

Tracing separate property in a commingled world

Family law tips to protect separate property claims in complex assets cases for business managers and financial planners.

By Mara Berke

Preserving separate property claims requires financial management and comprehensive record-keeping. The best way to protect separate property claims is to keep your separate property separate and not commingle it or change its characterization to community property. Commingling of assets can complicate property characterization, necessitating precise tracing methods to establish separate property contributions. This article outlines the statutory and case law principles governing reimbursement claims, the evidentiary burden placed on the proponent of a separate property claim, and the methodologies courts employ in tracing commingled assets. Additionally, it addresses the complexities associated with cryptocurrency transactions and the evidentiary challenges they present in asset division.

Tracing separate property and cryptocurrency issues

Parties routinely commingle their separate property with community property, which complicates how they protect their separate claims. *Family Code* Section 2640 defines a parties' rights to reimbursement claims for separate property contributions to the acquisition of community property and separate property of the other party unless there is a written waiver of the right to reimbursement. The contributions include "downpayments, payments for improvements, and payments that reduce the principal of a loan



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used to finance the purchase or improvement of the property but ... not ... payments of interest on the loan or payments made for maintenance, insurance, or taxation of the property." *Fam. C. §2640(a)*. The problem is that "if the separate property and community property interests have been commingled in such a manner that the respective contributions cannot be traced and identified, the entire commingled fund will be deemed community property pursuant to the general community property presumption of [Family Code] section 760." *In re Marriage of Simonis*, 95 Cal.App.5th 1129, 1142 (2023); *In re Marriage of Ciprari*, 32 Cal.App.5th 83, 92 (2019). The separatizer has the burden to prove the separate funds were used to

acquire the property to overcome the community property presumption. *In re Marriage of Simonis*, *supra*, 95 Cal.App.5th at 1142.

There are two methods for tracing the commingled funds: "direct tracing" or "family living expense tracing" (or "recapitulation" method). *Id.* at 1143; Ciprari, *supra*, 32 Cal.App.5th at 96. Direct tracing can be used to demonstrate a spouse's separate property was used to purchase an asset with "(a) documentary proof that sufficient separate property funds were available in the account at the time of purchase; and (b) proof that the spouse making the purchase intended to use separate, rather than community, funds." Ciprari, *supra*, 32 Cal.App.5th at 96-97. "Exhaustion tracing" attempts to

trace a payment or purchase from a commingled mass to separate property funds by process of elimination; i.e., by showing that - because all community property funds were exhausted at the time the purchase or payment at issue was made - separate property funds necessarily must have been used." *Id.* at 95-96. The Ciprari court notes that trial courts have the flexibility to consider credible evidence and to evaluate alternative tracing methods (including reasonable, well-supported, and nonspeculative expert testimony) to determine whether the proponent of the tracing carries the burden of proof. *Id.* at 97. The best way to protect separate property is by not commingling community and separate assets and in-

come. Once a party commingles, that party assumes the burden of keeping records adequate to establish the separate claim.

Performing separate property tracings is a complicated and expensive exercise even when documents are readily available. A separate property tracing analysis entails a detailed review of each transaction occurring within commingled account(s) to determine the source of funds (i.e. community or separate property) used to acquire each asset purchased from or within the account(s), characterizing any income generated by such assets thereafter, and tracking the disposition and/or reinvestment of sales proceeds to the current assets in the estate to be divided between the parties.

There are unique hurdles in characterizing and dividing cryptocurrency, which is determined using the direct tracing method. *See* tracing analysis in the seminal California Supreme Court case of *See v. See*, 64

Cal.2d 778 (1966), which first established the tracing methods discussed above. Unlike monthly statements issued by typical financial institutions, cryptocurrency platforms do not automatically generate monthly statements. Users may download transaction histories, typically in a CSV file, which reflect trade activity. The transaction history is necessary to prepare a tracing of the community and separate property interests. Cryptocurrency activity is not always reported on tax returns correctly since there are no uniform reporting requirements for these platforms. Not all cryptocurrency exchanges issue formal tax forms (1099s) to report income activity for their users. In some cases, the holder is responsible for accurate tax reporting in the absence of formal tax reporting documents, which may not occur. That makes it harder to track and reconcile separate property claims for tracing purposes per Alexandra Peais, CPA, of Gursey Schneider LLP,

a forensic accountant who performs complex tracings.

Allocating cryptocurrency assets between parties is also complicated because of the form, location, and methods to transfer. Cryptocurrency assets are held in digital “wallets,” which can be online “hot wallets” or offline “cold wallets.” Confidential/individual “key” information (akin to a password) is required for users to access such wallets. According to Peais, “identifying and requesting the wallet and key information, including the physical location of any cold wallets, is imperative to quantify, characterize and divide cryptocurrency assets.”

This is the second of three articles exploring key issues in protecting separate property claims in complex asset marital dissolution cases for estate planners, business managers, financial experts and business owners. The first article, Protecting separate property claims in complex asset cases, appeared on Feb. 27. Part three will be published on March 27.

Mara Berke is a family law attorney with over 30 years of experience, including in her own practice, Berke Family Law, and as Of Counsel, Hanson Crawford Crum Family Law Group LLP in San Mateo. She was also formerly Of Counsel at Jaffe Family Law Group in Los Angeles.

