Fall 1985

Source of Funds: The Preferred Alternative

David E. Lemke

Follow this and additional works at: http://scholarship.law.missouri.edu/mlr

Part of the Law Commons

Recommended Citation

Available at: http://scholarship.law.missouri.edu/mlr/vol50/iss4/11

This Note is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Missouri Law Review by an authorized administrator of University of Missouri School of Law Scholarship Repository.
SOURCE OF FUNDS: THE PREFERRED ALTERNATIVE

Hoffmann v. Hoffmann

Among common law states that have adopted schemes for the equitable distribution of property upon divorce, there are basically two systems. The first system is commonly known as the "all property" system. Under this approach, the division of the divorced parties' property is based upon the concept that marriage is a partnership. Therefore, upon divorce all property owned by the married couple at the time of the divorce is subject to division. The court takes into account various factors to determine the share of the property to which each spouse is entitled.

A second system used among equitable distribution states is called the "dual property" system. Again, under this system marriage and the dissolution of the marriage are treated as if they were a partnership. Under the dual property system, however, not all property belonging to the couple at the time of the divorce is necessarily subject to division. Only property which is determined to be marital will be divided between the spouses. Any other property will be the separate property of one or the other spouse, and that spouse will thereby receive that property upon divorce.

This Note is applicable to dual property jurisdictions such as Missouri. This Note will look at the processes which have developed and are being used among dual property states for determining whether property is marital and thereby subject to division, or separate and thereby belonging solely to one spouse.

1. 676 S.W.2d 817 (Mo. 1984) (en banc).
3. Lacey v. Lacey, 45 Wis. 2d 378, 380, 173 N.W.2d 142, 144 (1970); see also Krauskopf, supra note 2, at 33.
4. Lacey, 45 Wis. 2d at 380. 173 N.W.2d at 146.
5. Krauskopf, supra note 2, at 31-32.
6. Id.
   1. In a proceeding for dissolution of the marriage or legal separation, or in a proceeding for disposition of property following dissolution of the marriage by a court which lacked personal jurisdiction over the absent spouse or lacked jurisdiction to dispose of the property, the court shall set apart to each spouse his property and shall divide the marital property in such proportions as the court deems just after considering all relevant factors. . .
   For a list of other jurisdictions with dual property systems see Krauskopf, supra note 2, at 32.
Hoffmann v. Hoffmann involved a question of whether corporate stock held in the name of the husband at the time of the couple's divorce was the property of the marital estate, or the separate property of the husband. In dealing with this issue, the Missouri Supreme Court reformed the law of Missouri. It held that for purposes of determining the status of property upon dissolution of a marriage the "source of funds" rule is to be applied instead of the "inception of title" rule. This Note will discuss both of these rules, and it will explore the effects adoption of the source of funds rule may have on future property distribution cases in Missouri.

Under Missouri's Dissolution of Marriage Act, all property acquired by either spouse subsequent to the marriage is presumed to be marital property. All property acquired prior to the marriage by either spouse is that spouse's separate property. Thus, the critical issue is the determination of when property was acquired. There are two basic theories which have developed over the years for determining when property was "acquired." One is the inception of title theory, and the other the source of funds theory. Prior to Hoffmann,

8. Hoffmann, 676 S.W.2d at 825.
   2. For purposes of sections 452.300 to 452.415 only, "marital property" means all property acquired by either spouse subsequent to the marriage except:
      (1) Property acquired by gift, bequest, devise, or descent;
      (2) Property acquired in exchange for property acquired prior to the 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 prior to the marriage.
3. All property acquired by either spouse subsequent to the marriage and prior to a decree of legal separation is presumed to be marital property regardless of whether title is held individually or by the spouses in some form of co-ownership such as joint tenancy, tenancy in common, tenancy by the entirety, and community property. Each spouse has a common ownership in marital property which vests not later than the time of commencement by one spouse against the other of an action in which a final decree is entered for dissolution of the marriage or legal separation, the extent of the vested interest to be determined and finalized by the court pursuant to this chapter. The presumption of marital property is overcome by a showing that the property was acquired by a method listed in subsection 2.
11. Property acquired after marriage may be separate if it falls within one of the exceptions enumerated in the statute. See supra note 10; infra note 21 and accompanying text; see also Missouri Practice, § 1065.25 (Supp. 1984).
12. Tibbetts v. Tibbetts, 406 A.2d 70, 74-75 (Me. 1979); Krauskopf, Marital Property at Marriage Dissolution, 43 Mo. L. Rev. 157, 180 (1978).
13. There also is a theory of law adopted by Illinois courts known as the "transmutation" theory. This theory is not used for determining when property is acquired. It is used, however, to cause property which was originally separate to become marital. The court in Hoffmann rejected the Illinois theory of transmutation. 676 S.W.2d at 825. Note, however, that Missouri's appellate courts have for many years recognized
Missouri courts applied the former theory. Under inception of title, property is fixed as either separate or marital at the moment title is acquired. Thus, if title is obtained by one spouse prior to the marriage, the property is the separate property of that spouse, and remains as such after the marriage. If marital funds are used to pay any outstanding debt owed on the property, or invested in its maintenance, the status is not affected. It remains separate, although there may be a right to reimbursement to the marital estate for the marital funds expended. Any increase in the value of the property would belong to the separate estate. The only way the property could change its colors is by a clear showing that the parties intended the separate property be contributed to the community. Of course, on the other side of the coin, prop-

their own “transmutation” doctrine. See Jaeger v. Jaeger, 547 S.W.2d 207, 211 (Mo. App., St. L. 1977); Conrad v. Bowers, 533 S.W.2d 614, 620 (Mo. App., St. L. 1975). Whether the Hoffmann court intended to overrule these prior cases is not entirely clear. There is an argument, however, that it did not, since the Illinois approach and Missouri approach to transmutation of property appear to differ significantly.

In In re Marriage of Lee, 87 Ill. 2d 64, 430 N.E.2d 1030 (1981), the Illinois court found that a capital contribution (improvement) of marital funds to non-marital property (house) resulted in a rebuttable presumption that the entire property was transmuted to marital property. 87 Ill. 2d at 66, 430 N.E.2d at 1032. In Jaeger, the husband sold his separate property and commingled the proceeds with marital funds. Then he purchased new property with the commingled funds. The Missouri court found that such a commingling indicated an intent of the husband to transmute the separate property to marital property. Thus, the newly purchased asset was marital. 547 S.W.2d at 211.

It appears that under the Illinois approach, the separate property of one spouse could be transmuted to marital property regardless of whether the owner of the separate property subjectively intended such a result. It seems that this transmutation without subjective intent is what Hoffmann has rejected, and not the doctrine as it was applied in Jaeger.

14. E.g., Cain v. Cain, 536 S.W.2d 866 (Mo. App., Spr. 1976); Stark v. Stark, 539 S.W.2d 779 (Mo. App., K.C. 1976); see also, Note, Dissolution of Marriage—Division of Property Which Has Increased in Value, 42 Mo. L. Rev. 479 (1977).

15. Cain, 536 S.W.2d at 871; Stark, 539 S.W.2d at 782; 42 C.J.S. Husband and Wife § 583 (1944); TIFFANY, THE LAW OF REAL PROPERTY, § 439 at 241 (3d ed. 1939).

16. Jaeger, 547 S.W.2d at 211.

17. Tibbetts, 406 A.2d at 76 (dicta) (citing Cain, 536 S.W.2d at 866, and Gillespie v. Gillespie, 84 N.M. 618, 506 P.2d 775 (1973), for the proposition that these states allow the marital community to be reimbursed for the marital funds expended). The marital community is said to have a lien on the separate property. Bartke, Yours, Mine, and Ours—Separate Title and Community Funds, 44 WASH. L. REV. 379 (1969). But see Stark, 539 S.W.2d at 783 (entire farm which had increased in value due to improvements made by marital funds awarded to husband; marital estate received no reimbursement; court cited Cain, 536 S.W.2d at 866).

18. Davis v. Davis, 544 S.W.2d 259, 264 (Mo. App., K.C. 1976) (time payment of a major part of the purchase price of the property, even though the payments occurred after the marriage, did not alter the status of the property).

19. In re Marriage of Pate, 591 S.W.2d 384, 390 (Mo. App., W.D. 1979) (court found that the husband did not intend to transfer ownership of his separate

Published by University of Missouri School of Law Scholarship Repository, 1985
SOURCE OF FUNDS

property acquired subsequent to the marriage is presumed to be marital, unless it falls within one of the exceptions in the statute.

The inception of title rule is very old. It was adopted in Missouri fairly recently, in response to Missouri's Dissolution of Marriage Act. From its birth in the state, the inception of title rule has borne the brunt of much criticism. It has been suggested that the inception of title rule fails to promote the partnership theory of marriage which is reflected in Missouri's Dissolution Act. For example, a married couple would be reluctant to invest marital funds in separate property, because the spouse who does not have a separate ownership interest in the property will receive no benefit from any appreciation in its value. In Hall v. Hall, the Maine Supreme Court noted that the inception of title rule gives incentive for one spouse to divert marital funds for the enhancement of separate property, without giving any equitable interest to the marital estate. Thus, it has been suggested that the inception of title rule breeds marital discord. The proffered alternative to the inception of title rule has been the source of funds doctrine. The court in Hoffmann agreed with these arguments, and decided that the source of funds rule is the more desirable rule for determining when property is acquired.

The facts of Hoffmann v. Hoffmann are as follows. Sybil and Paul Hoffmann were married in 1963. Paul worked for Lillie-Hoffmann Cooling Tow-
ers, Inc., a closely held corporation which had been founded by his father. Paul had worked for Lillie-Hoffmann since 1913, and had acquired 256 shares of the corporation's stock by the time he and Sybil were wed; the stock represented 16 percent of the outstanding shares. In 1964, the corporation redeemed 858 shares of stock which were owned by Paul's father, causing Paul's relative interest in the corporation to increase. Between the years of 1964 and 1980 the corporation prospered, and by 1984, Paul's interest in the corporation was worth $962,662.

In 1984, Sybil and Paul were divorced, and certain property was divided by stipulation. The trial court, under statutory mandate, also made a determination and division of other marital property. In doing so, the court set aside the shares of Lillie-Hoffmann stock as the husband's separate property. The wife, Sybil, appealed this decision.

Sybil proposed several theories under which the corporate shares should have been characterized, at least in part, as marital property. One of the

---

31. Paul's father had bought out another founder's interest sometime after the corporation was formed. Id. at 821.
32. "The corporation paid near book value price for the redemption of the father's 858 shares. . . . The book value of the husband's stock remained the same after the purchase of the father's stock by the corporation. The value of the corporation was reduced by the amount of the purchase." Id. at 821 n.2.
33. After his father's stock was retired, Paul had a 35% interest in the corporation, but by the time of this action, Paul had only 29.5% ownership of outstanding shares. He had given 32 shares to his son and one share to a newly hired corporate officer; his total number of shares was reduced to 223. Hoffmann, 676 S.W.2d at 821.
34. The value of Paul's stock at the time of the marriage is indeterminable from the opinion. Sybil's expert witnesses had valued the shares at $2,723,000. The discrepancy occurs because the husband's experts discounted the stock value because of the lack of a public market for the stock, among other factors. Id. at 826.
35. Mo. REV. STAT. § 452.330.1 (Supp. 1983) ("In a proceeding for . . . dissolution of marriage . . . the court shall set apart to each spouse his property and shall divide the marital property . . ."); see also Corder v. Corder, 546 S.W.2d 798, 800 (Mo. App., K.C. 1977); Davis, 544 S.W.2d at 265.
36. Sybil raised several other issues on appeal, but for purposes of this Note they are not significant.
37. The first two theories dealt with the increase in Paul's percentage interest in the corporation as a result of the redemption of Paul's father's 858 shares. These two
proposals made by Sybil was that a portion of the appreciation in the value of the corporate shares was marital property. She asserted that the increase was partially due to marital funds and efforts. It was with regard to this argument that the source of funds rule received the court’s consideration and acceptance.

The court found the source of funds theory best suited to promote the partnership theory of property distribution behind Missouri’s Dissolution statute. The court recognized that a wife could share in the enhanced value of a corporation’s stock brought about by the husband’s efforts. To do so the wife must establish the value of the husband’s services to the corporation, or show that he had sacrificed payment of marital funds, by way of salary or dividends, in order to increase the value of the corporation’s stock. If she could show this, then the property would not be deemed to have been fully acquired until subsequent to the marriage. The marital estate would receive an interest in the property determined by the ratio of marital contributions to the total contributions. Sybil, however, did not meet this burden of proof. Because Paul had been adequately compensated for his efforts by salary which was marital property and which Sybil had shared, she failed to show that uncompensated marital efforts caused the appreciation in the value of the stock. Therefore, the stock and the increased value were both Paul’s separate property.

Although it is clear that Missouri has not adopted the “equitable source of funds” rule, it is not entirely clear what effect Hoffmann will have on all arguments were disposed without mention of either the inception of title or source of funds rule. Hoffmann, 676 S.W.2d at 822-23. It appears that the real issue involved was the definition of “property” rather than “acquired” as is used in Mo. Rev. Stat. § 451.330 (Supp. 1983). Source of funds is only concerned with when property is acquired; therefore, these first two issues raised by Sybil are not relevant to this Note.

38. Hoffmann, 676 S.W.2d at 823.
39. Id. at 825.
40. Id. at 11-13 (citing In re Marriage of Moore, 28 Cal. 3d 366, 371-72, 618 P.2d 208, 210, 168 Cal. Rptr. 662, 664 (1980); Tibbetts, 406 A.2d at 76; Harper, 294 Md. at 65, 448 A.2d at 929).
41. Hoffmann, 676 S.W.2d at 825. The court cites no authority for this proposition. It is unclear how other jurisdictions would handle a similar situation. See infra note 104 and accompanying text.
42. Id. at 826; accord Tibbetts, 406 A.2d at 77 (marital estate is entitled to a proportionate return on its investment).
43. E.g., Smith v. Smith, 472 A.2d 943, 945 (Me. 1984); Moore at 373-74, 618 P.2d at 211, 168 Cal. Rptr. at 665.
44. Hoffmann, 676 S.W.2d at 826. Judge Blackmar, in his separate opinion, was not satisfied that Sybil had a full opportunity to prove her case, because at the trial, the trial court was applying the old rule. Judge Blackmar opined that the wife should have been allowed to remand to the trial court to further develop her case under the new law. Hoffmann, 676 S.W.2d at 829-30 (Blackmar, J., concurring in part and dissenting in part).
45. Mo. Rev. Stat. § 452.330.2(5) (Supp. 1983) provides that the “increase in value of property acquired prior to the marriage” is separate property.
46. Sybil did not receive any benefit from the rule because the court ultimately
subsequent cases involving disputes over the status of property upon dissolution of marriage. The result reached by the Missouri Supreme Court was the same as the lower courts, but the lower courts were applying the inception of title rule and not source of funds. Because the Hoffmann court chose to apply the new rule in a case in which it had no impact on the outcome, there is only marginal guidance to practitioners. The rest of this casenote will look at the source of funds rule, how it is applied in other jurisdictions, and how it may develop in Missouri.

Under the source of funds rule acquisition is seen as a dynamic process. The term “acquired” is defined “as the ongoing process of making payment for property.” Thus, characterization of the property “depend[s] [upon] the source of each contribution as it is made.” It should be noted that in some situations, however, it is immaterial whether the source of funds rule or the inception of title rule is being applied. The ultimate determination of whether the property is separate or marital will be the same under either approach.

For example, if husband purchases a house and pays the entire purchase price with his separate funds prior to that marriage, then the house is clearly his separate property. The source of the entire contribution of the purchase price was separate property and title was obtained prior to marriage. A subsequent marriage will not change any portion of the property to marital property. Likewise, if the house was purchased after the marriage, entirely with marital funds, the house would belong to the community estate and it would be subject to division as marital property upon dissolution of the marriage.

found that the property was her husband’s separate property. Hoffmann, 676 S.W.2d at 825. Adoption of the source of funds rule was not necessary for the decision the court reached. Thus the argument could be made that the court’s adoption of the source of funds rule is merely dicta.

Although announced in dicta, there is little doubt that the “source of funds” rule is now the law in Missouri. The court in Hoffmann clearly overruled past cases which followed the inception of title rule, listing as examples, Cain, 536 S.W.2d at 866, Stark, 539 S.W.2d at 779, and Busby v. Busby, 669 S.W.2d 597 (Mo. App., W.D. 1984). See Hoffmann, 676 S.W.2d at 825. It seems unlikely that the court will subsequently withdraw from this new position.

47. Tibbetts, 406 A.2d at 77.
49. Tibbetts, 406 A.2d at 77.
50. Id. at 76-77 n.9.

The presumption may be rebutted, for example, if the spouse purchasing the asset can establish that the property was exchanged completely for that spouse’s separate property. Then the newly acquired asset is separate also. Smith v. Smith, 472 A.2d 943, 945 (Me. 1984). There are several other ways that property acquired after marriage may be established as separate property. See Mo. Rev. Stat. § 452.330.2(1)-(5)
In either case the outcome would be the same regardless of whether source of funds or inception of title were applied. In this regard, it has been noted that the inception of title rule is the general rule of characterization, and the source of funds rule is the equitable exception.\(^5\)

Source of funds is needed to avoid unfairness that would occur in situations where property was not completely obtained by either separate funds or marital funds.\(^6\) Under this equitable exception, property acquired with a mixture of separate and marital property is given a dual characteristic, and is treated as marital in part and separate in part. Each estate, marital and non-marital, is entitled to an apportioned interest in the acquired property, determined by the ratio of community funds to separate funds.\(^5\)

In adopting the source of funds rule in Missouri, the Hoffmann court relied mainly on three jurisdictions that have previously employed the rule: Maine,\(^5\) California,\(^5\) and Maryland.\(^5\) Like those other courts, the Missouri Supreme Court recognized that property distribution should be accomplished in the most equitable manner, and decided that the source of funds rule best served this goal.\(^5\) The court found that the source of funds rule better implemented Missouri's partnership theory of property distribution by deeming property to be acquired as it is paid for,\(^5\) thereby allowing the marital estate to share proportionately in any increased value in the property due to marital funds and efforts.\(^5\)

One of several fact patterns may occur which requires the use of the source of funds rule. In the first fact pattern, property is purchased by the wife prior to the marriage. At the time of purchase, that spouse pays only a portion of the total price, and gives a mortgage for the rest.\(^5\) Marriage ensues, and

\(^{52}\) Tibbetts, 406 A.2d at 77 n.9.
\(^{53}\) Hoffmann, 676 S.W.2d at 825.
\(^{55}\) See, e.g., Tibbetts, 406 A.2d at 70.
\(^{56}\) See, e.g., Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662.
\(^{57}\) See, e.g., Harper, 294 Md. 54, 448 A.2d 916.
\(^{58}\) Hoffmann, 676 S.W.2d at 825.
\(^{59}\) Id. (citing Harper, 294 Md. at 65, 448 A.2d at 929; Tibbetts, 406 A.2d at 77).

60. Id.
61. A situation that is analogous to the mortgage transaction is a credit transaction:

Where property is acquired on credit, its characterization depends upon the nature of the agreement extending the credit. Where the credit obligation is not shown to be the separate and sole obligation of one spouse, then the credit funds are presumed to be marital property and thus that portion of the property acquired is marital property. The portion of the property acquired in
the remainder of the obligation is paid off with marital funds. 62

The facts of Cain v. Cain 63 are almost identical to the above example. In that case, however, the Missouri Supreme Court applied the inception of title rule. As was noted earlier, under the inception of title rule, the property remains unitary, and is deemed the wife's separate property, as it was in Cain. 64 The best the marital estate could hope for would be a right to reimbursement for marital funds expended. 65 Under the source of funds rule, however, a more equitable approach is taken. Marriage is treated as a partnership, 66 and consistent with this analogy, dissolution is treated as if it were a partnership. The wife, upon dissolution of the marriage, would receive as her separate estate an interest in the property that reflects the ratio of the wife's separate contribution to the total contribution for the property. The marital estate would then receive the remainder. 67

To illustrate, suppose wife purchased the land at $100,000 prior to the marriage, giving $10,000 down and signing a note for the remaining $90,000. The following day, wife and husband marry. For the next ten years the two live in wedded bliss, and continue to pay of the $90,000 note. In the eleventh year, after the note has been paid off, the wife seeks a divorce from husband, and it is granted. Subsequently the trial court is called upon to determine and dispose of the property. 68 Assume also that the property is now worth $150,000.

According to the source of funds rule, wife would receive $15,000 as her separate estate—10 percent of total equity of the property. The remaining $135,000 would belong to the marital estate, and would be subject to divi-

exchange for marital credit and at the time of the divorce not yet fully paid with either marital or non-marital funds is, therefore, marital property. This is, of course, only significant where the property has so appreciated in value that the value of the portion acquired on credit exceeds the amount of the credit itself.


62. In all of the situations discussed, proof of the source from which the funds comes is an essential element of the proponent's case. This may, in fact, prove to be the fatal weak link in the proponent's chain. See Hoffmann, 676 S.W.2d at 826.

63. 536 S.W.2d 866 (Mo. App., Spr. 1976).

64. Id.


66. Under the Uniform Marriage Act, marriage and the acquisition of marital property are viewed as a partnership. Thus, this partnership theory is recognized in pure inception of title jurisdictions also, but with a somewhat different perspective. Corder, 546 S.W.2d 798. See Krauskopf, supra note 12, at 158; Krauskopf, A Theory for "Just" Division of Marital Property in Missouri, 41 Mo. L. REV. 165 (1976).

67. Tibbetts, 406 A.2d at 77.

68. Mo. REV. STAT. § 452.330.1 (Supp. 1983) requires the court to set aside to each his (her) separate property and divide the marital property.
This is not to say, however, that the entire $135,000 will be divided down the middle, with each spouse getting half. The marital property is divided "in such proportions as the court deems just after considering all relevant factors." 69

The preceding example quite obviously treated a simplified situation where no outstanding obligation remained, and the entire equity of the property belonged to the marital and non-marital estates. In such a case, all jurisdictions which apply the source of funds rule would reach the same result. Where the loan has not been fully paid at the time of the dissolution, the formula used above may be inadequate. The court will be faced with the issue of whether or not to give credit to the estate which obtained the loan for the proceeds of the loan.

Hoffmann clearly does not answer this question, nor is it clear that the answer is uniform throughout source of funds jurisdictions. 70 The court in Hoffmann does, however, cite to the California case of In re Marriage of Moore 71 with approval. In Moore, the court articulated a formula in which credit was given to the estate which obtained the loan. 72 It appears that the California approach effectuates the more equitable distribution, which would be in line with the purpose behind Hoffmann's adoption of the source of funds rule. 73 Thus, there is strong indication that such an approach will be followed in Missouri. 74

In In re Marriage of Moore, 75 the California court was faced with the

69. E.g., Moore, 28 Cal. 3d at 366, 618 P.2d at 208, 168 Cal. Rptr. at 662; Tibbetts, 406 A.2d at 70.
70. Mo. Rev. Stat. § 452.330.1 (Supp. 1983). Included among the factors is the contribution of each spouse to the acquisition of the property, the value of each spouse's separate property, economic circumstances, and the conduct of the parties during the marriage. Id.
71. There are a few appellate level cases that provide a definitive answer, although at least one court has given a specific formula for such a problem. See infra notes 72-81 and accompanying text.
72. 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980).
73. Moore, 28 Cal. 3d at 373-74, 618 P.2d at 211, 168 Cal. Rptr. at 665 (citing In re Marriage of Aufmuth, 89 Cal. App. 3d 446, 152 Cal. Rptr. 668 (1979) (court gave marital community credit for the loan because the loan was taken out against marital assets)).
74. Hoffmann, 676 S.W.2d at 825. "By adopting this definition of 'acquired' and the source of funds 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."
75. See Brooks v. Kunz, 637 S.W.2d 135 (Mo. App., E.D. 1982). The Court of Appeals for the Eastern District was faced with a question of partitioning property held by non-marital co-tenants. One of the co-tenants had paid the entire cash down payment, but both had jointly executed a note for part of the purchase price. The court found that credit should be allowed to each co-tenant for one-half the mortgage amount financed subject to contribution if one co-tenant pays more than his share. Id. at 139-40.
76. 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662.
following situation. Prior to the marriage, Lydie purchased a house at a price of $56,000.\(^7\) Lydie made a down payment of $16,000 and secured a loan for $40,000.\(^8\) Eventually she and David married, making payments on the home with community funds in the amount of about $5,000. The parties subsequently divorced. The total paid on the purchase price was $21,000 and the balance owed was $35,000. The market value of the house at the time of dissolution was $160,000, and the equity therein was $125,000.

The court decided that in calculating the pro-rata shares of the separate and marital estates, the economic value of the loan taken out by Lydie should be taken into account.\(^9\) The value of the loan is accounted for because the loan contribution by Lydie was a separate property contribution. It is based on separate assets, it is a separate obligation, and will be paid off in the future out of Lydie’s separate funds. Therefore, the separate property percentage interest should be calculated by adding the down payment to the full amount of the loan, less the amount by which the community funds have reduced the principal,\(^8\) and then by dividing that figure by the purchase price.

In Moore, the calculations would have been as follows: (1) Add the $16,000 down payment to $35,000 (the difference between the $40,000 loan payment and the $5,000 paid on the principal with marital funds). The total separate contribution is $51,000. (2) Divide the $51,000 by the total purchase price of $56,000. Thus Lydie’s separate percentage interest is 91 percent. (3) Determine the separate property interest in the capital appreciation that is attributable to the separate funds. Multiply the 91 percent by the $104,000 capital appreciation to get $94,640. The $104,000 is calculated by subtracting the total amount of money paid on the principal from the equity: $125,000 - 21,000 = $104,000. (4) Add the $94,000 to the $16,000 separate contribution actually made by Lydie toward the equity. The result is that Lydie’s separate property interest is $110,640. By applying this formula, complex as it is, the role of the loan on the value of the property is accounted for.\(^8\)

If the loan had occurred after the marriage, then the loan proceeds would be treated as a community property contribution, the same principles would apply, and the marital community would receive the credit for the amount of the loan.\(^8\)

\(^7\) All of the numbers have been rounded off to make the case more illustrative.
\(^8\) Title was in her name alone. 28 Cal. 3d at 370, 618 P.2d at 209, 168 Cal. Rptr. at 663.
\(^9\) Id. at 373-74, 618 P.2d at 211, 168 Cal. Rptr. at 665. It is not entirely clear all “source of funds” jurisdictions follow this approach, although there are no cases to the contrary.
A second fact pattern may also arise wherein the source of funds doctrine will have a significant impact. This case involves a situation where property is purchased by wife prior to the marriage. The entire purchase price is paid and title is in her name free and clear. Wife then marries husband, and the two make improvements on the property with community funds. The Maine case of *Hall v. Hall* involved a similar situation. Husband and wife married and lived in what was undisputably the separate house of the husband. In the course of the marriage, renovation and improvements were made on the house, increasing the value of the property. Upon divorce, the court was faced with deciding the extent to which the separate property was converted to marital property.

After considering several alternatives, including the inception of title rule, the Maine Supreme Court applied the source of funds rule. It decided that the marital estate acquired an interest in the property to the extent that marital funds enhanced the value of the property; thus the marital estate was entitled to more than just the cost of improvements. The opinion stated that courts should treat the expenditures as an equity investment of community funds, thereby allowing the community to share in the market fluctuations. Any other result would be grossly unfair. The court applied the ratio of “separate investment to total investment” to determine the respective interests of the marital and separate estates in the property.

Quite obviously, the adoption of this new rule will cause dramatic changes and differing results from past cases with regard to property distribution. Circumstances which heretofore would have given one spouse a distinct advantage

---

$175,000, with an outstanding mortgage of $75,000; therefore the equity therein is $100,000.

The community estate would be determined by first calculating the community property percentage interest. On these facts it would be 80% ($80,000 community contribution divided by the $100,000 purchase price). Next, to determine the dollar value of the community’s interest, the 80% is multiplied by $75,000 ($100,000 equity less the amount of principal already paid; the amount of principal already paid must be subtracted from the equity because the community is only being credited here with the amount of capital appreciation attributable to the community funds) which equals $60,000. The amount of equity paid by community funds ($80,000 minus $75,000) is added to the $60,000, and the result is $65,000 as the net value of the community property interest. See *In re Marriage of Lucas*, 27 Cal. 3d 808, 816-17 n.3, 614 P.2d 285, 290 n.3, 166 Cal. Rptr. 662, 667 n.3 (1980); *Aufmuth*, 89 Cal. App. 3d 446, 152 Cal. Rptr. 668.

83. *E.g.*, *Stark v. Stark*, 539 S.W.2d 779 (Mo. App., K.C. 1976) (inception of title was applied and the entire house including the improvements remained the husband’s separate property).
84. 462 A.2d 1179 (Me. 1983).
85. *Id.* at 1180.
86. *Id.* at 1181 (citing *Stark*, 539 S.W.2d 779).
87. *Id.* at 1182.
88. *Id.* at 1182 (citing *Portillo v. Shappie*, 97 N.M. 59, 64, 636 P.2d 878, 883 (1981), which in turn quoted *Bartke*, *supra*, note 18, at 161).
89. *Hall*, 462 A.2d at 1182; *Tibbetts*, 406 A.2d at 75.
in the distribution phase of the divorce, will now allow the marital estate to share more equitably in the total estate. Although there are obvious changes that will occur, there are still many unanswered questions regarding application of the source of funds rule in Missouri. The answers, of course, depend to some extent on the facts involved in each case. They also, however, depend upon which jurisdictions the Missouri courts may look to for guidance in the future.

Because of the court's obvious reliance in Hoffmann on the California, Maine, and Maryland decisions, it is logical to assume that in future cases the Missouri courts will continue to look to these other jurisdictions for guidance; at least until the Missouri courts develop their own body of case law. There are situations, however, where it is not entirely clear that Missouri courts will follow the lead of these other states. Suppose husband purchases a house prior to marriage. Then he marries wife, and the two subsequently purchase a marital home, using proceeds from the sale of the first home to pay most of the purchase price on the second. However, at least part of the funds used to pay for the second house are the wife's separate property, and subsequent mortgage payments are made with marital funds. Title is in both husband's and wife's names. Then the parties sell the second home and purchase a third, using proceeds from the sale of the second home and paying on the mortgage with marital funds, also putting title in both names.90

In Grant v. Zich, the Maryland court applied the source of funds doctrine, without considering that title was in both husband and wife's name.91 The court determined that a presumption of gift arising from the titling of property by tenancy by the entirety was not consistent with Maryland's dispository scheme. The court declared that a gift of separate property to the marital estate is to be established, the spouse claiming the gift must prove that a gift was made.92 In absence of such proof, the house will be characterized as part non-marital and part marital. Of course, the spouse claiming the asset to be partially his separate property must be able to trace the separate funds originally expended through to the final asset acquired.93 Assuming this tracing is accomplished, the interest of the marital estate would then be determined by the ratio that the non-marital investment bears to the total investment.94

Whether Missouri courts will reach the same result as that reached in Grant, if presented with similar facts, is questionable. There is authority in Jaeger v. Jaeger95 that they will not. In Jaeger, the husband sold certain stocks and bonds that he had owned prior to the marriage. At the same time,  

90. See Grant v. Zich, 300 Md. 256, 477 A.2d 1163.
91. Id. at 276, 477 A.2d at 1173.
92. Id.
93. Id. In this case, the husband was able to show the separate funds as they passed from one residence to the other.
94. Id. at n.9.
95. 547 S.W.2d 207 (Mo. App., St. L. 1977).
he also sold stocks belonging to the marital estate. Following the sales, the husband commingled the proceeds and purchased entirely new stocks and bonds with the commingled funds. The court found that the proper result under Missouri's Dissolution Act would be to treat the newly acquired assets as marital, regardless of whether the new asset was titled in both or only one spouse's name. Because the husband had commingled separate funds with marital funds and purchased new assets therewith, he had intended to transmute his separate property into marital property; therefore, the newly acquired asset was wholly marital.

Applying these same principles to facts similar to those in Grant, there is strong argument that the newly purchased house is marital, and not non-marital to any extent. Where the husband sells a house he owned prior to marriage, and purchases a new one subsequent to marriage, with both his separate and marital funds, there is just as strong an indication that he intended the new house to be entirely marital, as there was that the husband in Jaeger intended the new stocks to be entirely marital. Assuming Jaeger controls, there would be no opportunity for the husband to trace his separate property into the new asset and establish the property as separate in part. This result would clearly be contrary to Grant.

Exactly how Missouri courts will decide this type of case is not a foregone conclusion, but it is reasonable to say that Jaeger will control since it can be applied consistently with the purposes behind the source of funds doctrine and Missouri's dissolution statute. Attorneys, therefore, will still have to advise clients of the likely consequences of combining marital and separate assets to purchase property subsequent to the marriage.

There is one final situation worth noting in which the source of funds rule may play a significant role, and in which it is not clear how Missouri courts will decide. In this situation, the asset under dispute is the interest that the married couple has in a corporation, a circumstance analogous to Hoffmann. Missouri courts have clearly had no problem finding that shares in a corporation are subject to division as marital property upon dissolution of marriage. This is true at least where the stock was purchased with marital funds subsequent to marriage. In Hoffmann, the court also implied that the marital estate could share in corporate shares, even if title was established in one

96. Id. at 211. The court notes that under Mo. Rev. Stat. § 452.330.3 (Supp. 1983), property acquired subsequent to marriage is presumed marital. Further, the court states that the “exchange” exception to this presumption found in § 452.330.2(2) is inapplicable in a case where a person uses both marital and non-marital property to purchase new property during the marriage. By commingling the property, the separate property loses its separate identity. Id. at 211. See supra note 10 for a list of the presumptions and the exceptions.

97. 547 S.W.2d at 211; see also supra note 13.

98. See supra notes 88-92 and accompanying text.


100. E.g., Jaeger, 547 S.W.2d at 211 (citing Conrad, 533 S.W.2d 614; In re Marriage of Powers, 527 S.W.2d 949 (Mo. App., St. L. 1975)).
spouse prior to the marriage. It appears that the marital estate must show that
marital funds and efforts were expended which caused, at least in part, the
increase in value of the stock.101

The Missouri case of Davis v. Davis102 involved a husband who owned a
corporation prior to the marriage and continued to do so during the marriage.
He was also president of the corporation, kept the books, and did several other
tasks connected with running the business. The husband’s salary at the time of
trial was $6,500 a year. The corporation was purchased for $84,000 in 1976.
At the time of the divorce it was valued at approximately $152,000. Much of
the increased value was due to the husband’s efforts during the marriage.103
Furthermore, the wife introduced evidence that she had become a director and
vice-president of the corporation, and had signed notes secured by deeds of
trust, the proceeds of which were used for the corporation. Thus, it may also
be said that the wife’s efforts during the marriage contributed to the increase
in value of the corporation.

The court in Davis applied the inception of title rule. It ruled that regard-
less of the wife’s efforts, the obligation she incurred for the corporation, or the
fact that a major part of the corporate assets were purchased after the mar-
riage, the corporation remained the separate property of the husband.104

If the source of funds rule was applied, a different result would occur.
One way to reach the increased value of the corporation under the source of
funds rule would be for the wife to show that the husband was not adequately
compensated for his services to the corporation.105 If she could show this, the
court might determine that marital funds and efforts were sacrificed for the
increased value. Therefore, the marital estate would have an interest in the
stock to the extent of the salary that the husband should have received.106
Furthermore, in Davis, the wife also contributed to the corporation by way of
industry and by incurring obligations for the corporation’s benefit. Under these
circumstances, she could assert that she too was not fairly compensated for her
services, thereby sacrificing marital assets which inured to the corporation’s
benefit. Thus, a strong argument could be made that the marital estate should
receive an interest in the corporation to the extent of marital assets
sacrificed.107

In theory, the above argument is plausible, but in practice it may be diffi-
cult to prove. The burden of proving that the compensation was inadequate is

101. Hoffmann, 676 S.W.2d at 826.
102. 544 S.W.2d 259 (Mo. App., K.C. 1976).
103. Krauskopf, supra note 12, at 188.
104. Davis, 544 S.W.2d at 264.
105. The Hoffmann court recognized that this would be a perfectly legitimate
    theory to pursue. 676 S.W.2d at 825.
106. Id. at 15; see also King, The Challenge of Apportionment, 37 WASH. L.
107. Hoffmann, 676 S.W.2d at 825-26.
difficult to meet. In most instances, in fact, the courts have declined to reverse findings that the increase in value of the corporation was separate property.

Another argument is available that would allow the marital estate to reach the increased value of stock that was owned by one of the spouses prior to marriage. In *Norris v. Vaughan*, a Texas court found that the husband owned a one-fourth interest in a partnership. During the marriage he secured for the partnership the right to drill several oil wells. It was held that the one-fourth interest he had in the new wells was community property. The court treated the increased value of the partnership as a new asset acquired subsequent to marriage, rather than an increase in value in the husband's separate asset. This same theory could be applied to the increased value of corporate stock where the husband's efforts during the marriage led to the increase. It could be said that the increased value of the stock is new property acquired subsequent to marriage, and, therefore, marital property under the dissolution statute.

Whether the source of funds rule is superior to the inception of title rule in all aspects of property distribution is probably open to debate. Judge Welliver, in his separate opinion in *Hoffmann*, opined that "adoption of the source of funds test [will] only serve to saddle an already overburdened judiciary with a tedious task of tracing that will generally be as undeterminative of the case as the discussion was [in *Hoffmann*]." While it might be true that in some cases the tracing of property through the marriage will be difficult and may be futile, this should not discourage application of the rule altogether. The Missouri Marriage and Dissolution Act was adopted to promote the partnership theory of marriage. The source of funds rule is better suited to carry out this objective. By applying the source of funds rule, a non-owning...
spouse is able to realize a return on his investment in the marital partnership. Where improvements or payments of debts are made on separate property with marital funds the marital community is "entitled to share in the proportionate increase in value of the property attributable to [the marital funds and efforts expended]."117 The source of funds rule allows the marital estate to share in the appreciation in the value of the property,118 rather than just allowing it to be reimbursed for its efforts. Clearly this approach is the most equitable approach to property distribution.119

Adoption of the rule may have more effect than just fairly dividing property. It will influence advice that attorneys will give to their clients. The attorney will have to counsel his client that property she owned, prior to the marriage, may lose its status as separate property upon the happening of certain events such as payment of part of the purchase price after marriage, or improvements made on the property after marriage with marital funds. Of course, the attorney may also advise his client that she can invest in the enhancement of her spouse's separate property with the knowledge that she is investing in the marital community. This may be the best reason for adopting the source of funds rule. Knowledge by both spouses that the marital community will be treated as a partnership, and will be treated equitably upon possible dissolution may lead to marital harmony.120 Both spouses will feel free to make their investment in the marriage knowing that they are making an investment in something that they will share in regardless of future events.

DAVID E. LEMKE

---

117. Hoffmann, 676 S.W.2d at 825 (citing Tibbetts, 406 A.2d at 76-77).
118. See supra notes 75-81 and accompanying text.
119. Hoffmann, 676 S.W.2d at 825.
120. Note, supra note 14, at 480.