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Family Law Issues in Agriculture: Community Property

Cari Rincker¹

Rincker Law, PLLC



National Agricultural Library

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A handful of states, including Texas, California, Arizona, Washington, Idaho, Nevada, New Mexico and Wisconsin are considered “Community Property” states with the remainder being equitable distribution states. Alaska has an “opt-in” law as it applies to community property. In some ways, Connecticut is a quasi-community property state. It is important to confirm this with a licensed

attorney in the applicable jurisdiction as there are differences from state-to-state as there are no cut and dry rules.

In Community Property (“CP”) states, property fits into one of two categories: separate property or community property. All property acquired during the marriage is presumed community property and remaining property is characterized as separate property. Separate property is any property owned prior to the marriage, inherited property, and property that is gifted to one spouse. A spouse seeking to prove certain property is separate property has the burden to prove so through clear and convincing evidence.

Property that is characterized as CP must be divided upon divorce. While CP may often be split equally between spouses, it is a common misconception that people in a divorce always split property 50/50. The court may deviate from this standard using various factors to ensure the division is “just and right” which may not necessarily be an equal division. How community property is divided can be set forth in the nuptial agreement, if applicable (e.g., 50/50, pro rata based on income, or some type of agreed-upon equation or division). If there is no contractual agreement on how to divide CP, then courts divide CP. Trial courts typically divide CP equally between spouses unless a spouse proves that this equal division is not “just and right.”

¹ Cari Rincker is the principal attorney at [Rincker Law, PLLC](#), nationally recognized law practice focusing on food, farm and family. Cari is a trained mediator and adjunct professor both at Vermont Law School and the University of Illinois, School of Law. She runs a small farm outside of Champaign Illinois.

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This Fact Sheet discusses 5 items that should be considered to determine what property is CP and how it should be divided upon divorce: (1) identification of separate and community property; (2) income from separate property; (3) valuation of property; (4) prenuptial and postnuptial agreements; (5) and division of community property and debt.

Step 1: Identification of Separate and Community Property

Property acquired during the marriage is presumed to be CP unless the spouse claiming that it is separate property can prove otherwise through clear and convincing evidence. Therefore the first step in the analysis is to determine what property may be characterized as separate property and then all remaining property will be considered CP. Again, the law can vary somewhat from state to state on what property fits into each category, and there can even be sophisticated nuances in some areas in the same jurisdiction. A detailed property list should be drafted that includes grain inventory, farm equipment inventory, and livestock inventory. Debt acquired during marriage and prepaid expenses should also be on this list. Once a detailed list is generated, separate property may be identified.

Here are a few examples of property that is characterized as separate property:

1. Gifts (except for joint gifts or wedding gifts);
2. Inheritance (except if in joint name);
3. Premarital property, and;
4. Property from a personal injury award (excluding lost wages).

Keep in mind that the definition of property is broad. It can include intellectual property (e.g., trademarks), business interests, retirement/ pensions, animals, farm equipment, etc. The most overlooked property in a farm or ranch divorce is the business itself, and it is oftentimes forgotten as an asset that is either separate or community.

As a caveat, separate property can transfer to community property if funds are commingled or it is titled jointly in both spouses' names. This is called transmutation. For example, if a premarital piece of farm equipment was sold and deposited into the joint bank account, then those monies are now part of the CP. Livestock can also become community property absent detailed records identifying those that are separate property.

If Rancher John owned a herd of beef cattle prior to marriage that were commingled with cows purchased after marriage, the court may characterize all of his cattle as CP unless Rancher John produces clear and convincing evidence identifying which cows were owned prior to marriage.

Importantly, the burden of proof is on the person claiming separate property to show that property should

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be characterized as such. This person may use a method known as “tracing” and through “tracing” the spouse must determine the value of the property prior to marriage, any changes in value or character to property overtime including the sale of said property, use of proceeds from a sale of separate property to purchase community property, and changes in value of the separate property. For example, if a Farmer Jane had a \$200K retirement account at the time of the marriage and it increased to \$500K during the marriage, Farmer Jane would need to prove that the value at the date of the marriage was \$200K. It is difficult to obtain documentation more than seven years of age by subpoena to financial institutions, so hopefully Farmer Jane kept good records and can find this statement. If she cannot, then Farmer Jane can hire an actuary to do a sophisticated analysis with the known statements. The point is this: if Farmer Jane wants to keep the \$200K separate property (plus any appreciation thereof, depending on her state), then she has to do the work to find the proof.

Debt must also be characterized as either separate or community. If one person comes to the marriage with student loan debt or a mortgage on separate farm ground, then it is considered separate debt. When people walk down the aisle, their debt liability does not get “cut in half” as some people may joke about at the bachelor(ette) party. Although states differ in this regard, as a general rule, spouses are jointly and severally liable for debt during the marriage only. It is not unusual for people to think they are no longer responsible for the debt of their spouse once they “separate”; unfortunately for some, that is not the case. Of course, they may have wasteful dissipation claims or equitable arguments once divorce papers are filed, but parties should keep this in mind during the divorce.

Step 2: Income Separate Property

Income generated from and the appreciation of separate property is typically considered CP, however states vary in this area. This is particularly important for agricultural assets such as land and livestock. For example, if a spouse inherited a farm during the marriage it is separate property, but the rents generated from that farm during the marriage are CP. Similarly, even if a spouse owned cattle prior to marriage all offspring born during the marriage are considered CP.

Farmer Jill owns 20 dairy cows prior to marriage. During the marriage, Farmer Jill’s cows raised 15 calves which were retained in the herd. The 15 calves born during the marriage are considered income and will be categorized as CP.

Step 3: Valuation of Property

Property should then be valued, if appropriate. This is where appraisers can be used to appraise real property, farm equipment, art, or other valuable items. It may be difficult to find a livestock appraiser, but auctioneers may feel comfortable in doing so.

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Do not forget the value the business interest(s). Business evaluators should be used to value the farm/ranch/agri-business itself; in doing so, typically 5+ years of tax returns, bank statements, and other financial records are reviewed. If a farming enterprise has several entities, then each needs to be valued separately (e.g., sole proprietorship, family partnership, trucking company, restaurant).

Step 4: Prenuptial or Postnuptial Agreements

Prenuptial or postnuptial agreements can help identify the characterization of property. Absent a nuptial agreement, the definition of what fits in each category are different from state-to-state and can change over time. Specific rules to execute a valid nuptial agreement vary by state but most require that the document must include some or all of the following: (1) be in writing; (2) voluntarily signed by both parties; (3) both parties disclose all assets and liabilities; (4) and both parties waive right to any further disclosures. Each party should hire their own individual attorney to represent their interests and ensure all requirements are met according to their state's law.

A prenuptial agreement is executed prior to marriage and allows couples to identify and inventory all of their separate property. It also allows spouses to agree that income from separate property will also be separate property.

Rancher Joe owns 30 registered breeding ewes prior to marriage. Rancher Joe and his future wife draft a prenuptial agreement. The prenuptial agreement clearly identifies Rancher Joe's 30 ewes using registration numbers and ear tattoos. It also characterizes these ewes and all future lambs born after the marriage as separate property.

A postnuptial agreement is similar to a prenuptial agreement except that it is executed after the marriage has commenced. Unlike a prenuptial agreement, a postnuptial agreement allows spouses to characterize separate property as community property. This may be advantageous if the spouses wish for each other to inherit their separate property rather than other family members under state intestacy laws.

Step 5: Distribution of Community Property and Debt

The last and final step in the analysis is to decide how to divide community property and community debt. Note community property and community debt are generally split equally between the parties, but the court may deviate from equal shares if an equal split is not what is "just and right" under the circumstances.

There are a myriad of factors that are considered with this determination, oftentimes enumerated in the CP statute. Some factors include the differences in each spouses earning potential, the needs of each spouse and children, or if a spouse was at fault (adultery, cruelty, etc.) for the divorce.

Keep in mind that families do not have to liquidate assets in order to divide property. One spouse may

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keep the farmland, farm equipment, and cows, while the other gets the retirement, investment property, and farm vehicles, depending on the arithmetic. Spouses can “buy” each other out or negotiate long-term payment plans for farm business interests.

Furthermore, spouses can also decide not to break up the farm and keep it intact; in this scenario, the divorcing spouses remain business partners. Language should be carefully crafted on paying distributions to the owners, responsibilities of each owner and buy-out provisions in case one or both ex-spouses decide to go their separate way in business.

While CP is typically split equally between spouses in a divorce, litigation can become expensive if parties choose to attempt to deviate from this 50/50 split. To keep costs down, parties are encouraged to cooperate with discovery and consider Alternative Dispute Resolution (ADR) such as mediation or arbitration (economic issues only).

For more information:

Cari B. Rincker et al., ONWARD AND UPWARD: GUIDE FOR GETTING THROUGH NEW YORK DIVORCE AND FAMILY LAW ISSUES (2015) available at <https://www.amazon.com/Onward-Upward-Getting-Through-Divorce/dp/0692556540>

Mediate.com Everything Mediators, at mediate.com

Cari B. Rincker, “I’m Talking About the Big D and I Don’t Mean Dallas” (May 2019), available at <https://www.slideshare.net/rinckerlaw/im-talking-about-the-big-d-family-law-issues-in-agriculture>

American Academy of Matrimonial Lawyers, Online Book store, available at <https://aaml.org/store/ListProducts.aspx?catid=704530>

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