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CLASSIFYING MARITAL AND SEPARATE PROPERTY—COMBINATIONS AND INCREASE IN VALUE OF SEPARATE PROPERTY

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I. INTRODUCTION

The equitable distribution statutes in half the common law states authorize or mandate division of marital property rather than all the property of the spouses. A dual classification of property into marital and separate or nonmarital property must occur under these statutes. West Virginia is such a "dual property" jurisdiction.

The concept of partnership marriage is the foundation of all equitable distribution systems, but this theoretical basis is heightened by a system dividing only marital property. When a legislature provides solely for the division of only property acquired during the marriage, it emphasizes that the partnership nature of marriage justifies division. The partnership marriage concept underlies the Uniform Marriage and Divorce Act of 1970 (UMDA) which has been the model for most of the statutes. Courts throughout the country have recognized that equitable distribution is based on the premise that marriage is an economic partnership to which both parties contribute. As one prominent court stated:

> [T]he function of equitable distribution is to recognize that when a marriage ends, each of the spouses, based on the totality of the contributions made to it, has a stake in and right to a share of the marital assets accumulated while it endured, not because that share is needed, but because those assets represent the capital product of what was essentially a partnership entity.[1]

In agreement with this philosophy, the West Virginia Supreme Court of Appeals has described marriage as roughly analogous to a business partnership.[2]

Three components of the marriage partnership theory justify equitable distribution. First, the theory rests on an implied assumption that when two persons

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[1] O'Brien v. O'Brien, 66 N.Y.2d 576, 587, 489 N.E.2d 712, 717, 498 N.Y.S.2d 743, 748 (1985).

[2] Dyer v. Tsapis, 162 W. Va. 289, 291-92, 249 S.E.2d 509, 511 (1978).

marry they make a commitment[3] to the marital unit created by their union. Each person will contribute all time and effort to the family welfare and will share the results of their commitment—good and bad, monetary and nonmonetary. Each party relies upon the commitment of the other to serve the family unit. Second, partnership marriage theory, as articulated by courts and analysts around the world, recognizes the enablement function of homemaking which allows the income producer to produce.[4] Justice Woodhouse of New Zealand said that "[t]he provision of an efficient home base by a wife will leave the husband free to earn the family income and attend to a business enterprise or the investment of capital savings. . . ."[5] Thus, both partners contribute to the success of the marital unit in different but equally important ways. The third component of the partnership marriage theory also was articulated by Justice Woodhouse when he stated that "so must his achievements be reflected in the increasing value of the correlative contribution of the wife."[6] The "so" in his statement reveals that because homemaking enables earning, the value of homemaking contributions increase in *proportion* to the increasing value of income production. In *LaRue v. LaRue*,[7] the West Virginia Supreme Court of Appeals apparently recognized this phenomenon when it stated that the "value of homemaking services must also be considered in relation to the net assets available at the time of the divorce"[8] and that homemaking "contributions must be calculated against the net marital estate."[9]

II. Classification and Power

A. *Classification Determines Power*

The power granted to the courts to divide property in equitable distribution is one of the broadest powers known to the law. The definition of property itself

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[3] Michelson v. Michelson, 89 N.M. 282, 551 P.2d 638 (1976); Laughrey, *Uniform Marital Property Act: A Renewed Commitment to the American Family*, 65 Neb. L. Rev. 120 (1986). *See, e.g.*, Preamble to the Maryland Equitable Distribution Act which provides:

> Both spouses owe a duty to contribute his or her best efforts to the marriage, and both by entering into the marriage, undertake to benefit both spouses and any children they have. . . .[I]t is the policy of this State that when a marriage is dissolved the property interests of the spouses should be adjusted fairly and equitably, with careful consideration being given to both monetary and nonmonetary contributions made by the respective spouses to the well-being of the family. . . .

1978 Md. Laws, ch. 794 at 2305.

[4] Price v. Price, 113 A.D.2d 299, 306, 496 N.Y.S.2d 455, 460 (1985), *aff'd*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d (1986); Poe v. Poe, 711 S.W.2d 849, 855 (Ky. Ct. App. 1986); Herron v. Herron, 608 P.2d 97 (1980); Bruch, *Property Rights of De Facto Spouses Including Thoughts on the Value of Homemakers' Services*, 10 Fam. L. Q. 101, 110-14 (1976); Landes, *Economics of Alimony*, 7 J. Leg. Stud. 35, 36 (1978); Kiker, *Divorce Litigation: Valuing the Spouses' Contributions to the Marriage*, 16 Trial 48 (Dec. 1980); *see also* Krauskopf, *Recompense for Financing Spouse's Education: Legal Protection for the Marital Investor in Human Capital*, 28 U. Kan. L. Rev. 379 (1980).

[5] Reid v. Reid, [1979] 1 New Zea. L. Rpts. 572, 584.

[6] *Id.*

[7] LaRue v. LaRue, 304 S.E.2d 312 (W. Va. 1985).

[8] *Id.* at 323.

[9] *Id.* at 326.

is ordinarily so broad as to include all forms of value—marital home, other real estate, shares of stock both publicly traded and in close corporations, automobiles, airplanes and all other motorized vehicles, pension rights whether private or military, jewels, cash value of life insurance, pets and animals of any description, contracts to buy or sell, bicycles and swing sets, video recorders and cameras, accounts receivable, personal injury claims, eggbeaters and power saws, sole proprietorships and partnership interests, country and health club memberships, often professional goodwill, and, occasionally increased earning capacity represented by a degree or license. The property interests in these forms which are divisible are as varied as the law recognizes—possessory interests such as leaseholds, intangible rights such as stock options, future interests such as remainders after life estates, nonvested retirement benefits, and interests under trusts.

Perhaps the most difficult concept to comprehend in a common law jurisdiction is that these interests are subject to division no matter how titled. Lawyers must remind themselves constantly and then advise their clients of the two meanings of separate property—separate in the sense of not subject to division at marriage dissolution and separate in the sense of separately titled but still marital property and divisible. This means breaking old habits of protecting one spouse's property from possible claims of the other spouse by titling it only in the first spouse's name. Now, not only a dower interest in separately titled property, but the entire value, if classified as marital property, could be obtained by the other spouse.

In dual property jurisdictions classification as marital property is the key that unlocks the judicial power to divide.[10] The final aspect of the power given to the court is that not only may it divide the marital property equally, but it has broad discretion to divide it unequally as well.

B. *Statutory Classification and Unresolved Problems*

West Virginia uses the definition of property subject to division which prevails in most dual property jurisdictions: marital property is "all property acquired by either spouse during a marriage, except that marital property shall not include"[11] that defined as separate. The definition of marital property as all property acquired, unless excepted, should operate as a presumption to place the burden of proof on the party asserting that property acquired during the marriage is not marital.

The first four categories of separate property defined in the West Virginia statute are typical of exceptions provided for in the UMDA and other dual prop-

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[10] Statutory provisions which apparently allow West Virginia courts power to divide separate property in order to protect business are beyond the scope of this Article. *See* W. VA. CODE § 48-2-32(e) (1986); Crandall, *Critique of West Virginia's New Equitable Distribution Statute,* 87 W. VA. L. REV. 87, 88 (1984).

[11] W. VA. CODE § 48-2-1(e)(1) (1986).

erty jurisdictions[12] and includes property (1) acquired before marriage; (2) acquired during marriage in exchange for separate property acquired before marriage; (3) excluded from marital property by a valid agreement of the parties; (4) and acquired during marriage by gift, bequest, devise, descent, or distribution.[13]

Combinations of separate and marital property often occur because all earnings during marriage are marital; therefore, nearly all money spent on separate property is marital. Marital property includes earnings from separate property, such as rent from a separate apartment building. When the rent is used to improve the premises, marital funds increase the value of separate property. Increase in value of separate property also is separate under most statutes; however, these statutes rarely address an increase in value due to marital funds spent on separate property or marital effort devoted to separate property. Consequently, courts have determined how to classify combinations of marital and separate property applying one of three equitable principles.

First, whenever any marital money is spent on separate property, the entire property is converted to marital.[14] Second, the inception of title rule classifies property according to its character when title first "incepted."[15] Thus, separate property remains totally separate but the separate property owner may be obligated to reimburse the marital estate for money or effort spent on the separate property. Third, the source of funds rule classifies a particular piece of property depending upon the source of funds or effort which created its value.[16] Such property may have a dual character. Separate property is the portion of a piece of property acquired with separate funds or effort and that portion's increase in value due to inflation or market forces. When marital funds or efforts are used to improve or pay for a piece of property, that portion, with its concommitant increase in value, is marital property.

Since the West Virginia Legislature had the benefit of court decisions from other states, it presumably acted with the background of those interpretations in mind. It dealt with the combination issue by adopting the source of funds approach in its definitions of separate[17] and mari-

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[12] *See, e.g.,* ARK. STAT. ANN. § 55-404 (Supp. 1985); KY. REV. STAT. 403.190(1) (1984); Mo. REV. STAT. § 452.330 (1986); TENN. CODE ANN. § 36-4-121(b)(2) (Supp. 1985); N. Z. STAT. Matrimonial Property Act of 1976 § 8.

[13] W. VA. CODE § 48-2-1(f)(1)-(4) (1986).

[14] *See In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981), in which the court aplied this rule and erroneously called it "transmutation"; the legislature subsequently changed the law. *See* discussion, *infra* at notes 26-31 and accompanying text.

[15] *See* Fisher v. Fisher, 86 Idaho 131, 383 P.2d 840 (1963).

[16] The Missouri Supreme Court is the most recent to adopt the source of funds rule. *See* Hoffmann v. Hoffmann, 676 S.W.2d 817 (Mo. 1984) (en banc).

[17] W. VA. CODE § 48-2-1(f) (1986) defines separate property to include:

(1) Property acquired by a person before marriage; or

tal[18] property. Thus, a single piece of property can have a dual character in West Virginia—part separate and part marital.

Although the theory of the West Virginia statute is obvious, its application presents proof problems in determining contributions to separate property by marital funds and efforts over the years of a marriage. Furthermore, the statute is silent or ambiguous concerning other legal rules for classification after a combination of funds. This Article will discuss three problem areas in classification of combined separate and marital property when using the source of funds rule: applying the rule of transmutation by intent; determining the source of increase in value of mortgaged real estate; and apportioning the increase in value of a separate business.

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(2) Property acquired by a person during marriage in exchange for separate property which was acquired before the marriage; or

(3) Property acquired by a person during marriage, but excluded from treatment as marital property by a valid agreement of the parties entered into before or during the marriage; or

(4) Property acquired by a party during marriage by gift, bequest, devise, descent or distribution; or

(5) Property acquired by a party during a marriage but after the separation of the parties and before the granting of a divorce, annulment or decree of separate maintenance; and

(6) Any increase in the value of separate property as defined in subdivision (1), (2), (3), (4) or (5) of this subsection which is due to inflation or to a change in market value resulting from conditions outside the control of the parties.

[18] W. VA. CODE § 48-2-1(e) (1986), defines marital property to include:

(1) All property and earnings acquired by either spouse during a marriage, including every valuable right and interest, corporeal or incorporeal, tangible or intangible, real or personal, regardless of the form of ownership, whether legal or beneficial, whether individually held, held in trust by a third party, or whether held by the parties to the marriage in some form of co-ownership such as joint tenancy or tenancy in common, joint tenancy with the right of survivorship, or any other form of shared ownership recognized in other jurisdictions without this state, except that marital property shall not include separate property as defined in subsection (f) of this section; and

(2) The amount of any increase in value in the separate property of either of the parties to a marriage, which increase results from (A) an expenditure of funds which are marital property, including an expenditure of such funds which reduces indebtedness against separate property, extinguishes liens, or otherwise increases the net value of separate property, or (B) work performed by either or both of the parties during the marriage.

The definitions of "marital property" contained in this subsection and "separate property" contained in subsection (f) of this section shall have no application outside the provisions of this article, and the common law as to the ownership of the respective property and earnings of a husband and wife, as altered by the provisions of article three [§ 48-3-1 et seq.] of this chapter and other provisions of this code, are not abrogated by implication or otherwise, except as expressly provided for by the provisions of this article as such provisions are applied in actions brought under this article or for the enforcement of rights under the article.

III. TRANSMUTATION

A. *Theory Compatible with Source of Funds*

Under the theory of transmutation, the parties, by their own actions or manifestation of intent, may classify property so as to override any source of funds or statutory classification. This equitable theory was developed by courts to solve classification problems in accord with the parties' intent.[19] It is a highly efficient method of solving combination problems. For example, assume a contract to purchase real estate before marriage for $20,000, a sixteen year marriage, and a significant increase in value of the land due to market conditions so that at dissolution it is valued at $500,000. The spouse whose name is on the contract, deed, and mortgage will have no initial presumption of marital property to counter because he acquired title before the marriage. In inception of title jurisdictions, the property would be entirely separate and the only obligation of the separate owner would be to repay the marital estate for marital funds spent on it. Under the source of funds theory, the property can be marital only to the extent marital funds or efforts were devoted to it; therefore, the nonowner spouse must be able to trace the expenditure of marital funds on the separate property. Tracing financial records of a family may entail complex and expensive discovery. Often, the lawyer representing the nonowner spouse will hear, "Well, I always thought it was ours. I'm sure we used our money to pay off that mortgage. I deserve some of that $500,000. Oh, that was ten or twelve years ago. You can't expect me to find records of that." At this point, unless the nonowner spouse can trace marital funds to paying off the mortgage, the property remains separate. Assume the nonowner spouse adds, "The reason I always thought it was ours is that we changed the title right after we married. We titled it jointly in both our names." If by titling the property in both names the parties intended it to be marital, then transmutation would classify it as totally marital.

Under transmutation theory, if the parties evidence intent that the property be marital, such intent overrides the statutory scheme for classification and trans-

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[19] Quinn v. Quinn, 512 A.2d 848, 852 (R.I. 1986); *cf.* Coney v. Coney, 207 N.J. Super. 63, 75, 503 A.2d 912, 918 (1985). In Illinois, the courts had not recognized that transmutation rested on intent and applied what it termed "transmutation" to any combining of marital property with separate property. *See, e.g.,* In re *Marriage of Smith,* 86 Ill. 2d 518, 427 N.E.2d 1239. The effect was to transform all separate property on which any marital funds had been expended to marital. Other courts recognized the departure from true transmutation. *See, e.g., Hoffmann,* 676 S.W.2d at 825 n.4; Kramer v. Kramer, 709 S.W.2d 157, 159 n.1 (Mo. Ct. App. 1986). The Illinois approach has been overturned by legislation. *See In re* Marriage of Harmon, 133 Ill. App. 3d 673, 479 N.E.2d 422 (1985).

mutes the entire property to marital without regard to tracing funds.[20] Transmutation theory is consistent with recognizing marriage as a partnership of two persons whose primary goal is furtherance of the family relationship.[21] Classification can be neat, clean, and quick in contrast to applying any of the statutory definitions. Transmutation combines the advantages of administrative efficiency with reaching results intended by the parties, thereby enhancing settlement possibilities.[22]

Transmutation and source of funds theories can exist simultaneously. Transmutation by intent has been adopted in the source of funds jurisdictions that have ruled on it.[23] Since many of these decisions were prior to the enactment of the West Virginia statute,[24] there is no reason to assume that the legislature intended to preclude transmutation theory by statutory adoption of source of funds theory. In fact, West Virginia Code section 48-2-32, which provides that contribution of separate property should be considered in dividing the marital property, would be useless unless transmutation is adopted. However, section 48-2-1(d), which defines property exchanged for separate property as separate, is a special application of the source of funds theory permitting separate contributions to marital property to remain separate so long as such contributions can be traced. Only transmutation can explain how property could become marital so that the separate contribution would be a factor in the division. It does not matter that the statutory scheme would classify property as separate; the parties' evidenced intent to treat it as marital prevails. The equitable way to consider the separate contribution to transmuted marital property is the division process required by section 48-2-32.[25]

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[20] The reverse of this procedure occurs when marital property or separate property is transferred to one of the spouses as a personal gift. It is donative intent that causes the transformation in the character of the property. The gift exception for separate property is so well accepted that courts tend not to use transmutation terminology. *See, e.g., Quinn,* 512 A.2d at 854.

[21] *Id.* at 852.

[22] Because this is an equitable theory utilized for classification purposes only, it is unnecessary to find the parties' intent manifested to the level of a contract between the parties. No one is seeking to enforce a contract. Consequently, the writer assumes there would be no problem because of W. VA. CODE § 48-3-9 (1986) providing that contracts between husband and wife shall not be enforceable unless there is a memorandum in writing.

[23] *See Hoffmann,* 676 S.W.2d 817; Hall v. Hall, 462 A.2d 1179 (Me. 1983); Tibbetts v. Tibbetts, 406 A.2d 70 (Me. 1979). Grant v. Zich, 300 Md. 256, 273-76, 477 A.2d 1163, 1171-73 (1984), apparently is the only decision in equitable distribution states refusing to recognize transmutation from joint titling after adopting the source of funds theory. The opinion overzealously relied on language in Harper v. Harper, 294 Md. 54, 448 A.2d 916 (1982) in which the court, in adopting source of funds, criticized the unwise extension of transmutation that occurred in Illinois.

[24] J. Cobb, ed., *Joint Names Transmutation,* 3 EQ. DIST. J. 101 (Aug. 1986); *Hall,* 462 A.2d 1179. The one decision counter to the majority, *Grant,* 300 Md. 256, 477 A.2d 1163, has been rejected by intermediate courts in Missouri, *Kramer,* 709 S.W.2d 157, and North Carolina, McLeod v. McLeod, 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied,* 314 N.C. 331, 333 S.E.2d 448 (1985).

[25] For a possible example, *see* discussion of Dodd v. Hinton, *infra,* at note 30 and accompanying

B. *Establishing Transmutation*

1. Joint Titling and Interspousal Gifts

A written memorandum of agreement between the parties may indicate their intent that property, no matter how titled, was intended to benefit the marital unit and, therefore, was intended to be marital. This would be the clearest evidence for transmutation; however, this type of written agreement seldom exists. Instead, other documentary evidence such as joint titling is more likely.

Many courts have held that joint titling transmutes the entire piece of jointly titled property to marital property.[26] For example, if property worth $500,000 at the time of the dissolution had been purchased by the husband prior to the marriage but subsequently was titled in both names, he would have evidenced intent to transmute it to marital property. It would be subject to division in its entirety without the necessity of determining how much, if any, marital funds had been devoted to its purchase or improvement. Such decisions require reforming the traditional common law presumption that joint titling constitutes a gift or settlement upon the other spouse of half the property. That presumption, if unmodified, would result in classifying each half of the property as nonmarital or separate: the original owner's half acquired prior to marriage and the other spouse's half acquired by gift during the marriage. The logic and effect of the unmodified presumption would be contrary to the underlying concept of marriage partnership. The more logical assumption is that joint titling, even if termed a gift, is meant to benefit the marital unit. Its effect, should be to enlarge the amount of marital property subject to equitable distribution when the unit is dissolved, not to constrict it. Consequently, several courts have modified the common law presumption that joint titling constitutes a contribution of the entire property to the marital estate for purposes of equitable distribution.

The common law presumption of a gift when one spouse purchases property but takes title in the name of the other spouse is codified in West Virginia Code section 48-3-10. When the equitable distribution law was enacted, the legislature amended this section and provided that in actions involving equitable distribution this presumption "shall not apply, and a gift between spouses must be affirmatively proved."[27] Although the legislature has removed the common law presumption from equitable distribution cases, it has not suggested how to classify property purchased by one spouse but titled in the name of the other spouse. Unless there is affirmative proof that the transaction was intended to benefit the

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text. This analysis assumes that provisions in the distribution section, W. VA. CODE § 48-2-32 (1986), cannot affect classification of property; thus, it differs from that of Crandall, *supra note* 10, at 91.

[26] Conrad v. Bowers, 533 S.W.2d 614 (Mo. Ct. App. 1975); *Quinn*, 512 A.2d 848.

[27] W. VA. CODE § 48-3-10 (1986).

spouse individually rather than to benefit the marital unit, the courts are free to adopt transmutation.[28] In fact, the logical inference is that the legislature was encouraging classification of such property as marital.[29] Consequently, perhaps titling in one name and certainly joint titling, would be documentary evidence of intent to benefit the marital unit and transmute separate property to marital.[30]

A similar result should be reached whenever a gift to one party is actually an investment for the family. Expensive jewels, art works, and even a stereo or a television set might be purchased with either one spouse's separate funds or with marital funds and "given" to the other spouse on a holiday or birthday. Commonly, when this is done, both parties realize it to be a family investment. In this situation, the parties' intent would be that the item is marital property.[31]

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[28] In Brewer v. Brewer, 338 S.E.2d 229 (W. Va. 1985), the court stated that intent to make a gift, in absence of the presumption, required proof of intent to bestow complete, absolute, irrevocable title. This, of course, would create separate ownership. However, so long as this intent was for the purpose of benefitting the marital partnership, the separately owned property could be classified as marital for distribution purposes.

[29] Justice Neely advocates elimination of the gift presumption at the time of divorce to intra-marital gifts of a nonpersonal nature in *LaRue,* 304 S.E.2d at 335-36 (Neely, J., concurring).

[30] Justice Neely noted in *LaRue* that titling "marital property in the name of one spouse is an expedience and that mutual benefit is intended." *Id.* at 335. In Patterson v. Patterson, 277 S.E.2d 709 (W. Va. 1981), *overruled, LaRue* 304 S.E.2d 312, the court noted the "obvious fact. . . that transfers of property between spouses [are] usually intended for the joint benefit of both." *Patterson,* 277 S.E.2d at 716. *See* Hamstead v. Hamstead, No. 16765, slip op. (W. Va. Mar. 18, 1987).

Dodd v. Hinton, 312 S.E.2d 293 (W. Va. 1984), implies that this result may now be possible in West Virginia. *Dodd* involved a partition action brought after *LaRue* but prior to the equitable distribution statute. Mr. and Mrs. Hinton bought a home jointly titled and mortgaged. Mr. Hinton later made some payments with his own funds. He then sold his previously owned residence and deposited the funds in a checking account jointly titled with Mrs. Hinton. They withdrew these funds and applied them to pay off the balance of the loan on the jointly titled house. The common law presumption of a gift of half to Mrs. Hinton applied both when the husband made payments on the loan on the jointly titled home and when he deposited funds in the joint checking account. A divorce suit had been completed. The court affirmed partition, noting that the husband's equitable distribution argument presented a "colorable claim under *LaRue* principles," but was inappropriate in the partition action. A colorable claim under the statute for equitable distribution of the portion "given" to Mrs. Hinton requires classifying it as marital and not separate property. This can be accomplished by presuming transmutation both when separate money is spent to acquire or pay indebtedness on jointly titled property and when it is deposited in a jointly titled account. No particular section of the statute defines this as marital property. Consequently, equitable consideration of the two parties' contributions to the property and a just, but not equal, division would be possible only if transmutation had converted the property to marital for equitable distribution purposes.

[31] *See Hamstead,* No. 16765 (W. Va. Mar. 18, 1987). In O'Neill v. O'Neill, 600 S.W.2d 493 (Ky. Ct. App. 1980), the court believed the husband's testimony that expensive jewelry given to the wife was a family investment. In contrast, in Townsend v. Townsend, 705 S.W.2d 595 (Mo. Ct. App. 1986), in which the family benefit argument apparently was not made, household items including a refrigerator, a stove, and a table and chairs, which the husband had given the wife on special occasions, were classified as her separate property. *See also Quinn,* 512 A.2d 848, in which inherited jewelry became the wife's separate property by gift from the husband.

Surely, it would be in furtherance of the public policy underlying the entire equitable distribution system to give legal effect to all transactions evidencing intent to enlarge the marital property category.

2. Commingling

Another common method of evidencing transmutation is by commingling separate property with marital property so that the separate property can no longer be traced and identified. This phenomenon is best understood by first concentrating on situations in which separate property is not commingled, *i.e.*, exchange. The statute provides that separate property includes "[p]roperty acquired during marriage in exchange for separate property which was acquired before the marriage."[32] An exchange is obvious if a spouse trades a gold coin owned prior to the marriage for a different gold coin, or for a subdivision lot. Exchange traces the separate property into the newly acquired property so that one can continue to identify the separate contribution.

Complications arise when there is not an "even" trade because then marital property and separate property are combined in order to acquire the new asset. When real property is involved, courts applying the source of funds rule have held that record keeping is sufficient tracing to identify the portion of the acquired property which was obtained in exchange for the separate property.[33] That portion and its increase in value will be classified as separate. When the exact amount of separate funds expended on the newly acquired property is known, the source of funds rule then classifies that portion as separate property.[34]

In contrast, commingling occurs when tracing is impossible. When one spouse combines his or her separate property with marital property so that it is impossible to determine what amount had been separate, the exchange definition cannot be applied.[35] The separate property may be added to the value of marital property

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[32] W. VA. CODE § 48-2-1(f)(2) (1986).

[33] Use of transmutation theory in states that follow the inception of title theory or that have not adopted source of funds is beyond the scope of this Article. For example, South Carolina appears to be using transmutation beyond its meaning of intent to benefit the marital estate. *See, e.g.*, Trimnal v. Trimnal, 287 S.C. 495, 339 S.E.2d 869 (1986). This was the early experience in Illinois as well. This writer believes that courts take this approach to ease the harshness of the inception of title rule which denies to the marital estate any increase in value of marital funds invested in separate property.

[34] *Tibbetts*, 406 A.2d 70. The operation of uncommingling combined funds by tracing is illustrated in Caldwell v. Caldwell, 350 S.E.2d 688 (W. Va. 1986). The wife had brought $25,000 to the first marriage which was used in purchasing the first marital home and the proceeds of that home were used in purchasing a second marital home. The parties agreed to divide this property so that exchange or commingling never became an issue. However, the court noted that the wife had carried into the marriage assets worth $25,000. Had the exchange issue been litigated, she could have claimed at least $25,000 as her separate property (so long as transmutation had not occurred) because she could trace her $25,000 into the purchased home.

[35] *See, e.g.*, McHugh v. McHugh, 108 Idaho 347,352 n.6, 699 P.2d 1361,1366 n.6 (1985).

or may be combined with marital funds to acquire another item of property. In either case, the normal definition of marital property as that acquired during marriage without regard to title applies. One may assume that the separate property owner was considering the welfare of the marital unit and furthering partnership objectives.[36] The commingling spouse has transmuted the formerly separate property to marital.

Some decisions reveal a troubling uncertainty involving the commingling of nontangible property as to whether the inability to trace the property or the fact of combining itself causes transmutation. Combining separate and marital funds to acquire investments, such as certificates of deposit and shares of stock, often results in classifying the entire amount as marital. This procedure is in accord with the transmutation theory of intending to benefit the marital estate when it is impossible to trace the amount of separate funds.

In Missouri, an early appellate opinion held that a man who combined the proceeds from sales of stock owned prior to the marriage with proceeds from sales of stock purchased after the marriage and who, apparently, could not account for the precise amount of proceeds from his separate stock, had transmuted the separate property to marital property by commingling.[37] In two subsequent Missouri cases,[38] an investor spouse owned certificates of deposit which were separate property. She reinvested both the principal (separate property) and the interest (marital property) together in newly acquired certificates titled in her name only. If she had kept careful records of the amount of principal invested each time, that would have indicated an intent not to contribute those separate funds to the marital estate. Record keeping is the sensible way to demonstrate intent to isolate and keep separate the separate property.[39] Yet, the Missouri courts have not clarified whether it was inability to trace or the fact of combining alone that transmuted.[40]

If transmutation by commingling occurs, even though the amount of separate funds can be traced, then solely combining marital and separate funds brings about transmutation. The result is inconsistent with the theory of transmutation and creates a far-reaching danger to separate property owners. If neither separate

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[36] The Rhode Island Supreme Court stated that the doctrine of transmutation is consistent with the recognition of marriage as a partnership. *Quinn,* 512 A.2d 848,852.

[37] Jaeger v. Jaeger, 547 S.W.2d 207 (Mo. Ct. App. 1977).

[38] *See, e.g.,* Goldberg v. Goldberg, 691 S.W.2d 312 (Mo. Ct. App. 1985); Cartwright v. Cartwright, 707 S.W.2d 469 (Mo. Ct. App. 1986).

[39] An extreme case in which income from separate property was held separate rested on the finding that the income from the separate property never was distributed or subject to the control of the non-owner spouse. Wierman v. Wierman, 130 Wis. 2d 425, 387 N.W.2d 744 (1986).

[40] Recently, the Nebraska Supreme Court emphasized the ability to identify. *See* Ross v. Ross, 219 Neb. 528, 364 N.W.2d 508 (1985). However, the Rhode Island Supreme Court emphasized combination rather than ability to trace and identify. *See Quinn,* 512 A.2d at 853.

titling nor record keeping will negate transmutation, nearly all intangible separate property will be converted to marital property, over a rather short period of time through the common practice of reinvesting principal and income together.[41] Hopefully, the West Virginia Supreme Court of Appeals will clarify the issue of whether combining or inability to trace evidences transmutation of separate funds to marital.

3. Use by the Marital Unit

Courts also have found that shared use of otherwise separate property converts or transmutes it to marital. This theory is consistent with the shared enterprise theory of marriage. Transmutation by use could manifest intent to confer untitled property upon the marital estate in the same manner that joint titling does for titled property. The Rhode Island Supreme Court held that a husband who inherited household furniture from his father and placed the furniture in the family home for use over most of a thirty-year marriage transmuted the furniture to marital.[42] Interestingly, the fact that he had placed some of the furniture in storage meant that it retained its character as separate and also demonstrated the intent to transmute that which was used.[43] In contrast, Missouri courts dealing with titled property that remained titled in the separate owner's name but was used for a family home held that transmutation did not take place.[44]

A few decisions have extended transmutation to unusual business situations. In *Wanberg v. Wanberg*,[45] the parties operated rental properties which the husband brought to the marriage and which remained titled in his name. The court found that the parties had improved and managed the property as partners demonstrating their intent to treat the specific holdings as joint property. Without using the terminology of transmutation, courts have made similar classifications

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[41] This danger was recognized in regard to real property in *Hall*, 462 A.2d at 1181-82. The former Illinois rule transmuted to marital any separate property upon which marital funds had been spent, including real property, by considering any combination a commingling. In re *Marriage of Smith*, 86 Ill.2d 518, 427 N.E.2d 1239. This holding was unworkable because it nearly eliminated the category of separate property. *See* Gregory, *Marital Property in Illinois: The Complexities Wrought by the Presumption of Gift, Transmutation, and Commingling*, 1982 S. Ill. L.J. 159; Kalcheim & Shapiro, *Transmutation and Commingling: The Supreme Court's Rebuttable Presumption of Marital Property*, 71 Ill. B.J. 220 (1982). Subsequent to *Hall*, the legislature changed the rule. *See* ILL. ANN. STAT. ch. 40 § 503(c) (Smith-Hurd Supp. 1985).

[42] *Quinn*, 512 A.2d at 853.

[43] Other courts have found transmutation of titled property when it was used for the family home. *See, e.g.*, Jenks v. Jenks, 294 Or. 236, 656 P.2d 286 (1982); Stevenson v. Stevenson, 680 P.2d 642 (Okla. Ct. App. 1984).

[44] *See* Busby v. Busby, 669 S.W.2d 597 (Mo. Ct. App. 1984); Cochenour v. Cochenour, 642 S.W.2d 402 (Mo. Ct. App. 1982); Hauser v. Hauser, 625 S.W.2d 924 (Mo. Ct. App. 1981); Stark v. Stark, 539 S.W.2d 779 (Mo. Ct. App. 1976).

[45] Wanberg v. Wanberg, 664 P.2d 568 (Alaska 1983).

when one party devoted most of his time during a long marriage to earning a livelihood by investments which began with property brought to the marriage. Various rationales can justify this marital classification: intent to benefit the marital unit shown by commingling;[46] increase in value all due to marital effort;[47] or that profits represent income rather than increase in value.[48]

IV. Apportioning Marital and Separate Combinations

A. *Full Value Classified in Proportion to Contributions*

The source of funds rule includes within marital property the increase in value of separate property resulting from martial funds or work of the spouses. The West Virginia Legislature adopted the source of funds rule; however, the statute does not state the complete rule. The source of funds rule provides that the character of property as marital or separate initially is determined in proportion to the amount of funds or effort devoted to its acquisition or improvement. A dynamic continuous process of acquisition as property is paid for or improved is recognized. Therefore, the values originally acquired by the respective contributions are part marital and part separate.

The true importance of the source of funds rule, however, is the different effect it has from the inception of title rule on classification of the increase in value of property acquired prior to marriage or by gift. The inception of title rule would require the separate owner to reimburse the marital estate for marital funds spent on it, but would classify all increase in value of originally separate property as separate, thereby encouraging diversion of marital funds into separate property. For example, in the fact situation described earlier in which land was purchased prior to marriage under a contract for $20,000 but was worth $500,000 at dissolution, the entire increase in value would be classified as separate even though three-quarters of the purchase price was paid with marital funds.

In contrast, the heart of the source of funds rule is that each estate enjoys the increase attributable to its contribution.[49] Once the value of separate and marital contributions is determined, the entire value is classified in proportion to those contributions. In the fact situation stated, three-quarters or $375,000 of the ultimate value would be marital and subject to division. Thus, the source of funds rule promotes the partnership or shared enterprise theory of marriage by enabling

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[46] Millington v. Millington, 259 Cal. App. 2d 896, 67 Cal. Rptr. 128 (1968).

[47] Brennan v. Brennan, 103 A.D.2d 48, 479 N.Y.S.2d 877 (1984) (dairy operation); Nolan v. Nolan, 107 A.D.2d 190, 486 N.Y.S.2d 415 (1985) (investments).

[48] Sousley v. Sousley, 614 S.W.2d 942 (Ky. 1981).

[49] *Hoffmann,* 676 S.W.2d 817; *Harper,* 294 Md. 54, 448 A.2d 916; *In re* Marriage of Herr, 705 S.W.2d 619 (Mo. Ct. App. 1986).

the marital enterprise to benefit from the investment of its funds and effort.

Source of funds is a process for classifying property by considering the time and method whereby property was acquired and disregarding the intent of the parties. Of course, there is no need to determine source of funds if the parties have evidenced their intent to treat the entire value as marital by transmutation.

Understandably, the West Virginia Legislature chose to emphasize in the statute the crucial increase in value aspect of the source of funds rule. Under the statutory language, marital property includes increase in value of separate property "which increase results from" marital funds or work. However, the first step in the analysis is to determine the different, initial contributions of separate and marital property or effort.[50] Once the total value is classified into separate and marital portions, then the proportionate increase in value also can be classified.[51]

B. *Determining Contributions to Mortgaged Property*

1. Interest Payments

The first contribution issue to consider in regard to mortgaged property is whether interest payments are contributions toward the acquisition or increase in value of the property to be divided. The Missouri Supreme Court described the source of funds rule as dependent upon the source of funds "financing the purchase"[52] and defined "acquired" as the "ongoing process of making payment"[53] for property. Either definition could justify treating interest payments as a source of acquiring the property. This was done once by a California court of appeals;[54] however, the California Supreme Court overruled the decision in 1980 holding that interest payments, like taxes and insurance, do not contribute to capital investment.[55] The court noted that "[t]he value of real property is generally represented by the owner's equity in it, and equity value does not include finance charges or other expenses incurred to maintain the investment."[56] Several other

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[50] Failure to define the initial contributions creates one of the ambiguities in the West Virginia statute which was noted by Ms. Crandall who suggested legislative amendment for clarification. *See* Crandall, *supra* note 10, at 92.

[51] For example, in *Caldwell,* 350 S.E.2d 688, the wife contributed $25,000 of separate funds to the purchase of property for $60,000. Marital funds paid off the remaining $35,000. Assuming the property was titled in the wife's name, it should be classified 5/12 wife's separate property and 7/12 marital property. It was sold for $85,000. This ultimate value should be classified 5/12 or $35,416 separate property and 7/12 or $49,583 marital property.

[52] *Hoffman,* 676 S.W.2d 817, 824.

[53] *Id.* at 825.

[54] Vieux v. Vieux, 80 Cal. App. 222, 251 P. 640 (1926).

[55] *In re* Marriage of Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980).

[56] *Id.* at 369, 618 P.2d at 211, 168 Cal. Rptr. at 665; *accord In re* Marriage of Saslow, 40 Cal. 3d 848, 867, 710 P.2d 346, 356, 221 Cal. Rptr. 546, 555-56 (1985); *In re* Marriage of Gowdy, 178 Cal. App. 3d 1228, 224 Cal. Rptr. 400 (1986).

courts, like California, also take into account only payments which reduce principal.[57]

The West Virginia statute specifically includes within marital property the increase in the value of separate property which results from expenditure of marital funds "which reduces indebtedness against separate property, extinguishes liens, or otherwise increases the net value of separate property."[58] Because interest payments do not increase net value in the sense of the equity, the legislative intent appears congruent with the theory of the California Supreme Court. However, the obligation to pay interest is indebtedness and is the largest portion of mortgage payments during the early years of a loan. Consequently, it could be argued that the statutory language requires interest payments to be considered in determining the share of marital property.[59] The total amount of money spent, principal and interest, would be used to determine the proportionate share of each in the equity.

Including interest payments as contributions would make a difference in the total amount of marital property subject to division. Interest payments from both separate and marital funds would be most likely when property was purchased and partially paid for prior to marriage, and the mortgage debt was further reduced during marriage. Thus, if separate funds prior to the marriage had reduced the principal significantly, so that later payments from marital funds included less interest and more principal, considering both interest and principal payments as contributions would increase the percentage or ratio contributed by the separate funds. The effect would be a decrease in the amount subject to division as marital property. Lessening the proportionate value of the marital contribution seems contrary to the legislative goal reflecting the partnership nature of marriage. Therefore, the more logical analysis is that the statutory language "reduce indebtedness," when construed in the context of payments which "increase the value

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[57] *See, e.g., Tibbetts,* 406 A.2d 70; Brandenburg v. Brandenburg, 617 S.W.2d 871 (Ky. Ct. App. 1981); Winter v. Winter, 712 S.W.2d 423 (Mo. Ct. App. 1986); In re *Marriage of Herr,* 705 S.W.2d 619. *Compare, McHugh,* 108 Idaho 347, 699 P.2d 1361, in which interest was not discussed but results, so bizarre as to incite an unusual dissent, might be due to including interest payments in the calculations.

[58] W. VA. CODE § 48-2-1(e)(2) (1986).

[59] Crandall suggests that interest payments as reduction of debt could be included in the amount of increase in value of the separate property which is marital. Crandall, *supra* note 10, at 93. This writer disagrees. Interest payments cannot enlarge the amount of property to be classified and divided because they do not enlarge any value. The "property" is the market value of the interests owned by the parties, *i.e.,* the equity. Although interest is part of the indebtedness, it is a cost of acquisition which does not affect the value subject to division. Therefore, the only logical way in which interest could affect the amount of separate or marital property is by changing the proportion of those contributions to the actual value acquired. Because the ratio of interest in each monthly payment changes over the life of the loan, a larger proportion of the early payments is interest. Crandall stated that including interest payments would increase the marital pool. Crandall, *supra* note 10, at 93. This would be true only if the marital funds were contributed early in the life of the loan.

of separate property," was only intended to insure that payments which increase equity of otherwise separate property would be classed as marital.

2. Mortgage Remaining at Dissolution

The West Virginia statute requires a determination of the net value of marital property.[60] Net value is determined by subtracting the amount of indebtedness from the market value of the property. However, this equation does not tell one how to account for the remaining payments. If both spouses are responsible for retiring the debt or if the property is sold to extinguish the debt, no classification problems exist. But when the debt was incurred by only one of the spouses prior to the marriage or has been assumed by only one of them and remains to be paid off after the marriage, that spouse may claim credit for the amount of the remaining indebtedness as a separate contribution to acquire the property. She not only may assert that what she has already paid from her separate funds should be included in the amount of separate contribution, but what she will pay in the future also should be included. In other words, this spouse may argue that the total contributions to acquire the equity value should be based not on what has actually been spent, but, on the total purchase price, the unpaid part of which is now represented by the loan.[61]

Other courts, exemplified by Kentucky and Missouri, do not give credit for the loan value as a nonmarital property contribution.[62] Consequently, the marital pool is increased because the relative percentages change. Since credit would be given only for the the amount of money already spent, the relative proportions

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[60] W. VA. CODE § 48-2-32(d)(1) (1986).

[61] In California, the economic value of the loan is considered part of the nonmarital contribution. *See* In re *Marriage of Moore,* 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662. The effect is to increase the separate proportion of the property. As an example, modify the basic facts of *Caldwell,* 350 S.E.2d 688. Assume that $10,000 remained outstanding on the loan for the $60,000 purchase price. Assume that the wife, in addition to the $25,000 contribution of her separate funds, would be solely obligated to pay off $10,000, thus, the total nonmarital contribution would be $35,000. The marital payments had been $25,000. The relative percentages of the $60,000 would be nonmarital, $35,000 or 58%, and marital, $25,000 or 42%. When these ratios are applied to the equity (market value $85,000 minus $10,000 indebtedness), the separate property is $43,500 and the marital property is $31,500.

[62] *Winter,* 712 S.W.2d 423; *Brandenburg,* 617 S.W.2d 871; Graham, *Using Formulas to Separate Marital and Non-Marital Property: A Policy Oriented Approach to the Division of Appreciated Property Upon Divorce,* 73 KY. L. J. (1985).

Although Kentucky does not do so, the loan amount should be credited to the marital estate if, as part of the dissolution settlement, the debt is extinguished either with other marital funds or by selling the property. See Porter & Ewing, *Apportioning Marital and Nonmarital Assets in a Single Asset,* 9 KY. BENCH & B. (1983); Note, *Equitable Distribution: Approaches to Apportionment,* 87 W. VA. L. REV. 95, 108 (1984).

would not include the loan amount which would be subsequently paid by the separate owner.[63]

If the nonmarital contribution was originally a gift to the contributing spouse, the amount credited as a nonmarital contribution would be the fair market value of the gift when contributed. For example, in In re *Marriage of Herr*,[64] the husband's father transferred to the husband his interest in a farm upon which there was a modest mortgage. Marital funds paid off the mortgage. The gift was the husband's nonmarital contribution, valued when received.

Another situation in which market value rather than actual separate funds spent can be used is when the separately contributing spouse paid part of the purchase price prior to the marriage and there is evidence that the value also increased prior to the marriage. In *Winter v. Winter*,[65] the court held that the nonmarital contribution would be the equity value (market value minus outstanding indebtedness) at the time of marriage. Both simplicity in determining the relative shares of marital and separate property and the policy of increasing the marital pool favor using actual expenditures or equity value at time of marriage to calculate the nonmarital contribution.

C. *Apportioning Increase in Value of Separate Business*

1. The Dilemma and Early Solutions

In dual property jurisdictions, property owned before marriage or acquired by gift or inheritance during marriage is separate property. Lawyers should advise business clients contemplating marriage and who want to keep prior owned or inherited property separate to consider incorporating their business affairs. A real estate developer, a cattle breeder, a stock and bond investor, or a proprietor of a retail business each will sell and reinvest proceeds continually. Whenever property is turned over during marriage, the newly acquired investment will be marital property unless tracing can meet the exchange definition of separate property. However, if the assets are part of a corporation the property does not change from separate to marital as assets are sold and purchased because only the shares are the property of the spouse and they are not transferred. Incorporation is a method to avoid tracing and many transmutation problems as well. An added advantage of segregating the separate property is that many dual property statutes

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[63] In the *Caldwell* example, the wife's nonmarital contribution would be only the $25,000 she had already contributed giving her a 50% share of the $75,000 equity, *i.e.*, $37,500. Likewise, the marital estate would be credited with $25,000 or one-half, resulting in $37,500 subject to division.

[64] In re *Marriage of Herr*, 705 S.W.2d 619.

[65] *Winter*, 712 S.W.2d 423; *see also Brandenburg*, 617 S.W.2d 871; *In re* Marriage of Marsden, 130 Cal. App. 3d 426, 181 Cal. Rptr. 910 (1982).

provide that increase in value of separate property is separate. In West Virginia, any increase in value of separate property due to inflation or a change in market value resulting from conditions outside the control of the parties is separate.[66] So long as no efforts are devoted to the business, increases in value of separate property remain separate.

Conflict arises when during the marriage the shareholder spouse devotes most working efforts toward the separate business. When the business has been successful, its value will increase significantly. Historically, this situation created a dilemma which defied satisfactory solution. A fundamental concept of community property systems, that in recent times is reflected in the common law dual property systems, is that whatever is acquired by the efforts of either or both parties is community property.[67] In other words, the earning power of both spouses belongs to the marital community.[68] The main philosophical underpinning of the partnership marriage system would be defeated if values acquired by efforts, skill, and ability of a spouse were not recognized as part of the marital estate.[69] Therefore, in Spanish community property law, all earnings and increase in value were community property.[70] Apparently due to influences from the common law, another fundamental concept developed early in most community property states: increases in the value of separate property belong to the separate property owner.[71] The clash of these two fundamental principles has been particularly acute when the separate property is a business to which one or both spouses devote time and effort. The increase in value is almost always due to both the efforts of the shareholder spouse and general market conditions.[72] Uncertainties in measuring the value of the input from either economic conditions or efforts renders apportionment of the increase in value and classification more difficult than determining separate and marital dollars contributed to acquisition of real property. By the early 1920s, courts were reaching disparate results and no satisfactory rule had been developed.[73]

In 1962, Professor King analyzed and critiqued the variety of judicial solutions that had been developed in the struggle to resolve this dilemma.[74] King criticized the *all community method* because it deprived the separate property of its contribution; however, he also stringently criticized an *all separate method* as ine-

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[66] W. VA. CODE § 48-2-1(f)(6) (1986).

[67] W. DEFUNIAK, PRINCIPLES OF COMMUNITY PROPERTY, § 11.1 (1971); Evans, *Primary Sources of Acquisition of Community Property*, 10 CALIF. L. REV. 271 (1921).

[68] *See Michelson*, 89 N.M. 282, 286, 551 P.2d 638, 642; *In re* Caswell's Estate, 105 Cal. App. 475, 288 P. 102 (1930). *See also*, materials cited at note 3, *supra*.

[69] Evans, *supra* note 67, at 273.

[70] King, *The Challenge of Apportionment*, 37 WASH. L. REV. 483, 484 (1962).

[71] *Id.*

[72] *Id.*

[73] Evans, *supra* note 67, at 284.

[74] King, *supra* note 70.

quitable because it gave the separate property a gain that had been earned by the community. He noted that "[i]f the husband is allowed to spend all his time working on his separate property, the community might never accumulate any community assets. The only satisfactory use of this system is in cases where the labor expended is so minute that the court should not consider it."[75] The *reimbursement method,* which only allows reimbursement to the community for the marital efforts devoted to separate property, and thus, does not allow the community to share in the proportionate increase in value, also was unfair to the community. An *all or nothing method,* labeled the principal contribution method by King, classes the increase in value as either entirely separate or community depending upon the principal contribution. King notes that this approach has an added shortcoming: a small error in making the decision of which contribution is primary will have a large effect in unjustly denying anything to the other estate. The only virtue of this method is that it avoids a precise apportionment decision on the basis of a more easily determined gross or rough estimate. The other methods analyzed by Professor King all attempt to apportion the increase in value between that caused by marital efforts, skill and ability, and that due to general economic conditions.

The *reasonable rate of return* method attempts to give the separate property owner a reasonable return on the separate property investment. California decisions applied this method when the increase in value was largely due to the efforts of the spouses.[76] The method is designed to assure that the separate property which is developed by the community efforts receives something even though most of the value should be classed as community. The court in *Pereira v. Pereira,* which originated this method, said, that "[t]he increment being attributable to the personal efforts of the husband belonged to the community. . .but without capital he could not have carried on the business."[77] Thus, the reasonable rate of return method implies "a decision that community efforts bear the predominate responsibility for the increase in value. . . ."[78] When real property forms the separate estate, a reasonable rental is considered separate.[79] Return figured as interest on the value of the separate property is used for a wide range of businesses. In California, the legal rate of interest was used in the absence of evidence that

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[75] King, *supra* note 70, at 486, criticizing *In re* Pepper's Estate, 158 Cal. 619, 112 P. 62 (1910) (all separate constant efforts) *overruled, In re* Neilson's Estate, 57 Cal. 2d 733, 371 P.2d 745, 22 Cal. Rptr. 1 (1962); but approves of *In re* Buchanan's Estate, 128 Cal. App. 489, 17 P.2d 1046 (1932) (all separate but very small amount of work).

[76] Pereira v. Pereira, 156 Cal. 1, 103 P. 488 (1909); Randolph v. Randolph, 118 Cal. App. 2d 584, 258 P.2d 547 (1953).

[77] *Pereira,* 156 Cal. at 7, 103 P. at 491.

[78] Speer v. Quinlan, 96 Idaho 119, 126, 525 P.2d 314, 321 (1974); Comment, *Never Marry a Rich Man: The Lesson of Beam v. Bank of America, A California Apportionment Case,* 13 SANTA CLARA L. REV., 121, 124, 132 n.69 (1972) (*Never Marry a Rich Man.*).

[79] *See, e.g.,* Laughlin v. Laughlin, 49 N.M. 20, 155 P.2d 1010 (1944).

special economic conditions rendered the investment more or less profitable.[80] For example, in *Randolph v. Randolph*,[81] the husband had spent all of his efforts working in a separate floral business. The court approved awarding all the increase to the community except for a return at the legal rate of interest of seven percent to the separate property. The court said that they would use the legal rate of interest unless the accruals actually attributable to the separate property were proved different from that rate. King criticized this method because of litigation over what rate should be used, indicating that evidence relating to the amount of increase in value and economic conditions could justify a greater or lesser rate of interest.[82] King's main criticism of the rate of return method was that it avoids actual apportionment of the full increase in value.[83] An important advantage of the rate of return method, noted by King, is ease of application with a fair degree of predictability of results.

The California cases developed the *reasonable compensation method* for situations in which the invested separate property contributed more than skills and effort to the increase in value.[84] This method was first applied in *Van Camp v. Van Camp*,[85] in which the court described the husband at the time of the marriage as a man of means, acting as general manager of a very successful seafood corporation which was organized long before the marriage. Although the court recognized the contribution of his skill and capacity, they noted that he had been paid a very substantial salary during the marriage and concluded that, otherwise, the increase in value was derived from the property. The court noted that the wife was much younger than the husband and described their marriage as one of convenience, thus, revealing its reason for not wishing to enlarge the community estate any more than necessary. The reasonable compensation method leaves most of the increase to the separate estate, assuring that the community will obtain at least reasonable compensation for its efforts. In the reasonable compensation method, which King labeled the "salary system," the court allocates a reasonable compensation to the community for its labor. What is reasonable may or may

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[80] Weinberg v. Weinberg, 67 Cal. 2d 557, 432 P.2d 709, 63 Cal. Rptr. 13 (1967).

[81] *Randolph*, 118 Cal. App. 2d 584, 258 P.2d 547.

[82] King, *supra* note 70, at 489-90 (citing Logan v. Forster, 114 Cal. App. 2d 587, 250 P.2d 730 (1952)).

[83] For example, if the rate chosen is too high and the legal rate of interest is likely to be spread over extended periods of time (*See Never Marry a Rich Man, supra* note 78, at 132 n.69), so much could be allocated to the separate property that the community gets insufficient or no credit for efforts even if they undoubtedly improved the value of the enterprise. *See, e.g.*, Beam v. Bank of America, 6 Cal. 3d 12, 490 P.2d 257, 98 Cal. Rptr. 137 (1971); Price v. Price, 217 Cal. App. 2d 1, 31 Cal. Rptr. 350 (1963).

[84] *Speer*, 96 Idaho 119, 126, 525 P.2d 314, 321, in which the court said that using this method "signals the court's determination that community efforts were not so essential to the growth as to merit compensation beyond a just and reasonable salary"; *See also* King, *supra* note 70, at 489; *Never Marry a Rich Man, supra* note 78, at 124, 132 n. 69.

[85] VanCamp v. VanCamp, 53 Cal. App. 17, 199 P. 885 (1921).

not be larger than the amount actually drawn as salary depending upon whether the court finds the salary paid was adequate recompense for the services performed. Several courts determine what is reasonable by what a comparable business would pay a person of the same level of responsibility, including bonuses and fringe benefits.[86] King noted that the salary system is seized upon by courts, especially when the business is incorporated and there is evidence that economic conditions contributed significantly to the increase, as an easy way to avoid the difficult actual apportionment issue.[87] King's heaviest criticism was that this system, like the reimbursement method, accords to the community only the reasonable value of the managerial services from the perspective of what similar businesses would pay for them. The separate owner retains all the remaining increase because the evidence shows that the separate property was the chief contributor. King pinpointed the unjustness in depriving the community of its share in the "product," *i.e.,* the increase in value actually due to the services.

The only method praised by Professor King was the *mathematical formula method.* This approach, used in tax cases, combines both the interest and salary methods, allocating to the separate and community estates a share in the excess increased value in proportion to their relative contributions.[88] In *Todd v. McColgan,*[89] state income tax was allocated between partners operating a separate business and their spouses by using a formula to differentiate the portion of increased value due to the capital and that due to the efforts of the partners neither of whom had ever had a salary or fixed compensation. The court approved the process which it described:

> First the defendant Commissioner estimated what would constitute a fair return upon the separate capital investment under the particular circumstances of this case and next estimated what would be a fair salary for the taxpayers for each of the years in question. These figures so obtained were totalled and the percentage of each to the total constituted the proportion of the distributable income attributable to capital and to services.[90]

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[86] *Speer,* 96 Idaho 119, 525 P.2d 314.

[87] King, *supra* note 70, at 488 (citing as the leading case, *VanCamp* 53 Cal. App. 17, 19 P. 885, for acknowledgement that it was avoiding the "impossible" apportionment problem).

[88] King, *supra* note 70, at 491.

[89] Todd v. McClogan, 89 Cal. App. 2d 509, 201 P.2d 414 (1949).

[90] *Id.*, affirming an 8% rate of interest rather than the 7% legal rate because the lumber business had acquired and held a large inventory at the beginning of World War II when lumber was subject to an inflationary spiral. In Todd v. Commissioner, 153 F.2d 553 (9th Cir. 1945), federal income tax for these same partners was allocated. The opinion is valuable for setting out in detail the methodology used. The amount found by applying the interest rate to the average capital value during each year in question was the separate property contribution and was described as the "capital base." The court then determined the community contribution by determining "salaries for services. . .annually for the base of the capital earnings." The dollar amounts of the two contributions were then added together and the proportion that each had contributed to the total contributions was determined. That proportion was used to allocate the entire undistributed increase in value between the separate and community estates.

King praised this mathematical formula method because it divides the increase more fairly than any of the other methods and because it should lend stability and predictability to apportionment. The method eliminates the unfairness of allocating all the value in excess of either reasonable salary or reasonable rate of return to the other estate by allowing proportionate sharing.[91] However, the method requires extensive evidence in order to establish both the reasonable rate of return and reasonable compensation. Perhaps this is why the mathematical formula method appeared only sparingly in early reported dissolution cases.[92]

Finally, King listed the *percentage* and *substantial justice approaches* in which no particular method for apportionment was even suggested for the trial courts. These early community property cases demonstrate clearly that the appellate courts avoided favoring one of the conflicting theories over the other by refusing to require a particular apportionment method. Of course, lack of predictability on whether to further the interests of the community or the separate estate was the result. Because relatively few divorce cases were litigated in those earlier times, the impact of that ambiguity was slight. Because the number of marriage dissolutions has grown in modern times and as equitable distribution has spread throughout the country, the uncertainty may be more untenable.

2. Modern Theories and Solutions

By the mid-1980s, nearly all dual property jurisdictions followed the rule that an increase in value of separate property should be apportioned between the separate and marital estate depending upon whether economic forces or spousal efforts produced that increase. Among the community property states, Arizona,[93] in 1983, became the last state to eliminate the all or nothing method based on primary contribution.[94] Only Texas[95] forthrightly continues to apply the strict inception of title reimbursement method that does not apportion the enhanced value beyond reimbursement for the value of the contribution.

In the common law dual property jurisdictions, with rare exceptions,[96] most courts facing the issue require allocation to the marital estate of the increase due

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[91] *See* Jacobs v. Hoitt, 119 Wash. 283, 205 P. 414 (1922) (applying a somewhat similar formula).

[92] *Never Marry a Rich Man, supra* note 78, at 125.

[93] *In re* Marriage of Cockrill, 124 Ariz. 50, 601 P.2d 1334 (1979), *aff'd,* 139 Ariz. 72, 676 P.2d 1130 (1983).

[94] *Id.*

[95] Jensen v. Jensen, 665 S.W.2d 107 (Tex. 1984).

[96] The Rhode Island Supreme Court held that because the statute includes only income from separate property in marital property, all increase in the value of close corporations due to the husband's efforts over a 25-year marriage must be separate. Lancellotti v. Lancellotti, 481 A.2d 7 (R.I. 1984), criticized by, Note, *Family Law,* 19 SUFFOLK U. L. REV. 427 (1985). All increase in value of separate property is marital in Colorado and Pennsylvania. Anthony v. Anthony, 514 A.2d 91, 102-03 (Pa. 1986).

to marital funds or spousal effort.[97] They do so in spite of apparently clear statutory language which states that the increase in value of separate property is separate.[98] Some courts acknowledge that they are applying the source of funds rule.[99] In a few jurisdictions, courts have read this distinction into statutes which allow division of jointly acquired or improved property.[100] In Wisconsin, after the court held that statutory words required classing increase in value of gifted property as nonmarital, it authorized division on the basis of hardship, finding that failure to divide the increase due to the nonowner spouse's contribution would constitute hardship.[101] The New York statute includes as separate property an 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."[102] New York courts have held that appreciation due to the owner spouse's effort also must be marital property in order to recognize the portion contributed by the nonowner spouse.[103]

Strong policy reasons underlie such judicial modifications of statutory language.[104] The stated reasons hark back to the fundamental concepts underlying community property and equitable distribution. These common law courts, newly acquainted with equitable distribution, are thinking freshly about what it means for the law to recognize that marriage is a partnership. The hallmarks they note are commitment of spousal effort to the marriage, spouses enabling and supporting one another in their efforts, and spousal expectation of sharing gains thereby jointly achieved.

A Pennsylvania trial judge emphasized commitment of effort and sharing when he said that the cornerstone of equitable distribution is that the activities

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[97] Wade v. Wade, 72 N.C. App. 372, 325 S.E.2d 261 (1985).

[98] *See, e.g., Hoffmann,* 676 S.W.2d 817; Hall v. Hall, 462 A.2d 1179 (Me. 1983); *Tibbetts,* 406 A.2d 70; Lawing v. Lawing, 81 N.C. App. 159, 344 S.E.2d 100 (1986); *McLeod,* 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied,* 314 N.C. 331, 333 S.E.2d 488 (1985); Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985) (describing increase in value due to effort as active appreciation and increase due to economic conditions as passive appreciation).

[99] *Id.*

[100] *See, e.g.,* Van Newkirk v. Van Newkirk, 212 Neb. 730, 325 N.W.2d 832 (1982); Templeton v. Templeton, 656 P.2d 250 (Okla. 1982); Moyers v. Moyers, 372 P.2d 844 (Okla. 1962).

[101] Plachta v. Plachta, 118 Wis.2d 329, 348 N.W.2d 193 (1984).

[102] N.Y. DOM. REL. LAW § 236(B)(1)(d)(3) (McKinney 1986).

[103] Price v. Price, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219 (1986); Majauskas v. Majauskas, 61 N.Y.2d 481, 474 N.Y.S.2d 699, 463 N.E.2d 15 (1984); Roffman v. Roffman, 124 Misc. 2d 636, 476 N.Y.S.2d 713 (N.Y. Sup. Ct. 1983); Wood v. Wood, 119 Misc. 2d 1076, 465 N.Y.S.2d 475 (N.Y. Sup. Ct. 1983); Conner v. Conner, 97 A.D.2d 88, 468 N.Y.S.2d 482 (1983). *Contra* Jolis v. Jolis, 111 Misc. 2d 965, 446 N.Y.S.2d 138 (1980), *aff'd,* 98 A.D.2d 692, 470 N.Y.S.2d 584 (1983).

[104] Presumably, the same policies lie behind the unusual specific statutory language in West Virginia which defines marital property to include the increase in value of separate property due to work and defines the increase in value of separate property as separate only to the extent the cause is beyond the control of the parties.

of either party during the marriage are considered taken on behalf of the marital enterprise; therefore, the benefits of one spouse's labor should accrue to both spouses.[105]

New York's highest court, in *Price,* centered on enablement when it said:

> The Equitable Distribution Law reflects an awareness that the economic success of the partnership depends not only upon the respective financial contributions of the partners, but also on a wide range of nonremunerated services to the joint enterprise, such as homemaking, raising children and providing the emotional and moral support necessary to sustain the other spouse in coping with the vicissitudes of life outside the home.[106]

Earlier, in *Roffman v. Roffman,* a lower New York court eloquently described commitment and enablement:

> The concept of equitable distribution is a corollary of the principle that marriage is a joint enterprise whose vitality, success and endurance is dependent upon the conjunction of multiple components, only one of which is financial. The non-remunerative efforts of raising children, making a home, performing a myriad of personal services and providing physical and emotional support are, among other noneconomic ingredients of the marital relationship, at least as essential to its nature and maintenance as are the economic factors, and their worth is consequently entitled to substantial recognition. . . .[107]
>
> The inexorable conclusion to be drawn from these definitions is that partnership theory prevails in the distribution of the fruits produced through the efforts of either spouse during marriage, since any efforts not directly related to such production are deemed to have enabled the other spouse to engage in efforts that were so related.[108]

A North Carolina Court of Appeals recognized the enablement function of the homemaker spouse as a reason for sharing the increase in value of separate property due to effort when it said that:

> [If the assets were immune] . . . even if the spouse who acquired them was only able to do so because his or her spouse devoted time and money to maintaining the household, enabling him or her to engage in profitable business dealings. . .then equitable distribution simply is no help to the person whose spouse is a businessman or entrepreneur, who brings considerable corporate property into the marriage, and acquires most of the assets used in the marriage by profit-making manipulation of corporate funds.[109]

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[105] Pascoe v. Pascoe, 11 Fam. L. Rep. (BNA) 1091 (Pa. Ct. Comm. Pleas 1984); Birkel v. Birkel, 9 Fam. L. Rep. (BNA) 2191 (Pa. Ct. Comm. Pleas 1982).

[106] *Price,* 69 N.Y.2d at 14, 503 N.E.2d at 687, 511 N.Y.S.2d at 222.

[107] *Roffman,* 124 Misc. 2d at 636, 476 N.Y.S.2d at 715 (quoting *Wood,* 119 Misc. 2d 1076, 465 N.Y.S.2d 475).

[108] *Id.,* 476 N.Y.S.2d at 715 (quoting *Conner,* 97 A.D.2d 88, 99, 468 N.Y.S.2d 482, 490).

[109] *Phillips,* 73 N.C. App. at 72, 326 S.E.2d at 60.

The Maine and Missouri Supreme Courts highlighted expectation of sharing when they stated that the marital unit should share in values attributable to marital funds and labor to prevent a sophisticated spouse from diverting marital funds and effort to aggrandize separate property at the expense of the marriage and the other spouse.[110] Some judges have said specifically that the close corporation shareholder, even with sound business decisions, should not be permitted to deprive the other spouse of a share in the fruits of the shareholder's labor.[111]

The dual property equitable distribution statutes of these states define marital property as all property acquired during marriage and add an exception for property defined as separate;[112] therefore, these courts are relying on the principles of partnership marriage to justify narrowly limiting the statutory exception for separate property. The effect is a broad construction of marital property to include contributions by effort. The New York Court of Appeals in *Price* held that the legislature, by so defining the terms, intended that marital property should be broadly construed and the separate property exception narrowly construed "in order to give effect to the economic partnership concept of the marriage relationship recognized in the statute."[113] Once a court holds that apportionment of the increase in value of separate property is required in order to further the values of partnership marriage, appropriateness of methods for apportionment should be measured by their effectiveness in advancing that goal.

The burden of proof on the issue of whether an increase in value of separate property during the marriage is due to efforts or economic conditions is rarely discussed. However, there is a clear split of authority along the lines of the original dilemma. Some courts recognize that the increased value in itself is property acquired during marriage and apply the underlying presumption that property acquired during marriage is community or marital.[114] Therefore, in the absence of evidence that general economic conditions caused a natural or inherent enhancement in the value of the separate property, the entire increase is presumed to be due to effort and classed as marital. This approach favors the community[115] and

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[110] *Hoffmann*, 676 S.W.2d 817; *Hall*, 462 A.2d 1179.

[111] *McLeod*, 74 N.C. App. at 151; 327 S.E.2d at 915 (quoting *Hoffman*, 676 S.E.2d at 830 (Blackmar, J. concurring in part)).

[112] *See, e.g.*, U.M.D.A. § 307 (1970); Fam. Law Rep. (BNA) Desk Guide to the Uniform Marriage and Divorce Act 57 (1974); Mo. ANN. STAT. § 452.330 (Vernon 1986); N.Y. DOM. REL. § 236(B)(5) (McKinney 1986); N.C. GEN. STAT. § 50-20(a) (1981); 23 PA. STAT. ANN. tit. 23 § 401(d) (Purdon 1986).

[113] *Price*, 503 N.E.2d at 687, 511 N.Y.S.2d at 222 (citing *Majauskas*, 61 N.Y.2d 481, 463 N.E.2d 15, 474 N.Y.S.2d 699).

[114] In re *Marriage of Cockrill*, 124 Ariz. 50, 601 P.2d 1334; Cord v. Cord, 98 Nev. 210, 644 P.2d 1026 (1982); Downs v. Downs, 410 So. 2d 792 (La. Ct. App. 1982), *cert. denied*, 414 So. 2d 375 (burden to rebut on separate owner after evidence that efforts did contribute); Deliberto v. Deliberto, 400 So. 2d 1096 (La. Ct. App. 1981).

[115] *Jacobs*, 119 Wash. 283, 205 P. 414.

the partnership aspect of the marriage relation by treating the increase as any other exception to the presumption and placing the burden on the separate property owner.[116] Adopting the source of funds rule that the process of acquisition is an ongoing process, so that the increase is property acquired during marriage, seems to demand this result. As one writer noted, placing the burden of proof on the party seeking to establish that some part of the income should be credited to the community is inconsistent with the substantive presumption that all property acquired during marriage is community.[117]

Many other courts have placed the burden on the community or the nonowner spouse to show that efforts, rather than economic conditions, produced the increase.[118] Sometimes, the courts rely upon the specific statutory language that the increase in value of separate property is separate. By viewing the increase as part of the property already classed as separate, courts avoid the marital property presumption.[119] This appears inconsistent with the source of funds philosophy and more congruous with the inception of title reasoning.

The West Virginia statute is unusual. It defines increase by work as marital and increase due to market conditions as separate. Yet, these definitions do not suggest who should have the burden of proof. The subsection setting out the general definition of marital property as all property acquired during the marriage concludes by stating, "except that marital property shall not include separate property as defined in subsection (f) of this section. . . ."[120] Subsection (d)(6) defines the increase in value of separate property due to market conditions as separate property. Implicit in these provisions is a legislative intent that the latter be construed as an exception to a basic presumption that property acquired during marriage is marital.[121] Thus, all increase in separate property should be classed as marital unless the separate property owner sustains the burden of showing that the increase is due to market conditions beyond the control of the parties.

Beam v. Bank of America,[122] decided by the California Supreme Court in 1971, heralded the modern era in community property states by stating that California courts had in their long history of litigating the issue of increase in value of separate businesses during marriage used one of two alternative methods: reasonable rate of return or reasonable compensation depending on the circumstances

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[116] *Cf. Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219 (broadly construing marital property to promote the economic partnership concept).

[117] *Never Marry a Rich Man, supra* note 78.

[118] *See, e.g., Hoffman*, 676 S.W.2d 817; *In re* Marriage of Elam, 97 Wash. 2d 811, 650 P.2d. 213 (1982); *Michelson*, 89 N.M. 282, 551 P.2d 638; *In re* Ney's Estate, 212 Cal. App. 2d 891, 28 Cal. Rptr. 442 (1963).

[119] In re *Ney's Estate*, 212 Cal. App. 2d 891, 28 Cal. Rptr. 442.

[120] W. VA. CODE § 48-2-1(e)(1).

[121] *Cf. Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219.

[122] *Beam*, 6 Cal. 3d 12, 490 P.2d 257, 98 Cal. Rptr. 137.

of the case. The court affirmed the apportionment made after applying both methods and thereby avoided ruling on which method was appropriate under the facts. Nevada, in 1973, and Arizona, in 1983, also held that apportionment was required but specified no particular method.[123] The Idaho Supreme Court, in *Speer v. Quinlin,*[124] although noting that there was no predominate pattern for apportioning in the community property states, adopted a newly restrictive method which limited the community to reasonable compensation apparently without regard to whether property or effort was the chief contributor to the increase in value. The mathematical formula method of proportionate sharing apparently is no longer used in modern dissolution cases.

In the common law states, activity has been sparse with no clear choice of a single apportionment method being utilized. The decision in *Hoffman*[125] apparently placed the burden of proof on the nonowner spouse as to whether efforts did increase the value and, when evidence indicated that the increase was due largely to economic conditions, limited the marital estate only to reasonable compensation for efforts.[126] There appear to be no other recent appellate court decisions adopting a particular method of apportionment.[127]

Surely, there will be more litigation in the common law states on apportioning increase in value of separate business interests in the future. Presently, confusion abounds both in the community property and the common law jurisdictions because the appellate courts have not articulated the basis upon which trial courts

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[123] In Johnson v. Johnson, 89 Nev. 244, 510 P.2d 625 (1973), the Nevada Supreme Court said courts could select whichever of the two methods "will do substantial justice" and affirmed a judgment apportioning a reasonable rate of return to the separate property owner and the remainder to the community. Later, in *Cord,* 98 Nev. 210, 644 P.2d 1026, the Nevada court affirmed finding all increase separate because none was attributable to effort. Although expert witnessses for both sides used the rate of return method, the court did not rule on the propriety of doing so. In in re *Marriage of Cockrill,* 124 Ariz. 50, 601 P.2d 1334, the Arizona court affirmed a finding, using the reasonable compensation method, that $75,000 of the $79,000 increase in value was community property and held that the trial court was not bound by any one method to determine reasonable rental, reasonable rate of return, and reasonable compensation.

[124] *Speer,* 96 Idaho 119, 525 P.2d 314; *see also* Mifflin v. Mifflin, 97 Idaho 895, 556 P.2d 854 (1976).

[125] *Hoffman,* 676 S.W.2d 817; *See also* Heilman v. Heilman, 700 S.W.2d 843 (Mo. 1985) (en banc).

[126] *See* discussion, *infra* notes 163-177 and accompanying text.

[127] Two decisions held that economic conditions caused the increase and added that minimal spousal efforts had been sufficiently compensated. *See Van Newkirk,* 212 Neb. 730, 325 N.W.2d 832 (1982); *Templeton,* 656 P.2d 250; *see also* Schweizer v. Schweizer, 55 Md. App. 373, 462 A.2d 462, *cert. granted,* 298 Md. 49, 468 A.2d 1013, *aff'd in part,* 301 Md. 626, 484 A.2d 267 (1983). *Cf. Plachta,* 188 Wis. 2d 329, 348 N.W.2d 193 (home appreciated due to general economic conditions only). One opinion without discussion, citation, or full statement of facts affirmed the trial court's award of 40% of the increase in value of a retail business to the wife after finding that she had contributed 40% of the increase through her own efforts. *Caldwell,* 17 Mass. App. 1032, 461 N.E.2d 834 (remanded for findings on value).

should use one or another of the familiar methods. What fact patterns cause one method rather than another to "do substantial justice" have not been delineated at the appellate level. After considering the effect of common approaches in view of the policies underlying community property and equitable distribution systems, this Article will suggest a new approach.

3. Critique of Modern Decisions

Courts often hold the entire increase in value separate. In these cases community effort, especially managerial effort, is so minimal as to be insignificant in affecting the value.[128] A recent California decision, In re *Ney's Estate*,[129] continued the pattern of looking for active management efforts in order to class the value as community. In this case, the husband had retired with investments in the stock market. For fourteen years, he read the *Wall Street Journal,* visited his broker once a week when in town, and sold stock approximately once a month.[130] The court held that the modest increase was not due to his skill. In a 1982 decision, the Nevada Supreme Court upheld allocating all the increase in value to separate property when evidence from several witnesses established the shareholder's declining health, management by others, and inflation. The appeals court thus upheld the trial court's finding that the shareholder had no active participation in the business and that "any increase. . .was attributable to other managers or general economic conditions."[131] The Idaho Court affirmed allocation to the separate estate when financial statements and testimony from accountants and a banker supported a finding that the increase was not due to labor.[132] Recent decisions from common law states involving real property rest on findings that inflation was the principal factor causing an increase in value and that the effort

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[128] Early California cases are illustrative. *See* Harrold v. Harrold, 43 Cal. 2d 77, 271 P.2d 489 (1954); Gilmore v. Gilmore, 45 Cal. 2d 142, 287 P.2d 769 (1955) (evidence showed new car dealerships after World War II were staffed by competent well-trained personnel; the shareholder spouse did not take part in the routine operations or worked only short hours, was frequently absent on extended vacations, and was primarily concerned with policy matters; ample compensation was taken).

See also Logan, 114 Cal. App. 2d 587, 601, 250 P.2d 730, 738 (evidence showed most increase was due to the capital and its managers; shareholder had no office at the plant and only visited it sporadically, spent most of her time at home or in travel; shareholder had the manager at her home for dinner twice a week when she was home and obtained reports from him but made no significant business decisions; substantial sums in dividends and salary were withdrawn).

[129] In re *Ney's Estate,* 212 Cal. App. 2d 891, 28 Cal. Rptr. 442.

[130] The court also noted that during that time the DOW Jones average on industrial stocks rose from 207.69 to 582.69 but the value of the investor's shares had not quite doubled and that there was no evidence that he had special investment skill or ability. *Id.* at 898, 28 Cal. Rptr. at 446.

[131] *Cord,* 98 Nev. 210, 644 P.2d 1026. *See also* Smith v. Smith, 94 Nev. 249, 578 P.2d 319 (1978) (overruled as to burden of proof in *Cord*).

[132] *Mifflin,* 97 Idaho 895, 556 P.2d 854; *see also Michaelson,* 89 N.M. 282, 551 P.2d 638 (no proof of amount or value of contribution by spousal labor).

involved was not a significant cause.[133] The Maryland Court of Appeals held that the alleged effect on the increased value of a corporation by a shareholder's decisions as a member of a board of directors was "too tenuous and speculative."[134]

These decisions clarify that the threshold inquiry is whether the time and effort expended, in fact, did contribute to the increase in value of the corporation. If it did not, there is no value attributable to the community to apportion. However, if the burden of proof is on the separate property owner, he must present evidence in regard to day-to-day management efforts and, if possible, opinions of experts to show that his services did not affect the value.[135] The community is still entitled to compensation for work in the separate business whether or not that work increased value. This explains why a court refers to having been compensated for efforts even after it finds that efforts did not significantly affect value.

In re *Marriage of Lopez,*[136] which involved a law practice, is a good example of a service profession in which little property exists to contribute significantly to the increase in value of the business. It is not surprising that the California court in *Lopez* attributed all the increase during the marriage to the effort and skill of the spouse. Similarly, a court held that the equipment in a "one man" welding business was essential to the business but did not in any sense constitute a contribution to capital and affirmed an allocation entirely to the community.[137] Another illustrative community property decision is *Downs v. Downs*[138] in which the husband had been the managing partner in a furniture business devoting all his work efforts to it during the twenty-six year marriage. The Lousiana Appeals Court upheld classifying all the increase in value as community in that it was obvious the growth and prosperity of the business was largely attributable to his capable management of its affairs.

A few recent decisions in Kentucky and New York follow this pattern. The crucial fact in each is that the separate property owner spouse devoted all working

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[133] *Plachta,* 118 Wis. 2d 329, 348 N.W.2d 193; *Van Newkirk,* 212 Neb. 730, 325 N.W.2d 832 (1982); *Templeton,* 656 P.2d 250; *see also* Midyett v. Midyett, 206 Okla. 312, 243 P.2d 650 (1952) (discovery of oil). *See also* Halpern v. Halpern, 13 Fam. L. Rep. (BNA) 1187 (Ga. Sup. Ct. 1987).

[134] *Schweizer,* 55 Md. App. 373, 462 A.2d 562.

[135] This consideration is not clear in *Hoffmann,* 676 S.W.2d 817. The court said that the increase in value was "directly attributable" to legislative enactments (Clean Water Acts) affecting economic conditions and only said that the efforts for which he was compensated "had an impact on the increase in value." *Id.* at 825-26. If the burden of proof that efforts were the primary contribution to the increase in value is on the nonowner spouse, the technical holding of the case may be that the evidence was insufficient to make that finding. *See* Krauskopf, *The Transmutation and Source of Funds Rules in Division of Marital Property,* 50 Mo. L. REV. 759,787 (1985).

[136] *In re* Marriage of Lopez, 38 Cal. App. 3d 93, 113 Cal. Rptr. 58 (1974).

[137] Austin v. Austin, 190 Cal. App. 2d 45, 11 Cal. Rptr. 593 (1961) (affirming allocation entirely to the community).

[138] *Downs,* 410 So. 2d 792.

efforts and time during the marriage to the business enterprise. The courts find the property inconsequential to the value of the business at dissolution even though the separate property was originally the focus of the owner's efforts. The growth in value is described as a product of the marital partnership due to the active efforts of one or both spouses.

In *Brennan*,[139] the husband had twenty years earlier brought to the marriage a small herd of dairy cattle. The New York Appellate Division Court held the prosperity and growth of the present dairy operation valued at $90,000 occurred through the mutual efforts of the parties over the twenty-year period and classified the entire operation marital property.

In *Roffman*,[140] the value of a furniture business started by the husband three years prior to the marriage had been the sole subject of his efforts over the entire thirty-two year marriage. The court held that the growth in the business was marital property and not merely an appreciation in separate property. The court stated:

> Therefore, the term "increase in value of separate property" does not apply to the growth and evolution of a business venture that was the primary economic foundation of a lengthy marriage. . .to do. . . [otherwise] would effectively eliminate the concept of the "economic partnership" of marriage in certain marriages merely because an ultimately successful business venture was started by one party prior to the marriage.[141]

In *Nolan v. Nolan*,[142] a second New York Appellate Division Court held that the increase due to the husband's active management of investments, to which he devoted his efforts after leaving a salaried job, was marital property. The court commented that the contribution of the homemaker was no less significant than when the husband had been salaried, saying that: "[i]n both situations the income, in the form of wages or appreciation, is attributable to some degree to the marital partnership."[143] Apparently, these two New York cases were settled without further litigation; however, *Nolan* was cited with approval by the New York Court of Appeals in *Price*[144] for having recognized that increase in value due to efforts must be available for the homemaker spouse to share.

In 1981, the Kentucky Supreme Court, in *Sousley*,[145] classed the "profit" from the sale of an incorporated retail store owned prior to a short marriage as

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[139] *Brennan*, 103 A.D.2d 48, 479 N.Y.S.2d 877.
[140] *Roffman*, 124 Misc. 2d 636, 476 N.Y.S.2d 713.
[141] *Id.* at 639, 476 N.Y.S.2d at 715-16.
[142] Nolan v. Nolan, 107 A.D.2d 190, 486 N.Y.S.2d 415 (1985).
[143] *Id.* at 193, 486 N.Y.S.2d at 418.
[144] *Price*, 69 N.Y.2d at 18, 503 N.E.2d at 689, 511 N.Y.S.2d at 224.
[145] *Sousely*, 614 S.W.2d 942.

income, not an increase in value of separate property. The key factor in treating this corporate profit as income to the husband was that he earned his living from buying, improving, and selling real estate and businesses; therefore, the court characterized the profit on sale of the business as income from his "stock in trade."[146] The decision may be questionable for not allocating any portion to the separate property.

Protecting the marital partnership's claim on the efforts of the spouses is a powerful public policy. In these New York and Kentucky decisions, one can see the influence of the commitment, enabling, and sharing components of the marriage partnership concept. These rulings indicate that separate origins or business form will not be exalted over substance when it is obvious that spousal efforts were devoted exclusively to the enterprise that produced the value. The courts are concerned that the commitment of effort to family welfare expected of a marital partnership not be subverted. This concern is warranted when all efforts of one spouse have been devoted to the business enterprise. It would be fair to assume that the other spouse supported and enabled those endeavors because both individuals expected the increase in value to benefit the marriage partnership. The modern courts heightened concern with protection of the marital partnership is so strong that they discount as inconsequential the original input from separate property. These decisions suggest that a married person who devotes his or her full working time to the separate estate may have a heavy burden in demonstrating that the enhancement in the property's value during the marriage is due to economic conditions wholly apart from the efforts.

In contrast to merely apportioning the increase in value of shares of an appropriately managed business, courts may reach corporate assets because of manipulative business practices. These are not simply apportionment of increase in value cases and would not require finding an increase in value of the corporation at all. They are discussed here because ignoring the corporate form furthers the policy of classifying as marital all that is acquired by marital effort. However, unlike apportionment of increase in value, either tapping retained earnings or piercing the corporate veil requires special findings.

To classify retained earnings as marital property requires finding the shareholder spouse was in a position to influence corporate decisions about salary, bonuses, and dividends and that earnings due to the spouse's efforts were retained as a result of that influence.[147] Power to control disposition of corporate earnings, not an increase in value, is necessary. The policy of protecting earnings created by marital effort was apparent when the Delaware Supreme Court in *J.D.P.*[148]

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[146] *Id.* at 943.

[147] *Hoffmann*, 676 S.W.2d 817; J.D.P. v. F.J.H., 399 A.2d 207 (Del. 1979) (discussed in, Krauskopf, *supra* note 135, at 789-90); *Simplot*, 98 Idaho 239, 526 P.2d 844; Brazier v. Brazier, 111 Idaho 692, 726 P.2d 1143 (1986).

[148] *J.D.P.*, 399 A.2d 207.

said that to prevent retained earnings from being classified as marital property would invite evasion of the property division law. It held whether to classify the earnings as marital would depend upon consideration of various factors including whether the earnings were retained for ordinary business reasons or for the purpose of preventing the earnings from becoming marital property. This approach failed in *Jolis*[149] in which evidence showed the need for large amounts of capital in the diamond business and that an excess had never been found in Internal Revenue Service annual audits.[150] In contrast to the apportionment approach, tapping retained earnings depends upon the reason for retaining earnings and shareholder influence on the decision.[151]

When a shareholder spouse controls the corporation and uses it extensively for his personal and family expenses, the corporate form may be ignored by piercing the corporate veil. This approach is seldom successful because it requires finding that the controlling shareholder used the corporation as his alter ego for purposes of diverting marital funds to his personal benefit.[152] *Lawing v.Lawing*[153] illustrates that the corporate form can be ignored in order to reach specific property. The husband shareholder had dominated the corporation and used it extensively to provide for the family needs with little accountability. Shares in unrelated corporations titled in the husband's name had been purchased with corporate funds. The court held they were actually compensation to the husband and marital property.[154] The court also recognized the corporate form as legitimate for other purposes and, therefore, apportioned the increase in value of the shareholder's shares between that attributable to active efforts and that due to passive economic conditions.[155]

When the evidence indicates that both spousal efforts and economic conditions have contributed to the increase in value of the separate property, most decisions since the early 1960s apply either the rate of return or reasonable compensation methods for apportionment. However, there is a dearth of discussion about the effects of various methods and their relevance to the underlying marriage part-

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[149] *Jolis*, 98 A.D. 692, 470 N.Y.S.2d 584.

[150] *Contrast, Hoffmann,* 676 S.W.2d at 827, in which the court said it was without jurisdiction to determine the reasonably anticipated needs of the business. Discussed in Krauskopf, *supra* note 135, at 790-91.

[151] *See McLeod,* 74 N.C. App. 144, 327 S.E.2d 910 (sound corporate decision might deprive spouse of a share of the fruits of the shareholder's labor; remand for determination of increase in value due to active efforts).

[152] *Hoffmann*, 676 S.W.2d at 826 n.7 (distinguishing the instant case because the spouse did not have a controlling interest in the corporation and his financial dealings were in accordance with good business practices); *Mifflin*, 97 Idaho 895, 556 P.2d 854 (1976); Dillingham v. Dillingham, 434 S.W.2d 459 (Tex. Ct. App. 1968); Uranga v. Uranga, 527 S.W.2d 761 (Tex. Ct. App. 1975).

[153] Lawing v. Lawing, 344 S.E.2d 100 (N.C. Ct. App. 1986).

[154] *Id.* at 107.

[155] *Id.* at 112.

nership policy of community property and equitable distribution systems.

The reasonable return on separate property method, which originated for use when the chief contributing factor to the increase in value was effort, has experienced problems. Its purpose was merely to give the separate property some return. Yet, in *Price v. Price,*[156] when the court applied the seven percent legal rate of interest, it found no excess to attribute to the community. That is a strange result for a method in which the court found that the predominate cause of the increase was effort. The shortcomings of using the legal rate of return were even more evident in *Beam*[157] in which the husband had not been employed for twenty-nine years but, instead, devoted all his time to handling his inherited property. There was little increase in the value of the property itself because he had chosen to invest it in tax-free government bonds which returned only one percent. One commentator attacked the use of the legal rate of return for long-term business investments, arguing that a normal business cycle would not allow for such return.[158] In response, the California courts would reason that evidence can be used to show that the legal rate is inappropriate for businesses of this type.[159] The *Beam* court used an incorrect standard when it applied the rate someone else would have obtained by investing the property. The danger of inappropriately ignoring factors such as tax advantages is apparent in *Beam* in that the separate owner deliberately chose a lesser return for tax purposes. The court should have held that tax advantages were evidence that an appropriate rate should have been one percent. The decision is justly criticized for eliminating all the increase actually attributable to his efforts.[160] The reasonable return method is still used in Nevada[161] and California, but it is apparent that the legal rate of interest is not always applied.[162]

To further both its original purposes and the concept of partnership marriage, the reasonable return method is useful primarily when evidence indicates an increase in value largely due to efforts, but there is clearly also a significant con-

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[156] Price v. Price, 217 Cal. App. 2d 1, 31 Cal. Rptr. 350 (1963).

[157] *Beam,* 6 Cal. 3d 12, 98 Cal. Rptr. 137, 490 P.2d 257.

[158] *Never Marry a Rich Man, supra* note 78.

[159] *Weinberg,* 67 Cal. 2d 557, 63 Cal. Rptr. 13, 432 P.2d 709; *Randolph,* 118 Cal. App. 2d 584, 258 P.2d 547 (1953).

[160] *Never Marry a Rich Man, supra* note 78. This article also criticizes it for assuming that community expenses were paid out of the increase. Later cases have declined to follow those statements when income had already paid for community expenses. *In re* Marriage of Frick, 181 Cal. App. 3d 997, 226 Cal. Rptr. 766 (1986).

[161] *Cord,* 98 Nev. 210, 644 P.2d 1026; *Johnson,* 89 Nev. 244, 510 P.2d 625.

[162] *See, e.g.,* In re *Marriage of Frick,* 181 Cal App. 3d 997, 226 Cal. Rptr. 766, holding the rate of return method appropriate when the increase in value was due in large part to labor, but affirming less to the separate property than the legal rate of interest. *See also* 4 Fed. Tax Coordinator 2d (Res. Inst. Am.) § A-5107 (1985), stating that when income of separate business is primarily due to services, the portion allocable to separate capital is made on the basis of a reasonable return on a long-term, well-secured investment.

tribution from the property. Then the return method at one time credits the marital estate with most of the increase but respects the input of the separate property by assuring that some of the increase will be apportioned to the separate estate. From the perspective of the separate property owner, this might aid situations like *Sousley*—a short marriage in which evidence is probably readily available concerning the value of the separate property at the beginning of the marriage and in which the separate property was the focus of productive spousal efforts. However, in accord with protecting the fruits of spousal effort for the marital partnership, this method allows all the remaining increase to be classed as marital. Significantly, no limit is put on the amount of increase due to efforts that can be classed as marital. Consequently, when a reasonable rate of return is carefully determined by accounting for the limitations of the particular investor, this method best credits the marital partnership with the full fruits of its efforts. A different, but no less important advantage in times of increased dissolution litigation, is that apportionment is relatively easy since only a reasonable return on the property need be determined.

Paradoxically, the reasonable compensation method developed as a measure of spousal effort when enhancement of the separate property was the chief contributor to the increase in value. In the 1960s, California appellate courts affirmed the reasonable compensation method only after noting evidence that the increase in value was largely due to economic conditions.[163] However, in *Beam,*[164] the California Supreme Court emphatically stated that either method of apportionment could be used, referring obliquely to finding which was the chief contributor, but avoiding the issue of when each method should be used.[165] Apparently, desire

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[163] In Berry v. Berry, 117 Cal. App. 2d 624, 256 P.2d 646 (1953), evidence showed profits on the sale of property due to World War II inflation; community earnings due to effort. In Tassi v. Tassi, 160 Cal. App. 2d 680, 325 P.2d 872 (1958), evidence showed high profits in the meat business following World War II and the Korean War; fully one-third of the customers were generated prior to the marriage.

In Owens v. Owens, 219 Cal. App. 2d 856, 33 Cal. Rptr. 599 (1963), the husband incorporated his successul sole proprietorship the day before the marriage and devoted his full time to the business during the marriage, but the evidence supported trial court findings that increase in value was largely due to inflation and the faithful service of employees. In Somps v. Somps, 250 Cal. App. 2d 328, 58 Cal. Rptr. 304 (1967), the shareholder spouse had withdrawn extensive sums as compensation for his considerable efforts; but the evidence also showed unprecendented population growth creating demands for the engineering services and services of others in the business which contributed to its increase in value.

Millington, 259 Cal. App. 2d 896, 67 Cal. Rptr. 128, should be distinguished from all others because the court upheld finding the increase largely attributable to management activities, yet allowed all the increase to be classed as community because of retained earnings and commingling.

[164] *Beam,* 6 Cal. 3d 12, 98 Cal. Rptr. 137, 490 P.2d 257.

[165] *Id.* at 18, 98 Cal. Rptr. at 141, 490 P.2d at 261. Since the increase was minimal over 29 years one could fairly attribute it to inflation on the original inheritance, but the court did not state that such evidence warranted the reasonable compensation method. In fact, it made one highly questionable reference in dicta that suggested it would be appropriate to use the rate of return method

to provide trial courts with flexibility has discouraged stating that a *sine qua non* to the reasonable compensation method was increase chiefly due to property enhancement. Consequently, California courts have continued to use either method without restriction from their supreme court.[166]

Outside of California, the reasonable compensation rule has sometimes been applied differently with adverse effects on the goal of protecting all property developed by spousal effort for the marital estate. A serious misapplication of the reasonable compensation method can occur when it is not differentiated from the reimbursement method. This is best understood by analyzing the Texas Supreme Court opinions in *Jensen*.[167] The state follows a reimbursement rule, not a source of funds or apportionment rule, for community funds and efforts devoted to separate property. In its first opinion, which was later withdrawn,[168] the court allowed all the increase in value of the corporation due to spousal efforts to the community. In the second opinion, the court reaffirmed the reimbursement rule, holding that reasonable compensation for the time and effort was the community share. The court contrasted "community ownership" theory which it said holds that any increase in the value of the stock as a result of the time and effort of the owner spouse becomes community property. In the third modified opinion, the court indicated that enhanced value of the stock could be considered as a factor in determining reasonable compensation, thereby solidifying its holding that only what the market would pay for services and not what those services produced was relevant to the reimbursement method.[169] The court noted that the reimbursement "rule will obviate the need for the trial court to undertake the onerous and quite often impossible burden . . . of attempting to determine just what factors actually contributed to the increase in value of the stock and in what proportion."[170]

The contrast with the California rule is dramatic. The California courts limit to reasonable compensation only when the chief contributor to the increase in value is economic forces on the separate property. The "community ownership" theory *Jensen* referred to is actually the California reasonable rate of return method which allows all increase over that reasonably attributable to the property to go to the community. The Texas reimbursement method deprives the community of

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when the increase was due to the property. That, of course, would not be consistent with any of the preceding decisions. "We cannot. . .condemn. . .the judge's implicit decision that the modest increment. . .was more probably attributable to the 'character of the capital investment' than to the 'personal activity.'" *Id.* at 20, 98 Cal. Rptr. at 142, 490 P.2d at 262.

[166] As late as 1986, the rate of return method was applied when the increase in value of a business was largely due to labor. *See* In re *Marriage of Frick*, 181 Cal. App. 3d 997, 226 Cal. Rptr. 766.

[167] *Jensen*, 665 S.W.2d 107.

[168] Jensen v. Jensen, 9 Fam. L. Rep. (BNA) 2581 (Tex. 1983).

[169] Weekley, *Appreciation of a Closely Held Business Interest Owned Prior to Marriage: Is it Separate or Community Property?*, 11 COMM. PROP. J. 257, 271 (1984).

[170] *Jensen*, 665 S.W.2d at 109.

value it creates in excess of market compensation for the services rendered.[171] Only the traditional California application of the two methods gives the marriage partnership protection for the value produced by marital effort.

Two decisions illustrate that courts may actually apply the reimbursement system but label it reasonable compensation. In *Speer*,[172] the Idaho Supreme Court recognized that California courts used the reasonable compensation method when separate property was the chief contributor to the increase in value. Based on legislative intent that the separate property "not be assimilated" into the community, the court held that fair compensation to the community based on what would be paid in salary, bonuses, and fringe benefits would be enough. Since the court labeled this method "reasonable compensation," it is not clear whether the court realized it was applying the reimbursement rule of Texas. However, limiting the community only to reimbursement would be consistent with earlier decisions adopting the inception of title theory for the state.[173]

Ten years later, in 1984, the Missouri Supreme Court followed suit in *Hoffmann*[174] when it held that no portion of the increase would be marital property because the nonowner spouse failed to prove that the shareholder spouse's compensation had been inadequate or that he had sacrificed payment of marital funds. It is unclear in the opinion whether the record showed that most of the increase was due to economic factors or to spousal efforts. If the former, the holding is in accord with the California reasonable compensation cases. If the latter, which the dissenting justice thought possible,[175] only a reimbursement rule was applied. If the Missouri court was limiting the marital property when efforts were the major contributor to the increase, this case would be a strange anomaly.[176]

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[171] *See, e.g.*, Holloway v. Holloway, 671 S.W.2d 51 (Tex. Ct. App. 1983), which was tried before and the appeal decided after *Jensen*. The husband had two separate stock holdings which increased from $1,000 to thirty million dollars and from $3,000 to sixty million dollars. The trial court had found the increase due to efforts and divided it all as community property. The court applied *Jensen* holding that the community could be reimbursed only for the value of the husband's services and remanded for new trial.

[172] *Speer*, 96 Idaho 119, 525 P.2d 314.

[173] *See Fisher*, 86 Idaho 131, 383 P.2d 840. *See also* Baum v. Baum, 120 Ariz. 140, 584 P.2d 604 (1978), holding adequate compensation sufficient for the community.

[174] *Hoffman*, 676 S.W.2d 817.

[175] *Id.* at 830 (Blackmar, J., dissenting).

[176] The writer questions that the opinion actually adopted reasonable compensation as the only way to apportion any increase in value. The case was tried and argued under the inception of title theory; there was no discussion of apportionment methods or a rule stated and no cases were cited for the proposition that reasonable compensation was the only appropriate method. There is even room for doubt that the record established efforts contributing to the increase at all. The court stated that the shareholder spouse's efforts had "an impact" on the increased value, *Id.* at 825, but also stated that the "unusual growth and prosperity of the company was directly attributable to the unforeseen. . .consequences of federal and state legislative enactments. . . ." *Id.* at 826.

The Missouri court also has stated that the shareholder spouse must be in a position to control

Earlier in the opinion, the court adopted the source of funds rule in order to better recognize the partnership nature of marriage by classing increase in value acquired during marriage due to marital funds and efforts as marital.[177] To limit the marital estate to only reimbursement is wholly inconsistent with that larger purpose.

The reasonable compensation method, when evidence establishes that the property was the chief contributor to the increase in value, protects both the marital and separate interests fairly well. However, when efforts are the primary contributor to the increase in value, the reasonable compensation method is unwarranted because it limits the marital share to less than actual contribution. In the *Speer* case, the limitation protected the separate property at the expense of the community.[178] Although this is appropriate in a community property jurisdiction following the inception of title approach, modern equitable distribution statutes call for an expansive definition of marital property to further the legislative intent of recognizing the partnership contribution to property. Insulating a portion of the value created by partners' efforts within separate property prevents sharing that product of the partnership.

4. Suggested Approach to Apportionment

None of the methods commonly used for apportionment escape criticism. The shortcomings of the reasonable return and reasonable compensation methods include paradoxical labels which tend to obscure their purpose and requirements. The risk of converting the reasonable compensation method to the reimbursement method, thus, inappropriately limiting the amount credited to the marital partnership could undermine the purposes of equitable distribution when a close corporation has increased in value. A disadvantage of both methods is that they require a baseline decision or approximation as to whether separate property or marital effort was the primary contributor. King's criticism of this feature remains applicable even after twenty-five years of ensuing litigation: the risk of small error in determining the primary contributor has large consequences. Both methods

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or influence the remuneration received. Heilman, 700 S.W.2d 843. This requirement is unusual in a straight apportionment case and probably was misapplied from retained earnings and piercing the corporate veil cases. *See* Krauskopf, *supra* note 135, at 787-88.

[177] The court said, "By adopting the source of funds rule theory, our statutes and their purpose of promoting the partnership theory of marriage will be consistent in providing for the most equitable distribution of property," and referred to a statement in a leading case that the marital community should be entitled to share in the proportionate increase in value of property attributable to *marital funds and labor* [emphasis added]. *Hoffman,* 676 S.W.2d at 825 (citing *Tibbetts,* 406 A.2d at 76-77).

[178] The community portion was limited to reasonable salary even though the trial court had found community efforts "greatly exceeded" the compensation paid. *Speer,* 96 Idaho 119, 525 P.2d 314, 323 (1974).

entail extensive production of evidence to show which source contributed more to the increase and to establish the adequacy of compensation. The range of possible findings on those ambiguous factors causes highly unpredictable results.

To enhance uniformity and, thereby, to increase predictability of results and encourage settlements, a single method of apportionment should be articulated as guidance for trial judges. Preferably, application should be relatively clear and predictable. The method should have an unambiguous descriptive label. Either allocating only a reasonable salary for the services to the marital estate or allocating only an investment return on the separate property would meet these simplification requirements. But a more important requirement must be met.

The old dilemma of whether to favor the marital or separate estate must be answered in order to choose a single apportionment method. The answer is to choose the method which favors the marital estate, thus promoting the basic partnership concept of the statute.

Consider the common conditions under which one spouse renders most of his or her working efforts to investments or a business enterprise owned prior to marriage or acquired by gift during marriage. Ordinarily, this begins early in the marriage with the express or tacit agreement of the nonowner spouse. Often, the couple knows they are foregoing a higher standard of living while efforts are devoted to the business rather than in a salaried position. Commonly, the nonowner spouse not only helps in the business in the early days, but also continues to take an active interest in its progress and supports the efforts of the working spouse, thus enabling more productivity. Both of these married partners are willing to engage in the risks and stresses of developing that business because they ultimately expect to share greater rewards from its prosperity than they would if the owner spouse were merely a salaried employee. The owner of an already well-established business who marries, particularly a second or third marriage later in life, may not have these expectations. However, that person knows that a premarital agreement can safely protect the value of efforts devoted to the business in the event of a marriage dissolution. In the absence of an agreement, it is fair to assume that even then all efforts of the spouses are committed to the marriage.

The practical context of the apportionment issue is a marriage in which marital effort has been expended for the benefit of the family. All the components of marriage as an economic partnership are present: commitment of effort, enablement, and expectation of sharing. Therefore, all capital value created by spousal efforts should be marital without regard to previous compensation for the efforts. To hold otherwise is to imply that marriage does not include a commitment of all effort to family welfare, but rather, that only a salary is owed.[179] Assuming the goal of equitable distribution is to recognize the full marriage partnership

[179] *Krauskopf, supra* note 135, at 789.

concept, the marital estate should be favored. However, the underlying object of a marriage partnership in which efforts are committed to the partnership is not offended by allocating to the separate estate an investment return when economic conditions have affected the separate property. An acknowledged willingness to expand the marital property and narrow the separate property at the classification stage can clarify the selection of a more appropriate apportionment method which accomodates both these goals.

The following guidelines are offered for an equitable distribution state with a legislative or judicially created source of funds theory that attributes to marital property all values created by spousal effort during the marriage. Increase in value during marriage should be presumed due to marital efforts. The burden of proof to show that the increase is due to economic conditions should be on the separate property owner. When this is not possible or when transmutation has occurred, commonly after a long marriage, all increase should be subject to division.[180] If the separate property owner sustains the burden of showing that economic conditions enhanced the separate property and of establishing a reasonable return for that property, then the increase in value represented by that investment should be classed as separate property. The excess should be marital property.[181] This should be labeled the *marital effort method* to distinguish it from other apportionment methods.

5. Nonowner Spouse's Contributions

Since source of funds jurisdictions classify as marital the increase in value of separate property due to efforts of either spouse, any increase attributable to work of the nonowner spouse should also be included in marital property. Full analysis of this issue is beyond the scope of this Article.[182] Although a split of authority may be developing,[183] it is likely that most courts will hold that those efforts include not only work in the business,[184] but also work in maintaining the home and family.[185]

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[180] *See* cases discussed, *supra,* notes 136-146 and accompanying text.

[181] An analogous system has been set out as jury instructions for apportioning profits of a separate business owned and operated by a spouse during the marriage. *See* 7 AM. JUR. PL. & PR. FORMS *Comm. Prop., Form 126 (1982).*

[182] On this topic, *see* Goldfarb, *Recognizing the Homemaker's Contribution to Appreciation in Separate Property,* FAM. L. REV., N.Y. St. Bar Assoc. Fam. Law Section (Mar. 1987); Note, *The Need to Value Homemaker Services Upon Divorce,* 87 W. VA. L. REV. 115 (1984); Avner, *Valuing Homemaker Work: An Alternative to Quantification,* 4 FAIRSHARE 11 (Jan. 1984); Bruch, *Property Rights of De Facto Spouses Including Thoughts on the Value of Homemaker Services,* 10 FAM. L. Q. 101 (1976).

[183] *Compare, e.g.,* In re *Marriage of Herr,* 705 S.W.2d 619 (contribution as homemaker not a substantial contribution of effort that caused an increase in value) with *Price,* 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219; Griffith v. Griffith, 185 N.J. Super. 382, 448 A.2d 1035 (1982).

[184] The "sweat equity" of *Patterson,* 277 S.E.2d 709.

[185] Given credit to a limited extent in *LaRue,* 304 S.E.2d 312.

The policy of recognizing both the income producing efforts and the indirect contributions of the homemaker as an equal partner in the marriage when determining what is marital property lies behind the rule of apportionment. The homemaking function contributes to the marriage directly in the home and indirectly by enabling the income producer to devote all efforts to that task. The most significant decision on this issue was in *Price*[186] in which the New York Court of Appeals held that both direct work in the business and indirect efforts as a homemaker must be considered marital contributions when determining what portion of the increased value of separate property is subject to division. The method for valuing indirect contributions at the distribution stage was not ruled upon. The court held, at the classification stage, that a homemaker's contributions should be equated with that of the owner spouse's efforts. The New York court at an earlier time also had suggested that the contributions of the spouses should be regarded as equal in value.[187] The value of homemaker efforts as enabling contributions, unlike that of direct contributions, would merge into the increase due to the owner's efforts. Thus, the amount of appreciation due to efforts during the marriage would be considered a product of the marital partnership. This is in accord with the underlying concept that each marital partner contributes equally, even though in different ways, to the marriage. Similar decisions would be possible under the West Virginia statutory language specifically including increase due to the work of either spouse in defining marital property.[188]

V. Conclusion

By limiting power to divide property at marriage dissolution to property acquired during the marriage, a legislature emphasizes the state's policy that both spouses, by entering marriage, undertake to contribute their best efforts to benefit the spouses and any children of the marriage. The commitment of effort, rather than prior owned or inherited property, characterizes a partnership of equals. Both commit to the welfare of the family the most precious and the most equally possessed wealth they have—their time and effort. It follows that classification of property as marital is the key to a court's power to divide it equitably between the spouses when the partnership ends. However, the technicalities of classification give pause to consider its wisdom. Unless courts devise practical rules for classification, ensuing litigation may vitiate the lofty goal of conceptualizing marriage as a partnership commitment. The more bitter and extended the battles over the broken pieces, the more we may come to doubt the original devotion. As a society, we need to strengthen, not weaken, the sense of commitment to the family that marriage implies. Perhaps we should modify the statutory classification schemes.

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[186] *Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219.

[187] *O'Brien*, 66 N.Y.2d 576, 498 N.Y.S.2d 743, 498 N.E.2d 712.

[188] W. Va. Code § 48-2-1(e)(2).

For example, the legislature might decide that marriage implies commitment of all effort and of all property no matter how acquired unless a contrary intent is clearly demonstrated. In the meantime, courts should strive for easily administered rules of classification which will further the principles of partnership marriage and enhance predictability of decisions.