Jade and Nico: Where Family Law, Estate Planning and Probate Law Came Together

Jade and Nico, in their early forties, had been living together for several years in Jade's home when they decided to buy a vacation home together in joint tenancy. Both were frugal and had amassed considerable savings and retirement accounts with the thought of retiring by age sixty to their beautiful vacation home at Hidden Lake. Jade's total assets were about twice as valuable as Nico's.

As they celebrated their forty-fifth birthdays together, they decided it was time to get married. Both agreed that they should have a prenuptial agreement and retained family lawyers. The prenuptial agreement provided for most of their assets and income to stay separate, with the option of creating community property by agreement or creating or acquiring jointly titled accounts or assets. The agreement provided that Nico would be able to stay in Jade's home should Jade predecease Nico, with the length of the residency depending on the length of their marriage. Their lawyers said they should waive their statutory rights related to probate since they were doing a prenuptial agreement. Jade and Nico didn't know what the statutory rights really meant but it seemed to make sense. The lawyers told Jade and Nico they should consult their estate planning lawyers after their marriage.

#1. Possible problem—Jade's Trust and Their Prenuptial Agreement Are Not Consistent

Jade's sister needed financial assistance from time to time because of health issues and Jade was committed to helping her as long as needed. The trust Jade created before the marriage provided that in the event of their death, Jade's residence would be transferred to Jade's sister. Jade did not change this trust in the first five years of her marriage to Nico.

If Jade dies before amending the trust, the prenuptial agreement would be enforceable by Nico because it is a contract. Jade's sister would receive the remainder interest in the property pursuant to the terms of the Trust.

California Probate Code sections 140-147 address the contractual arrangements relating to rights at death which can be waived, whether signed before or during the marriage. Such a waiver must be in writing, signed by the surviving spouse, and is enforceable against the surviving spouse subject to the same defenses as enforcement of contract, except that lack of consideration is not a defense. (Prob. Code, § 142, subd. (c)(1).) In the event of Jade's death, Nico's waiver would likely be effective. So Nico would not be able to request rights under section 141(a), including a probate family allowance, a probate homestead, the right to set aside exempt property, and other rights that might have been meaningful. However, Probate Code section 144 gives the Court broad, equitable discretion to enforce or not enforce the waiver based on the facts and circumstances.

Four and a half years later, Jade and Nico finally got around to estate planning. They decided that they loved each other so much that they wanted to create a joint trust using the same lawyer. They explained to the lawyer that even though their prenuptial agreement kept their property mostly separate, they had decided that on their fifth anniversary, their gift to each

other would be to pool all of their assets and income as jointly owned property, except for a few family heirlooms that each would own individually. The trust the lawyer created stated that all their property was community, including a specific list of community assets, except for another list of their respective separate property. The lawyer explained that community property was a tax-advantaged way to hold their assets, so congratulated them on taking that step. The attorney advised them to change the titles on their real properties to the trust. Jade transferred title to the house to the trust but they never got around to transferring the title to the vacation home (it was already jointly owned so not a priority.)

#2. Massive problem—Their Separate Property Was Not Properly Transmuted to Community Property

Family Code section 852 states: "A transmutation of real or personal property is not valid unless made in writing by an express declaration that is made, joined in, consented to, or accepted by the spouse whose interest in the property is adversely affected." The provisions in their trust concerning community property do not meet this test.

In *Marriage of Holtemann* (2008) 166 Cal.App.4th 1166, the court concluded that characterizing separate property transferred to a trust as "community property" is insufficient to effectuate a transmutation of the property in the absence of "`language which expressly states that the characterization or ownership of the property is being changed.'" (Id., at p. 1169, quoting *Estate of MacDonald* (1990) 51 Cal.3d 262, 272.)

This rule applies even if their intent was to transmute the property per *Estate of MacDonald* (referencing the predecessor statute to Section 852.): "We are aware that § 5110.730(a), construed as we have construed it today, may preclude the finding of a transmutation in some cases, where some extrinsic evidence of an intent to transmute exists. But, as previously discussed, it is just such reliance on extrinsic evidence for the proof of transmutations which the Legislature intended to eliminate in enacting the writing requirement of § 5110.730 (a)." (*Estate of MacDonald*, supra, at p. 273.) Jade and Nico's trust, or a separate transmutation agreement, should have specifically stated that each of them was changing the character of their separate property to community property.

Further, because of their marriage, they have fiduciary duties to each other which results in a presumption of undue influence if a transaction between them results in a favorable gain, benefit, or profit to one of them. The presumption applies here since Jade's assets were worth twice as much as Nico's, and Nico therefore benefited from the transmutation. If the transmutation is challenged, Nico will have to show that the agreement was "freely and voluntarily made, with full knowledge of all the facts, and with a complete understanding of the effect." (In re *Marriage of Delaney* (2003) 111 Cal.App.4th 991, 996. 1000.)

The better practice is for each party to have their own counsel to advise them and include provisions in their postnuptial agreement that describe the impact on the value of each of their separate and community estates of the transmutation as well as any other facts that show the Delaney test was met.

#3. Further Problem—A Right to Reimbursement Was Not Waived

Even if the transmutation had been done properly, there is another potential landmine in the event of a divorce. Per Family Code section 2640, a spouse who contributes separate property to the acquisition of community property is entitled to reimbursement of the amount contributed at the time of a divorce unless there is a written waiver of that right. Jade and Nico's trust did not include a waiver, so if they divorced, each would be entitled to reimbursement of the value of the separate property transmuted to community property at the time the trust was established, ***even if their intent was to gift it to each other***. (In re *Marriage of Carpenter* (2002) 100 Cal.App.4th 424.) So if Nico and Jade divorce, each will be reimbursed for the value of their separate property at the time the postnuptial agreement was signed. Unfortunately for Nico (and the malpractice carrier for Nico's attorney), Jade's residence had appreciated considerably between the time they married and the time the transmutation agreement was signed, so Jade's right of reimbursement was now triple the amount of Nico's right.

Unfortunately, their love for each other was eclipsed by Nico's love for someone else, and Nico filed for divorce just before their tenth anniversary. Not surprisingly, Jade was not too happy about this turn of events. Jade was worried about her sister and wanted to make sure she would be provided for in the event of Jade's death. Jade's family law attorney told Jade that the Automatic Temporary Restraining Orders ("ATROs") restricted what was possible during a divorce, but that the trust could be revoked and the vacation property could be converted from a joint tenancy to a tenancy in common. The attorney offered to do these steps and refer Jade to an estate planning attorney to create a new trust. The attorney drafted a statement revoking the trust, helped Jade prepare a holographic will, and kept the originals in the file to have on hand in the event of Jade's death. The attorney also prepared and recorded a deed transferring the vacation property from joint tenancy to tenancy in common.

#4. Deathly Problem—Filing a notice and serving it on the other party are required!

If Jade dies during the divorce, Jade's wishes will likely not be carried out because Jade's actions violated the ATROs applicable while a divorce is pending (Family Code section 2040, subdivision (b)(2) effective on Petitioner when filed and on Respondent when served.) Family Code section 2040(b)(2) allows a party to revoke a trust, but only with written consent of the other party or after "notice of the change is filed and served on the other party." Jade's attorney did neither of these. Thus, the trust is still in effect.

Family Code section 2040, subdivision (b)(3) allows a party to eliminate a right of survivorship, but in the absence of written consent, again only after "notice of the change is filed and served on the other party." Jade's attorney did neither of these. Thus, the title of the Hidden Lake property is still in joint tenancy.

#5. Additional Deathly Problem—Trust Not Properly Revoked

Even if the proper notice was given to Nico, the trust was not properly revoked. The trust described a process for revocation, which required personally serving a notarized copy of the revocation to Nico, which was not done.

Probate Code section 15401, subdivision (a) sets out two alternative methods for the revocation of a trust. Under the first method, a trust may be revoked by "compliance with any method of revocation provided in the trust instrument." Under the second method, a trust may be revoked in "a writing, other than a will, signed by the settlor...and delivered to the trustee during the lifetime of the settlor." But, if "the trust instrument explicitly makes the method of revocation provided in the trust instrument the exclusive method of revocation," that method must be used. (*Cundall v. Mitchell-Clyde* (2020) 51 Cal.App.5th 571, 581, 584.)

However, there is a split in authority in the California courts regarding whether a method specified in a trust is the exclusive means of revocation if not explicitly designated as such. At this time, the First, Third, and Fifth Districts have all adopted a restrictive approach, while the Fourth District has adopted a more lenient view. The Supreme Court has granted review in Haggerty v. Thornton (2021) 68 Cal.App.5th 1003 and *Balistreri v. Balistreri* (2022) 75 Cal.App.5th 511. Until the Supreme Court renders its decisions, it is most prudent to closely follow the procedure specified in the trust instrument.

Fortunately, Jade had decided to consult with an estate planning attorney to create an individual trust. That attorney saw that the trust with Nico had not been properly revoked and corrected that error. The attorney created a trust for Jade but told Jade to wait to transfer assets into it until Jade knew what they would be getting in the divorce (since creation of an unfunded trust during a divorce is permissible under Family Code section 2040, subdivision (b)(4).) However, the attorney also recommended that Jade change the beneficiary on their 401(k) as soon as possible, which is a violation of Family Code section 2040, subdivision (b)(2).

In anger from the betrayal, Jade mentioned to the attorney that Nico should be killed before the divorce went through so Jade could keep all the property. Fortunately, the attorney advised Jade about the "slayer" statutes (Probate Code §§ sections 250-253) that would mean not only would Jade be in prison but Jade would not be entitled to any of Nico's property.

With the assistance of their lawyers and a mediator, Jade and Nico reached an agreement on all issues and have updated estate plans.

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1. Spouses are allowed to waive their rights at the death of their spouse, but only in a writing signed after the marriage.

2. Even if a surviving spouse signed a waiver of rights of death, the court can equitably decide not to enforce it.

3. If parties to a prenuptial agreement are keeping their assets and income separate, it is always advisable to waive their rights at the death of their spouse.

4. An asset owned prior to marriage is transmuted from separate to community if a trust states all property is community and lists the asset on a community property exhibit.

5. For an effective transmutation, there must be language which expressly states that the characterization or ownership of the property is being changed.

6. If there is proof that a spouse intended to make a gift to their spouse when placing separate property in a trust, then an express statement that the character or ownership is being changed is not required.

7. If separate property is properly transmuted to community property by agreement when creating a family trust, during a divorce the spouse who owned the separate property is entitled to reimbursement of the value of the property at the time of the transmutation unless there was an express written waiver of such right.

8. If there is proof that a transmutation of separate property to community was intended as a gift from one spouse to the other, there is no right to reimbursement in a divorce.

9. If a transmutation from separate to community, or vice versa, benefits one party, there is a presumption of undue influence.

10. When there is a presumption of undue influence, the party seeking enforcement of the transaction must show that it was made freely and voluntarily, with full knowledge of all the facts, and with a complete understanding of the effect.

11. Although not required, the best practice is for both parties to be represented for any significant spousal transmutation agreement.

12. As soon as a Petition for Dissolution is filed, Automatic Temporary Restraining Orders are in effect prohibiting either spouse from engaging in any transaction that affects the other spouse's financial interests.

13. While a divorce is pending, a trust can only be revoked after filing a notice of the change and serving it on the other party.

14. While a divorce is pending, a joint tenancy may only be severed after filing a notice of the change and serving it on the other party.

15. The restrictions on changing a beneficiary during a divorce don't apply to 401(k) plans because they are governed by ERISA, a federal law.

16. A trust can be created during a divorce but cannot be funded while the divorce is pending except with the consent of the other party.

17. A trust can always be effectively revoked by a writing, other than a will, signed by the settlor and delivered to the trustee during the lifetime of the settlor.

18. If a trust instrument explicitly makes the method of revocation provided in the trust instrument the exclusive method of revocation, the alternative method described in the Probate Code is not sufficient.

19. The issue of whether a method specified in a trust is the exclusive means of revocation if not explicitly designated as such is pending in the California Supreme Court.

20. One who feloniously and intentionally kills another cannot receive any of their victim's property, including as a designated beneficiary, by intestacy, or by right of survivorship.