The Revocable Inter Vivos Trust and the New California Community Property Laws

Gary S. Phillips

Follow this and additional works at: http://digitalcommons.law.scu.edu/lawreview

Part of the Law Commons

Recommended Citation
Available at: http://digitalcommons.law.scu.edu/lawreview/vol16/iss3/3

This Comment is brought to you for free and open access by the Journals at Santa Clara Law Digital Commons. It has been accepted for inclusion in Santa Clara Law Review by an authorized administrator of Santa Clara Law Digital Commons. For more information, please contact sculawlibrarian@gmail.com.
COMMENTS

THE REVOCABLE INTER VIVOS TRUST AND THE NEW CALIFORNIA COMMUNITY PROPERTY LAWS

INTRODUCTION

Estate planning requires application of complex rules of tax and property law, and harmonization of tax advantages with substantive objectives. While broad principles exist, there is no single rule of universal application, and no formalized technique or procedure which is always best. Planning an estate requires reviewing the total situation of a client: his family, his property, his capacity, and his desires. All must be understood, interrelated and, if need be, interpreted or amplified by the attorney.

The use of a revocable inter vivos trust may be called for, sometimes merely to supplement a plan principally embodied in a will and sometimes to specify both lifetime and post-mortem disposition of the bulk of the client’s estate.

A revocable inter vivos trust exists where the settlor alone has the power to terminate the trust at will. The effect of the revocation is to force the return of the corpus to the settlor or to force the payment of the corpus as he may direct. Until a power to revoke is exercised, the interests created by the trust instrument remain unaffected. The living trust can be distinguished from a testamentary disposition, which remains ambulatory until the death of the one who makes it, in that the settlor of the inter vivos trust presently passes all legal and equitable interests.¹

The creation of the living revocable trust has almost no immediate tax consequences, and is generally neutral as to taxes in the long run.² The action as an estate planning technique, then, is usually considered for other than tax reasons. Principal among the purposes served by the revocable inter vivos trust is the classic avoidance of probate.³ Prior to

---

3. See authorities cited note 2 supra.
1975, if the husband died first, the entire community estate was subject to probate. If the wife died first, only her half of the community estate was probated, subject to the husband’s continued right to management.\(^4\)

Perhaps too much emphasis has been placed in recent years on the avoidance of probate as a goal to be accomplished at all costs. In California, probate administration has been partially streamlined by “The Independent Administration of Estates Act”\(^5\) and the community property set-aside laws.\(^6\) However, with the 1973 amendments to the California community property laws granting equal control and management to the spouses,\(^7\) probate may become something to be avoided indeed. Upon the death of the first spouse it is entirely possible that the surviving spouse could effectively impede administration of the decedent’s estate as a result of the equal management and control provisions.\(^8\) In this instance, the revocable trust may be a valuable estate planning tool, since the provisions contained in the trust instrument will control with respect to the disposition of the community estate.\(^9\)

Prior to the 1973 reforms, the husband alone held the powers of management and control of the community.\(^10\) Now, however, both spouses enjoy such powers and each has an equal right to deal with the property of the marriage during their joint lifetimes. Problems are certain to arise with respect to this dual scheme of community property management. If community property is to be transferred to a revocable living trust, it is essential for tax purposes and for determination of the spouses’ respective property rights, as well as for the orderly administration of the trust, that certain basic issues be resolved at the outset. The trust instrument should clarify such matters as the effect of the creation of the trust on the nature of the spouses’ ownership interests and the rights of each as to

---

\(^4\) Kasner, *Administration of a Deceased Wife’s Interest in Community Assets*, 4 SANTA CLARA LAW 30 (1963) [hereinafter cited as Kasner].


\(^6\) Id. §§ 650-659 (West Supp. 1975).

\(^7\) CAL. CIV. CODE §§ 5125(a), 5127 (West Supp. 1975).

\(^8\) For a discussion of the management problems encountered during probate under the previous laws, see Kasner, supra note 4. With equal management and control, the same types of problems are likely to arise on the death of either spouse when community property is subject to probate.


management of the trust properties. It should further define the scope of their respective powers of revocation; the power to make, and the effect of making, withdrawals of corpus and distributions of income; and the disposition to be made of the trust corpus upon the incompetency of either or both spouses, upon divorce, or at the death of each spouse.

The purpose of this comment is to explore the effect of the new California community property reforms on the revocable inter vivos trust as an estate planning tool and to suggest methods for its effective use. Practical considerations to be examined include preserving the community estate and the effect upon the spouses' respective property rights where one spouse executes the trust without the other spouse's consent or knowledge. Specifically to be considered is the effect of the non-settlor spouse’s subsequent consent, waiver or refusal to consent; the effect of trust distributions; and the effect of the death of the settlor spouse on the rights of the non-settlor spouse. Additionally, this comment will explore the drafting problems likely to arise and suggest methods of avoiding or minimizing them.

PRACTICAL CONSIDERATIONS

Preserving the Community Estate

Depending upon the terms of the trust indenture and its validity under local law, execution of the trust may have the effect either of preserving the original community status of the property or, instead, of converting it to some form of separate ownership. If, for example, a trust involving community real property is totally invalid for failure to comply with the local requirement that it be created or declared in a written instrument, the original community character of the property persists. If the trust is valid, however, then in order to retain the community status of the property, it seems likely that the spouses' powers of management and revocation over the trust

---

11. 1 A. Scott, Scott on Trusts § 57.1 (3rd ed. 1967).
12. Such conversion can be accomplished by express terms. Cal. Civ. Code § 5103 (West 1972) provides in part: "Either husband or wife may enter into any engagement or transaction with the other ... respecting property, which either might if unmarried ...." Cal. Civ. Code § 5113.5 (West Supp. 1975) provides that the community property status will persist "unless the trust otherwise expressly provides." See Tomaier v. Tomaier, 23 Cal.2d 754, 759, 146 P.2d 905, 906 (1944).
property must be made approximately equivalent to the extent of the interest each has in the property otherwise held in community form. The Internal Revenue Service suggested this as the standard in Revenue Ruling 66-283.14 There, a husband and wife transferred their California community property to a revocable trust. They had reserved to themselves a life interest in the income as well as the powers to alter, amend, or revoke the trust, in whole or in part, during their joint lives. The trust instrument further provided that the property would retain its community character, and that any corpus withdrawn would remain community property. The Service determined that the transfer to the trust in these circumstances did not work a conversion of the assets into separate property, but rather that the community interest in the assets continued.15

In 1967, the United States Court of Appeals for the Ninth Circuit had occasion to determine whether a conveyance to trust of community property effected a conversion into the husband's separate property in *Katz v. United States.* 6 Under the terms of that trust, the husband had retained the rights to enjoy and direct disposition of the income, and the powers to revoke, terminate, or amend the trust. The court determined that the husband did not control the wife's share of the trust properties in his individual capacity, but as the managing agent of the community estate, and that such control was not inconsistent with continuing community property status.17

California Civil Code section 5113.5, effective January 1, 1975, is in accord with the underlying theme of both Revenue Ruling 66-283 and *Katz* regarding the exact scope and nature of the powers required if the spouses' community interest is to persist: it leaves the management and control of the community property exactly where it was before the trust was created. That section dictates that the spouses shall retain their community interest in property transferred to trust, provided the trust

(a) is revocable in whole or in part during their joint lives,
(b) provides that the property after transfer to the trust shall remain community property and that any withdrawal therefrom shall be their community property, (c) grants to

16. 382 F.2d 723 (9th Cir 1967).
17. *Id.* at 730.
the trustee during their joint lives powers no more extensive than those possessed by a husband and wife . . . , and (d) is subject to amendment or alteration during their joint lifetime upon their joint consent.18

In 1973, numerous sections of the California Civil Code governing the relationship between husband and wife with respect to their property were revised, effective January 1, 1975.19 The main objective of the revision was to equalize the rights of husband and wife in their community property.20 Accordingly, the basic principle of the new law which most significantly affects the drafting of revocable trusts is that each spouse has equal management and control over the community property of the marriage.21 Prior to January 1, 1975, the husband was the sole manager of the community property.22 Civil Code sections 512523 and 512724 now provide that either spouse has management and control over the community personal property and community real property, respectively, except that "a spouse who is operating a business or an interest in a business which is community personal property has the sole management and control of the business or interest."25 The limitations formerly imposed upon management of the community property by the husband will now apply to both spouses.26 Civil Code section 5113.5 reflects these changes and limits the trustee’s powers to those possessed by either spouse under sections 5125 and 5127.27

19. The following CALIFORNIA CIVIL CODE sections were amended: 5102, 5110, 5113.5, 5116, 5117 (amended in 1973, repealed in 1974), 5120, 5121, 5122, 5123, 5125, 5127, 5127.5 (added), 5131 and 5132.
23. CAL. CIV. CODE § 5125(a) (West Supp. 1975) provides that "[e]ither spouse has the management and control of the community personal property . . . ."
24. CAL. CIV. CODE § 5127 (West Supp. 1975) provides that "[e]ither spouse has the management and control of the community real property . . . ."
26. Conveyances of real property still require the consent of both spouses, CAL. CIV. CODE § 5127 (West Supp. 1975); neither spouse can transfer community personal property without valuable consideration, CAL. CIV. CODE § 5125(b) (West Supp. 1975); and neither spouse may sell, convey or encumber certain community personal property without the written consent of the other. CAL. CIV. CODE § 5125(c) (West Supp. 1975).
27. CAL. CIV. CODE § 5113.5(c) (West Supp. 1975) (emphasis added) now provides that the trustee be granted "powers no more extensive than those possessed by a husband or wife under Sections 5125 and 5127 . . . ."
While it may be assumed that the section 5113.5 requirements must be satisfied if the community character of the property is to persist whenever community property is transferred to a revocable trust, the matter, it would seem, is not a foregone conclusion. That section provides:

Nothing in this section shall be deemed to affect community property which, before or after the effective date of this section, is transferred in a manner other than as described in this section . . . . 28

In the event the terms of the trust do not meet the section 5113.5 requirements, apparently it could be argued that the property nevertheless has retained its community status if the trust contains elements which were deemed adequate for that purpose in either Revenue Ruling 66-283 or Katz.

If the courts interpret section 5113.5 literally, it will be applied only when community property is transferred to a trust created jointly, by "the husband and wife." 29 Provided the terms of the trust satisfy its requirements, that section will serve to maintain the spouses' community interest in the trust property. Even in those instances where the section 5113.5 requirements are not satisfied, Revenue Ruling 66-283 and Katz may preserve the community status. However, both Revenue Ruling 66-283 and Katz involved trusts which were created upon the joint consent of the spouses. Arguably, neither that ruling nor Katz would be of significant precedential value, and section 5113.5 would be inapplicable in the situation where one spouse has transferred community property to a revocable trust absent the consent or joinder of the other spouse. In that instance the settlor spouse should not be able to contend successfully that the trust property had been converted to separate property by reason of his or her having placed the assets in trust. The community nature of the property could seemingly be maintained on the following theory.

There is a presumption that all personal property acquired during marriage by a married person while domiciled in this state is community property. 30 As the law favors community property, the presumption would be difficult to overcome absent evidence of a specific intent to convert community prop-

---

29. Id.
property to the separate estate of the settlor spouse. While Civil Code section 5103 allows the spouses to convert their community property into separate property of either, such a transmutation requires an agreement between the parties to so change the character of the property. The unilateral actions of one spouse resulting in a transfer of the community property in trust cannot serve to deprive the other spouse of his or her community interest in the assets. Accordingly, any legal title created in favor of the settlor as trustee, or any equitable interest retained as a trust beneficiary, should be community property, with the non-consenting and non-joining spouse entitled to equal participation.

Where One Spouse Unilaterally Executes the Trust: Spouse’s Consent or Waiver

Certain practical problems are to be anticipated with respect to the revocable inter vivos trust and the new community property laws. The effect of these laws is particularly important because in California all trust agreements are revocable unless specifically stated to be irrevocable. Given that the husband and the wife now share equally in the control and management of the community property, a preliminary question is whether either spouse can effectively convey community property to a revocable living trust, absent the consent of the other.

Consent. Under the new laws, since each spouse has management and control of the community property, either spouse may execute a revocable trust and place the community assets in the hands of the trustee. If the other spouse subsequently assents to the transfer, no problem is likely to arise as to the validity of the trust. However, affirmation of the trust will necessarily raise the ancillary issues of the consenting

32. See note 12 supra.
35. Katz v. United States, 382 F. 2d 723 (9th Cir. 1967); CAL. CIV. CODE § 5113.5 (West Supp. 1975) supports the proposition that interests created by the trust are proper objects of community status.
spouse's participation in management and the power of revocation. Of course, the spouse may simply assent and allow the settlor spouse to manage the community assets in trust. On the other hand, it would seem that with the dual management and control scheme, the consenting spouse is afforded the further opportunity of exercising his or her sections 5125 and 5127 rights with respect to the trust.\textsuperscript{38}

\textbf{Waiver.} It is entirely possible, although ill-considered, for the trust to achieve after-the-fact validation if the non-settlor spouse simply waives his or her community rights. However, the draftsman and the spouses should be aware of the potential adverse tax consequences resulting from such a waiver. Should the spouse choose to waive his or her community property rights, the waiver may effect a conversion of that community interest to the other spouse's separate property—hence, a gift incurring a gift tax.\textsuperscript{39} If it is determined that a taxable gift has been made, it is then necessary to determine the amount of the gift. Consider, for example, the situation where the husband has placed all of the community property in trust for the benefit of himself and his wife, naming himself as trustee; the wife, upon learning of the transfer, has waived her community interest. The author can anticipate two approaches.

First, and least persuasively, it can be argued that by waiving her rights to manage and control the whole of the community estate jointly with her husband, the wife has made a gift of the whole community. Since the husband's exercise of his right to manage and control the assets is no longer subject to his wife's veto power, he arguably owns the entire estate as his separate property, or at least has a general power of appointment over the wife's half.\textsuperscript{40} However, this reasoning assumes that the wife can effect a gift by the non-exercise of her veto power. While there are instances where the non-exercise or relinquishment of a power will be considered a taxable

\textsuperscript{38} The consent of the non-settlor spouse would not seem to preclude a revocation of the trust at anytime by either party.

\textsuperscript{39} If the non-settlor spouse waives only the right to participate in the management of the community assets in trust and retains the beneficial enjoyment of those assets, the waiver will not effect a conversion to the settlor spouse's separate estate, hence will not constitute a taxable gift. Katz v. United States, 382 F.2d 723 (9th Cir. 1967). See text accompanying note 86 infra.

\textsuperscript{40} \textit{Int. Rev. Code} of 1954, §§ 2038, 2041. A party is considered to own, for federal estate tax purposes, any property over which he can, alone, exercise a power to revoke or a general power of appointment.
event, it appears to be the exception rather than the rule and would lead to unduly harsh results under these facts. The sounder position would be that the spouses constructively transmuted the community property into equal divisions of separate property, and that the wife’s waiver effected a transfer of her separate property to her husband. Therefore, the tax should be assessed on the basis of the wife’s gift of her separate property, or on one half of the community property held in trust. It is essential to an informed determination of whether to waive the rights that the spouses be advised that such a transmutation would have effects well beyond those contemplated with respect to the trust.

Where One Spouse Unilaterally Executes the Trust Without the Other Spouse’s Knowledge or Consent

Also to be given consideration with respect to revocable inter vivos trusts and the new California community property reforms is the situation where one spouse has transferred the community property of the marriage into trust and the other spouse is either unaware of the transfer or, upon learning of the trust, has refused to consent to the transfer. Absent some affirmative conduct by the non-settlor spouse, the trust would continue. To the extent that the trust was composed of community personality, this conclusion would hardly run afoul of Civil Code section 5125 (b), which prohibits either spouse from

41. Int. Rev. Code of 1954, § 2514 (a), (b), (c), relating to the transfer of property for gift tax purposes stemming from the release or lapse of a general power of appointment; id. § 2038(a), relating to the inclusion in a decedent’s gross estate for federal estate tax purposes where the decedent had made an inter vivos transfer of property subject to his power to alter, amend, revoke or terminate and either failed to exercise that power or relinquished it in contemplation of death.

42. This proposition is supported by the fact that either spouse has the testamentary capacity to dispose of only one-half of the community property. Cal. Prob. Code § 201 (West 1975).


44. If the couple should obtain a divorce, the wife would not be entitled to any of the property in the property settlement. Cal. Civ. Code §5102 (West Supp. 1975); See Bank of America Nat’l Trust & Savings Ass’n v. Mantz, 4 Cal. 2d 322, 49 P.2d 279 (1935). Also, the husband would have the entire trust corpus included in his gross estate for federal estate tax purposes rather than the one-half interest that would otherwise have been included if the community character of the property had been preserved, Int. Rev. Code of 1954, § 2033; see Katz v. United States, 382 F.2d 723 (9th Cir. 1967); Brooks v. United States, 84 F. Supp. 622 (D.C. Cal. 1949).

45. See note 34 supra.
disposing of community personal property without considera-
tion. Clearly, a transfer to a revocable trust is not a “gift”
and, arguably, is not a “disposition” because the existence of
the power to revoke keeps the property within the dominion
and control of the grantor. To the extent that the trust corpus
was composed of community real property, its validity would
turn on the court’s interpretation “conveyed” within the con-
text of Civil Code section 5127, which requires that both
spouses join in any conveyance.

If the non-consenting spouse was desirous of protecting her
rights, her power to do so would be commensurate with the
circumstances existing at the time of her contemplated ac-
tion. If she acted during the spouses’ joint lifetimes, it would
appear that she could revoke the entire trust, or at least revoke
it to the extent that it was composed of community property.
Katz v. United States suggested that the spouses hold the
same rights with respect to the community property in trust as
they would enjoy if no trust existed. However, as was suggested
previously, Katz would apply only where both spouses con-
sented to the execution of the trust, although the same reason-
ing should prevail where one spouse has secretly established
the trust. Under the prior community property law, the wife
could not revoke any part of the trust since the husband had
the sole right to management and control. In contrast, the
new laws confer upon both spouses equal management and
control over the community estate. If then, the spouses retain
their property interests irrespective of the trust, logic dictates
that just as either spouse may create the trust, either spouse
should be able to revoke it.

One further issue with respect to the non-consenting
spouse’s power to revoke is whether that power is retained if,
upon acquiring knowledge of the trust, the spouse takes no
action to veto the trust. Consider a situation where the wife

46. See note 26 supra.
47. Treas. Reg. § 25.2511-2(b) (1976); see Estate of Sanford v. Commissioner, 308
48. See note 26 supra.
49. Katz v. United States, 382 F.2d 723 (9th Cir. 1967).
50. See text accompanying note 29 supra.
§§ 5125, 5127 (West Supp. 1975).
knows that her husband has placed the community property in trust but has not made any attempt to terminate the trust. The husband may contend in this instance that his wife is estopped from revoking the trust.\textsuperscript{54} Such a contention seems to be without merit. If the wife were to be estopped from revoking the trust, her rights to management and control would be reduced to privileges to be lost if not exercised. Furthermore, even if the wife's inaction is construed as an implied consent to the transfer, she should retain her right to revoke the trust at any time to the same extent as if she had actually consented.\textsuperscript{55}

Where One Spouse Unilaterally Executes the Trust—Effect of Distributions on Non-Consenting Spouse’s Rights

A further question concerns what the non-consenting spouse’s rights are when there has been a distribution of community property corpus or income to a beneficiary of the trust other than the settlor spouse. Clearly, such a distribution would constitute a “gift” within the meaning of IRC §2511.\textsuperscript{56} It is equally clear that as such, the distribution would run afoul of either Civil Code section 5125 (b) as a gift made of community personal property, or Civil Code section 5127 as a gift made of community real property without valuable consideration and without the written consent of the other spouse.\textsuperscript{57} It would seem, therefore, that the non-consenting spouse would revoke the gift in its entirety.\textsuperscript{58}

Where One Spouse Unilaterally Executes the Trust: Effect of Settlor Spouse’s Death on Survivor’s Rights

An additional problem is the effect upon the non-consenting spouse’s property rights if the settlor spouse were to

\textsuperscript{54} \textit{Cal. Civ. Code} § 5127 (West Supp. 1975) provides for a one year statute of limitations where one spouse conveys community real property without the joinder of the other. However, this statute of limitations may be imposed only where the wrongful conveyance is for valuable consideration. \textit{Gantner v. Johnson}, 274 Cal. App. 2d 869, 79 Cal. Rptr. 381 (1969). Arguably, the transfer in trust is not for valuable consideration and will not trigger the provision.

\textsuperscript{55} See note 38 and accompanying text supra.

\textsuperscript{56} See authorities cited note 47 supra.

\textsuperscript{57} See note 26 supra.

\textsuperscript{58} \textit{Boyd v. Oser}, 23 Cal. 2d 613, 145 P.2d 312 (1944); \textit{Britton v. Hammell}, 4 Cal. 2d 690, 52 P.2d 221 (1935); \textit{Trimble v. Trimble}, 219 Cal. 340, 26 P.2d 477 (1933). Note, however, that if the settlor spouse had died prior to the other spouse’s revocation of the trust, the gift would be irrevocable to the extent of the decedent’s one-half interest. \textit{Boyd v. Oser}, supra.
die before the non-consenting spouse had revoked or consented to the trust. In the case where the wife knows of her husband's transfer to trust of the community property, but has not attempted to terminate the trust, it must be determined whether the wife, upon the death of the husband, could revoke the trust only to the extent of her one-half interest or whether she could revoke the entire trust. Clearly, the surviving spouse would be entitled to only one-half of the community estate.

Consider, however, the situation where the community assets in trust are not easily divisible and the survivor spouse refuses to leave her share in the trust. For example, assume that the community property in trust consists in part of the family house and an apartment complex. The wife would find it difficult, as a practical matter, to revoke her one-half interest. Arguably, the trustee would not be in a position to ignore the surviving spouse's demand that her share of the community property be released from the trust. On the other hand, however, the trustee should not be required to release all of the community trust corpus to the wife. To permit the trustee to do so would effectively defeat one of the primary purposes of placing the assets in trust, in that the husband's share of the community estate would necessarily be required to pass through probate administration.

An alternative would be to require the surviving spouse to share the management and control of her interest in the community assets with the trustee if, upon the death of the husband, the trust became irrevocable to the extent of the husband's interest. As a practical matter, however, such co-management could effectively impair the survivor's right to the unfettered enjoyment of her one-half community interest. The inequities presented by this situation are particularly acute

59. See text accompanying note 54 supra.
61. See generally Cal. Civ. Code § 2228 (West 1972). Because of her vested one-half interest as surviving spouse, the wife should be considered a beneficiary. See also Home v. Title Ins. & Trust Co., 79 F. Supp. 91 (D.C. 1948); In re Keystone's Estate, 41 Cal. 2d 166, 258 P.2d 1009 (1953).
62. See generally Cal. Prob. Code § 300 (West 1975). The husband's dispositive designs would most likely be violated since the property would probably pass by intestate succession; it is unlikely that the husband would provide by will for a disposition which he thought he had provided for by his execution of the revocable inter vivos trust.
where the wife had no knowledge of the existence of the trust prior to her husband’s death.

One further alternative is to petition the probate court to effect a division of the community estate held in trust. Presumably, the court would have jurisdiction over this matter whether or not the husband’s estate was subject to probate. For example, the court could order the widow to take the decedent’s interest in the family home in exchange for the release of her interest in the apartment complex held in trust. However, this would not only impair the wife’s enjoyment of her one-half interest in the apartment complex, but would defeat it altogether.

To require the survivor to choose between taking the family home outright in exchange for her community share of the apartment complex and participating in her rightful share of the community estate jointly with the trustee of the trust set up by decedent, puts the widow to an election as surely as if the decedent had expressly so provided in the trust instrument. Of course, should the widow elect to stand on her community interest, it is possible, depending upon the terms of the trust, that she would forfeit any interest she might otherwise have had in the decedent’s share of the community. Given the rights of equal management and control conferred by the new laws, one may heartily question whether the unilateral action of the spouse placing the community property in trust should force an election.

If the surviving spouse were to seek resolution of her property rights by petitioning the probate court—assuming that the court could order such a division of the property—one must consider the potential income tax consequences to both the survivor and decedent’s estate. Depending upon the basis of the various properties and their fair market values at the time of the husband’s death or the alternate valuation date, it could be argued that the exchange is a taxable event under IRC

63. Cal. Prob. Code § 1138.1 (West Supp. 1975) permits access to the probate court by the trustee, beneficiary, or remainder of a revocable trust when there are problems of interpretation or administration.
64. Presumably the court would also distribute the other community assets so as to achieve an equal division of the entire community estate.
Whether it should be so considered remains to be seen.

Presumably, a court-ordered exchange of the family home for the apartment complex would be more than an isolated division of specific community assets; it would be part and parcel of an overall design for splitting the total community estate equally. It would seem that if the court were careful in the allocation of the community assets, no tax liability should result, especially since each spouse retains a vested right in one-half of the community. The Internal Revenue Service has recently stated that such an equal division of the community estate incident to a divorce is not a taxable exchange. A court-ordered allocation of the community assets upon dissolution by death should be given the same tax-free treatment.

Clearly, the alternatives proposed above are unfair and untenable solutions. It is apparent that the current laws are not adequate to protect the surviving spouse's community interest upon the death of the sole-settlor spouse. Remedial legislation is needed to complete the equal management and control scheme.

Where One Spouse Unilaterally Executes the Trust: Effect of Non-Consenting Spouse's Death on Decedent's Property Rights

If the non-consenting spouse is the first to die, her estate should be permitted to attack the trust and recapture the decedent's rightful share of the community. Recently, the assumption that the right to challenge a transfer of community property was personal to the wife was declared inconsistent with the vested character of her property rights in community wealth. The wife's estate was allowed to challenge the transfer. The new reforms should serve to add strength to that challenge as the wife's inter vivos property rights are no longer subject to the husband's sole management and control.

67. INT. REV. CODE OF 1954, § 1001 relates to the "determination of amount and recognition of gain or loss."
68. See authorities cited note 60 supra.
70. Harris v. Harris, 57 Cal. 2d 367, 369 P. 2d 481, 19 Cal. Rptr. 793 (1962) (action by decedent wife's estate to recover community property which had been transferred by decedent's deceased husband while the wife was an adjudged incompetent).
71. CAL. CIV. CODE §§ 5125(a), 5127 (West Supp. 1975).
If the husband and wife jointly execute the trust, and if the community nature of the property persists, 72 California Probate Code section 206 73 will apply and the provisions, if any, in the trust for disposition in the event of death will govern. In the event that one spouse alone transfers the community property in trust and the other spouse subsequently consents to the transfer, 74 it is not clear whether Probate Code section 206 would apply, since that section encompasses transfers to revocable trusts, pursuant to Civil Code section 5113.5, by "the husband and wife" jointly. 75

If one spouse acting alone transfers the community property in trust with the knowledge but without the consent of the other spouse, and if the trust instrument makes provision for the disposition of the property in the event of the death of one of the spouses, the non-consenting spouse's rights with respect to her one-half share are uncertain. The implied consent approach 76 would seem inappropriate in that it would probably serve to make the trust irrevocable as to the decedent's interest. However, if the decedent's estate were allowed to challenge the trust and recapture her share of the community property, 77 there might be overwhelming practical problems involved in extricating the assets from the trust. 78

If one spouse transfers the property of the marriage to a revocable trust without either the knowledge or consent of the other spouse, the disposition of the assets held in trust upon the death of the first spouse is very difficult to anticipate. The disposition of the decedent's share of the community property is further confused if the non-consenting spouse, not having known of the trust, executed a will with testamentary provisions inconsistent with those contained in the trust indenture. Arguably, Probate Code section 206 should not apply and the trust provisions should not prevail since the trust does not satisfy the requirements of Civil Code section 5113.5. 79 There-
fore, the provisions of the decedent spouse's will would govern. Again, however, the same practical difficulties of extricating the non-consenting spouse's share of the trust assets present themselves. To add to the confusion and further emphasize the need for statutory clarification, one need only consider the situation where the non-consenting spouse dies intestate, thereby creating a head-on collision between the trust provisions and the succession statutes.®

DRAFTING CONSIDERATIONS

Introduction

It is important to consider the mechanics of the revocable inter vivos trust where both spouses consent to the execution of the trust. When both husband and wife are the settlors of the trust, the instrument must be drafted so as to protect the parties' rights of equal management and control and to facilitate the efficient administration of the trust. Under the prior community property law, the trustee was obliged to concern himself principally with the husband.® Under the new laws, however, since the spouses have equal rights with regard to management and control of the community assets, the trustee must respect the wishes of either the husband or wife. Unless the draftsman carefully provides for the contingency of a disagreement between the spouses, the trustee may find himself in the untenable position of being unable to follow or disobey a directive without infringing upon the rights of one or the other spouse.

Management of the Community Property in Trust

With respect to the power to direct the management of the trust, including the power to invest any trust funds and to sell, exchange or otherwise dispose of trust assets, there are four possible alternatives to be considered by the draftsman and selected by the spouses. First, it is possible that the parties may designate that one or the other spouse will act as trustee and administer the trust or have the sole authority to direct the third-party trustee in the management of the trust. For exam-

ple, the parties may include in the trust instrument a provision specifically granting such power to the husband. The practical effect of such a provision would be to restore the old community property standard. Of course, the husband having such power would be saddled with a good faith obligation to respect the property rights of his wife. It should be noted that in this instance the non-participating spouse may forfeit her section 5127 right to join in any instrument affecting the community realty if the trust provisions do not expressly require the consent of both spouses.

The draftsman should be careful to avoid the possible imposition of a gift tax on the wife resulting from a waiver of her right to participate in the management of the community. This may be accomplished if the instrument limits the waiver to the trust and specifically provides that the wife shall retain her power to revoke. In this manner she could keep the community assets within her dominion and control.

While this alternative may be the most efficient solution, it is perhaps the most difficult to implement. Clearly, before any waiver in the trust instrument can be effective, the wife should be advised as to the rights she is waiving. Upon learning that she has the legal right of equal control and management, the wife may be unwilling to execute the waiver.

The second alternative is to grant to the spouses the same powers with respect to the management of the community assets as they would have outside the trust. In operation, such a provision would be nearly identical to the third alternative, which is to simply provide that either spouse may direct the management of the community property in trust. In both instances, there is a plethora of problems waiting to erupt upon the first family dispute or discordant note.

Initially, there is the problem of identifying and scheduling all of the trust assets if there is a co-mingling of the

---

82. Id.
83. CAL. CIV. CODE § 5125(e) (West Supp. 1975).
84. CAL. CIV. CODE § 5113.5 (West Supp. 1975) provides in part: "[N]or shall this section be construed to prohibit the trustee from conveying any trust property, real or personal, in accordance with the provisions of the trust without the consent of the husband or wife unless the trust expressly requires the consent of one or both spouses."
85. See text accompanying note 39 supra.
86. See authorities cited in note 47 supra.
87. See note 18 and accompanying text supra.
88. "Scheduling" is the process of inventorying the trust assets. BLACK'S LAW DICTIONARY 1511 (4th ed. rev. 1968).
spouses' separate property, business interests and community property. Only in this way can the third-party trustee, or the spouses as co-trustees, accurately appraise their rights with respect to each asset in the trust. This should not present a difficult obstacle in itself because presumably the thorough draftsman would schedule the property anyway.

Additionally, and more significantly, there is the obvious problem of trust administration when the husband and wife disagree as to a proposed transaction regarding the community property. As mentioned previously, the third-party trustee would not be able to act without injuring the rights of one of the spouses. Perhaps Probate Code section 1138.1 (4) will permit the trustee access to the courts to resolve this conflict. If the spouses are the co-trustees this conflict could, if unremedied, lead to the termination of the trust, if not the marriage. (Apparently, the new community property laws could have the latter effect, too.) Clearly, a provision in the trust instrument requiring that the spouses retain their statutory community property rights or a provision that either may manage the trust are not viable alternatives.

Perhaps the best method of providing for management of the trust is to require either that the trustee act upon the joint direction of the spouses or that the spouses act jointly if they are the co-trustees. While these provisions may in some instances tend to inhibit community property transactions, they do provide the best protection for each spouse's rights.

Revocation and Withdrawal Provisions

As to the power of revocation and the right to withdraw funds, the situation is most uncertain. Logically, the power to withdraw corpus or income constitutes a power to effect a partial or total revocation of the trust. Civil Code section 5113.5 (b) requires only that such withdrawals remain community property. Equally uninformative is subsection (a), which requires only that the trust be "revocable in whole or in part

89. CAL. CIV. CODE §§ 5107, 5108 (West 1972).
91. See text accompanying note 81 supra.
92. See note 63 supra.
94. CAL. CIV. CODE § 5113.5(b) (West Supp. 1975).
during [the spouses'] joint lives." Presumably, provision would be made in the trust instrument for the withdrawals or distributions of corpus or income at the discretion of the settlors. However, nowhere in the statutes is there a suggestion as to how that discretion may be exercised.

If the powers to revoke and withdraw funds are held jointly, the rights of the spouses are adequately protected, but only at the expense of inhibiting the administration of the trust. Further, one must give serious consideration to the potential gift tax consequences. Since each spouse as a beneficiary of the trust has an adverse interest in the revocation, whether it be partial or total, there may be a completed gift of each spouse’s respective interest in the community estate.

If, however, the powers to revoke and withdraw are given to the spouses individually, so that either spouse may exercise them at his or her discretion, no gift tax will be incurred. However, while this seemingly protects the respective rights of the spouses, as each will be able to deal with the property to the same extent as if no trust existed, it does not avoid the problems mentioned earlier, where the spouses disagree as to the proposed transaction. With respect to revocation and withdrawal, it appears as though the parties will be required to choose between incurring a gift tax on the one hand, and risking the stability of the trust on the other.

The Power to Alter or Amend

With respect to the power of the parties to amend or alter the trust during their joint lifetimes, a drafting solution has been provided by Civil Code section 5115.3 (d). That subsection requires that the trust be subject to amendment or alteration upon the spouses’ joint consent. The apparent purpose of this provision is to protect the trust and the unwary spouse from the unilateral actions of his or her mate. If the trust is operating smoothly and efficiently, the necessity of joint action to alter or amend the trust provisions adequately serves to

95. Id. § 5113.5(a) (West Supp. 1975).
96. Camp v. Commissioner, 195 F.2d 999 (1st Cir. 1952); Higgins v. Commissioner, 129 F.2d 237 (1st Cir. 1942); Commissioner v. Prouty, 115 F.2d 331 (1st Cir. 1940).
97. See note 47 supra.
98. See text accompanying note 81 supra.
maintain the status quo. Yet the overall impact of this subsection is less clear. So long as the parties enjoy the joint power to amend, the allocation of the powers to manage, revoke and withdraw may be modified at any time if they prove untenable. However, if the current provisions of the trust are such that one spouse may benefit at the expense of the other's property rights (one spouse, for example has been given sole management powers), the statutory requirement will fail in its objective and, indeed, may be self-defeating. The spouse who is benefitting from the trust is not likely to give his or her consent to amend or alter the trust instrument. Unless each spouse has the right to revoke the trust alone, this provision leaves as a remedy to the aggrieved spouse an action for breach of the good faith obligation, or dissolution of the marriage.

As was suggested previously, however, strict compliance with the section 5113.5 requirements may not be mandatory. Perhaps the parties can provide that one or the other spouse is to have the sole power to alter or amend without sacrificing the property's community status. In this instance, however, the trust provisions should evidence the parties' intention that the power is to be exercised only in the capacity of managing agent for the community rather than in an individual capacity for either spouse's separate estate.

**Incompetency and Incapacity Provisions**

As is necessary in any revocable trust, provision should be made with respect to management of the trust in the event of the incompetency or incapacity of either or both of the spouses. Civil Code section 5128 dictates that "where one or both of the spouses are incompetent, the procedure for dealing with and disposing of community property is that prescribed in Chapter 2a of Division 4 of the Probate Code."

Sections 1435.1 et seq. of the Probate Code provide, *inter alia*, that as to real and personal property, any disposition must be approved by the probate court. With respect to community real property held in trust, upon the incompetency of either spouse the probate

---

100. See text accompanying notes 97 & 92 supra.
101. See note 83 supra.
102. See text accompanying notes 28 & 29 supra.
103. See note 16 supra.
104. CAL. CIV. CODE § 5128 (West 1972).
court apparently shares the management powers with the other spouse. On its face, this provision is consistent with Civil Code section 5127, which requires that the spouses act jointly in making a disposition of realty.\footnote{Curiously, the 1973 amendment to Cal. Prob. Code § 435.1 (West Supp. 1976) specifically overrides Cal. Civ. Code § 5127 (West Supp. 1975).} Obviously, if one of the spouses is incompetent, this joint power cannot be exercised and it is reasonable to require the non-incapacitated spouse to seek court approval before taking any action regarding the community realty. In this way, the non-incapacitated spouse’s right to share in the management and control is not significantly impaired and the incapacitated spouse’s property rights are not seriously jeopardized.

Curiously, with respect to the community personal property, Probate Code section 1435.1 provides in the concluding sentence: “Nothing herein is intended to or shall affect the husband’s management and control of community personal property unless he is incompetent.”\footnote{Cal. Prob. Code § 1435.1 (West Supp. 1975).} This provision preserving the husband’s right to manage and control the personal property of the marriage upon the incapacity of his spouse is difficult to justify. Indeed, if Civil Code section 5125 was intended to confer upon the spouses equal management and control over the community personal property, the discrepancy is impossible to reconcile. The 1973 amendment to Probate Code section 1435.1 specifically added a reference overriding section 5127 of the Civil Code.\footnote{See note 106 supra.} In the interest of consistency the legislature should have overridden section 5125 as well. Arguably, section 1435.1 should be interpreted as being consistent with the other Code provisions, but one making this contention must deal with the fact that reference to section 5125 was omitted. Further, it could hardly be maintained that the reference to “husband” is a convenience used to designate either spouse, since the 1973 amendment to section 5125 specifically deleted reference to either “husband” or “wife” and substituted the general designation “spouse”. Clearly, had the legislature intended to include the husband’s power over the community personalty within the ambit of section 1435.1, it could easily have done so. This necessarily leads to the conclusion that in the event of the wife’s incapacity or incompetency, the husband shall have the sole power of management and control over the community personal property. Here, too, statutory clarification is needed.

---

108. See note 106 supra.
Retroactivity

One final observation with respect to revocable trusts and the new California community property reforms is the issue of retroactivity.¹⁰⁹ Both sections 5125 and 5127 specifically refer to community assets acquired “prior to or on or after January 1, 1975.”¹¹⁰ Likewise, Civil Code section 5113.5 applies to transfers in trust “before or after the effective date” of January 1, 1975.¹¹¹ However, the scope of section 5113.5 is not so broad as to encompass all transfers of community property in trust.¹¹² Indeed, the language of that section expressly provides for, and makes its terms inapplicable to, conveyances in trust which depart from the section’s requirements.¹¹³ Yet every transfer in trust which preserves the the provisions of section 5113.5, will be subject to the sweeping retroactive language of sections 5125 and 5127. As the wife now participates equally with her husband in the right to manage the community, it will, perhaps, be necessary to review and revise all revocable trust instruments where California community property is involved.

CONCLUSION

The suppositions and analogies which the author has frequently resorted to in this article are required by the concepts of dual management and control which are new to California and as yet untested. It may be that future legislation or case decisions will eventually clarify these matters and provide more definite guidelines to the estate planner for the efficient and effective use of the revocable inter vivos community property trust.

Gary S. Phillips

¹⁰⁹. See Reppy, Jr., Retroactivity of the 1975 Community Property Reforms, 48 S. Cal. L. Rev. 977 (1975), for an excellent discussion as to the retroactivity of the new California community property laws.
¹¹². See text accompanying notes 28 & 29 supra.
¹¹³. See note 28 and accompanying text supra.

The author wishes to express his most sincere appreciation and gratitude to Jerry A. Kasner, Professor of Law, University of Santa Clara School of Law, for his inspiration and guidance.