LAW AND THE FAMILY

"Tracing Assets to Their Source"

Dr. Doris Jonas Freed, Joel R. Brandes and Carole L. Weidman [FNa]

New York Law Journal

July 23, 1991

Long gone are those exhilarating days, those wondrous moments, when one was undisguisedly affected by the very touch of a loved one's hand and a cherished carved figure on a mantel. But the racking dissensions between divorcing spouses quickly transforms romantic remembrances into the cold, hardhearted business of deciding who gets what. The shift to such behavior is a compelling testimony. We are privy to the workings of unfettered minds addressing themselves to the primeval instinct: survival. The daily ebb and flow of spousal activity is no longer the central issue. The source of the asset, made up perhaps of a considerable mix of things, is the issue with which they and we are concerned here.

Between a husband and wife, "separate property" ordinarily retains its identity as such with its concomitant rights of management, control and freedom of disposition. However, what is separate property for purposes of marital dissolution under general law is not conterminous with the classification of separate property under the Equitable Distribution Law (EDL). For distribution purposes, the statutory definition in Domestic Relations Law (DRL) s236, Part B Subdivision (1)(d) usually controls. [FN1] And it is the property that is covered by that statutory definition that is excluded from equitable distribution under DRL s236, Part B, Subdivision (5)(a). In other words, the general definition of separate property that applies in other areas of the law is replaced and superseded by the statutory definition for equitable distribution purposes.

In some other states, in effect, what would be statutory separate property in New York, becomes marital property upon marriage, at least for the purposes of equitable distribution. [FN2] New York

rejected that policy when it was decided that the "pot" for equitable distribution was the "product" of the marital partnership and that pre-marital separate property ordinarily retained that characteristic. When it came to property acquired after marriage, however, the form in which title is held no longer controls the distribution of property upon divorce. Before July 19, 1980 (and where DRL 236[A] is now applicable), separate property was an "untouchable" unless in rare cases an equitable interest was established or a constructive trust was imposed. However, if the marriage endured, a contingent spousal interest in the other party's property was recognized and protected by the right to a statutory share under the Estates, Powers and Trust Law.

Economic Partnership

The elimination of the "tyranny of title" when equitable distribution is made was one of the important reforms, primarily for the benefit of wives, in the EDL. The concept that marriage creates an "economic partnership" in its application means that assets acquired by the contributions or efforts of either or both parties are marital property subject to equitable distribution in the event of divorce. This is so even though, for other purposes, a particular asset may be separate property. In this sense, therefore, separate property becomes marital property for distribution purposes if it falls within the statutory definition of marital property.

The EDL [FN3] provides that "property acquired in exchange for or the increase in value of separate property is separate property. Subdivision 5-b [FN4] provides that "separate property shall remain such," and it is marital property that is subject to equitable distribution under that provision.

But what happens when separate funds or property are commingled with marital funds or property? There are three approaches: [FN5]

1. "Inception of Title Approach." The character of the asset as separate or marital is determined when it was acquired. Thus if the realty on which a home was built was separate property, subsequent improvements during the marriage retain that characterization, although the marital fund might be reimbursed for cash outlays. Under this rule, the spouse whose property it was would retain the land and the home but would be required to reimburse the family assets (marital property) for any outlays, and any appreciation in value would inure to the benefit of the owner.

2. "Source of the Funds Approach." This approach allocates the value of the property in question in proportion to the fund that contributed to the acquisition of the asset. Thus, property may have a dual characterization, part separate and part marital or community.

3. "Transmutation." Under this approach, the character of property may be changed from separate to marital, or marital to separate, when additional assets are utilized. Thus, the subsequent use of marital funds, to build a house on one spouse's separate real property during the marriage might convert the realty and house into marital property.

Under the EDL, the New York decisions routinely trace assets to their source when that is in issue. That property that was separate property before marriage, [FN6] or received by inheritance or gift from others during marriage, [FN7] or property (or assets) "acquired in exchange for" such separate property ordinarily retains that identity. [FN8] However, the burden of establishing that property or assets are "separate" rests on the claimant. [FN9]

In some decisions, the problems of commingling or spousal contributions to the appreciated value of the other party's separate property, have been circumvented or avoided, perhaps because of the ineptitude of counsel, or a failure to understand the policies underlying the statute. [FN10] Other cases have been remanded to the trial court for its reconsideration of the sources of particular assets. [FN11]

The premier decision on "source of the funds" is Kobylack v. Kobylack, [FN12] where it was held that other factors canceled out and that the value of the marital home would be apportioned according to the respective contributions of the parties, with 72 percent to the husband and 28 percent to the wife. Regardless of the merits of that decision, otherwise, it did apportion the respective interests of the parties on the basis of the sources of the funds used to purchase and pay for the marital home.

Apportionment Based on Sources

Since Kobylack, almost every New York case has applied the "source of the funds approach." Duffy v. Duffy, [FN13] involved a short marriage with no children, where the husband had contributed $32,000 of his separate funds towards the purchase of the marital home. The Second Department directed that after the sale of the marital home, the husband was to be reimbursed for the $32,000 and

the balance of the net proceeds divided 75 percent to the husband and 25 percent to the wife.

In Alwell v. Alwell, [FN14] the marital home was held to be the husband's separate property since he had title and it was acquired before the marriage but that since the wife had spent her own funds for home improvements and in paying off the mortgage, she had a spousal interest in the home and in its appreciated value. However, it was held that it was inequitable for the trial court to give the wife one-half of the appreciated value of the home due to the disparity between the respective contributions of the parties. The investment was computed to be $23,520 by the husband, compared with the $1,520 by the wife.

Brennan v. Brennan, [FN15] involved rather complicated facts, the essence of which was an alleged spousal interest in a farm, farm equipment and livestock. The farm had been bought by the husband before marriage, but the future wife had contributed $1,000 toward its purchase price, although she made no other direct contributions. During the marriage the farm greatly increased in value. The court awarded the wife 40 percent of the value of the farming enterprise ($174,373), but no maintenance, since she had received a substantial inheritance from her family. The Third Department remanded the case to the trial court to determine the credit to be given to the husband for having advanced all but $1,000 of the purchase price and all of the other expenses during the marriage.

Reimbursement

In Parsons v. Parsons, [FN16] the parties married in 1972 and lived in a house owned by the wife. In acquiring a $32,000 mortgage, the house was transferred into both names in 1978, when it was valued at $60,000. Thus, it became marital property by virtue of the transfer. The trial court held that the wife was entitled to credit for her contribution of her property towards the creation of this marital asset. The Appellate Division affirmed the divorce judgment which directed that the net proceeds of the sale of the home be divided equally after reimbursing the wife her $60,000.

In Coffey v. Coffey, [FN17] the parties married in 1968 and separated in 1982. In 1959, the husband began construction on the marital home that the parties moved into in 1970. In 1972, the husband inherited it and other property from his mother. In 1973, he conveyed title to he and his wife. The home was enlarged and improved in 1974. The trial court held that the marital residence and certificates of deposit (bought from the sale of other property) were "marital."

The Appellate Division rejected a 50-50 division of these assets and remitted to the trial court for proof as to their 1973 value and increase in value since 1974 because of the addition. The wife was held entitled to half of the increase in the current value of the house due to the 1974 addition and half of appreciation in value of the original structure attributable to her efforts as a homemaker and parent. The husband was entitled to be credited for the creation of both of these marital assets and was awarded a 100 percent credit for the principal of the certificates of deposit.

In Monks v. Monks, [FN18] the Appellate Division modified that part of the divorce judgment that awarded the wife half of the proceeds of the sale of the marital residence and 45 percent of the proceeds of sale of certain other real property. Both of these properties were bought by the husband prior to the marriage in 1979 and transferred into the parties' joint names. The Appellate Division held that the trial court erred in failing to credit the husband for the contributions of his separate property toward the creation of the marital assets. The matter was remitted to the trial court to determine the value of the properties at the time of the conveyance to the parties as tenants by the entirety, their current fair market value, the appreciation in value because of the wife's contributions or efforts and an equitable distribution.

In Cunningham v. Cunningham, [FN19] the Appellate Division modified a judgment of divorce that awarded 90 percent of the proceeds of the sale of the marital home to the plaintiff wife and 10 percent to the defendant husband, after credit to the wife for mortgage payments. It distributed the equity in the home 65 percent to plaintiff and 35 percent to defendant after plaintiff received credit for the initial downpayment of $27,000, from her funds, on the parties' prior house; $8,442.62 she paid in 1982 to partially satisfy the mortgage; and $1,120.56 she paid for repairs.

In Brawer v. Olmstead, [FN20] the defendant wife was awarded exclusive occupancy of the marital home until the youngest of two children completed high school or reached age 18. The net profit from the sale of the house was to be divided equally after the husband received a credit of $25,000 for his use of separate funds to help purchase the house.

In Basile v. Basile, [FN21] the Appellate Division increased to $15,000 the award to the husband for his interest in the former marital residence. It held it was error for the trial court to award the husband only $7,500 for his interest in the former marital home since it was

bought before marriage and he provided the entire downpayment of $15,000.

In Lord v. Lord, [FN22] the trial court, among other things, awarded the wife 50 percent of half of the value of one property (the other half being found to be separate property) and 50 percent of the net value of eight apartment buildings. The Appellate Division modified. It held that four of the buildings were plaintiff's separate property because he traced the funds to purchase them to his separate property. It also held that he was entitled to a credit for $31,015 of his separate property that was used to acquire the four other buildings before the equity was to be evenly divided.

Marital Property

In Lobotsky v. Lobotsky, [FN23] the Appellate Division modified the judgment to direct that the marital home and its furnishings be sold at their fair market value and the net proceeds be divided equally after a credit to the husband of $18,891 to reflect the net proceeds of the sale of the home he owned prior to the purported marriage. While the parties' marriage was declared void, the home and property purchased during the purported 10-year marriage was marital property.

In Mink v. Mink, [FN24] the Appellate Division modified the property division to provide that upon the sale of the marital home, the husband was to be reimbursed for $2,500 in closing costs, in addition to the $10,000 downpayment, which he made from his separate property, before the net proceeds were to be equally divided. He was entitled to return of the total contribution he made toward the purchase from his separate property. The husband was also entitled to $7,500 from the parties' joint savings account, before the balance was equally divided, representing the proceeds of the sale, during marriage, of his separate real property, which he traced into this account, together with interest.

In Lolli-Ghetti v. Lolli-Ghetti, [FN25] the Appellate Division held, that the trial court erred in dividing the marital property on a 60-40 basis in favor of the wife and in failing to credit the husband for his contribution of $215,340 of his separate property to the acquisition of marital assets.

In this eight-year marriage, the wife devoted herself entirely to the care of the home and the children, as well as to the development of the husband's career but made no financial contribution to the marriage.

At the time of trial in 1987, the husband, age 40 and the wife, age 39, had three children. They were married in 1976. The action for divorce was commenced in 1984.

At the time of trial, the husband was living in Monaco and earning $90,000 per year tax free, working for his father's shipping company. During the marriage, the parties enjoyed a lavish lifestyle.

The Appellate Division noted that unless proven otherwise, all property acquired by either or both spouses during the marriage is marital property, regardless of the name title to the property is taken, except for such property acquired by gift or otherwise so as to render it separate property within the meaning of DRL s236, [B][1][d].

The court found that the parties' original cooperative apartment was purchased in 1977 in the husband's name and paid for with his separate property. It held that the purchase could not have been consummated without the wife's consent, since, as a co-tenant, she had an equal right to purchase the cooperative apartment. Continuing this line of reasoning, the court noted, inasmuch as the right to purchase a cooperative apartment is a valuable property right, it was clear that the wife contributed to the purchase of that apartment. Accordingly, the source of funds for its purchase notwithstanding, the apartment was not separate, but was marital property as were the proceeds of its sale.

The Appellate Division in modifying the order noted that the next acquired marital apartment was purchased with the proceeds of the sale of the marital cooperative apartment, as well as with additional funds provided by the husband's father and that it too was marital property. Its renovation, which was overseen by the wife, increased its value and provided a further basis for classifying the proceeds from the sale of that apartment as marital property. The sale of that apartment to the husband's sister at an inflated price of $900,000, although paid for by the husband's father, was held to be in exchange for marital property. Thus, those funds became available for the purchase of a subsequent apartment, which when purchased, became marital property. Since the gifts of money to the husband from his father, which financed the renovation of the apartment, were co-mingled with marital property, the Appellate Court held there was no reason to disturb the trial court's finding that the funds used for the renovation were largely marital assets. Thus, it agreed with the trial court that the next acquired apartment located at 640 Park Avenue, which was purchased in the husband's name alone in 1980 for $825,000, was marital property. However, it held that the husband

should receive a credit for the contribution of his separate property toward the creation of this marital asset.

FNa Dr. Doris Jonas Freed is of counsel to the law firm of Brandes, Weidman & Spatz P.C. in Manhattan. Joel R. Brandes and Carole L. Weidman are partners in the firm, which maintains law offices in New York City and Garden City, N.Y. Dr. Freed and Mr. Brandes are fellows of the American Academy of Matrimonial Lawyers and are co-authors with the late Henry H. Foster of Law and the Family, New York (Lawyers Co-operative Publishing Co., Rochester, N.Y.) Ms. Weidman is a co-author with Dr. Freed and Mr. Brandes, of the annual supplements to Law and the Family, New York.

FN1 DRL s236 (B)(1)(d) provides:

"The term separate property shall mean:

"(1) property acquired before marriage or property acquired by bequest, devise, or descent, or gift from a party other than the spouse;

"(2) compensation for personal injuries;

"(3) property acquired in exchange for or the increase in value of separate property, except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse;

"(4) property described as separate property by written agreement of the parties pursuant to Subdivision Three of this part."

FN2 According to Freed and Walker, "Family Law in the Fifty States: An Overview," 23 Fam. L.Q. 495, 523-524 (Table IV) (1990), some 18 American jurisdictions include all property of each party in the "pot" while some 25 states include only marital property acquired after marriage.

FN3 DRL s236 (B) (1)(d)(3).

FN4 DRL s236 (B)(5)(b).

FN5 Harper v. Harper, 294 Md 54, 448 AD2d 916.

FN6 See DRL s236 (B) (1)(c) and (1)(d).

FN7 For example, see Barnes v. Barnes (2d Dept.), 106 AD2d 535, 483 NYS2d 358, where what became the marital home was purchased by

the wife before marriage and placed in her name, and her parents had given the wife $150,000 in securities, all held to be her separate property. Compare, Jeruchimowitz v. Jeruchimowitz (Sup), 491 NYS2d 576, where wife had lived in apartment and had paid its rent before marriage but after marriage it was converted into a cooperative and so was held to be marital property, but the wife was awarded a 75 percent interest in the cooperative.

FN8 See Rubin v. Rubin (2d Dept.), 105 AD2d 736, 481 NYS2d 172, which held that the husband's interest in a corporation and its pension plan that accrued before marriage was his separate property, especially since it was a short marriage of seven years and the wife made no direct contributions to the business. See also, Wegman v. Wegman, ___ AD2d ___, 509 NYS2d 372.

FN9 See McCormack v. McCormack, NYLJ, Oct. 29, 1982, P. 7, Cols. 4-6 (NY Co. 1982) and Connor v. Connor (2d Dept.), 97 AD2d 88, 468 NYS2d 482.

FN10 See Weinstock v. Weinstock, NYLJ, Dec. 15, 1983 (Queens Co. 1983) (failure to evaluate furniture constituted waiver) Erlich v. Erlich, NYLJ, May 16, 1983 (Queens Co. 1983) (because wife offered no proof as to value of marital property, each entitled to retain that in his or her possession.

FN11 For example, see Pacifico v. Pacifico (4th Dept.), 101 AD2d 709, 475 NYS2d 952; Kobylack v. Kobylack, 62 NY2d 399, 477 NYS2d 109, 465 NE2d 829, on remand (2d Dept.), 111 AD2d 221, 489 NYS2d 257; Blickstein v. Blickstein (2d Dept.), 99 AD2d 287, 472 NYS2d 110; and Bizzarro v. Bizzarro (3d Dept.), 106 AD2d 690, 484 NYS2d 144.

FN12 Kobylack v. Kobylack, 110 Misc2d 402, 442 NYS2d 392, mod (2d Dept.) 96 AD2d 831, 465 NYS2d 581, revd 62 NY2d 399, 477 NYS2d 109, 465 NE2d 829, on remand (2d Dept.), 111 AD2d 221, 489 NYS2d 257 and (disapproved Blickstein v. Blickstein (2d Dept.), 99 AD2d 287, 472 NYS2d 110).

FN13 (2d Dept.) 94 AD2d 711, 462 NYS2d 240.

FN14 (2d Dept.) 98 AD2d 549, 471 NYS2d 899.

FN15 (3rd Dept.) 103 AD2d 48, 479 NYS2d 877.

FN16 115 AD2d 289, 496 NYS2d 138 (4th Dept., 1985).

FN17 ___ AD2d ___, 501 NYS2d 74 (2d Dept., 1986).

FN18 ___ AD2d ___, 520 NYS2d 810 (2d Dept., 1987).

FN19 105 AD2d 997, 482 NYS2d 148 (3d Dept., 1984).

FN20 NYLJ, 7-16-90, P. 29, Col. 1, Sup.Ct., Kings Co. (Rigler, J.).

FN21 ___ AD2d ___, 505 NYS2d 448 (2nd Dept., 1986).

FN22 ___ AD2d ___, 508 NYS2d 676 (3d Dept., 1986).

FN23 ___ AD2d ___, 505 NYS2d 444 (2d Dept., 1986).

FN24 ___ AD2d ___, 558 NYS2d 329 (3d Dept., 1990).

FN25 Lolli-Ghetti v. Lolli-Ghetti, ___ AD2d ___, 568 NYS2d 29, NYLJ, (1st Dept., 1991).

7/23/91 NYLJ 3, (col. 1)

END OF DOCUMENT