Rule

Reppy, Samuel and Richardson explain that, in the other states, the general rule is equal management with a concurrently possessed power to act unilaterally when personal property is involved. If real estate, both spouses must join a conveyance, but routine matters are subject to the same “equal management” concept described for personal property. There are, of course, exceptions. *See* Reppy, Samuel and Richardson, *supra*, Chpts. 14 and 15.

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 with a fundamental duty to not commit a “fraud on the community.” Tex. Fam. Code § 7.009. In any event, some sort of fiduciary relationship is typically found to exist between the managing spouse and non-managing spouse. *See* Reppy, Samuel and Richardson, *supra*, at 18 and Chpt. 16.

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. In Texas, *see* Tex. Fam. Code § 3.104; generally, *see* Reppy, Samuel and Richardson, *supra*, Chpts. 14, 15.

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. In Texas, it is, typically, a “fraud on the community” analysis. *See*

Tex. Fam. Code § 7.009, generally, *see* Reppy, Samuel and Richardson, *supra*, Chpt. 16, and Schoenblum, *supra*, at 10:21[A][3][4].

E. Constructive Trust

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. In Texas, *see* Tex. Fam. Code §§ 3.401-3.410; generally, *see* Reppy, Samuel and Richardson, *supra*, at 316, 317, 331, 357 and 358.

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. Tex. Fam. Code §§ 3.201-3.203.

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. Texas has dispelled the myth of "community debt." *See Tedder v. Gardner Aldrich, LLP*, 421 S.W. 3d 651 (Tex. 2013)

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, Samuel and Richardson, *supra*, Chpt. 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* IRS Manual 25.18.1 (June 6, 2017), *Basic Principles of Community Property Law* (the "IRM").

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.

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. United States*, 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 (1971). A change of domicile does not generally change the property interests of the spouses in 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). For "movables," *see* Restatement (Second) Conflicts, §§ 258-259. But the real question is whether the couple's community property is still community after the move, or do they just maintain their respective ownership interests, but as tenants in common or joint tenants?

On the other hand, 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. Some noted commentators are more optimistic that the community property status of the couple's assets can be maintained even after a move to a common law state. *See* Dukeminier, Sitkoff and Lindgren at pages 513-514. The bottom line is that there is very little definitive law!

A. General Conflicts Principles

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, Paula Monopoli, *Contemporary Approaches to Trusts and Estates*, 610 (2nd Ed. 2014). *See*, also, Kenneth W. Kingma, *Property Division at Divorce or Death for Married Couples Migrating Between Common Law and Community Property States*, 35 ACTEC J. 74 (2009).

B. Unique Features

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. Attributes of Ownership

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, should still be 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. See Exhibit A, attached Green and Gold Acres.

D. Real Property

If a tract of land was community property in a community property state, after the change of domicile, both spouses still own an undivided one-half interest, even though title may be 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 depends on the law of the state having the most significant contacts, typically the state of the current domicile. The approach taken by some states appears to preserve the community character of any "movables" at least until the couple takes some kind of action that is inconsistent with community property principles. In those states, it is unclear how the new state of domicile will treat the unique attributes of community ownership that existed prior to the change of domicile. *See* Reppy, Samuel and Richardson, *supra*, pgs. 437-440. In fact, a critical review of the cases in those states suggests that the property that is called community property by the court may not be community property.

Ladd v. Ladd, 580 S.W. 2d 696 (Ark. 1979) has been cited as authority that land in Arkansas purchased by a couple who moved from New Mexico to Arkansas with the proceeds of the sale of land in New Mexico was community property. However, the Arkansas court simply held that the wife was entitled to her one-half interest in what her husband had purchased in Arkansas with what had been community property in New Mexico. The court even refers to the "source of payment" doctrine followed by a majority of states and cites cases in Missouri and California. *See also Edwards v. Edwards*, 233 P. 477 (Okla. 1924).

People v. Bejarano, 358 P.2d 866 (Colo. 1961) is frequently cited as authority that Colorado recognizes that transported community property remains community property under Colorado law, even after the couple moves to Colorado. However, the Colorado Supreme Court's actual holding is the recognition of the surviving spouse's one/half ownership interest in what was community property following the couple's move to Colorado and her husband's subsequent death. The same analysis can be made of perhaps the leading case cited for that argument that transported community remains community property in some common law states, *Commonwealth v. Terran*, 90 S.E. 2d 801 (Va. 1956). *See also In re Kessler Estate*, 203 N.E. 2d 211 (Ohio 1964).

Similarly, a Missouri case is cited to support the same argument, but its actual holding is that that personal property located in Missouri owned by a decedent domiciled in Texas was the community property of the decedent and his spouse under Texas law. Personal property is governed by the law of the domicile. *In re Estate of Perry*, 480 S.W.2d 893 (Mo. 1972).

Note: After the cited cases were decided, Virginia and Ohio, as well as Colorado, enacted the Uniform Act (see IX, F, infra), which codifies the majority view, the source of payment/resulting trust approach, not the maintained "community property" rule.

When a couple moved from Texas to Iowa and later divorced, an Iowa court was asked whether a cash management account that was left behind in Texas was to subject to division by an Iowa divorce court. The court explained that Texas law should be used to determine the respective ownership interests of the spouses in the account that had been opened while they were living in Texas and maintained there after the move to Iowa. However, Iowa law determined its marital property status for its division by the Iowa divorce court. *See In re Marriage of Whelchel*, 476 N.W.2d 104 (Court of Appeals Iowa (1991).

On the other hand, the law in most common law states appears to convert the transported "movables" into some form of common law ownership. In the often-cited case for the majority view, *Quintana v. Ordono*, 195 So. 2d 577 (Fla. App. 1967), the court explained that a wife's vested interest in community property stock was not affected by the couple's change of domicile from Cuba to Florida. But to reach that result, the court relied on Florida's common law concept of a resulting trust. The court did not hold the property was community property; the property was now held in a common law form. It still reached a result that maintained both spouses' respective ownership interests.

Note: The bottom line is the answer depends on the law of the new domicile. But it is generally accepted that each spouse retains his or her vested one-half interest in what was their community property when the couple moves to a non-community property jurisdiction. See Reppy, Samuel and Richardson, supra, pages 437-440. There is certainly no consensus that the transported property is still community property.

F. "UDCPRDA"

A number of states have adopted the Uniform Disposition of Community Property Rights at Death Act (1971) ("the Uniform Act"), which causes what was community property, or what 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 Uniform Act has very limited application; it does not preserve the property's community character. It actually only codifies the above described majority view by preserving the surviving spouse's one-half interests in what was community property after the couple moved to an enacting state. It was not intended to have any effect on the rights of creditors, the spouses themselves or other persons prior to a spouse's death. The Uniform Act has been enacted in Alaska, Arkansas, Colorado, Connecticut, Florida, Hawaii, Kentucky, Michigan, Minnesota, Montana, New York, North Carolina, Oregon, Utah, Virginia and Wyoming. *See* Reppy, Samuel and Richardson, *supra*, pgs. 440-443.

G. 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 any transported personal property will receive an adjusted basis under IRC § 1014(b)(6) at the first spouse's death. If the law of the new domicilary state actually preserves the community character of the assets, it would appear that IRC § 1014(b)(6) should apply. The result is not clear in a state that applies the majority rule or has enacted the Uniform Act. While there is some authority that the IRS will allow the "step-up" for the surviving spouse in those states, 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 Nev. 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).

H. Law of Domicile – Effect on Situs

Whether the surviving spouse's one-half of the real property still owned and located in the community property state after the change of domicile receives the § 1014(b)(6) adjustment in basis should depend on whether it is still "community property" under the law of the situs state. A key factor to reaching that conclusion is determining the relevance of the law of the state where the couple is or was domiciled.

In that context, *Hammonds v. Commissioner of Internal Revenue*, 106 F.2d 420, 424 (10th Cir. 1939), a federal income tax case, the court noted that, in community property states, marital rights in land are generally regulated by the law of the situs regardless of the domicile of the couple. There the couple lived in Oklahoma and the wife acquired an interest in Texas oil and gas leases in exchange for services rendered. If common law principles applied, the leases would be her separate property; if Texas law applied, under Texas community property law, the leases would be their community property. The court applied Texas law and quoted *Heidenheimer v. Loring*, 6 Tex. Civ. App. 560 (Tex. Civ. App. 1894), 26 S.W. 99, 101, as its authority. *Hammonds* suggests that the domicile of the spouses (perhaps even a change of domicile) is irrelevant if the land has its situs in Texas. In *Hammonds*, the court quoted from *Heidenheimer*:

> The statute of Texas declaring that all property acquired by either husband or wife during the marriage shall be deemed the common property of both will control as to real estate situated in Texas, although the parties may both reside in another state, where a different rule of law may apply to such property.

But the *actual* quote from *Heidenheimer* is:

> The statute of Texas declaring that all property acquired by either husband or wife during the marriage shall be deemed the common property of both, will control as to real estate situated in Texas, although the parties may both reside in another state, where a different rule of law may apply to such property. There was no proof, however, that a different rule of law prevailed in Massachusetts, where Loring and his wife lived.

Note: The Hammonds court omitted the last sentence in the key paragraph. The Texas court did say that the domicile of the parties is a key factor! However, in the absence of proof of Massachusetts law, the court treated the property in question as community property and explained that the wife had retained her one-half interest upon her husband's death subject only to administration for the debts of the community. It also noted that, even though legal title was in the deceased husband's name, all persons who ". . . deal with it after his death must take notice of whatever community rights there may be in a surviving wife. . . ."

A later Texas case, *Thayer v. Clarke* (Court of Civil Appeals, Texas 1903), was critical of *Heidenheimer*. It also cites two early Texas Supreme Court cases, *Blethen v. Bonner*, 93 Tex. 141, 53 S.W. 1016, and *Oliver v. Robertson*, 41 Tex. 422, as well as another Texas Court of Appeals decision, *Blethen v. Bonner* (Tex. Civ. App.) 71 S.W. 291.

The *Thayer* opinion states:

> And in all jurisdictions so far as we know, where property is exchanged that received in exchange is held by the same title as that parted with. So, if the husband buy [sic] real estate with his separate money, the real estate is his, wherever located. The presumption growing out of the fact of its acquisition during marriage [the community presumption] affects only the burden of proof and is a mere detail which becomes irrelevant when the facts are established.

In that case, the couple was domiciled in New York. The husband purchased land in Texas; his wife later died. The Texas court applied New York law to conclude that the wife had not acquired a community interest in the Texas land, because under New York law, the Texas property was purchased by the husband with his funds.

Note: While there is tax authority that a community property state may deny to nonresidents the attributes of its community property law, it may extend its community property system to nonresidents at least to lands acquired by them within the state. Black v. Commissioner of Internal Revenue, 114 F.2 355 (9th Cir. 1940). However, should land in Texas purchased by a married couple domiciled in a noncommunity property state be Texas community property with all its attributes simply by relying on a presumption and ignoring the fact that purchaser resided in a common law state (i.e., the source of payment – consideration could not have been community property)? The generally accepted "source of payment rule," as well as Texas' traceable mutation rule, indicate the Texas land cannot be community property.

I. Does the Surviving Spouse Get the "Step-Up"?

The Uniform Act codifies the source of payment/resulting trust approach followed by most, if not all, common law states. Thus, in those states, what was community property before being transported into the common law state acquires a new characterization in a common law form as defined by the new state of domicile. Then, upon the subsequent death of the first spouse, the majority view and the Uniform Act both preserve the surviving spouse's one-half ownership in the transported property and its mutations. The real question: Is the surviving spouse's retention of his or her one-half interest in the transported property sufficient to qualify the surviving spouse's one-half interest for the IRC 1014(b)(6) basis adjustment?

In a Field Service Advisory, 1993 WL 1609164 (1993), a California couple sold their California residence and used the sales proceeds to purchase a replacement residence in Oregon (upon presumably moving to Oregon). Oregon had only recently enacted the Uniform Act. The advisory notes that the key factor in all cases is the characterization of the property under controlling state law. It then explains that, under the Uniform Act, the deceased spouse only had testamentary power over one-half of the Oregon property, thereby the surviving spouse retained her one-half interest. The advisory did not state the Oregon replacement residence was community property (because it wasn't under Oregon law). Nevertheless, the advisory stated that both halves of the Oregon property were entitled to the adjusted basis upon the death of the first spouse. It further stated that the purpose of the Uniform Act was to ensure that the surviving spouse would have the same ownership rights in Oregon as she would have had if still domiciled in California. Of course, a field service advisory is not to be used or cited as precedent.

Further, in its revised IRM 25.18.1, dated June 6, 2017, the IRS stated: A community property estate, having been created, is terminated when spouses change their domicile from a community property state to a common law state. 25.18.1.3.4. (03-04-2011). At least one commentator has noted that this observation does not appear to be supported by any authority. Wendy Goffe, *Yours, Mine and Ours: An Introduction to the Laws of the U.S. Community Property States*, ALI-CLE course materials, VCWBD709-ALI-CLE37 (July 9, 2014), § IX.

J. Texas Real Property

In one Texas case, a Texas couple had acquired a community property home in Texas prior to moving to Iowa. In a Texas trespass to try title action involving the home following the couple's divorce in Iowa, the Texas court enforced the Iowa divorce decree, awarding the home to the husband. *Pascoe v. Keuhnast*, 642 S.W.2d 37 (Tex. App.—Waco 1982, writ ref'd n.r.e.). The Iowa divorce court had awarded the Texas home to the husband while being unaware that the wife previously had fraudulently conveyed the home to a friend. In its opinion, the Texas court stated that the home was the couple's community property while they were domiciled in Texas and that it remained their community property even after they moved to Iowa. Then based on the facts and circumstances, the property was awarded to the husband pursuant to the Iowa divorce decree. *In this author's opinion, the court's often cited statement that the property was still community property after the couple moved to Iowa is questionable, and in any event, that the finding that it was still community property was irrelevant to the ultimate decision and should be considered, at best, to be questionable dicta.*

If the community real property that is left behind in Texas after a couple moves to a common law state is no longer community property, the spouses actually own the property as tenants in common (or perhaps joint tenants if they had agreed to rights of survivorship). Thus, it would appear that only the deceased spouse's one-half interest is entitled to receive the adjustment in basis under IRC § 1014(b)(6). However, in Rev. Rul. 87-98 (1987), a couple in a community property state purchased real property in that state with community funds but had its title conveyed to themselves as joint tenants with rights if survivorship (a common law estate); both halves still qualified for the adjusted basis at the first spouse's death since there wasn't any evidence that they had intended to convert the property to separate property. Some commentators suggest that this ruling supports the argument that any community real property that is left behind when a couple moves to a common law state should still receive the full 100% basis adjustment upon the death of the first spouse to die.

The weakness in that argument is the actual language in the ruling which acknowledged that, under controlling state law, the property was still community property. In addition, the couple did not change their domicile. If under controlling state law, community property had been converted into the spouses' respective separate properties, only the deceased spouse's interest is entitled to receive the adjusted basis. The surviving spouse's one-half interest does not. See *Murphy v. Commissioner*, 342 F.2d 356 (9th Cir. 1965) and Rev. Rul. 68-80, 1968-1 C.B. 348.

K. <u>Texas Conclusions</u>

In Texas, as in other states, the ownership of property acquired during marriage by a married couple is generally determined at the time the property is acquired. If the couple is domiciled in Texas, the property so acquired would typically be either one spouse's separate, the other spouse's separate or the couple's community property, assuming it is real property located in Texas or personal property wherever located. If characterized as community property under Texas law, each spouse owns an equal undivided one-half interest in the property whether the property is titled in one spouse's name or in both spouses' names; if titled in one spouse's name, the other spouse's interest is equitable in nature.

Texas marital property characterization as community or separate affects not only the underlying ownership, but also the "attributes of ownership," such as the spouses' management rights, liability issues and the disposition of the property upon the termination of the marriage either by death or divorce. These attributes are defined primarily by the law of the couples' current domicile. In Texas, these attributes are defined in Title 1 of the Texas Family Code. The Texas Family Code, Section 1.103, states the Family Code applies to persons who are married elsewhere who are domiciled in Texas (suggesting it applies only to those couples domiciled in Texas); <u>it does not state what happens to those couples who were domiciled in Texas but change their domicile to a common law state</u>. But the underlying ownership is typically set as being owned by one spouse or both spouses at the inception of title according the law of the couple's domicile at the time of acquisition, regardless of their current domicile.

In other words, a subsequent change of domicile by the couple does not change the ownership rights of the spouses in such what was their community property regardless of where the assets may be located after the change of domicile. However, a change of domicile does affect the attributes of ownership as originally defined in the Texas Family Code. For example, if after the change of domicile, the couple get a divorce, the divorce court in the state of domicile acquires personal jurisdiction over the couple and will apply its laws in the divorce proceedings.

Note: *Back to the key issue: Following the death of the first spouse, will the surviving spouse be entitled to a "step-up" in the survivor's half of what was their Texas community property? If they are moving to one of the common law states that purports to enable them to retain transported property as "community property," in order to gauge their confidence level that the transported property will be considered to be community property under IRC 1014(b)(6), the couple should request a legal opinion from a lawyer in the common law state that explains how the domiciliary state will define the attributes of ownership of the transported "community property" (management rights, liability rules and disposition upon termination—divorce or death) and how those attributes would compare/differ from owning the property in the state's common law form. If there is a substantive difference, the couple can be more confident that IRC 1014(b)(6) will apply. If there is no substantive difference, perhaps they shouldn't count on it.*

If it appears that the transported property is "community property" in name only and/or the domiciliary state has adopted the Uniform Act (or perhaps even under the majority source of payment rule), will the IRS rely on the previously referenced Field Service Advisory so that the transported property will qualify for the hoped for step-up in basis for both halves of the transported community property under IRC § 1014(b)(6)? Or will the IRS rely on the referenced IRM?

L. 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, *supra*, at 10:21[D][2]. The Uniform Act recognizes this principle; however, what was the community property may not be subject to the surviving spouse's elective share. *See* Gary, et al., at 661.

X. SO, YOUR OUT-OF-STATE CLIENT SAYS . . .

The Texas lawyer may be asked to represent an out-of-state client (or assist the client's out-of-state lawyer) because (i) the "objects of the client's bounty" may reside in Texas, (ii) a client may acquire property in Texas, or (iii) a client may be moving to Texas. For example, the client may say:

A. "My Daughter Lives in Texas"

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 a 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. "I Just Bought a Ranch in Texas"

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, *supra*, at 10:21[C]. For example, real property purchased in a community property state with funds earned by one or both spouses 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 Lines Square Pegs and Round Hole)* 19 Prob. & Prop. 8, 9 (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. The property was not purchased with community funds. *See* IX, H, *supra*.

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. <u>"I Am Moving to Texas"</u>

Once a couple establishes their domicile in a community property state, that state's law governs their marital rights. However, any property acquired while residing in the common law state can (but not necessarily will) maintain its original ownership status. Louis Mezzallo, *Tax Management Portfolio, The Mobile Client: Tax, Community Property and Other Considerations*, 803 (BNA). Reppy, Samuel and Richardson at pages 423-436 discuss the different approaches taken by some of the community property states both during the remainder of the marriage and after its termination by reason of death or divorce.

i. Existing Assets

Once they establish their new domicile, each traceable asset acquired while domiciled in the common law state will remain a spouse's property or they will each own an undivided one-half interest in the property as tenants in common, *assuming the recently attached community property presumption can be overcome by clear and convincing evidence.* Early on, it is likely that ownership of the asset as established in the common law state can be proven, but as time passes, the ability to meet the burden of proof (that the asset was owned prior to the move to the community property state) may be lost.

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 traceable 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. *See* Tex. Fam. Code § 7.001-7.002.

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. *See Estate of Hannau v. Hannau*, 730 S.W.2d 163 (Tex. 1987).

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 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. *See* Tex. Fam. Code §§ 4.201–4.206.

EXHIBIT A – GREEN AND GOLD ACRES

Texas Couple, H&W, 2 Adult Children

Green Acres	**Gold Acres**
1. Title, "H&W"	1. Title, "H&W"
2. Community property (can partition into tenancy in common); any rental income is community property	2. Tenancy in common (separate property, but can "transmute" into community property); any rental income is community property
3. Joint management	3. Joint and several management
4. If homestead, joint management	4. If homestead, joint management
5. Liable for both spouses' debts	5. A spouse's interest is exempt from other spouse's debts
6. If homestead, generally exempt from both spouse's debts	6. If homestead, generally exempt from both spouses' debts
7. At divorce, subject to equitable division	7. At divorce, remains tenancy in common
8. At first spouse's death, survivor retains her ½ interest	8. At first spouse's death, survivor retains her ½ interest
9. If intestate, survivor inherits decedent's 1/2 (now has fee simple title)	9. If intestate, survivor inherits 1/3 life estate in decedent's ½ (if homestead, survivor has right of possession)
10. Still subject to decedent's debts, if not homestead	10. Survivor's ½ still exempt from decedent's debts; if homestead – decedent's ½ exempt
11. 100% subject to administration (if not homestead)	11. Only decedent's ½ subject to administration (if not homestead)
12. Can avoid probate with "rights of survivorship"	12. Can avoid probate with "rights of survivorship"
13. Decedent's ½ included in gross estate, but 100% gets "step-up" in basis (even if decedent devises decedent's ½ to the children)	13. Decedent's ½ included in gross estate, but only decedent's ½ gets "step-up" in basis (even if decedent devises decedent's ½ to survivor, who then has fee simple title)