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Putting Your Nest Egg In The Wrong Basket

by Stacy D. Phillips and Jeffrey P. Bollinger

This is a family law case. Now, before you turn the page, let me just tell you that the ruling in this case has implications for any litigator presenting evidence at trial, and for weighing the advantages and disadvantages of characterizing property as community or separate, be it during marriage, in the event of a divorce, and in the event of death - which is guaranteed.

In this case, *In Re Marriage of Sonne*, 164 Cal.App.4th 1331 (80 Cal.Rptr.3d 453, 2008), the husband (Gordon) finds himself divorcing his third wife (Theresa). Gordon began employment as a Monterey County deputy sheriff in March 1971 and participated in the California Public Employees' Retirement System as a benefit of his employment. During a portion of his employment by Monterey County, Gordon was married to his second wife, Dalia, who received an interest in Gordon's PERS retirement as part of their divorce in 1991. Gordon remained employed by Monterey County, and married Theresa in November 1994. In 1995, Dalia withdrew her share of Gordon's contributions and interest from his PERS retirement account, which triggered Gordon's ability to repurchase the service credits represented by the contributions and interest withdrawn by Dalia, which he did by having monthly deductions made from his paychecks (and later his retirement allowance payments) beginning in 1997 and continuing throughout his marriage to Theresa. In February 2002, Gordon's years of service and age qualified him for the maximum level of retirement benefits. In November 2002, Gordon selected Option 2 PERS retirement, and he irrevocably named Theresa as the beneficiary of the survivor benefit funded by Option 2. Gordon retired in December 2002.

The Court of Appeal addressed three issues in this case: Gordon contended that the trial court improperly found that service credits associated with his interest in his PERS retirement allowance, which were earned prior to marriage but repurchased during marriage, were community property; he contended that the trial court abused its discretion in awarding Theresa the entire survival benefit associated with his PERS membership as long as she paid the monthly cost, equating the cost of the survivor benefit with its value; and Theresa contended that the trial court should



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reconsider the amount of spousal support and attorney fees awarded to her if it credited either of Gordon's contentions regarding the first two issues. In addressing the first two issues, the Court of Appeal noted that the trial court was obligated to arrive at a result that is reasonable and fairly representative of the relative contributions of the community and separate estates. The Court of Appeal reached a "split decision" - i.e., while the trial court correctly ruled as to the first issue, it abused its discretion in awarding Theresa the entirety of the survivor benefits with only an offsetting payment of monthly cost; the Court of Appeal found no basis for the trial court to reconsider spousal support or attorney fees, because it remanded solely for the trial court to properly apportion the survivor benefit.

As to the first issue, the Court of Appeal "hung its hat" on an evidentiary issue: Gordon failed to meet his burden of proving what portion of the value of the repurchased service credits was attributable to a separate property source. Why? Because Gordon's expert did not or could not unequivocally trace a particular value or proportion of the repurchased service credits to his separate property contribution and the available, credible evidence showed they were paid with community property funds. In California, as in all community property states, property acquired during marriage is presumptively viewed as community unless the property holder is able to prove otherwise. Consequently, commingling community property with separate property and failing to maintain adequate records so that tracing becomes impossible will eventually transform separate property into community property. As Mark Twain once observed, "If it is a Miracle, any sort of evidence will answer, but if it is a Fact, proof is necessary." And so it is when rebutting the community property presumption.

Thus, this case cautions that when rebutting the community property presumption for property acquired by purchase during marriage, in order to meet the burden, the family law practitioner must do more than offer a "broad implication" to trace the separate property contribution. The Court of Appeal states no fewer than three times that it was Gordon's burden (which he failed to meet) to reliably prove the specific value or proportion of his separate property contribution. Was Gordon's expert ineffective, or did Gordon simply lack sufficient records to prove his separate property contribution? The lesson learned: If your evidence is not sufficient, you will not overcome the presumption.

Gordon's decision-making during his marriage to Theresa was clearly not made in contemplation of divorce, as is often the case. Even where a spouse may try to think "globally" about the various ramifications of his or her financial decisions during marriage, it is not always easy to weigh the benefits and drawbacks of a particular decision at a specific point in time. For example, there are potential tax advantages to converting separate property to community property during a marriage, and potential advantages for married people holding property as community property over property held jointly by a married couple. The federal tax system provides a unique benefit to the surviving spouse who holds community property at the date of death of the first spouse. Because of the nature of



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community-property ownership, the federal income tax basis of both halves of the property becomes the fair market value at date of death or other optional valuation date. If the community property has appreciated in value, a federal income tax on that appreciation is avoided. If it is depreciable property, the basis for future depreciation is reset back to fair market value with the potential of increased depreciation deductions against future taxable income. While this is a discussion better left to an estate planning expert, the point is that married people often make choices for the benefit of their union and each other during marriage, which they would not make if they were contemplating divorce.

Gordon elected Option 2, available to him as a PERS member, to have his retirement benefit paid to him until his death, and thereafter to his stated beneficiary for that person's life. Gordon designated Theresa as his beneficiary (Option 2 does not require the PERS member to select a spouse or even a relative as the beneficiary). Gordon made the Option 2 election more than a year before he filed for divorce from Theresa. When the love was lost, Gordon no longer wished to be so generous. Unfortunately, an Option 2 election is irrevocable after retirement, and Gordon retired a year prior to filing for divorce. So it is understandable that Gordon was none too thrilled when the trial court held that the repurchased service credits for his years of service to his employer prior to his marriage were community property.

As to the second issue (i.e., allocation of survivor benefits), the Court of Appeal concluded that the trial court failed to reach a result that is reasonable and fairly representative of the relative contributions of the community and separate estates and, therefore, abused its discretion. The law requires the trial court to divide community property equally, and to ensure that each party receives a full community property share of survivor benefits. There is little doubt that the trial court's decision in this regard did not pass "the smell test." The adage, "pigs get fat, hogs get slaughtered," comes to mind. Why the trial court deviated from the methodology it used to allocate retirement benefits in fixing Theresa's share of the survivor benefits goes unexplained. Clearly, the deviation did not sit well with the Court of Appeal. In this case, the Court of Appeal emphasized the need to adhere to the principles embodied in the relevant statutes and case law.

The Court of Appeal ordered the trial court either to apportion the survivor benefit using the same method it used to allocate the community share of Gordon's PERS retirement benefits (dividing the number of years Gordon earned benefits during his marriage to Theresa by his total number of years of service to his employer) or another method that complies with statutory and case law (i.e., to reach a result that is reasonable and fairly representative of the relative contributions of the community and separate estates). With undisputed evidence before it that the value of the survivor benefit "far exceeded" its cost, the trial court nevertheless awarded 100 percent of the survivor benefit to Theresa, with her compensating Gordon by paying him an amount equal to the cost of the survivor benefit. The



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trial court's approach in dividing the survivor benefits is so obviously flawed, especially in comparison to its approach in dividing the service credits, that it amounts to a penalty against Gordon.

This case tells us that the trial court has discretion in dividing the community interest in survivor benefits - either a "cash out" of the present value of the community's interest, establishing a trust to divide the community's interest in kind with the court reserving jurisdiction to supervise future payments to each, or some other method that complies with the statutes and case law. The practical and real problem is that a "cash out" may not be financially feasible for the party buying out the former spouse, and the establishment of a trust creates potential monitoring/enforcement problems down the road. To quote former President Ronald Reagan, "Well, the truth is, there are simple answers, they just are not easy ones."

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