

Commonwealth Of Kentucky

Court Of Appeals

NO. 2000-CA-002275-MR

JOHN GALLAGHER

APPELLANT

v. APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE RICHARD J. FITZGERALD, JUDGE
ACTION NO. 98-FC-006168

SHARON CONYER

APPELLEE

AND

NO. 2000-CA-002347-MR

SHARON GALLAGHER CONYER
AND MOBLEY & LLOYD

CROSS-APPELLANTS

v. CROSS-APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE RICHARD J. FITZGERALD, JUDGE
ACTION NO. 98-FC-006168

JOHN GALLAGHER

CROSS-APPELLEE

OPINION
AFFIRMING IN PART,
VACATING IN PART, AND REMANDING
** ** * * * * *

BEFORE: EMBERTON, CHIEF JUDGE; SCHRODER, AND TACKETT, JUDGES.

SCHRODER, JUDGE: This is an appeal and a cross-appeal from a decree of dissolution awarding sole custody of the minor child to the mother, assigning the parties=nonmarital property, refusing to award attorney fees and dividing the parties=marital property, debt, and tax loss carryover. We affirm on the issues regarding custody, attorney fees, and division of marital property and debt. However, we vacate the court's determination that the wife did not have a marital interest in the parties= residence when marital funds were used to pay off a loan in which said property was pledged as security therefor during the marriage. In addition, we vacate the court's order allowing the parties to equally divide the tax loss carryover. Accordingly, we affirm in part and vacate in part and remand the matter for further proceedings consistent with this opinion.

Appellant/cross-appellee, John Gallagher, and appellee/cross-appellant, Sharon Gallagher (now Ayers), were married on May 28, 1994. One child was born of the marriage, Catherine, born January 10, 1995. The parties separated on August 24, 1998, and on August 27, 1998, Sharon filed the dissolution action at issue in this case.

After a hearing held on March 10, 11, and 24, 2000, the court entered its findings of fact, conclusions of law and judgment on July 11, 2000. The court awarded sole custody of Catherine to Sharon with reasonable and liberal visitation by John. The court assigned the parties= residence to John as his nonmarital property, except for \$5,300 that Sharon contributed to

the residence that was restored to her. Further, the court restored 92,558 shares of United Parcel Service Common stock to John as his non-marital property. The court specifically found that John's sale of a large quantity of marital stock during the parties' separation without the knowledge of Sharon did not constitute a dissipation of marital assets, since the proceeds were applied to pay off a portion of marital debt resulting from John's margin trading. However, the court did assign the remaining \$498,649 of that marital debt to John. Finally, the court refused to award attorney fees to either party, finding that both parties had sufficient funds with which to pay their respective attorneys. A subsequent order on a motion to alter or amend was entered in which the court determined that the tax loss carryforward was to be divided equally between the parties. From these two orders, both parties now appeal.

We shall first address John's appeal regarding the custody determination. John's primary assignment of error regarding custody was that the court improperly made an award of sole custody when Sharon never asked for sole custody in any of her pleadings. It is true that Sharon initially sought an award of joint custody in her petition for dissolution. However, Sharon made it clear during a case management conference on November 9, 1999, three months prior to the cutoff date for discovery, that she was seeking sole custody of the child. Accordingly, John's argument that he did not have notice that Sharon was seeking sole custody for purposes of preparing for

trial is without merit. As to his claim that Sharon was required to include her specific demand for sole custody in the form of a pleading, we agree with the trial court that the court is to make all custody determinations based on the best interests of the child. KRS 403.270(2). Although the wishes of the parents are to be considered, the overriding concern is the best interests of the child. KRS 403.270(2)(a); see Eviston v. Eviston, Ky., 507 S.W.2d 153 (1974). Clearly, custody was an issue in dispute in this case and even if both parties had sought only joint custody, since the likelihood of future cooperation between the parties was so remote, the court could not have awarded joint custody. See Squires v. Squires, Ky., 854 S.W.2d 765 (1993).

As to John's other assignments of error related to the merits of the court's custody decision, we cannot review those arguments since the record before us does not contain the videotapes of the hearing, which constituted the majority of the evidence regarding custody. In both appeals before us, there was no designation of the record pursuant to CR 75.01(1)(1) which requires that the party "list such untranscribed portions of the proceedings videotaped or stenographically or mechanically recorded as appellant wishes to be included in the record on appeal.". Further, CR 98(3) provides in part that "[t]he official videotape recordings, as properly designated under Rule 75.01, together with the clerk's written record, shall constitute the entire original record on appeal." (emphasis added.) The burden is on the appellant to see that the circuit court include

those portions of the trial record necessary for an adequate review. Fanelli v. Commonwealth, Ky., 423 S.W.2d 255 (1968), reved on other grounds, Ky., 445 S.W.2d 126 (1969).

Moving on to the parties' arguments regarding the assignment and division of nonmarital and marital property, we shall first address Sharon's argument that the trial court erred in assigning the parties' residence to John as his nonmarital property with the exception of a \$5,300 contribution by Sharon. Sharon maintains that because marital funds were used to pay off a loan in which the residence was used as collateral, she acquired a marital interest in the residence. There was evidence that the residence in question at 7408 Shadwell Lane was valued at \$200,000 - \$250,000. It is undisputed that John acquired the residence prior to the parties' marriage and at the time of the parties' marriage in 1994, he owned the house free and clear. Therefore, at the time of the marriage, the residence was John's nonmarital property pursuant to KRS 403.190(2). However, in 1996 John began trading stocks on the margin and, in order to secure the margin, pledged certain UPS stock he had acquired. Pursuant to an anomalous arrangement between UPS employee stockholders and PNC Bank, referred to as a hypothecation agreement, John was able to actually use his house as collateral to secure the margin so that he could deduct the interest for tax purposes. For tax years 1994-1997, John and Sharon did, in fact, deduct that interest on their tax returns until the IRS put a stop to such practice. By the time of the parties' separation, a significant

amount of margin debt had accumulated. By May of 1997, the balance had climbed to \$812,300. In February of 1999, John sold off a significant amount of stock, some marital and some nonmarital, including 756 shares of Overseas Partner Limited (OPL) stock and 4,874 shares of UPS stock, to pay down the margin debt with PNC Bank. Up to that point, the parties had paid only the interest on the debt. The total amount of principal paid off by the time of the parties' divorce was \$335,000, leaving a balance of \$457,006.

Sharon argues that since marital funds were used to partially pay off what was essentially a mortgage on the house securing the loan from PNC Bank for the margin trading, she has a marital interest in the house. It is John's position that the hypothecation agreement did not constitute a purchase of equity in the house and further that he should be able to use his nonmarital property to finance the acquisition of marital property without converting the nonmarital property to marital property. Although there is some mention by Sharon of a mortgage executed contemporaneous with the hypothecation agreement, apparently no lien was ever filed by PNC Bank against the property. The record does, however, contain a copy of a lien release on the Shadwell Lane property by PNC Bank dated November 23, 1999.

John cites a Florida case, Farrior v. Farrior, 712 So.2d 1154 (Fla. App. 2d Dist. 1998), in support of his position that a spouse is entitled to use nonmarital property as

collateral for a purchase of marital property without affecting his interest in the nonmarital property. However, the standard in Kentucky relative to marital contributions to nonmarital property was set out by this Court in Brandenburg v. Brandenburg, Ky. App., 617 S.W.2d 871 (1981). In Brandenburg, the husband bought certain properties prior to the marriage, but after the marriage, marital funds were used to pay off the mortgages thereon. The Court in Brandenburg provided a formula to be used to prorate the marital and nonmarital interests in the property based on the respective marital and nonmarital contributions to total equity in the property. John attempts to distinguish the present situation from that in Brandenburg by the fact that this was not an actual mortgage on the Shadwell Lane property, but rather a device that would simply allow him to "tie in" the equity in the house to the hypothecation so that he could deduct the interest on the loan on his taxes. He maintains that his nonmarital UPS stock was actually the collateral for the loan. In our view, despite the fact that no formal mortgage was ever filed against the property, once John "tied in" the equity in his nonmarital property to secure the loan, thereby risking foreclosure if the loan was not paid off (as evidenced by the release executed by PNC Bank), a mortgage, in fact, existed. Thereafter, any marital funds used to buy back the equity would result in a marital interest in the property according to Brandenburg. The lower court's decision essentially allowed John to use marital funds to keep his nonmarital property at the

expense of Sharon's interest in those marital funds.

Accordingly, we vacate the lower court's decision assigning the Shadwell Lane property to John as his nonmarital property and remand for the court to calculate Sharon's marital interest therein pursuant to the formula in Brandenburg.

Next, we shall address Sharon's argument that John's sale of marital stock to pay down his margin debt without her approval constituted dissipation of marital funds. Sharon maintains that John sold off this stock which he knew to be marital after the court had entered an order forbidding the parties to transfer any marital funds. She also asserts that certain of those stocks later significantly increased in value or were subject to stock splits. In order to prove that a spouse has dissipated marital assets, it must be shown that the funds were spent in contemplation of divorce and with the intent of depriving the other spouse of her share of marital assets. Brosick v. Brosick, Ky. App., 974 S.W.2d 498 (1998). As to this issue, the trial court found:

There is not a clear showing of any intent to deprive the spouse of her share of the property or the expenditure of the assets for a non-marital purpose. Prior to separation he incurred substantial debt using his premarital stock as the collateral basis attempting to make a profit in a stock market. He acknowledged that the parties did not discuss the individual stock trades. It was clear that the Petitioner [Sharon] knew that he was trading and investing and that certain brokerage statements as well as trade tickets were mailed to the marital residence. Both the tax returns from 1996 and 1997 reflect the losses. During a period of time

where the parties entered into some marital counseling, the issue of anxiety or stress in the marriage due to the stock trading was raised by the parties.

The trial court's findings in a domestic case will not be overturned unless they are clearly erroneous. Ghali v. Ghali, Ky. App., 596 S.W.2d 31 (1980). The evidence was disputed as to Sharon's knowledge of John's trading, and we are loathe to say that the above findings by the trial court were clearly erroneous. In any event, our previous ruling adjudging that Sharon has a marital interest in the Shadwell Lane property as a result of the application of the proceeds from the marital stock sales in effect nullifies this argument since Sharon now gets some indirect monetary benefit from the sale of stocks in question.

The next issue Sharon raises is with regard to 46,027 shares of UPS common stock which John insists that he acquired prior to the marriage. Sharon contends that John acquired those shares after the marriage on June 22, 1994, pointing to an income investment summary reflecting that those shares were issued on that date. From our review of the record, there was sufficient evidence in the record that John actually purchased those shares in 1991. Although the stock certificates may not have been issued until 1994, the issuance is a mere formality. The controlling date for purposes of determining whether property is marital or nonmarital pursuant to KRS 403.190(2) is the date when

the property was "acquired," which would be when the stock was initially purchased.

Sharon's final argument is that the trial court erred in refusing to award her attorney fees. Under KRS 403.220, the trial court may award reasonable attorney fees and costs only upon a finding of an imbalance in the financial resources of the parties. Lampton v. Lampton, Ky. App., 721 S.W.2d 736 (1986). Allocation of court costs and attorney fees is entirely within the discretion of the trial court. Browning v. Browning, Ky. App., 551 S.W.2d 823 (1977). Sharon argues that given the immense disparity in the assets awarded to John and her, the trial court abused its discretion in failing to award her attorney fees. It must be noted that the trial court advanced Sharon \$2,500 at the outset of this litigation. Further, Sharon is employed as an attorney and was awarded assets in excess of \$100,000, not including her marital share of the residence she will receive on remand. The court found "[t]hat the parties' assets are sufficient to require them to each pay his or her own attorney's fees and to equally divide the costs of this action." We cannot say the trial court abused its discretion in so finding.

We now turn to John's arguments. John first argues that the trial court erred in assigning him full responsibility for the \$498,649 in debt resulting from his margin trading. There is no presumption that marital debt must be divided equally. Neidlinger v. Neidlinger, Ky., 52 S.W.3d 513 (2001).

Debts incurred during the marriage should be assigned on the basis of such factors as receipt of benefits and extent of participation, whether the debt was incurred to purchase assets designated as marital property, whether the debt was necessary to provide for the maintenance and support of the family, and the economic circumstances of the parties relative to their respective abilities to assume the indebtedness. Id. at 523. Although there was evidence that Sharon had some awareness of John's trading, there was also evidence that John, at worst, did some of his trading behind Sharon's back and, at best, did not fully disclose his trading activities or actively seek Sharon's approval therefor. Given the parties' assets prior to the trading, we can assume that the debt was not incurred to provide for the maintenance and support of the family. Although the purpose of John's trading was ostensibly to increase marital funds, John's application of the sale of marital stock to pay off the lien on the then nonmarital residence demonstrates that John's motives in this regard were self-serving in the end. Finally, it cannot be disputed that John, given the more than \$6,000,000 in assets awarded to him, is financially more capable of assuming the debt in question. As to the debt issue, the trial court found:

As noted down below the Court will shift to Mr. Gallagher responsibility for the entirety of this outstanding debt recognizing that he came into the relationship and marriage with pre-existing debt based on hypothecation of the shares and also recognizing that if he had not in an untimely

fashion sold the marital shares in February of 1999, those share [sic] would have been part of this marital estate after the stock split of November, 1999, at a significantly increased value. . . . The sale of the stock and application to the marital debt did occur during separation[.] It occurred without the context of joint decision-making regarding disposition of a marital asset.

We cannot say that the above findings were clearly erroneous. Hence, we affirm the assignment of the entire stock trading debt to John.

John additionally argues that the trial court erroneously failed to give him credit for items Sharon has which were purchased with marital funds. However, John does not specify what these items were or provide any other details concerning this property. Hence, we cannot provide an adequate review of the argument.

Finally, John argues that the trial court erred in failing to allow him to claim the entire tax loss carryover. The court divided the tax carryover equally between the parties. John maintains that according to the Internal Revenue Service, tax loss carryover cannot be divided amongst multiple individuals, rather it can only be claimed by the person who actually incurred the loss. Specifically, John directs us to IRS-PUB, 2000, IRS PUBLICATION NO. 550, Capital Losses which states in pertinent part:

If you and your spouse once filed separate returns and are now filing a joint return, combine your separate capital loss carryovers. However, if you and your spouse once filed a joint return and are now filing

separate returns, any capital loss carryover from the joint return can be deducted only on the return of the spouse who actually had the loss. (Emphasis added.)

The trial court in the present case erroneously failed to defer to the position of the Internal Revenue Service that tax loss carryovers cannot be split between former spouses once they begin filing separately. Accordingly, we vacate the court's ruling allowing the parties to split the tax loss carryover and remand for a ruling in keeping with the above Internal Revenue Service publication.

For the reasons stated above, the judgment of the Jefferson Circuit Court is affirmed in part and vacated in part and remanded for further proceedings consistent with this opinion.

ALL CONCUR.

BRIEF FOR APPELLANT/
CROSS-APPELLEE:

Virginia Collins Burbank
Wynter Reneaux Collins
Louisville, Kentucky

BRIEF AND ORAL ARGUMENT FOR
APPELLEE/CROSS-APPELLANT:

J. Russell Lloyd
Louisville, Kentucky

ORAL ARGUMENT FOR
APPELLANT/CROSS-APPELLEE:

Wynter Reneaux Collins
Louisville, Kentucky