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COMMUNITY-PROPERTY TREATMENT OF THE INCREASE IN VALUE OF A SEPARATELY OWNED BUSINESS

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I. INTRODUCTION

The underlying policy of modern community-property law is to recognize the mutual nature of the economic contributions that a husband and wife make to a marriage, regardless of whether one or both spouses work outside the home. This policy not only provides the basis for the division of property on divorce and death but also supports an integrated system for the management of a married couple's property during the existence of a marriage. Consequently, community-property concepts govern most property related transactions conducted by either spouse during marriage as well as the disposition of property at the termination of the marriage. This integrated policy is reflected in the central unifying rule of community property that property acquired during a marriage through the labor and industry of either spouse is presently owned by both spouses in two undivided shares.

Some community-property jurisdictions recognize, in addition, that the rents and profits of separate property are community property when the rights to such rents and profits are acquired during the marriage.

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2. DEFUNIAK & VAUGHN, supra note 1, at § 1; MCCLANAHAN, supra note 1, at § 2:29.

3. Idaho, Texas, Louisiana and Wisconsin, commonly referred to as “Civil Rule” jurisdictions, recognize that rents and profits of separate property are community property. See IDAHO CODE § 32-906 (1983); TEX. CONST. art. XVI, § 15, as amended 1987; LA.
This recognition, based on the original Spanish antecedents to American community-property law, revolves in part around the idea that such rents and profits are the result of community labor and industry and in part around the idea that married persons, having the economic well-being of the marriage in mind, would naturally contribute rents and profits to the marital community. The community's claim does not extend, in any jurisdiction, to "natural increases" in the value of community property resulting from appreciation or inflation.

Determining whether a community-property interest exists in the increase in value of a separate-property business has presented many problems for community-property jurisdictions. These problems include: 1) determining whether some of the increase in value is attributable to the labor of one of the spouses and/or to rents and profits from one spouse's separate property, 2) characterizing and valuing whatever interest the community may have, and 3) adopting a fair and realistic method of satisfying the claims of the non-owner spouse once an interest is identified and valued.

In this article, the author will first argue that the community has two potential claims to the increase in value of a separate-property business. Most community-property jurisdictions recognize that the non-owner spouse may have a claim that some of the increase in value is attributable to community labor and industry and therefore consti-


4. McClanahan, supra note 1, at § 2:29; DeFuniak & Vaughn, supra note 1, at § 71.

5. "The community" is not an entity with separate legal status. In this article, the term "the community" will be used as a shorthand way of discussing the common undivided property interest owned by the spouses in property acquired during a marriage and the claim that one spouse may have for the distribution of community property upon the termination of the marriage.

6. See DeFuniak & Vaughn, supra note 1, § 73 at 169-70.

7. In this article, the term "increase in value" in a separate-property business refers to gross increases in the value of the business assets which are not distributed. This type of increase may not be reflected in an increase in market price of the stock of an incorporated business. Since there is frequently no market for the stock of these businesses, measuring the increase in value of the stock would be difficult if not impossible to do.
tutes community property. Furthermore, in Civil Rule jurisdictions, the community has a claim to the increase in value attributable to unpaid rents and profits on the separate property. Although most of the cases addressing this problem contain common themes, no consistent recognition of community and separate interests in the increase in value of separate-property businesses has emerged. Second, the author will discuss the various tests used to value the two community-property claims. Finally, the author will propose a method of valuing these claims and a method for recognizing and characterizing the unrealized community interest in the increase in value of a separate-property business on the termination of the marital community by either divorce or death.

II. THE NATURE OF THE COMMUNITY INTEREST IN THE INCREASE IN VALUE OF A SEPARATE-PROPERTY BUSINESS

The most basic tenet of community-property law is that income resulting from the labor and industry of the spouses during marriage is community property. Problems in applying this rule arise, however, when one spouse owns a share of a business which is that spouse’s separate property and contributes labor and effort to the business. Such a business could be separate property because it was acquired or incorporated prior to marriage; was acquired by one of the spouses during marriage by gift, devise or inheritance; or was acquired during the marriage in exchange for separate property. In any case, no matter how

8. See infra, notes 17 - 27 and accompanying text. All community-property jurisdictions theoretically recognize the community interest in property which is acquired through the labor and industry of either of the spouses. Texas has recognized that a spouse may be permitted to contribute some de minimis amount of labor to maintain the value of that spouse’s separate property and that such labor does not create a community interest in the separate property. Cf. Norris v. Vaughan, 152 Tex. 491, 260 S.W. 2d 676 (1953).

9. See infra notes 12 - 49 and accompanying text.

10. See infra, notes 50 - 105 and accompanying text.

11. See infra, notes 106 - 125 and accompanying text.

12. See De Funiak & Vaughn, supra note 1, at § 1; McClanahan, supra note 1, at § 2:29.

the spouse acquires the property, the community may be deprived of property while the net worth and profitability of the separate-property business may be enhanced if the owner-spouse does not receive a reasonable salary and/or the business does not distribute profits.14

The decision of the owner-spouse to undercompensate himself or herself and/or to not distribute profits may not necessarily be the result of selfish or bad-faith motives. Rather, the decision may be based on the exercise of reasonable and informed business judgment for the purpose of getting the business underway, getting it through a tight financial situation or helping it grow. In other words, the decisions of the owner-spouse may be the type any entrepreneur would make in nurturing a business. However, if the community's claims based on the underpayment of salary and/or the retention of profits are not recognized, then one spouse will be permitted to make a unilateral gift of community property to the benefit of his or her separate property. Such a gift would fly in the face of the basic tenets of community-property law.15

If the business does not turn a profit, then the community does not have a claim. The community-property interest only attaches to income and profits which are actually produced. Certainly the community would not be able to claim that one of the spouses could have found a better paying job during the marriage, and therefore, a court should recognize a community claim in the earnings that the working spouse did not realize.16 Neither would the community have a claim if


16. The only way that such a claim could be advanced is if the spouse had a claim in a future stream-of-income, either earned or unearned, such as by acquiring a property interest in a degree or license. Community-property jurisdictions however, have thus far declined to recognize such interests. See e.g. Muckleroy v. Muckelroy, 84 N.M. 14, 498 P.2d 1357 (1972). California has enacted a statute giving the non-degree/license spouse a claim. Cal. Civ. Code § 4800.3 (West Supp. 1987). Some community-property jurisdictions have recognized that the good will of a professional practice may be community
the business venture of the owner-spouse fails. However, where the business of the owner-spouse increases in value, the community should be entitled to the value of labor and industry contributed towards the generation of those profits and, in Civil Rule jurisdictions, the profits themselves.

Courts have been willing to recognize that some of the increase in value of a separate-property business may be attributable to the labor and industry of one of the spouses, primarily in cases where the owner-spouse has a controlling interest in the business. Where the owner-spouse lacks control over the business, no presumption of uncompensated labor or unpaid rents and profits has been made because in such a situation, the owner-spouse would not be able to unilaterally determine the compensation level of the business's employees or determine the manner in which the business's profits are distributed. In *Simplot v. Simplot*, 96 Idaho 119, 525 P.2d 314 (1973) (recognizing a community claim when the husband owned 65 percent of company's stock) *with* *Simplot v. Simplot*, 96 Idaho 239, 526 P.2d 844 (1974) (holding that no community claim existed where the husband owned 8.4 percent of the company's stock). See also *Abraham v. Abraham*, 230 La. 78, 82, 87 So.2d 735, 739 (1956) ("It is clear that the growth and success of the business is chiefly due to the efforts of the defendant, who has been in sole control of its management over the years . . . ."); *Downs v. Downs*, 410 So.2d 793, 798 (La. Ct. App. 1982) ("Plaintiff exercised these powers [of managing partner] throughout the existence of the partnership and it is obvious that the growth and prosperity enjoyed by it is largely attributable to his capable management of its affairs").

17. *Compare* *Speer v. Quinlan*, 96 Idaho 119, 525 P.2d 314 (1973) (recognizing a community claim when the husband owned 65 percent of company's stock) *with* *Simplot v. Simplot*, 96 Idaho 239, 526 P.2d 844 (1974) (holding that no community claim existed where the husband owned 8.4 percent of the company's stock). See also *Abraham v. Abraham*, 230 La. 78, 82, 87 So.2d 735, 739 (1956) ("It is clear that the growth and success of the business is chiefly due to the efforts of the defendant, who has been in sole control of its management over the years . . . ."); *Downs v. Downs*, 410 So.2d 793, 798 (La. Ct. App. 1982) ("Plaintiff exercised these powers [of managing partner] throughout the existence of the partnership and it is obvious that the growth and prosperity enjoyed by it is largely attributable to his capable management of its affairs").

18. This article focuses on the situation in which the owner-spouse is employed or renders services to a separately held business. In such a situation, the owner-spouse will frequently have control. However, drawing the line regarding reimbursement of the non-owner spouse at control does not necessarily make sense. In the small business context, a control-oriented test would result in providing a reimbursement claim to the spouse of a 51 percent owner and not providing a reimbursement claim to the spouse of a 49 percent owner, even though there is little reason to doubt that the 49 percent owner has the same motives and the same amount of practical "control" as the 51 percent owner. Moreover, a spouse could avoid a reimbursement claim by structuring the business so that no single small group of owners had control.

The real reason for the distinction based on control appears to be that courts have been unwilling to consider providing a reimbursement claim based on the increase in value of stock in which the owner-spouse is a minority owner and is not employed by the business. This situation does not pose a problem in American Rule jurisdictions where the increase in value of such stock would be separate property except that attributable to the labor and industry of the owner-spouse. Cf. *Beam v. Bank of America*, 6 Cal. 3d 12, 490 P.2d 257, 98 Cal. Rptr. 137 (1971). However, in Civil Rule jurisdictions, which hold that the increase in value of separate property is community property, the abandonment
v. Simplot, the Idaho Supreme Court held that the community did not have a claim against the retained earnings of a corporation in which the husband was employed, owned 8.4 percent of the stock and was a member of the board of directors. There, the court held that the decision of the corporate board of directors to reinvest the retained earnings of the company or declare a dividend was a matter of business judgment. The court reasoned that the husband had no legal right to the retained earnings because those earnings were the property of the corporation unless and until the board decided to declare a dividend. The court declined to substitute its judgment for the board of directors by giving the wife a claim against the retained earnings.

The analysis of most courts changes, however, when the owner-spouse controls the business. As controlling owner, the owner-spouse owes a fiduciary duty to the other owners of the business. However, along with this added responsibility comes a greater level of discretion of a control standard opens the door for a spouse to advance a reimbursement claim when, for example, stock of a corporation in which the wife owns a minority interest, is not employed by the business and has no control, increases in value due to the decision of directors to reinvest profits rather than distribute a dividend. No reported case recognizes this type of a reimbursement claim. Cf. Simplot v. Simplot, 96 Idaho 239, 526 P.2d 844 (1974).

The control standard is difficult to rationalize in relation to the question of whether the community has a claim to the increase in value of separate property. Certainly the increase in value of a company in which the owner-spouse lacks control could be attributable to the reinvestment of business rents and profits just as easily as when the owner-spouse has control. Part of the control distinction may be related to the fact that the owner-spouse has not "realized" the increase in value of the non-control stock because no dividend was declared; whereas, because of the access to profit secured by control, the controlling stockholder has "realized" the increase in value. This distinction does not account for the fact that at least some of the increase in value of the non-control stock on the market may be attributable to the corporate directors' decision to reinvest profits. That value will be "realized" when the owner-spouse sells the stock at a profit.

Another possible rationale for the control distinction may be related to the idea that it is easier for the controlling stockholder to make decisions which would deprive the community of the benefit of the rents and profits of the business. The reality of the stock market, however, is that the non-controlling stockholder may limit the community's claim to business rents and profits by carefully selecting stocks based on their growth potential, as opposed to income potential, and because the respective businesses declare few and small dividends. Thus, there does not seem to be any basis upon which to presume a greater intent to deprive the community of property in the situation where the owner-spouse has control.

20. Id. at 241, 526 P.2d at 846.
21. Id. at 242, 526 P.2d at 847.
22. Id. at 243, 526 P.2d at 848.
23. Id.
regarding the distribution or retention of dividends and the determination of salary. In fact, as long as the controlling-owner spouse does not breach his or her fiduciary duty, he or she is entitled to set his or her own rate of compensation with virtually no outside interference. In addition, the controlling-owner spouse, subject to fiduciary duties, may determine by himself or herself whether to pay dividends.

On the other hand, in the situation where the owner-spouse is a minority owner, he or she would have to rely on his or her ability to persuade the managers and/or the majority owners of the business to pay a dividend or increase his or her salary. Thus, the minority-owner spouse would be in a position similar to that of a non-owner employee or minority stockholder of a larger corporation.

The problem is not necessarily that the owner-spouse will purposefully use the corporation to shelter his or her income from community claims. While that is part of the underlying concern, a greater risk is that, in the normal process of running the business, the owner-spouse will retain earnings and depress his or her salary in order to maximize profitability at the expense of the community. This behavior has the inadvertent effect of allowing the owner-spouse to underwrite the business's success through the indirect use of community assets. In many instances, had the owner-spouse not made these decisions, the business might not have been as profitable or even might have failed. Moreover, the stabilization and profitability of the business may very likely inure to the benefit of the community while the marital relationship is intact in the form of a larger salary and more benefits for the owner-spouse. Such sacrifices are usually made by married couples as a form of investment in the future economic well-being of the family. However, courts should not use this reasoning as a justification to ignore the community's investment in the success of the business when the marital relationship ends. Instead, the community should be entitled to a reimbursement for those contributions to and investments in the success of the business.

Most community-property jurisdictions—American Rule or Civil Rule—have recognized that where the owner-spouse has not compensated himself or herself for labor contributed to the separate-property business, some of the increase in value of the business is attributable to

25. Id. at § 4.1 and § 6.1 - 6.3.
26. See e.g. Dillingham v. Dillingham, 434 S.W. 2d 459 (Tex. Civ. App. 1968) (holding that a corporation was the alter ego of the husband where he was the only stockholder, conducted all his business affairs through the corporation and co-mingled corporate funds with community funds).
the owner-spouse’s labor and have permitted a claim for reimbursement of that unpaid compensation.27

A. American Rule Jurisdictions

In most American Rule jurisdictions, courts have treated the community’s claim to apportionment to increases in value the same regardless of whether the separate-property business is incorporated or unincorporated.28 Although the American Rule jurisdictions do not recognize a community interest in the rents and profits of separate property, most have held that where the increase in value of the separate property is the result of community management, labor or services, the community is entitled to be reimbursed for that contribution.29 The Nevada Supreme Court in Johnson v. Johnson30 expressed the basis for the American Rule jurisdiction analysis of this issue:

Profit or increase in value of property may result from the capital investment itself, or from the labor, skill and industry of one or both of the spouses or from the investment of separate property and the labor and skill of the parties. Where both factors contribute to the increase in value of a business, that increase should be apportioned between the separate and community property.31

27. See e.g. Cockrill v. Cockrill, 124 Ariz. 50, 52-53, 601 P.2d 1334, 1336 (1979) (en banc) (recognizing that the increase in value of separate property could be “due to the inherent nature of the property” and/or “the individual toil and application” of the owner-spouse); Lucini v. Lucini, 97 Nev. 213, 214-15, 626 P.2d 269, 270 (1981) (apportioning increase in value of separate property between community and separate ownership); Gillespie v. Gillespie, 84 N.M. 618, 623, 506 P.2d 775, 780 (1973) (“there must be a fair apportionment between the return on the separate property . . . and the value of the labor, industry and skill” of the owner-spouse); Speer v. Quinlan, 96 Idaho 119, 128, 525 P.2d 314, 323 (1973) (holding that the increase in value of a separate-property business must be apportioned between the community and separate estates); La. Civ. CODE ANN. art. 2368 (West 1985) (applied in Phillips v. Wagner, 470 So.2d 262, 268-69 (La. Ct. App. 1985)).

Wisconsin has not yet addressed the question of apportioning increases in value of a separate-property business. See generally, Oldham, Separate Property Businesses that Increase in Value During Marriage, 1990 Wis. L. Rev. 585.


29. See note 27 supra, and cases cited therein.


31. Id. at 246, 510 P.2d at 626.
B. Civil Rule Jurisdictions

In Civil Rule jurisdictions, where the rents and profits generated from separate-property are community property, courts have reached different results in evaluating whether the community has a property interest in the earnings of a separate-property business depending on whether the business is incorporated.32

Some Civil Rule jurisdictions have recognized that the profits of a separately owned unincorporated business are community property. In Swope v. Swope,33 the Idaho Supreme Court recognized the claim of the non-owner spouse to the retained earnings of a partnership even though the underlying partnership interest was separate property. The court analogized the retained earnings of the separate-property partnership to a certificate of deposit purchased before marriage but not redeemable until after marriage. It reasoned that “[t]he interest income on such a certificate would clearly constitute community property . . . even though it accumulates and is not distributed to the owner/spouse.”34 Furthermore, the court reasoned that retained earnings in a partnership could not be treated the same as retained earnings in a corporation; while a stockholder in a corporation has no property rights in the accumulated earnings and surplus of the corporation because the corporation is a separate legal entity, an owner of a partnership interest has a right to direct payment of earnings or dissolve the partnership if the other partners disagree.35 Moreover, the court reasoned that in contrast to a corporation, a partnership has no distinct legal status apart from the individual partners.36 For these reasons, the court in Swope concluded that the retained earnings of a partnership, being owned by the partner/spouse directly, were commu-


34. Id. at 980, 739 P.2d at 279.

35. Id. at 981, 739 P.2d at 280. The court’s analysis of the nature of a partner’s property interest is consistent with the existence of an “at will” partnership. See Uniform Partnership Act § 31 (1914). However, if the partnership is for a term of years, a partner cannot unilaterally force a dissolution of the partnership without breaching the partnership agreement. See id.

36. Swope, 112 Idaho at 981, 739 P.2d at 280.
nity property subject to division on divorce. The same result has occurred when the owner-spouse's business is a sole proprietorship.

The Swope court's analysis of the differences between a partnership and a corporation over-simplifies the problem. First, the analysis, by focusing on the ownership rights of individual partners, disregards the partnership entity. Second, the analysis does not pay close enough attention to the nature of the property rights each partner has in the partnership. Under the Uniform Partnership Act (UPA), a partner is accorded three types of property rights: (1) his specific rights in partnership property, (2) his interest in the partnership, and (3) his right to participate in the [partnership] management. With respect to part one, the partner's rights in specific partnership property, the partner may only possess partnership property for partnership purposes, his rights are not assignable, they are not subject to attachment or execution for non-partnership obligations and they do not survive the partner's death.

The partner's "interest in the partnership" is defined by the UPA as "his share of the profits and surplus..." While this interest is assignable, the only way a partner could realize this interest against the wishes of the other partners is to force a dissolution. If the partnership is for a term of years, as opposed to at-will, such an act by the partner would constitute a breach of the partnership agreement. If the dissolution of the partnership is a breach of the partnership agreement, the breaching partner may be liable for damages and will lose his or her right to the good will of the partnership.

37. Id.
39. The drafters of the Uniform Partnership Act waffled on the question of whether the partnership should be a juridical entity. However, they incorporated many aspects of the entity concept into the Act. See Jensen, Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity, 16 Vand. L. Rev. 377, 380 (1963)("[t]he uncontradictable result of the clear language of the act [is to make] the partnership a juridical person in substantive law . . . ").
41. UPA § 24 (1914).
42. Id. § 25 (1914).
43. Id. § 26 (1914).
44. See A. Bromberg, Crane and Bromberg on Partnership § 75 (1968).
45. UPA §§ 32(1)(d) and (2)(b) (1914).
46. Id. § 38 (1914).
results in the business being unable to continue operations, the value of the partnership as a going concern may be significantly affected. All of these concerns limit the practical ability of a partner to force a distribution of partnership rents and profits. Thus, as a practical matter, there is little justification for treating partnerships and corporations differently as to a community-property claim for undistributed profits.47

With respect to incorporated businesses, in Civil Rule jurisdictions most courts have recognized that the community has a claim for uncompensated labor.48 However, with the possible exception of Idaho, these jurisdictions have not recognized the community's claim for undistributed profits.49

III. VALUING THE COMMUNITY'S INTEREST IN THE NATURAL INCREASE OF THE SEPARATE-PROPERTY BUSINESS

A. American Rule Jurisdictions

1. California

Two California decisions have governed the valuation of the community-property interest in separate-property businesses in most Civil Rule jurisdictions. In Pereira v. Pereira,50 the California Supreme Court held that in order to determine the community interest in a separate-property business managed by one spouse, the court should allocate a fair rate of return to the separate-property investment as separate property, and any excess in profits should be community property.51 The Pereira test protects the separate-property capital by guaranteeing a reasonable rate of return on that capital. However, it has the effect of permitting the community to retain the benefits of a windfall return as well as placing the risk of no return on the community.52

48. See supra note 27 and accompanying text.
49. See infra notes 92 - 105 and accompanying text.
50. 156 Cal. 1, 103 P. 488 (1909)
51. Id. at 7, 103 P. at 491. See Beam v. Bank of America, 6 Cal. 3d 12, 490 P.2d 257, 98 Cal. Rptr. 137 (1971).
52. See Beam, 6 Cal. 3d at 18, 490 P.2d at 261, 98 Cal. Rptr. at 141. For an extended and thoughtful analysis of the Pereira test see Bodenheimer, The Community Without Community Property: The Need for Legislative Attention to Separate Prop-
The *Pereira* approach for valuing the community interest in a separate-property business has been used in cases where the chief contributing factor to the gain or loss of the separate property is the personal skill, industry and labor of the owner-spouse. Some Civil Rule jurisdictions, however, have been reluctant to apply the *Pereira* test apparently out of a concern that the application of the test would result in converting proceeds of the separate-property capital into community property when the community has been adequately compensated for its contributions to the increase in value of the separate-property business.

In a second California case, *Van Camp v. Van Camp*, an appellate court allocated a portion of the profits of a separate-property business as the reasonable value of the owner-spouse's services and treated the balance of the increase in value as separate property. In contrast to the *Pereira* approach, *Van Camp* fixed a value for the services contributed to the separate-property business by the owner-spouse. Thus, *Van Camp* protected the community by ensuring that a fair return on community labor would be received. However, it limited the claim of the community by placing the benefits of windfall profits on the separate-property estate as well as the risk of loss on the separate-property estate. The *Van Camp* test has been applied in cases where the chief contributing factor to the profit or loss on the separate property is the capital itself.

California courts apply one or the other of the above tests depending on which would accomplish "substantial justice" on the facts of an individual case, considering whether the profits result from the character of the capital investment in the property or the labor, skill and industry of the owner-spouse.

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53. *See Beam*, 6 Cal. 3d at 18, 490 P.2d at 261, 98 Cal. Rptr. at 141.
54. Lucini v. Lucini, 97 Nev. 213, 215, 626 P.2d 269, 270-71 (1981) (holding that apportionment of the increase in a separate-property partnership is a proper way of achieving substantial justice between the parties), Gillespie v. Gillespie, 84 N. M. 618, 624, 506 P. 2d 775, 781 (1973) ("With the value of the services and efforts being established and not challenged, and all of those monies having been withdrawn from the business, it is difficult to see how there could have been a community interest still in the business").
55. 53 Cal. App. 17, 199 P. 885 (1921)
56. Id. at 27-28, 199 P. at 888-89. *See Beam*, 6 Cal. 3d at 19, 490 P. 2d at 141, 98 Cal. Rptr. at 261. *See Bodenheimer, supra* note 52 at 395 - 401.
57. *Beam*, 6 Cal.3d at 18, 490 P.2d at 141, 98 Cal. Rptr. at 261.
One of the problems with the California approach is that it does not provide much guidance on when Pereira and Van Camp should be applied. One California decision suggested that where the labor and industry of the owner-spouse had a minor influence on the increase in value of the separate property, the Van Camp approach should be applied.\textsuperscript{59} This reasoning is presumably based on the assumption that the Van Camp approach would permit the court to establish a very low figure for the compensation due the owner-spouse to reflect his or her minor influence. While this reasoning is attractive, it is not easily applied where the influence of the owner-spouse's labor on the increase in profits is difficult to evaluate. In fact, where the separate property is highly capital intensive, it seems that the Pereira test would be appropriate since that test would place the risk of loss on the community by establishing a fixed rate of return for the capital investment.\textsuperscript{60}

Furthermore, with respect to the Van Camp test, the California courts have provided little guidance on what constitutes a reasonable return on community labor. For example, should the rate of return be based solely on what the business would have had to pay a third party to manage the business? Does it consider the entrepreneurial skills of the spouse? Several commentators have observed that focusing on what a non-owner employee would have been paid will frequently under-value the community contribution to the business.\textsuperscript{61}

In addition, the California approach, especially when the Pereira test is applied, does not seem to focus on the right question. Because the community's claim in an American Rule jurisdiction arises only as a result of the labor and industry of the owner-spouse, the courts should directly focus on valuing that labor and industry. This question should turn on the nature and extent of the services rendered. While Van Camp allows such an inquiry, the Pereira test does not adequately consider the services rendered to the separate-property business. Finally, courts have had difficulty determining what is a reasonable rate

\textsuperscript{59} In re Marriage of Lopez, 38 Cal. App. 3d 93, 105, 113 Cal. Rptr. 58, 65 (1974).

\textsuperscript{60} Commentators have gone to great lengths to establish when Van Camp or Pereira should be applied. See, e.g. Adler, Arizona's All-or-Nothing Approach to the Classification of Gain from Separate Property: High Time for a Change, 20 Ariz. Law Rev. 597, 609-613 (1978).

\textsuperscript{61} W. Brockelbank, The Community Property Law of Idaho 176-77 (1962) ("The employed manager watches the clock. He is interested in what he can get out of it. In contrast the husband puts his whole being into the enterprise . . . . At least it is certain that the wages one would pay a hired manager are not the fair value of the vigilant and extraordinary services of the spouse."); Bodenheimer, supra note 52 at 396 ("The wages that would be paid a hired manager as well as the self-determined salary are often too low to serve as an adequate measuring stick for the community share in the profits.").
of return on the capital investment of the owner-spouse and, as a result, have frequently applied a pre-set interest rate.\textsuperscript{62}

Professor Brigitte Bodenheimer commenting about the California apportionment system, concluded: "Generally speaking, however, the results are uncertain and unpredictable, often unfair to either the husband or the wife—under present societal conditions more often the wife. Thus, it is probably no overstatement to say that present apportionment mechanisms are not working."\textsuperscript{63} Despite these problems, most American Rule jurisdictions have followed the California approach.\textsuperscript{64}

2. Washington

Washington is the only American Rule jurisdiction that does not follow the California apportionment system. With respect to an incorporated business, the Washington Supreme Court in \textit{Hamlin v. Merlino}\textsuperscript{65} held that "where a salary is paid to the husband by [the separate-property corporation], . . . the community is thereby compensated for his services, and . . . dividends paid or any enhanced value of the stock resulting from profits reinvested in the corporation are separate property."\textsuperscript{66} This approach has been referred to as a segregation approach;\textsuperscript{67} that is, the owner-spouse's payment of salary to himself or herself is, by itself, sufficient evidence that community funds have been segregated from separate-property profits. The court in \textit{Hamlin} recognized that "where a husband owning a \textit{large corporation} pays to the community a salary which is grossly unfair, such salary should be disregarded with the result that profits accruing partly from community labors and partly from natural increase of the separate property will be held to be commingled and community property."\textsuperscript{68} On the facts of the case, however, the court refused to find that the husband's salary of $1,858 per year was grossly unfair even though the


\textsuperscript{63} Bodenheimer, \textit{supra} note 52, at 394.


\textsuperscript{65} 44 Wash. 2d 851, 272 P. 2d 125 (1954).

\textsuperscript{66} \textit{Id.} at 859, 272 P. 2d at 129.

\textsuperscript{67} W. \textit{REPPI} & C \textit{SAMUEL, COMMUNITY PROPERTY IN THE UNITED STATES} 138-39 (2d ed. 1982) [hereinafter \textit{REPPI & SAMUEL}]; Adler, \textit{supra} note 60 at 604, 606-609.

\textsuperscript{68} \textit{Hamlin}, 44 Wash. 2d at 860, 272 P. 2d at 129 (emphasis in original).
value of the assets of the husband's grocery business were between $72,000 and $133,000.69

Washington's approach on unincorporated businesses appears to be that the community has a claim for the enhancement in value of the separate property that results from community labor.70 However, in order to establish that claim, the community must rebut the presumption that the increases in value of separate property are due to natural forces and consequently are separate property.71

Washington's approach is, in some ways, akin to the "all or nothing" approach which at one time was followed in Arizona and Nevada.72 Washington's approach discourages apportionment of increases in the value of separate property between community and separate estates. In most cases, Washington will not recognize a community claim in the increase in value of a separate-property business where that business is incorporated. Even in the case of an unincorporated business, the approach of the Washington courts would only permit apportionment when the non-owner spouse could overcome a presumption to the contrary and prove that the value of the separate property was enhanced by community labor.

B. Civil Rule Jurisdictions

1. Louisiana

The Louisiana Civil Code article 2368 appears to limit the community's claim to the increased value of a separate-property business to that amount attributable to the "uncompensated labor and industry of the spouses."73 Thus, even though the general rule in Louisiana is that the proceeds of separate property are community,74 the civil code does

69. Id.
70. Id. at 858, 272 P.2d at 129 ("[w]here the separate property in question is an unincorporated business with which personal services ostensibly belonging to the community have been combined, the rule is that all the income or increase will be considered as community property in the absence of a contemporaneous segregation of the income between the community and the separate estates.") (emphasis in original).
73. LA. CIV. CODE ANN. art. 2368 (West 1985).
74. Id. art. 2339 (West 1985) provides: "The natural and civil fruits of the separate property of a spouse, minerals produced from or attributable to a separate asset, and bonuses, delay rentals, royalties, and shut-in payments arising from mineral leases are community property."
not appear to permit reimbursement for undistributed profits of a separate-property business that has increased in value. Furthermore, the comments to article 2368 appear to provide that if the owner-spouse is compensated for his or her labor, then the community has no claim for reimbursement.  

Consistent with the provisions of article 2368, the Louisiana courts have held that the value of the community claim against the increase in value of a separate-property business is measured by whether the owner-spouse was adequately compensated.  

In Phillips v. Wagner, a Louisiana appellate court held that the community had no claim to the increase in value of a separate-property partnership because, although the husband was one of two partners, he was not directly employed by the partnership and consequently his "common labor" did not contribute to the increase in value.

Under the predecessor of article 2368, the Louisiana Supreme Court took the view that if common labor, industry or expenses contributed to the increase in value, then the entire increase was treated as community property. Through a literal application of the former provisions, the court held that the separate estate had to establish that the increase in value resulted only from the ordinary course of things. The language of the revised article appears to reverse this all-or-noth-

75. The comment to article 2368 provides in relevant part: "Under this provision, when separate property has increased in value due to the uncompensated common labor and industry of either spouse, the other spouse is entitled to one-half of the increase. To the extent that a spouse is compensated for his labor no reimbursement is due." La. Civ. Code Ann. art. 2368 (West 1982), comment.

76. Under an earlier version of article 2368, Louisiana appears to have applied an "all or nothing" approach to the apportionment of the increase in value of a separate property business. See notes 79-81, infra and accompanying text; Abraham v. Abraham, 230 La. 78, 87 So.2d 735, 738-39 (1956).


78. Id. at 268.


When the separate property of either the husband or the wife has been increased or improved during the marriage, the other spouse or his or her heirs, shall be entitled to the reward of one half of the increase or amelioration, if it be proved that the increase or amelioration be the result of the common labor, expenses or industry; but there shall be no reward due if it be proved that the increase is due only to the ordinary course of things, to the rise in the value of property, or to the chances of trade. (emphasis added).


81. See supra note 79. The express language of article 2408 appears to have required this result. See e.g. Abraham v. Abraham, 230 La. 78, 87 So. 2d 735, 739 (1956).
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ing approach by expressly eliminating the clause of the original statute relating to increases in value of the ordinary course of things and by providing expressly that "the spouse whose property has increased in value [must reimburse the other spouse in the amount of] one-half of the increase attributed to the common labor." 82

Because of the limitation of the Louisiana Civil Code as to increases in value of a separate-property business, Louisiana effectively takes the same approach as an American Rule jurisdiction. The only basis for a community claim in a separate-property business is uncompensated community labor and industry. Moreover, if the language of the comments to article 2368 is given literal effect, it would appear that Louisiana's approach is akin to that of Washington, 83 since the payment of compensation to the owner-spouse by the separate-property business would likely bar the community claim to allocation. 84

2. Texas

Like Washington, Texas appears to treat the increase in value of a separate-property business differently depending upon whether the business is incorporated. With respect to an incorporated separate-property business, the Texas Supreme Court has limited the community claim to that portion of the increase attributable to uncompensated labor and industry of the spouses. 85 In Jensen v. Jensen, 86 that court held that the community should be reimbursed for the value of


83. See, supra, text accompanying notes 65 - 72.

84. Commentators discussing the extensive 1980 revision of Louisiana's community-property laws curiously do not mention the abandonment of the statutory provision forcing the separate estate to establish that increases resulted only from the ordinary course of things. Nor do they discuss the language of the comment which appears to bar a community claim if the community labor was compensated. See Riley, Analysis of the 1980 Revision of the Matrimonial Regimes Law of Louisiana, 26 LOYOLA L. REV. 453, 517-19 (1980); Bartke, The Reform of the Community Property System in Louisiana—A Response to its Critics, 54 TULANE L. REV. 294 (1980); Community Property Symposium, 39 LA. L. REV. 323 (1979).

85. For an excellent analysis of the Texas Supreme Court's struggle with this issue over the years, see, Comment, Closely Held Corporations in the Wake of Vallone: Enhancement of Stock Value by Community Time, Talent and Labor, 35 BAYLOR L. REV. 47, 49-67 (1983).

the time and/or effort expended by either spouse on the separate-property business, less compensation received in the form of salary, bonuses, dividends or other benefits. This holding does not appear to provide any basis for reimbursement to the community of undistributed corporate profits, even though Texas is a Civil Rule jurisdiction recognizing generally that rents and profits on separate property are community property.

With respect to unincorporated business profits, Texas may not recognize apportionment. Instead, Texas has developed a set of "all-or-nothing" rules based on the nature of the underlying business property. However, in her dissent in *Vallone v. Vallone*, Justice Sondock suggested that the increase in value of a sole proprietorship would be community property.

3. Idaho

In *Speer v. Quinlan*, the Idaho Supreme Court recognized that a non-owner spouse should be reimbursed for uncompensated labor where the owner-spouse was not paid adequate compensation. The measure of adequate compensation was set forth as follows:

87. 665 S.W.2d at 109. One commentator described the law of Texas after *Vallone and Jensen* as follows:

The formula [for valuing the community's claim to reimbursement] consists of four steps. First, determine how much of the appreciated value is attributable to the efforts and talents of either spouse. . . . Second, calculate what compensation would be adequate for the services rendered by the owner spouse. . . . Third, subtract some portion of the spousal services necessary to maintain and preserve the separate estate. . . . Fourth, offset all compensation previously received during marriage (such as salaries, bonuses and fringe benefits) against the amount necessary to reimburse the community.

Smith, *supra* note 1 at 718 - 719.

88. Tex. Const. art. XVI, § 15, as amended 1987. Smith, *supra* note 1 at 718 ("The concept of 'adequate compensation' ignores the basic definition of earnings as community property.")

89. These rules are described and criticized in *Reffy & Samuel, supra* note 67 at 155 ("Texas seems not to realize that a civil law system has an apportionment problem. The Texas courts have categorized cases presenting apportionment problems and developed all-or-nothing rules for each category. The 'rules,' if they can be called that, are irreconcilable and without logic.").

90. 644 S.W. 2d 455 (Tex. 1982).

91. *Id. at* 462 ("If Tony's Restaurant, Inc. had continued its operation as a sole proprietorship, the form in which it was originally organized during the marriage, there could be no doubt that the entire increase in value of the business would be community property.")(footnote omitted)(Sondock, J., dissenting); see also Note, *Community Property and the Business Partnership*, 57 Tex. L. Rev. 1018 (1979).


93. *Id. at* 128, 525 P.2d at 323.
In determining whether the community has been adequately compensated for its labor over the period of the marriage, the trial court should take the following factors into consideration: the nature of the business, the size of the business, the number of employees, the nature and extent of community involvement in the conduct of the business, the growth pattern of the business. (Did it steadily enhance in value? Did periods of prosperity alternate with periods of decline?) Once these questions are answered the proper inquiry is whether the over-all compensation received by the community for its contribution to the conduct of the business was equivalent to the compensation which the business would have had to pay to secure a non-owner employee to perform the same services which were rendered by the community.  

The court concluded that the community should be entitled to a judgment against the owner-spouse in the amount of the difference between the compensation actually received and the compensation which the community would have received if the owner-spouse had been adequately compensated.

In addition to its holding regarding compensation for community labor, the Idaho court, in contrast to Louisiana and Texas, addressed the problem of whether the community had a claim for undistributed rents and profits of separate property. The court concluded that the community had no ownership rights to undistributed business profits of a corporation where the decision of the corporate directors to retain earnings was an exercise of reasonable business judgment and where there was no intent to defraud the community. Nonetheless, the court recognized that, but for the fact of incorporation, the owner-spouse's share of those undistributed earnings would have been community property. Curiously, the court, although recognizing the "inequity" of the situation, did not provide a claim for reimbursement of undistributed business profits to the non-owner spouse. Instead, the court directed the trial court to consider the "inequity" as one factor in dividing the community property under the equitable-division property settlement statute. This latter holding in the Speer case is more

94. Id.
95. Id.
96. Id at 129, 525 P.2d at 324.
98. Id. Professor Reppy has suggested, citing Speer, that Idaho "ignore[s] the corporate form when a spouse owns more than fifty percent of the stock." Reppy, supra note 82, at 703, n. 111-112. This is an inaccurate summary of Speer which expressly
doctrinally supportable than the Texas approach of completely ignoring the potential community claim for undistributed profits, nonetheless it is problematical for two reasons. First, the decision does not make clear the basis for the different treatment of uncompensated community labor and undistributed rents and profits; for the former, the community receives a judgment, while the latter is merely a factor to be considered in making an unequal division of community property. If no other community assets exist, the Speer analysis would leave the non-owner spouse with no remedy for the undistributed corporate profits. Second, by relying on the equitable-division statute and not recognizing that the surviving spouse has a right to reimbursement of the undistributed profits, the court provided no basis for the non-owner spouse's heirs to obtain reimbursement upon that spouse's death. Even with these problems, Speer stands alone in recognizing that in a Civil Rule jurisdiction, undistributed business profits raise a question of community-property characterization and/or reimbursement.

The problem in Idaho is that despite Speer, the community claims appear to be limited to uncompensated labor when the business is incorporated. Even though later courts have addressed the inequity of not compensating the community for undistributed profits, they have not clearly articulated the claim for profits as distinct from the claim for uncompensated labor. In Josephson v. Josephson,99 the Idaho Court of Appeals, relying on Speer, recognized that dividends, if they had been distributed, would have been community property.100 However, despite its recognition of the potential community interest in undistributed dividends, the court concluded: "[A] proper inquiry is whether community efforts. . . were adequately rewarded through salary."101 Furthermore, the court, apparently combining the two distinct parts of Speer into one test, concluded that the business's retention of earnings and failure to distribute a dividend should be considered in the context of whether the owner-spouse's salary was adequate.102

rejected the argument that the community had a property interest in the retained earnings of a separate-property business. Not only did the Speer court reject the direct claim against retained earnings, but, as to undistributed rents and profits of a separate-property business, the court did not even recognize that the non-owner spouse had a claim for reimbursement. 96 Idaho at 129-30, 525 P.3d at 324-25.

100. Id. at 1148, 772 P. 2d at 1242.
101. Id.
102. Id.
In *Wolford v. Wolford*, the Idaho Supreme Court perpetuated the confusion begun in *Josephson*. There, the court could have disposed of the entire case based on an antenuptial agreement between the parties. Instead, however, the court treated the case as governed by *Speer* and apparently limited its decision to a compensation analysis:

Thus, under the analysis contained in *Speer*, whenever one party to a marriage claims that he or she is entitled to share in the increase in the value of a separate property business in which one of the parties was an employee during the marriage, the proper inquiry upon dissolution of the marriage is whether the community has been adequately compensated for its labor.

**IV. THE CHARACTERIZATION OF THE COMMUNITY INTEREST IN UNDISTRIBUTED INCREASES IN A SEPARATE-PROPERTY BUSINESS: REIMBURSEMENT VS. OWNERSHIP**

When courts have recognized the community's claim to increases in value of a separate-property business whether based on uncompen-

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104. *Wolford*, 117 Idaho at 68, 785 P.2d at 630 (“Since... [the parties] entered into that comprehensive antenuptial agreement, which the courts below found to have been voluntarily entered into without fraud or duress, our analysis of the issues in this case will be made with that contractual property regime in mind”) (emphasis added). In a footnote the court observed:

The antenuptial agreement provided that “[e]ach party shall separately retain all rights and have complete control of his or her own separate property, whether now owned or hereafter acquired and the rents, profits, and increase thereon, ... with the same effect as if no marriage had been consummated between them.” It may well be that under the property regime contracted between the parties in their ante-nuptial agreement that neither party was entitled to any interest in the “increase” in their separate property, regardless of whether that increase was the result of the personal efforts of David. We need not resolve that question, however, since we agree with the district court's analysis that, even assuming that the ante-nuptial agreement did not preclude Kathryn from claiming an interest in David's separate property stock in CommTek, Inc., the uncontradicted evidence in the record demonstrates that the community was adequately compensated, and therefore under *Speer* v. Quinlan, the community has no claim against David's separate property stock in CommTek, Inc.

*Id.* at 67-68, 785 P.2d at 631-32, n.3 (emphasis added).

105. *Id.* at 68, 785 P.2d at 632. See Note, 27 Idaho L. Rev. 127.
sated salary or undistributed profits, that claim has been characterized most often as one for reimbursement. In Jensen v. Jensen, the Texas Supreme Court addressed the issue of whether the nature of the community claim was one for ownership or reimbursement and held that the claim was a reimbursement claim. The Louisiana Civil Code provides for a reimbursement claim.

Professor Oldham has suggested that both Washington and section 14 of the Uniform Marital Property Act (UMPA) treat the community claim as one for ownership as opposed to reimbursement. Oldham cites In re Estate of Smith as support for the proposition that Washington treats the community claim as one for ownership. Smith held that where personal services of one spouse have been commingled with a separate-property business that is unincorporated and where no salary was segregated from the profits, the increase in the value of the business is community property. However, Washington is the only community-property jurisdiction that treats cases involving the increase in value of unincorporated businesses as simple improvement or commingling cases.

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106. See e.g. Speer, 96 Idaho at 128, 225 P. 2d at 323 (holding that on divorce, the court should enter a judgment in favor of the non-owner spouse where compensation is found inadequate); Jensen v. Jensen, 665 S.W. 2d at 109. Oldham points out that the implication of the Pereira test is that the community’s claim is one for reimbursement. Oldham, Separate Property Businesses That Increase in Value During Marriage, 1990 Wis. L. Rev. 585, 621-22.

107. 665 S.W. 2d 107 (Tex. 1984).

108. Id. at 109.

109. LA. CIv. CODE ANN. art. 2368 (West 1985).

110. Oldham, supra note 106 at 622 relying on, In re Estate of Smith, 73 Wash. 2d 629, 440 P. 2d 179 (1968) and UNIFORM MARITAL PROPERTY ACT § 14(b) (1983) [hereinafter UMPA]. Section 14(b) of the UMPA provides in relevant part:
(b) Application by one spouse of substantial labor, effort, inventiveness, physical or intellectual skill, creativity, or managerial activity on individual property of the other spouse creates marital property attributable to that application if:
(i) reasonable compensation is not received for the application; and (ii) substantial appreciation of the individual property of the other spouse results from the application.

The UMPA is a community-property statute which substitutes the term “marital property” for “community property” and the term “individual property” for the term “separate property.” Kornfield, Uniform Marital Property Act—Preparatory Note, 4 Equit. Distribution Rep. 6, 70-71 (Dec. 1983).

111. Oldham, supra note 106 at 622.

112. In re Estate of Smith, 73 Wash.2d at 630-31, 440 P.2d at 180-81.

113. Id. See supra notes 65-72 and accompanying text for a discussion of Washington’s unique approach to this problem. Although Washington has never recognized such a claim, it appears that Washington would hold that the community interest in the increase in value of an incorporated separate-property business is an ownership claim. Cf.
Furthermore, section 14(b) of the UMPA is ambiguous.\textsuperscript{114} That provision apparently deals with a special application of commingling, or "mixing" as the UMPA refers to it, in which one spouse "mixes" his or her efforts with the "property of the other spouse."\textsuperscript{115} In comparison, the enhancement in separate business property cases involve situations in which a spouse has devoted his or her effort to the management and improvement of his or her own separate property. Commingling cases have been treated differently—consistently giving rise to an ownership interest when property cannot be "uncommingled"\textsuperscript{116}—than the enhancement of separate business-property cases. Conceptually, commingling is distinguishable from the situation where separate property increases in value due to the labor and industry of one spouse. Commingling results when separate and community property are combined so that the owner of the separate property cannot show how much of the mixture is separate property. In such a case the entire amount of mixed property is treated as community property

\textsuperscript{114} The meaning of the § 14(b) is subject to some debate. Oldham states, "[T]he drafters of the Uniform Marital Property Act decided that the marital property claim (created from services rendered toward individual property) was an ownership claim not a reimbursement claim." Oldham, supra note 106 at 621 n.177, (citing UNIFORM MARITAL PROPERTY ACT § 14, comment). However, the comments to section 14 do not address the separate-property business problem. They state in relevant part:

The section deals with another extremely important issue. It is the situation arising from the application to the individual property of one spouse of personal effort by the other spouse. . . [The section] articulates a bias against the creation of marital property from such an act unless the effort has been substantial and has been responsible for substantial appreciation. . . Many situations can be visualized. Real property transactions are those in which the problem will typically occur. One spouse will bring real property into the marriage. After the marriage, the real property will be an important element in the life of the couple. The other spouse will improve it by physical labor. This might be work on a farm, or improvements or additions to a home or to a piece of commercial real estate.

\textsuperscript{115} UMPA § 14, comment.


116. McClanahan, supra note 1, at § 6:8; Reppy & Samuel, supra note 67 at 113-14 (2d ed. 1982).
under the commingling doctrine. The commingling doctrine has been viewed as a special application of the general presumption in favor of community property which requires a person claiming that property is separate property to establish that the property is not community property. Commingling can result in property which was once separate property being considered community property because it is irretrievably mixed with community property.

One commentator has attacked the reimbursement option as fundamentally unfair:

The remedy of equitable reimbursement as formulated in Val lone and Jensen III fails conceptually and practically to fulfill the promise that all property acquired during marriage by either spouse's efforts is community property. The community-property principle of marriage as a joint venture is frustrated as is the more recent use of the partnership principle to increase the marital property distributed to the dependent spouse upon divorce. Moreover, separate-property owners could have been creating a successful community business if they had not devoted their time and efforts to a separate corporation. The community loses this opportunity ....

In spite of the arguments advanced above, the community claim in the increase in value of a separate-property business should be treated as a claim for reimbursement, as most courts have concluded, and not as a claim for ownership. Allowing the non-owner spouse to acquire an ownership interest in a separate-property business would create significant problems in determining the ownership of businesses and would undermine the management of those businesses. If the community

117. McClanahan, supra note 1, at § 6:8, 339. See also Reppy and Samuel, supra note 67, at 113-114.
118. McClanahan, supra note 1, at § 6:8, 339.
119. Smith, supra note 1, at 719. Curiously Smith seems to argue that the "equitable apportionment" approach of the California case of Pereira has the potential to provide more than a reimbursement claim. She concludes, "[T]he apportionment rule can reward a return on investments in both separate and community property, including investments of human capital." Id. at 720. On the other hand, Oldham interprets Pereira as implying only a reimbursement claim: "Most Pereira cases imply that the community interest arises only at dissolution. The Pereira 'increase in value' computation normally is conducted by comparing the value of the business at the time of the wedding to the value at the time of divorce. A year-by-year accounting is not attempted. This procedure suggests that the community only has a reimbursement claim that arises at dissolution." Oldham, supra note 106 at 621. In fact, while Pereira appears to have been a reimbursement case, nothing in the opinion advances the reimbursement versus ownership argument.
claim is treated as giving rise to an ownership right in a business, then questions regarding whether the spouse is a partner or stockholder in the business with all the rights such ownership would entail would have to be addressed. The result could be that in community-property jurisdictions, spouses would obtain management and voting rights in businesses. In addition, the ownership rights would belong to the spouses after divorce and would be inheritable, divisible, and possibly assignable. This result would subject businesses to disruption upon the marriage or divorce of a “traditional” owner or the death of the spouse of a “traditional” owner. These results might interfere with the functioning of the business as a going concern. Moreover, as a practical matter, such ownership rights may have little value to the non-owner spouse. As personal property, the owner-spouse may be able to manage the non-owner spouse’s interest in the business. In addition, when the marriage ends, an ownership right might limit the property distribution options available to the non-owner spouse. For example, if the business is a corporation, the non-owner spouse might be left with a distribution of a minority interest in the stock of the corporation. Such a minority interest may have little or no market value and may not give that spouse a meaningful say in the management of the business. If reimbursement claims are fully recognized, the marginal additional benefits of ownership do not justify the potential problems that would accompany ownership.

V. PROPOSAL

In both Civil and American Rule jurisdictions, the non-owner spouse should have a reimbursement claim for unrealized compensation of the owner-spouse’s services rendered to a separate-property business based on a reasonable compensation standard. In a Civil Rule jurisdiction, the non-owner spouse, in addition to the adequate compensation claim, should also have a reimbursement claim for undistributed rents and profits of the business. These claims should be enforced regardless of separate-property structure of the business (sole proprietorship, partnership or corporation).

A. Adequate Compensation

In order to determine whether the community has an interest in the increase in value of a separate-property business as a result of uncompensated labor and industry, courts in all community-property jurisdictions—American and Civil Rule—should apply a reasonable

120. See infra notes 121-125 and accompanying text.
compensation test. Such a test should consider the nature of the business, the nature of the efforts the owner-spouse contributed to the business and the compensation actually received by the owner-spouse in the form of salary, bonuses and fringe benefits, if any. The original test articulated in Speer is a thorough and well-thought-out version of the reasonable compensation test.\footnote{121}

In applying the test, courts should be careful not to place too much emphasis on what the business would have to pay to secure a non-owner employee to perform the services performed by the owner-spouse. Such a non-owner employee would not have the same entrepreneurial commitment to the company that an owner would have. Moreover, the services of the owner-spouse may be such that a non-owner employee could not be found to perform the same services. The non-owner employee test is an attractive test because it provides court with an objective and measurable standard by which to evaluate the owner-spouse’s compensation. However, for the reasons stated above, it should not be the only measure of adequate compensation; therefore, a court should consider such evidence in the context of the nature of the business and the character of the services rendered to the business by the owner-spouse. Moreover, no distinction ought to be made between incorporated and unincorporated businesses. In both cases, labor of the community may have gone uncompensated and the nature of the business operation does not change that fact.

B. Rents and Profits

In addition to the adequate compensation test, Civil Rule jurisdictions should recognize that the community has a second claim for undistributed profits of a separate-property business.\footnote{122} Such profits (as compared to appreciation in the value of the corporate assets) can be objectively measured by a careful examination of the financial and tax records of the corporation.\footnote{123} In order to calculate the community’s interest in the undistributed profits, the court should calculate the

\footnote{121. See Speer 96 Idaho at 128, 525 P.2d at 323, discussed supra notes 92-95 and accompanying text. As to the community’s claim for uncompensated labor, Speer is essentially a thoughtful elaboration of the Van Camp test. See supra notes 55-57 and accompanying text.}

\footnote{122. The result is legislatively precluded in Louisiana. See, supra notes 73-84 and accompanying text.}

\footnote{123. Professor Reppy has suggested that the “corporate veil” be routinely “pierced” when the owner-spouse controls more than fifty percent of the stock even where there are no allegations of fraud or bad faith. See Reppy, supra note 82 at 702-705. This suggestion fails to protect the legitimate interests of minority stockholders and is an unnecessarily invasive solution to the problem.}
owner-spouse's proportional share of the annual earnings\textsuperscript{124} of the business reduced by any unusual sources of income, such as proceeds on the sale of equipment for each year of the marriage. That total should be reduced by any distribution of corporate profits that took place during the marriage. The total amount of all the undistributed profits should also be reduced to the extent that the court, using the adequate compensation test, determines to be withheld compensation for community labor. Finally, the amount should be reduced to the extent that the court determines that any other stockholders employed by the corporation were inadequately compensated.\textsuperscript{125} The information necessary to complete this computation should be available to the court in the form of annual earnings statements and tax returns prepared using generally accepted accounting methods. Finally, if the corporation's financial and tax records are so inadequate that the necessary information is not available, the court should presume that the non-owner spouse's proportional share of all the corporate earnings during the marriage would have been community and give the community a reimbursement claim in that amount.

\textsuperscript{124} As distinguished from the value of the corporate assets.
\textsuperscript{125} 96 Idaho at 130, 525 P.2d at 395.