

***[Almost] Everything You Wanted To Know About  
Community Property But Were Afraid To Ask***

a presentation for

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by

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1. **Introduction**

A. What Is this Thing Called “Community Property”?

Community Property (hereafter “CP”) is a form of ownership of marital property based on the concept that a marriage is an economic partnership between the spouses in which each spouse owns an undivided interest in the CP assets. As discussed below, while the specifics differ from State to State, each CP State also recognizes that the spouses can own Separate Property (hereafter

“SP”) in addition to their respective interests in their CP. Thus, it is not at all uncommon in a CP State for a couple to have “Yours, Mine and Ours”. Depending on State law, while conceptually it would be nice to visualize this tripartite arrangement as three (3) distinct baskets, the distinction between “my” SP, “your” SP and “our” CP can become confused and problematic if “my” SP is used to improve or repair “your” SP or “our” CP. B. Where Does It Exist?

The eight (8) original CP states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington along with Puerto Rico. All of them initially based their systems on Mexican-Spanish law (hence the geographical locus being in the West). Subsequently, as a result of the favorable treatment CP receives under the Internal Revenue Code, Wisconsin adopted the Uniform Marital Property Act which incorporates CP principles and is therefore considered a CP state.

C. Definitions

1. Black's Online Law Dictionary defines CP as follows:

“Community property is property acquired by husband and wife, or either, during marriage, when not acquired as the separate property of either. In re Lux's Estate, 114 Cal. 73, 45 Pac. 1023; Mitchell v. Mitchell, 80 Tex. 101, 15 S. W. 705; Ames v. Hubby, 49 Tex. 705; Holyoke v. Jackson, 3 Wash. T. 235, 3 Pac. 841; Civ. Code Cal.”<sup>1</sup>

2. IRS Publication 555 “Community Property” defines CP and CP income as property:

“•That you, your spouse (or your registered domestic partner), or both acquire during your marriage (or registered domestic partnership) while you and your spouse (or your registered domestic partner) are domiciled in a community property state;

•That you and your spouse (or your registered domestic partner) agreed to convert from separate to community property; and

•That can't be identified as separate property.

Generally, community income is income from:

•Community property;

•Salaries, wages, and other pay received for the services performed by you, your spouse (or your registered domestic partner), or both during your marriage (or registered domestic partnership) while domiciled in a community property state; and

•Real estate that is treated as community property under the laws of the state where the property is located.”<sup>2</sup>

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<sup>1</sup> [www.thelawdictionary.org/communityproperty](http://www.thelawdictionary.org/communityproperty)

<sup>2</sup> [IRS.Gov/pub/irs.pdf/p555.pdf](https://www.irs.gov/pub/irs-pdf/p555.pdf)

3. States

California and Texas, the two (2) largest CP states, define CP respectively as follows:

**“§ 760. Community property**

Except as otherwise provided by statute, all property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in this state is community property.”<sup>3</sup>  
and

**“Sec. 3.001. SEPARATE PROPERTY.** A spouse's separate property consists of:

- (1) the property owned or claimed by the spouse before marriage;
- (2) the property acquired by the spouse during marriage by gift, devise, or descent; and
- (3) the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.

**Sec. 3.002. COMMUNITY PROPERTY.** Community property consists of the property, other than separate property, acquired by either spouse during marriage.

**Sec. 3.003. PRESUMPTION OF COMMUNITY PROPERTY.**

- (a) Property possessed by either spouse during or on dissolution of marriage is presumed to be community property.
- (b) The degree of proof necessary to establish that property is separate property is clear and convincing evidence.’<sup>4</sup>

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<sup>3</sup> Cal. Fam. Code §760.

<sup>4</sup> Tx. Fam. Code §§3.001-3.003.

D. Why Are We Talking About It Today?

1. Elder Law and Special Needs Trust attorneys, especially those practicing in CP states, need to be fully informed as to the nature of the property interests they may be dealing with when representing married clients. This is especially true where the parties may have owned property prior to marriage that may be involved in planning and funding a SNT. Attorneys practicing in SP jurisdiction may encounter couples who have moved from a CP state to the practitioner's SP state. As will be discussed in greater detail below, the nature of the property ownership, *i.e.* CP or SP, does not change simply because the couple moved from one jurisdiction to the other. The nature of the property interest is fixed at the time of acquisition unless voluntarily changed by parties later on.
2. As a result, it is necessary to start at the very beginning (with apologies to Rogers & Hammerstein, but in fact, it is a very good place to start) by defining "Property."

Black's Law Dictionary defines "property" as:

"1. The right to possess, use, and enjoy a determinate thing (either a tract of land or a chattel); the right of ownership. 2. Any external thing over which the rights of possession, use and enjoyment are exercised.<sup>5</sup>

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<sup>5</sup> Black's Law Dictionary, 3<sup>rd</sup> Pocket Ed.

3. Combining the definition of “property” with the definitions of Community Property and Separate Property we see that at the first level, property acquired during marriage by either spouse other than by inheritance, or gift is presumed to be CP. This holds true regardless of how title to the asset is held because the nature of ownership is determined by its method and timing of acquisition, not how title to the asset reads. Hence, a careful practitioner will not stop asking questions when she sees that an asset is in joint names or one name but will dig further to determine when and how the asset was acquired. This is especially significant in the case of multiple marriages and parties moving from one state to another.

4. An additional question that the prudent practitioner will ask early on is whether or not the couple has Pre-Nuptial or Post-Nuptial Agreement. Depending on state law, the couple may be able to define and/or alter the nature of their property interests. For example, if one spouse owns a business prior to marriage that business is the SP of the spouse. However, the paycheck that spouse brings home is CP since it is property acquired during the marriage. Again, depending on state law, the parties may be able to provide in their Pre- or Post-Nuptial Agreement that not only the business, but the spouse’s income from the business remains that spouse’s SP.

5. Another way the nature of ownership can be changed is through “transmutation.” Where permitted, a Transmutation Agreement is a

method by which a spouse owning SP can convert it into CP and *vice versa*. In most cases these agreements are creatures of statute and the statute formalities must be observed for the transmutation to be effective.<sup>6</sup>

## 2. **Community Property In Estate & Public Benefit Planning**

### A. “Traditional” Estate Planning

1. After gathering information and getting to know the clients, the next question the practitioner usually asks the clients during a meeting to create an estate plan is, “So, what do you want to do with your property?” When the answer from each spouse is “I want to leave the property to X” and the other one says “I want to leave the property to Y” there is (theoretically) no “problem” in a CP state, since each spouse owns one-half (½) of the CP and all of that spouse’ SP and can do whatever the spouse wants. Period. Obviously it is rarely that cut and dried or that simple, but the point is made that ownership is clearly defined and can be dealt with.

2. On the other hand, in the Public Benefit arena, particularly in the context of Medicaid benefits for long term care, things get murky. Medicaid benefits are one of the areas in which Federal law does not recognize a distinction between CP and SP. Medicaid eligibility is determined by looking at the couple as a single

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<sup>6</sup> See for example, Ca. Fam. Code §§850 et seq.

economic unit, lumping all assets of both spouses together in determining eligibility (or the lack thereof). This can create serious confusion for practitioners not familiar with the rules. For example, spouses may have entered a pre-nuptial agreement with the expectation that one spouse's SP assets would be shielded from the SP debts of the other spouse only to find that the state Medicaid agency totally ignores the existence of the Pre-Nuptial Agreement for purposes of determining eligibility for Medicaid for Long Term Care.

B. At Death

1. CP ends with the death of the first spouse to die. In a "conventional" estate plan, each spouse would probably leave their entire estate to the survivor. In a CP state this means the decedent's one-half (1/2) of the CP and all of the deceased spouse's SP which is now the surviving spouse's SP.

2. However, if part of the goal in the planning is to take into account the possibility that a surviving spouse may need Medicaid for Long Term Care, this approach is probably disastrous for the surviving spouse. But the existence of a spouse's CP interest can mitigate the problem. If the deceased spouse leaves her or his one-half of the CP and all of her or his SP to a Testamentary Special Needs Trust created for the benefit of the surviving spouse in the deceased spouse's Will, the deceased spouse's assets will be sheltered in the same manner as any other SNT. The surviving spouse may need to use all of her or his assets to become eligible for Medicaid for Long Term Care, but the deceased spouse's

assets will not complicate the picture and can be used to continue to improve the surviving spouse's quality of life.

3. From a tax standpoint, the biggest advantage CP has of SP is that both halves of a CP asset receive an adjustment to basis (commonly referred to as "stepped-up basis), not just the deceased spouse's half.<sup>7</sup> From an income tax standpoint this can be a significant windfall to the surviving spouse. It is for this reason that the concept of "Elective Community Property" was created. [identify states]. Under the various Elective Community Property statutes, married residents (and non-residents in some cases) can elected to classify some or all of their property as CP notwithstanding that the jurisdiction is a SP jurisdiction.

C. Community Property and Domestic Relations Issues In Planning SNTs

1. Judgments and Settlements

a. The treatment of sums received as a result of a Personal Injury or Medical Malpractice judgment or settlement by a spouse (*i.e.* is it CP or SP?) is state law dependent. If the award is SP and the injured spouse needs to dispose of the award in order to maintain public benefit eligibility, she or he can, all other things being equal, transfer those funds to a SNT and maintain public benefit eligibility without the consent of the other spouse.

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<sup>7</sup> IRC §1014(b)(6). IRS Publication 555 Provides excellent information regarding the tax treatment of CP assets.

2. On the other hand, if the proceeds are CP, then (again depending on state law), the couple may be well advised to either transmute the CP into the injured spouse's SP (if possible under state law) before transferring the funds or in some other manner having the well spouse divest herself or himself of any interest in the award so as not to create any confusion as to who was the owner of the award prior to its transfer. If this is not done, theoretically an argument could be made that the well spouse's interest is third-party money and the injured spouse's interest is first-party money and an impermissible commingling of first- and third-party funds has occurred.

D. Domestic Relations Issues

1. When a marriage is dissolved, the CP ceases to exist and is allocated between the spouses pursuant to the Court's Order or by a Settlement Agreement.

2. At that time, if one of the spouses is receiving or is entitled to receive public benefits and/or a child of the marriage is receiving or is entitled to receive public benefits, the issue of child and/or spousal support and its effect on public benefits becomes very important.

3. In these cases, consideration should be given to having the Domestic Relations Court establish a SNT for the benefit of the spouse or child in need and direct that all spousal or child support payments be directed to those trusts for the benefit of the Beneficiary. If the Domestic Relations Orders are already in effect, counsel should consider going back into Court to seek modification of the Orders

either creating the SNTs and directing future payments into the SNT or, if a SNT has already been created, directing payments into the pre-existing SNT.

4. In the author's experience, many Domestic Relations practitioners are not aware of these options. Elder Law and Special Needs Law attorneys perform a very useful function in educating their fellow members of the Bar in this regard (and it's not bad marketing either).

3. **Conclusion**

While CP currently exists in only eight (8) jurisdictions (not including the Elective Community Property states), the number of us migrating from state to state, either permanently, occasionally or annually as "snowbirds," is increasing (at least prior to the Pandemic). Since the nature of ownership doesn't change by virtue of a move, it is incumbent on practitioners everywhere to at least be aware that the issues exist and that questions need to be asked early in the representation in order to avoid problems down the road.