# New Jersey Family Lawyer

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Newsletter


CHAIR'S COLUMN

## Getting Divorced is Worse Than Being Divorced

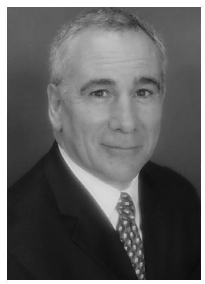
*by Michael J. Stanton*

A former client called to ask for my help in getting her former husband to pay for their son's college expenses as provided in their interspousal agreement. I had prepared the agreement on her behalf when I represented her in her divorce three years earlier. During the conversation, she complemented me on the excellent representation I had given her during her divorce case. Then she told me that, with the benefit of three years hindsight, she had come to realize that "getting divorced was worse than being divorced."

That was about 10 years ago — everything these days seems to have happened about 10 years ago — and I have adopted that client's remark as a mantra for my clients ever since. At times when the obstacles presented during the process of getting a divorce seem insurmountable to my client, I tell him or her that getting divorced is worse than being divorced. My purpose is to give the client hope that there is an end to this process, and that things will get better.

Our clients come to us to help them divorce their spouse. Whatever the problem, whatever the failure in the relationship, they have made the hardest decision of all, the decision to divorce, to dissolve their marriage. They believe that life without their spouse will be better than life with their spouse.

But most of our clients — some much more than others — are fearful of the unknown. They fear the loss of companionship and love, the loss of financial security, the loss of physical security, and the disintegration of their family. Divorce is as psychologically traumatic as the death of someone we love. Perhaps it is unrealistic to hope that the process of obtaining a divorce will actually relieve some of that psychological trauma, but we can and should do everything possible to ensure that the process does not exacerbate that psychological trauma.



Early in my career as a divorce attorney, I adopted the philosophy that my professional responsibilities were threefold. First, I must educate my client regarding his or her rights, obligations and reasonable expectations under the law. Second, I must provide advice and recommendations regarding issues arising in the context of his or her divorce case. Third, I must negotiate, advocate and litigate (if necessary) his or her case at the highest professional level.

My method of dealing with the emotional roller coaster experienced by my clients was to recommend they seek counseling from a psychologist or other mental health professional. This was the extent of the emotional support I offered clients. I was fond of telling them that I was not a psychologist, but a lawyer. I told them that I was available to help them navigate the legal waters to obtain for them the best result possible in their divorce. If they needed counseling to survive the emotional trauma of the divorce, they needed to see a psychologist. While it was sound advice to advise clients to seek the assistance of a psychologist or other mental health professional to deal with the emotional trauma of divorce, it was also short sighted, and an avoidance of an essential aspect of my responsibility as an attorney to clients in divorce matters. Of course, divorce attorneys who focus only on the emotional needs of their clients cannot be objective, and cannot perform adequately as attorneys. Similarly, divorce attorneys who ignore the emotional needs of clients also perform a disservice to their clients.

*New Jersey Family Lawyer*

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## Chair's Column

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How then do we strike a balance between the objective needs and the emotional needs of our divorce clients? Make your client feel as though you are including him or her as your partner in the divorce process. Take the time to listen to your client. Return phone calls promptly. This is the client's opportunity to ask you questions and discuss his or her concerns. When you meet with the client, always give him or her the opportunity, perhaps at the end of the consultation, to ask any questions he or she may have, or make comments regarding the case.

Meet with your client well in advance of settlement conferences, MESP appearances and trial dates. Give the client tasks to complete in preparation for those meetings. Regardless of how much or how little these exchanges with the client will actually assist you with your preparation, it will make the client realize that you care what he or she thinks, and that you are concerned about him or her as a person, not just a file, a case or a fee.

We owe this kind of personal attention to our clients. This is what makes the family bar different from other specialty bars. If we really strive to take the time to care about our clients, which doesn't really consume all that much additional time, we serve three constituents. First, we help our clients survive the emotional trauma of divorce. This is a reward in itself. Second, we enhance our reputation as a compassionate person, as well as a skilled family law practitioner. This has obvious financial rewards in terms of referrals. Third, we improve the reputation of the legal profession in general, as well as family lawyers in particular. This is our greatest legacy. ■

EDITOR'S COLUMN

# Only We Think What We Do is So Important

*by Mark Sobel*

I note with a mixture of chagrin and surprise that the Supreme Court of New Jersey declined to accept the petition for certification in the recent appellate decision of *Brown v. Brown*.[1] The surprise comes from the fact that we, as family law attorneys, have this egocentric belief that what we do is not only important, but is also of vital interest to all who practice law. Thus, *Brown*, a case that establishes a new path for business valuation in a divorce proceeding, seemingly would justify analysis at the highest level of our judicial system. A good dose of reality is always helpful, especially to those of us who wander in the surreal world of family law.

The *Brown* decision, in pertinent part, dealt with an evaluation of a husband's interest in a florist business, which he owned with his brother and parents. *Brown* delved into the specific mechanics and mechanisms for calculating the value of an individual's interest, which was less than 50 percent, in a closely held corporation subject to equitable distribution. The *Brown* court determined that the appropriate value of the husband's interest is its fair value, which could be calculated based upon the value of the husband's interest *without* any reduction of that value for discounts regarding minority interest or lack of marketability.

*Brown* is compelling, not only for its holding, but for its analysis of the valuation issue. Prior to the pronouncement in *Brown*, it was the general belief that the valuation of an individual's interest in a business for purposes of determining equitable distribution would be predicated upon the fair market value (*i.e.* the amount of a hypothetical sale between a willing buyer and a willing seller, each having all relevant facts) subject to various discounts for lack of marketability and/or a lack of majority control, as well as others factors such as the existence of covenants not to compete or restrictive covenants or key-man allowances.

In *Brown,* the court moved away from the fair market value approach to *fair value*, which would not allow for discounts except in the most extraordinary circumstances. However, as cases get distilled and converted into short mantras, *i.e. Lepis*[2] — change of circumstances, *Miller*[3] — imputation of interest, or *Isaacson*[4] — unlimited ability to pay child support, our fear is that *Brown* will simply be relegated to: fair value means no discounts.

There are two primary concerns I have with this possibility. The first is that this hypothetical valuation of an asset not to be sold, or likely not to be sold, without the allowance of discounts, will artificially inflate its value, which many attorneys see already as a double dip, especially in the case of personal services businesses. The second concern is that *Brown's* utilization of the New Jersey Supreme Court opinions in both *Balsamides v. Protameen Chemicals, Inc.*,[5] and *Lawson Mardon Wheaton Inc. v. Smith*,[6] as precedent, may now inject into the valuation process *qualitative* determinations regarding the parties and their marriage, rather than *quantitative* assessment of economic factors.

The first issue of potential over valuation presents problems, which can be best illustrated by a variety of hypotheticals.

1. Does a two-percent owner of a multi-million dollar business really have two percent of the entity's value in the same way as a 65-percent owner has 65 percent of that entity's value?
2. Does an accountant with an extensive restrictive covenant, compared to an accountant without any restrictive covenant, each in equally successful firms, have the same value for their interests in their respective practices?
3. Does the value of an individual's interest in a business differ depending on whether the individual has or does not have the right to sell his or her interest?

All of these fact patterns (and many more), unfortunately, are now covered with the same broad brush of the *Brown* opinion, *i.e.* fair market value with no discounts. That seems contrary to the particularized attention we should give to each and every fact pattern that presents itself to the family court. It also seemingly deviates from providing the particular trial judge's flexibility in allowing experts to provide assistance in determining

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## The NJSBA successfully lobbied for passage of legislation important to lawyers and their clients, including legislation which:

Creates **six Superior court judgeships** to allow for the expansion of the drug court program and provides appropriations for court staff and substance abuse treatments.

Provides retirement benefits for **workers' compensation judges.**

Provides for **public access to government records** and protects certain government records from public disclosures, and establishes the privacy study commission and appropriates $95,000 to the commission.

Prohibits insurers from requiring the filing of a municipal court complaint as a precondition to payment of certain claims.

Revises the rules concerning secured transactions and replaces **chapter 9 of the Uniform Commercial Code.**

Modifies the **Probate Code** with regard to settlement of intestate estates when heirs are missing or unknown.

Eliminates the **corporation business tax** on regular income of S Corporations.

Establishes the crime of **bias intimidation.**

Protects IRA and **higher education tuition savings account** assets and distributions from creditors.

Concerns recovery of Temporary Disability Insurance (TDI) payments for **workers' compensation awards.**

Makes it a crime of the fourth degree to tamper with electronic devices installed in police patrol cars.

Allows **stalking victims** protected by a temporary restraining order, to register to vote, without disclosing their street address.

Criminalizes the use of the Internet and other electronic communication devices to commit harassment or stalking.

Requires a municipality to issue zoning permit within 10 business days.

Establishes the "New Jersey Adult Family Care Act."

the real economic value of this particular asset, which is often the largest asset to be divided. While *Brown* has *dicta* relating to that, the hurdles that one must now jump over to obtain any such discounts set the bar way too high. In essence, the high jump has been turned into a pole vault, but no pole is provided.

More important, however, since the first concern may be able to be dealt with through effective counseling, is the second concern, which becomes *more* problematic with the same effective counseling. A close reading of *Balsamides* and *Lawson* emphasizes this point. In *Balsamides* a marketability discount was allowed because the person seeking the discount (and buying the other partner's interest) wore the *white hat*. In the *Lawson* case, the same discount for marketability was *not* allowed because the entity seeking the discount wore the *black hat*.

In those cases, the issue of whether a discount, allowed in one and not the other, turned on the Court's determination of the good faith and bad faith of the respective parties — *non-economic* factors. In essence, an *economic* determination as to value was predicated upon a *qualitative* assessment of who had *justice* on their side. Thus, in these two oppressed shareholder suits, an economic analysis was replaced by qualitative analysis on the very issue of the *value* of the asset.

While the Court in *Balsamides*[7] specifically stated that such an analysis is not appropriate within the context of a matrimonial setting, we only had to wait a few years (until *Brown*) to find out *Balsamides* and *Lawson* were to be directly utilized in a matrimonial setting. Thus, it is essential in understanding *Brown* to look closely at both *Balsamides* and *Lawson*.

The court in *Brown* also looked at both *Balsamides* and *Lawson,* but our respective analysis of these cases are disparate. The *Brown* court's comments on those cases included the following:

> In *Balsamides* the extraordinary circumstance that warranted use of a marketability discount was that it was the *oppressing* 50% shareholder who was to acquire the shares of the *oppressed* 50% shareholder and equity demanded that the oppressor not be rewarded for his conduct by allowing a buy-out at a discounted price. In *Lawson* the Supreme Court found no comparably extraordinary circumstance and rejected use of discounts where discounting would have allowed the oppressive majority shareholder to buy out minority shareholders at less than full value."[8]

In fact, in *Balsamides* our Supreme Court emphasized that it was the *oppressed* shareholder, not the *oppressing* shareholder, who was buying the shares.

> "In *Lawson* [citations omitted] as in the present case we know who is buying the shares. In *Lawson* it is the company; in this case [*Balsamides]* it is the *oppressed* shareholder."[9]

The Supreme Court in *Balsamides* thus wanted the oppressed shareholder, who was buying the shares, to obtain the benefit of a discount — a substantial discount of 35 percent. Thus, the value of an asset was altered by a determination by our Supreme Court in that oppressed shareholder case regarding the equities. Conversely, in *Lawson*, where the majority shareholders sought to buy out the minority dissenters, a discount was not allowed. Again, the use or absence of a marketability discount was not done to determine a true economic value; but, rather, the court applied or chose not to apply a marketability discount for non-economic reasons.

This disparite application of an economic analysis based upon non-economic factors caused family part practitioners to be concerned about these cases, hence footnote 9 of *Balsamides.* One reason for that concern is that an effective practitioner may utilize the equities in the case — fault for the divorce, reasons for the end of the marriage, who was the better partner — and a variety of non-economic factors, to influence the economic determination of whether or not a discount should be applied. *Brown* does not say that, nor does it articulate what the extraordinary circumstances are. But *Balsamides* and *Lawson* both say it, and now *Brown* has applied *Balsamides* and *Lawson* within the context of family law. It is only a small step to argue that the equities in a case, which effected the economic determinations in *Balsamides* and *Lawson*, should do the same in our cases.

Interestingly, despite all of the statements that the discounts were utilized in *Balsamides* to protect the oppressed plaintiff, in footnote 5 of that case, at page 357, the Supreme Court stated: "if *Balsamides* was unable or unwilling to buy Pearl's shares of Protameen and Mardon; Pearl would be given the opportunity to buy Balsamides' *at the same price and terms*." Thus, in a little footnote the whole fulcrum for the providing of the discount is turned on its head. Because in that very case, if for some reason the plaintiff were unwilling or unable to buy the oppressing shareholder's shares, the oppressing shareholder would have received the same benefit of a 35 percent discount!

The difficulty with the *Brown* decision and its utilization of *Balsamides* and *Lawson* is not changing the standard of valuation from fair market value to fair value; the difficulty is that it provides for non-economic factors to create an economic determination as to value. Those issues, while very important in a case, should not determine the *value* of an asset. They may effect the *distribution* of an asset, but not its real value.

Those equity factors also may result in other types of relief the

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FROM THE EDITOR EMERITUS

# A Resource That Must Not be Squandered

*by Lee Hymerling*

**When a judge who has had no matrimonial or family law involvement ascends the bench with only two weeks of judicial training, the experience can be mystifying.**

As we move through the new court year, regrettably our system seems to have squandered one of its greatest resources. Generically, that resource is those excellent judges who, having reached age 70, must constitutionally retire but who are willing to continue their service. During times when our statewide bench has been beset with vacancies that for political or other reasons have not been filled, recall judges have performed an invaluable service to assure that calendars are moved and justice dispensed.

A judge on recall receives a *per diem* stipend that, when added together with his or her pension benefits, may not exceed the salary of a sitting superior court judge. Unfortunately, because of the constraints of an extremely tight budget and an even more difficult economic climate, adequate funds may not be available to permit those who have, in some instances, served on recall for years, to continue and in other instances, including one of our most qualified family part judges, to continue on recall after recent retirement. This is a crying shame and a systemic disgrace.

If the situation continues and the problem is not solved, the family part may disproportionately suffer, as those among its most experienced judges who are willing to accept recall might not be permitted to serve. In every trial-level division experience counts, but in the family part it counts even more. There is a sharp learning curve in the family part. Since we have all come to recognize that, frequently, a family part judicial assignment comes at the beginning of a judicial career, it sometimes takes many months, if not years, for the new judge to acclimate him or herself to the regimen of difficult decisions that must be made daily. This is not to denigrate the well-meaning and extremely committed new judges who are assigned to the family part. It is merely to acknowledge the reality of the situation. When a judge who has had no matrimonial or family law involvement ascends the bench with only two weeks of judicial training, the experience can be mystifying.

Although gone may be the days when a new judge is appointed, confirmed, sworn in and hears his or her first case with little or no training, even the best of training does not provide the seasoning that the experience of years of service can give. Even when, in those few instances, a family lawyer is appointed to the bench with years at the bar, the newly appointed judge still requires time to fully permit the transformation from lawyer to judge.

The family part, as we who daily appear before it know, is blessed with few judges who have made it his or her career. But when there is such a judge — when that judge is able and that judge wishes to serve on recall — the system should never refuse.

In a recent issue, I wrote of the distinguished service of the Honorable Stephen Schaeffer, whose untimely death has left a gaping hole not only in the family part in Morris County but an experiential hole in our statewide bench. For Judge Schaeffer's reach went far beyond the cases over which he presided. As important, Judge Schaeffer was a friend and mentor to new judges, assisting them as they assumed their judicial functions, being there to offer a kind and patient hand seasoned by his years of experience. The same would hold true for any long-term family part judge who is permitted to serve on recall.

Budget crisies come and go. The economy will undoubtedly improve. But what will forever be lost if recall judges are not allowed to serve will be the wisdom they accord to the cases they will hear, and the guidance they could provide to those parties, judges and lawyers whom they can assist.

This is not to suggest that every judge necessarily should be allowed to sit on recall.The sound discretion of the chief justice, guided by our assignment and presiding judges, will forever be an important part of the process of determining who should be allowed to sit on recall and who should not. For every judge, there comes a time when enough is enough.

On the other hand, a solution to budgetary constraints must be found. To our system, recall judges are one of the few *bargains* available.

Some may argue that the cost of a recall judge exceeds simply their salary, because of the need for courtrooms and the use of court staff. This, however, is a false issue. There are almost always courtrooms available and court staff that sit idle because of judges' vacations, illnesses or the vicissitude of the court's calendar. With confidence, I believe that where there is a recall judge who can serve, a courtroom and staff can be found.

Does this editorial criticize anyone or any current policy as such? It does not. On the other hand, it is intended to be a gentle and constructive reminder that the quality and timeliness of justice will be improved by use of all resources, including the resource of those who have recently retired from the bench. ■

## Editor's Column

Continued from Page 5

court can order, such as constructive trusts. But the core concept should always be that the value of an asset should be empirically determined based upon economic criteria. Once the door is slightly ajar in the valuation context to allow non-economic components to alter that matrix, as *Balsamides* and *Lawson* do, and as *Brown* now also accepts within our practice, a careful and clever practitioner can shove that door wide open.

While that may be good lawyering, I think it will make bad law. We have taken fault and non-economic criteria out of the valuation of assets. The sub-surface reading of *Brown* seemingly incorporates them back within that evaluative process. Thus, at the very time when we should have a definitive, concrete, empirical, articulated standard for determining the monetary amount of an asset, we have instead created the ability for substantial dispute on that issue. It is one that merits further analysis, even if only by those of us in our business who deem it so important. ■

**ENDNOTES**

1. 348 N.J. Super. 466 (App. Div. 2002).
2. 83 N.J. 139 (1098).
3. 160 N.J. 408 (1999).
4. 348 N.J. Super. 560 (App. Div. 2002).
5. 160 N.J. 352 (1999).
6. 160 N.J. 383 (1999).
7. Footnote 9 of *Balsamides* stated "we further recognize that valuation principles that are appropriate for appraisal actions are not necessarily useful in other contexts such as valuation of stock for tax and equitable distribution purposes." *Id.* at 375.
8. *Brown* at 484 (emphasis added).
9. *See Balsamides* at 381.


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- Check our online Legal Career Resource Center, a centralized location where employers, lawyers, paralegals and support staff meet. There are currently more than 3,000 legal positions available (locally and nationally) for review.
- Visit our Law Office Management section — with legal software program directory listings, law-clerk referral, lawyer-to-lawyer consultation programs and discounted ABA Law Practice Management books. (This is for members only.)
- Access links to state and federal government and courts, NJ State Legislature, county and state bar associations, law schools, other legal associations and legal research.

NEW JERSEY STATE BAR ASSOCIATION 1899

# The Dirty Socks: Can They be Laundered by an Application of the Rules of Evidence?

*by Thomas J. Hurley, Robert J. Durst II and Lisa Madden*

Years ago, a well-known judge of the family part told one of the authors of this article — "you can get your dirty socks into evidence during a matrimonial trial."

Most family lawyers purchase a copy of the *New Jersey Rules of Evidence.* On occasion the book is opened by them and on occasion it is actually cited to a judge, who then reaches for the book and hopefully has it.

This scenario is, of course, not applicable to any practitioner or judge who is taking the time to read this publication, but is, all too often, the scenario with those *other ones*.

A bit of sarcasm aside, the Rules of Evidence and their proper application should be every bit as important to the practitioners and the judge in a family part bench trial as they are in a civil or criminal jury trial.

Through the proper use and application of even the fundamental Rules of Evidence we can all be assured that family court decisions will be based upon competent, admissible evidence appropriately subjected to cross-examination. The risk of unfounded opinion testimony, unchallengeable hearsay, innuendo instead of fact he said, she said decisions will be minimized.

The following is a concise summary of some of the fundamental rules every family law attorney should know and apply.

**RULE 401 — DEFINITION OF RELEVANT EVIDENCE**

Relevant evidence means evidence having a tendency to prove or disprove any fact of consequence to the determination of the action. Family lawyers should memorize this rule.

**Through the proper use and application of even the fundamental Rules of Evidence we can all be assured that family court decisions will be based upon competent, admissible evidence appropriately subjected to cross-examination.**

The range of relevancy in a family part action is broad and wide.

In custody and visitation matters, tangential and ephemeral facts may be relevant. For example, the Appellate Division recently held that evidence as to the motives of a custodial parent who seeks to move out-of-state are relevant in considering whether to approve the move over the opposition of a non-custodial parent.[1]

In *Horswell*, the plaintiff and the defendant were awarded joint legal custody of their two children.[2] While married, the couple lived at McGuire Air Force Base, where the plaintiff-father was a career non-commissioned U.S. Air Force officer.[3] Upon their separation, the defendant-mother (and custodial parent) moved with the children to her parents' home in Arkansas, where they resided in close proximity to the defendant's grandfather, sister and brother-in-law, and a number of aunts, uncles and cousins.[4] The plaintiff-father, unable to obtain a transfer for a least five years, appealed the defendant's application to relocate permanently to Arkansas.[5] While recognizing that the defendant's move had adversely affected the plaintiff's parenting rights, the court remanded the case for further fact-finding, and noted the relevance of several factors, including the integrity of the defendant's motives in moving, the prospective advantages of the move, and the development of a reasonable visitation schedule.[6]

A child's heritage, the opinion of his or her only surviving natural parent, and evidence of substantial bonding between the child and his or her foster parents have been held to be relevant facts the court should consider in evaluating child custody issues.[7] *L.L.* involved a custody dispute in which L.L. Sr. appealed the placement of his son, L.L., with foster parents, Mr. and Mrs. H.[8] L.L. Sr. was sentenced to 18 years in prison for aggravated manslaughter of his wife, the mother of his son.[9] On the day after his mother's death, pursuant to a voluntary placement agreement executed by L.L. Sr., L.L. was placed in the foster care of Mr. and Mrs. H.[10] Pursuant to L.L. Sr.'s request, the Division of Youth and Family Services contacted Mr. and Mrs. Doe, L.L. Sr.'s half-brother and sister-in-law, who are of Hispanic heritage, lived in Panama, and expressed a strong desire to take custody of L.L.[11] L.L. Sr. subsequently revoked his voluntary placement agreement, and the division notified the foster parents that it intended to place L.L. with the Does in Panama.[12] Mr. and Mrs. H. successfully moved to prevent the division from removing L.L. from their home, and L.L. Sr. appealed.[13]

In denying the division's placement plan, the Appellate Division found that the trial court correctly applied the best interests standard.[14] The court deemed several factors relevant to the custody inquiry, including: (1) the changes that L.L. Sr. would have to re-establish his paternity with L.L. if he remained with the Does, a prospect the court found to be "a dangerous situation for the child"; (2) the substantial bonding between L.L. and the foster parents and the subsequent emotional harm L.L. would suffer upon separation from them; and (3) the lack of any meaningful interaction between L.L. and the Does.[15] While these compelling circumstances cited by the experts outweighed considerations of L.L.'s Hispanic heritage, the court found the considerations of L.L.'s heritage relevant.[16]

N.J.R.E. 401's definition of relevant evidence may even include confidential government information.[17] *Cargulia* involved an application for an increase in alimony where the defendant-wife served a subpoena on the Internal Revenue Service (IRS).[18] According to Mrs. Cargulia, Mr. Cargulia's income and earning capacity were greater than he had previously claimed.[19] Mrs. Cargulia's claims were confirmed by the IRS's audit of Mr. Cargulia's returns. However, the IRS resisted providing any testimony regarding the source of the information which had led to the IRS decision to investigate Mr. Cargulia.[20] The court examined N.J.R.E. 401, noted its broad definition, and consequently found the audit information sought from the IRS to be relevant.[21] While the information was found to be relevant, it could not be obtained because the court had no power to order the U.S. to provide the information.[22]

Relevant, on the other hand, does not necessarily equate with admissibility.

Although Rule 402 provides that "except as provided in these Rules or by law, all relevant evidence is admissible," the immediately subsequent Rule 403 provides "relevant evidence may be excluded if its probative value is substantially outweighed by the risk of (a) undue prejudice, confusion of issues or misleading the jury or (b) undue delay, waste of time or needless presentation of cumulative evidence."

In a preamble to a written opinion, a family court judge recently wrote the following:

> This prolonged trial produced a welter of testimony and by comparity a paucity of information ... the parties may be surprised to learn just how unimpressed the Court was with this ... repetitive nature of questioning more designed to obtain a pound of flesh than to elicit cogent information.

The trial judge who offered those comments, and it is suggested, many others, would welcome an objection to repetitive, needless and marginally probative (although perhaps technically relevant) evidence. However, in all but the most extreme situations, a 403 objection must be made by the attorney. Few judges will interpose their own Rule 403 observations.

A balancing of Rule 402 and Rule 403 may lead to a much more expeditious, drastically less expensive and ultimately better trial presentation. As practitioners, we owe it to our clients to strike that balance and trust our judges to properly assess the balance and to apply Rule 403 to eliminate lengthy, repetitive and marginally probative testimony.

## RULE 505 — PSYCHOLOGIST-PATIENT PRIVILEGE

The rule that mirrors New Jersey Statute 45:14B-28, provides that confidential relations and communications between and among a licensed practicing psychologist and individuals, couples, families or groups in the course of the practice of psychology are placed on the same basis as those provided between attorney and client. Nothing in the act will be construed to require any privileged communications to be disclosed by any person.

In application, an issue often overlooked in Rule 505 is whether the psychologist is a licensed psychologist. If the psychologist has not been licensed by the state, the privilege may not apply.

The most pertinent case on Rule 505 is *Kinsella v. Kinsella*,[23] where the New Jersey Supreme Court gave a detailed analysis of the law regarding the psychologist-patient privilege.

In *Kinsella*, the plaintiff-husband filed a complaint for divorce, alleging extreme cruelty, and the wife counterclaimed, alleging extreme cruelty and seeking tort damages for physical and mental abuse by her husband. As they proceeded toward trial, the parties filed cross-motions for orders releasing their medical and psychological records.[24] The defendant contended that the order should provide for each party to have access to all of the other party's psychological records, including the records of the plaintiff's treating psychologist. The plaintiff objected to release of those records.[25]

In a letter brief addressing the question of whether the plaintiff should be required to release his medical records, the defendant stated that she believed the plaintiff had revealed to his therapist a course of abusive conduct toward the defendant.[26] The defendant sought to review the therapist's records because of their relevance to the custody and tort claim issues, but the plaintiff objected to the release, claiming that his treatment records were privileged pursuant to N.J.R.E. 505, and that the information sought was available from less intrusive sources.[27]

The plaintiff claimed further that physical custody was not an issue in the case and that, in any event, the court-appointed psychologist's report provided sufficient information on the mental state of the plaintiff for the purposes of custody and visitation.[28] The plaintiff added that, unlike the defendant's psychologist records, which were put at issue by her tort claims, his mental state was not at issue.[29]

In denying the defendant's request for the production of the plaintiff's psychological records, the *Kinsella* court made it clear that the psychologist-patient privilege should be analyzed similarly to the lawyer-client privilege.[30] The court noted several exceptions to the psychologist-patient privilege, namely: (1) where a party had effected a limited waiver of the privilege by placing his or her emotional and mental state in issue; (2) where the privilege may be required to yield to the defendant's right to exculpatory evidence in a criminal proceeding; and (3) where piercing of the privilege is required for a best interests analysis by the court in a custody dispute.[31]

For the purpose of litigation, the *Kinsella* court held that the parties should first resort to the independent court-appointed or hired experts for the needed information.[32] If the information furnished by the independent experts is found to be inadequate after consideration of all of the evidence, then "the court should consider piercing the psychologist-patient privilege to compel disclosure of prior treatment records to the court and the parties."[33]

> [T]he decision to order such disclosure must be based on independent evidence of potential for harm to the child ... the opinion of an expert or the court's own observations. The court must also consider whether, based on the context of the prior treatment, the records are likely to contain relevant evidence, and whether such evidence is likely to be merely cumulative. Before releasing records to the parties, the court should conduct an *in camera review,* releasing only material that is relevant and material to the issues before it.

In short, "only in the most compelling circumstances should the courts permit the privilege to be pierced."[34]

**RULE 509 — MARITAL PRIVILEGE — CONFIDENTIAL COMMUNICATIONS**

Rule 509, which recites verbatim N.J.S. 2A:84A-22, relates to confidential communication between spouses.

It reads, in pertinent part, that no person shall disclose any communication made in confidence between such person and his or her spouse unless both shall consent to the disclosure or unless the communication is relevant to an issue in an action between them (or in a criminal action or proceeding in which either spouse consents to this disclosure).

Significantly, this rule has not been cited in any published family part cases. However, on its face, it would not seem to preclude testimony as to communications between spouses which is relevant to any issue in a family court action between the parties.

Query: Are such communications always relevant to a matter in issue, or are they often introduced to simply portray one or the other of the parties as *the black hat*? If the latter, they may not be admissible.

**RULE 510 — MARRIAGE COUNSELOR PRIVILEGE**

Rule 510, which recites verbatim N.J.S. 45:8B-29, is perhaps the most tightly drafted exclusionary rule of all.

There are no communications with a marriage counselor that can be disclosed in trial, and the privilege is not waivable.

The rule provides that:

> A communication between a marriage and family therapist and the person or persons in therapy shall be confidential and its secrecy preserved. This privilege shall not be subject to waiver, except where the marriage and the family therapist is a party defendant to a civil, criminal or disciplinary action arising from the therapy, in which case, the waiver shall be limited to that action.

Unlike the psychologist privilege no licensing requirements, there is no definition of a marriage family therapist or counselor.

This privilege is much broader than the psychologist privilege, as it protects *all* communications between the marriage counselor and the people he or she counsels, and the fact that a marriage counselor is not licensed is no bar to a claim of marriage counselor privilege.[35]

There are no published cases in New Jersey where communication between a marriage counselor and the litigants appears to have been overridden.

The *Wichansky* case was a matrimonial action in which the *defendant wife* and the *marriage counselor* sought to quash the subpoena *duces tecum* served by the plaintiff on the counselor.[36] Prior to the matrimonial action, the parties to the action sought counseling from a person who happened to be a licensed psychologist.[37] The plaintiff-husband subpoenaed for the counselor to testify about certain conversations which took place during the course of marriage counseling.[38] The marriage counselor sought to quash the subpoena, claiming the communications were protected under N.J.S. 45:8B-29, part of the practicing marriage counseling. The plaintiff took the position that since the psychologist was not a licensed marriage counselor the privilege could only be invoked under the statute applicable to psychologists.[39] The plaintiff further argued that since the confidential communications between a psychologist and patient are on the same basis as those between an attorney and client, the privilege is lost when the communication occurred in the presence of the other party.[40]

The defendant argued, and the Chancery Division agreed, that the privilege against disclosure of confidential communications applies to all marriage counselors whether or not they are licensed under the act or whether or not they are engaged in marriage counseling as part of their practice in another profession.[41] The court noted further that the confidentiality of communications afforded under the act is broader in scope than that afforded under the psychologist's privilege, and applies to all communications, confidential or not, and that the privilege cannot be waived.[42]

In *Kerr v. Kerr*,[43] the marriage counselor privilege was attacked as being unreasonably broad and extending more protection to communications with marriage counselors than is afforded to communications between patients and physicians.[44]

The marriage counselor privilege has been strengthened by our Supreme Court. In *Kinsella v. Kinsella*,[45] the Court held that there is no exception to the privilege simply because the parties were in therapy together.

Some limits have been imposed upon the marriage counselor privilege used in child custody disputes. For example, the marriage counselor privilege has been held to impermissibly interfere with the child's due process rights, to introduce into the proceeding material evidence relevant to the determination of what custodial arrangement is in the child's best interests and welfare.[46]

In *M. v. K.,* the plaintiff-father filed a complaint for custody and attached to his application a number of letters and reports from psychologists.[47] The defendant relied upon the marriage counselor privilege and requested the plaintiff be barred from introducing any and all reports, statements, opinions or other evidence, either written or oral, based directly or indirectly on the defendant's communications with the psychologist.[48] The court denied the defendant's position, recognizing the court's obligation to preserve and protect the best interests and welfare of a child.[49] The court further found it "inconceivable ... that in promulgating ... the [marriage counselor] privilege, the Legislature took into consideration the best interests and welfare of the children of a marriage, especially as might affect proper, and indeed, safe custodial placement."[50]

In *E. v. T.,*[51] the court held: "It is basic ... that in all matters relating to the custody of minor children, the paramount consideration of this and any other court is and should be the safety, happiness, physical, mental and moral welfare of the child."[52] In sum, the court declared that, "N.J.S.A. 45:8B-29 [the marriage counselor privilege], in child-custody disputes, impermissibly interferes with the aforesaid rights of children, and is unconstitutional."[53]

One trial court case, *Touma v. Touma*,[54] has held that a *marriage counselor alone* (as opposed to the wife *and* the counselor in *Wichansky*) cannot claim the privilege for him or herself where waiver of the privilege had been consented to by the parties.[55] In *Touma*, the plaintiff in a matrimonial proceeding sought to compel the testimony of a marriage counselor on the issue of custody.[56] Both the plaintiff and the defendant entered into a consent order waiving the marriage counselor privilege afforded by the act.[57] The counselor's claim that he could avail himself of the privilege was flatly rejected by the court.[58] In rejecting the counselor's claim, the court noted that allowing the marriage counselor to invoke the privilege "would deprive litigants of their proprietary rights to information ... [and] hamper the parties seeking to produce relevant, competent evidence at trial, in violation of procedural due process."[59]

Although the court reasoned to the contrary, it would appear that the *Touma* decision contradicts the plain language of the rule and underlying statute, and may be of limited precedential value.

### RULE 608 — EVIDENCE OF CHARACTER FOR TRUTHFULNESS OR UNTRUTHFULNESS

This rule provides that the credibility of a witness may be attacked *or supported* by evidence in the form of opinion or reputation, for truthfulness, provided that the evidence relates to the witness's character for truthfulness or untruthfulness, and provided further that the witness's truthfulness has been attacked by the opposing party.

Credibility of witnesses is often one of the most important issues for a matrimonial judge to discern during the course of trial. Many cases turn upon who is telling the truth — the typical he says, she says battle. Often, only the two litigants have witnessed an event, and their credibility is the determinative factor.

Certainly any reasonably experienced trial attorney will use an opposing party's reputation for untruthfulness as a basis for cross-examination.

The rule, however, can be of equally significant importance for the family lawyer in attempting to prove his or her client's reputation for truthfulness.

Under Rule 608, if opposing counsel has attempted to cast doubt upon the truthfulness of a client's testimony on cross-examination (as would almost certainly be the universal rule in virtually every family part trial), counsel for the party, or the party on behalf of whom the witness has testified, is able under Rule 608 to provide opinion or reputation testimony as to the witness's propensity for truthfulness.

The question is: How much of such evidence should an attorney put on? And, how probative is the testimony?

In those instances in which the parties' reputation for truthfulness can be supported by credible testimony of persons in a position to competently evaluate a person's truthfulness (perhaps a supervising attorney for an associate attorney, a person with whom the witness has done business, a person who made the witness's annual employment evaluations, etc.) it may be persuasive evidence.

Although a potentially valuable tool, counsel should be careful to balance the use of this type of evidence with Rule 403.

**RULE 612 — WRITING USED TO REFRESH MEMORY**

Each year, the family trial judges participating in the Institute for Continuing Legal Education seminars on evidence for family lawyers state that "refreshing recollection" is one of, if not the, most often misunderstood and misused rules of evidence by family lawyers.

The rule provides:

> Except as otherwise provided by the law in criminal proceedings, if a witness while testifying uses a writing to refresh the witness' memory for the purpose of testifying, an adverse party is entitled to have the writing produced at the hearing for inspection and use in cross-examining the witness. The adverse party shall also be entitled to introduce in evidence those portions which relate to the testimony of the witness but only for the purpose of impeaching the witness. If it is claimed that the writing contains material not related to the subject of the testimony, the court shall examine the writing *in camera* and excise any unrelated portions. If the witness has used a writing to refresh the witness' memory before testifying, the court in its discretion and in the interest of justice may accord the adverse party the same right to the writing as that party would have if the writing had been used by the witness while testifying.

This rule becomes pertinent when a litigant brings to the stand a sheath of paper. That sheath of paper is always subject to an attorney's review. Therefore, counsel must caution their client to bring with them to the witness stand only those documents which may be seen by the opposing attorney.

For example, a case information statement that has been filed with the court, and which the attorney wants to admit into evidence, may be acceptable for the witness to take to the stand. On the other hand, clients should never inadvertently or otherwise bring in their diary, personal notes or communications to or from their attorney. Remember that an adverse party is entitled to have a writing produced at the time of the hearing for inspection, and may use any part of the document in cross-examining the witness.The attorney is not precluded from using pages of the diary other than the particular page to which the witness was referring.

The rule states that if it is claimed that the writing contains material not related to the subject of the testimony, the court shall examine the writing *in camera* and excise any unrelated portions. However, if a judge has read a diary or other significant document, he or she may be influenced by that writing, no matter what is formerly excised.

Counsel should also use this rule during the course of any deposition testimony. Ask the witness at the outset of their deposition what document they reviewed in advance of their testimony, and then compel the production of those documents.

**RULE 613 — EXAMINING PRIOR STATEMENTS OF WITNESSES**

Rule 613 provides:

> (a) Examining witness concerning prior statement. In examining a witness concerning a prior statement made by the witness, whether written or not, the statement *need not be shown or its contents disclosed to the witness at that time.* Upon request the statement shall be shown or disclosed to opposing counsel. (Emphasis added).
>
> (b) Extrinsic evidence of prior inconsistent statement of witness. Extrinsic evidence of a prior inconsistent statement made by a witness may in the judge's discretion be excluded unless the witness is afforded an opportunity to explain or deny the statement and the opposing party is afforded an opportunity to interrogate on the statement, or the interests of justice otherwise require. This rule does not apply to admissions of a party opponent as defined in Rule 803(b).

In *State v. Baluch*,[60] the New Jersey Superior Court examined the admissibility of prior inconsistent statement. In *Baluch*, defendant Marcelina Baluch and her husband, Ejaz Baluch, were co-indicted for the murder of their nanny.[61] Due to *differently admissible* proofs, they were tried separately.[62] During Ejaz's trial, he testified that he told a friend that his wife, Marcelina, had beaten the nanny on the day of her death, causing her to fall down the stairs and subsequently pass away.[63] Ejaz further testified that, against his own wishes to notify the authorities, the Baluchs agreed to dispose of the body because Marcelina had "cried and begged him not to call the police."[64] Ejaz successfully shifted the blame for the nanny's death to Marcelina, and was acquitted of all homicide charges.[65] Following Ejaz's trial, his factual contention changed, and he joined in Marcelina's defense.[66] During Marcelina's trial, Ejaz testified that it was entirely his idea to dispose of the nanny's body, and he claimed to have lied about his wife's involvement.[67] He further testified that his previous testimony during his own trial regarding the statements he made to a friend were not true.[68] Marcelina attempted to exclude Ejaz's prior inconsistent statements to his then proffered statement. The court disagreed, and held that the statement was admissible.

Section (a) of the rule is often overlooked, if not misapplied by both counsel and the court. It is almost knee-jerk that when a witness is questioned on cross-examination about a prior document or statement, the witness's counsel will immediately interject an objection asking the court to require that the questioner show the witness a copy of the document. However, to be required to do so may often eliminate the purpose and/or effectiveness of the cross-examination, and is in direct contradiction to the rule which specifically provides that the prior statement "need not be shown or its contents disclosed to the witness at that time [i.e. the time of questioning]." The rule does provide that upon request of opposing counsel, the document should be shown *to him or her*. Care must then be taken by the examining counsel to be sure that opposing counsel does not undermine provisions of the rule or the effectiveness of the cross-examination by relaying the contents in a speaking objection, which alerts the witness to the crux of the cross-examination.

**RULE 614 — CALLING AND INTERROGATION OF WITNESSES BY A JUDGE**

This rule provides that the judge, subject to the right of the party to make timely objection, may call or interrogate any witness. Generally, counsel should never object to a judge calling or interrogating a witness at the time of matrimonial actions unless they are intent upon appealing the case. This rule also provides the authority for the court to appoint *and call as their own witness* independent experts.[69] In *Fellerman*, the court noted that the use of the court-appointed expert witness not only minimized the litigants' costs, thus preserving the marital estate, but also increased the likelihood of a negotiated settlement and reduced trial time.[70] However, the court's power to appoint or call its own expert witnesses does not preclude each party from retaining his or her own experts, as parties to matrimonial actions often do.[71]

**RULE 701 — OPINION TESTIMONY OF LAY WITNESSES**

This rule provides:

> If a witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences, may be admitted if it (a) is rationally based on the perception of the witness and (b) will assist in the understanding of the witness' testimony or in determining a fact in issue.

This rule may be pertinent to a custody matter.

For example, a neighbor, friend or relative may discuss their *opinion* of the parenting ability of a litigant. Opposing counsel may stand and object, indicating that this *fact witness* is voicing an opinion. Counsel who has originally questioned the witness need only lay a foundation that the testimony is rationally based on the perception of a witness. In other words — Was the grandmother a mother herself? Is the neighbor a mother herself? How much time has the witness spent with either party?

**RULE 704 — OPINION ON ULTIMATE ISSUE**

This rule provides "testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact." During the course of trial, objections are often raised on this issue. However, any such objections are contrary to the plain language of the rule. The real issue is that although an expert may voice an opinion regarding the ultimate issue, how can counsel maximize the probative value of that opinion?

The obvious answer is to lay a detailed and solid foundation for the opinion.

Generally speaking, the more solid the foundation, the more likely the court may accept the opinion.

**RULE 1006 — SUMMARIES**

This rule may be the family trial lawyers best friend.

Rule 1006, reads, in pertinent part, that:

> The contents of voluminous writings or photographs which cannot conveniently be examined in Court may be presented by a qualified witness in the form of a chart, summary, or a calculation. The originals or duplicates shall be made available for examination or copying or both by other parties at a reasonable time and place. The Judge may order that they be produced in Court.

The authors suggest that these charts and records be produced to opposing counsel in advance of trial, so their feet stomping is kept to a minimum.

However, the use of charts to outline or summarize a series of financial transactions, trace a series of deposits and withdrawals or trace premarital, gifted or inherited funds is a persuasive and effective means of presenting such testimony.

For counsel to think that any judge can follow or track complex financial transactions without a road map is foolish and ineffective.

Charts and summaries should be

used in all but the simplest cases, and, unlike mere easel notes made while a witness is testifying, are admissible into evidence.

Several weeks after the testimony, as the court is writing its decision, it is a virtual certainty that he or she will refer to the chart, and in all probability use it as an outline for his or her findings.

**CONCLUSION**

The Rules of Evidence are not designed to be tricks or traps for the unwitting trial attorney.

The rules have evolved over decades of experience, and are designed to insure that the decisions of fact finders (whether they be judges sitting without a jury or juries) be premised upon competent evidence which is properly subject to question and cross-examination by the opposing parties.

As practitioners and judges who practice and preside in trials without a jury, we are all often tempted to even admit the dirty socks into evidence under the guise that "there is no jury here and I [the trial judge] can determine the weight to be given to such evidence."

It is respectfully submitted that in full deference to the good intentions and competency of our family court trial judges, it is very difficult to unspill the milk. Once incompetent evidence, or evidence which is not appropriately subject to proper cross-examination, is admitted, even the most competent and experienced of our family court judges can't help but be affected to some extent by having heard or seen such evidence.

Practitioners and judges alike will better serve the system and our clients by increasing our knowledge of the Rules of Evidence and competently applying them in every family court proceeding. ■

**ENDNOTES**

1. *Horswell v. Horswell,* 297 N.J. Super. 94, 101-102 (App. Div. 1997).
2. *Id.* at 98.
3. *Id.* at 99.
4. *Id.*
5. *Id.* at 100.
6. *Id.* at 102-103.
7. *State v. Interest of L.L.,* 265 N.J. Super. 68, 81-82 (App. Div. 1993).
8. *Id.* at 72.
9. *Id.* at 73.
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.* at 81.
16. *Id.*
17. *See, e.g., Cargulia v. Cargulia,* 309 N.J. Super. 649 (Ch. Div. 1996).
18. *Id.* at 653.
19. *Id.*
20. *Id.* at 653-54.
21. *Id.*
22. *Id.* at 655, 662.
23. 150 N.J. 276 (1997).
24. *Id.* at 291.
25. *Id.*
26. *Id.*
27. *Id.* at 292.
28. *Id.* at 291.
29. *Id.*
30. *Kinsella,* 150 N.J. at 297.
31. *Id.* at 302-304.
32. *Runyon v. Smith,* 322 N.J. Super. 236, 245 (App. Div. 1999) (*citing Kinsella,* 150 N.J. at 328).
33. *Kinsella,* 150 N.J. at 328.
34. *Runyon,* 332 N.J. Super. at 244 (*citing Kinsella,* 150 N.J. at 328); *see e.g., State v. Shell,* 314 N.J. Super. 331 (App. Div. 1998) (general provisions of psychologist- patient privilege must yield to statute requiring persons to report evidence of child abuse to DYFS).
35. *See Wichansky v. Wichansky,* 126 N.J. Super. 156 (Ch. Div. 1973).
36. *Id.* at 158.
37. *Id.*
38. *Id.*
39. *Id.* at 224.
40. *Id.*
41. *Id.* at 156.
42. *Id.* at 160.
43. 129 N.J. Super. 291 (App. Div. 1974).
44. *Id.* at 295.
45. 150 N.J. 276, 305 (1997).
46. *M. v. K.,* 186 N.J. Super. 363 (Ch. Div. 1982).
47. *Id.* at 366.
48. *Id.* at 368.
49. *Id.* at 371.
50. *Id.*
51. 124 N.J. Super. 535, 540 (Ch. Div. 1973).
52. *Id.*
53. *M. v. K.,* 186 N.J. Super. at 374.
54. 140 N.J. Super. 544 (Ch. Div. 1976).
55. *Id.* at 551.
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.* at 561.
60. 341 N.J. Super. 141 (App. Div. 2001).
61. *Id.* at 152.
62. *Id.*
63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.* at 153.
67. *Id.*
68. *Id.*
69. *See, Alk Assoc. v. Multimodal App. Sys.,* 276 N.J. Super. 310 (App. Div. 1994) (wherein court cited N.J.R.E. 614 as authority for trial judge's power to appoint an independent expert witness); *Fellerman v. Bradley,* 191 N.J. Super. 73 (Ch. Div.), *aff'd* 192 N.J. Super. 556 (App. Div. 1983), *aff'd* 99 N.J. 493(1985) (wherein court commended the use of court-appointed expert accountant to determine value of assets available for equitable distribution in matrimonial action).
70. *Fellerman,* 191 N.J. Super. at 77-78. *See also Marxe v. Marxe,* 223 N.J. Super. 247, 249 (Ch. Div. 1989); *Staver v. Staver,* 217 N.J. Super. 541, 547 (Ch. Div. 1987).
71. *See, e.g., Prol v. Prol,* 226 N.J. Super. 394, 396-97 (Ch. Div. 1988).

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# Taxability of Unallocated Support Payments Made in a Divorce Proceeding and Determining Which Spouse is Entitled to the Dependency Exemptions for the Children

*by Scott A. Maier and Stephen Haller*

Proper tax planning must be an essential part of any divorce proceeding. The divorcing couple and their attorneys must consider the taxability of payments made during and after the pendency of the action. This article will explore two areas of matrimonial litigation:

1. When and to what extent are support payments treated as alimony (*i.e.* deductible by the payor spouse and taxable to the payee spouse) when these payments are not specifically called alimony or child support by the court, consent order or other written agreement by the parties?
2. Which party can take the dependency exemption for each child of the marriage in the absence of written agreement by the parties as to this issue?

#### TAXABILITY OF UNALLOCATED SUPPORT

There are three types of payments or transfers of property (including cash) typically made in the context of the matrimonial litigation — alimony, child support and payments for or in advance of equitable distribution. We will concentrate on the first two categories (*i.e.* payments for support) in this discussion.

Alimony and child support may be paid during and after the divorce proceedings pursuant to court order or agreement between the parties. Alimony is taxable to the receiving spouse and deductible by the paying spouse. Child support payments (and equitable distribution) are, for the most part, non-taxable events. The issue of taxability arises most often in the context of payments not allocated between alimony and child support.

The taxability of payments from one spouse to the other is governed by Section 71 of the Internal Revenue Code (IRC), although other sections of the IRC, such as 215 (which allows for the deduction to the paying spouse) are applicable in divorce actions. According to Section 71(b)(1), payments from one spouse to the other are alimony if:

1. The payment is in cash;
2. The payment is made pursuant to a written divorce or separation instrument;
3. The instrument does not designate such payment as not being alimony for tax purposes;
4. After the divorce is final, the paying and receiving former spouses may not be members of the same household;
5. The obligation to make the payment does not survive the receiving spouses' death;
6. Payments to third parties made on behalf of the receiving spouse must be evidence writing.

The above criteria for determining whether spousal payments are alimony became effective in 1985. Prior to 1985, payments were required to be periodic and made in discharge of a support obligation. Also, payments would not be considered child support payments unless the parties specifically fixed them as child support payments in a written instrument.

The 1985 amendments to Section 71 were designed to remove this form over substance requirement by allowing for the characterization of payments as child support payments under certain circumstances, even if they are stated to be alimony payments. Thus, the current standards focus more on the substance of the written instrument than on the form.

The issue of whether a payment is taxable alimony or non-taxable child support arises most often in cases where the payments between spouses are unallocated in the instrument which fixes them. This typically occurs in *pendente lite* orders. These orders, as the name implies, are issued during the divorce proceedings, and are intended to maintain a certain level of support until the divorce is final. In these circumstances, the factor that is most often determinative of whether a payment is alimony or child support is the survival of the obligation to make the payment beyond the death of the receiving spouse. As stated above, in order for a payment to be considered alimony the obligation to make the payment must cease upon the death of the receiving spouse.

In instances where there are unallocated payments, federal courts will often look to state law to determine whether the obligation to make the payment must cease upon the death of the receiving spouse. This occurred in *Gonzales v. Commissioner of Internal Revenue*.[1] In this case, the paying spouse had claimed payments required by a *pendente lite* order as deductible alimony. The IRS then determined that the receiving spouse should have included the payments as income.

The receiving spouse argued before the tax court that since New Jersey law would have required the payments to continue past the death of the receiving spouse, the payments consisted entirely of non-taxable child support.

The court agreed with the receiving spouse, and held that the payments were child support payments, and therefore were not taxable. The court's ruling relied primarily on two factors — the paying spouse's parental duty to support the children should the receiving spouse pass away and the temporary nature of the written instrument which established the obligation to make the payments in question. According to the court, the terminating event of the *pendente lite* payments would be the issuance of the final divorce decree; therefore, the payments would continue past the death of the receiving spouse. The court relied upon the IRS regulations issued in conjunction with Section 71, which provide that if even only one payment is made after the death of the receiving spouse, then none of the related payments made before the death can be considered alimony.

Under the IRC, the death of the paying spouse is irrelevant to the determination of whether spousal payments are deductible alimony. The written instrument establishing the obligation to make the spousal payments should specify if the paying spouse's estate would be responsible for the continuation of the payments. If the only heirs to the paying spouse were the children from the terminated marriage, it would basically be difference without distinction. However, if the paying spouse has remarried and has additional children, the children from the first marriage should be protected in case of the death of their parent. This end can also be accomplished with the provision for life insurance.

Although the obligation to make payments beyond the death of the receiving spouse is at the center of most of the disagreements between the IRS and taxpayers, other issues do arise. For example, in order for spousal payments to be considered alimony the obligation must be contained in a written instrument. This instrument is most often a *pendente lite* order or a final divorce decree. However, this requirement can be satisfied by a separation agreement entered into between the parties. If a separation agreement is in fact signed, the parties are not even required to have engaged in formal divorce proceedings. In some cases correspondence between the spouses and/or their attorneys can satisfy this requirement. Of course, this is fact sensitive. Correspondence that merely proposes settlement terms or correspondence containing offers will not be considered to have satisfied the written instrument requirement. A clear intention of the parties that the correspondence contains an agreed upon payment obligation must be present.

One of the major changes imposed by the 1984 amendments to Section 71 was the requirement that payments must be in cash or cash equivalents to be considered alimony. Prior to this amendment transfers in the form of personal property (non-cash) and real property could possibly have been considered alimony.

Payments made to third parties can still be considered alimony if they are made on behalf of the receiving spouse. The payments must be evidenced in writing. Also, the receiving spouse must have requested or consented to the payment. Examples of these kinds of payments are mortgage payments and payments to creditors, such as credit card companies. Insurance payments can also be considered alimony. Essentially, the IRC treats these payments as if they were made to the receiving spouse and then the receiving spouse made the payments to the third party. Once again, this is an example of the 1984 amendments emphasizing substance over form.

The paying spouse and the receiving spouse can choose to designate certain payments as non-taxable alimony. This is normally done for tax planning purposes. The designation must be in writing. The ability to designate the form of the payment is not a two-way street. The spouses cannot simply designate a payment as alimony. Only payments that satisfy the requirements of Section 71 are considered alimony.

In addition to the requirements regarding alimony set forth above, Section 71 also provides the standards for determining whether payments are child support. Payments will be considered child support and not alimony if the payments are:

1. Identified in a written instrument as child support;
2. Deemed to be child support;
3. Terminated on the happening of a contingency related to the child;

4. Linked to a contingency related to a child.

One requirement that is not articulated in Section 71, but nevertheless exists, is the requirement that the child who is the subject of the payment be the child of the paying spouse.

Payments tied to child-related contingencies are usually obvious. Payments that stop when a child reaches the age of 18 or 21 are clearly child support. Similarly, payments that cease when a child leaves the house or is married are child support. If the payments are terminated or reduced around the time of a specific child-related event, they will be considered child support even if the specific event is not stated. For example, assume that a divorce settlement agreement provides that $500 of the monthly payments will end on August 31, 2003, and further assume that one of the children reaches the age of 18 on August 20, 2003, then the payment will be considered child support. Also, if the amount of payments are reduced more than once and the reductions occur near a specific, similar date for all of the children, then the payments will be considered child support.

The child support standards have made it more difficult for divorcing spouses to cloak child support payments as alimony. This presents practitioners with some complications on tax planning for divorcing clients. There are still ways to ensure that payments for the support of children are treated as alimony (and thus deductible for the paying spouse).

Two primary examples are alimony trusts and qualified domestic relations orders (QDROs). These are complex tools, and beyond the scope of this article. It is critical for someone entering in the divorce process to obtain competent legal and accounting advice in order that his or her concerns receive proper attention.

## DEPENDENCY EXEMPTIONS

One other issue which we briefly discuss here is related to the alimony/child support determination. The dependency exemptions for the children obviously give the spouse who receives the exemption additional reductions in taxable income, and therefore income tax liabilities are reduced. The perceived benefit, in our view, is many times greater than the actual financial one, after considering the cost to obtain the exemption. The actual exemption is $3,000 per dependent in 2002. It is our practical experience that these exemptions are bargaining chips used late in the settlement game or an afterthought in a trial.

Theoretically, a taxpayer is required to provide over 50 percent of the support for a child to claim that child as a dependent. In order for a divorcing/divorced parent to claim a child as a dependent, the parent must meet the standards set in IRC Section 152(e). Although this section applies to children of divorced or separated parents, the standards enunciated in the earlier portions of Section 152 still apply.

Section 152(e) provides that the custodial parent will have the right to claim the child as a dependent if:

1. The child receives more than 50 percent of his or her support from both parents.
2. The child is in the custody of one or both of the parents for more than 50 percent of the year.
3. The parents are divorced pursuant to a divorce decree or are separated pursuant to a written separation agreement.
4. The parents are living apart from each other for at least six months of the calendar year.

The custodial parent, as determined in accordance with the IRC, can agree to allow the non-custodial parent to utilize the dependency exemption. The parents must file Form 8332 with their respective 1040 forms to accomplish this.

As a practical matter, this option should always be considered for the following reason. In many cases, especially where the adjusted gross income (AGI) of one or the other spouse is significant, that spouse may lose the benefit of the exemption due to the phase out provisions of the IRC. The IRC sets forth a schedule for the loss of this exemption for individuals with AGIs over (approximately) $200,000 for married persons filing jointly, $166,000 for heads of household, $133,000 for individuals filing single, or $100,000 for married people filing individually (*i.e.* the threshold amounts). Therefore, for these individuals consideration should be given to allowing the other spouse to claim the exemption to reduce the overall tax burden for the parents. This may also be a *free* concession which can be used to gain trust between warring litigants.

## CONCLUSION

This article has highlighted some of the intricacies involved in tax planning during divorce proceedings. Too often, tax issues are among the last items considered in a divorce case. Issues such as the amount of the support payments, which parent will get custody of the children and how marital property will be equitably distributed are complicated and sometimes obscure the underlying tax issues.

It is imperative that attorneys and accountants be engaged so that proper tax planning for their divorcing clients can be accomplished. ■

## ENDNOTE

1. T.C. Memo 1999-332, 78 TCM 527.

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# The Imputation of Income to Assets Distributed in Divorce: *Miller v. Miller* — Then and Now

*by Charles F. Vuotto Jr. and Lee Ann McCabe*

The imputation of income has been an integral part of our jurisprudence for many years. Income is routinely imputed to an underemployed or unemployed spouse. This is done regardless of whether that spouse is the supporting or the supported spouse, and in the context of both alimony and child support. Although the Supreme Court's decision in *Miller v. Miller*[1] was the first in New Jersey to unanimously hold that a reasonable rate of return,[2] different from the actual rate of return, can be imputed to a payor's investment assets, the concept of imputing income was not new to the courts. This requirement is now codified within N.J.S.A. 2A:34-23 (b)(11),[3] which provides that "the income available to either party through investment of any assets held by that party" is to be considered in the alimony calculus.

The conclusion reached from review of the statutory and case authority is that when fixing alimony and child support incident to divorce, income should be imputed when asset-based capital is underutilized. Specifically, a spouse cannot insulate his or her assets from a support calculation by investing them in a non-income producing manner inconsistent with the marital lifestyle.

In *Aronson v. Aronson*,[4] the court made it clear that interest income from an inheritance could be considered in the alimony calculation. The court's subsequent decision in *Stifler v. Stifler*[5] went further. That decision held that interest income could be imputed to an asset inherited by the supporting spouse, which had been converted into a non-income bearing asset, at a level that could have been realized had the funds been invested differently. The court reasoned that if this were not the case, supporting spouses would have a "perfect blueprint" for evading the clear intent of *Aronson*. Our appellate court, in *Connell v. Connell*,[6] adopted the reasoning of *Aronson* and *Stifler* in the context of a child support calculation.

In *Miller* the Supreme Court expanded the concept of imputing income to assets to permit the imputation of a "reasonable rate of return" in excess of the actual return. In his written opinion, Justice James H. Coleman stated:

> [G]iven that both income earned through employment and investment income may be considered in a court's calculation of an alimony award, it follows that there is no functional difference between imputing income to the supporting spouse earned from employment versus that earned from investment.[7]

The essence of the opinion was that it was fair to impute additional income to Mr. Miller under the facts of that case.

#### THE FACTS IN *MILLER*

The parties were divorced in 1988, after a 21-year marriage. When the complaint for divorce was filed in early 1987, Mr. Miller was employed by Merrill Lynch, as manager of municipal markets. Mr. Miller received a base salary of $150,000, and was entitled to an annual bonus based on his performance, as well as the overall performance of the company. In 1987, Mr. Miller's bonus peaked at $1.1 million. Mr. Miller's compensation package also included an unspecified amount of Merrill Lynch restricted stock. In comparison, Mrs. Miller had been a homemaker throughout the marriage, and had raised the parties' two children.

The parties entered into a property settlement agreement which provided for the payment of alimony to Mrs. Miller in an amount equal to 50 percent of Mr. Miller's monthly net income from his employment (which at that time entitled her to $3,750 per month) and 50 percent of the first $300,000 of Mr. Miller's bonus, with an annual cap of $200,000. Mrs. Miller waived any interest in 10,000 shares of restricted stock that Mr. Miller had received for work performed in 1987, as well as an interest in any additional shares he might receive thereafter. The marital estate was distributed equally, with each party receiving approximately $1 million in equitable distribution.

For the years 1988, 1989, 1991 and 1992,[8] Mr. Miller had earned income and paid alimony as follows:

| | HUSBAND'S INCOME | WIFE'S ALIMONY |
|---|---|---|
| 1988 | $859,354 | $194,493 |
| 1989 | 1,323,838 | 193,700 |
| 1991 | 1,974,310 | 203,307 [9] |
| 1992 | 5,684,004 [10] | 199,277 |

In late 1991, Mr. Miller became ill, and in early 1992 took a new and less stressful position with Merrill Lynch. He received the same salary and believed that he was still entitled to a bonus. Contrary to his expectations, he did not receive any additional bonus income. He received his last paycheck in May 1994, and later that year filed a complaint with the Equal Employment Opportunity Commission (EEOC), charging Merrill Lynch with discrimination against him based on age, disability and retaliation. Mr. Miller was terminated in January 1995.

Commencing in 1993, Mr. Miller fell behind in his payment of alimony. As a result, Mrs. Miller filed an application with the Court seeking, among other things, to compel Mr. Miller to pay the agreed upon alimony.[11] After the exchange of limited discovery as to Mr. Miller's income, the trial court held a *Lepis*[12] hearing to determine whether or not Mr. Miller's circumstances had changed so substantially that he was entitled to a modification of his alimony obligation. The trial court held that Mr. Miller had experienced "a substantial change in circumstances which was not temporary in nature."[13] The Court further found that Mr. Miller had a net worth of $6,561,644, of which $4.5 million was liquid. Of that, he had $1.5 million invested in municipal bonds, which yielded tax-free income of $87,500 per year, and the remaining $3 million invested in growth stocks, which paid approximately $50,000 per year in interest and dividends. The Court also imputed $100,000 of income to Mr. Miller that he could have otherwise earned through self-employment, consulting or other employment.

In contrast, Mrs. Miller was found to have earned $40,000 in 1994. Her assets, worth approximately $1,162,000 included a home worth $425,000, a small IRA and an investment account worth approximately $700,000. Her annual budget of $173,216 was found to be inflated and unreasonable. The trial court found that, based upon Mr. Miller's changed circumstances, neither party would be able to maintain the marital standard of living. The court set Mr. Miller's alimony obligation at $48,000, compared to the agreed upon formula which had a maximum cap of $200,000. The Appellate Division affirmed the trial court's entire decision. In her argument to the Supreme Court, Mrs. Miller asserted that the trial court failed to identify and consider all of Mr. Miller's passive income in determining an amount of alimony, including income earned from his substantial investment portfolio. She argued that given his extensive experience as a knowledgeable and successful investor, his investments could earn substantially more than the figure accepted by the trial court. In response, Mr. Miller argued that the computation of a potential yield on his investments was "an overly complicated task that the courts should not undertake."[14] The Court rejected Mr. Miller's argument, stating that the "mere difficulty in determining the quantum of value of a party's claim is no reason to bar that claim if it is otherwise established."[15]

Although the Court acknowledged that there was additional work that would have to be done by the bench and bar in order to fine tune the complex task of imputing income to more sophisticated investments, "justice cannot 'sit … by and be flaunted in case after case before a remedy is available.'"[16]

In considering whether or not Mr. Miller was entitled to a modification of his alimony obligation, the Court restated the fundamental standard as follows:

> When the support of an economically dependent spouse is at issue, the general considerations are the dependent spouse's needs, that spouse's ability to contribute to the fulfillment of those needs, and the supporting spouse's ability to maintain the dependent spouse at the former standard.[17] Although the supporting spouse's ability to pay, based upon his earned income through employment, is the central issue in a modification application, it is not the singular measure of the ability to pay inquiry.
>
> Real property, *capital assets, investment portfolio,* and capacity to earn by 'diligent attention to … business' are all appropriate factors for a court to consider in the determination of alimony modification. (Emphasis added)[18]

Mrs. Miller asserted that the Court should adopt a different definition of income. She suggested that "potential yet unrealized, income from plaintiff's investments should be imputed to plaintiff in much the same way as income earned through employment is imputed to an unemployed or underemployed supporting spouse."[19] In reviewing our jurisprudence, the Court reiterated the well-settled principles that:

- A supporting spouse's assets can be considered in calculating an alimony award;
- Income derived from assets that are otherwise excludable from equitable distribution may be considered in the calculation; and
- A supporting spouse cannot insulate his or her assets from an alimony calculation by investing them in a non-income producing manner.

The Court concluded that there was no functional difference between imputing income to the supporting spouse from employment versus that earned from investments. In both instances, the supporting spouse is required to appropriately utilize his or her human capital in the form of employment or his or her investment capital or risk the imputation of income.[20] The Court noted that the trial court imputed $100,000 of income to Mr. Miller even though he was not working. In expanding that rationale and applying the same principles, the Court held that Mr. Miller could invest his substantial capital assets to yield more than the 1.6 percent that they were then earning. Requiring him to do so did not mean that he would be required to deplete his principal, but rather meant only that he could invest differently to realize a higher yield in the same manner that an underemployed spouse could obtain a higher paying position to make more productive use of his or her human capital.

Finally, the Court had to determine the appropriate rate of return to be imputed. The Court chose a variable rate "because it is more equitable in that it accommodates market fluctuation."[21] The Court concluded that "under the present circumstances" the most equitable solution for imputation of income to Mr. Miller's investments was to utilize the long-term corporate bond rate based upon Moody's composite index on A-rated corporate bonds.[22] This method, the Court held, would provide a "prudent balance between investment risk and investment return."

The Court made it clear that Mr. Miller did not have to actually invest his entire portfolio in long-term corporate bonds. Rather, he was free to diversify and invest his assets, as he deemed appropriate. The Court's decision required only that no matter how Mr. Miller chose to invest his assets, reasonable income would be imputed for purposes of the alimony calculus.

On remand, the trial court was directed to consider the imputed investment income in the same manner that it imputed and considered income from salary and bonus in its alimony recalculation. Assuming that Mr. Miller was imputed income from earnings of $100,000 and income from his $4.5 million liquid investment portfolio of $346,500 ($4.5 million x 7.7 percent), his after tax income would be about $254,505 (assuming a 43 percent federal/state-blended tax rate). Based on the parties' agreement, Mrs. Miller was entitled to 50 percent of this, with a cap of $200,000. Therefore, she should have received an award of approximately $127,253.

Prior to making a determination on the remand, the trial court requested clarification from the Supreme Court. Judge Whitken submitted three questions to the Supreme Court, requesting a response. Those questions were as follows:

1. Is the court at the remand hearing to merely recalculate the plaintiff's income by using 7.7 percent, which is the average rate on Moody's composite index on A-rated corporate bonds, as to the $3 million stocks owned by the plaintiff and then determine what alimony amount should have been set at the time of the plenary hearing conducted before me in 1995?
2. Rather than proceeding on the above, should the court order additional discovery, including case information statements of the parties, and make a determination as to the present needs of the defendant and establish an alimony figure as of the date of a new plenary hearing utilizing 7.7 percent as the rate of income on the present value of plaintiff's stocks?
3. In either of the above situations, am I also to attribute a 7.7 percent rate of return on the defendant's invested assets?

The Supreme Court responded by way of a letter issued by Stephen Townsend, clerk of the Supreme Court, amending the final paragraph of its prior opinion to read as follows:

> We hold that the parties' original property settlement agreement should not be reformed based upon [the wife's] allegation of unconscionability. We also hold that *annual* income should be imputed from *all of* [the] plaintiff's investments based upon the average *preceding* five-year historical rate of return on A-rated long-term corporate bonds. Consequently, the decision of the Appellate Division is modified and affirmed. We remand the matter to the Family Part for further proceedings consistent with this opinion.

The remand brought an interesting new twist to an already captivating case. An application to intervene was made on behalf of Mr. Miller's present wife, Mrs. Nolan Miller, whom he married on February 14, 1990. That application was denied. The trial court held that Mr. Miller's present wife's interests would be "amply and adequately protected by [the plaintiff]." Following the remand, Judge Whitken issued a letter in May 2000 which provided, *inter alia*, that the "only interpretation" he could derive from the Supreme Court's response to the three questions he submitted to the Court for clarification was:

> Each year a determination must be made as to what all of [the husband's] investments are and then impute income based upon the preceding five-year historical rate of return on A-rate Long-Term Corporate Bonds. It certainly appears that not only is the 7.7% figure to be applied to the $3 million worth of [husband's] assets as they were at the time of this Court's hearing, but 7.7% is also to be imputed to the $1.5 million invested by [the husband] in municipal bonds.

The judge proceeded to recalculate the plaintiff's income by imputing a 7.7 percent return to his $4.5 million worth of assets. The Court further proceeded to "set alimony based upon all of the considerations set forth in the statute, which findings have already been made by the Court in its written opinion which findings were not in any way reversed by the Supreme Court." With that in mind, Judge Whitken determined that it was not necessary to hold another plenary hearing. He did hold, however, that a "recalculation of the parties' income [would] be required each year [to see] if there is a substantial change in those figures," which might warrant further modification of the husband's alimony obligation.

Again utilizing the 7.7 percent average rate of return on corporate bonds as identified by the Supreme Court, Judge Whitken then calculated that the plaintiff's total imputed income from all of his investments was $346,500, which was then added to the $100,000 of earned income he had previously imputed to the husband in his 1995 opinion. Therefore, the plaintiff's total imputed income was $446,500. Similarly, by applying the 7.7 percent figure to the defendant's investments, the judge calculated that the defendant had $55,733 in imputed investment income, which was added to her $40,000 salary[23] for total income of $95,733.

Judge Whitken went further and reviewed the parties' marital standard of living and the expenses claimed by the defendant in her case information statement. He then noted the differences in the income imputed to or earned by each, and determined that the plaintiff's alimony obligation should be $100,000 per year.[24]

The Court issued a supplemental letter opinion on June 12, 2002, directing that the parties' income be recalculated each year following 1995 (the date of the original hearing) to determine if a further modification of the husband's alimony obligation was appropriate. On August 1, 2002, the judge's order was memorialized in a written order.

On September 11, 2000, the trial judge issued another order and letter in which he indicated that, in lieu of a plenary hearing each year to determine if changed circumstances had occurred to such a degree that would warrant further modification in the plaintiff's obligation to pay alimony, the parties would only be required to submit their tax forms. If the returns indicated a substantial change in their respective financial conditions, either party could seek a modification with regard to the alimony amount.

Both parties appealed, as did Mrs. Nolan-Miller. Mr. Miller's present wife appealed, *inter alia*, on the issue that she should have been allowed to intervene in order to protect her interest in the marital assets on which the Court imputed income.

On the second appeal, the Appellate Division addressed the numerous issues raised by the parties, as well as by Mrs. Nolan-Miller. First, the Court found that the trial judge should not have expanded his consideration of the alimony issue to include an evaluation of Mrs. Miller's actual earned income and imputed investment income in setting Mr. Miller's alimony obligation. Judge Whitken was found to have erred in failing to set the husband's alimony obligation strictly in accordance with the formula set forth in the parties' property settlement agreement.

The court relied heavily on the exact language used by the Supreme Court. They pointed out that the critical issue that was examined by the Supreme Court was "whether income should be imputed *from a supporting spouse's* investments for the purpose of determining his or her ability to pay alimony *pursuant to an agreement*."[25]

The Appellate Division found the statement firmly and clearly revealed that the Supreme Court viewed the matter as urged by the wife, specifically, that Mr. Miller's imputed investment income should simply be utilized in the formula set forth in their negotiated property settlement agreement in order to determine his alimony obligation. The appellate court cited various other language in the Supreme Court decision which, they believed, made it clear that investment income was not to be imputed to Mrs. Miller.

The most significant indication that the Supreme Court intended for the trial court to use the formula set forth in the agreement in recalculating Mr. Miller's alimony obligation was their statement that "[u]nder our holding, the trial court must consider the imputed investment income in the same way as income from salary and bonuses earned from employment in determining how much alimony *is due and owing under the agreement. The $200,000 cap on alimony remains valid and enforceable*."[26] The appellate court concluded that "the Supreme Court intended that the Family Part judge mechanically recalculate [the] plaintiff's alimony obligation under the agreement by using his imputed earned income and his imputed investment income with the $200,000 cap remaining in place."

The authors believe that this opinion must be read in context. In other words, the Supreme Court's decision in *Miller* suggests, in any way, that absent a specific agreement, which excludes the payee's income or some portion of it from the alimony calculus, that the rule, espoused in *Miller*, would and should not apply to both the payor and payee.

Another relevant issue addressed by the appellate court was Mr. Miller's argument that Judge Whitken erred in failing to exclude 50 percent of his assets when imputing income to his investment assets in light of the fact that they were jointly held with his present wife, Mrs. Nolan-Miller. Mrs. Miller opposed that argument and asserted that the *law of the case* doctrine precluded Mr. Miller from raising that issue for the first time at that stage of the litigation.

The court concluded that Mr. Miller should be barred from raising his current wife's "alleged interest" in the assets at this juncture of the case. The court reached the conclusion:

> in light of the findings by the Family Part judge, this Court, and the Supreme Court, regarding the size and ownership of husband's financial investments, the reliance on those findings by the three courts in issuing their decisions, and the opportunity plaintiff had to litigate the issue earlier. The plaintiff had never challenged Judge Whitken's findings that he had financial assets worth $6 million, though he was now claiming that many of those assets were jointly owned with his current wife.

Likewise, the Appellate Division found that Mr. Miller failed to raise the issue on the initial appeal and on appeal to the Supreme Court, even though the critical issue raised there was clearly framed as "whether income should be imputed from a supporting spouse's investments for the purpose of determining his or her ability to pay alimony pursuant to an agreement."[27]

Lastly, with regard to Mrs. Nolan-Miller's argument that the trial court erred in failing to grant her request to intervene, the court concluded that her application was not timely made. The Appellate Division agreed with the trial court that any interest Mrs. Nolan-Miller had in the matter was amply protected by her husband's participation in the case. The matter was again remanded to the trial court for further proceedings, consistent with this most recent decision.

Given the questions raised by the initial *Miller* decision, and the issues that have arisen since as a result of the appeals, it is likely that the Supreme Court has not seen the last of the Millers. A petition for certification has been filed.

**IMPUTATION OF INCOME TO ASSETS BEFORE *MILLER***

Courts in other jurisdictions have applied the principles enunciated by our Supreme Court in *Miller* for years in both the contexts of child support and alimony. For example, in *Kay v. Kay*,[28] the Court held that the payor's capital and other assets could be used to pay alimony and child support, and would not be exempt because he knowingly maintained them in a form that limited the amount of income they produced. The Court of Appeals of Indiana, in *Gardner v. Yrttima*,[29] relied upon the decisions of sister states, including the New Jersey decision in *Connell*, *supra,* holding that interest, dividends and other return on investments from inherited assets of the payor, therein the mother, was income for purposes of calculating child support. That court further held that if the inherited assets were invested in such a way that they failed to produce income, the court could consider whether it was equitable and appropriate, in a particular case, to impute income to those assets.[30]

The California Court of Appeals held that the imputation of income to investments was appropriate in the context of a child support calculation, even where the payor's assets had historically been non-income producing. The court further held that although the history of non-income production was a factor to be considered by the court, it did not prohibit the court from exercising its discretion in imputing income.[31]

A number of states have addressed the issue, as it relates to child support, by including, within their child support guidelines or applicable statutes, a definition of income that specifically provides for the imputation of income to investment assets or other non-income producing assets. For example, New York's Child Support Standards Act[32] grants express discretion to the family court to "attribute or impute income from non-income producing assets to a parent charged with the support of his or her children."[33] In Vermont, child support is based on the parent's gross income. That state's statute defines gross income as the "actual gross income of the parent" including "income from any source, including, but not limited to, … trust income" and further provides that "income at the current rate for long-term United States Treasury Bills[34] shall be imputed to *non-income producing assets* with an aggregate fair market value of $10,000.00 or more."[35]

**THE AFTERMATH – HOW HAS *MILLER* CHANGED THE PRACTICE**

Not including the claims by Mrs. Nolan-Miller, the decision in *Miller* raised many questions for practitioners and judges alike, including, but certainly not limited to, those raised in an intriguing article by John P. Paone Jr., which was published shortly after the *Miller* decision. Mr. Paone raised the following questions:

- Should income imputation of investment assets be applied in all cases, or is this analysis fact/case specific? (The authors propose that it should be applied in all cases where it is equitable to do so. In other words, a reasonable rate of return should be imputed against non-income producing assets, except to the extent non-income producing assets should exist to meet the marital lifestyle. For instance, if the parties lived in a $300,000 home during the marriage and now one spouse uses $600,000 of his or her assets to buy a new home, $300,000 should be imputed with a reasonable rate of return. Also, a threshold amount may be considered, which must exist before imputation is performed. For instance, the Vermont Legislature chose $10,000 in that state's definition of gross income.)
- Does this imputation of income

also apply to the supported spouse's investments? (The authors say yes, except as otherwise specifically agreed by the parties, as in *Miller*.)

- Will the court apply this same bright-line rule to initial alimony awards, or does it apply only in the context of a modification application? (The authors propose, and believe the law now provides, that it should be applied equitably at the time of an initial award and upon review for modification.)
- If child support is also an issue, are two different income figures utilized since the definition of income used in *Miller* is more expansive than that set forth in our Child Support Guidelines?[36] (The authors propose that one standard should be used for each party's income. The *Miller* standard should be used and the Child Support Guidelines appropriately modified.)

The decision in *Miller* has been cited in only a few cases, and even then only with general reference to a change of circumstances application.[37] It was also cited in the recent unpublished case of *William Van Stuck v. Christine H. Van Stuck*,[38] decided by the Appellate Division on March 11, 2002.

In that case, the appellant-husband contended, *inter alia*, that the trial court had failed to apply *Miller* when calculating the parties' respective incomes for alimony purposes, and the cross-appellant wife contended, among other things, that the trial court erred in not imputing income to the husband's real property. The court responded as follows:

With regard to the wife's assertion, the court held that *Miller* did not apply to the husband's real property since the facts in this case were distinguishable from those in *Stifler,* where income-producing assets were used to purchase non-income producing assets. Moreover, the court recognized that the trial court did take into consideration the rental income from the property, as well as the potential sale proceeds from the properties as required by N.J.S.A. 2A:34-23(b)(11).

The appellate court rejected the husband's contention that the trial court should have used a lower rate of return than that which was actually received on his investments for the alimony calculus. The court properly recognized that the trial court was not faced with the problem of imputing income to an investment or asset, which is earning only negligible income as in *Miller*. The husband's portfolio was realizing a healthy rate of return above the 7+ percent suggested in *Miller*.

There is nothing in *Miller* that would require a judge to utilize a lesser rate of return than what was actually earned."[39]

The court in the Connecticut case of *Leidner v. Leidner*[40] cited *Miller* specifically with reference to the imputation of income to an inherited asset. However, that case is neither instructive nor enlightening, as the court merely imputed an interest, at the rate of six percent, to an inheritance that was deposited in a Fleet money market account. This imputation occurred only because the litigant failed to address the issue of what interest rate was being paid, and does not provide any guidance on the complex tasks suggested in *Miller*.

Relying in part on the decision in *Miller*, the Supreme Court of Vermont clarified the definition of gross income for the purpose of calculating child support. The Court held that "income at the current rate for long-term United States Treasury Bills shall be imputed to *non-income producing assets* with an aggregate fair market value of $10,000.00 or more."[41]

## CONCLUSION

Based upon the instruction provided by *Miller*, the matrimonial practitioner is now given at least two guideposts in calculating a reasonable rate of return for investment assets. We propose that the law should clearly require this imputation to apply equally to supporting and supported spouses. The *Miller* guideposts are:

Moody's Composite Index on A-rated Corporate Bonds (now resulting in 7.44 percent);[42] and

Lehmann Brother's Five-Year Average on T-Bonds Index. Since this indicator could not be found for this article, we used the Salomon Smith Barney Term U.S. Treasury Bond Index (now resulting in 6.04 percent).

Other courts have suggested other rates (*e.g., Barrett v. Barrett*, 963 S.W.2d 454 (Mo. Ct. App. 1998) suggesting a five to six percent rate). Another example of other rates is the Vermont statute that requires imputation at the current rate for long-term United States Treasury Bills. This law requires that income shall be "imputed to *non-income producing assets* with an aggregate fair market value of $10,000.00 or more."[43]

There are still other indicators of reasonable rates of return such as the change in the Dow Jones Industrial Average and the change in the Standard and Poor's 500 Index. An advocate could ask a court to consider the average of the four above-referenced indicators, (which is 4.33 percent), for the past five years, as follows:

**Note Problem When Using Historical Indexes:** Beware that the above-stated bond rates may include a combination of dividend plus/minus appreciation or loss of the bond (which doesn't always result in direct income to the bondholder). Therefore, the bond may not actually throw off that much income.[44]

However, whether one follows the strict ruling of *Miller*, an average of various indicators or some other reasonable rate of return dictated by the facts and equity, one thing is very clear — liquid assets (and non-liquid assets which reflect

| | 1998 | 1999 | 2000 | 2001 | 2002* | Average |
|---|---|---|---|---|---|---|
| Yield of Moody's Composite Bond Index Of A Rated Corporate Bonds | 6.87% | 7.45% | 7.98% | 7.49% | 7.39% | **7.44%** |
| Yield of Salomon Smith Barney Long Term US Treasury Bond Index | 5.86% | 6.37% | 6.38% | 5.77% | 5.80% | **6.04**% |
| Change in Dow Jones Industrial Average | 16.10% | 25.22% | -6.17% | -7.11% | -12.21% | **3.17%** |
| Change in Standard And Poor's 500 Index | 26.67% | 19.53% | -10.14% | -13.04% | -19.52% | **0.70%** |
| Average of Four Indicators | | | | | | **4.33%** |

*The figures reported for 2002 are through July 31.*

an above marital lifestyle standard of living — See *Stiffler*) are subject to the fair imputation of income.

The full impact of *Miller* has yet to be seen in New Jersey. The Supreme Court left it to the bench, bar and Legislature to fine tune the rather complex task of imputing income to assets distributed incident to divorce and to answer, perhaps on a case by case basis, some of the questions posed in this and other articles on the subject.[45] Since the *Miller* decision was rendered, the issue was at least partially addressed by the Legislature with the addition of N.J.S.A. 2A:34-23(b)(11), which provides that "the income available to either party through investment of any assets held by that party," must be considered in the alimony calculus.

What is clear is that the practitioner must be mindful of the possibility of the imputation of income as prescribed by *Miller,* and make zealous inquiry from the very first consultation with a matrimonial client as to the nature of each and every one of the assets held by each party and how those assets will be situated after a divorce. If these issues are explored from the very start of the litigation, we will be in the best possible position to creatively and artfully address the issue of imputing income to assets in the appropriate case and assist the court as to the manner in which the imputation should be undertaken.

**ENDNOTES**

1. 160 N.J. 408 (1999).
2. Defined as a rate of return on an investment that balances risk commensurately with reward.
3. This amendment was signed by the governor on September 13, 1999, but had been pending, along with other proposed amendments to the alimony statute, for years. For the full history of the amendments to N.J.S.A. 2A:34-23, see the Legislative History for Bill No. S-54 along with the Report of the Commission to Study the Law of Divorce, April 18, 1995.
4. 245 N.J. Super. 354 (App. Div. 1991).
5. 304 N.J. Super. 96 (Ch. Div. 1997).
6. 313 N.J. Super. 426 (App. Div. 1998).
7. *Id.* at 423.
8. The opinion did not provide this information for 1990.
9. Mr. Miller remarried on 2/14/90.
10. This peak in income was due in part to the vesting of the restricted stock.
11. Mrs. Miller also sought to modify the final judgment of divorce on the basis that it was unconscionable, a concept rejected by the trial court as well as the appellate and Supreme courts. That aspect of the case is not addressed in this article.
12. *Lepis v. Lepis,* 83 N.J. 139 (1989).
13. *Miller,* at 416.
14. *Id.* at 417.
15. *Id.* at 424 (*quoting Whitfield v. Whitfield,* 222 N.J. Super. 36, 47 (App. Div. 1987)).
16. *Id.* (*quoting State v. Gilmore,* 199 N.J. Super. 389, 409 (App. Div. 1985)).
17. *Id.* at 420 (*quoting, Lepis, supra,* 83 N.J. at 152).
18. *Id.* at 420-21 (*citing Innes v. Innes,* 117 N.J. 496, 503 (1990)) (*quoting Bonanno v. Bonanno,* 4 N.J. 268, 275 (1950)).
19. *Id.* at 422.
20. *Miller*, at 423.
21. *Id.* at 424.
22. Agencies such as Standard & Poor's and Moody's generally rate bonds in two broad categories - investment grade and speculative grade.
23. Her salary at the time of the 1995 hearing.
24. The court also fixed plaintiff's support arrears, denied defendant's request for counsel fees and directed the defendant to contribute $14,123 towards her son's college and law school education. These issues are not relevant to this article and therefore are not discussed any further.
25. *Miller, supra,* 160 N.J. at 413 (emphasis added).
26. *Id.* at 426 (emphasis added).
27. *Miller, supra,* 160 N.J. at 413. A number of other collateral issues were raised by the parties and Mrs. Nolan-Miller and were addressed by the Court. They are not discussed at length herein.
28. 37 N.Y. 2d 632 (1975).
29. 743 N.E. 2d 353 (2001).
30. *Accord, Ford v. Ford,* 1998 Tenn. App. LEXIS 703, *10, No. 01 A01-9611-CV-536, 1998 WL 730201, *3 (Tenn. Cr. App. 1998).

**Continued on Page 29**

# Before and After the Vows: From Pre-Nups to Post-Nups

*by Toby Solomon*

Enforceability of agreements procured fairly has been part of our jurisprudence. However, courts have always treated marital agreements with greater scrutiny. Marital agreements differ from other contracts as they are to be performed in the future, and are made in the context of a relationship which may continue for many years after the agreement is executed, and before it is enforced. Consequently, the possibility that subsequent events or the nature of the parties' relationship may render it unfair or unconscionable to enforce is greater than in the case of ordinary contracts.

## PREMARITAL AGREEMENTS

In the last 20 years, however, New Jersey has increasingly recognized the benefits of premarital agreements, and accordingly the courts have enforced such agreements. Initially, our courts were reluctant to enforce premarital agreements, holding that it was contrary to public policy to enforce contracts that might facilitate divorce. However, in *Marschall v. Marschall*,[1] a trial court reversed that trend with its holding that "any possibility that New Jersey might regard antenuptial agreements fixing post-divorce rights and obligations as generally void or unenforceable, or that the courts of this State will grant them only grudging acceptance, should be discarded."

In *Marschall, supra*, the plaintiff/wife and defendant/husband were married when they were 60 and 65 years of age, respectively.[2] It was the second marriage for each of the parties, and each had adult children from prior marriages.[3] Six weeks prior to their marriage, the parties entered into an antenuptial agreement, each seeking to preserve his or her respective estate for their children of prior relationships.[4] Each party was represented by independent counsel, although the plaintiff later claimed that no discovery was conducted prior to the execution of the antenuptial agreement, and that she did not know that the defendant was worth at least $5,000,000.[5] Nonetheless, the parties entered into the agreement, each waiving any claim to the other's estate, with the exception that the plaintiff was to receive $100,000 if the parties divorced or if the defendant predeceased her.[6] Approximately four years later, the parties separated, at which time the plaintiff contested the validity of the antenuptial agreement.[7]

The court in *Marschall* acknowledged that until that time, courts favored antenuptial agreements which defined each parties' rights at the time of death, but disfavored agreements which specified the parties' rights in the event of divorce.[8] Courts had been unwilling to enforce agreements fixing the parties' rights at the time of divorce because it was perceived that such agreements were against public policy, which favored preserving marriages.[9] The *Marschall* court concluded that this *traditional* approach was no longer practical in light of the number of marriages which end in divorce, and held that "antenuptial agreements fixing post-divorce rights and obligations should be held valid and enforceable" as long as there is full disclosure prior to the execution of the agreement, and the agreement is not unconscionable.[10]

The court was adamant that full disclosure of one's assets, income and any other relevant information was absolutely necessary, observing that at the time antenuptial agreements are executed, the parties are at their closest, and most likely to trust the other party.[11] However, the court concluded that as long as both parties had fully disclosed all relevant information, the agreement should be enforced unless the agreement was unconscionable. For example, if the agreement would result in one spouse becoming a public charge, or being forced to live at a standard of living which was considerably below that which he or she enjoyed prior to and during the marriage.[12]

The court's holding in *Marschall* was codified as N.J.S.A. 37:2-31, *et. seq.* (the Uniform Premarital Agreement Act).The act sets forth that parties may contract with respect to the rights and obligations of each with regard to any property, spousal support, death benefits, wills, choice of law, and matters concerning their personal rights and obligations. The burden of proof to set aside such an agreement is on the party alleging the agreement to be unenforceable. A party must prove by clear and convincing evidence that the party either executed the agreement involuntarily, that it was unconscionable at the time enforcement was sought, that there was not full disclosure of all financial information, or that he or she did not have independent legal counsel.

The issue of unconscionability must be determined by the court as a matter of law. The act defines an unconscionable premarital agreement as one which, either due to a lack of property or unemployability: 1) renders a spouse without a means of reasonable support; 2) makes a spouse a public charge; or 3) provides a standard of living far below that which was enjoyed before the marriage.[13]

**RECONCILIATION AGREEMENTS**

Recognition and enforcement of premarital agreements led at least one New Jersey court to recognize a reconciliation agreement. The enforceability of reconciliation agreements was examined in *Nicholson v. Nicholson*.[14] The Nicholson agreement was entered into when the parties were on the brink of divorce. In *Nicholson*, the husband agreed to deed the marital home to the wife while the two were separated, in exchange for the wife's assurance that he could return to the marital home and that they would attempt to reconcile.[15] The execution of the agreement was the basis for the parties' reconciliation. They remained married for an additional 12 years, during which time the husband never asked to have his name returned to the deed of the marital home. At the time of divorce, however, the husband asserted a claim against the marital home.

The *Nicholson* court stated that the reconciliation agreement could not be treated as a premarital agreement, nor could it be treated as a separation agreement entered into as part of a divorce proceeding.[16] Although the court recognized that it could not enforce every promise made during a marriage, it held that when "the marital relationship has deteriorated at least to the brink of an indefinite separation or a suit for divorce, a spousal promise that induces a reconciliation will be enforced if it is fair and equitable."[17]

The court further held that before such an agreement could be enforced, courts must determine whether there was a substantial rift between the parties at the time the promise was made, that the agreement was fair and equitable when made, and that the parties are acting in good faith and changed circumstances must not have rendered literal enforcement inequitable.[18] If both of these conditions were met, the court held that such agreements should be enforced, as public policy favors preserving marriages, and reconciliation agreements are, by definition, increasing the duration of an otherwise doomed marriage.[19]

**MID-MARRIAGE AGREEMENTS**

It is against this background that the New Jersey Appellate Division addressed the issue of mid-marriage agreements in *Pacelli v. Pacelli*.[20] In *Pacelli*, the wife challenged the validity of a mid-marriage agreement which resolved all issues of equitable distribution and alimony in the event of a divorce.[21] At the time the parties were married, the husband, who was 24 years older than the wife, was worth at least $3 million dollars. The husband was the sole source of support during the marriage, and the parties lived an affluent lifestyle. Ten years into the marriage, when the parties had two children, the husband told the wife that he would divorce her if she did not agree to sign a mid-marriage agreement encompassing the financial terms he set forth. To demonstrate that he was serious, the husband moved into an apartment above the garage during this time.

Both parties retained independent counsel, and entered into an agreement whereby the wife would receive $500,000 for equitable distribution and alimony if the parties were to divorce in the future.[22] The wife and her attorney both testified that the wife was willing to sign anything to save her marriage. The husband told his attorney that he wanted to limit his financial liability in the event of a divorce.[23] There were no negotiations, and the wife was told that either she sign the agreement as is, or the husband would file for divorce.[24] The wife signed the agreement. When the husband filed for divorce almost nine years later, his net worth was more than $11 million dollars and he had an annual income of about $500,000. After a 20-year marriage, the wife received only $500,000, half the equity in a vacation home and a contribution by her husband toward her legal fees. She received no alimony.

Whether the mid-marriage agreement should be enforced was an issue of first impression in New Jersey. While the trial court upheld the mid-marriage agreement, the appellate court reversed, finding that the agreement was so inherently coercive and unfair that it should not be enforced. The appellate court's decision was a welcome step at the time in addressing mid-marriage agreements. The court held that judges must more closely scrutinize mid-marriage agreements than premarital agreements.

The court began its analysis by finding that mid-marriage agreements could neither be compared to premarital agreements, nor separation agreements, made at the conclusion of a marriage.[25] The court distinguished mid-marriage agreements from premarital agreements, because one party can always walk away from an impending marriage if the other party proposes unreasonable terms, whereas in the *Pacelli* case, the wife was married for 11 years with two children and was desperate to save her marriage.[26]

Similarly, the court distinguished separation agreements, when parties are adversarial, and each party is attempting to preserve his or her economic future.[27] The court relied in part upon the holding in *Nicholson, supra*. Specifically, the court found two factors particularly relevant: (1) that the marital relationship be on the brink of divorce at the time of the agreement; and (2) that the agreement be fair and equitable at the time it is executed, and at the time enforcement is sought.[28] This is a significant difference from the enforceability of premarital agreements which need to be found *unconscionable* rather than fair and equitable, and must be found to be so only at the time enforcement is sought. The *Pacelli* court stated that mid-marriage agreements "are pregnant with the opportunity for one party to use the threat of dissolution 'to bargain themselves into positions of advantage.'"[29] Nonetheless, the court held that "[w]e need not decide whether such agreements are so inherently and unduly coercive that they should not be enforced, though we conclude that, at the very least, they must be closely scrutinized and carefully evaluated."[30]

This holding leaves parties with a vast gray area, and a great deal of latitude in determining what is fair and equitable, which presents a dilemma for both attorneys and parties contemplating a mid-marriage agreement. For couples who do want such an agreement, the question becomes how should they proceed. Presently, the answer is — with extreme caution.

Although other jurisdictions have addressed the issue of mid-marriage agreements, there is little instruction. Typically, these cases involve agreements entered into by the parties in an attempt to preserve their estates for children born of prior relationships. These cases have not addressed the rights of each party upon the dissolution of the marriage, but rather upon the death of one party, and therefore courts have been willing to uphold such agreements. Courts have expressed a reluctance to enforce agreements, however, where the parties have contemplated the dissolution of the marriage.

In *Rockwell v. Estate of Leon Rockwell*,[31] the court upheld a mid-marriage agreement where each party waived his or her interest in the other's estate so that children from their prior marriages would inherit upon their death. The court held that a spouse could waive his or her interest in the other's spouse's property as long as the decision was fair, and voluntarily made.[32] The *Rockwell* court stated that, "Post-nuptial agreements made during an exiting separation are thought to further judicial policy favoring settlement of controversies over litigation." However, the court noted that "objections are validly raised to post-nuptial agreements where those agreements seek to effectuate a separation or contemplate a future separation."[33]

*In re the Marriage of: Florence S. Button,*[34] the Supreme Court of Wisconsin considered whether a postnuptial agreement should be binding upon the parties. Although the statute provided that a "written agreement for property distribution shall be binding upon the Court" and that "the Court shall presume any agreement to be equitable as to both parties," the court unequivocally stated that "No written agreement shall be binding, however, where the terms of the agreement are inequitable as to either party."[35] The court held that the requirements were assessed at the time of the execution of the agreement, but if circumstances significantly changed since the agreement, they should also be assessed at the time of divorce.[36]

The *Button* Court stated:

> Marriage is not simply a contract between two parties. Marriage is a legal status in which the state has a special interest. Certain rights and obligations dictated by the state flow from marriage, and the legislation requires the divorce court to scrutinize an agreement between the spouses carefully. The parties are free to contract, but they contract in the shadow of the court's obligation to review the agreement on divorce to protect the spouses' financial interests on divorce.[37]

In *Flansburg v. Flansburg*,[38] the court upheld a mid-marriage agreement entered into by the parties while they were separated and attempting to reconcile. This agreement, designated as a post-nuptial agreement, was similar to the reconciliation agreement addressed by the New Jersey Appellate Division in *Nicholson, supra*. The court in *Flansburg, supra*, held that the extension of the marriage was sufficient consideration, and since there was no evidence of fraud or misrepresentation, and both parties had freely entered into the agreement, the agreement was enforceable.[39]

In *Dahlin v. Dahlin*,[40] the court upheld a post-nuptial agreement by finding that it was actually a "property status agreement."[41] In *Dahlin*, the parties divorced, subsequently reconciled and eventually remarried. Under the terms of their first divorce, the wife was granted sole ownership of the marital home.[42] Ten months after the parties were remarried, and four months prior to their second separation, the parties entered into a post-nuptial agreement.[43] According to the terms of the agreement, all of the parties' property as of the date of execution became community property, including the wife's home, and the husband's law practice.[44]

The court distinguished their agreement from a prenuptial agreement, concluding that the agreement was simply a "property status agreement," rather than a "property settlement agreement."[45] The court based its decision upon the fact that the parties' agreement did not set forth a resolution with regard to the division of assets if the parties were to subsequently divorce. The agreement merely recharacterized the parties' separate property as community property.[46]

The Kansas Supreme Court upheld a parties' mid-marriage agreement because the parties specifically incorporated Kansas' statute regarding prenuptial agreements, and the agreement complied with the requirements of the statute.[47] The parties entered into the mid-marriage agreement while they were separated, and thereafter reconciled. Approximately one year later, the parties filed for divorce, and the husband sought to enforce the agreement.

The Court examined the Kansas Uniform Premarital Agreement Act, and concluded that the statute was not intended to be applied to mid-marriage agreements.[48] This conclusion was based not only upon the legislative history, which clearly delineated that the statute was intended for agreements entered into in contemplation of marriage, but also upon the recognition that parties are in vastly different negotiating positions when entering into a mid-marriage agreement as opposed to a prenuptial agreement.[49] However, the court proceeded to hold that parties can voluntarily bind themselves to the terms of an otherwise inapplicable statute as long as to do so would not violate public policy.[50]

The court found that public policy would not be violated by applying the state's prenuptial statute to the parties' mid-marriage agreement, and concluded that the mid-marriage agreement complied with the requirements of the prenuptial statute, and was therefore enforceable.[51] In so doing, the court was explicit that this was only proper because the parties had specifically incorporated the prenuptial statute into their mid-marriage agreement, and that otherwise the prenuptial statute would not apply.[52]

While there is little guidance on this issue, a mid-marriage agreement in certain instances may be an ideal manner of resolving issues, particularly financial ones, which may arise between spouses. It should be possible to properly craft a mid-marriage agreement to define the rights and responsibilities of each party. Such agreements provide spouses with the opportunity to ensure predictability, plan their futures with more security and decide their own destiny.

**LEGISLATION**

As premarital agreements became more common, so did the litigation regarding their enforceability. As a result, the New Jersey Legislature enacted a statute setting forth standards for such agreements. Similarly, perhaps there should be a statute addressing mid-marriage agreements, to guide lawyers, clients and courts. Although, as in premarital agreements, each case will ultimately be decided on a case-by-case basis, there should be a guidepost, and factors to consider when determining whether such an agreement is enforceable. The Legislature may adopt a higher bar for enforcement, as the *Pacelli* court did in determining that a mid-marriage agreement has to be fair and equitable, and not simply unconscionable, both at the time it was entered into and at the time of enforcement.

Determining what is fair, however, is a subjective standard, and could actually encourage litigation rather than avoid it. Courts are not blind, nor should they be, to the fact that parties may be in unequal bargaining positions due to economics, education and sophistication. However, voiding such agreements is not the solution. Instead, the existing legal principles relating to fraud, duress, undue influence and unconscionability as embodied in New Jersey's Uniform Premarital Act should be applied. If safeguards are in place, *i.e.,* both parties are represented by counsel, there is full disclosure of all assets and income, and no coercion, then parties can clarify their rights and responsibilities. Just as importantly, a party's expectations can be determined and defined at this time, and should the parties subsequently divorce, costly litigation should not be necessary.

Agreements made between spouses should be valid and enforceable, as long as they are procured fairly and are not unconscionable. Presently, however, without a statute to rely upon, a lawyer must inform any party entering into a mid-marriage agreement that the provisions altering support rights are particularly vulnerable to review. It must be remembered that, first and foremost, the family court is a court of equity, and a distinction has always been drawn between marital and other contracts. In the special context of family litigation, the New Jersey courts have held that only settlement agreements which are fair and equitable "…fall within the category of contracts enforceable in equity."[53]

The law has allowed particular lenience to agreements made in the domestic relations arena and provides judges with greater discretion when interpreting such agreements.[54] Such discretion lies in the principle that even though marital agreements are contractual in nature, "contract principles have little place in the law of domestic relations."[55] New Jersey has specifically recognized that a marital agreement may be set aside if there is overreaching by one party with the power to take advantage of a confidential relationship, or if it is unconscionable.[56]

Waivers of spousal support in premarital and mid-marriage agreements, although not *per se* unenforceable, may be violative of public policy, and will almost always be analyzed on a case-by-case basis. A potentially problematic aspect of this particular issue is the interplay between the time period for measuring the unconscionability of an agreement with regard to spousal support. Due to the possibility of a change of circumstances, although both parties may be self-sufficient in earning ability at the time the agreement is entered into, the agreement may later become inequitable.

N.J.S.A. 2A:34-23(b), sets forth factors to be considered in determining alimony, and although parties may waive their rights, these factors can only be measured at the time of dissolution. Accordingly, the *Pacelli* court holding that a mid-marriage agreement should be evaluated at the time it is entered into and at the time enforcement is sought may be the better standard. It seems apparently clear that courts will have to find some means of determining the validity of spousal support waivers within the context of mid-marriage agreements.

Jurisprudence clearly favors the validity and enforcement of agreements. Therefore, what is needed at present is for our Legislature to address the issue of mid-marriage agreements. Courts have enforced reconciliation agreements when they could find that they help promote marriages. However, this fiction should be dismissed, as the reality is that many marriages do end in divorce. With proper safeguards and legislative involvement, mid-marriage agreements should be enforceable just as premarital agreements are now enforceable. The key to ameliorating the impact of post-agreement events is to try to address them in the agreement to the extent possible. However, until there is clarity on this issue, family law practitioners should be wary of drafting mid-marriage agreements. ■

**ENDNOTES**

1. 195 N.J. Super. 16, 28 (Ch. Div. 1984).
2. 195 N.J. Super. at 20.
3. *Id.*
4. *Id.* at 21.
5. *Id.* at 21-2.
6. *Id.* at 21.
7. *Id.*
8. *Id.* at 23.
9. *Id.*
10. *Id.* at 27-31.
11. *Id.* at 29.
12. *Id.* at 30-1.
14. N.J.S.A. 37:2-32(c).
15. 199 N.J. Super. 525 (App. Div. 1985).
16. *Id.* at 529.
17. *Id.* at 530-31.
18. *Id.* at 531.
19. *Id.* at 532.
20. *Id.* at 531-32.
21. 319 N.J. Super. 185 (App. Div. 1999).
22. *Id.* at 187.
23. *Id.* at 188.
24. *Id.* at 192-93.
25. *Id.*
26. *Id.* at 190.
27. *Id.*
28. *Id.* at 190-91.
29. *Id.* at 192-93.
30. *Id.* at 195 (*quoting Mathie v. Mathie*, 363 P. 2d 779, 783 (Utah 1961)).
31. *Id.*_
32. 24 Mich. App. 593, 180 N.W.2d 498 (Mich. Ct. App. 1970).
33. *Id.* 180 N.W.2d at 500.
34. *Id. See, e.g., Estate of Mary E. Brosseau*, 176 Ill. App. 3d 450, 531 N.E.2d 158 (Ill. App. 3d, 1988).
35. 131 Wis. 2d. 84; 388 N.W. 2d. 546; (1986).
36. *Id.* at 86.
37. *Id.* at 89.
38. *Id.* at 94.
39. 581 N.E.2d 430 (Ind. Ct. App. 1991).
40. *Id.* at 436-37.
41. 1999 Wash. App. LEXIS 134 (Wash. Ct. App. 1999).
42. *Id.* at 8.
43. *Id.* at 3.
44. *Id.* at 4.
45. *Id.* at 14.
46. *Id.* at 8.
47. *Id.*
48. *Davis v. Miller*, 269 Kan. 732, 7 P.3d 1223 (Kan. 2000).
49. *Id.*
50. *Id.*
51. *Id.* at 1229-30.
52. *Id.* at 1230-34.
53. *Id.* at 1230.
54. *Peterson v. Peterson*, 85 N.J. Super. 638, 642 (1981).
55. *Guglielmo v. Guglielmo*, 253 N.J. Super. 531 (App. Div. 1991), (*citing* N.J.S.A. 2A:34-23).
56. *Id.* (*quoting Lepis v. Lepis*, 83 N.J. 139, 148 (1980)).
57. *Dworkin v. Dworkin*, 217 N.J. Super. 518, 523-524 (App. Div. 1987), *citing Schiff v. Schiff*, 116 N.J. Super. 546, 561 (App. Div. 1971) *cert. den.* 60 N.J. (1972); *Petruccio v. Petruccio*, 205 N.J. Super. 577, 581 (App. Div. 1985).

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## *Miller v. Miller* — Then and Now

**Continued from Page 24**

31. *In re the Marriage of Destein v. Destein,* 91 Cal. App. 4th 1385 (2001).
32. McKinney's Family Ct. Act §413(1)(b)(5)(iv)(A).
33. *See Ogborne v. Hilts,* 262 A.D. 2d 857, 692 N.Y.S. 2d 490 ( 1999).
34. 10-year - 4.94 percent, 20-year - 5.65 percent, 30-year - 5.42 percent.
35. 15 V.S.A. § 653(5)(A)(I).
36. With regard to investments, the guidelines include income from the sale of investments (net capital gain) or earnings from investments, thereby adopting Mr. Miller's argument that only actual income should be considered. *See*, Appendix IX-B *Sources of Income.*
37. *See Crews v. Crews,* 164 N.J. 11 (2000); *Colt v. Colt,* 163 N.J. 9 (2000); and *Schwarz v. Schwarz,* 328 N.J. Super. 275 (App. Div. 2000).
38. A-1807-00T5 (App. Div. 2002). On appeal from Superior Court of New Jersey, Chancery Division, Family Part, Ocean County, Docket No. FM-15-1524-98.
39. *Van Stuck,* at 14.
40. 1999 WL 956660.
41. *Clark v. Clark,* 779 A. 2d 42, 45-46 (2001)(*quoting Ainsworth v. Ainsworth,* 154 Vt. 103, 107, 574 A. 2d 772, 775 (1990)) (Emphasis added).
42. Interestingly, based upon the instruction provided by *Stiffler*, the rate is six percent.
43. 15 V.S.A. § 653(5)(A)(I).)
44. Jack Wiener, vice president of investments, Gibraltar Securities, a division of TA in Florham Park.
45. *See Miller v. Miller Revisited,* by John P. Paone Jr.

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# Recent Developments in Stock Options: The Once-Popular Compensation Plan at a Crossroads

*by Charles F. Vuotto Jr. and Theodore P. Brogowski*

When the heady days of the technology boom slipped away, and the general public began to hear frequent references to men like Kenneth Lay and Bernard Ebbers (CEOs of Enron and WorldCom, respectively), it was clear to most pundits, legislators, and market analysts that stock options could come under fire as being responsible for a sizeable portion of the losses that had recently befallen investors. For example, in a recent article in the *Wall Street Journal*, Diya Gullapalli noted that the distribution of stock options in divorce now appears more akin to a game of hot potato than a battle over a coveted asset.[1]

Notwithstanding such comments, it is clear that employee stock options represent, for many parties, an important component of the marital estate. For every company, like Lucent, that is trading in the single digits,[2] there is another, like Exxon-Mobil,[3] that remains profitable. Furthermore, options on a depressed company's stock may have no or little value now, but may very well have great value before their expiration. As most companies continue to provide stock options as components of executive compensation and incentive compensation packages, these assets will continue to be issues that affect property distribution in divorce for the foreseeable future.

Because stock options will remain assets to be distributed in divorce, it is important to consider the recent developments that have changed the way options will be addressed by the legal system after the financial scandals that have recently rocked the nation. This article will address the current view on stock options by a number of key figures in the worlds of finance and law, the recent corporate fraud law, an IRS regulation addressing taxation issues related to transferred options, and recent case law addressing employee stock options.

### OPTIONS TO BE EXPENSED BY CORPORATIONS

Most commentators regard the failure of major corporations, such as Enron and WorldCom, to be reflective of a widespread problem regarding the accounting of executive compensation and pension plans.[4] One of the most well-respected and successful corporate officers, Warren Buffett, Chief Executive Officer of Berkshire Hathaway, Inc..[5] stated that corporations have erred in their treatment of stock options by virtue of their failure to list these options as compensation expenses in their financial statements.[6] Mr. Buffett noted that the failure to report stock option grants on their financial statements as expenses has been, at best, a foolish accounting practice, and at worst, dishonest.

> Chief exeutives frequently claim that options have no cost because their issuance is cashless. But when they do so, they ignore the fact that many CEOs regularly include pension income in their earnings, though this item doesn't deliver a dime to their companies. They also ignore another reality: When corporations grant restricted stock to their executives these grants are routinely, and properly, expensed, even though no cash changes hands.
>
> When a company gives something of value to its employees in return for their services, it is clearly a compensation expense. And if earnings don't belong in the earnings statement, where in the world do they belong?[7]

A similar critique — that a major flaw concerning corporate accounting relates to the expensing of executive compensation (options in particular) — was made by Jeffrey Garten, Dean of the Yale School of Management.[8] As Garten puts it, "[the] magnitude of stock options — and the fact that they were not treated as a company expense — gave executives too much incentive to cut corners to pump up stock prices in the short term."[9] In response to the public's demand for reform of corporate practices, primarily with relation to accounting and executive compensation (and therefore stock options), the present administration has endorsed the reform platform. The chairman of the board of governors of the Federal Reserve Bank (FRB), Alan Greenspan, has also urged that stock options be treated as expenses by corporations.[10]

Perhaps as an attempt to provide some encouragement for those corporations who have resisted reform, the IRS has proposed a regulation that would require U.S. companies to treat stock options as an expense when involved in international ventures.[11]

The end result of this groundswell of criticism of corporate accounting practices and the Enron/WorldCom scandals has been some changes in the federal government's treatment of corporate accounting practices and compensation programs. Two in particular stand out: The Sarbanes-Oxley Act of 2002 and IRS Revenue Ruling 2002-22. The first directly addresses many of the accounting practices now under fire. The second addresses the taxation of stock options incidental to divorce.

### THE SARBANES-OXLEY ACT OF 2002

The Bush Administration and Congress responded to the problems created by the recent accounting scandals through the non-partisan passage of the Sarbanes-Oxley Act of 2002.[12] Much has been made of this act,[13] but it remains to be seen whether it has the teeth to combat corporate malfeasance. Sarbanes-Oxley was designed to address the questionable accounting practices undertaken by accounting firms, such as Arthur Anderson, and corporations, such as Enron, in the preparation of required Securities and Exchange Commission (SEC) financial statements.[14]

One of the biggest problems with the accounting practices used in the preparation of these statements has been the issue of expenses, such as loans and non-salary executive compensation. Corporations, as part of a combined incentive and retention program, often offer executives stock options and enhanced performance pay. The key issue, with regard to accounting practices, has been how or if these incentives are shown on annual and quarterly financial statements.

The position of the IRS has been that corporations should list these plans (options in particular) as expenses on their financial reports.[15] While this would certainly reduce the profit shown by some corporations on their statements, it is the position of many, including the aforementioned CEO of Berkshire Hathaway, that this is the more accurate profit figure for corporations.[16]

Sarbanes-Oxley only indirectly addresses the problem of the inclusion of executive compensation in financial statements. Title I, Section 108 of the act requires audits to follow generally accepted accounting practices in the preparation of corporate financial statements.[17] In order to enforce this requirement, the act creates an oversight body (the Public Company Accounting Oversight Board, or PCAOB)[18] that will determine which principles of accounting are *generally accepted*.[19] While creating this new board to determine the appropriate methodology for accountancy in the preparation of financial reports, the act makes no judgment as to the treatment of options by corporate auditors. Thus, the newly created oversight board will be forced to determine what standards are acceptable in the treatment of stock options.

The oversight board's treatment of these options will be determined based on whether the board approves of the accounting methods used by corporate auditors.[20] Given the fact that there are opposing views on the treatment of options,[21] it is conceivable that the board will not require corporate auditors to expense options. This leaves open the same loopholes that existed prior to Sarbanes-Oxley.[22] Past shareholder derivative cases have demonstrated that this may be problematic, especially when addressing executive compensation, as shareholders will still lack accurate information upon which they can act to ensure accountability in their boards of directors.[23]

Sarbanes-Oxley also imposes much stiffer penalties for accounting malfeasance than has been imposed in the past.[24] The act imposes longer terms of incarceration, fines, and fee awards against those who violate the act or other sections of the Securities Exchange Act of 1934 (the underlying act for all federal securities law).[25] While the penalties are more severe, it is unclear whether the increased penalties enable greater discovery and apprehension of those engaged in accounting fraud.

While the same standards problem exists with regard to accounting practices, it is clear that the board will be able to enforce whatever standards it does impose. However, the act's relationship to equitable distribution may be limited to the impact it has on corporations' willingness to grant options if they are required to expense them and thereby reduce their bottom line.

### REVENUE RULING 2002-22

On May 13, 2002, the IRS released Revenue Ruling 2002-22, in order to address confusion concerning stock options and taxation.[26] When stock options are transferred incident to divorce, two particular tax regulations apply to that transfer: 26 C.F.R. 1.1041-1T and 26 C.F.R. 1.83-7. The first specifically deals with the transfer of property between spouses during divorce.[27] Under this regulation,

> A taxpayer who transfers interests in nonstatutory stock options and nonqualified deferred compensation to the taxpayer's former spouse incident to divorce is not required to include an amount in gross income upon the transfer. Rather, the former spouse [receiving the options] is required to include an amount in gross income when the former spouse exercises the stock options or when the deferred compensation is paid or made available to the former spouse.[28]

The ruling only applies to the transfer of stock options or non-qualified deferred compensation transferred in the context of a divorce.[29]

Prior to Revenue Ruling 2002-22, it was possible for the transferor spouse to be taxed upon the transfer of stock options to the transferee spouse.[30] Now, the transferor spouse has non-recognition of the transfer of the options as a taxable event, and the transferee spouse bears the tax burden for the options.[31]

The impact of this recent ruling concerning stock options is the resolution of confusion concerning the taxability of transferred non-qualifying options after parties have distributed them during divorce. Admittedly, this does not happen often, since most plans do not permit transfers of such assets. However, where transfers are permitted, the taxation has now been clarified. The IRS has ensured that the parties garnering the benefits of property after equitable distribution will also bear the taxation burdens associated with that property.[32]

### *HANSON V. HANSON* AND THE TREATMENT OF STOCK OPTIONS

Other than *Callahan*[33] and *Pascale,*[34] there are no reported cases addressing employee stock options in the context of a New Jersey divorce. Until recently, the authors were only aware of two unreported decisions which addressed the intricacies of option/restricted stock distribution incident to divorce.[35] The first, *Allex v. Allex*,[36] addressed the award of restricted stock and options. In *Allex* the employed spouse received the restricted stock and options during the marriage but was not able to exercise them until after the date of complaint.[37] However, the inability to exercise the options was not the crux of the ruling to exclude them from equitable distribution. The Appellate Division affirmed the trial court's finding that the restricted stock and options in question were not subject to equitable distribution, because the Merrill Lynch compensation plan was "designed to reward continuous employment."[38] Therefore, the court concluded that the restricted stock and options were not earned during the marriage, and marital effort had not been expended in their acquisition.

In *Klein v. Klein*,[39] the Appellate Division addressed the inclusion of options in equitable distribution by a trial court even though they vested after the date of complaint. The Appellate Division ruled that the inclusion of such options in equitable distribution was not an abuse of discretion, as the options were awarded for past labors by the employee-spouse.[40]

Each of these decisions is consistent with the seminal case, *i.e., Pascale*, but does not address the thornier issue of how to properly, fairly and uniformly determine the marital and non-marital portions of unvested options or restricted stock.

No published New Jersey opinion has addressed the core issue of how to *accurately* distinguish between the marital and non-marital portions of unvested stock options. Although *Pascale* deals with the issue by imposing a general obligation to distribute all assets earned during the marriage, this gives little practical guidance. Throughout the nation, most states adopt a *coverture fraction* or *time-rule formula* when determining which portion of unvested stock options (or restricted stock for that matter) is in the pool of assets subject to equitable distribution.[41]

A recent unpublished opinion by the New Jersey Appellate Division, issued in the matter of *Hanson v. Hanson*,[42] dealt with a trial court's inclusion of restricted stock (analogous to unvested stock options) in equitable distribution. The trial court, in including the restricted stock in equitable distribution, applied the coverture fraction to the division of this stock.[43] The appellate court did not disturb this portion of the trial court's ruling, implicitly affirming the trial court's use of the majority rule (*i.e.,* the coverture fraction) with restricted stock (as set forth in the groundbreaking California case of *In re Marriage of Hug*[44]*)*. This appears to mark the first occasion where the Appellate Division has sanctioned, at least implicitly, the use of the coverture fraction for an asset such as restricted stock.[45] As for the actual formula used in this case, the trial court adopted a coverture fraction covering the date of the initial award of restricted stock (*In re Marriage of Hug* used the date of employment as the start date) to the date of trial as the numerator and the date of the initial award to the first date of allowable exercise as the denominator.[46]

In *Hanson*, the Appellate Division adjusted the fraction's end date based upon the trial court's imposition of the principle of *momentum* to justify including a post-complaint period.[47] By momentum, the court meant "the impressive consistent upward trend in [the husband's] earnings over a period of several years."[48] Momentum is a principle that has been applied only to alimony in the past, in *Gugliotta v. Gugliotta*.

> Where a family's expenditures and income had been consistently expanding, the dependent spouse should not be confined to the precise lifestyle enjoyed during the parties' last year together. Defendant's income picture should be viewed with an eye toward the future, since it was to this potential that both parties contributed during the marriage. The then existing earning potential of the working spouse may be shared by the spouse who kept the home, and that standard of living should be implemented through an adequate alimony award.[49]

It appears that the difference between the use of momentum in *Gugliotta* and in *Hanson* is that in *Hanson*, momentum was being applied by the trial court as to equitable distribution, not alimony. For this reason, the Appellate Division remanded the case, holding that there was no basis for applying momentum to the fixing of assets for the purposes of equitable distribution.[50] However, what is critical, is the appellate court's adoption of the coverture fraction for determining the marital portion of restricted stock.

The adoption of the majority rule continues across the nation, as is evidenced by a recent case from New Hampshire, *In re Valence*.[51] In *Valence*, the New Hampshire Supreme Court reversed and remanded the decision of a trial court with instructions to distribute all vested and unvested stock options earned by one of the spouses, regardless of whether these assets were earned during the marriage.[52] The New Hampshire Supreme Court stated that the trial court should determine whether the unvested stock options were granted as incentives for future services. If so, then, according to the court, the trial court was instructed to apply the coverture fraction in order to determine which portion of the assets were earned prior to the dissolution of the marriage.[53]

It appears that the utilization of a straightforward coverture fraction to distribute restricted stock and unvested options, as done by the majority of states, remains the most objective and fair formula, without sole reliance on the often unclear and contradictory evidence that may be presented with regard to why such assets were awarded.

**CLOSING THOUGHTS**

In the past two years, executive compensation plans, including those dealing with stock options, as well as corporations in general, have taken a great hit in public approval. Because of the crash of the stock market and the reported conduct engaged in by Enron, WorldCom and Arthur Anderson, corporations have become a hot item for regulators and legislators alike.

Congress has responded to the scandals by passing the Sarbanes-Oxley Act, designed to reform the enforcement wing of the SEC and the practices used for corporate statements by creating an oversight body (the PCAOB). This board will ensure that the reporting of corporate profits adheres to widely accepted accounting practices. The act will also introduce tougher penalties for fraudulent reporting regarding the financial state of corporations. For corporations, this may mean that they will have to be more conservative in their executive compensation plans. In turn, this may indicate a reduction in the number of stock option-related issues arising during divorce. ■

**ENDNOTES**

1. *See* Diya Gullapalli, Divorcing Couples Spar Over Worthless Options: 'No, You Take 'Em', *WALL ST. J.,* Aug. 7, 2002, at D1.
2. As of the time of writing, Lucent Technologies, Inc., is worth $1.52 per share.
3. Exxon-Mobil traded at $37.16 per share as of the time of writing.
4. *See* Warren Buffett, Who Really Cooks the Books?, *N.Y. TIMES*, July 24, 2002, at A19.
5. A remarkably successful company, Berkshire Hathaway reported net earnings of $795 million for 2001. *See* Berkshire Hathaway, Inc., 2001 Annual Report, Selected Financial Data for the Past Five Years, *at* <http://www.berkshirehathaway.com/2001ar/fiveyear.html> (last viewed Aug. 15, 2002). Presently, a *single share* in Berkshire Hathaway Class A stock trades for $74,800.
6. *Supra.*
7. *Supra*.
8. *See* Jeffrey E. Garten, Five Steps to Make Wall Street Safer for Investors, *BUS. WEEK,* July 15, 2002, at 28.
9. *Supra*.
10. *See* Laura Smitherman, SEC Denies Shareholders a Vote on Treating Options as Expenses, *BLOOMBERG NEWSWIRE*, July 25, 2002. Despite Chairman Greenspan's hopes for treatment of options as expenses, the Securities and Exchange Commission refused to require corporations, such as National Semiconductor Corporation and ConAgra Foods, Inc., to submit to a vote a referendum by shareholders demanding that options be expensed. *See* Maxine Clayton and Courtney Schlisserman, Anheuser-Busch 2nd-QTR Net Rises 12% on Higher Prices, *BLOOMBERG NEWSWIRE*, July 24, 2002. Anheuser-Busch stated that it would not expense stock options, unlike Coca-Cola Co. and Washington Post Co.
11. *See* Simon Kennedy and Brendan Murray, IRS Proposes Stock Options for Some U.S. Affiliates, *BLOOMBERG NEWSWIRE*, July 26, 2002. This regulation may also be a perfect avenue for the federal government's imposition of business practices beyond the borders of the United States, as it imposes burdens on overseas corporations that may not normally expense these compensation plans.
12. *See* H.R. 3763, 107th Cong. (2002) (hereinafter Sarbanes-Oxley).
13. *See* Sandra Sobieraj, Bush Enacts Corporate Fraud Law, *Yahoo News/AP Newswire*, at <http://www.story.news.yahoo.com/news?tmpl=story&u=/ap/20020730/ap_on_go_pr_wh/bush_business_scandals_18> (last viewed July 30, 2002).
14. *Supra.*
15. *See* Kennedy and Murray, *supra*.
16. *See* Buffett, *supra*.
17. *See* Sarbanes-Oxley, H.R. 3763, T. I, § 108(b)(1).
18. *See* Sarbanes-Oxley, H.R. 3763, T.I, § 101(a).
19. *Supra.*
20. *Supra.*
21. *See* Smitherman, *supra*, Note 11, where SEC Chairman Pitt refused to require a vote as to the treatment of options as expenses; Clayton and Schlisserman, *supra*, Note 12, where the Anheuser-Busch Corporation defended its refusal to treat options as expenses.
22. *See* Buffett, *supra*, Note 4.
23. *See In re Walt Disney Co. Derivative Litigation*, 731 A.2d 342, 350 (1998). In this case, shareholders unsuccessfully challenged the award of $140 million in executive compensation to Michael Ovits for *14 months* of work.
24. *See* Sarbanes-Oxley, H.R. 3763, T.VIII, §§ 802-805.
25. *Supra*.

26. *See* Rev.Rul. 2002-22, 2002-19 I.R.B. 849 (2002).
27. *See* 26 C.F.R. 1.1041-1T.
28. *Supra*, at 1.
29. *See* Rev. Rul. 2002-22, *supra*, at 5.
30. *Supra*, at 3; *citing Rubin v. Commissioner*, 429 F.2d 650 (2d Cir. 1970).
31. *Supra*, at 4.
32. *See* Scott E. Vincent, IRS Clarifies Treatment of Options Transferred Incident to Divorce, 58 *J. Mo. B.* 162, 163 (2002). As noted in Mr. Vincent's article, the regulation is prospective, applying to stock option transfers occurring after November 9, 2002. Until that date, the old transfer tax liability rules will apply.
33. *See Callahan v. Callahan,* 142 N.J. Super. 325, 328 (Ch. Div. 1976).
34. *See Pascale v. Pascale*, 140 N.J. 583, 612 (1995).
35. *See Allex v. Allex,* A-5739-95T3 (App. Div. 1997) and *Klein v Klein*, A-5019-97T1 argued June 3, 1999 and decided on June 24, 1999. While *Mailman v. Mailman*, A-2321-97T3 (App. Div. 1999), also addressed stock options, it did so in a cursory fashion, focusing more on situations where the time limitation on revisiting property settlement agreements under Rule 4:50-1 would be tolled.
36. *Supra*.
37. *Supra*, at 8.
38. *Supra*, at 8.
39. A-5019-97T1 (App. Div. 1999).
40. *Supra*, at 8. The inclusion at a post-judgment motion occurred because the trial judge forgot to so include the options as of the time of the initial trial.
41. The most prevalent time rule fraction evolved from a formula implemented by the California Court of Appeals in *In re Marriage of Hug*, 154 Cal. App. 3d 780 (Cal. Ct. App. 1984). In *Hug*, the trial court expressed the options that were part of the marital estate in terms of a fraction. *See id.* at 782. For example, the court stated that the numerator represented the difference in months between the spouse's commencement of employment with the company and the date of the parties' separation. *See id.* The denominator was established by first determining the difference, in months, between commencement of employment and the date when the first option was exercisable. *See id.* This factor was then multiplied by the number of shares that could be purchased on the date that the option was first exercisable. The remaining options were determined to be the separate property of the husband, the employed spouse. *See id.* at 782-83. (*See also Bornemann v. Bornemann*, 245 Conn. 508 (1998))
42. *See Hanson v. Hanson*, A-4492-00T1 (App. Div. 2002), at 3.
43. *See supra*, at 9-10.
44. *See* 154 Cal. App.3d 780, 46 A.L.R.4th 623 (Cal. App. 1984).
45. *See Whitfield v. Whitfield*, 222 N.J. Super. 36 (App. Div. 1987) (as to pensions).
46. *See Hanson*, *supra*, at 10.
47. *See Hanson*, *supra,* at 9.
48. *Supra*, at 10.
49. *Gugliotta v. Gugliotta*, 160 N.J. Super. 160, 164, *aff'd* 164 N.J. Super. 139 (App. Div. 1978).
50. *See Hanson*, *supra*, at 17.
51. 798 A.2d 35 (N.H. 2002).
52. *Supra*, at 39.
53. *Supra*.

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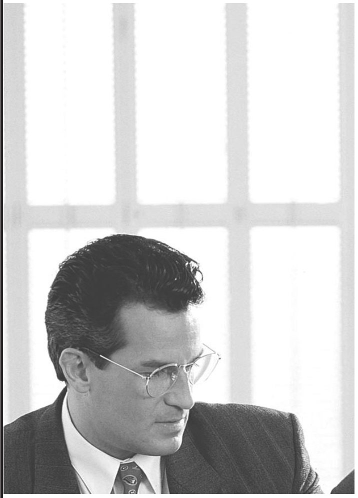

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