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Transmutation Landmine: *Marriage of Starkman's* Questionable Application of the *MacDonald* Test and Failure to Acknowledge the Possibility of "Estate Planning Transmutations" under Federal Tax Law

by Gregory W. Herring

Since 1985 Family Code section 852, subdivision (a), has required transmutations to be accomplished through a 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. In 1990 the California Supreme Court, in *In Re Marriage of MacDonald*, refined the rule, providing that, while magic words are not required, such a writing must ". . . expressly [state] that the characterization or ownership of the property is being changed." The courts closely followed these principles until the Court of Appeal issued its opinion in 2005's *In Re Marriage of Starkman*. The *Starkman* opinion questionably applied the *MacDonald* test and also failed to acknowledge the possibility of "estate planning transmutations" that can be accomplished separate and apart from *MacDonald*, through federal tax law

Statutory Bases and Requirements for Transmutation

Family Code section 850 provides that married persons may by agreement or transfer, with or without consideration, transmute (1) community property to separate property of either spouse; (2) separate property of either spouse to community property; and (3) separate property of one spouse to separate property of the other spouse.[1]

In 1984 the California Legislature modernized the law by enacting section 852, subdivision (a), which bars oral transmutations.[2] The prior rule, which allowed oral transmutations between spouses, generated extensive litigation in dissolution proceedings. It was found to encourage spouses to transform passing comment (e.g., "pillow talk") into an agreement, or to commit

[1] Fam. Code, § 850. All further statutory references in the main text are to the Family Code unless otherwise stated.
[2] *Id.*, § 852. The section was originally enacted as Civ. Code, § 5110.730.

perjury by manufacturing oral or implied transmutations. In doing so, the Legislature made it substantially more difficult to change the character of property through inter-marital gifts.[3]

Section 852, subdivision (a), provides in pertinent part "[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."[4] As such, it imposes a special statute of frauds requirement on the transmutation of marital property.[5]

This comports with Civil Code section 683, which provides that a joint tenancy can only be created by a written instrument.[6]

Section 853 provides an exception to section 852, subdivision (a), in providing that a statement in a will of the character of property is not admissible as evidence of a transmutation of the property in a proceeding commenced before the death of the person who made the will.[7] The commonsense rationales for this rule are that such testamentary statements (1) are not intended to convey present interests in property; and (2) are ambulatory in nature, subject to revocation or modification during the testator's life.[8] Another exception is for informal transmutations for certain personal property gifts between the spouses.[9]

Seminal Case: *Estate of MacDonald*

In 1990 the California Supreme Court, in *Estate of MacDonald* (1990) 51 Cal.3d 262, analyzed section 852, subdivision (a), in the context of Individual Retirement Account ("IRA") benefits. During the marriage, Ms. MacDonald discovered that she had a terminal illness.

One of the community's assets was an interest in an employee benefit pension plan in Mr. MacDonald's name. Prior to Ms. MacDonald's death, the pension terminated and paid $266,558 to Mr. MacDonald. He put this into IRA's that were solely in his name. Ms. MacDonald then

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[3] *In re Marriage of Campbell* (1999) 74 Cal.App.4th 1058, 1062.
[4] Fam. Code, § 852, subd. (a). Fam Code, § 852, subd. (e) expressly makes §852, subd. (a) non-retroactive.
[5] *In re Marriage of Weaver* (1990) 224 Cal.App.3d 478, 484-485.
[6] Civ. Code, § 683. Unlike Fam. Code, § 852, subd. (a), however, Civ. Code, § 683 explains what the express declaration it calls for must include.
[7] Fam. Code, § 853.
[8] *Estate of Gallio* (1995) 33 Cal.App.4th 592, 598. While some commentators have suggested that section 853 should be extended to estate planning documents beyond wills, the ultimate point of this article, that "estate planning transmutations" are made outside the *MacDonald* test when completed irrevocable gifts are made in such plans to qualify for a stepped-up tax basis, would argue against this.
[9] See Fam. Code, § 852, subd. (c), as discussed in *Estate of MacDonald, infra*., (1990) 51 Cal.3d 262, 269. Subsection (c) excepts a gift between the spouses of clothing, wearing apparel, jewelry, or other tangible articles of a personal nature that is used solely or principally by the spouse to whom the gift is made and that is not substantial in value taking into account the circumstances of the marriage. *In re Marriage of Steinberger* (2001) 91 Cal.App.4th 1449 provides an in-depth discussion of this subsection.

signed IRA adoption agreements whereby she consented to Mr. MacDonald's naming a third party in her stead as the beneficiary.[10]

Ms. MacDonald died soon afterwards, leaving her estate, which did not include any interest in the IRA's, to her children. Her executrix filed a petition to establish a community property claim to the IRA's. The trial court denied the claim, holding that Ms. MacDonald's signature on the IRA adoption agreements constituted a waiver or transmutation of her community property interest.[11]
The executrix appealed, and the Supreme Court reversed. After pointing out that the Law Revision Commission did not explicitly expand upon the question of what a writing under section 852, subdivision (a), should be required to contain,[12] the Court stated that precise words, like "transmutation," "community property," or "separate property," need not be used.[13]

The Court held that a writing must, however, ". . . *expressly [state] that the characterization or ownership of the property is being changed*."[14]

The court additionally made it clear that, even though it could lead to unfair results in some cases, section 852, subdivision (a), also prohibits consideration of extrinsic evidence in analyzing whether a transmutation has been accomplished.[15]

The Courts' Close Adherence to *MacDonald*

In 1994 the Court of Appeal addressed multiple properties in another probate case, *Estate of Peterson* (1994) 28 Cal.App.4th 1742.

In the trial court, Mr. Peterson's estate claimed a variety of properties for the benefit of his heirs against Ms. Peterson. Ms. Peterson filed a motion for summary judgment or, in the alternative, summary adjudication as to each of the properties.[16]

One of the properties was a money market account, the funding source for which was not expressly identified, but where an account statement had been issued identifying the parties as "joint tenants." In denying summary judgment to Ms. Peterson as to this asset, the court framed the issue as being ". . . whether the designation of joint tenancy on the statement of account is sufficient to overcome the community property presumption and to establish a joint tenancy right of survivorship as a matter of law." It found that the account statement did not clearly and unambiguously establish a right of survivorship and it did not contain a "written joinder" or

[10] *Estate of MacDonald* (1990) 51 Cal.3d 262, 265.
[11] *Id.*
[12] *id*. at p. 269.
[13] *Id*. at p. 273.
[14] *Id.* at p. 272 (emphasis added).
[15] *Id.* at p. 273.
[16] *Estate of Peterson* (1994) 28 Cal.App.4th 1742, 1744-1745

"written consent" to a nonprobate transfer of community property.[17] Following *MacDonald*, the court emphasized that (1) there were no signatures on the statement; (2) the statement did not reveal that the legal effect of the joint tenancy designation was to alter the character of ownership of community funds; and (3) the statement did not indicate that the parties consented to such a change.[18]

In 1999 the Court of Appeal, in *In re Marriage of Barneson* (1999) 69 Cal.App.4th 583, put a finer point on MacDonald's requirement for an express written showing of a change in character of property for a transmutation.

Mr. Barneson, who owned a multi-million dollar stock portfolio, suffered a stroke approximately a year after marriage.[19]

Shortly thereafter, Mr. Barneson signed a typed letter to transfer substantial stock holdings into Ms. Barneson's ("Kaiser") name. He then signed an "Irrevocable Stock or Bond Power," which began with the phrase, "For value received, the undersigned does (do) hereby sell, assign, and transfer unto," after which her name was written. A stock certificate was then issued in her name, "c/o" Mr. Barneson. Mr. Barneson's social security number, however, continued to be used for reporting stock dividends to the tax authorities.[20]

Ms. Kaiser subsequently caused the removal of the "c/o" designation on the certificate. An exchange journal entry reflects that this was done, although the entry also listed Mr. Barneson's Social Security number on both sides of the transaction.[21]

As part of the above, Ms. Kaiser opened an account with Charles Schwab in her name alone. Schwab then "received" different stocks into Mr. Barneson's separate account, after which Mr. Barneson signed blank forms authorizing transfer of these stocks into Ms. Kaiser's name. Mr. Barneson then signed a request to journal "all stock" in his account into Ms. Kaiser's account. The transactions met regulatory agency requirements.[22]

Mr. Barneson then filed for divorce and sought the return of all the stock he had transferred to Ms. Kaiser. Although he died soon thereafter, the family law court, which retained jurisdiction due to the bifurcated termination of the marriage prior to his death, upheld the transactions, citing section 852, subdivision (a), and MacDonald in its analysis.[23]

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[17] *Id.* at p. 1754 (citations omitted).
[18] *Id.* at p. 1755.
[19] *In re Marriage of Barneson* (1999) 69 Cal.App.4th 583, 585.
[20] *Id.*
[21] *Id.*
[22] *Id.* at p. 586.
[23] *Id.* at p. 587.

The Court of Appeal, however, reversed, pointing out that *MacDonald's* interpretation of the "express declaration" language in section 852, subdivision (a), can be viewed as effectively creating a "presumption" that transactions between spouses *are not* transmutations, "rebuttable by evidence the transaction was documented with a writing containing the requisite language." The court stated that the *MacDonald* bright line test is not difficult to meet, requiring only a clear showing of a change in ownership or characterization of property at issue.[24]

As Mr. Barneson's instructions had been either to "transfer" or to "journal" the stock to Ms. Kaiser, the court did not find the clear showing of a change in ownership or characterization of the stock. Rather, it stated that had Mr. Barneson "truly intended" transmutation, he could have added to his directions to transfer stock wording indicating that he was "giving" his interest in the stocks to Ms. Kaiser or he could have directed them transferred into her name "as her sole and separate property."[25]

The court also held that the more specific rules governing transmutations of property in transactions between spouses should control over the general presumption of ownership from title as set forth in Evidence Code section 662.[26]

In 1999 the Court of Appeal also issued *In re Marriage of Campbell* (1999) 74 Cal.App.4th 1058, which, based on the express language of section 852(a) and *MacDonald*, easily knocked down a claim of an oral transmutation of an interest in real property. In doing so, the *Campbell* Court expressly rejected the attempt to apply the doctrine of estoppel to try to create an oral transmutation.[27]

2001's *Estate of Bibb* (2001) 87 Cal.App.4th 461 created the "grant deed" rule for transmutation documents under the M*acDonald* test. In that case, Mr. Bibb owned certain real property prior to marriage. He was forced to use Ms. Bibb's good credit to obtain a loan to improve the property. As part of the transaction, he also signed a grant deed, granting the property from his own separate property to himself and his wife "as joint tenants."[28]

After Mr. Bibb died, his estate claimed that the real property had not been transmuted. The trial court disagreed. Finding that the word "grant" in a grant deed is equivalent to the word "give," as had been expressly suggested as a way to accomplish transmutations by *MacDonald*, the Court of Appeal affirmed.

In another portion of *Bibb*, the court found that a Rolls Royce automobile that Mr. Bibb had purchased prior to marriage had *not* been transmuted to Ms. Bibb. It found that the mere post-marital re-registration of the vehicle in both parties' names failed to satisfy the *MacDonald* test

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[24] *Id.* at p. 593.
[25] *Id.*
[26] *Id.* at p. 591-593.
[27] *In re Marriage of Campbell* supra 74 Cal.App.4th at p. 1064.
[28] *Estate of Bibb* (2001) 87 Cal.App.4th 461, 464.

since the registration failed to expressly state an intent to change the character of the property.[29] Although it did not cite *Peterson*, above, this aspect of *Bibb* mirrored that case's analysis as to the Petersons' money market account.

In 2005 the Supreme Court issued its opinion in *In re Marriage of Benson* (2005) 36 Cal.4th 1096.

It, like the opinion in *Campbell*, above, pointed out that section 852(a) does not operate like the general statute of frauds, where the requirement of a basic writing is subject to an implied exception for "part performance" of the contract's terms. It cited *MacDonald's* requirement of a special writing expressly changing the character of the disputed property. As such, the Court found that *MacDonald* all but decided that section 852, subdivision (a), is not satisfied where no such writing exists at all. On that basis, the Supreme Court easily rejected Mr. Benson's claim of an implied transmutation.[30]

The Court of Appeal bolstered the *MacDonald* rule in the November 2006 opinion in *In re Marriage of Leni* (2006) 144 Cal.App.4th 1087. In *Leni*, the parties sold their community property residence during their initial dissolution proceeding with escrow instructions providing, "proceeds to be split 50/50." After the sale was accomplished, the proceeds were distributed in equal shares even after the parties reconciled. Later, after a new dissolution case was filed, Mr. Leni argued that the escrow instructions accomplished a transmutation, whereby he gained his share of the proceeds as his own separate property, as opposed to his share of the community estate.

The court, however, properly held that the notation in the escrow instructions did not satisfy the "rigid" requirements set forth in section 852, subdivision (a), because the writing lacked an express declaration that the character of the property was being changed.

Thus, California courts have explored and applied the *MacDonald* test in relation to multiple types of property, "transfer" documents and situations.[31] The decisions have adhered closely to *MacDonald* in declining to find valid transmutations absent express written language to that effect.

In *Starkman*, the Court of Appeal Questionably Applied *MacDonald* and Failed to Acknowledge the Possibility of "Estate Planning Transmutations" under Federal Tax Law

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[29] *Id*. at p. 470.
[30] *In re Marriage of Benson* (2005) 36 Cal.4th 1096, 1100. In 2003 the Court of Appeal issued its Opinion in In re *Marriage of Delaney* (2003) 111 Cal.App.4th 991, which considered fiduciary and other interspousal duties in relation to transmutation law. This article purposely excludes that additional substantial aspect of transmutation analysis.
[31] See, e.g., discussion in *In re Marriage of Benson, supra.,* 36 Cal.4th 1096 at p. 1107.

While its opinion in *Benson*, above, was being reviewed by the Supreme Court in 2005, the California Court of Appeal, Second District, Division 6, was considering an appeal of another transmutation case, *In re Marriage of Starkman* (2005) 129 Cal.App.4th 659 (rev. den.).

Ms. Starkman brought few assets to the marriage. Mr. Starkman, on the other hand, was an heir to the United Parcel Service fortune. After marriage, he consulted with and employed a prominent San Luis Obispo attorney to prepare an estate plan. Among other instruments, the attorney drafted a revocable declaration of trust, entitled "The Starkman Family Revocable Trust" ("Trust)," which the parties executed, along with other related estate planning instruments.[32]

The Trust's Paragraph 1.01 stated that the parties settled the Trust "to simplify their affairs as well as update their estate plan and assure its efficient operation." It also provided that the Trust's purposes were "to avoid probate and provide for the orderly administration of the Settlors' property in the event of the death or incapacity of either Settlor."[33]

Paragraph 2.02 stated that the Settlors intended "to transfer all their assets to the Trust Estate, to the greatest possible extent."[34]

Paragraph 2.03 was at the heart of the appeal. It provided that the "Settlors agree that *any property transferred by either of them to the Trust . . . is the community property of both of them unless such property is identified as the separate property of either Settlor*. If either Settlor claims that a portion of the Trust Estate is separate property, the Settlor making such a claim agrees to indemnify the Trust and the Trustee from all costs and liability incurred in establishing or defending such claim." By contrast, it also stated that "Settlors declare that any *community property* transferred to the Trust shall retain its character as such, notwithstanding the transfer to the Trust."[35]

Contemporaneously with the execution of the Trust, the parties executed a "General Assignment." It conveyed "any asset, whether real, personal, or mixed . . . [they] now own or which we may own in the future" to the Trust. Moreover, and of central importance to the appeal, the General Assignment did not specifically exclude any property that Mr. Starkman intended to remain as his separate property.[36]

Mr. Starkman later executed various stock brokerage transfer forms to convey specific assets, which were undeniably originally all his separate property, into the Trust. Each form designated

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[32] *In re Marriage of Starkman* (2005) 129 Cal.App.4th 659, 661.
[33] *Id.* at p. 662.
[34] *Id.*
[35] *Id.* (emphasis added).
[36] *Id.*

the assets to be held by the parties as trustees of the Trust. The forms, however, did not describe the assets as either community property or separate property.[37]

Following the parties' separation, Mr. Starkman exercised his right to revoke the Trust, pursuant to its terms. Ms. Starkman asserted that the assets that he conveyed to the Trust by the stock brokerage forms, however, had been transmuted into community property.[38] The trial court, at a bifurcated trial, rejected Ms. Starkman's position based on the *MacDonald* test.

In contrast to the liberal position the Court of Appeal took in Benson (allowing *estoppel* to create an implied transmutation) and perhaps out of sensitivity to the Supreme Court's then-pending review of *Benson*, the same Court of Appeal in *Starkman* took a decidedly conservative approach in affirming the trial court's decision. Citing *MacDonald*, the *Starkman* panel found that the Trust's language, "Settlors agree that any property transferred by either of them to the Trust . . . *is* the community property of both of them . . . ," did not expressly purport to change the character of any property.[39] Rather, the Court of Appeal pointed-out in an echo of *Barneson*, above, that the parties might have stated that any property transferred to the Trust by either of them "*becomes*" or "*is changed into*" community property.[40] Or, the court opined, the Trust might have included a statement of purpose to the effect that Mr. Starkman was "*transmuting*" the entirety of his separate estate to community property.[41]

The suggestion of words like "becomes," "is changed to," or "transmuting," where the words, "community property" and "separate property," were already used in the Trust document, however, would not appear consistent with *MacDonald's* direction that "precise words," like "transmutation," need not be used.[42]
What other reasonable purpose, besides transmutation, could the Trust, the General Assignment and the stock brokerage transfer forms have had?[43]

Mr. Starkman's answer, set forth in his appellate brief, was "estate planning"—to use federal tax law to maximize the special double step-up income tax basis on death that applies to community assets.[44]

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[37] *Id.* At p. 662.
[38] *Id.*
[39] *Id.* (emphasis added).
[40] *Id.* (emphasis added).
[41] *Id.* at p. 664. (emphasis added).
[42] *Estate of MacDonald supra.*, 51 Cal.3d 262 p. at 273.
[43] The Court accepted Ms. Starkman's argument that the Trust, General Assignment and stock brokerage transfer forms must be taken together under Civil Code section 1642, providing that agreements relating to the same matters, between the same parties, and made as parts of "substantially one transaction," are to be taken together. *Id.* (Citations omitted).
[44] See Internal Revenue Code section 1014: "The tax basis of property passing from a decedent is the fair market value at the date of the decedent's death." (Internal Revenue Code section 1014(a).) If property owned jointly by the decedent and his or her spouse is not community property, only the decedent's interest in the property would have a date of death tax basis, and the surviving spouse's interest in that property would retain its historical cost basis with no date of death adjustment. On the other hand, if the jointly-owned property is community property, Internal

This is where the *Starkman* case could have turned from just another contested application of the MacDonald test into something substantially more. This is because, in stating the above, Mr. Starkman apparently unwittingly revealed another basis, completely separate and apart from the *MacDonald* test, by which his assets had been transmuted.

In her briefs and at oral argument Ms. Starkman argued in reply that Internal Revenue Code section 1014(e) provides that there must be a *completed* gift more than one year prior to the date of death in order for property to acquire a stepped-up basis. A completed gift requires that the donor relinquish complete dominion and control over the gift. If Mr. Starkman had retained the right to revoke the gift of his separate property to the community, he would not have relinquished complete dominion and control and the gift to the community would not occur (or be complete) until death (when the power to revoke would no longer be effective). Under these circumstances, a stepup in basis would be disallowed under Internal Revenue Code section 1014(e) because a completed gift would not have been made one year before death.[45]

Ms. Starkman raised serious concerns that Mr. Starkman's position, that property, although expressly stated to be community in nature, was not really community property but was merely stated as such to obtain a tax advantage of a stepped-up basis on death. He was essentially arguing that he authorized, and his estate planning attorney purposefully drafted, a trust provision designed to have an after-death mischaracterization of property for the purpose of misleading the tax authorities.

Ms. Starkman emphasized that "the law has been obeyed" is a long-established maxim of jurisprudence.[46] The maxim applies across the board to lay persons and to attorneys.[47] In this case Mr. Starkman consulted with estate planning counsel, who advised him and drafted the Trust and the General Assignment.[48] Under these circumstances, the court should not have indulged the possibility that the Trust would accomplish other than what the federal tax law required and what the Trust stated.

The *Starkman* opinion, however, acknowledged neither the above arguments nor the possibility of an "estate planning transmutation" through federal tax law. Rather, it characterized Ms. Starkman's thrust as being a mere complaint against Mr. Starkman's attempt to gain a stepped-up basis.[49] But that was not her point. Contrarily, it was the failure to recognize the *effect* of Mr. Starkman's *attempt* (which was to create a transmutation) about which she complained.

Revenue Code section 1014(b)(6) provides that both the decedent's one-half interest in the property and the surviving spouse's one-half interest in the property acquires a date of death tax basis

[45] See Internal Service Letter Ruling 9308002 (November 16, 1992, CCH IRS Letter Rulings Report No. 835,03-03-93.

[46] Civ. Code, § 3548.

[47] *Wolfgram v. Wells Fargo Bank* (1997) 53 Cal. App.4th 43, 60.

[48] Reporter's Transcript submitted to the Court of Appeal as Record Re Judgment on Bifurcated Issue (Vol.2) at 26:21-31:27; 50:1-51:1.

[49] *In re Marriage of Starkman, supra*., 129 Cal. App.4th 659 at p.665.

In failing to address the possibility of "estate planning transmutations" under federal tax law, the Court left a landmine for family law and estate planning practitioners, their clients and their clients' spouses. Although the Court expressly rejected the notion that a decision in Mr. Starkman's favor would ". . . create havoc in estate planning . . . ," a casual reader of the opinion could well miss the danger.[50]

Thus, estate planning counsel should keep Ms. Starkman's arguments in mind when drafting trust documents that are designed to qualify for a stepped-up basis.

Litigation counsel, too, should be aware that other courts, state and federal, could be willing to address the issue of "estate planning transmutations" under federal tax law and find such transmutations to be valid even outside of the *MacDonald* test and despite *Starkman*.[51]

[50] *Id.*

[51] The Court of Appeal, in *In re Marriage of Geraci* (2006)144 Cal.App.4th 1278, recently cited *Starkman* in addressing transmutation arguments as to another family revocable trust. Like *Starkman*, it analyzed the trust's language under the *MacDonald* test and found insufficient language for a transmutation. As the trust in *Geraci* expressly provided that all separate property transferred into it retained its separate property character, however, the Court apparently lacked a basis for considering the federal tax law issues raised herein.