BACKGROUND

DEFINITION OF PROPERTY

For divorce purposes, the definition of property is constantly evolving because of technological advances and the expansion of programs such as pensions and fringe benefits. The definition of property goes beyond earlier definitions that just considered tangible assets such as real estate, houses, stock and bank accounts. Property now includes intangibles such as professional degrees, earning capacity, and fringe benefits like stock options and pension rights. Few state divorce statutes have outlined these concepts, and case law must be relied upon to deal with this issue of what is property, let alone what property belongs to whom.

SEPARATE AND MARITAL PROPERTY

Not everyone enters a marriage without any property, and both parties often do not begin a marriage with equal assets. Not all parties are marrying for the first time. Many spouses have worked before the marriage and accumulated assets on their own. Some have saved their funds prior to the marriage, made investments, purchased property such as real estate and other financial assets. Some have inherited money. In a divorce, it is essential a determination be made of what each party brought into the marital partnership. This leads to the definitions of separate and marital property. Below we will discuss different aspects of the question of what is separate property and marital property. Also discussed will be the evaluation of each form of property.

WHAT IS MARITAL PROPERTY

In community property states (Pennsylvania, New York, New Jersey, Delaware Maryland, North Carolina, Virginia and Florida are not community property states), the only divisible property in a divorce is that which is community property, or “marital property.” Other than that, each spouse can retain his or her “separate” property. In some states, all property is divisible, but for the states that do distinguish, it is necessary what is “marital.” Marital property is normally defined as “all other property acquired by either spouse after the marriage.” Below are specific approaches that courts have used to determine what is separate property and marital property.

The Implied Exclusion Approach

This approach goes by statutory law, which defines separate property as exhaustive, meaning that if a certain property is not referred to in a statute as separate property, it is normally considered marital property. There are some exceptions, of course, specifically regarding property received for post-divorce services, which is generally considered to be separate property.

The Onerous Acquisition Test

This method applies a test to characterize property. An item is considered to be community property only if it has been accumulated due to the efforts of either spouse during marriage the marriage.

The Marital Property Presumption

In many states, there exists a presumption that property owned by either spouse at divorce is marital property, but this assumption can be disproved if the owning spouse can effectively show that the property is actually separate. However, in some states the wording of their statutes are ambiguous, and courts have ruled only property acquired during marriage are marital, and not property possessed at the time of divorce.

When Parties Begin to Accumulate Marital Property

Based on the definition that martial property must be acquired during the marriage and is not separate property, many courts have concluded that property earned before marriage is not marital, as long as no marital funds or efforts are contributed to it during the marriage. There are some exceptions, such as considering the intentions of some pre-marital property or credit purchases paid during the marriage. For instance, if a prospective spouse purchases a house before marriage in his or her own name with separate property it is marital property if it was purchased with the intent that it be the marital home.

Considering intent is inconsistent with some marital property principles that do not take intention into account. This presents a problem in cases in which parties cohabited and later married, though; some courts do include property acquired during cohabitation as part of the marital estate.

When Parties Stop Accumulating Marital Property

Many states have a statutory definition of when parties stop accumulating marital property. This concept is called the “cut-off” date. Depending on the state, the cut-off date can be the date of separation, immediately after the parties file for divorce or sign a separation agreement, or simply that marital property is all property accumulated before separation.

Property Acquired with Contemporaneous Separate and Marital Property Consideration

Whether property is marital or separate is usually determined by the time that item is required and its intended use. Property acquired during the marriage is usually considered to be marital, unless it can be shown that it was purchased only with separate property; if that is so, the property is considered separate itself. The issue is not always clear if, for example, a mix of marital and separate property was used to purchase the property.

The Pro Rata Approach Applied in Community Property States

Many states have solved the problem presented by property purchased with both marital and separate property by accepting the idea that some property does not have to be entirely marital or entirely separate. These states will consider the value of the property in terms of how much of each type of property went into acquiring it and will share any natural increases in its value between each portion.

These states generally take the position that the involvement of separate property makes that property an intended gift to the marital estate, because most spouses do not think about purchases in that light until they must divide them in divorce.

The Unitary Property Approach

In some states that item which is purchased by both separate and marital funds is considered to be marital property for which the separate portion is reimbursed. The spouse who put in separate funds would share on any and all gains on the marital portion.

Different Approaches to Characterizing Property Acquired Over Time

When property is acquired over time without a distinct, lump-sum payment, it becomes more difficult to classify which portions of it are marital or separate. There are several methods to determine what is separate and what is marital.

The Inception of Title Approach

This method uses a particular time to determine the character of property. This method means that any separate contributions do not change the character of the property but do allow that separate spouse a refund of some or all of those funds.

The Time of Vesting Approach

This approach also focuses on a particular time to determine the character of the property, in this case considering the time the title vested. This method also uses the concept of reimbursement for any payments made before or after that time.

The Pro Rata Approach

In this method, all contributions made at any time are considered, not just those made at one particular time. The property is characterized based on the percent of separate contributions made to the total purchase. This method also does not use any form of inflation and considers all dollars to be worth the same amount, even though many would argue that older payments should be given greater weight.

The Presumption of a Gift

As already mentioned, it could be argued that separate property could have been intended as a gift to the marital estate. But since parties do not often focus upon the nature of consideration spent until they confer with a divorce lawyer, this argument is easily refutable. Courts have generally abolished this method and will instead apply one of the aforementioned approaches.

DISTINCTIONS BASED UPON THE TYPE OF PROPERTY INVOLVED

Courts will often use different methods to characterize different types of property, for example, using the inception of title approach for real estate transactions and the pro rata approach for pensions. Credit purchases and installment purchases also may receive different classifications in comparison to cash purchases. Marital and separate property generally cannot be classified without consideration of the specific type of property in question and the transaction used to obtain it. In states containing marital property statute systems, certain types of property are clearly designated as marital or separate. Almost all of those states declare that any property obtained before the marriage or obtained during the marriage by gift or inheritance can be designated as separate, and many declare that any increase in value during marriage of that property is still separate. In some cases, property such as pensions and professional degrees are also designated as separate.

TYPES OF PROPERTY COVERED BY CASE LAW

APPRECIATION OF SEPARATE PROPERTY DURING MARRIAGE
Most statutes clearly define property obtained before marriage as separate property, but an issue arises if that property's value increases during the marriage.

States with Express Statutes

Some statutes expressly state that all appreciation in value of all types of separate property are separate themselves, while in other states, only the increase in value of property obtained before the marriage is separate. The reason for this important, for if it is the result of any efforts by either spouse during the marriage, the increase becomes part of the marital estate. The distinction changes from state to state, in some cases depending on the efforts of both parties. It seems that if the owning spouse makes the effort to gain value on his or her separate property, there should be no marital claim, but the other spouse does have some claim to this property if his or her efforts indirectly contributed.

States Having No Express Statutes

Many states have codified definitions of increases in value of marital and separate property, but other states have no specific statutes defining whether an increase in separate property remains separate property or becomes marital property. The courts are the sole decision-makers. In these states, there are several possible approaches to the appreciation of value on separate property. That increased value could be looked at as something acquired during marriage and could therefore be considered marital, but it is crucial to also consider that the property existed before the marriage and is therefore not marital. More commonly, states without statutes on the issue look at how the efforts of the parties contributed to the increased value of the property, and any appreciation due to inflation or market forces is purely separate property.

What Is an "Increase in Value"?

Increases in value are not always clear unless they are steady and continuous. Sometimes, values drop and rise throughout the marriage, making it important to calculate if there has been any actual gain by the time of divorce. Some statutes demand the comparison of values, while others are not as clear and only cover increases in value.

CHANGES (MUTATONS) IN SEPARATE PROPERTY

A mutation of separate property is a change in form of separate property, normally affected by a purchase. This concept reflects the idea that even though the property itself changes, the character of it is still separate. In order to be a mutation, the property must be purchased entirely with separate property; if part of it was acquired with marital funds, only part of it is separate. If separate property, such as money in a pre-marital bank account, is exchanged for property during a marriage, such as a car, stock or furniture, this property takes on a new character that needs to be examined.

States with Express Statutes

These statutes expressly state that property obtained with separate property remains separate.

States Without Express Statutes

These states have no clear position regarding this issue, and they apply several approaches to classifying this kind of property. This property could be looked at as entirely marital; but since no effort is required by either spouse to acquire the property and no marital funds contribute to it, and as long as it can be traced to separate funds, it could be separate. Most states have accepted the latter approach.

COMINGLED ASSETS

In most states, it must be established that that separate proper still exists as separate property at the time of the divorce. Although property owned by either spouse at the time of the divorce is presumed to be marital property, this presumption is refuted by tracing the property to the inception of the marriage as separate property.

Often, pre-marriage funds are commingled in a joint bank account, and at the time of the divorce a determination must be made as to what is marital and what is separate property. If the property cannot be commingled, it is presumed to be marital property.

DEBTS AND INSTALLMENT PURCHASES

In an installment purchase the buyer promises to pay some or the entire purchase price in future installments. The buyer is merely contractually obligating himself to make payments in the future. No promissory note is signed. The difference between this and a credit purchase must be noted.

In a credit purchase, the title of the property is generally assessed when a promissory note is signed. In an installment purchase, title does not pass until the last payment is made.

Inception of Title Approach

Property purchased in an installment sale is characterized as the date when the installment contract was signed. Later payments have no effect on ownership, although they may create reimbursement rights.

Time of Vesting Approach

Separate or marital property is determined when the rights of either spouse in the property is vested, usually when the last payment is made. Payments made at other times merely create reimbursement rights.

Pro Rata Approach

In contrast to the above two approaches, under the pro rata approach an installment purchase is characterized according to all contributions made toward installment payments. As a result, percentages can change during marriage, based upon the how payments were made and with what funds. This does present some problems when it comes to divorce proceedings and the determination of marital and separate property that have yet to be resolved. For example: If a spouse purchased a house before the marriage, and the spouses live in the house during the marriage and marital funds are used to make the installment payments, it is unclear whether any rental value offset should be made before the pro rata ownership computation is made.

EMPLOYEE BENEFITS

There are several types of employee benefits—stock options, sick pay, vacation pay, severance pay are but some of these fringe benefits. Divorce courts have to determine whether to distribute these benefits as marital property or designate them separate property. Stock options are given as compensation to employees. They are a right to purchase stock in the employer's company at a certain price. They often are exercised years in the future. The question is: is stock options separate or marital property? Some courts have held that stock options that have not been exercised are separate property. Other states have ruled that stock options are martial property based on the date they were granted rather than exercised.

For employees who have earned payment for unused sick or vacation days, in some states the question is whether the leave was earned before or during the marriage. Generally, if it was earned before the marriage, it is separate property; if it was earned during marriage, it is marital property, if the leave could be redeemed for cash.

Many courts have ruled that severance payments received after divorce are not deferred compensation for services rendered during marriage but are post-divorce earnings. Thus, they are separate property. In contrast, at least one court has ruled that severance pay received during marriage is marital property because it replaces pre-divorce lost wages.

PROPERTY ACQUIRED BY GIFT

Even though almost every marital property state defines property received under marriage by gift as separate property, there are several issues with this exclusion that deserve to be addressed.

Nature of Gift

Under marital property statutes, any property given to one of the spouses for no special reason is considered separate from the marital estate, because it was not acquired with the effort of either spouse. This is because marriage is considered a partnership, and marital property only includes property that is the result of the effort of either party.

“Gifts” given in appreciation for past services or for expected future services that will be provided during the marriage, however, are likely to be looked at not as gifts but as part of the marital estate.

A Gift to Both Spouses

Gifts made to both spouses during the marriage also raise certain questions, such as whether or not that gift was actually intended for both spouses. Parents, for example, frequently claim at the time of divorce that property was only intended for their son or daughter, and courts are usually sympathetic to these claims.

Gifts that were truly intended for both spouses, however, present a problem, because even though marital property definitions claim to exclude any gifts obtained, most statutes only clearly designate as separate property gifts that were received by either spouse, not by both. Depending again on the state and situation, some statutes designate those gifts as separate property while others classify them as marital.

Inter-spousal Gifts

Gifts from one spouse to the other spouse raise separate classification issues. Some situations are clear, such as a gift of real estate, which must include a document transferring title, but others are not. One approach might be to consider the value of the “gift” in relation to the entire marital estate and determine whether or not it appears to be a gift or something shared. A court might also consider donor intent; a spouse may transfer property to the other spouse simply for financial reasons rather than as a gift. Engagement rings are considered to be separate property of the recipient, because of their status as premarital gifts.

If property is eventually found to be an inter-spousal gift, it is, in most states, the recipient’s separate property. In other states these gifts are marital property if they were purchased with marital property.

Gifts from One Spouse to the Marital Estate

Normally, a gift from one spouse to both is treated as if a third party had made that gift. This can be defined as either separate or marital property, depending on the situation and the usage of that gift. If a spouse adds the name of the other spouse to the title of property purchased before marriage, that item becomes marital unless it can be proven otherwise.

INHERITED PROPERTY

Most states designate property inherited during marriage as separate from the marital estate, because no labor on either party's behalf is required to obtain that property. Property inherited by both spouses takes on the same issues as described above regarding gifts to both spouses.

Determining What Constitutes Inherited Property

Inherited property is considered separate from the marital estate if it is received without any effort or for any services. If inheritance is given as a reward or in exchange for something provided during a marriage, it might be considered marital property in some cases.

PROFITS FROM SEPARATE PROPERTY

Rents and profits earned on separate property are different than appreciation in the value of that property. Technically, this can be a difficult distinction to make, but it could change that property's divisibility as separate or marital in some states. "Rents and profits" refer to net profits, not gross profits, and can apply to interest on bank accounts, cash stock dividends and real estate rents.

States with Express Statutes

Though many statutes express appreciation of separate property value, few discuss rents and profits. For those that do, it is generally accepted that rents and profits are separate property themselves.

States Without Express Statutes

For the majority of the states in which rents and profits are not expressly addressed, several methods can be applied to characterize this property. To some extent, rents and profits can be looked at as marital, because they are acquired during marriage and are not specifically defined as separate property. Looking closer at these items, however, many types of profits, such as interest on investments, do not require any spouse effort, though some, such as real estate rents, do. As discussed previously, one approach could be to consider those efforts in connection with determining the marital or separate value of acquisition of rents and profits, though some states do not follow this approach and consider all rents and profits to be marital.

Community Property States

Some community property states have adopted the rule that all rents and profits are always separate property while others have taken the position that they are always community property.

PROPERTY ACQUIRED BEFORE MARRIAGE AND AFTER DIVORCE

Premarital Acquisitions

Since marital property is usually defined as anything acquired by either spouse during the marriage, property earned before that time is separate. However, this is not always easy to determine, especially if some property is purchased before the marriage with the intention of being used later. Often, earning rights that existed before — but change or are renewed during — a marriage are also considered to be marital. Benefits earned from pre-marital behavior, though, are not considered marital. In some states, however, courts may divide all pre-marital acquisitions as well.

Acquisitions After Divorce

Property obtained after divorce is generally classified as separate, but in some long-term instances, it is hard to determine when the property is actually “obtained.” If a spouse acquires the rights to obtain payments for something related to marital property but which won’t be received until after divorce, such as lottery winnings or a bonus provided by an employer, those payments should be considered marital property themselves. If one spouse has the right to funds because of efforts made during the marriage and receives the funds after the divorce with no additional effort, the property is marital.

Property Acquired After Separation

As discussed previously, this depends on the cut-off date, which differs from state to state.

CHARACTERIZING IMPROVEMENTS

An “improvement” is any action or expense used to improve, enhance or maintain an existing property, as opposed to acquiring a new property. In the great majority of cases, these issues concern real estate. For example, funds may be used to repair a roof, paint the house or add a room or a swimming pool; these are considered improvements.

Characterization of Improvement

Majority Rule

Most states have found that if marital funds are contributed for improvements to separate property, ownership of the property is not changed. Most, however, have agreed that a reimbursement claim on the marital estate has been created. Uniform rules for this reimbursement are still unsettled.

The same rules are generally applied to determine reimbursement for marital improvements to separate property as for separate improvements to marital property or when one spouse's separate property is used to improve the other's separate property. A claim for reimbursement has been created.

If the justification for reimbursement is that funds were used from one spouse's estate to satisfy a necessary expense of the other estate, reimbursement would be appropriate.

These opinions are based on the view that marriage as a partnership, and the idea that all the fruits of either spouse's efforts expended during marriage should be allocated to the marital estate. If one spouse improves separate property with efforts contributed during marriage, a reimbursement claim can arise.

The Effect of Title

Many courts have adopted a rule that, if parties take title jointly, a contribution of separate funds is presumed to be a non-reimbursable gift.

CHARACTERIZING CREDIT PURCHASES

A "credit purchase" is one in which some or all of the purchase is "borrowed". The funds can be borrowed from the seller or a third party.

Characterizing the Loan Proceeds

The Primary Intention of the Lender Test

Some states have adopted the view that the loan is based upon the intent of the lender. A loan can be separate property even if both spouses sign the note and the loan can be marital property even if the security for the loan is only separate property. The test is what the lender intended.

The Collection Rights of the Lender Test

In some community property states, creditors of one spouse can reach community property and the obligor's separate property if there is no agreement by the creditor to only look to separate property.

The Nature of Security Provided Test

Some states take the position that the loan takes on the character of the property provided as security. If both spouses sign the note, however, the issue becomes even more confused if separate property security is also provided. Some courts have held that the additional signature renders all the proceeds marital property, while other cases have considered the one spouse's property separate despite the additional signature.

The Use of Proceeds Test

Another approach is to characterize property according to the use of the loan proceeds, viewing whether the loan was used for separate or marital property.

The Source of Repayment Test

This approach looks to the nature of the property with which the parties intend to repay the obligation. It is unclear whether the funds actually used are the determinate or the intention of the parties when the note was signed. At least one court has suggested that the understanding of the parties is the determinate factor.

PENSIONS

A pension is marital property. It is a form of deferred wages to the employee. A spouse in a divorce proceeding may lay claim to an employee's pension as community property or as marital property in an equitable distribution state. When the marriage ends by divorce and marital property is to be divided, the deferred wage aspect of a pension becomes important for consideration; it is an asset subject to allocation between the husband and wife. Therefore, establishing a value for the pension is necessary, especially when you intend to divide the retirement benefits using the Immediate Offset Method.

The Immediate Offset Method is a method that divides the pension as an element of property. One must determine the present worth of the pension as a dollar amount and add it to the inventory of all of the assets of the couple. In the use of immediate offset, the value of the pension is considered at the time of the settlement of the divorce case and is offset by comparing it to other assets.

There is also the Deferred Distribution Method. This occurs when there are instances where the parties agree on a court order called a "qualified domestic relations order" (QDRO). The QDRO is a method for dividing the pension as an element of property between the employee and the non-employee spouse. This comes into play when the non-employee spouse is awarded a piece of the employee's pension when that pension becomes payable, hence the word "deferred." This is sometimes referred to as the method of "if-as-and-when", but that is misleading. A court order may arrange for a payment to the non-employee spouse even before the employee spouse gets a pension.

Most private sector pension plans are covered by the Employee Retirement Income Security Act (ERISA). Congress enacted ERISA on September 2, 1974 to protect the interests of retirement plan participants and their beneficiaries. It established a set of rules for participation in retirement plans, added mandatory schedules for the vesting of benefits, fixed minimum funding standards, set standards of conduct for administering the plan and handling plan assets, required disclosure of plan information, and established a system for insuring the payment of benefits. Under an ERISA plan, payment is at the employee's earliest retirement age. Some ERISA defined contribution plans, however, have been amended to allow the distribution immediately instead of waiting until the employee's earliest retirement age. A deferred distribution or lump sum transfer is usually accomplished by the QDRO. Thus, the word "qualified" refers to a plan being qualified under ERISA. Therefore, strictly speaking, the term "QDRO" refers to ERISA plans only. However, non-ERISA plans, such as the federal Civil Service Retirement System, recognize court orders similar to a QDRO that attach a component of a member's pension for the benefit of a former spouse.

There are two main classes of pension plans, those subject to ERISA and those that are not subject to ERISA. Generally speaking, all private pension plans are subject to ERISA. These are corporate and multi-employer union pension plans. Government plans (federal, state, and local) are not subject to ERISA. Quasi-governmental plans, such as state public school teachers' plans, are also not subject to ERISA. A participant accrues a pension benefit for each year of credited service in the plan, along with vesting rights to that benefit. At retirement the employee has a choice of forms of pension payment, all of which have equivalent actuarial value at that time. In an ERISA plan, a married participant is limited in pension choices at retirement.

If the divorce case is such that the pension will be handled by deferred distribution instead of immediate offset, it is important to know the present value so that parties know what the value is that they are settling for. The future distribution of a portion of a pension by court order has a present value just as the person's pension itself has a value.

The Retirement Equity Act of 1984 (REA) created rights for the former spouse. REA is the federal statute that created the QDRO. REA also created rights for a current spouse that did not exist under ERISA. Under REA, a married employee must choose a joint and survivor annuity at retirement so that, in the case of the death of the participant, the surviving spouse will receive no less than 50 percent of the monthly payment or annuity paid while the participant was alive. REA also states that under a QDRO, the former spouse (known as the alternate payee) shall be treated as a surviving spouse for both pre-retirement and postretirement death benefits, regarding the portion of the pension that is divided under the QDRO. Since a current spouse must be provided a death benefit, a former spouse also has the right to a death benefit under a QDRO, so that benefits continue after the death of the participant. In fact, the logic of REA with respect to QDROs allows a plan to create a pension payable over the alternate payee's lifetime, independent of the life of the participant. In this way, the death of the participant after retirement has no effect on the alternate payee's benefits. This type of division of pension benefits is often referred to as a "separate interest benefit." If the alternate payee's benefit is tied to the life of the participant, it is called a "piggyback, or shared interest benefit."

When calculating pensions for distribution between parties, we need to determine the type of pension. There are 2 types of pensions, defined benefit and defined contribution. A defined benefit pension is defined by a formula based upon service and salary, and is usually in the form of a monthly annuity. A defined contribution pension, such as a 401(k), has the form of an individual account, like a bank account. Please review What Are Pensions [link] for further analysis of this topic.

State case law on defined contribution pensions is almost always based on general case law on passive appreciation of property. If passive appreciation of a pre-marital asset is non-marital, then only the contributions of a 401(k), and gains on those contributions, are marital property. This is the situation in most states.

Regarding defined benefit pensions, some states use the “bright line” approach, in which the marital portion is defined as the benefit accrued as of the cut-off date. Other states use the coverture approach, where the pension benefit is multiplied by a fraction, in order to determine the marital portion. For purpose of immediate offset, the benefit is the benefit as of trial date, the numerator of the coverture fraction is service during the marriage, and the denominator is total service as of trial date. For purpose of deferred distribution, the benefit is the benefit as of retirement date, the numerator is still service during the marriage, and the denominator is total service as of retirement date.

For further reference on equitable distribution of property, see J. Thomas Oldham, Divorce, Separation and the Distribution of Property, Law Journal Press: 1987.