

FEBRUARY 2003 COMMUNITY PROPERTY QUESTION

Henry and Wanda married in 1980 when both were students at State X University. State X is a non-community property state. Shortly after the marriage, Henry graduated and obtained employment with a State X engineering firm. Wanda gave birth to the couple's only child, and Henry and Wanda agreed that Wanda would quit her job and remain home to care for the child. They bought a house in State X using their savings for the down payment and obtained a loan secured by a twenty-year mortgage for the balance of the purchase price. Mortgage payments were subsequently paid from Henry's earnings. The title to the State X house was in Henry's name alone.

In 1990, Henry accepted a job offer from a California engineering firm. The couple moved to California with their child and rented out the State X house.

In 1992, Wanda's uncle died and left her an oil painting with an appraised value of \$5,000 and a small cabin located on a lake in California. Wanda took the painting to the cabin and hung it over the fireplace.

In 1993, after reading a book entitled "How to Avoid Probate," Henry persuaded Wanda to execute and record a deed conveying the lake cabin to "Henry and Wanda, as joint tenants with right of survivorship." Wanda did so, believing that the only effect of the conveyance would be to avoid probate.

In 1995, after three years of study paid for out of Henry's earnings, Wanda obtained a degree in podiatry and opened her own podiatry practice. Her practice became quite successful because of her enthusiasm, skill, and willingness to work long hours. Henry continued to work for the engineering firm.

In 2002, Henry and Wanda separated and filed for dissolution of marriage. Wanda had the painting reappraised. The artist, now deceased, has become immensely popular, and the painting is now worth \$50,000.

Upon dissolution, what are Henry's and Wanda's respective rights in:

1. The lake cabin? Discuss.
2. The painting? Discuss.
3. The State X house? Discuss.
4. Wanda's professional education and podiatry practice? Discuss.

Answer according to California law.

Answer A to Question 6

HENRY & WANDA'S RIGHTS

1. The Lake Cabin

California is a community property state. All assets acquired by earnings during the marriage are presumed to be community property. Assets acquired by gift, inheritance or devise or otherwise acquired before the marriage or after a permanent separation are separate property.

Property can change form and be transmuted from community or separate property and courts will consider the source of funds if they can be traced.

Here, the lake cabin was initially separate property because Wanda acquired the lake cabin from her inheritance. When Wanda transferred the lake cabin to Henry a transmutation occurred and the house was placed in joint names. This occurred in California.

Previously in California, a gift would be presumed to Henry based on the Lucas case. After 1987, however, any property in any joint title is presumed community property. Wanda can, however, receive the initial separate property value of the lake cabin back if she can trace the assets, such as through the title and probate documents and show it was hers. Then, if it is traced properly, any value over the separate property contribution would be divided equally. Henry would alternatively argue a gift and that each spouse receive $\frac{1}{2}$ but Wanda could rebut this and rebut the community property presumption with her testimony that Henry told her it was just to avoid probate without donative intent.

2. The Painting

Wanda inherited the oil painting so it is separate property. Wanda kept the painting at the cabin, so it could be argued that she intended to keep the painting as her separate property. No community earnings or funds were used to enhance the value of the painting and no skill or labor was used to enhance the value of the painting. Wanda should keep the painting as her separate property.

3. The State X House

The community property laws of California create a presumption that all property acquired with earnings during the marriage is community property.

Quasi community property is property acquired in another state that would be considered community property if it were acquired in a community property state. Quasi community property is treated the same as community property in the event of a divorce.

Here the house was bought in another state — non-community property with earnings, a loan and savings that were all acquired during the marriage. Although the house was in Henry's name, all contributions to the house were community contributions. Henry's earnings were community earnings, the loan was acquired by both after the marriage, so the lender's intent was to rely on the community for repayment. Also the savings were their joint savings; it appeared they were acquired during the marriage. If the house would be community property in California, since it was acquired from all community sources, then it is quasi community property and would be treated as community property in a divorce. Each spouse received one-half of community property in a divorce unless there is some exception that applies (one spouse cares for a minor child in the house, one spouse misappropriates funds, one spouse is injured and should receive personal injury proceeds). No exceptions apply here, so each spouse receives one-half of the quasi community property State X house.

4. Wanda's Education & Practice

Wanda's education is not community property. However, the community estate is entitled to repayment of her educational expenses if there is a time of 10 years or less. If less than ten years has passed there is a presumption the community has not yet received all the benefits of the enhanced earning capacity from the education.

If, however, Wanda can show the community has already received sufficient benefits, she would not have to repay the community. If she cannot prove this, then she would have to repay the education expenses ($\frac{1}{2}$) to Henry.

The podiatry practice was acquired exclusively from community funds (Henry's earnings) and from Wanda's enthusiasm, skill, and labor during the marriage. These are all community sources so that the practice and the goodwill of the practice should be valued and divided one-half to each spouse.

Because all sources of labor and capital are community sources, the Pereira and Van Camp methods of accounting do not apply. Pereira would allow a spouse their initial investment back if it is separate property plus a reasonable rate of return (10%) on the initial investment. Because Henry's investment in Wanda's education was community earnings, there is no initial separate property to return and Pereira does not apply, for either Henry or Wanda, since Wanda's labor was all during the marriage and was all community labor.

Similarly Van Camp accounting does not apply because this principle allows a reasonable salary to be deducted from the business, multiplied by all years of the marriage, less any community expenses paid from the business and that would be considered community property with the balance of the value of the business returned as separate property. It is inapplicable because all community labor and earnings were used for the business, resulting in a community property podiatry business.

Van Camp is used where a unique separate property business has appreciated during

the marriage due to circumstances rather than community labor. It does not apply here because there was no separate property contribution to the podiatry practice, so each spouse receives one-half of Wanda's practice.

Answer B to Question 6

1. Quasi Community Property

The threshold issue is whether the laws of California community property govern property that Harry and Wanda acquired in State X, a non-community property state. Property acquired in another state that would be considered community property if acquired in California is treated as quasi community property and is treated as community property on the dissolution of marriage.

Here, at the dissolution of Harry and Wanda's marriage, the property they acquired in State X will be treated exactly under the same principles as the property they acquired in California. Both will be governed by California community property laws.

As mentioned, California is a community property state. All property acquired during the course of marriage is presumptively community property (CP). All property acquired prior to marriage or after separation is presumptively separate property. In addition, a gift, devisee, or bequest is presumptively separate property (SP).

In order to determine the character of a property, courts will trace back the source of funding used to acquire the property. A mere change in the form of a property will not change its characterization. At divorce, each item of community property is split equally, absent special circumstances.

With these principles in mind, we can turn to the specific assets involved.

2. The Lake Cabin

The lake cabin was a gift to Wanda from her uncle and as such is SP.

Henry will argue that Wanda made a gift of the property to him in 1993 and therefore the property became CP.

Prior to 1985, gifts to a spouse did not have to be in writing. Post 1985, however, transmutations of property required writing. Henry will argue the execution and recording of the deed was a writing satisfying this requirement and, therefore, the gift should be treated as CP and he should have half of the she [sic].

Henry will also argue that, under Lucas, taking title in joint and equal form creates a presumption of community property and a relinquishment of the separate property rights. Moreover, the Anti-Lucas statutes provide that this presumption of CP holds true even for property taken as joint tenants on dissolution. While joint tenancy would not create a presumption of CP on death, it does on dissolution. Therefore, Henry will argue the fact that the property was in joint tenancy is further indication that it is community property.

Wanda, however, will counter that the only reason she put the property in her and

Henry's name was to avoid probate of the cabin. The courts have held under the Married Women's Presumption that a gift is not presumed when a party does so for improper purposes, such a shielding from creditors. By analogy, in this context the court may not presume a gift or title in joint and equal form because it was done for an improper purpose.

In sum, if Wanda had given Henry a share in the lake cabin for a proper purpose, the Lake Cabin would be CP. But since it was done for an improper purpose, a court will probably hold it is SP and that Wanda should keep it.

3. The Painting

The painting was a gift to Wanda from her uncle, and as such was SP. Wanda is entitled to the appreciation of the painting that is now worth \$50,000. This appreciation was not in any way commingled because the painting was never sold. Moreover, Wanda committed no labor in the appreciation of the painting. Therefore, Wanda is entitled to the entire appreciation of \$50,000 which is simply a capital return on separate property.

4. The State X House

The State X house was bought using savings (quasi CP) and payed off using Henry's earnings (quasi CP). Therefore, it is presumptively quasi CP which is treated as CP for the purpose of dissolution. There is no need to apply Marriage of Moore because the house was entirely purchased by CP, and there is no division of CP and SP in acquiring the interest.

Henry will argue, though, that the fact that he took title alone creates the presumption of a gift to him. Prior to 1975, when a women took title alone in a property, that property was presumptively considered a gift to the women. But, this presumption did not apply to men. It also does not apply post 1975. But, Henry will still argue that this property was a gift because he was the sole title owner.

This argument is unlikely to succeed because Wanda remained in the home and cared for the child in the home. Courts will look beyond the facade of sole title, and will not interp[r]et the title as a gift to Henry. Instead, they will loo[k] at the property as jointly owned by Wanda and Henry who lived there together.

The question, then, becomes if the house is quasi CP how can it be split given that it is in a different state. California, after all, does not have juri[s]diction over property that is in State X.

Courts, however, will either give Wanda and [sic] equivalent amount of resources from other assets to compensate for the State X house, or they will force Henry, given their personal jurisdiction over him, to sign over half of the property to Wanda.

In short, Wanda is entitled to her share of half the house despite the problems of jurisdiction given that California has personal jurisdiction over Henry.

5. Wanda's Professional Education

The issue is whether Wanda's podiatry degree is community property.

The law is that an educational accreditation is not CP. However, the community is entitled to reimbursement for the education expenses unless: (1) 10 years have passed since the spouse acquired the degree creating a presumption that the community has reaped its benefits; (2) the other spouse also received a professional degree or (3) the education that the spouse receive[s] will lessen the need for spousal support[.]

Here, seven years passed after Wanda acquired the property, so the community is not presumed to have benefitted. Also, there is no indication that Henry received an education.

Wanda may argue that her education helped her open a successful practice and lessened her need for spousal support. Thus, the community should not receive any reimbursement. This will be persuasive only if Wanda can show that she would have been entitled to significant spousal support, absent the degree, which is a dubious proposition considering she had a job prior to giving birth. In other words, it is not clear that she would not have been capable of earning a good income, even without the degree.

A fair solution would probably be to reimburse the community 3/10 of the money it spent on Wanda's education. This would represent amount of benefit the community did not receive, under the 10 year presumption.

Henry then would be entitled to $\frac{1}{2}$ of $\frac{1}{3}$ or $\frac{1}{6}$ of the expenses spent on Wanda's education degree.

6. Podiatry Practice: Accounting and Goodwill

The issue is whether Wanda's podiatry practice is community property or separate property. Here, Wanda did not inherit a business, but rather opened the business during the marriage. Therefore, the earnings are presumptively all community property since the entire business was a result of her "enthusiasm, skill, and willingness to work long hours."

Pereira and Van Camp accounting principles **do not** seem to apply to this situation. Under Pereira, an independent business's rate of return at 10% is SP, and the rest is CP. This test applies when the growth of a business is primarily the result of a spouse's labor. Under Van Camp, CP is determined by subtracting a community's family expenses from the FMV of the spouse's labor, and the rest of the business value is SP. This test is appropriate when a large part of the business is a result of capital as

opposed to community labor.

Wanda may try to argue that the business is her separate property. She may concede that it grew as a result of her labor, but may argue that the Pereira principles must govern, entit[ing] her to a 10% per annum share as SP.

But, Henry will counter that Wanda started the practice while they were married, and as such, the entire business is a result of her labor. She did not inherit the business, Hen[r]y will argue, but rather opened it during the course of marriage. As such, all of the business earnings are presumptively CP.

Given that Wanda opened the practice after marriage and her labor is solely responsible for the practice, Henry is entitled to half of the practice.

If the court gives Wanda the practice, then it must compensate Henry for half the value. In such a scenario, Henry is also entitled to the value of the **goodwill** of the business. The goodwill is calculated by looking at the total revenue and subtracting the value of Wanda's services as well as cost. The remainder can be attributed to goodwill. In short, if the court decides to grant Wanda control of the business because she is responsible for managing it, it must grant Henry half the value of the business, including the value of goodwill for the foreseeable future discounted to present value.