

California Community Property/Liability for Judgments



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April 2017

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California Community Property/Liability for Judgments

1. California Law – Community Property

If assets constitute community property, it is usually irrelevant that the assets are titled in the name of one spouse. The creditor can attach all of the community property, even if only one spouse is the debtor. This may hold true even if the debt arose prior to the marriage. (See CCP Sections 695.020, 703.020 and 703.110.)

In community property states, most property acquired during marriage is treated as community property. Even if property so acquired is titled in the name of one spouse, that merely creates a rebuttable presumption as to the community or separate nature of such property. Because each spouse has a coextensive ownership interest in community property, creditors of either spouse can reach all community property of the two spouses.

However, on divorce, the treatment of the spouses' property is different. All property acquired during marriage, (other than by gift or inheritance) regardless of how it is titled, is treated as marital property, and is subject to a division on divorce. Generally, in a common law state, marital property will be any property owned by a spouse except: (i) property acquired prior to marriage; (ii) property acquired during marriage by gift or inheritance; and (iii) property designated as nonmarital through an agreement between spouses. **During marriage, the creditor can reach only the property titled in the name of the debtor spouse. However, on divorce, all marital property will be divided, regardless of how it is titled and may become reachable by a creditor.**

2. Community Property Jurisdictions – Overview of Community Property

In a community property state there are two types of property: separate and community. (There is actually a third form of property in a community property state: quasi-community property. Quasi-community property is real and personal property, wherever it is located, that would have been community property had the spouse been domiciled (resided) in California when he or she acquired it, or any property acquired in exchange for such property.) Separate property is acquired in much the same manner as in common law states: (i) property acquired prior to marriage; (ii) property acquired during marriage by gift or inheritance; and (iii) property acquired during marriage but as to which the spouses entered into an agreement treating it as separate property. (California Family Code Sections 770(a) and 850(a))

Separate property in a community property state is afforded similar treatment to separate property in a common law state. During marriage, a creditor of one spouse cannot reach the separate property of the other spouse. However, the one important distinction is that in a community property state, separate property is separate for all purposes, including divorce. In common law states separate property may also be marital property, subject to an equitable division on divorce.

Community property is a form of joint ownership of property by husband and wife. It is defined as real or personal property, wherever situated, acquired by a married person during the marriage while domiciled in this state. Each spouse can manage, direct and control community property.

The distinctive feature of community property (Community property states include: Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico,

Texas, Washington and Wisconsin.) is that both spouses own coextensive interests in all of community property. This means that a creditor of one spouse can reach all the community property of the spouses.

California Family Law Code Section 910(a) provides:

Except as otherwise expressly provided by statute, the community estate is liable for a debt incurred by either spouse before or during marriage, regardless of which spouse has the management and control of the property and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt.

The liability of community property extends to contracts entered into by either spouse during marriage, to torts of either spouse during marriage, and to most pre-marriage obligations of either spouse.

3. Characterization of Community Property – Generally

The five major factors affecting characterization of property as separate or community are the following: (i) time of the property's acquisition; (ii) the source of funds used to acquire the property; (iii) whether spouses entered into a "transmutation agreement" to change the character of property from community to separate, separate to community, and from the separate property of one spouse to the separate property of the other spouse; (iv) actions by parties, including actions that "commingle" or combine separate and purchased or money borrowed is presumed to be community property. The general rule is that property acquired during marriage is community property.

For property acquired during marriage, it is important to establish not only the actual amounts of separate and community contributions, but also their respective proportions. Thus, when the property appreciates in value, it will be still possible

to apportion.

4. Pursuing a Separate Business

When one spouse devotes time during marriage to develop his or her separate business and the business appreciates in value, then a portion of that appreciation is attributable to the community. During marriage the time of each spouse belongs to the community, and the time expended on a separate business is community's time. California courts have established complicated formulas to apportion the appreciation in value between separate property and community property.

5. Transmutation

Married persons may, by agreement or transfer, and with or without consideration, change or "transmute" the character of their property in any of the following ways: (i) from community property to separate property of either spouse; (ii) from separate property of either spouse to community property; (iii) from separate property of one spouse to separate property of the other spouse. (California Family Code Section 850)

To be effective, a transmutation agreement must be in writing, the spouses must fully disclose their properties to each other, and a transmutation of real property will be effective as to third-party creditors only if it is recorded.

(California Family Code Sections 852(a) and (b). See, also Estate of MacDonald, 51 Cal. 3d 262 (1990).) The law of fraudulent transfers applies to transmutation agreements. (California Family Code Section 851)

6. The Community Property Presumption

There is a legal inference, called a "presumption," that all property acquired

during marriage by either husband or wife or both is community property.

(California Family Code Section 760)

The general community property presumption specifically applies to the following types of property: (California Family Code Section 760) (i) all real property, including leased property, that is located in California and is acquired during marriage by a spouse while domiciled (living with intent to remain) in California; (ii) all personal property, wherever located, that is acquired during marriage by a married person while domiciled in California; and (iii) all community property transferred by husband and wife to a trust pursuant to Family Code Section 761. However, the general community property presumption that property acquired during marriage is community property may be overcome by evidence that the disputed property is actually separate property.

Evidence that may be used to overcome the community property presumption includes the following: (i) an agreement between the parties to change the character of (transmute) the property from community to separate property; (ii) tracing property to a separate property source; or (iii) reliance on separate property as collateral when property is purchased on credit.

If the community property presumption cannot be overcome, the party who has made traceable separate property contributions to the acquisition of property may obtain reimbursement in certain circumstances. (California Family Code Section 2640)

There are several statutory exceptions to the general presumption that all property acquired during marriage is community property: (i) property acquired

by either husband or wife by gift, will, or inheritance;' (ii) property that either spouse acquires with the rents, issues, or profits from separate property; (iii) property held at death and that a spouse acquired during a previous marriage if that marriage was terminated by dissolution more than four years before death; (iv) any real or personal property interest acquired by the wife by written instrument before January 1, 1975; (v) property acquired by either spouse after separation, unless the property is acquired with community property funds; (vi) property designated as separate by a transmutation agreement; (vii) personal injury damages paid by one spouse to the other spouse if the cause of action arises during marriage; and (viii) personal injury damages received by one spouse from a third party after a court renders a decree of legal separation or a judgment of dissolution of marriage. (See, Family Code Sections 770, 781, 802 and 803)

7. Effect of Title on Community Property – Joint Tenancy and Tenancy in Common

The general community property presumption applies to all property acquired during marriage, including property titled in joint form, such as joint tenancy or tenancy in common. A spouse intending to rebut the community property presumption for jointly titled property may do so in one of two ways: (i) a clear statement in the deed or other documentary evidence of title by which the property is acquired that the property is separate and not community property; or (ii) proof that the spouses have made a written agreement that the property is separate property.

California community property laws suggest holding assets in a community property form is less desirable than separate property, at least from an asset

protection perspective. The reason is that all of community property is liable for the debts of either spouse, whether incurred before or during marriage. Contrast that with separate property, which is only liable for the debts of that spouse who owns the separate property (except for obligations with respect to necessities of life).

In the context of asset protection planning, one may want to convert community property to separate. One way of accomplishing that goal is for spouses to transmute their community property into separate. However, transmutation agreements are subject to the fraudulent transfer laws.

In most community property states, the general rule is that community property can be seized to satisfy community debts even after a divorce. This means that once the community incurred a debt, both spouses are liable for that debt, even following a divorce, and even if the liability has been allocated entirely to only one spouse. (Wilkes v. Smith, 465 F. 2d 1142, 1146 (9th Cir. 1972))

In California, this rule has been changed so that community property awarded to a nondebtor spouse as separate property is protected from the claims of his or her ex-spouse's creditors, even if the debts are community debts. This means that a community debt, which is generally an obligation of both spouses, can be assigned to only one spouse, in California. (California Family Code Section 2551)

With respect to the separate property of spouses following a divorce, the allocation and division of liabilities on divorce in California are as follows:

(California Family Code Section 916(a))

a) Separate property owned by a married person and property received by that

person pursuant to the division of property is liable for debts incurred by the person before or during marriage whether the debt is assigned for payment by that person or that person's spouse.

- b) Separate property owned by a Married person at the time of the division and other property received by that person is not liable for debts incurred by the person's spouse before or during marriage and the person is not liable for such debt unless it was assigned to him or her in the division of property.
- c) Separate property and other property received by a married person is liable for debts incurred by the person's spouse before or during marriage and the person is personally liable for the debt if it was assigned for payment by the person pursuant to the division of property.

While a community debt can be assigned to only one spouse (in California), that does not mean that the spouses can assign all of the liabilities to one spouse, and all of the assets to the other spouse. Transfers of property pursuant to a divorce, like any other transfers of property, are subject to the fraudulent transfer laws.

For example, in Britt v. Damson, (Britt v. Damson, 334 F. 2d 896, 902 (9th Cir. 1964), cert. denied, 379 U.S. 966 (1965)) the spouses divorced and the husband filed for bankruptcy. There was a claim that the property transferred to the wife pursuant to the divorce was fraudulent. The court held that although the division of property was not fraudulent under state law, it could be under the Bankruptcy Code's fraudulent conveyance provisions. The court stated:

To the extent that the value of the community property ordered to [the wife] was offset by the value of the community property awarded to husband, the

'transfer' to [the wife] was, as a matter of law, supported by 'fair consideration.'...

To the extent that the award of community property to [the wife] may have exceeded half of the total value of the community property, there is a question whether, under all the circumstances, [the husband] received fair consideration as a matter of law.

The Ninth Circuit thus made it apparent that even on divorce; transfers of property can be scrutinized and tested under the fraudulent transfer laws.

In a more recent case, the California Supreme Court attempted to harmonize California Family Code Section 2551 and the UFTA. (Mejia v. Reed, 31 Cal. 4th 657 (2003)) Section 2551 provides that the property received by a person on divorce is not liable for debt incurred by the person's spouse before or during marriage, and the person is not personally liable for the debt, unless the debt was assigned pursuant to the divorce to that person. This means that in California divorce overrides the asset protection disadvantages of the community property system.

In contrast to Section 2551 is the UFTA which provides that any transfer of property is subject to the laws of fraudulent conveyances.

The California Supreme Court reasoned that the California Legislature has a general policy of protecting creditors from fraudulent transfers, including transfers between spouses. Just as the fraudulent transfer laws apply to transmutation agreements during marriage, so do those laws apply to transfers of property on divorce.

Despite the court's holding the transfers of property on divorce are subject to the UFTA, challenges under the UFTA are still limited in the context of divorce and

leave room for planning opportunities. Under the UFTA, a creditor can allege that the transfer was either actually or constructively fraudulent.

Constructive fraud requires little more than a finding that one of the spouses was left insolvent – a straight forward and objective analysis. However, actual fraud requires a subjective analysis which makes it more difficult for a creditor to prevail in the context of divorce.

