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ENHANCED VALUE OF A CLOSELY HELD CORPORATION AT THE TIME OF DIVORCE: WHAT ROLE WILL WISCONSIN'S MARITAL PROPERTY ACT PLAY?

Dave managed and was the majority shareholder of a closely held corporation. He had inherited the stock of the corporation from his father. Carol and Dave were married in March of 1986. During their marriage, Dave received a sal-

1. The hypothetical posed at the outset of this article assumes that the parties do not have a marital property agreement concerning the husband's interest in the closely held corporation. It is further assumed that the husband did not execute a statement unilaterally designating income from the corporation as his individual property pursuant to 1985 Wis. Laws 37, § 122r (to be codified at Wis. Stat. § 766.59). A marital property agreement or unilateral statement could alter the parties' interest in the corporation. This Comment does not deal with the possible consequences of such an action by the parties.

The hypothetical corporation's stock would be classified as property generally exempt from division at the time of divorce by section 767.255 of the Wisconsin Statutes and as individual property. Wis. Stat. § 766.31(7)(6) (1983-84) (effective Jan. 1, 1985). Section 767.255 governs the treatment of property at the time of dissolution. Under this statute the stock would, at least initially, be considered the separate property of the husband. The section provides, in part, that:

Any property shown to have been acquired by either party prior to or during the course of the marriage as a gift, bequest, devise or inheritance or to have been paid for by either party with funds so acquired shall remain the property of such party and may not be subjected to a property division under this section except upon a finding that refusal to divide such property will create a hardship on the other party or on the children of the marriage, and in that event the court may divest the party of such property in a fair and equitable manner. Wis. Stat. § 767.255 (1983-84).

Section 766.31 governs the classification of property under Wisconsin’s Marital Property Act. Under this section the stock would be classified as individual, separate, property because it was owned before the marriage which occurred after January 1, 1986. Section 766.31(6) provides that: [p]roperty owned at a marriage which occurs after 12:01 a.m. on January 1, 1986, is individual property of the owning spouse if, at the marriage, the spouse has a marital domicile in this state.” Wis. Stat. § 766.31(6) (1983-84) (effective Jan. 1, 1986), as amended by 1985 Wis. Laws 37.

Even if the stock had been acquired after the marriage, it would still be classified as individual, separate, property under section 766.31. Section 766.31(7)(a) provides, in part, that:

(7) Property acquired by a spouse during marriage and after the determination date is individual property if acquired by any of the following means: (a) By gift during lifetime or by a disposition at death by a 3rd person to that spouse and not to both spouses . . . .  
ary from the corporation. The value of the corporation's stock increased over the course of the marriage. This increase was due, in part, to Dave's efforts. A divorce action is now pending between Carol and Dave. All of the above facts occurred in Wisconsin.

Query: Is the community entitled to a portion of the enhanced value of the corporation's stock? What role, if any, will Chapter 766 play in this scenario?

If the court would choose to look at community property principles for guidance, which principles would be material?

The hypothetical outlined above presents one of the most difficult areas of property classification practitioners face in a community property state. Difficulties arise because this situation brings two general principles of community property law into conflict. One, the intrinsic increase in value of separate property remains separate. This is true whether the income from a spouse's separate property is classified as separate or community property. Two, "anything produced by the time, talent or labor of either spouse is community property."

The fundamental issue raised by this conflict of principles is "whether the increased or enhanced value of the [separate property] closely held business interest should be characterized as separate or community property or whether the community has a right of reimbursement as a result of the increased or enhanced value of the closely held business inter-

2. The income received during the marriage would constitute marital property. Section 766.31(4) provides that "[e]xcept as provided under subs. (7) (a), (7p) and (10), income earned or accrued by a spouse or attributable to property of a spouse during marriage and after the determination date is marital property." Wis. Stat. § 766.31(4) (1983-84) (effective Jan. 1, 1986), as amended by 1985 Wis. Laws 37.

3. See infra note 165 and accompanying text.


6. Id.

Courts in community property states have been troubled by this issue for years.  

This Comment will begin by identifying the origins of Wisconsin's Marital Property Act in an effort to determine which of the eight community property states to look to for guidance on this subject. Section II will outline some of the actions taken by these states. Finally, the Wisconsin statutes will be examined in light of these findings.

I. INTRODUCTION

A. Origins of Wisconsin's Marital Property Act

Wisconsin's Marital Property Act\textsuperscript{10} is based upon the Uniform Marital Property Act (UMPA).\textsuperscript{11} The Uniform Marital Property Act has been referred to as "a community property act."\textsuperscript{12} Although UMPA is not expressly identified as a community property act within the Act itself, its community property roots are acknowledged in the prefatory note.

Some of the root concepts can be traced to the sharing ideal which is at the center of the historical community property approach. The fundamental principle that ownership of all of the economic rewards from the personal effort


9. Id. at 130.


Make no mistake about it, UMPA is a community property proposal—the principal purpose of which is to recognize that most property acquired during marriage, however titled, becomes immediately co-owned by the spouses, with such co-ownership rights being already in existence at the termination of the marriage at death or divorce.

\textit{Id.} at 67.
of each spouse during marriage is shared by the spouses in vested, present, and equal interests is the heart of the community property system. It is also the heart of the Uniform Marital Property Act.13

The informational material connected with Chapter 766 acknowledges that the Act represents a "new system of property rights [which] embodies many principles of community property."14

It should be noted, however, that Chapter 766 does not refer to the terms "community property" and "separate property." Property has been labeled in Chapter 766 as it was in UMPA: marital15 or individual.16

In light of the acknowledged roots of UMPA, the choice of these labels has been criticized as being misleading.17 Professor William A. Reppy, Jr. observed that the term "marital property" has acquired a settled meaning in many common law and community property states.18 In common law states "'[m]arital' property refers to property that is separately owned by one spouse during marriage yet is divisible at di-

14. Id. at 1.

The act creates a new system of property rights applicable to property owned by spouses during a marriage. Under the common law property system previously applicable in this state, any person, including a married person, who "owns" a particular item of property by virtue of having brought, earned or otherwise received it has an exclusive property interest in and complete control over that property. Under this act, much of the property "owned" by one or both spouses is marital property and is subject to the property interests and control rights of both husband and wife.

Id.


17. Suggested Revisions, supra note 12, at 682-83. "There simply is no reason to reject the historic terms 'community' and 'separate' property when enacting what is clearly a community property regime." Id. at 689.

18. Id. at 682.
This meaning is different from that embodied in UMPA and Chapter 766.

19. Id. Marital property is not defined in Wis. Stat. § 767.255; however, the only property, absent a showing of hardship, excluded from division is property that was a gift, bequest, devise or inheritance or purchased with proceeds from such property.

The term individual, or separate, property is not used in § 767.255. One result might be that different types of individual property could be treated differently under § 767.255. The possible difference in treatment has been noted.

Property brought to the marriage, whether inherited or acquired by other means, and property acquired by gift or inheritance after marriage are classified by the Act as individual property without distinction. §§ 766.31(6) and 766.31(7)(a). However, although classified the same during marriage, these two types of property are treated differently at dissolution. Property brought to the marriage which was not acquired by gift or inheritance is within the marital estate subject to division under § 766.255, although the extent of such property is one of the factors considered in awarding one spouse a greater share of the estate.

§ 766.255(2). The property acquired by one spouse by gift or inheritance before or after the marriage is excluded and is awarded to the recipient unless it would be a hardship to the other to do so.

2 K. CHRISTIANSEN, F. WM. HABERMAN, J. HAYDON, D. KINNAMON, M. McGARITY, M. WILCOX, MARITAL PROPERTY LAW IN WISCONSIN §§ 11.2c-.2d, at 11-5 to 11-6 (1984) [hereinafter cited as MARITAL PROPERTY LAW IN WISCONSIN]. (The section numbers above are in error in the original and should read 767.255 and 767.255(2) respectively).

20. A comparison of Wisconsin Statute section 767.255 with section 766.31 indicates that the "pool" of property excluded from marital property is potentially larger under section 766.31 classifications. Wis. Stat. § 766.31 classification of property of spouses, provides:

(1) All property of spouses is marital property except that which is classified otherwise by this chapter.

(2) All property of spouses is presumed to be marital property.

(3) Each spouse has a present undivided one-half interest in each item of marital property, but the marital property interest of the nonemploye spouse in a deferred employment benefit plan terminates at the death of the nonemploye spouse if he or she predeceases the employe spouse.

(4) Except as provided under subs. (7)(a), (7p) and (10), income earned or accrued by a spouse or attributable to property of a spouse during marriage and after the determination date is marital property.

(5) The transfer of property to a trust does not by itself change the classification of the property.

(6) Property owned at a marriage which occurs after 12:01 a.m. on January 1, 1986, is individual property of the owning spouse if, at the marriage, the spouse has a marital domicile in this state.

(7) Property acquired by a spouse during marriage and after the determination date is individual property if acquired by any of the following means:

(a) By gift during lifetime or by a disposition at death by a 3rd person to that spouse and not to both spouses. A distribution of principal or income from a trust created by a 3rd person to one spouse is the individual property of that spouse unless the trust provides otherwise.

(b) In exchange for or with the proceeds of other individual property of the spouse.
Concern has been voiced by some that refusal to use the term “community property” may create problems for practitioners. Professor Reppy has speculated that “special rules in the Internal Revenue Code and regulations that apply to community property” may be overlooked by attorneys because of UMPA’s labeling.\(^\text{21}\) In addition, he points out that another potential problem area is the “possibility that bench and bar might believe that cases from community property states should not be cited as precedents.”\(^\text{22}\) In Professor Reppy’s opinion, this is simply not accurate. The possible confusion which might be caused by the use of the words marital and individual rather than community and separate may have been eliminated by the enactment on October 22, 1985, of

(c) From appreciation of the spouse’s individual property except to the extent that the appreciation is classified as marital property under s. 766.63.
(d) By a decree, marital property agreement or reclassification under sub. (10) designating it as the individual property of the spouse.
(e) As a recovery for damage to property under s. 766.70, except as specifically provided otherwise in a decree or marital property agreement.
(f) As a recovery for personal injury except for the amount of that recovery attributable to expenses paid or otherwise satisfied from marital property and except for the amount attributable to loss of income during marriage.
(7p) Income attributable to all or specified property other than marital property, with respect to which a spouse has executed under s. 766.59 a statement unilaterally designating that income as his or her individual property, is individual property.
(8) Except as provided otherwise in this chapter, the enactment of this chapter does not alter the classification and ownership rights of property acquired before the determination date or the classification and ownership rights of property acquired after the determination date in exchange for or with the proceeds of property acquired before the determination date.
(9) Except as provided otherwise in this chapter and except to the extent that it would affect the spouse’s ownership rights in the property existing before the determination date, during marriage the interest of a spouse in property owned immediately before the determination date is treated as if it were individual property.
(10) Spouses may reclassify their property by gift, marital property agreement, written consent under s. 766.61(3)(e) or unilateral statement under s. 766.59. If a spouse gives property to the other spouse and intends at the time the gift is made that the property be the individual property of the donee spouse, the income from the property is the individual property of the donee spouse unless a contrary intent of the donor spouse regarding the classification of income is established.

Wis. Stat. § 766.31 (1983-84) (effective Jan. 1, 1986). (Wis. Stat. §§ 766.31(3), (4), (5), (6), (7), (8) and (10) appear as amended by 1985 Wis. Laws 37. Section 766.31 (7p) was created by 1985 Wis. Laws 37, § 81m).
21. Suggested Revisions, supra note 9, at 688.
22. Id.
Wisconsin Senate Bill 150. This "trailer bill" states that "[i]t is the intent of the legislature that marital property is a form of community property."23

Given the underpinnings of UMPA and Chapter 766, community property states can be a source of information as Wisconsin courts grapple with this "new system of property rights."24 Caution must be used, however, in selecting cases from community property states. "While common law practitioners tend to think in terms of a single community property system operating in Arizona, California, Idaho, Lousiana, Nevada, New Mexico, Texas, and Washington, there is considerable diversity from community property state to community property state . . . ."25 The question then becomes which state or states to look to as possible sources of information.

B. Civil Law Rule versus American Rule

As stated previously, Chapter 766 is based on UMPA.26 The Uniform Marital Property Act adopted "the civil law rule that rents and profits of separate property are community property if they accrue during marriage."27 The civil law system is also referred to as the Spanish law system.28 Under the Spanish law system of community property, the fruits29 and profits of separate property belong to the community, regardless of whether the separate property was acquired before or

23. 1985 Wis. Laws 37, § 68 (to be codified at Wis. STAT. § 766.001(2)). The legislative note accompanying this section is as follows:

NOTE: Expressly states that it is the intent of the legislature that marital property is a form of community property. The special committee concluded that an express statement of that intent is important for purposes of the application of other law, such as federal tax law, federal law relating to equal access to credit and federal law relating to deferred employment benefits.

1985 Wis. Laws 37, § 68 note.
25. Regional Report, supra note 12, at 149.
26. See supra notes 10-16 and accompanying text.
27. Suggested Revisions, supra note 12, at 698.
28. W. REPPY & C. SAMUEL, COMMUNITY PROPERTY IN THE UNITED STATES, 131 (2d ed. 1982) [hereinafter cited as REPPY & SAMUEL]. See generally McClanahan, supra note 5, at §§ 2:27 -39 (overview of some of the theories and terms applicable in states following the civil law system).
29. "Civil Fruits. In the civil law (fructus civiles) are such things as the rents and income of real property, the interest on money loaned, and annuities. Rents and revenues of an immovable." BLACK'S LAW DICTIONARY 603 (5th ed. 1979).
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during the marriage. 30 Wisconsin, Idaho, Louisiana and Texas follow this civil law rule with slight deviations. 31

This is in contrast to the American rule, under which "rents and profits have the same separate character as the productive property except to the extent there is an apportionment for labor of either spouse that helped generate the profit." 32 California, Nevada, Washington, Arizona and New Mexico follow the American rule for apportioning the income from separate property. 33

30. W. DeFuniak & M. Vaughn, Principles of Community Property § 71, at 160 (2d ed. 1971) [hereinafter cited as DeFuniak & Vaughn].

This was based on the conception that, although each spouse retained ownership of his or her separate property, each unselfishly and unhesitantly had at heart the success and well-being of the marital union and that, accordingly, the fruits and income of all property of each naturally were to be devoted to the benefit of the marital union.

Id. at 161.

31. Reppy & Samuel, supra note 28, at 131. "Louisiana adheres to this system, except where a spouse opts out of it by filing a declaration that he or she claims rents and profits from his or her separate property as separate property." Wisconsin has provided spouses with the same option in section 766.31(7p). This section allows a spouse to unilaterally designate as individual property the income from their property that is other than marital. 1985 Wis. Laws 37, § 81m (to be codified at Wis. Stat. § 766.31 (7p)). See supra note 20 for text. Idaho follows the civil law system:

[U]nless (1) the instrument conveying separate property to H or W specifies that rents and profits will also be separate or (2) H and W so agree in writing. Income from property given by one spouse to the other remains community unless the donor-spouse specifically states in the instrument of conveyance that the income is to be separate.


"Texas is basically a civil law rule state. However, . . . [i]f one spouse makes a gift of property to the other spouse, that gift is presumed to include all the income or property which might arise from that gift of property. Tex. Const. art. XVI § 15, as amended 1980." Id.

The same result has been achieved in Wisconsin with the amendment to section 766.31(10) in 1985 Wis. Laws 37. The legislative note to 1985 Wis. Laws 37, § 83 is as follows:

NOTE: Clarifies that the income from an interspousal gift, the principle of which the donee spouse intends at the time the gift is made to be the individual property of the donee spouse, is also the individual property of the donee spouse unless a contrary intent of the donor spouse is established. The special committee concluded that the provision reflects what, in most instances, a donor spouse intends with respect to the classification of income from such property. The special committee also concluded that it is important to allow the donor spouse to implement a contrary intent.

1985 Wis. Laws 37, § 83 note.


33. Id.
In both civil law states and American rule states, the natural increase in the value of separate property is separate.\textsuperscript{34} Gain that can be attributed to either spouse's labor is, however, an asset of the community in all community property jurisdictions.\textsuperscript{35} Once it has been determined that gain has resulted from both of these factors, natural increase and labor, it becomes necessary to allocate a portion of the gain to both the community and the separate estates. In order to do this fairly, some system of apportionment must be used.\textsuperscript{36} A variety of apportionment systems exist;\textsuperscript{37} furthermore, individual state courts may use a number of different systems rather than restricting themselves to only one or two methods.\textsuperscript{38}

Segregation of increases "consisting of separate rents and profits" from those resulting from labor is required in states following the American rule in which the rents and profits of separate property remain separate.\textsuperscript{39} While the issue of apportionment may not be as apparent in civil law states as it is in American rule states, problems can still occur.\textsuperscript{40}

\textsuperscript{34} Id. at 131-32. This concept is evident in the Wisconsin statute pertaining to the classification of property. Wis. Stat. § 766.31(7) (c) provides that property is individual to the extent it is derived: "From appreciation of the spouse's individual property except to the extent that the appreciation is classified as marital property under s. 766.63." (this section corresponds to § 4(g)(3) of UMPA).

\textsuperscript{35} Adler, Arizona's All-or-Nothing Approach to the Classification of Gain from Separate Property: High Time for a Change, 20 Ariz. L. Rev. 597, 597 (1978) [hereinafter cited as Adler].

\textsuperscript{36} Id. at 606.

\textsuperscript{37} See King, The Challenge of Apportionment, 37 Wash. L. Rev. 483 (1962) [hereinafter cited as King]. King identifies what he considers to be ten different systems of apportionment. See generally Adler, supra note 35. Adler identifies six systems of apportionment in his article. Semantics can be a problem as a comparison of these two articles points out. The two authors, at times, use different labels to identify similar systems. For example, King uses the term "salary system" and Adler uses the term "segregation test" to identify similar systems. Although both articles concentrate primarily on American rule states, their descriptions of the various systems are helpful to an understanding of apportionment. As Reppy and Samuel note, civil law states have apportionment problems, too. These problems are not, however, as well recognized as they are in American rule states. Reppy & Samuel, supra note 28, at 155.

\textsuperscript{38} King, supra note 37, at 485. "Courts of one state often refer to, and adopt, methods from other states. Furthermore, courts within a single state may utilize different formulae and courts have stated that they may utilize any system whatever." Id.

\textsuperscript{39} Reppy & Samuel, supra note 28, at 132.

\textsuperscript{40} Id. at 155.
cause rents and profits from separate property are community property. Civil law states require a separation of gains resulting from the natural increase in value which is separate property, from "rents, profits and return on labor," which is community property. Caution must be used when applying apportionment methods used in American rule states because the estates that are being segregated in the two community property systems are different.

In light of the basic difference between treatment of rents and profits under the civil law rule and the American rule, and the aforestated fact that Chapter 766 follows the civil law rule, this analysis will focus on the states of Idaho, Louisiana and Texas to determine their courts' treatment of a spouse's separate property interests in a closely held corporation at the dissolution of a marriage.

II. STATES FOLLOWING THE CIVIL LAW RULE

This section will outline some of the decisions from Idaho, Louisiana and Texas involving the enhanced value of a closely held corporation which was the separate property of one of the spouses.

41. Suggested Revisions, supra note 12, at 702-03.
42. REPPY & SAMUEL, supra note 28, at 132.
43. Suggested Revisions, supra note 12, at 702-03. Professor Reppy discussed apportionment approaches analogous to Van Camp (derived from Van Camp v. Van Camp, 53 Cal. App. 17, 199 P. 885 (1921)) and Pereira (Pereira v. Pereira, 156 Cal. 1, 103 P. 488 (1909)). In the former, "the community return is fixed by specific calculations and the separate share of gain 'floats'. This formula best benefits the separate estate if the gain is unusually large." In the latter, "[t]he community share 'floats', and thus this approach best benefits the community estate if the gain is unusually large; the separate estate benefits by this method if the gain is modest." Id. at 702.

In California, the courts choose which apportionment formula to apply by determining whether separate capital or community labor was the factor primarily responsible for the gain. The applicable "capital" factor is gain occurring without any labor. This factor raises no apportionment problem even if the asset was bought with the intention of reselling for profit. Under the UMPA's civil law approach, however, what California treats as "capital" must be broken down into natural appreciation and profit components. Thus, the "chief contributing factor" test cannot be borrowed automatically from California. Id. at 702-03 (emphasis added).

44. REPPY & SAMUEL, supra note 28, at 131. Idaho, Louisiana and Texas are the only community property states that consider the rents and profits of separate property to belong to the community. Id.
A. Idaho

In *Gapsch v. Gapsch*\(^45\) the Supreme Court of Idaho set forth several rules concerning the enhancement in value of separate property. Natural enhancement in value was declared to be separate.\(^46\) If separate property was improved with "community efforts, labor, industry or funds," the community would be entitled to reimbursement from the separate estate.\(^47\) Armed with these rules and Idaho's statutory definitions of separate\(^48\) and community property,\(^49\) the court set out to deal with the issue of whether a spouse was entitled to share in the increased value of a close corporation in *Speer v. Quinlan.*\(^50\)

A brief sketch of the financial picture in *Speer* is helpful to gain an understanding of the interests at stake. Raymond Speer was the majority stockholder of Speer, Inc., owning 65% of the stock.\(^51\) At the time of the trial court's decision, Speer was president of the corporation.\(^52\) The trial court made several findings concerning the value of the stock and the corporation. From 1965 to 1971, the book value of the stock had increased $718.43 per share; the corporation's market value had increased $1,160,000 between 1964 and 1971.\(^53\) Speer, Inc. had never declared a dividend nor issued a stock

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45. 76 Idaho 34, 277 P.2d 278 (1954).
46. 76 Idaho 34, 277 P.2d at 278-279.
47. Id. at 277 P.2d at 282. "As a general rule where the separate property of the husband is improved or his equity therein enhanced by community funds the community is entitled to be reimbursed from such separate estate unless such funds used for improvement or enhancement are intended as a gift." Id.
48. *IDAHO CODE* § 32-903 (1983). (This section remains the same as the Idaho Code in effect at the time of Speer v. Quinlan, 96 Idaho 119, 525 P.2d 314 (1973)).
49. *IDAHO CODE* § 32-906 (1983). The wording of this code section has been changed slightly since the version of the Idaho Code used in Speer. The change did not affect the status of income as community property. In the code section in force at the time of Speer the wife could acquire separate property and keep the rents and profits as her separate property if the conveying instrument so provided. The current version of § 32-906 extends this option to both spouses and further provides that the spouses can by written agreement declare the rents and profits of separate property to be separate.
51. Id. at 525 P.2d at 317.
52. Id.
53. The Idaho Supreme Court in *Simplot v. Simplot*, 96 Idaho 239, 526 P.2d 844 (1974), held that the market value of the corporation and not its book value must be ascertained; book value reflects only a historical value and not a present day value. *Id.* at 526 P.2d at 850.
dividend. Furthermore, at the time of the trial the corporation had accumulated $339,493 of undistributed after-tax earnings.

When the Supreme Court of Idaho surveyed the other community property jurisdictions to discover how they handle this issue, the court discovered conflicting authority and inconsistent decisions. What appeared to bother the court the most, however, was the "artificial distinction made between a separate property business organized in the form of a close corporation and an unincorporated sole proprietorship or partnership." Some believe this distinction reflects the reluctance of courts to pierce the corporate veil absent a showing that the corporation is the spouse's alter ego or the establishment of the perpetration of a fraud on the community.

The court in Speer attempted to provide guidelines in cases where a spouse's separate business benefits from community efforts and ability. Of prime importance to the Idaho court was the issue of whether the corporation had adequately compensated Raymond Speer for his labor. This inquiry was necessary to determine whether the correct balance between separate and community interests had been achieved. That is, if he had been adequately compensated it is less likely that community property was retained by the corporation. A number of factors which must be taken into consideration in reaching this determination were set forth by the court: "[T]he nature of the business, the size of the business, the number of employees, the nature and extent of community involvement in the conduct of the business, the growth pattern

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54. If dividends had been distributed, they would have been community property. Speer, 96 Idaho at __, 525 P.2d at 324.
55. Id. at __, 525 P.2d at 317. As to the retention of earnings, it was acknowledged that Mr. Speer's position as president and general manager gave him influence over the decision of whether to retain the earnings or declare a dividend. However, there were no allegations that the retention was unreasonable or was done to defraud the community. Id. at __, 525 P.2d at 324.
56. Id. at __, 525 P.2d at 321.
57. Id at __, 525 P.2d at 321-22.
58. Featherston & Trail, supra note 8, at 133.
59. The court in Speer noted that a couple acquires both tangible and intangible assets during a marriage. An important intangible asset is the ability of either spouse to contribute to the community by their labor. The court concluded "that to the extent that either spouse is rewarded for his or her labor during the marriage, such reward is community property." Speer, 96 Idaho at __, 525 P.2d at 323.
of the business. (Did it steadily enhance in value? Did periods of prosperity alternate with periods of decline?)" Once these questions are dealt with, the court must determine whether the compensation received was equivalent to that which a non-owner employee would have been paid to perform the same services. In reaching this determination, the salaries of individuals who are located in the same general geographical area and who possess similar skills and responsibilities could be one factor to consider. If it is determined that the community was not adequately compensated, the community is entitled to a judgment equal to the difference between actual compensation and that which would have been received had there been just compensation. Conversely, if it is found that the community was adequately compensated, the community has no further claim.

The corporation’s retained earnings presented the court with another problem. Again, the court established guidelines. It directed the trial court to determine the extent to which the community would have benefited if the earnings had been distributed. In order to do this, the trial court had

60. Id.

61. Id. The use of this criterion as a factor in determining whether the compensation received was adequate was criticized by Justice McFadden in his dissent in Speer: "[E]valuation of Raymond Speer’s compensation in comparison with other employees would be doing a great injustice in not recognizing the actual contribution made by both parties of the community to the increase in valuation of the separate property." Id. at , 525 P.2d at 330. The trial court had found that Olive Speer had made a "substantial contribution" to her husband’s success through her role of wife and mother, in addition to entertaining clients and business contacts.

62. Id. at , 525 P.2d at 330. Cutbacks in salary resulting from the payoff of corporate notes do not necessarily mean the individual was inadequately compensated; the court must look at the overall compensation received including fringe benefits and bonuses. Id. at , 525 P.2d at 324.

63. Id. at , 525 P.2d at 323. See also Gapsch, 76 Idaho at , 277 P.2d at 283. "The claim for reimbursement has been held to be in the nature of a charge or an equitable lien against such separate property so improved. . . . [T]he measure of the compensation generally is the increased value of the property due to the improvement.” Id.

64. McClanahan, supra note 5, § 6:18, at 359. “If an adequate salary is paid for the management. . . . there normally will not be any community claim to share in the increased value of the business. . . .” Id.

65. Having never been distributed, the net earnings could not be labeled as income, rents or profits. Speer, 96 Idaho at , 525 P.2d at 324.

66. The Supreme Court of Idaho determined that the Speer community would have received dividend distributions in proportion to Raymond Speer’s ownership interest in
to determine whether the retained net earnings figure was accurate. In doing so, the trial court was to consider at least two factors. First, the extent to which the community may be entitled to additional compensation because Speer had originally been undercompensated for his labor. If it were found that Speer and/or Luthy, the other employee stockholder, had originally been undercompensated for their labor, the additional salary would have to be deducted from the corporation's income in the process of reaching the net earnings figure. Second, the trial court was to give consideration "toward the maintenance of the corporate solvency." 

The Idaho Supreme Court recognized that any procedure designed to compensate for the detriment to the community resulting from a retention of the earned surplus would be inexact. However, the court also recognized that any such "procedure would be no more lacking in precision than awarding damages for pain and suffering, which has been accomplished satisfactorily by the courts for many years." Retained earnings were handled differently in the Idaho case of *Simplot v. Simplot*. In *Simplot*, the court refused to include the retained earnings of J. R. Simplot Company as a

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the corporation: 65%. The court noted that, "because of business exigencies, monies that might otherwise have been distributed to the community as cash dividends, instead remained in the business in which Raymond Speer holds a separate property ownership interest." *Id.*

The Supreme Court of Idaho instructed the district court to "determine the extent to which the community would have benefited, had 65% of the distributable earnings of the corporation been received by the community in the form of dividends." *Id.*

The [Speer] court initially held that the retention of the earnings in the business did not present a case of community funds being invested in a separate property business and thus that no ownership interest in the business was received. However, the court did hold that under the discretionary division at divorce statute applicable in Idaho, any inequity that the retention of income may have caused could be rectified. This decision gives the wife the right to participate in the accumulated income of a corporation during the time of the marriage.

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1 Marital Property Law In Wisconsin, supra note 19, § 3.26(c) at 3-50.


68. Id. at —, 525 P.2d at 325.

69. Id. The Speer court noted that § 32-712 of the Idaho Code providing for the discretionary division of community property was a device that could be used in this situation.

70. 96 Idaho 239, 526 P.2d 844 (1974). The *Simplot* court chose to ignore the treatment of retained earnings in *Speer* because a petition for rehearing had been granted in *Speer*. *Id.* at —, 526 P.2d at 846 n.1. The petition for rehearing in *Speer* involved a request for clarification on the types of job comparisons that are required in a
factor to be considered in the division of property between the spouses. The court noted that Don Simplot had "no legal right to the retained earnings and . . . there [was] no guarantee that they [would] ever become of economic benefit to him." Therefore, they could not be labeled as income, rents or profits. According to the court, the retention and reinvestment of the earnings in the business was a decision for the corporation's directors, a decision in which the court refused to "substitute its judgment for the business judgment of the directors . . . ."

There are factual differences between Speer and Simplot which could account for the court's reluctance to consider the retained earnings in the latter case. Don Simplot was a minority shareholder in Apex Corporation, a corporation whose sole function was to hold the shares of J. R. Simplot Company. Simplot's shares of J. R. Simplot Company, through his shares of Apex, amount to "8.4% of the total ownership of J. R. Simplot Company." Furthermore, the trial court had found that Simplot had been adequately compensated by the corporation for his services. These facts may have caused determination of adequate compensation. Speer, 96 Idaho at _, 525 P.2d at 330. It should be noted that:

In neither Speer nor Simplot did the court find the accumulated corporate income itself was a community asset. This means that the wife would not have been able to will her one-half interest in this asset, and that at the husband's death, his gift of the shares of stock would also transfer the wife's interest. It may be impossible to avoid this result in situations involving corporations.

1 Marital Property Law in Wisconsin, supra note 19, § 3.26 at 3-53.

71. Simplot, 96 Idaho at _, 525 P.2d at 847-48. The husband's proportionate share (8.4%) of the retained earnings at the start of the marriage in 1953 was $235,269. In 1971, the retained earnings amounted to $44,230,790; husband's share $4,039,480. During the marriage the husband's share of the retained earnings increased 88% or $3,789,090. Id. at _, 526 P.2d at 846.

72. Id. at _, 526 P.2d at 848.

73. Id.

74. Id. at _, 526 P.2d at 846.

75. Id. at _, 526 P.2d at 849. Sharidon Simplot contended that there was insufficient evidence to support the trial court's finding of adequate compensation for community labor. The Supreme Court of Idaho noted conflicting evidence was presented on this issue. However, the court also noted "the trial court is the arbiter of conflicting evidence, and its findings of fact will not be disturbed on appeal if supported by substantial and competent, though conflicting evidence." The court did not disturb the findings of the trial court on this issue. Id.

Again there were no allegations on the part of Sharidon Simplot that the retention of earnings was fraudulent or done to deprive the community. Id. at _, 526 P.2d at 848.
the appellate court to view the retained earnings in a different light than they did in Speer.

While acknowledging the need to protect the community from loss of earnings through the use of business organizations in these two cases, the Idaho court also recognized the need to protect separate property interests.\textsuperscript{76} This stance is not unusual in community property states because of the need to balance the interests of community and separate estates.\textsuperscript{77}

\section*{B. Louisiana}

Although \textit{Abraham v. Abraham}\textsuperscript{78} involved an unincorporated business, the Supreme Court of Louisiana's handling of several issues in that case has had implications in actions involving incorporated businesses. In \textit{Abraham}, the court was required to determine the extent of the husband's interest in the enhanced value of his wife's unincorporated mercantile business. The wife had played an active role in the management of the business during the marriage.\textsuperscript{79}

Several general policies were set forth by the court in \textit{Abraham} that have been applied in cases involving incorporated businesses. First, the court determined that the enhanced value of separate property resulting from the community labor of either spouse should benefit the community.\textsuperscript{80} Initially, there was a question of whether the spouse requesting a portion of the increase had to establish that that spouse's labor, as opposed to either spouse's labor, had caused the increase in value. The court concluded that the request could be premised on the labor of either spouse.\textsuperscript{81} Second, the

\begin{itemize}
  \item \textsuperscript{76} \textit{Id.} at \_, 526 P.2d at 848. "[T]he increase in retained earnings in this action must be considered natural enhancement and not income or rents and profits in order to preserve the right to own and hold separate property." \textit{Id.}
  \item \textsuperscript{77} \textit{See infra} notes 93, 117, and 127 and accompanying text.
  \item \textsuperscript{78} 230 La. 78, 87 So. 2d 735 (1956).
  \item \textsuperscript{79} The wife's share of the capital and undivided profits at the commencement of the marriage was $15,954.53. This figure had increased to $46,824.47 at the time of the dissolution of the marriage. \textit{Abraham}, 230 La. at \_, 87 So. 2d at 737.
  \item \textsuperscript{80} \textit{Id.} at \_, 87 So. 2d at 738-39. Courts, at times, have difficulty in determining what portion of income represents earnings, community property, as opposed to fruits, which become the wife's separate property if she files an instrument declaring her intention to reserve these for herself. \textit{See Paxton v. Bramlette}, 228 So. 2d 161, 163 (La. Ct. App. 1969).
  \item \textsuperscript{81} \textit{Abraham}, 230 La. at \_, 87 So. 2d at 738. The court interpreted the words "common labor", as used in \textit{LA. CIV. CODE ANN.} art. 2408 (repealed 1980), to mean
court considered the implications of an earlier case, Beals v. Fontenot, which dealt with the increase in value of corporate stock. Implicit in the Beals decision is the assumption that if community efforts contributed to the increase in the value of stock, the non-owning spouse would be entitled to one-half of such increase. The court noted that the question was not whether the spouse had been adequately compensated but whether the labor had contributed to the increased stock value. Finally, the court declared that the "legal status of the business has no relevancy whatever; the only inquiry is whether the value of the separate property of a spouse, whether it be in the form of stock or otherwise, has been enhanced by the labor or industry of the community."

This last concept was reiterated by the Louisiana Court of Appeals in Mohr v. Mohr. Mohr required the court to determine whether the husband had been adequately compensated for his labors by the Crescent Cigarette Vending Corporation. Crescent, a closely held corporation, was owned and totally controlled by the husband. Mrs. Mohr contended that at least part of the enhanced value of the stock was a result of her husband's management. In response to Mrs. Mohr's contention, the court of appeals enumerated four requirements that must be met before the community is entitled

"community labor or industry as the word 'common', as used in the Civil Code is synonymous with 'community'." Abraham, 230 La. at __, 87 So. 2d at 738 (emphasis in original).

82. 111 F.2d 956 (5th Cir. 1940).
83. Abraham, 230 La. at __, 87 So. 2d at 738.
84. Id. at __, 87 So. 2d at 739 n.5.

The court in Abraham indicated that the "[a]pplicability of Article 2408 of the Civil Code is dependent on" whether community labor contributed to the enhancement of the separate property and "not upon whether the community has been adequately remunerated by the salary and dividends received." Abraham at __, 87 So.2d at 739 n.5.

Article 2368, which became effective January 1, 1980, concerns the handling of the increase in value of separate property and discusses reimbursement for "uncompensated common labor or industry," LA. CIV. CODE ANN. art. 2368 (West 1985). See infra note 93 for text of Article 2368. Article 2368 has been interpreted recently by the Louisiana Court of Appeals in McKey v. McKey, 449 So. 2d 564 (La. App. 1984).

85. Abraham, 230 La. at __, 87 So. 2d at 739.
87. Crescent bought out its competitor, Talcott. As one of the conditions for this sale a $20,000 limitation was placed on Mohr's annual salary by Talcott. In addition, no dividends were paid during the course of this obligation. Id. at 204.
88. Id.
89. Id.
to reimbursement for the enhanced value of the husband’s separate property:

[(1)] that the improvements did in fact enhance the property; (2) that the improvements were made with community funds or joint labor; (3) the value at the commencement and dissolution of the community; and (4) that the enhancement did not result from the ordinary course of events, i.e. a natural appreciation of immovable property . . . 90

Once the spouse asserting the right of reimbursement for the community establishes that community labor contributed to an increase in the value of the separate property, the burden shifts to the owning spouse to establish that the increase was the result of “the ordinary course of things.” 91 The result of this process has been referred to as an all or nothing approach. If the spouse was successful in establishing that the increase in value was due to “the ordinary course of things,” all of the increase would be separate. If the spouse were unsuccessful, all would be community property. 92 Since it was amended in 1980, the Louisiana Civil Code now calls for an apportionment of increase in value of separate property resulting from uncompensated community labor. 93

The court noted that the fact that Mohr’s salary had been limited as a condition of Crescent’s acquisition of a competitor did not mean that the salary represented “a fair return for the labors expended . . . .” 94 Directions were given to the trial court to determine the “real value of Mohr’s labors” and to “accord credit for one half of same to appellant.” 95

90. Id. (quoting Fontenot v. Fontenot, 339 So. 2d 897, 901 (La. Ct. App. 1976)).
91. Abraham, 230 La. at __, 87 So. 2d at 739 (emphasis in original). See also Downs v. Downs, 410 So. 2d 793, 797-98 (La. Ct. App. 1982).
92. When the owning spouse had to establish that the enhancement was “due only to the ordinary course of things rise in values or chances of trade” the failure to do so resulted in the entire enhancement belonging to the community. This has been referred to as “an all or nothing proposition.” Deliberto v. Deliberto, 400 So. 2d 1096, 1101 (La. Ct. App. 1981) (emphasis in original).
93. LA. CIV. CODE ANN. art. 2368 (West 1985) provides:

If the separate property of a spouse has increased in value as a result of the uncompensated common labor or industry of the spouses, the other spouse is entitled to be reimbursed from the spouse whose property has increased in value one-half of the increase attributed to the common labor.

Id. The comments to Article 2368 indicate that “[t]o the extent that a spouse is compensated for his labor, no reimbursement is due.” Id.
94. Mohr, 374 So. 2d at 205.
95. Id. at 205-06.
this determination the court noted that “the corporate entity has no particular significance.”

C. Texas

Vallone v. Vallone and Jensen v. Jensen are two recent Texas cases concerning the enhanced value of close corporations. Both cases have prompted a number of articles which attempt to analyze their impact on Texas law. Both are in sharp contrast to an earlier Texas Court of Appeals case, Bell v. Bell.

It is important when reading the majority's opinion in Vallone to remember that the only issue under consideration was whether the trial court had abused its discretion in dividing the property at dissolution. The majority did not consider the issue of whether the property had been properly classified by the trial court. Therefore, they never reached the question of whether the increase in value of the corporation was separate or community property. This is an important distinction and one which the dissent in Vallone was quick to point

96. Id. at 206.
98. 665 S.W.2d 107 (Tex. 1984). Care must be used when reviewing materials pertaining to or citing Jensen. The case has generated one opinion from the Texas Court of Appeals, 629 S.W.2d 222 (Tex. Civ. App. 1982) and three opinions from the Texas Supreme Court, 26 Tex. Sup. Ct. J. 480 (July 6, 1983), opinion withdrawn; 27 Tex. Sup. Ct. J. 68 (Nov. 9, 1983), opinion withdrawn; 665 S.W.2d 107 (Tex. 1984). The three Texas Supreme Court opinions in Jensen are sometimes referred to as Jensen I, II, and III.
100. 504 S.W.2d 610 (Tex. Civ. App.), rev'd on other grounds, 513 S.W.2d 20 (Tex. 1979). The court of civil appeals of Texas had remanded the Bell case to the trial court with directions to consider the increase in value of the corporate assets when dividing the property at divorce. The Supreme Court of Texas reversed the court of civil appeals's decision finding that the trial court did not fail to take the corporations into consideration when making the division of property. The trial court, in the opinion of the Supreme Court of Texas, had awarded the corporations to the husband in the exercise of its discretion.
101. Vallone, 644 S.W.2d at 457. “The case comes to us in the following posture: Did the trial court abuse its discretion by ignoring community rights and equities which might have existed in the corporation?” Id.
Nevertheless, the *Vallone* majority opinion did clarify a few issues.

At the center of the controversy in *Vallone* was a restaurant which was initially operated as a sole proprietorship and incorporated after the marriage. Initial capitalization of the restaurant was $19,663. At the time of the trial, the restaurant constituted the "major asset of both the community estate and the husband's separate estate" and was valued at one million dollars. Of this one million, $700,000 represented retained earnings. Mr. Vallone had received $200,000 a year from the corporation as compensation. Forty-seven percent of the corporate stock was awarded to Mr. Vallone and seventy percent of the remaining fifty-three percent of the stock was awarded to Mrs. Vallone "as her share of the community interest in the corporation . . . ."

It was Mrs. Vallone's contention that the corporation had been operated as her husband's alter ego, the implication being that the corporate veil could be pierced on this basis, thus allowing the community access to the corporation's enhanced value. This theory had been used successfully in earlier Texas cases dealing with corporations under similar circumstances. In this instance, the trial court decided that the corporation was not the husband's alter ego.

In addition to her claim that the corporation was her husband's alter ego, Mrs. Vallone requested reimbursement

102. *Id.* at 460 (Sondock, J., dissenting).
103. *Id.* at 457. The restaurant had been owned by the husband's father as a sole proprietorship. After his marriage in 1966, the husband worked at the restaurant for his father. In 1969, the father transferred the restaurant's assets to the husband as a gift. The restaurant was incorporated in 1969. *Id.*
104. *Id.*
105. *Id.* at 464 n.7. The husband's records indicated the figure of $700,000 as retained earnings.
106. *Id.* at 457.
107. *Id.* The 47% figure represented that portion of the initial capitalization ($19,663) represented by the husband's separate property ($9,365 worth of used restaurant equipment gifted to the husband). *Id.*
108. *Id.*
109. See, e.g., Dillingham v. Dillingham, 434 S.W.2d 459 (Tex. Ct. App. 1968). See also Bell, 504 S.W.2d at 612 (Keith, J., dissenting) (dissent voiced opposition to the majority's finding that the enhanced value was community property in light of the trial court's finding that the corporation was not the husband's alter ego).
110. *Vallone*, 644 S.W.2d at 457.
111. *Id.* at 458.
if it was found that her husband’s separate estate had been unjustly enriched at the community’s expense.113 A prior Texas case, *Hale v. Hale*,114 “held that a contribution of community labor should not be taken into account in determining the amount of reimbursement that may be owing to the community by the benefited separate estate.”115 While disapproving of the exclusion in *Hale* of community time, talent and labor as factors to be considered in determining the amount of reimbursement, the court in *Vallone* refused to find that these factors entitled the community to reimbursement.116

Although the majority did not expressly state that it considered the community to have been adequately compensated, the language of the opinion seems to imply just that. Specifically, the court noted that reimbursement is “premised on uncompensated time, talent or labor” and further that the “right of reimbursement arises when the funds or assets of one estate are used to benefit and enhance another estate without itself receiving some benefit.”117 By implication, it would appear that the court considered the community to be compensated for the husband’s labor.

The dissent in *Vallone* viewed the facts of this case in a far different light than did the majority. The dissent noted that if the restaurant had been run as a sole proprietorship, the entire increase in value would have been community property.118 This same view was expressed in *Bell*, where the Texas Court of Appeals stated that “it would be unreasonable to apply one rule to an individually owned situation and another to a cor-

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113. *Vallone*, 644 S.W.2d at 457-58.

114. 557 S.W.2d 614 (Tex. Civ. App. 1977). *Hale* was disapproved in *Vallone* to the extent that it “held that the expenditure of community time, talent and labor may under no circumstances give rise to an equitable right of reimbursement in the community’s favor, . . . .” *Vallone*, 644 S.W.2d at 459.

115. *Vallone*, 644 S.W.2d at 457.

116. *Vallone*, 644 S.W.2d at 459. The possibility of reimbursement for community labor which resulted in the increase in value of a spouse’s separate property was alluded to in dicta in *Wachendorfer*, 615 S.W.2d at 855.

117. *Vallone*, 644 S.W.2d at 459 (emphasis added).

118. *Id.* at 463-64 (Sondock, J., dissenting).
porately owned situation.”119 In the opinion of Justice Sondock, the majority in *Vallone* had elevated form over substance by allowing a spouse to transform community earnings to separate property “by a simple *ex parte* paper transaction . . . .”120

The concept of a court being able to fix “adequate compensation” for the labors of the spouse was also criticized in the *Vallone* dissent. Justice Sondock pointed out that what an individual or court might view as “adequate” could be far below what is actually received as income. He stated his impression of the rule concerning earnings during marriage being community property as applying to “all of the earnings” and not only the “portion of the earnings found to be adequate compensation . . . .”121

Despite Justice Sondock’s strong dissent in *Vallone*, when the court was faced squarely with the need to decide the character of the increase in value of a corporation, it chose to acknowledge the corporate entity and allow only adequate compensation to the community in *Jensen III*.122 According to the findings of the trial court in *Jensen*, there was no question that the husband’s role was the key to the success of RLJ Printing Company, Inc.123 RLJ Printing Company, Inc. had been acquired by the husband four months before his marriage and was the holding company for all the stock in Newspaper Enterprise, Inc., which was acquired sixty-four days before the marriage.124 The trial court had found that the RLJ Printing Company, Inc. was not the alter ego of the husband and was not created in fraud of the community estate’s rights.125

Finding that the trial court’s decision regarding the reasonableness of the husband’s compensation was based on inadequate support, the Texas Supreme Court remanded the

119. *Bell*, 504 S.W.2d at 611. “[T]he trial court shall take into consideration the increase in value of the corporate assets by reason of the business transacted through such corporation during the term of the marriage. This rule is not founded upon fraud, but rather upon the broad principle of equity.” *Id.* at 611-12.
120. *Vallone*, 644 S.W.2d at 465 (Sondock, J., dissenting) (emphasis added).
121. *Id.* at 461 (emphasis supplied).
122. *Jensen*, 665 S.W.2d at 107.
123. *Id.* at 108.
124. *Id.*
125. *Id.*
case for retrial on that issue. In doing so, the court set out guidelines for the trial court concerning the rights of the community if the compensation was found to be inadequate. These guidelines are an attempt to indicate the extent of the community’s interest in any increase in value of the corporation over the length of the marriage.

The court first briefly examined the underlying differences between the right to reimbursement theory and the community ownership theory, and concluded that the “reimbursement theory more nearly affords justice to both the community and separate estates.” Next the court set out a formula to be used to ensure protection for the interests of both estates.

The community will be reimbursed for the value of time and effort expended by either or both spouses to enhance the separate estate of either, other than that reasonably necessary to manage and preserve the separate estate, less the remuneration received for that time and effort in the form of salary, bonus, dividends and other fringe benefits, those items being community property when received.

D. Comparisons

It is obvious from the review of cases in these three states that they view the issue of the increased value of a spouse’s separate property interest in a close corporation from different perspectives. Louisiana’s position of considering the legal status of the business to be of no relevance129 appears diametrically opposed to the respect Texas seems to pay the corporate

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126. Id. at 110. Compensation from 1976 to 1979 consisted of salary, bonuses and dividends equalling respectively: $64,065.97; $95,426.00; $106,143.00; and $115,000.00. Id. at 108. The trial court’s finding was based on the opinion of an expert in the field of corporate evaluation whose opinion concerning the husband’s compensation was based on the husband’s percentage of stock ownership. The supreme court concluded that the correct measure is whether the “salary, bonuses and dividends received by the community” was reasonable compensation for the husband’s “time, toil and effort . . . .” Id. at 110.

127. Id. at 109. The court also concluded the reimbursement theory is consistent with the laws of Texas and that the “status of the property is to be determined by the origin of the title to the property, and not by the acquisition of the final title.” Id. The former is referred to as the inception of title theory and the latter is sometimes referred to as the source of funds theory.

128. Id.

129. Abraham, 230 La. at ___, 87 So. 2d at 739.
entity, minus a showing of fraud or alter ego.\textsuperscript{130} It must be remembered, however, that cases of this kind tend to be very fact oriented.\textsuperscript{131}

While there are differences in treatment among these states, there are similarities as well. Each state speaks of reimbursing the contributing estate for its uncompensated effort;\textsuperscript{132} reimbursement as opposed to creating an ownership interest in the benefited estate.\textsuperscript{133} Each is concerned that the community has been compensated in some way for the efforts expended on the separate property. The concept of adequate compensation, despite the difficulties in determining what is adequate, concides with basic principles of community property law. Each estate must be protected from encroachment by the other. Therefore, the contributing estate is entitled to be compensated for its efforts and no more.\textsuperscript{134}

How will Wisconsin deal with these issues when they arise in the context of a divorce action? Will the aforesaid decisions from Idaho, Louisiana and Texas form a backdrop against which those in Wisconsin are played? A brief look at a few of the differences between Wisconsin and these three states is necessary before attempting to answer these questions.

III. WISCONSIN

A. Equitable Distribution

Today Wisconsin, which is referred to as an equitable distribution common-law state,\textsuperscript{135} bases its divorce statutes, in part, on community property principles.\textsuperscript{136} Although begin-

\begin{itemize}
\item 130. Featherston & Trail, \textit{supra} note 8, at 133.
\item 131. McClanahan, \textit{supra} note 5, § 6:18, at 359.
\item 132. See supra notes 62, 90 and 117 and accompanying text.
\item 133. See McClanahan, \textit{supra} note 5, at §§ 6:6, 6:7. "If ownership is determined by the inception of title doctrine, subsequent payments in the acquisition process usually give rise to a right of reimbursement to the 'other' estate, but do not change the character of the ownership." \textit{Id.} at § 6:6, at 337. This is in comparison with "co-ownership by the separate and community estates according to their respective contributions." \textit{Id.} at § 6:7, at 338.
\item 134. McClanahan, \textit{supra} note 5, § 6:18, at 359.
\item 136. Wisconsin divorce law is based upon the Uniform Marriage and Divorce Act. Dixon v. Dixon, 107 Wis. 2d 492, 499 n.6, 319 N.W.2d 846, 850 n.6 (1982). The Uniform Marriage and Divorce Act's proposal for division of property is in substance a
ning in 1986 Wisconsin will become a community property state, distribution of property at the dissolution of the marriage will remain unchanged. Distribution will be equitable but not necessarily equal. This is an important distinction to remember when considering case law from the civil law states. Louisiana divides property along “equal in value” lines, while Idaho and Texas divide property along equitable lines.

Although it might appear that Wisconsin, Idaho and Texas would handle the distribution of property upon divorce in a like manner, the results in these states could be far different. In Idaho, “the court has no power to divide or assign the separate property of one spouse to the other spouse . . . .” In a recent Texas case, *Cameron v. Cameron*, the Texas Supreme Court concluded that separate property could not be distributed to the non-owning spouse in a division of property at dissolution. Wisconsin, in contrast, allows the court to include property of a spouse that was gifted or inherited in the hotchpot to be divided if the failure to do so would cause hardship to the other spouse or the children.

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137. See supra notes 10 to 24 and accompanying text.
139. Freed & Walker, supra note 135, at 390. See also McClanahan, supra note 5, at § 12:7, at 536.
140. McClanahan, supra note 5, at § 12:11, at 541. Idaho provides for an equitable distribution. Id. at § 12:13, at 543-44. Texas courts have wide discretion to determine an equitable division.
141. Id. at § 12:3, at 528 and at § 12:17, at 556-57.
142. 641 S.W.2d 210 (Tex. 1982).
143. Cameron, 641 S.W.2d at 213. “Allowing a trial court to divest separate property from one spouse and award it to the other spouse as part of the latter’s separate estate would impermissibly enlarge the exclusive constitutional definition of separate property.” Id.
See also 2 Marital Property Law in Wisconsin, supra note 19, §§ 11.1-2(a) at 11-2 to 11-4. (Louisiana and Idaho also award separate property to its owner).
144. Wis. Stat. § 767.255 (1983-84). Community property states are not consistent on the issue of which property may be divided at the time of divorce.

There has always been considerable variation in the laws of the community-property states as to the power of the court to divide, or assign, or otherwise deal with the separate property of the spouses in divorce proceedings . . . . In New Mexico . . . and Washington, the court has power to divide or assign the separate property of one spouse to the other spouse, but there are circumstances in
An additional factor to remember is that the Wisconsin statute section dealing with divorce makes no mention of individual, separate, property. The only property excluded from division at the time of divorce is that which was "a gift, bequest, devise or inheritance" acquired prior to or during the marriage or property acquired with the proceeds from such property. The type of property excluded from division in Wisconsin constitutes only a portion of the type of property classified as separate and, therefore, excludable, in Idaho, Louisiana and Texas. Property a spouse brings into the marriage is also classified as separate in Idaho, Louisiana and Texas; thus, the amount of property that could be excluded in these three states is, potentially, larger than that which could be excludable in Wisconsin.

This brief comparison indicates that there is no one state which precisely matches Wisconsin's approach to handling property at divorce. This is not to imply that Wisconsin courts should ignore the way community property states deal with various issues; in light of the differences pointed out above, caution should be exercised.

Current Wisconsin case law may indicate an inclination of the courts to be thinking in terms of community property

which this power is limited. In Nevada, the power of the court is limited to certain situations and the cases appear not to have been consistent in this area. McCLANAHAN, supra note 5, § 12:3, at 528.

In Washington, the statutory power to assign separate property in a divorce decree appears unlimited.

In New Mexico, the power to deal with separate property is an integral part of the statute dealing with alimony and limits the use of separate property to the satisfaction of orders for alimony and support.

Id. at § 12:3, at 528 n.19. It should be remembered, however, that Washington "treats both inherited property and property brought to the marriage in the same manner as separate property." 2 Marital Property Law in Wisconsin, supra note 19, § 11.2(a), at 11-4.

145. Wis. Stat. § 767.255. It should be noted that this property may be divided "upon a finding that refusal to divide such property will create a hardship on the other party or on the children of the marriage . . . ." Id. See also, supra note 19 and accompanying text.

146. McCLANAHAN, supra note 5, § 4:10, at 188, 190. The statute sections of Idaho, Louisiana and Texas defining separate property vary. However, all three states define property acquired by gift or inheritance as well as property brought to the marriage as separate. See Idaho Code § 32-903 (1983); La. Civ. Code Ann. art. 2341 (West 1979); Tex. Fam. Code Ann. § 5.01(a) (Vernon 1975).

147. McCLANAHAN, supra note 5, § 4:10, at 188, 190.
principles already. This is apparent in two recent Wisconsin cases, *Plachta v. Plachta*\(^{148}\) and *Arneson v. Arneson*.\(^{149}\) Neither of these cases, however, deal directly with the question of the enhanced value which consists of both income and natural appreciation components of a closely held corporation.

**B. Plachta and Arneson**

The sole issue in *Plachta* was "whether the appreciated value of a home gifted to Margaret Plachta during her marriage is a marital asset subject to property division."\(^{150}\) The court of appeals in *Plachta* speaks of the inflation in the value of the home as having the same character as the home because it was "due to the general economic conditions of inflation and the normal appreciation of real estate."\(^{151}\) In all of the community property states the results as to the characterization of the property would have been the same as the Wisconsin court's in *Plachta*.\(^{152}\) In addition, the finding in *Plachta* corresponds to one of the two general principles of community property law mentioned at the beginning of this article: the intrinsic increase in value of separate property remains separate.\(^{153}\)

*Arneson* involved shares in a closely held corporation. In *Arneson* the court of appeals was concerned primarily with purchases made with the dividends of shares gifted to the husband.\(^{154}\) The issue in *Arneson*, as framed by the court of appeals, was "whether other property purchased with the dividend income generated by an excluded asset should also

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148. 118 Wis. 2d 329, 348 N.W.2d 193 (Ct. App. 1984).
149. 120 Wis. 2d 236, 355 N.W.2d 16 (Ct. App. 1984).
150. *Plachta*, 118 Wis. 2d at 330, 348 N.W.2d at 194.
151. *Plachta*, 118 Wis. 2d at 334, 348 N.W.2d at 196. The court did point out that this increase in value would still be subject to division upon a showing of hardship. *Id.* at 333-34, 348 N.W.2d at 195-96.
152. McClanahan, supra note 5, § 6:18, at 357.
153. *Id.* at 359. Chapter 766 would also classify the increased value as individual, separate, property because it was acquired "[f]rom appreciation of the spouse's individual property except to the extent that the appreciation is classified as marital property under § 766.63." *Wis. Stat.* § 766.31(7)(c). (this section corresponds to § 4(g)(3) of UMPA).
154. *Arneson*, 120 Wis. 2d at 242, 355 N.W.2d at 19. The husband owned 250 shares, 100 of which were a gift from his father. *Id.* at 240, 355 N.W.2d at 18.
be excluded from the marital estate?" The court's answer was that the property so acquired should not be excluded.

In Arneson, the trial court wrote in terms of classifying the purchases made with the "fruits" of the husband's gifted and inherited property. The court of appeals found that "income generated by an asset" is not only "separate and distinct from the asset itself," but it is also "separate and distinct from the appreciation of the asset." The income was held to be marital property. This finding would correspond with those states following the civil law system in which all income is community whether it is generated from separate or community property. In states following the American rule, on the other hand, the income would have been held to be separate because it was generated from separate property.

The closely held corporation hypothetical posed at the beginning of this article is not dealt with directly by either Plachta or Arneson. Plachta deals with the appreciation of an excluded asset and Arneson deals with income generated by an excluded asset. Neither case provides a method for determining what portion of the enhanced value of an excluded asset represents natural appreciation and what portion resulted from the uncompensated efforts of a spouse.

The courts may find that Chapter 766 is of help in this situation. Chapter 766 was not intended to have an effect on decisions concerning property at the time of divorce. The prefatory note to UMPA emphasized that UMPA was meant only to confirm ownership in property.

The Act [UMPA] takes the parties "to the door of the divorce court" only. It leaves to existing dissolution procedures in the several states the selection of the appropriate

155. Id. at 242, 355 N.W.2d at 19.
156. Id. at 245, 355 N.W.2d at 20.
157. Id. at 241, 355 N.W.2d at 18.
158. Id. at 244, 355 N.W.2d at 20.
159. Id. at 245, 355 N.W.2d at 20.
161. Reppy & Samuel, supra note 28, at 132. This would be the outcome in California, Arizona, Nevada, New Mexico and Washington. Id.
162. Plachta, 118 Wis. 2d at 330, 348 N.W.2d at 194.
163. Arneson, 120 Wis. 2d at 242, 355 N.W.2d at 19.
164. Informational Bulletin, supra note 11, at 47.
procedure for dividing property. On the other hand, the Act [UMPA] has the function of confirming the ownership of property as the couple enters the process. Thus reallocation of property derived from the effort of both spouses during the marriage starts from a basis of the equal undivided ownership that the spouses share in their marital property.165

Although the provisions of Chapter 766 were not intended to affect parties once they were on the other side of the door of the divorce court, Wisconsin courts may find section 766.63(2) to be a useful tool in determining how to handle the enhanced value of a closely held corporation.

165. Id. (emphasis in original).
William P. Cantwell, who served as Reporter to the Drafting Committee of the Uniform Marital Property Act of the National Conference of Commissioners on Uniform State Laws, recently discussed the intent of the drafters of the Act in regard to divorce:

Articulation with respect to divorce property division procedures is essentially handled by going to the door of the divorce court but not through it. The drafters foresaw the opportunity for adopting jurisdictions to leave their existing procedures entirely in place. If an adopting jurisdiction already allowed the court to divide all property of the spouses, then that plan would continue, and the marital property would simply be part of that universe of divisible assets. For example, if a given state's procedure had a lesser reach, such as a defined type of divorce-only marital property, that could easily be integrated with UMPA. The important point, from the drafter's perspective, was to permit complete latitude and not to urge in any respect that marital property must necessarily be divided in precisely equal ratios, unless that was already the preference of an adopting state.


In addition, 1985 Wis. Laws 37, § 141 repeals Wis. STAT. § 766.75 (1983-84) (effective Jan. 1, 1986). Section 766.75 concerned the treatment of property at the time of the dissolution of the marriage. The note to 1985 Wis. Laws 37, § 141 states:

NOTE: Repeals the provision of Act 186, which is also contained in UMPA, stating: "[I]n a dissolution, all property then owned by either or both spouses which was acquired during marriage and before the determination date and which would have been marital property under this chapter if acquired after the determination date shall be treated as if it were marital property."

The repealed language raised questions about the effect of Act 186 on s. 767.255, relating to property division at divorce, annulment or legal separation. The special committee concluded that neither UMPA nor Act 186, by including the repealed language, intends to affect existing law that applies to property division at dissolution of a marriage. See the comment to UMPA, section 17. The special committee concluded, therefore, that, while the repealed provision may have some conceptual and psychological value, it should be repealed to avoid any confusion about whether ch. 766 affects the court's equitable powers to divide the property of spouses under § 767.255.

1985 Wis. Laws 37, § 141 note.
C. Wisconsin Statute Section 766.63(2)\textsuperscript{166}

One section that may be significant in a consideration of the issue at hand is section 766.63(2):

Application by one spouse of substantial labor, effort, inventiveness, physical or intellectual skill, creativity or managerial activity to either spouse's property other than marital property creates marital property attributable to that application if both of the following apply:

(a) Reasonable compensation is not received for the application;

(b) Substantial appreciation of the property results from the application.\textsuperscript{167}

It should be noted that this section varies slightly from the version in UMPA. Wisconsin provides that the labor of one spouse to either spouse's property can create marital property if certain conditions are not met, whereas the UMPA version provides for this outcome only where the labor of one spouse is applied to the "individual property of the other spouse."\textsuperscript{168} Thus, under UMPA's version it would appear that a spouse would be free to devote time and effort to his or her own individual property without incurring obligations to the other spouse.\textsuperscript{169} Wisconsin rejected this approach.\textsuperscript{170} This variation, while significant, will not affect a comparison of section 766.63(2) with the corresponding section in UMPA, section 14.


\textsuperscript{167} Wis. Stat. § 766.63(2), as amended by 1985 Wis. Laws 37. The phrase "individual property" in the introduction to § 766.63(2) was amended to read property "other than marital property." The classification "other than marital property" would include both individual property and property referred to as deferred marital property.

The legislative note accompanying 1985 Wis. Laws 37, § 129 provides:

NOTE: Clarifies that the appreciation rule applies to either spouse's property other than marital property, rather than solely to either spouse's individual property. The clarification is significant since it expands the pool of property to which the appreciation rules applies. According to members of the UMPA drafting committee, reference to "individual property" in UMPA is in error; it was intended that the rule apply to all of the spouse's property other than marital property, not just individual property.

1985 Wis. Laws 37, § 129 note.

\textsuperscript{168} UMPA § 14, reprinted in Informational Bulletin, supra note 11, at 65-67 (emphasis added).

\textsuperscript{169} But see Suggested Revisions, supra note 12, at 703 (critical of this result).

\textsuperscript{170} Wis. Stat. § 766.63(2), as amended by 1985 Wis. Law 37.
For the non-owning spouse attempting to tap the increased value of a closely held corporation, section 766.63(2) could provide the means. The non-owning spouse would have the burden of establishing three elements. First, the effort applied to the individual property must be proven to have been substantial. "Routine, normal, and usual effort is not substantial." The need to establish that the effort was substantial follows community property principles which allow a spouse the opportunity to preserve his or her separate estate without incurring an obligation to the community. Second, the appreciation of the property must not only be proven to have been substantial, but it must also be due to a spouse's efforts. In order for the rights of the community to arise, the increase in value must be attributable to the efforts of a spouse and not to natural appreciation. If the increase in

171. UMPA § 14 comment, reprinted in Informational Bulletin, supra note 11, at 66. Comments to § 14 of UMPA, which correspond to section 766.63, contain a reference regarding who bears the burden of proof in establishing the status of property. "A spouse claiming a particular classification for an asset contrary to the general presumption of Section 4(b) will have the burden of proof on that claim, and failure to meet it would render any mixing issue moot." Id. at 66.

172. UMPA § 14 comment, reprinted in Informational Bulletin, supra note 11, at 66.

173. See REPPY & SAMUEL, supra note 28, at 156.

value were due to the latter, the appreciation would remain
the spouse's individual property.175 Distinguishing the cause
of the increase in value is also an important factor in commu-
nity property states.176 Finally, reasonable compensation
must not have been received. Again the concept of reasonable
compensation is one which is familiar to community property
states in cases involving the claims of one estate against the
other.177

Therefore, in a case involving the enhanced value of a
spouse's separate property interest in a closely held corpora-
tion, if section 766.63(2) would be considered by the court at
dissolution, it would appear that in order to share in the in-
creased value at dissolution the non-owning spouse would
have to establish that:

1) Either of the spouses applied substantial effort to the
corporation;
2) A substantial increase in the value of the corporation
was due to this effort, and;
3) Reasonable compensation was not received.

What would be the results if the non-owning spouse were
able to prove all three elements? The language of section
766.63(2) indicates that the application of substantial, uncom-
penated labor "creates marital property attributable to that
application."178 According to the Comments to section 14 of
UMPA, the term "creates marital property" means that an
interest in the asset is granted to the marital property estate
and not that a right of reimbursement has arisen.179 The crea-

175. See DEFUNIAK & VAUGHN, supra note 30, at § 73.
This principle is stated in section 766.31(7)(c) which provides:
(7) Property acquired by a spouse during marriage and after the determina-
tion date is individual property if acquired by any of the following means:

(c) From appreciation of the spouse's individual property except to the ex-
tent that the appreciation is classified as marital property under § 766.63.
Wis. STAT. § 766.31(7)(c).
176. See DEFUNIAK & VAUGHN, supra note 30, at § 73.
177. See supra notes 63, 64, 90, 117 and accompanying text.
178. Wis. STAT. § 766.63(2), as amended by 1985 Wis. Laws 37 (emphasis added).
179. UMPA § 14 comment, reprinted in Informational Bulletin, supra note 11, at
66 (emphasis deleted). The term "creates marital property" means that the right is to
an interest in the asset and not to a right of reimbursement. Id. "As the marital prop-
erty component rises and falls in value, the interest rises and falls." Id.
tion of an ownership interest is not the same as a right to reimbursement, which is the approach taken in the three community property states reviewed in this article. A right of reimbursement does not create an ownership interest in the asset. 180 Professor Reppy has criticized the creation of an ownership interest as being inappropriate in situations involving corporations. 181

By carrying the burden of proof as to the three elements encompassed in section 766.63(2) the non-owning spouse could, conceivably, receive a proportionate share in the asset corresponding to the labor expended. 182 If, however, the non-owning spouse failed to prove any one of these elements, it would appear that no portion of the property would be classified as marital. In the latter situation, the non-owning spouse would, presumably, be entitled only to a share of the compensation already received. 183

180. See Jensen, 644 S.W.2d at 109 for a brief discussion of the difference between the “reimbursement” and “community ownership theories.”

181. Suggested Revisions, supra note 12, at 705. Professor Reppy refers to this as “buying in” by the improving estate. “The estate thereby acquires a percentage of ownership, apparently equal to the value of the contributed labor or property compared to the prior unadjusted basis in the property of the improved estate.” Id.

182. In a speech presented at the 1985 Annual Convention of State Bar of Wisconsin, Attorney Keith A. Christiansen, a member of the law firm of Foley & Lardner, Milwaukee, Wisconsin, and a co-author of Marital Property Law in Wisconsin, suggested that the general rules concerning classification of property would apply to the stock or partnership interest of a corporation or partnership and “apparently not to underlying business assets.” Christiansen, Application of Marital Property to Management of a Small Business, 1985 Annual Convention 411 (June 19-21, 1985).

183. Professor Reppy notes that “UMPA simply ignores the corporate veil problem.” Suggested Revisions, supra note 12, at 703.

Another section of Chapter 766 which may be helpful to the non-owning spouse is section 766.31(4) which provides that “[e]xcept as provided under subs. (7)(a), (7p) and (10), income earned or accrued by a spouse or attributable to property of a spouse during marriage and after the determination date is marital property.” Wis. Stat. § 766.31(4), as amended by 1985 Wis. Laws 37. The issue would be whether the increase in value of a closely held corporation could be classified as “income earned or accrued” that is “attributable to property of a spouse,” or classified as appreciation of individual property of the spouse. In the first instance, the increase would be termed marital. Wis. Stat. § 766.31(4). In the second, the increase would be the individual property of the owning spouse. Wis. Stat. § 766.31(7)(c). Again the burden would appear to be on the non-owning spouse attempting to classify the increase in value as marital property. Informational Bulletin, supra note 11, at 66.
IV. Conclusion

In the past, Wisconsin courts have considered issues relating to closely held corporations at the time of divorce.\textsuperscript{184} Recently, courts in Wisconsin have dealt with the appreciation of an excluded asset\textsuperscript{185} and income from an excluded asset.\textsuperscript{186} The question of how to deal with the enhanced value of an excluded asset when that value potentially includes both natural appreciation and labor remains unanswered.

What will the courts do when faced with this last issue? A review of cases from Idaho, Louisiana and Texas may be helpful in gaining an understanding of the issues involved. It is hoped that when an interest in a closely held corporation is involved in a divorce action, courts will not restrict themselves to labeling the enhanced value as only natural appreciation, which would be separate, or "fruits", which would be marital. Instead, it is hoped that courts will consider the rights of both separate and marital estates. If a consideration of the interests of both estates is undertaken, section 766.63(2) could provide the divorce court with the rationale to apportion the enhanced value.

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\textsuperscript{184} See Wahl v. Wahl, 39 Wis. 2d 510, 159 N.W.2d 651 (1968); Whitman v. Whitman, 34 Wis. 2d 341, 149 N.W.2d 529 (1967) (court discussed factors to consider in determining the value of stock of a closely-held corporation).

\textsuperscript{185} See supra notes 150-53 and accompanying text.

\textsuperscript{186} See supra notes 154-61 and accompanying text.