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Baruch v. Clark Appellant's Brief Dckt. 39224

IN THE SUPREME COURT OF THE STATE OF IDAHO

AMY BARUCH, Plaintiff/Respondent, v. WILLIAM CLARK, Defendant/Appellant.	Supreme Court Docket No. 39224-2011

APPELLANT'S BRIEF

Appeal from the District Court of the Fourth Judicial District for Ada County. The Honorable Kathryn Sticklen affirming the Honorable Michael J. Reardon, Magistrate Judge, Presiding.

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I. STATEMENT OF THE CASE

A. Nature of the Case

This Appeal involves the property characterization in a divorce between Defendant/Appellant Bill Clark (hereinafter referred to as "Bill") and Plaintiff/Respondent Dr. Amy Baruch (hereinafter referred to as "Dr. Baruch"). Bill is appealing from the August 25, 2011 Memorandum Decision and Order entered by the Honorable District Court Judge, Kathryn Sticklen affirming the decision of the Honorable Michael J. Reardon, Magistrate Judge, as set forth in the Findings of Fact and Conclusions of Law entered on July 26, 2010, the Judgment and Decree of Divorce entered on August 10, 2010 and the Judgment and Order Re: Motion to Alter or Amend Findings of Fact, Conclusions of Law and Judgment entered on September 24, 2010.

Bill argues that the district court erred in affirming the magistrate because (1) the magistrate court's characterization of the entirety of Bill's IRA as community property is not supported by Idaho law; and (2) the magistrate court erred as a matter of law by characterizing Bill's capital gains income on separate property as community property and further concluding that he was not entitled to reimbursement for separate property contributions that were applied towards the acquisition of a condominium.

B. Course of the Proceedings

The trial in this matter took place on March 31, 2010 and April 1 and 2, 2010. (R., p. 5.) On July 26, 2010, the magistrate court issued Findings of Fact and Conclusions of Law. (R., p. 561.) The Decree of Divorce was entered on August 10, 2010. (R., p. 605.)

The magistrate court ordered that Bill's IRA with Charles Schwab was community property. (R., pp. 586 and 614) The magistrate further held that the capital gains distribution Bill received on one of his separate business entities was community and therefore he was not entitled to any reimbursement for his application of the funds towards the acquisition of the Ketchum Condominium. (R., p. 582.)

Bill filed a Motion to Alter or Amend Findings of Fact and Conclusions of Law and Judgment on August 16, 2010. (R., p. 624.) The hearing on the matter was heard on September 13, 2010. (R., p. 6.) The magistrate court issued a Judgment Re: Motion to Alter or Amend Findings of fact and Conclusions of Law and Judgment on September 21, 2010. (R., p. 679.) The magistrate subsequently issued the Judgment and Order Re: Motion to Alter or Amend Findings of Fact and Conclusions of Law on September 24, 2010 which simply corrected the title of the order. (R., p. 683.) Other than noting a few clarifications at the hearing, the magistrate court did not amend its conclusions on the issues raised in this appeal.

Bill timely filed a Notice of Appeal on November 4, 2010. (R., p. 689.) On August 25, 2011, the Honorable District Court Judge, Kathryn Sticklen, entered her Memorandum Decision and Order. (R., p. 826.) The District Court affirmed the magistrate court's decision. (R., p. 826.)

On September 28, 2011, Bill filed a timely Notice of Appeal to this Court. (R., p. 862.)

C. Statement of Facts

Bill and Dr. Baruch were married on December 1, 2000 in Boise, Idaho. (Tr., Vol. 1, p. 27, L. 3-6.) Dr. Baruch was 44 years old at the time of trial. (Tr., Vol. 1, p. 27, L. 1.) Dr. Baruch is employed as an emergency medicine physician at St. Luke's Hospital and has an

ownership interest in Emergency Medicine of Idaho, PA. (Tr., Vol. 1, p. 29, L. 13-18.) She graduated from medical school in 1994 and completed her residency in 1997. (Tr., Vol. 1, p. 29, L. 23-25.) Dr. Baruch earned a base income of approximately $260,000 in 2009.

Bill was 64 years old at the time of trial. (Tr., Vol. 1, p. 236, L. 21.) Bill is a real estate developer and has a real estate development firm, Clark Development, LLC. (Tr., Vol. 1, p. 237, L. 13-20.)

Retirement Accounts

Prior to getting married, both of the parties had established their own retirement accounts. Dr. Baruch had a 401(k) with EMI through Charles Schwab. (Tr., Vol. 1, p. 71, L. 22-24.) The balance of Dr. Baruch's 401(k) on the date of marriage was $74,776.85. (Plaintiff's Exhibit 32(b).) As of the date of divorce the account balance, through community contributions, increased to $479,274.03 (Plaintiff's Exhibit 230.)

Bill had an IRA with Charles Schwab ending in account number 3713 (hereinafter referred to as "Schwab 3713 IRA"). The balance of this account on the date of marriage was $386,363. (Defendant's Exhibit 528, Bate Nos. 349-350.) During marriage, Bill rolled over some of his retirement funds from the Schwab 3713 IRA into two other retirement accounts, but never withdrew any substantial funds from his IRA.[1] (Tr. p. 434, L. 5-9.) The Schwab 3713 IRA had a value less than it did on the date of marriage with a balance of $354,350. (Plaintiff's Exhibit 230.) Just as the parties did with Dr. Baruch's 401(k), they also made contributions to Bill's retirement account. (Tr., Vol. 1, p. 102, L. 23-25.)

[1] As the magistrate court noted, Bill received one *de minimus* distribution in the amount of $1,495.24 in 2007. (R., p. 570.)

As stated above, during marriage Bill did not withdraw any substantial funds from his IRA. (Tr., Vol. 1, p. 434, L. 5-9.) Bill did rollover or transfer funds from his the Schwab 3713 IRA into two other retirement accounts. (Tr., Vol. 1, p. 434, L. 9-13.) Defendant's Exhibit 638 provides a summary of all of the rollovers to which Bill testified to and provided underlying documentation. Plaintiff's Exhibit 638 was offered and admitted which is a summary of all the documents on the Schwab 3713 IRA, Pensco Trust and Sterling Trust. (Tr., Vol. 1, p. 481, L. 11-25, p. 483, L. 3.)

Bill made transfers and rollovers between two other retirement accounts, the first of which is called Pensco Trust. Pensco Trust is a trust company based in San Francisco that manages IRAs. (Tr., Vol. 1, p. 432, L. 1-2.) Bill also rolled over funds from his Schwab 3713 IRA into Sterling Trust which is similar to Pensco Trust, just a different company that handles self-directed IRAs. (Tr., Vol. 1, p. 466, L. 4-8.)

Bill testified at trial that all three of the accounts, Schwab 3713 IRA, Pensco Trust and Sterling Trust are all IRAs in his name. (Tr., Vol. 1, p. 483, L. 9-18.) All of which are essentially one, big IRA held in three different entities. (Id.) There were transfers and investments made within each of them during the marriage. (Id.) Bill never made any substantial withdrawals to himself from the any of the three accounts.[2] (Tr., Vol. 1, p. 483, L. 19-22.) Bill provided detailed testimony regarding the investments and rollovers reflected on Defendant's Exhibit 638, but other than the *de minimus* $1,495.24 distribution in 2007, no funds were ever withdrawn. (Defendant's Exhibit 638, Tr., Vol. 1, p. 483-496.)

[2] No funds were ever distributed to Bill from the Sterling or Pensco Trusts. (Defendant's Exhibit 638.) As noted above, there was only one *de minimus* distribution made from the Charles Schwab account in 2007.

On the date of divorce, the Schwab 3713 IRA had a value less than it did on the date of marriage and had a value of $354,350. (Plaintiff's Exhibit 230.)

Bill's Separate Property Claim

During the parties' marriage they purchased a condominium unit in Ketchum, Idaho. (Tr., Vol. 1, p. 422, L. 14-18.) Bill contributed separate property proceeds towards the acquisition of the condominium. Bill's separate property contribution consisted of a capital gains distribution he received in the amount of $342,149 from his separate business entity called Veltex Building, LLC on February 7, 2007. (Tr., Vol. 1, p. 420, L. 6-15, p. 421, L. 9-16.) Bill acquired his ownership interest in Veltex Building, LLC prior to marriage and this fact was not disputed. (Tr., Vol. 1, p. 412, L. 1-5; p. 232, L. 4-8; Defendant's Exhibit 517.)

Veltex Building, LLC was a partnership formed to acquire the Veltex site, a former gas station, and to provide equity for planning and design of the project. (Tr., Vol. 1, p. 412, L. 8-14.) The real property was acquired by Veltex Building, LLC prior to marriage. (Tr., Vol. 1, p. 242, L. 19-25.) Bill acquired his interest in Veltex Building, LLC prior to marriage. (Tr., Vol. 1, p. 412, L. 1-5; p. 232, L. 4-8; Defendant's Exhibit 517.) After Bill and Dr. Baruch were married, no funds were put into Veltex Building, LLC. (Tr., Vol. 1, p. 418, L. 15-19.)

The property was acquired in 1997. (Tr., Vol. 1, p. 242, L. 19-25.) The construction of the Veltex Building was completed in 2004. (Tr., Vol. 1, p. 511, L. 22-25.) After the property was developed it was sold as condominiums, both commercial and residential. (Tr., Vol. 1, p. 420, 6-15.) The proceeds on the sale were capital gains and distributions were made to the various partners in accordance with their percentage of ownership. (Id.) On February 7, 2007, Bill received a distribution which was capital gains from Veltex Building, LLC in the amount of

$342,149 which was deposited directly into his Charles Schwab account ending in 3714. (Tr., Vol. 1, p. 421, L. 4-16, p. 422, L. 4-8; Defendant's Exhibit 596, Bate Stamp 1283; Plaintiff's Exhibit 232.) Bill testified that this was a capital distribution and not income. (Tr., Vol. 1, p. 421, L. 15-16.)

Dr. Baruch presented no evidence to dispute this testimony other than her claim that the community was entitled to a portion of the distribution because Bill put in "sweat equity" during the construction which occurred during marriage. (Tr., Vol. 1, p. 588, L. 19-22.) However, Dr. Baruch did not present any evidence of any labor or efforts expended by Bill towards the Veltex Building, LLC. Further, Bill testified that none of the equity in Veltex Building, LLC was due to any sweat equity because Clark Development, LLC was paid a fee for developing the project. (Tr., Vol. 1, p. 626, L. 11-28.) Bill historically has received a draw from Clark Development, LLC after expenses are paid, which is his primary source of income. (Tr., Vol. 1, p. 238.) In 2009, he was receiving income of $15,000 per month until April of 2009. (Id.) As of January 2010, Clark Development, LLC was receiving income of $15,000, which after expenses were paid Bill received approximately $8,500 per month. (Tr., Vol. 1, p. 244.)

Additionally, the parties' tax returns reflect that the distribution from Veltex was capital gains. The $342,149 distribution actually consisted of a combination of two sources. First, the distribution consisted of funds returned to Bill from his capital account which contained capital that he initially invested in the entity prior to marriage in the amount of $181,735. (Defendant's Exhibit 517A.) Second, the distribution consisted of capital gains in the amount of $160,414. (*Id.*)

The parties' 2007 tax returns further show that the distribution was not income, but rather capital gains. (Defendant's Exhibit 547.) With regard to the return of a portion of Bill's capital account, Defendant's Exhibit 517(a) reflects that in 2007, Bill's capital account was reduced from $193,790 to $12,055, the difference of which is $181,735. (Defendant's Exhibit 517(a).) This return of capital accounts for a portion of the $342,149 distribution.

The second portion of the $342,149 distribution consists of capital gains. Exhibit 517(a) reflects that Bill received 1231 gain of $126,906 and 704c gain of $34,625, which is a total capital gains of $161,531. (Defendant's Exhibit 517(a).) The total capital gains of $161,531 is reflected on Schedule E, Part II, line 11 and is not included as ordinary income. (Defendant's Exhibit 547, bate stamped Def00500.) However, Bill did not receive the full capital gains of $161,531 because there was a loss of rental income in the amount of $1,339 that reduced the amount. (Defendant's Exhibit 517(a).) There was also a *de minimus* amount of interest income of $222. (*Id.*) Because the *de minimus* interest income of $222 was consumed by the $1,339 loss on rental income, the remaining balance of $160,414 included entirely of capital gains. (*Id.*) The capital gains of $160,414 and the return of his capital of $181,735 accounts for the distribution of $342,149. (*Id.*)

This distribution is not ordinary income, as the tax returns reflect. The $161,531 is identified as capital gains in Schedule E related to the sale of the building. (Defendant's Exhibit 547.) Pursuant to Bill's testimony, Veltex Building, LLC developed the Veltex building and it was sold as condominiums and the proceeds of those sales were counted as capital gains. (Tr., Vol. 1, p. 420, L. 3-15.) The return of a portion of the capital account is not reflected at all on

the tax returns because it was simply a return of a portion of his initial capital contribution that was made when the entity was established, prior to marriage.

II. ISSUES ON APPEAL

A. Did the district court err when it affirmed the magistrate's characterization of the entirety of Bill's IRA as community property?

B. Did the district court err when it affirmed the magistrate's characterization of the capital gains distribution earned on Bill's separate property as community property?

C. Did the district court err when it affirmed the magistrate's holding that Bill was not entitled to reimbursement for separate funds expended on the acquisition of the condominium unit in Ketchum?

III. LEGAL ARGUMENT

A. Standard of Review.

When this Court reviews a decision rendered by a district court acting in its appellate capacity, it considers the trial court's decision, and if that decision is free from error and if the district court affirmed that decision, the Court affirms the district court's decision as a matter of procedure. *Dunagan v. Dunagan*, 147 Idaho 599, 600, 213 P.3d 384, 385 (2009); *Losser v. Bradstreet*, 145 Idaho 670, 672, 183 P.3d 758, 760 (2008). This Court has free review of the legal issues analyzed by the district court acting in its appellate capacity. *Carter v. Zollinger*, 146 Idaho 842, 844, 203 P.3d 1241, 1243 (2009)(citing *Losser*, 145 Idaho at 672, 183 P.3d at 760.) This Court will find error in a district court's decision to affirm the magistrate court only if the magistrate's decision is not supported by substantial and competent evidence, and therefore,

clearly erroneous. *State Dept. of Health & Welfare v. Doe*, 145 Idaho 662, 664, 182 P.3d 1196, 1198 (2008).

The trial court's findings of fact will not be set aside on appeal unless they are clearly erroneous such that they are not based upon substantial and competent evidence. *Kraly v. Kraly*, 147 Idaho 299, 302, 208 P.3d 281, 284 (2009); *Stewart v. Stewart*, 143 Idaho 673, 676, 152 P.3d 544, 547 (2007).

The characterization of property as either community or separate involved mixed questions of law and fact. *Krebs v. Krebs*, 114 Idaho 571, 573, 759 P.2d 77, 79 (Ct.App.1988). The manner and method of acquisition of property are questions of fact for the trial court. *Batra v. Batra*, 135 Idaho 388, 391, 17 P.3d 889, 892 (Ct.App.2001). The characterization of an asset in light of the facts found, however, is a question of law over which the appellate court exercises free review. *Id.*

B. The district court erred in affirming the magistrate's holding that the entirety of Bill's IRA, which was worth less than it was worth on the date of marriage, was community property.

Both of the parties had their own retirement accounts established before they were married. Dr. Baruch had a 401(k) with EMI through Charles Schwab. The balance of Dr. Baruch's 401(k) on the date of marriage was $74,776.85. (Plaintiff's Exhibit 32(b).) As of the date of divorce the account balance, through community contributions, increased to $479,274.03 (Plaintiff's Exhibit 230.)

Bill established his Schwab 3713 IRA prior to marriage. The balance on the date of marriage was $386,363. (Defendant's Exhibit 528, Bate Nos. 349-350.) During marriage, Bill rolled over some of his retirement funds from the Schwab 3713 IRA into other retirement

accounts, but never took any substantial distributions from his IRA.[3] (Tr., Vol. 1, p. 434, L. 5-9.) The magistrate court noted that in 2007 Bill received a distribution in the amount of $1,495.24, which was declared on the parties' joint tax returns. (R., p. 570.) The magistrate did conclude that the distribution was "more likely than not" used for a community purpose. (Id.) The magistrate did not conclude that any of the other rollovers or transfers were actually received by Bill. Bill's testimony, and the evidence presented established that the funds in the Schwab 3713 IRA were rolled over and transferred between two other retirement accounts, which in turn invested the funds in various entities. The magistrate determined that this activity provided a basis for treating Bill's retirement account differently from Dr. Baruch's retirement account.

It has always been Bill's position that the Idaho Supreme Court decisions in *McCoy v. McCoy,* 125 Idaho 199, 868 P.2d 527 (Ct.App.1994) and *Maslen v. Maslen*, 121 Idaho 85, 822 P.2d 982 (1991) were equally applicable to both Dr. Baruch's pre-marriage interest in her retirement account and his own pre-marriage interest in his IRA. In fact, it was Bill's position that the cases applied to both parties' retirement accounts and that each of them were entitled to receive, as their separate property, the balance that existed in the account on the date of marriage.

Although the magistrate court did not substantively address Dr. Baruch's separate property claims to her retirement account, it appears from the Findings of Fact and Conclusions of Law that the magistrate court applied the *McCoy* and *Maslen* analysis only to Dr. Baruch's retirement account because she was awarded $74,777 as her separate property, which was the

[3] There was one de *minimus* distribution during the span of the ten-year marriage that included one distribution of $1,495.24 on August 15, 2007. (Defendant's Exhibit 638.)

balance of the account on the date of marriage. The magistrate court viewed Bill's differently and found that the entire account was community property.

On appeal, the district court appears to have concluded that Bill stipulated to the treatment of Dr. Baruch's account as her separate property and stated:

> In addition, while Bill objects to the different treatment that the magistrate afforded his IRA and Amy's, he testified that he was claiming no interest in her IRA (*see id.*, at 477-78 – "Are you claiming any interest in that IRA?" "No, I don't claim any interest in it." "We will agree to treat it as separate property.") *See Kohringer v. Robertson*, 137 Idaho 94, 99, 44 P.3d 1149, 1154 (2002)("Oral stipulations of the parties in the presence of the court are generally held to be binding, especially when acted upon or entered on the court records.")

(R., p. 834.) A review of the transcript from the trial clearly reflects that Bill was not referencing Dr. Baruch's 401(k), but was referencing a totally different IRA. The testimony was as follows:

> **MR. WELSH**: Bill, just so you're referencing exhibit 592 which was our property and debt schedule, Bill on line item 27A, we added to the schedule, called it new IRA. And Exhibit 234, which Amy introduced and described an IRA that has a value, according to the --- I think Exhibit 234 shows a value of $3,361.
>
> Bill, were you familiar with an IRA of Amy's?
>
> **A.** I knew that Amy had an account of some sort. I didn't' know if it was an IRA or an open market account with Wachovia.
>
> **Q.** And she said she had this IRA before marriage but could not locate the statements?
>
> **A.** Uh-huh. Yes.
>
> **Q.** Are you claiming any interest in the IRA?
>
> **A.** No, I don't claim any interest in it.
>
> **Q.** You agree that would just be awarded to her?
>
> **A.** Yes.

Q. Amy also testified that –

THE COURT: I'm sorry, Counsel. Do I understand that there is an agreement that it is separate property?

MR. WELSH: We will agree to treat it as separate property, Your Honor, even though we don't have a statement back then. But –

(Tr., Vol. 1, p. 477, L. 3-25, p. 478, L. 1-5.) It is clear that Bill was referring to the line item 27A on Defendant's Exhibit 592 which reflects that it is an IRA with a value of $3,361. This is not the 401(k) that was the issue on appeal. The district court clearly erred when it appeared to conclude that Bill had stipulated to the treatment of Dr. Baruch's 401(k).

The method for determining the community portion of the retirement accounts has been addressed by this Court in *Maslen v. Maslen*, 121 Idaho 85, 822 P.2d 982 (1991). In *Maslen*, the husband had a "directed account" plan. Under the plan, his employer contributed into his account an amount equal to nine percent of his monthly salary. There was no guaranteed retirement benefit; rather the benefit was based on the value of the account at the time of distribution or retirement. The husband's retirement account had a significant value on the day the parties were married. This Court upheld the magistrate's determination of the community portion of that account by subtracting the amount which husband was entitled on the date of the marriage from the amount he was entitled on the date of divorce and that the difference between the two amounts was determined to be the portion of the benefits acquired during the marriage.

The Idaho Court of Appeals affirmed the same analysis in *McCoy v. McCoy*, 125 Idaho 199, 868 P.2d 527 (Ct.App.1994). In *McCoy*, in order to calculate the community share of wife's IRAs and 401(k), the magistrate determined the value as of the date of the marriage and

the value at the time of the difference and the difference between the two was community. The Court of Appeals affirmed this division on appeal.

It has always been Bill's position that the analysis under these cases controls, but that the analysis is equally applicable to both his and Dr. Baruch's accounts. The magistrate court provided no rationale or explanation as to how it arrived at its conclusion to award Dr. Baruch the balance of her 401(k) on the date of marriage. At the conclusion of the trial the magistrate found that Bill's account was distinguishable from the *Maslen* and *McCoy* cases because (1) he "withdrew" funds and (2) because the community contributed to the account after marriage and therefore the account was commingled and could not be traced. (R., p. 585.)

The community made significant contributions to Dr. Baruch's account and the account increased in value by nearly $400,000 during marriage. (Plaintiff's Exhibits 32(b) and 230.) On the date of marriage, Bill's account was valued at $386,636. (Defendant's Exhibit 528, bate stamped 349-50.) The magistrate court found that the community made contributions towards Bill's account and that the account was community because it was comingled with community funds. However, community funds were contributed to *both* accounts and therefore both accounts have been comingled. There is no way to determine on *either* of the accounts whether it was the separate portion or community portion of the accounts that increased or decreased in value. The magistrate court erred in making its holding inconsistent because it found that Bill's account was commingled and Dr. Baruch's account was not when community funds were contributed to both accounts after marriage.

Furthermore, the magistrate found that Bill "withdrew" funds. The magistrate court then refers to the numerous transfers and rollovers between the accounts, however with the exception

of the one *de minimus* $1,495.24 distribution in 2007, no funds ever came out of the accounts. Furthermore, the one *de minimus* distribution is also not relevant because it is presumed to have been community and used on community purposes. *Batra v. Batra*, 135 Idaho 388, 395, 17 P.3d 889, 896 (2001). There was no evidence that any of the funds that Bill testified were rolled over into Pensco Trust or Sterling Trust were ever withdrawn.

The magistrate determined that in *Maslen* and *McCoy* funds were not withdrawn from the accounts during the course of the marriage and appeared to make that a distinguishing factor. It was clear that the magistrate court in this case was concerned about the transactions between the three retirement accounts, however it failed to provide any explanation as to why a self-directed IRA would not be given the same treatment as an account directed by a third party and thus equal treatment under *Maslen* and *McCoy*.

Subsequently, at the hearing on Bill's Motion for Leave to Amend Findings of Fact and Conclusions of Law and Judgment, the magistrate court attempted to clarify its findings and held that the reason he treated Bill's account differently than Dr. Baruch's account was because, "my belief that the circumstances with which Mr. Clark treated his retirement account during the course of the marriage were significantly different than the way Dr. Baruch treated her retirement account during the course of the marriage." (Tr., Vol. 1, p. 678, L. 1-6.) While the magistrate court was correct when it noted that property division is discretionary with the court, the magistrate court abused its discretion because it failed to act within the outer boundaries of its discretion and consistently with the applicable rules and its decision was not made with an exercise of reason. *Hentges v. Hentges*, 115 Idaho 192, 195, 765 P.2d 1094, 1097 (Ct.App.1988).

Bill had a significant balance in the account on the date of marriage. "Any contributions, increases, or earnings in the account which occurred prior to the marriage are separate property under I.C. § 32-903, and this portion of the account is reflected in the account balance at the time of marriage." *Maslen*, 121 Idaho at 90, 822 P.2d at 987.

The magistrate erroneously found that,

> In 2009 Bill took a net distribution of $34,611.72. It appears from the evidence that $28,000 of this distribution was invested Pearson Partners relative to the buy down of the loan discussed in paragraph 41above. The evidence as unclear as to the remainder of the distribution.

(R., p. 571-72.) The evidence shows that Bill rolled over $28,000 from the Schwab account to Pensco Trust (Defendant's Exhibit 614, bate stamp 1945, Exhibit 623, bate stamp 2193.) The evidence shows that Bill rolled over $6,611.72 from the Schwab account to Pensco Trust. (Defendant's Exhibit 614, bate stamp 1986, Exhibit 623, bate stamp 2197.) These funds were not distributed to Bill.

The magistrate court attempted to clarify its reason for treating the two accounts different by explaining that it was because the parties treated the accounts differently, however this reasoning is, at best, a distinction without a difference because Bill never withdrew any funds of any significant value. While Bill is aware the *Maslen* court did not set a specific rule for calculating the community interest in retirement plans, the decision still must be based upon an exercise of reason. It is difficult to discern, especially without any analysis, how the fact that two[4] of Bill's retirement accounts were more self-directed than Dr. Baruch's 401(k) supports a conclusion that the entire account should be characterized as community. The fact that Bill had

[4] Pensco Trust and Sterling Trust were self-directed IRAs. These accounts had values of $1,619.14 and $29,810.00 respectively at the time of trial. (R., p. 576, 596, 597.)

some directive as to what funds the Pensco Trust and Sterling Trust invested in does not support the conclusion that the account should be community. There must be to be a rational basis to support the division.

Either *Maslen* or *McCoy* apply to both or they don't apply to either. To the extent the court concluded that the transfers among IRAs was the basis to determine the entire account as community is a distinction without a difference and does not rationally support the magistrate's conclusion. Therefore, Bill should be entitled to be awarded the balance of his account as of the date of marriage as his sole and separate property. If it is determined that Bill's entire account is community property, then Dr. Baruch's account should be characterized the same way.

C. C. The district court erred in affirming the magistrate's conclusion that the capital gains distribution on Bill's separate property was community property.

The magistrate court initially concluded, as set forth in the Findings of Fact and Conclusions of Law, that capital gains earned on separate property is income.[5] (R., p. 582.) Bill filed a Motion to Alter or Amend Findings of Fact Conclusions of Law and Judgment and pointed out the error in the magistrate court's conclusion that capital gains earned on separate property is "income." Bill's full legal analysis is set forth in the Memorandum in Support of Motion to Alter or Amend Findings of Fact Conclusions of Law and Judgment filed on August 16, 2010. (R., p. 627-32.) Bill will not reiterate the legal authorities herein because the magistrate court acknowledged the misstatement at the hearing and attempted to clarify its

[5] "This presumption appears to be based on his belief that capital gains form a separate asset received during marriage are separate property, a proposition that the Court can find no support." "Given those circumstances, funds received through the asset must be regarded as income. Income from separate property, received during the marriage, is community property."

ruling. The magistrate stated that, "It was incorrect as I wrote it."[6] (Tr., Vol. 1, p. 667, P. 18.) The Order Re: Motion to Alter or Amend Findings of Fact, Conclusions of Law and Judgment reflects the corrected language and provides at paragraph 2 that, "the court corrects the statement that '...capital gains from a separate asset received during marriage are separate property...' because the court meant to say that capital gains from separate assets are not always separate property." (R., p. 680.)

Although the magistrate court corrected its language, it did not alter its conclusion that the distribution was still community property. The magistrate attempted to clarify its findings, but the magistrate court erred because it conflated and misapplied the requisite legal analyses. It initially appeared as though the magistrate court concluded that what the increase in value of Bill's separate asset was a result of community effort by stating, "But what difference does it make whose burden it was if I make a finding, based on all the evidence that I have received, that there was increase in value as a result of community effort." (Tr., Vol. 1, p. 653, L. 13-17.) The court later stated:

> I mean, my finding was based upon my determination that it was more probable than not that Mr. Clark put a significant amount of effort into this project in the planning, building, and selling of the units after they were married. And that the compensation that was received in 2007 that has been characterized as capital gains was income because he didn't give anything up in exchange for that. He kept this interest in the Veltex building. It was not diminished at all. He was simply compensated for the increase in value that resulted his – as a product of his efforts.

[6] Dr. Baruch even acknowledged that capital gains earned on separate property is not income. (Tr. p. 667, L. 8-10.)

(Tr., Vol. 1, p. 655-656.) The magistrate held, "I think, that based upon the evidence that I heard, that it's more likely than not that the gain that they realized in 2007 was as a result of community effort, and it's income." (Tr., Vol. 1, p. 660, L. 4-10.)

Ultimately, at the conclusion of the hearing the magistrate court articulated its final ruling as follows:

> With respect to the findings that the proceeds from the Veltex building were community property in 2007, I can't find a reason to change that as well. We are talking about a period of time that was seven years post marriage. And my findings – I mean, we start with the presumption that the income received is community income. And it seems to me that I have to have something that demonstrates clearly and convincingly that it was separate property. The only finding that I can make, based upon the evidence that I heard, was that this far into the marriage, given the state of the project at the time of the marriage and the amount of effort that I found that he put into it during the marriage, that there is nothing that overcomes the presumption that it's community income. And so I never got to a trace.

(Tr., Vol. 1, p. 678-679.) The Order Re: Motion to Alter or Amend Findings of Fact, Conclusions of Law and Judgment provides that the magistrate's findings states that, "The Veltex Building was built and developed during the marriage and proceeds from the Veltex Building and income are presumed to be community property and Defendant failed to overcome the community presumption." (R., p. 680-81.)

The magistrate court's analysis is flawed because it conflates and confuses different analyses that are employed in different factual scenarios under Idaho law. To further complicate matters it made findings that were totally unsupported by the evidence and then further misapplied those findings to the correct legal analysis. In one statement it appears that the magistrate court characterized the distribution as community property because it found that through Bill's effort and labor there was an increase in his interest in Veltex Building, LLC. In

another statement, it appears as though the magistrate court was holding that the distribution was community because the community was not adequately compensated for Bill's effort and labor applied towards his separate business. Finally, it appears that the court simply assumed that the distribution was income based upon its finding that Bill put in effort and labor during marriage and therefore the distribution was presumed to be community and Bill did not rebut the presumption. Whatever the analysis employed, it was misapplied to the facts and does not support—under any theory—the conclusion that the capital distribution made on Bill's separate property was community property.

First, it appears that the magistrate court concluded that the community was not properly compensated for the labor and efforts that Bill put into his separate business. The magistrate states numerous times that Bill put in significant effort and labor during marriage and therefore he was forced to conclude that the capital distribution was community income, despite the fact that no evidence was presented of any community labor or effort. In 1973, this Court established the requisite analytical process that must be followed by our magistrate courts in determining the proper compensation to the community for labor dedicated to a separate property business. *Speer v. Quinlan*, 96 Idaho 119, 525 P.2d 314 (1973). In *Speer*, this Court stated: "The community property statutes in Idaho do not contemplate that upon marriage, the interests of each spouse in his or her separate property be assimilated by the community." *Id.*, at 128, 525 P.2d at 323. Stating that such a rule strikes a balance between the legitimate claims of both the separate and community estates, this Court ruled that the proper inquiry upon the dissolution of the marriage is whether the community has received fair and adequate compensation for its labor. *Id.*

In 1987, this Court cited to its *Speer* decision as follows:

> During the marriage, Speer, Inc., never distributed any earnings as dividends. All earnings were retained as working capital and invested in inventory, equipment and raw materials. This Court held in both cases that the divorced spouse gained no interest in the husband's separate property stock as a result of the corporation retaining its profits as working capital rather than distributing them as dividends.

Swope v. Swope, 112 Idaho 974, 983, 739 P.2d 273, 282 (1987) (hereinafter referred to as *Swope I*).

Finally, in 1990, this Court again reiterated that the ruling in *Speer* must be followed when deciding whether the community was entitled to a share of the increase in value in a separate property closely-held corporation. *Wolford v. Wolford*, 117 Idaho 61, 785 P.2d 625 (1990). The wife in *Wolford*, just like the wife in *Speer*, argued that she was entitled to share in the increase in value of a separate property business in which one of the parties was an employee during the marriage. *Id.* at 632, 785 P.2d at 68. *Speer*, *Swope* and *Wolford* clearly establish this Court's requirement that "the proper inquiry upon dissolution of the marriage is whether the community has been adequately compensated for its labor." *Wolford, supra*, at 68, 785 P.2d at 632.

> In determining adequate compensation, a three-pronged analysis is called for. First, business factors should be considered. Second, once the business factors have been considered, the question is whether the overall compensation received by the community was equivalent to the compensation that would have been necessary to secure a non-owner employee to perform the same services the community rendered. And third, if it is found that the community has been under-compensated, the community is then entitled to a judgment against the owner-spouse equivalent to the deficiency found. If, however, no deficiency is found, the community has no claim.

Wolford, supra, at 68, 69, 785 P.2d at 632, 633 (emphasis added).

Under Idaho law, the party seeking reimbursement as a result of alleged community contribution with respect to separate property has the burden of proving that community expenditures have enhanced the value of the separate property and the amount of the enhancement. *Bliss v. Bliss*, 127 Idaho 170, 173, 898 P.2d 1081, 1084 (1995); *Josephson v. Josephson*, 115 Idaho 1142, 772 P.2d 1236 (Ct. App. 1989); *Suter v. Suter*, 97 Idaho 461, 465, 546 P.2d 1169, 1173 (1976); *Hooker v. Hooker*, 95 Idaho 518, 521, 511 P.2d, 800, 803 (1972); and *Swope, supra*, at 983, 739 P.2d at 282. With regard to the burden of proof, this Court has ruled that, not only must the party claiming a community reimbursement from a separate property business demonstrate that the value of the business increased during the years of the marriage, the party must also demonstrate <u>why</u> the value of the separate property business increased. *Swope v. Swope*, 122 Idaho 296, 834 P.2d 298 (1992) (emphasis added) (hereinafter referred to as *Swope II*). In *Swope II*, the defendant failed in her burden to show that the value of the enhancement of the separate property business was <u>not</u> due to social economic trends, climatic conditions, trends in national popularity, advertising, capital invested in the business, ability to finance, ability to provide product to meet demand, business management, value of the franchise, value of the tangible assets of the business, and the amount of liability. *Swope II, supra*, at 299, 834 P.2d at 301.

The requirement of proving the amount of enhancement to separate property attributable to community contributions has been demonstrated by both the Idaho Court of Appeals and this Court. *See, e.g., Sherry vs. Sherry,* 108 Idaho 645, 701 P.2d 265 (Ct. App. 1985), and *Swope II, supra.*

In *Sherry*, the Court of Appeals held that the trial judge correctly concluded the community was not entitled to reimbursement for contributions to the separate real property because no evidence had been presented demonstrating that the $20,000 increase in value was due to community contributions. *Sherry, supra*, at 650, 701 P.2d at 270. Mr. Sherry had presented evidence of community expenditures made on Mrs. Sherry's separate property, but he presented no evidence of the amount of increase in value of the property attributable to the community expenditures. *Id.* The Court of Appeals recognized that the natural increase in value of the property retains the status of the underlying property. *Id.* (Citing *Martsch v. Martsch*, 103 Idaho 142, 645 P.2d 882 (1982)).

In *Swope II*, this Court found that the trial court had correctly applied the enhancement in value rule when the magistrate held that, because the wife had not shown that the increase in value of the husband's separate property was due solely to the use of their community property, she was not entitled to reimbursement. *Swope II, supra*, at 299, 834 P.2d at 301. The Court stated that the increase in value of the husband's separate property could have been attributable to factors such as socio-economic trends of the consumer, advertising, capital invested in the business, business management or value of the assets of the business. *Id.* To determine that *any* or *all* of the increase in value of the separate property was attributable *solely* to community contribution is pure speculation. *Id.* (emphasis added).

The magistrate court in this case failed to cite to any of the aforementioned cases when it concluded that the distribution was community because it was earned through community efforts and labor. There was no evidence presented at trial as to any community efforts or labor expended towards Veltex Building, LLC. Rather, the magistrate simply assumed such labor

based purely upon the fact that construction of the building occurred during the marriage and stated, "... my finding was based upon my determination that it was more probable than not that Mr. Clark put a significant amount of effort into this project in the planning, building, and selling of the units after they were married." (Tr., Vol. 1, p. 678-679.) The magistrate did not cite any authority that would support that conclusion. Most importantly, if in fact the magistrate court was holding that the capital distribution was community income because it was received through community effort and labor, then it incorrectly applied the analysis and well-established law. Most significantly, it improperly placed the burden upon Bill to rebut a community presumption, when the burden of proof is clearly upon Dr. Baruch to prove either that Bill's separate business increased in value during marriage due to community effort and labor or that the community was not adequately compensated for its labor; neither of which Dr. Baruch presented any evidence on.

Moreover, though not required to rebut any presumption, even if the burden were upon Bill, he rebutted any community property presumption through his testimony regarding the entities. All of the evidence presented established that the distribution from Veltex Building, LLC was a capital distribution. Dr. Baruch presented no evidence to rebut it. Additionally, Bill presented evidence, although also not required to do so, that the community was adequately compensated. Bill testified that one of his other entities, Clark Development, LLC was paid a fee for developing the project. (Tr., Vol. 1, p. 626, L. 11-28.) Bill receives a draw from Clark Development, LLC after expenses are paid. (Tr., Vol. 1, p. 238.) As of January 2010, Clark Development, LLC was receiving income of $15,000, which after expenses were paid Bill received approximately $8,500 per month. (Tr., Vol. 1, p. 244.) Therefore, the community was

compensated for any labor expended by Bill, even though there was no evidence of any community labor presented by Dr. Baruch.

The magistrate court also confused the aforementioned analysis with the analysis employed in determining when property is characterized. The magistrate court presumes that because the funds were disbursed during marriage that the date of the disbursement is the date the asset is characterized. However, under Idaho law, the character of property vests at the time the property is acquired. *Winn v. Winn*, 105 Idaho 811, 815, 673 P.2d 411, 415 (1983). Bill acquired his interest in Veltex Building, LLC before marriage. The undisputed testimony provided that Bill's interest in Veltex Building, LLC was acquired prior to marriage. The undisputed testimony was that the community contributed no funds to this asset during marriage. (Tr., Vol. 1, p. 418, L. 15-19.) Therefore, the asset was not acquired during marriage.

In the alternative, even if the court were correct in its view that the property is presumed to be community, Bill rebutted that presumption. The only evidence presented was that the $342,149 came from Veltex Building, LLC, even Dr. Baruch acknowledged this, and the only testimony about the funds was from Bill that the distribution was a capital gains distribution on his separate property.

Based upon the evidence that was presented and the well-established law in Idaho, the capital distribution that was issued on Bill's separate business during marriage is presumed to be separate property. Dr. Baruch did not rebut that presumption. Further, Dr. Baruch presented no evidence at trial to support any claim that either Veltex Building, LLC increased in value due to community effort and labor or that the community was not adequately compensated for any

community effort and labor expended on the business. The magistrate court erred and the distribution is properly characterized as Bill's separate property.

D. The district court erred in affirming the magistrate's conclusion that Bill failed to trace to his separate property.

The magistrate court never considered Bill's trace back to the capital gains distribution because it concluded that the distribution was community property and not separate. The district court affirmed. However, in the event this Court reverses the district court's characterization, Bill has presented evidence to trace his separate funds to a reasonable degree of certainty. Bill is entitled to reimbursement for the separate funds he contributed to the acquisition of the Ketchum Condominium. Under Idaho law he is entitled to dollar-for-dollar reimbursement. "It is further well established that where the separate funds of one spouse are used for the benefit of the community, such as payment of a debt arising from the acquisition of community property, the separate estate is entitled to reimbursement *of the amount expended*, absent clear and convincing evidence that a gift of the separate funds was made or intended." *Ustick v. Ustick*, 104 Idaho 215, 222, 657 P.2d 1086, 1090 (Ct.App.1983)(emphasis added); *see also In re Estate of Freeburn*, 97 Idaho 845, 850, 555 P.2d 385, 390 (1976).

As addressed above, Bill received funds from his separate property, the capital distribution from Veltex Building, LLC, on February 7, 2007 in the amount of $342,149. (Defendant's Exhibits 517(a), bate stamped 238, Exhibit 596 bate stamped 1287).) Bill testified, and it was not disputed, that those funds were deposited into the Schwab 3714 account and the statements for that period were admitted as Defendant's Exhibit 618. (Defendant's Exhibit 618, bate stamped 2114-2137; Tr., Vol. 1, p. 191, L. 18-21.) The statements reflect that on February

9, 2007, funds were received into the account in the amount of $342,149. (Defendant's Exhibits 618, bate stamped 02125 and Exhibit 596, bate stamped 1287.) There is also no dispute that the down payment for the Ketchum condominium was paid from the Schwab 3714 account in the amount of $30,000 as reflected on the check dated February 17, 2007 (Defendant's Exhibits 618, bate stamped 02126 and Defendant's Exhibit 596, bate stamped 1278) and an additional payment of $176,000 on March 27, 2007. (Defendant's Exhibit 618, bate stamped 02134 and Defendant's Exhibit 596, bate stamped 1278.)

At the time that Bill deposited $342,149 of his separate money into the Schwab 714 account, the account balance was $195,024.51. (Defendant's Exhibit 618, bate stamped 02115.) For the purposes of this tracing, Bill presumed that the $195,024.51 is community property. On the same date the funds were deposited, $15,000 was withdrawn. On February 17th, the check for $30,000 was drawn for the condominium and on February 23rd, $21,170.58 was withdrawn from the account. (Defendant's Exhibit 618, bate stamped.) The account balance as of March 1, 2007 was $472,634.53. On March 21st, $50,000 was withdrawn for the equity contribution to Jefferson Condominiums (Defendant's Exhibit 596, bate stamped 1305), on March 26th, $10,000 was withdrawn (Defendant's Exhibit 596, bate stamped), and on March 27th, $176,000 was withdrawn and applied to the Ketchum condominium (Defendant's Exhibit 596, bate stamped 1306). The account activity is detailed below:

Date	**Withdrawal/Deposit**	**Explanation**
February 1	$195,024.51 (CP)	Starting balance on February 1st.

February 9	+ $342,149 (SP)	Deposit of Bill's separate funds from Veltrex
February 9	- $15,000 (CP)	Subtracted from CP leaving balance of $180,024.51.
February 17	- $30,000 (CP)	Subtracted from CP leaving balance of $150,024.51. This went to the purchase of the condominium.
February 23	- $21,170.58 (CP)	Subtracted from CP leaving balance of $128,853.93.
March 21	- $50,000 (CP)	Subtracted from CP leaving balance of $78,853.
March 26	- $10,000 (CP)	Subtracted from CP leaving balance of $68,853.
March 27	- $176,000 (CP)	This was withdrawn and applied towards the acquisition of the condominium, however, at this time only $68,853.93 was remaining of the community portion of the funds, therefore after applying the $68,853.93 of remaining community funds, $107,146.07 of the $176,000 had to have come from the $342,149 that was Bill's separate property

Based on the foregoing, Bill is entitled to reimbursement in the amount of $107,146.07 for separate funds used to acquire the condominium.

There is no presumption that separate funds are used for community expenses. *Gapsch v. Gapsch*, 76 Idaho 44, 277 P.2d 278 (1954). Although the Schwab 3714 account held commingled funds, Bill's separate property can be traced. A specialized application of the overriding community property system is found in the "commingling rule." Essentially, commingling occurs when community and separate property assets are mixed, combined and treated as one fund to such an extent that tracing is not possible. The commingling doctrine frequently arises in connection with bank or other deposit accounts into which both separate and community funds are deposited, and then specific assets are purchased with the account. *Winn v. Winn, 105 Idaho 811, 673 P.2d 411; Speer v. Quinlan*, 96 Idaho 119, 525 P.2d 314 (1974);

Houska v. Houska, 95 Idaho 568, 570, 512 P.2d 1317 (1973); *Rose v. Rose*, 823 Idaho 395, 353 P.2d 1089 (1960); *Gapsch v. Gapsch*, 76 Idaho 44, 277 P.2d 278 (1954). "Tracing" is the term frequently employed to describe the undertaking by one spouse to remove a given asset acquired after marriage from the operation of the community property presumption. In *Stahl v. Stahl*, 91 Idaho 794, 430 P.2d 685 (1967), the Idaho Supreme Court refined the "commingling" rule by holding that commingling alone does not serve to *ipso facto* convert separate property to community property; rather, the court held that so long as the separate property is "traceable," it retains its separate property character:

> So long as the separate property of either spouse is identifiable and traceable, commingling of such separate property with community property does not convert the separate property into community property.

91 Idaho at 797, 430 P.2d at 688.

"In cases involving commingled property, the courts have recognized the use of an accounting method that treats expenditures for community purposes as having been made from community funds and expenditures for separate purposes as having been made from separate funds." *Batra v. Batra*, 135 Idaho 388, 17 P.3d 889 (Ct.App.2001); *see also Josephson v. Josephson,* 115 Idaho 1142, 1145, 772 P.2d 1236, 1239 (Ct.App.1989) *overruled on other grounds* (*citing Mix v. Mix*, 14 Cal.3d 604, 122 Cal.Rptr. 79, 536 P.2d 479 (1975)).

Therefore, it is presumed that the withdrawals from the account that were expended for community purposes are presumed to have come from the community funds in the account. Because there was not enough community funds remaining to pay the full $176,000 towards the

condominium, Bill has met his burden of tracing $107,146.07 to his separate money and is entitled to reimbursement.

IV. CONCLUSION

Bill respectfully requests this Court to reverse the district court's decision affirming the magistrate's findings and conclude that the balance of Bill's IRA on the date of marriage is his separate property and therefore the account, since it is less than that balance, is Bill's separate property. In the alternative, if this Court characterizes Bill's account as community, then Bill respectfully requests the Court to hold that Dr. Baruch's account should also be characterized as community property. Finally, Bill respectfully requests the Court to hold that he is entitled to reimbursement in the amount of $107,146.07 for his separate property contributions towards the acquisition of the Ketchum Condominium.

DATED: February 15, 2012

COSHO HUMPHREY, LLP

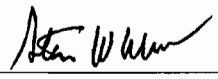
By: _____
STANLEY W. WELSH
Attorneys for Defendant/Appellant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY That on the 15th day of February, 2012, a true and correct copy of the within and foregoing instrument was served upon:

James A. Bevis
BEVIS JOHNSON & THIRY, PA
412 East Parkcenter Blvd., Ste. 211
Boise, Idaho 83706

- ☒ U.S. Mail
- ☐ Hand Delivery
- ☐ Overnight Courier
- ☐ Facsimile
- ☐ Email



STANLEY W. WELSH