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When Term Life Policy Proceeds Are Community Property

Cite: [*In re the Marriage of Becky and Gary Burwell*](#), No. F064265, 2013 WL 5878251 (Cal. Ct. App. Oct. 31, 2013).

Summary: The California appellate court held that the characterization of term life insurance policy death proceeds as community or separate property depends, not only on *who* paid the final premium (*i.e.*, was it paid with separate or community funds), but also on other factors such as (1) the insurability of the insured and (2) whether the amount of the final premium payment is capped or otherwise discounted against the current market cost of comparable coverage.

If a final premium payment is paid with *separate* assets, to the extent that the final premium represents the cost of the insurance coverage for the final period of coverage in which the insured died, the death proceeds should be separate property. However, to the extent that the coverage being purchased is worth more than the final premium payment, either because the medical state of the insured would render him uninsurable at that time (or more costly to insure) or because the renewal premium is capped or discounted from what is generally available for comparable coverage in the market place, then a court may determine that *some* portion of the renewed coverage has been paid for by prior premium payments which may have been made with community assets.

This Court therefore sent the case back to the trial court for further factual findings regarding the allocation of the final premium payment between the current annual cost of term coverage and the value of the renewal rights.

Facts: Gary and Becky Burwell separated on September 2004 and embarked on a long and complicated divorce proceeding resulting in a stipulated judgment. In each of his asset disclosures in the context of the dissolution action, Gary omitted any reference to an existing term life insurance policy he owned on his life.

On October 7, 2008, Gary changed the beneficiary on the policy from Becky to his new wife, Cynthia. On April 17, 2010, Gary committed suicide and Becky filed an action to prevent payment of the term policy proceeds to Cynthia. The trial court found that Gary had failed to disclose the term policy in the dissolution proceedings and that the beneficiary change he made was void because it violated a restraining order prohibiting changes to beneficiaries generally during the dissolution process.

The trial court ordered that half of the proceeds be paid to Becky as her community property and the other half to Gary's estate. Cynthia appealed.

Result: The discussion of the appellate court with respect to whether the term life insurance policy was community or separate property was very interesting. The court began by noting that the earnings and accumulation of a spouse while living separate and apart from the other spouse are the separate property of the spouse. Gary apparently paid the annual term insurance premium from his separate property from 2005 through 2010 when he died.

The court noted that a term insurance policy contains two elements: (i) "dollar coverage" payable in the event of death during "the specific term for which the premium was paid," and (ii) "a right to renewal for future terms without proof of current medical eligibility." The court held that the term life insurance policy was not a unitary and indivisible asset but a combination of "individual enforceable contractual rights derived from the policy." The court also said that each premium paid on a term policy purchases a distinct right to coverage for a specified period.

Prior to this couple's separation, community assets purchased the right to coverage in the event death occurred in each of the prior years to which the premiums were attributable and the community "fully received everything it bargained for," and after separation, the payment of premiums with separate property results in the proceeds of coverage occurring in a post separation year being separate property.

However, the court noted that "[c]omplications arise when the separate estate uses a community asset to acquire the final term of coverage." The court concluded that this may occur when the final year of coverage is purchased at a discount from its true market value either because the insured is medically uninsurable or more expensive to insure during the final term, or the amount of the premium is capped or discounted such that comparable coverage is not available for a comparable cost

during the final term. The rationale being that if the coverage for the final term is being obtained at a discount, the right to the discount may have been paid for, at least in part, by assets of the community which was paying premiums in prior years.

The appellate court summarized its conclusions as follows:

The proceeds are entirely community when the final premium is paid solely with community property The proceeds are entirely separate property when: (1) a separate estate has paid the final premium with separate funds; and (2) the insured spouse was insurable at the end of the last term paid for by community funds; and (3) either (a) the insured spouse's health was such that he or she could have purchased a comparable policy at a comparable price when the separate estate began paying the premiums, or (b) the policy did not contain a premium cap when the separate estate began paying the premiums. The proceeds are part community and part separate where (1) the separate estate has paid the final premium with funds that are part community and part separate; or (2) the insured spouse has become medically uninsurable before he or she began paying the premiums with separate property; or (3) the insured spouse could not have purchased a comparable policy at a comparable price when he or she began paying the premiums with separate property.

Relevance: Members should take note of the fact that in community property states such as California, the proceeds of a term life insurance policy will generally take on the character of the source of the final premium payment. If the most recent premium for a life insurance policy is paid from community property funds, for example, that will make the life insurance policy and its benefits community property. However, the value of the renewal rights based on the continued insurability of the insured or a capped or discounted premium may cause a portion of the proceeds to be treated differently.

WRNewswire #13.11.12 was written by Marla Aspinwall of [Loeb & Loeb, LLP](#).

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