



## COURT OF APPEALS RULES ON DIVISION OF 401(K) FUNDED LARGELY BEFORE MARRIAGE – *CHENEY V CHENEY*, MICH APP NO. 311555 (4/29/14)

BY JOSEPH W. CUNNINGHAM, JD, CPA

### Facts

- At the time of the divorce trial in September 2011, H's Ford 401(k) account balance was \$315,862.
- When the parties married in September 1999, the balance was \$208,942.
- Contributions were made to the account during the marriage.
- The trial court determined that the entire Ford 401(k) was marital and awarded W \$157,931.
- The Court's rationale was that the pre-marital funds in the account were commingled with contributions made during marriage and, hence, were marital.

- H appealed, claiming the entire 401(k) account was separate property because (1) most of the account was funded before marriage and (2) he was the sole contributor during marriage.
- Alternatively, he claimed that the \$208,942 premarital balance was his separate property.

### Court of Appeals Opinion

- The COA rejected H's claim that the entire account was separate property because, pursuant to MCL 552.18(1), retirement benefits accrued during marriage "shall be considered part of the marital estate subject to award by the court."

Continued on next page

- However, the Court agreed with H's alternative claim that the pre-marital balance of \$208,942 was his separate property.
- The Court cited *McNamara v Horner*, 249 Mich App 117 (2002) and *Reeves v Reeves*, 226 Mich App 490 (1997) in support of its decision.

### Comments on the Case

- In *McNamara v Horner*, the COA ruled that all appreciation during marriage on a retirement account owned at time of marriage is marital because such funds were commingled with contributions during marriage. Thus, the Court limited the account owner's separate property to the balance at time of marriage.
- **However, following the Court's logic in *McNamara v Horner*, the entire account should have been marital since the premarital funds were also commingled with contributions during marriage.**
- That is precisely the tack the trial court took in *Cheney* in including H's entire Ford 401(k) in the marital estate. But, the COA, as it did in *McNamara v Horner*, ruled that the account balance at date of marriage was H's separate property – regardless that such funds were commingled with contributions during marriage.
- As previously noted in this column, the *McNamara v Horner* decision appears to apply form over substance because contributions during marriage to a premarital retirement account does not make it impossible to allocate to a reasonable degree – albeit perhaps not with 100% precision - appreciation during marriage between account balances at date of marriage and divorce, respectively.
- This can be done simply by allocating annual appreciation between (1) the premarital balance and (2) the average balance of contributions since marriage, assuming annual contributions are made in the midpoint of each year.
- Though, as noted, not 100% precise, this method provides a considerably more equitable result than to treat all appreciation as marital notwithstanding that all growth is wholly passive.

### About the Author

*Joe Cunningham* has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy though his practice is statewide.

### Example

Balance at Date of Marriage .....	\$250,000
Contributions During Marriage .....	50,000
Earnings/Growth During Marriage .....	<u>100,000</u>
 Total at Divorce .....	 <u>\$400,000</u>
 Appreciation Allocable to \$250,000	
Premarital Balance .....	\$ <u>80,000</u>
 Appreciation Allocable to \$25,000	
Marital Contributions .....	<u>\$20,000</u>
 Marital appreciation under <i>McNamara v Horner</i> ..	 <u>\$100,000</u>
=	
Marital appreciation under allocation method.....	<u>\$20,000</u>

- Thus, under *McNamara v Horner*, a contribution to a premarital 401(k) account – even if mandatory or by the party's employer – results in all appreciation during marriage deemed marital – no matter how substantial the account was at marriage.
- The allocation method is somewhat akin to the generally accepted use of coverture fractions to allocate the marital and separate components of pensions. Though not 100% precise, the coverture fraction provides a reasonable method of allocation for defined benefit plan interests, as does the above method for defined contribution (account balance) plan interests (401(k) and IRA accounts).
- Thus, in sum, use of the allocation method results in a considerably more equitable determination of the marital versus separate property division of passive appreciation during marriage on a premarital retirement account than does application of *McNamara v Horner*.
- **Take Away** - In the large majority of cases resolved by settlement, the allocation method can be – and frequently is – applied.