# Property Law

## A Survey of Transfer and Ownership Law for Trustees

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# Property Law

This article is intended to be a survey of those aspects of property law most important to those serving in the role of corporate trustee. For most of us, the concept of “ownership” is instinctive. “Mine” is something that we understand even before we arrive in kindergarten. But the underlying legal nature of ownership and the basis in western society for transferring ownership of various interests has evolved from a complicated and ancient body of law. Because the very essence of the trust relationship comes from the concept of ownership for someone else, a review of property law is critical to a deep understanding of fiduciary law.

Despite the widely diverse nature of wealth today, the roots of trust law are grounded in real property. Trust law has its beginnings in the ancient traditions associated with the transfer of property (land estates) primarily in what is now Europe and Great Britain. Ancient English common law principles govern property ownership rights. But even before the deed was devised as a means of transferring the rights to property, the British had a means to document the transfer of ownership that was steeped in tradition.

## Nature of Property

Wealth, which once meant exclusively the ownership of land, has evolved into a complex variety of asset classes. To a layperson, the term property usually refers to a thing such as land, a boat, or jewelry. The word *property* comes from the Latin *proprius* - to own. Property is anything which can be owned – tangible or intangible. It is also the legal relationship of a person to a thing conferring one or more rights of ownership. The concept of “private property” is fundamental in our society; and, there is a distinction between the thing and the various interests or claims that people may own in the thing. In trusts, the things owned by the trust may be described in older documents using the Latin terms as the *res* of the trust or its *corpus*.

To be efficient any system of property rights must include: (1) universality (2) exclusivity and (3) transferability. Universality is required because a system for transfer of ownership rights is only effective if everyone recognizes it. History is filled with examples of conflict caused by a failure in the universality of property rights between societies. Native Americans did not accept the European colonists’ concepts of property ownership. They were peoples who had their own inherent system of rights - rights that required no validation or legitimization from the newcomers who found their way onto the soil. They had a complex system of property rights, “universal” among most tribes and across vast geography that was based largely upon occupancy, need and – surprisingly – conservation and management of resources. Unfortunately, the European system that was in their view based upon imaginary lines drawn upon paper, was entirely incomprehensible to them. Their refusal to accept the “universality” of

European property rights and willingness to engage in conflict around that disparity in systems had tragic outcome.[1]

Exclusivity is the second critical aspect of a system of property rights for the same sort of common sense reasons. Exclusivity is the limited possession, control, or use of the thing by a single individual or group - the exclusive authority to determine how a resource is used. For example, the owner of an apartment has the exclusive right to determine whether to rent it out and, if so, which tenant to rent to; to live in it himself; or to use it in any other peaceful way. He also has the right to all the rental income from the property. This notion is so deeply ingrained in Western Cultures that when a rogue government chooses to usurp the rights to resources – it nearly always acts by seizing "ownership" of the underlying property. Instead of simply taking the rents, the taking is of the ownership of the asset itself.

Finally, property rights must be transferable. If I am not allowed to buy some rights from you and you therefore are not allowed to sell rights to me, all property rights are reduced. The third element of a property rights system therefore, must include the right to exchange the resources at mutually agreeable terms.

Within the parameters of our system, property is generally divided into two categories – real property and personal property. Personal property can itself be further divided into two subcategories – tangible and intangible. The idea that different types of ownership of property could be transferred arose early as well. Complete or partial ownership of property (where only some of the rights in the property were transferred) could be transferred. What follows is a survey of some basic concepts of property law employed in the various functions of trust and estate administration.

## Types of property

As noted above, there are two types of property and virtually anything that can be owned falls into one or the other of these categories. The first is "real property" which is generally described as land. This is an oversimplification of real property because depending on the law of the jurisdiction, oil and gas, minerals and certain other advantages running with the land may also be considered real property. For example, in Texas oil and gas is considered to be real property. This is derived from concepts of ownership that a piece of land originally including everything from the surface to the

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1 "One of the most fundamental requirements of a capitalist economic system—and one of the most misunderstood concepts—is a strong system of property rights. For decades social critics in the United States and throughout the Western world have complained that "property" rights too often take precedence over "human" rights, with the result that people are treated unequally and have unequal opportunities. Inequality exists in any society. But the purported conflict between property rights and human rights is a mirage—property rights are human rights. " Armen A. Alchian

core of the Earth (what was known as Blackstone's Wedge). Specific assets below or even above the surface may be severed from the original estate but they are still considered to be items of real property.

Personal property, as noted consists of nearly everything else and is further divided into two categories: (1) tangible personal property or chattel (property that has a physical existence such as jewelry, livestock or furniture) and (2) intangible personal property (property that has no physical existence such as rights under a trademark, a copyright, stocks or accounts). Evidence of ownership of each of these types of property, as accepted by current legal systems, will be different. The ownership or transfer of real property, since 1677, must be evidenced in writing such as a deed, lease, contract, will or grant from a government. The only evidence of ownership of tangible personal property, however, may simply be possession.

**Categorizations by Acquisition**

The concept of possession as "evidence" of ownership is why an important facet of property law is that property may be categorized by how it is acquired. Property may have been acquired by gift, purchase, grant, capture, find, adverse possession, or, at some points in our history, divine right. Different rights may attach to property by virtue of how it is acquired.

**Capture**

For example, under the Rule of Capture, one acquires property rights in a wild animal (or something sufficiently analogous to a wild animal) if one captures, traps, or mortally wounds the animal. Thus, a fisherman acquires the ownership of what he pulls up in his net. But there are exceptions. Owners of land have constructive possession over all wild animals on their property, which generally voids the rights of capturers who trespass and capture game. This may not seem relevant to the work of a trustee. However in Texas, where the recreational ranch property (which is often most valuable for its hunting rights) becomes an asset of a trust, it suddenly becomes very important. And in keeping with this principal that this property right runs with the land, if we transfer the "right to capture" on our real property, we do so with a "lease".

In some jurisdictions, oil and natural gas may be considered to be analogous to wild animals and the rules of capture apply to those assets. But as those who live and work in Texas know well, other jurisdictions (including Texas) clearly label oil, gas, and minerals and as real property.

Another example of a type of property not always categorized the same way in every jurisdiction is groundwater. The English rule has always been one of absolute ownership – the landowner could draw as much water as he liked and the devil to your neighbor. In the United States ownership of groundwater is subject to a rule of reasonable use – that is that wasteful use that hurts neighbors is inappropriate.[2] And water, minerals, surface and many other forms of property have become subject to various statutory and administrative regulations. Oddly, that surface waters are treated differently in different states creates the situation that theoretically, the water in a river flowing from one state to another might be subject to different rules of ownership as it flows.

Generally, in Western States (those most likely to be arid) the principle called "prior appropriation" applies. This is basically a rule of first in time – the first to capture water and put it to reasonable use acquires ownership. (Interestingly, this law has nuances involving preferred uses – and despite its evolution from early mining claims - agriculture has strong preference over industry.)

In Eastern states (where water is generally more plentiful), the rule of law developed into what is called "riparian rights". As people moved inward off of the east coast towards the west, and land was being claimed, people would claim land next to rivers, lakes and ponds in order to have access to the water that is vital to human existence.

As long as an owner's land was part of the banks of these waters, owners had the right to use the water for the purpose of gain or pleasure which gave the land its chief value. They had the rights to the access of the fish in the waters and to divert the water for irrigation.[3] As more people populated the east there were more riparian land owners. Governments began to monitor the use of the waters so that riparian land owners were not deprived of their rights because they were further down stream to others. As the need for water increased, so did the laws that defined the uses of it. Now a riparian land owner may use the waters but may not deprive or injure the rights of other riparian land owners downstream – may not divert the water or block the fish that would otherwise continue downstream to other riparian land owners.

**Found Property**

Property may also be acquired by simply having been "found". As a general rule, a finder has title to found property against all but the true owner and prior possessors. But if an employee or agent is acting in the scope of his employment when the property is found, the property belongs to the employer or principal. This rule is has been applied in the occasional case of cash or jewelry found hidden inside a desk or other piece of furniture being sold at auction.

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2 This is one example of how the Native American cultures that existed in the "new world" influenced the development of property rights otherwise imported from Europe.

3 Under the common law, "riparian" rights are called "natural" rights because they are seen as arising from the laws of nature.

There is an elaborate system of law to apply to “treasure” hidden in the earth or “salvage” of a vessel sunk under water. In the case of “buried treasure” the British rule is that it belongs to the crown. In the United States, however, it goes to the finder. This rule of law presumably evolved as a matter of policy to encourage finding such items under the theory that if the finder reaps nothing by his effort, he is not motivated to look. The same theory is applied to shipwrecks. British rule holds the salvage to be the property of the crown but the rule of law in the United States is statutory in nature and mandates a split - with a percentage to the finder and a percentage to those governments (federal, state or local) in whose territorial waters the find occurs.

It is also interesting to note that the intent of the previous owner may be taken into account in the analysis of “found” property – with different standards applying to property abandoned (voluntarily left with no intent to recover) or misplaced. It is also worth noting that the law makes it clear that it is certainly an abuse of discretion for a trustee to misplace property. And it may be difficult to meet the evidentiary burden to show that a thing is so worthless as to justify a trustee’s abandonment of property.

**Gift**

Of course, trustees are very familiar with the concepts surrounding property acquired by gift, or purchase. In the legal sense, a gift is a transfer of property to another person without any benefit given in return for the property. Gifts can be compared to sales and loans but a gift is distinguished from a sale in which parties to the sale exchange something of value with each other. And a loan has a clear expression of intent to either return the property or repay the funds advanced. A gift may be made to a total stranger, close family member, or an institution (usually charitable). A gift may be either total or partial and may be a gift of a present interest in property or an interest in the future (discussed below).

There is much discussion in the law, particularly tax law, as to what constitutes a completed gift. Generally, a completed gift is a transfer in which the giver (donor) does not retain any interest in the property and the recipient (donee) does not give any consideration or benefit to the donor.

There are three requirements that distinguish a gift from some other form of transfer such as a sale. First, is the intent to make a gift. Since the intent to act in a certain way is important, evidence of a person’s intent becomes important. Such evidence may be found in written or spoken words or by evaluating a variety of typical situations that the person has behaved in the past. In some situations, a legal presumption arises that a transfer is or is not a gift. Generally, if the donor retains the rights to take back the property the presumption is that it was never a gift in the first place (see below).

In addition to state property law presumptions regarding whether a gift is made, the federal gift tax law impacts specific transactions. For example, when a joint ownership interest is created in a joint bank account, for federal gift tax purposes a gift does not occur until money is withdrawn from the account by the recipient of the gift. If the recipient of the gift contributed some of the funds in the account, a gift does not occur until the recipient withdraws more money from the account than he or she had contributed to it. Delivering a check to another person is not treated as a gift until the check is paid or transferred for value to someone else.

The second requirement of a gift is that the donor must give up full dominion, ownership, and control of the item to the person who receives it. In some situations a person may give up ownership and control of an item, but still retain possession of it after the transfer. This may indicate several things, such as the owner wants to retain the right to change his or her mind about making the gift, or the gift is intended to take effect only after the owner's death. In the first instance, the right to revoke the gift may indicate that a complete gift has not occurred (see above). In the second instance, a gift that is delayed until after an owner's death is a gift of a smaller interest in property than a gift of a full interest. This future interest that follows after an owner's death is referred to as a remainder interest.

The third requirement is that the recipient of the gift actually receives and accepts it. Often the right to disclaim a gift has important tax consequences. The law does not force acceptance of a gift.

In addition to these requirements, several other factors influence the determination of whether a gift is made. If property is transferred in return for something that cannot be valued in terms of money or money's worth, such as love and affection, or a promise of marriage, the transfer is viewed as a gift. Waiving or surrendering marital rights to property is also treated as a gift, except where a married couple actually obtains a divorce and settles their property rights by written agreement. Gifts can be either directly or indirectly. Direct gifts are gifts made to the recipient without first passing through another entity or person. Indirect gifts, such as gifts in trust, ultimately pass to the intended recipient, but only after passing through the trustee's legal ownership form.

### Grant

The word “grant” may indicate the property itself or a gift (as of land or money) for a particular purpose. It may be used to refer to the process of according a right as a favor, prerogative, or privilege. It may also refer to a transfer of property by deed or writing or the instrument by which such a transfer is made. Most often found in the history of real property transfer in the context of land given by government to a citizen and often the original documentation of individual ownership in North America where land grants from the Spanish, French and British crowns are the last entry in a reverse chronology of title. The concept of transfer of ownership by government grant may seem quaint today but is still a very important aspect of modern property law. While seldom is real property transferred today by grant of a government, it is still a government grant that confers rights under a patent or copyright. And the concept of grant is very relevant to the rights of law in franchise, trademark, academics, and charitable property today.

### Adverse Possession

Another method by which an asset may be acquired is the rule of Adverse Possession. The definition of Adverse Possession is an unconventional means of acquiring title to land which occurs when a person occupies and possesses another's land under claim of right or color of title for a period of time set by the applicable statutes. Adverse Possession has evolved from a mishmash of common and statutory law and varies from jurisdiction to jurisdiction in what period of time is required, whether the occupation must be open and notorious, whether it must be continuous and uninterrupted, what constitutes actual possession and what constitutes color of title. There are also various statutes specifying from what type of owner property may be adversely possessed. Nevertheless, the concept exists in some form in virtually every state and is an additional good reason for a prudent trustee to take care to inspect and maintain real property held in trust. It is important to note that a successful adverse possessor may only get the interest the true owner had in the land at the time they began adverse possession. As will be discussed below, that state of ownership may fall into several categories. (While it is also possible to adversely possess certain types of personal property, the law that applies is ancient and vague and virtually never applied in modern society.)

### Purchase

Of course, property may be acquired by purchase. In general, a purchase is defined as an act or instance of purchasing as in the acquiring of real property by any means other than descent or inheritance. Of course, it may apply to personal property as well. A purchase then is generally the acquiring of an interest in property usually in exchange for valuable consideration. A purchase is a contractual transaction (although the transaction may not be documented in writing).

### The Estate System (Estates in Real Property)

While the “fee simple” is by a wide margin the most often experienced form of property ownership today, it is not the only method by which an estate in real property may be held. In categorizing estates in land there are three characteristics to examine: (1) duration; (2) transferability and (3) inheritability. This area of the law arises from an ancient tradition. In 1066, Edward the Confessor, King of England, died celibate and childless. In a controversy over who was the rightful heir to the throne of England, William of Normandy (a/k/a William the Bastard and William the conqueror) invaded England. He defeated his opponents at the Battle of Hastings, claimed the English throne, and subsequently expropriated all the nobles of their land. In the redistribution of the land, the estate system arose. A gradual enactment of statutes eroded feudalism and resulted in the basic concepts that exist today which include the independent ownership of land; the ability to freely alienate or transfer land; and inheritability. When we examine an estate to see what type of ownership it may be we look at the words used to transfer the property. But it is important to note that for centuries, even millennia, the written word was not the medium of transfer.

**Seisin or what *Braveheart* and *Kingdom of Heaven* have to do with Trust Law**

As noted previously, prior to the use of deeds, the tradition for transfer of a freehold estate was through a ceremony called "livery of seisin". The ceremony took place in front of witnesses, usually the youngest members of the peasantry or serfs who occupied and worked the land. The grantor and recipient stood in the presence of these witnesses and the grantor handed the purchaser a twig, a clump of soil, or a rock which symbolized the transfer of the property. Then the children were beaten in order to ensure that they would remember the ceremony. It wasn't until 1536 and the passage of a law known as the Statute of Uses that our modern method of transfer and ownership was entrenched in the legal system. Questions of seisin were what led Robert the Bruce to waiver in his support of Sir William Wallace's quest for Scottish freedom (the subject of the movie *Braveheart*). And when the movie *Kingdom of Heaven* premiered in 2005 including a scene depicting a livery of seisin, viewers were critical of the director for his graphic depiction of the beating of a child administered to ensure memory of the transfer of the asset.

**Some Types of Present Interests**

**Fee Simple Absolute** - Ownership in "fee simple absolute" is the most extensive type of ownership. The owner in fee simple absolute owns all of the property rights that presently exist in the property and his rights last indefinitely. There is no restriction on inheritance and the interest is freely transferable. There can be concurrent or shared owners of a fee simple absolute interest such as a joint tenancy or a tenant in common. But each of these owners has complete ownership rights to the property – use, time and title.

**Fee Simple Determinable** – A defeasible fee simple estate also called a Fee Simple Determinable is one in which the ownership rights will or may be terminated at some future time. A simple example of a defeasible fee simple is a life estate. When the ownership terminates the property reverts to the grantor. The grantor retains an interest in the property known as a possibility of a reverter. This is a "future interest".

**Fee Simple Subject to an Executory Limitation -** The grantor may also give away his possible future interest in a conveyance such as: "I convey Blackacre to the City of Chicago so long as the land is used as a public park, and if it is not so used, to University of Chicago." This is called a *Fee Simple Subject to an Executory Limitation* – sometimes just referred to as an "executory" interest. Ownership terminates automatically if the condition specified in the conveyance arises and upon termination, the property transfers to a third party who holds a future interest in the property.

**Fee Simple Subject to a Condition Subsequent** - Another mechanism for transfer limited by use is the *Fee Simple Subject to a Condition Subsequent* – provided some condition is met. An example of this would be a conveyance "to the City of Chicago provided that the land is used for a public park." The grantor or successor in interest can terminate the estate upon the "broken condition". This right is called a power of termination or a right of re-entry, which is also classified as a future interest. Unlike the two previous examples, the fee simple estate in this example does not terminate automatically, but continues until the power of termination is exercised.

**Life Estate -** A present interest in property is one in which the owner has the present right to use, possess and enjoy the property. It differs from a fee simple in that the right expires at some point in the future. An example of a Present Interest would be a Life Estate. A *Life Estate* is an interest in the property that terminates upon the death of the life tenant or the death of someone else. An example seen often in trust is "I leave my interest in my home to my wife until her death and thereafter to my children."

**Estate for Term of Years** - Another Present Interest is the *Estate for Term of Years*. This interest terminates automatically upon the expiration of a fixed period of time. This is not used often but works like a long-term lease and is sometimes used in lieu of a ground lease. Although the life tenant (or the tenant for the term of years) has the current possessory interest, the law imposes upon the current tenant the duty to take no action that would diminish the value of the property for the taker (remainderman) at the expiration of the present interest.

In any of these types of present interest the "doctrine of waste" imposes upon the life tenant a duty to keep the property in reasonable repair to preserve the value of the remainder interest. The life tenant usually pays current taxes and assessments on the property. Many states have delineated the rights and obligations of a legal life tenant and the owner of the remainder interest by statute.

(A reminder - under IRC Section 2503(b), in order for a gift to qualify for the annual gift tax exclusion of $12,000 it must be a gift of present interest. Those discussed above should therefore qualify. Those about to be discussed would not.)

## Future Interests

A Future Interest is an interest in property in which the right of possession, use and enjoyment is in the future - not the present. A reversion is a future interest retained by the grantor that becomes possessory after an intervening estate, such as a Life Estate. In other words, in the examples of a Life Estate or Estate or a Term of Years discussed above the property reverts when the term (or present interest holder) expires. In each example, a future interest is also created.

A grantor may also hold a *possibility of reverter* with respect to a fee simple determinable or a *right of re-entry* (power of termination) in a fee simple subject to condition subsequent - both are classified as future interests. A remainder interest becomes possessory in a third person after the intervening estate, such as a life estate or term of years.

## Vested and Contingent Interests

**Vested Interest –** The interest created if there are no conditions precedent to be met before an estate becomes a present estate, except the natural expiration of the preceding estate. A conveyance "to my spouse for life, then to my children" creates a vested remainder interest in the children.

**Contingent Interest** - An interest is contingent if possession is subject to a condition precedent; when the condition is satisfied - the interest vests. A conveyance "to my wife for life, then to my daughter if she is at least 21" creates a contingent remainder interest in the daughter. Her interest in the property vests only if she is alive and at least 21 when the surviving spouse dies.

**Vested Interest Subject to Divestment** - A vested interest can be divested by the satisfaction of a condition subsequent. A conveyance "to my wife for life, then to my daughter, but if my daughter quits school, then to The Greta Garbo Home" creates a vested remainder interest in the daughter, but she will be divested of her interest if she does not stay in school.

## Rule Against Perpetuities

The Rule Against Perpetuities arose out of a desire of the common law courts to keep the landed aristocracy from exercising excessive dead hand control over property by tying it up with future interests for inordinate periods of time. It does NOT apply to future interests created in the transferor, that is, powers of reverter, rights of re-entry, powers to terminate, or reversions. The rule applies to interests not yet vested.

The most common statement of the rule is that "No interest is good unless it must vest, if at all, not later than [21] years after some life in being at the time of the creation of the interest." If it is possible for the interest to vest outside the perpetuities period, the interest is VOID from the time the conveyance is made. Probabilities are not relevant. The Rule applies to real and personal property including trusts. The life in being may be a member of a class who survives the longest so long as that class is reasonable in size. (A class of 120 measuring lives has been found to be reasonable.) In many jurisdictions, the Rule is supplemented by the gestation period (10 lunar months). Although it varies from state to state and has been repealed or significantly lengthened (in some cases to as much as 1,000 years) in twenty[4] states including Alaska, Idaho, Nevada, Utah, Arizona, Wyoming, Colorado, South Dakota, Nebraska, Missourri, Illinois, Wisconsin, Ohio, Maine, New Hampshire, Rhode Island, and New Jersey, Delaware, Maryland, Virginia and Florida, the Rule persists in a majority of the states.

The Rule is applicable to more than trusts and has been applied in modern courts in several ways. For example, in a case where the owner gave an option to purchase real estate to a corporation for a period of 25 years, the court unwound the transaction because the option did not specify any measuring lives, the option could only be good for 21 years or it was void. (Competent counsel could easily have written around this problem.)

The Rule Against Perpetuities is a rule of logical proof. In order to test a transfer to see if it violates the Rule, first, locate all persons capable of affecting vesting of the interest. (All other lives are irrelevant.) The measuring lives need not be specifically mentioned in the conveyance – frequently only classes of persons are actually desribed. Test each life to see if the interest will vest or fail within that life or 21 years afterwards. If you find a life that meets the Rule requirement, you have found the measuring life. If none of the lives meet the Rule requirement, then the contingent interest is void. Courts in various jurisdictions will provide different outcomes to attempt to “cure” a Rule violation and still honor the wishes of the transferor (usually a testator now long gone).

## Forms of Concurrent Ownership

Another basic premise of the law affecting property rights is that property may be categorized by the number of owners and character of their interests. Some methods by which more than one owner may hold a concurrent interest in property are Joint

[4] To attract trust business and the lawyers’ fees and trustees’ commissions that come with it, twenty states have abolished the Rule as applied to interests in trust. These states have thus authorized perpetual trusts. Real money is at stake. In an empirical study, described in the Yale Law journal, it was found that roughly $100 billion in trust assets have poured into the abolishing states. Not surprisingly, perpetual trust legislation is under consideration in several of the states that have not yet abolished the Rule. Robert H. Sitkoff & Max Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L. J. 356, 375 (2005).

Tenancy, Tenancy by the Entireties, Tenancy in Common, Community Property and Quasi Community Property.

**Joint Tenancy** - In a Joint Tenancy, each joint tenant holds an undivided interest in the whole. Each is equally entitled to use and enjoy the property. The key characteristic to joint tenancy is the right of survivorship. On the death of one joint tenant, the interest of the deceased joint tenant passes automatically to the surviving joint tenant(s) - the interest in joint tenancy property is not a probate asset. (The words "with right of survivorship" may not be necessary in every state, but many deeds will contain those words to remove any question as to the form of ownership.) If the joint tenancy is "severed," the owners become tenants in common.

**Tenancy in Common** - In a Tenancy in Common, each tenant holds an undivided interest in the whole. Unlike a joint tenancy, there is no survivorship feature in a tenancy in common. Each tenant may sell or bequeath his/her interest in the property. If a tenant dies intestate, the interest passes by intestacy and not to the other tenants in common. The ownership interests of each tenant need not be equal. A conveyance "to Tom, Dick and Harry" will create a tenancy in common – whether the conveyance specifies it as such. It is the "default".

**Tenancy by the Entireties** - Tenancy by the Entireties is available only to married couples, and today it is often restricted to homestead property. Tenancy by the entireties is similar to joint tenancy in that it contains a right of survivorship feature. A tenancy by the entireties may provide creditor protection for the couple's homestead, which distinguishes it from a joint tenancy. Only a few states still recognize tenancy by the entireties.

**Community Property** - The community property system, which stems from the Spanish/French civil law system rather than from English common law, exists in a minority of (8) states. They are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington. (Wisconsin has adopted the Uniform Marital Property Act that creates a system similar to community property.) Community property is founded on the concept that husband and wife constitute a community; therefore, the activities of each are considered to be for the benefit of both.

In a community property system, there are important distinctions in the characterization of property. Separate Property is all property owned by a spouse before marriage and all property acquired after marriage by gift, bequest or devise. It may also include property acquired after separation and divorce. In a few jurisdictions, it includes the income generated by separate assets.

Community property, therefore, is all property acquired during the marriage other than separate property (and other than real estate acquired in a common law jurisdiction) while domiciled in a community state. Property acquired with community property funds generally will be community property and vice versa. (In other words, a change in the type of assets does not change the character of the wealth.)

Each spouse owns one half of the community property, regardless of how it is titled. When and how the property was acquired are key in determining whether an item is community property or not. Property is deemed to have been "acquired" at the time rights in and to the property arise.

An important consideration in community property states is what constitutes a marriage. Generally, it is whatever would constitute a legal marriage in the state. Some states will apply community property concepts when both parties thought the marriage was legal, but due to a technicality it wasn't.

The determination due to divorce or death as to what is separate and what is community property often involves a determination as to whether the property was acquired with community or separate funds. This process is known as *tracing*. Although it may be as simple as determining whether funds used for the purchase of an asset came from a separate or community account, it is often more complicated. It may involve a determination as to whether property was acquired by community or separate credit.

Tracing may also require careful analysis regarding the ratio of separate to community funds contributed to acquire the asset. This might arise in an interest in an employee benefit plan or a life insurance policy. Characterization of property as community or separate also depends upon each state's law. By way of example, income from separate property in Idaho, Louisiana and Texas is community property. Most remaining jurisdictions treat income from separate property as separate property. Other areas where jurisdictions differ include things such as damages from personal injury claims or future earnings based on professional education received during marriage (medical, dental, law).

It is possible to change the character of property from community to separate or vice-versa. This process is called "transmutation". As a general rule a husband and wife may change separate property to community property and vice versa by agreement. In most instances a written agreement is necessary to effect a transmutation but this too is a matter of state law. A written premarital agreement can also change the character of property acquired after marriage, provided that the marital agreement is otherwise enforceable. Transmutation can occur also as a result of a gift from one spouse to the other. When community funds are used to purchase a gift (i.e. birthday present) for the other spouse it is presumed that the donor spouse has gifted to the other his/her community interest in the property and the gift is, therefore, the separate property of the donee spouse.[5]

Another transaction that may require tracing is when one spouse takes community funds for the benefit of the spouse's separate property (for example, remodeling or improving a separate property home). In some states this would be treated as a gift; however, this also varies between states.

*Commingling* is the term used to describe the "mixing" of separate and community property. If separate property and community property are commingled to such an extent that it is impossible to distinguish community from separate, the separate property loses its separateness and generally is presumed to be community property. Generally, if assets are commingled, but the source can be traced to community or separate funds, tracing will be recognized for characterization purposes. If one spouse uses community property to benefit his/her separate property, the community estate will either have a right of reimbursement or may gain an ownership interest in what was previously the separate property, depending upon state law. Similarly, separate property used to improve community property may give rise to reimbursement rights, unless it can be established that a gift is intended.

General appreciation in the value of a separate property asset is also separate property. When the growth in a separate property asset is due to the efforts (time and talent) of the one spouse in managing those assets, many states view the increase as a result of the community effort and, therefore, deem a portion of that property community property.

There are a number of presumptions used to "simplify" the characterization of property in community property states. Generally, property acquired during marriage is presumed to be community property, unless there is sufficient evidence to rebut the presumption. In many states, a conveyance or transfer to husband and wife, without more, is presumed to be community property (See above). When husband and wife take title "as joint tenants," there are different presumptions as to the true nature of the property. Some states presume it's joint tenancy unless rebutted by sufficient evidence of a contrary intent. Other states presume it is community property unless it can be shown that the spouses actually meant for ownership to be as joint tenants.[6]

Some states (Idaho and Nevada) do have a specific form of property ownership called "community property with rights of survivorship." In states that do not have a

[5] Property purchased with community or separate funds but titled in the name of "Mr. and Mrs." may be presumed community in some but not all community property jurisdictions.

[6] Recall that the difference would be that instead of each owning a 50 % community interest – each would own a 50% undivided separate property interest.

survivorship feature in their community property law, joint tenancy and community property are mutually exclusive forms of ownership.

There are also complicated statutes governing the rights to manage and control property – community and separate. Both spouses usually have the right to manage and control the community property unless the spouses have modified that right by pre or post marital agreement. Although most states allow either spouse to manage the property, the participation of both spouses may be required in some circumstances. Each spouse has a fiduciary duty to the other spouse in management and control of community property.[7] There are limitations on the control - most states don't allow one spouse to make a gift of the community property to a third party without the consent of the other spouse. If such a gift is made, the non-gifting spouse can force the donor spouse to reimburse the community.

On the death of either husband or wife, one-half of the community property belongs to the surviving spouse and the other half is subject to testamentary disposition by the deceased spouse. This means that a testator's bequest of "all my interest in" the family home only transfers a 50% interest in the house as the other 50% isn't his to bequeath. If a spouse dies intestate, some states provide that the decedent's share of the community property will pass automatically to the surviving spouse (California) and others provide that it would pass to the issue of the decedent spouse (Texas)[8]. Non-probate transfers of assets, such as insurance and employee benefit plans, may present issues if someone other than the spouse is named the beneficiary. Because each spouse owns one-half of the community property, the decedent spouse does not have the power to transfer the survivor's interest in the community asset. It is important to note that the entire community property is stepped up in basis on the death of the first spouse to die, not just the decedent's ½ community interest.[9]

**Quasi-Community Property** - There is another category of property known as "quasi-community" property. Most non-community property states have "forced share" statutes, which prevent one from totally disinheriting a spouse. There is no comparable provision in community property law. If a one wage-earner couple retired and moved to a community property state, it could be that all of the property would be one spouse's separate property. If that spouse left all his/her property to a third party, the surviving spouse typically has no remedy in a community property state. In order to prevent that

[7] See the list on page 17 of various relationships giving rise to a fiduciary duty. The duty of spouses is in the nature of the duty between partners or joint venturers in most jurisdictions.

[8] This occasionally results in the children holding an interest in the property as tenants in common with the second (or fifth) spouse. An excellent argument to those married more than once to be CERTAIN that their affairs are kept in order and a measure of job security for probate litigators and trust officers.

[9] IRC. 1014(b)(6). The Service has taken the position that Wisconsin Marital Property will also receive a full step up in basis on the death of the first spouse to die.

from happening, California developed the concept of quasi-community property. A few states have also enacted similar concepts into their community property system. Quasi-community property substantially reduces the ability of one spouse to move to a community property state to disinherit the other spouse.

## Powers of Appointment

A power of appointment is an authorization given to one person, who is not the owner of the property, to designate recipients of an interest in the property. Put another way, it is a delegation of the power to transfer a right in property. The creator of the power is the "donor" of the power. The holder of the power is the "donee". The donee of the power does not hold title to the property over which he has the power of appointment (although he/she may benefit from the property during life). The donee of the power is merely an instrumentality for transferring title. The property over which the donee holds the power is the appointive property or property subject to a power of appointment. Those to whom the property may be appointed are the permissible appointees. Those to whom property is appointed are the appointees.

The donor of the power can place whatever restrictions or conditions on the power as he/she wants. The donor can limit the permissible appointees to a particular class or classes, such as descendants, grandchildren or charities.

## General Nature of Fiduciary Law

Modern day fiduciary law can best be described as a basket of equitable and legal remedies that arise in a variety of relationships with a common ingredient - potential abuse of a transferred power. The essence of a fiduciary relationship is that it is a confidential relationship. Confidential and fiduciary relations are synonymous in law and exist whenever trust and confidence is reposed by one person in the integrity and fidelity of another. Courts apply equitable concepts such as full disclosure and conflict of interest not only to formal fiduciary relationships such as trustee-beneficiary but to a wide variety of other relationships. These are labeled confidential. They are varied but consistent in that they involve not just dominance alone but dominance as a necessary result of a trust or confidence.

Some examples of "confidential relationships" (those giving rise to fiduciary duty) include:

- Trustee to beneficiary
- Executor or administrator of an estate to beneficiaries
- Guardian (conservator) of an estate to ward
- Participants of a joint venture or general partnership to each other
- General partner to limited partners in a limited partnership

- Owners of executive rights to non-participating royalty owner
- Lawyer to client
- Spouse to spouse (in most states)
- Corporate officers and directors to shareholders
- Parent company to minority shareholders of its subsidiary
- Securities dealer to client
- Co-tenants stand as a quasi-fiduciary to other co-tenants
- Upon insolvency/bankruptcy director to creditors of corporation

In nearly all of these relationships, there is an example of possession or ownership of property, assets, or rights by one party for benefit of another. A shift in the character of wealth (the nature of the property) over the centuries has had a dramatic effect on fiduciary law. Although these concepts first arose when nearly all wealth was land, the most common assets today are interests in business entities such as shares of stock (equity in a company), preferred stock, shares of a family limited partnership, limited liability company, sole proprietorship, REIT, limited partnership interests in real estate, oil and gas working interests, or other ownership of small or closely held business entities. (In light of the various relationships listed above this may result in a layering of fiduciary duty.)

## Legal Versus Equitable Title

The concept of a trust is based upon a division of ownership -- a split between legal title and equitable (beneficial) ownership. This concept also originated in England, and the technique was called a "use".[10] It is because of the split of ownership that property held in trust may avoid probate - the trustor no longer possesses legal title to the assets in the trust. Rather, the trustee holds legal title for the benefit of the beneficiaries.

## Ownership in Trusts

Recall that the parameters of any trust relationship are defined by three primary sources:

- The document creating the relationship;
- Statutes which apply to the relationship;
- "Common law" of fiduciary duty to extent not superseded by statute or the document creating the relationship.

But the transfer of property rights in a trust will also be subject to the default statutes of the jurisdiction.

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[10] It is easy to remember - property was conveyed to someone "for the use" of someone else.

The shift toward the adoption of default statutes is largely an invention of the most recent century. An example of a default statute relevant to trust and property law would be the Texas Uniform Principal and Income Act. The Uniform Law Commissioners proposed the first model Uniform Principal and Income Act in 1931 and a revision was promulgated in 1962. Almost all of the states in the United States had adopted one or the other of the earlier acts by 1997. Then in 1997, the Uniform Law Commissioners promulgated a revised model Uniform Principal and Income Act. The Commissioners had two primary objectives. The first objective was to update the prior Principal and Income Acts to reflect modern developments in fiduciary law and investments, such as wide spread use of alternative investments, to reflect the modern portfolio theory of investing[11], and the widespread use of revocable living trusts as a will substitute. The second objective was to allow fiduciaries the means for making the best investment decisions under the prudent investor rules in the Uniform Prudent Investor Act, especially the principle of investing for total return rather than investing to produce a certain level of "income" as traditionally perceived in terms of interest, dividends and rents.[12] Almost as an afterthought, certain changes were included that dramatically changed the character of "ownership" of certain assets – specifically, oil and gas, timber, copyrights and other assets that have income characterized as "royalty".

Those revised Acts have now been adopted in 42 states (with Minnesota and Rhode Island considering adoption during 2007) but a number of states have passed amended versions of the model Acts. (Think of those as NUPIAs – Non Uniform Principal and Income/Prudent Investor Acts.) The legislative fact sheets for these Acts, can be found on at www.nccusl.org. Anyone interested in those (and any of the over 300 other uniform laws promulgated by the National Conference of Commissioners on Uniform State Law) can see text, a summary and a state-by-state history of passage on that website. This organization is now more than 100 years old.

Texas default statutes setting out rules that may apply to transfer of ownership of assets -in some instances where not addressed specifically by the document and in others for all transfers - include:

- Texas Trust Code
- Texas Uniform Prudent Investor Act

[11] Modern Portfolio Theory is defined as: An overall investment strategy that seeks to construct an optimal portfolio by considering the relationship between risk and return. This theory recommends that the risk of a particular stock should not be looked at on a standalone basis, but rather in relation to how that particular stock's price varies in relation to the variation in price of the market portfolio. The theory goes on to state that given an investor's preferred level of risk, a particular portfolio can be constructed that maximizes expected return for that level of risk. It is also often referred to as the modern investment theory. (See www.investorwords.com)

[12] Uniform Principal and Income Act (Prefatory Note) (1997)

- Texas Uniform Principal and Income Act
- Uniform Trustees' Powers Act
- Uniform Custodial Trust Act
- Texas Probate Code
- Texas Uniform Child Support Enforcement Act
- Uniform Securities Act
- Texas Statutory Power of Attorneys Act
- Texas Uniform Transfers to Minors Act
- Texas Limited Partnership Act
- Texas Business Organizations Code

These include provisions adopted in Texas and by an increasing number of states that cannot be overridden by a testator or grantor.

The traditional duties of a trustee are to receive, invest, account, distribute, and report within the requirements of the document, state and federal law. Courts and the legislature constantly refine the concept of fiduciary duty but a key duty applicable to fiduciaries has been the duty of competence which includes possession, custody, control of the assets. Generally, assets must be within the trustee's possession and control; although, default legislation (as mentioned above) allows a trustee to employ agents and delegate investment authority.

Holding assets in "street name" at DTC or under a similar scheme has long been considered acceptable and is now virtually mandatory. Texas default statutes permit the use of "money market" funds and address the use of mutual funds – mechanisms that allow the trustee to maintain ownership of but not physical possession of the assets. These modern accommodations affect the methods by which we document transfer and ownership of property – but do not change the underlying duty of the trustee to competently maintain and manage the assets owned by the trust.

As noted above, certain default statutes may include specific instructions regarding how a trustee should treat the property received during the administration of a trust. And example of would be the provisions of the Uniform Principal and Income Act, Article 4 entitled "Allocation of Receipts During Administration of Trust". The rules regarding the allocation of receipts are largely dependent upon the characteristics of the receipt. As a result, this is often the easiest way to review the rules.[13]

The general rule is simple. If the trustee receives money, it is income (and is, therefore, the property of one class of beneficiary) unless other sections of the Act provide

[13] The UPIA divides Article 4 into the following three parts: Part 1, Receipts from Entities, Part 2, Receipts not normally apportioned and Part 3, Receipts Normally Apportioned.

differently. Examples from the uniform provisions including language that specifies allocation of receipts to principal (the other class of beneficiary) include:

- Money received in one distribution or a series of related distributions in exchange for a part or all of a trust's interest in the entity is allocated to principal. UPIA § 401(c)(2) and Texas Property Code §116.151(c)(2).
- Money received in total or partial liquidation of the entity is allocated to principal. UPIA § 401(c)(3) and Texas Property Code §116.151(c)(3). A receipt is a total or partial liquidation:

  1. To the extent that the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation UPIA § 401(d)(1); or

  2. If the total amount of the money and property received in a distribution or series of related distributions is greater than 20 percent of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt. UPIA § 401(d)(2).

  3. Money is not received in partial liquidation, and should not be taken into consideration for the "20% rule," to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of the entity that distributes the money. UPIA § 401(e).

Money received from an entity that is a regulated investment company or a real estate investment trust if the money distributed is a capital gain dividend for federal income tax purposes is principal. UPIA § 401(c)(4). Stated another way, any net short-term capital gain from entities is income under the Act. Cf. Comments to UPIA Section 401 (describing federal income tax laws). All of the above provisions are essentially mandates to the trustee regarding which of the classes of beneficiary of a trust are entitled to use and enjoy the benefits of ownership of the property.

**Evidence of Transfers**

There are many ways to document the transfer of legal ownership or rights in property. As discussed above, intangible personal property (for example stocks, bonds or royalties) is often transferred by a certificate of ownership or in some cases merely an electronic entry. The best evidence of ownership in some cases may be possession of the thing itself. Real property is transferred in most cases today by deed, contract, or will. Automobiles have a title certificate; software may have an electronic certificate and the simple assignment is used to transfer a wide variety of interests in partnerships and other business entities. This is an area of property law that changes from year to year and state to state. A prudent and competent trustee must take care to determine the correct method to document the acquisition of and disbursement of any type of property that may be held in a fiduciary capacity.

## Conclusion

This is by no means an exhaustive discussion of every aspect of property law. We have merely attempted to hit the “highlights” and make students aware of the many aspects of ownership that affect trust and estate administration. As noted in the beginning, there is much more to property law and the concepts of ownership than the kindergarten concept of “mine”.