Classification discussion problems with notes and suggested 'answers'

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a. Wendy did not trust her husband Howard with money because she knew he had a serious gambling problem. During the marriage, she inherited $25,000 from her great aunt. Wendy did not tell Howard about the money, and she put all of it into an investment account that Howard did not know about. Wendy met with an investment advisor twice each year, and on a couple occasions, she called and instructed the advisor to make a trade based on information she read in the Wall Street Journal. The rest of the time, the advisor made all decisions about managing the account. By the date of separation, the account had a balance of $55,000.

   <u>Discussion:</u>

   Court of appeals opinion addressing the classification of an investment account is *O'Brien v. O"Brien*, 131 NC App 411, 508 SE2d 300, *rev. denied*, 350 NC 98, 528 SE2d 365 (1999).

   The marital property presumption applies because the account was acquired by a spouse during the marriage, before the date of separation and was owned on the date of separation. The burden then falls to Wendy to prove the account is separate. She easily can establish that the $25,00 used to fund the original account is her separate property because it was a bequest from her great aunt. G.S. 50-20(b)(2). Passive appreciation of separate property during the marriage is separate property. However, all appreciation of separate property which occurs during the marriage and before the date of separation is presumed to be marital property, meaning the appreciation is presumed to be appreciation caused by marital effort, *see Conway v. Conway,* 131 NC App 609 (1998) and *O'Brien*, so Wendy also has the burden of proving that the increase in the value of the account in the amount of $30,000 was passive, meaning it was not the result of marital effort.

   The court in *O'Brien* held that the increase in value of a separate investment account during the marriage was not marital property where neither spouse rendered "substantial services" in managing the account during the marriage. To determine whether a spouse's services during the marriage were substantial, the court in *O'Brien* stated that the trial court should consider the following:

   "(1) nature of investment; (2) extent to which investment decisions are made only by party or parties, made by party or parties in consultation with their investment broker, or solely made by investment broker; (3) frequency of contact between investment broker and parties; (4) whether parties routinely made investment decisions in accordance with recommendation of investment broker, and frequency with which spouses made investment decisions contrary to advice of investment broker; (5) whether spouses conducted their own research and regularly monitored investments in their accounts, or whether they primarily relied on information supplied by investment broker; and (6) whether decisions or other activities, if any, made solely by parties directly contributed to increased value of investment account."

This scenario with Wendy and Howard seems very similar to the facts in *O'Brien*, indicating the entire value of the account should be classified as Wendy's separate property because Wendy did not render substantial services in managing the account during the marriage. *Cf. Barton v. Barton, unpublished opinion,* 215 N.C. App. 235*,* 715 SE2d 529 (2011)(husband failed to rebut presumption that appreciation of investment account was active where evidence showed husband met with broker every month or two and husband authorized every trade, and there was frequent trading throughout the marriage).

b. Polly began contributing to a 401K plan through her employer 5 years before she married Frank. On the date of marriage, the account contained $20,000. She continued to contribute to the plan through direct deduction from her monthly paycheck throughout her 20-year marriage to Frank. On the date of separation, the account contained $100,000. Polly introduces evidence that $40,000 was deducted from her paycheck during the marriage to fund the account.

<u>Discussion:</u>

GS 50-20.1 governs the classification and distribution of "pension, retirement and other deferred compensation plans." That statute was amended significantly by S.L. 2019-172, with the amendments applying to distributions made on or after October 1, 2019.

G.S. 50-20.1(h) specifies that G.S. 50-20.1 applies to all vested and nonvested pension, retirement and deferred compensation plans, programs, systems of funds, specifically including but not limited to "uniformed services retirement programs, federal government plans, State government plans, local government plans, Railroad Retirement Act pensions, executive benefit plans, church plans, charitable organization plans, individual retirement accounts within the definitions of Internal Revenue Code sections 408 and 408A, and accounts within the definitions of Internal Revenue Code section 401(k), 403(b), or 457."

Polly's 401K is a defined contribution plan. A defined contribution plan is an account wherein the benefit payable to the participant spouse is determined by the contributions contained in an account with a readily determinable balance. G.S. 50-20.1(d1) provides that that a defined contribution plan should be classified through tracing.

Tracing means classifying an account by establishing through evidence how much of the account balance on the date of separation was the result of marital contributions and growth on marital contributions and how much of the account balance on the date of separation was the result of separate contributions and growth on separate contributions, in accordance with the principles of *Wade v. Wade*, 72 N.C. App. 372 (1985)(both the separate and the marital estates are entitled to "an interest in the property in the ratio its contribution bears to the total investment in the property."). In this case, $20,000 clearly is separate and $40,000 is marital. Expert testimony generally can trace growth (the remaining $40,000) to specific contributions to allow for an accurate classification.

If insufficient evidence is presented to allow the court to classify the marital portion of the account by tracing, the court is required to determine the marital portion of the defined contribution plan by application of the coverture fraction - the numerator of the fraction being the time spent earning the pension while married and before the date of separation, and the denominator of the fraction being the total time spent earning the pension before the date of separation. G.S. 50-20.1(d). That fraction is applied to the date of separation value of the plan to determine the value of the marital component of the plan.

In this case, the coverture fraction will be 20/25 – meaning the account is 4/5ths marital property ($80,000).

c. Shea and Edward opened a joint savings account a week after they married. They deposited money into the account over the years and on the date of separation the account had a balance of $100,000. They both agree that each of them made regular deposits into the account from their monthly work paychecks throughout the marriage and that they took money out of the account whenever they needed extra funds for household expenses or family vacations. In addition, they both agreed that Shea deposited into this account the $15,000 she received when she sold the diamond ring her grandmother gave her before the wedding and that Edward always deposited into this account the dividends he received from IBM stock he purchased years before the marriage. He estimates these dividends amounted to approximately $40,000.

Discussion:

Because the account was acquired during the marriage and owned on the date of separation, the entire account balance is presumed marital. Both Shea and Edward have the burden of tracing out their separate components of the account. The court of appeals addressed classification of a commingled account in *Minter v. Minter*, 111 NC App 321 (1993)(where evidence showed that it was “impossible” to trace husband’s inheritances out of joint account, trial court was required to classify account as marital property). Similarly, in *Holterman v. Holterman*, 127 NC App 109 (1997), the court held that the wife had the burden of tracing her inheritances to assets actually owned by the parties on the date of separation, and in *Power v. Power*, 236 NC App 581 (2014), the court held husband failed to adequately trace his separate portion of the account where all he established was that funds he inherited during the marriage were deposited into the account. The court held that he failed to meet his burden of proving the separate funds remained in the account on the date of separation. *See also Comstock v. Comstock*, 240 NC App 304 (2015)(same).

Because there were withdrawals made throughout the marriage from this account, it will be difficult for either Shea or Edward to trace out the separate property and prove separate funds still existed on the date of separation. Probably cannot be done without expert testimony. If neither party can show how much of the date of separation value of the account was their separate property, the entire date of separation value will be marital property.

d. During the marriage, Edward inherited his grandmother’s horse farm. Edward’s accountant testifies that the farm was worth $500,000 at the time of the inheritance. Both Edward and Shea were thrilled with the inheritance because they love horses. The farm included a farmhouse and a couple of small barns. Shea and Edward painted all the buildings and replaced the roof on the farmhouse. They also fixed several broken fences. Shea painted the inside of the farmhouse, bought new furnishings and curtains and planted a beautiful flower garden in the yard. Unfortunately, their mutual love of horses was not enough to sustain their marriage, and they separated 5 years after Edward inherited the farm. Shea offers into evidence an appraisal of the farm which states that it was worth $650,000 on the date of separation.

Discussion:

The farmhouse is Edward's separate property to the extent of $500,000 because it was an inheritance. GS 50-20(b)(2). The $150,000 appreciation of that separate property during the marriage is presumed to be marital (meaning it is presumed to have been caused by the actions of a spouse). Edward will have the burden of proving the appreciation in value was not the result of marital efforts. Because the passive verses active distinction for classifying increases in the value of separate property during the marriage is intended to ensure that marital contributions to the equity in separate property are credited to the marital estate, see discussion in *Smith v. Smith*, 111 NC App 460 (1993), spousal efforts to maintain property which do not lead to increased equity should not be sufficient to cause a marital interest in the property. If that is true, Edward should be able to meet his burden of proof by showing that the marital efforts in this case were in the nature of maintenance and did not cause the market value of the property to increase. See *Romulus v. Romulus,* 215 NC App 495 (2011)(addressing postseparation increase in value of marital business; holding husband failed to show increase was the result of his day-to-day work in the practice after separation because there was no evidence that his daily efforts caused the value of the dental practice to increase). *See also Brackney v. Brackney,* 199 NC App 375 (2009)(for purpose of classifying postseparation increase in value of marital property it is critical to determine whether actions of spouse actually caused the change in value). *But cf. Lawrence v. Lawrence*, 75 NC App 592 (1985)(contributions by wife in form of property management, redecorating, and paying bills related to a rental condominium owned by husband before the marriage resulted in a marital interest in that property).

e. Same facts as d. above except Edward transferred title to the horse farm to tenancy by the entirety shortly after receiving it from his grandmother's estate. Edward testifies that he transferred title only because his accountant told him he should do so for tax and liability purposes.

Discussion:

As of October 1, 2013 (*see* S.L. 2013-103), G.S. 50-20(b)(1) states: "It is presumed that all real property creating a tenancy by the entirety acquired after the date of marriage and before the date of separation is marital property. [This] presumption may be rebutted by the greater weight of the evidence." So, there is a presumption that the horse farm is marital property. This marital property presumption can be rebutted by showing – by the greater weight of the evidence – that the property is in fact separate property. In this case, Edward would argue that because the tenancy by the entirety was acquired in exchange for his separate property, the property is separate. G.S. 50-20(b)(2)(property acquired in exchange for separate property is separate property).

However, in *McLean v. McLean*, 323 NC 543 (1988), the supreme court held that when one spouse uses separate funds as consideration for real property held as tenancy by the entirety, it is presumed that the spouse has gifted the separate funds to the marriage. And, GS 50-20(b)(2) provides that "property acquired by gift from the other spouse during the marriage shall be considered separate property only if such an intent is stated in the conveyance." Therefore, unless Edward can prove *either* that he did not make a gift of his property to the marriage *or* that a gift was made but the conveyance contained an express statement that he did not intend for the property to become marital property, the property held as tenants by the entirety is marital property despite the fact that it was acquired in exchange for Edward's separate property. The court in *McLean* acknowledged and upheld the earlier court of appeals opinion in *McLeod v. McLeod*, 74 NC App 144 (1985), holding that when the separate property of one spouse is conveyed to both spouses as tenancy by the entirety, it is presumed the spouse has made a gift of his or her separate property to the marriage and the property held as tenants by the entirety will be marital property unless a contrary intent is stated in the conveyance.

While the appellate courts consistently have held that the presumption that the conveyance is a gift between spouses can be rebutted only by clear, cogent and convincing evidence, S.L. 2013-103 appears to change the burden to greater weight of the evidence.

There has been no appellate case to date upholding a trial court decision that the presumption has been rebutted, and it is unclear what type of evidence would be sufficient. *See Romulus v. Romulus,* 215 NC App 495 (2011)(there is no rule that the testimony of one spouse alone is insufficient as a matter of law to rebut the presumption; determining whether weight of evidence is sufficient to rebut the presumption is decision of trial judge).

In this case, there is no evidence that Edward did not intend to make a gift to the marriage. He states the *reason* he made the gift – his accountant told him to do it – but he does not dispute that he did in fact transfer his ownership interest to the marital unit without consideration – a gift. *See Milner v. Littlejohn*, 126 NC App 184 ((1997)("A gift is a voluntary transfer by one to another without consideration therefore"); and *McLean v.*

McLean, 323 NC 543 (1988)(presence of donative intent determines whether a gift was made; motivation for the transfer is not determinative).

f. The assets in Kristen and Steve's estate include the marital residence, two cars and one modest 401K. They have stipulated that each party will receive one of the cars and the 401K will be divided equally by a QDRO. An interim distribution order distributed the house to Kristen and ordered that she make the mortgage payments. She made the mortgage payments with her separate funds. The house had a market value of $350,000 on the date of separation and the mortgage indebtedness on the date of separation was $150,000. On the date of trial, the market value of the house was $400,000 and the mortgage had been reduced to $130,000 by Kristen's payments.

Discussion:

The house is marital property valued at $350,000, encumbered by marital mortgage debt of $150,000, giving a net value of $200,000 for the house on the date of separation. The net value on the date of trial is $270,000.

If there was no interim distribution order, the $70,000 increase in value of the house after the date of separation would be presumed to be divisible property, *see Wirth v. Wirth*, 193 NC App 657 (2008)(all increases and decreases in the value of marital property after the date of separation and before the date of distribution are presumed to be divisible property). Kristen could rebut the presumption at least in part by showing that $20,000 of the increase in net value was due to her reduction of the mortgage (active appreciation is not divisible property). The amount of interest she paid for the mortgage after the date of separation would be divisible debt. See GS 50-20(b)(4)(d)(divisible property includes "passive increases and passive decreases in marital debt and financing charges and interest related to marital debt). The fact that she paid marital debt following separation would be a distribution factor, and she would be entitled to a "credit" for any principal reduction that accrues to Steve's benefit in the distribution.

However, the court of appeals has held that, unless the interim order specifically states otherwise, property distributed by an interim order becomes the sole, separate property of the party to which it was distributed; the date of distribution for purposes of valuation is the date of the interim distribution order, even if the issue of valuation is held open for resolution at a later trial date. Any increase in the value of property after it is distributed pursuant to an interim distribution order is not divisible property but is the sole, separate property of the person receiving the distribution. And the person receiving the property in the interim distribution is not entitled to consideration or "credit" in the final distribution for any postseparation payment of debt associated with the property. *Lowder v. Lowder*, unpublished, 291 NC App 310 (2023), citing *Johnson v. Johnson,* 230 NC App 280 (2013). *See also Daly v. Daly*, 255 NC App 448 (2017)(same). *But cf. Brackney v. Brackney*, 199 NC App 375 (2010)(language in interim order preserved wife's claims regarding the classification and distribution of a house distributed to husband in interim order).

g. Janet and Eddie were married 10 years before they separated. On the date of separation, they owned the marital residence as tenants by the entirety. The house had a market value of $300,000 on the date of separation and a mortgage with a balance of $200,000. Janet remained in the house throughout the two years it took to get to court for the equitable distribution trial. For the first year of the separation, Janet paid the mortgage payment in the amount of $1500 each month, which included principal ($500) and interest ($700) on the loan, as well as the amounts required to be placed in escrow for homeowners' insurance ($150) and property taxes ($150). Because she was unemployed for the first three months of the separation, Janet paid the first three mortgage payments using funds from the marital savings account. The rest of the payments during that first year of separation came from her postseparation employment. At the end of the first year, the mortgage balance was $194,000. Before Janet could make any payment during the second year, Eddie used money he received from an inheritance to pay off the mortgage completely. Janet remained in the house and paid the homeowners' insurance premium and the property taxes for the second year of separation – a total of $3600.

Discussion:

For payments made before October 1, 2013

Since the house is owned as tenants by the entirety, we will assume it is marital property to the extent of the DOS value: **$300,000 marital property** (net value is $100,000 but with divisible debt, I find it much easier to classify the house and the mortgage separately. Court of appeals has approved of separating assets and debts for purpose of classification, *see Hay v. Hay,* 148 NC App 649 (2002). *See also Conway v. Conway*, 131 NC App 609 (trial court has discretion to distribute assets and liabilities separately; as long as court considers net value of estate, court can distribute all asset to one spouse and all debts to the other)).

Mortgage is marital debt because incurred to purchase marital property. Value on DOS is **($200,000) marital debt**.

Before October 1, 2013, GS 50-20(b)(4)(d) provided that a decrease in marital debt was divisible debt, so the decrease in principle of the mortgage resulting from payments made before October 1, 2013, is divisible debt. If we assume all payments were made before October 1, 2013: **$6,000 divisible debt paid by Janet and $194,000 divisible debt paid by Eddie.**

The court of appeals also has included the postseparation payment of mortgage interest as divisible debt, see *Warren v. Warren*, 175 NC App 509 (2006)(post divisible debt amendment in 2002) and *Smith v. Smith*, 111 NC App 460 (1993)(before 2002 amendment), so additional divisible debt is amount Janet paid in interest: **$8,400 divisible debt.**

Although there is no case specifically addressing classification of amounts paid for the required escrow of property taxes and homeowners' insurance as part of a mortgage payment, in cases decided before the statutory amendment in 2002, the court of appeals treated the payment of taxes and homeowners' insurance premiums related to the marital residence as the payment of marital debt, *see Smith v. Smith, id.*, and *Bowman v. Bowman*, 96 NC App 253 (1989)(taxes paid after DOS treated as marital debt). In *Jones v. Jones, unpublished opinion*, 193 NC App 610 (2008), the court distinguished the payment of insurance and taxes from the payment of interest and principle but upheld the trial court's decision to give "credit" to paying spouse for amounts paid for insurance and taxes – saying trial court can consider payments made benefiting the marital estate). So Janet's additional divisible debt (probably??) in the amount Janet paid for escrow account: **$7200 divisible debt.**

The court of appeals has held that once the trial court appropriately classifies divisible debt, distribution of the divisible debt is within the discretion of the trial court. *See Warren v. Warren*, 175 NC App 509 (2006); *McNeely v. McNeely,* 195 NC App 705 (2009); *Jones v. Jones, unpublished opinion*, 193 NC App 610 (2008)(each case rejecting idea that paying spouse is entitled to "dollar-for-dollar credit" for postseparation payments.

For payments made on or after October 1, 2013:

S.L. 2013-103 amended the definition of divisible debt found in G.S. 50-20(b)(4)(d), affecting all payments made on or after October 1, 2013. *Lund v. Lund*, 779 SE2d 175 (NC App 2015), relying on *Warren v. Warren,* 175 NC App 509 (2006)(applying last amendment of definition of divisible debt to payments made on or after the effective date of the statutory amendment). Divisible debt now includes only *passive* increases and *passive* decreases in marital debt after the date of separation. This means that *active* decreases in marital debt no longer need to be classified as divisible debt and distributed between the parties. In *Hay v. Hay*, 148 N.C. App. 649 (2002), the court of appeals held that an increase in the net value of real property caused by one spouse making payments on the encumbering debt during separation was an *active* increase in value rather than a passive one. Therefore, a reduction in debt caused by one spouse making payments on that debt is an *active* decrease in debt, not falling within the new definition of divisible debt pursuant to G.S 50-20(b)(4)(d).

While the trial court no longer is required to classify postseparation debt payments, it is clear that the court must give "some consideration" to postseparation payments made from separate funds that benefit the marital estate or the other spouse. Appellate cases recognize the court's ability to 'credit' a paying spouse for such debt payments. In addition, postseparation payment of marital debts must be considered as a distribution factor pursuant to GS 50-20(c) unless the parties stipulate that an equal distribution is equitable. For extended discussion of where we are now regarding the consideration of postseparation debt payments, see Family Law Bulletin #26, "Equitable Distribution Update: Tenancy By The Entirety, Postseparation Payment of Debt, and Defined Contribution Retirement Accounts." February 2014, UNC School of Government.

In this case, for purposes of classification, we have marital property valued at $300,000 on the date of separation and on the date of trial. In addition, the mortgage is classified as a marital debt with a value of ($200,000) on the date or separation and $0 on the date of trial. Using the current definition of divisible debt, there is no evidence of divisible property or divisible debt. The fact that both parties made payments related to the marital residence during separation will be addressed in distribution of the estate rather than at the classification stage.

h. Peg and Andrew were married for 30 years. During that time, they jointly owned and operated several business entities engaged in residential and commercial development. They also had owned several similar businesses over the years with various members of Andrew's family. About 5 years before the date of separation, Peg and Andrew formed a new Limited Liability Corporation (an LLC). The purpose of the LLC was to own and manage commercial rental property. Peg and Andrew were equal owners of the LLC and there were no other owners. Shortly after the LLC was formed, Andrew's parents transferred title to a small shopping center to the LLC and no consideration was paid. The LLC owned the shopping center and collected rents from the tenants in that shopping center up to and following the date of separation. The value of the LLC on the date of separation was $1.5 million dollars. The value was based in large part on the income-producing potential of the shopping center.

Discussion:

The ownership interest of the parties in the LLC is marital property because it was acquired during the marriage and owned on the date of separation. If Andrew's parents had transferred the shopping center to Andrew for no consideration during the marriage, there would be a presumption that it was a gift to Andrew and therefore his separate property. See *Joyce v. Joyce,* 180 NC App 647 (2006). However, in this case, the transfer was to the LLC rather than to either party. *See Montague v. Montague*, 238 NC App 61 (2014)(LLC was marital but court could consider as a distribution factor that shopping center was transferred to the LLC as part of husband's parents' estate planning). The shopping center is not marital or separate property because neither party owned the shopping center on the date of separation. The court cannot distribute the shopping center. The marital property to be distributed is the ownership interest of the parties in the LLC.

i. After the date of separation, Peg had no involvement with the LLC. Andrew had regular contact with the tenants in the shopping center and collected the rent. He also handled the business affairs of the LLC by keeping all business records, overseeing all maintenance of the shopping center, negotiating the renewal of leases with the tenants, and generally managing the day-to-day requirements of maintaining the business. During the 3 years between the date of separation and the date of trial, Andrew collected $250,000 in rent from the tenants; $75,000 was deposited into the LLC's business account and $175,000 was deposited by Andrew into his personal account and used for his personal expenses during separation. By the date of trial, the value of the LLC was $1.8 million dollars. The valuation expert testified that the date of trial value would be higher if Andrew had not used the $175,000 in rents for his personal benefit.

Discussion:

1) The postseparation increase in the value of the LLC from $1.5 million to $1.8 million is presumed to be divisible property. *See Wirth v. Wirth*, 193 NC App 657 (2008). Therefore, party seeking to prove it is not divisible (in this case Andrew), has burden of proving the appreciation was caused by the actions of a spouse. While there is some evidence that the appreciation was lower than it otherwise would have been due to actions by Andrew, there is no evidence that Andrew did anything to cause the appreciation because there is no evidence that he did anything other than normal, day-day management of the business. See *Romulus v. Romulus,* 215 NC App 495 (2011)(evidence of daily work in dental practice was not sufficient to rebut presumption that appreciation was not the result of actions of a spouse). *See also Montague v. Montague*, 238 NC App 61 (2014)(efforts by spouse that were fully compensated do not cause appreciation of the marital LLC).

2) The classification of the $250,000 in rental payments after the date of separation depends on the ownership of the funds. If the money is money owned by the LLC on the date of trial, the money should not be classified separate and apart from the value of the LLC because it is not a separate asset owned by either party. *See Simon v. Simon,* 231 NC App 76 (2013)(earnings of a subchapter S corporation belong to the corporation and not to the owners of the corporation until the corporation makes a distribution of the earnings to the shareholders; earnings cannot be classified as marital or divisible until they have been distributed to one or both spouses). *See also Hill v. Sanderson*, 244 NC App 219 (2015)(where amounts reflected on wife's tax return as "nonpassive income" from Subchapter S were retained earnings of the corporation and had not been distributed to her as a shareholder, the trial court did not err in refusing to classify and distribute the funds as divisible property). The LLC probably was valued using a methodology based upon the projected stream of future income. Counting that future income as a separate asset would be 'double-dipping' as the income already is reflected in the date of separation and date of trial values of the LLC. (much like the valuation of a pension or retirement account is a valuation of the future income to come from the pension or retirement account). From our facts, it appears that at least $75,000 remained property of the LLC and should not be classified as divisible property.

   Arguably, depending on the methodology used to value the LLC, all the $250,000 was income reflected in the valuation of the LLC. This probably is a good thing to keep in mind at the distribution stage.

However, any income actually passing to Andrew should be classified as divisible property, pursuant to GS 50-20(b)(4)(3) (passive income earned from marital property is divisible property), to the extent it is shown that the income was not generated by his postseparation actions. No case has established the burden of proof for any category of divisible property except for 50-20(b)(4)(1). However, in *Walter v. Walter*, 149 NC App 723 (2002), the court of appeals stated in a footnote that the party claiming property to be divisible has the burden of proving that classification. *But see Simon v. Simon,* 231 NC App 76 (2013)(court of appeals stated without discussion that party seeking to show that postseparation distributions from marital stock were not divisible property had the burden of proving the distributions were his 'separate' property). It seems, therefore, that Peg will have the burden of proving the income was not the result of Andrew's postseparation efforts, or not entirely the result of Andrew's postseparation efforts. One method of establishing that the income is partially divisible would be to show what amount could reasonably be assumed to be salary to Andrew for his management services. Any amount above and beyond that would be 'passive' income in that it was generated from the normal business activities of the LLC. *See Binder v. Binder, unpublished opinion,* 231 NC App 514 (2013)(affirming trial court determination that $304,014 of the $2,183,762 withdrawn from marital corporation during separation was payment for husband's work during separation based on evidence that 3-5% of rents received was a "customary management fee"; remainder of amounts withdrawn properly classified as divisible property). *Cf. Montague v. Montague*, 238 NC App 61 (2014)(trial court erred in concluding payments from LLC to husband following separation were compensation to him for services rendered to the LLC where the parties listed the payments as distributions from the LLC on their income tax return. Court of appeals held that parties cannot have it both ways and held that they were bound by their earlier statement on the tax return).

j. During John and Jane's 15-year marriage, Jane worked for the same company that hired her the day after the couple returned from their honeymoon. Sadly, one month after John and Jane separated, the company announced it needed to downsize by terminating most of their employees, including Jane. All terminated employees were given a severance payment in an amount determined by a formula which took into account the individual's salary at the time of termination and the number of years the individual had worked for the company. Jane received a lump sum severance payment of $75,000 three months after the date of separation and before the equitable distribution trial.

<u>Discussion:</u>

North Carolina appellate courts have not yet addressed the classification of severance pay. GS 50-20(b)(4)(2) provides that property acquired after the date of separation and before the date of distribution that was "acquired as the result of efforts of either spouse during the marriage and before the date of separation" is divisible property. Again, we have no case addressing the burden of proof on this issue, so the assumption based on the statement in the footnote in *Walter v. Walter*, 149 NC App 723 (2002), is that John will have the burden of proving what part, if any, of the severance pay should be classified as divisible property. The only case to date discussing this category of divisible property is *Ubertaccio v. Ubertaccio,* 359 NC 175, adopting concurring opinion by Levinson in 161 NC App 352 (2003), discussed in more detail below. In his concurring opinion, Judge Levinson stated that the fact that the right to receive the property in the future was not considered 'vested' on the date of separation was not relevant to the classification; rather classification must be based on the "source" from which the property was generated. In this case, the factual determination to be made by the trial judge is whether the severance pay was acquired totally or in part because of Jane's efforts before the date of separation.

Some courts in other states have held that severance pay generally replaces lost future income and therefore should not be considered divisible property. These courts held that the fact that the amount of severance pay received was based on a formula which took into account years of employment does not change the basic nature of the payment as a replacement of future income. *See e.g Davis v. Davis*, 87 P3rd 640 (OK Civ App 2004); *Wendt v. Wendt*, 757 A.2d 1225 (Conn. 2000); *Prescott v. Prescott*, 736 So.2d 409 (Miss. Ct. App. 1999); *Reinbold v. Reinbold*, 710 A.2d 556 (NJ 1998); and *Gordon v. Gordon*, 681 A.2d 732 1996 (Penn. 1996)(3 justices dissenting). However, other courts have held that when the *entitlement* to severance (rather than the amount to be paid) is based on past services, then the severance is marital property to the extent it is the result of employment during marriage. *See DeLuca v. DeLuca,* 762 N.E.2d 337 (NY 2001)(severance only awarded to employees with at least 20 years of service); *Osorio v. Orsorio*, 84 A.D.3rd 1333 (N.Y. 2011)(early retirement was in consideration of prior service); and *Malin v. Loynachan*, 736 nw2d 390 (Neb. 2007)(severance was one month's salary for every year of prior service).