A version of this article was printed in Minnesota Lawyer on July 13, 2015. Reprints are available from Minnesota Lawyer at minn.awyer.com or by calling 612-333-4244.

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Court should consider return on investments

Tax liability should be figured in as well

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A split decision from the Court of Appeals highlights an issue of increasing importance as we see more marriage dissolutions involving older couples who have accumulated an investment portfolio: May a district court base its spousal maintenance decision on an obligee's ability to rearrange her investments to generate more income? *Curtis v. Curtis,* No. A14-1841 (Minn. Ct. App. June 22, 2015). Unfortunately, the decision is unpublished and conflicts directly with another unpublished decision, something noted by Judge Michael Kirk in his dissenting opinion predicting continued uncertainty and inconsistency on the issue going forward. (Judge Kirk's thoughtful dissenting opinion raised other issues as well which are beyond the scope of this article.)

Invasion or reallocation?

The parties were married in 1990 and had two children, one of whom was emancipated. Husband was a dentist and had earned a substantial income. Wide was a homemaker. The parties stipulated that wife would receive 57 percent of the marital estate and husband would receive 43 percent of the marital estate. Wife's share totaled about $2.2 million and consisted of the homestead and a portfolio of investments.

They could not resolve wife's spousal maintenance claim and the district court, following trial on that issue, denied her request because it could that wife could meet her needs by reallocating her portfolio from growth-orientated funds to income-orientated funds. This finding was based on testimony from husband's financial expert that wife's portfolio could be generating about 7 percent instead of the 1.7 percent return it had been generating in growth-orientated funds. Wife argued that any reallocation of the portfolio amounted to an impermissible invasion of assets. The district court rejected this argument and the majority of the Court of Appeals agreed because only the income produced by the portfolio would be used to meet wife's needs and the principal would not be depleted at all.

Judge Kirk disagreed with the majority for a variety of reasons, but was critical of the reallocation conclusion because he saw that as amounting to a requirement that wife deplete the principal of her property award. First, he pointed out that reallocating the portfolio would trigger tax consequences for wife to the tune of about $150,000. The majority was aware of this but held that ignoring the taxes within the district court's discretion, citing *Maurer v. Maurer*, 623 N.W.2d 604, 608 (Minn. 2001), for the proposition that "whether to consider the tax consequences of a property distribution lies within the district court's discretion."

Judge Kirk was correct on this point. Without question, wife was shortchanged by the fact that her property award will immediately reduce by $150,000. This tax is the direct result of the expectation that the district court placed on wife's use of her property award. Ignoring the tax conflicts with the rule that tax consequences resulting directly from the property disposition should be considered. *See Aaron v. Aaron*, 281 N.W.2d 150, 153 (Minn. 1979) (stating that a district court "should" consider tax consequences "where sale of real estate is required or is likely to occur within a short time after dissolution"). Thus, in our view, when calculating wife's investable assets, the district court should have subtracted $150,000 to account for the taxes wife will incur in selling her growth-orientated funds and using the proceeds to purchase income-orientated funds.

Judge Kirk also argued that reallocating investments forced wife to deplete the principal of the property award because the 7 percent rate of return figure accepted by the court included capital gains. That does not make sense because the capital gains generated by a portfolio of investments constitutes new money above and beyond wife's property award. Thus, expecting wife to spend these gains to meet her ongoing living expenses does not force her to deplete her property award. Moreover, capital gains are considered to be a part of the income generated by an investment account, and not property. *See Baker v. Baker*, 753 N.W.2d 644, 649 (Minn. 2008) (describing income from investment account as consisting of income, dividends, and capital gains).

Conversion or spend-down?

Tax consequences aside, Judge Kirk also argued that "[c]onversion of one type of investment account into another also changes the nature of the asset, which is analogous to invading the principal of liquidating the investment." At least one unpublished opinion drew the same analogy: "Just as a court cannot order a spouse to invade her assets to meet her needs…neither can it require [a spouse] to change the nature of these assets in order to produce income to meet her needs." *Schneider v. Nicholls*, No. C5-91-832, 1991 WL 245229 (Minn. Ct. App. Nov. 26, 1991).

Neither Judge Kirk nor the Court of Appeals in *Schneider* explains why these concepts are analogous and the problem with this argument is that the analogy does not work. There is a big difference between forcing a spouse to deplete her property award every month in order to meet her living expenses and determining that a spouse has the ability to increase her unearned income by reallocating her investments. The spouse spending down her assets is left with a reduced property award; the spouse changing her investment portfolio sees no reduction in her property award (assuming that the tax consequences of the sale have been accounted for). These are very different outcomes.

Statute allows consideration of investment potential

Moreover, under Minn. Stat. § 518.522, subd. 2(a), the court is expressly directed to consider the "financial resources of the party seeking maintenance, including marital property apportioned to the party." Nothing in this language prohibits a court from determining the a spouse's investments could be producing more income than they are if invested differently. This situation is similar to *Passolt v. Passolt*, in which the Court of Appeals reasoned that the plain language of the statute directing the district court to consider the spousal maintenance claimant's ability "to meet needs independently" did not require the court to first find that the part was limiting her income in bad faith. 804 N.W.2d 18, 22 (Minn. Ct. App. 2011). As in *Passolt*, the plain language of the statute directs consideration of the party's property and contains to bright-line prohibition against considering the earning potential of the property that could be realized by reallocating investments.

In *Passolt*, the Court of Appeals also determined that the district court had interpreted case law too broadly in concluding that bad faith was a prerequisite to considering a spouse's ability to be self-supporting. *Id*. At 25. Likewise, it would be a mistake to interpret the case law holding that obliges are not required to spend down their property award to meet their needs as also prohibiting a district court from determining that an oblige could generate more income by reallocating her investments. The case most often cited for this principle is *Fink v. Fink*, 366 N.W.2d 340 (Minn. Ct. App. 1985), wherein the Court of Appeals explained that "[c]ourts normally do not expect spouses to invade the principal of their investments to satisfy their monthly financial needs." The logic behind this principle is compelling: forcing a spouse to support herself using the principal of her property award turns and equitable division of property into a lopsided division of property. But, as noted above, determining that a spouse can restructure her portfolio of investments to generate more income does not result in a reduction of property and, therefore, does not alter the division of property. Nothing in *Fink*, suggests that there is any kind of bright-line prohibition against a district court considering how a spouse could maximize the income from her property award.

Judge Kirk commented that if the majority's holding were correct, the decision out to be published. We agree with him on this. As noted by Judge Kirk, this decision conflicts with another unpublished opinion, *Levinson v. Levinson*, No. C5-99-1772, 2000 WL 890443 (Minn. Ct. App. July 3, 2000). In *Levinson*, the district court based its finding on wife's investment income using the parties' historical rate of return. Husband argued on appeal that this was error because wife could generate more income by investing in income-orientated stocks rather than growth-orientated stocks as the parties had done in the marriage. The Court of Appeals rejected this argument because reallocating the portfolio would have triggered capital gains taxes for wife that had not been accounted for in the division of property and no evidence was presented to the district court showing the amount of tax liability. *Levinson* conflicts with *Curtis* in its treatment of the tax consequences associated with reallocating investments within a portfolio. However, because the rationale in *Levinson* was based exclusively on the tax aspect, the decision cannot be read as a categorical prohibition against expecting an obligee to maximize her income by reallocating her investments. Judge Kirk is right that the conflict between these cases will fuel future uncertainty until it is resolved in a published opinion.

In our view, it does not make sense to have a bright-line prohibition against a district court's consideration of a spouse's ability to increase her unearned income by reallocating her investments because the fact that the parties invested a certain way during the marriage does not mean it would be prudent to continue investing in that way after the divorce. For starters, there may have been no strategy whatsoever during the marriage. Or perhaps there was a conscious choice at the start of the marriage twenty years earlier that has long since been forgotten and ceased to have any relevance. What if one party dominated all the investment decisions during the marriage? Should the other party be bound to follow their ex's investment strategy? What if the parties' financial strategy during the marriage was terrible?

For many couples, the divorce itself is a financial setback that warrants reworking individual financial plans. It would be a mistake to limit a district court to considering what "was" and not what "could be" in considering the parties' investments. Take, for example, a couple with $1 million sitting in a bank account producing only nominal interest income. Why should the district court be prohibited from considering what income that sum could generate if invested in the stock market? To us, that seems to fall clearly within the statutory directive to consider the "financial resources of the party seeking maintenance, including marital property apportioned to the party." Minn. Stat. § 518.552, subd. 2(a).

In summary, the majority got it right in holding that the district court properly considered what income the wife could be earning by investing differently. But it erred in ignoring the $150,000 reduction in wife's property award, which results directly from the district court's decision. As of this writing, no petition for review has been filed. If one is, we hope that the Supreme Court will accept the case and provide some much needed guidance on these issues.

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