EQUITABLE DISTRIBUTION OF CONTINGENCIES

by Elliot H. Gourvitz

Most issues in a divorce case are of a definite and certain quality, and thus they are able to be analyzed, valued and divided between the parties with some certainty. Others, which I have designated in this article, are "contingent," meaning they may come to pass, but this is dependant upon future events, and therefore, they are not susceptible to being specifically defined and divided.

The following list contains those items that subject to equitable distribution and are contingent. Not all items are discussed in this article.

Assets

Limited Partnership Interests
Recapture
Executive Stock Options
Intellectual/Intangible Property
Identifiable
Patents
Trademarks/Trade Names
Copyrights
Advertising Programs
Computer Software
Licenses, Certifications
Distribution Network
Training Material
Franchises
Formulas
The word "property" in equitable distribution denotes many forms of ownership. For equitable distribution purposes, property includes tangible assets, intangible assets, future interests, inheritances, devises and bequests (in some jurisdictions), pensions and many different forms of ownership, whether they are absolute, beneficial, joint or subject to reversion.
The New Jersey Supreme Court recognizing that all assets are not certain stated that "(t)he right to receive monies in the future is unquestionably...an economic resource."

One needs only to review the type of assets which have been held subject to equitable distribution in order to appreciate the scope of the term "economic resources."

Assets subject to equitable distribution may be intangible as well as tangible. Intangible assets are differentiated from tangible assets inasmuch as the former have no intrinsic value. Instead, their value is related to other tangible assets. Some intangibles are related to specific identifiable tangible assets such as trademarks, trade names and patents, but others such as goodwill have no specific relational identifications.

**LIMITED PARTNERSHIP INTERESTS**

In the 1970's and 1980's, limited partnership interests were popular because of tax incentives. In some cases, for every dollar invested a tax deduction of five, six, seven or more times the amount was received. Taxes could be deferred and in some instances completely eliminated.

Because of these substantial tax incentives, investors did not focus on the intrinsic value of these assets which were usually of an exotic and appealable nature such as movie rights, gas and oil and livestock. With the advent of the Tax Reform Act of 1986, most of the tax benefits associated with these types of investments were eliminated.

Today, the focus is on the value of the underlying assets rather than the tax benefits. Valuing the intrinsic benefits of these assets in extremely difficult because of the small, limited interest each holder has in the asset. Typically, there is one general partner who manages the assets, and many limited partners who participate only as investors.

The easiest method for distribution is to divide the asset in kind with each spouse receiving a proportionate share, allowing each spouse to receive his or her appropriate share of future tax write-offs and making each financial contribution to maintain the asset if needed. However, this method is not always favorable or desirable for each spouse and, in fact may not be allowed by the partnership. One spouse may need the tax write-offs still available, which could be wasted on the other, or one spouse may not be able to afford necessary to maintain the asset. These possibilities demonstrate the need to value the asset.

The valuation process begins with a careful review of the initial prospectus or the presentation of a memorandum prepared at the initial offering. These contain cash flow projections on a per unit basis. A comparison of these projections with the actual performance can give some insight.

There is limited marketability for these assets, and they are difficult to transfer. There is a secondary market for these assets, which are reported in *The Wall Street Journal* and can be brokered. Typically, these assets are sold at deep discount rates and with brokerage
fees. This allows the receiving spouse to receive the benefit of the reduced secondary market price, and the selling spouse, who is getting less for the asset, at least has the benefit of not having further reductions in the asset because of the non-deduction of brokerage fees, which would have to be incurred if the asset were sold.

**EXECUTIVE STOCK OPTIONS**

An executive stock option is an employee's perk wherein the company gives to the executive the right, but not the obligation, to acquire a firm's common stock at an agreed, fixed price (also known as the exercise price or strike price) for a specified time, usually one to five years.

It is accepted that stock options are subject to equitable distribution, but the manner in which they are distributed varies. In 1976, in *Callahan v. Callahan* the court imposed a constructive trust on the employee spouse in favor of the non-employed spouse for a percentage of the stock options that were held. The employee was ordered to be the trustee and execute the wife's options at the direction of the wife and with funds provided by her. Below is a provision for a property settlement agreement or judgment of divorce incorporating this provision:

The husband presently has _______ shares of stock ownership in his ________. As to this stock ownership, as well as any further stock ownership which would have been earned by him up until __________, the wife will be entitled to ____% of the stock options are available and if the wife wishes, the husband shall exercise the wife's options at her direction, the wife must supply the husband with the funds necessary to make the other purchase. When the wife exercises the option, the husband shall hold the stock in trust for the wife. Following the exercise of the option, the wife may require the husband to transfer the stock held in trust for her or to sell it on the market and turn over the proceeds with two restrictions:

1. First, wife shall not order to transfer of the stock to her or sale of the stock within six months of its acquisition so as not to violate the Securities Exchange Commission's "insider trading" rules.

2. Second, without expressing any opinion on the tax consequences, the transfer of the stock to the wife, or sale of the market for her benefit results in tax liability to the husband, the wife shall save him harmless from such liability. With regard to any option which has already been exercised by the husband, the husband shall sell those shares for the benefit of the wife under the same conditions as set forth above.

In the Maryland case of *Green v. Green*, the court stated that it might determine a percentage by which the profits may be divided when the options are exercised but did compel the employee spouse to have any interest. If the employee spouse did exercise it, he or she then would receive a percentage.
In Illinois, the court in *In re Marriage of Frederick* allowed the employee spouse the sole choice to exercise the option, and if profits were realized he was to share equally with his wife.

To illustrate, an employer might give its employees the option to buy a certain amount of its stock at $40 a share for one year. If the stock in the market is $40 or less, then the stock is not a bargain, and the employee would not take advantage of the option. On the other hand, if the stock on the market goes above $40, the employee can buy at the $40 figure, hold onto the stock or immediately sell it at a profit. The amount of share options that are given to the employee depends on what the employer wishes to give.

Usually, the right to acquire the stock lasts for a one to five year period, called the *vesting provision*. Thus, rights acquired during the marriage, which are vested, may not be exercisable for years after the divorce.

The easiest way to divide the stock is to give a percentage of the options to the non-working spouse, who may independently or through the working spouse exercise the option at any time. The usual method is to give the non-working spouse a percentage, which he or she receives when the working spouse exercise it, with that employee spouse fronting the exercise money and receiving it back when the stock is sold. There are five factors that affect the market value of an executive stock option:

1. an option's intrinsic value
2. an option's time to execution
3. the value of the underlying security
4. market interest rates
5. dividends

An option's intrinsic value is the difference between the stock price on the open market and the price at which the executive can purchase the stock. Thus, if the option or "call" price is $40 and the market price is $45, the intrinsic value is $5. However, if the market price is $35, the option has a zero balance. Executive stock options usually are granted an exercise price equal to the common stock price at the time of issue, so on the day of granting it has no value.

Even a zero stock option may have significant value beyond its intrinsic value. A zero stock option could offer an investor the opportunity to earn large gains if the underlying security goes up in price. While the option need not be exercised should the underlying security value fall, loses are limited to the cost of the option.

The longer the time of expiration, the more valuable the option because it gives the employee more time for the share price to increase. Executive stock options can have a
time to expiration as long as 10 years, and all of the options need not be exercised at the same time. Thus, there is more flexibility and more possibility of making a profit.

Volatility refers to the likelihood that a stock will lose or gain in value. The more extreme the highs or lows, the more volatile the stock. Blue Chip stocks such as utilities or industrials will have low volatility or little fluctuation in price. Pharmaceutical and glamour stocks such as Disney will have wide fluctuation in price and thus are highly volatile.

*Market Interest Rate*—Unlike regular options which require a purchase price, executive stock options require no money down to secure the option because they are given as a bonus. Since an employee can gain from the growth of the stock without paying any price for it, those monies not invested elsewhere and earn interest. Thus, the employee can take advantage of selecting the option and still use the money for other interests.

Since executives do not actually own the stock until they exercise the option, they are not entitled to receive the dividends that are paid by the stock. The loss of the dividend income from owning an option rather than owning the stock detracts from the value of the option. The magnitude of the loss depends on how much a dividend they would have received per year and the amount of years they forego the dividend.

The value of an executive stock option will change based upon the variables outlined in Table 1.

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<td>Time to Expiration Longer time Shorter time</td>
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<td>Market Interest Rates Higher Lower</td>
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<td>Dividend Yields Little Less A lot more</td>
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Several mathematical algebraic formulas have been developed to determine valuations. The most widely accepted of these models by both academies and matrimonial practitioners is the Black-Scholes Option Pricing Model CBS-OPM developed in 1973.

*Other Variables That Effect Marketability and Value*--Because executive stock options cannot be exercised until a certain date (the vesting date) and they cannot be sold on the open market, their marketability is limited, reducing their value. Executives who terminate employment before the executive stock option vests usually forfeit the option.

Even when the option is vested and employment continues, occasionally there is a waiting period before the stock can be purchased, then sold and the intrinsic value realized. The reduction in value from lack of marketability may reduce and price and result in a discount, but it does not make the value zero. Refer to Table 1.

**VALUATION OF INTANGIBLE ASSETS**

As noted, intellectual property, or intangible property, is divided into two groups: identifiable intellectual property and non-identifiable intellectual property. Intellectual valuation of some assets is not an algebraic formula with certain answers that must be the same in each and every formula. Three basic approaches to valuing intangible assets are discussed in this article.

*Income Approach*--The income approach involves the analytic conversion of income streams of various sorts into indications of value through direct capitalization and discontinuing mechanisms. It is the ultimate value determinant. Correctly and consistently applied, the income approach derives the present worth of anticipated future benefits. Perhaps an even better example is an identifiable stream of income can be attributed to the particular asset being valued, as is the case with certain intangible assets.

*Market Approach*--The market approach call for the identification and analysis of transactions in the marketplace involving the exchange of ownership of property, interest of rights, similar to those being appraised, and application of the market data, appropriate adjusted, to the subject property. Typically, this approach is used in the appraisal of real estate and may be used in the valuation of machinery and equipment for which there is a known unused market. It is less likely to be applicable in the treatment of intangible assets.

*Cost Approach*--The cost approach is based on the premise that a willing and knowledgeable buyer will pay no more for a used assets than what he or she would be obligated to pay for a new asset of equivalent utility. From this "replacement cost new," representing the upper limit of value except in the most extraordinary circumstances, amounts are deducted to reflect the value reductive effects of physical deterioration and functional and economic obsolescence, if evident and measurable. This approach is most appropriate in valuation when applied to specific assets such as land improvements, building, machinery and equipment, and certain intangible assets.
For a better understanding of the treatment of these assets we have to look to federal law and Internal Revenue Service cases and rulings.

**Identifiable Intellectual/Intangible Property**

Equitable distribution of identifiable intellectual property under patents, trademarks, copyrights and consumer or subscriptions lists begins with a definition of each by reference to *Black's Law Dictionary*.

In general terms, a patent is a grant of some privilege, property or authority made by a government to one or more individuals. In common parlance, a patent usually refers to right to the exclusive manufacture and sale of an invention or a patented article.

A trademark is a distinctive mark, motto, device or emblem of authenticity placed on manufactured articles, distinguishing one manufacturer's products from another. Governments usually provide some sort of statutory vehicle for registration and exclusive use of trademarks, although common law use of a trademark also may exist. A trade name is a name rather than a mark, which is similarly protected.

A copyright is the right of literary property as recognized and sanctioned by the law to the author or originator of certain literary or artistic productions, and the copying and reproduction thereof.
Customer or subscriber lists deal with various lists of business contracts.

As previously, these forms of identifiable intellectual/intangible assets are subject to equitable distribution under the equitable distribution law definition of "property."

**Non-Identifiable Intellectual/Intangible Property**

Intellectual property is a catch-all phrase for intangible assets that have no physical substance but grant rights and privileges to the owner. Some forms of intellectual property are inseparable from the business enterprise such as goodwill, a going concern or location. Others have a life of their own such as patents, trademarks, copyrights and customer or subscription lists. Some of the factors used in the valuation of these assets include relief from royalty, cost savings, present values, royalty payments and cost to create.

*Celebrity Goodwill*—The courts of New York and New Jersey in Elkus and Piscopo, respectively, decided that celebrity status is a form of marital property subject to equitable distribution to the extent that the spouse's contribution and efforts led to an increase in the value of the other spouse's career.

In 1991, the New York court determined in *Elkus* that the career of a performing artist and the accompanying celebrity status constituted marital property subject to equitable distribution, broadly defining the term "marital property" and the "economic partnership" concept of the marital relationship.

The court stated that "marital property" does not mean that an asset must have an exchange value or be saleable, assignable or transferrable, but the property could be intangible as well as tangible.

Referring to the state court's decision that medical licenses have been held to have value because of the holders enhanced earning capacities and that the other spouse who made direct or indirect contribution to the acquisition was entitled to share the value in equitable distribution, the court also chronicled the extension of other intangible assets, which included a law degree, an accounting degree, a podiatry practice, the licensing and certification of a physician's assistant, a master's degree in teaching and a fellowship in the Society of Actuaries.

Stressing that New York Domestic Relations Law Section 235 states that a career or career potential is an asset subject to equitable distribution and dismissing that the limitation should only be licenses or the document itself, the court cited with approval *Golub v. Golub*, noting that there is a tremendous potential for financial gain from the commercial exploitation of famous personalities.

The court decided:
the enhanced skills of an artist such as the plaintiff, albeit growing from innate
talent, which have enabled her to become an exceptional earner, may be valued a
marital property subject to equitable distribution.

The court then reversed the lower court and remanded it with directions that it measure:

the nature and extent of the contribution of the spouse seeking equitable
distribution, rather than the nature of the earner, whether licensed or otherwise,
that should determine the status of the enterprise as marital property.

Earlier, the court in Piscopo determined that comedian Joe Piscopo's celebrity goodwill
was a distributable asset and that his wife was entitled to a share in his excess earning
capacity, which she contributed to as a homemaker, caretaker of a child and a sounding
board for his artistic ideas. The court held:

It is the person with particular and uncommon aptitude for some specialized
discipline whether law, medicine or entertainment that transforms the average
professional or entertainer into one with measurable goodwill.

Questions arise as to how the "goodwill" or the nature of extent of the spousal
contribution should be measured.

Retirement Plans

Division of retirement and/or pension plans have been ruled subject to equitable
distribution. At one time, if the plan had not been vested, that mere fact excluded it from
equitable distribution.

Today, in New Jersey because of Whitfield v. Whitfield even non-vested pension plans are
subject to division. The court decided that a contingent pension, in this case any Army
pension which vested only after 20 years of service and was worth nothing before that
time, was marital property when and if the time contingency was met. Sixteen years of
the 20 had elapsed during which the parties were married. The court determined that the
wife was entitled to one-half of the accrued period or more than eight years, so if the
pension was received she would be entitled to two-fifths (eight-twentieths) of the
benefits. This method allowed the court to effectuate equitable distribution by
determining the parties' respective interest in the pension of a contingent marital asset,
but deferred the benefit sharing until a future date.

Deferred benefit sharing is one means of dividing a pension, vested or not. A second
method is "present value buy-out." Where the asset is valued as of today and the non-
employee spouse receives a percentage of the pension, usually one-third or one-half, as
an offset against another asset usually the marital home with the employee spouse
keeping the full benefit of the asset when it can be realized.
The asset also can be divided and enjoyed now even if it is not definite in amount. A qualified domestic relations order (QDRO) is the vehicle to use to accomplish this goal.

In order to determine present value of the plan and which parts are subject to equitable distribution, hire a credible accountant or actuary. The accountant or actuary will need copies of:

1. the booklet describing the plan
2. most recent statement of benefits
3. recent salary history including copies of W-2 forms
4. a letter from the employer explaining accrued benefits

Request the accountant or actuary to prepare a written report which summarizes the methodology utilized and defines the actual monthly benefits that have accrued as of the valuation date both in terms of the benefits payable at the plan's normal retirement age (usually 65) and at the plan's earliest age. This information is valuable in preparing a QDRO.

Once the value of the plan is determined, there is a variety of payout options which include:

1. the employee spouse maintaining the asset with an offset;
2. division of the asset with a QDRO;
3. payment of benefits periodically and directly to both spouses by the employer; and
4. lump sum payments to both spouses. (Most plans don't permit this option, and even those that allow it may place restrictions on the earliest date distribution may be made. Generally speaking, defined contribution plans are more likely than defined benefit plans to allow a lump sum payment.)

The payment of taxes should be figured into calculations of net benefits. If a lump sum payment is not permitted or desirable, then periodic payments must be considered.

Some choices to make include:

1. How much periodically and how often?
2. When do payments start, and how does it affect future payments?
3. How long do payments continue?
4. Are payments level, or is there an adjustment for future changes in the cost of living?

5. What are the survivor benefits?

Some fundamentals to consider are:

1. The older a person the date benefits began, the greater the amount of the periodic payment.

2. If a spouse receives a residuary benefit, the amount of each payment will be reduced.

In protecting a non-employed spouse, try to have a formula devised so that if benefits begin at some future date, the amount to be paid is based on the actual benefit accrued as of the date payments commence. This will allow your client to share in future increases in benefits due to such factors as future increases in salary. On the other hand, if you represent the participant, you would use a formula that limits the benefit to be paid to the non-employee spouse based on the benefit accrued at the date of the trial.

The New Jersey Supreme Court held in Moore v. Moore that "benefits accruing to spouses subsequent to a divorce are subject to equitable distribution if they are related to the joint efforts of the parties." The Moore court determined that costs of living increases, as well as salary increases, are to be considered in pension evaluations. Thus, the increased value of a marital asset, which occurs as a result of continued employment, should be shared when the pension plan is based upon salary value at the time of retirement.

**Follow-Up to Distribution**

Once distribution is made several options are available, depending upon the needs of your client and their plans. Consideration also must be given to the tax consequences of each choice.

Your client might choose to:

1. Take a cash distribution, pay the early distribution tax penalty (recipient is under 59 1/2 years of age) if applicable (10 percent) and pay the additional tax added to his or her income, as ordinary income.

2. Rollover the entire distribution to another plan or an IRA. This way if your client chooses this option, there is no money available for immediate use, taxes are deferred until distribution, but they must commence no later than the calendar year in which the recipient reaches 70 1/2 years of age.

**Liabilities**

**Equitable Distribution of Liabilities, Debts and Obligations**
In considering the entire financial picture of the parties, the court readily takes into consideration the negative aspects of the parties' balance sheet. This is accomplished in two ways: (1) by direct allocation thereof; and (2) by consideration thereof as a factor in the awarding of equitable distribution.

Notwithstanding the legal responsibilities to third parties, the Chancery Division in a divorce matter has the power to allocate responsibilities for debts as between husband and wife, regardless of the actual legal liability thereof:

**Proper allocation of the responsibilities debts as between husband and wife does not necessarily track legal responsibility therefor to a third party.**

Thus, in a divorce matter, the court may "equitably distribute" obligations of the parties in the exercise of its direction based upon all of the equities. Where one party incurs debts for family purposes such as for home building or purchase: other large purchases such as a boat or a horse; vacations; household maintenance, etc., especially where the incurring of such debt is known or should be known by the other spouse, both parties usually will be liable for such debts.

Noting the dearth of law in New Jersey concerning the payment of marital debts, the Appellate Division has stated that the allocation of debts depends upon the circumstances of the particular case. Trial courts have taken the position that if the defendant-wife saw the debt build up throughout the marriage and participated in the encumbrances, then she is subject to sharing in the liability. However, if the evidence shows that the husband's debts were incurred during the break-up of the marriage "in an attempt to undermine her equity in the marital home" she is not liable.

The Appellate Division suggests that, if debts are marital, they should be subtracted from the total value of the marital property before distribution; if non-marital, they should be taken into account only as a reflection on one party's economic circumstances in determining the amount and method of payment of the equitable distribution award. However, the court's caveat, that even if debts are determined to be marital they could be allocated to one party based upon his or her greater earning potential, should be noted.

The court has held that the plaintiff has the burden of establishing traceable debts, thus leading to the proposition that the one who incurs debt has the burden of proof. If the debt resulted de to the husband's intentional dissipation of marital assets, the wife will not be charged with a portion of such debt.

One plaintiff indicated that he was not required to repay the loans to his family until he sold his business or became financially able. under such circumstances, the Appellate Division held that it would be inequitable to require the defendant-wife to be charged with any portion of the loans if the plaintiff was not likewise required to pay. The Court cited *Biddle v. Biddle* for the proposition that it might be necessary for the relatives to establish the basis and amount of the debts.
The allocation and liability for obligations are not limited to those that are owed or due to third parties but include liabilities from one spouse to another. Thus, in Zuhlcke v. Zuhlcke the court was satisfied from the proofs that certain funds advanced to the husband by the wife were not satisfied by certain other sums of money later given to her by the husband during the marriage.

Used in the second way described above, the outstanding obligations of the parties at the time of the final hearing is a factor in the court's determination of an allocation of equitable distribution by virtue of case law and a state statute. Use of debts and liabilities as a factor for equitable distribution is different than allocation of the obligations themselves. Most often, within the context, is the effect of equitable distribution of assets on the ability to pay alimony and support or on the question of whether the marital residence should be sold presently or deferred to a later date. Exact balances of debts should be provided to the court.

Interestingly, very often one party asserts that his or her parent should be repaid moneys contributed by them to the marriage. In Pascarella v. Pascarella, the Appellate Division glossed over the trial court's finding that a certain debt was incurred by the defendant-husband during the marriage and was therefore a debt of the marriage and should have been deducted from the total value of marital property.

More often, courts require proof as to the elements of a loan as opposed to a gift. In such cases, usually no promissory note is executed by one or both of the spouses to the parents providing the funds, as would normally be the case in an arms-length transaction. Therefore, the court is put to the task of gleaning the existence of an obligation to repay from the circumstances. Such circumstance may be extracted from correspondence, repayments (especially in the form of checks) and other conduct of the parties consistent with the existence of an obligation as opposed to an outright gift. In making such a determination, the court should consider the elements of both a gift and a loan.

The general elements of a gift are:

1. an unequivocal donative intent on the part of the donor;
2. an act constituting actual or symbolic delivery of the subject matter of the gift; and
3. an absolute and irrevocable relinquishment by the donor of ownership and dominion over the subject matter of the gift, at least to the extent practicable or possible considering the nature of the article to be given.

The general elements of a loan are:

1. an advancement of money by the lender; and
2. a stipulation of agreement to repay it upon terms, such as interest and date of payment.
In the usual "parental loan" case, there is no date specified for repayment, may be loose. The question of whether or not an agreement to repay exists may depend upon the laxity of its terms. Note also, that an agreement to repay without a date is deemed a demand note.

In "parental note" or other family-member loan cases in which one marital partner is seeking a credit for the funds "invested" by his or her relative or in which the "lender" seeks to intervene on his or her own behalf, the general rule, that a resulting trust will be raised in favor of one paying the purchase price of property transfer to another unless it is shown that the payor manifested an intention that no resulting trust should arise, is tempered by the relationship of the payor with one of the transferees:

[where one of the certain relationships-- usually of blood or marriage--exists between the payor and the transferee, the inference to be drawn is not one of resulting trust but of gift or advancement and the burden is upon him who claims the resulting trust to show that the payor manifested an intention that the transferee should not have had the beneficial interest in the property.]

In this regard, the current test is not concentrated on questions of the closeness of the relationship or the extent of the natural affection or by any reason of legal obligation to furnish support, but focused instead on whether the relationship "is such as to constitute the transferee the natural object of the payor's bounty [in which case] ... the interference is one of gift and not resulting trust." Thus, the essential inquiry is one of probability of intention to make a gift to the transferee such that (in terms of the natural object of the payor's bounty theory) it would be natural for the payor to make provisions for transferee's advancement.

In the case of Biddle v. Biddle, a husband's mother sued both the husband and her former daughter-in-law for the imposition of an equitable lien on the former marital residence based on an alleged purchase money resulting trust. It is interesting that the wife's application to dismiss the action was reversed on appeal on the basis that the mother-in-law's participation of the divorce action as a witness was not res judicata or collateral estoppel to a subsequent action or in privity to the divorce proceeding.

Therefore, parents in these circumstances would appear to have two possible procedural alternatives: (1) request intervention in the divorce action; or (2) file a separate suit for the relief requested. If both suits are pending at the same time, it would seem that consolidation would probably be in order. It is interesting to note that the plaintiff-mother in Biddle, before instituting her own separate action, had unsuccessfully attempted to intervene in the prior divorce action.

The bottom line in practice appears to focus on two factors: (1) whether there is any supporting documentation; and (2) whether there were any payments of interest and/or principle. If there is no documentation and no payments have been made, the chance of sustaining the claim of loan appears small.
In the case of Schell v. Schell, the husband had declared bankruptcy after the filing of the complaint. As a result of the discharge order, he was able keep certain assets which were exempt under the Bankruptcy Code as well as discharge some $52,275.00 of unsecured debts. The court held that, in considering the realistic financial situation after discharge in bankruptcy, the husband's discharge of substantial debt could be taken into consideration in equitably dividing property.

In Harmon v. Harmon, the Appellate Division noted that the trial court had awarded to the plaintiff-wife a particular sum of money on the basis that she previously had the use of a particular bank account. the Appellate Division in the case stated:

**The record is not clear as to whether this is a portion of the settlement monies or jointly-owned marital assets which were spent prior to the distribution. Regardless, if this be a dissipated asset of the marriage before equitable distribution, we question its inclusion. A plenary hearing with oral testimony will eliminate questions of this nature.**

If assets subject to the marriage are either appropriately or improperly dissipated by either party pending litigation, the practice is quite clear that the court may allow a recoupment of such an asset, usually by way of offset against another, or require payment on account thereof. In citing the Lynn case for the position "that a party should not be able to use a marital asset to defray support ordered from current earnings and thereby defeat his wife's interest in the asset at the time of equitable distribution," the court in Schell v. Schell determined that the wife would dissipated by the husband in violation of a restraining order against such dissipation.

The more difficult question concerns assets that are dissipated just prior to the filing of the complaint. Into what length of time prior to the filing of the complaint will the court inquire as to the dissipation of an asset? The answer usually will depend upon the size of the asset alleged to have been dissipated balanced against the length of time. The question of whether or not an asset has been improperly dissipated will depend upon a finding of such proper dissipation at the final hearing.

In Daeschler v. Daeschler, there was no helpful specification of how this factor was taken into consideration by the trial court.

In Weiss v. Weiss, the husband depleted certain savings accounts, which were subject to equitable distribution, in order to discharge some of his pendente lite support obligations. In affirming, the trial court's inclusion of these assets over the husband's objections, the Appellate Division

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CONTINGENT LIABILITIES. EVEN THE BEST PLANNING CAN GO ASTRAY IF YOU ARE NOT AWARE OF AND MAKE ALTERNATE PLANS IN THE EVENT OF A BANKRUPTCY.

held that:

[a] party to a matrimonial action cannot use marital assets to discharge support obligations and then claim that those marital assets are unavailable for equitable distribution.

Much of the case law indicates that transfers between close relative are, at best, viewed with suspicion.

Finally, in Siegal v. Siegal the question arose as to whether gambling losses incurred prior to the filing of the complaint, but after the marriage had been "irreparably fractured, fall within the matrimonial 'pot' as a credit to distributable assets, or [do they] equate with a 'dissipation' of funds to be borne solely by the one who placed the family treasury at risk?"

The court, being one of equity, determined that the debt belonged to the gamble without further offset or credit. In so holding, the court relied upon N.J.S.A. 2A:34-23-1i, which identifies a dissipation of assets and the contributions of each party, as well as the facts of the case at bar.

**Bankruptcy**

As you, the attorney, prepare for division of assets which are contingent in a divorce, you also must prepare for and plan on contingent liabilities. Even the best planning can go astray if you are not aware of and make alternate plans in the event of a bankruptcy.

The key bankruptcy concept you should know is that a bankruptcy petition does not operate as a stay or discharge an obligation for payment of alimony or support, but it does stay or discharge liability for equitable distribution.

If bankruptcy is a possibility, be careful to distinguish between alimony and equitable distribution and plan accordingly. Which is which is decided not in state law but by Bankruptcy law. Neither the Bankruptcy Code nor regulations provide any specific guidelines for differentiating between alimony and support and equitable distribution.

Bankruptcy Code Section 523 goes on to provide hat to the extent that a "liability" is designated as alimony, maintenance or support it will not be discharged "unless such liability is actually in the nature of alimony, maintenance or support."

This does little more than define a term with a term. It provides little or no specific definition or guidelines for the practitioner.

For example, areas of concern and lack of definition are:
a. equitable distribution installment payments termed "alimony" for tax deduction purposes

b. alimony payments which are agreed to be non-taxable and non-deductible

c. rehabilitative alimony

d. lump sum alimony

e. attorney fees

It is common for matrimonial practitioners to attempt to maximize the federal tax advantages characterizing payments as alimony or conversely shifting tax liability by characterizing installment equitable distribution payments as alimony.

To do so without reviewing the applicable federal and state holdings is, perhaps, being "penny wise and pound foolish" if not inviting a malpractice claim in the event of a subsequent bankruptcy.

For many years, the bankruptcy courts did not seem to look beyond the language of the property settlement agreement or divorce decree. In re Gianakas, however, extends the scope and nature of the bankruptcy court inquiry. In Gianakas, the Third Circuit looked beyond the language of the agreement to examine:

1. the parties financial circumstances at the time of the agreement or judgment; and

2. the purposes or function of the payment.

3. the purposes or function of the payment

In essence, Gianakas looks to substance over form. It clearly stands for the proposition that simply calling an obligation alimony or child support does not make it so in the context of a bankruptcy proceeding and that the court should look to the actual substance of the provision as opposed to the language of the agreement or decree.

On the state court level, gray areas have developed with regard to counsel fees and the payment of obligations on behalf of the former spouse.

In DiGiacomo v. DiGiacomo, the court held that an award or agreement for the payment of attorney fees may or may not be effected by a bankruptcy. Judge Drier reasoned that the determination "depends upon whether the Trial Court intended the obligation to serve as a support function." Judge Drier cited In re Tosti and In re Brenegan in support of his conclusion. Thus, given the consistency of New Jersey and federal decisions it is probably safe to assume that counsel fees which are intended to "serve as a support function" are exempt from discharge. The question becomes were the fees intended to "serve as a support function?"
In *Stein v. Fellerman*, the Appellate Division reviewed the dischargeability of payments that a husband was to pay toward the mortgage on the former marital home, which the wife continued to occupy. The court concluded that payments were not in the nature of alimony or support principally because they were, by the terms of the agreement, to continue in the event of the death of the recipient wife. The court reasoned that it was contrary to customary practice, if not contrary to public policy, to continue alimony beyond remarriage and, thus, the payments could not be deemed alimony.

*Qualified Domestic Relations Order* (QDROs) -- if the equitable distribution of a pension is embodied in a QDRO, it is statutorily exempt from dischargeability in bankruptcy.

The courts have reasoned that the QDRO creates a constructive trust relationship and an obligation that is not discharged in bankruptcy and that the QDRO provisions on the 1984 ERISA were intended to "guarantee that the nation's private retirement income system [provide] fair treatment for women."

**Tax Returns**

*Filed*--Pas filed tax returns leave contingent liabilities for additional taxes, penalties and assessments to both spouses after a divorce. The statute of limitations for errors made in filing federal tax returns because of negligence is three years. If the misstatement on the tax return is because of fraud, there is no statute of limitations.

*Indemnification*--Even if one spouse indemnifies the other from financial liability, the government is not bound by such indemnification between the parties. The government goes against both parties, and they must litigate the indemnification and use the property settlement agreement or judgment of divorce as a basis for their claim.

*Unfiled*--A joint tax return can be filed only if the parties were not divorced in a calendar year. Personal tax returns for each individual year are to be filed by April 15. There is an automatic extension until Oct. 15; however, no extension is considered beyond this date, and further penalties for late filing can be assessed. In 1993, the government allowed an amnesty for late filing, waiving penalty and criminal prosecution, but interest still accrued. This amnesty may be extended to later years, but there is no guarantee.

Arrangements may be made for payment of unpaid balances for a 36-month period at a monthly rate, which includes interest (Form 9461).

**Other Debts and Obligations**

Increasingly, matrimonial actions are attended by other minor creditor suits or (in the case of foreclosures) not so minor creditor suits. Some attorneys advocate consolidation of such ancillary suits into the matrimonial action, if for no other reason than that all issues may be disposed of at one time (except for cognizable summary judgment applications). There is little case law in this area for guidance. For instance, to what
extent can the matrimonial court delay suit, judgment or execution as distinguished from levy by a creditor of one or both of the parties?

Implicit in the search for equitable distribution of debts and obligations is whether and to what extent such debts and obligations were legitimately incurred, that is, are they to be classified as marital debts and obligations or do they arise by virtue of individual flat usually in the commission of unilateral dissipation of the family finances by unreasonably incurred debts and obligations for other than family purposes? Unilateral dissipation refers to a purposeful erosion of the family finances through the unilateral disposition of assets or the unilateral incurring of debt.