# Equitable Distribution of Property in North Carolina: A Preliminary Analysis

Sally Burnett Sharp

# EQUITABLE DISTRIBUTION OF PROPERTY IN NORTH CAROLINA: A PRELIMINARY ANALYSIS

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*The recent passage of an equitable distribution statute in North Carolina marks a profound change in the distribution of property upon divorce. Through a statutory scheme that classifies the property subject to division as marital or separate property and enumerates the factors to be considered for equitable distribution, the statute seeks to effect the partnership concept of marriage. In this article, Professor Sharp reviews many of the difficult interpretive problems raised by the statutory definitions of marital and separate property. Using the experience of other classification-based states as a reference, Professor Sharp offers an assessment of the considerations that should be paramount in implementing the often conflicting goals evidenced by the equitable distribution format.*

## I. INTRODUCTION

On October 1, 1981, North Carolina became the fortieth common-law state to adopt a system for equitable distribution of property upon divorce.[1] The rapid growth of equitable distribution systems is largely reflective of the concept of marriage as a partnership, a shared enterprise to which both spouses make valuable contributions, albeit often in different ways.[2] In particular, such systems give long overdue recognition to the invaluable role played by a homemaker spouse. Equitable distribution aims, quite simply, at a fair distribution of property upon dissolution of marriage: it seeks to effect upon divorce those sharing principles that motivate most couples during marriage.[3]

Because it invests nontitled spouses with rights to property, the new statute does not merely create new rules for an old game in North Carolina. It

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1. Act of July 3, 1981, ch. 815, 1981 N.C. SESS. LAWS, 1ST SESS. 1184 (codified at N.C. GEN. STAT. § 50-20 (Cum. Supp. 1981)). Apparently only Mississippi, Virginia and West Virginia remain wedded to the traditional common-law scheme under which title alone controls the disposition of property upon divorce. *See* H. FOSTER, NEW YORK EQUITABLE DISTRIBUTION LAW 613 (1980), Freed & Foster, *Divorce in the Fifty States: An Overview*, 14 FAM. L.Q. 229, 250 (1981).

2. *See, e.g.*, Rothman v. Rothman, 65 N.J. 219, 229, 320 A.2d 496, 501-02 (1974); Kulzer, *Law and the Housewife: Property, Divorce, and Death*, 28 U. FLA. L. REV. 1, 18-22 (1975).

3. For an excellent discussion on the prevalence of sharing principles during marriage, and the effect of divorce property laws on those principles, *see* Prager, *Sharing Principles and the Future of Marital Property Law*, 25 U.C.L.A. L. REV. 1 (1978). *See also*, Comment, *What's Yours is Mine and What's Mine is Mine: The Classification of the Home Upon Dissolution*, 28 U.C.L.A. L. REV. 1365 (1981).

marks the greatest change in the domestic law of the state since at least the turn of the century.[4] In general it requires judges to undertake two major tasks: the determination of what property is subject to division, and the distribution of such property in a manner that is, in accord with a number of statutory factors that must be considered, equitable.[5] The first task is no less critical than the second if the goal of fair distribution is to be achieved.

The North Carolina statute is unusually detailed and complex. It anticipates and resolves many issues that have been the subject of extensive litigation in other states, but it leaves many other questions unanswered. A full discussion of the ramifications and complexities of G.S. 50-20 is beyond the scope of this article.[6] This discussion will, however, draw upon the experiences of other jurisdictions to suggest partial answers to the critical issue of what property is, or is not, subject to distribution. Defining the parameters of marital property is not merely the first step in equitable distribution: it is the most important one as well. Neither the statutory distributional factors nor judicial wisdom can effectuate a fair division of marital property unless that property is defined fairly in the first instance.

Here, as elsewhere, determining the boundaries of marital property will prove to be an extremely troublesome, and often troubling, task. In particular, the statutory provisions dealing with property acquired before marriage, increases in value of separate property, interspousal gifts, and property exchanged for separate property raise many difficult issues. It is hoped that some of the resolutions to such issues suggested in this article will illustrate the need to balance the cautious legislative embodiment of the marital partnership ideal with the fundamental fairness purpose that prompted passage of the statute.

## II. MARITAL PROPERTY

### *A. General Principles*

In the majority of common-law equitable distribution states, all property owned by either or both spouses at the time of divorce may, at least in some circumstances, be subject to judicially imposed distribution.[7] Thus, the classi-

4. Many commentators had mistakenly characterized North Carolina as an equitable distribution state prior to passage of the new Act. *See, e.g.*, H. FOSTER, *supra* note 1, at 614; Freed & Foster, *supra* note 1, at 250; Comment, *supra* note 3, at 1370 n.27. The source for this misinterpretation was undoubtedly G.S. 50-16.7(a), which provides for payment of alimony "by transfer of title or possession of personal property or any interest therein, or a security interest in or possession of real property . . . ." N.C. GEN. STAT. § 50-16.7(a) (1976). Contrary to what has occurred in some states, however, this alimony provision was emphatically not the vehicle for the introduction of equitable principles into the domestic law of North Carolina. *See, e.g.*, Leatherman v. Leatherman, 297 N.C. 618, 256 S.E.2d 793 (1979).

5. N.C. GEN. STAT. § 50-20 (a),(c) (Cum. Supp. 1981). *See also infra* note 19 and accompanying text.

6. The procedural issues raised by various sections of the statute are in themselves quite formidable. *See, e.g., infra* text accompanying note 27. Likewise, the effect of the new statute on private agreements is a topic whose implications are too vast for inclusion in this article.

7. Comment, *supra* note 3, at 1370 n.27. *See also* Note, *Property Division and Alimony*

fication of property as "separate" or "marital" does not limit a court's capacity to distribute property. Such classifications nonetheless do affect the division of property in a significant manner. Most of these "all property" states require a court to consider several factors in determining what constitutes a fair or equitable distribution, the most common of which is the contribution of each party to the acquisition of the property.[8] The result is that the distribution of "separate" property will, in all likelihood, be the same as that which would have been reached had the property not been subject to distribution at all. In theory, an "all property" state creates a large pool of assets subject to division, thus allowing the exercise of greater judicial discretion to achieve fairness.[9] In practice, it appears that property acquired largely through the efforts of one spouse will be distributed to the other spouse only in very rare circumstances.[10]

Under the North Carolina statute, however, only property determined to be "marital" within the definition of G.S. 50-20(b)(1) is subject to equitable distribution.[11] The new statute thereby falls into what has aptly been characterized as a "deferred community property law" system, under which property classified as separate is completely immune from distribution.[12] As the label indicates, this system is in many ways more closely related to the community property system than to the "all property" approach of the majority of equitable distribution states.[13] By definition, classification-based states subject a smaller pool of assets to distribution, thereby creating greater limits upon judicial discretion than do "all property" states.

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*Awards: A Survey of Statutory Limitations on Judicial Discretion*, 50 FORDHAM L. REV. 415, 427 (1981).

8. *See, e.g.*, IND. CODE ANN. § 31-1-11.5-11(b) (Burns 1980) (whether property is acquired prior to marriage or through inheritance or gift is a factor to be considered in distribution); IOWA CODE ANN. § 598.21 (West 1981) (separate property not available for distribution unless a refusal to divide would be inequitable); UTAH CODE ANN. § 30-3-5 (Supp. 1981) (manner of acquisition of assets only a factor to be considered in distribution); WIS. STAT. ANN. § 767.255 (West 1981) (gifts or property exchanged therefor cannot be subject to division unless hardship would otherwise result); WYO. STAT. § 20-2-114 (1977) (party through whom property was acquired is a distribution factor).

9. Greene, *Comparison of the Property Aspects of the Community Property and Common-Law Marital Property Systems and Their Relative Compatibility with the Current View of the Marriage Relationship and the Rights of Women*, 13 CREIGHTON L. REV. 71, 101 (1979).

10. For instance, Wisconsin requires the return of separate property to each spouse "except upon a finding that refusal to divide such property will create a hardship on the other party or on the children of the marriage." WIS. STAT. ANN. § 767.255 (West 1981).

11. "Upon application of a party, the court shall determine what is the marital property and shall provide for an equitable distribution of the marital property between the parties. . . ." N.C. GEN. STAT. § 50-20(a) (Cum. Supp. 1981). Under subsection (d) of the statute, the parties may also agree privately, by written agreement, to distribute their property. It should be noted that the statute says "distribution of the *marital* property" (emphasis added), but presumably spouses can divide their separate property as well, under existing law as provided for in G.S. 52-10 and G.S. 52-10.1. In any event, property excluded by a valid separation agreement would constitute an eighth variety of separate property.

12. Prager, *supra* note 3, at 3; Comment, *The Development of Sharing Principles in Common Law Marital Property States*, 28 U.C.L.A. L. REV. 1269, 1282 (1981).

13. Many commentators have noted the degree to which the community and common-law property systems have begun to converge, particularly within the previous two decades. *See, e.g.*, Younger, *Marital Regimes: A Story of Compromise and Demoralization, Together with Criticism and Suggestions for Reform*, 67 CORNELL L. REV. 45 (1981); Comment, *supra* note 12, at 1270.

In addition to the community property states, there are at least nine other common-law states that also restrict equitable distribution to marital property.[14] The experience of these states will therefore provide the most valuable guidance for interpretation of the marital and separate property provisions of the North Carolina statute.

### *B. Marital Property in North Carolina*

As in most classification-based states, the definition of marital property in North Carolina is essentially a negative one: marital property is "all real and personal property acquired by either spouse during the course of the marriage and presently owned, except property determined to be separate property."[15] Such language has been uniformly held to create a presumption that all property acquired during a marriage is marital.[16] The presumption is rebuttable by proof that property was separately acquired.[17]

Unlike most other states, however, North Carolina makes an additional presumption that marital property should be divided equally, unless "the court determines that an equal division is not equitable."[18] In that event, the court is directed to divide the property "equitably," taking into consideration twelve elaborately specified factors, including "[a]ny other factor which the court finds to be just and proper."[19] It is unclear whether these factors are to be

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14. COL. REV. STAT. § 14-10-113 (Supp. 1981); DEL. CODE ANN. tit. 13, § 1513 (1981); ILL. ANN. STAT. ch. 40, § 503 (Smith-Hurd 1980); KY. REV. STAT. § 403.190 (Supp. 1980); ME. REV. STAT. ANN. tit. 19, § 722A (1981); MO. ANN. STAT. § 452.330 (Vernon Supp. 1981); N.J. STAT. ANN. § 2A:34-23 (West Supp. 1981-82); PA. STAT. ANN. tit. 23, § 401(d) (Purdon Cum. Supp. 1981-82). The District of Columbia also has a classification-based system. D.C. CODE ANN. § 16-910 (1981). Additionally, several states will invade separate property only in limited circumstances. *See supra* notes 8 & 10 and accompanying text.

These states have essentially adopted Alternative B of § 307 of the Uniform Marriage and Divorce Act [hereinafter cited as UMDA]. Alternative A draws no distinction between marital and separate property. Alternative B was included at the insistence of the community property states. *See* UMDA § 307, Commissioner's Comment (1973); Rheinstein, *Division of Marital Property*, 12 WILLAMETTE L.J. 413, 426-30 (1976).

15. N.C. GEN. STAT. § 50-20(b)(1) (Cum. Supp. 1981). For a discussion of the possible significance of the omission of property acquired by "both" spouses see *infra* notes 28-32 and accompanying text.

16. *See, e.g.*, E.C.W. v. M.A.W., 419 A.2d 934 (Del. 1980); Hemily v. Hemily, 403 A.2d 1139 (D.C. 1979); Jaeger v. Jaeger, 547 S.W.2d 207 (Mo. Ct. App. 1977); Painter v. Painter, 65 N.J. 196, 320 A.2d 484 (1974). The statutes of several states also provide that all property acquired during marriage will be presumed marital. *E.g.*, ILL. ANN. STAT. ch. 40, § 503(b) (Smith-Hurd 1980); KY. REV. STAT. § 403.190(3) (Supp. 1980); PA. STAT. ANN. tit. 23, § 401(f) (Purdon Cum. Supp. 1981-82). The original version of § 307 of the UMDA contained the same presumption.

17. In Illinois, for example, the presumption may be rebutted only by "clear, convincing and unmistakable" evidence to the contrary. *In re* Marriage of Severns, 93 Ill. App. 3d 122, 125, 416 N.E.2d 1235, 1238 (1981). In Kentucky the presumption can be rebutted only by tracing the alleged separate property into specific assets. Brunson v. Brunson, 569 S.W.2d 173 (Ky. Ct. App. 1978).

18. N.C. GEN. STAT. § 50-20(c) (Cum. Supp. 1981). Arkansas and Wisconsin also have the same rebuttable presumption. ARK. STAT. ANN. § 34-1214(A)(1) (Supp. 1981); WIS. STAT. ANN. § 767.255 (West 1981). Idaho statutory law calls for a substantially equal division unless "compelling reasons" exist to the contrary. IDAHO CODE § 32-712(1)(a) (Supp. 1981). California requires an equal division of community property. CAL. CIV. CODE § 4800(a) (West Supp. 1981).

19. N.C. GEN. STAT. § 50-20(c)(12) (Cum. Supp. 1981). Factors the court is to consider under G.S. 50-20(c) include:

taken into account only in making the initial determination that an equal division would be inequitable, or in the determination of what would be equitable, or, as is more likely, in both instances.[20] It is clear, however, that the various factors are intended as guidelines to aid decision-makers in the determination of a fair division of property. They should not be allowed to assume the status of independent principles or rules of law. In any case, given the scope of the factors to be considered, the presumption of an equal division should not be difficult to rebut.[21] At a minimum, this presumption should provide a fifty-fifty "starting point" for distribution of marital assets.

A major question left unanswered by the North Carolina definition of marital property is the time at which the marriage ceases to exist for purposes of accumulation and evaluation of marital property.[22] Nearly all states have fixed some event or events, symbolic of the breakdown of the marriage, as the date after which assets accumulated by either party will no longer be deemed

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(1) The income, property, and liabilities of each party at the time the division of property is to become effective;
(2) Any obligation for support arising out of a prior marriage;
(3) The duration of the marriage and age and physical and mental health of both parties;
(4) The need of a parent with custody of a child or children of the marriage to occupy or own the marital residence and to use or own its household effects;
(5) Vested pension or retirement rights and the expectation of non-vested pension or retirement rights, which are separate property;
(6) Any equitable claim to, interest in, or direct or indirect contribution made to the acquisition of such marital property by the party not having title, including joint efforts or expenditures and contributions and services, or lack thereof, as a spouse, parent, wage earner or homemaker;
(7) Any direct or indirect contribution made by one spouse to help educate or develop the career potential of the other spouse;
(8) Any direct contribution to an increase in value of separate property which occurs during the course of the marriage;
(9) The liquid or nonliquid character of all marital property;
(10) The difficulty of evaluating any component asset or any interest in a business, corporation or profession, and the economic desirability of retaining such asset or interest intact and free from any claim or interference by the other party;
(11) The tax consequences to each party; and
(12) Any other factor which the court finds to be just and proper.

The "any other factor" language was apparently intended to allow for consideration of fault in property divisions. Alimony is wholly fault-based in North Carolina. *See* N.C. GEN. STAT. § 50-16.2 (1976). *See generally* Note, *The Discretionary Factor in the Equitable Distribution Act*, 60 N.C.L. REV. 1399 (1982). It is also, however, a means by which factors that were excluded from enumeration may be considered. It is to be hoped that the subsection will be used in positive ways, as, for instance, to allow for consideration of the future earning capacities of the spouses, a notable omission from the enumerated factors.

20. In any event, subsection (j) of the statute requires a court to make "written findings of fact that support the determination that the marital property has been equitably divided." N.C. GEN. STAT. § 50-20(j) (Cum. Supp. 1981).

21. It has apparently provided little more than this in Arkansas and Wisconsin, *supra* note 18, where fairly unequal divisions of property have been upheld. *See, e.g.*, Forsgren v. Forsgren, 630 S.W.2d 64 (Ark. Ct. App. 1982); Roberto v. Brown, 107 Wis. 2d 17, 318 N.W.2d 358 (1982); Jasper v. Jasper, 107 Wis. 2d 59, 318 N.W.2d 792 (1982).

22. Without such a date certain, "[m]eaningful settlement discussions would be virtually impossible; trials would be lengthened; fees for experts would skyrocket as they assimilate the necessary data to have an opinion on the fair market value of the numerous items of marital property on any number of dates . . . ." *In re* Marriage of Taylor, — Ind. App. —, —, 425 N.E.2d 649, 650 (1981).

to have been "acquired during the marriage."[23] This date will normally be used for evaluation of assets, at least in the absence of some stipulation to a different date by the parties.[24] In no jurisdiction has mere physical separation of the parties been deemed sufficient for either purpose.[25] Common "cut-off" points include the date of legal separation, filing of an action, time of trial, or time of divorce.[26] Various provisions of the North Carolina statute suggest that marital property may continue to be acquired in this state until an action for equitable distribution is filed.[27]

Another potential difficulty with North Carolina's definition of marital property is that subsection (b)(1) omits property acquired by "both" parties.[28] This should not, however, be interpreted as an intention to exclude jointly held property from equitable division. With one exception,[29] all common-law states have held that all jointly held property is subject to distribution.[30] One

23. *See infra* note 26. *But see* Schamber v. Schamber, 41 Mich. App. 589, 200 N.W.2d 454 (1972); Berish v. Berish, 69 Ohio St. 2d 318, 432 N.E.2d 183 (1982) (courts refusing to set any rules to determine when the marriage ceased, preferring to leave the matter within the discretion of the trial judge).

24. *See, e.g., In re* Marriage of Taylor, — Ind App. —, 425 N.E.2d 649 (1981). *See also* cases cited *infra* at note 26.

25. *See* Bussell v. Bussell, 623 P.2d 1221 (Alaska 1981); Stallings v. Stallings, 606 S.W.2d 163 (Ky. 1980); Murano v. Murano, — N.H. —, 442 A.2d 597 (1982).

26. New Jersey case law on this issue is particularly well developed, since its statute does not specify a date for valuation or cut-off of asset accumulation. The leading case is Brandenburg v. Brandenburg, 167 N.J. Super. 256, 400 A.2d 823 (App. Div. 1979), *rev'd on other grounds*, 83 N.J. 198, 416 A.2d 327 (1980). *See also In re* Marriage of Moffatt, 279 N.W.2d 15 (Iowa 1979) (time of trial or divorce); Painter v. Painter, 65 N.J. 196, 320 A.2d 484 (1974); Fletcher v. Fletcher, 615 P.2d 1218 (Utah 1980) (time of divorce decree); Holbrook v. Holbrook, 103 Wis. 2d 327, 309 N.W.2d 343 (1981); Storm v. Storm, 470 P.2d 367 (Wyo. 1970) (time complaint is filed). Colorado, Illinois, Kentucky, Maine, and Missouri exclude from division any property acquired by a spouse after a legal separation. COLO. REV. STAT. § 14-10-113(2)(c) (1973); ILL. ANN. STAT. ch. 40, § 503(a)(3) (Smith-Hurd 1980); KY. REV. STAT. § 403.190(2)(c) (Supp. 1980); ME. REV. STAT. ANN. tit. 19, § 722A(2)(c) (1981); MO. REV. STAT. § 452.330(3) (Vernon Cum. Supp. 1981). New York defines marital property as "all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action." N.Y. DOM. REL. L. § 236.1.c (McKinney Supp. 1981-82).

27. G.S. 50-21 states that "[u]pon application of a party to an action for divorce, an equitable distribution of property shall follow a decree of absolute divorce." N.C. GEN. STAT. § 50-21 (Cum. Supp. 1981). The section causes obvious confusion. Apparently, a party may only file for equitable distribution when he or she files for divorce; G.S. 50-20(k) indicates that the rights of the parties to distribution of marital property vest "at the time of the filing of the divorce action." It is unclear, however, if one may file for equitable distribution at the time of filing for a divorce from bed and board (which requires no set separation period) or only at the time of filing for an absolute divorce (which, under G.S. 50-6, the "no-fault" divorce statute, requires one year's waiting period).

28. N.C. GEN. STAT. § 50-20(b)(1) (Cum. Supp. 1981).

29. *See* Warren v. Warren, 273 Ark. 528, 623 S.W.2d 813 (1981) (construing ARK. STAT. ANN. § 34-1214 (Supp. 1981)). *Warren* held that the 1979 Arkansas equitable distribution act was not applicable to property owned as tenants by the entirety. Arkansas, however, has a peculiar history surrounding entireties property. *See* Davies v. Johnson, 124 Ark. 390, 187 S.W. 323 (1916).

30. The decision most directly on point is Kobylack v. Kobylack, 110 Misc. 2d 402, 442 N.Y.S.2d 392 (Sup. Ct. 1981) (construing N.Y. DOM. REL. L. § 236, pt. B(5)(d)(6) (McKinney Supp. 1981)). *See also* Grant v. Grant, 424 A.2d 139 (Me. 1981) (ME. REV. STAT. ANN. tit. 19, § 722A(3) (1981) (defines marital property as property acquired by "either" spouse, just as does the North Carolina statute); Corder v. Corder, 546 S.W.2d 798 (Mo. 1977) (error not to divide jointly held property equitably); Sanders v. Sanders, 118 N.J. Super. 327, 287 A.2d 464 (1972) (construing N.J. STAT. ANN. 2A-34-23 (West Supp. 1981)).

court that specifically addressed the issue concluded that in "light of the intention of the legislature in enacting the equitable distribution law, the failure to expressly include jointly owned realty as an item which may be equitably distributed must be deemed an oversight. For otherwise the very intention of the legislature could be subverted."[31] Exempting jointly held property from distribution would, in the majority of cases, leave virtually nothing for a court to distribute.[32]

## III. SEPARATE PROPERTY

### *A. Introduction*

The most unique feature of the North Carolina statute is the broad definition of separate property in subsection (b)(2).[33] Seven different types of separate property are enumerated: (1) property acquired before marriage, (2) property acquired by bequest, devise, descent, or gift during the marriage, except that "property acquired by gift from the other spouse during the course of the marriage shall be considered separate property only if such an intention is stated in the conveyance," (3) property acquired in exchange for separate property, "regardless of whether the title is in the name of the husband or wife or both," (4) increases in value of separate property, (5) income derived from separate property, (6) all "professional licenses and business licenses which would terminate on transfer," and (7) "vested pension or retirement rights and the expectation of nonvested pension or retirement rights."[34]

This section thus creates, by definition alone, a smaller pool of assets subject to division than any other state in the union. It is in this light that the equal presumption could take on somewhat ominous proportions, since an equal division of a negligible pool of marital assets could be quite inequitable. The potential for unjust results is at least partially mitigated by subsection (c), under which four of the types of separate property are listed as "factors" to be considered in making an equitable distribution.[35] These discretionary factors, however, will be of limited or no utility as a means of effecting truly equitable divisions of property if the pool of marital assets is, as it is apt to be in North Carolina, small or nonexistent in the first instance.[36]

Moreover, even this elaborate definition of separate property does not ad-

31. Kobylack v. Kobylack, 110 Misc. 2d at —, 442 N.Y.S.2d at 394.

32. A fine study recently conducted in California concluded that the typical divorcing couple had a total net worth of only $10,900. Only 12% had assets of $100,000 or more. The family home was the major community asset for almost half of divorcing couples. Weitzman, *The Economics of Divorce: Social and Economic Consequences of Property, Alimony and Child Support Awards*, 28 U.C.L.A. L. REV. 1181, 1191-94 (1981).

33. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

34. *Id.*

35. *Id.* § 50-20(c). These assets include pension rights, and contributions to the education of a spouse, to increases in value of separate property, and to acquisition of certain kinds of property.

36. In 1979 North Carolina ranked 41st nationwide in median family income. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 441 (1981). *See also* Weitzman, *supra* note 32, at 1188.

dress adequately many of the issues that have been particularly troublesome in other states and that are likely to cause even greater interpretative difficulties in North Carolina. The answers that courts ultimately give to some of these issues could do much to redress the imbalance created by the extraordinarily narrow definition of marital property. Fortunately, there is sufficient ambiguity in statutory terms such as "acquired during marriage" or "increase in value" to allow courts the opportunity to mitigate the inequitable results that are otherwise likely to be created in North Carolina.

### *B. Property Acquired Before Marriage*

All classification-based states, including community property jurisdictions, exclude from marital property any property acquired by a spouse prior to marriage.[37] The apparently straightforward language exempting such property is, however, somewhat deceptive. In particular, it does not resolve one of the most difficult and most frequently encountered problems that arises in a property division context: when does "acquisition" of property occur? Consider the common situation in which one spouse acquires legal title before marriage but mortgage payments are made from marital funds throughout a period of years.[38] Is the house to be classified as separate or marital property?

There are basically three options for courts confronted with this all too frequent situation. The older, and currently less well regarded, approach uses the "inception of title" theory, under which the status of property as either marital or separate is permanently fixed at the time title is acquired, regardless of the subsequent use of marital funds to pay for or improve it.[39] This approach is much more common to community property states,[40] although it has recently been adopted in Missouri, a common-law jurisdiction.[41]

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37. *See supra* note 11. These statutory provisions have also been interpreted to exclude property acquired before marriage but during the time when parties were living with each other. *See, e.g.*, Grisham v. Grisham, 407 A.2d 9 (Me. 1979), Smith v. Smith, 497 S.W.2d 418 (Ky. 1973).

38. A similar problem is created when property is bought after marriage but with a down payment made from separate funds. *See* Comment, *supra* note 3, at 1380.

39. Krauskopf, *Marital Property at Marriage Dissolution*, 43 MO. L. REV. 157, 180 (1978). *See also* W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 130-31 (2d ed. 1971), in which the authors point out that this approach actually creates a presumption, rebuttable by showing that the asset was intended to be community property once the marriage took place.

40. *See, e.g.*, Kingsbery v. Kingsbery, 93 Ariz. 217, 379 P.2d 893 (1963); Fisher v. Fisher, 86 Idaho 131, 383 P.2d 840 (1963); Michelson v. Michelson, 89 N.M. 282, 551 P.2d 638 (1976); Baker v. Baker, 80 Wash. 2d 736, 498 P.2d 315 (1972).

41. Cain v. Cain, 536 S.W.2d 866 (Mo. Ct. App. 1976). In *Cain*, the husband bought farm property (worth $565,000 at the time of divorce) a few months before marriage for a down payment of $20,000. Despite the fact that 85% of the total payments for its purchase were derived from marital funds, the property was held to be the husband's separate property. The *Cain* court reasoned that a contrary result would mean that the property had not been "acquired" until it was paid for. *See also* Stark v. Stark, 539 S.W.2d 779 (Mo. Ct. App. 1976) (similar judicial conclusion reached when a joint mortgage obligation was created after marriage on property husband had owned prior to the marriage).

It is possible that the inception of title rule has also been adopted in the District of Columbia. In Brice v. Brice, 411 A.2d 340 (D.C. 1980), the court held that a home bought two months before marriage remained the separate property of the husband despite the fact that payments for it were made throughout the ten-year marriage. In Darling v. Darling, 444 A.2d 20 (D.C. 1982), how-

In a majority of states adopting the inception of title theory, the nonowning spouse is entitled to reimbursement for the community funds used to complete the acquisition,[42] but such reimbursement does not normally include a portion of the increased value of the property.[43] Even reimbursement is apparently unavailable in Missouri, where the use of marital funds to satisfy the indebtedness on the separate property acquired before marriage is only a "factor" to be considered in making a distribution of marital property.[44] In either event, it could be argued that the nonowner spouse had made a gift of marital property to the separate estate of the other.[45]

A reasonable basis exists, however, for rejecting the inception of title rule in North Carolina. G.S. 50-20(b)(2) states in part that "property acquired by gift from the other spouse during the course of the marriage shall be considered separate property only if such an intention is stated in the conveyance."[46] Since the application of marital funds to satisfy indebtedness on separate property would virtually never satisfy this statutory requirement, the funds so used should be considered *marital* property, not a gift to the other spouse.[47] In short, adoption of the inception of title rule would seem to contravene the express statutory presumption that ordinary interspousal gifts are marital property.[48]

A generally less rigid and better accepted resolution of this problem is provided by the "source of funds" rule. Under this approach, property is deemed to have been acquired as it is paid for, so that it includes both marital and separate ownership interests.[49] The source of funds rule has been particularly well developed in California:

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ever, the court held that the contribution of the wife's efforts in her husband's separately owned business had transmuted the property to marital.

42. W. DEFUNIAK & M. VAUGHN, *supra* note 39, at 133. *See also* Comment, *supra* note 3, at 1377.

43. *See* Comment, *supra* note 3, at 1377. The result is that the marital community has in effect made an interest-free loan to the separate estate of one spouse throughout the marriage.

44. Stark v. Stark, 539 S.W.2d 779 (Mo. Ct. App. 1979). It should be noted that the Missouri statute lists as a factor to be considered in property distribution "[t]he contribution of each spouse to the acquisition of the marital property, including the contribution of a spouse as a homemaker." MO. REV. STAT. § 452.330.1(1) (Cum. Supp. 1981). The North Carolina provision is similar. *See supra* note 16. In *Stark*, however, the property was *separate*, not marital, so that reimbursement was clearly not an option foreclosed by the statute. Had the property at issue in *Stark* constituted the only major asset of the parties, there presumably would have been no source from which the nontitled spouse could have been adequately compensated.

45. Such a result would not be uncommon under community property law. *See* Schwartz v. Schwartz, 52 Ariz. 105, 79 P.2d 501 (1938); Overton v. Benton, 60 N.M. 348, 291 P.2d 636 (1955).

46. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

47. As the Supreme Court of Illinois concluded in a similar situation, "[i]t may be anachronistic now to refer to an intent to convey a gift to the other spouse, but it is not improper to refer to an intent to convey a gift to the marriage." *In re* Marriage of Rogers, 85 Ill. 2d 217, 223, 422 N.E.2d 635, 638 (1981). *See also In re* Marriage of Emken, 86 Ill. 2d 164, 166, 427 N.E.2d 125, 126 (1981).

48. For further discussion of the interspousal gift provision, *see infra* text accompanying notes 104-10. At a minimum it would seem that the interspousal gift provision requires that the marital estate receive reimbursement for use of marital funds to reduce indebtedness on separately owned property.

49. Krauskopf, *supra* note 39, at 180.

> If community funds are used to pay part of the purchase price on property acquired by one spouse prior to marriage, the property cannot be considered wholly community . . . . The community has a *pro tanto* interest in such property in the ratio that the payments on the purchase price made with community funds bears to the payments made with separate funds . . . . 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.[50]

The source of funds rule is premised on the realities of marital relationships, and on the proposition that it is fundamentally unfair to allow a spouse to claim, upon divorce, that property is separate when the property was clearly regarded as marital throughout the marriage.[51] It is also rooted in what has been characterized as a "dynamic" rather than static interpretation of the term acquisition.[52] In *Tibbetts v. Tibbetts*,[53] for example, the Supreme Court of Maine debated the relative merits of the inception of title and source of funds rules and concluded that:

> Where the marital estate chooses to invest its funds in certain property together with non-marital funds, . . . . in fairness to both spouses "acquisition" must not arbitrarily and finally be fixed on the date that a legal obligation to purchase is created . . . . Rather, "acquisition" should be recognized as the on-going process of making payment for acquired property.[54]

Such reasoning has apparently persuaded a growing number of classification-based states to adopt the source of funds theory in this context and in other situations as well.[55] Most notably, the Court of Appeals of Maryland has adopted this approach recently, relying upon the *Tibbetts* concept of acquisition as an ongoing process.[56]

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50. *In re* Marriage of Jafeman, 29 Cal. App. 3d 244, 256-57, 105 Cal. Rptr. 483, 491 (1972). *See also In re* Marriage of Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980).

51. It has been persuasively argued that marital property law does affect the behavior of spouses during marriage and that a system that dictates

> [t]hat a married person behave as if unmarried with respect to certain choices or suffer the consequences of subsequent property disadvantage for not doing so . . . works to reward self-interested choices which can be detrimental to the continuation of the marriage. At the same time it punishes conduct of accommodation and compromise so important to furthering and preserving the relationship.

Prager, *supra* note 3, at 12. If marital partnership is the ideal that the law should seek to foster, incentives to sharing should be encouraged, while incentives to the diversion of marital funds to the aggrandizement of separate property should be minimized.

52. Tibbetts v. Tibbetts, 406 A.2d 70, 75 (Me. 1979).

53. *Id.*

54. *Id.* at 77.

55. *See, e.g.*, Newman v. Newman, 597 S.W.2d 137 (Ky. 1980); Schmitz v. Schmitz, 309 N.W.2d 748 (Minn. 1981); Scherzer v. Scherzer, 136 N.J. Super. 397, 356 A.2d 434 (1975); *In re* Marriage of Gerlitz, 50 Or. App. 443, 623 P.2d 1088 (1981). *See also* discussion of increases in value *infra* text accompanying notes 81-88.

56. Harper v. Harper, — Md. App. —, 448 A.2d 916 (1982). In *Harper* the husband contended that a tract of land, bought before but paid for during a 29 year marriage, plus a house built on the land, were separate property. The court of appeals concluded that only the source of funds theory and a fluid definition of the term "acquired" were consistent with the Maryland statutory scheme.

The source of funds approach is, moreover, remarkably simple to apply. The courts of Kentucky, for example, have reduced proportionment of marital and separate shares to an easy and workable formula,[57] in which the ratio between the nonmarital contribution[58] and the total contribution, multiplied by the total equity, equals the nonmarital property proportion. Similarly, the ratio between the marital contribution[59] and the total contribution, multiplied by the total equity, yields the marital proportion. The ultimate ratio of separate to marital property simply reflects the relative contributions of the spouses to the property's acquisition.[60]

In view of the North Carolina rule that increases in value of separate property shall be separate,[61] it is also important to realize that this use of the source of funds theory does not result in the treatment of increases in the value of *separate* property as marital. Rather, the marital partnership is deemed simply to share in increases in value of property that *it* has proportionately acquired in its own right.[62] Furthermore, the source of funds approach appears to give a flexible and reasonable definition of the term "acquired" that fully comports with the expectations of parties to marriage and that steers a middle course between the inception of title rule and what is yet a third approach to this problem, the "transmutation through commingling" theory. The transmutation theory of equitable distribution is particularly well developed in Illinois,[63] although it is not unique to that state.[64]

After numerous and hopelessly contradictory decisions from the courts of

57. *See* Woosnam v. Woosnam, 587 S.W.2d 262 (Ky. Ct. App. 1979); Brandenburg v. Brandenburg, 617 S.W.2d 871 (Ky. Ct. App. 1981).

58. The Kentucky Court of Appeals in *Brandenburg v. Brandenburg* defined nonmarital contributions as "the equity in the property at the time of the marriage, plus any amount expended after marriage by either spouse from traceable nonmarital funds in the reduction of mortgage principal, and/or the value of improvements made to the property from such nonmarital funds." 617 S.W.2d at 872.

59. The marital contribution is defined as "the amount expended after marriage from other than nonmarital funds." *Id.*

60. Thus, a $20,000 marital contribution divided by a $50,000 total contribution, the quotient multiplied by a $100,000 total equity, would yield a marital property share of the property of $40,000. That marital share would then be subject to division in a manner that the court deems equitable. If it is equally divided, then the titled spouse would receive $60,000 (nonmarital share) plus $20,000 (marital share) for a total of $80,000.

61. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

62. By the same logic, G.S. 50-20(c)(8), which lists as a distributional factor "[a]ny direct contribution to an increase in value of separate property," should likewise not be interpreted to bar the adoption of the source of funds rule in North Carolina. For further discussion see *infra* text accompanying notes 92-96.

63. Illinois also applies the approach to sole proprietorships and closely held corporations to which marital funds or efforts have been contributed. *See, e.g.*, Westphal v. Westphal, 99 Ill. App. 3d 1042, 426 N.E.2d 303 (1981); cases cited *supra* at note 54. *See also In re* Marriage of Kennedy, 94 Ill. App. 3d 537, 418 N.E.2d 947 (1981) (finding insufficient evidence of commingling to transmute an entire business to marital property, but nonetheless finding that the stores acquired after the marriage were marital property, while those held at the time of the marriage remained separate).

64. *See, e.g.*, *In re* Marriage of Altman, 35 Colo. App. 183, 530 P.2d 1012 (1974) (rejecting husband's argument that a home he bought in his name a few days prior to marriage was separate property and holding instead that it was marital property). *See also* Darling v. Darling, 444 A.2d 20 (D.C. 1982) (holding that wife's efforts in her husband's separately owned business had transmuted it to marital property).

appeals,[65] the Supreme Court of Illinois rejected both the inception of title rule and the mixed title approach inherent in the source of funds rule.[66] It relied instead on the community property doctrine of transmutation[67] to hold that when property that is held in the name of one spouse is commingled with marital property or with nonmarital property of the other spouse, the resulting asset is presumptively marital property in its entirety.[68]

Because other states have made extensive use of the transmutation theory, particularly in the context of gifts, when marital and nonmarital assets are commingled,[69] the logic upon which the Illinois Supreme Court rested its conclusion warrants careful analysis. It reasoned first that the presumption of marital property and the underlying purposes of equitable distribution evinced a legislative preference for the classification of property as marital.[70] More significantly, it concluded that, although the Illinois statute clearly intended that separate property should be allowed to retain its separate character, the "affirmative act of augmenting nonmarital property by commingling it with marital property" was indicative of an intent to transmute such separate property to marital.[71] As a lower court had previously concluded:

> To hold that where one spouse owned the residence prior to marriage, the residence is nonmarital property of which the other spouse is entitled to nothing despite significant contributions is to guarantee an unequitable distribution of property in contravention of the purpose of the statute. Further, such a reading of the statute would have the anomalous effect of transforming marital property into nonmarital property . . . . We do not believe the legislature intended to create such a loophole from which manifestly inequitable results could frequently occur.[72]

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65. *See, e.g.*, *In re* Marriage of Atkinson, 82 Ill. App. 3d 617, 402 N.E.2d 831 (1980). *In re* Marriage of Dietz, 76 Ill. App. 3d 1029, 395 N.E.2d 762 (1979); *In re* Marriage of Key, 71 Ill. App. 3d 727, 389 N.E.2d 963 (1979); Klingberg v. Klingberg, 68 Ill. App. 3d 513, 386 N.E.2d 517 (1979).

66. *In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981). *See also In re* Marriage of Lee, 87 Ill. 2d 64, 430 N.E.2d 1030 (1981).

67. Transmutation refers to a change in the character of property from separate to marital, based upon agreement, either express or implied, or upon a gift between the spouses. *See* Stockdale v. Stockdale, — Idaho —, 643 P.2d 82 (1982). Probably the most common means of transmutation is commingling of marital and separate assets.

68. *In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981). *See also In re* Marriage of Lee, 87 Ill. 2d 64, 430 N.E.2d 1030 (1981) (holding that improvements to separate property evidenced an intent to transmute); *In re* Marriage of Emken, 86 Ill. 2d 164, 427 N.E.2d 125 (1981) (depositing separate funds into joint account transmuted property to marital); *In re* Marriage of Jones, 104 Ill. App. 3d 490, 432 N.E.2d 1113 (1982) (commingling of separate and marital businesses transmuted them to marital property).

69. *See, e.g.*, *In re* Marriage of Altman, 35 Colo. App. 183, 530 P.2d 1012 (1974); Darling v. Darling, 444 A.2d 20 (D.C. 1982); Harper v. Harper, — Md. App. —, 448 A.2d 916 (1982).

70. *In re* Marriage of Smith, 86 Ill. 2d 518, 531, 427 N.E.2d 1239, 1245 (1981). It also relied upon the use of the definite article in the phrase "*the* marital property" to indicate a legislative intent to adopt a "unitary" concept of property. *Id.* at 530, 427 N.E.2d at 1245. Thus separate property cannot be "traced out" of transmuted property in Illinois. *Id.* The unitary property concept has also been used in a different context in Missouri. *See* discussion *infra* at note 80.

71. 86 Ill. 2d at 532, 427 N.E.2d at 1246.

72. *In re* Marriage of Lee, 88 Ill. App. 3d 1044, 1047, 410 N.E.2d 1183, 1185 (1980), *aff'd*, 87 Ill.2d 64, 430 N.E.2d 1030 (1981).

Separate property contributions may not, of course, be "traced out" of property that has become marital.[73] Nonetheless, as the Illinois Supreme Court has recognized, the possibilities for inequitable results are far less with its solution than with the inception of title approach: "even where the contribution of one partner is insignificant, the possibility of the ultimate property division being inequitable is far less where commingled property is presumed marital rather than nonmarital, since the pool of marital property available for division is greater."[74]

In summary, three theories have evolved for classification of property to which legal title is taken before marriage but which is paid for during marriage with marital funds. Both the transmutation and source of funds approaches are consistent with the probable intentions of parties during marriage and with the general goal of fairness implemented by the equitable distribution scheme. The inception of title rule, on the other hand, has little to offer beyond a literalistic interpretation of the word "acquired." This is especially true in North Carolina, where the opportunities for genuinely equitable distributions of property are already severely curtailed by the narrow definition of marital property, and where interspousal gifts, including the use of marital funds to augment separate property, are presumptively marital in any case.[75] Adoption of a source of funds approach would create the opportunity to increase the available pool of marital assets in a manner consistent with the intentions of the parties and the legislature, and the underlying purposes of the statute.[76]

### C. *Increases in Value of Separate Property*

The issues raised with classification of increases in value of separate property are very similar to those encountered with property acquired before marriage. Here, however, the focus is on increases in value of property that was paid for or acquired in such a manner as to leave no doubt about its wholly separate character.[77] In the great majority of common-law classification-based states, only the increase in value of property that was acquired before

73. The "unitary" concept of property in Illinois mandates this result. *See supra* note 69. *See also In re* Marriage of Cleveland, 99 Ill. App. 3d 293, 425 N.E.2d 475 (1981); Klingberg v. Klingberg, 68 Ill. App. 3d 513, 386 N.E.2d 517 (1979).

74. *In re* Marriage of Smith, 86 Ill. 2d 518, 531, 427 N.E.2d 1239, 1245 (1981). Moreover, under Illinois statutory law, one of the factors to be considered in distribution is the "contribution or dissipation of each party in the acquisition . . . of the marital and nonmarital property." ILL. ANN. STAT. ch. 40, § 503(c)(1) (Smith-Hurd 1980).

75. *See* discussion *supra* text accompanying notes 7-14.

76. Nothing contained in G.S. 50-20 stands in the way of such an interpretation. Subsection (c)(6), directing the court to consider as a factor in the division of property "[a]ny equitable claim to, interest in, or direct or indirect contribution made to the acquisition of such marital property by the party not having title," cannot be interpreted as a contrary directive, since it speaks only to such contributions to the acquisition of "marital property." N.C. GEN. STAT. § 50-20(c)(b) (Cum. Supp. 1981).

77. There is, of course, a considerable overlap between these two areas, but the characterization of the increased value of an asset does not affect the underlying classification of the asset itself.

marriage is treated as separate property.[78] Under the North Carolina statute, in contrast, all increases in value of *all* separate properties are immune from distribution.[79] Regardless of whether the exclusion extends to increases in value of all or only certain types of separate property, the underlying issues are the same.

The three approaches used to classify property acquired before marriage can also be used to determine the status of increases in value of separate property. In practice, however, a fairly uniform treatment of such increases has evolved in both common-law and community property states. Missouri appears to be the only common-law state to hold that the entire increase in value of property acquired before marriage remains separate, regardless of the source of that increase.[80]

The overwhelming majority of classification-based states, however, have adopted a less rigid approach to increases in value. Using what is essentially a source of funds analysis, they draw a common-sense distinction between increases in value due to general economic factors, such as inflation, and increases due to the contributions, monetary or otherwise, from the marital unit or the nontitled spouse.[81] Increases in value that are attributable solely to

78. *See, e.g.*, DEL. CODE ANN. tit. 13, § 1513(b)(3) (1981) (excluding the "increase in value of property acquired prior to the marriage"); ILL. ANN. STAT. ch. 40, § 503(a)(5) (Smith-Hurd 1980) (excluding "increase in value of property acquired before the marriage"); KY. REV. STAT. § 403.190(2)(e) (Cum. Supp. 1980) (excluding from marital property increases in value of property acquired before marriage "to the extent that such increases in value of property did not result from the efforts of the parties during marriage"); ME. REV. STAT. ANN. tit. 19, § 722A(2)(E) (1964) ("increase in value of property acquired prior to the marriage"); MO. REV. STAT. § 452.330.2(5) (1977 & Supp. 1982) ("increase in value of property acquired prior to the marriage"). The New York statute includes a similar provision: separate property includes "property acquired in exchange for or the increase in value of separate property, except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse." N.Y. DOM. REL. LAW § 236 (d)(3) (McKinney Supp. 1981).

79. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981). Since community property states also provide for some increases in the value of separate property to be marital property, North Carolina would appear to be the only state in the union with such a sweeping definition of increases in value as separate property. See W. DEFUNIAK & M. VAUGHN, *supra* note 39, at 170-71 for a discussion of the community property rules regarding increases in value of separate property. *See also* discussion *infra* text accompanying notes 86-88.

80. Hull v. Hull, 591 S.W.2d 376 (Mo. Ct. App. 1979). In *Hull*, the court of appeals concluded that the "statutory directives for identification of marital and nonmarital property do not . . . contemplate any subclassification whereby an asset in part partakes of the attributes of nonmarital property and in part is considered marital property." *Id.* at 381. Therefore, the entire increase in value of property acquired before marriage was held to be separate. The holding is, of course, consistent with the inception of title rule previously adopted in Missouri. *See supra* note 41. *See also* Null v. Null, 608 S.W.2d 568 (Mo. Ct. App. 1980) (holding that separate real property remained separate despite the fact that its value was increased by the use of marital funds and efforts in constructing a house upon it).

81. *See, e.g.*, Cockrill v. Cockrill, 124 Ariz. 50, 601 P.2d 1334 (1979); Brandenburg v. Brandenburg, 617 S.W.2d 871 (Ky. Ct. App. 1981); Downs v. Downs, 410 So. 2d 793 (La. Ct. App. 1982); Schmitz v. Schmitz, 309 N.W.2d 748 (Minn. 1981); Johnson v. Johnson, 89 Nev. 244, 510 P.2d 625 (1973); Mol v. Mol, 147 N.J. Super. 5, 370 A.2d 509 (App. Div. 1977); Jolis v. Jolis, 111 Misc. 2d 965, 446 N.Y.S.2d 138 (Sup. Ct. 1981); Moyers v. Moyers, 372 P.2d 844 (Okla. 1962); *In re* Marriage of Gerlitz, 50 Or. App. 443, 623 P.2d 1088 (1981); Leeper v. Leeper. 301 N.W.2d 154 (S.D. 1981); Wachendorfer v. Wachendorfer, 615 S.W.2d 852 (Tex. Civ. App. 1981). *See also* Tibbetts v. Tibbetts, 406 A.2d 70 (Me. 1979), discussed *supra* text accompanying notes 52-54. As one recent Iowa opinion concluded, "[t]he underlying premise of our analysis is that an equitable property division of the appreciated value of the property should be a function of the tangible

external economic factors, and therefore result in no depletion of the marital estate, are deemed separate property. On the other hand, increases that result from contributions that belonged to and which would otherwise have augmented the marital estate are held to be marital property.[82] In Illinois such increases in value are said to result from a commingling of marital and separate property, so that if the marital contribution is sufficiently substantial, the entire asset is rebuttably presumed to be transmuted to marital property.[83] This transmutation result has also been reached in the District of Columbia.[84] More often, increases in value derived from joint efforts are regarded as property acquired by both spouses during the marriage.[85]

In either instance, the critical inquiry is whether the marital contribution is sufficiently substantial to warrant inclusion of the increase in value, or inclusion of the entire asset, as marital property.[86] In community property states, this has been termed the "all or nothing" approach, since increases in value would either be entirely separate or entirely marital property.[87] In fact, most increases in value derive from both general economic factors (that is, from the separate property itself) and from marital contributions. In recognition of this, several states, including at least two community property jurisdictions, apportion the increase in value between the marital and separate estates based on the relative contribution of each to the increase.[88]

Despite the apparently absolute language of G.S. 50-20(b)(2), the source of funds approach is a viable option for classification of increases in value of separate property in North Carolina. The distinction drawn by the great ma-

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contributions of each party. . . ." *In re* Marriage of Lattig, 318 N.W.2d 811, 815 (Iowa Ct. App. 1982).

82. Of course, if separate property is increased in value through the use of separate funds, the increase would remain separate under this analysis.

83. *In re* Marriage of Lee, 87 Ill. 2d 64, 430 N.E.2d 1030 (1981). In *Lee* a residence owned by the husband prior to marriage was improved with $20,000 in marital funds. The court rejected his argument that this fell within the statutory exclusion from marital property. *See also In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981).

84. Darling v. Darling, 444 A.2d 20 (D.C.1982) (holding that husband's separate business had become marital due to wife's substantial contributions to it).

85. See cases cited *supra* note 81.

86. *See, e.g., In re* Marriage of Kennedy, 94 Ill. App. 3d 537, 418 N.E.2d 947 (1981); Jolis v. Jolis, 111 Misc. 2d 965, 446 N.Y.S.2d 138, 147 (Sup. Ct. 1981) (holding wife's efforts at increasing the value of husband's stock in separate business were "indirect" and not substantial); Jensen v. Jensen, 629 S.W.2d 222 (Tex. Civ. App. 1982). The Oklahoma Court of Appeals has stated that increases in value are only to be considered marital property if there is proof of "(1) significant repairs which materially enhance life expectancy of asset; (2) improvements made which materially contribute to increase in value; and (3) material increase in equity since marriage [not due solely to inflation]." Bowman v. Bowman, 639 P.2d 1257, 1260 (Okla. Ct. App. 1981).

87. *See* cases cited *infra* note 88.

88. Cockrill v. Cockrill, 124 Ariz. 50, 601 P.2d 1334 (1979) (also abandoning the all or nothing rule and holding that the burden of proof is on the spouse who claims an increase is separate property to prove that such increase was not the product of marital efforts); *In re* Marriage of Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1981); Cord v. Neuhoff, 94 Nev. 21, 573 P.2d 1170 (1978); Johnson v. Johnson, 89 Nev. 244, 510 P.2d 625 (1973) (abandoning the old "all or nothing" rule whereby increases in value of separate property were either all marital or all separate). This is apparently also the rule in New York. *See* Kobylack v. Kobylack, 110 Misc. 2d 402, —, 442 N.Y.S.2d 392, 394 (1981) (judicial distribution of marital property based solely upon the "relative economic contributions" of the parties). As already noted, Kentucky has developed a workable apportionment formula. *See* discussion *supra* at notes 57-59 and accompanying text.

jority of states is, with two exceptions,[89] the product of judicial interpretation. It is based on the simple fairness principle that no distribution can be equitable unless it reflects on the contributions of each party.[90]

Subsection (c)(8) of the North Carolina statute, however, raises greater difficulties, because it lists "[a]ny direct contribution to an increase in value of separate property which occurs during the course of the marriage" as a factor to be considered in distribution.[91] The question thus arises whether a distributional factor should be used to expand the definition of separate property, that is, whether subsection (c)(8) should be interpreted to preclude a result otherwise allowable under G.S. 50-20(b)(2). Although the issue is a troublesome one, it is nonetheless possible to argue that this factor should not have such an effect.

As a general proposition, distributional factors should not take on the status of independent principles of law. They come into play *only* in the event that a judge decides that an equal distribution would not be equitable.[92] Thus, a decision to divide property equally requires only that marital and separate property be identified, and the North Carolina definition of separate property can easily accommodate the source of increased value distinction used in virtually all other states. Similar language in the Illinois statute has been held to mean only that "under the circumstances of a particular case, it is possible for one spouse to improve the other spouse's nonmarital property without making that property marital."[93]

Furthermore, the absence of any clear meaning of the word "direct" in subsection (c)(8) indicates that courts should be hesitant to interpret that factor in such a manner as to expand the definition of separate property.[94] For instance, although a straightforward interpretation of "direct" would appear to include the contribution by one spouse of funds used to enhance the value of property belonging to the other spouse, such a result would contravene the interspousal gift provisions of section (b)(2).[95]

A fully satisfactory resolution of the difficulties posed by subsection (c)(8) may require amendment of the statute. In the absence of such legislative action, however, it should be possible to limit the operation of this subsection to the situation in which one spouse's contribution to the increased value of the

89. These states are Kentucky and New York. *See supra* note 78.

90. *See, e.g., In re* Marriage of Lattig, 318 N.W.2d 811 (Iowa Ct. App. 1982).

91. N.C. GEN. STAT. § 50-20(c)(8) (Cum. Supp. 1981).

92. *See supra* notes 19-20 and accompanying text.

93. *In re* Marriage of Kennedy, 94 Ill. App. 3d 537, 547, 418 N.E.2d 947, 954-55 (1981) (construing ILL. ANN. STAT. ch. 40, § 503(c)(1) (Smith-Hurd 1980)).

94. Apparently no other state has drawn this distinction. The Texas Court of Appeals has drawn a distinction between increases in value derived from a nontitled spouse's labor (for which no reimbursement was allowed) and increases derived from the nontitled spouse's expenditure of separate funds. Hale v. Hale, 557 S.W.2d 614 (Tex. Civ. App. 1977). But this distinction appears to have been considerably weakened in Wachendorfer v. Wachendorfer, 615 S.W.2d 852 (Tex. Civ. App. 1981) (stating court could not say whether under Texas law a spouse could recover for his or her contribution of community labor to the enhanced value of the other spouse's separate property).

95. *See* discussion *supra* notes 46-47 and accompanying text.

other's separate property is not sufficiently substantial to warrant treatment of the increased value of the property, or the entire property itself, as marital.[96] An ambiguous distributional factor should not be allowed to foreclose an equitable interpretation of separate property otherwise permissible under the statute.

### *D. Property Acquired by Gift, Bequest, Devise, or Descent*

The exclusion from marital property of assets acquired by a spouse by bequest, devise, descent, or gift is common to virtually all classification-based states, including North Carolina.[97] Unlike gifts from a spouse, to which the exclusion is not applicable, gifts from third parties generally cause few difficulties. Wedding gifts, for instance, are normally presumed to be marital property, unless they are specifically earmarked for one spouse or are suitable for one spouse only.[98] Where a gift or devise is made to both spouses, it appears that title generally will control, so that the property thus acquired will be presumed to be marital.[99] The presumption may occasionally be overcome by proof of a contrary intent underlying the gift, devise, or bequest.[100]

Gifts between spouses present considerably more difficult issues. Beyond the normal problems associated with proof of the prerequisites of inter vivos gifts, however, an important issue within the interspousal gifts context is whether the gift becomes the separate property of the donee or marital property. Although some community property states consider interspousal gifts to be the separate property of the donee in certain circumstances,[101] the majority of common-law classification-based states presume that gifts between spouses are marital property.[102] This presumption may be overcome, usually by proof of lack of donative intent.[103]

G.S. 50-20(b)(2) also creates a presumption that gifts between spouses are

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96. *See* cases cited *supra* note 81.

97. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

98. *See, e.g.*, Darwish v. Darwish, 100 Mich. App. 758, 300 N.W.2d 399 (1980); Nehorayoff v. Nehorayoff, 108 Misc. 2d 311, 437 N.Y.S.2d 584 (1981); Avnet v. Avnet, 204 Misc. 760, 124 N.Y.S.2d 517 (1953).

99. *In re* Marriage of Lord, — Colo. App. —, 626 P.2d 698 (1980); Forsythe v. Forsythe, 558 S.W.2d 675 (Mo. Ct. App. 1977) (proceeds from $300,000 sale of property left to husband and wife by wife's parents held to be marital property). *But see* Grant v. Grant, 424 A.2d 139, 143 n.3 (Me. 1981) (holding that property devised to husband and wife as joint tenants was not subject to division; "title status produced through the instrumentality of a third party by way of 'gift, bequest, devise or descent' shall remain unaffected by the subsequent termination of a marriage").

100. *See, e.g.*, Hull v. Hull, 591 S.W.2d 376 (Mo. Ct. App. 1979); *In re* Marriage of Herron, 608 P.2d 97 (Mont. 1980).

101. *E.g.*, Schwartz v. Schwartz, 52 Ariz. 105, 79 P.2d 501 (1939); Overton v. Overton, 60 N.M. 348, 291 P.2d 636 (1955).

102. *See, e.g.*, *In re* Marriage of Altman, 35 Colo. App. 183, 530 P.2d 1012 (1974); Halsey v. Charlotte, 419 A.2d 962 (Del. Fam. Ct. 1980); *In re* Marriage of Emken, 86 Ill. 2d 164, 427 N.E.2d 125 (1981); Carter v. Carter, 419 A.2d 1018 (Me. 1980); Crawford v. Crawford, — Md. —, 443 A.2d 599 (1982); Conrad v. Bowers, 533 S.W.2d 614 (Mo. Ct. App. 1975); Winpenny v. Winpenny, — Pa. Super. —, 442 A.2d 778 (1982). *See also* N.Y. DOM. REL. L. § 236(d)(1) (McKinney Supp. 1981) (defining separate property to exclude interspousal gifts).

103. *See, e.g.*, Melvin v. Melvin, 270 Ark. 522, 606 S.W.2d 90 (1980); Singleton v. Singleton, 525 S.W.2d 642 (Mo. Ct. App. 1975).

marital property. This same provision also creates a restricted means whereby gifts may become the separate property of the donee: "the property acquired by gift from the other spouse during the course of the marriage shall be considered separate property only if such an intention is stated in the conveyance."[104]

Although this provision raises a number of issues,[105] it is at least relatively clear that most interspousal gifts will be presumed to be marital property. The ramifications of this are particularly significant when separate funds are deposited into a joint bank or savings account or are otherwise commingled with marital assets. In such instances, the general rule is that there has been a gift to the marital estate.[106] Even Missouri, an inception of title state, holds that commingling of marital and separate funds "is indicative of an intent on the part of the owner of [separate property] to contribute it to the marital estate."[107]

Whether North Carolina courts will adopt this rule depends on their interpretation, in light of the new statute, of a long line of cases which hold that placing funds into a joint account by one spouse does not constitute a gift to the other spouse.[108] Strictly speaking, such cases hold only that no gift to the separate estate of the other spouse was intended because the owner of the funds failed completely to divest himself of control over them.[109] This result is not inconsistent with the narrowly circumscribed circumstances under which a gift can be made to the separate estate of a spouse under the new statute. As other states have recognized, the control element is an inappropriate test of the intention to make a gift to the *marital* estate.[110] Therefore, existing North Carolina precedent would not seem to prohibit a finding that the deposit of

104. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

105. One of these problems is whether a separate gift can be made only by written conveyance, or whether, for instance, an oral gift of personalty made with appropriate language might suffice. A further issue is whether a gift to separate property can be made from marital property or only from separate property. In most common law states, a gift from marital property is not likely to lose its marital character. *See, e.g.*, Hemily v. Hemily, 403 A.2d 1139, 1143 (D.C. 1979) (holding that if "property initially was acquired as 'marital property' . . . it will remain so . . . , notwithstanding any subsequent interchange between the two spouses"). *See also In re* Marriage of Severns, 93 Ill. App. 3d 122, 416 N.E.2d 1235 (1981).

106. Wall v. Wall, 30 Cal. App. 3d 1042, 106 Cal. Rptr. 690 (1973); *In re* Marriage of Altman, 35 Colo. App. 183, 530 P.2d 1012 (1974); Darling v. Darling, 444 A.2d 20 (D.C. 1982); *In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981); Turley v. Turley, 562 S.W.2d 665 (Ky. Ct. App. 1978); Carter v. Carter, 419 A.2d 1018 (Me. 1980).

107. Jaeger v. Jaeger, 547 S.W.2d 207, 211 (Mo. Ct. App. 1977). *See also* Anderson v. Anderson, 584 S.W.2d 613 (Mo. Ct. App. 1979); Daniels v. Daniels, 557 S.W.2d 702 (Mo. Ct. App. 1977).

108. *E.g.*, Smith v. Smith, 255 N.C. 152, 120 S.E.2d 575 (1961). The supreme court held in *Smith* that "in the absence of evidence to the contrary, the person making a deposit in a bank is deemed to be the owner of the fund. If a husband deposits his own money in a bank and the money is entered upon the records of the bank in the name of the husband or his wife, it is still the property of the husband." *Id.* at 154-55, 120 S.E.2d at 578. The wife in such a situation is deemed her husband's agent, and not the joint owner of the funds. *See also* Overby v. Overby, 272 N.C. 636, 158 S.E.2d 799 (1968); McAuliffe v. Wilson, 41 N.C. App. 117, 254 S.E.2d 547 (1979).

109. *Smith*, 255 N.C. at 154-55, 120 S.E.2d at 578. *See also* Leatherman v. Leatherman, 297 N.C. 618, 624-25, 256 S.E.2d 793, 797 (1979).

110. *See* discussion *supra* note 102.

separate funds into a joint account constitutes a gift to the marital estate, particularly since the statute itself presumes such a result.

### *E. Property Exchanged for Separate Property*

Interspousal gift issues become considerably more complex when the gift is composed of property that was acquired in exchange for separate property. Many classification-based states, including North Carolina, define separate property to include any property "acquired in exchange for separate property."[111] A literal application of this rule would require that property exchanged for separate property be classified separate even if title to it were taken in the name of the nonowner spouse or by both spouses jointly.[112] Such an interpretation would have the effect of eliminating from marital property any gift between the spouses if the gift property could be traced, through exchanges, to separate property. No jurisdiction has been willing to hold that its legislature could have intended such an extraordinary result.

The issue has arisen most frequently when separate property has been exchanged for new property that is then transferred to the spouses as tenants by the entirety, and the transferor spouse claims that the property should, by virtue of the exchange exclusion, be considered separate property. The contention has been uniformly rejected. In the leading case of *Lucas v. Lucas*,[113] for instance, the California Supreme Court held that the "act of taking title in a joint and equal ownership form is inconsistent with an intention to preserve a separate property interest."[114] The Illinois Supreme Court also relied upon the affirmative act of placing title in joint names and the simultaneous failure

111. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981). It should be noted; however, that the North Carolina exclusion is again more sweeping than that of any other state. Illinois, Kentucky, Maine, and Missouri exclude from marital property only "property acquired in exchange for property acquired before the marriage or in exchange for property acquired by gift, bequest, devise or descent." ILL. ANN. STAT. ch. 40, § 503(a)(2) (Smith-Hurd 1980); KY. REV. STAT. § 403.190(2)(b) (Supp. 1980); ME. REV. STAT. ANN. tit. 19, § 722-A(2)(B) (1964); MO. ANN. STAT. § 452.330.2(2) (Vernon Supp. 1982). Delaware excludes only property acquired in exchange for property acquired prior to the marriage. DEL. CODE ANN. tit. 13, § 1513(b)(1) (1981). New York excludes "property acquired in exchange for or the increase in value of separate property, except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse." N.Y. DOM. REL. L. § 236(d)(3) (McKinney Supp. 1981-82). Pennsylvania excludes property "acquired in exchange for property acquired prior to the marriage except for the increase in value during the marriage." PA. STAT. ANN. tit. 23, § 401(e)(1) (Purdon Supp. 1982-83).

112. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981). This section states that "[p]roperty acquired in exchange for separate property shall be considered separate property regardless of whether the title is in the name of the husband or wife or both." The combination of a strict interpretation of this provision with an inception of title rule would be catastrophic. For example, if Husband buys a house with separate funds for $4,000 down, lives in it with Wife for 20 years, then sells it for $80,000, and reinvests that money in a second home, taken as tenants by the entirety, the second home would be the separate property of Husband.

113. 27 Cal. 3d 808, 614 P.2d 285, 166 Cal. Rptr. 853 (1980).

114. *Id.* at 815, 614 P.2d at 289, 166 Cal. Rptr. at 857. The court also held that only proof of a common agreement or understanding to the contrary would rebut the presumption that the specified ownership interest is intended. *See also In re* Marriage of Hayden, 124 Cal. App. 3d 72, —, 177 Cal. Rptr. 183, 185 (1981) (applying *Lucas* to joint bank accounts and stating that "since title to the family residence was taken as community property, the presumption of equal ownership arising therefrom may be overcome only by specific evidence showing a contrary agreement or understanding between the parties").

to preserve the separate nature of the exchanged property by segregating it, in holding that a marital home in joint tenancy is presumed "in fact" to be marital property.[115] The same conclusion has been reached in Colorado, Maine, New Jersey, and many other states.[116]

Significantly, even Missouri has joined the majority of states on this issue. In the leading case of *Conrad v. Bowers*,[117] the court concluded that "if the presumption of gift could be overcome merely by proof that the jointly held property had been acquired in exchange for separate property, then a spouse owning property prior to the marriage could exchange that property, place such exchanged property in joint names, and after many years of a happy marriage, defeat the right of the other spouse in such property. . . . We believe the general assembly could not have intended such a result."[118] The court went on to hold that the presumption of a gift to marital property could be overcome only when "(1) it is shown that the property acquired subsequent to the marriage was acquired in exchange for [separate] property . . . *and* (2) it is shown by clear and convincing evidence that the transfer was not in-

115. *In re* Marriage of Rogers, 85 Ill. 2d 217, 223, 422 N.E.2d 635, 638 (1981). *See also In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E. 2d 1239 (1981). In *Smith* the Illinois Supreme Court specifically addressed the exchange issue in these terms: "Clearly if after the exchange the property is segregated from the marital assets and held in the acquiring spouse's name alone . . . the property [will] be classified as nonmarital. Where, however, the spouse has failed to segregate the property during the marriage, we conclude that . . . [the property is marital]." *Id.* at 530, 427 N.E.2d at 1245.

Prior to the supreme court decisions in *Smith* and *Rogers*, a split of major proportions existed among the appellate courts in Illinois. One appellate court, for example, held that the new act had destroyed the presumption of gift between the spouses in this situation. *In re* Marriage of Dietz, 76 Ill. App. 3d 1029, 395 N.E.2d 762 (1979). *See also* In re Marriage of Preston, 81 Ill. App. 3d 672, 402 N.E.2d 963 (1980); *In re* Marriage of Key, 71 Ill. App. 3d 722, 389 N.E.2d 963 (1979). In *Rogers*, however, the Illinois Supreme Court held that the new Act did "not purport . . . to change the law regarding interspousal transfers of property owned individually. It does not indicate, by implication or otherwise, any dissatisfaction with prior cases in which the intention of a spouse conveying property was ascertained." 85 Ill. 2d at 222-23, 422 N.E.2d at 637. Therefore, the court concluded that "a marital residence owned by both spouses, even if one spouse has furnished all of the consideration for it out of nonmarital funds, will be presumed 'in fact' as marital property, absent convincing rebutting evidence." *Id.* at 223, 422 N.E.2d at 638.

116. In *In re* Marriage of Moncrief, 36 Colo. App. 140, 535 P.2d 1137 (1975), the court specifically rejected the husband's exchange argument and found that when a house bought with separate funds is placed in joint names, a gift to the marital estate will be presumed. The Supreme Court of Maine reached the same conclusion, relying on the common law presumption of gift and on the nature of marriage as a partnership. In Carter v. Carter, 419 A.2d 1018 (Me. 1980), the court concluded that a contrary result would require a court "to ignore the couple's recognition of their partnership and the fact of the joint tenancy by awarding all of the property to the spouse who originally provided funds for its purchase. If that were the result, the other spouse would be worse off than under the prior law despite the 'remedial' nature of the marital property statute, which was designed 'to provide a *more equitable* method of distributing property upon the termination of marriage.' " *Id.* at 1022-23 (quoting Fournier v. Fournier, 376 A.2d 100, 102 (Me. 1977) (emphasis in original)). *See also* Becehelli v. Becehelli, 17 Ariz. App. 280, 497 P.2d 396 (1972); Husband R.T.G. v. Wife G.K.G., 410 A.2d 155 (Del. 1979); Turpin v. Turpin, 403 A.2d 1144 (D.C. 1979); Canova v. Canova, 146 N.J. Super. 58, 368 A.2d 971 (1976) (discussed *infra* text accompanying note 122); May v. May, 596 P.2d 536 (Okla. 1979) (cotenants); Winpenny v. Winpenny, — Pa. Super. —, 442 A.2d 778 (1982) (per curiam) (personal property); Tyler v. Tyler, 624 P.2d 784 (Wyo. 1981).

117. 533 S.W.2d 614 (Mo. Ct. App. 1975).

118. *Id.* at 622.

tended as a . . . gift to the other spouse."[119]

Thus the unanimous conclusion of other states is that property acquired in exchange for separate property may retain its separate character *if* its owner so intends.[120] If, however, the owner of that substitute property makes a gift of it, by transferring ownership to a tenancy by the entirety, his intention at the time that estate is created must be controlling.[121] A contrary holding would, as a New Jersey court concluded, "make a nullity of every interspousal gift the funds for which could be traced to the funds owned by the donor."[122] Since most gift property can, by its very nature, be traced to some separate property source, the nonsensical result would be that only gifts *from* marital property traced to some separate property could be marital property, a result clearly not intended under the exchange provision of any state.

Unfortunately, the North Carolina exchange provision lends itself to just such an interpretation. Section (b)(2) states that "[p]roperty acquired in exchange for separate property shall be considered separate property regardless of whether the title is in the name of the husband or wife or both."[123] In *Mims v. Mims*,[124] a case involving a divorce granted before the effective date of the new statute, the North Carolina Supreme Court cautioned that it did not intend "definitely to construe" the interspousal gift or exchange provisions.[125] Nonetheless, it said in dicta that "in the context of a divorce and the 'equitable distribution' of all 'marital property' the legislature has opted for a rule that where land or personalty is purchased with the 'separate property' of either spouse, it remains the 'separate property' of that spouse regardless of how the title is made."[126] Application of the dictum in *Mims* would clearly have the

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119. *Id.*

120. In *In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981), for example, the Supreme Court of Illinois concluded that the exchange provision was a manifestation of "the legislative purpose to preserve the character of non-marital property in those situations *where the actions of the parties have not created ambiguity*." *Id.* at 530, 427 N.E.2d at 1245 (emphasis added).

121. In *In re* Marriage of Preston, 81 Ill. App. 3d 672, 402 N.E.2d 332 (1980), which was overruled in *In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981), Judge Kasserman disagreed with the majority's holding that property acquired in exchange for separate property retained its separate identity even though a transfer to joint title had been made. With persuasive logic he argued that:

> By what I believe to be an illogical line of reasoning the majority states that while the parties may intend to devote their separate property to their mutual welfare on a fifty-fifty basis in a 'functioning marriage,' when the 'union has faltered' either spouse may then disregard this intent and nullify a written transfer or conveyance of property. Such an approach to this problem lacks the adhesiveness of reason. While recognizing that a spouse whose funds are used to create a joint tenancy contemplates the marriage being a 'fifty-fifty proposition' at the time of the creation of the joint tenancy, the majority reached the conclusion that such spouse should be capable of extracting from the marriage any assets he is able to manipulate at the time of its dissolution . . . . The majority fails to recognize that in instances in which a spouse creates a joint tenancy, the intent of such spouse at the time of its creation is controlling.

81 Ill. App. 3d at 688, 402 N.E.2d at 344 (Kasserman, J., dissenting).

122. *Canova*, 146 N.J. Super. at 62, 368 A.2d at 973.

123. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

124. 305 N.C. 41, 286 S.E.2d 779 (1982).

125. *Id.* at 53, 286 S.E.2d at 787.

126. *Id.* In *Mims* the husband had purchased a house in the entireties with money he had

precise effect that all other states have deemed wholly unacceptable: interspousal "gifts" would in effect be subject to defeasance at the time of divorce if they could be traced to separate property. Since most separate property has, at some point, been the product of an exchange for other separate property, there could be virtually no gifts between spouses. This result could not have been intended by the spouses at the creation of the joint tenancy, or by the legislature in enacting the statute.

Assuming, moreover, separate property existed that could not be shown to be the product of an exchange for separate property, the following result would follow:

> Ex. 1 - Husband owns a home worth $70,000 which, for whatever reasons, cannot be traced to an exchange of separate property. He marries, then transfers title to the entireties. Since there has been no actual exchange here, the property will be deemed a gift, and so will be presumed to be marital property.

An insignificant factual variation produces the following bizarre result:

> Ex. 2 - Husband has $70,000 in separate property. He marries, then buys a house for that amount, title to which is taken in the entireties. Since there has been an "exchange" of property for his separate property, the house would remain part of his separate estate upon divorce.

Allowing the ultimate classification of gift property to turn on whether there was a gift of "simple" separate property or of property that had been the subject of an exchange misconceives the basic nature of the issue. The critical inquiry should be directed to whether or not a *gift* was made, not to whether the underlying nature of the gift is separate or marital property. If a gift has been made, then under the statute the property is presumed to be marital. If a gift has not been made, then the property retains its separate identity.

Where, however, one spouse transfers property to the entireties, the issue turns on his intent at the time of such transfer, and the North Carolina rule is that a presumption of gift arises.[127] As *Mims* recognized, the presumptive gift rule is "more in accord with the probabilities of the marital state."[128] The suggestion in *Mims* that the presumptive gift rule should not apply to equitable distribution proceedings under the new statute is contrary to the probable intent of the parties, the purposes of the new statute, and the result reached in all other states. Any interpretation of the statute that would prohibit a spouse from making an absolute inter vivos gift to the marital estate is simply unreasonable.

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inherited. Wife sought to take advantage of the gift presumption then operating only in favor of wives. Husband contended that the property was his alone through application of the resulting trust doctrine. The Supreme Court of North Carolina simply disapproved the theretofore unequal presumptions and held that a gift would be presumed when either spouse transferred property to the other. The presumption can be rebutted only by "clear, cogent, and convincing evidence that he did not intend to make a gift of an entirety interest" at the time of the conveyance. *Id.* at 57-58, 286 S.E.2d at 790.

127. *Id.* at 53, 286 S.E.2d at 787.

128. *Id.* at 54, 286 S.E.2d at 788.

*F. Pensions, Income from Separate Property, and Degrees*

In addition to the broad exclusions from marital property already discussed, the North Carolina statute identifies three other types of separate property. First, the statute states that "[v]ested pension or retirement rights and the expectation of nonvested pension or retirement rights shall be considered separate property."[129] Because pension rights are apt to be, except for a home, the most significant asset acquired during a marriage,[130] this exemption is particularly unfortunate. Moreover, to the extent that they were earned during the marriage, pension benefits are clearly the product of marital efforts and earnings.[131] The inclusion of such benefits as a distributional factor in subsection (c) of the statute is hardly an adequate remedy for their omission from marital property.[132]

North Carolina also exempts from distribution all "professional licenses and business licenses which would terminate on transfer."[133] The statute thus reaches the same conclusion that most other states have obtained only after extensive litigation.[134] Once again, the "direct or indirect contribution made by one spouse to help educate or develop the career potential of the other spouse" is included as a distributional factor in subsection (c).[135] This consideration is likely to offer little solace in the circumstance, all too often encountered, of the wife who puts her husband through six years of medical school only to find herself divorced prior to the accumulation of any substantial marital assets.[136]

The failure of the North Carolina statute explicitly to subject a professional license or degree to division as marital property, however, does not confer a similar immunity on a business or professional corporation founded upon that license or degree. The great majority of classification-based states

129. N.C. GEN. STAT. § 50-20(b)(2) (Cum. Supp. 1981).

130. Weitzman, *supra* note 32, at 1198. In the Weitzman study only 11% of divorcing women interviewed in Los Angeles County, California had pension benefits in 1978, compared with 24% of divorcing men; in general only women with incomes of $20,000 or more a year who had pensions, and only 2% of all divorced women earned that much yearly income. *Id.* at 1198-99.

131. In Deering v. Deering, 292 Md. 115, 437 A.2d 883 (1981), for instance, the court reviewed the great number of cases from other jurisdictions dealing with pension rights and concluded that such benefits are rightly viewed as "an economic resource acquired with the fruits of the wage earner spouse's labors which would otherwise have been utilized by the parties during the marriage to purchase other deferred income assets." *Id.* at —, 437 A.2d at 888.

132. G.S. 50-20 lists as a distributional factor "[v]ested pension or retirement rights and the expectation of nonvested pension or retirements rights, which are separate property." N.C. GEN. STAT. § 50-20(c)(5) (Cum. Supp. 1981).

133. *Id.* § 50-20(b)(2).

134. *See, e.g.*, Todd v. Todd, 272 Cal. App. 2d 786, 78 Cal. Rptr. 131 (1969); *In re* Marriage of Graham, 194 Colo. 429, 574 P.2d 75 (1978) (en banc); *In re* Marriage of McManama, — Ind. —, 399 N.E.2d 371 (1980); *In re* Marriage of Horstmann, 263 N.W.2d 885 (Iowa 1978); Moss v. Moss, 80 Mich. App. 693, 264 N.W.2d 97 (1978) (per curiam); Frausto v. Frausto, 611 S.W.2d 656 (Tex. Civ. App. 1981); DeWitt v. DeWitt, 98 Wis. 2d 44, 296 N.W.2d 761 (Ct. App. 1980).

135. N.C. GEN. STAT. § 50-20(c)(7) (Cum. Supp. 1981).

136. *See, e.g.*, Roberto v. Brown, — Wis. 2d —, —, 318 N.W.2d 358, 360 (1982), (upholding an award of 70% of the marital assets to a wife who had put her husband through medical school, and noting that since she was entitled to 50% anyway, a mere 20% extra "seems insufficient compensation in this case").

have held that a professional corporation, including its goodwill value, is marital property, despite the fact that the professional degree itself remains separate property.[137] In addition, the future earning capacity of a spouse, although not normally an asset subject to division,[138] is a factor that other states commonly require to be considered in dividing property.[139] The "any other factor" language of subsection (c) clearly creates the opportunity for such a factor to be taken into consideration in North Carolina as well.[140]

Finally, and perhaps most unfortunately, the North Carolina statute excludes from marital property any "income derived from separate property."[141] A discussion of the implications of this section, including the various interpretations that could be attached to the term "income," is beyond the scope of this article. It would appear, however, that the phrase might well include interest from separate funds, dividend payments, stock splits, and other forms of capital gains. Similarly, it would be logical to conclude that the term would not be construed to include all "income" as defined by the Internal Revenue Code. For example, finding that a spouse's salary, paid from a separately owned business, was "income from separate property" and therefore immune from distribution would make a mockery of the purposes of equitable distribution. In fact, even the exclusion of interest or dividend payments does only slightly less damage to the fairness goals embodied in the statute. "Income" from separate property can clearly be accumulated or invested (in property that would also be separate in North Carolina) only if marital funds are used for non-income producing purposes.[142]

There is little guidance for the interpretation or application of this section because no other common-law state excludes income from separate property.[143] In the relatively few cases that have considered the issue, income has been held to be marital property.[144] In about half the community property

137. As an Illinois court concluded, "[w]e are aware of no reason why the principles which govern the disposition of a sole proprietorship or closed corporation should not apply to professional corporations. Neither do we perceive any economic or public policy reason why a professional corporation should not be treated as marital property." *In re* Marriage of White, 98 Ill. App. 3d 380, 382, 424 N.E.2d 421, 423 (1981). *See also* Wisner v. Wisner, 129 Ariz. 333, 631 P.2d 115 (1981); *In re* Marriage of Aufmuth, 89 Cal. App. 3d 446, 152 Cal. Rptr. 668 (1979); Moss v. Moss, 190 Colo. 491, 549 P.2d 404 (1976) (en banc); Stern v. Stern, 66 N.J. 340, 331 A. 2d 257 (1975); Hurley v. Hurley, 94 N.M. 641, 615 P.2d 256 (1980); *In re* Marriage of Goger, 27 Or. App. 729, 557 P.2d 46 (1976).

138. *See, e.g., In re* Marriage of Goldstein, 97 Ill. App. 3d 1023, 423 N.E.2d 1201 (1981); Wilcox v. Wilcox, 173 Ind. App. 661, 365 N.E.2d 792 (1977); and Stern v. Stern, 66 N.J. 340, 331 A.2d 257 (1975). *But see In re* Marriage of Horstmann, 263 N.W.2d 885 (Iowa 1978) (holding husband's future earning capacity as a lawyer was an asset subject to distribution).

139. *See* Note, *Property Division and Alimony Awards: A Survey of Statutory Limitations on Judicial Discretion*, 50 FORDHAM L. REV. 415, 448 app. B (1981).

140. N.C. GEN. STAT. § 50-20(c)(12) (Cum. Supp. 1981).

141. *Id.* § 50-20(b)(2).

142. In many instances marital funds are used for day-to-day living expenses precisely in order to preserve income-producing property.

143. Only the Rhode Island statute mentions income from separate property, and it includes such income as marital property. R.I. GEN. LAW § 15-5-16.1 (1981).

144. *In re* Neilson's Estate, 57 Cal. 2d 733, 371 P.2d 745, 22 Cal. Rptr. 1 (1962); *In re* Marriage of Reed, 100 Ill. App. 3d 873, 427 N.E.2d 282 (1981); Sousley v. Sousley, 614 S.W.2d 942 (Ky. 1981).

states the "fruits and profits" of separate property remain separate, but the effect of such a rule in those states is considerably softened by the well established doctrines of transmutation and commingling.[145] In any event, it is hoped that courts of this state will, consistent with the underlying purposes of the statute, interpret the income provision as moderately as possible.

## IV. CONCLUSION

It appears that the North Carolina statute is, to a considerable degree, at war with itself. Many of its provisions embody the marital partnership ideal that has provided the major impetus for enactment of equitable distribution statutes. Marital property is defined broadly to include all property acquired by either spouse during the marriage. Interspousal gifts, unless the donor states a contrary intent, are deemed marital property. The distributional factors vest broad discretion in the judiciary to determine what constitutes an equitable division of property.

At the same time, the statute expansively defines separate property and immunizes it from distribution, so that the property available for distribution will in many instances be so limited as to make the goal of fair distribution impossible. Pension benefits, income from separate property, professional licenses and degrees, and property acquired by gift, bequest, devise, or descent clearly are excluded from marital property. Provisions excluding property acquired before marriage, increases in value of separate property, and property exchanged for separate property are somewhat ambiguous, and certainly should not be taken at face value. Nonetheless, they evince a strong legislative intent to preserve to each spouse his or her separate property.

In effect, the statute indicates preferences for both marital and separate property classifications. Fortunately, the dividing line between marital and separate property is, in many instances, quite unclear. It remains for the judiciary to delineate the precise boundaries between the classifications and to effect a reconciliation between the dual legislative purposes. Such a reconciliation is possible only if the goal of restoring separate property is reconciled with the more fundamental fairness purposes of the statute.

There are three propositions that can be of significant aid in balancing these dual legislative goals. First, it is clear that the effectiveness of judicial discretion as a tool for assuring equitable distribution of property is closely related to the definition of marital property. The more narrowly marital assets are defined, the more the function of the discretionary factors is undermined. Second, the critical distinction between classification and actual distribution of assets should not be overlooked. The initial classification of an asset as marital or separate should *not* be the vehicle for distribution of that asset. Classification should be made without regard to the ultimate disposition of the property. Only then can the discretionary factors function as they were clearly intended to by the legislature.

145. W. DEFUNIAK & M. VAUGHN, *supra* note 39, at 161-62.

Third, and most significantly, the classification-based system adopted in North Carolina is premised upon the notion that fair distributions of property must track the contributions of the parties to the acquisition of that property. Separate property should be defined within the context of this goal, and without reference to title. The significance of this is especially obvious with the classification of property to which title vests in one spouse before marriage but which is substantially paid for after marriage. Compelling reasons exist to indicate that adoption of the source of funds rule for resolution of this problem would be consistent with both legislative intent and the expectations of the parties. The truly reasonable basis for the statute's emphasis upon preserving to each spouse his or her separate property is that the property was derived from the resources of that spouse. When property is acquired with marital rather than individual resources, this basis no longer exists, and classification of the property as separate becomes arbitrary and contrary to legislative purposes.

Only the letter of the law is served by an approach that fixes ownership of property at the time title to it is "acquired." The great majority of states recognize this fact and have interpreted statutes that are substantially similar to North Carolina's in this respect to require adoption of the source of funds rule. Enrichment of a separate estate through the use of marital funds clearly does not reflect the intent of the parties during marriage. It should not be otherwise upon divorce. The North Carolina presumption that interspousal gifts are marital property, absent a specific statement of intent to the contrary, lends even greater force to the argument for adoption of the source of funds approach in this state.

The same rationale suggests that the source of funds rule may also provide the most acceptable resolution of the problem created when increases in value of separate property are substantially attributable to the expenditure of the funds or efforts of the marital community or the nontitled spouse. Such noninflationary increases in value must result either in the increase of the marital estate, in transmutation of the property, or a gift to the separate estate of the titled spouse. The gift alternative contradicts the intent of the parties, the underlying purposes of the statute, and the interspousal gift provision. Increases in value of separate property that are caused only or largely by economic factors do not, on the other hand, diminish the marital estate. They, and they alone, should properly be regarded as separate property.

Finally, the exchange provision of the statute cannot have been intended as a limit on the capacity of a spouse to alienate his or her separate property. If a spouse intends to maintain as separate property an asset that has been acquired in exchange for separate property, he may easily do so. Making a gift to the entireties of such property, however, is totally inconsistent with any intention that the property remain separate. The critical issue is not whether the property can be proved to be the product of an exchange of separate property; rather, it is whether the owner intended to make a gift. A contrary result would virtually nullify the interspousal gift provision.

The statute itself indicates that the legislature intended that the goal of preserving separate property should not be allowed to frustrate the basic purpose of achieving fair distributions of property. Any approach that fails to consider the actual contributions of the individual spouses and the marital unit to the acquisition of property would severely undermine that intent. Interpretation of the statute in a way that provides the *means* by which genuinely equitable distributions of property can be achieved is necessary in order to fulfill the very purpose of the legislature in enacting it.