

“separate” property? For some clients, the answer to this question may have everything to do with the resulting impact of the sound estate planning techniques that were employed while the parties were blissfully married and, certainly, not contemplating the possibility of divorce. Can we, as attorneys, simultaneously protect clients in both arenas? In certain circumstances, we may be able to achieve those objectives. Frequently, however, there are naturally competing interests which simply cannot be reconciled, and the client must make a choice. When advising a client of the estate, tax and business succession planning options available to him or her, and of the potential risks should the client’s marriage later end in divorce, it is important to have a working knowledge of how domestic relations courts tend to view the issue of “marital” versus “separate” property, and of how they approach this issue when making a determination of an “equitable” division of property between spouses.

### “It’s mine!” “No, it’s ours!”

While it seems that it may be relatively easy to recognize the “separate” character of certain property, particularly when the property was acquired by one spouse prior to the marriage, or when it was inherited by one spouse after the date of the marriage, it is far more difficult to determine whether or not the *appreciation* on that separate property is also “separate.” The issue that has come to the forefront in recent years in such cases is, what constitutes *labor*?<sup>4</sup>

R.C. § 3105.171, which became effective on September 21, 2000, is Ohio’s division of property statute, and it defines “marital” and “separate” property in the context of a divorce proceeding. R.C. § 3105.171(A)(3)(a)(ii) provides that “all income and appreciation on separate property due to the labor, monetary, or in-kind contribution of either or both spouses that occurred during the marriage” is *marital property*, subject to division. Conversely R.C. § 3105.171(A)(6)(a), R.C. § 3105.171(A)(6)(a)(iii) and R.C. § 3105.171(A)(4) define “separate property,” which includes “passive income and appreciation acquired from separate property by one spouse prior to the date of the marriage,” and define “passive” income and appreciation as income and appreciation “acquired other than as a result of the labor, monetary, or in-kind contribution of either spouse.” It is typically not difficult to identify monetary contributions of a spouse, provided that sufficient supporting documentation exists. It is also not particularly difficult to identify in-kind contributions of a spouse, although the issue of the economic value of those contributions may be disputed. Defining the term “labor,” however, has become the *key issue* when a separate property argument is raised, espe-

## The Perils of Estate Planning and Divorce

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Ohio law mandates that, in every divorce proceeding, the court must determine which property of the spouses is “marital” and which property, if any, is “separate.”<sup>1</sup> The court must then divide the marital and separate property *equitably* between the spouses.<sup>2</sup> Under R.C. § 3105.171, this generally means that the court shall equally divide the marital property, and that it will disburse a spouse’s separate property to that spouse.<sup>3</sup> It sounds simple enough, but how does the domestic relations court make the determination as to “marital” versus

cially in the context of the appreciation in the value of one spouse's business interest or the appreciation on an investment account over which one spouse has the decision-making control.

If a spouse owns a business prior to the marriage, is the only shareholder, works in the business forty hours per week, and is solely responsible for all executive decisions, the court will likely find the increase in the value of the business during the parties' marriage to be "marital." The issue becomes more complex, however, in a divorce proceeding involving a large, closely held business with a management committee, and the sole shareholder is not in complete control of the executive decision-making. Such a fact pattern raises a different question with respect to the "labor" issue. The efforts or labor of the shareholder spouse may very well not be responsible for the increase in value of the business during the marriage. In such cases, the court may look to whether or not the shareholder-spouse has been fairly compensated by the business for his or her efforts.<sup>5</sup> Additionally, if a business is owned exclusively by family members, and more than one family member is involved in its operation, the court may take a hybrid position, allocating to the shareholder-spouse a pro rata percentage of the increase in value occurring during the marriage, the calculation of which percentage will be based upon the total number of involved family members. While this formula will almost never reflect the true contributions of each of the members, it will almost always provide the court with an easy exit strategy that is arguably within a range of fairness, at least from the court's perspective.

Whether a business or investment account is at the core of the controversy, in today's digital world, the reality is that we need not work forty, thirty, twenty or even ten hours per week to be in control of the executive decision-making that might result in the increase in value of an asset. Indeed, a single keystroke once per year may be sufficient to cause the reinvestment of dividends and, therefore, increase the value of the account. Does this type of decision-making rise to the level of "labor" within the purview of R.C. § 3105.171? Some courts say, "yes," and some courts say, "no."<sup>6</sup>

### **Is a Dollar Really a Dollar in the World of Divorce?**

Unless an asset is to be promptly sold as a term of the property division award, the domestic relations court need not take into account the costs of a hypothetical sale, even if the spouse who is awarded the asset actually plans to sell it.<sup>7</sup> The court also need not consider the tax consequences of a hypothetical sale, such as any capital gains tax. The court must only take into account

the actual tax consequences of the property division on the respective awards to be made to each spouse.<sup>8</sup> The significance of this, for purposes of the division of property in divorce, is that a dollar of cash, a dollar of value in the equity of a closely held business, a dollar of cash value in a life insurance policy, and a dollar of value in a qualified retirement plan are simply not all the same. Despite this fact, the court need not sort out an effective tax strategy in its decision.

While this reality may help resolve matters due to predictability, the fiction that all dollars are equal, irrespective of the type of asset, allows the court to ignore practical asset values and tax consequences, and leads to an oversimplified resolution by grouping assets of like kind and then dividing them. An extreme example of this approach results when one spouse is a participant in a public retirement plan, such as STRS or PERS, each of which is funded, and the other spouse is employed in the private sector, contributing to Social Security. Although Social Security is not an asset subject to division in a divorce proceeding, but rather, is only a future promise by the government to pay, the Ohio Supreme Court case of *Neville v. Neville*,<sup>9</sup> and its progeny, require that the present value of the anticipated future Social Security benefit be determined, and that this "value" be included in the calculation of the marital estate, offsetting the present value of the other spouse's public retirement plan.

### **"...And, besides, I never thought that we'd be getting divorced."**

The standard of proof *generally* required with respect to all domestic relations issues is a "preponderance of the evidence."<sup>10</sup> This standard, therefore, applies to the issues of separate property, *unless* the property is alleged to have been a "gift" to only one spouse. Under R.C. § 3105.171(A)(6)(a)(vii), a spouse who is attempting to advance the "gift" argument must prove by "clear and convincing evidence," that the transfer of property was a gift. Just as it is in the area of estate planning, all elements of a completed gift must be present to prove the gift in a divorce matter.<sup>11</sup> Therein, however, lies the dilemma. If, for example, one spouse transfers his or her separate property to the other spouse during the marriage, whether it be for estate planning purposes, asset protection strategies, or tax reasons, does the property then become the *marital property* of both spouses, or, perhaps, even the *separate property* of the transferee spouse? Clients must be made aware that the domestic relations court may not be sympathetic to an argument that a transfer was a completed gift in one context, but should not be considered a completed gift in another. The court will not likely be sympathetic to, "I only trans-

ferred it into my spouse's name for estate planning reasons, on the advice of my attorney, and, besides, I never thought that we'd be getting *divorced*." To confuse matters, though, title is not dispositive of the separate property issue. R.C. § 3105.171(H) specifically provides that "...the holding of title to property by one spouse individually or by both spouses in a form of co-ownership does not determine whether the property is marital property or separate property."

Another fact pattern not atypical in a divorce setting might involve a business owner who decides to engage in an accelerated gifting program as a part of his or her overall estate plan. To this end, shares of the business are transferred to an adult child, and shares are also transferred to that child's spouse. It may be ineffective to later argue in the domestic relations court that the transfers to the child's spouse were not actually intended to be gifts to the *spouse*, but rather, were intended to be gifts only to the *child*. Even with the corroborating testimony of the transferor-parent, the child would not likely persuade the court, by clear and convincing evidence, that the spouse's shares are really the child's separate property.

Consider a different, more complex scenario. A family owns a business. A friend of the family presents a below-market offer to purchase that business, which purchase is never consummated. The family then uses the friend's low offer to support, to the IRS, a buy-out of the father's interest by one of his children. A few years later, the child finds himself in the midst of a divorce. In an effort to limit the value of the marital portion of his business interest and create a separate property interest for himself, the husband argues to the domestic relations court that the spread between his payment and the actual fair market value of his father's shares at the time of the purchase was a *gift* to him, since all of the parties knew that the price he had paid was artificially low. The domestic relations court is not likely to accept this argument. In the case of *Janosek v. Janosek*,<sup>12</sup> currently on appeal in the Eighth Appellate District, the trial court kicked to the curb the husband's argument that his father had gifted him stock in the business. Pursuant to a stock purchase agreement, the father's stock was redeemed by the company. The husband testified, however, that the stock transfer to the company was actually a gift to *him* from his father. The court found that the husband's testimony was not credible and was, in fact, in direct contradiction to the documents presented, which clearly supported a "sale" rather than a "gift." The court found the terms of the stock purchase agreement to be clear. It is also found that no gift tax return was filed, and that the parties involved had received the tax benefits of a

sale. The court determined that the husband had failed to prove, by clear and convincing evidence, that a *gift* was made to him, in any amount, and that he, consequently, had failed to prove his separate property claim.

The upshot of the current trend of decisions issued by Ohio domestic relations courts is that clients simply cannot have it both ways.<sup>13</sup> What may be the most desirable and aggressive estate planning strategies for a client, today, may hinder the client from successfully proving a separate property claim tomorrow.

### **"Oh, you shouldn't have. *Really*."**

During the course of a marriage, the husband purchases numerous items of fine jewelry, presenting them to his wife on birthdays, anniversaries and other special occasions. Being the handyman that he is, the wife purchases a number of hand tools for the husband during the marriage, also for birthdays, anniversaries and other special occasions. The wife thoroughly enjoys wearing her expensive jewelry, and the husband thoroughly enjoys using his hand tools – that is, until the wife files a complaint for divorce. Not surprisingly, the wife argues that all of the jewelry was a gift to her from her husband and is, therefore, her separate property. She doesn't care about the hand tools. He can have them. The husband, however, argues that the jewelry is marital property, purchased as an investment, and that he never intended the jewelry to be his wife's separate property. Whose argument will prevail? That will depend on the wife's ability to prove the gift by "clear and convincing evidence". The element of "*donative intent*" is the key issue.

A less common, but no less real scenario involves a husband and wife on the wife's 40th birthday. In the presence of approximately one hundred fifty of their closest friends, the husband surprises the wife by presenting her with a brand new Ferrari F 430. The following year, the wife initiates a divorce proceeding and alleges that the Ferrari is, of course, her separate property. After all, it was a birthday gift to her, and she has one hundred fifty witnesses to prove it. Who will prevail? Did the husband *intend* the automobile to be a gift to his wife and, thus, be her separate property? The wife must prove, by clear and convincing evidence that, at the time of the transfer, the husband possessed the donative intent necessary to have made a completed gift of the automobile to her, rather than intending that auto to actually be the marital property of both parties.

All of the "gift" cases have, both, subjective and objective elements, making them quite fact sensitive. The court has very broad discretion in these matters, and, in making its determination, it should consider all relevant facts including the type and value of the property at is-

sue, the timing of the transfer, the specific circumstances surrounding the transfer, and the equities involved.

### **Don't get too cozy.**

R.C. § 3105.171(A)(6)(b) provides that the "commingling of separate property with other property of any type does not destroy the identity of the separate property as separate property, except when the separate property is not traceable." Although the statute does not define "traceable," the spouse alleging the separate property character of any asset has the burden of tracing the asset to separate property in order to prove, by a preponderance of the evidence, that it has maintained its separate character. While Ohio courts typically do not require a dollar-for-dollar tracing, they do at least require tracing by a reasonable-progression. If the asset cannot be reasonably traced, it will be deemed as marital in nature and subject to equitable division between the spouses.

Further, although the statute *appears* to dispose of the common law concept of "transmutation," assets that were once the separate property of a spouse may still become marital property over the course of the marriage.<sup>14</sup> For example, if separate property from an inheritance is held in an account in which other deposits are made, and, therefore, commingled with marital funds, should the balance drop below the amount of the inheritance, the entire account balance at the time of the divorce will likely be considered to be marital property, and the spouse who inherited the funds will not be entitled to a return of, or credit for, those funds.

Because the *tracing* of separate property is so essential in divorce matters, clearly one of the most important items of advice to give to estate planning clients is the need to create separate accounts for separate property, and then to preserve them as separate accounts throughout the marriage by not commingling them with marital funds or by using them for marital expenses. Is this, however, the answer in every case? Not necessarily, because the court also has very broad discretion to make *distributive awards*.<sup>15</sup>

### **"But you said it was mine."**

To the extent that separate property is maintained, and the wages of the other spouse are used to pay debts and to support the family such that no other savings are created, the court may make a *distributive award* to the non-monied spouse. The court has discretion to make a distributive award to "facilitate, effectuate or supplement a division of marital property," to make a distributive award "in lieu of a division of marital property in order to achieve equity between the spouses," and, to make a distributive award if a spouse has engaged in

"financial misconduct, including but not limited to, the dissipation, destruction, concealment, or fraudulent disposition of assets."<sup>16</sup> Should the court determine that a distributive award shall be made, the court must issue findings of fact in support of its determination.<sup>17</sup>

### **Timing is everything— or at least something.**

A client for whom you have done estate planning over the years appears at your office and announces that he is considering the termination of his twenty-five year marriage to his spendthrift wife, now that the kids are grown and on their way. He wants advice to determine how he might plan for such an event, in order to best preserve his assets and prevent his wife from "taking him for all he's worth," which is what she has threatened to do many times, according to him. What do you tell him?

There is a fine line between a client's engaging in "pre-divorce planning" and attempting to perpetrate a fraud. The client must be made aware of this fact, and both, the client and the attorney, must be very sensitive to it, even though the client may have the "right" to change his or her estate planning at any time. Timing is crucial to the issue. The closer in time to the initiation of a divorce proceeding, the more likely the steps taken to plan for such an event will appear to be an attempt to defraud the other spouse, and the more likely the domestic relations court will find this to be. In fashioning a remedy, not only could the court cause the "protected" assets to be returned to the marital estate for division, but also, the court could find that the offending spouse had actually engaged in financial misconduct. As the statute provides, this could result in an order for a distributive award of the offending spouse's separate property to be made to the spouse who was the victim of the misconduct.<sup>18</sup>

Antenuptial agreements are certainly one method of pre-divorce planning. They are necessarily the most remote in time from the commencement of a divorce proceeding, since, in Ohio, the parties may only enter into such agreements prior to marriage. In 1984, the Ohio Supreme Court in *Gross v. Gross*, 11 Ohio St.3d 99, 11 OBR 400, 464 N.E.2d 500 (1984), established that property division in the event of a divorce may be contractually enforceable under an antenuptial agreement. With the enactment of R.C. § 3105.171 in September of 2000, the Ohio legislature codified this principle, providing that "separate property includes any real or personal property or interest in real or personal property that is excluded by a valid antenuptial agreement."<sup>19</sup> The Ohio statutory law governing divorce is designed to be fair to both parties. Antenuptial agreements, however, are frequently unfair to the non-monied spouse. As the case of *Mill-*

*stein v. Millstein*, 2002-Ohio-4783, 2002 WL 31031676 (Ohio Ct. App. 8<sup>th</sup> Dist. Cuyahoga County 2002), clearly holds, the general rule in the Eighth Appellate District is that antenuptial agreements are, in fact, *designed* to be *unfair*, and the fact they are does not make them any less valid. Now that *Gross* is more than twenty years old, however, some courts are reluctant to endorse a result that provides the non-monied spouse of a very long-term marriage with little or no property, whatsoever, due to the terms of an antenuptial agreement. In such cases, the court may, in fact, find the antenuptial agreement to be valid but still make a distributive award of separate property to supplement, or in lieu of, an award of marital property. The court clearly has the authority to do so under the statute, as it even has the discretion to make a distributive award simply to achieve equity.<sup>20</sup> The court may also fashion a substantial spousal support award, since spousal support provisions in antenuptial agreements are always subject to review and modification by the court.

In Ohio, unlike many other states, antenuptial agreements may not be modified after the parties' marriage. Since the consideration for an antenuptial agreement is the marriage itself, it is generally viewed that there can be no consideration for a modification of the agreement after the parties have married. Further, post-marital contracts altering marital relations are governed by R.C. § 3103.05 and R.C. § 3103.06, which require the immediate *separation* of the parties to be enforceable. One possible solution to the problem of lack of modifiability may be to consider causing the agreement be governed by the laws of a state that permits post-nuptial agreements.

An area of pre-divorce planning that may be considered an option *after* the date of the marriage is that of transferring assets to the next generation by way of custodial accounts, irrevocable transfers to children, limited liability companies and family limited partnerships. Transfers to children are generally not included in the marital estate; however, since the marital estate may be reduced as a result of such transfers, the timing may be questioned and the validity challenged as a conveyance intended to defraud the non-monied spouse of an interest in property that would otherwise have been marital. Likewise, the timing and validity of transfers into trusts may be challenged, and assets will not be protected from a division of property award transferring them into an *inter vivos* trust.

It is desirable that all estate planning be completed well before the commencement of a divorce. If the client, however, informs you that his or her spouse has already commenced a divorce proceeding, it may be too late to make any modifications to the client's estate plan

until the divorce has concluded. In fact, the other spouse may have obtained from the court an *ex parte* temporary restraining order prohibiting the modification or elimination of any estate planning already in place. The attorney needs to ask the client and check the domestic relations docket to determine the status of these issues. The client must be made aware that, even without a temporary restraining order, he or she may *never* eliminate a spouse from health insurance coverage during a divorce proceeding, as this is absolutely prohibited by statute.<sup>21</sup>

Once a divorce proceeding has commenced, the effect of the death of one of the spouses depends upon timing, as well. If the case is pending and has not proceeded to final hearing, the domestic relations court loses jurisdiction over the parties and property, and the probate court gains jurisdiction. The divorce case is closed, and any temporary restraining orders are dissolved. If, however, the divorce case has already proceeded to final hearing, it has been heard and submitted to the court, and the parties are simply waiting for the court's decision or judgment entry of divorce, the death of a spouse in the interim does not terminate the divorce case. The domestic relations court retains jurisdiction and proceeds to issue its final order, which is enforceable to the extent applicable and possible. In either event, the proper notice of the death of a party to be filed by counsel in the domestic relations court is the "Suggestion of Death Upon the Record."

## Other Pre-Decree Planning Considerations

If a client anticipates the likelihood of a termination of his or her marriage, there are some other simple, but effective and sometimes critical, items the client should consider, in addition to estate planning, maintaining separate assets as verifiably separate and creating a paper trail for purposes of tracing. Before the filing of a divorce complaint, the client should obtain credit in his or her sole name, if not already held. The client should anticipate that joint credit cards will either be cancelled or that the further use of joint credit cards, or the credit card of the other spouse, will be prohibited by temporary restraining order. In fact, even if a party has not requested such an order, courts in some counties may automatically issue mutual temporary restraining orders prohibiting either party from incurring debt upon the credit of the other or for which the other may be held liable.<sup>22</sup> Further, it is important for the client to have established a credit history to assist in post-divorce acquisitions and loans.

The client should be made aware that a spouse who has been married for at least ten years is currently en-

titled to 50% of the Social Security benefit of the participant spouse, provided certain other conditions are met. If a client wishes to obtain a divorce and has been married for nearly ten years, it may be prudent for the client to postpone the commencement of a divorce proceeding until reasonably confident that the divorce will not be concluded before the parties' tenth anniversary.

The client also needs to know that, in certain counties, a spouse who voluntarily vacates the marital residence and does not return for a specific and continuous period of time may be prohibited by *ex parte* temporary restraining order from returning to the marital residence during the pendency of the divorce proceeding. In Cuyahoga County, for example, the Local Rules of the Division of Domestic Relations make available such a restraining order in a divorce proceeding upon request or by motion, provided that the other spouse has voluntarily been absent from the marital residence for at least thirty consecutive days immediately preceding the filing of the request.<sup>23</sup> In Summit County, the court typically *requires* the parties to separate, after the commencement of a divorce action. The rationale is that they will eventually have to separate anyway, and that a separation in the early stages of the proceeding will likely reduce acrimony during the pendency of the divorce.

When nearing the end of a divorce proceeding, the client should keep in mind that income tax filing status is determined as of midnight on December 31 of each year. The official date of a party's divorce is the date it is entered on the journal of the court's docket. If the case has resolved near the end of the year, and the parties have agreed to file joint income tax returns, the parties will need to make sure that their Judgment Entry of Divorce is not journalized until after the first of the year.

## Conclusion

It is always important for clients who find themselves contemplating or faced with divorce to seek competent divorce counsel. It is also important for estate planning attorneys to be aware of the potential risks involved in employing certain estate planning strategies, so that they may best advise their clients. This is true, even if the clients are not currently considering divorce, or the clients are the parents of adult children. Sometimes the risks may be acceptable, and sometimes they may not. Clients simply need to have the information required to make the choice and to hopefully avoid the potential perils along the way.