FAMILY LAW NEWSLETTER

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Classifying Income, Rents and Profits from Separate Property

by Richard I. Zuber

On June 2, 1994, twenty-three years will have elapsed since the Uniform Dissolution of Marriage Act ("UDMA") first became law in Colorado.1 Despite the passage of time and innumerable court decisions, Colorado family law practitioners face indecision when in a dissolution proceeding they seek to classify income derived during the marriage from separate property. This article attempts to explain the source of the uncertainty, why it continues to exist and how this issue will probably be resolved.

Source of Uncertainty

The current uncertainty in Colorado's law can first be traced to the decisions rendered by the Colorado Court of Appeals and the Colorado Supreme Court in the case of *In re the Marriage of Jones*.2 The Colorado Court of Appeals in *Jones* held that a spouse's receipt of income derived from non-marital property during a marriage should be classified as marital property.3 After granting *certiorari* in *Jones*, the Colorado Supreme Court declined to affirm this holding under the facts of the case 4 Instead, in reversing in part the Court of Appeals, the Supreme Court left the issue undecided in Colorado.

In Jones, during the parties' marriage, the wife became a co-beneficiary with her father of a testamentary support trust created by her mother. The trustees were granted absolute discretion to distribute as much income and principal as necessary for the support of the two beneficiaries. During the marriage, the wife received income distributions from the trust and used most of that income in paying the mortgage and making improvements to her separate property residence. During the marriage, the corpus of the trust also appreciated in value, in addition to the income distributions made to the wife.

The husband in *Jones* first argued that the trial court, in making its property division, erred in not treating the appreciation in the trust corpus as marital property. Both courts, citing *In re the Marriage of Rosenblum*,5 held that for purposes of dividing property under CRS § 14-10-113, the wife had no "property rights" whatsoever in the corpus of the trust but merely an expectancy.6

The husband next argued that income distributions made to the wife from the trust and which she invested in her separate property residence should have been classified as marital property and considered by the trial court as part of the property division 7 In finding merit to this argument, the Court of Appeals created a new and otherwise unknown classification for the trust corpus, which had been held to be neither the separate property of the wife nor marital property, classifying it as "non-marital property." While the term non-marital property is frequently understood by courts and practitioners as a synonym for separate property, the Court of Appeals appeared to use it in a literal sense for one purpose and in an inexact legal sense for another purpose. The court found that "the question of whether income derived from *nonmarital property* is marital property has not been addressed in Colorado."8 *[Emphasis supplied.]* Citing legal authority, the Court of Appeals held that the

> income which wife had received from the trust during the marriage was marital income (from non-marital property) and to the extent that this income was used to renovate or reduce the mortgage debt to wife's residence, the resulting appreciation in value of the residence must be classified as marital property.9 *[Parenthetical supplied.]*

> The Colorado Supreme Court was not persuaded by either the Court of Appeal's reasoning or its recitation of legal authority in support of its holding. The Supreme Court first had difficulty with the concept that although the trust corpus was not the wife's separate or marital property, the income she received from the trust was being classified as "marital income" subject to division.10 The Supreme Court stated that

> the income here was from a trust that was neither the wife's marital property nor separate property. . . . Hence the income received by the wife from the trust is more properly a "gift" under subsection 14-10-113(2)(a) and thus not divisible.11

By implication, the Supreme Court also found that appreciation to a separate property asset resulting from separate property contributions should not be classified as marital property.

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Second, the Supreme Court questioned the citations relied on by the Court of Appeals to support its holding. The Court of Appeals in its opinion stated that

> under the Uniform Marriage and Divorce Act (UMDA), the model act on which § 14-10-113 is based, income from both marital and non-marital property received during the marriage is deemed to be marital property, [citing] Uniform Marriage and Divorce Act, 9A Uniform Laws Annotated Section 307 (1987) (Note 92).12

The Supreme Court clearly intimated that in its review of the text to § 307 of the 1987 edition to the Uniform Marriage and Divorce Act, it failed to locate any reference that supported the Court of Appeals' conclusion.13 Further, it appears that little weight was given by the Supreme Court to the "Note 92" citation to § 307 relied on by the Court of Appeals, since the note was simply a compilation of twenty-eight cases, many of which were not pertinent to the issue being considered.14

In addition, the Supreme Court found that the cases cited by the Court of Appeals were "inapposite" in that they were concerned with classifying income derived from separate property,15 whereas the issue before the court was classifying income derived by a spouse from nonproperty or an expectancy.

Despite its lengthy analysis of the Court of Appeals' reasoning and legal authority, and an acknowledgement that the issue remains unsettled in Colorado, the Supreme Court, relying on the mootness doctrine, declined to resolve the issue of "whether income from, as opposed to an increase in value of, separate property is [to be] treated as marital property."16

In reviewing the decisions of the Court of Appeals and the Supreme Court in *Jones,* it is easy to conclude that as a matter of procedure, the Supreme Court reached the correct decision when in this particular case it found the question moot. However, in attempting to predict how the issue will be resolved in the future, it is troubling that after twenty-three years of uncertainty the Supreme Court did not find it compelling to resolve this issue.17

Authority Circa Jones

It is clear that highly persuasive legal authority existed at the time the Court of Appeals rendered its decision in *Jones.* This authority, if cited by the Court of Appeals, would have strongly supported *dicta* that income derived from separate (non-marital) property during a marriage should be classified as marital property.

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By enacting the Uniform Dissolution of Marriage Act in 1971, Colorado adopted without change the property disposition provisions contained in the 1970 version of the Uniform Marriage and Divorce Act ("UMDA").ls Accompanying the 1970 text to UMDA § 307 were the commissioner's interpretative comments, one of which stated:

> the phrase *increase in value* used in (b)(5) is not intended to cover the income from property acquired prior to the marriage. Such income is marital property. Similarly, income from other non-marital property acquired after the marriage is marital property.19 *[Emphasis supplied.]*

This interpretative comment was made specifically applicable to subsection (c) of the UMDA, which statutorily created the presumption that "all property acquired by either spouse after marriage and prior to a decree of legal separation is presumed to be marital property. . . ."20 Thus, it would appear that the commissioners in the 1970 version of the Uniform Act were relying on the statutory presumption of marital property in reaching their conclusion that income from separate property was to be classified as marital property.

Noted legal scholars have arrived at the same conclusion as the commissioners, for a variety of reasons. In *The Law of Domestic Relations,* the treatise author states:

> The treatment of income, rents or profits from separate property is largely governed by statute in the community property states. *Traditional Spanish Community Property Law* had it that the income from separate property became community property and some states retain this rule. In other states it remains separate property. The *policy* of the marital property statutes would seem best vindicated by holding such income to be marital property, particularly in view of the *presumption* that property acquired during the marriage is marital?21 *[Citations omitted; emphasis added. I*

Other authority can be found in the House Judiciary Committee debates pertaining to two 1973 amendments to the UDMA. The archives tape recordings of these debates lend credence to the belief of many Colorado practitioners that the appreciation or increase in value provisions of CRS § 14-10-113(4) also can be relied on to justify classifying income derived from separate property as marital property.22

A review of the Colorado Session Laws for 1973 and the archives tape recordings reveal that the 1973 amendments repealed a provision of the 1971 Act that had expressly *excluded* from the definition of marital property "increases in the value of property acquired prior to the marriage."23 In addition, on the recommendation of the Colorado Bar Association (CBA), the legislature added by amendment an additional relevant factor for the court to consider in dividing marital property:

> *any increases* or decreases in the value of the separate property of the spouse during the marriage, or the depletion of the separate property for marital purposes.24 *[Emphasis added.]*

The archives tape recordings first disclose that this amendment was actually proposed by the CBA in the event the legislature chose not to repeal the 1971 provision excluding as marital property any increases in the value of property acquired before the marriage.

An alternative amendment also was proposed by the CBA at the same heal' ings, providing that

> an asset of a spouse acquired prior to the marriage or in accordance with subsection (2)(b) or (c) of this section should be considered as marital property, for purposes of this article only, to the extent that its present value exceeds its value at the time of the marriage or at the time of acquisition if acquired after the marriage.25

The legislature ultimately adopted both amendments, despite their submission as alternatives. By the enactment of both these amendments, it could be argued that the legislature intended to

carve out an exception for increases in value to separate property that are not a result of appreciation, but that result from accretions of income. The tape recordings do not support such an interpretation.

Additionally, in the discussions between the CBA representative and the members of the House Judiciary Committee pertaining to the alternative amendments, there was no attempt on the part of the representative to distinguish between increases in value to separate property caused by interest as opposed to other factors such as inflation or spousal efforts. In fact, the CBA representative in his testimony used the terms "interest" and "increase in value" interchangeably.

Classification Still an Issue in Colorado

Classifying income derived from separate property remains an issue in Colorado. One possible explanation for the delay in resolving the issue is the fact that courts in other jurisdictions that adopted versions of the UMDA have drawn a legal distinction between classifying income derived from separate property, as opposed to classifying increases in value to property resulting from inflation or spousal efforts.26 The Colorado Supreme Court in *Jones* suggested without deciding that such a distinction might have merit.27

However, it is important to note that in states where the courts have drawn a distinction between classifying income derived from separate property as opposed to classifying other increases in value of separate property, their statutes have mandated such a distinction. Colorado's statute between 1971 and 1973 would have mandated such a distinction. Nevertheless, in light of the 1973 statutory amendments and the policy considerations that went into the promulgation of Colorado's UDMA, such a distinction today would favor form over substance.

Conclusion

Ambiguities and uncertainties pertaining to the meaning of new statutes are not always resolved by appellate courts soon after enactment. However, the passage of twenty-three years without a definitive court decision on how to classify income derived from separate property lends itself to the suggestion that no ambiguity or uncertainty exists in Colorado's statute.

The authors of an article28 that was published in *The Colorado Lawyer* just after the 1971 adoption of Colorado's UDMA apparently perceived no ambiguity in the property disposition provisions of the statute based on the model act and its interpretative comments. Attorneys intereste

d in the answer to the classification issue need only follow the beacon that was first provided by the Colorado Supreme Court in *Jones*.

NOTES

1. The UDMA was signed into law on June 2, 1971, and became effective for dissolution proceedings filed after January 1, 1972. *See* H.B. 1299,1971 Colo. Sess. Laws at 520; Bayer and Bryant, "The (Non) Uniform Dissolution of Marriage Act-The Colorado Lawyer as Guinea Pig," *1 The Colorado Lawyer* 11 (Dec. 1971).
2. 791 P.2d 1173 (Colo.App. 1989), *cert. granted* 812 P.2d 1152 (Colo. 1991), *aff'd in part, rev d in part.*
3. *Id.* at 1175 (Colo.App.).
4. *Id.* at 1158 (Colo.).
5. 602 P.2d 892 (Colo.App. 1979).
6. *Jones, supra,* note 2 at 1174 (Colo.App.) and at 1154-57 (Colo.).

7. See In re the Marriage of Wildin, 563 P.2d at 386 (Colo.App. 1977), which held that contribution of a spouse to an increase in the other spouse's separate property is an important factor in dividing marital property.

8. Jones, supra, note 2 at 1175 (Colo.App.). *But see Wildin, supra,* note 7 at 386, where the Court of Appeals in *dicta* failed to indicate that a classification distinction exists where increases to the value of the separate property estate were the result of investments from income derived from separate property as opposed to appreciation caused by inflation (stock purchased from income derived from separate property stocks and bonds). *See also In re the Marriage of Fjeldheim,* 676 P.2d 1236 (Colo.App. 1983), holding that where property does not fall within any of the statutory exceptions to marital property, the statutory presumption of marital property controls.

9. Jones, supra, note 2 at 1175-76 (Colo. App.).

10. *Jones, supra,* note 2 at 1157-58 (Colo.). 11. *Id.* at 1158.

12. *Jones, supra,* note 2 at 1175 (Colo. App.).

13. *Jones, supra,* note 2 at 1157 (Colo.). *14. Jones, supra,* note 2 at 1174 (Colo. App.) and note 1 at 1157 n.5 (Colo.).

15. *Id.*

16. *Id.* at 1158.

17. See *Humphrey v. Southwestern Development Co.* 734 P.2d 637 (Colo. 1987), which held that the mootness doctrine is subject to tivo exceptions: (1) when a matter is one capable of repetition yet evading review, or (2) when the matter involves a question of great public importance or an allegedly recurring constitutional violation.

18. See Bayer and Bryant, *supra,* note 1; H.B. 1299, *supra,* note *1; Family Law Quarterly,* Vol. V, No. 2 (June 1971); Handbook of the National Commissioners on Uniform State Laws and Proceedings, 1970 edition *(hereinafter,* "1970 Handbook"), Uniform Marriage and Divorce Act at 202-04.

19. 1970 Handbook; *Family Law Quarterly,* Vol. V, No. 2 (June 1971) at 232-233. It should be noted that in 1973, § 307 of the UMDA was amended and the accompanying comments were changed significantly. As a result, the foregoing interpretive comment does not appear in the 1987 edition of Uniform Laws Annot. § 307 cited and relied on by the Court of Appeals in *Jones.* The Appendix to this article contains the relevant language and accompanying comment from the 1970 version of § 307.

20. 1970 Handbook, *supra*, note 18.

21. Clark, II *The Law of Domestic Relations in the United States, Practitioners Edition* (1987), Ch. 16, § 16.2 at 189; see also McCahey, *Valuation and Distribution of Marital Property,* § 3.03 at 3-32 ("[i]n the absence of an explicit statutory provision, the weight of authority seems to indicate that income from one spouse's separate property is nonetheless marital property subject to equitable distribution" *[Citations omitted.]);* Golden, *Equitable Distribution of Property* (1983) at 111-12 ("the usual rule in equitable distribution states is similar to that in community property states: income earned during the marriage from separate property is marital property").

22. H.B. 1235, 1973 Colo. Sess. Laws, Ch. 162, §§ 6, 7 and 12. *See* Colorado Archives tape recording of House Judiciary Committee debate on 5/9/73 and 5/10/73 on H.B. 1235.

23. *Id.*

24. H.B. 1235, *supra*, note 22 at § 6. *See also* CRS § 14-10-113(1)(d), as amended.

25. H.B. 1235, *id.* at § 7*; see also* CRS § 14-10-113(4), as amended.

26. *Mercer v. Mercer,* 836 S.W.2d 897, 899-900 (Ky. 1992); *In re the Marriage of Reed,* 427 N.E.2d 282, 285 (Ill.App. 1981); In *re the Marriage of Williams,* 639 S.W.2d 236, 237 (Mo.App. 1982); *Sousley v. Sousley,* 614 S.W2d 942 (Ky. 1981); see *also Arneson v. Arneson,* 355 N.W2d 16 (Wis.App. 1984); *MacDonald v. MacDonald,* 532 A.2d 1046 (Me. 1987).

27. Jones, *supra*, note 2 at 1158 (Colo).

28. Bayer and Bryant, *supra*, note 1.

APPENDIX

1970 Version of UMDA § 307: Text and Relevant Commentary Language

SECTION 307. *[Disposition of Property.]*

(a) In a proceeding for dissolution of the marriage or for legal separation, or 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 without regard to marital misconduct, in such proportions as the court deems just after considering all relevant factors including:

(1) the contribution of each spouse to the acquisition of the marital property, including the contribution of a spouse as homemaker;

(2) the value of the property set apart to each spouse; and

(3) the economic circumstances of each spouse at the time the division of property is to become effective, including the desirability of awarding the family home or the right to live therein for reasonable periods to the spouse having custody of any children.

(b) For purposes of this Act only, "marital property" means all property acquired by either spouse subsequent to the marriage except:

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(1) property acquired by gift, bequest, devise, or descent;

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(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.

(c) 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. The presumption of marital property is overcome by a showing that the property was acquired by a method listed in subsection (b).

COMMENT

Subsection (c) creates a presumption that all property acquired after marriage and prior to a decree of legal separation is marital property. In the absence of contrary evidence this presumption will be controlling, regardless of the manner in which title is held by the spouse. A spouse seeking to overcome the presumption has the burden of proof on the issue of identification. The presumption is overcome by a showing that the property (1) was acquired prior to the marriage, was the increase in value of such property, or was acquired after the marriage in exchange for such property; (2) was acquired after the marriage by gift, bequest, devise or descent or in exchange for property so acquired; (3) was acquired after the entry of a decree of legal separation; or (4) was designated as non-marital property by a valid agreement of the spouses, all as provided in subsection (b). The phrase "increase in value" used in subsection (b)(5) is not intended to cover the income from property acquired prior to the marriage. Such income is marital property. Similarly, income from other non-marital property acquired after the marriage is marital property.