Memorandum 83-68

Subject: Study F-642 - Combined Separate and Community Property

Background

Among the most difficult problems in family law are those that occur where separate and community property are combined in a marital asset. Is the asset treated as separate or community or a hybrid for purposes of management and control, creditors' remedies, dissolution, probate?

The Commission has dealt with one aspect of these problems in connection with its work on joint tenancy. AB 26 adopts a rule that if a community asset is acquired or improved in part with separate funds, at dissolution of marriage the community divides the asset and the person who contributed the separate funds is entitled to reimbursement on a dollar-for-dollar basis. This overrules the Lucas case, but of course is quite limited in scope since it deals only with property rights at dissolution of marriage and only with respect to property that can be characterized as community, as the result of a presumption or otherwise. It does not deal with the issues surrounding whether a particular asset should be characterized as community if initially acquired in part with separate property or if initially acquired wholly with separate property (with community contributions made later).

This area of the law is complex not only because community and separate contributions can be made to property at different times and in different sequences, but also because the same property may demand different treatment for different purposes, and different types of property may demand different treatment for the same purpose. The cases that deal with acquisition of real property and tangible personal property generally are distinguishable both from the cases that deal with acquisition of such property in installments or on credit and the cases that deal with improvements made to such property. Separate bodies of law govern acquisition of intangible personal property such as interests in pensions and in life insurance policies and their proceeds.

Portions of the following discussion of the law applicable to these different areas and the problems unique to each type of situation are drawn from W. Reppy, Community Property in California, 85, 87, 90, 93-94 (1980). The remainder was prepared by the staff. The memorandum concludes these matters are best left to case law development, for now, but points out one problem that requires legislative correction.

Asset Acquired at One Point in Time

The easiest case for determining the interests in an asset that is owned partly as community and partly as separate property (in effect making the community and one or both of the spouses cotenants) arises when during marriage a known amount of community and separate funds are paid over at one time as the complete purchase price of the asset. One simply calculates the percentage of community and separate funds used to buy the item and they are the fractional interests. If the purchase price was $1,500 and funds expended were $900 community and $600 W's separate estate, ownership is sixty percent community.

When the consideration is labor provided over time (only part of which is during marriage) or when an asset is bought over time on installment payments of mixed source, things become more complicated.

Acquisition in Installments or on Credit

Cases where tangible assets are acquired over time by installment payments have apportioned ownership on the basis of the amount of separate and community money spent to buy the item. This has been treated differently from the situation of an acquisition during marriage with borrowed money--the borrowed money and consequently the property itself is separate or community based on the intent of the lender in relying on separate or community credit or security. The distinction between these two situations is based on the time of passage of title to the property in an installment contract as opposed to a credit acquisition. In the case of a credit acquisition, separate payments on a community loan or community payments on a separate loan would be entitled to reimbursement in accordance with general gift and reimbursement principles.

In either case, there are practical problems in calculating separate and community property rights. To date the cases treat the initial payments as buying the same share of title, dollar for dollar, as the last payments. In an inflationary economy, $1.00 spent ten years ago is worth a lot more than $1.00 spent this year--particularly when one considers the lost interest that could have been earned on the early payments. The apparent difference may be offset by the fact that the separate estate making the early payments (before marriage) got use of the property over the years or perhaps even used the property to generate separate profits.

A portion of each payment is attributable to interest. If payments are amortized, the initial payments are almost all interest, the final payments almost all principal. Where property is used to generate profits, close calculations are necessary in deciding how the profits are owned if both separate and community funds have been used to make payments. The ownership of the capital assets shifts from month to month or year to year as more payments are made. In some cases a month-by-month proration of profits--corresponding to the shifting ownership of the asset will be required.

Improvements

A related but different set of issues arises where community property has been used to preserve, improve, or benefit the separate property of one of the spouses. If one spouse has applied community property for this purpose, at dissolution or death the community is entitled to reimbursement. See, e.g., Provost v. Provost, 102 Cal. App. 775, 283 P. 842 (1929); In re Marriage of Warren, 28 Cal. App.3d 777, 104 Cal. Rptr. 860 (1972); In re Marriage of Jafeman, 29 Cal. App.3d 244, 105 Cal. Rptr. 483 (1972). Cases have held, for example, that the community is entitled to reimbursement for taxes and assessments paid for the benefit of the separate property (e.g., Estate of Turner, 35 Cal. App.2d 576, 96 P.2d 363 (1939)), for improvements (e.g., Bare v. Bare, 256 Cal. App.2d 684, 64 Cal. Rptr. 335 (1967)), for incidental expenses (e.g., Somps v. Somps, 250 Cal. App.2d 328, 58 Cal. Rptr. 304 (1967)), and for mortgage payments (e.g., In re Marriage of Walter, 57 Cal. App.3d 802, 129 Cal. Rptr. 351 (1976)).

There is some confusion in the cases as to the amount of reimbursement that should be allowed. The latest ruling of the Supreme Court is that the community is entitled to reimbursement not on the basis of actual expenditures for interest, taxes, and insurance, but on the basis of the proportionate contribution of the community to the equity in the property. 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, 181 Cal. Rptr. 910 (1982). The conflict in the cases as to the reimbursement formula that is used seems to depend to some extent upon whether the spouses were aware of or consented to the payments, whether the spouses have resided on the property and used it as the family home, whether the community is, because of the nature or amount of the contribution, deemed to have acquired an interest in the property, and whether the spouses believed the property to be separate or community or whether there has been a deliberate misappropriation. In cases where the spouses have resided on the property, its fair rental value may also be a factor. Suffice it to say that although there are many cases dealing with this type of situation, the law is far from clear.

A different rule applies to the converse of this situation, where one spouse has spent community funds for the improvement not of the spouse's own separate property but for the improvement of the other spouse's separate property. Here a gift is presumed, and the community is not entitled to reimbursement. See, e.g., Dunn v. Mullan, 211 Cal. 583, 296 P. 604 (1931). This rule applies even though the spouses have made trust deed payments, paid refinancing expenses, taxes, and insurance, and made improvements out of community funds while living on the separate property as the family home. In re Marriage of Camire, 105 Cal. App.3d 859, 164 Cal. Rptr. 667 (1980). Although the gift presumption was first announced in cases where the husband, the manager and controller, applied community property to the separate property of the wife, the Camire case adheres to the gift presumption even though the husband no longer has sole management and control.

Apportioning Separate and Community Interests in Pensions

Pensions and retirement plans raise special prorating problems. Most difficult to deal with is the "defined-contribution" plan. Under such a plan a separate account is kept for each employee showing the sums contributed by him or her and on the employee's behalf by the employer. Trustees or plan managers invest these funds along with contributions of other employees and, periodically (e.g., at the end of the year) credit the account of the participant with a share of the gain accruing from the investments. Gains will be high in some years, low in others; there may even be years of net loss due to a declining stock market. In any event, an accountant can roughly formulate the portion of gain due to separate and to community contributions to the plan. In most instances the gain on initial contributions will be, on a dollar per dollar basis, substantially greater than gains on later contributions, for the reinvestment of early gains operates like the compounding of interest.

A simpler approach to apportionment in cases of defined-contribution plans is to prorate on the basis of "time"--from a fraction based on a number of months (or years) the spouse participated in the plan while married and on the number of months single (or living separate and apart from the other spouse.) This fraction supplies the total community and separate interests in the plan at the time of valuation. Example: H works ten years while single and then marries W and works fifteen years more before valuation is made. The community owns sixty percent of the plan. This "time apportionment" approach achieves a rough justice in many cases, for contributions are often a percentage of the participant's salary, which increases over time. Thus, initial contributions may have been $100 a month, the more recent $250. However, the plan managers have had more time to earn investments on the smaller, earlier contributions. Thus, one month of participation twenty-five years ago may well be roughly equal to one month two years ago.

With "defined benefit" plans separate accounts detailing contributions and earnings history for each participant are not kept. Rather, labor for the employer over a specified period of time qualifies the employee to receive plan benefits either in a fixed amount (as $400 per month for life) or as a percentage of salary at retirement, or of average salary for a period, such as five years, before retirement. With this type plan it is probably impossible to determine a particular amount of money paid over at a particular time by the employer to the plan managers on account of the employee spouse's participation. Accordingly, apportionment must be based on time and cannot be based on money contributions. But the time apportionment will, as indicated above, usually operate fairly. See Marriage of Adams, 64 Cal. App.3d 181, 134 Cal. Rptr. 298 (1976), suggesting that in the unusual case where it does not a different approach to apportionment of defined-benefit plan participation rights could be used.

Apportionment of Life Insurance Policies and Proceeds

Life insurance proceeds are often an asset on hand at dissolution of the community by death; a policy in effect is often on hand at divorce. How should ownership be apportioned where some premiums have been paid with community, some with separate, funds?

Little problem exists with the "investment portion" of whole life policies. The cash surrender value at the time of dissolution should be subjected to a "money apportionment" taking into account the rate of increase and the period of time the company has had to invest the portion of premiums used for that purpose.

The rest of the premiums in whole life polices and all the premiums of "term" policies purchase death benefits and do not build up a cash surrender value. Usually, however, such payments result in the additional benefit of continued insurability without need for passing a new physical examination.

To date California cases dealing with term policies have used a straight "money" apportionment. One dollar of premium paid twenty years ago with, for example, H's separate funds, is treated as buying the same fractional share of the policy and, if the insured has died, of the proceeds, as one community dollar of premium paid just before the characterization is made. This is based on the theory that it was because of the insured's "having regularly paid the premiums . . . that he was entitled to continue to enjoy the protection" of life insurance although past the age of insurability. Modern Woodmen of America v. Gray, 113 Cal. App. 729, 299 P. 754 (1931).

Elsewhere the last premium is viewed as the sole source of the proceeds payable at the insured's death--earlier payments are viewed as buying coverage for a period that has expired. Travelers Ins. Co. v. Johnson, 97 Idaho 336, 544 P.2d 294 (1975); Phillips v. Wellborn, 89 N.M. 340, 552 P.2d 471 (1976); Gaethje v. Gaethje, 8 Ariz. App. 47, 442 P.2d 870 (1968).

One writer proposes that ninety percent of the proceeds be viewed as purchased by the last premium while ten percent are subject to a "money" apportionment to take account of the continued insurability fact stressed in Modern Woodmen. Comment, Community and Separate Property Interests in Life Insurance Proceeds: A Fresh Look, 51 Wash. L. Rev. 351 (1976).

Aetna Life Ins. Co. v. Primofiore, 80 Cal. App.3d 920, 145 Cal. Rptr. 922 (1978), holds in a somewhat different context that a term policy has no value just before the insured dies, which must cast some doubt on the viability of Modern Woodmen. Nevertheless, Modern Woodmen was reaffirmed and the out-of-state authority rejected in Biltoft v. Wooten, 96 Cal. App.3d 58, 157 Cal. Rptr. 581 (1979).

Conclusion

This brief discussion illustrates the relative complexity of the combined separate and community property problem and the considerations unique to various types of property and situations. In the staff's opinion the cases have struggled with the problems and done a generally adequate job in reaching a fair result. We wonder whether legislation would improve the law in this area. A more likely result is that the legislation, while dealing with some of the problems in a satisfactory way, would create unforseen problems in special circumstances.

For example, in AB 26 we deal with the limited area of reimbursement for separate property contributions to a community assst. But it is conceivable that the statute could be read to apply to assets other than real property and tangible personal property and that the courts might construe it as a direction to abandon the pro-rata ownership concept applicable to intangibles such as pensions and life insurance policies and to substitute a reimbursement principle. It is an area in which we must tread very carefully.

The staff recommends that the Commission not attempt to codify general principles in this area but leave it to continued case development. If particularly bad decisions or lines of cases develop, such as the Lucas situation, we should respond to it on an ad hoc basis. We do not now see the need for, or feasibility of, a comprehensive revision of the law in this area.

One bad decision that should be corrected is the rule that when the husband makes a payment out of community property that benefits the separate property of the wife, the husband is presumed to have made a gift and the community has no right of reimbursement. This rule derives from the days when the husband had management and control of the community property and therefore an act by the husband to deplete the community could not unreasonably be viewed as intentional. With equal management and control, either spouse can make payments and it is clear that no gift is usually intended. Yet when the issue arose in In re Marriage of Camire, 105 Cal. App.3d 859, 164 Cal. Rptr. 667 (1980), the court held that although equal management and control appears to have undercut the old rule, the old rule is based on Supreme Court holdings that have not been overruled, and therefore the old rule is still the law. The Camire case is criticized in Lichtig, Characterization of Property, in 1 California Marital Dissolution Practice § 7.54 (Cal. Cont. Ed. Bar 1981). To cure this problem, the staff would add the following section to the presumptions and transmutations recommendation:

§ 5110.650. Community contribution to separate asset

5110.650. If community property is contributed by a married person, with or without the consent of the married person's spouse, to the benefit of the separate property of either spouse, the contribution is not presumed to be a gift.

Comment. Section 5110.650 overrules the gift presumption formerly applicable where a married person having management and control of community property made a contribution of the community property to the benefit of the separate property of the other spouse. Cf. In re Marriage of Camire, 105 Cal. App.3d 859, 164 Cal. Rptr. 667 (1980) (adhering to the traditional rule of law that denies either apportionment or reimbursement for community contribution to a wife's separate property). Under Section 5110.650, the community is not presumed to have made a gift but would acquire a proportionate interest in the property, or a right of reimbursement, on the same general principles as a community contribution made to the separate property of the spouse having management and control of the community property. This rule recognizes that under equal management and control, either spouse may be making payments, and both spouses may have consented to the payments, without thereby intending to benefit the separate property of one spouse to the detriment of the community. Section 5110.650 does not preclude either spouse from making a showing of an agreement between the spouses or an actual intent to make a gift.

Respectfully submitted,

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