

## JUNE 2012 NEWSLETTER

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# THE FINANCIAL DISSOLUTION OF A MARRIAGE- PART II EQUITABLE DISTRIBUTION

## FIRM ALERT:

### 1. UPCOMING CLE/CPE SEMINAR FOR ATTORNEYS AND CERTIFIED PUBLIC ACCOUNTANTS:

**Judith P. Rodden, Esquire and Lesley M. Ibanez, Esquire**

*“Commercial and Residential Real Estate Practice Today: From Agreement of Sale to Closing, with Ethics”*

Wednesday June 13<sup>th</sup> 8am-12pm

Penn State University, Cooperation Extension (Doylestown)

<http://bucks.extension.psu.edu/>

1282 Almshouse Road

Neshaminy Manor Center  
Doylestown, PA 18901-2896

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To Register or More Information: Theresa Bloom (215) 881-7402

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## **2. OMG! MY PARENTS ARE GETTING OLD!**

Pozzuolo Rodden, P.C. are pleased to announce that Joseph R. Pozzuolo, Esquire, Jeffrey S. Pozzuolo, Esquire, and Stephen P. Taylor, Esquire have been retained to write two chapters of Faye Levow's new book titled OMG! My Parents Are Getting Old! This book is intended to be the definitive resource for families on what to do when you are caught up in the whirlwind of dealing with unprepared, aging parents. It is written to be very user friendly. Ms. Levow is targeting an October 2012 release date and the temporary website is:

[www.OMGMYPARENTSAREGETTINGOLD.com](http://www.OMGMYPARENTSAREGETTINGOLD.com). Joseph R. Pozzuolo and Jeffrey S. Pozzuolo wrote the chapter titled: Estate Planning for Pet Owners. Joseph R. Pozzuolo and Stephen P. Taylor wrote the chapter titled: Same Sex Couple Estate Planning. Pre-publication drafts are available by emailing Chrissy at: [chrissy@pozzuolo.com](mailto:chrissy@pozzuolo.com)

## **3. QUESTION OF THE MONTH:**

If there are any legal questions you would like this office to answer in the future, please email the question to us at [info@pozzuolo.com](mailto:info@pozzuolo.com). Commencing with the July 2012 Newsletter, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in a new section of our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning and administration, tax and pension law, family law litigation.

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## **THE FINANCIAL DISSOLUTION OF A MARRIAGE - PART II**

### **EQUITABLE DISTRIBUTION**

In the May 2012 newsletter, we covered the topic of the support and maintenance of the spouse and children during and after a divorce. In this month's newsletter, we will discuss the equitable distribution of marital assets in a divorce.

In a divorce, spouses must divide their property between them. If the spouses cannot enter into a settlement agreement to divide the property themselves, the court will intervene. "Equitable distribution" is the process by which courts divide marital property between the spouses. In performing an equitable distribution, the court will:

- Determine which property is marital property;

- Determine the value of the marital property, and;
- Distribute the marital property.

#### I. **Determining which property is marital property**

Generally, the distinguishing characteristic between marital property versus non-marital property is *when* the property was acquired. In Pennsylvania, for example, property acquired by either spouse during the marriage, including any increase in value of pre-marital property which occurs during the marriage, is presumed to be marital property. Which spouse's name is on the deed, certificate, or other form of title to the property is often irrelevant. It matters when the property was acquired. There are exceptions to this rule, of course. Pennsylvania has eight exceptions to the rule that property acquired after the date of marriage and before the date of final separation is presumed marital property. The exceptions are:

- Property acquired before the marriage or property acquired in exchange for property acquired before the marriage;
- Property excluded by agreement between the spouses;
- Property acquired by gift, except between spouses, bequest, or inheritance or property acquired in exchange for such property;
- Property acquired after final separation until the date of divorce, except for property acquired in exchange for marital assets;
- Property which a party has sold, granted, conveyed or otherwise disposed of in good faith and for value prior to the date of final separation;
- Veterans' benefits exempt from attachment, levy or seizure, except for those benefits received by a veteran where the veteran has waived a portion of his military retirement pay in order to receive veterans' compensation;
- Property to the extent to which the property has been mortgaged or otherwise encumbered in good faith for value prior to the date of final separation; and
- Any payment received as a result of an award or settlement for any cause of action or claim which accrued prior to the marriage or after the date of final separation regardless of when the payment was received.

How property is titled matters sometimes. For example, if non-marital property is placed into joint names during the marriage, it may be "transmuted" into marital property. However, a spouse may be able to "trace" non-marital property from one account to another during the marriage, thereby preserving non-marital property.

Determining which property is marital property involves a complete financial disclosure by each spouse, which may be the most important part of a divorce. An experienced lawyer will be invaluable in financial disclosure work. An experienced divorce lawyer will be able to determine the scope and content of the marital estate especially when a complete disclosure is made more difficult by the existence of "invisible" assets, such as pensions, deferred compensation, cash surrender value of life insurance policies, stock options, patents and royalties, company cars, and other entitlements. An experienced lawyer will know to look for these latent assets for his client who may not know of their

existence. You may not know of all your spouse's assets, or even all of the property titled in your joint names. An experienced lawyer will know where and how to look for assets, such as prior tax returns, balance sheets and profit and loss statements, personal financial statements, bank statements, brokerage accounts, loan applications, insurance applications, real estate records, estate plans, safety deposit box records, insurance policies, inheritance records, or records of significant purchases. A lawyer will prepare interrogatories and conduct depositions to discover the spouse's assets and financial situation.

## **II. Determining the value of the marital property**

A court assesses the value of marital property based on its "fair market value", or what a willing and able buyer would pay to a willing and able seller in an arm's length transaction. A court will generally use the date of the trial to determine the date for valuation.

Value of marital property may be offset by credits or debits given to one of the spouses. A spouse may receive a credit for any non-marital property he/she contributes to the marital estate, or to maintain marital property, but that credit will decline over the length of the marriage. In other cases, the value of a marital asset may be reduced by the amount of the owner's real or hypothetical income tax liability or selling expenses.

## **III. Dividing the marital property**

After marital property is identified and valued, the court must weigh several factors to determine equitable distribution. The division will not necessarily occur as a 50-50 split. The court will consider the parties' respective incomes, their abilities to rebuild their assets and income in the future, their parental responsibilities and other factors. Whether the marriage is dissolving due to the fault of one spouse may be relevant, but it depends on state law.

### **A. Equitable Distribution Factors**

In Pennsylvania, which permits "no-fault" divorces, courts may consider the following factors during equitable distributions:

- Length of marriage;
- Prior marriages of either party;
- Age, health and station of parties;
- Amounts and sources of income, vocational skills, and future employability;
- Liabilities and needs of each party;
- Contribution of one party to the education, training or increased earning power of the other party;
- Opportunities of each parties for future assets and income;
- Standard of living during the marriage;
- Tax ramifications of property division;
- Value of property set aside to each party;

- Contribution or dissipation of marital property by each party; and
- Whether a party will be the custodial parent of any minor children.

Ultimately, a court seeks to fairly, although not necessarily equally, divide the marital estate. Financial disclosure will be important in distributing and dividing the marital estate. A lawyer will be able to assist you in developing an accurate and fair financial outlook, thereby securing your interests in marital property and in any future distributions.

#### **B. Non-Cash Marital Property**

Special considerations arise where the assets are not simply cash, and division of the assets is made tougher. For example, the assets making up the marital estate may include the following:

- Investment or vacation properties, or interests in real estate investment trusts;
- Family business assets, interests in professional practices and partnerships, or other closely held business interests;
- Division of pensions, retirement benefits, and executive compensation packages, including those involving stock options or deferred payments;
- Interests in property affected by the terms of prenuptial agreements or postnuptial agreements; and
- Appreciation during the marriage of property acquired by either spouse before marriage.

Dividing some of the assets listed above may be difficult because they are not liquid assets. Furthermore, the asset may not have the same value broken up as it does whole. The result is that a court may distribute property in kind or may compel one spouse to buy out the other spouse's interest in marital property. The logical goal is to compensate one of the spouses on a pro rata basis for the value of the interest in the hard-to-divide asset with a greater distribution of other, more easily divisible assets. Real property, specifically, is the type of asset that is not easily distributed. If a couple owned a vacation home, the couple or the court may decide that one spouse receives the vacation home with the other spouse receiving offsetting bank accounts. A lawyer can advise as to how to compromise interests and in what form is best to receive a distribution.

#### **C. Family Business**

Another hard-to-divide, non-liquid asset is the family business. Handling the division of a family business in a divorce can be a difficult issue. A family business is a complex asset, made up of tangible assets, like buildings, bank accounts, inventory, fixtures, and machinery, and intangible assets, such as mortgages, leases, patents, trademarks, tradenames, stock, accounts receivable and intangible assets such as "goodwill." The court will look to many factors in deciding how to divide and distribute a family business, including:

- Did either of the spouses own the business prior to marriage?
- Were marital assets invested in the business?
- Has the business increased in value during the course of the marriage?
- Who contributed to the business?
- What is the reasonable value of the business?
- Are the spouses going to continue operating the business or will they sell?
- Does the name of one spouse give all the value to the business?
- What are the assets and debts of the business?

Of course, valuation of the business is difficult and will be contested. Each side will likely bring in their own experts to make valuations, and contest the other side's valuation of the business. Two common valuation methods are the (1) book value method and (2) earnings or market approach method. The book value method is based on the values of the assets and liabilities as they are listed on the corporate books. The earnings or market approach is based on the market value or earning capacity of the business. Essentially, this second approach measures what an outside buyer would pay for the business, taking into account the future earning capacity of the business. Other factors that play into valuation of a business may include:

- Nature and history of the business;
- Economic outlook;
- Value of the stock and the financial condition of the business;
- Earnings capacity of the business; and
- Whether or not the enterprise has goodwill or other intangible value.

The court will determine the value of the business, determine which of the parties shall continue to own and operate it if necessary, and will determine the amount necessary to compensate the other party for his/her share of the business.

#### **D. Pension Assets**

In fact, a pension or retirement plan may be a spouse's most valuable asset. Pensions are marital property that will be subject to equitable distribution, but only that portion of the pension attributable to the period beginning on the date of marriage and ending on the date of separation. Pension benefits acquired after separation should not be subject to equitable distribution. In distributing pensions, a court will generally use one of two ways to distribute the benefits. It may use the "immediate offset" method, in which it determines the present value of the pension benefits and requires an immediate offset of those benefits by the spouse owning the pension. In cases where an immediate offset is not feasible, the court may use the "deferred distribution" method and a qualified domestic relations order (QDRO) would be entered. The QDRO would be included in the divorce agreement and establish an ex-spouse's legal right to receive a designated percentage of future payments of benefits. QDROs can be prepared by lawyers, so it is imperative to have an experienced lawyer on your side in the settlement and distribution of pension benefits.

**E. Appreciation of Non- Marital Assets During the Marriage**

It is important to remember that the appreciation in value during the marriage of a prior owned asset, such as company stock, may be subject to equitable distribution. Generally, whether such an asset is subject to distribution depends on whether the asset is active or passive. Passive assets are assets that fluctuate in value based solely on market conditions. Active assets are assets that directly increase in value as a result of contributions and efforts by one or both spouses towards the assets growth and development. For example, an active asset may be the stock of a closely held corporation run and operated by one spouse. If the increase in value of an active asset is brought about solely through the efforts of the owner spouse, that value should not be subject to equitable distribution. However, if the non-owner spouse contributes to the increase in value of the active asset, it may be subject to distribution.

**F. Alternative Dispute Resolution Alternatives**

Courts do not necessarily have to be the sole authority on who gets what in a divorce. Couples may also divide marital property on their own through a marital settlement agreement. They may even have a prenuptial agreement by which they state their rights and interests to property prior to marriage, thus, making any later divorce easier. Couples may also seek mediation, a process in which an impartial third party meets with a divorcing couple to help them reach a mutual agreement for the terms of their divorce. Mediation is less adversarial and does not require a trial and other court proceedings. It is a more cooperative environment and allows parties to retain control over the decisions made, rather than having a court make decisions. Most importantly, mediation can be legally binding, at the option of the couple.

**IV. Conclusion**

Divorce is one of the most emotionally significant events in a person's life. It just so happens to be one of the most legally significant events as well. It is important to have an experienced attorney on your side to guide you through the process to ensure that you receive all that you are entitled to in the most tax effective way.

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### **Publications**

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: [http://pozzuolo.com/Pubs Articles.shtml](http://pozzuolo.com/Pubs%20Articles.shtml)

#### **Corporate/Tax**

Design Buy-Sell Agreements For Maximum Utility

Deferred Compensation Rewards And Retains Key Employees

How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool

Protecting A Client's Business From Unfair Competition Using Restrictive Covenants

Money Purchase Pension Plan Falls Out Of Favor

Why An Employment Contract Is Mandatory

What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs

Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules

How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend

Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business

How To Look, Act And Sound Like A Professional Corporation

How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations

How to Structure a Suitable Buy-Sell Agreement

## **Estate Planning**

Estate Planning For Pet Owners

The Limited Liability Company -A Sophisticated Tool For Estate Planning

Diversify Strategies For An Effective Estate Plan

Use Wills To Maximize Family Protection And Minimize Tax

Six Proven Estate Planning Techniques

Divorce Raises The Need For Performing An Estate Planning Review

Divorce and Estate Planning

Remarriage Situations Can Raise Special Estate Planning Considerations

College Funding Tool Offers Estate Planning Advantage

Drafting The Durable Power Of Attorney For Wealth Protection Purposes

Why Living Wills Advance Directives Are An Essential Part Of Estate Planning

Special Needs Trust - An Estate Planning Tool For The Disabled

Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples

***Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.***

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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