

# Division of Third-Party Property in Divorce Cases

by  
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**I. Introduction**

In the typical divorce case, most of the property at issue is titled in the name of one or both parties. In a growing number of cases, however, the court must resolve a claim against property titled in the name of a third person. Consider the following not-uncommon fact scenarios:

- At the time of their marriage, the parties are young, and they lack sufficient resources and credit to afford their own home. They therefore move into an extra home located on property owned by the wife’s parents. During the marriage, the parties pay the mortgage on the marital home, and significant marital efforts are used to maintain, repair and improve the property. But legal title remains in the names of the wife’s parents. Upon divorce, the parents assert that they are the exclusive owners of the property—even though they intend to give the property to the wife as soon as the divorce case is over.<sup>1</sup>
- During the marriage, the parties use marital funds to establish an account for paying the future college expenses of their three children. Upon divorce, the wife assumes that the college fund belongs to the children. But the husband claims that the fund, which is titled in the names of the parties, is a marital asset—and under the law of state in which the divorce occurs, the court cannot order the husband to pay college expenses.<sup>2</sup>
- A financially sophisticated older husband marries a financially naive younger wife. During the marriage, he manages all of their finances. Upon divorce, the wife seeks a share of the marital property, only to learn that the husband has titled all of the parties’ assets in the name of a shell corporation. Because the shell was incorporated before the marriage, and because 3% of the corporation’s stock is owned by the husband’s best friend, he argues that the corporate assets cannot be treated as marital property.<sup>3</sup>
- Early in their marriage, the wife’s parents give the parties \$100,000. There are no discussions about repayment, and for over a decade no actual payments to the parents are made. After filing for divorce, the wife claims that the payment was really a loan, and to repay it she conveys the \$300,000 marital home to her parents. The parents assert that the home is now entirely theirs—even though,

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1 See generally note 67 *infra* and accompanying text. R  
2 See generally note 29 *infra* and accompanying text. R  
3 See generally note 107 *infra* and accompanying text. R

once again, they intend to give it back to the wife as soon as the divorce case is over.<sup>4</sup>

In each of the above situations, the court faces a serious claim that the marital estate should include property titled in the name of a third party. In each situation, there is at least a significant chance that the claim is justified.

The purpose of this article is to provide a reasonably complete listing of the theories under which property titled in the name of a third party can be divided in a divorce case. The general rule is that third-party property is not subject to division. But the rule has a good number of exceptions, particularly when it can be shown that the third party is receiving a windfall or is acting with actual intent to defraud one of the spouses. Substantial case law applies these exceptions, and as a result third-party property is divided on the facts in a significant number of reported decisions.

## II. General Rule

### A. Not Divisible

Roughly two-thirds of all American states follow the dual-classification model of property division.<sup>5</sup> Under this model, the court must divide all of the parties' property into two categories: marital or community property, and separate or nonmarital property. Marital property is divided by the court; separate property is awarded to the spouse who holds legal title.

The remaining states, roughly one-third of the total, follow the all-property model of property division.<sup>6</sup> Under this model, the court may divide any asset owned by the parties, regardless of how and when it was acquired. The time and manner of acquisition is an important factor in dividing the property, but the court's power and jurisdiction extend to all of the parties' property.

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<sup>4</sup> See generally note 124 *infra* and accompanying text.

<sup>5</sup> See generally Brett R. Turner, *Rehabilitative Alimony Reconsidered: The "Second Wave" of Spousal Support Reform*, 10 *DIVORCE LITIG.* 185, 205 (1998) (classifying 35 of 51 American jurisdictions as following the dual-classification model: 28 equitable distribution states and 7 community property states).

<sup>6</sup> See generally *id.* (classifying 16 of 51 American jurisdictions as following the all-property model).

Regardless of which system a given state follows, the general rule regarding third-party property is simple: *property owned by third parties cannot be divided upon divorce*. In dual-classification states, marital property is generally all property acquired by either spouse during the marriage, except for assets specifically falling with the statutory definition of separate property.<sup>7</sup> None of the various statutory definitions expressly include third-party property. But the definition of marital property includes only property acquired by a spouse. Since property owned by third persons has not been acquired by a spouse, it falls outside the definition of marital property.

All-property states do not recognize the concept of separate property, but third-party property still cannot be divided. All-property statutes generally give the court power to award one spouse all or any part of the estate or property “of the other.”<sup>8</sup> Property owned by a third person is not property “of the other” spouse. Thus, it again falls outside the scope of property that the court is permitted to divide.<sup>9</sup>

Not only is property owned by third parties outside the definition of marital property, but it cannot be transmuted into marital property as long as third party ownership continues. In *Minsky v. Minsky*,<sup>10</sup> the trial court held that property owned by the children became marital when it was borrowed and used for marital purposes by one of the parties, and the loan was then repaid. The appellate court quite properly reversed. Transmutation is a theory of equitable distribution law, and equitable distribution law does not apply to property owned by third parties. So long as legal title to the asset is held by a third party, the doctrine of transmutation does not apply. Moreover, to find transmutation was to take property away from the children, which could

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<sup>7</sup> *E.g.*, 750 ILL. COMP. STAT. ANN. § 5/503(a) (Westlaw 2003). Some statutes refer to “either or both” spouses, *e.g.*, OHIO REV. CODE ANN. § 3105.171(A)(3)(a)(i) (Westlaw 2003), and others refer to either or both “parties,” *e.g.*, MD. FAM. L. CODE ANN. § 8-201(e)(1) (Westlaw 2003). No discernible difference exists in how the courts have construed these slight variations in language.

<sup>8</sup> *E.g.*, MASS. GEN. LAWS ANN. ch. 208, § 34 (Westlaw 2003).

<sup>9</sup> “The kinds of property subject to division, as set out in the statute, all share a common characteristic: they are owned by the parties, either jointly or separately.” *Elkins v. Elkins*, 763 N.E.2d 482, 486 (Ind. Ct. App. 2002).

<sup>10</sup> 779 So. 2d 375 (Fla. Dist. Ct. App. 2000).

not be done because the children were not parties to the case. The court held that the repayment became property of the children, and was not subject to division upon divorce.

B. *“Third-Party Property”: A Distinct Category*

For the reasons set forth above, property owned by a third party is not marital property. But it is important to note that property owned by a third party is not separate property, either. No statutory definitions of separate property presently include property titled in the name of a third party. The general common-law definition of separate property includes only property acquired before the marriage, property acquired by gift or inheritance, property acquired in exchange for separate property, and property acquired as active income from or appreciation in separate property.<sup>11</sup> None of these general types of separate property includes property titled in the name of a third party.

The fact that property owned by a third party is not separate property does not mean that it must be marital property. As noted above, property owned by a third person is clearly outside the definition of marital property in dual-classification states, and outside the definition of divisible property in all-property states.

In short, property owned by a third party is neither marital nor separate property, but rather a distinct category of property in itself. In this article, the general term “third-party property” will be used to describe property owned by persons other than the husband and wife who are being divorced.

C. *Burden of Proof*

The general rule is that a party who asks the court to include a particular asset in the divisible estate bears the burden of proving to the court that the asset exists.<sup>12</sup> If the existence of an asset is not proven by a preponderance of the evidence, the court has no property to divide.

As noted above, property which is owned by a third party universally falls outside the statutory definition of marital or divisible property. The burden is therefore on the spouse who

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<sup>11</sup> *E.g.*, *Hemsley v. Hemsley*, 639 So. 2d 909 (Miss. 1994) (adopting equitable distribution by court decision).

<sup>12</sup> *E.g.*, *Roger v. Roger*, 28 P.3d 1264 (Or. Ct. App. 2001).

seeks division of an asset to prove by a preponderance of the evidence that one or both parties have some ownership interest in it.<sup>13</sup> Stated differently, there is no presumption that the court has the power to divide any asset which one spouse or the other desires to own. Property comes within the jurisdiction of the divorce court only if someone convinces the court, by a preponderance of the evidence, that the asset is owned by one or both spouses.

This result is not changed by the universal rule that all property owned by the parties is marital or divisible property until proven otherwise. As noted above, third-party property is not separate property. The general presumption against separate property therefore does not apply. When parsed closely, most statements of the marital property presumption recognize this fact. Consider the above language: all property *owned by the parties* is marital or divisible property until proven otherwise. The emphasized clause shows that the presumption applies only to property owned by one or both spouses. Property owned by neither spouse falls outside the scope of the presumption.

While affirmative proof of ownership is generally required, such proof is not difficult to produce. Documentary evidence that legal title is in the name of one or both spouses is almost always sufficient.<sup>14</sup> In individual cases, such evidence might be overcome by proof that the parties do not own a beneficial interest in the asset, but proof of legal title normally raises a presumption of beneficial ownership.<sup>15</sup> Proof that an asset is exclusively controlled by the parties may also be sufficient to raise a presumption of ownership.<sup>16</sup> Proof of past ownership or control is usually sufficient to permit an inference of present ownership,

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<sup>13</sup> *E.g.*, *Atkins v. Atkins*, 401 S.E.2d 784 (N.C. Ct. App. 1991).

<sup>14</sup> *See Finlayson v. Finlayson*, 874 P.2d 843 (Utah Ct. App. 1994) (husband's mother executed deed giving lot to husband and wife, but mother and husband denied that parties owned the lot; since valid deed unquestionably existed, error to hold that lot was still owned by mother; remanded with instructions to treat lot as marital asset).

<sup>15</sup> "There is a presumption that the equitable title is with the holder of the legal title." 73 C.J.S. "Property" § 36 (2003); *see, e.g.*, *Morales v. Coca-Cola Co.*, 813 So. 2d 162, 167 n.2 (Fla. Dist. Ct. App. 2002) ("a rebuttable presumption of ownership arises from possessing legal title").

<sup>16</sup> *See Ritter v. Ritter*, 920 S.W.2d 151, 158 (Mo. Ct. App. 1996) ("A presumption of ownership arises in favor of one with exclusive possession and con-

but the inference must be rejected if evidence exists that the asset was later sold or otherwise conveyed away.<sup>17</sup>

Where legal title is undocumented, or where title is documented but the documents are not produced, a simple claim of ownership by a spouse is sufficient to bring property within the marital estate, if the trial court finds that spouse's testimony to be credible. In fact, in the great majority of all cases, the requirement that marital or divisible property be owned by the parties is met mostly by the testimony of the parties.

In a small number of cases, however, evidence will be presented both for and against third-party ownership. That is, some evidence will suggest that a specific asset is owned by one

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trol over personal property"). *Ritter* also held that a stipulation on the value of an asset does not bind either party on the question of who owns the assets.

Ownership is not proven, however, by the mere fact that the property was used on land belonging to third parties, so long as it was used only by third parties. On the facts of *Ritter*, the appellate court expressly rejected the testimony of an appraiser, because he assumed that all farm equipment on the husband's land was owned by the husband. The land was farmed by third persons, the husband testified that the third persons owned the equipment, and the appraiser had not taken sufficient care to determine actual ownership. The case was remanded with instructions to include in the marital estate only the equipment actually owned by the husband.

Where the title to the asset involved is documented (e.g., real estate), any inference of ownership arising from control or use is often overcome by contrary documentation of title. *See, e.g., Oaks v. Cooper*, 536 Pa. 134, 638 A.2d 208 (1994) (unowned farm not marital property, even though husband operated it during the marriage).

<sup>17</sup> *See Morgan v. Morgan*, 686 So. 2d 308 (Ala. Civ. App. 1996) (error to divide three mobile homes sold by the parties before the divorce was filed); *Cooper v. Cooper*, 639 So. 2d 153 (Fla. Dist. Ct. App. 1994) (error to classify IRA as marital property where it had been spent before divorce; expressly noting that there were no allegations of dissipation), and *Knecht v. Knecht*, 629 So. 2d 883 (Fla. Dist. Ct. App. 1993) (error to award wife IRA depleted for support during separation); *Hitchcox v. Hitchcox*, 693 N.E.2d 629 (Ind. Ct. App. 1998) (funds used to pay past debts were not divisible assets); *Rhodus v. McKinley*, 16 S.W.3d 615 (Mo. Ct. App. 2000) (error to treat as marital property cows which husband had sold before the divorce); *McElduff v. Mansperger*, 625 N.Y.S.2d 594 (N.Y. App. Div. 1995) (dental practice terminated before divorce not marital property); *Hatfield v. Hatfield*, 489 S.E.2d 212 (S.C. Ct. App. 1997) (error to treat as a separate asset certain separate funds spent by the wife during the marriage); *Brock v. Brock*, 941 S.W.2d 896 (Tenn. Ct. App. 1996); *Long v. Long*, 539 N.W.2d 462 (Wis. Ct. App. 1995) (bonus received by the husband but spent before the date of classification was not marital property).

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or both parties, while other evidence will suggest that the asset is owned by someone else. When the evidence is conflicting, the party seeking to include the asset within the marital or divisible estate bears the burden of proving, by a preponderance of the evidence, that one or both parties have some degree of ownership interest.

*D. Application*

The general rule against division of third-party property has been widely applied. Many of the cases involve property owned by one spouse's parents.<sup>18</sup>

Another common area of application is property owned by the parties' children. The mere fact that custody and support are at issue does not permit the court to divide property titled in the children's names.<sup>19</sup> For purposes of equitable distribution, chil-

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<sup>18</sup> See *Capps v. Capps*, 699 So. 2d 183 (Ala. Civ. App. 1997) (error to award wife property owned by husband's mother); *Lacher v. Lacher*, 993 P.2d 413 (Alaska 1999) (error to divide husband's mother's interest in property owned jointly with the husband); *Hacker v. Hacker*, 659 N.E.2d 1104 (Ind. Ct. App. 1995) (farm owned by husband's parents was not marital property); *Bullard v. Bullard*, 929 S.W.2d 942 (Mo. Ct. App. 1996) (error to treat home as marital property merely because wife lived there after separation; home was owned by wife's parents); *Stoneman v. Drollinger*, 14 P.3d 12 (Mont. 2000) (artwork loaned to parties by husband's parents was not divisible property); *Merzon v. Merzon*, 620 N.Y.S.2d 832 (App. Div. 1994) (where husband and father each owned 50% of stock in business, proper to divide only stock owned by husband); *In re Bushell*, 857 P.2d 174 (Or. Ct. App. 1993) (antiques owned by husband's mother were not marital property, even though parties had full use of them, mother was elderly and in a nursing home, and husband was entitled to receive them under her present will); *Mattera v. Mattera*, 669 A.2d 538 (R.I. 1996) (stock owned by husband's mother); *Tracey v. Gaboriault*, 691 A.2d 1056 (Vt. 1997) (husband's father purchased property during separation; property was not divisible asset);

<sup>19</sup> See *Davidson v. Davidson*, 643 So. 2d 1001 (Ala. Ct. App. 1994) (savings accounts owned by children not divisible); *Cox v. Cox*, 882 P.2d 909 (Alaska 1994) (savings accounts owned by parties' children); *Bishop v. Bishop*, 961 S.W.2d 770 (Ark. Ct. App. 1998) (CD given to parties' son); *In re Marriage of Gorman*, 36 P.3d 211 (Colo. Ct. App. 2001) (securities owned by children); *Hedendal v. Hedendal*, 695 So. 2d 391 (Fla. Dist. Ct. App. 1997); *Madere v. Madere*, 632 So. 2d 1180 (La. Ct. App. 1994) (CD owned by parties' son was not community property); *Stratman v. Stratman*, 948 S.W.2d 230 (Mo. Ct. App. 1997) (child cashed certificate of deposit owned jointly by husband, wife, and child; proceeds were third-party property); *Lawrence v. Lawrence*, 394 S.E.2d



dren are third parties. Indeed, at least one court held that an order dividing property owned by the children was void, and thus subject to collateral attack.<sup>20</sup>

Whether a given asset is actually owned by the children is sometimes a contested issue. The clearest cases are those involving transfers under the Uniform Gifts to Minors Act and the Uniform Transfer to Minors Act. Compliance with these acts creates a strong presumption that the assets are owned by the children.<sup>21</sup> Where title is formally transferred to the children, and documentation proves the fact, the children are likewise probably the owners.<sup>22</sup> Where the asset involved requires documentation of title (e.g., vehicles, real estate), and the formalities are not followed, the children may not own the asset.<sup>23</sup>

Where the children have received nominal title, but the parents have not yet given up complete control over the asset, there may be no *completed* transfer of ownership. In *Hansel v. Hansel*,<sup>24</sup> the husband deposited marital funds into a joint CD with

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267 (N.C. Ct. App. 1990) (educational trust owned by parties' children); Crawford v. Crawford, 469 S.E.2d 622 (S.C. Ct. App. 1996) (various collectibles given to parties' children were not marital property); Reymann v. Reymann, 919 S.W.2d 615 (Tenn. Ct. App. 1995) (error to divide property owned by parties' daughter).

<sup>20</sup> Benedetto v. Benedetto, 738 A.2d 745 (Conn. Ct. App. 1999).

<sup>21</sup> See Minsky v. Minsky, 779 So. 2d 375 (Fla. Dist. Ct. App. 2000) (divorce court can order a spouse to repay funds dissipated from a UTMA account); In re Marriage of Hendricks, 681 N.E.2d 777 (Ind. Ct. App. 1997) (funds so transferred property of the children, and thus not divisible); Parker v. Parker, 492 N.W.2d 50 (Neb. Ct. App. 1992) (funds in Uniform Gifts to Minors Act account were property of child); Jefferies v. Jefferies, 895 P.2d 835 (Utah Ct. App. 1995) (funds given to children under Uniform Transfer to Minors Act were not divisible). *But cf.* Parker v. Parker, 492 N.W.2d 50 (Neb. Ct. App. 1992) (funds in Uniform Gifts to Minors Act account were not a valid gift to children, because parent had not yet given up control over the funds; funds were marital property).

<sup>22</sup> See In re Gebhart, 783 P.2d 400 (Mont. 1989) (property held in irrevocable trust for children was third-party property); Lawrence v. Lawrence, 394 S.E.2d 267 (N.C. Ct. App. 1990) (educational trust titled in names of children; no evidence that parties themselves had not respected children's ownership during the marriage).

<sup>23</sup> See Panettiere v. Panettiere, 945 S.W.2d 533 (Mo. Ct. App. 1997) (cars given to daughters were still property of parties, because parties had not filed documents required to change legal ownership of motor vehicles).

<sup>24</sup> 939 S.W.2d 110 (Tenn. Ct. App. 1996).

his daughter. He did not, however, deliver the certificate to her or otherwise give up control over it. The court refused to find a completed gift to the daughter, since a valid gift requires delivery as well as donative intent. Thus, the husband still had ownership of the whole CD, and the entire amount was marital property.<sup>25</sup>

If the parent has not only retained control, but actually used that control to disregard the transfer at the parent's convenience, a complete transfer is extremely unlikely.<sup>26</sup>

Taken to an extreme, the requirement that control be completely given away would prevent any completed transfer from a parent to a minor child. The assets of minor children are managed by their parents; a complete transfer of control by a parent is impossible. The court in *Hansel* did not state the age of the daughter, but custody was not discussed in the reported opinion, and she may well have been an adult. Other cases applying a strict control rule involve grandparents or other third parties, who logically would have allowed the child's parents to manage the property if a complete transfer had been intended.<sup>27</sup> By contrast, in *Lawrence v. Lawrence*,<sup>28</sup> the court had little trouble holding that an educational trust for the parties' children was

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<sup>25</sup> For additional cases holding that transfers to adult children were incomplete because the transferor retained control, see *Gallo v. Gallo*, 2002 WL 1173492 (Ohio Ct. App. 2002) (husband titled account in name of himself and daughter, but required that she repay any withdrawals before his death, and made withdrawals for his own use; husband "never completely relinquished control or dominion over the property," and "lacked the requisite donative intent to establish that he made an inter vivos gift to his daughter"); *Hyslop v. Hyslop*, 2002 WL 31002816 (Ohio Ct. App. 2002) (husband purchased time share interest in condominium in name of himself and son, allegedly with intent to make a gift, but did not introduce evidence showing that he had given up control of the property; time share properly treated as a marital asset).

<sup>26</sup> See *Amrhein v. Amrhein*, 560 N.E.2d 157 (Mass. App. Ct. 1990) (husband conveyed property into trust for children but ignored the trust whenever it suited his convenience; trial court properly disregarded trust in dividing property).

<sup>27</sup> See *Parker v. Parker*, 492 N.W.2d 50 (Neb. Ct. App. 1992) (funds in bank account for grandchildren were not a valid gift to children, because wife had not yet given up control over passbooks and certificates; funds were marital property); *Whetstone v. Whetstone*, 420 S.E.2d 877 (S.C. Ct. App. 1992) (trial court properly concluded that husband had not conveyed assets into educational trust for grandchildren; husband continued to exercise actual control of assets, just as if trust did not exist).

<sup>28</sup> 394 S.E.2d 267 (N.C. Ct. App. 1990).

third-party property, even though the trust was managed by the parties. As long as the parents have retained only such control as is needed to manage property involved, and most importantly have not regularly used the property for their own purposes, a formal transfer of title to minor children should be deemed complete.

Some of the hardest cases involve money placed in bank or investment accounts, often for purposes of financing a future college education. If the account is in a child's name alone, and the transfer is complete, the child is the owner.<sup>29</sup> If a parent's name is on the account, but the parent is legally required to use the money for the child's benefit—for example, child support from a prior relationship, social security benefits as the child's nominee, or a gift or inheritance as the child's financial guardian—the child is likewise the owner.<sup>30</sup> If the parents merely intend to use

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<sup>29</sup> *E.g.*, Davidson v. Davidson, 643 So. 2d 1001 (Ala. Ct. App. 1994); Cox v. Cox, 882 P.2d 909 (Alaska 1994).

In Pittman v. Pittman, 791 So. 2d 857 (Miss. Ct. App. 2001), the court reached the surprising holding that educational trusts for the children were marital property, because they were intended to pay a valid expense of the marriage. On the contrary, funds that are not owned by the parties cannot ever constitute marital property. No other decision has ever permitted the trial court to divide funds that are titled in the names of the children. The court did give some recognition to the rights of the children, since it went on to hold that the trial court should “at least mentally” exclude the trust assets in determining the final division of the marital estate. *Id.* at 865. Why should the court treat the trust as marital property, if it is then going to exclude the trust in computing the division? Why not simply hold, as a strong and convincing dissent argued, that the trust assets are owned by the children and not marital property?

The only conceivable rationale for the result reached by the majority would be that the funds were actually owned by the parties, and simply informally earmarked for educational use. In that event, the funds would be marital, and an informal set-aside would be appropriate. But the dissent clearly believed, and the majority appeared to believe, that the children had enforceable legal ownership rights in the trust. If that was true, it was grave error to hold that the trust was marital property.

<sup>30</sup> *See* Miller v. Miller, 763 N.E.2d 1009 (Ind. Ct. App. 2002); Elkins v. Elkins, 763 N.E.2d 482 (Ind. Ct. App. 2002) (although unequal division made error harmless on the facts); Jendreas v. Jendreas, 664 N.E.2d 367 (Ind. Ct. App. 1996) (lump-sum Social Security benefit payable to parties' child was not divisible property). *See also* In re Marriage of Driscoll, 563 N.W.2d 640 (Iowa Ct. App. 1997) (reaching the same result, on the basis that the funds were not created through active marital efforts).

the account for benefit of the child, the parties' intention could rise to the level of an enforceable trust or contract.<sup>31</sup> If neither a trust nor an enforceable contract exists, the account is marital property.<sup>32</sup>

Ownership is not, of course, an all-or-nothing question. Many assets, including especially such large assets as real estate, are owned by more than one person. When the parties own property jointly with third persons, the court is permitted to divide the interest owned by the spouses.<sup>33</sup> This is true even where the parties' interest is less than joint legal title, such as the right to use a leased asset during the term of the lease.<sup>34</sup> The court is

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<sup>31</sup> Contractual provisions obligating the parties to use certain accounts for the benefit of the children are not uncommon in separation agreements. *See, e.g.,* *Damascus v. Damascus*, 2002 WL 31310095 (Conn. Super. Ct. 2002); Martin M. Shenkman, *Negotiating Education Trusts as Part of a Divorce Agreement*, 17 *MATRIM. STRATEGIST* 1 (May 1999). Since midnuptial agreements are now enforceable in almost all states, *see generally* LAURA W. MORGAN & BRETT R. TURNER, *ATTACKING AND DEFENDING MARITAL AGREEMENTS* chap. 16 (2001), there is no reason why the court could not enforce a similar agreement formed during the marriage. Of course, the agreement would have to be clearly proven, and either the statute of frauds or a specific provision governing midnuptial agreements might require that it be in writing. *E.g.,* VA. CODE ANN. §§ 20-147, 20-155 (Westlaw 2003) (requiring that midnuptial agreements be in writing and signed by both parties). Research for this article did not reveal any divorce cases in which the court was asked to enforce such an agreement.

<sup>32</sup> *See* *Shields v. Shields*, 59 S.W.3d 658 (Mo. Ct. App. 2001) (CDs owned by parties and children were cashed in, and proceeds titled in names of parties; proper to hold that children had no interest in proceeds); *Weiss v. Weiss*, 954 S.W.2d 456 (Mo. Ct. App. 1997) (bank accounts held as custodian for children are marital property, unless parties have complied with requirements of Uniform Gifts to Minors Act); *Roehmholdt v. Russell*, 712 N.Y.S.2d 709 (N.Y. App. Div. 2000) (bonds informally set aside by wife alone for benefit of children were still marital property); *Krall v. Krall*, 703 N.Y.S.2d 340 (N.Y. App. Div. 2000); *Matter of Marriage of El Bitar*, 934 P.2d 608 (Or. Ct. App. 1997), *review denied*, 939 P.2d 45 (Or. 1997) (father's testimony that he told bank manager to place funds in children's names was not sufficient to show that children actually owned the funds).

<sup>33</sup> *E.g.,* *Krinsky v. Krinsky*, 618 N.Y.S.2d 36 (N.Y. App. Div. 1994) (dividing husband's one-half interest in bank account held jointly with his father).

<sup>34</sup> *See* *Milner v. Littlejohn*, 484 S.E.2d 453 (N.C. Ct. App. 1997), *review denied*, 493 S.E.2d 458 (N.C. 1997) (where husband leased automobile, court could award automobile to wife during term of lease, but could not award her

not permitted to divide any portion of the asset owned by the third persons.<sup>35</sup>

The parties cannot prevent the court from dividing property merely by *claiming* that property is owned by a third party. If the evidence is conflicting, the court is free to resolve the dispute by rejecting the alleged third-party interest.<sup>36</sup> A mere claim of third-party ownership may be sufficient, however, to force the court to join the alleged third-party owner as a party.<sup>37</sup>

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outright ownership; error to order husband to purchase car at end of lease period).

<sup>35</sup> *Crockett v. Crockett*, 708 So. 2d 329 (Fla. Dist. Ct. App. 1998) (error to classify as marital property entire value of property owned jointly by the parties and their two children; marital estate included only parties' interest, and not children's interest); *In re Marriage of Krutsinger*, 140 Or. App. 215, 914 P.2d 1096 (1996) (error to divide all of real property when third person owned 50% interest).

<sup>36</sup> *See* *Hunt v. Hunt*, 645 N.E.2d 634 (Ind. Ct. App. 1994) (finding on the facts that third party had no interest in wife's business); *Burns v. Burns*, 789 So. 2d 94 (Miss. Ct. App. 2000) (rejecting argument that conveyance of certain stock from third person to husband was invalid, so that third party still owned the stock); *Butler v. Butler*, 683 N.Y.S.2d 603 (N.Y. App. Div. 1998) (trial court properly disbelieved wife's claim that certain assets belonged to the children); *Dormann v. Dormann*, 606 N.W.2d 837 (Neb. Ct. App. 2000) (trial court did not err by holding that personal property was owned by husband and not by his corporation); *Riggs v. Riggs*, 478 S.E.2d 211 (N.C. Ct. App. 1996), review denied, 485 S.E.2d 297 (N.C. 1997) (rejecting on the facts a claim that certain marital assets were held in trust for the benefit of a third party); *Burse v. Bursey*, 761 A.2d 491 (N.H. 2000) (proper to order husband to transfer property, even though he claimed he did not own it, where husband had failed to provide information regarding property during discovery; noting that third-party ownership would be a defense to any contempt petition for failing to make the transfer); *Glick v. Glick*, 729 N.E.2d 1244 (Ohio Ct. App. 1999) (husband claimed that account was owned by partnership, but he used it for his own purposes; trial court properly held that husband himself owned the account); *Nemirovsky v. Nemirovsky*, 776 A.2d 988 (Pa. Super. Ct. 2001) (rejecting argument that father's corporation owned certain assets of husband's business).

The court is also free to resolve conflicting evidence by finding that the property is owned jointly by both the parties and a third person. *See* *Bermudez y Santos v. Bermudez y Santos*, 773 So. 2d 568 (Fla. Dist. Ct. App. 2000) (parties built home with husband's mother's funds, with understanding that home would be titled in the names of husband and mother; husband then added wife's name to title without mother's consent; home owned 50% by mother, 25% by husband and 25% by wife).

<sup>37</sup> *See generally* note 144 *infra* and accompanying text.

The rule against division of third-party property has been applied in a variety of other contexts as well.<sup>38</sup>

#### E. *Limited Ownership*

The law has recognized for centuries that ownership consists of two parts: the legal title and the beneficial interest. Legal title is formal, nominal ownership: the right to be listed as owned on deeds and other formal ownership records. The beneficial interest is the right to the actual ultimate use of the asset. Legal title is generally ownership in a court of law; the beneficial interest is ownership in a court of equity.<sup>39</sup>

In most situations, legal title and the beneficial interest are in the same set of persons. In some situations, ownership of legal title and beneficial interest will be divided. The most common example, of course, is property held in trust by one person, for the benefit of another.

Where the same person or persons have both the legal title and the beneficial interest, the concept of “ownership” is easily applied. Difficult challenges arise, however, when legal title and the beneficial interest are divided.

##### 1. *Legal Title Only*

Property division, like divorce in general, falls within the jurisdiction of the courts of equity. As a general rule, therefore, ownership for purposes of property division means ownership in equity—possession of the beneficial interest.

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<sup>38</sup> See *Bragg v. Bragg*, 553 S.E.2d 251 (S.C. Ct. App. 2001), *cert. denied*, (Jan. 24, 2002) (third-party property is particular not subject to division where third party acquired title by authority of a bankruptcy court); *Calhoun v. Calhoun*, 331 S.C. 157, 501 S.E.2d 735 (Ct. App. 1998), *aff'd in part, rev'd in part on other grounds*, 529 S.E.2d 14 (S.C. 2000) (error to treat as marital property assets which had been given to husband's prior wife in earlier divorce settlement); *Denton v. Denton*, 902 S.W.2d 930 (Tenn. Ct. App. 1995) (property conveyed to third party cannot be classified as marital unless requirements of fraudulent conveyance statute are met); *State ex rel. Evans v. Frye*, 534 S.E.2d 389 (2000) (error to order sale of all property without resolving outstanding claim of third-party ownership).

<sup>39</sup> On the distinction between legal and equitable title, see generally *Upchurch v. Upchurch*, 468 S.E.2d 61 (N.C. Ct. App. 1996), *review denied*, 472 S.E.2d 26 (N.C. 1996).

If the spouses hold only legal title and not beneficial ownership, the underlying asset generally cannot be divided upon divorce. In other words, the court cannot divide property which one or both spouses own only as trustees.<sup>40</sup>

When a spouse owns property jointly with a third party, sometimes a claim surfaces that the spouse holds title only as a trustee. The crucial fact in resolving such a claim is who controlled the asset. Where the third party exclusively controlled the asset, the court is likely to hold that the spouse was only a trustee.<sup>41</sup> Where the spouse actually controlled the asset, the third party may be a trustee.<sup>42</sup> If both the spouse and the third party shared control, they are probably joint owners.

## 2. Beneficial Interest Only

Since divorce courts look to equitable ownership, the court has power to divide any asset in which one or both spouses hold a beneficial interest. This is true even where legal title is held by a third person.<sup>43</sup>

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<sup>40</sup> See *Friedman v. Friedman*, 2002 WL 314363 (Conn. Super. Ct. 2002) (husband shared title to custodial account, but his parents were the sole beneficial owners); *McAfee v. McAfee*, 971 P.2d 734 (Idaho Ct. App. 1999) (trial court properly held that home was not an asset of husband's corporation; third parties paid for the home, made the mortgage payments, and conducted many home-related transactions in their own names; home did not appear as an asset on the corporate books, and the corporation never exercised control over it in any material way); *In re Gebhart*, 783 P.2d 400 (Mont. 1989) (property held in irrevocable trust for children was third-party property); *Largiader v. Largiader*, 542 N.Y.S.2d 789 (N.Y. App. Div. 1989)).

<sup>41</sup> See *McLane v. McLane*, 619 N.Y.S.2d 899 (N.Y. App. Div. 1994) (trial court properly refused to divide husband's car; car was purchased for husband's friend, with the friend's money, and husband therefore lacked beneficial ownership); *Alteno v. Alteno*, 2002 WL 99538 (Ohio Ct. App. 2002) (husband purchased real property at foreclosure sale for benefit of a friend, who reimbursed husband for the purchase price and made all future payments on the property; friend owned the beneficial interest, and property was not part of marital estate)

<sup>42</sup> See *Shaw v. Shaw*, 646 N.W.2d 693 (N.D. 2002) (husband's car was divisible, even though car was titled in names of both mother and husband, where mother purchased the car for husband, and husband conceded that repayment was not expected; note that gifts are divisible property in North Dakota).

<sup>43</sup> See generally note 50 *infra* and accompanying text.

#### F. *Property Owned By Entities Owned By The Parties*

Another common area of dispute involving third-party property is property owned by entities, which in turn are owned by one or both parties. The first step in determining whether property owned by an entity is subject to division is to determine whether the entity is generally capable of owning property in its own name. If the entity can own property, its assets are third-party property, and they cannot be divided directly. The value of the assets is part of the value of overall value of the entity, and the parties' interests in the entity can of course be divided. For example, since corporations are always capable of owning property, corporate assets are generally not subject to division by the court. But the value of the assets is part of the value of the corporation, and therefore part of the value of the parties' stock, which is held by the parties directly and therefore can be divided.

As an exception to the general rule, the court may ignore the independent existence of at least a corporation, and perhaps other types of entities capable of owning property, if the requirements of the alter ego doctrine are met. Those requirements are addressed elsewhere in this article.<sup>44</sup>

If the entity is not capable of owning property in its own name, or if the alter ego exception applies, assets owned by the entity are treated as if they were owned by the parties. For example, a sole proprietorship is not legally recognized as a separate entity, and its assets are therefore treated no differently than any other assets titled in the name of the owning spouse.

This article will now examine individually some of the different entities which have been considered in the reported cases.

##### 1. *Corporations*

As noted above, corporations are always capable of owning property in their own name. Property owned by a corporation is therefore third-party property, not subject to division in the event of divorce. This is true even where the parties together or even one party alone owns 100% of the corporation's stock. A recent Arkansas decision explains:

The fact that one person owns all the stock in a corporation does not make him and the corporation one and the same. . . . A corporation

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<sup>44</sup> See note 107 *infra* and accompanying text.



and its stockholders are separate and distinct entities, even though a stockholder may own the majority of the stock. . . . A stockholder does not acquire any estate in the property of a corporation by virtue of his stock ownership; the full legal and equitable title thereto is in the corporation.<sup>45</sup>

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<sup>45</sup> Dalrymple v. Dalrymple, 47 S.W.3d 920, 924 (Ark. Ct. App. 2001) (citations omitted).

For additional cases holding that property owned by a corporation is third-party property, see Banks v. Evans, 64 S.W.3d 746 (Ark. 2002); Hedendal v. Hedendal, 695 So. 2d 391 (Fla. Dist. Ct. App. 1997) (error to treat as marital asset \$25,000 spent by husband to redecorate office; amount was included in value of corporation); Rohrer v. Rohrer, 734 N.E.2d 1077 (Ind. Ct. App. 2000) (car owned by husband's medical practice was not divisible property; court could use monetary award to divide value of car, as practice itself was divisible property); Taylor v. Taylor, 772 So. 2d 891 (La. Ct. App. 2000) (error to treat oil and gas leases as community property; leases were signed during marriage, but were owned by premarital corporation); Fox v. Fox, 584 A.2d 128 (Md. Ct. Spec. App. 1991) (key is whether and how husband acquired stock during marriage, and not whether business was incorporated during marriage); Mehra v. Mehra, 819 S.W.2d 351 (Mo. 1991); Comminellis v. Comminellis, 2002 WL 31414321 (Mo. Ct. App. 2002) ("In a dissolution decree, a court may not exercise control over property belonging to a corporation, even if one of the spouses is the sole shareholder of that corporation"); Wendel v. Wendel, 72 S.W.3d 626 (Mo. Ct. App. 2002) (collectibles owned by husband's corporation were not marital assets, even though husband was sole shareholder); # Chen v. Li, 986 S.W.2d 927 (Mo. Ct. App. 1999) (corporate assets were not marital property; excellent discussion); Graves v. Graves, 967 S.W.2d 632 (Mo. Ct. App. 1998); M.A.Z. v. F.J.Z., 943 S.W.2d 781 (Mo. Ct. App. 1997) (error to treat country club and golf club memberships as both assets of corporation and husband's personal assets); In re Martin, 874 P.2d 1219 (Mont. 1994); Traut v. Traut, 580 N.Y.S.2d 792 (N.Y. App. Div. 1992) (error to treat same \$35,000 as both distinct marital asset and part of marital property business); In re Melander, 758 P.2d 415 (Or. Ct. App. 1988) (error to consider same asset twice, once as part of marital property corporation and once as marital asset owned by parties); Siefkas v. Siefkas, 902 S.W.2d 72 (Tex. Ct. App. 1995). *See also* Randolph v. Randolph, 626 So. 2d 342 (Fla. Dist. Ct. App. 1993) (while increase in value of separate property corporation during marriage may be marital property, error to include in marital estate appreciation in specific asset owned by corporation); Caccamise v. Caccamise, 747 A.2d 221 (Md. Ct. Spec. App. 2000), cert. denied, 753 A.2d 2 (Md. 2000) (error to award wife exclusive use of jeep owned by husband's corporation, even though husband was the only shareholder).

Likewise, corporate debts are not personal obligations of the parties. *See* Blackstone v. Blackstone, 681 N.E.2d 72 (Ill. App. Ct. 1997) (error to value corporation at its net worth, and then treat corporate obligation as personal obligation of husband; court counted value of the debt twice in valuing marital estate).

As an exception, the court may ignore the independent legal existence of a corporation which constitutes the alter ego of one or both parties. As discussed below, the alter ego doctrine requires much more than proof that the parties together owned all of the stock of the corporation. Ordinarily, there must be at the very least some positive reason why recognizing the corporate entity would be unjust on the facts. In the ordinary case, the full value of the corporate assets is considered by the court when it values and divides the parties' stock in the corporation. Only in extreme cases will courts consider treating corporate assets as divisible property, rather than as an element in determining the value of the parties' stock.

## 2. Partnerships

Whether a partnership is capable of owning property in its own name is a question of state partnership law. In most states, a partnership is an independent entity which is capable of owning property. Thus, partnership assets, like corporate assets, are not subject to division upon divorce.<sup>46</sup>

In a few states, however, partnerships are not independent entities. In these states, property owned by a partnership is treated as property owned individually by the partner who holds legal title.<sup>47</sup> The issue of whether partnerships have independent legal existence is not an issue of divorce law. The answer is always found in the state partnership statutes, and the treatment of partnerships will affect many different areas of law.

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The Missouri cases hold on their face that the court can treat corporate assets as marital property if the corporation is a party to the case. *E.g.*, *Cominellis*, 2002 Wh 3141432. This rule confuses substantive law with a procedural requirement. As a matter of due process, the court must join the third party (or indeed any defendant) before taking its property away. BRETT R. TURNER, *EQUITABLE DISTRIBUTION OF PROPERTY* § 3.04 (2d ed. 1994 & Supp. 2003). But joinder is only the first step in the process of dividing corporate property. If there is no *substantive* basis for treating corporate property as a marital asset, division of corporate property would be a clear injustice, especially if the corporation has innocent third-party shareholders.

<sup>46</sup> See *In re Marriage of Paul*, 821 P.2d 925 (Colo. Ct. App. 1991); *Schiller v. Schiller*, 625 So. 2d 856 (Fla. Dist. Ct. App. 1993); *In re Marriage of Werries*, 616 S.E.2d 1379 (Ill. Ct. App. 1993); *Wilen v. Wilen*, 486 A.2d 775 (Md. Ct. Spec. App. 1985).

<sup>47</sup> *E.g.*, *Coleberd v. Coleberd*, 933 S.W.2d 863 (Mo. Ct. App. 1996).

### 3. *Sole Proprietorships*

As noted above, unincorporated sole proprietorships universally lack the ability to own property in their own name. The owner may keep separate records or even a separate detailed set of books for assets used to operate a sole proprietorship, but the law still recognizes no difference between assets used in the business and assets not used in the business. Both are deemed equally owned by the operator individually. Thus, the assets of a sole proprietorship are always subject to classification and division for purposes of divorce.<sup>48</sup>

### 4. *Trusts*

Trusts, like corporations, are able to own property in their own names. Unlike corporations, however, trusts can be subject to automatic revocation by the settlor—the person who originally created the trust. The power to revoke has an important effect upon how trust assets are treated for purposes of divorce.

#### a. *Irrevocable Trusts*

If a trust is irrevocable, then it is not materially different from a corporation. It can own property in its own name, and its existence cannot be terminated by anything short of an agree-

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<sup>48</sup> See *Cutsinger v. Cutsinger*, 917 S.W.2d 238 (Tenn. Ct. App. 1995) (assets acquired during the marriage by a sole proprietorship were marital property, even though the business started before the marriage and the assets were purchased with business funds); see also *In re Marriage of Haugh*, 978 S.W.2d 80, 82 (Mo. Ct. App. 1998) (parties deeded real property to the “Trustees of the Mokane Bible Church,” an unincorporated entity of which the husband was the pastor; church had appointed no trustees and could not hold real property in its own name; property remained marital).

A Maryland decision can be read to treat a sole proprietorship as a distinct entity. In *Speropulos v. Speropulos*, 631 A.2d 514 (Md. Ct. Spec. App. 1993), the husband ran a business which used several vehicles. The court did not expressly refer to the business as a sole proprietorship, but it did also did not refer to the business as a corporation, and it made no reference to any third parties with ownership interests. The business had debts far in excess of its assets, but the trial court nevertheless valued the vehicles as individual assets rather than as assets of the business. The appellate court reversed, holding that all assets customarily used in the business should be treated as part of the business for valuation purposes. Thus, where the debts of the business exceed its assets, no asset which is customarily used in the business would have a positive value.

ment among all beneficiaries. Thus, assets held by irrevocable trusts are not divisible property for purposes of divorce.<sup>49</sup>

Of course, any interest held by either spouse in an irrevocable trust can be divisible property, just as stock in corporation can be divisible property.<sup>50</sup> The value of the trust assets is therefore fully considered when the court values the trust itself.

#### b. *Revocable Trusts*

A revocable trust is a deceptive creature. On its face, it appears to own property, and there is no doubt that a trust of any sort has independent legal significance. The problem, however, is that the trust's existence is conditional. It can be destroyed at the unfettered discretion of the settlor, with the trust assets reverting back to his or her sole ownership. Because a revocable trust is so easily terminated, the beneficiary does not have truly *permanent* ownership of anything.

In light of the extensive nature of the power to revoke a trust, the general rule is that assets titled in the name of a revocable trust are the individual property of the settlor.<sup>51</sup> To the ex-

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<sup>49</sup> See *McGinn v. McGinn*, 540 S.E.2d 604 (Ga. 2001); *Findlen v. Findlen*, 695 A.2d 1216 (Me. 1997); *In re Marriage of Jones*, 981 P.2d 338 (Or. Ct. App. 1999); *Endrody v. Endrody*, 914 P.2d 1166 (Utah Ct. App. 1996). *But see* *Riechers v. Riechers*, 679 N.Y.S.2d 233 (N.Y. Sup. Ct. 1998) (awarding wife half of funds conveyed by husband into irrevocable trust; drawing no distinction between the assets of the trust and the trust itself).

<sup>50</sup> See *McGinn v. McGinn*, 540 S.E.2d 604 (Ga. 2001); *Fox v. Fox*, 592 N.W.2d 541 (N.D. 1999) (trial court erred by refusing to consider trust as divisible asset); *Caccamise v. Caccamise*, 747 A.2d 221 (Md. Ct. Spec. App. 2000), *cert. denied*, 753 A.2d 2 (Md. 2000); *In re Marriage of Jones*, 973 P.2d 361 (Or. Ct. App. 1999), *reconsideration denied*, 981 P.2d 338 (Or. Ct. App. 1999), review denied, 987 P.2d 515 (Or. 1999); *McLoughlin v. McLoughlin*, 996 P.2d 5 (Wyo. 2000) (portion of husband's ranch held in trust for his benefit was still divisible property).

Inherited and gifted trusts are often separate property in dual-classification jurisdictions, and often divided unequally in all-property jurisdictions. But a trust established during the marriage, with marital funds, is no different from any other marital asset. *E.g.*, *Skokos v. Skokos*, 968 S.W.2d 26 (Ark. 1998); *cf.* *Lawrence v. Lawrence*, 394 S.E.2d 267 (N.C. Ct. App. 1990) (contribution of marital funds to an existing separate property trust can result in a partial marital interest). If this were not true, irrevocable trusts could be used freely to dissipate marital property.

<sup>51</sup> See *Salvio v. Salvio*, 441 A.2d 190, 197-98 (Conn. 1982); *In re Marriage of Seewald*, 22 P.3d 580 (Colo. Ct. App. 2001) (classifying individual assets of

tent that the settlor lacks legal title, he can obtain title by the simple act of revoking the trust. The power to revoke the trust, for all practical purposes, is tantamount to the power of ownership.

### III. Exceptions

The preceding part of this article discussed case law on determining whether an asset is owned by a third party. The clear general rule is what when a third party owns either complete title or beneficial ownership of an asset, that asset cannot be divided in divorce proceedings.<sup>52</sup>

This section considers a series of exceptions to the general rule. Four major situations exist in which property which is technically owned by a third party can still be divided upon divorce.

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revocable trust); *In re Malquist*, 227 Mont. 413, 739 P.2d 482 (1987); *Galachiuk v. Galachiuk*, 691 N.Y.S.2d 828 (App. Div. 1999) (where husband failed to prove that trust was irrevocable, proper to divide trust assets between the parties); *Dorn v. Heritage Trust Co.*, 24 P.3d 886 (Okla. Ct. App. 2001) (assets of revocable trust were marital property); *In re Estate of Knickerbocker*, 912 P.2d 969 (Utah 1996) (for purposes of equitable distribution, assets of a revocable trust are owned by the settlor); *Lynch v. Lynch*, 522 A.2d 234 (Vt. 1987); *Kelln v. Kelln*, 515 S.E.2d 789 (Va. Ct. App. 1999) (marital assets transferred into revocable trust did not become separate property, as transferor had not given up complete control over them; stating in dicta that court can treat revocable trusts assets as if owned by the settlor (on the facts, the trusts were revoked before the divorce)).

One court reached a similar result where the settlor of an irrevocable trust retained a power of appointment. In *Ruml v. Ruml*, 738 N.E.2d 1131 (Mass. App. Ct. 2000), *review denied*, 742 N.E.2d 82 (Mass. 2001), the husband conveyed divisible assets into an irrevocable trust, reserving to himself a power to appoint income and remainder beneficiaries. The appointment could not be used to benefit creditors. The court held in essence that the power to appoint the wife as beneficiary was tantamount to ownership, and therefore treated the trust assets as marital property. It is questionable whether the husband could really appoint the wife as beneficiary, since the wife was clearly among his creditors, a class which the power could not be used to benefit. A better option might have been to rescind the transfer into the trust under the law of fraudulent conveyances. See note 124 *infra* and accompanying text. But the purpose of the trust was probably to harm the wife's rights, and it is therefore hard to feel much sympathy for the husband's position.

<sup>52</sup> See *supra* part II.

### A. *Implied Ownership*

Implied ownership is the single most common exception to the rule against division of third-party property. Even where a third person has clear beneficial ownership on the face of the law, the law will still sometimes impose a trust on the property for the benefit of the marital estate. As a general rule, a trust is imposed when the parties have invested funds or efforts in maintaining or improving the asset, and exercised a great deal of control over it.

None of the rules of implied ownership are unique to equitable distribution law. Under property law generally, those who maintain, improve and control the property of another are sometimes found to have an equitable interest in the asset. The implied ownership cases apply basic principles of property law in the domestic setting.<sup>53</sup> If the courts were not willing to do this, one or both spouses could file a nondomestic action against the third parties, on the same theory, to obtain the same relief. To avoid a multiplicity of actions, it is obviously advantageous to resolve the claim in the divorce proceedings.

#### 1. *Implied Trust*

A conveyance of title which appears absolute on its face is sometimes not as absolute as it appears. There may be a contemporaneous agreement, oral or even implied, that the asset will be conveyed back to the transferor upon certain conditions. When these conditions appear sufficiently loose, the court may find that the third party is really holding the asset in some form of unwritten trust. If so, then the beneficial interest in the asset may be divisible property in the transferor's divorce case.

For instance, in *In re Marriage of Bell*,<sup>54</sup> the parties transferred their home to the parties' parents so that the parents could borrow against it and pay off a lien for back taxes. The parties' poor credit prevented them from taking out the loan themselves. After the transfer, the parties continued to live in the home and

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<sup>53</sup> For cases particularly stressing that third-party issues are resolving under the normal rules of property law which apply to claims of equitable ownership generally, see *Gore v. Gore*, 638 A.2d 672 (D.C. 1994); *Upchurch v. Upchurch*, 468 S.E.2d 61 (N.C. Ct. App. 1996), *review denied*, 472 S.E.2d 26 (N.C. 1996).

<sup>54</sup> 998 P.2d 1163 (Mont. 2000).

act as if they owned it, and they gave no consideration for the conveyance. The court held that the home was still marital property.<sup>55</sup>

An implied trust is especially likely when the transferor never gave up control over the asset. Indeed, in this situation the entire transfer could be a sham. In *In re Marriage of Goodwin*,<sup>56</sup> one month before the divorce action was filed, the wife conveyed her car to the parties' daughter. The wife continued to drive the car regularly, however, and the daughter (who lived in another state) did not drive the car. Instead, she used another car which was also titled in her name. The court held that the transfer to the daughter was a sham, and that the car driven by the wife was properly treated as a marital asset.<sup>57</sup>

The same result can be reached where title was initially taken in a third party's name. For example, in *Febroriello v. Febroriello*,<sup>58</sup> a home was titled in the name of the husband's girlfriend. But the husband made the mortgage payments, and his name was on both the mortgage and the contract to purchase. The court held that the husband had an interest in the home.<sup>59</sup>

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<sup>55</sup> See also *Osborne v. Osborne*, 978 S.W.2d 786 (Mo. Ct. App. 1998) (parties conveyed marital home to wife's parents, who paid off a tax lien; express oral understanding that home would be reconveyed when parents were repaid; home was never conveyed, but constructive trust imposed to protect parties' clear right to reconveyance); *In re Marriage of Gochanour*, 4 P.3d 643 (Mont. 2000) (husband transferred the marital home to his parents to avoid a potential claim by his first wife; parties continued to live in the home; in divorce arising out of the second marriage, home was divisible property).

<sup>56</sup> 606 N.W.2d 315 (Iowa 2000).

<sup>57</sup> *Contrast* *Warnecke v. Warnecke*, 2002 WL 479158 (Ohio Ct. App. 2002) (car purchased for benefit of daughter, who agreed to make all of the loan payments, although parties ultimately did provide some assistance with the payments; trial court properly held car was property of daughter).

<sup>58</sup> 572 A.2d 1032 (Conn. Ct. App. 1990).

<sup>59</sup> See also *In re Flory*, 525 N.E.2d 1008 (Ill. Ct. App. 1988) (husband and his female roommate owned a car as joint owners, but the husband paid for the car with marital funds; car held marital property); *Weast v. Weast*, 655 S.W.2d 752 (Mo. Ct. App. 1983) (property purchased after separation in name of husband's brother was marital property where husband negotiated purchase, supplied downpayment from marital funds, made all mortgage payments, and occupied premises); *In re Ruff*, 807 P.2d 1345 (Mont. 1991) (three vehicles were titled in husband's father's name, but parties treated the cars as their own and paid license, tax, and insurance costs; father held cars in trust for parties); *Liciardello v. Liciardello*, 570 A.2d 1062 (Pa. Super. Ct. 1990) (parties bought

## 2. Resulting Trust

Under the doctrine of resulting trust, if one person pays the consideration for purchase of property, but the property is titled in the name of another, and no gift was intended, the person who took title generally holds the property as trustee for the person who provided the purchase price.<sup>60</sup>

In divorce cases, the spouses sometimes use marital funds to acquire property in the name of a third party—often the parents of the one of the spouses. Courts have held in these cases that a resulting trust exists in favor of the marital estate.

For example, in *Ravenscroft v. Ravenscroft*,<sup>61</sup> the parties desired to purchase a home. “[B]y reason of a misapprehension as to disability occasioned by their age, they arranged for title to be taken in the names of [the husband’s] parents.”<sup>62</sup> But the parties made all payments regarding the property, and exercised complete control over it. The court held that the parents owned the home in resulting trust for the parties, and that the parties’ equitable interest was marital property.

In *Wolf v. Wolf*,<sup>63</sup> the husband wished to buy a home, but was unable to obtain financing. The husband’s parents then bought the home which the husband and wife selected, taking title and mortgage in their own name. The parties made all purchase and maintenance payments on the property, and used marital funds to make substantial improvements. The trial court imposed a resulting trust upon the property in the parties’ favor. The appellate court affirmed, stating that “[t]he facts of this case present a classic example of resulting trust.”<sup>64</sup>

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asset in name of son, who later conveyed it to the parties for \$1 consideration; trial court properly treated asset as marital property); *Hough v. Hough*, 440 S.E.2d 387 (S.C. Ct. App. 1994) (error to hold that home titled in name of husband’s mother was not marital property; husband used marital funds to pay for home with intent to evade federal taxes).

<sup>60</sup> See generally *Upchurch v. Upchurch*, 468 S.E.2d 61 (N.C. Ct. App. 1996), *review denied*, 472 S.E.2d 26 (N.C. 1996).

<sup>61</sup> 585 S.W.2d 270 (Mo. Ct. App. 1979).

<sup>62</sup> *Id.* at 271.

<sup>63</sup> 514 A.2d 901 (Pa. Super. Ct. 1986).

<sup>64</sup> 514 A.2d at 905.

For additional cases finding a resulting trust, see *Dallas v. Dallas*, 670 S.W.2d 535 (Mo. Ct. App. 1984) (title to home was in husband’s parents’ names, but spouses made monthly mortgage payments pursuant to agreement; result-



A resulting trust generally must arise at the time the property is acquired; it cannot arise based upon future events.<sup>65</sup> Where contributions of marital funds are made after title passes, a resulting trust technically is not possible. Similar relief can often be granted, however, under the doctrines of constructive trust and/or unjust enrichment.<sup>66</sup>

### 3. Constructive Trust

A constructive trust arises when one party owns legal title to property which equitably should belong to another. It is most frequently applied to avoid unjust enrichment, when the legal title owner knowingly consents to the making of improvements by another.<sup>67</sup>

A good example is *Gore v. Gore*.<sup>68</sup> There, the parties desired to purchase a home, but the wife had substantial credit problems. To avoid these problems, the parties bought the home in the name of the husband and his mother. The mother made a modest contribution to the down payment, but the parties made all of the mortgage payments from marital funds. Upon divorce, the court did not directly apply equitable distribution law to the mother's interest. It noted, however, that in view of her minimal actual contributions and the acknowledged intent to use her name only to obtain credit, the mother would be unjustly enriched if awarded 50% of the home.<sup>69</sup> While an unjust enrichment claim could be made in a separate action, judicial economy would be greater if the issue were resolved in the divorce case. The court therefore imposed a constructive trust on the mother's interest.

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ing trust created for benefit of husband and wife); *see also Gore v. Gore*, 638 A.2d 672, 675 n.6 (D.C. 1994) (noting that there was a strong argument for a resulting trust, although that theory had not been alleged in the pleadings).

<sup>65</sup> *E.g.*, *Osborne v. Osborne*, 978 S.W.2d 786 (Mo. Ct. App. 1998).

<sup>66</sup> *See id.* at 792 (where trial court imposed resulting trust, based on express oral agreement to reconvey property made after title passed, appellate court ordered that "resulting" be replaced with "constructive", and otherwise affirmed).

<sup>67</sup> *See generally Upchurch v. Upchurch*, 468 S.E.2d 61 (N.C. Ct. App. 1996), *review denied*, 472 S.E.2d 26 (N.C. 1996).

<sup>68</sup> 638 A.2d 672 (D.C. 1994).

<sup>69</sup> *Id.* at 675.

In *Upchurch v. Upchurch*,<sup>70</sup> marital funds were used to purchase property in the joint names of the husband and his son. Among the funds so used were a substantial amount of the wife's own earnings. After the date of separation, much of the jointly held property was converted into bonds in the name of the son alone.

The trial court initially held that some of the property titled in the son's name was marital property. The North Carolina Court of Appeals initially reversed, holding that property owned by third parties cannot be marital property. But the court observed that equitable as well as legal interests can be marital property, and noted that divisible equitable interests can be found under the common-law doctrines of express, resulting, and constructive trust. The case was remanded with instructions to apply these theories to the facts. On remand, the court held that the son owned substantial assets in constructive trust for the marital estate, and made an unequal division of the marital property to account for the value of the constructive trust. The result was affirmed in a second appeal.<sup>71</sup>

#### 4. *Unjust Enrichment*

Another equitable theory mentioned in some of the cases is known by several different names. This article will call it unjust enrichment. Other courts and commentators have called it quantum meruit, quasi-contract, or contract implied by law.<sup>72</sup> The elements of unjust enrichment have been set forth as follows:

The essential elements of recovery under quantum meruit are (1) valuable services were rendered or materials furnished; (2) for the person

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<sup>70</sup> 468 S.E.2d 61 (N.C. Ct. App. 1996), *review denied*, 472 S.E.2d 26 (N.C. 1996).

<sup>71</sup> *Upchurch v. Upchurch*, 495 S.E.2d 738 (N.C. Ct. App. 1998), *review denied*, 501 S.E.2d 925 (1998). *See also* *Weatherford v. Keenan*, 493 S.E.2d 812 (N.C. Ct. App. 1997), *review denied*, 1998 WL 305640 (N.C. 1998) (likewise recognizing a constructive trust based on improvements to third-party property); *In re Marriage of Moss*, 977 P.2d 322 (Mont. 1999) (property was purchased in name of husband's parents, but marital funds were used to pay the parents the purchase price over time; finding that the marital estate owned a constructive trust interest in the home).

<sup>72</sup> *See Myrtle Beach Hosp., Inc. v. City of Myrtle Beach*, 532 S.E.2d 868, 872 (S.C. 2000) (“*quantum meruit*, quasi-contract, and implied by law contract are equivalent terms for an equitable remedy”).

sought to be charged; (3) which services and materials were accepted by the person sought to be charged, used and enjoyed by him; and (4) under such circumstances as reasonably notified person sought to be charged that plaintiff, in performing such services, was expected to be paid by person sought to be charged.<sup>73</sup>

Substantial potential exists for applying the law of unjust enrichment in any situation in which the parties improve real property owned by another, or in which others improve real property owned by the parties. Where the owners knowingly accepted the improvements, and allowed or even encouraged the improving party to believe that some form of compensation or other ownership interest was reasonably to be expected, there is at least an argument that the law of unjust enrichment provides the remedy. The value of that remedy, or perhaps the amount of any resulting equitable interest in the property, could be treated as a marital asset.

Despite the potential usefulness of unjust enrichment as a device for bringing third-party property into the marital estate, the number of cases actually applying the doctrine remains fairly small.<sup>74</sup> In many cases matching the above fact pattern, the court has instead applied the doctrine of constructive trust, which admittedly covers much of the same ground.<sup>75</sup>

### 5. *Express Contract*

Once in a great while, the facts will show that a third party expressly has agreed to convey certain property to the husband or wife when various conditions are met. In this situation, the conditional contract right itself may constitute property.

For example, in *Rocca v. Rocca*,<sup>76</sup> the husband conveyed real property to his father, subject to an express understanding that the father would convey the property back whenever the husband desired. The husband concealed the agreement from the court, which held that the property was not subject to divi-

<sup>73</sup> In re Estate of Fitzner, 2003 WL 152377 at \*7 (Miss. 2003).

<sup>74</sup> See *McIver v. McIver*, 374 S.E.2d 144 (N.C. Ct. App. 1988) (likewise mentioning quantum meruit); *Rolle v. Rolle*, 530 A.2d 847 (N.J. Super. Ct. Ch. Div. 1987) (including quantum meruit in a list of property law theories which can generally be raised in divorce cases); *Hurley v. Hurley*, 610 A.2d 80 (R.I. 1992) (applying the theory on the law, but rejecting on the facts).

<sup>75</sup> See generally note 67 *supra* and accompanying text.

<sup>76</sup> 760 N.E.2d 677 (Ind. Ct. App. 2002).

sion. When the wife learned of the agreement, she moved to reopen the decree for fraud. The trial court granted her motion, and the appellate court affirmed. While the transfer was almost certainly a voidable fraudulent conveyance,<sup>77</sup> an alternative rationale is that the husband's contractual right to reclaim the property at will was itself a divisible asset.<sup>78</sup>

### 6. *Businesses*

Equitable ownership of businesses has been at issue in several cases over the past few years. To begin with, if the business is a corporation, at least some precedent suggests that the stock certificates are only presumptive proof of ownership. Where the facts show that real ownership of the business differs from what is listed on the certificates, the presumption may be rebutted. "Prima facie evidence of the true ownership of stock can be overcome by other evidence and testimony to the contrary."<sup>79</sup> In a Louisiana case, for example, the stock was titled in the name of the parties' minor daughter, but parties were clearly the real owners. The court held that the certificate presumption was rebutted.<sup>80</sup>

In addition, if two persons or entities share the profits from an enterprise, and otherwise act as joint owners, they could be members of an implied partnership. This result is so favored under the law of partnerships that sharing of profits is often presumptively sufficient to show that an implied partnership exists.<sup>81</sup> There is currently no reported case law applying implied partnership in the equitable distribution context, although occasional divorce cases considered the issue under earlier law.<sup>82</sup> No logical reasons exists why the law of implied partnership should not continue to apply.

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<sup>77</sup> See generally note 124 *supra* and accompanying text.

<sup>78</sup> See also *Lew v. Lew*, 735 N.Y.S.2d 192 (App. Div. 2001) (\$100,000 which husband's father held for husband should have been treated as marital property, apparently upon theory that husband could obtain the property back at will).

<sup>79</sup> *Age v. Age*, 820 So.2d 1167, 1172 (La. Ct. App. 2002).

<sup>80</sup> *Id.*

<sup>81</sup> See Unif. Partnership Act § 202(c)(3) (1997).

<sup>82</sup> *E.g.*, *Eggleston v. Eggleston*, 67 S.E.2d 243 (N.C. 1948).

If a spouse is somehow involved with a business, but receives none of the business's profits and has no ownership control, no property interest exists to be divided. In *Ladow v. Ladow*,<sup>83</sup> the husband "was loosely involved with a technology company, Convolve, owned by a business acquaintance." But "he had no position, no contract of employment, and at no time did he receive compensation [from it] in any form."<sup>84</sup> Because the husband had neither an ownership interest nor an enforceable contractual right to receive anything of value from the company, the court held that he "had no interest in Convolve which could be divided."<sup>85</sup> The result is correct on the facts presented, but obviously heavily dependent on the factual finding that the husband had not received any form of compensation from the company.

In *Homan v. Homan*,<sup>86</sup> the parties owned nominal interests in one spouse's parents' partnership. They never received any money from the partnership, however, never owned any partnership property, and had no value in their capital accounts. The court held that "the 'partnership' in this case was not a true partnership, but rather a partnership only on paper, the purpose of which was to confer tax benefits" on the parents.<sup>87</sup> It accordingly found that no partnership existed. Since the parties did have legal title interests in the partnership, the court probably should have held that a partnership did technically exist. Nevertheless, given the facts, it is hard to see how the parties' partnership interests could possibly have had any value.

### 7. Indiana

The equitable ownership theories discussed in this section have been rejected as a matter of law in only one state: Indiana. In *In re Marriage of Dall*,<sup>88</sup> the parties lived in a home owned by one spouse's parents. The court held that the home was third-party property, and that the parties' interest, if any, was unvested and could not be divided. The Indiana Supreme Court then fol-

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<sup>83</sup> 824 So.2d 278 (Fla. Dist. Ct. App. 2002).

<sup>84</sup> *Id.* at 280.

<sup>85</sup> *Id.*

<sup>86</sup> 2002 WL 31453097 (Mo. Ct. App. 2002)

<sup>87</sup> *Id.* at \*8.

<sup>88</sup> 681 N.E.2d 718 (Ind. Ct. App. 1997).

lowed *Dall* in *Vadas v. Vadas*.<sup>89</sup> Strong and better-reasoned dissents in both cases would have followed the general rule nationwide.

Courts in other states need to understand that *Vadas* and *Dall* are products of one of the most singularly inequitable rules of equitable distribution law: the notion that only vested rights can constitute marital property. That notion has been rejected out of hand by 48 states; it is accepted in Indiana, and in some decisions from Arkansas.<sup>90</sup> In any state where unvested rights are subject to equitable distribution, *Vadas* and *Dall* have zero persuasive value.

Moreover, the dissents in both cases were correct even in Indiana. The overwhelmingly important fact about both cases is that *contributions of marital funds and marital efforts were made to the property*. The parties did not have some sort of unenforceable expectation: they had a very real claim to receive value from the property under the law of constructive trust, resulting trust, unjust enrichment and implied contract. Indiana has recognized such claims under property law for many years.<sup>91</sup> All of the equitable ownership cases discussed in this article agree that these principles do not cease to operate merely because they are invoked in a divorce case. North Carolina had no difficulty recognizing equitable ownership claims at a time when it too followed the mistaken notion that marital property must be vested.<sup>92</sup>

*Vadas* expressed the belief that strict application of the vesting requirement to third-party property “promotes predictability, consistency and efficiency by excluding ‘remote and speculative’ interests from the marital estate.”<sup>93</sup> Since Indiana law has recog-

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<sup>89</sup> 762 N.E.2d 1234 (Ind. 2002).

<sup>90</sup> Most of the cases involve unvested pensions. See generally TURNER, *supra* note 45, § 6.09. Another common subject of the rule is bonus and other rights in the nature of deferred compensation. See generally *id.* § 5.09.

<sup>91</sup> E.g., *Stafford v. Barnard Lumber Co., Inc.*, 531 N.E.2d 202 (Ind. 1988); *Estate of Hann v. Hann*, 614 N.E.2d 973 (Ind. Ct. App. 1993); *Rickes v. Rickes*, 141 N.E. 486 (Ind. Ct. App. 1923); *Koehler v. Koehler*, 121 N.E. 450 (Ind. Ct. App. 1919).

<sup>92</sup> See *Upchurch v. Upchurch*, 468 S.E.2d 61 (N.C. Ct. App. 1996), *review denied*, 472 S.E.2d 26 (N.C. 1996). North Carolina abandoned the vesting requirement in a 1998 statutory change. See generally TURNER, *supra* note 45, appendix A (North Carolina section).

<sup>93</sup> 762 N.E.2d at 1236.

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nized equitable claims in the *Vadas* situation for years, the parties' interests in the property were not at all remote or speculative. They may very well have had an immediate vested beneficial interest under the law of resulting or constructive trusts, or an immediate vested right of recovery under the law of unjust enrichment. Moreover, strict application of the vesting requirement works a fundamental injustice by tolerating and indeed encouraging dissipation of marital property. The funds used to improve the property and pay the mortgage in *Vadas* were divisible property. By holding that the entire asset was property of the husband's father, and discounting any equitable claim on the part of the parties, the court in all likelihood gave that property to the husband alone. That was not an equitable result on the facts.

#### 8. *Defenses*

Of course, the fact that equitable ownership principles apply to third-party property in a divorce case does not mean that claims based on those principles will always succeed. Merely possessing or residing in third party property, without making any material contributions to value, does not result in any marital interest.<sup>94</sup> In addition, the trial court has its usual authority to disbelieve evidence that contributions to value were made.<sup>95</sup> Finally, since all of the third party property theories raise issues of equity, the court is free to deny relief to parties with unclean hands.<sup>96</sup> All of the cases applying unclean hands to date have

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<sup>94</sup> *Wilcox v. Wilcox*, 649 N.Y.S.2d 222 (App. Div. 1996).

<sup>95</sup> *See Crisp v. Crisp*, 486 S.E.2d 485 (N.C. Ct. App. 1997), *aff'd*, 496 S.E.2d 379 (N.C. 1998) (husband built home before marriage on land owned by father; any equitable interest arising from premarital efforts would be marital property, but trial court properly found no such interest existed on the facts).

<sup>96</sup> *See In re Marriage of Ricci*, 18 P.3d 255 (Kan. Ct. App. 2001) (where parties transferred interest in marital home to their son to defeat creditors, purpose for transaction was fraudulent, and court refused to impose constructive trust for parties' benefit); *Simmons v. Simmons*, 724 So. 2d 1054 (Miss. Ct. App. 1998) (where parties paid consideration for property titled in the name of third parties, prima facie resulting trust claim had been proven; but the purpose for third party title was tax fraud, so that all of the parties had unclean hands, and the court refused to grant relief).

presented situations in which property was titled in the name of a third party for the purposes of defrauding creditors.<sup>97</sup>

### B. *Retained Earnings*

As noted above, the assets of corporations and partnerships are normally owned by the business, and not by the owners individually. The assets of the business are part of the overall value of the owner's interest, but they are not generally marital property.

Nevertheless, the law recognizes two exceptions to the general rule against treating the assets of corporations and partnerships as marital property. This section considers the first exception: the retained earnings of a separate property business. The retained earnings of a business are owned by the business, and as such they are technically not marital property. But some courts have been troubled by the fact that retained earnings are separately identified. Sometimes they are even placed in a specific account which includes no other asset. If the retained earnings had been distributed, they would have been income and they probably would have been marital property. Because retained earnings seem so *close* to being marital property, some courts have been willing to hold that they are marital property.

The easiest cases are those in which the owner retains substantial earnings, while paying himself or herself an unreasonably low salary. In *Heineman v. Heineman*,<sup>98</sup> the wife owned a separate property incorporated art studio. An antenuptial agreement provided that the increase in value of separate property remained separate. But the agreement allowed the court to treat income from separate property as marital. During the marriage, the wife drew no salary from the studio. The trial court held that the studio's retained earnings were an increase in value, and therefore separate property under the agreement. The appellate court reversed, holding that the retained earnings were actually income from separate property:

We hold however that the retained earnings did not represent an increase in value of the premarital studio. The corporation did not exist at the time of the marriage, it came into being after the marriage. The retained earnings account was accumulated from money which

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<sup>97</sup> See *Ricci*, 18 P. 3d 255; *Simmons*, 724 So. 2d 1054.

<sup>98</sup> 768 S.W.2d 130 (Mo. Ct. App. 1989).



otherwise would have been paid to wife as her salary. If the business had remained unincorporated all the profits thereof would have constituted earnings to the wife and would have constituted marital property.<sup>99</sup>

The court elaborated:

Here it is clear that the wife, the sole stockholder of the corporation, for some period of time forewent all compensation for her services, which would have been marital property, and that the retained earnings account of the corporation is directly traceable to that forbearance. It is clear, too, that the earnings of the corporation were attributable in only a minor way to the capital of the corporation. Chiefly the earnings were from wife's valuable services. We hold, then, that the retained earnings account in the amount of \$128,063 is marital property.<sup>100</sup>

Because the wife's salary was so low, the court held essentially that she was refusing in bad faith to draw from the corporation a fair value for her efforts. By treating the retained earnings as marital property, the court was essentially imputing to the wife the income that she should have drawn from the business.

The result in *Heineman* obviously depended greatly upon the unquestioned fact that the wife had the power to distribute the retained earnings. Where the owning spouse is a minority shareholder with no ability to force distribution of retained earnings, the retained earnings are clearly no different from any other corporate asset. Thus, they cannot be treated as distributed income:

Generally, retained earnings of a corporation do not constitute marital property. . . . Retained earnings and profits of a corporation are a corporate asset and remain the corporation's property until severed from other corporate assets and distributed as dividends. . . . As retained earnings are a corporate asset, title remains in the corporation; the shareholder does not have legal title. . . . Accordingly, the court's treatment of corporate assets as marital property is in error.<sup>101</sup>

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<sup>99</sup> 768 S.W.2d at 137.

<sup>100</sup> *Id.*

<sup>101</sup> *Craig-Garner v. Garner*, 77 S.W.3d 34, 38 (Mo. Ct. App. 2002) (citations omitted). *See also* *Hoffmann v. Hoffmann*, 676 S.W.2d 817, 827 (Mo. 1984) ("the wife could not claim the retained earnings as marital property, because the earnings and profits of a corporation remain its property until severed from other corporate assets and distributed as dividends"); *Thomas v. Thomas*, 738 S.W.2d 342, 344 (Tex. Ct. App. 1987) ("in an ordinary corporation, retained earnings are a corporate asset. They are not marital property[.]").

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A Minnesota court reached the same result:

We note first that the Siegel-Robert AAA [a retained earnings account] is not “income” under the plain meaning of Minn. Stat. § 518.54, subd. 6 (2000), which defines “income” as “any form of periodic payment to an individual.” Although the Internal Revenue Code treats AAA earnings as income attributable to individual shareholders for federal tax purposes, there is no evidence in the record before us that an asset-bearing account was set aside by Siegel-Robert for respondent or that any amounts were, or will be, held in such an account or distributed to either party. Retained earnings and profits of a corporation are a corporate asset and remain the corporation’s property until severed from other corporate assets and distributed as dividends. . . Respondent agrees that Siegel-Robert dividends actually paid to the parties were marital property. But because Siegel-Robert never distributed the retained earnings to respondent, the earnings never became respondent’s income under Minn. Stat. § 518.54.<sup>102</sup>

This result does not change merely because the business is organized as an S corporation, the shareholders are taxed individually on the retained earnings, and marital funds are used to pay the taxes. A Louisiana court explained:

Notwithstanding taxation rules promulgated expressly for the purpose of a subchapter S corporation, tax regulations are not the determinant in the characterization of income with respect to Louisiana property laws. Although Wall McKneely might have possessed the right to transfer the fruits [the retained earnings] to an individual account [in his own name], he had not in fact done so. Title to those fruits remained in the subchapter S corporation. Until those funds were actually disbursed, or distributed, they were not the property, or a fruit, of Mr. McKneely individually.<sup>103</sup>

The hardest cases are those in which the spouse controls the business, but is not drawing an unreasonably low salary. Authority exists for treating retained earnings as distributed income whenever the owner has the power to distribute the earnings. One of the leading decisions is the opinion of the Minnesota Supreme Court in *Nardini v. Nardini*:<sup>104</sup>

[I]n addition to the corporate income distributed to Ralph and Marguerite as salary and [fringe benefits], the corporation had retained earnings of \$563,598 (all of which were, of course, earned during the

<sup>102</sup> Robert v. Zygmunt, 652 N.W.2d 537, 543 (Minn. Ct. App. 2002) (citation omitted); accord Gottsacker v. Gottsacker, 664 N.W.2d 848 (Minn. 2003).

<sup>103</sup> McKneely v. McKneely, 764 So.2d 1157, 1160 (La. Ct. App. 2000); accord Thomas, 738 S.W.2d at 344.

<sup>104</sup> 414 N.W.2d 184 (Minn. 1987).

marriage). It seems to us that *the nature of income generated through the efforts of the marital partners is not directly changed by its retention as shareholder equity in a wholly owned corporation*. Whether the business be carried on as a family corporation or a partnership or a sole proprietorship, income earned during the marriage, whether distributed or undistributed and reinvested in the business, is marital property.<sup>105</sup>

*Nardini* was a wise decision on many issues, including particularly the classification of appreciation in separate property. But the passage emphasized above is fundamentally wrong. It is not accurate to speak of a corporation retaining income generated by a spouse. The owning spouse may generate *value*, but *income* does not exist until something is actually distributed to the shareholders. If the owner is refusing in bad faith to distribute income equal to the fair value of his or her efforts—the *Heineman* situation—then a fair salary should be treated as distributed income, so long as the owner had the power to make the distribution. Short of bad-faith failure to distribute, however, value created by marital efforts does not come within the definition of “income” until it is actually distributed. By speaking of marital “income” which had never been distributed, *Nardini* put the cart before the horse.

It is important to understand, however, that *Nardini* erred only by suggesting that the retained earnings were distributable *as income*. They were not income; they were an asset of the corporation. But when active marital efforts create value in a separate property corporation, even value which no one would ever think of distributing, the mere growth in value is marital property. *Nardini* quite properly held that the overall growth in value of the company was marital on the facts. Since the company grew substantially, all of the retained earnings at issue in *Nardini*

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<sup>105</sup> *Id.* at 195 (emphasis added). A Wisconsin court reached the same result:

[R]etained earnings represent appreciation in the value of the corporation itself rather than income generated by the corporation. While we understand the distinction which Dorothy is drawing and fully accept that a corporation’s retained earnings may serve to increase the value of the stockholder’s shares, the property division law of this state clearly views income generated by an exempt asset as separate and distinct from the asset itself.

*Metz v. Keener*, 573 N.W.2d 865, 868 (Wis. Ct. App. 1997).

were divisible as appreciation. The court should not have taken the unnecessary step of suggesting that they were independently divisible as income—a holding which presumably would have permitted division even if the overall value of the company had declined.

Two fact situations which have not yet arisen in the reported cases highlight the potential unfairness of using control alone as a basis for dividing retained earnings. First, assume that two adjacent separate property businesses are solely owned by husbands in marriages of the same length. Both husbands create value for their respective businesses. Both husbands classify the newly-created value as retained earnings. The second husband then uses the entire retained earnings account to purchase new machinery for his business. When these two husbands are divorced in a state following a pure control rule, the entire value of the first husband's retained earnings account will be treated as distributed income. Yet the only difference between these two situations is the second husband's unilateral, even self-interested decision to invest the retained earnings back into the business. Under a pure control rule, owners of businesses have a powerful incentive to reinvest rather than retain corporate earnings. In addition, major differences in result could attach to minor differences in the labels given to corporate accounts (for example, a general bank account as opposed to a specific retained earnings account).

Second, assume that a husband is sole operator of a business which manufactures widgets. Every 40 years, the company must replace and upgrade its expensive widget factory to remain competitive, and indeed to be able to produce widgets at all. For years before the divorce, under both the husband's management and the management of prior unrelated owners, the company has accumulated a portion of its earnings in 39 out of 40 years, so that it can more easily afford the large expense of replacing its factory in the 40th year.

In this situation, the business has a clear need, indeed really a compelling necessity, to retain earnings. The fact that the husband has the nominal power to distribute earnings is not relevant, for prudent business practice requires that a portion of the earnings be retained. Any other practice would injure long-term profitability of the business. Perhaps a court facing this situation

could be convinced to hold that the husband did not really have the power to distribute the earnings, because his decision was really dominated by an outside economic factor—the expense of replacing the factory. The ability to choose to distribute earnings, and thereby choose to face difficulty or even bankruptcy in the 40th year, might not be a real choice. But the example nevertheless shows that some businesses retain their earnings for very sound reasons. It is wrong to assume that every owner who retains corporate earnings is short-changing the marital estate.

Because of these problems, the better rule is to treat all retained earnings as an asset of the company. Like any other corporate asset, they are part of the value of the company. If the value increases during the marriage because of marital efforts, the increase should be marital property. This should be true regardless of the size of the owner's salary, for all increased corporate value produced by marital efforts, whether reasonable in size or not, should be marital.<sup>106</sup> But it is wrong to choose one particular asset of the corporation, whether called “retained earnings” or anything else, and insist that it must be divided merely because the owner had the raw power to divide it. Regardless of the owner's power, the fact is that the asset was not distributed. Retained earnings should be divided *as income* only

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<sup>106</sup> The size of the owner's salary must be relevant to division of corporate value *as income*, because the owner has no obligation to pay herself the largest income possible. She must give the marital estate *as income* only a fair value for the efforts she actually performs for the company. But there is no limit to the rule that all value actually produced by the efforts of the owner is divisible *as appreciation*. On the contrary, the marital estate includes all value actually produced by marital efforts, regardless of whether that amount is reasonable or unreasonable in amount. For a general discussion why the size of the owner's salary should be irrelevant to division of corporate value *as appreciation*, see TURNER, *supra* note 45, § 5.22 nn. 495-497.

The wisest option is to avoid the distinction altogether by applying the same rule of classification to both income from separate property and appreciation in separate property. This rule is presently a minority position, as it would require statutory amendment in many states. Efforts to distinguish between income and appreciation are fraught with problems, however, since the two concepts differ only in form and not in substance. The best rule is therefore to treat all forms of value derived from separate property, both appreciation and income, as marital property only to the extent that the value arose from marital contributions. *See generally id.* § 5.21.

in those rare cases where the owner is clearly defrauding the marital estate by failing to pay himself a fair value for his efforts.

### C. *Alter Ego: Piercing the Corporate Veil*

The second exception to the general rule against treating the assets of a corporation as marital property is the alter ego doctrine. The rule that a corporation is a distinct legal identity is a rule of equity. Where the facts show that the corporate form is being used to accomplish injustice, courts in many different types of cases can pierce the corporate veil and treat the corporate assets as individual property of the shareholders.

The court's power to pierce the corporate veil clearly applies in divorce cases:

Although a question of first impression in this jurisdiction, it is not unusual for a domestic relations court to pierce the corporate veil in a dissolution proceeding. . . . When the equitable principles set forth above have been applied to dissolution of marriage and division of the marital estate, it has generally been concluded that the assets of a spouse's corporate alter ego may be considered to be, and distributed as, part of the marital estate.<sup>107</sup>

The cases generally agree that the corporate veil may be pierced for purposes of property division if the corporate form is being used to accomplish injustice, so long as (1) the parties are the only persons with interests in the business,<sup>108</sup> and (2) the parties themselves have regularly failed to respect the independent existence of the corporation, usually through widespread use of

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<sup>107</sup> *Medlock v. Medlock*, 642 N.W.2d 113, 125 (Neb. 2002) (citation omitted).

Technically, when courts apply the alter ego doctrine in divorce cases, they are engaging in "reverse piercing"—allowing a creditor (the shareholder's spouse) to reach corporate assets to satisfy an individual debt against a shareholder. Traditional forward piercing allows a creditor of the corporation to reach the individual assets of the shareholders. For a general discussion of the distinction between the two types of piercing, see, e.g., *C.F. Trust, Inc. v. First Flight Ltd. Partnership*, 111 F. Supp. 2d 734, 740 (E.D. Va. 2000).

<sup>108</sup> "If Union Oaks had been financed by donations from third parties, intended to support religious activities, the equities of this situation would be far different." *Medlock*, 642 N.W.2d at 113. The court was speaking of third-party donations to an incorporated church, but the same general warning would apply where third-party shareholders have contributed to an incorporated business.

corporate assets for their own personal benefit.<sup>109</sup> A Utah court listed some of the factors to be considered when deciding whether the veil should be pierced:

- (1) undercapitalization of a one-man corporation;
- (2) failure to observe corporate formalities;
- (3) nonpayment of dividends;
- (4) siphoning of corporate funds by the dominant shareholder;
- (5) nonfunctioning of other officers or shareholders;
- (6) absence of corporate records;
- (7) the use of the corporation as a facade for operations of the dominant stockholder or stockholders;
- and (8) the use of the corporate entity in promoting injustice or fraud.<sup>110</sup>

Except for the last factor, these points are mainly just different ways in which the parties can demonstrate their lack of respect for the independent status of the corporation.

Where the facts show clear abuse of the corporate form, the argument for piercing the corporate veil can be strong. The clearest cases are those in which a spouse deliberately used a corporation with the specific intent to commit fraud. In *Lytal v. Lytal*,<sup>111</sup> for instance, the husband, “pursuant to a ‘preplanned divorce strategy,’ was systematically removing funds from the corporate structures.”<sup>112</sup> The court had little trouble finding that the corporation was the husband’s alter ego, and it affirmed an

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<sup>109</sup> “Among the factors which are relevant in determining to disregard the corporate entity are diversion by the shareholder or shareholders of corporate funds or assets to their own or improper uses and the fact that the corporation is a mere facade for the personal dealings of the shareholder and that the operations of the corporation are carried on by the shareholder in disregard of the corporate entity.” *Medlock*, 642 N.W.2d at 124. “At the least, a finding of alter ego sufficient to justify piercing in the divorce context requires the trial court to find: (1) unity between the separate property corporation and the spouse such that the separateness of the corporation has ceased to exist, and (2) the spouse’s improper use of the corporation damaged the community estate beyond that which might be remedied by a claim for reimbursement.” *Lifshutz v. Lifshutz*, 61 S.W.3d 511, 517 (Tex. Ct. App. 2001).

Conversely, where the spouse who invokes the alter ego doctrine has consistently recognized the separate legal identity of the corporation for a period of years, he or she may be estopped from denying that identity. *See Turner v. Turner*, 809 A.2d 18 (Md. Ct. Spec. App. 2002).

<sup>110</sup> *Colman v. Colman*, 743 P.2d 782, 786 (Utah Ct. App. 1987) (footnotes omitted).

<sup>111</sup> 818 So.2d 111 (La. Ct. App. 2001).

<sup>112</sup> *Id.* at 114.

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interlocutory order enjoining the corporation against further dissipation.<sup>113</sup>

Courts will sometimes pierce the veil even in the absence of specific fraudulent intent, where the failure to follow the corporate form is substantial and clear injustice is present. For example, in *Medlock v. Medlock*,<sup>114</sup> the husband owned a nonprofit corporation. The corporation purported to be a church, but it had no contributing third-party members. During the marriage, the husband “made extensive personal use of corporate funds and assets,” “carried on personal dealings in the name of the corporation” and “regularly purchased vehicles, travel, and other goods and services in the corporate name for his family’s personal use.”<sup>115</sup> The parties “did not acquire personal property in their own names because all the property that would ordinarily have been acquired over the course of a 28-year marriage was instead acquired in the name of” the corporation.<sup>116</sup> The court reversed a trial court decision which refused to treat the corporate assets as marital property. The court also held that the veil of a nonprofit corporation can be pierced,<sup>117</sup> and that piercing the corporate veil of a church, under the facts presented, did not violate the Establishment Clause.<sup>118</sup>

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<sup>113</sup> See also *Scudder v. Scudder*, 485 So. 2d 743 (Ala. Civ. App. 1986) (husband claimed that wife signed document stating that ring he had given her during the marriage was property of corporation; wife denied signing document; held, corporation was used to defraud wife, and alter ego applied); *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. Ct. App. 1985) (piercing the veil where corporate books were prepared with divorce in mind and only shareholder other than husband and wife took no interest in and knew very little about corporate affairs).

<sup>114</sup> 642 N.W.2d 113 (Neb. 2002).

<sup>115</sup> *Id.* at 125.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* See also *Barineau v. Barineau*, 662 So. 2d 1008 (Fla. Dist. Ct. App. 1995) (trial court erred by holding that the alter ego doctrine did not apply to nonprofit corporations; remanding with instructions to consider whether the doctrine applied on the specific facts presented).

<sup>118</sup> For additional cases piercing the corporate veil, see *A & L, Inc. v. Grantham*, 747 So. 2d 832 (Miss. 1999) (husband regularly paid parties’ personal expenses with property of his solely-owned corporation; trial court properly pierced the corporate veil); *Capasso v. Capasso*, 477 N.Y.S.2d 155 (App. Div. 1987) (where husband regularly used corporate funds for individual purposes, court ignored transfer of a valuable painting from husband to corporation); *Colman v. Colman*, 743 P.2d 782 (Utah 1987) (relying mainly upon lack of



In this second type of case, use of corporate funds for personal purposes is often more important than whether corporate formalities were properly followed.<sup>119</sup> Many small businesses do not rigidly follow corporate formalities, but they are still run in a fair manner, and refusing to recognize their existence will not cause injustice. Regular use of corporate funds for personal purposes, especially in large amounts, can cause injustice in at least some cases. Mere failure to keep proper records or hold regular shareholders' or directors' meetings is unlikely to cause substantial prejudice to the nonowning spouse.

It is important to stress that failure to respect the corporate form and use of the corporate form to create injustice are not sufficiently proven by the mere fact that both spouses or even one spouse owned all of the corporation's stock.<sup>120</sup> The number of cases actually piercing the corporate veil on the facts is a very small percentage of the many cases in which an incorporated business is solely owned by one or both spouses. Because the owning spouse's stock is itself marital property to the extent acquired during the marriage, it is possible in most cases to divide the *value* of the business without dividing the actual corporate assets.

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corporate formalities); *Watson v. Watson*, 837 P.2d 1 (Utah Ct. App. 1992) (husband was sole shareholder of corporation, regularly used corporate cars for personal purposes, and listed corporate assets on his personal financial statements); *Stainback v. Stainback*, 396 S.E.2d 686 (Va. Ct. App. 1990) (husband's corporation was engaged only in his personal business, the parties personally guaranteed the corporation's debt, and corporate funds were regularly spent for personal use; paintings owned by corporation were marital property).

<sup>119</sup> See *Carlton v. Carlton*, 997 P.2d 1028 (Wyo. 2000) (where parties regularly commingled corporate and personal funds, and generally did not treat corporation as distinct entity, trial court properly pierced corporate veil, even though corporate books were properly kept).

<sup>120</sup> See *Guetzow v. Guetzow*, 379 N.W.2d 704, 707 (Minn. Ct. App. 1986) (where corporate assets and marital property were never commingled, "rather informally run small corporation" not the husband's alter ego); *Wendel v. Wendel*, 72 S.W.3d 626, 631 (Mo. Ct. App. 2002) (husband's corporation was not his alter ego, even though he owned all of its stock; facts did not show either fraud or failure to observe corporate formalities); *S.R. v S.M.R.*, 709 S.W.2d 910 (Mo. Ct. App. 1986) (refusing to treat marital property corporations and separate property corporations as a single entity, even though their affairs were extensively interrelated); *Lifshutz v. Lifshutz*, 61 S.W.3d 511, 517 (Tex. Ct. App. 2001) ("to properly pierce [the corporate veil] in a divorce case, the trial court must find something more than mere dominance of the corporation by the spouse").

Indeed, division of the corporate assets might well harm both parties by reducing the long-term profitability of the company. Even if the corporation is separate property, it is frequently possible to divide any value created by marital funds or marital efforts, for *active appreciation* in the value of a separate property business is generally marital property.<sup>121</sup>

Injustice is shown for purposes of the alter ego doctrine only where some reason exists why dividing the value of the business is not a sufficient remedy. For example, in *Medlock* the corporation owned title to many of the assets which were actually used daily by the parties during the marriage, so that without the alter ego doctrine, the wife would have been left with a money judgment for the value of her interest in the marital estate, and not much else. A spouse seeking to invoke the alter ego doctrine must generally begin by showing the court some reason why dividing the value of the owner's stock will not result in a sufficient award.

The cases reach conflicting results as to whether the court may ignore the independent legal existence of a partnership.<sup>122</sup> There is no logical reason why the court should not have this authority; the independent existence of partnerships does not stand on a higher plane than the independent existence of corporations. In those cases that have applied the alter ego doctrine to partnerships, the elements of the doctrine are substantially the same as in the cases involving corporations.<sup>123</sup>

#### D. *Property Conveyed Away Wrongly*

The third exception to the general rule against division of third party property applies to assets that were conveyed away wrongly. Unlike the implied ownership exception, this third exception assumes that both legal and equitable title to the asset

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<sup>121</sup> See generally TURNER, *supra* note 45, § 5.22.

<sup>122</sup> Compare *C.F. Trust, Inc. v. First Flight Ltd. Partnership*, 111 F. Supp. 2d 734, 740 n.11 (E.D. Va. 2000) ("Although discussion of the alter ego doctrine typically focuses on the corporate form, it is settled that the doctrine also applies to limited partnerships"); *In re Werries*, 616 S.E.2d 1379 (Ill. Ct. App. 1993) (partnership assets are normally third-party property and thus not divisible; suggesting that the result might be different if the partners regularly used partnership assets for personal purposes) with *Lifshutz v. Lifshutz*, 61 S.W.3d 511 (Tex. Ct. App. 2001) (court cannot pierce the veil of a partnership).

<sup>123</sup> See, e.g., *C.F. Trust, Inc.*, 111 F. Supp. 2d 734.

have been conveyed to a third party. Where the conveyance was made by one of the divorcing spouses, however, and the purpose for the conveyance was to defraud the other spouse, a very real possibility exists that the transfer may be invalid. Even if the transfer is valid, the court may be permitted to ignore it for purposes of dividing other marital property between the divorcing spouses.

### 1. *Fraudulent Conveyance*

The strongest remedy for any improper conveyance of a marital asset to a third party is the relevant state fraudulent conveyance statute. The language of these statutes varies from state to state, but they generally permit the court to rescind any conveyance made with actual intent to defraud creditors.<sup>124</sup> In addition, transfers are often subject to rescission if the transfer leaves the transferor insolvent and the consideration is substantially inadequate.<sup>125</sup>

Fraudulent conveyance statutes are powerful remedies, for when the requirements of the statute are met, the transfer itself is rescinded. The property is therefore available for distribution in the divorce case if it meets the other requirements of divisible property. Where actual fraudulent intent is proven, courts have not hesitated to apply fraudulent conveyance statutes in divorce cases.<sup>126</sup>

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<sup>124</sup> *E.g.*, Unif. Fraudulent Transfer Act § 4(a)(1) 7A U.L.A. 198 (1999) (“UFTA”); Unif. Fraudulent Conveyance Act § 7A U.L.A. 351 (1999) (“UFCA”).

It is well settled that a spouse qualifies as a creditor for the purpose of fraudulent conveyance statutes, even if the conveyance is made before a divorce action is filed. *E.g.*, *Buchanan v. Buchanan*, 585 S.E.2d 533 (Va. 2003). Indeed, this has been the rule since long before equitable distribution existed. *E.g.*, *Davis v. Davis*, 391 S.E.2d 255 (Va. 1990) (conveyance defrauded wife of her right to alimony, even though equitable distribution had been waived by an antenuptial agreement); *Wallace v. Wallace*, 291 S.E.2d 386 (W. Va. 1982) (conveyance deprived the wife of her right to alimony; pre-equitable distribution decision).

<sup>125</sup> *E.g.*, UFTA § 4(a)(2); UFCA § 4.

<sup>126</sup> For cases holding that the fraudulent conveyance statute may be applied in divorce proceedings, see, *e.g.*, *Shah v. Shah*, 513 S.E.2d 730 (Ga. 1999) (although damages cannot be awarded); *Mayes v. Stewart*, 11 S.W.3d 440 (Tex. Ct. App. 2000); *In re Marriage of Zabel*, 565 N.W.2d 240 (Wis. Ct. App. 1997).

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Despite the power of the remedy, fraudulent conveyance statutes are difficult to apply in practice. When the attacking spouse relies upon actual fraudulent intent, that intent must be proven by clear and convincing evidence.<sup>127</sup> In addition, a conveyance cannot be set aside if the recipient was a bona fide purchaser for value with no notice of the fraud.<sup>128</sup> Actual fraudulent intent need not be shown to set aside a conveyance based upon insolvency plus insufficient consideration,<sup>129</sup> but there will obviously not be many fraudulent conveyances that leave the trans-

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For specific cases setting aside fraudulent conveyances on the facts, see *Dietter v. Dietter*, 737 A.2d 926 (Conn. Ct. App. 1999) (husband and fellow beneficiaries terminated trust by agreement, and conveyed same assets into new trust, where husband's right to benefits was conditioned upon wife not receiving benefits; fraudulent conveyance); *Svadbik v. Svadbik*, 776 So. 2d 968 (Fla. Dist. Ct. App. 2000), *review denied*, 786 So. 2d 1189 (Fla. 2001) (husband conveyed 50% interest in certain home to his father, 33 days before divorce complaint was filed, for consideration of only \$10; noting that trial court found conveyance fraudulent; finding had not been appealed); *A & L, Inc. v. Grantham*, 747 So. 2d 832 (Miss. 1999) (husband sold stock to brother and sister for less than fair value); *Firmani v. Firmani*, 752 A.2d 854 (N.J. Super. Ct. App. Div. 2000) (husband conveyed marital property to family partnership for \$1 consideration); *Spencer v. Hylton-Spencer*, 709 N.Y.S.2d 207 (N.Y. App. Div. 2000) (husband conveyed marital home to his siblings, with actual intent to defraud the wife); *Leathem v. Leathem*, 640 N.E.2d 1210 (Ohio Ct. App. 1994) (rescinding husband's conveyance of marital property into trust without wife's knowledge or consent); *Craveiro v. Craveiro*, 773 A.2d 896 (R.I. 2001) (conveyance of real estate to husband's sister for 1/8 amount of husband's investment in the property); *Bradford v. Bradford*, 993 P.2d 887 (Utah Ct. App. 1999), *cert. denied*, 2000 WL 1027280 (Utah 2000) (wife transferred her interest in marital home to son, in return for only \$10).

<sup>127</sup> See, e.g., *Dietter*, 737 A.2d 926; *Bradford*, 993 P.2d 887.

<sup>128</sup> Under the UFCA, the court cannot rescind a conveyance to "a purchaser for fair consideration without knowledge of the fraud at the time of purchase, or a person who has derived title immediately or mediately from such a purchaser." UFCA, § 9(1). The UFTA expressly states that a transfer "is not voidable . . . against a person who took in good faith and for a reasonable equivalent value or against any subsequent transferee or obligee." UFTA, § 8(a).

Note that the law requires only knowledge of the fraud; the third party need not actually desire that the innocent spouse be harmed. See *Osuna v. Quintana*, 993 S.W.2d 201 (Tex. Ct. App. 1999) (if husband's paramour did not intend to harm the wife, she was at least aware that the conveyance at issue was improper).

<sup>129</sup> E.g., UFTA § 4(a)(2); UFCA § 4.

ferring spouse literally insolvent after the transfer.<sup>130</sup> Finally, where the transfer did not occur immediately before the divorce, the statute of limitations may be a problem.<sup>131</sup> Fraudulent conveyance statutes are powerful when they apply, but the requirements of the statute will be difficult to meet in many divorce cases.

## 2. Dissipation

Where marital property is conveyed away for an insufficient consideration, but the requirements of the fraudulent conveyance statute cannot be met, the property itself is third-party property for purposes of the divorce action. It is not, therefore, subject to division.

Nevertheless, the court may still be able to apply a more limited remedy between the parties themselves. The cases recognize two specific theories. To begin with, wrongful conveyance of any marital asset is a negative economic contribution to the marriage which can be considered as a factor in dividing other assets.<sup>132</sup>

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<sup>130</sup> Note also that the definition of inadequate value does not necessarily require fair and sufficient consideration. *See, e.g.*, *In re Marriage of Enders*, 960 P.2d 896 (Or. Ct. App. 1998), *reconsideration denied*, 964 P.2d 1097 (Or. Ct. App. 1998) (husband sold cars assessed at \$9500 for only \$1500; no fraud); *Denton v. Denton*, 902 S.W.2d 930 (Tenn. Ct. App. 1995) (where affidavit of consideration attached to deed showed consideration of \$5,300, and wife valued conveyed asset at \$4,400, substantial consideration was present; no fraud). *But see* *Craveiro v. Craveiro*, 773 A.2d 896 (R.I. 2001) (real estate conveyed to husband's sister for 1/8 amount of husband's investment in the property; consideration was not substantial).

<sup>131</sup> *See* *McGinley v. McGinley*, 583 N.W.2d 77 (Neb. Ct. App. 1998) (where wife knew of transfer during marriage, fraudulent conveyance action barred by four-year statute of limitations).

<sup>132</sup> *See, e.g.*, *In re Ebel*, 874 P.2d 406 (Colo. Ct. App. 1993) (proper to award wife 56% of assets, where husband improperly removed funds from marital golf course business); *Bleuer v. Bleuer*, 755 A.2d 946 (Conn. Ct. App. 2000) (80% to wife not error, where husband destroyed his own business and abused wife and parties' three children); *Goodman v. Goodman*, 754 N.E.2d 595 (Ind. Ct. App. 2001) (funds spent for excessive living expenses, over wife's protests, were dissipation; awarding wife "virtually all" marital property); *Williams v. Williams*, 645 A.2d 1118 (Me. 1994) (proper to award husband only 40% of marital estate, where husband had written substantial checks to girlfriend after separation); *Maharam v. Maharam*, 666 N.Y.S.2d 129 (App. Div. 1997) (husband moved assets to foreign bank account and squandered them on luxury

In addition, as a matter of classification, it is not equitable to permit property to leave the marital estate entirely, simply because it has been conveyed away wrongfully by one spouse alone. Because the rights of third parties are involved, the asset itself cannot be retitled in the name of the transferring spouse unless the relatively strict requirements of the fraudulent conveyance statute are met. But no reason exists why the court cannot treat the asset as divisible property *as between the parties alone*. Since the asset itself cannot be divided, it cannot be awarded to the innocent spouse, but it can still be awarded to the transferring spouse as part of that spouse's share of the marital estate.

This remedy, known as wrongful dissipation of marital property, is probably the most common remedy actually employed against improper conveyances of divisible assets.<sup>133</sup> Since it is a rule of classification, it is more certain and consistent than a mere discretionary unequal division of the remaining assets. Also, “[d]issipation resulting in the reinclusion of the property so disposed of is obviously a much more effective deterrent than considering such conduct as a ‘factor’” in dividing other property.<sup>134</sup>

A full discussion of when a transfer is and is not wrongful lies outside the scope of this article.<sup>135</sup> In general, a transfer is wrongful when marital funds are used during or after the breakdown of the marriage for a purpose which does not benefit the marriage.<sup>136</sup> Benefit to the marriage must be understood in light of the universal practice of married couples to spend some mari-

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items; awarding wife 65% of marital estate); *Conceicao v. Conceicao*, 611 N.Y.S.2d 318 (App. Div. 1994) (where husband gambled away substantial marital assets, proper to award wife 70% of marital estate).

Of course, in specific cases, the effect of dissipation may be offset by other factors. *See, e.g.*, *Innerbichler v. Innerbichler*, 752 A.2d 291 (Md. Ct. Spec. App. 2000), *cert. denied*, 760 A.2d 1107 (Md. 2000) (equal division proper; husband had gambled away marital property and committed adultery, but made extraordinary direct financial contributions to the marital estate).

<sup>133</sup> *See generally* TURNER, *supra* note 45, § 6.30.

<sup>134</sup> Sally Burnett Sharp, *Step by Step: The Development of The Distributive Consequences of Divorce in North Carolina*, 76 N.C. L. REV. 2017, 2121 (1998).

<sup>135</sup> For an extensive discussion of the subject, see TURNER, *supra* note 45, § 6.30.

<sup>136</sup> *E.g.*, *In re Marriage of Finer*, 920 P.2d 325 (Colo. Ct. App. 1996); *In re Marriage of Adams*, 538 N.E.2d 1286 (Ill. Ct. App. 1989); *In re Marriage of Coyle*, 671 N.E.2d 938 (Ind. Ct. App. 1996); *Harris v. Harris*, 621 N.W.2d 491 (Neb. 2001); *Booth v. Booth*, 371 S.E.2d 569 (Va. Ct. App. 1988).

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tal funds for the benefit of each spouse individually. For example, purchase of clothing is normally a marital purpose, even though the clothing will be worn by only one spouse, so long as the amounts spent on clothing by both spouses are consistent with the overall marital standard of living.<sup>137</sup> Gambling and gifts to paramours are almost always nonmarital purposes;<sup>138</sup> living expenses (within the general marital standard of living) and expenses of a marital business are almost always marital purposes.<sup>139</sup> As an exception, where the date of classification is the date of separation or the date of filing of the divorce action, so that income earned after that date is separate property, living expenses incurred after that date should normally be paid first from separate income.<sup>140</sup>

When marital assets are conveyed away during or after the marital breakdown, many courts will place upon the transferring spouse the burden of proving,<sup>141</sup> or at least introducing sufficient evidence to prove,<sup>142</sup> that the conveyance was for a proper purpose. If this were not the rule, the innocent spouse would be effectively required to prove exactly how any given missing marital asset was dissipated. Since the spouse who conveyed the asset away is clearly in the best position to prove the purpose for the conveyance, placing the burden on that spouse is not inequitable.

#### IV. Procedural Issues

When one or both spouses assert a claim to property titled in the name of third party, it is theoretically possible to insist that the claim be pursued in separate litigation. This would delay the

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<sup>137</sup> For a particularly clear explanation of how purposes that benefit only one spouse can be marital, so long as the amounts spent for each spouse are similar and consistent with the overall marital standard of living, see *In re Marriage of Coyle*, 671 N.E.2d 938 (Ind. Ct. App. 1996).

<sup>138</sup> See *TURNER*, *supra* note 45, § 6.03 nn.856, 864

<sup>139</sup> *Id.* at nn.835, 844.

<sup>140</sup> See *Holland v. Holland*, 1999 WL 262433 (Va. Fairfax County Cir. Ct. Mar. 3, 1999); see generally the extended discussion in *TURNER*, *supra* note 45, § 6.30 at 745 et seq. (Supp. 2003).

<sup>141</sup> *E.g.*, *In re Marriage of Smith*, 471 N.E.2d 1008 (Ill. Ct. App. 1984); *Bratcher v. Bratcher*, 26 S.W.3d 797 (Ky. Ct. App. 2000); *Clements v. Clements*, 397 S.E.2d 257 (Va. Ct. App. 1990).

<sup>142</sup> *E.g.*, *Jeffcoat v. Jeffcoat*, 649 A.2d 1137 (Md. Ct. Spec. App. 1994); *Conrad v. Conrad*, 76 S.W.3d 305 (Mo. Ct. App. 2002).

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divorce case substantially, however, since a final division of the marital estate would have to await the result of the other litigation, which would determine whether the marital estate includes a legal or equitable claim to the property at issue. In the interests of judicial efficiency, the majority rule is that claims against third parties can be litigated in the divorce case.<sup>143</sup>

When third-party claims are litigated in the divorce case, the third person is not bound by the result unless he or she is joined as a party.<sup>144</sup> There would be a fundamental violation of due

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<sup>143</sup> It is difficult to find case law expressly rejecting an argument that claims involving third-party property cannot be litigated, as that argument has not often been made in recent years. The cases cited throughout this article are proof that third-party property claims are actually being heard and resolved in divorce cases. A few older cases disfavoring this practice are cited in TURNER, *supra* note 45, § 3.03 n.47.

<sup>144</sup> For cases holding that joinder of a third party is required, see, for example, *In re Marriage of Sammons*, 642 N.W.2d 450, 457 (Minn. Ct. App. 2002) (error to impose constructive trust upon property titled in the name of husband's mother; mother was not a party to the case, and the "court thus did not have personal jurisdiction to enter a judgment affecting her rights to her property", even though transfer to mother was arguably fraudulent); *Daetwyler v. Daetwyler*, 502 S.E.2d 662 (N.C. Ct. App. 1998), *aff'd per curiam*, 514 S.E.2d 89 (N.C. 1999) (third persons with ownership interests in marital assets were indispensable parties).

For cases holding in particular that the recipient of a fraudulent conveyance must be joined before the conveyance can be set aside, see *Capps v. Capps*, 699 So. 2d 183 (Ala. Civ. App. 1997) (error to resolve fraudulent conveyance claim without joining the grantee (the husband's mother as a party)); *DeGarmo v. DeGarmo*, 499 S.E.2d 317 (Ga. 1998) (error not to add recipient of alleged fraudulent conveyance as a party); *Mitts v. Mitts*, 39 S.W.3d 142, 146 (Tenn. Ct. App. 2000), appeal denied, Mar. 5, 2001 (court cannot set conveyance aside unless recipient is joined as a party); *In re Marriage of Zabel*, 565 N.W.2d 240 (Wis. Ct. App. 1997) (where wife alleged fraudulent conveyance to husband's mother, mother was properly joined as a party to the case).

For cases holding that joinder of a third party was permitted on the facts, see, for example, *Arnold v. Spears*, 36 S.W.3d 346 (Ark. 2001) (trial court has power to join third party in divorce action even against the third party's will, if the third party has an interest in marital property); *Schnabel v. Superior Court*, 36 Cal. Rptr. 2d 677, 680 (Cal. Ct. App. 1994) (where husband's employer showed "blatant and egregious" favoritism by freezing husband's salary, retaining large amount of earnings, and paying for husband's representation by the same attorneys who represented the employer, wife could join employer in divorce action).

Note that where the spouses own property jointly with a third person, and the size of the spouses' interest is not contested, the court may treat the



process if ownership of third-party property were litigated in a binding manner without giving the owner a chance to appear and assert his or her rights.

A minority of states holds that a third-party claim can be litigated without actually joining the third party, so long as the result of the case does not prejudice the third party's rights.<sup>145</sup> This rule is problematic, for the third party obviously must retain the right to litigate his or her claim separately. If a future court hearing the separate litigation does not reach exactly the same result as was reached in the divorce case, the end result will be unfair to at least one of the parties.

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spouses' interest as marital property without joining the third party, so long as the court is not dividing the asset itself. For example, in *Schiller v. Schiller*, 625 So. 2d 856 (Fla. Dist. Ct. App. 1993), the court held that the husband's partner need not be joined as a party if the court intended only to consider the husband's partnership asset as marital property and compensate her with other assets. If the court intended to secure its award with a charging lien on the husband's interest, however, then the partner's interest was sufficiently implicated to require joinder.

In *Burns v. Burns*, 789 So. 2d 94 (Miss. Ct. App. 2000), the court held that the trial court did not err by failing to join a third party, where the court ultimately found that the third party had no interest in a marital asset. Under *Burns*, whether joinder is required apparently depends on the result that the court ultimately reaches on the merits. Since the court does not have any idea what result it will reach on the merits at the time when joinder issues arise, the rule set forth in *Burns* seems unworkable in practice. Moreover, a declaration that a third party does not have an ownership interest in marital property actually harms the third party's interests more than a holding that an ownership interest is present. A strong and convincing dissent argued for the general rule requiring joinder of any third party who states an arguable claim to an ownership interest in any marital asset, regardless of whether that claim ultimately succeeds or fails on the facts. *Id.* at 101 (McMillin, C.J., dissenting). The dissent's position is consistent with *Cohen v. Cohen*, 748 So.2d 91 (Miss. 1999), which allowed a third party to intervene to protect a direct financial interest.

<sup>145</sup> *E.g.*, *Gerow v. Covill*, 960 P.2d 55 (Ariz. Ct. App. 1998) (court can decide fraudulent conveyance issue without joining recipient, so long as recipient's rights are not affected); *Carroll v. Carroll*, 737 A.2d 963 (Conn. App. Ct. 1999) (where husband's mother was not a party to divorce action, divorce court's decision as to amount of debt would not bind husband in later action against mother); *Colclasure v. Colclasure*, 892 P.2d 676 (Okla. Ct. App. 1995) (proper to find that wife had 25% interest in business with third party; noting that third party would not be bound by the result).

A good illustration of this kind of unfairness is *Morris v. Morris*.<sup>146</sup> In that case, a husband and wife desired to purchase property. Because the husband was unemployed, they could not obtain financing without additional co-signers. The husband's parents agreed to sign the loan, and all four persons (the couple and the husband's parents) took title to the property. The husband and wife "live on the property, and they have paid the mortgage payments, real estate taxes, and property insurance premiums."<sup>147</sup>

The status of the property first arose when the husband's parents were divorced. The court treated the husband's father interest in the property as a marital asset, ordering him to pay the husband's mother \$14,675 for her interest. Several years later, the couple sued the husband's parents in a nondivorce action to establish complete ownership of the property. The trial court imposed a resulting trust, but ordered the couple to reimburse the husband's father for the \$14,675 he had paid in the divorce case.

The Virginia Supreme Court affirmed the resulting trust, on the basis that the husband and wife had provided paid all costs related to the property.<sup>148</sup> But the order to pay \$14,675 to the husband's father was reversed. The couple were not parties to the parents' divorce case, and they were not bound by the divorce court's ruling. They were instead free to argue that the divorce judgment was simply wrong—a contention that the supreme court accepted. Because the later independent action reached a different result from the earlier divorce case, the husband's father suffered an unfair loss of \$14,675. This loss would have been avoided if the court had joined all four interested parties in the divorce action and made a final determination of ownership rights in the property.

A few cases have questioned the very concept of litigating third party claims in the divorce case at all. The general policy behind these cases was stated by the West Virginia Supreme Court:

The paramount goal in any divorce proceeding is a just and equitable resolution of the interests and rights of the divorcing spouses. The as-

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<sup>146</sup> 449 S.E.2d 816 (Va. 1994).

<sup>147</sup> *Id.* at 818.

<sup>148</sup> *Id.* at 819.

serted interests of third parties in marital property are best resolved in legal actions separate and apart from divorce proceedings.<sup>149</sup>

The above reasoning is flawed, for it is not possible to make “a just and equitable resolution of the interests . . . of the divorcing spouses” without first determining what those interests are. When the spouses and a third party assert conflicting claims of ownership to property, the court must determine the spouses’ ownership rights (and by necessary reverse inference, the third party’s ownership rights) before it can determine the size of any marital interest in the property. Because third party ownership rights cannot be severed from the parties’ respective marital rights, the best option is to resolve all conflicting claims to the property in the divorce action.

If third party rights cannot be litigated in the divorce action, a better option would be to divide the parties’ interest in the property on a deferred percentage basis, without determining how much of the property is actually owned by the parties. For example, on the facts of *Morris*, the court in the divorce action could have ordered that the parents’ interest be divided equally between them, without determining exactly how much (if any) of the property the parents actually owned. This is similar to the method that courts use to divide a pending personal injury claim.<sup>150</sup>

But this method also has serious limitations. If the court cannot join the third parties, it cannot force anyone to litigate the third party claim. It seems excessive to divide an asset on a deferred basis every time any possibility arises that a third party might, at some point in the future, assert a claim. Recall in this regard that when the parents were divorced in *Morris*, no third party claim was pending. Yet when such a claim was filed several years later, the court ultimately determined that the parents owned no real interest in the property. To foresee all future claims would require tremendous foresight from the court and the parties, and prevent final division of a substantial amount of property.

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<sup>149</sup> *Boyle v. Boyle*, 459 S.E.2d 401, 405 (W. Va. 1995); *see also* *Timmerman v. Timmerman*, 891 S.W.2d 540 (Mo. Ct. App. 1995) (where third party could still file independent action against spouses to assert its interest, joinder in the divorce case was not permitted).

<sup>150</sup> *See generally* TURNER, *supra* note 45, §§ 6.17-6.18.

In addition, final resolution of the divorce case will be difficult if the court does not know whether the parties actually own significant contested assets. For example, in the not-uncommon situation where the marital home is titled in the names of one party's parents, if the court cannot actually resolve the parents' claim in the divorce case, then it will not know for certain whether the parties actually own the marital home. But one can easily see how the court's overall property and support awards might be different, depending upon whether the children and the party who receives custody will continue to live in the former home. In particular, if the marital home is actually the parents' property, the party with custody will need either an award of alternate housing (e.g., a vacation home) in the property division, or a sufficient support award to be able to afford new housing. Even if a deferred percentage award is made, therefore, there will still be situations in which the court will not be able to divide the marital property fairly between the parties without determining exactly how much of the property is owned by third persons. In all situations, the best option is the majority rule: resolve all outstanding third-party claims to marital property in the divorce action.

It should be noted that the majority rule does not allow any and all third parties to intervene in a divorce action. For example, unsecured creditors with no actual claim to any specific marital asset never have standing to intervene.<sup>151</sup> Even a secured creditor should probably lack standing to intervene, based only upon the presence of a lien, unless the underlying debt is so substantially in default as to give the creditor a claim for immediate ownership. The key limitation under the majority rule is that third parties can intervene (and their joinder is required) only to the extent that they possess a *prima facie* claim to ownership rights in a specific marital asset. Hearing third party *ownership* claims in the divorce proceeding is the only way to assure that the court will have accurate knowledge of what property the parties actually own, and the only way to avoid the tremendous risk of harm if a future third-party action resolves the third-party claim in a manner different from what the divorce court expects.

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<sup>151</sup> Luthen v. Luthen, 596 N.W.2d 278 (Minn. Ct. App. 1999); Nielson v. Thompson, 982 P.2d 709 (Wyo. 1999).

## V. Conclusion

Division of property upon divorce cannot be an exercise limited to the parties themselves. Real life conspires in many ways to frustrate the neat distributional theories of courts and commentators, and one of these ways is the frequency with which married persons title the actual fruits of marital efforts in the names of third parties.

This finding is not entirely surprising, for the entire foundation of property division theory is the demonstrated tendency of married persons to ignore legal title generally. While legal title is probably least relevant within the marriage, the cases cited in this article show that married persons tend to pay little attention to legal title in other sorts of family relationships as well. Through such equitable theories as resulting trust, constructive trust, and unjust enrichment, the law has traditionally recognized that beneficial interests in property can be held by those other than the holder of legal title. The concept of divisible or marital property is really nothing more than an expanded form of beneficial ownership, applying only in the context of a divorce case. Given the large amount of conceptual common ground shared by the law of property division and the law of beneficial ownership generally, the growing tendency of modern courts to apply trust theories to third-party property is a thoroughly sound development.

At the same time, it is important to remember that theories of divisible, marital and community property apply only between married persons. Where marriage and divorce are not involved, the rights of one person to property titled in the name of another are governed generally by the law of property and contracts. No basis exists for applying different rules of law to third-party property merely because the alleged holder of the beneficial interest is now being divorced. On the contrary, the rights of a divorcing spouse to property titled in the name of a third party should be the same as they would be if the spouse were not being divorced, or even had never married. To increase judicial efficiency, and to avoid the potential harm of inconsistent results, it is important that third-party claims be litigated in the divorce case. The claims themselves, however, must continue to be resolved under the traditional principles of law that govern property relations outside of marriage generally.

