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# Community Property Reimbursement

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## Community Property Reimbursement

*ROGER BERNHARDT*

So the kid is finally getting married and your clients are so happy to get her out of the house that they have volunteered to make the down payment on the newlyweds' new condo. Do they know what they are doing? A recent bankruptcy case should alert you and them to some of the risks spouses (and their parents) run when their mates turn out to be deadbeats.

### *In re Mantle*

In *In re Mantle* (Dumas v Mantle) (9th Cir 1998) 153 F3d 1082 (reported at p 176), Dorothy and John married in 1985, sold Dorothy's former residence in San Fernando for \$80,000 cash, and used those funds as a down payment on a new house in Canoga Park. They took title as "husband and wife as joint tenants" and both signed the mortgage, but the \$62,000 down payment came entirely from the proceeds of Dorothy's San Fernando residence. All subsequent mortgage payments were made with community money. After John filed for dissolution in 1990, the trial court held that Dorothy was entitled to reimbursement for her down payment contribution of separate funds to the community home. When a subsequent sale of the Canoga Park house generated \$67,000 cash, it looked as though most of the funds would go to Dorothy as reimbursement.

In 1993, however, before the divorce court divided the funds, John filed for bankruptcy under Chapter 7. His trustee asserted that, despite Dorothy's right to reimbursement, the entire \$67,000 in proceeds was property of the estate, because all community property becomes part of the debtor's estate in a bankruptcy proceeding. Dorothy claimed that the sale funds were her separate property because of her right to reimbursement, and therefore were not in John's estate.

This was not an easy issue to resolve. The bankruptcy court rejected Dorothy's argument, but the bankruptcy appellate panel rejected the bankruptcy court's holding and ruled in favor of Dorothy. The Ninth Circuit rejected that position, however, and held that the trustee was correct. Thus, until the proceeds were actually divided by the state court, they were still all community funds, notwithstanding Dorothy's right to reimbursement.

The case has many unusual facts that take a long time to tell, but it seems to me that it has wide-ranging consequences. John probably filed bankruptcy because he had too many creditors; if those creditors had gone after the house while he and Dorothy were still living in it, how useful would her reimbursement claim have been?

### **The Presumption of Community Property**

Three rules interact, although it is pretty difficult to predict all the effects of that interaction. One rule says that property held in any joint form is presumed to be community property. Fam C §2581. This section could make analysis simpler because there would be no need to decide how the consequences would differ if the title were held, say, in joint tenancy or tenancy in common instead. The scope of the rule is problematic, however, because its preface confines it to cases involving division of property on dissolution. Thus, a house may be community property in a divorce action, but not community property in a creditor's action against one or both of the spouses. (All this is complicated even further by the section's assertion that the presumption of community property is rebuttable.)

### **The Liability of Community Property**

A second rule says that all of the community property is liable for the debts of either spouse. Fam C §910. This means that a judgment creditor can reach the entire house or subject the entire

title to its judgment lien. See Bernhardt, *Trading Mortgages for Judgments Against Community Property*, 20 CEB RPLR 127 (May 1997). But how does this statute apply if title is held in joint tenancy rather than as community property and no divorce is pending? Is the creditor then limited to going after only the debtor's half, and not the interest of the debtor's spouse?

### **Spousal Reimbursement Rights**

The third rule is that a spouse who contributes separate property to the acquisition of community property "shall be reimbursed for the party's contributions to the acquisition of the property." Fam C §2640. (That was the basis of Dorothy's claim in *In re Mantle*.) The problem is that §2640's reimbursement right applies only to dissolution actions. Outside of divorce actions, there is apparently no statutory right of reimbursement. So how does Dorothy's claim stack up in a third party creditor's action to levy on the house, if no divorce has been filed (and completed)? And the uncertainties of the creditor's rights outside of divorce court, discussed above, complicate it even further.

### **The Intent of the Funder**

Finally, add in a fourth variable: If the down payment came from the parents, what was it intended to be: a gift (which means no reimbursement rights), an investment (which could mean some fractional ownership of the house), or a loan? And, if it was a gift or loan, was it made to her, to him, or to both? If it was a gift or loan just to her, was she gifting it, lending it, or investing it in the house? Was her treatment of the funds according to her parents' instructions or did she decide on her own?

The answers to many of these questions are hard to know. I don't believe that any attorney can confidently tell the parents what the status of the donated down payment is; we can make only weak guesses about how the courts will treat such transactions. Given this uncertainty, the attorney's job is to structure and document the transaction to best ensure the desired outcome.

### **Find Out and Document What They Want**

First, obviously, you have to find out what results are desired. What, for instance, do the parents want to happen to the funds if the kids get divorced? What should happen if their child dies? Next, you have to figure out a way to establish the desired rights. If you count only on the reimbursement statute to cover you, you may end up with no protection against third party creditors either (1) in a nondivorce action, or (2) in a dissolution action when the down payment donors are separate from the spouses or the presumption of community property is rebutted.

Those worries should justify you in urging the parties to put the transaction in writing. If properly documented, the parents' or spouse's reimbursement rights need not be confined to divorce actions (or, incidentally, subject to the other restrictions that §2640 imposes, such as no interest).

### **Make Provisions Effective Against Outsiders**

Finally, and most importantly, you have to ensure that the contributor is protected against third parties in a way that Dorothy Mantle was not. The statutory right of reimbursement has already failed against the bankruptcy trustee, whose status is really no different from that of a creditor. Even a written agreement for reimbursement could be strong-armed aside by creditors or the bankruptcy trustee on the ground that it is a secret lien of which they had no notice. See Bernhardt, *A Comment on Caito v United California Bank*, 1 CEB RPLR 65 (July 1978). Something has to be spread out on the records if the reimbursement claim is to trump all others.

One cannot record a mere note or agreement to reimburse, but if the promise to reimburse is secured by the same property, then it does affect an interest in property and can be recorded. I have previously suggested that spouses use mutual marital deeds of trust to protect their claims

against outsiders. See Bernhardt, *Secretly Severing Joint Tenancies*, 19 CEB RPLR 125 (May 1996). Perhaps that is too narrow a protection; perhaps there should be a recorded family deed of trust to protect the parents who contributed funds toward the down payment of a new house (or the spouse who sold her old, separate house to get funds to purchase the new, community one). The future advance clauses in such instruments would also sweep in other temporary imbalances resulting from unequal payments of common bills at any one time, and should be immune from attack by creditors and bankruptcy trustees (as long as they are bona fide).

By contrast, a deed of trust for the down payment is probably a purchase money deed of trust. That means there is no possibility of a deficiency judgment (because of CCP §580b) and no right to sue on the reimbursement promise (because of CCP §726). Foreclosure is the only remedy. The antideficiency rules bite again!