Do the assets a party got in a divorce really belong to him or her "free and clear of all claims" by the ex-spouse? No, say most cases, if the assets are retirement benefits and – especially – if the claims are for child support.

By Reuben A. Bernick

When Property Becomes Income in Post-Judgment Divorce Litigation

Suppose you return from an appearance in domestic relations court one day to find a new potential client waiting for you. He is 63 and himself a lawyer. He was divorced three years ago. He is paying guideline child support for two children (16 and 14 years old) and maintenance to his ex-wife, who is 10 years younger than he. His divorce judgment provides for rehabilitative maintenance reviewable after five years.

He came to you because he suffered a stroke and has been advised by his doctor that he is not fit to continue his stressful litigation practice (the only area he knows). He has had to retire.

He gets payments from a military pension and Social Security, which meet about half his current expenses (including support payments). For the rest, he takes distributions from his IRA. He wants to know whether he can get a reduction or termination of his support obligations based on his loss of income.

On further inquiry and review of the judgment of dissolution, you learn that the client's ex-wife received about 55 percent, and the client 45 percent, of the marital assets (none was non-marital). Of the principal assets, the ex-wife was awarded the house and some financial accounts; your client was awarded his law practice and his pension and IRA.

The main property issue during the divorce was whether goodwill could be counted in the valuation of the law practice. Ultimately the court excluded the goodwill on the authority of *In re Mar-*

riage of Zells,[1] which holds that professional goodwill is a measure of a professional's ability to generate income. Because it is taken into account in determining maintenance and property distribution, the court held, to include it in the valuation of the practice would be "duplicative and improper."[2]

Your client feels strongly that the loss of income from his forced retirement is a "substantial change in circumstances" justifying relief from his support obligations and that under the reasoning of *Zells*, his pension and IRA should not be counted in deciding this issue because they were previously counted in the property distribution incident to the divorce. He asked his ex-wife to agree to a modification of his obligations, but she refused.

Divorcing clients with large retirement accounts often try to keep them by letting the other party have non-retirement marital assets. As the cases show, that may not always be the best approach.

You agree to prepare and present an appropriate petition. Then, after the retention papers are drawn up and signed, you head for the library, confident you will find case support for your position.

After all, your client no longer has income from employment. His retirement accounts are assets, not income, so they cannot be used to calculate the amount of support due under the statutory guidelines. And because the accounts were assets awarded to him in the divorce, his ex-wife no longer has any claim to them, so that to require him to pay maintenance from them would indeed be "double counting" and an impermissible modification of the property distribution as well. Wouldn't it?

Well, perhaps not. Here is what the cases say.

"Net income" for determining support obligation includes retirement account distributions

In *In re Marriage of Colangelo and Sebela*,[3] the former wife sought a post-decree increase in child support, claiming that the former husband's post-decree receipt of stock distributions was income to him upon receipt. The former husband argued that the distributions were not income because they were made upon the vesting of stock options that had been awarded to him as property in the divorce, so that to treat the distribution as post-decree income would be an impermissible double counting of the value of the property.

The trial court agreed that the stock distributions were property and not income, but the appellate court reversed, holding that the distributions were, for purposes of child support, includible in net income. The court considered that the distribution of the stock upon the vesting of the options "transformed" them into a realized distribution that was income, not property.[4]

Without further explaining this reasoning, however, the *Colangelo* court also held that even if the stock distribution were marital property, it would still be held to be income for child support purposes, citing *In re Marriage of Klomps*,[5] in which pension payments to a former husband were held to be income for child support purposes even though the pension had been treated as marital property and awarded to the former husband as his property in the divorce judgment. The *Klomps* court held that because the pension payments came within the definition of "net income" in section 505(a) of the Illinois Marriage and Dissolution of Marriage Act (the "Act")[6] and did not fall within any of the section 505(a) exclusions, the payments must be treated as income. The *Colangelo* court adopted this reasoning and applied it to the stock distributions in issue.[7]

In treating stock option distributions and pension payments, respectively, as income despite the previous distribution of these items as marital property, both the *Colangelo* and *Klomps* courts distinguished an earlier second district case, *In re Marriage of Harmon*,[8] in which the court held that monthly interest payments that comprised the recipient former wife's share of marital property previously awarded to her in the divorce should not be considered in the calculation of her net income.[9]

Soon after the second district's decision in *Colangelo,* it again confronted the issue in *In re Marriage of Lindman*.[10] There, the question was whether distributions from the former husband's IRA, which had been awarded to him as marital property in the divorce, should be included in his child support "net income."

The *Lindman* court, again following the reasoning of *Klomps,* held that because such distributions were not excluded from "net income" by section 505(a) of the Act, they must be included.[11] Tellingly, the *Lindman* opinion refers to the distributions as "money [the former husband] *earned* from an individual retirement account,"[12] an unusual nomenclature to apply to such a distribution.

Thus, it appeared, at least as of 2005, that the appellate court had established the principle that distributions from retirement accounts, whether pension or IRA, and unvested stock options were income for post-decree child support purposes, notwithstanding that these assets were arguably being double-counted because they had been distributed as part of the marital property in the divorce.[13]

However, in *In re Marriage of*

1. 143 Ill 2d 251, 572 NE2d 944 (1991); see also *In re Marriage of Schneider,* 214 Ill 2d 152, 824 NE2d 177 (2005).
2. *Zells* at 256, 572 NE2d at 946.
3. 355 Ill App 3d 383, 822 NE2d 571 (2d D 2005).
4. Id at 390-92, 822 NE2d at 576-79.
5. 286 Ill App 3d 710, 676 NE2d 686 (5th D 1997).
6. 750 ILCS 5/505(a).
7. *Colangelo* at 390-92, 822 NE2d at 576-79.
8. 210 Ill App 3d 92, 568 NE2d 948 (2d D 1991), overruled on other grounds by *In re Marriage of Rogers,* 213 Ill 2d 129, 820 NE2d 386 (2004).
9. See also *In re Marriage of Baumgartner,* 384 Ill App 3d 39, 56, FN8, 890 NE2d 1256, 1272, FN8 (1st D 2008).
10. 356 Ill App 3d 462, 824 NE2d 1219 (2d D 2005).
11. Id at 466-67, 824 NE2d at 1223.
12. Id at 462, 824 NE2d at 1220 (emphasis added).
13. The *Lindman* court did perceive a potential double-counting problem in one situation. If an IRA owner continues to contribute money to the IRA *after* the divorce, such monies will be included in net income in the year of receipt (since the amounts contributed are not excludable from net income under § 505(a) of the Act). If such monies are later included again in net income when distributed from the IRA to its owner, a double counting of the same income, *Lindman* acknowledged, will occur. Id at 470, 824 NE2d at 1225. Inasmuch as this issue was not presented in *Lindman,* the court did not rule concerning how it should be resolved.

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O'Daniel,[14] the fourth district disagreed with *Lindman*. In *O'Daniel,* as in *Lindman*, the issue concerned whether the former husband's post-decree withdrawals from his IRA should be included in net income in calculating child support. The trial court refused to include them, and the fourth district upheld this result, reasoning as follows:

> The Second District's decision [in *Lindman*] does not adequately take into account that IRAs are ordinarily self-funded by the individual possessing the retirement account. Except for the tax benefits a person gets from an IRA and the penalties he or she will incur if he or she withdraws the money early, an IRA basically is no different than a savings account, although the risks may differ. The money the individual places in an IRA already belongs to that individual. When an individual withdraws money he placed into an IRA, he does not gain anything as the money was already his. Therefore, it is not a gain and not income. The only portion of the IRA that would constitute a gain for the individual would be the interest and/or appreciation earnings from the IRA.[15]

Which view, then, will prevail? While only the appellate court can answer this question, the latest word appears to favor the *Lindman* position.

In *In re Marriage of Eberhardt*,[16] the first district was again faced with whether to include in the calculation of net income post-decree distributions taken by a former husband from an IRA awarded to him as property in the divorce. The *Eberhardt* court, rejecting the former husband's argument that improper "double-counting" occurs when an IRA awarded in a property settlement is liquidated and treated as income, followed *Lindman* and *Klomps* (and not *O'Daniel,* which was cited but not discussed) in holding that section 505 of the Act required inclusion. Indeed, *Eberhardt* went further, citing a Massachusetts case, *Croak v Bergeron*,[17] which holds that equity requires the consideration of IRAs as income regardless of the acknowledged existence of double counting.[18]

Previously awarded retirement accounts: subject to maintenance?

The rulings are a bit less one-sided when maintenance, not child support, is involved. In *In re Marriage of Bryant*,[19] the former husband, having lost his employment, petitioned to terminate maintenance on the ground of a substantial change in circumstances. In attempting to show such a change, he asserted that his receipt of pension and stock income should not be taken into account because he had been awarded the underlying stock and pension as part of the property distribution.

The trial court took the income into account and was affirmed on appeal. The appellate court held that the factors to be considered concerning modification of maintenance are set forth in section 504 of the Act, namely the payor ex-spouse's ability to pay and the recipient ex-spouse's needs. Apparently (although *Eberhardt* does not say so explicitly), since the prior award of such property to the payor is not a factor enumerated in section 504, it should be disregarded. This reasoning parallels that of *Klomps* and *Lindman*.

However, in *In re Marriage of Munford*,[20] the trial court, ruling on the former wife's post-decree petition to increase maintenance, took into account the income the former husband got from his pension, which had been awarded to him as part of the property settlement. On appeal, the first district reversed. It regarded the award of increased maintenance, based on the former husband's retirement benefits, as an impermissible rewriting of the parties' property settlement.[21]

In *In re Marriage of Klomps,* pension payments to a former husband were deemed income for child support purposes even though the pension had been awarded to him in the divorce.

Analysis: statutory construction versus property rights

At first glance, the analysis of the issue of reclassification (or double-counting) of previously awarded property in the context of post-decree support appears to differ depending on whether child support or maintenance is involved. Where child support is at issue, the analysis focuses on the definition of net income in section 505 of the Act. For maintenance, the analysis focuses on ability to pay versus need, which is enumerated in section 504 of the Act.

However, the way the courts have approached these issues is similar. On the one hand, the courts in *Klomps, Lindeman* and *Bryant* relied solely on the language of the statute, ruling that a factor, such as a previous property award, not mentioned in the statute cannot be considered. Other cases, however (*O'Daniel* and *Munford*), referred to property rights acquired in the divorce judgment. They have held that such rights cannot be modified by the subsequent reclassification of previously awarded property as current income.

Approaching the question solely in light of the statutory language, as most of the cases do, seems illogical. The implicit assumption is that because the legislature did not exclude prior property distributions from child support net income, or include them as a factor in the maintenance analysis, it must have intended that such distributions not be considered.

This assumption – especially in the context of net income – begs the question. Property is not income. If a property distribution is considered property, not income, there is no reason to exclude it from the definition of net income, and no inference concerning legislative intent can properly be drawn from the lack of such an exclusion.

Similarly, treating as income property previously awarded to the payor ex-spouse would seem to be a *de facto* modi-

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14. 382 Ill App 3d 845, 889 NE2d 254 (4th D 2008).

15. Id at 850, 889 NE2d at 258. The *O'Daniel* opinion dos not disclose whether the IRA in question had been awarded to the former husband in the distribution of marital property or whether it had been funded by him post-decree. If the latter, it would then fall within the special situation acknowledged in *Lindman*.

16. 387 Ill App 3d 226, 900 NE2d 319 (1st D 2008), appeal denied 231 Ill 2d 666, 904 NE2d 979 (2009).

17. 67 Mass App Ct 750, 856 NE2d 900 (2006).

18. Id at 759, 856 NE2d at 907.

19. 206 Ill App 3d 167, 563 NE2d 834 (1st D 1990).

20. 173 Ill App 3d 576, 527 NE2d 892 (1st D 1988).

21. Id at 579-80, 527 NE2d at 894. See § 510(b) of the Act, 750 ILCS 5/510(b). The court also held that the former wife had not adequately demonstrated an increase in her needs.

fication of the pre-existing property judgment.[22] The observation of *O'Daniel,* in particular, that IRA distributions should not be considered income because they are only assets that already belong to the recipient seems difficult to dispute.

In the case of maintenance, it is possible to avoid reclassifying the property as income by arguing that the maintenance should be paid from the payor's ex-spouse's property, not income. Indeed, the language of section 504 of the Act permits this result. However, this argument runs counter to the point made in *Munford* that the property was awarded to the payor in the divorce, and requiring that it later be paid to the payee ex-spouse is a *de facto* reopening of the property judgment.

Advising clients

What, then, can you do in this situation, especially if your client is the one receiving the retirement distributions? If you're already in post-decree litigation over the issue, you can present the analysis suggested above, recognizing, as you must, that if your client is far wealthier than the ex-spouse, the court may be unsympathetic, especially if children are involved.

If, however, you are representing such a client pre-decree, and he or she could receive distributions from a marital retirement account when still paying child support or maintenance (or both), you may be able to do more. Many people who have substantial retirement accounts seek to hold on to them in divorce and balance the distribution by allowing the other party to retain other non-retirement marital assets. They also hope by so doing to avoid the expense and trouble of preparing qualified domestic relations orders or dealing with administrators of retirement plans, both of which are attendant to dividing retirement assets as part of the divorce.

However, this approach to retirement accounts should be reconsidered in light of the issues raised in this article. Even if these assets are awarded to your client as marital property in the divorce, they may later be reclassified as income and double-counted. Consider advising a client in this situation, whether in settlement negotiations or at trial, that he or she might be better off seeking assets that cannot be reclassified and recaptured by the other spouse.

The same advice applies to a dependent spouse who may be the recipient of child support or maintenance when the other spouse begins to take retirement account distributions. Because the dependent spouse may be able to recover a portion of these distributions anyway through their future reclassification as income, he or she might do better to leave such assets to the other spouse rather than receiving them in the property distribution.

The foregoing discussion illustrates unacknowledged difficulties created by the judicial reclassification of formerly distributed assets as income for purposes of child support and maintenance. While such reclassification may be a way to compensate for wide disparities in income between former spouses, it creates a disfavored class of asset – retirement benefits – that both spouses would prefer to avoid because of the possibility of future reclassification as income.

Moreover, reclassification contributes to the perception of unfairness in the post-decree process because it disappoints settled expectations created by the distribution of marital assets in the property judgment.

The best long-term solution might be for the legislature to enact a specific statutory provision to address the situation. That would eliminate the need for the current judicial *ex post facto* reclassification as income of assets – assets the party who received them expected would belong to him, or her, alone. ■

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22. In fact, § 504(a((1) of the Act seems to recognize this, in that it specifically directs the court to consider "...marital property apportioned and non-marital property assigned *to the party seeking maintenance*" – not the party from whom maintenance is sought (emphasis added).