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Community and separate property regimes:
Educating the mobile client and the multijurisdictional attorney

by Christopher Weeg

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Most clients and many attorneys are unfamiliar with the concept of community property—that is, how it works and how it affects a broad spectrum of legal practices including family law, tax law and estate planning. For attorneys with diverse clients and multijurisdictional practices, ignorance of community property law can be costly. This article provides an introduction to the community property system and highlights topics to discuss with clients planning a move either to or from a community property state.

The two marital property systems in the United States are separate property (also known as the common law system) and community property. Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington are the traditional community property states. Additionally, Wisconsin has adopted the Uniform Marital Property Act modeled after the community property system, and Alaska and Tennessee allow couples to elect into community property classification through a community property trust. It's worth noting that while community property is the minority, the two most populous states, California and Texas, follow this system.

In separate property states, for most purposes, property acquired during marriage is deemed to be the separate property of the spouse who acquired it. The community property system, on the other hand, manifests the social and legal belief that property acquired by spouses during marriage should be construed as one total "community" of property. While each community property state has its own set of rules, the following concepts are generally common to all in the community property system.

In the absence of a written agreement to the contrary, all property acquired (and income earned for that matter) during marriage is owned one-half by each spouse *regardless* of how title to the property is taken. Thus, educating the client that *title does not affect classification* is imperative. Exceptions to the presumption that all property acquired during marriage is part of the community are property acquired by gift or inheritance, proceeds from the sale of separate property and property acquired with separate property. The chart below helps to illustrate the foregoing general rule and its exceptions as applied to a married couple living in a community property state.

Property	Classification
Automobile purchased during marriage and titled in husband's name	Community property (owned one-half by husband and one-half by wife)
Income earned by wife during marriage and deposited into bank account in wife's name	Community property (owned one-half by husband and one-half by wife)
Gift of cash received by wife from her parents during marriage	Separate property of wife
Vacation home acquired by husband before marriage	Separate property of husband

The separate or community property classification of an asset is determined at the time the asset is acquired and according to the laws of the state in which the couple was domiciled when acquired. That original classification is not altered when the couple later moves to a different state—that is, the character of property follows the couple as they move from state to state. For example, in a separate property state, property acquired from a husband's efforts during marriage is "his" property, and if the couple thereafter moves to a community property state, it generally remains his "separate property." In this scenario, to prevent severe injustice upon a subsequent divorce or death, community property states typically recognize a third marital property category called quasi-community property. Quasi-community property is separate property that would have been community property if acquired in the community property state. While the exact application of quasi-community property varies from state to state, the general concept is to protect a non-owner spouse upon a property division.

Besides ownership classification, other important differences exist between separate property and community property states. Because spouses in community property states by law own one-half of all property acquired during marriage, these states typically do not have spousal protection statutes, which prevent a spouse from completely disinheriting the other spouse. All

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separate property states (with the exception of Georgia) provide for some form of spousal protection. For example, under Florida's elective share statute, a surviving spouse has a right to 30% of the deceased spouse's "elective estate."[1]

From a tax perspective, community property benefits from a "double basis adjustment" at death under Internal Revenue Code § 1014(b)(6). At death, property included in a decedent's estate obtains a new tax basis equal to the property's fair market value (in the tax world, a "basis adjustment"). While only the predeceasing spouse's one-half of the community property is included in the estate, the entire community property interest is adjusted to fair market value at the death of the predeceasing spouse. To illustrate, a husband and wife purchase an asset while married and living in Texas. The asset has a basis of $100 and a fair market value of $1,000. At the husband's death, the husband bequeaths the asset to his wife. The husband includes one-half of the value of the asset in his gross estate (*i.e.*, his community property interest) equal to $500, and the wife obtains a new basis in the asset equal to $1,000 pursuant to § 1014(b)(6). On the other hand, if a husband and wife purchase an asset as joint tenants with rights of survivorship while married in Florida, and the husband dies, then the husband similarly includes one-half of the value of the asset in his gross estate (*i.e.*, what he actually owned) equal to $500, but his wife obtains a new basis in the asset equal only to $550, which represents the wife's $50 share of the original basis in the asset plus the husband's $500 share included in his estate.

Planning for a move from separate property to community property

As mentioned above, when moving to a new state, property generally will maintain its character as determined by the laws of the state in which the property was acquired. Property thereafter acquired is determined under the laws of the new state. Accordingly, property acquired during marriage in a separate property state will remain separate property, and following a move to a community property state, all property thereafter acquired during the marriage is the community property of the spouses.

Once domiciled in the community property jurisdiction, however, separate property can lose its separate classification if it is commingled with newly acquired assets or if its classification is simply lost through poor record keeping. Moreover, a spouse generally must rebut the presumption of community property with clear and convincing evidence that such property remained separate by, *inter alia*, lack of contact and integration with community property. Finally, the unavailability of the elective share to a surviving spouse could allow the spouse owning significant separate property to disinherit the non-owner spouse in certain circumstances, subject to applicable quasi-community property rules.

As an illustration, let's say you represent a Palm Beach couple who has grown tired of beautiful beaches and cocktails at The Breakers and is planning to relocate to a fixer upper in Waco. At a minimum, you should educate the couple as to the community property system and advise them to take one of the following actions:

1. **Do nothing.** If the clients do nothing with respect to their financial affairs, all of the income generated by the separate property brought to Texas will be community property. In many cases, the community property income will become commingled with the original separate property corpus, and at some point, the separate property may become untraceable. As a result of the presumption that all property is community property, unless it can be shown by clear and convincing evidence that it is the separate property of one spouse, the commingling may unintentionally convert separate property into community property by default.
2. **Do nothing but keep very good records.** A second alternative is for the clients to keep very accurate records as to the initial corpus of the separate property and allow the accumulation of community property income. This method would preserve the separate property character of the initial corpus and provide the clear and convincing evidence as to its separate property character.
3. **Keep the income and corpus separate.** In order to facilitate the record keeping, the clients may wish to arrange their financial affairs so that items of income, including earnings, interest and dividends on separate property investments, are segregated into a separate community property account, leaving the corpus of the separate property asset free from any community property taint.
4. **Enter into a marital property agreement.** The final alternative for the clients is to enter into a marital agreement that clarifies the character of the property and the income generated by the property. For example, the marital agreement could be limited to a particular asset and provide that all income generated by that asset will be separate property. This avoids any commingling of the reinvested income. To be effective, such agreements must meet all the requirements of Texas Family Code § 4.101, *et seq*. Alternatively, the spouses can enter into an agreement to convert separate

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property into community property under Texas Family Code § 4.201, *et seq*.

Regardless of which action the clients decide to take, it is important that they 1) understand the basics of the community property regime, and 2) understand the consequences of the characterization of property as it relates to distribution upon death, division upon divorce, management during the marriage and the issues related to taxation of such assets.

Planning for a move from community property to separate property

When spouses move from a community property state to a separate property state, as with the inverse move from separate to community, existing community property maintains its community classification unless lost through commingling or poor record keeping, and all future property acquired during the marriage is separate property. Accordingly, if the spouses desire to maintain the community classification, they should carefully segregate current community property from newly acquired separate property. If the couple owns appreciating assets, then maintaining their community property classification is particularly desirable to obtain the § 1014(b)(6) double basis adjustment at the death of the first spouse. To that end, the couple could fund a revocable trust with existing community property, explicitly providing in the trust agreement that such property shall retain its community property status.

Property rights affect a myriad of legal issues, be it family law, tax law, estate planning or bankruptcy and creditors' rights, to name a few. Knowing precisely what a client owns, especially at divorce or death, is a basic foundational issue of sound legal representation. Therefore, understanding where a client has lived and acquired property, as well as the client's marital status during those times, is very important.

Endnote

1 *See* Fla. Stat. § 732.201 *et seq.*

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