

REAL ESTATE ISSUES IN DIVORCE CASES

by

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I. Introduction

It is typical for divorce attorneys to oversee the transfer of real estate as part of their clients' divorce cases. This article addresses several aspects and issues of Virginia real estate law of interest to divorce attorneys, with a particular focus on the legal consequences of the tenancy by the entirety during the divorce process. This article briefly discusses the legal construction of the tenancy by the entirety, surveys several cases, and recommends methods to properly protect the client's interest in real estate against creditors of the other party.

II. The Legal Shield of Tenancy by the Entirety

Tenancy by the Entirety is a form of joint ownership that can only exist between a married couple. VA. CODE ANN. § 55-20.2. A remnant of ancient common law, the tenancy by the entirety creates a legal fiction that a husband and wife are one person. Although modern Virginia law has largely abandoned this characterization of a married couple as a single legal entity, this type of joint real estate ownership remains.

In a tenancy by the entirety, a husband and wife each own an undivided interest in marital property. One spouse cannot transfer any interest in the property without the consent of the other spouse. As a result, a creditor of only one spouse cannot attach a lien to real estate held as tenants by the entirety. Only a creditor of both a husband and wife can attach a lien or judgment against such property, while the parties are both living and married.

A bankruptcy trustee can attach and sell property owned as tenants by the entirety to satisfy joint debts of the married couple, but not debts of just one spouse. If the couple does not have any joint debts, then the property is sheltered from the reach of a bankruptcy trustee. *See Roanoke Indus. Loan & Thrift Corp. v. Bishop*, 482 F.2d 381 (4th Cir. 1973) (holding that a house and lot owned in tenancy by the entirety did not pass to the bankruptcy trustee, and preventing creditors solely of wife from obtaining a lien against the property).

III. The Legal Effect of Divorce upon Tenancy by the Entirety

A tenancy by the entirety is terminated by operation of law upon the divorce of the owners. The property automatically converts to a tenancy in common upon entry of the final

order of divorce. VA. CODE ANN. § 20-111. A preexisting judgment against an individual spouse docketed in the clerk's office of the circuit court where the real estate is located attaches to the interest of that spouse immediately upon his or her divorce. A title search will assist the lawyer in assessing the legal implications of real estate held as tenants by the entirety. With a title search, the lawyer can discern whether the property at issue in the divorce risks attachment of judgment liens at the entry of the divorce order and consequent dissolution of the tenancy by the entirety.

Even if there are no liens in place at the time of the entry of the divorce, liens are sometimes filed between the time of the divorce and the subsequent transfer of the real estate from the divorcing parties to the subsequent owner.

In some divorce cases the parties enter into a property settlement agreement transferring one spouse's interest in marital property to the other. Property settlement agreements are typically incorporated into the final order of divorce pursuant to Virginia Code Section 20-109.1. In other cases parties litigate the disposition of property, and the presiding judge may order a transfer of one party's interest in marital property as part of equitable distribution. VA. CODE ANN. § 20-107.3.

Neither a property settlement agreement nor an order of divorce protects the parties and the subsequent transferee against third party creditors until such instrument is recorded in the county or city where the property is located. The recording act in Virginia provides that unrecorded deeds or contracts for transfer of property, including property settlement agreements, are void as to lien creditors. VA. CODE ANN. § 55-96. Likewise, an unrecorded order of divorce, while binding on the spouses, does not protect the parties and a subsequent transferee against creditors (joint or individual). *See Secrest v. Secrest*, 453 B.R. 623 (Bankr. E.D. Va. 2011) (an equitable distribution award does not limit the rights of third-party creditors); *see also Terry v. Paschall*, 403 B.R. 366 (Bankr. E.D. Va. 2009) (an unrecorded marital agreement made in respect to real estate is void as to the debtor's judgment creditors).

The failure to effectively deal with title issues in connection with a divorce can cause severe problems because creditors of a former spouse, like other *bona fide* purchasers for value without notice, can exercise their power to enforce record title. *Mayer v. United States*, 236 B.R. 219 (Bankr. E.D. Va. 1999) (*bona fide* purchasers take property free of any unperfected liens against it). The failure to record an agreement or a final order of divorce providing for the transfer of real estate can result in the loss of the property to creditors of either former spouse.

IV. Virginia Code § 20-107.3(C) Provides Protection based upon Recordation

If there are no title issues at the time of divorce and there will be a delay in the transfer of the real estate, for example to allow time for financing, the parties can protect their interests against creditors by timely recording the final order of divorce (providing for the transfer of the ownership of the real estate) pursuant to Virginia Code Section 20-107.3(C):

As a means of dividing or transferring the jointly owned marital property, the court may transfer or order the transfer of real or personal property or any interest therein to one of the parties, permit either party to purchase the interest of the other and direct the allocation of the proceeds, provided the party purchasing the interest of the other agrees to assume any indebtedness secured by the property, or order its sale by private sale by the parties, through such agent as the court shall direct, or by public sale as the court shall direct without the necessity for partition. . . . *All orders or decrees which divide or transfer or order division or transfer of real property between the parties shall be recorded and indexed in the names of the parties in the appropriate grantor and grantee indexes in the land records in the clerk's office of the circuit court of the county or city in which the property is located.* (emphasis added).

Such recordation of the divorce order provides notice of the pending transfer of the interest in real property, and protects the non-debtor spouse's property interest against claims of the debtor spouse's creditors.

V. *Tribby v. Tribby*, 26 Va. Cir. 372 (Feb. 27, 1992) (Spotsylvania County)

In *Tribby*, the divorced parties' property settlement agreement incorporated into their final divorce decree required the husband to convey his interest in the jointly-owned marital residence to his wife within fifteen days of the date of the agreement. Without transferring his interest to her, the husband failed to make payments on a loan from the bank, which then obtained a judgment against him. The wife sought specific performance of the conveyance of the husband's interest in the residence, and a determination that the bank's judgment against the husband did not constitute a lien against the property.

The circuit court found that the unrecorded property settlement agreement and divorce decree, while binding on the divorced parties, did not protect the wife against the husband's creditors.¹ Although the wife could seek specific performance of the property settlement agreement against her husband, the bank could extend its judgment lien to the husband's interest in the home since the former spouses had become tenants in common.

VI. *Phillips v. Chandler*, 215 B.R. 684 (Bankr. E.D. Va. 1997)

In *Chandler*, the husband and wife owned certain real property as tenants by the entirety. When they divorced, the decree provided that the wife would become the sole owner of the property. Subsequently, the husband filed a voluntary petition for relief under Chapter 7 of the

¹ As originally enacted, Virginia's equitable distribution statute, Virginia Code § 20-107.3, did not specify any authority for the court to transfer, divide in kind, or order the sale of the marital property of the parties. Effective July 1, 1988, the legislature amended the Code to permit the court this authority upon "failure of a party to comply with a previous order of transfer." Not until July 1, 1993, did the legislature amend § 20-107.3(C) to allow the court itself to convey or transfer jointly owned property, deleting the "failure of parties to comply" language. See SWISHER, DIEHL & COTTRELL, FAMILY LAW: THEORY PRACTICE, AND FORMS § 11:32 (West 2012); 1993 Va. Acts 79 (H.B. 1692).

Bankruptcy Code, while the divorce decree transferring ownership of the property remained unrecorded. The trustee was appointed in the bankruptcy proceedings and filed a complaint to avoid the transfer of the husband's one-half interest in the real property to the wife. In the proceedings below, the U.S. Bankruptcy Court for the Eastern District of Virginia granted the wife's motion to dismiss.

On appeal, the U.S. District Court for the Eastern District of Virginia reversed and held that the wife's failure to record the divorce decree pursuant to Virginia Code Section 20-107.3(C) rendered any transfer of the property void under Virginia Code Section 55-96. The unrecorded divorce decree left the husband and the wife each owning an undivided one-half interest in the property to which the trustee's hypothetical lien could have attached pursuant to the Bankruptcy Code. See 11 U.S.C. § 544(a)(1).

The Court held that if and when the divorce decree is recorded, its legal force in preempting claims would be restored. However, any and all claims originating between the time that the decree was issued and the time that the decree is recorded remain viable even after the recordation of the decree.

VII. *Robinson v. Robinson*, 346 B.R. 172 (Bankr. E.D. Va. 2006)

In *Robinson*, the divorce decree of the husband and the wife incorporated a property settlement agreement in which the husband agreed to convey his interest in the real property to the wife. Before the husband had conveyed the property, the trustee in husband's Chapter 7 bankruptcy proceeding filed a complaint seeking to sell the husband's one-half interest in his former marital residence which was jointly owned by the husband and his former wife as tenants in common. The wife filed a motion to dismiss, claiming that the trustee could not sell the property because the property settlement agreement imposed a constructive trust on the property for her benefit.

The Bankruptcy Court denied the motion to dismiss. While holding that a constructive trust on the property was inappropriate, the Court further held that, even if there was a constructive trust, the trustee's rights and powers of a *bona fide* purchaser without notice allowed him to take free from the constructive trust under Virginia Code Section 55-96. Because neither the property settlement agreement nor the final decree of divorce were recorded pursuant to Virginia Code Section 20-107.3(C), the trustee was without notice and protected against the transfer provided for by the agreement. The trustee in bankruptcy was permitted to sell the debtor/husband's one-half interest in the former marital residence.

VIII. Conclusion

To properly protect your client's interest in real estate against creditors of the other party, divorce attorneys should do the following:

1. Obtain a title search prior to the entry of the order of divorce. If there are liens that will attach upon the entry of the divorce order (due to the termination of the tenancy by the entirety), then arrange for the transfer of the real estate prior to the entry of the divorce order.
2. If the title is clear at the time of the title search and the parties enter into a property settlement agreement, then record the agreement pursuant to Virginia Code Section 55-96. (In addition to the full property settlement agreement, consider preparing an abbreviated agreement for recordation to avoid the unnecessary publication of your client's entire agreement in the land records.)
3. If the title is clear and there is going to be a delay between the time of the entry of the divorce order and the transfer of the real estate, identify the required transfer in the divorce order and record the order pursuant to Virginia Code Section 20-107.3(c).