

Rental Property Purchased with Separate Funds

Approximately 30 years after the enactment of Equitable Distribution Law, courts continue to grapple with issues of statutory interpretation pertaining to the classification of property as marital or separate.

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NOVEMBER 2010

Approximately 30 years after the enactment of Equitable Distribution Law, courts continue to grapple with issues of statutory interpretation pertaining to the classification of property as marital or separate. In *Fields v. Fields*, 15 N.Y.3d 158 (2010), handed down on June 10, the Court of Appeals addressed the issue of whether the husband's interest in a certain rental property, which was purchased by him during the marriage using his separate funds for the down payment, should be classified as marital or separate property. The court, with two judges dissenting, held that the townhouse in question constituted marital property subject to equitable distribution, notwithstanding the husband's purchase of the property with his separate funds.

Husband Buys Property, Wife Does Not

In *Fields*, the husband purchased a five-story townhouse in Manhattan approximately eight years after the parties' marriage. The townhouse contained 10 apartments and a basement. The husband paid \$130,000 for the property, with a \$30,000 down payment. That down payment was derived from funds gifted to the husband from his grandparents, and the balance of the purchase price was financed through two mortgages held jointly by the husband and his mother.

Title was taken solely in the husband's name, initially. However, approximately five years after the purchase, the husband conveyed a one-half interest in the premises to his mother. The property was managed by the husband and his mother as a partnership.

Throughout the marriage, the parties and their child resided in various apartments in the townhouse, at first together and then separately. The parties paid rent to the partnership between the husband and his mother; the partnership managed the building. The other apartments were leased to various tenants, and the rental income derived from them was used to pay the mortgages and other expenses on the property. However, according to the majority opinion, the partnership's bank account was not used exclusively for the building's income and expenses; the husband acknowledged during the trial that he commingled marital funds in the account.

After a hearing before a special referee, the Supreme Court confirmed the referee's report, which recommended that the husband's one-half partnership interest in the townhouse (\$1,312,500, or one half of the \$2,625,000 value of the townhouse at the time of trial) should be classified as marital property, less a separate property credit to the husband of \$30,000, representing the funds he had received from his grandparents for the down payment on the townhouse. The report also recommended that the court award the wife 35% of all marital assets because she had made direct and indirect contributions to the townhouse during the parties' long-term marriage, including by providing services as a spouse and mother. The judgment of the Supreme Court was affirmed by the Appellate Division, with two justices dissenting.

Commingling Dooms Husband's Case

At fundamental issue before the Court of Appeals was whether the husband's interest in the townhouse as a whole should be classified as marital or separate property. The majority, citing *DeJesus v. DeJesus*, 90 N.Y.2d 643 (1997), stated that there is a "well-settled statutory presumption" that all property acquired by either spouse during the marriage, unless clearly separate, is deemed marital property. The court found that because the townhouse was purchased eight years after the parties' marriage with the intent that it would be used as a marital residence,

there was a presumption that it was marital property. The court noted that New York courts have long treated a marital residence that was purchased after the marriage as marital property subject to equitable distribution.

The Court of Appeals found that once this statutory presumption was triggered, the burden shifted to the husband to rebut that presumption. To meet this burden, the husband argued that his interest in the townhouse was “acquired in exchange for” his \$30,000 down payment and, therefore, the townhouse constituted his separate property pursuant to the statutory definition set forth in Domestic Relations Law § 236(B)(1)(d)(3). The appellate court rejected this argument because the husband’s \$30,000 down payment covered only a fraction of the purchase price. It held that the use of a “separate property” down payment did not alone establish the property’s character as separate property. The remaining \$100,000 of the purchase price was financed through two mortgages, and the husband failed to substantiate his claim that he made the mortgage payments solely from the rental proceeds. His testimony at trial that he had commingled marital assets in the partnership bank account from which mortgage payments were made sunk that argument.

In addition, both the husband and wife paid rent to the partnership using income from outside sources. Based on these factors, the court found that the husband had failed to establish that the mortgage loans, which were taken to fund most of the purchase price of the townhouse, were repaid using monies derived exclusively from his own separate property. Based on the foregoing and certain other factors, including the fact that the parties occupied the residence during the marriage, the court concluded that the lower courts properly determined that the husband failed to rebut the statutory presumption that his interest in the townhouse was marital property subject to equitable distribution.

All Do Not Agree

Judge Robert S. Smith, in his dissent, found that the Husband’s interest in the townhouse should have been classified as separate property because it was acquired “in exchange for separate

property.” The dissent argued that a proper analysis of the case would have involved classifying the rental property as the husband’s separate property and determining to what extent, if any, the appreciation in value of the husband’s interest in the townhouse should be treated as marital property subject to equitable distribution. This analysis would involve a determination of the extent to which the wife’s direct and indirect contributions resulted in the appreciation in value of the property.

The dissent also took issue with the majority’s finding that marital funds were commingled in the account used to repay the mortgages and, therefore, the townhouse was properly classified as marital property. The dissent stated that there was no evidence in the record to support this conclusion and that neither of the lower courts had found that any marital funds had been used to repay the mortgage loans.

Some Lessons to Take from *Fields*

The decision in *Fields* is noteworthy in several respects. First, the court, citing its opinion in *DeJesus v. DeJesus, supra*, states that there exists a “statutory presumption” that all property, unless clearly separate, is deemed marital property and that it is the titled spouse’s burden to rebut that presumption. Although the term “marital property” is broadly defined in the statute while the definition of “separate property” is highly specific, there is nothing in the express language of Domestic Relations Law ‘ 236 that states that there is a legal presumption that property shall be considered marital. However, notwithstanding the lack of any language expressly stating that such a presumption exists, the Court of Appeals has now, for at least the second time, superimposed such a presumption upon the statute.

The majority in *Fields* also appears to afford special status to real property that is acquired during the marriage and used by the parties as a marital residence. In its opinion, the court notes that “New York courts have long treated a marital residence that was purchased after the marriage as marital property subject to equitable distribution.” The fact that the property was occupied by the parties during the marriage appears to have influenced the decision to classify

the property as marital, although the relevance of this factor is not clearly articulated. Justice Smith, in his dissent, notes that there is no provision in the Domestic Relations Law that affords special status to a marital residence as opposed to other types of property.

One More Lesson: Classification Is Key

The decision in *Fields* is also illustrative of the stakes involved in initially classifying property, especially real property, as marital or separate. If the titled spouse can meet his or her burden of demonstrating that an asset should be classified as separate, then pursuant to the holding in *Price v. Price* 69 NY2d 8 (1986), the burden shifts to the non-titled spouse who is claiming an equitable interest in separate property to show that the appreciation in value of the property, if any, was due to his or her direct or indirect contributions as a spouse and homemaker. Although this standard is not to be rigidly applied by the courts (*see Hartog v. Hartog*, 85 NY2d 36 (1995)), it is nonetheless a substantial burden to meet. With respect to real property that is classified as separate property, the non-titled spouse is required to demonstrate that the property has in fact appreciated in value and then to quantify the extent to which the appreciation is due to his or her direct or indirect efforts during the marriage. In most instances, the proponent of such a claim must rely on expert testimony to meet this burden.

In contrast, where an asset is purchased in whole or in part with separate property but is nevertheless classified as marital property, the burden on the non-titled spouse seeking equitable distribution of the asset is not as difficult to meet. In such instances, the party who contributed separate property to the acquisition or creation of marital real property will be relegated to a dollar-for-dollar “source” credit based on the contribution of separate funds, as was the case in *Fields*. The balance of the equity in the property will be considered marital property, subject to equitable distribution. Once the property is classified as marital property, the non-titled spouse is not required to demonstrate a nexus between his or her contributions during the marriage to the increase in value of the property in view of the fact that the property as a whole is subject to equitable distribution. Thus, expert testimony will not be required to prove the non-titled

spouse's equitable distribution claim. It is enough for the non-titled spouse to demonstrate generalized contributions to the marriage.

The foregoing dichotomy demonstrates the importance of the initial classification of property. When confronted with such an issue, the matrimonial practitioner representing the non-titled spouse may be well advised to make an application, through a motion for partial summary judgment, for a pre-trial determination that the property in issue constitutes marital property. If successful, such a determination will dispense with the need to prove at trial, through expert testimony or otherwise, that the appreciation in value of the property at issue is due to the direct or indirect contributions of the non-titled spouse. It may also bolster the non-titled spouse's position in pre-trial settlement negotiations.

Conclusion

The importance of classification issues cannot be overstated. As demonstrated by *Fields*, even where the non-titled spouse may have a legitimate claim to a share of the appreciation in value of real property which may be classified as separate property, an initial determination that such property should be classified as marital property subject to equitable distribution will generally enhance the non-titled spouse's claims with respect to such property.

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