TRANSMUTATION OF THE CHARACTERIZATION OF PROPERTY

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Transmutations, boom or bust. There isn't much middle ground on transmutations, you either have one or you don't. The devil is in the details. These are fact sensitive cases and the law isn't very helpful either. At least when the court does find a transmutation, the donor typically gets his/her F.C. § 2640 reimbursement for the value of the item at the date of the transmutation less any encumbrance.

F.C. § 2640 states at (b) "In the division of the community estate under this division, unless a party has made a *written waiver* of the right to reimbursement or has *signed a writing that has the effect of a waiver*, the party shall be reimbursed for the party's contributions to the acquisition of property of the community property estate to the extent the party traces the contributions to a separate property source. There have been no published cases advising us as to what qualifies as a "writing" sufficient to qualify as a waiver. There have been a few cases advising us what does not qualify. It would seem that a clear and unambiguous writing would be necessary and may even require attorney advisement before this right to reimbursement is given up.

F.C. § 850 states "Transmutation by agreement or transfer: Subject to Sections 851 to 853, inclusive, married persons may by *agreement* or *transfer*, with or without consideration, do any of the following. . ." Thus a transmutation may be evidenced by either a deed or titling to transfer or an *agreement to transfer*, which is not evidenced by a deed or other title document. Second, F.C. § 852 states "Requirements(a) 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."

Transmutations are of course subject to Fraudulent Transfer Laws and lastly, transmutations are subject to the Fiduciary relationships established by F.C. § 721.

Looking at the annotations of F.C. 852 you will find something for everyone. That's the problem. Early case law focused on the voluntariness of the transfer. Subsequent case law looked to the requirements of the writing. The focus on current decisions is that the writing is being enlarged by being viewed through the fiduciary lens of F.C. § 721. This is what *Delaney* further clarifies.

In re Marriage of Delaney, 111 Cal.App.4th 991, 4 Cal.Rptr.3d 378 the court set forth a three prong test to be met to validate an apparent transmutation. This test is based on F.C.§ 721. The court stated that "whenever the parties enter into an agreement in which one party gains an advantage, the advantaged party bears the burden of demonstrating that the agreement was not obtained through undue influence". The court's analysis resulted in a three part test, stated by the court, at page 1000, as "CONSEQUENTLY, IT WAS WIFE'S BURDEN TO ESTABLISH THAT HUSBAND'S TRANSMUTATION OF THE PROPERTY TO JOINT TENANCY WAS *1)* FREELY AND VOLUNTARILY MADE, WITH *2)* FULL KNOWLEDGE OF ALL THE FACTS, AND WITH A *3)* COMPLETE UNDERSTANDING OF THE EFFECT OF A TRANSFER FROM HIS UNENCUMBERED SEPARATE PROPERTY INTEREST TO A JOINT INTEREST AS HUSBAND AND WIFE. I have added the numbering sequence for clarification. All transmutations do not have an advantaged party, so these three steps do not apply to all transmutations. Transmutation language must be a clear, unambiguous declaration of the intent

to transfer title.

We have tried six of these cases to a decision in the past year or two, with four of them being appealed. Three of the appeals did not get through the procedural stage. Three different Orange County Family Judges have agreed with the three step analysis. What is so troubling though, is that six very good and able opposing counsel have different opinions, so different that they believed the Court of Appeals would support their client's point of view, pointing out the difficulty with these cases. In three of the six cases, step three of Delaney was not proven and it is a very difficult issue to prove. In the other three cases, it was not an issue as the proof failed in step one or two.

Since the transmutation document is a contract, it is subject to the Parol Evidence rule. Unless you have a clause in the transmutation documents stating the understanding is clear regarding the legal consequences of the transmutation, how does one get around the Parol Evidence rule to present an unwritten understanding to the trier of fact?

In *In re Marriage of Matthews*, 133 Cal.App.4th 624, 35 Cal.Rptr.3d 1, Cal.App. 4 Dist.,2005 citing *Delaney,* the court stated in recognizing step 3 of the *Delaney* approach "Husband's most difficult factor in overcoming the presumption of undue influence was showing Wife had a complete understanding of the effect of the quitclaim deed. Wife contends that language barriers limited her comprehension of the purchase of the residence. However, the record shows Wife was above average in her English skills and competent to complete a college certification course taught in English. She spoke English from the time she met Husband and eventually worked as a translator, suggesting a more than adequate command of the English language. Further, Husband entrusted almost all financial matters to wife, relying on her judgment

and management. Wife had separate investment accounts and made her own investment decisions with those accounts. She controlled both her income and Husband's, and paid all of the household bills. Wife acknowledged her bad credit rating prevented her and Husband from receiving a lower interest rate if they both acquired title to the residence, and made a conscious decision to sign the quitclaim deed. Wife further admitted to knowing her name was not on the title and assumed it would be added later. On this record, there is no basis for overturning the trial court's decision that the quitclaim deed was valid and executed freely and voluntarily in good faith. Husband rebutted the presumption of undue influence by a preponderance of the evidence."

The Matthews court did not discuss the wife's knowledge of the legal effect of the transmutation, just that she understood the financial effect. There is no discussion of whether the wife understood community property vs. separate property issues and whether she understood that she would have no further interest in the property. In fact she testified that she assumed that she would be on title later, which indicates that she did not understand the legal effect of the transmutation. But the Matthews court was looking at this issue through the glass of sufficiency of evidence, i.e. preponderence vs. clear and convincing evidence, finding that a preponderence was all that was required.

It seems to us that the legal insight in *Delaney* is well supported, takes fully into account the fiduciary duty owed by the parties, one to the other and ought to be the requirements for all transmutations. In this area of law, where understanding should be more intuitive between the parties, the *Delaney* approach adds clarity and simplicity and would go a long way toward resolution of this difficult issue.

Three recent cases have highlighted the fact that "estate planning" may be a motivation for

creating an estate plan, but it is not a limitation regarding transmutations. In Marriage of Lund, 174 Cal.App.4th 40, 94 Cal.Rptr.3d 84; In re Marriage of Starkman, 129 Cal.App.4th 659, 28 Cal.Rptr.3d 639; and In re Marriage of Holteman, 166 Cal.App.4th 1166, 83 Cal.Rptr.3d 385 are the recent cases dealing with this issue.

Starkman found that language in a trust stating that all property transferred to the trust was community property was ambiguous and not specific as to any property and therefore did not meet the unambiguous declaration test. Starkman further found conflicting provisions within the same trust document created ambiguity. In Holteman there was a separate, stand alone transmutation document which the court found did meet all the requirements for a transmutation. In Lund there was similarly a separate document which the court found met the requirements for a transmutation, though the separate document stated the transfers were for only for the purposes of estate planning and the related trust contained provisions similar to Starkman which were in conflict provisions with the transmutation document.

Merely stating property is transferred to the other spouse for estate planning purposes will likely be treated as a transmutation. Until the law changes, which may be in 2010, don't use a separate document to transfer property, stick with the trust document and use language similar to that used in Starkman, where the court found that there was no transmutation. Don't have the client execute an acknowledgment of understanding of the trust document. The court may interpret the acknowledgment as understanding the legal effect, not merely the facts of the transfer.

There are a few issues which are often litigated in family law. Some we can't do much about, like "What is the date of separation?". But some we can do something about, like

Transmutations. How can we do something about this issue? Be proactive about these agreements. Speak to your trust and estate planning colleagues. Attack these issues at the root, at the agreement stage. Do what you can to inform about the need for clear, unambiguous statements of intent.