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Montana's Treatment of Community Property Interests

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MONTANA'S TREATMENT OF COMMUNITY PROPERTY INTERESTS

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Two separate and distinct property systems exist within the United States: the community property system and the common law system. Numerous legal complexities and disputes arise when property is transferred from one system to another or when there is a change of domicile by a married couple from a jurisdiction following one system to a jurisdiction following a different system.[1] For example, will a common law state recognize the spouses' interests in community property as such interests are recognized and protected in a community property state? The importance of this problem and the need for clarification will increase with the increasing mobility of the population.

In Re Hunter's Estate[2] involved a facet of this general problem. This note will review that decision discussing the recognition and protection the Montana court accorded the community property interests. It will analyze the decision in terms of basic community property theory and community property law as it presently exists in the community property jurisdictions. This note will compare and contrast *Hunter's Estate* with other common law states' decisions involving community property. Finally, the ramifications of *Hunter's Estate* upon community property interests in Montana will be analyzed.

THE DECISION

The Hunters, a California couple, purchased Montana realty with community property funds. Record ownership of the realty was in the husband's name. Upon his death, he devised his entire interest in the realty to his wife. The state of Montana sought to collect inheritance tax upon the whole value of the Montana realty. Thelma Hunter contended, however, that since the Montana realty had been purchased with community property funds, half of which she had owned under California law, she owned a half interest in the Montana realty prior to her husband's devise. Therefore, she contended that only half the value of the Montana realty should be taxed under the Montana inheritance tax statute.[3]

The Montana supreme court agreed that the determination of the dispute depended upon the nature of Mrs. Hunter's interest in the community property funds. The court ruled, however, that under existing California law, Mrs. Hunter's interest in the community funds was a

[1]N. LAY, TAX AND ESTATE PLANNING FOR COMMUNITY PROPERTY AND THE MIGRANT CLIENT, 8-16 (1971) [hereinafter cited as LAY].

[2]In Re Hunter's Estate, 125 Mont. 315, 236 P.2d 94 (1951) [hereinafter referred to as Hunter's Estate].

[3]REVISED CODES OF MONTANA, § 91-4401 (1947).

"mere expectancy" and not a vested interest. Therefore, Mrs. Hunter received the entire Montana realty by reason of her husband's devise and would be taxed accordingly.

BASIC COMMUNITY PROPERTY THEORY

Community property is a civil law institution, originating with the Visigoths who settled southern France and Spain during the decline of the Roman Empire.[4] Underlying the system is the marital community. Generally, community property is described as a system under which the husband and wife become co-owners of property acquired during the marriage by either or both through labor, industry, or skill.[5] This is in contrast to a modernized common law system of individual ownership of property by the spouse individually acquiring it. Furthermore, the community property concept of co-ownership has no equal in the common law pattern of marital rights, for the basic community property concept is one of co-ownership as "conjugal partners" in acquests and gains.[6]

A second basic principle of the community property system is the division of property into separate and community property. Separate property is usually defined as property owned by either spouse before marriage or acquired afterward by gift, devise, or descent.[7] Community property is defined as all other property acquired after marriage.[8] The spouses' interests in community property is said to be "equal, present, and existing" in each of the parties of the community upon the acquisition of the property and regardless of which spouse acquired it.[9] This division of the interest in community property is qualified by the fact that the husband is given the right to manage and control the whole of the community property during the marriage.[10] In no way, however, does this qualification alter the spouses' respective interests in the community property.[11]

The ruling in *Hunter's Estate* is contrary to community property theory. To rule that a wife's interest in community property is a "mere expectancy" is to hold also that the husband's interest is a "mere expectancy"; otherwise, the word "equal" has no meaning.[12] The theoretical absurdity of such a ruling is manifest.

[4] 2 AMERICAN LAW OF PROPERTY § 7.2 (A. J. Casner ed. (1952); W. DE FUNIAK & M. VAUGHAN, PRINCIPLES OF COMMUNITY PROPERTY, § 2 (2d ed. 1971).

[5] 2 AMERICAN LAW OF PROPERTY, *supra* note 4 at § 7.1.

[6] *Id.*

[7] *See, e.g.*, CALIFORNIA CIVIL CODE §§ 5107, 5108 (1970) [hereinafter cited as CAL. CIVIL CODE]; IDAHO CODE § 32-903 (1948) [herinafter cited as ID. C.]; ARIZONA REVISED STATUTES § 25-213 (1956) [hereinafter cited as A.R.S.].

[8] *See, e.g.*, CAL. CIVIL CODE § 5105; ID. C. § 32-906; A.R.S. § 25-211.

[9] *See, e.g.*, CAL. CIVIL CODE § 5110; NEVADA REVISED STATUTES § 123.225 (1967).

[10] *See, e.g.*, CAL. CIVIL CODE §§ 5125, 5127; ID. C. § 32-912.

[11] DE FUNIAK, *Commonwealth v. Terjen: Common Law Mutilates Community Property*, 43 VA. L. REV. 47, 50 (1957).

[12] LAY, *supra* note 1 at 203.

COMMUNITY INTERESTS IN THE COMMUNITY PROPERTY STATES: FROM CONFUSION TO ACCORD

The institution of community property presently exists in eight states: Louisiana, Texas, New Mexico, Arizona, California, Nevada, Washington, and Idaho.[13] All eight states, with a minor exception in California,[14] presently recognize the wife's interest in community property as vested and equal with the husband's.[15] This is in accord with basic community property theory. This position, however, was not arrived at without a good deal of fumbling and contradictory language in the case law—especially in the California decisions.[16]

The confusion revolving around the rule of "mere expectancy" originated from a mistranslation of the Spanish word "dominino" to mean ownership rather than control.[17] Thus, in *Guice v. Lawrence,*[18] the Louisiana supreme court ruled that the husband owned the community property rather than just having a right to control it. The Louisiana court subsequently recognized the original error in *Guice,* reversing itself in *Philips v. Philips.*[19] However, by then the California supreme court, acting in reliance upon the *Guice* decision, had adopted the rule of "mere expectancy."[20] This remained the law in California until 1927 when the legislature enacted a statute stating that the wife's interest in community property was "existing, present, and equal" with the husband's.[21] Idaho and New Mexico initially followed California's lead, however, both subsequently judicially repudiated the rule of "mere expectancy."[22]

THE COMMON LAW STATES' TREATMENT OF COMMUNITY PROPERTY INTERESTS: CONFUSION

Although the community property states all presently follow the rule that the wife's interest is an "equal, present, and existing" interest, the common law states are in disarray. The present confusion revolves around California couples who acquire community property in Cali-

[13]Six additional states: Oklahoma, Ohio, Michigan, Nebraska, Pennsylvania, and Hawaii (at the time a territory) adopted the community property system between 1939 and 1948 due to a favorable income tax treatment of community income. Since Congress passed the 1948 statute providing for joint returns, all six states have rejected the system. LAY, *supra* note 1 at 13.

[14]A wife's interest in California community property prior to 1927 is a "mere expectancy." *See* Spanfelner v. Meyer, 57 Cal. App.2d 786, 124 P.2d 862 (1942).

[15]Poe v. Seaborn, 282 U.S. 101 (1930); Kohny v. Dunbar, 21 Idaho 258, 121 P. 544 (1912); In Re Williams Estate, 40 Nev. 241, 161 P. 741 (1916).

[16]In Re Williams Estate, 40 Nev. 241, 161 P. 741 (1916).

[17]Philips v. Philips, 160 La. 813, 107 So. 584, 588-589 (1926).

[18]Guice v. Lawrence, 2 La. Ann. 226, 227 (1847) [hereinafter referred to as Guice].

[19]Philips v. Philips, *supra* note 17.

[20]Packard v. Arellannes, 17 Cal. 525, 538 (1861).

[21]CAL. CIVIL CODE § 5110.

[22]Hall v. Johns, 17 Idaho 224, 228, 105 P. 71 (1912) *rev'd.*, Kohny v. Dunbar, 21 Idaho 258, 265, 121 P. 544 (1912); Reade v. DeLea, 14 N.M. 442, 95 P. 131 (1908) *rev'd.*, Arnett v. Reade, 220 U.S. 311, 319 (1911).

fornia and migrate to a common law jurisdiction or transfer the community property to such a jurisdiction. Much of this confusion is undoubtedly attributable to the historical confusion in the California case law and the use of common law terminology by the California courts in explaining the community property system.[23]

Hunter's Estate was the first dispute involving California community property to be settled by a court in a common law jurisdiction. There, the Montana court ruled that the wife's interest in community property was a "mere expectancy" despite the theory of community property and an unequivocal California statute stating otherwise.[24]

The next case appeared in Virginia. *Commonwealth v. Terjen*[25] involved a California couple who moved to Virginia and purchased a home with community funds. Record ownership was placed in Mrs. Terjen's name. A gift tax return was filed for half the value of the house by Mr. Terjen.[26] The State of Virginia sought to tax the total value of the house under the gift tax statute. The Terjens, using the same theory as Mrs. Hunter,[27] contended only half the value of the house should be taxed. The Virginia supreme court, relying heavily upon the Montana ruling in *Hunter's Estate,* likewise adopted the rule of "mere expectancy" and taxed the Terjen home accordingly.[28]

In 1964 *In Re Estate of Kessler*[29] came before the Ohio supreme court. The case involved the determination of the taxable value of stocks in Mr. Kessler's estate. The Kesslers had acquired the stock while living in California and then moved to Ohio. Again, the state sought to tax the whole value of the stocks, contending that Mrs. Kessler had no vested interest in the stock prior to her husband's devise. Mrs. Kessler, again employing the theory used by Mrs. Hunter,[30] argued that only half the value of the stocks should be subject to the succession tax.

The Ohio supreme court rejected the Commissioner's adoption of the rule of "mere expectancy" stating:

> . . . her interest in the community property vested as of the date and place of acquisition and, as stated by the California statute, her interest in such property was present, existing, and equal.[31]

[23]34 OP. ATT'Y. GEN. 395 (1924).

[24]For criticism see Note, 27 TUL. L. REV. 116 (1953).

[25]Commonwealth v. Tergen, 197 Va. 596, 90 S.E.2d 801 (1956).

[26]Mr. Tergen owned a half interest in the home, for it was purchased with community property funds. The record showed that Mrs. Terjen was the sole owner, which meant that Mr. Tergen had given her his half interest in the home.

[27]In Re Hunter's Estate, *supra* note 2 at 317 and discussion *supra.*

[28]The value of the ruling is questionable. The appellee (Tergens) did not appear before the Virginia supreme court. Possibly this is attributable to the fact that only $140 worth of tax was involved. *See* criticism de Funiak, *Commonwealth v. Tergen: Common Law Mutilates Community Property,* 43 VA. L. REV. 47 (1957); Note, 42 VA. L. REV. 724 (1956).

[29]In Re Estate of Kessler, 177 Ohio St. 136, 203 N.E.2d 221 (1964).

[30]In Re Hunter's Estate, *supra* note 2 at 317 and discussion *supra.*

[31]In Re Estate of Kessler, *supra* note 29 at 139.

Still, Ohio applied the succession tax to the whole value of the stock. The theory was that although Mrs. Kessler had a vested half interest in the community property, she received additional incidents of ownership (e.g., such as the right to directly control and manage her interest) in regard to her half interest upon her husband's death.[32] It was upon the transfer of these additional incidents which the succession tax was imposed, thus making the total value of the stocks taxable.

The only common law jurisdiction not to tax the wife's half interest in community property is Colorado. *People v. Bejarano*[33] involved the determination of the taxable value of retirement benefits. The Bejaranos had acquired the benefits while living in California and Texas. The controversy again revolved around whether Mrs. Bejarano's half interest in the benefits vested prior to her husband's death or afterward. Again, the state's contention was that Mrs. Bejarano had a "mere expectancy" in the community property which became vested upon her husband's death. The Colorado supreme court rejected the rule of "mere expectancy" and simply concluded:

> It is sufficient answer to this contention to point out that the right is vested to the extent that the death of the decedent did not under the present statute give rise to a taxable event.

It is to be noted that two of the common law states adopted the rule of "mere expectancy" and two rejected it. Three applied a tax and one did not. Of the decisions, the Colorado ruling is the preferable one since it is more consistent with the true nature of the community property interests in theory and in practice. Moreover, it recognizes and protects the community property interests, affording the owners the full benefit thereof notwithstanding their change of domicile or transfer of property to a common law state.[35]

Of the three common law jurisdictions taxing the wife's interest in community property, two followed a legally ill-founded theory. Montana and Virginia not only adopted a theory contrary to the theory and law of community property, but one which fails to recognize and protect the spouses' respective interests in community property.[36] In *Kessler*, the Ohio court adopted a theory more in accord with that of community property.[37] The Ohio theory recognizes the respective interests in community property, but does not allow the owners the full

[32]For a discussion of the constitutionality of a federal tax based upon this theory, *see Fernadez v. Weiner*, 326 U.S. 340 (1945).

[33]People v. Bejarano, 145 Colo. 304, 358 P.2d 866 (1961).

[34]*Id.* at 869.

[35]LAY, *supra* note 1 at 205.

[36]For example, a wife from California loses her vested interest in community property once it is transferred into a jurisdiction following the rule of "mere expectancy." For criticism of this approach, see LAY, *supra* note 1 at 205.

benefit of the interests when there is a transfer of property to a common law state.[38]

RAMIFICATIONS OF HUNTER'S ESTATE

The Hunter decision raises two serious problems. First, will the rule of "mere expectancy" be followed by the Montana court in a dispute involving the determination of the spouses' respective interests in community property transferred to Montana?[39] If so, it would be possible for a California husband to deprive his wife of her interest in community property by simply transferring the property to Montana. Second, *Hunter's Estate* places a cloud of uncertainty over community property for the Montana estate planner. How the property will pass upon the death of a spouse and the applicability of the inheritance tax both depend upon the characterization of the interests in the community property. Because of the questionableness of *Hunter's Estate* and the confusion existing in other common law states, possibly the best approach here would be to transfer the community property into a common law form of ownership. This would insure the predictability of ownership for planning purposes.

CONCLUSION

It is submitted that the decision in *Hunter's Estate* was legally and theoretically ill-founded. The decision is contrary to the modern trend of property law, the basic theory of community property, and the law of community property in the community property jurisdictions. It is also a haunting specter to couples with community property interests who move from California to a common law jurisdiction, to estate planners who come in contact with an estate containing community property, and to those members of the women's rights movement who are calling for the adoption of the community property system as a more equitable property system.

[38]For example, the community property jurisdictions do not impose an inheritance tax upon the wife's half interest in community property upon the husband's death, but Ohio did. *See, e.g.*, ID. C. § 14-401.

[39]A second major area of litigation involving community property is the determination of the spouses' respective interests. Depas v. Mayo, 11 Mo. 314, 49 Am. Dec. 88 (1848); Edwards v. Edwards, 108 Okla. 93, 233 P. 477 (1925); LAY, *supra* note 1 at 122.