Equitable Distribution: LLCs and Divisible Property

Because the marital estate 'freezes' on the date of separation, *see Becker v. Becker*, 88 NC App 606 (1988), an increase or decrease in the value of marital property occurring after the date of separation, or income received from marital property after the date of separation, is not included in the marital estate. The category of divisible property was created to allow a court to distribute these postseparation assets along with the marital property. If the change in value or the income is classified as divisible, it can be distributed. If it is not divisible property, the court can do nothing more than consider the income or change in value as a distribution factor.

LLCs and the *Montague* Case

The continuing operation of a marital LLC during separation often creates challenging divisible property classification issues and the recent case of [*Montague v. Montague*, 767 SE2d 71, (NC App, Dec. 16, 2014)](), illustrates a fairly common fact pattern in ED. The Montagues were co-owners of an LLC during the marriage, with wife owning 49% of the LLC and husband owning 51%. The LLC owned and managed rental property, and the distributions from the LLC provided income to the family before the date of separation. After the date of separation, husband continued to manage the LLC and continued to receive payments. By the time of the ED trial, husband had collected approximately $31,200 and the LLC had increased in value since the date of separation by about $32,000. Wife claimed both the payments and the increased value of the LLC as divisible property subject to distribution, but husband claimed both belonged to him because both had been earned as the result of his work following separation.

Shareholder Distributions as Divisible Property

[GS 50-20(b)(4)(c)]() defines divisible property to include "passive income from marital property received after the date of separation… ". Ms. Montague argued that the income received by Mr. Montague from the LLC was a "passive" distribution from the LLC and therefore should be classified as divisible property and distributed along with the marital estate. Mr. Montague, on the other hand, argued that he received the money from the LLC as compensation for the services he provided to the LLC during separation. Because the funds were not "passive" income but rather were earned from his personal effort during separation, he argued the funds could not be classified as divisible property and distributed by the court.

Unlike in the classification of marital property, there are no presumptions and clearly delineated burdens of proof with regard to divisible property yet – except to the extent discussed below with regard to increases and decreases in the value of marital property. Instead, the court of appeals has stated only that the party claiming property to be divisible must establish that it is divisible. *Walter v. Walter*, 149 NC App 723, n.2 (2002); *but cf. Simon v. Simon*, 753 SE2d 475 (2013)(husband had burden of showing distributions from marital corporation were not divisible property). Ms. Montague attempted to establish the divisible classification of the payments received by Mr. Montague during separation by showing they were distributions from the LLC. Because distributions from a LLC are paid to shareholders based solely on ownership interest and are unrelated to actions of the owners, she contended the distributions were passive income.

The trial court concluded the income received by husband was management fees, compensation for his services to the LLC during separation. The ED judgment stated:

[Husband] actively manages the commercial property (negotiates all leases, collects rent payments, arranges for any “fit-up” required for a tenant, handles maintenance calls, does the landscaping, touch-up painting) and has done so since prior to the parties' separation. *Plaintiff pays himself a management fee for this work in the form of a distribution.*

Based on this finding of fact, the trial court refused to classify the payments as divisible property and left them in the possession of Mr. Montague.

The court of appeals did not disagree with the trial court’s conclusion that this finding of fact regarding husband’s actions during separation would be sufficient to establish that the payments were not divisible property. However, the court of appeals reversed the trial court because the record showed the parties had claimed the income as shareholder distributions from the LLC on their joint tax return. According to the court of appeals, the parties were “bound by their established methods of operating the business,” meaning husband could not tell the IRS the payments were shareholder distributions but claim them as personal compensation in the ED.

Appreciation of the LLC as Divisible Property

GS 50-20(b)(4)(a) defines as divisible property “all appreciation and diminution in value of marital property … except that appreciation or diminution in value which is the result of postseparation actions or activities of a spouse…”. In *Wirth v. Wirth*, 193 NC App 657 (2008), the court of appeals interpreted this provision as creating a presumption that any increase or decrease in the value of marital property between the date of separation and the date of distribution is divisible property. Therefore, the party seeking to classify appreciation of a marital asset as divisible simply needs to show that the property is worth more on the date of distribution than on the date of separation. The burden then shifts to the party resisting the divisible property classification to show the change in value was caused by actions of one of the spouses during separation.

The trial court in Montague concluded that the increase in the value of the marital LLC was the result of Mr. Montague’s work with the LLC after separation. Wife did not dispute that husband’s efforts contributed to the profitability of the business. Rather, she argued that because he had been fully compensated for his efforts by the LLC, any appreciation of the LLC by the date of trial was value acquired above the value of his efforts.

The court of appeals did not address the merits of Ms. Montague’s contention. Instead, the court held that because she had argued that the payments to husband from the LLC were distributions rather than compensation for his work on the issue relating to the income received during separation, she could not argue the opposite on the issue relating to the appreciation of the business. Because she argued the payments were distributions, she was estopped from asserting on this issue that Mr. Montague had in fact been compensated by these payments.