

Summer 1977

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### Recommended Citation

Marjorie Wholey Haines, *Dissolution of Marriage-Division of Property which has Increased in Value*, 42 MO. L. REV. (1977)  
Available at: <http://scholarship.law.missouri.edu/mlr/vol42/iss3/10>

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## DISSOLUTION OF MARRIAGE—DIVISION OF PROPERTY WHICH HAS INCREASED IN VALUE

*Cain v. Cain*<sup>1</sup>

*Stark v. Stark*<sup>2</sup>

John Cain purchased a \$20,000 farm in 1958 giving \$3,500 in cash and a note for \$16,500. Before his marriage to Camille in 1959, Cain made seven payments on the note totalling approximately \$1,000. Mr. and Mrs. Cain lived on the farm for eight years and, until dissolution of their marriage in 1974, paid approximately \$25,000 principal and interest on the mortgage with marital funds. In 1974, the land was worth \$565,000, less \$5,000 outstanding on the mortgage. Upon dissolution the circuit court set aside the farm to Mr. Cain as separate property. The Springfield District of the Missouri Court of Appeals affirmed.<sup>3</sup>

Marvin Stark purchased a farm in 1957 for \$15,000 of which \$10,000 was borrowed. In 1961, when he owed \$6,000 on the farm, Marvin and Evelyn were married. In 1965, the couple borrowed \$18,000 by mortgaging the farm. They used \$6,000 to pay off all of Marvin's old debts including the remaining first mortgage balance. Twelve thousand dollars were used to erect a new house and two outbuildings on the farm. Upon dissolution of their marriage in 1974, the circuit court set aside the farm to Mr. Stark as separate property. The Kansas City District of the Missouri Court of Appeals affirmed.<sup>4</sup>

Both of these farms were set aside as separate property. The properties were alike in form of acquisition but differed significantly in causes of increased value. In *Cain*, marital funds were used to reduce the encumbrance on the farm. The total increase in value of the farm was attributable to external economic conditions. In *Stark*, marital funds were used both to reduce the encumbrance on the farm *and* to improve the farm. The increase in value of the farm was due to external economic conditions *and* the improvements made with marital funds and labor.

The Missouri Divorce Reform Act<sup>5</sup> is modeled after the divorce, child custody, and maintenance sections of the Uniform Marriage and Divorce Act.<sup>6</sup> The Commissioners who drafted the Uniform Act recommended that the "distribution of property upon the termination of marriage . . . be

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1. 536 S.W.2d 866 (Mo. App., D. Spr. 1976).

2. 539 S.W.2d 779 (Mo. App., D.K.C. 1976).

3. 536 S.W.2d at 868.

4. 539 S.W.2d at 781.

5. §§ 452.300-.415, RSMO (1975 Supp.). The Missouri statute modified the UMDA by adding spousal conduct as an element to be considered in the distribution of property. In *Cain* and *Stark* each party alleged that the other was at fault; neither court found fault to be a significant factor in the property settlement.

6. Uniform Marriage and Divorce Act., (U.L.A.), vol. 9 (master ed., 1973).

treated, as nearly as possible, like the dissolution of a business partnership."<sup>7</sup> In the United States, community property law exists as a model for distributing marital property on a partnership theory.<sup>8</sup> Under community property theory,<sup>9</sup> marriage is a partnership in which each partner retains his or her prior owned assets as separate property.<sup>10</sup> Property acquired during the marriage, regardless of title, is presumed to be marital, or community, property.<sup>11</sup>

Community property law as it exists in the United States is borrowed from Spain. Under Spanish law if one partner initiated the acquisition of a piece of property before marriage, the status of the property was fixed and remained his or her separate property regardless of the source of funds which ultimately paid for it. The community was reimbursed for the amount of marital funds used to acquire the property.<sup>12</sup> Income derived from either separate or marital property was marital.<sup>13</sup> Spanish law distinguished between the sources of increase in value of separate property. Increases due to general economic conditions or derived solely from the expenditure of separate funds by the owner remained separate. The community was reimbursed for increases due to improvements made by marital efforts. The measure of reimbursement was the appreciated value of the property resulting from the improvements. Title to the improvement followed title to the property.<sup>14</sup>

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7. HANDBOOK OF NATIONAL CONFERENCE OF COMMISSIONERS OF UNIFORM LAWS 111 (1970).

8. FAMILY LAW REPORTER, DESK GUIDE TO THE UNIFORM MARRIAGE AND DIVORCE ACT 57 (1974). Krauskopf, *A Theory for "Just" Division of Marital Property in Missouri*, 41 MO. L. REV. 165 (1976).

9. Eight western states are community property states. They are: California, Texas, Arizona, Nevada, Idaho, Washington, Louisiana and New Mexico.

10. W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 116-18 nn.18-24 (2d ed. 1971); Bartke, *Yours, Mine and Ours—Separate Title and Community Funds*, 44 WASH. L. REV. 379 (1969); Knutson, *California Community Property Laws: A Plea for Legislative Study and Reform*, 39 SO. CAL. L. REV. 240 (1966).

11. The presumption may be rebutted by clear and convincing evidence. If successfully rebutted, one partner will be deemed to hold the property by himself, *i.e.*, separate from the community, or marital, property.

12. W. DEFUNIAK & M. VAUGHN, *supra* note 10, at 130-33. The Spanish rule regarding acquisition, which may be called a title theory, is followed in New Mexico and Texas. Gillespie v. Gillespie, 84 N.M. 618, 506 P.2d 775 (1973); Moore v. Moore, 71 N.M. 495, 379 P.2d 784 (1963); Hodge v. Ellis, 268 S.W.2d 275 (Tex. App. 1954); 15A AM. JUR. 2d *Community Property* § 22 (1976).

13. *Id.* at 140-43, 160-61; Knutson, *supra* note 10, at 241 states: "The basic concept underlying the system is a simple one: marriage is a partnership in which the spouses devote their particular talents, energies and resources to the common good; and in which acquisitions and gains attributable, directly and indirectly, to such expenditures of labor and resources are shared by the partnership." Income may be derived from rents and profits of property as well as wages earned by the partners and other sources.

14. W. DEFUNIAK & M. VAUGHN, *supra* note 10, at 168-69. Because income from separate property is community property, the community recognizes an immediate gain if marital funds or labor improves the separate property.

Some of the states which adopted the Spanish community property theory have modified it. Under the modified view of acquisition, courts look to the source of funds used to pay for the property. The courts then allocate property acquired with both separate and marital funds in proportion as each paid for it.<sup>15</sup> As a result, the property's increase in value due to external economic conditions is divided when the property is allocated. This approach, which may be called a "source of funds" theory, is followed in Idaho<sup>16</sup> and Washington<sup>17</sup> as well as in California.<sup>18</sup>

As an example of the application of the "source of funds" theory, assume that prior to marriage a woman bought a \$10,000 house and paid for half of it by the time of the marriage, the remainder being paid during the marriage. No improvements were made on the house. If the marriage is dissolved, the woman as separate owner is entitled to 50% of the present value of the house and the other 50% would be divided as marital property.<sup>19</sup>

All the community property states allow recovery to the community for improvements to separate property made with marital funds or labor.<sup>20</sup> A majority of the community property states follow Spanish law in that the measure of recovery is the resultant increased value to the property.<sup>21</sup> A

15. *In re Marriage of Jafeman*, 29 Cal. App. 3d 244, 256, 105 Cal. Rptr. 483, 491 (1973). Community funds were used to pay off indebtedness on the separate property, a home, acquired before marriage. The court said, "The community has a *pro tanto* interest in such property in the ratio that payments on the purchase were made with community funds bears to the payments made with separate funds." *Forbes v. Forbes*, 118 Cal. App. 2d 324, 257 P.2d 721 (1953); *Vieux v. Vieux*, 80 Cal. App. 222, 251 P. 640 (1926); Note, *Characterization of Property in California When Period of Acquisition Overlaps Creation or Termination of Marital Community*, 17 HASTINGS L.J. 815 (1966).

16. *Gapsch v. Gapsch*, 76 Idaho 44, 277 P.2d 278 (1954).

17. *Guye v. Guye*, 63 Wash. 340, 115 P. 731 (1911); *Heintz v. Brown*, 46 Wash. 387, 90 P. 211 (1907).

18. "If the fair market value has increased disproportionately to the increase in equity, the community is entitled to participate in that increase in a similar proportion." 29 Cal. App. 3d at 256-57, 105 Cal. Rptr. at 493. Cases exist in states following the new view which indicate that the courts are looking at the facts of acquisition and analyzing them under the theory that retiring an encumbrance on separate property is a type of improvement. Under the rationale of these cases, the community is allowed a recovery measured by the increased value of the property in proportion to the amount of marital funds used to retire the encumbrances.

19. In community property theory the marital property is divided equally between the partners. In Missouri the court has discretion in dividing the marital property. § 452.330(1), RSMO (1975 Supp.).

20. The problem of the increase in value is caused by the conflict of two basic principles: "1) that the separate property of the spouses continues as such so long as it can be identified or, conversely, that the spouses are entitled to compensation or reimbursement for such property, and 2) that the community is entitled to all fruits of labors and efforts of both spouses." Bartke, *supra* note 10, at 383.

21. *Suter v. Suter*, 97 Idaho 461, 546 P.2d 1169 (1976); *Michelson v. Michelson*, 551 P.2d 638 (N.M. 1976); *Girard v. Girard*, 521 S.W.2d 714 (Tex. 1975); *Hiatt v. Hiatt*, 94 Idaho 367, 487 P.2d 1121 (1971); *Tilton v. Tilton*, 85 Idaho 245, 378 P.2d 191 (1963); *Jacobs v. Hoitt*, 119 Wash. 283, 205 P. 414 (1922).

minority of the states grant recovery measured only by the amount of marital funds spent on the improvements.<sup>22</sup>

The Missouri Divorce Reform Act describes marital property as all property acquired subsequent to the marriage which is not specifically excluded by one of the five listed exceptions.<sup>23</sup> Thus, by definition, property "acquired" prior to marriage is separate. *Income* from separate property produced after the marriage is not one of the enumerated exceptions to marital property.<sup>24</sup> However, if the *value* of property acquired before marriage increases during the marriage, the increase is a statutory exception to marital property, thus it is separate. No definition is given for "increase in value" (*i.e.*, by separate improvements, by joint improvements, or by economic conditions). Therefore, any marital efforts or funds spent on separate property would be converted from marital to separate property unless increases in value are differentiated according to their source and those resulting from marital improvements are removed from the category.<sup>25</sup> In *Cain* the dispute centered on the question of when the farm was "acquired" because payments on the farm mortgage were made both before and during the marriage. Mr. Cain argued that the encumbrance was irrelevant because title to property is unaffected by a mortgage in a lien state; hence the acquisition or ownership of the property is determined at inception of title. Mrs. Cain contended that the farm was in part marital property. She urged the court to adopt the "source of funds" theory on acquisition which would allocate the farm at its present value to the marital community in the same proportion as marital money was used to reduce the encumbrance on the property. Under this theory, acquisition is a continuing process with property division based upon the proportion of equity contributed by the parties. This theory would emphasize the under-

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22. Gillespie v. Gillespie, 84 N.M. 618, 506 P.2d 775 (1973).

23. § 452.330(2), RSMo (1975 Supp.).

Marital property means all property acquired by either party subsequent to marriage except:

- 1) Property acquired by gift, bequest, devise or descent;
- 2) Property acquired in exchange for property acquired prior to marriage or in exchange for property acquired by gift, bequest, devise or descent;
- 3) Property acquired by a spouse after a decree of legal separation;
- 4) Property excluded by valid agreement of the parties; and
- 5) The increase in value of property acquired before marriage.

24. Some community property states have modified the Spanish rule regarding income of separate property. Louisiana, Texas and Idaho follow the Spanish rule; rents and profits of separate property are community property. Five of the community property states consider that income from separate property remains separate. DeFuniak says that this is the result of applying common law principles to a community property system. W. DEFUNIAK & M. VAUGHN, *supra* note 10, at 162.

25. In some community property states the exception is recognized in this type of situation. "When the investment takes the form of improvements on, or discharge of encumbrances upon, the separate property of one of the partners, the problem is not essentially different and the community is entitled to its fair share in the resulting gain." Bartke, *supra* note 10, at 419-20.

lying partnership concepts of the law and de-emphasize the impact of mortgage law on divorce law. Under this approach, one-sixth of the farm would be allocated to Mr. Cain and two-thirds to the marital community according to their respective contributions. The remaining one-sixth would also be Mr. Cain's because he would remain liable for the balance due on the mortgage.

Viewing the case as presenting a question of mortgage law, the *Cain* court determined that Mr. Cain, the mortgagor, acquired the property prior to the marriage. This parallels the more traditional community property view on acquisition which allocates the entire property to the individual who initiated the purchase prior to the marriage regardless of the source of the funds which ultimately paid for the property. The court of appeals affirmed the circuit court's decision to award the farm at its entire value to Mr. Cain. However, the court also awarded Mrs. Cain three parcels of real property valued at \$79,000. The court justified this division on the fact that a substantial portion of the farm's mortgage had been paid with marital funds, *i.e.*, Mrs. Cain had a right to reimbursement for marital funds used in the acquisition of the property.<sup>26</sup> The validity of encumbering the farm for the amount of reimbursement was not at issue since additional property existed with which the community could be paid.

The appellate decision did not provide or explicitly utilize any mathematical formula valuing the marital contribution to acquisition, increasing the marital property by this amount and then allocating a portion of this additional amount to Mrs. Cain. Utilizing its discretionary powers,<sup>27</sup> it divided the property as it deemed just. This method foreclosed the necessity of exact valuations and allocations as is required under community property law.

The *Stark* court, relying on the *Cain* decision, awarded the farm to the husband. However, *Cain* clearly should have been considered precedent only for setting aside "separate" property to the one who initiated the purchase even though an encumbrance existing prior to the marriage was retired with marital funds, *i.e.*, payment on the 1965 Stark mortgage. The *Stark* court gave all increases in value to Mr. Stark, which included those resulting from the improvements due to the marital funds (*i.e.*, the funds paid on the loan to build the new house) and the improvements due to marital efforts (*i.e.*, the work of the spouses in building the new house). The court acknowledged that "the increased value resulted from improvements constructed on the farm after the marriage with marital funds."<sup>28</sup> The improvements (in this case a new house and two outbuildings) clearly were property acquired subsequent to the marriage. Thus, in order to be deemed separate property the improvements had to be within one of the exceptions. The court construed the fifth exception to marital property in

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26. 536 S.W.2d at 875.

27. § 452.330(1), RSMO (1975 Supp.).

28. 539 S.W.2d at 783.

the Missouri Act—an increase in value of separate property—to include the increase due to additions to the separate property even when the additions were accomplished solely with the funds and efforts of the community.<sup>29</sup>

The partnership theory, on which the law of all the community property states is based, requires that the community be entitled to share in the proportionate increase in the value of the property attributable to improvements made by marital funds and labor.<sup>30</sup> The marital community is entitled to a return on its investment in the same way as any investor receives a return on an investment. When the marital community chooses to invest its funds in the separate property of one partner, the community is not forced in community property states to forego a return on the investment. The partnership theory would require that an allocation be made based on four factors. The court should have allocated to Mr. Stark the value attributable to his investment prior to marriage and to the appreciation due to general economic conditions. The marital community should have been allocated the value of the retirement of encumbrances and the appreciation due to its improvements of the property. The *Stark* court characterized the improvement as a fixture of the separate property under real property law instead of marital property acquired by marital efforts and funds during the marriage under the Uniform Marriage and Divorce Act.

The interpretations of the *Cain* and *Stark* courts are pertinent to decisions made at the beginning of a marriage. An attorney advising a client who owns property prior to a marriage can tell the client that he is in an advantageous position in the event of a divorce. He will keep his property and any improvements made on it by the couple subject only to reimbursing the community for actual funds used on the separate property. Likewise the attorney would have to advise the client's future spouse that the investment value of any funds or labor expended on the separate property by the couple during the marriage would be lost to the non-owner if divorce should occur. This is the probable outcome because in most cases the owner of the separate property will have no separate funds to retire the debt on the separate property, pay taxes and assessments, and improve it as desired.<sup>31</sup> By defining income from separate property as marital income, the Act has removed the obvious source of separate funds which the owner could use to maintain and improve separate property. If the Act denies the community a proportionate share in the increase in the value of the separate property due to community funds and labor, the non-owner will be discouraged from allowing marital funds to be contributed to the separate property. The non-owner spouse reasonably would want marital funds and labor invested only in marital property where both partners would be

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29. See statute quoted note 23 *supra*.

30. *Waheed v. Waheed*, 423 S.W.2d 159 (Tex. App. 1967); *Lindsay v. Clayman*, 151 Tex. 593, 254 S.W.2d 777, 781 (1952).

31. A person may have separate funds acquired before marriage or as a gift, bequest, devise or descent or in exchange for one of these after marriage.