#F-640 12/15/82

First Supplement to Memorandum 82-103

Subject: Study F-640 - Marital Property Presumptions and Transmutations (Mixed Assets)

At the November 1982 meeting the Commission requested the staff to draw a broad-based recommendation to allow reimbursement where community property is acquired, produced, or improved in part with separate property and where separate property is acquired, produced, or improved in part with community property. The staff was also to consider whether the recommendation could feasibly be submitted to the 1983 legislative session.

Attached to this memorandum as Exhibit 1 is a staff draft of a recommendation to accomplish the result desired by the Commission (as well as a transitional provision to make the draft effective immediately, to the extent practical). Rather than phrase the statute in terms of reimbursement rights, the staff found it simpler and more direct to provide that a marital asset is part community and part separate, based on the community and separate contributions for its acquisition or benefit.

A major difficulty in this area is specifying the proportions of community and separate ownership of a mixed asset. The Commission's decision was to leave the problem for continued case development until we have time to go in depth into the extraordinarily complex and difficult questions surrounding such matters as the character of loan proceeds with which the property is acquired, whether payment of interest, taxes, and insurance should be credited, whether benefits (such as use value of the property or income tax deductions) should be offset, and whether expenditures must be discounted to present value. Although these are matters the Commission ultimately must grapple with, they will consume a substantial amount of Commission and staff time; in light of the Commission's priorities, the staff agrees they should be deferred for now. The draft statute is silent on these matters.

The staff believes the recommendation should not be submitted to the 1983 legislative session even if the Commission approves it as drafted. First, the rule of proportionate ownership, as the Commission has recognized, should be subject to the general community property

presumption and to contrary agreements by the spouses; we are seeking to clarify the law governing presumptions and transmutations (see Memorandum 82-103) and the staff deems it inadvisable to proceed until this matter is resolved. Second, the staff believes interested persons should have an opportunity to review and comment on the recommendation; the recommendation will make significant changes in existing law and practice and, if not carefully done, could cause substantial problems. The staff believes the comments of our consultants, of experts in the field, and of interested persons generally are essential.

The staff's proposal is that the recommendation, after any revisions and approval by the Commission, be incorporated in the tentative recommendation on presumptions and transmutations and distributed for comment and submitted to the Legislature in due course. We have drafted the recommendation accordingly.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

Mixed Assets[1]

Couples often use both community and separate property in the acquisition of major assets, especially those paid for over time. One who purchases a home or begins a business before marriage, for example, may use borrowed funds and have loans still outstanding at the time of marriage. Typically, payments on such debts during marriage are made from current income, community property. Similarly, life insurance policies or retirement plans are often initiated before marriage with separate property funds or efforts, and continuing payments or efforts are expended during the marriage to maintain or increase the coverage. Even when a business or home is purchased during marriage, separate property acquired before the marriage or from a spouse's family is often incorporated in the down payment. Current income is typically used to meet the monthly mortgage payments that are an almost inevitable part of the scheme. Rarely do couples give any thought to their respective ownership interests in the home or business, other than to indicate with survivorship provisions that each wishes the other spouse to retain the home after his or her death. Indeed, only some of those who have given the matter thought will have actually discussed their views with their spouses. Yet, when death or divorce occurs, some allocation of the asset, including any appreciation, must be made.

Case law has developed several applicable doctrines. Originally, a property's character as separate or community theoretically was established at the time of purchase. According to this "inception of the right" doctrine, unless the parties agreed to alter the nature of the property, ownership interests were fixed at the time title was acquired.[2] If property of another source was later used to improve the property, absent a gift, the owner of the property had a right to reimbursement for either the amount expended or the benefit to the improved property.

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1. Portions of the following discussion are drawn from Bruch, The Definition and Division of Marital Property in California: Towards Parity and Simplicity, 33 Hastings L.J. 769, 787-790 (1982), a background study prepared for the Law Revision Commission.

2. W. De Funiak and M. Vaughn, Principles of Community Property § 64, at 130 (2d ed. 1971).

This rule, too, and its accompanying presumptions could be displaced by showing that the parties had agreed otherwise, because California freely permits spouses to alter marital property rights by agreement.

Although these doctrines often operated sensibly during the era of sole management and control, when only one spouse had management power over any given item of community or separate property, they did not provide satisfactory results in all cases. An exception gradually developed. Life insurance and pensions, which were typically acquired with payments over many years, came to be considered "installment purchases" rather than rights acquired at the time of an initial payment.[3] This treatment permitted a fair accounting of both separate property payments before and after marriage and community property payments during marriage. Title was accordingly treated as having been acquired pro rata by all payments from whatever sources, whenever made.

This reasoning was extended to the purchase of a home. Faced with separate property title acquired by one party shortly before marriage, the court in Vieux v. Vieux[4] refused to hold that the home was separate property and that the community had, at best, a right to reimbursement for its expenditures. Instead, it reasoned that for marital property purposes the home should be viewed as an asset that was purchased over time, and that the respective property sources shold be given pro rata ownership interests in proportion to their contributions. In a rising market, where the equity contributed in payments was frequently less substantial than that which was added to the home's value by appreciation, this rule gave the community a share in the home's increased value. The doctrine was later extended to the purchase during marriage of a business in a case involving a separate property down payment, borrowed funds, and repayment from the business' earnings.[5]

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3. See Smith v. Lewis, 13 Cal.3d 349, 530 P.2d 589, 118 Cal. Rptr. 621 (1975) (retirement plans); Gettman v. City of Los Angeles, Dept. of Water & Power, 87 Cal. App.2d 862, 197 P.2d 817 (2d Dist. 1948) (life insurance); Modern Woodman of America v. Gray, 113 Cal. App. 729, 299 P. 754 (1st Dist. 1931) (term life insurance).

4. 80 Cal. App. 222, 251 P. 640 (2d Dist. 1926).

5. Gudelj v. Gudelj, 41 Cal.2d 202, 259 P.2d 656 (1953) (separate property down payment, borrowed funds, repayment out of the business' earnings).

In recent years, the details of shared ownership interests have been the subject of frequent litigation. Recent decisions of the California Supreme Court have attempted to bring order to the case law. Under these cases the community has an ownership share in property on the basis of the proportionate contribution of the community to the equity in the property.[6] However, title presumptions are permitted to defeat the effort to trace community and separate contributions to the property.[7]

An approach more consonant with the realities of contemporary economics and the dynamics of marriage, as well as with the trend of the law, is that ownership of a marital asset should be based not on its status or title presumptions at the time of its acquisition but on the amounts of community and separate property contributed to its acquisition, production, or improvement. Recognition of the mixed character of marital assets will conform to the reasonable expectations of spouses in the ordinary case, who contribute both separate and community property to marital assets without intending a gift. The ownership of the property should be presumed to be community, but the spouses should have the opportunity to show the proportionate community and separate character of the property or to show that they have made an agreement as to the character of the property.

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6. In re Marriage of Moore, 28 Cal.3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980). See also In re Marriage of Marsden, 130 Cal. App.3d 426, ___ Cal. Rptr. ___ (1982).

7. In re Marriage of Lucas, 27 Cal.3d 808, 614 P.2d 285, 166 Cal. Rptr. 853 (1980). The placement of separate funds in a joint tenancy title is held to constitute a gift that cannot be avoided by demonstrating that no gift was intended. Instead, "an agreement or understanding" to hold as other than joint tenants is required.

Article 3. Combined Community and Separate Property

§ 5110.310. Mixed assets

5110.310. (a) Property that is acquired, produced, or improved by either spouse during marriage with community property, separate property, or a combination of community and separate property, is part community property and part separate property to the extent of the proportionate community and separate contributions to its acquisition, production, or improvement.

(b) The following provisions apply to property that is part community and part separate:

(1) The community and separate portions of the property are governed by the laws of this state that govern community and separate property except to the extent a different rule is provided in this subdivision.

(2) The property is subject to the provisions of this title that govern the management and control of community property.

(3) The community and separate portions of the property may be partitioned in the manner provided in Title 10.5 (commencing with Section 872.010) of Part 2 of the Code of Civil Procedure (partition of real and personal property).

(4) If the property is applied to the satisfaction of a debt for which the community or separate portion is not liable or is liable subject to a right of reimbursement, a right of reimbursement arises to the extent, and is enforceable in the manner, provided in Chapter 3 (commencing with Section 5120.010) (liability of marital property).

Comment. Section 5110.310 establishes the rule that the character of marital property acquired or improved with a combination of community and separate property is determined not by its character at the time of acquisition ("inception of title") but by the character of the expenditures for its acquisition or improvement ("pro rata sharing"). This rule is consistent with cases that gave the community an interest in separate property acquired in part with community funds. See, e.g., In re Marriage of Moore, 28 Cal.3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980). It is also consistent with cases that allowed reimbursement for expenditures for the improvement of separate property with community funds. See, e.g., Bare v. Bare, 256 Cal. App.2d 684, 64 Cal. Rptr. 335 (1967). However, Section 540.310 applies equally whether the separate property acquired or improved by community property expenditures belongs to the person who made the expenditures or the spouse of the person who made the expenditures. This overrules cases such as Dunn v. Mullan, 211 Cal. 583, 296 P. 604 (1931), and In re Marriage of Camire, 105 Cal. App.3d 859, 164 Cal. Rptr. 667 (1980), which denied reimbursement where a married person expended community funds for the acquisition or improve-

ment of the separate property of the spouse. Section 5110.310 also reverses the effect of the rule that a married person is not entitled to reimbursement for expenditures of separate funds for the acquisition or improvement of community property. See, e.g., In re Marriage of Lucas, 27 Cal.3d 808, 166 Cal. Rptr. 853, 614 P.2d 285 (1980).

Unlike the reimbursement cases, Section 5110.310 achieves the result of recognizing the community and separate contributions to a marital asset by characterizing the asset as a combination of community and separate property rather than by defining it as property of one character and giving a reimbursement right for contributions of the other character. Thus under Section 5110.310 the character of a marital asset is based on expenditures for the asset regardless of the good or bad faith of the spouse making the expenditures and regardless of the knowledge or consent of the other spouse. However, these factors may enter into a determination whether the community is entitled to reimbursement pursuant to Section 5125 (duty of good faith) for expenditures for the preservation, maintenance, or other benefit to the separate property of a spouse that are not acquisitions or improvements.

Section 5110.310 does not specify the manner of computation of the proportionate community and separate ownership of a mixed asset, but leaves the matter to continued case development. See, e.g., In re Marriage of Moore, 28 Cal.3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980). Moreover, the mixed character of the asset is subject to the general community property presumption and is affected by any transmutations or agreements between the spouses as to the character of the property. See Sections 5110.520 (community property presumption) and 5110.610 (transmutation of character or ownership of property).

Under Section 5110.310 a mixed asset is divided at dissolution of marriage or distributed at death of a spouse proportionately in accordance with its community and separate character. During marriage, however, a mixed asset is treated as community property for purposes of management and control, and the property is subject to partition. If a creditor seeks to apply the asset to a debt for which only a portion of the property is liable, a spouse may prevent the nonliable portion from being applied to the debt by means of a third-party claim procedure or, if it is applied, may obtain reimbursement.

Subdivision (a) of Section 5110.310 applies to all mixed marital assets, including assets acquired or benefited by the separate property of both spouses, as well as assets acquired or benefited by a combination of separate and community property. Subdivision (b) applies only to community-separate combinations; separate-separate combinations are held as tenants in common and are governed by the general rules applicable to tenancy in common property.

§ 5110.930. Determination of character of property

5110.930. A determination of the character of marital property made before, on, or after the operative date in an action or proceeding brought to trial before the operative date is governed by the applicable law in effect before the operative date.