

Equitable Distribution Case Study The Magnolias

Wilma Lee Magnolia v. Henry Magnolia

Basic Information:

Important Dates:

Wilma and Henry were married July 4, 1997 – the “DOM”.

They separated on December 1, 2017 – the “DOS”.

Date of Trial is April 10, 2019 – the “DOT”.

Children:

There were two children born during the marriage, Henry Junior is 17 on the DOT and Rosa Lee is 14.

Wilma Lee has custody of the children pursuant to court order.

Henry Junior is mentally and physically disabled and has been since birth.

Other Information:

Wilma Lee is 45 years old.

Wilma Lee has not worked outside of the home since DOM.

Wilma has a BA degree from a liberal arts college. She also has a nursing degree that she earned during the first several years of the marriage.

Henry is 49 years old.

Henry completed high school but did not attend college.

Henry’s salary at the DOT from both businesses is \$90,000 per year.

Both parties are in good health.

Information about Assets and Debts

1. Magnolia Knitting Mill

-Located on 3 acres adjacent to the marital residence. A chain link fence with a gate separates the two structures and encloses the 3 acres on which the mill is operated. The 3 acre track is titled in the name of Magnolia Knitting. However, at the time of marriage, the three acres were part of a 5 acre tract owned by Henry. Henry transferred title to the 3 acres to the mill sometime during the marriage, but kept title to the remaining 2 acres for the marital residence.

-The Magnolias built and opened the mill one year after they were married

-The mill operated steadily with 3 shifts of workers during the marriage. During separation, Henry reduced operations to 2 shifts.

-Henry has been both the owner and manager since the mill opened. He worked long days and most weekends throughout the marriage. Henry considers the business to be a sole proprietorship. It is not incorporated.

- Wilma helped out at the mill from time to time during the marriage, but spent most of her time caring for the children and the marital home.
- Wilma's expert – a CPA, CVA, ABV, from Charlotte with a resume 25 pages long - testified that the value of the business as a going concern on the DOS was \$300,000, but by the DOT that value had dropped to \$260,000. He explained that he used the capitalization of earnings method to arrive at both values. He also explained that the reduction in value during separation was the result of the decreased productivity of the mill following the separation of the parties.
- Henry offered the testimony of his accountant, Mr. John Magnolia. In addition to being Henry's uncle, John has kept the books for Magnolia Knitting since the formation of the business, and he has kept books for mills in the area for the last 25 years. John tells you that on the DOS the business owned assets, including the 3-acre tract upon which it is built, worth \$150,000. By DOT, that value had dropped to \$100,000 due to the fact that several pieces of equipment had been sold by Henry to Super Sewing, Inc. John testified that there is "no way" Henry could sell the mill for any more than the value of the assets. In John's opinion, the textile industry "is moving out of this country" and Henry will be lucky if he is able to continue to make enough from the mill to pay for its operation.

2. Stock in Super Sewing, Inc.

- Super Sewing, Inc. is a knitting mill located one mile from Magnolia Knitting Mill formed two months after the DOS.
- Henry owns 25% of the stock of that corporation, and he is paid a salary to help manage the mill. There is no evidence of the value of the stock.
- Wilma testified that Henry took equipment from Magnolia Knitting to use at the new mill. Henry admits that he sold a few pieces of equipment to Super Sewing, but he claims it was a legitimate business transaction between the two businesses. Wilma contends that the stock is marital property because the new mill is operating with the benefit of the marital property removed from Magnolia Knitting.

3. Marital Residence

- Built before the marriage by Henry on the 5 acre tract of land given to him by his father
- Henry borrowed \$80,000 to build the house.
- On the DOM, the house and remaining 2 acres of the land had a market value of \$95,000 and the loan balance was \$75,000.
- During the marriage, the mortgage was paid with marital funds and the knitting mill was built on the property. The parties devoted 3 acres to the mill, keeping the remaining 2 acres for use as their residence.
- Parties stipulated that the fair market value of the house and 2 acres of land on DOS was \$200,000. The mortgage balance was \$15,000.
- During separation, Henry has paid the mortgage pursuant to an order of postseparation support. Wilma and both children have lived in the house throughout separation and continue to do so at the time of trial.
- On DOT, the house has a fair market value of \$210,000 and the mortgage has been reduced to \$13,000.

4. Mustang Convertible Automobile

- Purchased one month before DOS by Henry who gave it to Wilma as a birthday gift.
- Wilma has driven the car since Henry gave it to her.
- On DOS, the car loan had a balance of \$28,000. Henry has made all payments since separation to "save his credit." He has paid a total of \$3200 since separation. On DOT, the balance on the car loan is \$26,000.
- Wilma introduces evidence of that the "blue book" value was \$22,000 on the DOS and \$18,500 on the DOT. Henry argues the value would have been higher at the time of trial if Wilma had not driven the car to Key West Florida on two separate occasions to visit a new male friend.

5. Joint Savings Account

- DOS value was \$24,000
- DOT value is \$0.
- Interim distribution at beginning of case gave \$12,000 to each party and thereafter the account was closed.
- Both parties admit that in 1999 Henry deposited \$8,000 into the account that he received as an inheritance from an uncle. Henry argues that the \$8,000 is his separate property.
- Both parties admit that numerous withdrawals and deposits were made in the account during the marriage.

6. 37-acre tract of land

- Located immediately south of the 5-acre tract containing the marital home and knitting mill.
- Land titled in both parties
- The land was received as a gift from Wilma's elderly aunt during the marriage.
- Aunt testified that she gave the land to Wilma and Henry because of her love of her niece. She stated that she did not intend for Henry to have any part of the land that she and her late husband worked so hard for.
- Wilma introduced evidence that the tax value at the time of conveyance was \$14,500 and the tax value on DOS was \$20,000. Neither party introduced evidence of the value on the DOT.

7. IRS Debt

- Assessed against Wilma and Henry as individuals and against Magnolia Knitting. Incurred as the result of an audit of the tax records of Magnolia Knitting.
- On DOS, debt had balance of \$18,000. Henry made payments during separation and the balance on the DOT is \$17,000.
- Wilma testified that she had no idea that Henry was "defrauding the IRS" during the marriage and that there is no way this debt was her fault.

8. “Collectibles”

-On the 37-acre tract, there are two barns full of old farm machinery, items Henry has collected over the years of the marriage from flea markets and auctions, and old sewing machines.

-Henry says it is all “junk” with no value.

-Wilma testified that Henry told her during the marriage that they would be able to retire and move to Florida with the proceeds from the sale of the “antiques” in the barn.

-Wilma had to obtain an order from the court during discovery because Henry kept the barns locked and refused to allow her to inventory the contents. She also testified that she saw Henry removing farm machinery from the barns after separation but before she was able to inventory the contents of the barn.

-Wilma’s appraiser – who is the owner of a local auction house and regularly buys and sells personal property as part of his business - testified that the contents of the barn had a value of \$25,000 on the DOS. He also testified that, based on Wilma’s description of the farm equipment she saw Henry remove from the barn, the missing equipment had a DOS value of at least \$5,000.

9. 401K Accounts

-Both Henry and Wilma have accounts in their individual names.

-On DOS, Wilma’s had a value of \$22,000. On the DOT, it had a value of 21,000. All contributions to Wilma’s account were made during the marriage. No contributions have been made into her account since the DOS.

-Henry’s account had a value of \$50,000 on the DOS. He opened the account 5 years before the marriage, and the account had a value of \$10,000 on the date of marriage. 3 months before separation, Henry withdrew \$15,000 from the account and spent it on a Caribbean vacation that he took with a female friend (the cause of the separation).

-On DOT, the balance in Henry’s account was \$51,000; Henry made contributions to the account in the amount of \$800 during separation.

10. Credit Cards

-Both Henry and Wilma have a credit card in their individual name.

-Wilma’s card had a balance of \$1,500 on the DOS. On the DOT, it had a balance of \$2,500. Wilma made \$500 worth of purchases with the card after the DOS. She testified that the entire debt was incurred for household needs and clothing for herself and the children.

-Wilma has made monthly minimum payments on her card of \$15 per month since the DOS, for a total of \$240.

-Henry’s card had a balance of \$300 on the DOS. On the DOT, the balance is \$1,000. Henry made \$500 worth of purchases with the card after the DOS. He testifies that the debt was incurred for his clothes, gifts for the children, as well as for his living expenses after the DOS. He also has made the \$15 per month minimum payment on the debt since the DOS, for a total of \$240.

WORKSHEET
Classify and value the assets and debts

	<u>MARITAL</u>	<u>SEPARATE</u>	<u>DIVISIBLE</u>
1. Magnolia Knitting Mill	_____	_____	_____
2. Stock in Super Sewing, Inc.	_____	_____	_____
3. Marital Residence	_____	_____	_____
4. Mustang Convertible	_____	_____	_____
5. Car Loan	_____	_____	_____
6. Joint Account	_____	_____	_____
7. 37-acre tract	_____	_____	_____
8. IRS Debt	_____	_____	_____
9. Collectibles	_____	_____	_____
10. Henry's 401(k)	_____	_____	_____
11. Wilma's 401(K)	_____	_____	_____
12. Wilma's Credit Card Debt	_____	_____	_____
13. Henry's Credit Card Debt	_____	_____	_____

Notes:

WORKSHEET DISTRIBUTION

List all distribution factors:

WORKSHEET
Distribute the assets and debts

	<u>HENRY</u>	<u>WILMA LEE</u>
1. Magnolia Knitting Mill	_____	_____
2. Stock in Super Sewing, Inc	_____	_____
3. Marital Residence	_____	_____
4. Mustang Convertible	_____	_____
5. Car Loan	_____	_____
6. Joint Account	_____	_____
7. 37-acre tract	_____	_____
8. IRS Debt	_____	_____
9. Collectibles	_____	_____
10. Henry's 401(k)	_____	_____
11. Wilma's 401(k)	_____	_____
12. Wilma's Credit Card Debt	_____	_____
13. Henry's Credit Card Debt	_____	_____
Distributive Award?	_____	_____

Suggested Classification and Valuation

	<u>MARITAL</u>	<u>SEPARATE</u>	<u>DIVISIBLE</u>
1. Magnolia Knitting Mill	_\$300,000__	_____	_____
2. Stock in Super Sewing, Inc.	_____	_____	_____
3. Marital Residence	_\$138,750__	_\$49,250__	_\$9,000__
4. Mustang Convertible	_\$22,000__	_____	_(3,500)__
5. Car Loan	_(\$28,000)__	_____	_(\$1,200)__
6. Joint Account	_\$24,000__	_____	_____
7. 37-acre tract	_\$20,000__	_____	_____
8. IRS Debt	_(\$18,000)__	_____	_____
9. Collectibles	_\$25,000__	_____	_____
10. Henry's 401(k)	_\$40,000__	_\$10,040__	_\$160__
11. Wilma's 401(K)	_\$22,000__	_____	_(1,000)__
12. Wilma's Credit Card Debt	_(\$1,500)__	_____	_(\$500)__
13. Henry's Credit Card Debt	_(\$300)__	_____	_(\$200)__

Notes:

1. **Mill:** Acquired during marriage so classified as marital property. Issue about valuation regarding which expert you find more credible? Fact that uncle's testimony is not based upon an accepted valuation methodology may be a problem under some court of appeals' opinions.

Postseparation depreciation of \$40,000 is a distribution factor. Is not divisible property because I am convinced it was caused by postseparation actions of Henry. (if you are not convinced it was brought about by the actions of one spouse, the depreciation would be divisible property).

2. **Stock:** A distribution factor only – as an asset of Henry. Could be marital if Wilma was able to show that stock was acquired in direct exchange for marital property. But, there is no evidence about how stock was acquired or about the value of the stock.

3. **Residence:** Both marital and separate due to Henry's pre-marital contribution. If you use the *Mishler* "formula": separate estate contributed one-fourth of the total contribution, so one-fourth DOS net value is separate (\$46,250). Remainder is marital (\$138,750).

There also has been a postseparation increase in net value of the residence in the amount of \$12,000. This amount is presumed divisible to the extent it is an increase in the value of marital property. To determine the portion attributable to marital property, apply *Mishler* formula that applied to determine marital component on DOS: three-fourths attributable to marital property (\$9,000), and the remaining one-fourth or \$3,000 will be Henry's separate property because it is appreciation of his separate property. Only evidence of cause of the increase is Henry's payments on the mortgage. However, this should not be considered as an 'action' of a spouse because Henry made these payments pursuant to a PSS order. So, the entire \$9000 is divisible.

For distribution: Henry should receive no "credit" in distribution for his payment of the mortgage during separation because he paid pursuant to an order of PSS.

4. **Car:** Marital because it was a gift between spouses with no contrary intent stated in the conveyance (would be separate if Wilma could show a contrary intention specifically stated at the time of the conveyance). Postseparation decrease in value of \$3,500 is divisible because I believe the depreciation would have occurred even if Wilma had not driven the car to Florida. (But if you can find –based upon evidence – that all or part of the decrease was the result of the actions of one spouse, then the depreciation caused by the postseparation actions of one spouse would not be divisible and would be a distribution factor).

5. **Car loan:** Marital debt because it was incurred to purchase a marital asset. Decrease in debt during separation is divisible property - \$2,000 – if the payments were made between 10/02 and 10/01/13. But statute was amended to define divisible debt to include only passive increases or decreases in marital debt. So decreases that are the result of payments no longer need to be classified and accounted for as divisible debt. Rather, trial court has discretion to determine most appropriate way to 'consider' debt payments made after the DOS.

Remaining payments represent divisible interest and finance charges that accrued after the DOS in the amount of \$1,200 (a passive increase in marital debt).

6. **Account** presumed marital because acquired during marriage. Henry has burden to trace the separate component of the DOS value. Henry made no attempt to trace, so entire account is marital. For an example of a party successfully tracing separate property, see *Fountain v. Fountain*, 148 NC App 329 (2002).

7. **37-acre tract.** Acquired during the marriage so presumed marital. If a gift to Wilma alone, it would be her separate property. Intent of donor at time of conveyance determines whether gift was intended as gift to Wilma alone or to Wilma and Henry together. Could go either way based upon your assessment of aunt's testimony, but I do not find aunt's testimony to be credible. *But see Hunt v. Hunt*, 85 NC App 484 (1987)(checks written to both husband and wife found to be gifts to wife alone based upon testimony of donor).

8. **IRS debt.** Marital debt, assuming you are willing to find it was incurred for joint benefit of the parties because it was incurred by the marital business. *See Glaspy v. Glaspy*, 143 NC App 435 (2001)(where both benefited from profits earned by business during the marriage, tax lien on business incurred during marriage was a marital debt). \$1,000 decrease in debt during separation is divisible property if made between 10/02 and 10/1/13. Because the definition of divisible debt was amended effective 10/1/13 to include only passive changes to marital debt after the DOS, payments on debt made after

that effective date will be ‘considered’ as deemed appropriate by the trial judge but do not need to be classified and distributed as divisible debt.

9. **Collectibles.** Marital property because acquired during the marriage. Issue is valuation. No methodology needed for valuation of personal property. I am willing to accept \$25,000 but not the remaining \$5,000 value attributed to the missing property. I do not believe valuator had enough information upon which to base an opinion as to the value of that missing property. Wilma has burden to prove DOS value.

10. **Henry’s 401(k).** Henry’s account is marital only to extent earned during the marriage. GS 50-20.1 requires that all pension, retirement, and other deferred compensation plans be classified using the coverture fraction (time earning pension/account during marriage over total number of years earning pension). Coverture fraction in this case is $\frac{4}{5}$ th (15 years married and earning account over 20 total years earning the money in the account) – so \$40,000 is marital. The withdrawal from his account for his trip is a distribution factor if you find it was a use of marital funds for a non-marital purpose “contemporaneous with marital breakdown or in anticipation of separation.” See *Fountain v. Fountain*, 148 NC App 329 (2002). Increase in account is divisible property to the extent that is attributable to the marital portion of the DOS value of the account and to the extent it is not the result of Henry’s efforts. \$200 is passive growth – applying the same ratio as applied to DOS value to find marital component – $\frac{4}{5}$ ^{ths} – to attribute \$160 of the \$200 passive appreciation to the marital component of the account. The remaining \$40 is Henry’s separate property.

However, in *Watkins v. Watkins*, 746 SE2d 394 (NC App 2013), the court of appeals held that a 401K may or may not be ‘deferred compensation’ for purposes of equitable distribution. If it is not deferred compensation, it is not required to be classified using the coverture fraction found in GS 50-20.1 and it is not subject to the distribution restrictions found in that statute. According to *Watkins*, the fund is not ‘deferred compensation’ if the owning spouse has immediate access to the funds. If it is not deferred compensation, the account can be classified using the source of funds approach. If we assume the entire account is vested and Henry can withdraw the funds at any time, then \$10,000 clearly is separate property of Henry. The growth in the account during the marriage - \$40,000 - is presumed marital, so the burden will be on Henry to show how much of the growth during the marriage was passive growth on the \$10,000 separate contribution.

11. **Wilma’s 401(k).** Entire DOS value is marital property, and decrease during separation is divisible because it was not the result of actions by either spouse.

12. **Wilma’s credit card:** DOS balance is all marital if you are willing to find that debt incurred to buy household furnishings and clothing was debt incurred for the joint benefit of the parties. Increase after DOS will be divisible debt to the extent it is interest and finance charges relating to marital debt. I am willing to assume that the \$500 not attributable to new purchases is interest and finance charges related to pre-DOS charges. The payments made after DOS would be divisible debt if it is shown that the payments reduced the marital part of the debt – and if made between 10/02 and 10/1/13. But – since neither party paid more than they charged after DOS and the balance of the account increased rather than decreased after separation, I would not be willing to find that the payments amounted to a decrease in marital debt.

Because the definition of divisible debt was amended effective 10/1/13 to include only passive changes to marital debt after the DOS, payments on debt made after that effective date will be 'considered' as deemed appropriate by the trial judge but do not need to be classified and distributed as divisible debt.

13. Henry's credit card: DOS balance all marital and increase in balance not attributable to new purchases after DOS is divisible (same analysis as Wilma's card).