Death and Divorce: Crossover Issues in Estate Planning and Family Law

NAPABA Convention
San Diego, CA

Friday, November 4, 2016
PANELISTS

Eric M. Tokuyama
Holland & Knight LLP (Los Angeles, CA)

Steven K. Yoda
Walzer Melcher LLP (Woodland Hills, CA)

Hung Nguyen
The Nguyen Law Firm (Coral Gables, FL)
OVERVIEW

- Estate planning depends on the context:
  - Before marriage
  - The happily married couple
  - When a separation is expected or occurs
  - During a family law action
  - After the divorce is final
- We will discuss each situation in order
BEFORE MARRIAGE

- Estate planners and family law attorneys can assist parties prior to marriage by helping them plan for the end of their marriage, whether by death or divorce.

- A premarital agreement can accomplish these goals, but the attorney cannot represent both parties in consideration of ethical issues.

- Goals depend on the unique facts presented by each client.
California Premarital Agreement Act

- Applies to premarital agreements executed on or after January 1, 1986.
- Agreement must be in writing and signed by both parties. FC §1611.
- No consideration is needed. Id.
- Execution requirements
  - Diminished or lack of capacity
  - Undue influence
  - To record or not
Proper Matters for a Prenup

- May contract regarding any matter "not in violation of public policy or a statute imposing criminal liability." FC § 1612(c).
- May agree in advance on the disposition of property on separation, divorce, or death. FC § 1612(a)(3)
- May affect rights and obligations regarding property "wherever acquired or located." FC § 1612(a)(1).
May affect the right to buy, sell, transfer, assign, encumber, manage, or dispose of any property. FC §1612(a)(2).

May include a provision for the making of a will, trust, or other agreement to carry out the agreement. FC §1612(a)(4).

May affect the "ownership rights in and disposition of the death benefits from a life insurance policy." FC §1612(a)(5).

May specify the choice of law governing the agreement. FC §1612(a)(6).
ERISA and Prenups

- ERISA controls regarding survivorship rights in a qualified retirement plan.
- Waiver may only be made by a "spouse" - which means that a prenup cannot be effective to waive these rights.
- Former spouse may have contractual right to a survivorship annuity.
No Fiduciary Relationship

- "[P]rospective spouses negotiate at greater arms' length than married persons" and "premarital contracts are not construed and enforced under the same standards as interspousal agreements." *Marriage of Benson* (2005) 36 Cal.4th 1096, 1110-11.

- A fiduciary relationship begins at marriage. This is the main distinction between a prenup and a postnup.
Confidential Relationship

- However, when there is a close relationship plus great age, weakness of mind, sickness or other incapacity, the presumption of undue influence may arise, and the burden is on the other party to show that no oppression took place. Marriage of Bonds (2000) 24 Cal.4th 1, 27-29.

- However, the law depends on your jurisdiction

- See Civil Code §1575 (undue influence).

- Presumption of undue influence

- Presumption may not apply to spouses
Waiver of Marital Rights in Premarital Agreement

12.4 Except as otherwise provided in this Agreement, each party relinquishes, releases and forever gives up any and all right, claim or interest, actual, inchoate or contingent, in law or equity, in which either party may acquire in the separate property of the other by reason of their contemplated marriage or otherwise. This is a waiver pursuant to California Probate Code § 140-147 and under similar laws in other jurisdictions. The waiver of these marital rights include, but are not limited to:

(a) Any rights arising out of the community property law, except any such rights expressly created by this Agreement;

(b) The right to a family allowance;

(c) The right to a probate homestead;

(d) The rights or claims of dower, curtesy, or any statutory substitutes herefor, as provided by the statutes of the state in which either of the parties may die, are lorniced or in which the parties may own real property;

(e) The right to take under the laws of intestate succession;

(f) The right of election to take against the Will of the other;

(g) The right to act as administrator of the estate of the other; and

(h) The right to take as a pretermitted heir.
Waiver

- Homestead rights
- Family allowance
- Exempt property
- Elective share
- General waivers
Pretermitted Heirs

- Children born or adopted after execution of testamentary instrument receive intestate share. PC §21620
- Testamentary instrument includes Wills and revocable trusts. PC §21601
- Exceptions in PC §21621 – intentional omission, disposition to other parent and other instruments
Omitted Spouse

- Receives intestate share, but not more than 50% of the value of the separate property
- Exceptions:
  - PC §21611
  - PC §§140-147 (probate waivers)
- Order of recourse:
  - Children. PC §21623
  - Spouse. PC §21612
Portability and Prenups

- Deceased spouse’s unused exclusion amount
- Transfer to surviving spouse
- Requires filing of gift tax return
- Value of gift exclusion
- Negotiation opportunities
Prenup as Contract to Make a Will

- Protecting children from a prior marriage
- Percentage of the estate
- Fixed amount
- Pre-tax or post tax
- Probate homestead and allowance
HAPPLY MARRIED COUPLES

- After marriage, parties without a premarital agreement may plan for the termination of their marriage by death or divorce by changing the character of assets, creating a post-marital agreement, or by excluding the surviving spouse from inheriting the deceased spouse's property.

- Common law versus community property versus other (including equitable distribution)

- Proper titling

- Keeping proper records

- Not commingling funds
Fiduciary Duties

- "[A] husband and wife are subject to the general rules governing fiduciary relationships which control the actions of persons occupying confidential relations with each other." (FC § 721)
- If a party obtains an asset or other advantage in violation of the fiduciary duty, the court will set aside the transaction.
Scope of Duty – FC § 721

- Spouses are "subject to the same rights and duties of nonmarital business partners" including the following obligations:
  - Access at all times to records.
  - Rendering, upon request, true and full information of all things affecting any transaction which concerns the community property.
• Accounting to the spouse, and holding as a trustee, any benefit or profit derived from any transaction by one spouse without the consent of the other spouse which concerns the community property.

• The law, however, does not impose a duty for either spouse to keep detailed books and records of community property transactions.
Additional Duties - FC § 1100

- One spouse may not unilaterally make a gift of community property to a third party.
- One spouse may not sell, convey, or encumber the family residence without written consent of the other spouse.
This duty includes the obligation, upon request, to make full disclosure to the other spouse of all material facts and information regarding the existence, characterization, and valuation of all assets in which the community has or may have an interest and debts for which the community is or may be liable.
A spouse who operates or manages a community business may act alone in all transactions, but shall give prior written notice to the other spouse of any sale, lease, encumbrance, or other disposition of the personal property used in the business.

Written notice is not, however, required when prohibited by the law otherwise applicable to the transaction.
Compare - Trustee's Powers

- The trustee may convey and otherwise manage and control trust property - including community property in the trust - in accordance with the provisions of the trust without the joinder or consent of the husband or wife unless the trust expressly requires the joinder or consent of one or both spouses. F.C. § 761(c)

- Fiduciary duties TRUMP all other rights
Remedies for Breach

- "Remedies for breach of the fiduciary duty by one spouse, including those set out in [FC § 721 and FC § 1100], shall include, but not be limited to, an award to the other spouse of 50 percent, or an amount equal to 50 percent, of any asset undisclosed or transferred in breach of the fiduciary duty plus attorney's fees and court costs. FC § 1101"
There is most likely an actual conflict of interest between two spouses when one of them will receive an advantage from the other in a transaction.

Dual representation of parties with actual or potential conflicts of interest requires strict compliance with the Rules of Professional Conduct.

Waiver
Character of Property

- Community property.
- Separate property.
- Changing the character of property is called "transmutation."
- Other jurisdictions
Parties will often want to have property characterized as community property so that, at one spouse's death, the surviving spouse will receive a basis adjustment in his or her share of the property.

There are, however, unique issues for a spouse dying in 2010. IRC §1022.

The problem is that a transmutation applies on divorce too.
A transmutation must:

1. Be in writing. See EC § 250 for definition of "writing."
2. The writing must be an "express declaration" (must contain language which "expressly states that the characterization or ownership of the property is being changed"). Estate of MacDonald (1990) 51Cal.3rd 262, 272.
And . . .

- (3) The writing must be "made, joined in, consented to, or accepted" by the spouse whose interest in the property is adversely affected. (Extrinsic evidence is not admissible to prove a transmutation, so the joinder, consent, or acceptance must also be in writing. See Marriage of Campbell (1999) 74 Cal.App.4th 1058; Marriage of Leni (2006) 144 Cal.App.4th 1087.)
Examples

- The Lenis signed written escrow instructions for the sale of a house, stating: "proceeds to be split 50/50." *Marriage of Leni* (2006) 144 Cal.App.4th 1087

- Mr. Barneson signs written brokerage instructions to "transfer" his stock to his wife. *Marriage of Barneson* (1999) 69 Cal.App.4th 583
Other Examples

- Mr. Bibb registers his Rolls Royce owned before marriage in the names of "H or W." Estate of Bibb (2001) 87 Cal.App.4th 461

- Mr. Bibb also signs a deed to his SP apartment building: "For a valuable consideration, [Mr. Bibb] hereby grants to [himself and Mrs. Bibb], his wife as joint tenants." Id.
Quitclaim Deeds

- Example: Wife "hereby quitclaims, remises, and releases all of her right, title, and interest in the property described as..."
- Is this a transmutation or merely a transfer? Marriage of Mathews (2005) 133 Cal.App.4th 624
- Note: A quitclaim deed transfers any interest which the grantor has in the property.
Estate Plan Examples

- Mr. Holtemann signs a "Spousal Property Transmutation Agreement" stating that several items were "hereby transmuted from his separate property to the community property of both parties."

- The agreement was made "solely for the purpose of interpreting how property shall be disposed of at death." Marriage of Holtemann (2008) 166 Cal.App.4th 1166

- Mr. Holtemann is entitled to reimbursement for the value of the property on the date of the transmutation (Fam. Code § 2640 (b))
Lessons From Holtemann

- This is a perilous area where you can find yourselves driven onto the rocky shoals of malpractice by their failure to consider the effects of these types of estate planning devices in the family law context.

- Family lawyers for the nonowner spouse should do a title search to determine if property is in trust. If there is property in trust, a subpoena should be sent to the estate planning attorney for the file to determine if a Community Property Agreement, Spousal Property Transmutation Agreement, or other such agreement exists.
"Settlors agree that any property transferred by either of them to the Trust . . . is the community property of both of them unless such property is identified as the separate property of either Settlor." Mr. Starkman then transferred his separate property assets to himself and his wife as trustees. Marriage of Starkman (2005) 129 Cal.App.4th 659
Transfers to Revocable Trust

- Unless the trust instrument expressly provides otherwise, community property transferred to a revocable trust during marriage remains community property. FC §761(a)
The waiver of a right to a joint and survivor annuity under ERISA is not a transmutation of the community property rights of the person executing the waiver. FC § 853(b)
A statement in a Will of the character of property is not admissible as evidence of a transmutation of the property in a proceeding commenced before the death of the person who made the Will. FC § 853(a)

Should there be a parallel statute for other types of estate planning documents?
No Oral Testimony as to Content

- Extrinsic evidence is not admissible to establish the requirements of FC §852. MacDonald, supra; FC §1523

- The court must look to the writing itself, without resort to oral testimony or other extrinsic evidence, to see if it is a transmutation as defined by FC §852.
Estoppel

- Ms. Campbell spent $66,000 of her separate property funds to improve her husband's separate residence, based on his alleged oral agreement to place her on title.

- Is husband precluded from arguing against transmutation, even though there is no FC § 852 writing? Marriage of Campbell (1999) 74 Cal.App.4th 1058; Benson, fn. 6.
Partial Performance

- Mr. Benson transferred community property residence to his wife's trust. He claimed that wife orally agreed to transmute her community property interest in his retirement plan as part of the deal.

- Is the oral agreement enforceable under the partial performance exception to the statute of frauds? Marriage of Benson (2005) 36 Cal.4th 1096
Is Testimony Ever Allowed?

- The Holtemanns' trust attorney sent them a letter advising the agreement has "clear and potentially irreversible consequences."

- The letter is admissible to rebut husband's claim that he made the writing unknowingly or inadvertently. Holtemann, fn. 4.

- Extrinsic evidence is also allowed to show duress or breach of fiduciary duty.
Gifts Exception

- General transmutation rule does not apply to a gift of clothing, wearing apparel, jewelry or other articles of a personal nature used solely or principally by the spouse to whom the gift is made and that is not substantial in value, taking into account the circumstances of the marriage. FC §852(c)
Breach of Fiduciary Duty

- A transmutation is subject to attack as a breach of fiduciary duty. If a spouse receives an unfair advantage as a result of an interspousal transaction, a presumption of undue influence arises. Burkle (2006) 139 Cal.App.4th 712; FC § 721(b)

- The undue influence presumption wins over all other presumptions. Marriage of Delaney (2003) 111 Cal.App.4th 991
What's Unfair?

- An unfair advantage is "not merely a gain or benefit obtained in a mutual exchange." Burkle, p.731

- A transaction "for no consideration or for clearly inadequate consideration" results in an unfair advantage. Id.

- One spouse must obtain a benefit at the expense of the other, who receives nothing in return. Id.
Overcoming the Presumption

- "When a presumption of undue influence applies to a transaction, the spouse who was advantaged by the transaction must establish that the disadvantaged spouse's action 'was freely and voluntarily made, with full knowledge of all the facts, and with a complete understanding of the effect of the transaction.'" Burkle, p. 738.

- Laws in other jurisdictions
How is this Established?

- Just like any other waiver, there must be proof of a voluntary relinquishment of a known right. Proof is required that:
  - The transaction was made "freely and voluntarily"
  - The spouse had "full knowledge of all the facts"
  - The spouse had a "complete understanding of the effect of the transaction"
Right of Reimbursement

- A spouse who transmutes separate property to community property has a right of reimbursement, upon divorce, for his or her "contributions to the acquisition of property," which include the down payments, improvements, principal payments on a loan used to finance the purchase or improvement of the property - but do not include interest payments, maintenance, insurance, or property taxes. FC § 2640(b)
The right exists unless there is a written waiver of right to reimbursement. FC § 2640(b)

There is no right to interest or appreciation on the capital contribution. Id.

Reimbursement is made prior to the division of community property. In re Marriage of Walrath (1998) 17 Cal.4th 907
Compare – Probate Proceedings

- With the exception of PC § 5305, which is limited to bank accounts, there is no statutory authority granting a right of reimbursement to the separate estate similar to FC § 2640 at death. Estate of Blair (1988) 199 Cal.App.3d 161
A party shall be reimbursed for the party's separate property contributions to the acquisition of property of the other spouse's separate property estate during the marriage, unless there has been a transmutation in writing . . . or a written waiver of the right to reimbursement. FC § 2640(c)
Postmarital Agreements

- Fiduciary duty applies
- Different types of agreements:
  - Agreement between couple remaining married
  - Reconciliation agreement
  - Marital settlement agreement (MSA) between couple separating or divorcing
Agreements must be in writing. FC § 852(a) (transmutations); PC § 142(a) (probate waivers)

Consideration is not required to have a transmutation (FC § 850), but a lack of consideration creates an “unfair advantage” and the undue influence presumption will arise.
When separation is expected, or has already occurred, there may be a need to create an estate plan or change an existing one.

Once a divorce case is filed, though, certain orders automatically go into effect which limit the rights of the parties with respect to estate planning. These orders will be discussed in detail later in this presentation.
Definition of Separation

- Living separate and apart, and one spouse has decided that the marriage is over and acts consistent with that intention.
- Separate residences – Marriage of Davis (2015) 61 Cal.4th 486
- Income earned from the efforts of a spouse during marriage is community property, regardless of when the income is actually received, whereas income earned from the efforts of a separated spouse after separation is that spouse's separate property.
Effect of Separation on Estate Plan

- Each party remains the spouse of the other until their marriage is terminated by the court; separation or filing of divorce does not terminate their marital status. PC § 78; PC § 6122.

- Possible solutions:
  - Execute a temporary Will and revoke trust.
  - Divide all community property so the spouse will not be considered a "surviving spouse."
Complying with the Automatic Temporary Restraining Orders (ATROs) is the greatest challenge for an estate planner when the client is involved in a family law action.

- ATROs apply to all family law actions.
- ATROs are binding on petitioner upon filing of the action, and are binding on respondent upon receipt of service.
- ATROs remain in effect until final judgment.
- Capacity to divorce
- Prohibition in divorces in certain cases
Prohibited Activities – FC § 2040

- Transferring, assigning, selling, or encumbering property, except in the usual course of business or for necessities of life.
- Cancelling, transferring, borrowing against, or changing beneficiaries of any insurance.
- Creating or modifying a non-probate transfer in a manner that affects the disposition of property, without written consent or court order.
"Non-probate transfer"

- Any instrument, other than a will, which transfers property on death, **including revocable living trusts, pay on death accounts, Totten trusts, and similar items.** FC §2040(d)(1)
Ordinary Course of Business

- "[T]he reallocation of assets to obtain a better return on capital is most assuredly in the 'usual' course of business for a company whose business it is to hold and manage property." Gale v. Super. Ct. (2004) 122 Cal.App.4th 1388, 1393
Permitted Activities - FC
§ 2040

- Creation, modification or revocation of a will
- Revocation of a non-probate transfer if notice is filed and served before revocation takes effect
- Severing joint tenancy (with notice)
- Creation of an unfunded revocable or irrevocable trust
- Execution and filing of a disclaimer
- Payment of attorney’s fees
Retirement Plans

- Need to review IRA beneficiary designations
- Changes made before filing for dissolution may be reversed by the court
- Cannot change beneficiary post filing of divorce unless the other party consents or the court grants relief from the ATRO
- Temporary QDRO may be necessary for ERISA qualified retirement plans
Life Insurance

- Upon filing a petition for dissolution or upon judgment of the existence of a claim to the insurance proceeds, a notice may be served on the insurance company that all beneficiaries be maintained, and that notice be given in case of any change or lapse in the policy. FC § 2050; FC § 2051
Pre-Filing Options

- Prior to filing a divorce action, the client is not limited by the ATROs.
- The client is, however, limited by interspousal fiduciary duties. FC § 721
AFTER THE DIVORCE

- A dissolution judgment revokes a Will as to the former spouse's rights. PC §6122
- Trust and non-probate provisions for a spouse are also revoked by dissolution or nullity. PC §5600
- Issues do, however, exist with respect to how relatives of the ex-spouse named in the estate plan are treated
- Laws in other jurisdictions
Exception

- A dissolution revokes all non-probate transfers in favor of former spouse, **unless**

  (1) there is clear and convincing evidence that decedent intended the contrary,

  (2) the court ordered that the non-probate transfer be maintained for the former spouse, or (3) the non-probate transfer is not subject to revocation by transferor at time of death. PC § 5600.
Child Support After Payor's Death

- Child support obligation continues after death, but may be satisfied by insurance proceeds. Taylor v. George (1949) 34 Cal.2d 552
- Child support is a charge against the decedent's estate, requiring that a creditor's claim be filed. IRMO O'Connell (1992) 8 Cal.App.4th 565
- Child support is modifiable after death
Securing Child Support

- Child support payments may be secured per Probate Code §11460 et seq. as follows:
  - Court-approved agreement of the parties
  - Deposit of an amount in a financial institution
  - Distribution of estate property to a distributee, with or without a bond
  - Appointment of a trustee to receive payment of the debt
  - Child support from third party trusts
Spousal Support

- Terminates on death of either party unless otherwise agreed. FC § 4337
- Nevertheless, the family court may require a party to purchase an annuity or maintain a life insurance policy for the benefit of the supported spouse, or establish a trust for the supported spouse to provide the spouse with support following the payor's death. FC § 4360
- Spousal support from third-party trusts
Property Not Subject to Division

- Property in irrevocable trusts is not owned by either party
- It may not be easy, or even possible, for a spouse to terminate his or her status as a beneficiary of an irrevocable trust
- Nevertheless, parties may, and probably should, make agreements relating to irrevocable trusts that can be embodied in MSA
ETHICS

- Dual representation. A potential or actual conflict of interest arises when there is:
  - Separate/mixed property
  - Transmutation
  - Waiver of reimbursement rights
- The attorney must be competent to handle the assignment
- Dealing with clients with diminished capacity
- Dealing with unrepresented clients
Assessing Possible Conflicts

- Length and stability of the marriage
- Desire to maintain or change the character of assets
- Unequal bargaining power
- Possible undue influence
- Education/understanding of rights
- Language barriers
Mistakes to Avoid

- Dual representation without conflict and confidentiality waiver
- Failing to document advice to client
- Ignoring FC § 2640 when transmuting property in premarital agreements or estate plans
- Failing to revoke Will or trust and prepare a new one when client is separated, consistent with ATROs
More Mistakes to Avoid

- Failing to sever joint tenancies, as permitted by ATROs
- Forgetting to re-title property after trust is revoked, if allowed by ATROs
- Failing to review beneficiary designations in retirement plans, bank accounts, and life insurance policies
Even More

- Agreeing to a termination of marital status before the property has been divided, without considering the effect the termination of status will have on survivor spouse rights
- Providing representation in specialized areas without competency in that area
Post-death issues (pre and post divorce)

- Challenging prenuptial or postnuptial agreements
- Filing claims against estates
- Elective shares
- Homestead issues
- Presumption of undue influence against spouse
THE END

Thank you for attending our program!