FEBRUARY 2001 CALIFORNIA BAR EXAMINATION
ESSAY QUESTIONS AND SELECTED ANSWERS

Community Property

QUESTION

In 1980, Herb married Wanda, and the couple took up residence in a California home, which Herb had purchased in 1979.

Herb had bought the home for $50,000 by making a $5,000 down payment and signing a promissory note for the balance. At the time of the marriage, the outstanding balance on this note was $44,000. During the next 20 years, the couple paid off the note by making payments from their combined salaries. The home now has a fair market value of $200,000.

In 1985, Wanda sold for $10,000 a watercolor she had painted that year. She and Herb orally agreed that the $10,000 would be her sole and separate property. Wanda invested the $10,000 in a mutual fund in her name alone. The current value of the mutual fund is $45,000.

In 1995, Herb and Wanda bought a vacation cabin on the California coast for $75,000. They made a down payment of $25,000 with community property funds, and both signed a note secured by a deed of trust on the cabin for the balance. Title to the cabin was taken in the names of both Herb and Wanda "as joint tenants."

Shortly afterward, Herb inherited a large sum of money from his mother and used $50,000 of his inheritance to pay off the note on the cabin. In 2000, Herb and Wanda added a room to the cabin at a cost of $20,000, which Herb pail out of the funds he had inherited. The current fair market value of the cabin is $150,000.

In 2001, Wanda instituted a dissolution proceeding. What are Herb's and Wanda's respective rights to:

1. The home? Discuss.
2. The mutual fund? Discuss.
3. The cabin? Discuss.

Answer according to California law.

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Community Property

ANSWER A

California is a community property state. This means that all property earned during marriage by a spouses' efforts, labor or skill is deemed community property. All property earned before marriage or after separation, or property that is acquired by devise or inheritance during marriage is separate property. A transformation in form of the property does not change its characterization. In order to determine whether property is community property or separate property, a court will trace back to the original form of the property. At divorce, courts will divide the community assets 50-50 and in kind, if possible, unless special rules provide otherwise.

1. The Home

If a home is purchased with both separate and community funds, and there is no joint title presumption, then, at dissolution, both the separate and community property estates will receive the pro rate share of the home's value at divorce. (Marriage of Moore) When Herb purchased the home in 1979, he contributed $5000 as the down payment. He additionally paid $1000 of the loan amount prior to marriage. Therefore, his separate property contribution was $6000 at the time of the marriage. The purchase price of the home was $50,000. Therefore Herb should receive 6/50 (or 3/25) of the appreciation value of the home (i.e., 3/25 of $150,000) in addition to his separate property contribution of $6000, at divorce.

As stated above, community property is that property which has been earned as a result of a spouse's efforts, skill or labor during marriage. Here, the facts indicate that during the next 20 years, from 1979-1999, the community paid off the rest of the loan which had a balance of $44,000 at the time of the marriage. Therefore, the portion that the community contributed to the purchase of the home was 44/50 or 22/25. The community property pro rata share, at divorce, is then 22/25 of the appreciation of $150,000 plus $44,000.

2. The Mutual Fund

The original source of the monies that purchased the mutual fund was the $10,000 that Wanda earned for the sale of her painting. Given that this painting was the result of her skill, effort and labor during marriage, it is community property.

Wanda and Herb orally agreed that the $10,000 would be her sole and separate property. Had this agreement taken place prior to 1985, it would have been a valid agreement and this community property would have been transmuted to separate property simply by this oral agreement. However, after 1985, all agreements between spouses to transmute any property (i.e., to change it from community property to separate property, from separate property to community property or even from the separate property of one spouse to the separate property of another spouse) must be in writing. Further, this writing must have a clear and express statement of what is being transmuted. Therefore, when Herb and Wanda made the agreement to have the proceeds from Wanda's painting sale be separate property, it had no enforceable effect.

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Therefore, notwithstanding their oral agreement, the $10,000 from the sale of the painting remained community property.

Under California community property law, if a spouse deposits community monies in her name alone, takes title to property in her name alone or, as is the case here, invests in a mutual fund in her name alone, it is irrelevant as to the characterization of the property. Here, when Wanda invested the $10,000 in a mutual fund in her name alone it did not have any effect on the community property character of the money. The mutual fund therefore is community property.

The current value of the mutual fund is $45,000. As community property it should therefore be divided 50-50, with $22,500 going to each spouse. If the court should determine that this is not in the interests of justice, or that this division would greatly devalue this appreciating asset, it may determine that Wanda gets all of the $45,000 mutual fund and offset Herb with a community asset of equal value.

3. The cabin

Herb and Wanda bought their cabin during their marriage. Therefore, the funds used, and the asset acquired (the cabin) are presumptively community property. In addition to making a down payment of $25,000, they also took out a note secured by a deed of trust for $50,000. It is important to note here that given that they both signed the note and that they took title as joint tenants, the lender most likely intended that it was making a loan to the community. Therefore the loan was a community liability (not separate liability of one of the spouses).

Herb and Wanda took title as joint tenants. Since 1989, courts have held that when a married couple takes title as joint tenants it is presumptively community property. At divorce, any separate property contributions will not go toward a pro rata share at dissolution. At divorce, the separate property contributor is only entitled to reimbursement for payments made toward principal and improvements. A spouse will not be reimbursed for separate property that has been used for payments of taxes and insurance.

When Herb used the $50,000 of his inheritance to pay off the note, he was using separate property because property acquired by inheritance, regardless of whether one is married, is separate property. In addition, he also used $20,000 of his separate property for an improvement. At divorce, he can be reimbursed for this $20,000 he used for the improvement and for any of the $50,000 that went toward principal payments on the loan. The remaining $80,000 is community property. Herb and Wanda will each take their 1/2 community property share, for a total of $40,000 each.

ANSWER B

Wanda v. Herb

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California is a community property ("CP") state. All property acquired during marriage is presumptively community property. All property acquired before marriage or after permanent legal separation is presumptively separate property ("SP"). Additionally, all property acquired through gift, devise, or bequest is also considered SP.

The Home

The issue is how a home should be divided upon dissolution of a marriage when that home was acquired by one spouse before marriage, but the balance of the promissory note was paid off during marriage with community funds. As a general rule, the fair market value of the house is divided into SP and CP based on the proportionate shares of the purchase price that were expended. Here, Herb ("H") made a $5000 down payment before marriage (thus, from SP), and by the time of marriage he had paid an additional $1000 of the note, leaving a balance of $44,000. This balance was paid by H and Wanda ("W") during the course of the marriage using CP. Thus, H contributed 12% of the purchase price from SP and the community contributed 88% of the purchase price ($44,000 out of $50,000 purchase price). Upon dissolution, H will be entitled to 12% of the fair market value of the house (12% of $200,000), and the remainder of the fair market value is community property. This result is reached to enable each spouse to obtain a proportionate amount of equity in the house.

The Mutual Fund

The issue is whether there has been a valid transmutation of property. As a general rule, property acquired through the labor of one spouse during marriage is presumed to be CP. Here, W received $10,000 as a result of the labor she used to paint the watercolor. Thus, this $10,000 is presumptively CP. However, as a modification to this presumption, the parties can agree to change the form of property from CP to SP (or from SP to CP), if that agreement is made in a valid, legally enforceable way. Here, H and W orally agreed that the $10,000 would be W's SP. As a general rule, oral transmutations made on or after January 1, 1985 are invalid and not legally enforceable. To be enforceable, the oral agreement must be in writing and signed by the party whose rights are affected. Here, the agreement was made in 1985 and was oral; thus, it does not work to transmute the $10,000 from CP to SP.

The next issue is determining, through the method of tracing, what happened to the $10,000. As a rule, property can be traced to later locations and then divided into SP or CP. Here, W invested the $10,000 in a mutual fund in her name alone. Since there is no issue of federal preemption (as there would be if W used the money for a U.S. savings bond, for example), the money can be property traced to the mutual funds and the entire current value of the funds ($45,000) will be treated as CP to preserve H's interest in W's labor during marriage.

The Cabin

The issue is how title to property should be divided when SP is expended on the improvement of CP. As a general rule, under the Marriage of Lucas, title to property taken in

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community property form is presumptively CP, and one spouse may not be reimbursed for money expended out of SP on contributions to CP upon death of one of the spouses. Instead of receiving a reimbursement, a presumption arises that the SP contribution was a gift to the CP estate. However, upon divorce, the rule is different. Upon divorce, title taken in CP form is still presumptively CP, but a spouse contributing SP for down payments, improvements, or principal payments on a mortgage is entitled to reimbursement without interest for these contributions under the Anti-Lucas Statutes (as long as the contribution was made post-1984). Here, H and W hold title in one of the community property forms - namely, a joint tenancy (a joint tenancy is treated as a community property form of title for purposes of divorce, but is treated differently for death). Thus, in CP form, the property is presumptively CP, entitling each spouse to a 1/2 CP interest. This conclusion is buttressed by the facts that CP funds were used to make the down payment, the cabin was purchased during marriage, and they both signed the note as joint tenants.

The only issue, remaining is whether H can receive reimbursement for the money he spent on improving the cabin. As a general rule, property received through inheritance is presumptively SP. Here, H received $50,000 from his mother as an inheritance (SP). Under the Anti-Lucas statutes, as explained above, SP contributed to CP for an improvement or principal payment can be reimbursed without interest. Here, H's SP ($20,000) was used to add a room (an improvement) to the cabin. Furthermore, H spent $50,000 to pay off the principal owed on the mortgage. Thus, H can be reimbursed without interest for $70,000, and the remainder of the fair market value of the cabin will be treated as CP.