The Equitable Distribution of Farms

by
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A farm that has passed from generation to generation is not just an asset to be divided but a way of life. Divorce directly challenges the ability of both spouses to continue that lifestyle and to preserve the farm for the next generation. Current equitable distribution policies may tend to overly protect the farmer at a significant cost to the farmer's spouse.

Many family farms are acquired by gift and inheritance. Legal title is protected and even in long term marriages the non-owner spouse may not acquire any direct ownership interest in the land. Family farms are protected under a variety of laws and policies.[1] In divorce and other legal proceedings, family farms are also protected by longstanding legal precedent with the implicit or explicit goal to preserve the ongoing viability of the farm.[2] Although the spouse may have been an exemplary homemaker and may have worked off the farm and contributed significant financial support to the family, unless he or she can prove that those efforts directly improved the fair market value of the farm, the spouse may not be compensated for those efforts. The authors have used gender neutral titles but, still, for the most part, it is the wives who are the "non-owner spouses" and the husbands who are the farmers. If women contemplating mar-

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1 Steven C. Bahls. *Agri-Business: The Way Ahead: Preservation of Family Farm*, 45 DRAKE L. REV. 311, 312 (1997).

2 *Id.; See also* Jesse J. Richardson & Leon L. Geyer, *Ten Limitations to Ponder on Farm Limited Liability Companies Regarding Divorce Planning to Preserve the Family Farm*; Susan A. Schneider, *Who Owns the Family Farm? The Struggle to Determine the Property Rights of Farm Wives,* 14 N. ILL. U. L. REV. 689 (1994).

riage to farmers were fully aware of the potential costs, they would insist on premarital agreements that allowed them to create and protect their own assets that would not be subject to distribution upon divorce.

This article will address the surprisingly different approaches to the equitable distribution of farms in several Midwestern states. Overall, fairness may be achieved but, even within the jurisprudence of one state, it is difficult to predict or plan for the outcome of any particular divorce involving farming interests.

I. Identification of the Farm or Ranch as Marital or Separate Property

In a farm divorce involving gifted or inherited property, the threshold question is whether the land is included in the marital estate or if it is one party's separate property. Equitable distribution jurisdictions use a variety of approaches with subtle nuances to resolve this question. Practitioners should use extreme caution when relying on case law from outside their jurisdictions.

The majority of equitable distribution jurisdictions provide that property acquired during the marriage is marital property.[3] Generally, the marital estate does not include premarital property or property acquired by one of the parties through gift or inheritance.[4] In many farm divorces, the heart of the conflict will be whether the increase in value of farmland owned prior to the marriage, or acquired by gift or inheritance during the marriage, should be included in the marital estate.

In multi-generational farming families, senior members may retain title to the land for significant periods of time while the younger generation operates the farm. Formal or informal agreements between the generations may exist regarding allocation of operating expenses and division of profits. Although the land is owned by the older generation, the younger generation may have ownership interests in growing crops or livestock.

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[3] *See e.g.* I.C.A. 598.21 (2002); Ks. St. § 23-201 (2002); Mo. St. § 452.330 (2002); Neb. Rev. St. § 42-365 (2002).

[4] AMERICAN LAW INSTITUTE, *Principles of the Law of Family Dissolution: Analysis and Recommendations*, § 4.03, Reporter's Notes, comments (a) and (b) (LexisNexis 2002) [hereinafter ALI PRINCIPLES].

Sorting out the various and competing interests at the time of a divorce can be complex.

Occasionally, courts recognize that the land involved in a farm operation has something of a "life" or "status" of its own—somewhat like the status of an interested nonparty who may be materially affected by the outcome of litigation.[5] In Iowa, the appellate court has subtly recognized this fact recently in *In Re Marriage of Bishop*. The *Bishop* case involved a marriage of approximately twelve years in duration. At the time of the marriage, the wife sold her premarital home and received $113,500 in proceeds. The parties used approximately $100,000 of the wife's proceeds to pay a debt due the husband's ex-wife. During the marriage, the husband farmed land that he had owned prior to the marriage. The value of the farm doubled during the marriage and was worth over one million dollars. The trial court awarded the wife the $113,500 that she brought into the marriage but refused to allow her to share in the appreciation of the farm during the marriage based on its finding that the appreciation was solely due to inflation.[6] The trial court also refused to allow the wife to share in the farm's appreciation because such an award would force the husband to sell the farm, resulting in drastic tax consequences. The appellate court agreed but it did modify the trial court's award to compensate the wife for her lost appreciation on the $113,500 that she brought into the marriage. The appellate court held that the wife was entitled to the same return on her $113,500 that the husband received on his farmland and doubled the cash settlement.

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5 For example, in Albrecht v. Albrecht, 609 N.W.2d 765 (S.D. 2000) the court held that the homestead was a marital asset but that it should be awarded to the husband because the homestead had been owned by the husband's family for many generations, had significant sentimental value to the husband's family, and was necessary for the husband's continued farming activities. The wife was required to move her small farming operation to a less desirable acreage.

6 In re Marriage of Bishop, 665 N.W.2d 440 (Ia. Ct. App. 2003). The Bishops married in the late 1980s during the depth of the farm crisis. Mr. Bishop's land would have been valued at a very low amount at the time of the marriage. The *Bishop* case combines interesting facts and analysis and is included by the authors as exemplary of the competing interests and public policy issues arising in farm divorces despite the lack of designation.

Iowa is not alone in this judicial sensitivity to the land.[7] North Dakota has perhaps been the most explicit about this policy stating that "[w]e recognize the importance of preserving the viability of business operations, such as farms, and the potential for economic hardship should those entities be divided in a divorce."[8]

In the *Bishop* case, it would appear that the husband devoted all of his efforts to farming over a twelve year period but that those efforts did not contribute any value to the marital estate.[9] This is not an uncommon result. In one case, a husband and wife farmed on land owned by the husband's mother for 26 years.[10] Since neither spouse had any ownership interest in the land, the farm was not subject to division. In anticipation of the eventual inheritance and associated taxes, the couple had purchased insurance on the life of the husband's elderly mother. The wife asked the trial court to require the husband to maintain the life insurance and pay her 50% of the proceeds when received. The wife testified that she "looked at that as a form of our retirement, because for farming for the 26 years that we were farming together, there was no retirement of any kind, and so therefore, I have no retirement of any kind for 26 years."[11] Although the trial court did award the wife an interest in the life insurance, the Kansas Court of Appeals reversed on the basis of public policy and the wife's lack of insurable interest in her ex-mother-in-law's life.

In general, farming families are very conscious of protecting legal title to the land. Many of the reported cases reveal similar stories and circumstances: a young couple move onto a farm owned by the husband's family. Eventually, the husband acquires an interest by gift or inheritance and keeps sole title. He may operate the farm with his father and brothers. The farming family may or may not formalize their business arrangements as a subchapter S corporation or other entity. Profits are plowed back into the farming operation rather than being invested or

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7 Findlen v. Findlen, 695 A.2d 1216 (Me. 1997); Albrecht v. Albrecht, 609 N.W.2d 765 (S.D. 2000).

8 Linrud v. Linrud, 552 N.W.2d 342, 346 (N.D. 1996).

9 *Bishop*, 665 N.W.2d 440.

10 Day v. Day, 31 P.3d 46, 48 (Kan. Ct. App. 2003).

11 *Id.*

accumulated in the marital estate. The wife works as a homemaker and may be employed full or part-time off the farm. The wife's employment brings in needed cash and, hopefully, health insurance. Then, after five, ten, fifteen or twenty years, a divorce looms.[12]

The very fact that a wife is working off the farm can lead to additional stress and divorce. During the farm crisis of the 1980s, many women were forced into the workplace.[13] Some courts refused to consider the wives' contributions to the marriage from their off-farm jobs of income and health insurance as contributions to the farming operation so as to justify inclusion of the farms as marital property.[14]

A. *Consideration of Contributions*

Depending upon the jurisdiction, to determine whether separate property has become part of the marital estate, the contributions of both the non-owner spouse to the farm and the owner spouse must be examined. In other jurisdictions, such as Nebraska, only the contributions of the non-owner spouse are scrutinized.[15] Section 4.04 of the American Law Institute's *Principles of the Law of Family Dissolution: Analysis and Recommendations* suggests that the appreciation in value of separate property during a marriage should be characterized as marital property to the extent the income or appreciation is attributable to the labor of either spouse.[16] Section 4.12 of the *ALI Principles* suggests that separate property should be recharacterized as marital property after a marriage exceeds a minimum duration to be specified by statute.

In the opinion of some commentators as well as the *ALI Principles,* the issue of whether separate property should be in-

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12 *See* Day v. Day, 31 P.3d 46 (Kan. Ct. App. 2003); Grace v. Grace, 380 N.W.2d 280 (Neb. 1986); Sullivan v. Sullivan, 388 N.W.2d 516 (Neb. 1986).

13 Jerry Perkins, *80's Farm Crisis Shook Iowa to Its Roots*, DES MOINES REG., Oct. 26, 1997, see also *Sullivan*, 338 N.W.2d 516, where Mrs. Sullivan refused to further participate in the troubled farm operations in the 1980s and obtained employment in town to supplement the family income.

14 *See* In re Marriage of Callenius, 309 N.W.2d 510 (Iowa 1981); In re Marriage of Thomas, 319 N.W.2d 209 (Iowa 1982); Herr v. Herr, 705 S.W.2d 619 (Mo. Ct. App. 1986).

15 Van Newkirk v. Van Newkirk, 325 N.W.2d 832 (Neb. 1982).

16 ALI PRINCIPLES, *supra* note 3, at §4.04.

cluded in a marital estate should be resolved by analyzing whether it has appreciated in value during the marriage as a result of active or passive forces.[17] Passive appreciation includes market forces, inflation, and the efforts of third parties. Active appreciation would include actual labor, contribution of funds, etc.

Lack of active appreciation was a factor in *Van Newkirk v. Van Newkirk.*[18] The wife's parents gifted a 320 acre wheat farm to her in 1963. Approximately twenty years later, the ownership of this wheat farm became a point of bitter contention. The trial court awarded the wife the value of the farm as of 1963 as her separate property, but included the appreciation in the marital estate. The trial court also included in the marital estate the value of the unharvested crops.[19] On appeal, the Nebraska Supreme Court noted that neither the husband nor the wife spent much, if any, time in harvesting or planting the crops.[20] The court recited the general rule that "property acquired by one of the parties through gift or inheritance ordinarily is set off to the individual receiving the inheritance or gift and is not considered a part of the marital estate."[21] The court noted the exception to this rule

> is where both of the spouses have contributed to the improvement or operation of the property which one of the parties owned prior to the marriage or received by way of gift or inheritance, or the spouse not owning the property prior to the marriage or not receiving the inheritance or gift has significantly cared for the property during the marriage.[22]

Finding that neither spouse had expended any significant effort towards the farm or the crops, the court held that both the increased value of the farm and the value of the growing crops should be the wife's separate property. Thus, *Van Newkirk* generates several principles that are applicable to Nebraska cases. First, passive appreciation in separate property is non-marital.

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17 Brett R. Turner, *Distinguishing Between Active and Passive Appreciation in Separate Property: A Suggested Approach,* 5 DIVORCE LITIG. 73 (May 2001).

18 *Van Newkirk*, 325 N.W.2d 832 (Neb. 1982).

19 *Id*. at 833

20 *Id*. at 834.

21 *Id*.

22 *Id*.

Second, active appreciation can only be marital if the non-owner spouse significantly cares for the property and the property increases in value. A corollary is that if a non-owner spouse significantly cares for separate property but that the fair market value does not increase, then the property remains separate. The *Van Newkirk* holding violates the more general proposition that is applied in Nebraska cases which is that the fruits of a spouse's employment and efforts are marital property.[23] If the increased value of a farm is solely due to the labor of the owner spouse or appreciation, the farm remains separate property.

Van Newkirk provoked a line of Nebraska cases that examined various contributions made by farm wives to their husband's separate property.[24] As early twentieth century author Hamlin Garland wrote, "There is no gilding of setting sun or glamour of poetry to light up the ferocious and endless toil of the farmers wives."[25] In Nebraska, the farmer's spouse must be prepared to prove not only how ferociously and endlessly he or she toiled, but how that toil directly contributed to an increase in the value of the farm before a marital interest can be claimed.[26]

We question just what a person can do to increase the value of land. One or both spouses may devote all of their labor to the farm. Pulling thistle and helping with calves does not affect the fair market value of land but such activities are a direct contribution to the marriage and the farming operation. Contributions of off-farm income and health insurance may enable the farming spouse to continue to farm but such contributions do not affect the value of the land. Land values fluctuate primarily due to passive forces such as inflation, drought, federal farm programs and

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23 Turner, *supra* note 16 at 5*;* Davidson v. Davidson, 578 N.W.2d 848 (Neb. 1998).

24 Jirkovsky v. Jirkovsy, 525 N.W.2d 615 (Neb. 1995); Sullivan v. Sullivan, 388 N.W.2d 516 (Neb. 1986); Grace v. Grace, 380 N.W.2d 280 (Neb. 1986); Applegate v. Applegate, 365 N.W.2d 394 (Neb. 1985); Walker v. Walker, 622 N.W.2d 410 (Neb. Ct. App. 2001).

25 Hamlin Garland, *Melons and Early Frost*: BOY'S LIFE ON THE PRAIRIE (1899), available at http://www.bartleby.com/66/60/24460.html.

26 This principle of law was questioned by the Nebraska Court of Appeals in *Walker*, 622 N.W.2d at 421. The court stated, "[i]t seems unrealistic and nearly impossible . . . to require precise proof of the monetary value of what a farm or ranch spouse has done over the years to contribute to the success of a farm or ranch."

interest rates.[27] On more than one occasion, a non-owner spouse will detail significant contributions to the farm only to be defeated by a holding that the primary factor contributing to an increase in the land's fair market value was inflation.[28]

Applegate v. Applegate involved the dissolution of a nineteen year marriage.[29] The couple purchased an 80-acre tract of land early in their marriage. The husband later acquired a small 14.7 acre parcel by gift. When the husband's father died, the husband inherited a one-half interest in a 152-acre farm (containing the homestead) and his mother subsequently gifted the other half interest to both the husband and wife as tenants in common.[30] All of the tracts were contiguous.

The wife adduced evidence that she helped with "branding, dehorning, calving, sorting out, feeding, weed burning, irrigation, fencing, putting up hay, and resetting irrigation pipe."[31] The trial court excluded the small parcel received by gift and 75% of the value of the 152-acre parcel from the marital estate as Mr. Applegate's separate property.[32] Mrs. Applegate's half-interest in the 152-acre parcel was included in the marital estate. The Nebraska Supreme Court stated that Mrs. Applegate's "efforts, though not to be minimized, did not contribute directly to any preservation of or increase in value of the property," and refused to include the land in the marital estate.[33] With regards to the 152-acre parcel, however, the appellate court noted that one-half of the tract was gifted to both spouses and that the couple had substantially improved the homestead located on the tract. The court reallocated the division of the value of the 152-acre parcel so that 75% was included in the marital estate.

Nebraska clearly requires some proof that the non-owner spouse directly contributed to an increase in value of the farm or ranch before the spouse can claim that the asset has become mar-

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27 Institute of Agricultural and Natural Resources, University of Nebraska-Lincoln, *NU Survey: Ag Land Values Take a Slight Drop Due to Drought*, Mar. 27, 2003.

28 *In re Bishop*, 665 N.W.2d 440; V*an Newkirk,* 325 N.W.2d 832.

[27]*Applegate*, 365 N.W.2d at 395.

29 365 N.W.2d 394 (Neb. 1985).

30 *Id.* at 395.

31 *Id.* at 397.

32 *Id.* at 396.

33 *Id.* at 397.

ital in nature. Missouri requires a showing that marital funds and labor have been expended and that the appreciation in the separate property is attributable to those funds and labor.[34] The non-owner's performance of usual spousal duties is not a sufficiently substantial contribution of effort to cause the increase in the value of the separate property to be marital.[35] In contrast, under South Dakota law, a wife's performance of typical household duties constitutes a valuable contribution to the farm or ranch property.[36] Iowa examines the tangible contributions of each party, whether the appreciation in the value of the property can be attributed to fortuitous circumstances or the efforts of the parties, and the length of the marriage, in its analysis of whether the appreciated value of separate farm property should be included in the marital estate.[37] The lack of consistency between these states is surprising.

B. *Consideration of Fault and Other Equity Factors*

Nebraska divides property without regard to fault or improper economic conduct by a spouse.[38] But only marital assets are considered and divided. Nebraska courts often describe the process by noting the statutory provision making the purpose of a property division an equitable distribution of the marital assets.[39] Although the division of property is not subject to a precise mathematical formula, the general Nebraska rule is to award the spouse from one-third to one-half of the marital estate, the polestar being fairness and reasonableness as determined by the facts of each case.[40] Equitable distribution is a three-step process: classify the parties' property as marital or non-marital;

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34 In re Marriage of Ballay, 924 S.W.2d 572, 574 (Mo. Ct. App. 1996); In re Marriage of Meservey, 841 S.W.2d 240 (Mo. App. Ct. 1992); In re Marriage of Schatz, 768 S.W.2d 607 (Mo. App. Ct. 1989); In re Marriage of Herr, 705 S.W.2d 619, 622-23 (Mo. App. Ct. 1986).

35 In re Marriage of Schatz, 768 S.W.2d at 610; In re Marriage of Herr, 705 S.W.2d at 623.

36 Temple v. Temple, 365 N.W.2d 561, 567 (S.D. 1985).

37 In re Bishop, 665 N.W.2d 440; In re Marriage of Williams, 449 N.W.2d 878, 881 (Iowa Ct. App. 1989).

38 NEB. REV. STAT. § 42-361 (1998).

39 NEB. REV. STAT. § 42-365 (1998).

40 Tyma v. Tyma, 644 N.W.2d 139 (Neb. 2002); Paulsen v. Paulsen, 650 N.W.2d 497 (Neb. 2002); Gibilisco v. Gibilisco, 637 N.W.2d 898 (Neb. 2002).

value the marital property and liabilities; and divide the net marital estate between the parties.[41]

North Dakota considers fault.[42] North Dakota's statutes direct its courts to consider all assets in dividing marital property. North Dakota's highest court has explained its law as follows:

> An equitable distribution does not necessarily mean an equal distribution, but a substantial disparity must be explained. . . In determining an equitable distribution under N.D.C.C. § 14-05-24, the trial court applies the guidelines established under *Ruff v. Ruff*, 78 N.D. 775, 52 N.W.2d 107, 111 (1952) and *Fischer v. Fischer*, 139 N.W.2d 845, 852 (N.D. 1966). The *Ruff-Fischer* guidelines allow the trial court to consider certain factors, including the conduct of each party during the marriage. . . Fault of a party is conduct to be considered under the *Ruff-Fischer* guidelines. . . Economic misconduct, also referred to as financial misconduct or economic fault, is conduct the trial court may consider when applying the *Ruff-Fischer* guidelines. *Zacher v. Zacher*, 493 N.W.2d 704, 705 (N.D. Ct. App. 1992). This Court has long recognized that both economic and noneconomic fault are proper factors for the trial court to consider in dividing marital property.[43]

Unlike Nebraska's three-step process, North Dakota's judiciary first considers all property, evaluates equity and considers the circumstances of each party. They require consideration of:

> the respective ages of the parties, their earning ability, the duration of the marriage and conduct of the parties during the marriage, their station in life, the circumstances and necessities of each, their health and physical condition, their financial circumstances as shown by the property owned at the time, its value at the time, its income-producing capacity, if any, whether accumulated before or after the marriage, and such other matters as may be material.[44]

Protection of the family farm is a factor the North Dakota courts consciously consider.[45] The North Dakota Supreme Court's decisions recognize that "liquidation of an ongoing farming or business operation is ordinarily a last resort . . . . If it is not an economically viable enterprise, it should be sold and the proceeds divided between the parties."[46] Yet there is a limit to how

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41 Gibilisco v. Gibilisco, 637 N.W.2d 898 (Neb. 2002).

42 Reiser v. Reiser, 621 N.W.2d 348 (N.D. 2001).

43 Hoverson v. Hoverson, 629 N.W.2d 573 (N.D. 2001).

44 Reihl v. Reihl, 595 N.W.2d 10 (N.D. 1999).

45 Marschner v. Marschner , 621 N.W.2d 339, 344 (N.D. 2001).

46 *See, e.g.*, Linrud v. Linrud, 552 N.W.2d 342, 346 (N.D. 1996) (*noting* that preserving the viability of the business operations, such as a farm, does not

far the North Dakota courts will go. "Preserving the family farm is not to be done at all costs nor should it engulf all other factors. Rather, we have said its purpose is to avoid 'the potential for economic hardship' if the farm is divided or sold."[47]

Despite these differences in law and judicial analysis, it is clear the courts in the Midwestern states considered—-Nebraska, Missouri, South Dakota, North Dakota, and Iowa—-all place real emphasis on preservation of farming operations when doing so is realistically possible and would not be an utterly unfair or undue imposition upon one spouse. Managing this judicial emphasis is a crucial task for counsel handling a farm divorce case.

C. *Farm Equipment, Growing Crops and Livestock*

In general, the focus during farm divorces is on the land. If the land is held to be separate property, one can still argue that the other assets are marital if they were acquired during the marriage for valuable consideration.[48] One should not overlook growing crops, machinery, livestock, homestead improvements, and other farm related assets.

In re Marriage of Ballay addresses the inclusion of a cattle herd in the marital estate.[49] The farmer had been given an interest in a farm, dairy herd and machinery by his parents prior to the marriage of 24 years. At the time of the divorce, the farmer asserted that the cattle were his separate property because they were descendants of the original herd. The appellate court rejected the farmer's argument and held that the cattle were presumed to be marital property because they were born during the marriage.[50] Further, the income earned and saved during the

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call for a windfall for one spouse). *See also* Schoenwald v. Schoenwald, 593 N.W.2d 350 (N.D. 1999).

47 Gibbon v. Gibbon, 569 N.W.2d 707 (N.D. 1997).

48 Sprock v. Sprock, 882 S.W.2d 183, 186-87 (Mo. Ct. App. 1994). B*ut see* In re Marriage of Conley, 243 N.W.2d 220, 223 (Iowa 1979) (*holding* that a growing crop is part of the land and that it should not be treated separately from the land).

49 924 S.W.2d 572 (Mo. Ct. App. 1996).

50 *Id.* at 575.

marriage from the sale of milk and cattle was also marital property as was the equipment purchased.[51]

In contrast to the *Ballay* case, consider *In re Marriage of Bishop*.[52] There the wife argued that she was entitled to one-half of the value of the farm equipment, growing crops, and livestock. The husband had owned farm equipment, livestock, and other farm implements prior to the marriage but the wife argued that those premarital assets had been replaced during the marriage. The husband argued that such assets are commodities as part of a continuing farm operation. The appellate court agreed with the husband.[53]

Depending upon your jurisdiction and the facts of your case, it may be worthwhile to consider equipment, livestock and growing or stored crops as assets separate and apart from the farmland.

II. Valuation Issues

After you and your client decide that the farming interests should be considered for division in the marital estate, you must determine the value of the farming operation. Farm divorces may require appraisals and valuations of land, equipment, growing crops, stored crops, and livestock.

Farming is complex. While its complexity is little appreciated, even by farmers themselves, farming is one of the most complicated business models in America. Farming involves a significant ratio of capital investment to income. Virtually all classes of assets and a multitude of debt forms can be found in a farming operation.

Farm divorces cannot be effectively handled without understanding of the federal farm programs. Federal farm programs offering payments include the Conservation Reserve Program,[54] Wetlands Reserve Program,[55] and the Grassland Reserve Pro-

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51 *Id.* at 576. S*ee also* In re Marriage of Sprock, 882 S.W.2d 183, 187 (Mo. Ct. App. 1994) (holding that income from a non marital farm earned during the marriage is marital property).

52 In re Bishop, 665 N.W.2d 440.

53 *Id*.

54 16 U.S.C. §§ 3831-3836 (1994)(for planting permanent vegetation on idle, highly erodible farmland).

55 16 U.S.C. §§ 3837-3837f (to restore wetlands).

gram[56] to name a few. Excellent sources of information about the farm programs are available from the government or online.[57]

Forensic accountants are indispensable in farm valuations. The accountant will help not only as a witness but also as an investigator. The forensic accountant can help the attorney trace cost flow which can be an underutilized approach to asset discovery. Many large farming operations use multiple business entities to maximize the benefits of the various farm programs. The farm programs benefits may be paid as the farmer elects and by timing the payments, the farmer may minimize tax consequences. A forensic accountant can assist an attorney to collapse the various entities and address the true value of the farm programs.

The seasons and the calendar year affect farm budgets and values. Expenses for next year's crop may be prepaid.[58] Stored crops may not be accounted for until they are sold. The farming operation's accounting practices need to be carefully examined. Farm balance sheets can be seductively simple and should be seldom relied upon as authoritative. Although balance sheets are used to obtain credit, they may not be as thorough as otherwise expected.

Livestock and growing crops present valuation difficulties due to judicial aversion toward speculative values. In *Johnson v. Johnson,*[59] one-half of the land was tilled in the fall requiring an outlay of cash for seed, planting and tilling. In the year in question, some $50,000 in prepaid expenses had been incurred but the crop was still about six months from harvest. The court held that the prepaid expenses should not be considered an asset subject to division in the divorce due to the speculative nature of the expected return.[60] It is not clear what evidence was before the court as to the value of the growing crop.

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56 16 U.S.C. §§ 3838a(b)(3)(financial incentives to restore and protect grasslands).

57 A summary of the Farm Bill is available at www.usda.gov/programs/farmbill/2002 from the United States Department of Agriculture. The *Catalog of Federal Domestic Assistance* is available through the United States General Services Administration at *http://12.46.245.173/cfda/cfda.html.*

58 *See* Albrecht v. Albrecht, 609 N.W.2d 765, 771 (S.D. 2000).

59 307 N.W.2d 783, 788 (Neb. 1981).

60 *Id*.

The Nebraska Supreme Court addressed the valuation of growing crops in the context of a dispute involving crop damage by wandering cattle.[61] With regards to an unmatured, damaged crop, the court held that the trier of fact should consider:

> the nature of the land; the type of crop planted; the kind of season, whether wet or dry; the yield of crops growing in such a season, the average yield of crops on neighboring land; the development of the crop at the time of destruction; the yield of a similar crop not injured; the market value of the crop as injured; the market value of the probable crop without injury; the time of the injury; the expense that would have been incurred had the crop not been injured; the circumstances which surrounded the crop which may have resulted in the crop's not maturing; and other circumstances illustrated by the evidence tending to establish such a value.[62]

The measure of damages for the destruction of a mature crop requires a calculation of the difference in value of the mature crop without injury and the value of the actual harvest, less the necessary costs of harvesting the crop and getting to market.[63]

Tax returns must be carefully scrutinized. Obviously, W-2 forms will not only reveal income, but also contributions to retirement plans, health insurance, car allowances, etc. Schedule B will reveal taxable interest and dividends. Look for tax refunds and carry forwards for various credits. Tax loss carry forwards may be significant tax credit to be factored into the marital estate. Capital loss carryovers have been held to constitute marital property.[64]

Passive losses can be used to shelter non-passive income for years after the activity ceases. Passive loss carryover credits can have substantial value to shelter future income and should be divided.[65]

Be aware of possible collusion between members of the farming family to delay payments or delivery of assets. Phony

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61 Pribil v. Koinzan, 665 N.W.2d 567, 574 (Neb. 2003).

62 *Id*.

63 *Id.* at 574-75.

64 Mills v. Mills, 663 S.W.2d 369 (Mo. Ct. App. 1983); Finkelstein v. Finkelstein, 701 N.Y.S.2d. 52 (2000).

65 Silverstein v. Silverstein, 943 S.W.2d 300 (Mo. Ct. App. 1997). S*ee also,* Richard B. Malamud, *Allocation of the Joint Return Marriage Penalty and Bonus*, 15 VA TAX REV. 489 (1996).

intra-family debt may be created.[66] There may be sudden delays in collecting accounts receivable or prepayment of accounts payable. Expenses may be overstated. It is possible that crops or other assets will be kept from market to minimize profits. Watch out for bartering and other "under the table" transactions. Smaller farms may have struggled for quite some time and individuals may have become adept at minimizing taxable income and maximizing the value of farm programs.

Financial statements must be filed annually with lenders, equipment creditors, chemical, fertilizer and seed creditors, and the United States Department of Agricultural ("USDA") or the FHA to obtain operating and other loans. Financial statements may be used, but should not be relied upon, without inquiry as decisive because the producer may overstate assets in order to qualify for loans. Obtain copies of financial statements from all of the various creditors or lenders. Financial statements filed before divorce problems surfaced may be invaluable. These documents are good resources to value assets at the time of the marriage and at the time of the divorce.[67]

Analyze financial statements by comparing the statements to the tax returns. "Off-balance sheet" items such as unpaid farm program payments, growing crops, or prepaid expenses may not appear on the balance sheet. Balance sheets are prepared on a book value basis and may not reflect fair market value. The balance sheet may include deductions for potential tax consequences. Those potential tax consequences may not be recognized in divorce court if the court considers them to be speculative in nature.

Lenders and insurers may also conduct appraisals or inventories of collateral which should be obtained during discovery. Property tax assessments may also prove to be reliable depending upon the jurisdiction. Machinery and equipment can be inventoried and appraised by farm auctioneers or certified appraisers.

Obtain the work papers from the farming operation's accountant. An accountant's work papers often disclose unanticipated results and information. The work papers belong to both

66 *See* Albrecht v. Albrecht, 609 N.W.2d 765 (S.D. 2000).

67 Bennett v. Bennett, 516 N.W.2d 672, 674 (S.D. 1994).

parties and the accountant should be alerted early in the divorce proceeding of his or her duty to protect and preserve the records.

Many farming operations are organized into business entities creating the possibility of claiming discounts. In *Walker v. Walker*, the farmer's valuation expert applied discounts for minority ownership interest and lack of control to his interest in a farming corporation after calculating book value.[68] The Nebraska Supreme Court rejected the discounts and noted that the evidence was clear that all of the shareholders (four brothers) of the farming corporation were committed to the continuation of the farm and managed well by agreement.[69]

III. Dividing the Farm or Ranch

When faced with dividing a marital estate that includes a farm or a ranch, a divorce court will do everything in its power to enable the farmer to continue to farm.[70] The least favored approach would be to award the non-farming spouse an ongoing interest in the farming operation. To "inject an outsider" into a farming operation that might not only include the ex-spouse but also extended family would be inherently unfair.[71]

Liquidation is another disfavored option. Every divorce practitioner becomes exasperated when the parties resort to fighting over pots, pans, and other household goods. Farms are equipped with lots of "stuff" to argue about, such as machinery, livestock, pets, stock tanks, fencing equipment, and tools. In one case, the couple fought over the division and value of not only all of the farm equipment, household goods, and livestock, but also over the belt buckle and toy tractor collections.[72] The frustrated trial court, faced with voluminous and conflicting evidence, ordered all of the property sold and the proceeds divided equally. The appellate court overruled the forced sale since it would force

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68 *Walker*, 622 N.W.2d at 418.

69 *Id.* at 420.

70 Michal v. Michal, 301 N.W.2d 100, 101 (Neb. 1981)(stating that property should be divided in such a manner so as to permit the farmer to retain the means for payment of any judgment in favor of the ex-spouse); Johnson v. Johnson, 307 N.W.2d 783 (Neb. 1981).

71 *Grace*, 380 N.W.2d at 285.

72 Kellner v. Kellner, 593 N.W.2d 1, 7-8 (Neb. Ct. App. 1999).

the farmer out of business and result in unnecessary tax consequences.[73]

A favored approach is a property settlement paid over time, with or without interest.[74] Generally, the property settlement is structured to avoid liquidation and to maintain continued viability of the farming operation.[75] However, where the evidence suggests that the farmer has no reasonable likelihood of meeting his or her support obligations and making a profit from the farm, the avoidance of liquidation seems questionable.[76]

IV. Conclusion

Adoption of the *ALI Principles* would bring a measure of fairness and uniformity to farm divorces. Section 4.05(1) of the *ALI Principles* provides that "A portion of any increase in the value of separate property is marital property whenever either spouse has devoted substantial time during marriage to the property's management or preservation." The worthy goals of preserving the viability of a family farm and protecting separate property should be offset in marriages of long duration by a recognition of direct and indirect contributions regardless of whether those contributions caring for children, providing off-farm income or actual farm labor. Uniformity, both within individual states and across state borders, would enable farming families to plan for and manage the consequences of a divorce.

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73 *Id.* At 12-13.

74 In re Marriage of Callenius, 309 N.W.2d 510, 514-15 (Iowa 1981); Reich v. Reich, 680 P.2d 545 (Kan. 1984); Thiltges v. Thiltges, 527 N.W.2d 853 (Neb. 1995)(holding that failure to provide interest on deferred property division calling for a long term payment plan was error). *Johnson*, 307 N.W.2d at 787 (no interest); Nickel v. Nickel, 267 N.W.2d 190, 192 (Neb. 1978)(requiring interest would be an intolerable burden).

75 Bennett v. Bennett, 516 N.W.2d 672, 676-77 (S.D. 1994), Temple v. Temple, 365 N.W.2d 561, 565 (S.D. 1985).

76 Marschner v. Marschner, 621 N.W.2d 339, 344 (N.D. 2001); Simmons v. Simmons, 228 N.W.2d 432, 434 (Mich. Ct. App. 1975) (Peterson, J. dissenting).