

## Exemption claims in equitable distribution

# Using asset tracing



Divorcing couples come to court with all sorts of assets; some joint, some shared; some never intended to be shared. Asset tracing is simply the documentation and support of a claim of exempt property. Simple concept. Sometimes difficult process.

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One of the main components in a divorce action is the distribution of the marital property between the parties. Identifying the assets subject to distribution can be a difficult task. All property owned by one spouse individually or jointly is assumed to be marital property subject to distribution unless it can be shown that it is exempt from distribution. See *Painter v. Painter*, 65 N.J. 196, (1974). The burden of proof for the exemption claim is on the party seeking it.

Considering the dynamics of a modern-day couple, it is not always clear what assets are entirely subject to distribution. A vast majority of litigants come to court after a significant period of cohabitation and accumulation of assets; some of these assets are intended to be shared, some are not.

The purpose of transmutation and its related claim for disproportionate distribution is to establish that an asset was transformed from individual ownership to joint ownership or conversely during the marriage or period of cohabitation.

By definition, transmutation is the process of turning separate property into property subject to distribution. Some clues that a practitioner should look for are gifting of property from one spouse to another, commingling of property by joining of assets, and the use of joint property.

The documentation and support of a claim of exempt property is typically done using a process called asset tracing. Unfortunately the tracing of assets is not as easy as obtaining a credit report. Many times it is necessary to engage a CPA to aid in proving or disproving the separate nature of the property through an asset tracing accounting. The resulting documentation should demonstrate

that at the date of complaint the asset is either exempt, marital or a combination of the two.

The asset-tracing process can range from examination of documents that existed at the time of marriage to creating schedules detailing years of financial transactions involving the asset in question. The methods used are designed to demonstrate that the asset qualified as exempt property at the date of marriage and then to trace the exempt ownership and/or all transmutations of that asset up to the date of complaint. To establish this claim, it is imperative the attorney, the CPA and each party provide proof through the use of paper documents. For instance, in the case of realty, the gifting documents such as gift tax returns, the will, the letter of gift, the deed and checks that would evidence payment of consideration and the source of those funds.

## Client interview

During the client interview process, a listing of the exempt and/or transmuted assets should be prepared. The following records and information should be obtained and will be used to produce the asset tracing: All documents regarding the acquisition of the property and the source of funds used to acquire it, in addition to the name of the titleholder. Also, the parties should provide all records and details relating to any dispositions or conversions of all or part of the property in question. These documents may include bank statements, investment statements, real estate closing statements and any other documents regarding the source of funds for the transactions.

## Tracing

In all of the methodologies, the CPA will utilize a schedule tracing the flow of assets from the date of marriage through the date of complaint. The transactions — deposits and withdrawals — will be documented by the date of the transaction, the amount of the transaction and whether it is separate or marital. The schedule, notes and the supporting documentation will be used to defend the client's position.

Communication between the CPA and the attorney is key to understanding the intent of the parties and the most appropriate accounting method.

## Transmutation

In the event you are faced with a transmutation issue on an investment account, the complications might lie not in the claim for the exemption of the initial funds but in the allocation of the growth. See *Sculler v. Sculler*, 348 N.J. Super 374 (Ch. 2001).

This issue is at the forefront of changing trends in New Jersey law as well as nationwide. As in most matrimonial cases, the legal arguments are conditioned on the facts presented. When arguing for or against transmutation, you must consider the intent of the parties. See *Wadlow v. Wadlow* 200 N.J. Super 372 (AD 1985). In *Wadlow* the key was Mrs. Wadlow's ability to establish through the use of documentary evidence that the funds were acquired by way of exempt gift, inheritance and savings.

One issue frequently raised in the context of transmutation is whether preservation and maintenance of an asset can result in this equitable claim of transmutation. For instance, is it fair that in a two-year marriage, where one party utilizes all of his/her premarital assets to purchase the marital home, this asset should be equally divided? Instinctively, the answer is no. But what if the premarital asset totaled less than the marital contribution made by the other spouse towards preserving or maintaining the asset? If the asset is real estate, is it fair to deny a claim of transmutation and a resulting equitable determination based on title alone? Conversely, is it fair to allow distribution of an asset where only one party has been exposed to risk?

These arguments and those found in the prevailing law precisely demonstrate the need for asset tracing. Without providing a clear picture of the source of funds, growth of funds, intent of the parties and contribution of risk, the exposure is an inequitable result.

The united efforts of the attorney and the CPA can be critical to supporting an exemption claim in equitable distribution. Asset-tracing accounting can be critical in supplementing your claim for exemption from equitable distribution. ©

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