Revisiting Transmutation 20 Years Later: Still Untamed?

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REVISITING TRANSMUTATION 20 YEARS LATER: STILL UNTAMED?

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In 1977, the Illinois legislature's adoption of the Illinois Marriage and Dissolution of Marriage Act[1] (IMDMA) heralded an important shift in the philosophy underlying the marital relationship: husband and wife were now deemed to be equal partners. This change had its greatest effect in the area of property ownership; instead of traditional ownership by title, Illinois now recognized both the separate estates of each of the spouses and the marital estate, the first consisting of property each party owned before the marriage or acquired later by various prescribed methods,[2] and the second consisting of property acquired during the marriage in which both spouses have a common interest regardless of title.[3]

As courts began applying the new law, problems began to develop in situations in which the spouses had commingled either marital and non-marital property or non-marital property from their respective separate estates. By 1981, the law in Illinois governing the characterization and distribution of a couple's property upon the dissolution of their marriage had evolved into a mechanical application of the principle that any combination of property from any two different estates, marital or non-marital, transmuted the blended property into marital property.[4]

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[1] 750 ILCS 5/101 *et seq.*
[2] 750 ILCS 5/503(a).
[3] 750 ILCS 5/503(b)(1).
[4] *E.g., In re Marriage of Lee,* 87 Ill.2d 64, 430 N.E.2d 1030 (1981).

The seminal case highlighting the extremist nature of the doctrine of transmutation is *In re Marriage of Smith,*[5] in which the parties spent $3,800 of marital funds to improve the husband's non-marital office/apartment building, worth approximately $45,000.[6] Even though at the time of the Smith divorce no statutory provision for reimbursement existed in the IMDMA, the trial court attempted to reach an equitable solution by fashioning a rough form of reimbursement that returned to the original owner any non-marital contributions to assets, even those assets held in joint tenancy, as long as they could be clearly traced.[7] While the appellate court affirmed much of the trial court's decision,[8] the Illinois Supreme Court, invoking its interpretation of the law in place at the time, held that the statutory preference for marital property was so strong that any intentional commingling of property from any two different estates resulted in the creation of marital property.[9] As a result, the contribution of $3,800 of marital funds to Mr. Smith's $45,000 non-marital building transmuted the entire property into a marital asset.[10] Theoretically, using the logic in *Smith,* a contribution of $1 in marital funds to a non-marital asset worth $1 million would result in the entire $1,000,001 being deemed marital.

The legislative response to *Smith* was Public Act 83-129, an amendment to then-Ill.Rev.Stat 1983, ch. 40, sec. 503, drafted by James H. Feldman, Esq. and Charles J. Fleck, Esq., at the request of the Illinois House Judiciary Committee, the purpose of which was to temper the *Smith* rationale and "tame" transmutation. Under the

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[5] 86 Ill.2d 518, 427 N.E.2d 1239 (1981).
[6] *Id*, p. 523
[7] *Id.*, pp. 523-26.
[8] *Smith v. Smith,* 90 Ill.App.3d 168, 412 N.E.2d 985 (5th Dist. 1980).
[9] *Smith, supra* note 5, p. 529
[10] *Id.*, p. 533

amendment, now codified at 750 ILCS 5/503(c), the character of contributed property is transmuted to that of the recipient estate, but the contribution is reimbursable to the contributing estate as long as certain conditions are met. Feldman and Fleck, the authors of Public Act 83-129, published an article, *Taming Transmutation: A Guide to Illinois' New Rules of Property Classification and Distribution Upon Dissolution of Marriage*[11] ("Feldman and Fleck") explaining the intricacies of the new statute and making clear that the *Smith* decision no longer reflected the law. The authors noted,

> Under the *Smith* rationale, the use of a spouse's salary to make a mortgage payment could transmute an entire asset into marital property regardless of the discrepancy between the slight value of the contribution and the far greater value of the asset. Such a rule renders the concept of nonmarital property illusory.[12]

Subsequent cases have acknowledged that the purpose of the amendment was to reverse the effect of *Smith*,[13] and the Feldman and Fleck article is arguably the most often-cited and authoritative article on any aspect of matrimonial law.[14]

The initial rules for characterizing marital and non-marital property are found in 750 ILCS 5/503. Under 750 ILCS 5/503(b)(1), all property acquired during the marriage, no matter how titled, is presumed to be marital property, a presumption that may be overcome by showing that the property at issue was acquired by one of the methods set forth in 750 ILCS 5/503(a):

> (a) For purposes of this Act, "marital property" means all property acquired by either spouse subsequent to the marriage, except the following, which is known as "non-marital property":

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[11] 72 Ill. B. J. 336 (1984).
[12] *Id.*, pp. 336-37.
[13] *E.g., In re Marriage of Mayzner,* 144 Ill.App.3d 645, 649, 494 N.E.2d 615, 618 (1st Dist. 1986); *In re Marriage of Harmon,* 33 Ill.App.3d 673, 675, 479 N.E.2d 422, 424 (5th Dist. 1985).
[14] The article has been discussed and quoted in over 15 cases and dozens of articles.

(1) property acquired by gift, legacy or descent;

(2) property acquired in exchange for property acquired before the marriage or in exchange for property acquired by gift, legacy or descent;

(3) property acquired by a spouse after a judgment of legal separation;

(4) property excluded by valid agreement of the parties;

(5) any judgment or property obtained by judgment awarded to a spouse from the other spouse;

(6) property acquired before the marriage;

(7) the increase in value of property acquired by a method listed in paragraphs (1) through (6) of this subsection, irrespective of whether the increase results from a contribution of marital property, non-marital property, the personal effort of a spouse, or otherwise, subject to the right of reimbursement provided in subsection (c) of this Section; and

(8) income from property acquired by a method listed in paragraphs (1) through (7) of this subsection if the income is not attributable to the personal effort of a spouse.

The new provisions, designated as 750 ILCS 5/503(c), went a step farther and set out rules for the court to use when confronted with assets consisting of a mix of marital and non-marital property:

(c) Commingled marital and non-marital property shall be treated in the following manner, unless otherwise agreed by the spouses:

(1) When marital and non-marital property are commingled by contributing one estate of property into another resulting in a loss of identity of the contributed property, the classification of the contributed property is transmuted to the estate receiving the contribution, subject to the provisions of paragraph (2) of this subsection; provided that if marital and non-marital property are commingled into newly acquired property resulting in a loss of identity of the contributing estates, the commingled property shall be deemed transmuted to marital property, subject to the provisions of paragraph (2) of this subsection.

> (2) When one estate of property makes a contribution to another estate of property, or when a spouse contributes personal effort to non-marital property, the contributing estate shall be reimbursed from the estate receiving the contribution notwithstanding any transmutation; provided, that no such reimbursement shall be made with respect to a contribution which is not retraceable by clear and convincing evidence, or was a gift, or, in the case of a contribution of personal effort of a spouse to non-marital property, unless the effort is significant and results in substantial appreciation of the non-marital property. Personal effort of a spouse shall be deemed a contribution by the marital estate. The court may provide for reimbursement out of the marital property to be divided or by imposing a lien against the non-marital property which received the contribution.

While the principles incorporated into the 1983 amendment have remained intact, some courts, responding to extraordinary circumstances, have recently been crafting new restrictions to reimbursement, proving that the supposedly "tamed" transmutation still has sharp claws.

New questions have emerged concerning the measure of reimbursement to a marital estate for traceable contributions to non-marital property. First, is all reimbursement to be measured by the increased value of the non-marital estate, or is the reimbursement simply a mathematical calculation--dollars contributed equal dollars reimbursed? A related question arises when courts deal with reimbursement to the marital estate for personal efforts contributed to non-marital property. Logically, 750 ILCS 5/503(c)(2) could be construed as requiring the court to consider appreciation in value only in the case of a spouse's contribution of "personal efforts" to non-marital property. However, some appellate courts have held that appreciation in value, if not the key, is at least an important consideration in the calculation of any reasonable

reimbursement, whether attributable to personal efforts[15] or contribution of funds;[16] others courts do not measure value but simply reimburse the contributing estate dollar for dollar.[17]

When marital money is contributed to a non-marital bank account, simple accounting would appear to support a dollar for dollar reimbursement. However, if marital expenses have been paid from the same commingled non-marital account throughout the marriage, a dollar for dollar reimbursement would result in an artificial enrichment of the marital estate. The solution devised by the courts to avoid such an unjust result is to deem the marital estate already reimbursed by the benefit it has already received through use of the funds[18] or the property.[19]

Obviously, the enactment of 750 ILCS 503(c) was not intended to eliminate the concept of transmutation; as the Feldman and Fleck article clearly asserts, the intent and effect of the law was simply to limit or *tame* its application in the following circumstances:

A. Transmutation occurs when non-marital property is subsequently titled in a form of co-ownership or used to acquire property that is thereafter titled in a form of co-ownership.[20] The affirmative action of titling a non-marital asset in a form of co-ownership raises the presumption that a gift was made to the marital estate. This presumption may be rebutted by clear and convincing evidence that no gift was intended.[21]

B. Transmutation also occurs when funds from two different estates are contributed to the purchase of a new asset; if the funds from each estate

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[15] *In re Marriage of Raad,* 301 Ill.App.3d 683, 704 N.E.2d 964 (2d Dist. 1998).
[16] *In re Marriage of Nelson,* 297 Ill.App.3d 651, 698 N.E.2d 1084 (3d Dist. 1998).
[17] *In re Marriage of Phillips,* 229 Ill.App.3d 809, 594 N.E.2d 353 (2d Dist. 1992).
[18] *Nelson, supra* note 16.
[19] *In re Marriage of Snow,* 277 Ill.App.3d 642, 660 N.E.2d 1347 (4th Dist. 1996).
[20] 750 ILCS 503(b)(1)
[21] *In re Marriage of Benz,* 165 Ill.App.3d 273, 518 N.E.2d 1316 (4th Dist. 1988).

lose their identity, the new asset is marital.[22] A common example of this type of transmutation occurs when a non-marital home is sold during a marriage and a new home purchased. At closing, the proceeds from the sale of the non-marital home are combined with marital funds to purchase the new home, which is classified as marital. On the other hand, if funds from one estate are contributed to a bank account owned by another estate, the contributed funds do not lose their identity but take on the character of the recipient estate, and a new asset purchased with the combined funds will also take on the character of the recipient estate, subject to possible reimbursement.[23]

C. Finally, when property from one estate is contributed to another estate and one party requests reimbursement to the contributing estate, reimbursement is not required if the contributed funds cannot be traced by clear and convincing evidence.[24]

It would appear that the above circumstances, each of which incorporates Illinois law of property classification, are reasonably straightforward. However, problems can arise with the application of these principles, as shown in the following scenarios:

Scenario 1:

A spouse owns a non-marital home. The spouse also has a non-marital checking account titled solely in his or her name, opened either before the marriage or using non-marital funds. The account is clearly non-marital. However, during the marriage, the spouse also deposits all of his or her wages from employment into the account and uses funds from the account to pay everyday marital expenses as well as expenses for the non-marital home. Further, one of the spouses has children of a prior marriage whose expenses are paid from this account as well. What is the measure of reimbursement?

The logical answer is to return to the intent of the reimbursement legislation: The Court must "...determine the value of the item in question in order to determine the

[22] 750 ILCS 5/503(c)(1).
[23] 750 ILCS 5/503(c)(1).
[24] *In re Marriage of Phillips,* 229 Ill.App.3d 809, 594 N.E.2d 353 (2d Dist. 1992)

amount of reimbursement."[25] Using a pure dollar for dollar approach, the measure of reimbursement to the marital estate would appear to be the total marital funds contributed. However, such an approach would distort the real value of the actual marital contribution because marital expenses were paid using the funds. Not to reduce the marital contributions (the measure of the potential reimbursement) by subtracting the marital expenses paid would unjustly enrich the marital estate because that estate has, in effect, already been reimbursed.[26]

In the same scenario, if all post-marital contributions to the non-marital account are marital and no non-marital expenses are paid, the reimbursement would be the value of the account at dissolution less the non-marital balance at the time of the marriage. Finally, if both non-marital and marital expenses are paid from the account, the total marital deposits less the marital expenses would be the measure of reimbursement. The difficulty, of course, is that while the value of the funds is quantifiable, the value of what was acquired is not.[27]

Scenario 2:

> A spouse owns a non-marital checking account. A down payment is made on the purchase of a home from a marital account. The spouse's non-marital property is then utilized to fund the balance of the purchase. The combination of marital and non-marital funds in this sequence creates marital property[28]

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[25] Feldman & Fleck, pp. 340-44; *In Re The Marriage of Patrick*, 233 Ill.App.3d 561, 569, 599 N.E.2d 117, 122 (Dist. 1992).

[26] *In Re Marriage of Crook*, 839 Ill.App.3d 377, 388, 778 N.E. 2d 309, 318 (4th Dist. 2002); *In Re Marriage of Snow*, 277 Ill.App.3d 642, 650, 660 N.E. 2d 1347, 1352 (4th Dist. 1996).

[27] See *In Re Marriage of Phillips*, 229 Ill.App.3d 809, 819-20, 594 N.E.2d 353, 359-60 (2nd Dist. 1992), where the marital contributions could be specifically traced to the acquisition, and therefore appreciation, of shares in a retirement/savings plan; *Van Ness v. Van Ness*, 136 Ill.App.3d 185, 482 N.E.2d 1049, 1052 (4th Dist. 1985), where the failure to show differences in the actual appreciation of a residence resulted in the reimbursement being the percentage contribution.

[28] 750 ILCS 5/503(c)(1).

Scenario 3:

> A spouse owns a mutual fund prior to marriage. During the marriage, the spouse contributes marital earnings to the same mutual fund. Assuming all the funds are in the same investment vehicle, the appreciation, if any, would be the difference between the percentage of the funds contributed and the balance in the fund at the time of each contribution. If the mutual fund is multi-tiered, the reimbursement calculations must be made per fund. Assume, however, that the same marital funds are contributed but adverse market changes cause the value of the fund to plummet. As in Scenario 1, a dollar for dollar reimbursement might well be an artificial enrichment of the marital estate, particularly if the marital contributions exceed the current value of the account.

All of the above demonstrate that, given thoughtful analysis, the 1983 statutory provisions will provide a consistent guide for unraveling complicated fact patterns and producing consistent results in harmony with the principles underlying section 503(c). Nevertheless, the appellate court's application of the law to the "unique facts" in a recent case, *In re Marriage of Henke*,[29] has created an anomaly in the law that ignores governing principles and creates unsettling unpredictability.

The parties in *Henke* had been married for 16 years; the wife was a stay-at-home mom, the husband a self-employed farmer. The parties lived in a single-family home on the "Home Farm," consisting of 160 of the 840 acres of Henkeview Farms, which was owned in trust by the husband's parents. The husband farmed all of Henkeview Farms and paid rent to his parents and siblings for the use of their portions of the property.

The wife, who was not allowed to have her own checking account, paid for groceries and all household and family expenses out of the husband's non-marital checking account titled in the names of Henkeview Farms and the husband. Because the wife did not have signature authority on the account, the husband would either sign the

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[29] 313 Ill.App.3d 159, 728 N.E.2d 1137 (2d Dist. 2000).

checks or have the wife sign his name. The money that was deposited into the checking account came solely from the profits of the husband's farming operations and was used to pay family and farm expenses, reduce the mortgages on certain properties, and purchase vehicles.

In its judgment, the trial court held that the Home Farm was non-marital property but ordered reimbursement to the marital estate for $80,000 worth of marital funds spent out of the account to build new grain bins and $40,000 used to build a Morton building, both of which added to the value of the Home Farm. It also classified the checking account, which contained $3,886 on the date of judgment, as marital property, so all the vehicles and other assets purchased with funds from the checking account were also marital property.

On appeal, the husband contended that the trial court's decision labeling the checking account as marital property was against the manifest weight of the evidence. The wife conceded that the checking account initially was non-marital property because it existed prior to the marriage. However, she argued, the checking account was transmuted into marital property because income earned during the parties' marriage was deposited into the account and funds from the account were used to pay family expenses throughout the parties' 16-year marriage.

The Appellate Court acknowledged that section 503(a)(6) of the IMDMA defines non-marital property to include property acquired by either spouse before the marriage,[30] and that section 503(c)(1) applied to the facts of the case:

[30] 750 ILCS 5/503(a)(6).

> (1) When marital and non-marital property are commingled by contributing one estate of property into another resulting in a loss of identity of the contributed property, the classification of the contributed property is transmuted to the estate receiving the contribution ...."[31]

The court also observed that, notwithstanding any transmutation, section 503(c)(2) provides that the contributing estate shall be reimbursed from the estate receiving the contribution, unless the contribution cannot be retraced by clear and convincing evidence or was a gift.[32]

Looking only to the plain language of the statute,[33] the mere fact that the husband deposited marital earnings into his non-marital bank account and used them to pay household bills and expenses should have been insufficient to transmute his non-marital account into marital property. Indeed, Feldman and Fleck anticipated the very fact pattern that occurred in *Henke* and described the legislative intent and effect of section 503(c)(1):

> The wife deposits her salary checks (marital property) into her non-marital bank account. This money loses its identity and is transmuted to non-marital property, subject to a possible right of reimbursement to the marital estate. The "newly acquired property" provision of Section 503(c)(1) does not apply to this example because no newly acquired property resulted from the deposit of any marital checks into the non-marital bank account. The account itself is not new property as it already existed prior to the marriage and prior to any additional deposits being made.[34]

Obviously, because the checking account at issue was in existence prior to the parties' marriage and the husband had never added the wife as a signatory, the account was non-marital property. The funds deposited into the checking account during the

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[31] 750 ILCS 5/503(c)(1).
[32] 750 ILCS 5/503(c)(2).
[33] 750 ILCS 5/503(c)(1).
[34] Feldman & Fleck, *supra* note 11, p. 338.

marriage, all of which came from earnings, were marital property. Therefore, under a strict application of section 503(c)(1), the marital funds contributed to the non-marital checking account were transmuted into non-marital property, subject to reimbursement.

However, reimbursement requires tracing by clear and convincing evidence,[35] and the Appellate Court saw that it would be extremely difficult, if not impossible, for the wife to trace 16 years of marital contributions into specific purchases.[36] If the wife could not accomplish the tracing, all the funds in the checking account over the past 16 years and all property purchased with those funds would be the non-marital property of the husband; the only step the court then had authority to take was to "assign each spouse's non-marital property to that spouse."[37]

The Appellate Court decided that a strict application of section 503(c)(1) was improper under the facts of the case:

> We believe that to hold that those funds were transmuted to nonmarital property would contravene the intent behind section 503(c) of the Act. The instant case presents the opposite situation of that sought to be ameliorated by the amendment to section 503(c) of the Act, where a small amount of marital money was contributed to a large amount of nonmarital property. . . Presumably, the amount of marital funds contributed over 16 years greatly exceeded the amount of non-marital funds initially present in the account. Under the circumstances, we do not believe that the marital funds put into the checking account were transmuted to nonmarital property. Rather, we hold that, under the unique circumstances of this case, the checking account contained marital funds and therefore was properly characterized as marital property.[38]

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[35] 750 ILCS 5/503(d)
[36] *Henke, supra* note 29, p. 167.
[37] 750 ILCS 5/503(d).
[38] *Henke, supra* note 29, pp. 168-69.

Clearly, while the *Henke* result might satisfy the court's sense of fairness and equity, it is an anomaly in the body of Illinois law addressing property distribution upon dissolution of marriage.[39] The danger it creates is its precedential authority allowing a court to ignore a controlling statute in order to fashion a result that it believes to be more compatible with its interpretation of the spirit of the 1983 amendments. Unless *Henke* is strictly limited to its "unique" facts, what was previously a predictable outcome in property litigation under the IMDMA will again become the proverbial "roll of the dice."

Could the court in *Henke* have reached the same result without wreaking such havoc with the statute? The authors submit that the trial court had four choices, any of which could be affirmed as comporting fully with the language and intent of the statute:

1. The easiest solution would have been to issue the decision as a Supreme Court Rule 23 Order. The court would have reached the same desired result without creating difficulties for future litigation.

2. Using the reasoning found in *Snow* and *Crook,*[40] the court could have ruled that, under the statute, while the marital estate had a clear right to reimbursement, the fact that all the marital expenses and purchases of assets had been paid using the marital funds deposited into the account meant that the marital estate, now including all

[39] See, *e.g., In re Marriage of Uehlein*, 265 Ill.App.3d 1080, 1086, 638 N.E.2d 706, 712 (1st Dist. 1994) (property purchased with an initial payment of $6,000 by a check drawn on the parties' joint checking account was properly considered marital property because funds received by petitioner from the sale of the non-marital property had been commingled with the marital funds when deposited in the parties' joint checking account); *In re Marriage of Davis,* 215 Ill.App.3d 763, 576 N.E.2d 44 (1st Dist. 1991) (assets in brokerage account purchased with a combination of marital and non-marital property properly held to be marital); *In re Marriage of Didier,* 318 Ill.App.3d 253, 742 N.E.2d 808 (1st Dist. 2000) (wife could not trace assets to a non-marital source when she presented no specific testimony or documents to support her claim).

[40] Note 26, *supra.*

assets bought with money from the account, had already been amply reimbursed and thus was not due any further reimbursement.

3. The court could have held that, because all the deposits into the account during the marriage were marital money, all the marital expenses and purchases of assets during the marriage had been accomplished using the marital deposits, and the husband would simply be awarded the account and its $3,886 as his non-marital property.

4. The court could have acknowledged the impossibility of tracing, designated the entire account and all property purchased with its proceeds as non-marital, and then awarded the wife an equitable amount of maintenance in gross "paid from the income or property of the other spouse . . ."[41]

Any of these choices would have comported with both the letter of the law and the intent of the drafters without creating an aberration in the law that practitioners will have to deal with for a very long time.

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[41] 750 ILCS 5/504(a).