



Forensic Accounting Today

Newsletter of Ron J. Anfuso, CPA/ABV, An Accountancy Corp.

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Issue 47
Serving all of California

Ron's Corner Methods of Tracing

In this and the following issue of *Forensic Accounting Today*, I cover The Court of Appeal Second Appellate District's ruling on a highly contested family law case where the central issue was tracing. As you are well aware, the two most frequently used methods of tracing are *Direct Tracing* and *Exhaustion Tracing*.

Direct Tracing can be used to demonstrate a spouse's separate property was used to purchase an asset, even though the purchase was made with funds from a commingled account. The direct method requires documentary proof that sufficient separate property funds were available in the account at the time of purchase, and proof that the spouse making the purchase intended to use separate, rather than community, funds.

Exhaustion Tracing, sometimes called *recapitulation*, *family expense*, *family living expense*, or *family income exhaustion tracing*, attempts to trace a payment or purchase from a commingled estate to separate property funds through a process of elimination. The exhaustion method presumes that available community property funds are used for family expenses before separate property funds are used for that purpose.

Are there Acceptable Alternative Methods?

The contention expressed by DeeDee Ciprari in this case was that under California Law, the two *exclusive methods* of tracing are Direct and Exhaustion Tracing. However, the current leading treatise states,

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Has Tracing Changed or Remained the Same?

In re the Marriage of Dorothy and Joseph Ciprari

Court of Appeal Decision Related to Forensic Accounting

Presented by Ron J. Anfuso, CPA, ABV, CFF, CDFA, FABFA

Part 1

Dorothy ("DeeDee") and Joseph ("Joe") fixed their date of separation as August 13, 2010, the date DeeDee commenced the marital dissolution proceeding. The marriage terminated pursuant to a judgment entered March 18, 2016, which attached the court's final statement of decision. On appeal from that judgment, DeeDee attacked the detailed tracing analysis performed by me, upon which the trial court relied. The court concluded the tracing was valid and constituted substantial evidence in support of the judgment.

Characterization of Assets

The parties stipulated Joe entered the marriage with \$2,053,573 of separate property. Of that amount, \$873,953 was held in two Wells Fargo accounts. The trial court found the money held in the bank accounts was "essentially 'gifted' to the community," a finding neither party contested.

On the date of the party's marriage, Joe held the balance of his separate property (\$1,179,620) in a brokerage account at PaineWebber. As is typical, the brokerage account had cash and investment components. The account held \$295,856 in cash and securities then valued at \$883,764. DeeDee's separate property amounts were not an issue.

In February 1996, Joe received a \$244,696 bonus from his employer for work performed during the prior year. Because the parties had married during 1995, the bonus was partly separate property and partially community property. Nevertheless, Joe deposited the entire amount into his PaineWebber brokerage account. This was the first time that community and separate funds became commingled in the account. But it was far from the last. Throughout the marriage, Joe indiscriminately

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Generally, either of two tracing methods may be used to characterize disputed property interests. This statement does not prohibit the use of other methods.

The findings of this case may change your views concerning tracing methods. I look forward to receiving your comments.

Ron



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deposited portions of his salary (which was community property) into the PaineWebber account and other commingled investment accounts he later opened. (*The PaineWebber account became a UBS account after UBS acquired PaineWebber.*) By the end of 2014, the combined balances in these commingled investment accounts equaled \$6,910,568.

How much, if any of that sum, was Joe's separate property and how much was community property is known as a *characterization* issue, which was the central issue in this case. Characterization refers to the process of classifying property as separate, community or quasi-community.

Joe's Tracing

At trial, I testified I had conducted a detailed and comprehensive direct tracing of all the accounts, analyzing every transaction, including all deposits, purchases, payments of interest or dividends, transfers, and withdrawals. Although tracing was lengthy and detailed — listing approximately 17,000 account entries in 23 accounts over almost 20 years, and consisting (along with various schedules) of 547 pages — it employed straightforward and readily understandable methods.

I gathered and reviewed all brokerage statements for each account, so I could list and analyze all transactions. For each account, I determined whether each deposit or transfer into the account was separate property or community property, or some combination.

As there was no evidence of intent in this case, the community was credited with any securities purchased in an account to the extent that community funds were available in the account for their purchase. To the extent community funds were not available in the account at the time an asset was purchased, the asset was characterized as separate property. Furthermore, the community received the benefit of any investment, including dividends, interest, and the sale of proceeds, to the same extent it owned the asset.

I concluded that at the end of 2014, the combined account balance in the investment accounts was approximately \$6,900,000, of which \$3,791,653 was Joe's separate property and \$3,228,916 was community property.

The trial court ruled Joe's tracing "was an appropriate tracing" and Joe carried his burden of proof to trace his separate property through the commingled accounts. The trial court also adopted the findings contained in the tracing and associated schedules.

DeeDee argued California law permits only two methods of tracing to overcome the presumption that property acquired during marriage is community property: *Direct Tracing* and *Exhaustion Tracing*. She contended that the trial court's adoption of a tracing method that failed to meet the requirements of either established an erroneous standard as a matter of law.

In the next issue of *Forensic Accounting Today*, I will present why the Court of Appeals Appellate Panel concluded that the tracing method I used was valid and constituted substantial evidence in support of the judgment.