

# Estate Planning for Married Couples Migrating Between Common Law States and Community Property States

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# Property Systems In The U.S.

- CP system:
  - Two types of property – CP and separate property (**SP**)
    - SP is property owned before marriage and acquired after marriage by gift or inheritance.
    - CP is all other property acquired during marriage
      - Income on separate property is CP in Idaho, Louisiana, Texas and Wisconsin
    - Any doubt, property presumed to be CP

# Property Systems in the U.S.

- CP system continued...
  - Marriage does *not* cause any property to become CP
  - CP is owned *equally* by spouses
    - Consider titleholder as a property manager
  - CP system determines ownership during *marriage* and at *divorce* and *death*

# Property Systems in the U.S.

- Common Law Property (**CLP**)
  - Property ownership is determined by *title* or *possession*
  - Each spouse owns property he or she acquires
  - CLP system determines ownership *during* marriage; other law applies upon divorce/death
    - CLP divided equitably upon *divorce*
      - “Dual classification” states
        - ❑ Marital property equitably divided
        - ❑ Separate property retained by titleholder
      - “All property” states
        - ❑ All property equitably divided
    - CLP divided at *death* under elective or forced share statutes

# Classification of Property When Migrating Between CL and CP States

- **General Rule:**

- The law of the state in which a married couple is *domiciled* at the time real or personal property is *acquired* determines the *character* of that property.
- The character of CP or CLP survives a move to another state
- When a couple domiciled in a CL state buys property in a CP state or vice versa, the character of the property is determined by the character of funds used to acquire it.

# Classification of Property When Migrating Between CL and CP States

- Can states impair property rights?
  - A state through its *police power* can enact statutes that impair contract or property rights upon *divorce* or *death* (but not before)
    - The state has a strong public policy concerning
      - Marriage
      - The protection of spouses upon divorce and death, and
      - The effect of marriage on property rights at divorce and death
    - The statute must have a rational relation to a legitimate legislative purpose

# Classification of Property When Migrating Between CL and CP States

- Divorce:

- CP states:

- Idaho, Nevada:

- Law of state where property acquired determines *character* and *division* of property.

- A court could find itself applying the law of many different states or countries during a single divorce proceeding

- Using equitable distribution law of foreign states can pose a significant administrative burden

# Classification of Property When Migrating Between CL and CP States

- Divorce continued...
  - Washington, Wisconsin:
    - Divide all, or nearly all, property equitably upon divorce
  - Arizona, California, Louisiana, New Mexico, Texas
    - Enacted quasi-community property (**QCP**) statutes
      - QCP is property acquired while a married couple was domiciled in a CL state that would have been CP if they were domiciled in a CP state
      - QCP is divided equally or equitably

# Classification of Property When Migrating Between CL and CP States

- Divorce continued...
  - CL states:
    - Majority of states *classify* and *divide* all property under law of forum
      - CP may be classified as “marital property” in these states
      - These states often grant broad equitable powers to a divorce court
        - ❑ Such courts are not limited by the property distribution laws of every state touched by a migratory marriage.
    - Minority of states *classify* property using foreign law but *divide* such property based on law of forum.

# Classification of Property When Migrating Between CL and CP States

- Death:
  - CP states:
    - Arizona, Nevada, New Mexico, Texas:
      - No law requiring deceased spouse's CLP to be shared with surviving spouse
        - ❑ Permits one spouse to disinherit other spouse when estate includes CLP
        - ❑ Courts recognize common law rule that disposition of property at death is wholly subject to statutory control and may be enlarged, limited or abolished by the legislature.
    - California, Idaho, Louisiana, Washington, Wisconsin
      - Enacted QCP statutes to *classify* and *divide* deceased spouse's CLP
      - It deals only with real property located in the enacting state and personal property domiciled in the enacting state.
      - The decedent's one-half portion of the QCP is *not* subject to the surviving spouse's elective share, dower or curtesy rights

# Classification of Property When Migrating Between CL and CP States

- Death continued...

- CL States:

- These states enact *elective share* and *forced share* laws to protect the surviving spouse.
      - Some laws pertain only to property passing under a will while others pertain to property passing under a will *and* revocable trust
    - 14 states have enacted the 1971 Uniform Disposition of Community Property Rights at Death Act (Uniform Act) to deal with CP acquired by a deceased spouse while domiciled in a CP state.
      - Property covered includes property transmuted into CP by agreement

# Classification of Property When Migrating Between CL and CP States

- Death continued...
  - Advantages of the 1971 Uniform Act
    - Two rebuttal presumptions
      - First, community property retains its character
      - Second, property acquired in the CL state as *joint tenancy, tenancy by the entirety*, or some other form *with right of survivorship*, is *not* community property.
      - Presumed transmutation even though retitling may be ineffective in CP state or the CP state treats the property as CPWROS

# Classification of Property When Migrating Between CL and CP States

- Death continued...
  - Advantages of the 1971 Uniform Act
    - Personal representative has *no* fiduciary duty to discover whether property is CP
    - Surviving spouse has no elective share, dower or courtesy rights in property subject to Act

# Planning For Married Couples Migrating Between CL and CP States

- Advisors will be called upon to determine:
  - The property rights of each spouse in an asset.
  - Whether spousal agreements or waivers exist that affect those rights.
  - The tax consequences of those rights
  - How those rights may be modified upon divorce or death.

# Planning For Married Couples Migrating Between CL and CP States

- Planners are usually familiar with only one property system
  - They are often “blind sided” by the other property system
  - CL planners tend to “unwind” CP into a co-tenancy without discussing impact on
    - Income tax basis at death
    - Spousal rights and expectations regarding the property

# Planning For Married Couples Migrating Between CL and CP States

- Planners in one regime often neglect or destroy advantages of property acquired in the other regime.
  - Example: Married couple moves from Texas to Missouri
    - H's real property in Texas is CP
    - H's IRA in Texas is CP
    - H dies - IRA and real estate not left to W
    - Missouri planner failed to recognize CP
      - ❑ No CP interest claimed for W in IRA and real estate
      - ❑ No 100% basis step-up for real estate
      - ❑ No fractional interest discount taken for real estate

# Planning For Married Couples Migrating Between CL and CP States

- Initial estate planning conference:
  - Ask if couple ever lived in a CP state or vice versa
    - The couple may own CP but cannot be relied upon to know if they do!
      - Planner must dig for information
      - Extended residence in CP state will often indicate presence of CP
      - Remember the presumption in favor of CP

# Planning For Married Couples Migrating Between CL and CP States

- Initial estate planning conference continued...
  - If couple has CP and CLP
    - Maintain an inventory
    - Preserve records to identify and trace property
      - Acquisition and improvement of property
        - ☐ Including business formation documents
      - Source of funds used to acquire or improve property
    - To avoid commingling and loss of property character:
      - Establish separate accounts for CP and SP
      - Keep property in old state to preserve character
      - Establish separate revocable trusts to hold SP and CP

# Planning For Married Couples Migrating Between CL and CP States

- Initial estate planning conference continued...
  - Ask for copies of any agreements or waivers that confirm or change the character of property
    - Look out for so-called “double pronged” and “three pronged” CP agreements
    - A double prong agreement may say:
      - All current property is CP except scheduled SP
      - All future property is acquired is CP
    - A three prong agreement may add that the deceased spouse’s share of CP passes automatically upon a spouse’s death to the surviving spouse without probate
      - Despite probate savings, the third prong bypasses tax-saving provisions in the deceased spouse’s will or trust
      - No credit shelter trust can be created here.

# Planning For Married Couples Migrating Between CL and CP States

- Planning tips
  - Confirm or change character of property by agreement, conveyance or partition
    - Discuss impact on property rights and spousal expectations
      - Reach agreement on character of property
    - Make title consistent with ownership rights under the agreement
      - “John Doe as his sole and separate property”
      - “John and Jane Doe as their community property”

# Planning for Married Couples Migrating Between CL and CP States

- Planning tips continued...
  - Confirm or change character of property by agreement, conveyance or partition
    - Governing Law
      - Character *confirmation* agreement – use law of domicile where property was acquired
      - Character *change* agreement - use law of domicile that will support validity of agreement
    - Interspousal agreements have tax consequences and ethical issues
      - Joint representation is possible with adequate disclosures
      - Potential conflicts of interest because it alters property rights

# Planning For Married Couples Migrating Between CL and CP States

- Planning tips continued...
  - Factors whether to confirm or change property character:
    - Step-up/step-down in basis planning
      - 100% of CP receives step-up/step-down in basis at first spouse's death
        - ❑ Sometimes called double-basis step-up
        - ❑ Consider converting *appreciating* CLP to CP to obtain 100% step-up
          - Rev. Rul 87-98 - JTWROS Property Treated as CP
        - ❑ Consider converting *depreciating* CP to CLP property to obtain 50% step-down basis
          - Rev. Rul. 68-80 - CP to tenancy in common treated as CLP

# Planning For Married Couples Migrating Between CL and CP States

- Planning tips continued...
  - Factors whether to confirm or change property character:
    - Income from separate property
      - If moving to Idaho, Louisiana, Texas and Wisconsin where income from separate property is treated as CP, consider changing character of that income to separate property by agreement

# Planning For Married Couples Migrating Between CL and CP States

- Planning tips continued...
  - Potential disinheritance of spouse
    - If couple is moving from a CL state to Arizona, Nevada, New Mexico or Texas, property acquired in a CL state is not subject to CP system.
    - QCP concept does *not* apply at death in those CP states
    - Consider changing character of CLP to CP by agreement.

# Planning For Married Couples Migrating Between CL and CP States

- Revocable trust forms:
  - CL states: separate revocable living trust for each spouse
  - CP states: joint revocable trust for both spouses
    - Comply with Rev. Rul. 68-283 to preserve CP tax treatment
  - Be careful if use revocable trusts to confirm/ change character of property

## EXAMPLE

- Example: *Katz v. United States, 382 F.2d 723 (CA9 1967)*.
  - H and W transfer CP to trust created by H
  - W consents to trust and to subsequent amendment
  - Held: consents did not transmute CP into SP of H
    - Nothing in trust or the consents overcame presumption that change in form of CP does not change its character
    - Rule that property acquired during marriage includes interest in trusts is applicable
    - Husband had same management rights before and after transfer to trust
    - Management powers held by Husband in fiduciary capacity

# Example #1

## Migration from Texas to Missouri

- **FACTS:**
  - H and W lived in Texas three different times during marriage
    - 1945-1947; 1949-1960; 1962-July 2005
  - H and W moved to Missouri in July 2005
  - W died on March 20, 2012
- **ISSUES:**
  - Any of the property CP?
  - Did H and W convert any CP property to CLP?
  - What does Missouri and Texas law say?

# Example #1

## Migration from Texas to Missouri

- Missouri Law:

- *In re Estate of Perry*, 480 S.W.2d 893 (Mo. 1972)
  - H and W were residents of Texas when H died
  - H and W owned a ranch in St. Clair County, Missouri as TBE
  - Issue: whether *personal* property at ranch was CP or CLP (TBE)?
  - Owned cattle, horses, saddles, machinery and trucks
  - Real estate not an issue

# Example #1

## Migration from Texas to Missouri

- *In re Estate of Perry*, 480 S.W.2d 893, 894-896

“Without any doubt, Texas community property laws of the nonresident Appellant and her deceased spouse, Ralph A. Perry, control her property rights in personal property having a situs in this state at the time of his death. See 41 C.J.S. Husband and Wife, §466, p. 991 et. seq., for the general rule. The rule has been applied *in principle* in this state in the early case of *Depas v. Mayo*, 11 Mo. 314.

“  
...  
”

“The evidence above is insufficient to prove that Mr. Perry had separate ownership in the estate inventoried, and is insufficient to rebut the presumption existing under Texas law that *all of the property was and is community property.*”

# Example #1

## Migration from Texas to Missouri

- *Holmes v. Beatty*, 290 S.W.3d 852, 855, 859 (Tex. 2009):

Prior to the constitutional amendment [permitting the creation of CPWROS], “the only way for a couple to create survivorship rights was to *partition* their community property into *separate* property, *then* execute survivorship agreements for that separate property.... This process came to be known among practitioners as the ‘Texas Two-Step.’”

“ ...

“The property cannot be joint tenancy property, a form of separate property, unless it has first been rendered separate by partition. ... But the agreement to hold such property with right of survivorship is now constitutionally sanctioned [as CPWROS].”

# Example #1

## Migration from Texas to Missouri

- Tex. Prob. Code §§451 and 452 – agreement to create CPWROS
  - Must be in writing and signed by both spouses
  - Must contain some right of survivorship language
  - Texas Supreme Court ruled that a joint tenancy has as a survivorship right via common law and trade usage.
  - Since 2011, survivorship is not inferred if an account is merely titled as a joint tenancy
- Rev. Rul. 87-98
  - CP with a right of survivorship is still CP and receives a full basis step-up

# Example #1

## Migration from Texas to Missouri

- Back to Example #1:

<u>Assets</u>	<u>Title</u>	<u>Where Acquired</u>	<u>When Acquired</u>	<u>Source</u>	<u>Treated</u>
Ring	N/A	N/A	1982	Gift from H	Separate
Oil/gas properties	W	TX	During marriage	Inherited	Separate
Residence	TBE	MO	2007	CP funds	CPWROS
Checking	JTWROS	MO	2008	CP funds	CPWROS
Securities	JT TEN	TX	1998/2001	CP funds	CP
Securities	JTWROS	TX	1998/2002	CP funds	CP
Invest. Acct.	JTWROS	MO	2009	CP funds	CPWROS
Coins in bank box	JTWROS	MO	2011	CP funds	CPWROS
Autos	TBE	MO	2001/2002	CP funds	CP
Oil/gas properties	H	OK	During marriage	Separate	H
H's IRA	H	TX	2009	CP funds	CP
W's IRA	W	TX	2009	CP funds	CP

# Example #1

## Migration from Texas to Missouri

- Full basis step-up for all CP and CPWROS
- How take IRAs?
  - W's IRA – H is primary beneficiary of 100%
    - IRD – no basis step-up
    - Daughter is contingent beneficiary
    - H will not disclaim ½ survivorship interest
    - If H is not designated beneficiary of 50%, then file claim in probate
  - H's IRA – W's Will left her ½ CP interest in H's IRA to H outright
    - Testamentary bequest per *Allard v. Frech*, 754 S.W.2d 111 (Tex 1988)
- H desired to use W's unified credit:
  - H disclaimed his ½ survivorship interest in all CPWROS property
  - Considered but rejected portability

# Example #2

## Nebraska Couple Purchases Real Estate In Washington

- **FACTS:**
  - Married couple domiciled in Nebraska (CL state)
  - Purchased real property in Washington (CP state)
  - Significant tangible personal property (TPP) kept there
  - Property is CLP without further planning because funds used to acquire the property were CL property
- **ISSUE:**
  - Convert CLP to CP and receive double basis increase?

# Example #2

## Nebraska Couple Purchases Real Estate in Washington

- PLANNING:
  - Under doctrine of *Volz v. Zang*, enter into an agreement to convert real and TPP to CP
  - Rights in land are regulated by law of situs
    - *Black v. Comm.*, 114 F.2d 355 (9<sup>th</sup> Cir. 1949)
  - Rights in TPP also regulated by law of situs when title transfers
    - 16 Am Jur 2d Conflict of Laws §§41-43 (2013)
  - Tax savings pays for estate plan!

# Example #3

## Migration from New York to Belgium

- **FACTS:**
  - H and W married in VA in 1996; first lived in NY as a married couple
  - H's employer asked H to live at least 2 years in Belgium
  - Employer provided bonus to H as incentive; was refundable if returned to U.S. within 2 years
  - H and W moved to Belgium on temporary assignment; no definite date to return
  - W dies 18 months later
  - Only Belgium assets are bank accounts in H's name in which a refundable signing bonus was deposited
  - Belgium notary claims the accounts are community property; that W's one-half interest is subject to Belgium inheritance tax and passes to H and W's daughter, but is subject to H's usufruct (life interest)

# Example #3

## Migration from New York to Belgium

- Belgium Law:
  - Belgium is a CP regime
  - Napoleonic civil law
    - Spouses can *select* a marital property regime to govern ownership of personal property, but if they do not choose any regime, the law of the country where they first established their domicile after they got married will apply.
  - Belgium notary claims NY law applies and that NY conflicts law provides that property acquired by H and W in Belgium is community property
    - H and W did not select a marital property regime
  - Domicile is an address in Belgium, whereas domicile in the U.S. is a state

# Example #3

## Migration from New York to Belgium

- Analysis:
  - *Estate of Charania*, 608 F.3d 67 (CA1 2010):
    - Ugandan couple moved to Belgium while Uganda was part of England
      - Husband died owning Citigroup stock
      - Issue: does Belgium law (CP regime) or English law (CL regime) govern stock ownership?
    - U.S. Courts favor doctrine of mutability
      - The marital property regime of the jurisdiction in which the spouses were domiciled when the property was acquired governs questions of ownership
    - Continental European countries favor doctrine of immutability
      - The marital property regime of the jurisdiction in which the spouses were domiciled at the time of their marriage governs all personal property that they acquire
    - *Charania* determined that law of England applied the doctrine of immutability and therefore 100% of stock was subject to U.S. estate tax

# Example #3

## Migration from New York to Belgium

- Belgium notary's position that *all* of NY's law applies appears to be correct
- *Charania* states:
  - "They agree that, for federal estate tax purposes, ownership of intangible personal property is controlled by the *whole law* of the decedent's domicile at the time of death. The parties further agree that the decedent in this case was domiciled in Belgium when he died and that a Belgian court, *applying Belgian choice-of-law rules*, would look to the *whole law* of the country of the spouses' common nationality."
- Belgium applies the whole law of NY
  - NY applies the doctrine of mutability
- H's legal counsel is arguing that H and W did not change domicile to Belgium, but the Belgium national federation of notaries disagrees. H moved back to U.S.

# Estate Planning for Married Couples Migrating Between Common Law States And Community Property States

- Remember: Married couples who migrate between CL and CP states during marriage have special estate planning needs.

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# Resources

- 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)
- The article can also be found at:
  - 16 J. Int'l Tr. & Corp. Plan. 254 (2009)
  - 2 Int'l Tr. Laws B8-1 (2010)