IN THE COURT OF APPEALS OF THE STATE OF IDAHO

Docket No. 29871

STEVE NEIBAUR,	)	
	)	**2004 Opinion No. 49**
Plaintiff-Appellant,	)	
	)	**Filed: July 30, 2004**
v.	)	
	)	**Frederick C. Lyon, Clerk**
PENNY NEIBAUR,	)	
	)	
Defendant-Respondent.	)	
	)	

Appeal from the District Court of the Fifth Judicial District, State of Idaho, Cassia County. Hon. Monte B. Carlson, District Judge; Hon. Michael R. Crabtree, Magistrate.

Property award in divorce decree, vacated, and case remanded.

Cosho, Humphrey, Greener & Welsh, Boise, for appellant. Stanley W. Welsh argued.

Parsons, Smith & Stone, Burley, for respondent. William A. Parsons argued.

LANSING, Chief Judge

This appeal challenges the distribution of property in a divorce action. The husband appeals from a district court decision affirming the magistrate's finding that the marital community has a right to reimbursement in the amount of $750,000 from the husband's separately held corporation. The husband contends that the corporation is his separate property and that the magistrate erred in concluding that the community was entitled to a reimbursement for community efforts that increased the value of the corporation. We vacate and remand.

I.

FACTUAL AND PROCEDURAL BACKGROUND

Steve and Penny Neibaur married in 1982. At that time, Steve was the sole shareholder in Steve Neibaur Farms, Inc., which was formed by Steve approximately one year before the marriage. All shares of stock have always been held in Steve's name. To the date of divorce, Steve had directed all of the farming operations and management of the corporation, and all

corporate decisions were made solely by him. Penny, who had outside employment (primarily as a school teacher), provided virtually no services to the corporate farming operation. Under Steve's direction, the corporation farmed about 2,100 acres of land and had one full-time employee and several seasonal employees. The value of the corporation increased from approximately $146,466 at the time of incorporation to $1,050,000 at the time of divorce.

In 2001, Steve filed a petition for divorce from Penny. At trial, Penny argued that the corporation was the alter ego of Steve and therefore the court should "pierce the corporate veil" and recharacterize the corporate assets as community property. In findings and conclusions rendered after a trial, the magistrate concluded that the corporation was Steve's separate property but also found that $750,000 of the increase in the value of the corporation during the marriage was due to community effort, namely Steve's services, expended for the benefit of the corporation. The magistrate further found that evidence presented at trial did not establish that the community was adequately compensated for Steve's work. As a result, the magistrate held that the community was entitled to reimbursement in the amount of $750,000 for community efforts that enhanced the value of the corporation, and the magistrate granted the community a lien in that amount against Steve's shares of stock.

Steve appealed to the district court, which affirmed the magistrate's order with regard to the corporation. Steve now further appeals.

II.

ANALYSIS

On review of a decision of the district court, rendered in its appellate capacity, we examine the record of the trial court independently of, but with due regard for, the district court's intermediate appellate decision. *Hentges v. Hentges*, 115 Idaho 192, 194, 765 P.2d 1094, 1096 (Ct. App. 1988). The trial court's findings of fact will not be set aside on appeal unless they are clearly erroneous, meaning that they are not based upon substantial and competent evidence. *Reed v. Reed*, 137 Idaho 53, 56, 44 P.3d 1108, 1111 (2002); *Hunt v. Hunt*, 137 Idaho 18, 20, 43 P.3d 777, 779 (2002). However, when reviewing the court's conclusions of law, this Court exercises free review of the trial court's decision. *Id*.

Under this state's community property laws, all property owned by either spouse prior to marriage remains the separate property of that spouse. Idaho Code § 32-903; *Suchan v. Suchan*, 106 Idaho 654, 657, 682 P.2d 607, 610 (1984); *Pringle v. Pringle*, 109 Idaho 1026, 1027, 712

P.2d 727, 728 (Ct. App. 1985). If a spouse's separate property has been improved or enhanced by the community, however, the community is entitled to a reimbursement from the separate estate unless the community contribution was intended as a gift. *Swope v. Swope*, 112 Idaho 974, 983, 739 P.2d 273, 282 (1987); *Gapsch v. Gapsch*, 76 Idaho 44, 53, 277 P.2d 278, 283 (1954). Such a claim for reimbursement is in the nature of an equitable lien against the separate property that was improved or enhanced in value. *Id*. at 53, 277 P.2d at 283. Generally speaking, the measure of compensation for community expenditures made on separate property is the increase in value of the separate property that can be attributed to the community contribution. *Swope*, 112 Idaho at 983, 739 P.2d at 282; *Suter v. Suter*, 97 Idaho 461, 465, 546 P.2d 1169, 1173 (1976).

When the separate property at issue is a spouse's corporation, however, the right of reimbursement does not follow the general rule stated above. The Idaho Supreme Court has recognized two circumstances in which the marital community may obtain a right of reimbursement from a corporation separately owned by one spouse. First, the community may be entitled to reimbursement if the community was not adequately compensated for a spouse's labor devoted to the corporation. *See Wolford v. Wolford*, 117 Idaho 61, 68-69, 785 P.2d 625, 632-33 (1990); *Speer v. Quinlan*, 96 Idaho 119, 128, 525 P.2d 314, 323 (1973). Second, the community may claim compensation if the separately owned corporation unreasonably or fraudulently retained earnings instead of distributing profits as dividends, which would have been community property. *Simplot v. Simplot*, 96 Idaho 239, 242-43, 526 P.2d 844, 847 (1974); *Speer*, 96 Idaho at 129-30, 525 P.2d at 324-25.

In the trial court and on appeal, Penny has asserted that there is a third basis upon which the marital community may acquire an interest in a separately owned corporation--by piercing the corporate veil. Penny asserts that in his operation of the farm, Steve did not observe corporate formalities or distinguish between the corporation and himself in handling corporate assets, profits and liabilities, and therefore the corporation has been converted to community property. Because it appears that the magistrate court based its award at least in part on this theory, we will begin our analysis by addressing Penny's corporate veil argument.

A. Piercing the Corporate Veil

We find no support in Idaho law for Penny's contention that piercing the corporate veil is a means by which the community may gain an interest in one spouse's separately owned

corporation. The doctrine of piercing the corporate veil allows a court to disregard the status of a corporation as a distinct legal entity, thereby making a shareholder liable for debts of the corporation or making corporate assets reachable to satisfy obligations of the shareholder. *See* I.C. § 30-1-622; *Hutchison v. Anderson*, 130 Idaho 936, 940, 950 P.2d 1275, 1279 (Ct. App. 1997); *Davidson v. Beco Corp.*, 112 Idaho 560, 568, 733 P.2d 781, 789 (Ct. App. 1986).

Penny relies upon *Sherry v. Sherry*, 108 Idaho 645, 701 P.2d 265 (Ct. App. 1985), to support her argument that in marital dissolution proceedings, the court may pierce the veil of a separate property corporation and award a share of the corporation as community property. Penny misinterprets *Sherry*, however, for that case did not involve any community claim to stock or assets of a separately owned corporation. Rather, the issue presented in *Sherry* was whether the husband's pre-divorce sale of *community-owned* stock should be set aside as having been conducted in fraud of the wife, who had not consented to the sale. This Court held that because the trial court had made no adequate factual findings regarding the fraud allegations, the case must be remanded for factual determinations. We noted that if the sale was fraudulent, the wife would be entitled to her share of the community interest in the stock. For clarity, we emphasized that the community's claim would be to the shares of stock, not to assets owned by the corporation:

> Absent a finding that the corporate status of the business should be disregarded, she is not entitled to an award of corporate assets. *See Duke v. Duke*, 605 S.W.2d 408 (Tex. Civ. App. 1980) (corporate identity should not be disregarded in property distribution absent a showing of a sham, fraud, or injustice to the non-employee spouse).

Id. at 649, 701 P.2d at 269. Thus, in *Sherry* we merely reiterated the general rule that ownership of corporate stock does not equate to ownership of assets belonging to the corporation, and that a corporate form may not be disregarded without justification.

The magistrate in the present case concluded that the above-quoted language in *Sherry* concerning the Texas court's *Duke* decision established three circumstances in which a court could award one spouse's separate property corporation as community property. The magistrate opined that under *Sherry* a non-owner spouse could pierce the corporate veil to reach the other spouse's corporation if: (1) the corporation was a sham; (2) the owner spouse acted fraudulently against the community interests; or (3) the non-owner spouse would suffer an injustice if the court did not reach through the corporate entity to make an award of the corporation. The magistrate concluded that the first and second circumstances were inapplicable but that, as to the

third factor, a substantial injustice would occur if Penny were not awarded a share of the corporation because the community had been inadequately compensated for Steve's work as a corporate employee. On that basis, the magistrate held that the community had a right to reimbursement for the increase in the value of the corporation attributable to Steve's services. The magistrate's interpretation and application of *Sherry* was incorrect. The *Sherry* decision does not address a community claim to separate property, much less announce a doctrine or legal theory by which piercing the corporate veil allows a marital community to gain an interest in a separately held corporation.

We turn therefore to consideration of the two circumstances in which the community may be entitled to reimbursement from a separate corporation--when the community has been inadequately compensated for a spouse's labor in the employ of a separate corporation and where the corporation has unreasonably retained earnings.

B. Adequacy of Steve's Compensation from the Corporation

If community efforts and ability have been expended in conducting a separate property business, "a proper inquiry upon the dissolution of that marriage is whether the community has received fair and adequate compensation for its labor." *Speer*, 96 Idaho at 128, 525 P.2d at 323. In determining whether the community was adequately compensated during the marriage, the trial court should look to a number of factors, including the size and nature of the business, the number of employees, the nature and extent of community involvement in the conduct of the business and the growth pattern of the business. *Id.*; *Wolford*, 117 Idaho at 68-69, 785 P.2d at 632-33; *Josephson v. Josephson*, 115 Idaho 1142, 1148, 772 P.2d 1236, 1242 (Ct. App. 1989). Once these business factors have been considered, the court must determine whether the overall compensation received by the community was equivalent to the compensation that would be necessary to compensate a non-owner employee to perform the same services that were provided by the community. *Speer*, 96 Idaho at 128, 525 P.2d at 323. If the court finds that the separate property business has under-compensated the community for its efforts, the community is entitled to compensation from the owner spouse in the amount of the deficiency. *Id.*

In the present case, the magistrate made a finding that "[t]he evidence did not objectively establish that the corporation in fact adequately compensated Mr. Neibaur for his services," but also found that the evidence "simply does not provide a substantial enough factual basis for the court to determine a deficiency amount." On the basis of these findings, the magistrate

concluded that the community had been inadequately compensated for Steve's labors, creating an injustice that gave the community a right to a portion of the increased value of the corporation.

Although we agree with the magistrate's initial findings that the evidence does not establish whether Steve was adequately compensated nor the amount of any deficiency in compensation, we for that very reason disagree with the magistrate's ultimate finding that the community was not adequately compensated for Steve's efforts. The spouse who is making the claim bears the burden of demonstrating that the community is entitled to reimbursement for community expenditures or work efforts benefiting separate property. *Swope*, 112 Idaho at 983, 739 P.2d at 282; *Suter*, 97 Idaho at 465, 546 P.2d at 1173. In the present case, the evidence as to the total value of compensation received by the community for Steve's labor is incomplete in that there was no effort to quantify the value of many of the forms of compensation that were received, and the record is devoid of any evidence concerning the amount of compensation that would have been adequate for a non-owner employee providing the same services. Penny not only produced no evidence to demonstrate what adequate compensation would be--she successfully objected on grounds of irrelevance when Steve proffered such evidence.

The evidence that was presented at trial shows that the community was compensated for Steve's labor in many ways. The corporation paid Steve approximately $2,000 per month and, additionally throughout the marriage, paid for various community personal expenses such as family vacations, ski trips, grocery and medical bills, health and auto insurance, utility payments, and an extensive remodel of the family home. The cars driven by the Neibaur family members were purchased by the corporation and titled in its name. No evidence was presented at trial as to the overall value of this compensation "package," nor was there evidence of the salary that would have to be paid for comparable work. Without such evidence, there is no basis for a finding that the community was under-compensated for Steve's labor. Accordingly, the magistrate erred in finding that the corporation under-compensated Steve and in holding that the community was entitled to reimbursement as a result of the inadequate compensation.

C. Retained Earnings

The other potential avenue for community compensation from one spouse's separately owned corporation is through consideration of the corporation's retained earnings. The earnings and profits of a corporation remain the property of the company, and shareholders have no

property rights in a corporation's retained earnings until the earnings are distributed to shareholders as dividends. *Swope*, 112 Idaho at 981, 739 P.2d at 280; *Simplot*, 96 Idaho at 242, 526 P.2d at 847. Once distributed as dividends, however, the income to the shareholder is community property because under I.C. § 32-906, the income from separate property is community property. *See Speer*, 96 Idaho at 129, 525 P.2d at 324; *Josephson*, 115 Idaho at 1148, 772 P.2d at 1242. The Idaho Supreme Court has recognized that a shareholder spouse with sufficient control of a separately held corporation could cause earnings to be inappropriately retained rather than distributed as dividends, to the detriment of the community. *Swope v. Swope*, 122 Idaho 296, 301, 834 P.2d 298, 303 (1992); *Simplot*, 96 Idaho at 243, 526 P.2d at 848; *Speer*, 96 Idaho at 129, 525 P.2d at 324. Although no reported Idaho decision has directly so held, two Idaho Supreme Court opinions suggest that in such a circumstance, the community would be entitled to reimbursement to the extent that the retention of the net earnings of the corporation was unreasonable from a business point of view or was done to defraud the community. *Simplot*, 96 Idaho at 243, 526 P.2d at 848; *Speer*, 96 Idaho at 129, 525 P.2d at 324. *See also Josephson*, 115 Idaho at 1148, 772 P.2d at 1242.

In the present case, as the sole shareholder and chief executive officer of the corporation, Steve was in a position to control the retention of corporate earnings. The magistrate found that Steve had not defrauded the community in his operation of the corporation, but the question whether any retention of earnings was unreasonable from a business standpoint was not addressed in the magistrate's findings and conclusions. Therefore, this matter will be remanded to the magistrate to make appropriate findings regarding any possible community interest based upon retained earnings of Steve's corporation.

III.

CONCLUSION

The magistrate court erred in concluding that the reference to piercing the corporate veil in the *Sherry* decision established a basis for creation of a community property interest in a corporation that is the separate property of one spouse. The magistrate also erred in finding that the community was under-compensated for Steve's labor as a corporate employee, for the trial evidence is insufficient to establish the value of the compensation that Steve received or to establish the level of compensation that would be adequate for such services. Therefore, that portion of the divorce decree awarding the community a $750,000 reimbursement and a lien

against the stock of Steve's corporation is vacated. The case is remanded for the magistrate court to address whether there was an unreasonable retention of earnings in the corporation, which would entitle the community to compensation for dividend income that it otherwise would have received. Penny's request for attorney fees on appeal is denied because she is not the prevailing party. Costs on appeal to appellant.

Judge GUTIERREZ and Judge Pro Tem WALTERS **CONCUR.**