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Community Property - Error of Law as to Nature of Funds Used in Purchase of Separate Property

John M. King

NOTES

COMMUNITY PROPERTY — ERROR OF LAW AS TO NATURE OF FUNDS USED IN PURCHASE OF SEPARATE PROPERTY

When plaintiff purchased a one-half interest in her father's plantation in 1944, the act of sale fully disclosed her intention to acquire the property with her paraphernal funds, for the benefit of her separate estate, subject to her separate management. In 1947, by an act of sale containing similar recitals, plaintiff joined with her father to sell the major part of the plantation to Alice C. Plantation & Refinery, Inc.,[1] plaintiff and her father retaining a three-fourths mineral interest. In the instant case plaintiff sought to have her share of the mineral interest and the remaining portion of the land purchased in 1944 declared her separate and paraphernal property. The question whether this property is community or separate arises from the interaction of three factors: (1) plaintiff's purchase from her father was entirely on credit with the purchase price secured by mortgage notes; (2) two of these notes were cancelled against plaintiff's share of the proceeds from the operation of the plantation;[2] (3) plaintiff never filed — in accordance with Civil Code article 2386 — the formal act reserving the proceeds from her separate property to the benefit of her separate estate, with the result that these revenues fell into the community.[3] The

1. In this suit for a declaratory judgment, brought by plaintiff individually and as executrix of her husband's succession, both Alice C. and the minor children of the marriage were joined as defendants. Plaintiff's appeal individually from the trial court's judgment converted the case on appeal into a contest between the plaintiff individually, and the husband's succession and the minor children. In the trial court, the minors had contended that the sale to Alice C. was invalid as a sale of community property by a wife, but the trial court sustained two of Alice C.'s alternative defenses that even if the property had been community Alice C. acquired a valid title: (1) because plaintiff's husband intervened in and signed the sale, thus constituting the wife agent of the community (see Garlick v. Dalbey, 147 La. 18, 84 So. 441 (1919); Kenner v. Leon Godchaux Co., 52 La. Ann. 965, 27 So. 542 (1900)); and (2) Alice C. acquired a valid title through the acquisitive prescription of ten years. Contentions as to validity of Alice C.'s title were not pressed on appeal.

2. In 1946 the $25,000 note and accrued interest was charged against funds held by the father representing plaintiff's share of the profits of the operation of the plantation. In 1952 the $25,000 note was charged against some $37,000 advanced by plaintiff and her husband to the father's executrix, to expedite the settlement of the father's succession. From counsel for plaintiff it was learned that plaintiff's husband contributed $5,000 of this, and the balance was advanced by plaintiff from the income from the plantation and other property.

3. LA. CIVIL CODE art. 2386 (1870): "The fruits of the paraphernal property of the wife, wherever the property be located and however administered, whether

district court ruled that the property retained from the 1947 sale to defendant corporation was community property, since it had been paid for with community funds — plaintiff's portion of the plantation's revenues. The First Circuit Court of Appeal reversed. *Held,* an error of law as to the status of the plantation revenues vitiated all consent to payments made with those funds; therefore there were never any payments made on the property, and it remains the separate property of the plaintiff subject to payment of the price. *Bailey v. Alice C. Plantation & Refinery, Inc.*, 152 So. 2d 336 (La. App. 1st Cir. 1963).

Under Louisiana's community property system all purchases made during the community are presumed to fall into the community.[4] As to purchases made by the husband, this presumption is conclusive unless the act of sale recites and the husband is able to prove that the property was acquired with his separate funds and for his separate estate.[5] The wife may establish property as paraphernal without such recitals in the act of sale,

natural, civil, including interest, dividends and rents, or from the result of labor, fall into the conjugal partnership, if there exists a community of acquets and gains; unless the wife, by written instrument, shall declare that she reserves all of such fruits for her own separate use and benefit and her intention to administer such property separately and alone. The said instrument shall be executed before a Notary Public and two witnesses and duly recorded in the Conveyance Records of the Parish where the community is domiciled.

"If there is no community of gains, each party enjoys, as he chooses, that which comes to his hand; but the fruits and revenues which are existing at the dissolution of the marriage, belong to the owner of the things which produce them. (*As amended by Acts 1944, No. 286.*)"

See Slater v. Culpepper, 129 So. 2d 499 (La. App. 2d Cir. 1961); Smith v. Smith, 117 So. 2d 670 (La. App. 2d Cir. 1960); Matthews v. Hansberry, 71 So. 2d 232 (La. App. Orl. Cir. 1954).

4. LA. CIVIL CODE art. 2334 (1870): "The property of married persons is divided into separate and common property. . . .

"Common property is that which is acquired by the husband and wife during marriage, in any manner [other than those specified] . . . . (*As amended by Acts 1920, No. 186.*)"

Id. art. 2402: "This partnership or community consists of the profits of all the effects of which the husband has the administration and enjoyment, either of right or in fact, of the produce of the reciprocal industry and labor of both husband and wife, and of the estate which they may acquire during the marriage, either by donations made jointly to them both, or by purchase, or in any other similar way . . . . (*As amended by Acts 1902, No. 68.*)"

See Vincent v. Superior Oil Co., 178 F. Supp. 276 (W.D. La. 1959); Prince v. Hopson, 230 La. 575, 89 So. 2d 128 (1956); Thomas v. Winsey, 76 So. 2d 33 (La. App. 1st Cir. 1954).

5. Pearlstine v. Mattes, 223 La. 1032, 67 So. 2d 582 (1953); Slaton v. King, 214 La. 89, 36 So. 2d 648 (1948) and cases cited therein. See Bruyninckx v. Woodward, 217 La. 736, 751, 47 So. 2d 478, 483 (1950): "[D]espite the double declaration, there was a presumption that the property belonged to the community as it was acquired during the marriage . . . . And this presumption has not been rebutted by [the heirs of the husband]." To the same effect, Lazaro v. Lazaro, 92 So. 2d 402, 404 (La. App. Orl. Cir. 1957); Sharp v. Zeller, 110 La. 61, 34 So. 129 (1902). After giving the double declaration the court considered whether the funds used had become community funds through use for community purposes.

but she must be able to show by clear proof that the property was purchased with her separate funds, for her separate estate, and was to be under her separate management.[6] When the issue of separateness is presented before full payment, the wife who purchased on credit must demonstrate that she had sufficient paraphernal funds for there to be a reasonable expectation of full payment from her separate funds.[7] If it is later shown that she in fact used community funds in payment of the price, the property will be community property.[8] Since the revenues from the wife's separate property are community property unless she has filed the declaration of paraphernality required by article 2386, a wife using such proceeds to satisfy the credit portion of

6. Southwest Natural Production Co. v. Anderson, 239 La. 490, 118 So. 2d 897 (1960); Succession of Blades, 127 So. 2d 263 (La. App. 4th Cir. 1961); Joseph v. Travis, 99 So. 2d 548 (La. App. 2d Cir. 1957); Morgan v. Hathaway, 77 So. 2d 169 (La. App. 1st Cir. 1954). See also Note, 15 LA. L. REV. 467 (1955).

7. In *Bailey*, 152 So. 2d at 338 the court quotes from Fortier v. Barry, 111 La. 776, 779, 35 So. 900, 901 (1904), wherein the test is stated: "[W]here the wife claims it as separate estate, the burden rests on her to establish, by proof dehors the recitals of the act by which it has been acquired, (1) the possession of some paraphernal funds under her administration, and available for investment, (2) that the cash portion of the price bears such a relation to the whole as to make the property purchased sufficient security for the credit portion, and (3) that her paraphernal property and revenues are such as to enable her to make the purchase with reasonable expectation of meeting the deferred payments." In connection with the test quoted above, the later case of Lotz v. Citizens Bank & Trust Co., 17 So. 2d 463 (La. App. 1st Cir. 1944) said that where the purchase was entirely on credit, there was an even greater burden placed on the party seeking to establish the separate title to the property. The court in *Bailey* took the *Lotz* holding as meaning that the property must be security for itself in all-credit transactions.

8. Perhaps the *Bailey* case could be cited as authority for his proposition, but this point was conceded by the plaintiff. No other cases were found wherein, after considering the test for credit purchases, the court later was required to look at actual payments made on the property. However, it is well settled that use of community funds will render the purchased property part of the community: Succession of Schnitter, 220 La. 323, 56 So. 2d 563 (1952); Betz v. Riviere, 211 La. 43, 29 So. 2d 465 (1947); Houghton v. Hall, 177 La. 237, 148 So. 37 (1933); Fluery v. Fluery, 131 So. 2d 355 (La. App. 4th Cir. 1961); and other cases cited in *Bailey*, 152 So. 2d at 340. In *Succession of Schnitter*, most clearly in point here, there is no indication of whether the purchase was on credit; however, the court found that $2,500 of a $2,800 purchase price were clearly paid from the separate funds of the wife. However, since there was no showing that the remainder was from separate funds, the presumption was that these were community funds and therefore the purchase was held to be community property.

Possibly there is some question whether the use of the community funds actually "converts" the title to the property from the separate estate of one spouse to the community. Many of the cases referred to above consider the evidence in light of the necessity of overcoming the presumption that property is purchased for the community; a finding that community funds were used, while effectually placing title in the community, might be only a ruling that the presumption had not been overcome. Note that if there is a true "conversion," title would seem to vest in the community at that time; if there is a "failure to overcome the presumption" presumably title would have been in the community from

the purchase price must comply with that article to establish the purchase as part of her separate estate.[9]

In the instant case plaintiff had not complied with article 2386 and payment had been effected by crediting the revenues from the separate property against the notes. Nevertheless, the court ruled that the property retained the separate character intended at the time of purchase. First, the court held that the notes had not been paid through compensation by effect of law. For compensation to be operative there must be a mutuality of indebtedness, *i.e.*, a standing-in-debt between the same two par-

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the date of acquisition. The instant case conceded that "conversion" would take place, and no square ruling was found which determined the proper approach.

9. Prior to the 1944 amendment to article 2386 whether fruits from the wife's separate property were separate or not depended on the often hard-to-establish fact of who administered the property. Trorlicht v. Collector of Revenue, 25 So. 2d 547, 551 (La. App. Orl. Cir. 1946): "[The 1944 amendment to article 2386] seems to us to evidence nothing more than a realization by the legislators of the fact that there may often be doubt as to how and by whom a wife's separate estate is administered and possibly a realization of the fact that in all fairness the fruits of a wife's separate property should go to the community unless she expressly declares that she does not desire this result." See also Matthews v. Hansberry, 71 So. 2d 232, 235 (La. App. Orl. Cir. 1954). By the amendment there is some alleviation of these problems since the wife can insure that the fruits will be community property merely by not filing the required declaration. While this is a considerable aid to those persons desiring, principally for tax purposes, that such revenues accrue to the community, the amendment's aid to the wife interested in maintaining these revenues as her separate property is somewhat doubtful. While it is clear that failure to file the declaration will be conclusive against the wife, it is not at all clear whether, even if the declaration has been filed, the wife alleging the separate nature of these revenues would still have to show separate administration of the property. A decision holding this to be the case would maintain the community system inviolate: the parties, if they so desire, can insure these revenues to the benefit of the community by the simple expedient of not filing the declarations; again, if the wife desires to maintain these funds for her separate estate she may do so by filing the declaration of paraphernality and then administering the property in such fashion as to prevent possible confusion of this separate property with that of the community. Such a result seems in line with the traditional French doctrine of individual freedom in contracting and the pre-1944 jurisprudence, which, it is arguable, was so well established that the legislature would not have attempted to overturn it without specific language to that end.

Before 1944 article 2386 read: "When the paraphernal property is administered by the husband, or by him and the wife indifferently, the fruits of his property, whether natural, civil, or the result of labor, belong to the conjugal partnership, if there exists a community of gains. If there do not, each party enjoys, as he chooses, that which comes to his hand, but the fruits and revenues which are existing at the dissolution of the marriage belong to the owner of the thing which produced them."

While the article refers specifically to the paraphernal property of the husband, the same rule applied to the wife's separate property which was administered by the husband, or both indifferently. See Lazard v. C.I.R., 153 F.2d 348 (5th Cir. 1946); C.I.R. v. Hyman, 135 F.2d 49 (5th Cir. 1943); Lucas v. C.I.R., 134 F.2d 319 (5th Cir. 1943); Trorlicht v. Collector of Revenue, 25 So. 2d 547 (La. App. Orl. Cir. 1946); K. & M. Store v. Lewis, 22 So. 2d 769 (La. App. 1st Cir. 1945).

ties.[10] The court pointed out that there was no mutuality in this case since the debt for the purchase price of the plantation was owed by the plaintiff in her *separate* capacity; but, since no declaration of paraphernality had been filed, the proceeds from the operation of the plantation (and later the mineral interest) constituted a debt owed to the *community* existing between plaintiff and her husband.

Second, the court held that there had been no payment, for an error of law vitiated plaintiff's consent to the use of the plantation revenues in paying the debt she owed separately. The error derived from plaintiff's ignorance regarding the operation of article 2386; she believed the funds to be separate when in fact they were community. Under Civil Code article 1846(3),[11] this error enabled plaintiff to avoid the payments made with the community property. Thus, in contemplation of law there had been no actual payment of the mortgage notes. Consequently, as the property was proved to be separate at the time of acquisition and no payments had been made since then to alter that status, plaintiff's interest in the plantation remained part of her separate and paraphernal property, although she still owed the full purchase price.

While the court gave full effect to the plaintiff's failure to comply with article 2386, it avoided the traditional concept that use of community funds constitutes the property purchased community property. In avoiding such a result the court relied on an error of law which did not concern the debt itself, but more remotely the legal nature of the revenues used to discharge it. With other recent decisions[12] the instant case stands as an ex-

10. LA. CIVIL CODE art. 2207 (1870): "When two persons are indebted to each other, there takes place between them a compensation that extinguished both the debts . . . ."

Id. art. 2208: [T]he two debts are reciprocally extinguished, as soon as they exist simultaneously, to the amount of their respective sums."

11. *Id.* art. 1846: "3. Error of law can never be alleged as the means of acquiring, though it may be invoked as the means of preventing loss or of recovering what has been given or paid under such error . . . ."

12. In Graves v. United States Rubber Co., 237 La. 505, 111 So. 2d 752 (1959) the court in an almost "all fours" case held that the purchase was made from capital assets earned before the marriage and not with fruits of those assets which would have fallen prey to article 2386. An analogous situation may be found in that group of cases holding that the sale of paraphernal property to a building and loan association by a wife, and the subsequent resale to the husband and wife dose not convert the property from separate to community, even though the transfers are held to be true sales. See Capillon v. Chambliss, 211 La. 1, 18, 29 So. 2d 171, 176 (1946); Mayre v. Pierson, 171 La. 1077, 1086, 133 So. 163, 166 (1931).

Compare decisions avoiding application of article 2386 by refusing to extend the meaning of fruits: Abraham v. Abraham, 230 La. 78, 87 So. 2d 735 (1956)

ample of judicial willingness to avoid a strict application of the rule that a use of community funds will make the purchased property community regardless of the intention of the parties. Since a rule of "conversion" through the use of community funds is seemingly based either on the theory that such use evidences an intention of the paying party that the property become part of the community, or on the principle that the community should be maintained inviolate and therefore uses of community funds for non-community purposes should be penalized, it is submitted that an error-of-law approach to such problems is proper. It is proper in the first instance because intention in these cases is surely misguided when formed under an error as to the legal nature of the funds used, and in the second, because penalties should be imposed only when it is known that the funds utilized for separate acquisitions were community property, and the use was undertaken regardless of this knowledge.

John M. King

STATUS OF UNENDORSED INSTRUMENT DRAWN TO MAKER'S OWN ORDER

In return for a $2,000 loan, defendant executed and delivered to plaintiff a demand instrument payable to the order of "myself" which was signed and dated, but unendorsed. A $200 payment held to constitute an acknowledgment of the debt was made one year later. Suit to recover the balance was filed some 4½ years after the partial payment; defendant excepted, pleading the three-year prescription on money lent.[1] Plaintiff contended the five-year prescription for suits on a promissory note was applicable.[2] The trial court sustained defendant's exception, dismissing the suit, and the Fourth Circuit Court of Appeal on rehearing affirmed. *Held,* an unendorsed instrument payable to the maker's own order is not a promissory note,

(increase in value of a one-half interest in furniture business); and dividends: Daigre v. Daigre, 228 La. 682, 83 So. 2d 900, 55 A.L.R.2d 951 (1956) (applies only to cash payments and not to stock dividends).

1. "The following actions are prescribed by three years: . . .
"That for the payment of money lent . . . " LA. CIVIL CODE art. 3538 (1870).

2. *Id.* art. 3540: "Actions on . . . all promissory notes, whether negotiable or otherwise, are prescribed by five years, reckoning from the day when the engagements were payable."