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STRANGER IN A STRANGE LAND: DEALING WITH FOREIGN AND DOMESTIC COMMUNITY PROPERTY ISSUES IN YOUR STATE

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I. Introduction

A. Societal Mobility

People are becoming increasingly peripatetic in today's mobile society. Sometimes people from different countries marry. Sometimes couples change domiciles. Sometimes individuals have property in more than one country. And sometimes individuals have close family members, even spouses, who live in different countries. In all of these instances, it is important to consider the issues presented when an individual from a community property jurisdiction has connections to a common law (i.e. separate) property jurisdiction. This paper will examine such considerations from the perspective of the common law states of the United States. For whatever reasons, the majority of United States case law involving foreign community property issues in common law states emanates from New York.

B. Tax Considerations

The tax attributes of community property, both from an income tax and a transfer tax standpoint, have some important distinctions. This paper will examine such distinctions and attempt to assess the relative pros and cons of each.

C. Non-Tax Considerations

Similarly, the non-tax attributes of community property vary considerably from those of common law property, particularly with respect to questions of relative rights and obligations, management and control, and disposition. This paper will examine such distinctions and attempt to assess the relative pros and cons of each.

II. Community Property in the United States

A. Community and Marital Property States

There are 10 states in the United States that have community or marital property regimes.

1. Community Property

Eight states have community property regimes that are derived from Spanish and French law:

a. Arizona

b. California

c. Idaho

d. Louisiana

e. Nevada

f. New Mexico

g. Texas

h. Washington

2. Marital Property

One state, Wisconsin, has adopted the Uniform Marital Property Act, which is based upon community property principles and is considered community property for United States taxation purposes.

3. Elective Community Property

One state, Alaska, has adopted an elective community property system.[1] It is available to married residents of Alaska, both of whom live in Alaska, and to non-resident spouses who transfer property to an Alaska community property trust. To be an Alaska trust, at least one trustee must be resident in Alaska.

4. Others

The territory of Puerto Rico has a community property regime as well. It is interesting to note that a larger percentage of Americans live in community property regimes, than there are community property states. Therefore, these people are accustomed to dealing with issues relating to community property. The country's two most populous states, California and Texas, both community property states, alone account for approximately 20% of the country's population.

B. Common Law States

The remaining 40 states of the United States, plus the District of Columbia and the remaining territories, do not have community property regimes, since their property laws originate from the United Kingdom. Most of the southern tier states had community property regimes at one time or another, however, and during the 1940's, Hawaii, Michigan, Nebraska, Oklahoma, Oregon and Pennsylvania enacted community property legislation that was subsequently repealed or declared unconstitutional. As a consequence, the case and statutory law of each such state reflects a different experience with the presence of property in its jurisdiction derived from community property origins.

C. Foreign Community Property Regimes

1. Universal Community

Under this regime, the community applies to all the couples' assets, both those brought into the marriage and those acquired thereafter.

2. Community of After-Acquired Property

Under this regime, the community applies only to assets that are acquired during marriage. Gifts and inheritances during marriage may be exempt.

3. Community upon Dissolution

Under this regime, the community does not crystallize until the marriage ends by death or divorce.

D. Rebuttable Presumptions

1. Case Law

Property brought to a common law jurisdiction from a community property jurisdiction is generally presumed to be community property unless:

a. There is an enforceable agreement to the contrary;

[1] ALASKA STAT. § 34.77 (2012).

b. the property was brought into the marriage by one of the spouses;

c. the property was given to one of the spouses;

d. the property was inherited by one of the spouses; or

e. the property had been separate prior to the couple's becoming domiciled in the preceding community property jurisdiction.[2]

2. Uniform Disposition of Community Property Rights at Death Act

Fourteen states have adopted the Uniform Disposition of Community Property Rights at Death Act.[3] It is important to note that this statute creates a rebuttable presumption as to death time transfers. It does not address:

a. rights of ownership;

b. rights and duties of management and control;

c. rights to make gifts;

d. rights to income during marriage;

e. rights to appreciation during marriage; or

f. rights upon divorce.

3. Restatement (Second) of Conflict of Laws

Under the Restatement (Second) of Conflict of Laws § 259 (1971), when a couple or a spouse acquires an asset, the fact that the couple or spouse moves to another state does not affect the character of the property. The principles articulated in this section, and the comments thereto, have generally been upheld by courts in common law states in order to protect a spouse's community property interests.

4. Uniform Probate Code

Under the Uniform Probate Code, individuals may choose the law of a state other than their domicile to control disposition of property at death.[4] Other states have comparable provisions as well.

5. Federal Statutes

Certain Federal statutes likely preempt what would otherwise be the state treatment of certain assets, such as qualified retirement plans. It will be important to ascertain whether any Federal laws are applicable to any assets.

a. ERISA

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[2] *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 259 (1971).

[3] *GUIDE TO UNIFORM AND MODEL ACTS*, UNIF. LAW COMM'N 13, 34 (2011), available at http://www.uniformlaws.org/Shared/Publications/GUMA_2011web.pdf.

[4] The Uniform Probate Code has been adopted in 16 states: Alaska, Arizona, Colorado, Hawaii, Idaho, Maine, Massachusetts , Minnesota, Montana, Nebraska, New Jersey, New Mexico, North Dakota, South Carolina, South Dakota, and Utah. Two states, Michigan and Pennsylvania, have enacted substantially similar codes. *Id.* at 21, 35.

b. Copyright

c. Bankruptcy

E. Jurisdiction

1. Generally, the situs of the property determines which law controls real and tangible property, and the testator's domicile (at the time of his death) determines which laws control personal property.

2. Courts often defer to foreign courts in matters concerning foreign real property, mindful that the domestic court is unable to affect title to the such property located abroad.[5]

3. However, estate planners should be mindful of the possibility of renvoi.[6]

III. Considerations When Marital Domicile is Changed

A. Most states recognize the general rule that property moved from a community property jurisdiction to a common law state retains its character as community property following a change in the marital domicile.[7]

B. Recognizing the need to protect the interests of spouses who moved from a community property jurisdiction to a common law jurisdiction, at least 14 states,[8] including New York,[9] have adopted the Uniform Disposition of Community Property Rights at Death Act. The Act is limited to defining the marital rights of a surviving spouse at the death of the other spouse concerning (1) real property located in the enacting common law state and (2) personal property (wherever situated) of a person domiciled in the common law state. The Act also creates a rebuttable presumption that property acquired while married and domiciled in a community property jurisdiction is considered community property and reciprocally for common law property.[10] Substantial evidence is generally needed to rebut this presumption. By its terms, the Act applies to property brought to a state from any other jurisdiction, not just from another state.

C. Rules vary dramatically from country to country with respect to which law regulates the community when couples change their marital domicile, such as place of celebration, place of initial marital domicile and place of current marital domicile.

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[5] *In re Estate of Warburg*, 38 Misc. 2d 997 (N.Y. Sur. 1963) (holding the question of validity of a devise of German real property was to be determined by the laws of the property's situs).

[6] Under single-reference renvoi (New York approach), the court first looks to the choice of law of the foreign jurisdiction to which it is directed by its own conflicts rule, as well as by the foreign jurisdiction's local law. For example, in determining the validity of a testamentary disposition of Swiss real property by a New York domiciliary, New York would first look to the Swiss choice of law provisions, which determined that Swiss law looks to the domicile of the testator at the time of his death (here, New York) to determine which law to apply. Accordingly, the New York court would apply its own laws to dispose of the Swiss property, as the testator was domiciled in New York at the time of his death. *See, e.g., In re Schneider*, 198 Misc. 1017 (N.Y. Sur. 1950).

[7] *In re Estate of Majot*, 199 N.Y. 29, 92 N.E. 402 (1910) (dictum) (reasoning where a couple relocated from France to New York bringing CP with them, each person's ownership therein would not change nor would the spouses rights upon death be affected); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 259 (1971); ROBERT C. LAWRENCE, INTERNATIONAL TAX AND ESTATE PLANNING: A PRACTICAL GUIDE FOR MULTINATIONAL INVESTORS § 4:4.2 (3d ed. 2010).

[8] Fourteen states have adopted the Uniform Disposition Act (1971) including: Alaska, Arkansas, Colorado, Connecticut, Florida, Hawaii, Kentucky, Michigan, Montana, New York, North Carolina, Oregon, Virginia and Wyoming. UNIF. LAW COMM'N, *supra* note 3.

[9] N.Y. EST., POWERS & TRUSTS LAW § 6-6.1-6-6.7 (McKinney 1981) (hereinafter referred to as EPTL). *See also In re Estate of Bach*, 145 Misc. 2d 945 (N.Y. Sur. 1989) (granting a widow a one-half share in community property pursuant to Bolivian law, only applying the provision of the decedent's will on the remaining one-half of the estate, resulting in a smaller share in trust).

[10] LAWRENCE, *supra* note 7 at § 4:4.2.

IV. Considerations When Marital Domicile is Not Changed

A. If the married couple maintains their community property domicile but transfers their community property to a common law jurisdiction, the common law state may apply the community property law of the domicile or the law of the property's situs, depending in part upon whether third party interests are involved, and whether the couple expressed their intention as to their choice of law.11

B. In more recent cases, New York courts have used a balancing approach (rather than simply looking to the individual's domicile) when dealing with choice of law issues of foreign and sister-community property states.[12]

V. Exchange of Property

A Both the Restatement and the Uniform Disposition of Community Property Rights at Death Act contemplate that community property may be exchanged for other property. The question is whether the character of the community property is transferred to the property received upon such transaction.

B. The Uniform Disposition of Community Property Rights at Death Act takes an especially liberal approach to asset tracing and generally considers that the property received in exchanged for community property retains its character as community property.

C. The Restatement takes a more qualified approach, reasoning that although it generally recognizes the continuity of the marital interest, such interest "may be affected by dealings" in the common law jurisdiction, particularly where a third person creditor or transferee is involved.[13]

VI. Choice of Law

A. Determining which jurisdiction's law should apply is a two-step process: (1) characterizing the property interest and (2) choosing the appropriate law to apply. The forum would then determine which jurisdiction has the most significant relationship to the given the particulars of the situation. In making this analysis, the following are important factors to be considered:

1. the needs of the interstate and international systems;

2. relevant policies of the forum;

3. relevant policies of the interested state or countries and the relative interest of those places in the particular issue;

4. protection of justified expectations;

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[11] *See, e.g., Wyatt v. Fulrath*, 16 N.Y.2d 169, 211 N.E.2d 637 (1965) (holding New York law, not Spanish community property law, governs money transferred by Spanish domiciliaries (in derogation of Spanish community property laws that voided such transfers) to a New York bank as joint tenants, citing New York's public policy concerns to protect the integrity of foreign investments, the bank's physical presence in New York, and the parties' intentions as controlling reasons)).

[12] *See, e.g., In re Estate Crichton*, 20 N.Y.2d 124, 228 N.E.2d 799 (1967) (using an approach that isolates the question, looks to the policies of the conflicting laws, and identifies what jurisdiction has "a superior interest in having its policy or law applied" based on contacts.); *Watts v. Swiss Bank Corp.*, 27 N.Y.2d 270, 265 N.E.2d 739 (1970) (finding that the New York court's "recognition will not be withheld merely because the choice of law process in the rendering jurisdiction applies a law at variance with that which would be applied under New York choice of law principles "and that res judicata applied.)

[13] The New York version of the Uniform Disposition of Community Rights at Death Act codified this feature of the Restatement considering third-party interests in exchanges of community property. EPTL § 6-6.1-6-6.7.

5. basic policies underlying the particular field of law;

6. predictability and uniformity of result; and

7. ease in the application and determination of the law.[14]

B. Many foreign civil law countries do not make the distinction between what Americans call "real" and "personal" property-- the distinction is made between "immovable" and "moveable" property. Though similar to the American concept of personal and real property, the category of moveable property generally includes all forms of assets other than those which are closely related to real property (i.e. leaseholds and mortgages); these are classified as immovable property.[15]

C. In a case where a U.S. citizen holds mortgages securing French real property, which law governs a testamentary disposition of these French mortgages, those of France or of the U.S. jurisdiction? Although typically classified as personal property in a common law jurisdiction, French law considers mortgages immovable property, and therefore, French law would govern the disposition.

D. Wills

1. Forced heirship, which is often closely allied with community property, has been an active area for litigation since testators often attempt to circumvent the restriction. A domestic court that assumes jurisdiction over a will of a decedent involving such an issue, must decide whether to recognize those rights; this decision will likely turn on the court's view of forced heirship, public policy of the forum and its own conflict of laws provision. However, transfers with the primary intent of frustrating foreign laws, without more, do not influence the court to apply the domestic laws. New York has adopted a comprehensive statute to direct the choice of law in this field and its courts have had opportunity to interpret the present conflicts of law statute by case law.[16] The cases involving the application of forced heirship should be instructive in determining how courts in common law states would deal with enforcing foreign community property rights.

2. Generally, a Will is to be probated in the decedent's domicile but it may be probated in any jurisdiction where the decedent left property.[17] However, with fewer in-state contacts, courts will

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[14] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971).

[15] Michael W. Galligan, *Ten Important Points to Remember About International Estate Planning*, 16 INT'L L. PRACTICUM 53, 62 (2003) available at http://www.phillipsnizer.com/publications/articles/tiptraieplan21303_art.cfm.

[16] EPTL § 3-5.1 (allowing a non-New York decedent to opt for application of New York law to testamentary dispositions); *In re Renard*, 437 N.Y.S.2d 860, 108 Misc.2d 31 (Sur. 1981), *aff'd* 447 N.Y.S.2d 573 (App. Div. 1981), *aff'd* 439 N.E.2d 341 (N.Y. 1982) (honoring statutorily authorized choice-of-law provisions). The decedent in *Renard*, a U.S. citizen who retired to France after 30 years in New York, left substantial assets in New York. Her son, who held dual U.S.-French citizenship, sought to recover a forced share under French law, arguing that France was his mother's domicile at the time of her death. The son received a small bequest with the majority of the estate divided between the decedent's French friend and a charity. The court held that decedent had sufficient contacts with New York and the court would follow direction in the will to apply New York law. *But see Swiss Bank Corp.*, 27 N.Y.2d 270 (1970) (New York courts honoring a foreign judgment in favor of a forced heir that was decided prior to any determination of the issue by New York courts). The decedent in *Watts*, an Italian citizen who was domiciled in France, had a joint bank account in New York with his second wife, an American citizen domiciled in France. Litigation was started first in France by the decedent's daughter from his first marriage and later in New York by the decedent's widow. The issue was decided in France in favor of the decedent's daughter before any New York court decided the case on the merits. The Court of Appeals in New York upheld the French verdict in New York on the basis of res judicata. *Watts*, a case decided prior to *Renard* and was not followed by the later courts, is distinguishable from *Renard* because it is based solely on the principal of res judicata case and therefore does not make any determinations regarding conflicts of laws.

[17] *See, e.g.*, *In re Chopitea's Estate*, 35 Misc. 2d 248 (N.Y. Sur. 1962) (Peruvian domiciliary who directed that his testamentary distribution was to be governed by the laws of New York state, had assets in New York, and named a New York beneficiary and executor); *Montgomery v. Nat'l Sav. & Trust Co*, 356 F.2d 806 (D.C. Cir. 1966) (probating the will of an U.S. citizen with an Italian domicile that disposed of securities and cash located in D.C).

generally decline jurisdiction over the Will[18] and will usually deny original probate to a non-resident's Will where the Will has already been admitted to probate in the testator's domicile (but will allow ancillary probate).[19]

3. In New York, admitting a will for original probate is a rule of ad hoc discretion and where the facts are convincing enough, the court will entertain jurisdiction. New York will generally accept jurisdiction of a foreign domiciliary' s will that operates to dispose of significant New York situs property, particularly where the will is executed in New York, and explicitly directs that New York law apply to its probate.[20] Other factors New York courts have considered in accepting jurisdiction include the wishes of the testator, convenience of the fiduciaries and beneficiaries, pending litigation related to the matter, and discrimination against New Yorkers.

VII. Income Taxation of Community Property

A. *In Poe v. Seaborn*, the U.S. Supreme Court held that if a community property jurisdiction provides that each spouse is the owner of an undivided one-half interest in the couples' community property, then each spouse is subject to U.S. federal income tax on 50% of the community income.[21] The determination of a spouse's interest in property during marriage is generally determined by the law of the marital domicile.[22]

B. IRC § 879 generally overrules Poe to the extent of the following special allocation rules:

1. Earned income is taxed as the separate income of the spouse performing the services by which it is earned.

2. Community income from a trade or business (other than a partnership) and the related deductions are treated as the separate income and deductions of the spouse carrying on the trade or business (and if jointly operated, on the basis of their respective distributive shares).

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[18] *In re Brunner's Estate*, 72 Misc. 2d 826 (N.Y. Sur. 1973) (denying jurisdiction involving the New York will of a French domiciliary who had most of his assets in France and only a small bank account in New York).

[19] Section 1605 of the Surrogate's Court Procedure Act allows original probate if ancillary probate would be unduly inconvenient, expensive, or impossible under the circumstances; if the laws of the decedent's domicile discriminate against a New York domiciliary; or if the testator explicitly directs probate in New York. N.Y. SUR. CT. PROC. ACT § 1605 (McKinney 2012).

[20] *Estate of Renard*, 100 Misc. 2d 347 (N.Y. Sur. 1979) *aff'd sub nom. Will of Renard*, 71 A.D. 2d 554 (N.Y. App. Div. 1979) (retaining jurisdiction of the New York will of a French domiciliary which directed that New York law govern probate, reasoning that although the will was already admitted to probate in France, there where substantial assets in New York, the executors were in New York, opposing the forced heirship claim of the decedent's son in France would prove burdensome for the interested legatees and the proceeding was brought in good faith without the intent to thwart French law). *See also In re Will of Heller-Baghero*, 26 N.Y.2d 337, 258 N.E.2d 717 (1970) (holding that New York had jurisdiction when an Austrian domiciliary's two wills (1962 and 1964) were offered for probate in Austria and New York, respectively, because: (1) the validity of the 1964 will was not foreclosed in Austria, (2) 90% of assets were in New York, (3) the executor and two legatees were New Yorkers and (3) the New York proceeding was brought in good faith not to thwart Austrian laws). *But see Swiss Bank Corp.*, 27 N.Y.2d 270 (honoring a French judgment in favor of a forced heir and declining to apply substantive New York law to the estate). However, *Watts* can be distinguished from *Renard* and *Heller-Baghero* because *Watts* was decided based on res judicata principles alone, and not based on probate principles.

[21] *Poe v. Seaborn*, 282 U.S. 117 (1930).

[22] *See Angerhufer v. Comm'r*, 87 T.C. 814, 819 (1986) (using applicable West German laws to citizens and domiciliaries of West Germany employed in New York); *Westerdahl v. Comm'r*, 82 T.C. 83, 86 (1984) (finding that Swedish citizens and docmiciliaries employed in New York were entitled to report their income for federal tax purposes as under Sweden's community property law); *Hall v. Comm'r*, 37 T.C.M. (CCH) 1500 (T.C. 1978) (finding that a U.S. citizen's German domicile meant German laws were to be applied to the treatment of gross income for tax purposes); *Rosenkranz v. Comm'r*, 65 T.C. 993, 996 (1976) (using the laws of the petitioners' domicile to determine the applicable laws); I.R.S. Priv. Ltr. Rul. 91-04-001 (Jan. 25, 1991). *See also* Treas. Reg. § 1.879-1(a)(1) (2012).

3. A distributive share of partnership income or loss, if it is community property, is the income or loss of the spouse who is the partner.

4. Community income from separate property (other than partnerships, trade or business assets), as determined under the applicable community property law, is taxed to the spouse owning the property.

5. All other community income is split between the spouses under the applicable community property laws.

C. The spouse who is a U.S. person, to the extent he or she recognizes income under IRC § 879, must be mindful of the CFC ("controlled foreign corporation") and PFIC ("passive foreign investment company") rules.

VIII. Transfer Taxation of Community Property

A. In all U.S. community property jurisdictions and in many foreign civil law countries, community property vests in each spouse to the extent of one-half of such property. Accordingly, when a decedent in a community property jurisdiction dies with such property, the surviving spouse is entitled to one-half of the community property plus the decedent's separate property, both of which are included in the decedent's gross estate.

B. This in effect places a community property domiciliary at a distinct advantage when compared to his common law domiciliary counterparts, in part because of the unlimited estate marital deduction which is only available for U.S. citizens. In a case where the surviving spouse is a non U.S. citizen, common law property may be taxed on the full value of the decedent's assets owned at death, while community property decedent's estates are taxed are only one-half of such property.[23] Furthermore, upon the death of the first spouse to die, both the separate property of the decedent and the community property interests of both spouses receive a stepped up basis.[24]

C. A married couple may enter into an agreement converting their community property into separate property. However, care should be taken because if divided unequally, the transaction may result in a gift to the transferee spouse of one-half of the community property. This gift is problematic where the transferee spouse is a non U.S. citizen who is ineligible for the unlimited marital deduction for gifts between spouses resulting in a gift tax liability.[25] Additionally, gift splitting is only available where the spouses are both U.S. citizens or U.S. domiciliaries.[26]

D. Where one spouse is a U.S. citizen or domiciliary, the transfer by the other spouse by gift or upon death of his or her interest in the community can result in worldwide gift or estate taxation. The same would be true with respect to U.S. situs property if neither spouse is a U.S. citizen or domiciliary.

IX. Agreements

A. Prenuptial Agreements

1. Many couples regulate the community property status of their assets pursuant to prenuptial agreements. The requirements vary from state to state, but by and large:

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[23] WILLIAM H. NEWTON, III, INTERNATIONAL INCOME TAX AND ESTATE PLANNING, § 2:13 (2d ed. 2011).

[24] I.R.C. §1014(b)(6) (2010). To be eligible for this special treatment, at least one half of the community property must be includible in the estate of the spouse who dies first.

[25] I.R.C. § 2523(i) (1997).

[26] I.R.C. § 2513 (2012).

a. There is no requirement that the spouses be separately represented, although separate representation will bolster an agreement against subsequent challenge.

b. The extent to which asset disclosure is required for a prenuptial agreement varies widely from state to state.

c. Agreements generally need not be witnessed and need only be signed and in writing -- although agreements between nonmarried couples may be oral and even merely implied.

d. Agreements may provide for property settlement, may provide reasonable limitations upon spousal support, and may provide or waive testamentary obligations; they may not, however, fix child support.

e. Up until 1999, Texas was the only state in which parties could not agree to alter the separate or community nature of their property. Following an amendment to Texas's constitution approved in November of 1999, married couples in Texas can now agree in writing to alter the separate or community nature of their property.

2. Policies that impact enforceability:

a. taxation of property settlements, alimony and support;

b. estate planning opportunities incident to divorce;

c. forum shopping;

d. international marriage fraud;

e. international parental kidnapping;

f. subject matter jurisdiction;

g. efficacy of discovery procedures;

h. security for post-marital obligations;

i. enforceability of foreign judgments; and

j. upholding secular aspects of religious law.

B. Postnuptial Agreements

The rules governing the validity of postnuptial agreements are generally the same as those for prenuptial agreements, except that virtually all states require asset disclosure for postnuptial agreements.

C. Uniform Premarital Agreement Act

The Uniform Premarital Agreement Act has been adopted in Arizona, Arkansas, California, Connecticut, Delaware, District of Columbia, Florida, Idaho, Indiana, Kansas, Maine, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Oregon, Rhode Island, South Dakota, Texas, Utah, and Virginia.[27]

D. Community Property Agreements

Commonly, community property agreements provide that:

[27] *Legislative Fact Sheet –Premarital Agreement Act*, UNIF. LAW COMM'N, available at http://uniformlaws.org/LegislativeFactSheet.aspx?title=Premarital%20Agreement%20Act (last visited July 10, 2012).

1. all or some portion of existing property is community property, subject to specific exceptions;

2. all or some portion of property acquired in the future is community property;

3. all survivorship community property vests with the surviving spouse at the death of the first spouse; and

4. the agreement does not apply with respect to divorce.

E. Consider Rights on Termination of Marriage by Death

F. Consider Enforceability of Marital Agreements under Foreign Law

X. Advantages of Preserving Community

A. Income Tax

1. Double Basis Step-Up – Internal Revenue Code § 1014(b)(6)

Under Internal Revenue Code § 1014(b)(6), even though only the decedent's one-half interest in community property is includible in his or her gross estate for U.S. estate tax purposes, the entire community obtains a new basis. This, of course, can be a disadvantage in the event that the property has depreciated in value through the date of the decedent's death.

B. Transfer Tax

1. Bracket Equalization

Because only one-half of community property is taxable upon the death of the first spouse, it is easier to take advantage of both couples' applicable exclusion amounts and lower-than-maximum tax brackets. Of course, the same result can be achieved for joint property with right of survivorship or tenancies by the entirety through qualified disclaimers.

2. Minority Interest Discounts

Because each spouse owns an undivided one-half interest in community property, each spouse may receive minority interest discounts for business assets, art, and other hard to value assets of which together they own a majority. This result may or may not be replicable in common law property states.

C. Creditor Protection

D. Availability for Same Sex Couples in Some States

XI. Disadvantages of Preserving Community

A. Gifting

Gifting community property requires the consent of the other spouse.

B. Divorce

Community property generally governs property division upon divorce.

C. Transfer Tax

1. Estate tax administration expenses, deductions and losses allocable to surviving spouse's interest in the community are not deductible.

2. Qualifications for elections based upon adjusted gross estate may be harder to achieve, since only one-half of closely held community property business interests will be includible in the gross estate.

3. Harder to do GRATs

XII. Techniques for Preserving Community Property after Importation

A. Tracing Assets

One must first essentially do an accounting of a couples' assets to see what community property was imported into the common law state and how it has transmogrified.

B. Segregating Assets

Once an accounting has been accomplished, assets that have community property origins should be segregated in order to simplify future accounting needs.

C. Joint revocable trusts

The joint revocable trust is a convenient mechanism by which to keep community property segregated. The trust must actually be funded. Income during the life of the joint settlors should be community property. Upon the death of the first spouse, the trust should divide into two shares

D. Not retitling assets

One should take care not to retitle assets inadvertently.

E. Community Property Agreement

The execution of a community property agreement after the move to a common law state can clearly determine which imported assets are to retain their community property character, as well as assets which were acquired after the move under a community property regime.

XIII. Ethical Concerns

A. Joint Representation – Model Rules of Professional Conduct 1.7

One must take care that one can represent each spouse without adversely affecting the client relationship with the other spouse. This may require each spouse to consent to the joint representation after complete disclosure of any potential conflicts of interest. This can be particularly problematic in the event of divorce.

B. Individual Representation

This approach eliminates potential conflicts of interest, but complicates the coordination of estate planning between spouses.

C. Engagement Letters

An engagement letter is essential to record how the issue of potential conflicts is being treated.