PROPERTY PUZZLES – CHARACTERIZATION, TRACING, 25 RULES, AND MORE

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CHAPTER 9.4

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I. SCOPE OF ARTICLE. This article presents twenty-five rules for characterizing marital property in Texas. Based on an article written by Richard R. Orsinger in 1995, it updates and chronicles the changes and explains the prominent additions to Texas marital property law over the last decade. By way of straight-forward explanation and example, the following are twenty-five rules to know to tackle marital property characterization issues.

II. 25 RULES FOR CHARACTERIZING MARITAL PROPERTY The following 25 rules can be used to determine the character of marital property as either separate or community property, under Texas law.

A. RULE 1 Marital Property

Property owned by a spouse is marital property. Marital property is either separate property or community property, or a mixture of the two.[1] Property not owned by a spouse is not marital property, and is neither separate nor community property.[2]

B. RULE 2 Inception of Title

The character of marital property as separate[3] or community[4] or mixed[5] is determined at the time of "inception of title." Inception of title occurs when a party first has a right of claim to the property by virtue of which title is finally vested.[6]

C. RULE 3 Property Acquired Before Marriage

Property which has its inception of title before marriage is separate property.[7]

D. RULE 4 Property Acquired During Marriage

Property which has its inception of title[8] during marriage is community property unless it is acquired in the following manner, in which event it is the separate property of the acquiring spouse:

(1) by gift;[9]
(2) by devise or descent;[10]
(3) by partition or exchange;[11]

(4) as income from separate property made separate by a spousal separate income agreement;[12]
(5) by survivorship;[13]
(6) in exchange for other separate property;[14]
(7) as recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.[15]

E. RULE 5 Property Acquired After Dissolution of Marriage

Property which has its inception of title after the marriage is dissolved is not community property.[16]

F. RULE 6 Presumption of Community; Burden of Persuasion

Property *possessed* by either spouse during or on dissolution of marriage is presumed to be community property, and the separate character of property must be proved by clear and convincing evidence.[17]

G. RULE 7 Commingling

When separate and community property have become so commingled as to defy resegregation and identification, the burden of persuasion to overcome the presumption of community is not discharged, and the assets in question are treated as community property.[18]

H. RULE 8 Tracing

The character of separate property is not changed by the sale, exchange, or change in form of the separate property. If separate property can be definitely traced and identified, it remains separate property regardless of the fact that the separate property undergoes mutations or changes in form.[19] Tracing involves establishing the separate property origin of the property through evidence showing the time and means by which the spouse originally obtained possession of the property.[20]

I. RULE 9 Divestiture of Separate Property in Divorce

In a divorce a court cannot divest a spouse of his or her separate property.[21]

J. RULE 10 Increases/Decreases

The natural increase or decrease in the value of a separate asset does not affect its characterization.[22]

K. RULE 11 Credit Obtained During Marriage

Credit obtained by a spouse during marriage is community credit unless the lender agrees to look solely to the borrowing spouse's separate estate for repayment.[23] Property acquired with community credit is community property, and property acquired with separate credit is separate property.[24] Credit during marriage is presumptively community, and the burden is on the proponent to prove separate credit.[25] Even property acquired with community credit can become separate property by interspousal gift, partition, etc.

L. RULE 12 Presumption Arising From Deed Recitals

When a deed recites that separate property was paid for the property, or that the property is taken as the receiving spouse's separate estate, a rebuttable presumption of separate property arises.[26] Where the other spouse is grantor or otherwise chargeable with causing or acquiescing in the recital, the presumption become irrebuttable, absent fraud.[27]

M. RULE 13 Presumption Arising From Interspousal Conveyance

Where one spouse conveys property to the other spouse, there is a rebuttable presumption of gift, even absent a recital in the instrument of conveyance.[28]

N. RULE 14 Presumption From Including Other Spouse's Name in Title

Where one spouse furnishes separate property consideration and title is taken in the name of the other spouse, a rebuttable presumption of gift arises.[29] Where one spouse uses separate property to acquire property during marriage and takes title to that property in the names of both spouses, a rebuttable presumption arises that the purchasing spouse intended to make a gift of a one-half separate property interest to the other spouse.[30]

O. RULE 15 Presumption Regarding Income From Interspousal Gift

When one spouse makes a gift of property to the other spouse, that gift is presumed to include all the income or property which might arise from the property given.[31]

P. RULE 16 Presumption Regarding Withdrawal of Commingled Funds

Where an account contains both community and separate moneys, it is presumed that community moneys are withdrawn first.[32]

Q. RULE 17 Putting Separate Property Money in Joint Account

The act of placing separate property funds into an account under the control of both spouses does not make the funds community property.[33]

R. RULE 18 Fixtures

Since, under the law of fixtures,[34] whatever is affixed to the land becomes part of the land,[35] improvements to realty take the character of the land, regardless of the character of the funds or credit used to make the improvements.[36]

S. RULE 19 Corporate Assets

Since a shareholder owns shares in the corporation and not the assets of the corporation, corporate assets are neither separate nor community property,[37] unless the court pierces the corporate veil.[38] The increase during marriage in value of a separate property corporation belongs to the separate estate.[39]

T. RULE 20 Partnership Rights of a Spouse

Under TUPA, there are three property rights of a partner.[40] Two of these cannot be community property (to-wit: rights in specific partnership property and the right to participate in the management of the partnership).[41] One can be community property (to-wit: the partner's interest in the partnership).[42] The rules are the same under TRPA.[43]

U. RULE 21 Partnership Assets and Partnership Distributions

Texas has adopted the entity theory of partnerships. Partnership property is owned by the partnership and not the partners, and in the absence of fraud, is not the separate or community property of individual partners. If a partner receives a share of profits during the marriage, they are community, even if the partner’s interest in the partnership is his separate property.[44]

V. RULE 22 Trust Holdings and Distributions

Property held by a trustee for the benefit of a spouse is not owned by a spouse, and cannot be marital property.[45] Howev9er, where the spouse/beneficiary has an unconditional right to have the property free of trust, then the property is treated as if it is owned by the spouse, even though still in the hands of the trustee.[46] Where the spouse is both settlor and beneficiary of the trust, the income of the trust property is likely community income.[47] Where the trust is established by gift or will, case law is conflicting as to whether trust distributions are separate or community property.[48]

W. RULE 23 Preemption of Texas Marital Property Law

Federal law sometimes preempts Texas marital property law.[49] In those circumstances, the federal law must be consulted to determine the rights of spouses in the property in question.

X. RULE 24 New Legislation in Certain Employment Benefits § 3.007

Effective September 1, 2005, the Texas Family Code was amended to add section 3.007 which concerns the characterization of certain employee benefits. Tex. Fam. Code § 3.007 (*infra* at p. 22-23) addresses three major categories of assets as follows:

A) Defined Benefit Plans

A participant spouse will have a separate property interest in a defined benefit retirement plan equal to the monthly accrued benefit the spouse had a right to receive at normal retirement age as of the date of the marriage, regardless of whether the benefit is vested or not.

The community property interest will be determined as if the spouse participant began his/her participation on the date of the marriage, regardless of whether the benefit had vested.

B) Defined Contribution Plans

The separate property interest of a defined contribution retirement plan may be traced using characterization principles used in regard to nonretirement assets.

C) Stock Options/Stock Plans

The separate or community interest in employer provided stock/stock option plans are now determined using a formula set forth in the statute.

Y. RULE 25 New Legislation in Certain Insurance Proceeds § 3.008

Effective September 1, 2005, the Texas Family Code was amended to add section 3.008 which concerns the characterization of certain insurance proceeds. Tex. Fam. Code § 3.008 (*infra* at p. 26) addresses several categories of insurance proceeds:

Casualty loss insurance proceeds take on the character of the asset that suffered the casualty.

Disability payments and worker's compensation payments are community property to the extent they are payments to replace earnings during the marriage. To the extend they are payments to replace income while the participant is not married, they are separate property.

III. EXAMPLES

A. Gift A gift is a transfer of property made voluntarily and gratuitously. *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565, 568 (Tex. 1961). A gift requires: 1) an intent to

make a gift; 2) delivery of the property; and 3) acceptance of the property. *See Grimsley v. Grimsley*, 632 S.W.2d 174, 177 (Tex. App.--Corpus Christi 1982, no writ). The burden of proving a gift is on the party claiming the gift. *Woodworth v. Cortez*, 660 S.W.2d 561, 564 (Tex. App.--San Antonio 1983, writ ref'd n.r.e.).

1. Lack of Consideration Lack of consideration is an essential characteristic of a gift; an exchange of consideration precludes a gift. *Pemelton v. Pemelton*, 809 S.W.2d 642, 647 (Tex. App.--Corpus Christi 1991), *rev'd on other grounds sub nom. Heggen v. Pemelton*, 836 S.W.2d 145 (Tex. 1992); *Kunkel v. Kunkel*, 515 S.W.2d 941 (Tex. Civ. App.--Amarillo 1974, writ ref'd n.r.e.). "Gift" and "onerous consideration" are exact antitheses and a recital of onerous consideration "negatives the idea of a gift." *Pemelton*, 809 S.W.2d at 647; *Ellebracht v. Ellebracht*, 735 S.W.2d 658, 659 (Tex. App.--Austin 1987, no writ); *Kitchens v. Kitchens*, 372 S.W.2d 249, 255 (Tex. Civ. App.--Waco 1963, writ dism'd). An exchange of consideration precludes a gift. *Williams v. McKnight*, 402 S.W.2d 505, 508 (Tex. 1966). *See Saldana v. Saldana*, 791 S.W.2d 316, 319 (Tex. App.--Corpus Christi 1990, no writ) (wife's testimony that she paid $ 10.00 to husband's mother in exchange for real estate was sufficient to support the trial court's finding that the property was community property and not gift).

2. Donative Intent A controlling factor in establishing a gift is the donative intent of the grantor at the time of the conveyance. *Ellebracht*, 735 S.W.2d at 659. In *Scott v. Scott*, 805 S.W.2d 835, 839-40 (Tex. App.--Waco 1991, writ denied), the jury found that the wife did not make a gift of money to the husband, even though she put a $ 100,000 certificate of deposit in his name alone. A gift cannot occur without the intent to make a gift. *Campbell v. Campbell*, 587 S.W.2d 513, 514 (Tex. Civ. App.--Dallas 1979, no writ). In *Scott*, the wife testified she had no donative intent, the jury believed her, and the appellate court affirmed. *See Haile v. Holtzclaw*, 414 S.W.2d 916, 927 (Tex. 1967) (proper to find gift based on circumstances, despite transferor's testimony of no donative intent.)

3. Transfer From Parent to Child Presumptively Gift A conveyance of title from parent to child is presumed to be a gift, but the presumption is rebuttable by evidence showing the facts and circumstances surrounding the deed's execution in addition to the deed's recitations. *Woodworth v. Cortez*, 660 S.W.2d 561, 564 (Tex. App.--1983, writ ref'd n.r.e.). *In re Royal*, 107 S.W.3d 846 (Tex. App.– Amarillo 2003, no pet.) (Donor grandparent testimony regarding gift to husband rebutted by contrary evidence of gift to couple).

4. Gift to Both Spouses A gift made by a third party to both spouses leaves the spouses owning the gifted asset in equal undivided one-half separate property interests. *Roosth v. Roosth*, 889 S.W.2d 445, 457 (Tex. App.--Houston [14th Dist.] 1994, writ denied) (engagement gifts and wedding gifts to both spouses were one-half the separate property of each); *Kamel v. Kamel*, 721 S.W.2d 450, 452 (Tex. App.--Tyler 1986, no writ) (where husband's father made payments on a liability owed by both spouses, the payments were a gift one-half to each spouse).

5. Gift Between Spouses A spouse can make a gift of community property to the other spouse. *See Pankhurst v. Weitinger & Tucker*, 850 S.W.2d 726, 730 (Tex. App.--Corpus Christi 1993, writ denied) (husband gave one-half of his community property interest in a cause of action to wife, to hold as her separate property).

6. Gift of Encumbered Property A grantor may make a gift of encumbered property and the conveyance may be a gift even if the grantee assumes an obligation to extinguish the encumbrance. *Taylor v. Sanford*, 108 Tex. 340, 193 S.W. 661, 662 (1917); *Kiel v. Brinkman*, 668 S.W.2d 926, 929 (Tex. App.--Houston [14th Dist.] 1984, no writ) (no showing that parents transferred land to son *in exchange* for his extinguishing the debt); *Van v. Webb*, 237 S.W.2d 827, 832 (Tex. Civ. App.--Amarillo 1951, writ ref'd n.r.e.).

B. Devise and Descent Tex. Const. art. XVI, § 15, and TEX. FAM. CODE ANN. § 3.001 (Vernon 2005) prescribe that property acquired during marriage by devise or descent are separate property. PJC 202.3 defines "devise" as "acquisition of property by last will and testament. PJC 202.3 defines "descent" as "acquisition of property by inheritance without a will."

Under Texas law, legal title vests in estate beneficiaries immediately upon the death of the donor. TEX. PROB. CODE ANN. § 37 (Vernon Supp. 1995); *Dyer v. Eckols*, 808 S.W.2d 531, 533 (Tex. App.--Houston [14th Dist.] 1991, writ dism'd by agr.). An argument can therefore be made that income of an estate is community property of the married heirs or devisees, even though the assets are titled in the decedent and the income arising from the assets may still be in the hands of the executor.

C. Land: Title Acquired Before Marriage In *Hopf v. Hopf*, 841 S.W.2d 898, 900 (Tex. App.--Houston [14th Dist.] 1992, no writ), proof that husband acquired his interest in a building before marriage established that the interest was his separate property. In *Murray v. Murray*, 15 S.W.3d 202, 205 (Tex. App. – Texarkana 2000, no pet) The spouses purchased and received title to real estate prior to marriage. The court found that the spouses owned the property as separate property in proportional percentages to what they contributed to the total purchase price.

> Example 1
> Wife's mother dies on 1-1-95. Wife receives substantial assets under her mother's will. The estate is open for a year and then the unspent accumulated income and assets left to Wife are distributed to her. Wife presents the will, order admitting the will to probate, the inventory, appraisement, and list of claims, and order approving that, and a copy of the check from the independent executor, as proof that the cash she received from her mother's estate was acquired by devise, and is her separate property. Husband presents the I.E.'s testimony that the estate earned the

D. Land: Contract For Deed Before Marriage In *Riley v. Brown*, 452 S.W.2d 548 (Tex. Civ. App.--Tyler 1970, no writ), where realty was acquired under a contract for deed, or installment land contract, inception of title occurred when the contract was entered into, not when title was ultimately conveyed. In *Welder v. Lambert*, 91 Tex. 510, 44 S.W. 281, 284-85 (1898), land was put under contract for colonization with the husband and wife; after wife died, despite husband's remarriage, that contract right still belonged to the first marriage, so that title ultimately acquired during the second marriage was not community property of the second marriage. Such a contract may

be oral. *Evans v. Ingram*, 288 S.W. 494 (Tex. Civ. App.--Waco 1926, no writ). In *Dawson v. Dawson*, 767 S.W.2d 949 (Tex. App.--Beaumont 1989, no writ), realty placed by husband under contract for deed prior to marriage was his separate property, despite the fact that title was taken during marriage in the name of both spouses, there being no evidence that a gift to wife was intended. In *In re Marriage of Read*, 634 S.W.2d 343, 347 (Tex. App.--Amarillo 1982, writ dism'd), an oral agreement for mineral lease made prior to marriage did not establish inception of title because the oral agreement was not enforceable due to the statute of frauds.

E. Land: Lease/Option with Deed in Escrow Before Marriage In *Roach v. Roach*, 672 S.W.2d 524 (Tex. App.--Amarillo 1984, no writ), where an unmarried man entered into a lease-option agreement pertaining to land, but the deed was placed into escrow, and delivered after marriage, inception of title occurred at the time of the original agreement, not when the deed was removed from escrow and delivered to the husband. The land was his separate property.

F. Land: Earnest Money Contract Before Marriage In *Wierzchula v. Wierzchula*, 623 S.W.2d 730 (Tex. App.--Houston [1st Dist.] 1981, no writ), where a man entered into an earnest money contract to purchase realty shortly before marriage, but the deed was received during marriage, inception of title occurred when the earnest money contract was signed, so that the property was the husband's separate property.

In *Carter v. Carter*, 736 S.W.2d 775 (Tex. App.--Houston [14th Dist.] 1987, no writ), the husband signed an earnest money contract and paid $1,000.00 in earnest money, shortly before marriage. The deed was received during marriage in the name of both husband and wife, and both husband and wife signed the note and deed of trust. Citing *Wierzchula*, the court of appeals held that, under the inception of title rule, title related back to the date the earnest money contract was signed and, since that predated marriage and since only the husband had signed the earnest money contract, the realty was his separate property.

In *Duke v. Duke*, 605 S.W.2d 408, 410 (Tex. Civ. App.--El Paso 1980, writ dism'd), where an earnest money contract entered into prior to marriage provided that the deed would be conveyed to "James H. Duke and wife, Barbara J. Duke." Title was taken during marriage in the name of husband and wife. It was held that the earnest money contract merged into the deed, and that the property was received by the spouses as community property.

G. Land: Earnest Money Contract During Marriage Where spouses enter into an earnest money contract to purchase land during marriage, the land is community property. *Leach v. Meyer*, 284 S.W.2d 164 (Tex. Civ. App.--Austin 1955, no writ). Where the purchase price paid for the real estate is separate property, the land is separate property.

In *Winkle v. Winkle*, 951 S.W.2d 80, (Tex. App. - Corpus Christi 1997, pet. denied.) A couple entered into an earnest money contract to purchase a vacant lot and put $1,250.00 of community funds as the down payment. Tied to the purchase of this lot was the sale of Husband's separate property house. The $23,750 received from the sale of the separate house was applied at closing by the same title company to the balance due on the vacant lot. The Court following the reasoning *Wierzchula, Infra.*, held the house was community property because the down payment at the time the earnest money was entered was community property. The Court then awarded the husband a reimbursement claim of $23,750 for his

separate property contribution. Can this result be squared, with the Court's holding in *Gleich v. Bongio*, 128 Tex. 606, 99 S.W.2d 881 (Tex. 1937).

> Example 2
> Husband enters into earnest money contract to buy a house, made contingent upon sale of his separate property house. The contract is placed with a local title company. Some months later, the separate property house closes at the same title company, and the proceeds from sale of the separate property house are applied directly to the new house, without ever leaving the title company. Wife contends that the house is community property because the earnest money contract created a community contractual liability, and under the inception of title rule the consideration for

H. Land: Purchase During Marriage for Cash Land purchased during marriage has the character of the consideration furnished for the land. Property purchased with separate and community funds is owned as tenants in common by the separate and community estates. *Cockerham v. Cockerham*, 527 S.W.2d 162, 168 (Tex. 1975). Percentages of ownership are determined by the amount of funds contributed by each estate to the total purchase price. *Gleich v. Bongio*, 128 Tex. 606, 99 S.W.2d 881, 883 (1937).

I. Funds on Deposit The big issue with funds on deposit is the commingling of separate and community funds. The situation is well-described in the following language from *Welder v. Welder*, 794 S.W.2d 420 (Tex. App.--Corpus Christi 1990, no writ):

> [U]nder Tex. Fam. Code Ann. Sec. 3.003 (Vernon 2005), property possessed by either spouse during or on dissolution of marriage is presumed to be community property, and the party claiming it as separate has the burden to overcome this presumption by clear and convincing evidence. *Estate of Hanau v. Hanau*, 730 S.W.2d 663, 667 (Tex. 1987); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965); *Harris v. Harris*, 765 S.W.2d 798, 802 (Tex. App.--Houston [14th Dist.] 1989, writ denied). To discharge this burden a spouse must trace and clearly identify the property claimed as separate. If separate property and community property have been so commingled as to defy resegregation and identification, the statutory presumption prevails. However, when separate property has not been commingled or its identity as such can be traced, the statutory presumption is dispelled. *Hanau*, 730 S.W.2d at 667; *Tarver*, 394 S.W.2d at 783; *Harris*, 765 S.W.2d at 802. As long as separate property can be definitely traced and identified, it remains separate property regardless of the fact that it may undergo mutations and changes. *Norris v. Vaughan*, 260 S.W.2d

676, 679 (Tex. 1953).

> Specifically, our courts have found no difficulty in following separate funds through bank accounts. *Sibley v. Sibley*, 286 S.W.2d 657, 659 (Tex. Civ. App.--Dallas 1955, writ dism'd). A showing that community and separate funds were deposited in the same account does not divest the separate funds of their identity and establish the entire amount as community when the separate funds may be traced and the trial court is able to determine accurately the interest of each party. *Holloway v. Holloway*, 671 S.W.2d 51, 60 (Tex. App.--Dallas 1983, writ dism'd); *Harris v. Ventura*, 582 S.W.2d 853, 855 (Tex. Civ. App.--Beaumont 1979, no writ). One dollar has the same value as another and under the law there can be no commingling by the mixing of dollars when the number owned by each claimant is known. *Trawick v. Trawick*, 671 S.W.2d 105, 110 (Tex. App.--El Paso 1984, no writ); *Farrow v. Farrow*, 238 S.W.2d 255, 257 (Tex. Civ. App.--Austin 1951, no writ).
>
> In addition, when separate funds can be traced through a joint account to specific property purchased with those funds, without surmise or speculation about funds withdrawn from the account in the interim, then the property purchased is also separate. See *McKinley v. McKinley*, 496 S.W.2d 540, 543-44 (Tex. 1973); *DePuy v. DePuy*, 483 S.W.2d 883, 887-88 (Tex. Civ. App.--Corpus Christi 1972, no writ).

Welder v. Welder, 794 S.W.2d 420, 424-25 (Tex. App.--Corpus Christi 1990, no writ).

1. Showing Only Separate Funds in Account In *Padon v. Padon*, 670 S.W.2d 354 (Tex. App.--San Antonio 1984, no writ), the husband successfully traced separate property funds into the parties' home. The parties agreed that husband received $160,000.00 by way of inheritance, which he deposited into an account in the name of husband and wife. The parties further agreed that they acquired a home in "early 1977," for $89,900.00. The March bank statement showed an initial deposit of $160,490.00, on February 25, 1977. The statement reflected no further deposits into the account until March 4, 1977. However, the statement reflects that a check for $89,900.00 cleared the account on March 1, 1977. The appellate court held that the husband had established that the house was his separate property, as a matter of law. *Id.* at 357.

2. Uncorroborated Assertion of Spouse Courts have held that the uncorroborated assertion that property is separate property will support a finding of separate property, in some situations. *See Holloway v. Holloway*, 671 S.W.2d 51, 56 (Tex. App.--Dallas 1983, writ dism'd) ("We know of no authority holding that a witness is incompetent to testify concerning the source of funds in a bank account without producing bank records of the deposits). *Faram v. Gervits-Faram*, 895 S.W.2d 839, 843 (Tex. App.--Fort Worth 1995, no writ) (testimony of wife that investment accounts and T-bill were either gifts from her father or proceeds from sale of separate real estate was, standing uncontradicted, at least some evidence of the character of the property); *Peterson v. Peterson*,

595 S.W.2d 889, 892 (Tex. Civ. App.--Austin 1980, writ ref'd n.r.e.) (husband's testimony that realty was purchased with separate property cash supported finding of separate property, even without evidence of activity in the account, where transaction occurred less than one month after marriage).

An uncorroborated assertion by a spouse as to separate property may not be enough to reverse a contrary finding in the trial court. In *Klein v. Klein*, 370 S.W.2d 769 (Tex. Civ. App.--Eastland 1963, no writ), the wife testified that she made a $3,000.00 separate property cash payment for a house acquired during marriage. She said that she got the money from a safety deposit box in an unnamed bank. The trial court nonetheless found that the house was community property. The appellate court affirmed, saying that the wife's testimony was not binding. *Id.* at 773.

3. Separate Funds Out First In *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973), the Supreme Court ruled on the tracing of funds in bank accounts. The husband had $9,500.00 of separate property money on deposit in a savings and loan account. By year end, it had earned $472.03 in interest. On January 5, the husband withdrew $472.03. The Supreme Court said that "the $9,500.00 originally deposited remained in the account and continued to earn interest, until on December 31 of the following year [1967], the account balance was $10,453.81. There were no withdrawals after the one mentioned above. All deposits were deposits of interest. On January 2 of 1968, $10,400.00 was withdrawn and used to purchase a CD. The Supreme Court concluded that the $9,500.00 originally on deposit had been "traced in its entirety" into the CD. Thus, $9,500.00 of the $10,400.00 CD was separate property. No explanation is given as to why all of the separate was deemed withdrawn from the savings account to purchase the CD before the $953.81 in community funds were tapped. It appears that separate came out first.

In *McKinley*, tracing failed as to another bank account for lack of evidence as to "the nature of funds deposited or withdrawn."

4. Community Funds Out First. In *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.--Dallas 1955, writ dism'd) (per curiam), the husband mixed community funds in a bank account with $ 3,566.68 of wife's separate funds. There were a number of deposits and withdrawals to the account. However, the account never dropped below $ 3,566.68. Seeing the husband as a trustee of the wife's separate property funds that were in his care, the appellate court invoked a rule of trust law, that where a trustee mixes his own funds with trust funds the trustee is presumed to have withdrawn his own money first, leaving the beneficiary's on hand. Since the husband owned none of wife' separate funds, and half of the community funds, it was presumed that the community moneys in the bank account were withdrawn first, before the wife's separate moneys were withdrawn. When the account had a balance of $ 4,009.46, the sum of $ 1,929.08 was withdrawn to buy a farm. The appellate court held that all $ 442.78 in community property came out, and the rest of the withdrawal was separate property, making the farm 11% community property and 89% wife's separate property. The court said:

> The community moneys in joint bank account of the parties are therefore presumed to have been drawn out first, before the separate moneys are withdrawn.

Id. at 659. *See Farrow v. Farrow*, 238 S.W.2d 255 (Tex. Civ. App.--Austin 1957, no writ) (although husband commingled his separate, his wife's separate, and community funds, husband

did not do so wrongfully, and the amounts of each could be calculated, so that the trust principle that all mixed funds belong to the beneficiary did not apply). *See Trevino v. Trevino*, 555 S.W.2d 792, 798 (Tex. App.--Corpus Christi 1977, no writ) (where husband managed community estate, a trust relationship existed between him and wife).

Example 3

In *Sibley* the Husband mixed community property with Wife's separate property, so he was deemed to be like a trustee of her funds. What if it was Wife who mixed her separate funds with community funds, in an account under Wife's control? Using *Sibley*'s trust law analogy, Wife would be the trustee of Husband's 50% interest in the community property. Would it be presumed that Wife drew out her own separate property (100% owned by her) first, leaving community funds (50% owned by Husband)?

In *Barrington v. Barrington*, 290 S.W.2d 297, 304 (Tex. Civ. App.--Texarkana 1956, no writ), *Sibley* was cited for the proposition that community funds in a joint bank account are as a matter of law presumed to have been drawn out before separate moneys are withdrawn. Then in *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1976, writ dism'd), another court cited *Sibley* for the rule that "where a bank account contains both community and separate moneys, it is presumed that community moneys are drawn out first." *See also Harris v. Ventura*, 582 S.W.2d 853, 855-56 (Tex. Civ. App.--Beaumont 1979, no writ) ("where the checking account contains both community and separate funds, it is presumed that community funds are drawn out first," citing *Horlock* and *Sibley*). *Smith v. Smith*, 22 S.W.3d 140, (Tex. App. - - Houston [14th District] 2000, no pet.) ("We assume without deciding that the community-out-first presumption is a rebuttable one.")

Example 4

Husband puts $ 10,000 of his own separate property funds into an account with $ 10,000 in community property funds. During the marriage, money comes in and money goes out, but the balance never drops below $ 10,000, the balance at the time of divorce. Is the $ 10,000 on hand at the time of divorce Husband's separate property or community property? Under a "community out first rule," the remaining $ 10,000 is Husband's separate property. Applying the "trustee's money out first" principle mentioned in *Sibley*, it would be presumed that the husband withdrew his own wholly-owned separate property funds first, leaving community funds in which Wife has a one-half interest. On these facts, the *Sibley* rationale would lead to a "separate out first" rule. Perhaps it would be better to have a "trustee's money out first" rule as a vehicle for better achieving justice under the facts of a particular case.

5. Minimum Balance Method As *Sibley* demonstrates, the courts have applied the community out first rule to trace separate property in a mixed-funds account that never went below a certain balance. In *Snider v. Snider*, 613 S.W.2d 8 (Tex. App.--Dallas 1981, no writ), at the time of marriage, the balance in the husband's savings account exceeded $27,000.00. During marriage, interest was added to the account, and withdrawals were made, reducing the balance to $19,642.45. More activity ensued, but the balance of the account never dropped below $19,642.45. Later, a deposit of $ 10,000.00 in separate property was made to the account, raising the separate property balance to $29,642.45. This proof was held to establish that the $29,642.45 balance in the account at the time of the husband's death was his separate property. *Id.* at 11.

Example 5

Husband and Wife have a joint account, into with they each deposit his/her own separate property funds. Both spouses write checks on the account. Since there is no community property in the account, a "community out first" rule will not work. Since the account is jointly controlled, and both spouses write checks on the account, a "trustee's money out first" rule will not work. What about a pro rata rule? What about letting the withdrawing spouse's intent control?

6. Pro Rata Approach An argument can be made that, where mixed funds are withdrawn from an account, the withdrawal should be pro rata in proportion to the respective balances of separate and community funds in the account. A pro rata rule was used to achieve equity in an embezzlement case, *Marineau v. General American Life Ins. Co.*, 898 S.W.2d 397, 403 (Tex. App.--Fort Worth 1995, writ denied). There the husband had embezzled $ 349,077.32 from his employer, and put it into an account where deposits totaled $ 512,594.32. Husband purchased a life insurance policy, which he paid incrementally out of the account. He later committed suicide, and the employer and the widow litigated who owned the policy proceeds. It was the employer's burden to trace its money into a specific asset. Having done that, the burden shifted to the widow (claiming through the wrongdoer) to prove what funds of the wrongdoer flowed into the asset. The employer claimed that the wrongdoer had to show the proportion of each type of funds in each payment, failing which the entire payment would be deemed to belong to the employer. The appellate court rejected this contention, relying on an Oklahoma Supreme Court case to hold that each party was entitled to a pro rata share of each payment, in the same proportion as total embezzled deposits bore to total deposits of husband's money. Thus, a sort of global average was used, as opposed to trying to calculate the respective components of each premium payment, in contradistinction to the tracing approach of some family law cases that analyze the character of each withdrawal. Perhaps the "broad overview" approach used in *Marineau* would more effectively, and certainly more cheaply, accomplish equity.

Example 6
Part 1
Husband puts $ 10,000 of community property funds into an account with $ 10,000 of Wife's separate property funds. During the marriage, Husband withdraws $ 10,000 to buy GM stock, which is on hand at the time of divorce. The rest of the money in the account is frittered away by Husband. Is the GM stock community property or is it Wife's separate property? Applying a "community out first" rule, the stock would be community property, and the Wife's separate funds were frittered away. Under a "trustee's money out first" rule, the stock would be Wife's separate and community funds were frittered away.

Part 2
Same facts as Part 1, except $ 5,000 is frittered away, then $ 10,000 in GM stock is purchased, then the remaining $ 5,000 is frittered away. Is the GM stock half community and half separate? Perhaps we should have an equitable principle that the presumption applied is one that will favor the party to whom equity should be done. That may be "separate out first" sometimes, "community out first" sometimes, and sometimes a presumption in favor of whatever gives greatest

7. "Borrowing" Between Separate and Community Funds. In *Newland v. Newland*, 529 S.W.2d 105 (Tex. Civ. App.--Fort Worth 1975, no writ), the husband maintained distinct bank accounts, the "general account" being for community deposits and expenditures, and the "separate account" being for business transactions relating to his separate estate. On occasion the balance of one account would run low, and Mr. Newland would "borrow" from the other account, for "short terms." The husband treated such transactions as loans, and repaid the borrowed funds "so that the two accounts were restored to the condition which would have obtained had there not been necessity for any transfer." *Id.* at 109. There was documentary proof of this type of activity for most of the 20-year plus period involved. The trial court, and the appellate court, found that the husband's methods avoided commingling of the funds, since "there was always ability to compute correct balances for purposes of resegregation." *Id.* at 109.

8. Clearing-house method; Deposit Followed by Withdrawal in Close Proximity. In *Higgins v. Higgins*, 458 S.W.2d 498 (Tex. Civ. App.--Eastland 1970, no writ), the jury found that, where the husband deposited $ 71,200.00 of separate funds in a joint bank account and shortly thereafter drew out $ 70,000.00 to purchase a ranch, the ranch was the husband's separate property. That finding was affirmed by the appellate court.

In *Beeler v. Beeler*, 363 S.W.2d 305 (Tex. Civ. App.--Beaumont 1962, writ dism'd), the spouses purchased real property, partly with a separate property down payment made by the husband, and partly with a community loan. The collateral for the loan was a separate property promissory note of the husband. Payments on the community loan were made to coincide with payments received by the husband on the

separate property note, in time and amount. During the marriage, the husband deposited his separate property note payments into a joint account, then wrote checks to make the payments on the community note. Husband sought reimbursement for his separate funds used to pay a community debt. Wife opposed the reimbursement claim, saying that the payments from the separate property note were commingled when they were deposited into the bank account. The trial court found, however, that the parties had agreed to pay the new note with the proceeds from the old note, and that "it was not the intention of the parties to commingle such funds with the community funds of the parties." The appellate court found that the momentary deposit of such funds into a joint bank account did not convert "the $2,500.00, plus interest" into community funds. "Such sum, in each instance, was, in effect, earmarked a trust fund, in equity already belonging to the bank from the moment collected by appellee . . . . This being so, the installments paid upon the bank note were paid from the separate funds of appellee and his separate estate is therefore entitled to reimbursement therefor." Id. at 308.

In *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973), as explained above, a savings account containing $ 9,500.00 of separate property earned $ 472.03 in interest at year end. On January 2, that amount of money was withdrawn. The Supreme Court held that the interest had been withdrawn, leaving the separate property balance of $ 9,500.00.

In *Estate of Hanau v. Hanau*, 730 S.W.2d 664, (Tex. 1987) the court approved of the clearinghouse method of tracing. In *Hanau*, the court allowed tracing of several same day transactions involving sales of stock and immediate repurchase of other stock.

9. Intent While the mechanical application of a rule, such as the "community out first" rule, has led to successful tracing, so too has evidence that it was intended that separate funds would be taken from a commingled account. For example, in *In re Marriage of Tandy*, 532 S.W.2d 714, 717 (Tex. Civ. App.--Amarillo 1976, no writ), the evidence showed that the husband mixed community proceeds from grain sales in an account with $ 25,000 in proceeds from the sale of land which was half-owned by the husband as separate property. After the $ 25,000 was received, the husband paid $ 6,250 to each of his sons for their ownership interests in the land, and then paid $ 12,500 on the husband's separate property debt. The appellate court, without using a mechanical rule regarding withdrawals, held that this evidence traced the separate property. The court upheld a finding, however, that another account had been hopelessly commingled. *Id.* at 718-19.

10. Recap The case of *Gibson v. Gibson*, 614 S.W.2d 487, 489 (Tex. Civ. App.--Tyler 1981, no writ), contains a good recapitulation of the law in the area:

> Courts dealing with the tracing of separate property commingled with community funds have required varying degrees of particularity in identifying separate property. See 6 St. Mary's L. J. 234 (1974). Many Texas cases have been strict in demanding a "dollar for dollar" accounting of separate funds used to purchase an asset, the ownership of which is in dispute. E. g., *Schmeltz v. Gary*, 49 Tex. 49 (1878); *Latham v. Allison*, supra; *West v. Austin National Bank*, 427 S.W.2d 906 (Tex. Civ. App.-San Antonio 1968, writ ref'd n. r. e.); *Stanley v. Stanley*, 294 S.W.2d 132 (Tex.

Civ. App.-Amarillo 1956, writ ref'd n. r. e., cert. den'd 354 U.S. 910, 77 S.Ct. 1296, 1 L.Ed.2d 1428).

> Certain other courts have been more lenient in their treatment of the tracing problem. The philosophy prompting these decisions was expressed in *Farrow v. Farrow*, 238 S.W.2d 255, 257 (Tex. Civ. App.-Austin 1951, no writ): "One dollar has the same value as another and under the law there can be no commingling by the mixing of dollars when the number owned by the claimant is known." In *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.-Dallas 1935, writ dism'd), the court allowed appellee to trace her separate property through a series of transactions, including the deposit of the proceeds from a sale of her separate realty into a joint account containing a substantial amount of community funds and separate funds belonging to the other spouse. According to Sibley, community funds will be presumed to have been drawn out before separate funds from a joint bank account.
>
> In still other cases, spouses have been permitted to distinguish their separate funds commingled in a bank account with community money by proving that community withdrawals, e. g. for living expenses, equalled or exceeded community deposits. For example, in *Coggin v. Coggin*, 204 S.W.2d 47, 52 (Tex. Civ. App.--Amarillo 1947, no writ), evidence was presented to show that income from the wife's property totaled approximately $1,000 per year, while family living expenses were $200-$500 monthly. The court found that such community funds could not have been used to pay for the property in question since they had already been depleted in paying for the living expenses. See *DePuy v. DePuy*, 483 S.W.2d 883, 888 (Tex. Civ. App.--Corpus Christi 1972, no writ).

Gibson v. Gibson, 614 S.W.2d 487, 489 (Tex. Civ. App.--Tyler 1981, no writ).

J. Mineral Interests/Income The character of a mineral interest is determined according to general marital property rules. *See In re Marriage of Read*, 634 S.W.2d 343, 346 (Tex. App.--Amarillo 1982, writ dism'd) (working interest was community property). Income from a community property mineral interest is community property. Where the mineral interest is separate property: (1) royalty income is separate property; *Norris v. Vaughan*, 152 Tex. 491, 260 S.W.2d 676, 679 (1953) (this is so because a royalty payment is for the extraction or waste of the separate estate, as opposed to income from the separate estate); *Welder v. Welder*, 794 S.W.2d 420, 425 (Tex. App.--Corpus Christi 1990, no writ); (2) lease bonuses are separate property; *Lessing v. Russek*, 234 S.W.2d 891, 894 (Tex. Civ. App.--Austin 1950, writ ref'd n.r.e.); and (3) delay rentals are community property; *Id.*; *McGarraugh v. McGarraugh*, 177 S.W.2d 296, 300-301 (Tex. Civ. App.--Amarillo 1943, writ dism'd).

K. Passive Income (Dividends, Interest,

Rentals) Cash dividends from corporate stock are community property. *See Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ); *Bakken v. Bakken*, 503 S.W.2d 315, 317 (Tex. Civ. App.--Dallas 1973, no writ). However, stock dividends deriving from separate property stock are separate property. *See Duncan v. U.S.*, 247 F.2d 845, 855 (5th Cir. 1957). Interest income is community property. *Braden v. Gose*, 57 Tex. 37 (1882). Rentals from real estate are community property. *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799, 802 (1925); *Coggin v. Coggin*, 204 S.W.2d 47, 52 (Tex. Civ. App.--Amarillo 1947, no writ) (rents and crops from separate property are community property).

Example 7

Wife owns, with her two brothers, equal undivided shares of the mineral interests which they inherited from their father. The siblings put the mineral interests into a closely-held corporation which is owned 1/3 by each of them. The corporation collects the royalty income and distributes it in thirds. The oil royalties were received by Wife as her separate property before the transfer to the corporation. The corporate dividends are received by Wife as community property, even though they are traceable to the royalty income. *See Marshall v. Marshall*, 735 S.W.2d 587, 592-93 (Tex. App.--Dallas 1987, writ ref'd n.r.e.) (revenues from oil and gas leases owned by partnership at time husband married were community property when distributed to husband as partnership profits).

L. Patent Royalties Royalties received by Husband during marriage from patents he had obtained prior to marriage were characterized them as community property.

Alsenz v. Alsenz, 101 S.W.3d 648 (Tex. App. – Houston [1st Dist.] 2003, pet. denied). The Court rejected Husband's argument that patents were equivalent to mineral royalties because their value diminished over time. The Court viewed the royalties as revenue from separate property and therefore characterized them as community property.

M. Wages Wages earned during marriage are community property, while wages earned before marriage or after dissolution of marriage are separate property. The fact that a spouse may have entered into an employment agreement prior to marriage does not cause the wages of that spouse earned during marriage to be separate property. *See Dessommes v. Dessommes*, 543 S.W.2d 165 (Tex. Civ. App.--Texarkana 1976, writ ref'd n.r.e.); *Moore v. Moore*, 192 S.W.2d 929 (Tex. Civ. App.--Fort Worth 1946, no writ). The fact that an employment agreement is contracted during marriage does not make wages earned after the end of the marriage community property. *See Echols v. Austron, Inc.*, 529 S.W.2d 840 (Tex. Civ. App.--Austin 1975, writ ref'd n.r.e.) (bonus paid to husband after divorce was his separate property).

Example 8

Husband is a professional athlete. He signs a 3-year contract, to be paid $ 30,000 per month, plus a so-called "signing bonus" of $ 600,000, to be paid in installments of $ 200,000, at the beginning of the first, second, and third years. Payments are guaranteed as long as Husband reports for work, even if Husband is injured, unless the injury is self-inflicted, or unless Husband is convicted of a felony or drug violation, in which event the Team can cancel the contract and no further payments will be due. The divorce is tried just before the second $ 200,000 installment is due. What payments are community property? What if the signing bonus was paid up front?

Post-divorce payments to husband, made under his contract with professional baseball team, were husband's separate property, where husband's performance was a condition precedent to payment, so husband's right to payment under the contract did not accrue until he performed his services as a professional baseball player. The contract's guarantee provisions did not excuse him from performance of his contractual obligation but only existed to provide husband with financial security in the event he sustained injury or the ball club decided that his services were no longer needed. *Loaiza v. Loaiza*, 130 S.W.3d 894, 906 (Tex. App. – Fort Worth 2004, pet. denied).

N. Retirement Benefits & Fringe Benefits

Retirement benefits, to the extent they derive from employment during marriage, constitute a community asset. *Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976).

1. Private Retirement Benefits: Defined Benefit Plan

Retirement benefits are considered by Texas courts to be "a mode of employee compensation earned during a given period of employment." *Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976). Thus, retirement, annuity and pension benefits earned during marriage are part of the community estate, *Id.*, at 662, while benefits earned before and after the marriage are the employee spouse's separate property. *See Berry v. Berry*, 647 S.W.2d 945, 947 (Tex. 1983). As with wages, the character of the retirement benefits is not determined by the circumstances surrounding the inception of the employment relationship, or the inception of the right to receive retirement benefits. Instead, the benefits are broken down into monthly increments, each of which is separate or community, depending upon whether the increment arises before, during or after marriage. Under the case of *Taggart v. Taggart*, 552 S.W.2d 422, 424 (Tex. 1977), the extent of the community interest is determined by a fraction, the numerator of which represents the number of months the parties were married while the retirement plan was in effect, and the denominator of which represents the total number of months the employee spouse was employed under the plan. In a divorce, the fraction is applied to a figure representing the value of the benefits as of the date of divorce. *See Berry v. Berry*, 647 S.W.2d 945, 947 (Tex. 1983). The product of the two figures gives the community interest subject to division by the court.

Effective September 1, 2005 § 3.007 of the Texas Family Code goes into effect. In relevant part it provides:

> § 3.007 Property Interest in Certain Employee Benefits.
>
> (a) A spouse who is a participant in a defined benefit retirement plan has a separate

property interest in the monthly accrued benefit the spouse had a right to receive on normal retirement age, as defined by the plan, as of the date of marriage, regardless of whether the benefit had vested.

(b) The community property interest in a defined benefit plan shall be determined as if the spouse began to participate in the plan on the date of marriage and ended that participation on the date of dissolution or termination of the marriage, regardless of whether the benefit had vested.

Querry: § (a) of 3.007 of the Texas Family Code includes the phrase "monthly accrued benefit" whereas § (b) does not. What effect if any does this have?

Example 9
Husband works for an employer who has a defined benefit plan with the following terms:
1.) On the sixth year of your employment you vest 20% in the plan, with an additional 20% vesting on the 7, 8, 9, 10th years at which time you are fully vested
2.) The plan pays 50% of your 3 years highest salary averaged. Husband works for the employer 3 years prior to marriage. He gets married and subsequently divorced in year 4 of the marriage. Under the new statute how is the plan characterized?

2. Private Retirement Benefits: Defined Contribution Plan In *Iglinsky v. Iglinsky*, 735 S.W.2d 536, 538 (Tex. App.--Tyler 1987, no writ), the appellate court held that it was improper to apply the time apportionment formula to a contribution retirement account. Instead, the court should have determined the community interest in the funds on the basis of contributions of earnings during marriage. *Id.* at 538, n. 2. The community share of a defined contribution plan is calculated by subtracting value at date of marriage from value at divorce. *Smith v. Smith*, 22 S.W.3d 140, (Tex. App. - - Houston [14th District] 2000, no pet.). *Accord, McClary v. Thompson*, 65 S.W.3d 829 (Tex. App. – Fort Worth 2002, pet. denied)

Example 10
The balance on the day of marriage in Husband's defined contribution plan account was $ 50,000. During marriage he and his employer made contributions to the plan account. The funds in the plan account also earned interest during the marriage, which was deposited into the account. Should the community share be all additions to the account between the date of marriage and the date of divorce, whether as contributions or earnings? Assume that the funds in the account were invested in company stock, and that all contributions to the account are automatically invested in company stock, whose value fluctuates with the market. Would it be improper to compare the value of the stock on the date of marriage versus on the date of divorce?

The newly implemented §3.007(c) of the Texas Family Code Provides as follows:

(c) The separate property interest of a spouse in a defined contribution retirement plan may be traced using the tracing and characterization principles that apply to a nonretirement asset.

This revision to the Code will have significant impact on plans that invest in assets that appreciate (i.e., stocks).

3. Stock Options

1. Character as Separate or Community. In *Bodin v. Bodin*, 955 S.W.2d 380, 381 (Tex. App.– San Antonio 1997, no pet.), the husband contended that employee stock options granted during marriage were his separate property because the options were not vested by the time of divorce. The appellate court rejected this position, saying that the fact that the options had not vested by the time of divorce did not make the options entirely separate property. The court analogized the options to non-vested military retirement benefits, which were declared to be divisible upon divorce in *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976). Mr. Bodin did not argue that a Taggart-line pro-rata allocation rule should apply to the stock options. Therefore *Bodin* does not address pro-rata allocation.

The case of *Farish v. Farish*, 982 S.W.2d 623, 625 28 (Tex. App.--Houston [1st Dist.] 1998, no pet.), addressed stock options granted as an incentive for future employment. *Farish* cites cases holding that options granted for work done outside of marriage requires an allocation between compensation for past work and incentives for future service. This important part of the *Farish* opinion is designated "not for publication." However, the unpublished portion of the *Farish* opinion can be considered by other courts, although it has no precedential value. See Tex. R. App. P. 47.7.

The court in *Charriere v. Charriere*, 7 S.W.3d 217 (Tex. App.--Dallas 1999, no pet.), rejected an argument that employee stock options were governed by a time-allocation rule. There the employee stock options were both received and had become exercisable during the parties' marriage, so they were deemed to be community property divisible upon divorce.

Kline v. Kline, 17 S.W.3d 445 (Tex. App.--Houston [1st Dist.] 2000, pet. denied), dealt with non-vested stock options. The husband argued that if the options were awarded for past services, they would be community property. If they were awarded to induce future employment after the divorce, they should be entirely his separate property. The options themselves recited that they were granted for services during marriage, so the appellate court rejected the husband's contention, citing among its supporting authorities the retirement

benefits case of *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976). The husband did not argue a pro-rata allocation, so the argument was not ruled on by the appellate court.

In *McClary v. Thompson*, 65 S.W.3d 829, 834 (Tex. App.--Fort Worth 2002, pet. denied), the court of appeals said that "[m]ost forms of property, including real estate, life insurance policies, and stock options, have been characterized as community or separate based upon their character at inception."

In *Boyd v. Boyd,* 67 S.W.3d 398, 410-411 (Tex. App--Fort Worth 2002, no pet.), the court of appeals said:

> Texas courts have consistently held that stock options acquired during marriage are a contingent property interest and a community asset subject to division upon divorce.
>
> * * *
>
> Because Randall's fair value stock options were acquired during the marriage, they were a contingent community property interest, and the trial court did not abuse its discretion by dividing all of the options between Randall and Ginger.

In *Matter of Marriage of Joiner*, 755 S.W.2d 496, 498 (Tex. App.-Amarillo 1988), *on reh'g*, 766 S.W.2d 263 (Tex. App.-Amarillo 1988, no writ), stands in contrast to the cases going "all or none" for the date the option was granted. In *Joiner*, the Amarillo Court of Appeals considered the proper characterization and division of the husband's stock plan. Under the terms of the husband's plan, a 20% interest in the employee's account vested after six years of service, *i.e.*, after the first fiscal year of participation in the plan, and a 20% interest vested each year thereafter until the tenth year of service, *i.e.*, the fifth fiscal year of participation in the plan, when the account became 100% vested. Prior to marriage, the husband had worked six and one-half years for his employer. *Id.*

On appeal of the parties divorce decree, the appellate court distinguished the husband's stock plan from military retirement or pension plans under which benefits are earned by reason of years of service, on the grounds that the husband's stock plan provided that benefits were not earned during the

five-year period of employment required for participation in the plan, but rather provided that an employee first acquired a vested interest in the benefits of the plan at the end of the sixth fiscal year of employment. *Id.* at 698. Thus, according to the Amarillo Court of Appeals, the initial five-year employment period only generated a mere expectancy which, by not fixing any benefit in any sums at any future date, was not a property interest to which property laws apply. *Id.* Since the character of property as separate or community is fixed at the very time of acquisition, the appellate court continued, the crucial time for determining the character of interests in and benefits of the plan was the time when the vested interests were acquired. *Id.*

Thus, held the Amarillo Court of Appeals, a 20% interest in the benefits of the husband's plan was acquired and vested at the end of the husband's sixth year of employment (prior to marriage), and a similar 20% interest was acquired and vested on each year thereafter for four more years, at which time the plan account was fully vested. *Id.* Because the initial 20% interest was acquired and vested while the husband was a single man, it was his separate property, and the remaining 80% was acquired and vested during the marriage, and thus was community property. *Id.* In *Joiner,* then, the appellate court adopted and advocated a time rule formula to determine the community's interest in a profit-sharing stock plan. On rehearing, the wife contended that the inception of title doctrine-*i.e.,* the character of property interests in the plan as separate or community is fixed at the time the vested interests are acquired-was not applicable to situations involving retirement or pension benefits. 766 S.W.2d 263. Rejecting the wife's argument, and reaffirming that the inception of title doctrine was applicable to the husband's stock plan, the Amarillo Court of Appeals noted that its focus was on the characterization of the separate property-community property interests in the husband's plan, which was relevant to the trial court's decision in dividing the community estate in a manner deemed just and right. *Id.* The appellate court stated that it did not measure the monetary value of the interests, a matter to be proved in the trial court, nor prejudge an apportionment of the value of the community interest, a matter reserved to the discretion of the trial court. *Id.* at 263-264. The Amarillo court also stated that its decision did prevent a party from offering proof that under the peculiarities of the plan - *i.e.*, the

amount of annual contributions being dependent upon the company's profits and the husband's salary, as well as upon the performance of the stock purchased with the contributions-there was an increase in the value of the husband's separate property interest which was attributable to his employment during marriage, giving the community an interest in the increased value which was subject to division by the trial court. *Id.* at 264.

2. **New Legislation** New Tex. Fam. Code § 3.007(d) provides in relevant part:

(d) A spouse who is a participant in an employer-provided stock option plan or an employer-provided restricted stock plan has a separate property interest in the options or restricted stock granted to the spouse under the plan as follows:

(1) if the option or stock was granted to the spouse before marriage but required continued employment during marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which the numerator is the period from the date the option or stock was granted until the date of marriage and the denominator is the period from the date the option or stock was granted until the date the grant could be exercised or the restriction removed; and

(2) if the option or stock was granted to the spouse during the marriage but required continued employment after marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which the numerator is the period from the date of dissolution or termination of the marriage until the date the grant could be exercised or the restriction removed and the denominator is the period from the date the option or stock was granted until the date the grant could be exercised or the restriction removed.

The effect of this statute and its application to the existing case remains to be seen.

Example 11

Company stock options are received by the employee as a benefit of employment, but they can be exercised only after 5 years, and provided that the employee is employed with Employer at the end of the 5 year period. Wife receives Grant One of 1000 options in July of 2000. Wife marries in January of 2003. Wife receives Grant Two of 1000 options in January 2004. Wife received Grant Three of 1000 options in November of 2007, with the employer expressly stating it is a bonus for work performed in 2007. Parties divorce in December of 2007. What is the characterization of each grant?

4. Keogh's, SEP's, and IRA's Self-created trust tax sheltered accounts such as Keogh's, SEP's and IRA's, though technically trusts, are treated like regular accounts, for tracing purposes. Where the trust funds are invested in cash or CD's, the balance in the account on the date of marriage is separate property, and all interest accumulated during marriage is community property. Where the trust corpus is invested in assets with fluctuating value, a more complicated effort to trace each individual asset may be required. In *Hopf v. Hopf*, 841 S.W.2d 898, 900 (Tex. App.--Houston [14th Dist.] 1992, no writ), tracing as to IRA or Keogh account failed because the spouse presented no evidence showing the amount of the plan before marriage, on the date of marriage, or deposits and withdrawals during marriage.

5. Texas Government Retirement Benefits A spouse's right to Texas government employee retirement benefits are community property according to the ordinary principles of retirement benefits. *Irving Fireman's Relief and Retirement Fund v. Sears*, 803 S.W.2d 747, 749 (Tex. App.--Dallas 1990, no writ) (firemen's retirement benefits divisible upon divorce); *Morgan v. Horton*, 675 S.W.2d 602, 604 (Tex. App.--Dallas 1984, no writ) (teacher retirement funds divisible upon divorce); *Collida v. Collida*, 546 S.W.2d 708, 710 (Tex. Civ. App.--Beaumont 1977, writ dism'd) (firemen's retirement benefits divisible on divorce).

6. Federal Civil Service Retirement Civil service retirement benefits earned during marriage are community property. *Hoppe v. Godeke*, 774 S.W.2d 368, 370 (Tex. App.--Austin 1989, writ denied). *See* 5 U.S.C.A. § 8331 et seq. (West 1980 & Pam. Supp. 1995).

7. Federal Railroad Retirement Benefits The United States Supreme Court, in *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 99 S.Ct. 802, 59 L.Ed.2d 1 (1979), held that retirement benefits payable under the federal Railroad Retirement Act were not subject to division by a state court on divorce, by virtue of § 231m of the Act. *See Eichelberger v. Eichelberger*, 582 S.W.2d 395, 401 (Tex. 1979) ("the [Supreme Court's] opinion makes it clear that such benefits are not to be treated as 'property' and future benefits are not subject to division upon divorce as property"). However, with the Railroad Retirement Solvency Act of 1983, Congress added a subsection to § 231m, expressly permitting state courts to characterize certain components of the benefits as community property. See 45 U.S.C.A. § 231m(b)(2) (West 1986). Under the new statute, railroad retirement benefits involve several statutory components. See 45 U.S.C.A.

§ 231b (West 1986). The "basic component" is described in § 231b(a), and is designed to provide benefits equivalent to those under social security. See H.R.Rep. No. 30(I), 98th Cong., 1st Sess., reprinted in 1983 U.S.Code Cong. & Ad. News 729, 730-34. Section 231m of the statute provides that "[N]o annuity or supplemental annuity shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated." Thus, state courts still cannot divide the basic component of railroad retirement benefits in a divorce. *See Kamel v. Kamel*, 721 S.W.2d 450, 452 (Tex. App.--Tyler 1986, no writ).

8. U.S. Military Retirement Benefits Military retirement benefits earned from years of service during the marriage are community property. *Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976); *Taggart v. Taggart*, 552 S.W.2d 422 (Tex. 1977); *Busby v. Busby*, 457 S.W.2d 551 (Tex. 1970). In *McCarty v. McCarty*, 453 U.S. 210, 101 S.Ct. 2728, 69 L.Ed.2d 589 (1981), the U.S. Supreme Court declared that federal law preempted the division of military non-disability retired pay in a divorce. Congress later passed a statute permitting divorce courts to divide military retired pay, provided that the state had sufficient jurisdictional ties specified in the statute. 10 U.S.C. § 1408 et seq. (the USFSPA), effective Feb. 1, 1983. Military retirement benefits remain preempted except to the extent that division is permitted under the USFSPA. *Mansell v. Mansell*, 490 U.S. 581, 109 S.Ct. 2028, 104 L.Ed.2d 675 (1989).

Any portion of the military retirement attributable to employment prior to marriage is the employee spouse's separate property. *Bloomer v. Bloomer*, 927 S.W.2d 118 (Tex. App. - Houston [1st Dist.] Jun. 13, 1996) (No. 01-91-01428-CV), *rehearing overruled* Jul. 11, 1996, *writ denied* Dec. 13, 1996. (involving retirement which included time in military reserves). Any portion of the retirement attributable to employment after divorce is not community property. *Berry v. Berry*, 647 S.W.2d 945, 947 (Tex. 1983). The right to receive post-divorce cost-of-living increases on the non-employed spouse's share of the retirement is community property that can be awarded on divorce. *Sutherland v. Cobern*, 843 S.W.2d 127, 131 (Tex. App.--Texarkana 1992, writ denied).

9. Social Security Benefits State courts have no power to divide Social Security disability benefits in a divorce, due to pre-emption by federal law. *Richard v. Richard*, 659 S.W.2d 746, 748-49 (Tex. App.--Tyler 1983, no writ) (citing cases from California, and relying upon the analysis in the *Hisquierdo* case).

O. Disability Benefits

1. Federal Military Disability Retirement Prior to the *Mansell* decision, Texas courts were divided on whether military disability retirement benefits were divisible on divorce. *Conroy v. Conroy*, 706 S.W.2d 745, 748 (Tex. App.--El Paso 1986, no writ) (are divisible); *Patrick v. Patrick*, 693 S.W.2d 52, 54 (Tex. App.--Fort Worth 1985, writ ref'd n.r.e.) (are not divisible). However, after the United States Supreme Court's decision in *Mansell v. Mansell*, 490 U.S. 581, 109 S.Ct. 2028, 104 L.Ed.2d 675 (1989), it seems certain that military disability retirement benefits are not divisible on divorce. *See Wallace v. Fuller*, 832 S.W.2d 714, 717-18 (Tex. App.--Austin 1992, no writ) (after *Mansell*, it is clear that military non-disability retirement benefits cannot be divided in a Texas divorce).

2. Veteran's Benefits According to

federal statute, Veteran's Benefits are not property. 38 U.S.C.A. § 101 (West 1991). They are not community property, and cannot be divided upon divorce. *Ex parte Burson*, 615 S.W.2d 192, 194-95 (Tex. 1981); *Kamel v. Kamel*, 721 S.W.2d 450, 453 (Tex. App.--Tyler 1986, no writ); *Ex parte Johnson*, 591 S.W.2d 453, 454 (Tex. 1979); *Ex parte Pummill*, 606 S.W.2d 707, 709 (Tex. Civ. App.--Fort Worth 1980, no writ). *See Mansell v. Mansell*, 490 U.S. 581, 109 S.Ct. 2028, 104 L.Ed.2d 675 (1989) (veteran's disability payments are not divisible on divorce, due to preemption).

3. Workers Compensation Benefits

a. Under State Law. The character of workers' compensation benefits is not controlled by the circumstances surrounding the inception of the right to these benefits. *See Hicks v. Hicks*, 546 S.W.2d 71, 73 (Tex. Civ. App.--Dallas 1977, no writ) (compensation for disability for a period after divorce is not community even though the injury may have occurred when the parties were married). *Accord*, *Bonar v. Bonar*, 614 S.W.2d 472, 473 (Tex. Civ. App.--El Paso 1981, writ ref'd n.r.e.) ("The law of the State is clear that workers' compensation benefits received after a divorce are not community property, even in those instances where the injury was received during the marriage").

This holding has been codified effective September 1, 2005 in Texas Family Code § 3.008(b). The statute provides in relevant part:

> § 3.008 (b). If a person becomes disabled or is injured, any disability insurance payment or workers' compensation payment is community property to the extent it is intended to replace earnings lost while the disabled or injured person is married. To the extent that any insurance payment or workers' compensation payment is intended to replace earnings while the disabled or injured person is not married, the recovery is the separate property of the disabled or injured spouse.

Workers' comp. claims may also include an award for medical expenses. In *Graham v. Franco*, 488 S.W.2d 390, 396 (Tex. 1972), the Supreme Court said that a recovery for medical and related expenses incurred during marriage belongs to the community, since the community is responsible for these expenses. Under this analysis, medical payments recovered in a comp. claim would belong to the community, to the extent that the community estate was liable for them.

According to *York v. York*, 579 S.W.2d 24, 26 (Tex. Civ. App.--Beaumont 1979, no writ), workers' comp. benefits received during marriage are presumed to be community property, and the burden is on the spouse asserting a separate property interest to establish what portion of the workers' comp. award is separate property.

In *Hicks v. Hicks*, 546 S.W.2d at 74, the husband's comp. claim was pending and unsettled at the time of divorce. The appellate court held that, in a post-divorce partition suit regarding the comp. claim settled after divorce, the *non-injured* spouse has the burden to show what part of the comp. claim was community property. One commentator has suggested that the burden of proving the existence of undivided community property is on the spouse seeking to recover an interest in such property. Smith, *Characterization of Property*, 1 KAZEN, FAMILY LAW AND PROCEDURE § 11.21 (1990).

b. Under Federal Law. In *Bonar v.*

Bonar, 614 S.W.2d 472 (Tex. Civ. App.--El Paso, writ ref'd n.r.e.), the ex-wife brought a partition case, arguing that her ex-husband's federal comp. award was community property, even though her ex-husband's injury occurred after divorce, because the right to receive the award constituted an earned property right which accrued by reason of the husband's employment during marriage, and because the ex-husband had elected to receive the comp. benefits in lieu of disability retirement, a portion of which had been awarded to the ex-wife in their divorce. The El Paso Court of Civil Appeals indicated that benefits under the Federal workers' comp. statute were divisible in a Texas divorce only to the extent the award represented lost earning capacity during marriage.

In contrast, in *Anthony v. Anthony*, 624 S.W.2d 388 (Tex. App.--Austin 1981, writ dism'd), the appellate court held that federal workers' compensation benefits were not analogous to Texas workers' compensation benefits, in that the federal benefits were funded out of the wages of the worker, and served as a substitute for Civil Service Disability Retirement benefits, whereas Texas workers' comp. benefits are unrelated to retirement rights, and do not replace them, and are not paid out of a fund created with the wages of the worker. In *Anthony*, the appellate court held that federal worker's comp. benefits were divisible in the same manner as retirement benefits or disability retirement benefits.

If *Bonar* is correct, then federal workers' comp. benefits will be treated just like Texas workers' comp. benefits. If *Anthony* is correct, then federal workers' comp. benefits will be treated like retirement benefits.

4. Contractual Disability Payments The courts have applied the inception of title rule to contractual disability payments, in contrast to the treatment of wages, retirement benefits, and state workers' compensation benefits. In *Simmons v. Simmons*, 568 S.W.2d 169 (Tex. Civ. App.--Dallas 1978, writ dism'd), where the right to receive disability benefits arose incident to employment during marriage, that right, and any benefits received, whether during marriage or after divorce, were held to be community property. *Accord*, *Andrle v. Andrle*, 751 S.W.2d 955, 955-56 (Tex. App.--Eastland 1988, writ denied) (disability insurance policy purchased with community funds gave rise to community payments, even after divorce; they are not separate property on the theory that they replace post-divorce income); *Copeland v. Copeland*, 544 S.W.2d 183 (Tex. Civ. App.--Amarillo 1976, no writ) (disability retirement benefits were not an award of damages but rather a property right earned during marriage). In *Rucker v. Rucker*, 810 S.W.2d 793, 794-95 (Tex. App.--Houston [14th Dist.] 1991, writ denied), the divorce decree awarded wife a portion of husband's police department retirement benefits. Six years after the divorce, ex-husband became disabled and started receiving disability benefits. Ex-wife was entitled to her portion of these benefits, because they were in the nature of retirement benefits.

Under new § 3.008(b) this result would likely be different. §3.008(b) provides as follows:

> § 3.008 (b). If a person becomes disabled or is injured, any disability insurance payment or workers' compensation payment is community property to the extent it is intended to replace earnings lost while the disabled or injured person is married. To the extent that any insurance payment or workers' compensation payment is intended to replace earnings while the disabled or injured person is not

married, the recovery is the separate property of the disabled or injured spouse.

P. Contractual Rights

1. Private Life Insurance *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App.--Waco 1963, writ ref'd), held that the inception of title rule applies to life insurance. The court rejected the so-called "apportionment method," under which the character of the policy would be directly proportional to the amount of premiums paid by each marital estate. *Accord Pritchard v. Snow*, 530 S.W.2d 889, 893 (Tex. Civ. App.--Houston [1st Dist.] 1975, writ ref'd n.r.e.). *Camp v. Camp*, 972 S.W.2d 906, (Tex. App. – Corpus Christi 1998, pet. denied).

2. Casualty Insurance While one would think that a community property casualty insurance policy would give rise to community funds upon a casualty loss, one case says that the insurance proceeds have the character of the asset insured, regardless of the character of the policy. *Rolator v. Rolator*, 198 S.W. 391, 393 (Tex. Civ. App.--Dallas 1917, no writ). Followed by *Ginsberg v. Goldstien*, 404 So2d 1098 (Fla. 3d DCA 1981); *Smith v. Eagle Star Insurance Co.*, 370 S.W.2d 448 (Tex. 1963).

This holding has now been codified in § 3.008 which provides in relevant part:

> § 3.008(a) Insurance proceeds paid or payable that arise from a casualty loss to property during marriage are characterized in the same manner as the property to which the claim is attributable.

Q. Federal Military Insurance

1. National Service Life Insurance Military personnel can obtain insurance pursuant to the National Service Life Act, 38 U.S.C.A. § 1901 et seq. (West 2005). That statute contains nonassignability language that has been held to preempt the power of state courts to award the insurance coverage to the non-military spouse in a divorce. *See Kamel v. Kamel*, 721 S.W.2d 450, 453 (Tex. App.--Tyler 1986, no writ) (improper for court to award 60% of cash value of National Service Life Insurance policy to other spouse, due to preemption). Followed by: *Belt v. Belt*, 398 N.W.2d 737 (ND 1987).

2. Servicemen's Group Life Insurance In *Ridgway v. Ridgway*, 454 U.S. 46, 102 S.Ct. 49, 70 L.Ed.2d 39 (1981), the U.S. Supreme Court held that provisions of the Servicemen's Group Life Insurance Act of 1965, giving an insured service member the right to freely designate and alter the beneficiaries named under the life insurance contract, prevail over and displace a constructive trust for the benefit of the service member's children imposed upon the policy proceeds by a state court divorce decree. *See* 38 U.S.C.A. §§ 1965 et seq. (West 2005). *Prudential Ins. Co. of America v. Goodman*, 895 F. Supp. 137 (S.D. Tex. 1995).

R. Money Loaned A debt for money loaned by a spouse before marriage is separate property. The character of a loan made during marriage depends on the character of the funds loaned. *See Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--El Paso 1981, no writ) (a claim against a third party existing on the day of marriage is separate property). *Mortenson v. Trammell*, 604 S.W.2d 269, 275-76 (Tex. Civ. App.--Corpus Christi 1980, writ ref'd n.r.e.) (where wife borrowed $ 3,500 using her separate credit and loaned the money to her daughter, the loan owed by the daughter was wife's separate property). In *Snider*, proof that during marriage credits exceeded debits to the balance of the debt successfully proved separate

character to the extent of the balance on date of marriage. *Id.* Of course, interest earned on a debt during marriage is community property.

S. Crops, Timber, Livestock, Etc. Crops grown during marriage, even on separate property land, are community property: *DeBlane v. Hugn Lynch & Co.*, 23 Tex. 25 (1859); *Coggin v. Coggin*, 204 S.W.2d 47, 52 (Tex. Civ. App.--Amarillo 1947, no writ); *McGarrangh v. McGarrangh*, 177 S.W.2d 296, 300 (Tex. Civ. App.--Amarillo 1944, writ dism'd). Timber produced from trees grown on separate real property is community property: *White v. Lynch & Co.*, 26 Tex. 195 (1862).

> Example 12
>
> Husband sold land before marriage, taking back a promissory note and deed of trust. Some years into marriage, the buyer defaults and Husband forecloses on the property, buying it in at the sale for the amount due on the note, including principal and unpaid interest earned during marriage. Since Husband's inception of title to the land (i.e., the deed of trust) arose prior to marriage, would the land be his separate property? Or would the land be a mixture of separate and community property, in proportion to the unpaid principal vs. unpaid interest as of the date of purchase in foreclosure? Would the answer be different if the property were sold for cash to a third party, and the proceeds paid to Husband?

McElwee v. McElwee, 911 S.W.2d 182 (Tex. App. – Houston [1st Dist.] 1995, writ ref'd].Bricks produced from a spouse's separate property are community property: *Craxton, Wood & Co. v. Ryan*, 3 Willson 439 (Tex. Ct. App. 1888). Offspring of livestock born during marriage are community property: *Blum v. Light*, 81 Tex. 414, 16 S.W. 1090, 1092 (1891); *Gutierrez v. Gutierrez*, 791 S.W.2d 659, 665 (Tex. App.--San Antonio 1990, no writ) (offspring of separate property cattle is community property; over time, heard became commingled); *Beaty v. Beaty*, 186 S.W.2d 88, 90 (Tex. Civ. App.--Eastland 1945, no writ).

T. Gains and Acquets Another way of looking at community property is the principle that property which is the fruit of the work, efforts, or labors of the spouses is community property, and property acquired otherwise is separate property. In *Norris v. Vaughan*, 152 Tex. 491, 260 S.W.2d 676, 682 (1953), the Court reiterated its statement in the *DeBlane* case:

> The principle which lies at the foundation of the whole system of community property is, that whatever is acquired by the joint efforts of the husband and wife, shall be their common property.

This is the so-called "affirmative test; i.e., that property is community which is acquired by the work, efforts or labor of the spouses or their agents, as income from their property, or as a gift to the community. Such property, acquired by the joint efforts of the spouses, was regarded as acquired by 'onerous title' and belonged to the community." *Graham v. Franco*, 488 S.W.2d 390, 392 (Tex. 1972).

Example 13
Wife buys a lottery ticket using $ 1.00 of separate property money. She wins. Are the winnings her separate or community property? According to *Dixon v. Sanderson*, 72 Tex. 359, 10 S.W. 535, 536 (1888), the winnings are community property. *Accord, Stanley v. Riney*, 907 S.W.2d 636 (Tex. App. – Tyler 1998, no writ).

U. Unincorporated Business

1. Generally "The increase from a spouse's operation of a business always has been considered community property, even when the business itself was owned by one spouse prior to the marriage and thus was the separate property of that spouse." *Vallone v. Vallone*, 644 S.W.2d 455, 462 (Tex. 1982) (Sondock, J., dissenting). *Accord, Zisblatt v.* Zisblatt, 693 S.W>2d 944 (Tex. App. – Fort Worth 1985, writ dism'd). See *Epperson v. Jones*, 65 Tex. 425 (1886). In *Epperson*, the Supreme Court held that profits from the operation of a business are "community property, and cannot, therefore, be said to increase ... [spouse's] separate estate to the extent of a single dollar." *Id.* at 428. *See Moss v. Gibbs*, 370 S.W.2d 452 (Tex. 1963); *Hardee v. Vincent*, 136 Tex. 99, 147 S.W.2d 1072 (Tex. 1941); *Smith v. Bailey*, 66 Tex. 553, 1 S.W. 627 (1886); *Cleveland v. Cole*, 65 Tex. 402 (1885); *Green v. Ferguson*, 62 Tex. 525 (1884). "[U]nder the laws, the services of the family are always to be rendered for the benefit of the community, and not for its individual members . . . ." *Yates v. Houston*, 3 Tex. 433, 455 (1848). In *DeBlane v. Hugh Lynch & Co.*, 23 Tex. 25, 29 (1859), the Supreme Court said:

> The principle which lies at the foundation of the whole system of community property is, that whatever is acquired by the joint efforts of the husband and wife, shall be their common property.

2. Labor Applied to Separate Property Assets When a spouse takes a separate property asset and works it with community labor to the degree that it is significantly enhanced in value, old cases say that the end product may be transmuted into community property. For example, in *Craxton, Wood & Co. v. Ryan*, 3 White & W 439 (Tex. Ct. App. 1888), the wife made a business of working her separate property clay soil into bricks. The bricks were held to be community property. Similarly, in *DeBlane v. Hugh Lynch & Co.*, 23 Tex. 25 (1859), the wife grew crops on her separate property land, using her separate property slaves. The crops were held to be community property. Again, in *White v. Hugh Lynch & Co.*, 26 Tex. 195 (1862), where a wife took trees from her separate property land and worked them into sawed lumber, the sawed lumber was held to be community property.

Example 14
Are all of the proceeds from the enterprise community property, or only the *profits* from the sale of the separate property materials?

3. Mercantile Business With Inventory In an unincorporated mercantile business the inventory and equipment owned by the spouse on the day of marriage is his/her separate property. The *profit* from the sale of the inventory is community. That means that the portion of the receipts representing a return of the cost of goods sold is separate property. *See Yaklin v. Glusing, Sharpe & Krueger*, 875 S.W.2d 380, 385 (Tex. App.--Corpus Christi 1994, no writ) (in an unincorporated used car dealership, of the $ 3.3 million in outstanding promissory notes, only the *profit* in the notes was community property). *Meshwert v. Meshwert*, 543 S.W.2d 877, 879 (Tex. Civ. App.--Beaumont 1976) (profits from heating and air conditioning business were community property), *aff'd*, 549 S.W.2d 383 (Tex. 1977). *Farrow v. Farrow*, 238 S.W.2d 255 (Tex. Civ. App.--Austin 1957, no writ) (when husband thoroughly documented receipts and expenditures connected with buying and selling real estate and livestock, separate funds of both spouses commingled in accounts with business receipts did not lose their separate identity).

4. Professional Practice The earnings from a married professional's practice are community property. *Hopf v. Hopf*, 841 S.W.2d 898, 900 (Tex. App.--Houston [14th Dist.] 1992, no writ) (CPA's practice). Business equipment, inventory, furnishings, and other items of the business on hand at the time of divorce are presumptively community property, and will be divisible unless traced. *Hopf*, 841 S.W.2d at 900.

5. Personal Goodwill Personal goodwill of a professional is not community property that can be divided upon divorce. *Nail v. Nail*, 486 S.W.2d 761, 764 (Tex. 1972). Goodwill in a professional business is not considered part of the marital estate unless it exists independently of the professional's skills, and the estate is otherwise entitled to share in the asset. *See Hirsch v. Hirsch*, 770 S.W.2d 924, 927 (Tex. App.--El Paso 1989, no writ); *Finn v. Finn*, 658 S.W.2d 735, 740-41 (Tex. App.--Dallas 1983, writ ref'd n.r.e.). Goodwill in a professional corporation which exists independently of a professional's personal skills may be subject to division. *Finn*, 658 S.W.2d at 740-41; *Geesbreght v. Geesbreght*, 570 S.W.2d 427, 435-36 (Tex. Civ. App.--Fort Worth 1978, writ dism'd). Some courts have expressed reluctance in following the rule set forth in *Nail*. See *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. App. – Corpus Christi 1992, writ denied).

6. Commercial Goodwill and the Applicability of Buy-Sell Agreements in a Divorce A split in the Courts of Appeal has left conflicting opinions on the effect of Buy-Sell Agreements on commercial goodwill during a divorce. Compare *Finn v. Finn*, 658 S.W.2d 735 (Tex. App. – Dallas, 1983, writ ref'd n.r.e.) (Court held that a law firms commercial goodwill was not divisible upon divorce because the partnership agreement does not provide any compensation for accrued goodwill to a partner who ceases to practice law with the firm, nor does it provide any mechanism to realize the value of the firm's goodwill) with *Keith v. Keith*, 763 S.W.2d 950 (Tex. App. – Fort Worth 1989, no writ) (Court held that the formula set forth in the partnership agreement with respect to death or withdrawal of the partner is not necessarily determinative of a spouses interest in the ongoing partnership as of the time of trial in a divorce.)

The issue framed before the Court in *R.V.K. v. L.L.K.*, 103 S.W.3d 612 (Tex. App. – San Antonio 2003, no pet.) concerned the valuation of a medical practice and whether the court should follow *Finn* or *Keith* in determining whether a buy/sell agreement controls the valuation of stock. *Id* at 617. The Court in a plurality opinion ducked the question of whether to follow *Keith* or *Finn* because the

parties differences in valuation did not concern commercial goodwill. The plurality opinion reversed and remanded in finding that the trial court failed to consider the buy/sell agreement a significant restriction on the marketability of the stock. *Id* at 619. In doing so, the Court expressly noted that the divorce had not triggered the buy/sell agreement. *Id*. at 618. The Court simply felt that the only expert to testify in the case had overvalued the medical practice.

Justice Opez wrote both a concurring and a dissenting opinion. Justice Opez agreed with the dissent that the Court should address *Finn* or *Keith*, and further agreed the Court should follow *Keith*. *Id*. At 619. Justice Opez concurred that the case should be remanded; but because the court had valued the medical practice too low. "I do not believe it was appropriate for the trial judge to select a thirty percent minority discount absent expert testimony that a minority discount should apply and what that minority discount should be for the particular entity. *Id*. at 621.

The dissenting opinion authored by Justice Marion, joined by Justice Stone would have affirmed the trial court ruling. The dissent further stated that the Court should follow *Keith* and "Hold that the value of R.V.K.'s interest should be based on the present value of the entities as ongoing businesses, which would include such factors as limitations associated with the buy/sell agreement and consideration of commercial goodwill." *Id*. The dissent narrowly framed the issue stating "The only issue on appeal is whether the formula in the buy/sell agreement controlled valuation of the parties interest in the medical practice group. *Id*. at 622. The dissent in affirming the trial court stated the trial court had properly applied a thirty percent minority discount to the value of the medical group.

7. Incorporating a Going Business A spouse who incorporates a going business cannot argue that inception of title in the corporation arose with the unincorporated business. *Allen v. Allen*, 704 S.W.2d 600, 604 (Tex. App.--Fort Worth 1986, no writ). A corporation comes into existence when the Secretary of State issues a certificate of incorporation. The character of the stock depends upon the consideration furnished to the corporation in exchange for the stock (i.e., the character of the assets contributed during the formation of the corporation). *Id.* at 604. Tracing through the incorporation of a going business was successful in: *Vallone v. Vallone*,

618 S.W.2d 820 (Tex. Civ. App.--Houston [1st Dist.] 1981), rev'd on other grounds, 644 S.W.2d 455 (Tex. 1982); *In re Marriage of Morris*, 12 S.W.3d 877 (Tex. App. – Texarkana 2000, no pet.) ; *Marriage of York*, 613 S.W.2d 764, 769-70 (Tex. Civ. App.--Amarillo 1981, no writ). Tracing failed in *Allen*, 704 S.W.2d at 603-04; *Hunt v. Hunt*, 952 S.W.2d 564 (Tex. App. – Eastland 1997, no writ). Separate property capitalization of a new corporation was established in *Holloway v. Holloway*, 671 S.W.2d 51, 56-57 (Tex. App.--Dallas 1983, writ dism'd).

V. Partnership

1. Revised Partnership Act. The Texas Revised Partnership Act (TRPA) became effective on September 1, 1994, and replaced the long-standing Texas Uniform Partnership Act (TUPA). Under TRPA, a partnership is an entity separate and apart from the partners. TRPA art. 6132-b-2.01 (Partnership as Entity). In all but a few areas, the partnership agreement controls the relations of the partners. TRPA art. 6132b-1.03(a) & (b) (e.g. can't unreasonably restrict partner's right to look at books and records, can't eliminate duty of loyalty, etc.). Where the partnership agreement is silent, the TRPA applies. TRPA art. 6132b-1.03(a). TRPA applies to limited partnerships to the extent the Texas Revised Limited Partnership Act does not apply. TRLPA art. 6132a-1, §13.03(a). Conversions from general to limited partnerships, and mergers of partnerships, are discussed in TRLPA art. 6132-b, art. IX.

2. Partnerships, Community Property, and Divorce. A partnership interest can be community property, but specific assets of the partnership cannot, and the partner's right to participate in management cannot. TRPA art. 6132b, §§4.01, 5.02(a), 5.03(a)(4). *In re SWEPI, L.P.*, 85 S.W.3d 800, 807 (Tex. 2002) ("in the Texas Revised Partnership Act, which applies to all partnerships after December 31, 1998, a partner is not a co-owner of partnership property"). The court in a divorce cannot award a community property partnership interest to the non-partner spouse. *McKnight v. McKnight*, 543 S.W.2d 863, 868 (Tex. 1976) (see below). The court can, however, give the non-partner spouse a community property assignee's interest in the partnership. (See below) Even where the spouse's partnership interest is community property, the court in a divorce cannot award specific partnership assets to the non-partner spouse. (See below).

Two recent cases say that you cannot "pierce the veil" of a partnership, like you can a corporation. *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n*, 77 S.W.3d 487, 499-500 (Tex. App.--Texarkana 2002, pet. denied) (see below); *Lifshutz v. Lifshutz*, 61 S.W.3d 511, 515 (Tex. App.--San Antonio 2001, pet. denied) (see below).

In proving the existence of a partnership, the mere fact of "co-ownership of property, whether in the form of joint tenancy, tenancy in common, tenancy by the entireties, joint property, community property, or part ownership, whether combined with sharing of profits from the property," by itself, does not indicate that a person is a partner in the business." TRPA art. 6132b-2.03.

3. Amendment of Partnership Agreement During Marriage The fact that the partners amend the partnership agreement during marriage does not establish that an interest in the partnership was acquired during marriage and is thus community property. Unless the partnership dissolved, the same partnership interest continues through the amendment. *See Harris v. Harris*, 765 S.W.2d 798, 803 (Tex. App.--Houston [14th Dist.] 1989, writ denied).

4. Profits Distributed From Partnership Partnership profits and surplus received by a partner during marriage is community property, regardless of whether the partnership interest is separate or community property. *Harris v. Harris*, 765 S.W.2d 798, 804 (Tex. App.--Houston [14th Dist.] 1989, writ denied); *Marshall v. Marshall*, 735 S.W.2d 587, 594 (Tex. App.--Dallas 1987, writ ref'd n.r.e.).

5. Limited Partnerships. The Texas Revised Limited Partnership Act (TRLPA). Art. 6132a-1, became effective on September 1, 1997. A partner has no interest in specific partnership property. TRLPA art. 6132-b-7.01. A partner's interest in a limited partnership can be assigned. TRLPA art. 6132-b-7.02. An assignee can become a limited partner (1) if the partnership agreement so provides, or (2) if all partners consent. TRLPA art. 6132-b-7.04(a). Permissible contributions to acquire an interest in a limited partnership including any tangible or intangible benefit to the limited partnership or other property of any kind or nature, including: cash; a promissory note; services performed; a contract for services to be performed; and interests in or securities of the limited partnership, or interests in or securities of any other limited partnership, domestic or foreign, or other entity. TRLPA art. 6132-b-5.01.

6. Statutes and Case Law.

a. Tex. Rev. Partnership Act art. 6132b-5.01. Partner's Interest in Partnership Property not Transferable

> A partner is not a co-owner of partnership property and does not have an interest that can be transferred, either voluntarily or involuntarily, in partnership property.

COMMENT OF BAR COMMITTEE--1993

This section provides that a partner is not a co-owner of partnership property and has no interest in partnership property that can be transferred, either voluntarily or involuntarily. This abolishes the TUPA § 25(1)'s concept of tenants in partnership and reflects the adoption of the entity theory of partnership. Partnership property is owned by the entity and not by the individual partners. This is consistent with Section 2.04, which states that partnership property is not property of the partners. TRPA also deletes the references contained in TUPA §§ 24 to 25 to a partner's "right in specific partnership property." Although Section 5.01 uses significantly different language and concepts from those of TUPA §§ 24 to 25, there is no significant substantive change from TUPA; the TRPA language primarily simplifies and clarifies the results under TUPA.

This section also has the effect of protecting partnership property from execution or other process by a partner's personal creditors. These creditors may seek to enforce any rights they may have against the partner's partnership interest, but not against partnership property.

A corollary of this section is that a partner's spouse has no community property right in partnership property, the same as in TUPA § 28-A(1).

b. Art. 6132b-5.02. Nature of Partner's Partnership Interest

(a) Personal Property. A partner's partnership interest is personal property for all purposes. A partner's partnership interest may be community property under applicable law.

(b) Certificate Evidencing Interest. * * *

COMMENT OF BAR COMMITTEE--1993

Subsection (a) states that a partner's partnership interest is personal property for all purposes (as in TUPA § 26) and retains the concept of TUPA § 28-A(2) that the partnership interest may be community property. The extent of a partner's partnership interest is defined in Section 1.01(12) and includes the partner's share of profits and losses, or similar items, and the right to receive distributions. A partner's partnership interest does not include the partner's right to participate in management of the partnership. It follows that a partner's right to participate in management is not community property, the same as in TUPA § 28-A(3)....

c. Art. 6132b-5.03. Transfer of Partner's Partnership Interest

(a) Act of Transfer. A transfer of a partner's partnership interest:

(1) is permissible, in whole or in part;
(2) is not an event of withdrawal;
(3) does not by itself cause a winding up of the partnership business; and
(4) does not, as against the other partners or the partnership, entitle the transferee, during the continuance of the partnership, to participate in the management or conduct of the partnership business.

(b) Basic Rights of Transferee. A transferee of a partner's partnership interest is entitled to receive, to the extent transferred, distributions to which the transferor otherwise would be entitled. After transfer, the transferor continues to have the rights and duties of a partner other than the interest transferred. Until a transferee becomes a partner, the transferee does not have liability as a partner solely as a result of the transfer. For a proper purpose the transferee may require reasonable information or an account of partnership transactions and make reasonable inspection of the partnership books.

(c) Rights of Transferee on Winding Up. If an event requires a winding up of partnership business under Section 8.01, a transferee is entitled to receive, to the extent transferred, the net amount otherwise distributable to the transferor. In a winding up

a transferee may require an accounting only from the date of the latest account agreed to by all of the partners.

> (d) Notice to Partnership. Until receipt of notice of a transfer, a partnership does not have a duty to give effect to a transferee's rights under this section.
>
> (e) No Effect if Prohibited. A partnership does not have a duty to give effect to a transfer, assignment, or grant of a security interest prohibited by a partnership agreement.

d. Tex. Rev. Partnership Act art. 6132b-5.04. Effect of Death or Divorce on Partnership Interest

> (a) Divorce. On the divorce of a partner, the partner's spouse, to the extent of the spouse's partnership interest, shall be regarded for purposes of this Act as a transferee of the partnership interest from the partner.
>
> (b) Death of Partner. On the death of a partner, the partner's surviving spouse, if any, and the partner's heirs, legatees, or personal representative, to the extent of their respective partnership interests, shall be regarded for purposes of this Act as transferees of the partnership interests from the partner.
>
> (c) Death of Partner's Spouse. On the death of a partner's spouse, the spouse's heirs, legatees or personal representative, to the extent of their respective partnership interests, shall be regarded for purposes of this Act as transferees of the partnership interest from the partner.
>
> (d) Event Involving Partner's Spouse not Withdrawal. An event of the type described in Section 6.01 occurring with respect to a partner's spouse is not an event of withdrawal.
>
> (e) No Impairment of Purchase Rights. This Act does not impair an agreement for the purchase or sale of a partnership interest at the time of death of the owner of the partnership interest or at any other time.

e. ***McKnight v. McKnight***, 543 S.W.2d 863, 868 (Tex. 1976):

> The trial court detailed a division of the partnership cattle between the husband and wife and awarded the wife one-half of the partnership bank account. The court of civil appeals held the award violated the Act. . . . [W]e think the court of civil appeals was correct in its application of the Act . . . .

f. Alter Ego Not Applicable to Partnership.

Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n, 77 S.W.3d 487, 499-500 (Tex. App.--Texarkana 2002, pet. denied):

> Pinebrook Properties, Ltd., a Texas limited partnership, owns the lake, dam, roadways, and recreational areas at issue in this case. Pinebrook Properties

Management, L.L.C., a Texas limited liability company, is the general partner of Pinebrook Properties. Musgrave is the president and general managing partner of Pinebrook Management.

> The trial court erred in its application of law. The theory of alter ego, or piercing the corporate veil, is inapplicable to partnerships. Under traditional general partnership law, each partner is liable jointly and severally for the liabilities of the partnership. The Texas Legislature has altered this general scheme and statutorily created limited partnerships which are governed by the Texas Revised Limited Partnership Act (TRLPA). Tex. Rev. Civ. Stat. Ann. art. 6132a 1, § 1.01, et seq. (Vernon Supp.2002). Under TRLPA, "a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to persons other than the partnership and the other partners." Tex.Rev.Civ. Stat. Ann. art. 6132a-1, § 4.03(b). Under the Texas Revised Partnership Act, "all partners are liable jointly and severally for all debts and obligations of the partnership...." Tex.Rev.Civ. Stat. Ann. art. 6132b-3.04 (Vernon Supp.2002). Therefore, in a limited partnership, the general partner is always liable for the debts and obligations of the partnership. Limited partners are not liable for the obligations of a limited partnership unless the limited partner is also a general partner or, in addition to the exercise of the limited partner's rights and powers as a limited partner, the limited partner participates in the control of the business. However, if the limited partner does participate in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based on the limited partner's conduct, that the limited partner is a general partner. Tex.Rev.Civ. Stat. Ann. art. 6132a-1, § 3.03(a).
>
> Under corporation law, officers and shareholders are not liable for the actions of the corporation absent an independent duty. *Leitch v. Hornsby*, 935 S.W.2d 114, 117 (Tex.1996). Because officers and shareholders may not be held liable for the actions of the corporation, the theory of alter ego is used to pierce the corporate veil so the injured party might recover from an officer or shareholder who is otherwise protected by the corporate structure. Alter ego is inapplicable with regard to a partnership because there is no veil that needs piercing, even when dealing with a limited partnership, because the general partner is always liable for the debts and obligations of the partnership to third parties. The trial court erred in finding Pinebrook Properties is the alter ego of Musgrave.

g. Can't Pierce Partnership Veil; ***Lifshutz v. Lifshutz***, 61 S.W.3d 511, 515 (Tex. App.--San Antonio 2001, pet. denied):

> Liberty Properties Partnership argues piercing is not appropriate for a partnership. Under the Texas Revised Uniform Partnership Act, a trial court may not award specific partnership assets to the non-partner spouse in the event of a divorce. TEXAS REVISED PARTNERSHIP ACT, Tex.Rev.Civ. Stat. Ann., art. 6132b-5.01, -5.02, -5.03, -5.04 (Vernon Supp.2001); *McKnight v. McKnight*, 543 S.W.2d 863, 867-68 (Tex.1976). The trial court may only award the spouse an interest in the partnership. Kymberly argues as a matter of policy that a partnership should be treated the same as a corporation. However, the comment of the bar committee to section 6132b-5.01 specifically notes the statute incorporates the limitation that "a partner's spouse has no community property right in partnership property." [FN6] Tex.Rev.Civ. Stat. Ann. art. 6132b-5.01 cmt. Because legislative intent is clear and the Texas Supreme Court has followed that dictate, we hold the trial court improperly pierced Liberty Properties Partnership.
>
> FN6. The statute reads: "A partner is not a co-owner of partnership property and does not have an interest that can be transferred, either voluntarily or involuntarily, in partnership property." Tex.Rev.Civ. Stat. Ann ., art. 6132b-5.01; see also Tex.Rev.Civ. Stat. Ann., art. 6132b-5.04 (in divorce, spouse is treated as transferee of partnership interest).

Example 15

Husband is partner before marriage. During marriage, Partnership liquidates a building owned by the partnership at the time of Husband's marriage. The proceeds from that liquidation are distributed to the partners. Are those distributions community property despite the fact that they are not profits?

W. Separate Property Corporation If a spouse owns stock in a corporation at the time of marriage, the stock is that spouse's separate property. *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ). Any increase in value of the separate property corporation is the owning spouse's separate property, and the community estate has no ownership claim over that increase in value. *Jensen v. Jensen*, 665 S.W.2d 107, 109 (Tex. 1984). However, the community estate may have an equitable right of reimbursement if the increase in value is attributable to undercompensation of the spouse for labor during marriage. *Id.* at 110. *Gutierrez v. Gutierrez*, 791 S.W.2d 659 (Tex. App. – San Antonio 1990, no writ); *Lucy v. Lucy*, 162 S.W.3d 770 (Tex. App. – El Paso 2005, no pet. hist.). Assets distributed to shareholders upon liquidation of a separate property corporation are separate property. *See Hilliard*, 725 S.W.2d at 723 (husband did not provide the trial court with corporate minutes, deed or other evidence to support claim that assets received were in liquidation of separate property stock). Stock acquired during marriage is characterized according to the ordinary rules of characterization.

Example 16

Husband's separate property Corporation is a Subchapter S corporation, so that all corporate profits drop to his tax return, regardless of whether profits are distributed. Undistributed profits are accumulated during marriage, and at the time of divorce Wife claims that such undistributed profits, already taxed on their joint tax returns, are community property. Are they? Not according to *Thomas v. Thomas*, 738 S.W.2d 342, 344 (Tex. Civ. App.--Houston [1st Dist.] 1987, writ denied).

Example 17

Husband owns 1000 shares of Corporation X (a Nevada corporation) prior to marriage. Corporation X has a net value of $10,000,000.00. During the marriage, Corporation Y (a Texas corporation) is created. It is capitalized with $1,000.00 of community property and Husband is issued 1000 shares. Immediately following the creation of Corporation Y, Corporation Z (a Texas Corporation) is created. Husband exchanges his 1000 shares of Corporation X and 1000 shares of Corporation Y for 1000 shares of Corporation Z. How are the 1000 shares of Corporation Z characterized?

X. Separate Property Corporation (Corporate Veil Pierced)A corporation exists as a separate entity from its shareholders. However, this distinction can be ignored for certain purposes. The separate identity of a corporation will be ignored (i.e., the corporate veil pierced) where the corporation is the alter ego of the shareholder, and there is such a unity between the corporation and an individual that the separateness has ceased to exist. *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex. 1986); *Southwest Livestock & Trucking Co. v. Dooley*, 884 S.W.2d 805, 809 (Tex. App.--San Antonio 1994, writ denied).[50] The corporate veil will be pierced when there is such a unity that the separateness has ceased to exist and adherence to the fiction of separateness would, under the circumstances, sanction a fraud or promote injustice. *Southwest Livestock & Trucking Co. v. Dooley*, 884 S.W.2d at 809; *Humphrey v. Humphrey*, 593 S.W.2d 824, 826 (Tex. Civ. App.--Houston [14th Dist.] 1980, writ dism'd). *See Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App.--Fort Worth 1985, writ dism'd) (corporate veil pierced in a divorce).

Y. Transactions Involving Corporate Stock

1. Stock Splits Shares of stock acquired through stock splits have the same character as the original stock. *Harris v. Harris*, 765 S.W.2d 798, 803 (Tex. App.--Houston [14th Dist.] 1989, writ denied); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd).

2. Tracing Through Purchases and Sales In *Carter v. Carter*, 736 S.W.2d 775 (Tex. App.--Houston [14th Dist.] 1987, no writ), the parties married on December 7, 1974. Husband testified that in 1970 he received 159 shares of stock in MPI, a family-owned business, as a gift from his father. He corroborated this testimony by showing dividends reflected on his 1974 tax returns, coupled with his testimony that MPI declared dividends at the end of the year and paid them in the following year. In 1976, MPI was acquired by Stauffer Chemical Company, and husband received 4,645 shares of Stauffer in exchange for his MPI stock. In 1979, Stauffer had a 2-for-1 split, raising husband's shares to 9,290 in number. In 1981, husband sold 1,156 plus 1,000 shares of Stauffer, and expended the

proceeds. Husband acquired 166 shares of Stauffer stock as a Christmas gift from his father in 1981 which he later sold, and participated in six short sales in 1982 and 1983. The trial and appellate courts held that the stock was proven to be husband's separate property. In *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd), husband owned stock in a corporation prior to marriage. During marriage, that corporation merged with two other corporations to create yet another corporation. The court found that the new stock was husband's separate property--this despite the fact that he and the other owners of the old corporation put $ 200,000 into the merger.

> Example 17
> Husband and Friend each own 50% of Corporation at time of marriage. After some years, Friend decides to sell out to Husband. Instead of Husband buying Friend's stock, they agree that Corporation will redeem Friend's stock using retained earnings of Corporation. After the redemption, Husband owns 100% of corporation, but he still has only the shares of stock he owned prior to marriage. Is Husband's interest in the corporation all his separate property, or half separate and half community? Note that the *value* of Husband's 100% interest in the corporation after the redemption is worth the same as his 50% interest immediately prior to redemption.

Z. Securities Registered in Brokerage Account In *Estate of Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987), the Supreme Court considered several stock transactions inside a brokerage account. On the date of marriage, the husband had 200 shares of Texaco stock. That stock was later sold for $ 5,755.00, and on the same day 200 shares of City Investing stock were purchased for $ 5,634.00. The City investing stock was later sold for $ 6,021.00, and on that same day 200 shares of TransWorld stock were purchased for $ 6,170.00. $ 149.00 in cash was supplied to complete this purchase. The trial court found that the husband's tracing had failed. The Court of Appeals affirmed, on the grounds that the husband had shown merely the possibility that separate property could have been the source of funds for the purchases of stock. The Supreme Court reversed, holding that the presumption of community had been overcome *as a matter of law*. The Court said:

> [T]he petitioner has shown the chain of events leading from the Texaco stock to the TransWorld purchase and shown that no other transactions occurred on the days in question, which would have planted the seeds of doubt upon the possible source of the funds used to buy the stocks.

Id. at 666. Thus, judgment was *rendered* that the stock was husband's separate property.

Tracing failed in *Merrell v. Merrell*, 527 S.W.2d 250 (Tex. Civ. App.--Tyler 1975, writ ref'd n.r.e.), where the husband asserted a separate property interest in real property premised upon his use of the proceeds from sale of separate stock to purchase the land. The Court said:

> Appellant testified that he inherited some corporate stocks

from the estate of his mother, and that he sold stocks worth approximately $ 100,000.00, and that such funds were used to finance the purchase of the duplexes. Under the record we are unable to conclude that such funds were properly traced as appellant's separate property and not commingled with appellee's separate property or the community property.

> The record shows that appellant had many stock and bond transactions during the marriage. He bought and sold many shares of stock and some were bought short or on margin. Bonds were also bought on margin. Sometimes he would owe his brokerage firm several thousand dollars, and at other times he would have a credit with them.

Id. at 255.

Example 18

Wife has securities registered in "street name" down at her broker's office. She buys 100 shares of GM stock using her separate property. Later she buys 100 more shares of GM stock using community funds. Her brokerage house statements now reflect 200 shares of GM. Wife later sells 100 shares of GM stock. Did she sell her separate shares, the community shares, a pro rata amount of half of each, or some other mix? Assume now that the community shares were purchased on margin (i.e., using community credit), and that the proceeds from sale of the 100 shares were used to pay Wife's margin loan. If Wife's separate property shares are deemed sold, would the remaining 100 shares be community property with Wife's separate estate being entitled to reimbursement for paying a community debt?

AA. Tort Recovery for Injuries Prior to Marriage Recovery for a personal injury claim that arose prior to marriage would be the injured spouse's separate property, under Family Code § 3.001(1) (property owned or claimed by the spouse before marriage). Note, however, that under Family Code § 3.001(3) recovery for loss of earning capacity during marriage is not a spouse's separate property. Does that mean that a recovery for loss of earning capacity of a spouse who is injured and then marries becomes

partially community property upon marriage? But under Family Code § 3.002, community property can only be property acquired during marriage, so that if the claim arose prior to marriage, under the inception of title rule it could not be community property.

> Example 19
> Prior to marriage, Husband suffers permanent impairment of his right hand and arm in an automobile accident. He recovers a judgment for $ 750,000. $ 500,000 was to compensate for diminished earning capacity for the balance of his life. A year later, Husband marries. Is any portion of the $ 500,000 community property? What if the case had been settled before marriage for $ 200,000, plus $ 3,000 per month for life? What if the case is settled after marriage for the $ 750,000?

BB. Tort Recovery for Injuries During Marriage

1. Physical Pain and Mental Anguish (Past & Future) Under *Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972), and Section 3.001 of the Texas Family Code, a recovery for physical pain and mental anguish is separate property. TEX. FAM. CODE ANN. § 3.001 (Vernon 2005).

2. Loss of Consortium A spouse's recovery for loss of consortium (i.e., loss of the other spouse's affection, solace, comfort, companionship, society, assistance, and sexual relations necessary to a successful marriage) is the recovering spouse's separate property. *Whittlesey v. Miller*, 572 S.W.2d 665, 666 & 669 (Tex. 1978).

3. Loss of Services A recovery for loss of the other spouse's services (i.e., performance of household and domestic duties) is community property. *Whittlesey v. Miller*, 572 S.W.2d 665, 666 n. 2 (Tex. 1978).

4. Lost Earning Capacity A recovery for lost earning capacity during marriage is community property, and a recovery for lost earning capacity before marriage or after divorce is separate property. TEX. FAM. CODE ANN. § 3.001 (Vernon 2005). A panel of the Dallas Court of Appeals, in *Dawson v. Garcia*, 666 S.W.2d 254 (Tex. App.--Dallas 1984, no writ), interpreted this language to be an "all or none" proposition. That is, under the reasoning in *Dawson*, if the claim for lost earning capacity arises during marriage, it is *entirely* community property, and if it arises before marriage or after divorce it is *entirely* separate property. *Id.* at 267. Thus, the recovery was not prorated over time, as are retirement benefits or worker's compensation benefits.

An important realization eluded the panel of Justices in *Dawson*: in Texas, the character of employment income is not governed by the inception of title rule. Instead, employment is divided into components of time (typically monthly), and the income deriving from employment during that time period (be it immediate or deferred) is separate or community according to whether you are married or not during that time period.

5. Disfigurement (Past & Future) Under the reasoning of *Graham v. Franco*, and Section 3.001 of the Texas Family Code, a recovery for disfigurement is separate property.

6. Physical Impairment (Past & Future) Under the reasoning of *Graham v. Franco*, and Section 3.001 of the Texas Family Code, a recovery for physical impairment, past and future, is separate property.

7. Medical Expenses (Past & Future) Under *Graham v. Franco*, a recovery for medical expenses incurred during marriage is community property to the extent that the community estate has incurred liability for such expenses. *Graham v. Franco*, 488 S.W.2d at 396. *Accord*, *Gracia v. RC Cola-7-Up Bottling Co.*, 667 S.W.2d 517, 520 (Tex. 1984). By extension, a recovery for medical expenses incurred before marriage or after divorce should be separate property.

8. Exemplary Damages The Texas Supreme Court has held that a recovery of exemplary damages by a spouse for a wrong committed during marriage is community property. *Rosenbaum v. Texas Building & Mortgage Co.*, 140 Tex. 325, 167 S.W.2d 506, 508 (1943). *See generally* Hennis, *Punitive Damages: Community Property, Separate Property, or Both*, 14 COM. PROP. J. 51 (1987).

9. Injury to Child Any recovery for loss of earnings or earning capacity of a child during minority belongs to the parents. TEX. FAM. CODE ANN. § 151.001(5) (Vernon Supp. 2005); *Bolling v. Rodriguez*, 212 S.W.2d 838, 841-42 (Tex. Civ. App.--Galveston 1948, writ ref'd n.r.e.). One case has said that such a recovery is the community property of the parents. *Hawkins v. Schroeter*, 212 S.W.2d 843, 845 (Tex. Civ. App.--San Antonio 1948, no writ). However, if a managing conservator has been appointed for the child, that conservator has the right to the services and earnings of the child. TEX. FAM. CODE ANN. § 153.132(7) (Vernon Supp. 2005). A recovery for loss of the child's consortium is also available. One case held that this recovery is separate property. *Williams v. Steves Industries, Inc.*, 678 S.W.2d 205, 211 (Tex. Civ. App.--Austin 1984), *aff'd*, 699 S.W.2d 570 (Tex. 1985). And the Supreme Court has held that a recovery for loss of spousal consortium is separate property. *Whittlesey v. Miller*, 572 S.W.2d 665, 669 (Tex. 1978).

10. Tracing the Personal Injury Claim Where a personal injury recovery is partly separate property and partly community property, the party claiming separate property must prove what portion of the recovery is separate and what portion is community. Tex. Fam. Code Ann. § 3.003(a) (Vernon 2005). Failing that, the presumption of community will cause the entire recovery to be treated as community property. See *Kyles v. Kyles*, 832 S.W.2d 194, 198 (Tex. App.--Beaumont 1992, no writ). *Licata v. Licata*, 11 S.W.3d 269 (Tex. App. – Houston [14th Dist.] 1999, no pet.). See McKnight, *Family Law*, 28 SW L J 66, 71-72 (1974), discussing a federal district court proceeding which found that sixty percent of the husband's personal injury recover was attributable to bodily loss, thirty percent to lost wages, earnings and earning capacity during marriage, and ten percent to future medical expenses.

CC. Contract Damages The character of contract damages is determined by the loss being compensated by the damages. For example, a claim for lost profits from a family business is community property. *Brazos Valley Harvestore Systems, Inc. v. Beavers*, 535 S.W.2d 797, 799 (Tex. Civ. App.--Tyler 1976, writ dism'd).

DD. Assets Held in Trust for Spouse

1. What is an "Express Trust"? An express trust is defined in the Texas Trust Code as a fiduciary relationship with respect to property "which arises as a relationship and

which subjects the person holding title to the property to equitable duties to deal with the property for the benefit of another." TEX. PROP. CODE ANN. § 111.004(4) (Vernon 2005). Literally speaking, under Texas property law, a trust is not an entity, like a corporation. It is a *relationship*, between an individual (i.e., the trustee) and certain property. Thus, it is not really accurate to talk about "commingling inside of a trust," or "the character of distributions from a trust." We should instead talk of the commingling of property held by a trustee, or the character of distributions by a trustee of property held in trust.

2. "Trust" Accounts. In Texas, the act of depositing funds in an account designated as a "trust account" for another person does not necessarily establish an express trust for the other person's benefit. Recitals on the bank signature card that the funds are held "in trust" for another are evidentiary only, and do not give rise to a presumption that a trust was intended. *Fleck v. Baldwin*, 141 Tex. 340, 172 S.W.2d 975, 978 (1943). In connection with a "trust account," the law requires that the settlor demonstrate the intent to create a trust "by a larger number of acts than in the case of an ordinary trust." *Frost Nat. Bank of San Antonio v. Stool*, 575 S.W.2d 321, 322 (Tex. Civ. App.--Beaumont 1978, writ ref'd n.r.e.). If a trust is found to have been intended, it is a revocable inter vivos trust, which terminates upon the death of the sole settlor/trustee and the proceeds are payable to the beneficiary. *See Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654, 657 (Tex. Civ. App.--Eastland 1978, writ ref'd n.r.e.) (involving certificate of deposit held "in trust"). However, such a trust does not become irrevocable upon the death of a single settlor where there are multiple settlors because there are purposes of the trust yet unfulfilled while any settlor is living. *Ayers v. Mitchell,* 167 S.W.3d 924, 931 (Tex. App.– Texarkana 2005) *reh'g overruled*.

3. Securities Held in Settlor's Name, "as Trustee" The rules discussed above for funds on deposit "in trust" for another also apply to securities held "in trust" for another. In *Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654 (Tex. Civ. App.--Eastland 1978, writ ref'd n.r.e.), the issue was whether the settlor/trustee intended to create a trust when she acquired a certificate of deposit in her own name, "as Trustee for" another person. The jury found, and judgment was rendered, that the settlor/trustee intended to establish a revocable trust for the benefit of the third person. The Court of Civil Appeals affirmed the judgment, finding that such an inter vivos revocable trust is permissible under Texas law, and that it becomes irrevocable and payable upon the death of the settlor/trustee. The Court also extended the rule to stock certificates held in the name of the purchaser in trust for another, where the purchaser so intends. As stated by the Court:

> The ultimate and controlling question is the intent of the purchaser. The recitals on the certificate that such is held "in trust" for another are evidentiary only, and do not give rise to a presumption that a trust was intended.

Id., at 658.

4. Undistributed Assets Held in Trust Are Not Marital Property According to the following cases, property held in trust for a spouse was not marital property: *Buckler v. Buckler*, 424 S.W.2d 514 (Tex. Civ. App.--Fort Worth 1967, writ dism'd) (undistributed income in a spendthrift trust not part of the estate of the parties, where distribution of such income was discretionary with the trustee); *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--

Texarkana 1978, writ dism'd) (undistributed income inside discretionary distribution trust not "acquired" by the spouse during marriage, and was therefore not part of the community estate); *Currie v. Currie*, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd) (property inside of discretionary distribution trust was not community property of the husband; property inside another trust, as to which husband was remainder beneficiary, was not "acquired" by the spouse, and was therefore not part of the community estate). *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App. – Corpus Christi 1997, no pet.). This is not so, however, when assets are voluntarily left with the trustee. *See In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ) (where one half of the corpus of the trust had passed to the husband free of trust, the income on that half of the corpus belonged to the community, despite the fact that the husband left that half in the hands of the trustee).

EE. Assets Distributed From Trust to Spouse

1. Where Spouse Creates Trust for His/Her Own Benefit Using Own Assets In *Mercantile National Bank at Dallas v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.), the Court held that the undistributed income of a trust created by wife for her own benefit, prior to marriage, is community property. *See In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd) (income on separate property corpus of trust created by spouse for his own benefit was community property to the extent it was received by husband); *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App. – Corpus Christi 1997).

2. Trust Funded by Gift or Devise There are a number of cases which say that income from a trust which was created in a separate property manner (i.e., by will or by gift) is received by the spouse/beneficiary as separate property. These cases do not address the question of whether a trust created by a spouse for his own benefit, using separate property, gives rise to separate or community income.

McClelland v. McClelland, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), is probably the most often quoted of these older cases. *McClelland*, which involved a testamentary trust created for the husband by his father, presented the issue as being a contest between the intent of the testator and community property claims of the wife. In *McClelland*, the intent of the testator won out. Thus, a monthly allowance paid by the trustee to the husband, pursuant to a provision in the will, as well as other discretionary distributions made by the trustee under the will, were held to be the husband's separate property. *See Sullivan v. Skinner*, 66 S.W. 680 (Tex. Civ. App. 1902, writ ref'd) (where wife received a life estate in land under her father's will, which provided that she was to receive the income for her sole and separate use, the rentals from the land were wife's separate property).

Several other old cases, involving a conveyance by one spouse into trust for the benefit of the other spouse, held that income from the property held in trust was also separate property. *See Hutchinson v. Mitchell*, 39 Tex. 488 (1873) ("We can find nothing in any of the Constitutions or laws of the state or republic which would prevent a man from declaring an express trust in favor of his wife, and giving her the exclusive use and enjoyment of all the rents, revenues and profits of the trust estate, provided there is no fraud in the transaction against creditors . . ."); *Shepflin v. Small*, 23 S.W. 432 (Tex. Civ. App.--El Paso 1893, no writ) (where husband and wife joined in conveyance of

wife's separate property to trustee, to collect the income and use it to support the wife and children, the income was withdrawn from the community estate).

In the case of *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-75 (Tex. App.--Amarillo 1994, no writ), the court of appeals without explanation treated a trust distribution from a testamentary trust as entirely separate property, even though the distribution included interest earned by the trust.

A more recent Tax Court case has reviewed the broad panorama of Texas cases on marital property law and trusts, and concluded that, where a trust is established by gift, the correct view is that distributions from the trust to a married beneficiary are the beneficiary's separate property, notwithstanding some authorities to the contrary. This occurred in *Wilmington Trust Co. v. United States*, 83-2 USTC (1983). The Court stated:

> It is concluded that, under the law of Texas, as developed and expounded by the Texas courts, the income derived during the marriage of [the spouses] from the seven trusts that are involved in the present case constituted the separate property of [the wife], and was not community property of [the spouses]. [The wife] never "acquired"--and she will never acquire--the corpus of any of these trusts. The corpus of each trust is to be held and controlled by the trustee or trustees during [the wife's] life-time, and, upon [the wife's] death, the corpus will pass to her issue. Accordingly, the corpus of each trust was not [the wife's] separate property, and the trust income was not from [the wife's] separate property.
>
> What [the wife] "acquired"--and what she used to purchase the stocks and establish the bank accounts that are involved in the litigation--was the income from the trust property. As the income resulted from the gifts made to trustees for [the wife's] benefit, the income necessarily constituted her separate property under section 15 of article XVI of the Texas Constitution.

Id. *See also Taylor v. Taylor*, 680 S.W.2d 645, 649 (Tex. App.--Beaumont 1984, writ ref'd n.r.e.) (trust distributions held to be separate property where trust instrument said that income of trust became part of the corpus and the parties had stipulated that corpus was separate property).

On the other hand, there are several cases suggesting that income on property held in trust is community property, even where the trust is established by gift or devise.

In *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ), the husband was the beneficiary of a trust created prior to marriage by his parents. Prior to the divorce, the husband's right to receive half of the corpus free of trust had matured, but the husband left that half in the hands of the trustee. The Court held that once the husband's right to receive half of the corpus matured, the income on such half began to belong to the community. However, the half of the corpus which emerged from trust was itself the husband's separate property, and the income on the other half of the corpus, which remained in trust, did not belong to the community since it still "belonged to the trust." It appears to have

been important to that last determination that the distribution of income was discretionary with the trustee. *Id.* at 718. *Long* can be read as tacitly agreeing that distributed income from a trust can be community property.

In *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd), the Court determined that undistributed income in several trusts was not community property because it had been neither received nor constructively received by the husband during marriage. This rule was applied not only to several trusts established for the husband by his parents and grandparents, but also to a trust established by the husband for himself, three months after marriage, using husband's separate property. The opinion suggests, albeit somewhat obliquely, that if the income from the trusts had been received by the husband, either actually or constructively, that the income would have been community property.

In *Commissioner of Internal Revenue v. Porter*, 148 F.2d 566 (5th Cir. 1945), the Fifth Circuit Court of Appeals concluded that income distributed from a trust established by the spouse's father was received by the spouse/beneficiary as community property. The Court said that while the income remained in the hands of the trustee, it was "protected," but once it was distributed it became subject to the "ordinary impact of the law."

In *Commissioner of Internal Revenue v. Wilson*, 76 F.2d 766 (5th Cir. 1955), the Fifth Circuit held that income from property held in trust for a married man was received by him as community property, although the corpus was not community property. However, some of the distributed trust income derived from royalties and bonuses on "separate property" corpus. Also, delay rentals were received by the trustee. According to the Fifth Circuit, the delay rentals would be community property, while the royalties and bonuses would not; therefore, whatever portion of the trust income could be shown to be derived from royalties and bonuses would be separate property when received by the beneficiary. This analysis required tracing of the distributions to income received by the trust. In this regard, the Court said:

> In the accounting, outlays by the trustee specially connected with [royalties] are to be considered, and also a fair proportion of the general expenses of the trust, so as to ascertain what part of the net payment to the beneficiaries really came from royalties.

Id. at 770. Proceeds from sale of trust assets was not an issue in the case.

3. Commingling Inside Trust In *McFaddin v. Commissioner*, 148 F.2d 570 (5th Cir. 1945), a tax case, a trust was created by the mother and father of the McFaddin children. The parents conveyed two large cattle ranches into trust, subject to the debts secured by the properties and further subject to an annual payment to the mother of $30,000 per year, payable from income or, if insufficient, from the corpus.

The Tax Court ruled that children who are beneficiaries of a trust, which is created by gift of their parents, hold that interest as separate property. The Tax Court further found that the rights of the beneficiaries did not attach to the gross income, but rather to the distributable net income, of the trust, and that the gross income of the trust used by the trustees to purchase additional property could not be community income of the beneficiaries. The Tax Court further held that the fact that the property was conveyed into trust subject to debts and liens did not convert what was otherwise a gift into a transfer for onerous

consideration. And oil royalties and bonuses distributed by the trustee remained the beneficiaries' separate property.

The Fifth Circuit agreed that the res of the trust was a gift, and thus separate property. *Id.* at 572. Therefore, the oil royalties, bonuses and profits from the sale of the land "came to" the McFaddin children as separate property, taxable as separate income.

Nonetheless, the Court held that property acquired by the trust during the beneficiaries' marriages was community because separate and community funds had been commingled within the trust. The Court stated:

> The theory of the Tax Court that none of the commingled property with which the after - acquired property was purchased was community property because, under the terms of the trust instrument, gross income was treated as corpus, the rights of the beneficiaries did not attach to gross income but only to the distributable net income, and the gross income used by the trustees was, therefore, not community property, will not at all do. The taxpayers were the beneficial owners of the trust properties, and every part and parcel of them, including income from them, belonged beneficially to them, either as separate or as community property, in the same way that it would have belonged to them had the property been deeded to the taxpayers and operated by themselves. The greater part of the normal income from the property during the years preceding the tax years in question was community income. When it was commingled in a common bank account with other funds of the trust so that the constituents had lost their identity, the whole fund became community; and when it was used by the trustees to purchase additional properties, those properties, taking the character of the funds which bought them, were community property. [footnotes omitted]

Id. at 573.

The Fifth Circuit Court of Appeals also rejected the Commissioner of Internal Revenue's argument that because the trusts were spendthrift trusts, they were in effect conveyances of income to the separate use of the beneficiaries. *Id.* at 574.

In sum, the *McFaddin* case stands for proposition that income received by a trust is community or separate by the same rules as would apply had the income been received outside of trust. And if those funds are commingled, then the separate corpus of the trust can be lost to the community, upon subsequent distributions to the beneficiaries.

This rule was applied to the gross income of the trust, not just to the distributable net income. *Id.* at 573. Since the gross income was commingled in trust bank accounts with separate property receipts, the whole fund became community property, and the subsequently-acquired property was community in nature, and the oil income therefrom was similarly community.

FF. Community Property Held by Spous-

es With Right of Survivorship TEX. CONST. art. XVI, § 15, and TEX. PROB. CODE ANN. § 451 (Vernon Supp. 2005), permit spouses to hold community property with a right to survivorship in the surviving spouse. *See* TEX. REV. CIV. STAT. ANN. art. 852a, § 6.09 (Savings and Loan Act provision permitting spouses to have survivorship accounts at savings and loan institutions). The Constitution says that the spouses "may agree in writing." The Probate Code says that an agreement between spouses creating a right of survivorship in community property "must be in writing and signed by both spouses." TEX. PROB. CODE ANN. § 452 (Vernon Supp. 2005). Upon death, the transfer to the surviving spouse occurs as a result of the agreement, and is not considered to be a testamentary transfer. *Id.* at § 454.

Example 20

Husband opens an IRA account using community funds, designating Wife as beneficiary to receive the contents upon Husband's death. Wife does not sign any of the IRA papers. Is this a valid survivorship arrangement? No, because the Constitution and statutes require a written agreement *between the spouses*, *signed by both spouses*.

GG. Assets Partitioned or Exchanged; Separate Property Income Agreement The Texas Constitution and the Texas Family Code permit spouses to partition community assets into separate assets, and to exchange the interest of one spouse in particular community property for the interest of the other spouse in other community property. Assets partitioned or exchanged in this manner become the separate property of the receiving spouse. TEX. CONST. art. XVI, § 15, TEX. FAM. CODE ANN. § 4.102 (Vernon 2005). The partition and exchange can be applied to community property on hand and community property to be acquired. *Id.* Persons about to marry can also partition and exchange community property to be acquired during marriage. TEX. CONST. art. XVI, § 15. The relevant Family Code provision regarding premarital agreements, being from a uniform law, does not expressly mention partition and exchange by premarital agreement. TEX. FAM. CODE ANN. § 4.102 (Vernon 2005). Additionally, spouses (not persons about to marry) can agree that income arising from separate property will be separate property of the owner. TEX. CONST. art. XVI, § 15, TEX. FAM. CODE ANN. § 4.103 (Vernon 2005).

Example 21

Part 1

Husband purchases a car on credit, with no agreement by the lender to look solely to Husband's separate estate for repayment. The car is therefore community property. After the car is acquired, the spouses enter into a partition agreement which, among other things, sets the car aside to Husband as his separate property. The car is now Husband's separate property, despite the fact that it was acquired with community credit.

Part 2

Assume the same facts, except that the parties agree by premarital agreement that all assets acquired through a note signed only by one spouse is partitioned to that spouse as his or her separate property. When the car is purchased by community credit, is it not received by the Husband as his separate property by virtue of partition?

HH. Funds Borrowed During Marriage

Debts contracted during marriage are presumed to be on the credit of the community, unless it is shown that the creditor agreed to look solely to the separate estate of the borrowing spouse for repayment. *Cockerham v. Cockerham*, 527 S.W.2d 162, 171 (Tex. 1975). And property purchased on credit during the marriage is community property unless there is an express agreement on the part of the lender to look solely to the purchasing spouse's separate estate for satisfaction of the debt. *Glover v. Henry*, 749 S.W.2d 502, 503 (Tex. App.--Eastland 1988, no writ).

In *Jones v. Jones*, 890 S.W.2d 471, 475-76 (Tex. App.--Corpus Christi 1994, writ requested), the appellate court overturned a jury finding of separate credit, because the record contained no evidence that the lender agreed to look solely to the borrowing spouse's separate estate for repayment.

In *Holloway v. Holloway*, 671 S.W.2d 51, 57 (Tex. App.--Dallas 1983, writ dism'd), an implied agreement of separate credit was inferred by the court where loan proceeds were deposited into an account designated as husband's separate property account, and husband alone signed the loan papers "Pat S. Holloway, Separate Property," and only husband's separate property was used as collateral.

In *Wierzchula v. Wierzchula*, 623 S.W.2d 730 (Tex. Civ. App.--Houston [1st Dist.] 1981, no writ), the court found an implied agreement, with the creditor, of separate credit where the husband had signed earnest money contract to buy a home prior to marriage, and had applied for credit prior to marriage, and the loan papers were in the husband's name alone, *despite* the fact that the note was signed by the husband *during marriage* and contained no terms restricting liability to the husband's separate estate.

In *Brazosport Bank of Texas v. Robertson*, 616 S.W.2d 363, 366 (Tex. Civ. App.--Houston [14th Dist.] 1981, no writ), the court held that a bank's loaning money to the wife over the husband's objection, where the note was signed by the wife alone and title to automobile taken in wife's name alone, constituted an implied agreement by the lender to look to wife alone for satisfaction of the debt.

In *Mortenson v. Trammell*, 604 S.W.2d 269, 275-76 (Tex. Civ. App.--Corpus Christi 1980, writ ref'd n.r.e.), the fact that the wife took a loan out in her name alone, and put up her separate property CD as collateral, was sufficient to support a jury finding of separate credit.

In *Broussard v. Tian*, 295 S.W.2d 405 (Tex. 1956), evidence that the down payment for land was made with the husband's separate property, and that all payments on the note secured by the land were also made with husband's separate property, and that the deed ran to husband alone, and that husband alone signed the note and deed of trust, and that the spouses were separated at the time of the transaction, and that the banker and husband discussed payment of the note with husband's separate property royalty income, was still not enough to support a jury finding of an agreement that the note would be paid out of the husband's separate estate.

A question arises whether such an agreement between the lender and the borrowing spouse can be proved by parol evidence. The Supreme Court expressly reserved judgment on that question in *Broussard v. Tian*, 295 S.W.2d 405 (Tex. 1956). *See Jones v. Jones*, 890 S.W.2d 471, 477 (Tex. App.--Corpus Christi 1994, writ requested) (Hinojosa, F.G., J., dissenting) (contents of promissory notes cannot be supplemented or varied by parol evidence of separate credit agreement without proof of

fraud, mistake, or accident).

II. Economic Contribution

A. General Considerations.

In 2001, the Legislature amended the Family Code by adding new Sections 3.401 through 3.410, eliminating "equitable interests" and creating in their stead a "claim for economic contribution" against a spouse's estate. The Legislature also added Family Code §7.007, which requires the court in a divorce to determine claims for economic contribution, and then to divide community property claims in a manner that is just and right, and order a claim for economic contribution in favor of a separate estate to be awarded to the owner of that estate. It would be unconstitutional under *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977), for the Legislature to purport to empower a trial court to take separate property of one spouse and give it to the other upon divorce. The economic contribution statute attempts to circumvent this prohibition by reaffirming the inception of title rule on the one hand while on the other hand making inroads in the rule by creating a claim for economic contribution that is tantamount to an ownership interest in the property which the trial court must award, *Eggemeyer* notwithstanding. Whether the distinction between a legal "taking" and an "equitable" taking has sufficient substance to withstand constitutional attack remains to be seen.

The scheme of economic contribution claims replaces the cost or enhancement model of equitable reimbursement, and instead substitutes a monetary claim, to be secured by a lien upon dissolution of marriage, for what amounts to pro rata "ownership" of the benefitted asset. This new approach is a radical departure from marital property reimbursement concepts, and it requires close attention.

The Family Code provisions governing economic contribution claims were again amended in 2003.

Some of the highlights of claims for economic contribution are as follows.

1. Economic contribution claims exist only as to debts secured by liens in property of another marital estate, not unsecured debts of another estate. TFC §3.402. Economic contribution claims also apply to property receiving capital improvements paid by another marital estate. *Id.* Economic contribution claims, when available and proven, supplant reimbursement claims for reimbursement. TFC §3.408(a).

2. If the property made the basis of an economic contribution claim is owned by a spouse at the time of marriage, the proponent of the claim must prove the value of the property on the date of the first economic contribution. Attorneys sometimes overlook getting this historical fair market value of the property.

3. The economic contribution claim is calculated as a fraction of the equity in the property on the date of divorce, or date of disposition. Thus, the economic contribution concept makes the contributing estate a sort of "partner" in ownership of the property. TFC §3.403(b)(1).

4. Economic contribution claims for paying debt includes only reduction in principal and not payment of interest. Economic contribution claims also do not include payment of property taxes or insurance. TFC §3.402(b).

5. Making "capital improvements" can give rise to a claim for economic contribution, but the term "capital improvements" is not defined. TFC §3.402(a)(6). Also, the measure of the economic contribution claim for making capital improvements is based on the cost of the improvements, and not any enhancement in value resulting from the improvements. TFC §3.402(a)(6). However, if capital improvements are financed during marriage by a loan secured by lien in the property, only the reduction in principal of the improvement loan is included in the claim for economic contribution. TFC §3.402(3) & (6). There appears to be a "gap" for capital improvements made to property by incurring debt that is not secured by lien in the property being improved. Those capital improvements do not fall under either TFC §3.402(3) or (6). Presumably a traditional reimbursement claim could be made, based on enhancement.

6. "Use and enjoyment" of property is not an offsetting benefit to a claim for economic contribution. TFC §3.403(e).

7. If the property giving rise to a claim for economic contribution is disposed of during marriage, the amount of the claim for economic contribution is fixed at the time the property is disposed of. TFC §3.403(b)(1).

8. A divorce court is required to impose a lien on property of the benefitted estate to secure a claim for economic contribution. This is not discretionary with the court. TFC §3.406(a). The lien is not restricted to the specific property benefitted, but can instead be placed on any other property of the benefitted estate, subject only to homestead protection of such assets. TFC § 3.406(c). This suggests that other exemption statutes in the Texas Property Code will not protect exempt property from such a lien.

9. The trial court must offset claims for economic contribution running between estates. TFC §3.407.

10. Marital property reimbursement principles still apply to payment of unsecured debt, and whenever someone fails to prove up an economic contribution claim. TFC §3.408(a). Economic contribution claims also do not apply to *Jensen* claims for undercompensation from a separate property corporation that is enhanced due to community labor. Tex. Fam. Code §3.408(b)(2). *See* Tex. Fam. Code §3.402(b)(2) (economic contribution does not include time, toil, talent or effort).

11. The statute does not say who must plead and prove offsetting benefits.

12. Reimbursement is not available for: (a) child support or alimony; (b) paying living expenses of a spouse or step-child; (c) contributing property of nominal value; (d) paying liabilities of nominal value; (e) paying student loans of a spouse. TFC §3.409.

B. Texas Family Code Provisions.

§3.401. Definitions

In this subchapter:

(1) "Claim for economic contribution" means a claim made under this subchap-

ter.

(2) "Economic contribution" means the contribution to a marital estate described by Section 3.402.

(3) "Equity" means, with respect to specific property owned by one or more marital estates, the amount computed by subtracting from the fair market value of the property as of a specific date the amount of a lawful lien specific to the property on that same date.

(4) "Marital estate" means one of three estates:

(A) the community property owned by the spouses together and referred to as the community marital estate;

(B) the separate property owned individually by the husband and referred to as a separate marital estate; or

(C) the separate property owned individually by the wife, also referred to as a separate marital estate.

(5) "Spouse" means a husband, who is a man, or a wife, who is a woman. A member of a civil union or similar relationship entered into in another state between persons of the same sex is not a spouse.

§3.402. Economic Contribution

(a) For purposes of this subchapter, "economic contribution" is the dollar amount of:

(1) the reduction of the principal amount of a debt secured by a lien on property owned before marriage, to the extent the debt existed at the time of marriage;

(2) the reduction of the principal amount of a debt secured by a lien on property received by a spouse by gift, devise, or descent during a marriage, to the extent the debt existed at the time the property was received;

(3) the reduction of the principal amount of that part of a debt, including a home equity loan:

(A) incurred during a marriage;

(B) secured by a lien on property; and

(C) incurred for the acquisition of, or for capital improvements to, property;

(4) the reduction of the principal amount of that part of a debt:

(A) incurred during a marriage;

(B) secured by a lien on property owned by a spouse;

(C) for which the creditor agreed to look for repayment solely to the separate marital estate of the spouse on whose property the lien

attached; and

(D) incurred for the acquisition of, or for capital improvements to, property;

(5) the refinancing of the principal amount described by Subdivisions (1)–(4), to the extent the refinancing reduces that principal amount in a manner described by the appropriate subdivision; and

(6) capital improvements to property other than by incurring debt.

(b) "Economic contribution" does not include the dollar amount of:

(1) expenditures for ordinary maintenance and repair or for taxes, interest, or insurance; or

(2) the contribution by a spouse of time, toil, talent, or effort during the marriage.

§ 3.403. Claim Based on Economic Contribution [as amended in 2003]

(a) A marital estate that makes an economic contribution to property owned by another marital estate has a claim for economic contribution with respect to the benefitted estate.

(b) The amount of the claim under this section is equal to the product of:

(1) the equity in the benefitted property on the date of dissolution of the marriage, the death of a spouse, or disposition of the property; multiplied by

(2) a fraction of which:

(A) the numerator is the economic contribution to the property by the contributing estate; and

(B) the denominator is an amount equal to the sum of:

(I) the economic contribution to the property owned by the benefitted marital estate by the contributing marital estate; and

(ii) the contribution by the benefitted estate to the equity in the property owned by the benefitted estate.

(b-1) The amount of the contribution by the benefitted marital estate under Subsection (b)(2)(B)(ii) is measured by determining:

(1) if the benefitted estate is the community property estate:

(A) the net equity of the community property estate in the property owned by the community property estate as of the date of the first economic contribution to that property by the contributing separate property estate; and

(B) any additional economic contribution to the equity in the property owned by the community property estate made by the benefitted community property estate after the date described

by Subdivision (A); or

(2) if the benefitted estate is the separate property estate of a spouse:

(A) the net equity of the separate property estate in the property owned by the separate property estate as of the date of the first economic contribution to that property by the contributing community property estate or the separate property estate of the other spouse; and

(B) any additional contribution to the equity in the property owned by the separate property estate made by the benefitted separate property estate after the date described by Subdivision (A).

(C) The amount of a claim under this section may be less than the total of the economic contributions made by the contributing estate, but may not cause the contributing estate to owe funds to the benefitted estate.

(D) The amount of a claim under this section may not exceed the equity in the property on the date of dissolution of the marriage, the death of a spouse, or disposition of the property.

(E) The use and enjoyment of property during a marriage for which a claim for economic contribution to the property exists does not create a claim of an offsetting benefit against the claim.

§3.404. Application of Inception of Title Rule; Ownership Interest Not Created

(a) This subchapter does not affect the rule of inception of title under which the character of property is determined at the time the right to own or claim the property arises.

(b) The claim for economic contribution created under this subchapter does not create an ownership interest in property, but does create a claim against the property of the benefitted estate by the contributing estate. The claim matures on dissolution of the marriage or the death of either spouse.

§3.405. Management Rights

This subchapter does not affect the right to manage, control, or dispose of marital property as provided by this chapter.

§3.406. Equitable Lien

(a) On dissolution of a marriage, the court shall impose an equitable lien on property of a marital estate to secure a claim for economic contribution in that property by another marital estate.

(b) On the death of a spouse, a court shall, on application for a claim of economic contribution brought by the surviving spouse, the personal representative of the estate of the deceased spouse, or any other person interested in the estate, as defined by Section 3, Texas Probate Code, impose an equitable lien on the property of a benefitted marital estate to secure a claim for economic contribution by a contributing marital estate.

(c) Subject to homestead restrictions, an equitable lien under this section may be imposed on the entirety of a spouse's property in the marital estate and is not

limited to the item of property that benefitted from an economic contribution.

§3.407. Offsetting Claims

The court shall offset a claim for one marital estate's economic contribution in a specific asset of a second marital estate against the second marital estate's claim for economic contribution in a specific asset of the first marital estate.

§3.408. Claim for Reimbursement

(a) A claim for economic contribution does not abrogate another claim for reimbursement in a factual circumstance not covered by this subchapter. In the case of a conflict between a claim for economic contribution under this subchapter and a claim for reimbursement, the claim for economic contribution, if proven, prevails.

(b) A claim for reimbursement includes:

(1) payment by one marital estate of the unsecured liabilities of another marital estate; and

(2) inadequate compensation for the time, toil, talent, and effort of a spouse by a business entity under the control and direction of that spouse.

(c) The court shall resolve a claim for reimbursement by using equitable principles, including the principle that claims for reimbursement may be offset against each other if the court determines it to be appropriate.

(d) Benefits for the use and enjoyment of property may be offset against a claim for reimbursement for expenditures to benefit a marital estate on property that does not involve a claim for economic contribution to the property.

§3.409. Nonreimbursable Claims

The court may not recognize a marital estate's claim for reimbursement for:

(1) the payment of child support, alimony, or spousal maintenance;

(2) the living expenses of a spouse or child of a spouse;

(3) contributions of property of a nominal value;

(4) the payment of a liability of a nominal amount; or

(5) a student loan owed by a spouse.

§3.410. Effect of Marital Property Agreements

A premarital or marital property agreement, whether executed before, on, or after September 1, 1999, that satisfies the requirements of Chapter 4 is effective to waive, release, assign, or partition a claim for economic contribution under this subchapter to the same extent the agreement would have been effective to waive, release, assign, or partition a claim for reimbursement under the law as it existed immediately before September 1, 1999, unless the agreement provides otherwise.

§7.007. Disposition of Claim for Economic Contribution or Claim for

Reimbursement

> (a) In a decree of divorce or annulment, the court shall determine the rights of both spouses in a claim for economic contribution as provided by Subchapter E, Chapter 3, and in a manner that the court considers just and right, having due regard for the rights of each party and any children of the marriage, shall:
>
> > (1) order a division of a claim for economic contribution of the community marital estate to the separate marital estate of one of the spouses;
> >
> > (2) order that a claim for an economic contribution by one separate marital estate of a spouse to the community marital estate of the spouses be awarded to the owner of the contributing separate marital estate; and
> >
> > (3) order that a claim for economic contribution of one separate marital estate in the separate marital estate of the other spouse be awarded to the owner of the contributing marital estate.
>
> (b) In a decree of divorce or annulment, the court shall determine the rights of both spouses in a claim for reimbursement as provided by Subchapter E, Chapter 3, and shall apply equitable principles to:
>
> > (1) determine whether to recognize the claim after taking into account all the relative circumstances of the spouses; and
> >
> > (2) order a division of the claim for reimbursement, if appropriate, in a manner that the court considers just and right, having due regard for the rights of each party and any children of the marriage.

JJ. Case Law. In *LaFrensen v. LaFrensen*, 106 S.W.3d 876, 879 (Tex. App.--Dallas 2003, no pet.), the appellate court described an economic contribution claim in the following terms:

> According to the family code, the amount of the claim is derived by multiplying the equity in the residence on the date of the divorce by a fraction. The fraction's numerator is the amount of the economic contribution by the community. Its denominator is equal to the sum of that same economic contribution, plus the equity in the residence on the date of the marriage, plus any economic contribution to the residence by the husband's separate estate. See Tex. Fam. Code § 3.403(b).

This description is now slightly

inaccurate because of the 2003 amendments to the Texas Family Code.

In *Langston v. Langston*, 82 S.W.3d 686, 689 (Tex. App.--Eastland 2002, no pet.), the court of appeals in dicta defended the constitutionality of imposing a lien in one spouse's separate property to secure an economic contribution claim, and later subjecting the property to foreclosure for failure to pay the claim. The court commented:

> The underlying but ultimate issue in this case is whether the imposition and foreclosure of an equitable lien against a spouse's separate property is tantamount to divesting that spouse of his separate property. It is not. Although a court cannot divest a spouse of his separate property, the trial court must impose an equitable lien on that spouse's separate property to secure the other spouse's claim for economic contribution. That lien, if not satisfied, is subject to foreclosure as any other judgment lien. [FN1]
>
> However, the court cannot abrogate the safeguards provided by the procedures to foreclose a judgment lien by directly divesting title to one's separate property and vesting title in another.

KK. Conclusion. This article attempts to provide a comprehensive guide to the characterization of marital property. The twenty-five rules provided are clearly not exhaustive but intended to provide a framework for the practitioner.

ENDNOTES

[2] *See Gutierrez v. Gutierrez*, 791 S.W.2d 659, 664 (Tex. App.--San Antonio 1990, no writ) (portion of rental payments belonging to husband's brother were not community property). Non-marital property includes professional goodwill *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972); Retained earnings in sub-chapter S, *Thomas v. Thomas*, 738 S.W.2d 382 (Tex. App. – Houston [1st Dist.] 1987, writ denied) and a variety of other items.

[3] The controlling definition of separate property is contained in the Texas Constitution, article 15, Section 15, which reads as follows:

> Sec. 15. Separate and community property of husband and wife
>
> Sec. 15. All property, both real and personal, of a spouse owned or claimed before marriage, and that acquired afterward by gift, devise or descent, shall be the separate property of that spouse; and laws shall be passed more clearly defining the rights of the spouses, in relation to separate and community property; provided that persons about to marry and spouses, without the intention to defraud pre-exist ing creditors, may by written instrument from time to time partition between themselves all or part of their property, then existing or to be acquired, or exchange between themselves the community interest of one spouse or future spouse in any property for the community interest of the other spouse or future spouse in other community property then existing or to be acquired, whereupon the portion or interest set aside to each spouse shall be and constitute a part of the separate property and estate of such spouse or future spouse; spouses also may from time to time, by written instrument, agree between themselves that the income or property from all or part of the separate property then owned or which thereafter might be acquired by only one of them, shall be the separate property

> of that spouse; if one spouse makes a gift of property to the other that gift is presumed to include all the income or property which might arise from that gift of property; and spouses may agree in writing that all or part of their community property becomes the property of the surviving spouse on the death of a spouse.

The Family Code definition of separate property comports with the constitutional definition, except that Section 3.001 says that "the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage" is separate property. TEX. FAM. CODE ANN. § 3.001 (Vernon 2005). This personal-injury related category of separate property, which is not in the Constitution, was validated in *Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972). Section 4.102 provides that "[p]roperty or a property interest transferred to a spouse by a partition or exchange agreement becomes his or her separate property." TEX. FAM. CODE ANN. § 4.102 (Vernon 2005).

[4] The definition of community property is set out in Section 3.002 of the Texas Family Code: "Community property consists of the property, other than separate property, acquired by either spouse during marriage." TEX. FAM. CODE ANN. § 3.002 (Vernon 2005).

[5] Property may be partly separate and partly community property, in proportion to the portion of the purchase price paid with separate and community property. *Gleich v. Bongio*, 99 S.W.2d 881, 883 (Tex. 1937). See State Bar of Texas Pattern Jury Charges PJC 202.16 (2002). In the case of *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-73 (Tex. App.--Amarillo 1994, writ denied), the court reviewed various descriptions of "mixed" ownership as being "pro tanto ownership," "equitable title," and "separate interest." The court felt that the most viable characterization of the interest of the spouse's separate estate in a mixed asset is one of "equitable title." *Id.* at 273. Tex. Fam. Code §3.006 Proportional Ownership of Property by Marital Estate (Vernon 2005).

[6] *Welder v. Lambert*, 91 Tex. 510, 22 S.W. 281, 284-86 (1898); *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 430 (Tex. 1970); *Saldana v. Saldana*, 791 S.W.2d 316, 319 (Tex. App.--Corpus Christi 1990, no writ), citing *Strong v. Garrett*, 148 Tex. 265, 224 S.W.2d 471 (1949).

[7] TEX. CONST. art. XVI, § 15; *Parnell v. Parnell*, 811 S.W.2d 267, 269 (Tex. App.--Houston [14th Dist.] 1991, no writ) (real estate owned by husband prior to marriage was his separate property); *Gutierrez v. Gutierrez*, 791 S.W.2d 659, 665 (Tex. App.--San Antonio 1990, no writ) (car purchased by husband prior to marriage was his separate property).

[8] *See Allen v. Allen*, 751 S.W.2d 567, 572 (Tex. App.--Houston [14th Dist.] 1988, writ denied) *Overruled on other grounds by Formosa Plastics Corp. USA v. Presidio Eng'rs and Contractors, Inc.,* 960 S.W.2d 41 (Tex 1998) (mineral interest received by former husband after divorce was community property because his inception of title to the interest arose during marriage).

[9] TEX. CONST. art. XVI, § 15; TEX. FAM. CODE ANN. § 3.001 (Vernon 2005). One consequence of this rule is that there can be no gift to the community estate. *Tittle v. Tittle*, 148 Tex. 102, 220 S.W.2d 637, 642 (1949); *Celso v. Celso*, 864 S.W.2d 652, 655 (Tex. App.--Tyler 1993, no writ). Note that when one spouse gives property to the other spouse a presumption arises that the gift includes all income or property arising from the property transferred. TEX. CONST. art. XVI, § 15; TEX. FAM. CODE ANN. § 3.005 (Vernon 2005). "Gift" means a voluntary and gratuitous transfer of property coupled with delivery, acceptance, and the intent to make a gift." State Bar of Texas Pattern Jury Charges PJC 202.3 (2002). *See Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565, 569 (1961) ("When an inter vivos transfer is made to either or both of the spouses during marriage, the separate or community character of the property is determined by looking to the consideration given in exchange for it. Any right, title or interest acquired for a valuable consideration paid out of the community necessarily becomes community property . . . .").

[10] TEX. CONST. art. XVI, § 15; Tex. Fam. Code Ann. § 3.001 (Vernon 2005). "Devise" means acquisition of property by last will and testament. State Bar of Texas Pattern Jury Charges PJC 202.3 (2002). "Descent" means acquisition of property by inheritance without a will. State Bar of Texas Pattern Jury Charges PJC 202.3 (2002).

[11] TEX. CONST. art. XVI, § 15. Family Code § 4.102 provides that "[p]roperty or a property interest transferred to a spouse by a partition or exchange agreement becomes his or her separate property." TEX. FAM. CODE ANN. § 4.102 (Vernon 2005).

[12] TEX. CONST. art. XVI, § 15. *See* TEX. FAM. CODE ANN. § 4.103 (Vernon 2005).

[13] TEX. CONST. art. XVI, § 15; TEX. PROB. CODE ANN. § 451 (Vernon 2005). *See Banks v. Browning*, 873 S.W.2d 763 (Tex. App.--Fort Worth 1994, writ denied) (signature card indicating survivorship by "X" in a box was sufficient to establish survivorship agreement as to community property); *Haynes v. Stripling*, 812 S.W.2d 397 (Tex. App.--Austin 1991, no writ) (constitutional amendment retroactively validated survivorship agreement, signed prior to effective date, that was invalid under prior law).

[14] *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965).

[15] "[T]he recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage" is separate property. TEX. FAM. CODE ANN. § 5.01(a)(3) (Vernon 1993). *See Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972). However, in *Graham v. Franco* 488 S.W.2d 390, 396 (Tex. 1972), the Supreme Court said that a recovery for medical and related expenses incurred during marriage belongs to the community, since the community is responsible for these expenses.

[16] *See Burgess v. Easley*, 893 S.W.2d 87, 90-91 (Tex. App.--Dallas 1994, no writ) (although deed was executed by husband's father during marriage, it was not delivered to husband until after divorce; since a conveyance is not effective until delivery, the property was not community property); *Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--El Paso 1981, no writ) (dividend declared after death of husband belonged to his heirs, not the community estate). *Berry v. Berry*, 647 S.W.2d 945, 948 (Tex. 1983).

[17] TEX. FAM. CODE ANN. § 3.003 (Vernon 2005); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965) (all property possessed at the time of dissolution of marriage is presumed to be community property). The uncorroborated testimony of a spouse is sufficient to support a finding of separate property, but is not binding on the fact finder. *Hilliard v. Hilliard*, 725 S.W.2d 722 (Tex. App.--Dallas 1985, no writ) ("Husband's uncorroborated testimony . . . is not conclusive as to whether the house was separate or community"). See *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App. – Houston [14th Dist.] 2003, pet. denied) (Community presumption rebutted by testimony and circumstantial documentary evidence.)

[18] *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Jackson v. Jackson*, 524 S.W.2d 308, 311 (Tex. Civ. App.--Austin 1975, no writ).

[19] State Bar of Texas Pattern Jury Charges PJC 202.4 (2002). To overcome the presumption of community, the party asserting separate property must trace and clearly identify the property which (s)he claims to be separate. *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965). The court in *Faram v. Gervitz-Faram*, 895 S.W.2d 839, 842 (Tex. App.--Fort Worth 1995, no writ) [1995 WL 108637], described tracing in the following way:

> [T]he party claiming separate property must trace and identify the property claimed as separate property by clear and convincing evidence. Tracing involves establishing the separate origin of the property through evidence showing the time and means by which the spouse originally obtained possession of the property. *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ). Separate property will retain its character through a series of exchanges so long as the party asserting separate owner-ship can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character. *Cockerham v. Cockerham*, 527 S.W.2d 162, 167 (Tex. 1975).

See Celso v. Celso, 864 S.W.2d 652, 654 (Tex. App.--Tyler 1993, no writ) (trial court reversed for failing to find that husband successfully traced CD funds into purchase of house); *Scott v. Scott*, 805 S.W.2d 835 (Tex. App.--Waco 1991, writ denied).

[20] *Celso v. Celso*, 864 S.W.2d 652, 654 (Tex. App.--Tyler 1993, no writ). The Court said: "Separate property will retain its character through a series of exchanges so long as the party asserting separate ownership can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character"). *See Martin v. Martin*, 759 S.W.2d 463, 466 (Tex. App.--Houston [1st Dist.] 1988, no writ) (of three lots, two were separate and one community; the lots were sold for a unified price; absent proof of the sales price for each lot, all proceeds were deemed to be community property; tracing failed).

[21] *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977)

[22] Sampson & Tindalls, FAMILY CODE ANNOTATED, (2004) Comments to §3.02 at page 25.

[23] *Cockerham v. Cockerham*, 527 S.W.2d 162, 171 (Tex. 1975); *Anderson v. Royce*, 624 S.W.2d 621, 623 (Tex. Civ. App.--Houston [14th Dist.] 1981, writ ref'd n.r.e.).

[24] *Glover v. Henry*, 749 S.W.2d 502, 503 (Tex. App.--Eastland 1988, no writ).

[25] *Cockerham v. Cockerham*, 527 S.W.2d 162, 171 (Tex. 1975).

[26] *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900); *Kyles v. Kyles*, 832 S.W.2d 194, 196 (Tex. App.--Beaumont 1992, no writ).

[27] *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900); *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 431 (Tex. 1970).

[28] *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900).

[29] *Pemelton v. Pemelton*, 809 S.W.2d 642, 646 (Tex. App.--Corpus Christi 1991), *rev'd on other grounds sub nom. Heggen v. Pemelton*, 836 S.W.2d 145 (Tex. 1992).

[30] *In re Marriage of Thurmond*, 888 S.W.2d 269, 273 (Tex. App.--Amarillo 1994, no writ), citing *Cockerham v. Cockerham*, 527 S.W.2d 162, 168 (Tex. 1975); *see Graham v. Graham*, 836 S.W.2d 308, 310 (Tex. App.--Tyler 1992, no writ) (recognizing rule but holding it was not applicable); *Peterson v. Peterson*, 595 S.W.2d 889, 892-93 (Tex. Civ. App.--Austin 1980, writ dism'd) (presumption overcome by husband's testimony that no gift was intended). In *Whorrall v. Whorrall*, 691 S.W.2d 32, 35 (Tex. App.--Austin 1985, writ dism'd), wife's testimony that she did not intend a gift was sufficient to support the trial court's finding of separate property.

[31] TEX. CONST. art XVI, § 15, TEX. FAM. CODE ANN. § 3.005 (Vernon 2005).

[32] *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1976, writ dism'd). *Accord*, *Harris v. Ventura*, 582 S.W.2d 853, 855-56 (Tex. Civ. App.--Beaumont 1979,

no writ). See the discussion in Paragraph III.I of this article.

[33] *Celso v. Celso*, 864 S.W.2d 652, 655 (Tex. App.--Tyler 1993, no writ) ("The mere fact that the proceeds of the sale were placed in a joint account does not change the characterization of the separate property assets. The spouse that makes a deposit to a joint bank account of his or her separate property does not make a gift to the other spouse." *See Higgins v. Higgins*, 458 S.W.2d 498, 500 (Tex. Civ. App.--Eastland 1970, no writ).

[34] A "fixture" is something that is personal but has been annexed to the realty so as to become part of it. *Fenlon v. Jaffe*, 553 S.W.2d 422, 428 (Tex. Civ. App.--Tyler 1977, writ ref'd n.r.e.). The three-pronged test for fixtures is: (I) has there been a real or constructive annexation of the personalty to the realty; (ii) was there a fitness or adaptation of the item to the uses or purposes of the realty; (iii) was it the intention of the party annexing the personalty that it would become a permanent accession to the realty? *O'Neill v. Quiltes*, 111 Tex. 345, 234 S.W. 528, 529 (1921). Intention is controlling; the first two prongs are primarily evidentiary. *Capital Aggregates, Inc. v. Walker*, 488 S.W.2d 830, 834 (Tex. Civ. App.--Austin 1969, writ ref'd n.r.e.).

[35] *Missouri Pacific Ry. Co. v. Cullers*, 81 Tex. 382, 17 S.W. 19, 22 (1891).

[36] *Lindsay v. Clayman*, 254 S.W.2d 777 (Tex. 1952).

[37] *See Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--El Paso 1981, no writ) ("Prior to the actual declaration of a dividend, all the accumulation of surplus in the corporation merely enhanced the value of the shares held by the husband as his separate property and the community had no claim thereto").

[38] *Parker v. Parker*, 897 S.W.2d 918, 928 (Tex. App. - Fort Worth 1995, writ denied), overruled on other grounds by *Formosa Plastics Corp. USA v. Presidio Eng'rs and Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998). (where corporation found to be alter ego of husband, corporate assets could become part of community estate; assets owned by corporation at time of marriage were husband's separate property, but assets acquired by the corporation during marriage were community property, absent tracing).

[39] *Jensen v. Jensen*, 665 S.W.2d 107, 109 (Tex. 1984).

[40] TEX. REV. CIV. STAT. ANN. art. 6132b § 24 (Vernon 1970).

[41] TEX. REV. CIV. STAT. ANN. art. 6132b § 28-A (Vernon 1970).

[42] TEX. REV. CIV. STAT. ANN. art. 6132b § 28-A (Vernon 1970).

[43] Tex. Rev. Civ. Stat. Ann. art. 6132b § 1.01 et seq. (Vernon Supp. 1995).

[44] *Marshall v. Marshall*, 735 S.W.2d 587, (Civ. App. - Dallas, 1987, writ ref'd n.r.e.)

[45] See Para. III.AC.

[46] See Para. III.AC.

[47] See Para. III.AD.

[48] See Para. III.AD.

[49]For a good discussion of preemption, see *Ex parte Hovermale*, 636 S.W.2d 828, 837 (Tex. App.--San Antonio 1982, orig. proceeding) (Cadena, C.J., dissenting). *See also Ridgway v. Ridgway*, 454 U.S. 46, 102 S.Ct. 49, 70 L.Ed.2d 39 (1981) (provisions of the Servicemen's Group Life Insurance Act of 1965, giving an insured service member the right to freely designate and alter the beneficiaries named under the contract, prevail over and displace a constructive trust for the benefit of the service member's children imposed upon the policy proceeds by a state-court divorce decree); *McCarty v. McCarty*, 453 U.S. 210, 101 S.Ct. 2728, 69 L.Ed.2d 589 (1981) (federal law preempted power of state court to divide military retirement benefits in a divorce); *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 99 S.Ct. 802, 59 L.Ed.2d 1 (1979) (federal law preempted power of state court to divide railroad retirement benefits on divorce); *Yiatchos v. Yiatchos*, 376 U.S. 306, 84 S.Ct. 742, 11 L.Ed.2d 724 (1964); *Free v. Bland*, 369 U.S. 663, 82 S.Ct. 1089, 8 L.Ed.2d 180 (1962) (savings bond survivorship provisions in treasury regulations preempted inconsistent Texas community property law); *Wissner v. Wissner*, 338 U.S. 655, 70 S.Ct. 398, 94 L.Ed. 424 (1950) (National Service Life Policy benefits are the sole property of the beneficiary, and are not community property); *McCune v. Essig*, 199 U.S. 382, 26 S.Ct. 78, 50 L.Ed. 237 (1905) (veteran's right, under federal statute, to designate beneficiary of life insurance could not be controlled by state court); *Ex parte Burson*, 615 S.W.2d 192 (Tex. 1981) (Veterans Administration disability payments are not property and cannot be divided upon divorce); *Eichelberger v. Eichelberger*, 582 S.W.2d 395 (Tex. 1979) (railroad retirement preempted); *Perez v. Perez*, 587 S.W.2d 671 (Tex. 1979) (military readjustment benefits held to be separate property due to gratuitous nature under federal statute); *United States v. Stelter*, 567 S.W.2d 797 (Tex. 1978) (ex-wife could not garnish ex-husband's retired pay, under federal statute); *Valdez v. Ramirez*, 574 S.W.2d 748 (Tex. 1978) (joint survivor annuity permitted by Civil Service Retirement Act preempted contrary state law); *Ex parte Johnson*, 591 S.W.2d 453 (Tex. 1979) (federal statute precluded division of V.A. disability benefits upon divorce); *Arrambide v. Arrambide*, 601 S.W.2d 197 (Tex. Civ. App.--El Paso 1980, no writ) (federal law prohibits division of VA disability payments upon divorce).

[50] The holding in *Castleberry* has been overuled by the Business Corporation Act to the extent that failure to observe corporate formalities is no longer "a factor in proving alter ego:" Tex. Bus. Corp. Act Ann art. 2.21(A)(3) (Vernon Supp. 2003).