COMMUNITY PROPERTY - REVIEW OF GENERAL RULES*

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COMMUNITY PROPERTY -REVIEW OF GENERAL RULES

I. Community Property System

A. Constitutional Base of Community Property System

The basis of the Texas community property system is constitutional, set forth in Art. XVI, §15 of the Texas Constitution, referred to herein as "Constitution" or "Texas Constitution", and basic changes to the system therefore require an amendment to the Constitution.[1] The constitutional rules have been expanded by the statutory rules found in Chapters 3 and 4 of the Texas Family Code.

B. Definition of Separate Property

The Constitution defines "separate property" as all property, real and personal, owned by a spouse before marriage and any property acquired after marriage by gift, devise or descent". [2] Section 3.001 of the Texas Family Code adds another category of separate property - "recovery for personal injuries" by the spouse. This category of separate property is discussed in more detail below at Section II.D.2.

C. Definition of Community Property

1. Negative Rule

The Constitution does not include a definition of community property. However, "community property" is defined by Section 3.002 of the Texas Family Code as "property other than separate property, acquired by either spouse during marriage."

2. Community Property Presumption

Property possessed by either spouse during or on the dissolution of marriage is presumed to be community property. Tex. Fam. Code §3.003(a). The burden of proving that a particular asset is separate property is on the party asserting that the asset is separate property and it must be proved by "clear and convincing" evidence. Tex. Fam. Code §3.003(b). This is an intermediate standard of proof that falls between the "preponderance" standard of ordinary civil proceedings and the "reasonable doubt" standard of criminal proceedings. ***Faram v. Gervitz-Faram***, 895 S.W. 2d 839 (Tex. App.–Ft. Worth 1995, no writ).

3. Income from Separate Property

Income from separate property is community property in Texas (and in Idaho and Louisiana). ***Colden v. Alexander***, 171 S.W. 2d 328 (Tex. 1943); ***King v. Matney***, 259 S.W. 2d 606 (Tex. Civ. App.–Amarillo, 1953, writ ref'd n.r.e.). In the other six community property states, the income from separate property retains its separate character (Arizona, California, Nevada, New Mexico, Washington and Wisconsin).

II. Determination of Separate or Community Character

A. Inception of Title Rule

The "inception of title" rule is the basic rule for determining the character of property and it provides that the separate or community character of an asset is determined at the time the asset is acquired and no subsequent actions will change its character. ***Creamer v. Briscoe***, 109 S.W. 911 (Tex. 1908); see, e.g., ***Hernandez v. Hernandez***, 703 S.W. 2d 250 (Tex. App. – Corpus Christi 1985, no writ). Therefore, if one party acquires property before marriage, or after marriage with separate funds, the property is the separate property of the acquiring party. ***Welder v. Lambert***, 44 S.W. 281 (Tex. 1898); ***Evans v. Ingram***, 288 S.W. 494 (Tex. Civ. App.– Waco 1926-no writ).

<u>Example</u>: H owns a vacation home before the marriage. After marriage, H and W use community funds to build an addition to the vacation home. Under the "inception of title" doctrine, the vacation home is H's separate property. The community estate will have a claim for reimbursement for the capital improvements; see discussion at Section II.A.6, ***infra***.

1. Property Purchased on Installment Contract Before Marriage

If one spouse purchases real property before marriage pursuant to an installment contract, the property continues to be the separate property of that spouse, even if community funds are used after the marriage to make payments on the installment contract. ***Welder v. Lambert***, 44 S.W. 281 (Tex. 1898); ***Evans v. Ingram***, 288 S.W. 494 (Tex. Civ. App.– Waco 1926-no writ).

2. Earnest Money Contract Entered into Before Marriage

If one spouse enters into an earnest money contract to buy land before marriage and gets married before closing on the contract, the land is the separate property of that spouse. This rule has been applied even where the deed was delivered in the name of both spouses and the deed of trust and note were executed by both spouses. ***Carter v. Carter***, 736 S.W. 2d 775 (Tex. App.- Houston [14th Dist.] 1987, no writ).

3. Assets Purchased During Marriage - Community Property Assumption Applies

If H and W buy a ranch and the funds used to pay for the ranch are one-half the separate property of H and one-half the community property of H and W, the ranch is one-half the separate property of H and one-half the community property of H and W (mixed ownership), determined by the source of funds used to buy the property. However, the community presumption applies in the first instance. The ranch is presumed to be community property as it was acquired during the marriage and H has the burden of proving by clear and convincing evidence that one-half of the property is his separate property.

4. Property Purchased During Marriage on Joint Credit

If H and W purchase an asset during the marriage on credit, the inception of title rule applies and the character of the asset is determined by (i) the source of funds used to make the down payment (either separate or community) and (ii) the source of credit for the balance of the purchase price (either separate or community). An asset acquired on credit is presumed to be acquired on community credit and the source of funds used to repay the debt is irrelevant. ***Gliech v. Bongio***, 128 Tex. 606 (1937); ***Broussard v. Tien***, 156 Tex. 371 (1956).

Example: W buys real property during marriage for $100,000, using $20,000 of her separate property and signing a note with a vendor's lien for $80,000. There is no indication that the creditor looked only to W's separate credit. The payments on the note are later made with W's separate funds. The property is 1/5th W's separate property and 4/5ths community property, because there is no evidence to overcome the presumption of community credit.

a. Overcoming the Presumption by Proof Creditor Looking only to Separate Estate

If it can be shown that the lender looked only to the separate estate of the borrowing spouse in extending the credit, then separate credit may be established. If, in the immediately preceding example, W had signed the note as "W, for her separate estate", that indicates that the lender agreed to look only to W's property for repayment. ***Gliech v. Bongio***, ***supra***.

b. Overcoming the Presumption by Proving Spouse Intended to Pay the Debt with Separate Property

The presumption can be overcome and separate credit proved if a spouse purchases an asset with borrowed funds with the intention of paying the debt with proceeds from the immediate sale of property. ***Edsall v. Edsall***, 240 S.W. 2s 424 (Tex. Civ. App. 1951).

Example**:** H wanted to buy a parcel of land and intended to pay for it with the proceeds of other land that he was selling (the second parcel was separate property). The purchase transaction took place first and H borrowed $10,000 from a bank to pay for the land. W did not participate in the loan transaction. Within a week, H sold the second property and paid the loan back with the sales proceeds (which were separate property). Due to the contemporaneous nature of the two transactions, the parcel H bought would be separate property.

Note: See Professor Featherston's article, ***Marital Property Liabilities, Dispelling the Myth of Community Debt***, Texas Bar Journal, January, 2010.

5. Gifts to Spouses from Third Parties

As noted above, property acquired by a spouse during marriage by gift, devise or descent is separate property of that spouse. Tex. Const. art. XVI, § 15; Tex. Fam. Code § 3.001.

A gift by a third party to H and W gives each spouse a separate property (undivided) interest equal to one-half of the value of the gift. ***Kamel v. Kamel***, 721 S.W. 2d 450 (Tex. App.–Tyler 1986 , no writ).

Even if the gift is designated a gift "to the community estate" of H and W, each spouse owns an undivided interest in the property as his or her own separate property. ***Marshall v. Marshall***, 735 S.W. 2d 587 (Tex. Civ. App.–Dallas 1987, writ ref'd n.r.e.); ***McLemore v. McLemore,*** 641 S.W. 2d 395 (Tex. App.–Tyler 1882, no writ). In other words, one can make a gift to the couple, but not a gift to the "community".

6. Claim for Reimbursement

a. Background

Prior to 1999, case law provided generally that spending community funds to enhance the value of one spouse's separate property gave rise to an equitable claim for reimbursement, for the increased value due to the expenditure. Legislation was enacted in 1999 that attempted to replace the existing common law with a statutory rule that applied to all cases in which the expenditure of community funds enhanced the value of one spouse's separate property. More legislation was enacted in 2001, naming the cause of action a "claim for economic contribution", limited it to cases involving secured debt or capital expenditures, providing a new formula for calculating the contribution and clarified that any of the three marital estates may make a claim against either of the other two. The three marital estates are the community estate, the separate estate of the wife and the separate estate of the husband. The 2001 system was strongly disliked by family law attorneys and probate practitioners and a version of the pre-1999 equitable reimbursement rules was enacted in 2009 (doing away with "claim for economic contribution").

b. Current rule - Equitable Reimbursement Remedy

Since 2009, the Family Code provides for an equitable reimbursement remedy, which provides more flexibility for the court. Section 3.402 lists the elements for a claim for reimbursement, which includes payment by one marital estate of unsecured liabilities of the other, inadequate compensation for time, toil, talent, and effort of a spouse for a business entity under the control of that spouse, reduction of debt on property obtained by one spouse by gift or inheritance, refinancing of principal debt on certain property, and making capital improvements to certain property (without incurring debt).

Courts are directed to use equitable principles in determining reimbursement claims, and to include offsets related to the use and enjoyment of property. The claim for funds expended by one estate for another is measured by the enhancement in value to the benefitted estate. The court may, but is not required to, impose a lien to secure a claim for reimbursement. Section 3.406, Texas Family Code.

Caveat: For divorces filed before September 1, 2009, or deaths occurring before September 1, 2009, the economic contribution laws will still apply.

7. How Title is Taken

As noted above, under the Texas "inception of title" rule, title is determined when the asset is acquired by determining the source of funds and the community property presumption is the starting point for determining ownership. Thus, the manner in which title is taken (i.e., what language is in the deed) is not controlling in determining ownership. (It is controlling in common law states.) There are a few exceptions to this general rule in Texas.

a. Title taken in Spouse's Name without Recital of Separate or Community Ownership

If H buys property but puts the title in W's name (with no recitation as to "separate" or "community" ownership in the title), under Texas case law, the characterization of ownership depends in part on the source of funds used to buy the property. If the consideration was H's separate property, there is a presumption that H intended to make a gift of the property to W as her separate property. The presumption can be overcome by proof that no gift was intended and that the transaction was conducted in this manner for some other purpose. ***Cockerham v. Cockerham***, 527 S.W. 2d 162 (Tex.1975). If the consideration was community funds (or credit), the community presumption applies. However, one case has held that only slight evidence is needed to show that H intended to make a gift of his community interest to W. ***Black v. Danborn***, 459 S.W. 2d 195 (Tex. Civ. App.–Fort Worth 1970, no writ).

b. Title taken in Spouse's Name "as Separate Property"

If title to an asset is put in the name of one spouse with language included such as "as her separate property" or "as her sole and separate" property, there is authority (if no fraud, accident, or mistake) that the asset conclusively belongs to the transferee spouse's separate estate, if the other spouse participated in the transaction. ***Messer v. Johnson,*** 422 S.W. 2d 908 (Tex.1968); ***Henry Miller Co. V. Evans***, 452 S.W. 2d 426 (Tex. 1970); ***Jacobs v. Jacobs***, 669 S.W. 2d 759 (Tex. App.-Houston [14th Dist.]1984, aff'd in pertinent part, 687 S.W. 2d 731 (Tex. 1985). If the other spouse does not participate in the transaction, however, the property is presumptively community property, in the absence of a showing that it was acquired with the first spouse's separate funds***.*** ***Holcemback v. Holcemback***, 580 S.W. 2d 877 (Tex.Civ.App.–Eastland 1979, no writ).

c. Title changed to Spouse's Name during Refinancing

In a 2007 Texas Appeals case, one spouse owned separate real property when she married. She later obtained refinancing on the house during the marriage and signed a Warranty Deed transferring a 1/2 interest to her house during the refinancing. The court found that she was presumed to have made a gift to the husband when she signed the deed and her testimony that she did not mean to make a gift was insufficient to overcome the presumption. ***Magness v. Magness*****,** 241 S.W.3d 910 (Tex.App. - Dallas 2007, pet. denied).

B. Tracing

1. General Rule

Property acquired during marriage which is traceable as a mutation of previously owned separate property is separate property. ***Love v. Robertson***, 7 Tex 6 (1851); ***Pechstein v. Pechstein***, 174 S.W. 2d 787 (Tex.Civ.App.–San Antonio 1943, no writ).

2. Commingling Separate and Community Property

Commingled separate property can become community property if the property loses its separate character. ***McKinley v. McKinley***, 496 S.W. 2d 540, 543 (Tex.1973). If the separate property becomes so commingled with the community property that it cannot be traced, it becomes community property. ***Tarver v. Tarver***, 394 S.W. 2d 780 (Tex. 1965).

a. Commingled Bank Accounts

Texas courts have recognized the inequity of strict application of the community presumption if the result would be a total loss of separate ownership because the records are insufficient. ***Harris v. Ventura***, 582 S.W. 2d 853 (Tex. Civ. App. 1979). In cases involving commingled bank accounts, the courts have developed a presumption that community funds are withdrawn before separate funds. ***Harris v. Ventura***, ***supra***; ***Welder v. Welder***, 794 S.W. 2d 420 (Tex. App.–Corpus Christi 1990, no writ).

In ***Sibley v. Sibley***, 286 S.W. 2d 657 (Tex. Civ. App. 1955), W deposited $3,500 of her funds in an account that already held $1,700 in community funds. Funds in the account were used to pay living

expenses of the couple and, at the time of the divorce, the account balance was $2,070. Applying the presumption that the community funds are withdrawn first, the $2,070 was held to be W's separate property.

However, another rule applies if, during the marriage, the balance in the account falls below the amount of separate funds that were put into the account. Under the "lowest intermediate balance" principle, the amount of the account held to be separate property cannot be more than the lowest intermediate balance in the account. ***Snider v. Snider***, 613 S.W. 2d 8 (Tex. Civ. App. 1981). In ***Snider v. Snider***, W put $20,000 of separate funds into an account that already held $10,000 in community funds. At the time of divorce, the balance is $35,000. During the marriage, the balance was as low as $14,000. The "community out first" presumption is applied, but at some point, some of W's separate funds must also have been withdrawn (to get down to $14,000). Thus, the finding of W's separate property is limited to the "lowest intermediate balance", or $14,000. The remainder of the funds in the account is community property.

C. Agreements that Change Character

1. Premarital Agreements

In 1980, the Texas Constitution was amended to allow persons about to marry to change the character of community property in a wide variety of ways, which can affect rights of creditors, rights on divorce and rights on the death of one spouse. In 1987, Texas enacted the Uniform Premarital Act, which defines what formalities must be followed in order for a premarital agreement to be valid. Tex. Fam. Code §§ 4.001-4.010.

a. Formalities

(1) In Writing; No Consideration

The premarital agreement must be in writing and signed by both parties. It is enforceable without consideration. Tex. Fam. Code §§ 4.002.

(2) Effective Date

The agreement is effective on the date of marriage. Tex. Fam. Code §§ 4.004.

(3) Revocation

The agreement may only be revoked or amended by a written agreement signed by both parties. Tex. Fam. Code §§ 4.005.

(4) Enforceability

The agreement is unenforceable if the party against whom enforcement is sought (i) did not sign it voluntarily ***or*** (ii) if the agreement was unconscionable when signed and that party did not receive full disclosure as to the other party's property and did not sign a waiver regarding the disclosure and did not have adequate knowledge of the other party's property. Tex. Fam. Code §§ 4.003.

b. Substance

The parties may contract with regard to the rights of each of the parties in any property of either or both of them. "Property" includes present or future interests in real or personal property, including income from separate property, income from community property and earnings. Tex. Fam. Code §§ 4.001 and 4.003. They may waive homestead rights and the right to a set-aside of exempt personal property. ***Williams v. Williams***, 569 S.W. 2d 867 (Tex. 1978). The agreement may govern the disposition of property on divorce, separation, death, including the making of a will, the modification of spousal support, and the ownership rights in life insurance policies. Tex. Fam. Code §§ 4.003(a).

The agreement cannot change child support obligations. Tex. Fam. Code §§ 4.003(b). Parties about to marry cannot agree to convert separate property to community, as only spouses can make such a conversion agreement. Tex. Const. art. XVI, § 15; Tex. Fam. Code § 4.202; see Section II..C.2.b ***infra***.

The parties can probably not change the distribution of retirement benefits governed by ERISA (retirement plan benefits) in a premarital agreement, as ERISA supersedes state law as it related to those plans. ***See*** 20 U.S.C.A. §1144; ***Manning v. Hayes***, 212 F. 3d 866 (5th Cir. (Tax) 2000. cert den.) (language in premarital agreement was not explicit enough to change plan provisions); ***Hurwitz,*** 789 F. Supp. 134 (S.D.N.Y.1992), aff'd 982 F.2d 778 (2d Cir. 1992) (only a spouse can waive the rights, not a person about to marry).

Caveat to Premarital Agreements: The Constitutional provision states that parties about to marry ***or*** spouses may partition and exchange existing property or property to be acquired, but appears to only give ***spouses*** the right to change the character of income from a spouse's separate property (from community to separate). The Supreme Court has stated in ***Beck v. Beck***, 814 S.W. 2d 745, (34 Tex.Sup.J.603) that ***spouses*** have the right to do so, but it is not clear from this case that this change can be accomplished in a premarital agreement. The Family Code does not make this distinction in Section 4.001. To protect against an adverse interpretation in the future, most estate planners have their premarital agreements ***ratified*** by the couple after they are married.

2. Marital Agreements

a. Partition and Exchange of Community Property (sometimes referred to as Marital Agreement)

As with premarital agreements, married couples in Texas may, by agreement, partition and exchange existing community property or property to be acquired in the future. "Property" has the same meaning set forth in Tex. Fam. Code § 4.001 for premarital agreements and includes future income from community property and future income from separate property and earnings.

Such an agreement is subject to the same enforceability requirements, such as disclosure, etc., that apply to premarital agreements. Tex. Fam. Code §§ 4.104 and 4.105. Such agreements are void as to existing creditors, but may be recorded in the deed records to give notice to various parties going forward of the property ownership. Tex. Fam. Code § 4.106.

Such agreements may contain an agreement to convert separate property to community property, as discussed in Section II.C.2.b, ***infra***.

b. Conversions of Separate Property to Community Property

Prior to January 1, 2000, a married couple could not convert their separate property into community property by agreement. A 1999 amendment to the Texas Constitution allowed this type of conversion. It is available only to married persons and, thus, cannot be accomplished in a premarital agreement. Tex. Fam. Code § 4.202. It can be part of a broader marital agreement, though. See discussion of

partition and exchange of marital property at Section II.C.2.a, ***infra.*** Only ***existing*** property may be converted. Tex. Fam. Code § 4.202.

The agreement must be in writing, signed by both spouses and must describe the property to be converted. Tex. Fam. Code § 4.203. It is enforceable without consideration. Tex. Fam. Code § 4.202. Such an agreement will not be enforceable if one spouse did not execute it voluntarily or did not receive fair and reasonable disclosure of the agreement's legal effect. The disclosure requirement can be waived, but only by including a lengthy statement from the statute in the conversion agreement. Tex. Fam. Code § 4.205. Management of the asset still depends on record title or possession. Tex. Fam. Code § 4.204.

The constitutional amendment for allowing this type of agreement was apparently motivated by two federal tax advantages: (1) at the death of a spouse, community property owned by that spouse gets a step-up in basis for the entire value of community property, rather than just the one-half owned by the decedent, and (2) the conversion of separate property, in the case where one spouse does not have enough assets to utilize his or her own estate tax exemption ($5 million in 2012, falls to $1 million starting in 2011), will allow the spouse with fewer assets to fully utilize his or her exemption.

There are some possible disadvantages that should be considered before entering into such an agreement. First, the new community property will be subject to a "just and right division" in a divorce court. Second, this transfer runs counter to asset protection arguments where more property is made separate property, rather than community property. Finally, the spouse whose separate property is converted may lose the power of sole management/disposition over his or her one-half of the property. See Section III, ***infra***.

c. Community Property with Right of Survivorship

In 1987, Art. XVI, §15 of the Texas Constitution was amended to allow spouses to agree to hold community property with survivorship rights. Prior to that time, in order to create a right of survivorship in community property, the spouses had to partition community property into separate property and then enter into a survivorship agreement with the separate property. ***Hilley v. Hilley,*** 161 Tex. 569, 342 S.W. 2d 565 (1961) ***Maples v. Nimitz***, 615 S.W. 2d 690 (Tex. 1981).

The legislative provisions that govern such survivorship agreements are found in the Texas Probate Code at Sections 451-462. Such an agreement must be in writing and signed by both spouses and have "right of survivorship" language of some sort. Tex. Prob. Code § 452. The agreement can be effective for just one asset, a class of assets, or all community property of the spouses.. Tex. Prob. Code § 451. Either spouse may revoke the agreement by written notice to the other. Tex. Prob. Code § 455. The agreement is valid without an adjudication; however, a method of adjudication is provided in which title of the surviving spouse can be formally established. Tex. Prob. Code § 456.

There is no requirement that the title to the asset contain the survivorship language; it can be set forth in a separate writing. Therefore, the statute protects third parties and, to some extent, personal representatives of the estate of one of the spouses, who have no actual knowledge or notice of the agreement. Tex. Prob. Code § 460. The agreement does not prejudice rights of creditors with existing claims against the property. The surviving spouse must account to the deceased spouse's personal representative for the property received by right of survivorship to the extent necessary to discharge such liabilities. Tex. Prob. Code § 461. However, multi-party bank accounts of a husband and wife with survivorship provisions are governed by the bank account rules in Tex. Prob. Code § 436-449, not Section 461. See discussion of multiple party bank accounts at II.C.2.d, ***supra***.

With respect to vehicles, Texas certificates of title contain a right of survivorship form which provides that, if the agreement is signed by H and W, the vehicle is owned jointly by them, with the interest of the spouse who dies passing to the other spouse.. To revoke the agreement, the title must be surrendered and the H and W must both sign an application for a new title. Certificate of Title Act, Tex. Rev. Civ. Stat. Art. 6687-1, § 35A.

Planning Point: As a practical matter, title companies in Texas do not favor survivorship agreements for real property transactions in Texas. Some title companies still require a probate proceeding and some require an affidavit of heirship in addition to the "survivorship agreement." When the property of a decedent is not being sold immediately, some Texas attorneys have the surviving spouse sign an affidavit of heirship and record it, on the premise that may be nothing else in the record for future sales that proves to a prospective buyer

(and the title company) that decedent has died and that the survivorship agreement was never revoked.

Recent Case on "Joint Tenancies": A 2009 Texas Supreme Court case, ***Holmes v. Beatty***, 390 S.W.3d 852, 52 Tex. Sup. Ct. J. 967 (Tex 2009, reh denied), muddied the water with respect to property owned by spouses as "joint tenants". Although some of the brokerage accounts and stock certificates owed by a decedent and her husband were not clearly designated survivorship accounts, the Supreme Court held that "joint tenancy or joint tenants" accounts between a husband and wife *did create rights of survivorship*. This case, which seemed to erode the clear requirements of Texas Probate Code Sections 439 and 452 that require specific survivorship language, was overturned by legislation in 2011.

d. Multiple Party Bank Accounts

In Texas, four different kinds of multiple party bank accounts are authorized (but not required to be offered by every bank), including joint accounts of spouses with right of survivorship. Tex. Prob. Code § 436-449. This is yet another way in which spouses change the attributes of ownership of various property. As spouses can enter into these accounts, it is extremely important for the estate planner to understand how his client's accounts are set up. This is one of the most frequent areas of misunderstanding in probate matters, as the clients often do not know or understand the importance of the designations on their various accounts. The wrong designation can also make or break an estate tax plan.

The types of accounts and the resulting ownership at death of one of the parties are summarized briefly here. For a more complete discussion of the statutes and voluminous interpretive case law, see Totusek, ***Multiple-Party Accounts in Financial Institutions: Special Issues in Estate Planning and Estate Administration***, Estate, Planning and Probate Section, Austin Bar Association (May 9, 2008).

Note that Probate Code § 436(3) appears to include brokerage firms in the definition of "financial institutions", which means these rules could apply to ***investment accounts,*** as well as bank accounts. However, if the investment account is offered by a national brokerage firm, as opposed to a Texas firm, "conflict of laws" principles may be apply and another's states laws might govern that account. However,

several national brokerage firms have a "transfer on death" option on their accounts similar to the "pay on death" option in the Texas statute.

(1) Joint Accounts - With or Without Right of Survivorship

Community property can be deposited by the spouses into a joint bank account that does not have survivorship language. Amounts in the account are presumptively community property and assets purchased with those funds are community assets. During the joint lifetime of the spouses, the accounts belong to the parties in proportion to their "net contributions" to the account, and at the death of party, the surviving party and the heirs/devisees of the deceased party continue to own the account in proportion to their "net contributions." Tex. Prob. Code § § 438(a).

Spouses can also contribute to joint accounts ***with*** right of survivorship provisions. The parties own the accounts during their joint lives in the same manner as a joint account without right of survivorship, described above. Upon the death of either spouse, the account becomes the property of the surviving spouse. Tex. Prob. Code § § 439(a). (Prior to 1987, at the death of a spouse, the account would generally go one-half to the surviving spouse and one-half to the heirs/devisees of the surviving spouse, as the account would have consisted of separate property of each spouse.)

CAREFULLY SCRUTINIZE SURVIVORSHIP ACCOUNTS OF YOUR ESTATE PLANNING CLIENTS. Because joint accounts with right of survivorship are an inexpensive way to avoid probate, they are often used by spouses without the benefit of a discussion of all of the other ramifications of such an account. If the parties' estate plan calls for funding a bypass trust, for example, the funds in the account would not be available for that purpose as they do not pass through the probate proceeding. The funds would not be available to fund a marital deduction trust or a charitable trust. The use of such an account may result in unequal treatment of beneficiaries or cause other unintended results. Upon a divorce, provisions in a Will for a former spouse are voided. Tex. Prob. Code § 69 (see further discussion of this rule below). That is not true for survivorship accounts. The joint

accounts may expose the funds in the accounts to creditors of more parties than before the account was formed. A careful review of joint accounts should be one of the first items on every estate planner's checklist for their clients.

(2) P.O.D Accounts

A P.O.D. account names a "pay on death" payee. Community funds can be deposited into one of these accounts. During the lifetime of the depositor, the funds in the account belong to the depositor and, at his or her death, the funds become the funds of the P.O.D payee. If the P.O.D. payee is not the surviving spouse of the depositor, the surviving spouse might assert that he or she is entitled to one-half of the funds in the account because the depositor committed fraud on that person's community interest. Tex. Prob. Code § § 436 and 439(b). Rules allowing for multiple depositors further complicate these types of accounts, but are beyond the scope of this outline. Note that some of the same problems created by survivorship accounts may also result from using a "P.O.D." account.

(3) Convenience Accounts

A "convenience signer" can be added to certain single-party accounts or multiple-party accounts since 1993, generally for the purpose of allowing that individual to assist the depositors with payment of bills. Tex. Prob. Code § § 438A. The funds in the account continue to belong to the depositor and, upon his or her death, will be paid to the estate of the depositor. These accounts are unique to Texas and are not always available at larger, multistate banks. See Totusek, ***Multiple-Party Accounts in Financial Institutions: Special Issues in Estate Planning and Estate Administration***, at page 15. While I do not see many instances of Dallas estate planners recommending convenience accounts, at least one planner in town does recommend their use in a situation where using a "right of survivorship" account might affect tax issues or the division of assets under a Will.

(4) Totten Trust Accounts

These accounts belong to the depositing "trustee" during the

trustee's lifetime and pass to the beneficiary of the account oat the trustee's death, if the beneficiary survives the trustee. This type of account cannot be used if the trust provisions are set forth in an express trust. Tex. Prob. Code § § 436, 438 and 439. As with P.O.D. accounts, if community funds are used to fund this type of account, they retain their character while in the trust account. Again, these types of accounts are rarely used by estate planners as there are more "certain" ways to achieve estate planning goals.

3. Gifts by One Spouse to the Other

One spouse can make a gift of property to the other spouse, thus converting separate property or community property of the first spouse to separate property of the other spouse. ***Marriage of Morrison***, 913 S.W. 2d 689 (Tex. App. 1995).

NOTE TO PLANNERS: Be careful here with a gift of H's one-half of community property to W, though. If not done in two steps, first as a partition of the community property into separate property, followed by a gift of H's separate property to W, the end result ***may be*** property owned one-half as W's separate property and the other one-half still owned as community property of H and W- a result not usually intended when H wants to make such a transfer. That result is more complicated if it is income-producing property. The income from the CP 1/2 would also be CP income, another result not usually intended in this situation.

D. Special Rules for Determining Character of Property

1. Income from Separate Property

Remember from the discussion in Section I, ***supra***, that generally ***income from separate*** property is community property. It is important to determine in many cases, whether the items being classified are income from separate property or a return of capital with respect to the asset, or perhaps proceeds from the sale of a separate property asset.

a. Oil and Gas Interests

Because they are a depleting asset, special consideration must be given to determine whether returns from oil, gas and other mineral interests are income or a return of capital that retains the same community or separate property character as the underlying interest. ***Norris v.***

Vaughan, 260 S.W. 2d 676 (Tex. 1963); ***Lessing v. Russek***, 234 S.W. 2d 891 (Tex. Civ. App.–Austin 1950, writ ref'd n.r.e.).

Lease bonus payments are considered to retain the same character as the underlying asset because the payments are part of the consideration for the sale of the asset; therefore, bonus payments paid with respect to a separate property mineral interest will be separate property. ***San Antonio Loan & Trust Co. v. Hamilton***, 283 S.W.2d 19 (Tex. 1955).

Royalty interests are also considered a return of capital and therefore retain the same character, separate or community, as the underlying interest. ***Norris v. Vaughan***, ***supra***. The reasoning is that the interests are regarded as part of the sale price of the land because they are depleting and the reserves will eventually be exhausted.

Delay rentals are amounts paid by the oil and gas lessee for the privilege of deferring his obligation to drill (similar to rental payments). Such payments are considered income and, therefore, community property, absent an agreement to the contrary. ***McGarraugh v. McGarraugh***, 177 S.W. 2d 296 (Tex. Civ. App.–Amarillo 1943, writ dism'd).

b. Income from Trusts

Undistributed trust income is normally neither separate or community property, but trust property. See ***In the Matter of Burns***, 573 S.W. 2d 555 (Tex. Civ. App. 1978); ***Buckler v. Buckler***, 424 S.W. 2d 514 (Tex. App.–Fort Worth 1967, writ dism'd), and ***McClelland v. McClelland***, 37 S.W. 350 (Tex. Civ. App., 1896, writ ref'd).

Remember, under the Constitution, separate property includes property acquired during marriage by gift, devise or descent. Income distributed to a trust beneficiary from a trust created by another party has been held to be separate property because it is acquired by a gift (either a lifetime gift or a devise). ***Hutchinson v. Mitchell***, 39 Tex. 488 (1973); ***Monday v Vance***, 32 S.W. 2d 559 (Tex. Civ. App. 1895, no writ); ***Wilmington Trust Company v. United States***, 53 F. 2d 1055 (Fed. Ct. 1985), affirming 4 Cl. Ct. 6 (1983). The gift is of the income interest itself, not the corpus that produces the income. ***Wilmington Trust Company v. United States***, ***supra***. The income will be separate property whether the trust is established before or during the spouse's marriage.

The same result has been reached if the trust beneficiary has a contingent interest in the trust corpus. ***In the Matter of Burns*, *supra***.

There are numerous exceptions to this general rule in the case law.

Exception: If the trust beneficiary has an unrestricted right to receive the corpus of the trust, the income will be community income. ***Marriage of Long***, 542 S.W.2d 712 (Tex.App.-Texarkana 1976, no writ); ***Cleaver v. Cleaver***, 935 S.W.2d 491 (Tex. App.–Tyler 1996, no writ). In ***Marriage of Long***, ***supra***, H's mother created a trust under which the trustee had the discretion to distribute income to h or accumulate the income. At 35, H had the right to terminate the trust and receive the trust assets outright, but he did not take that action. When H was 46, H and W were divorced. The Court held that income accumulated before H reached 35 was H's separate property, but income accumulated after he turned 35 was community property. The Court reasoned that H should not be able to prevent the income from being classified as community property by choosing not to terminate the trust.

Some of these cases have found an interest in the trust to be community property even where "spendthrift trust" language was present in the trust document. ***Ridgell v. Ridgell***, 960 S.W.2d 144 (Tex.App.-Corpus Christi 1997, no pet).

Recent case with "separate property" holding: In ***Sharma v. Routh,*** No. 14-06-00717-DV, 2009 Tex. App. LEXIS 7945 (Tex. App-Houston [14th District], October 8, 2009), a surviving husband had a right to income and corpus from a bypass trust, as much as he deemed necessary for his support and maintenance, and a right to all the income from a marital trust, and as much of the corpus as he determined was necessary for his health, support and maintenance. No part of the corpus had ever been distributed from either trust. The appellate court held the income from both trusts was separate property and not divisible on divorce because the husband did not have a "present possessory right" to any of the corpus. Although the reasoning was not totally clear, the standards for distributions in the trust apparently were not sufficient to constitute a "present possessory right".

Exception: If the trust beneficiary has a general power of appointment over trust assets, he may be considered to own the trust assets for

certain purposes (creditors can reach those assets). The assets over which he holds the power would probably be considered his separate property (the power was a gift), but an argument could be made that income from those assets is community property.

What if the trust beneficiary has a "Crummey" right of withdrawal or a "five or five" power? Can an argument be made that he has control over at the assets at that time? Note that Section 112.035(d) of the Texas Trust Code says the lapse or waiver of such a power does not make the beneficiary a grantor of the trust.

If the beneficiary has a special power of appointment over the trust assets (i.e., he cannot appoint to his creditors or his estate), that power should not cause the beneficiary to be treated as the owner of the assets.

Planning Point: Language in the ***Ridgell v. Ridgell*** case, supra, implies that specific language in the trust agreement stating that the corpus and/or income is to remain separate property might help support an argument that the trust assets are separate property.

c. Animals - Increase from Separate Property is Community Property

The increase from separately owned cattle, horses and other animals is community property. ***Gutierrez v. Gutierrez***, 791 S.W. 2d 659 (Tex. App. 1990); ***Moor v. Moor***, 24 Tex. Civ. App. 150 (1900).

d. Patent Royalty Income

The royalty income from patents held by one spouse at the time of the marriage is community property ("fruit" of the spouse's separate property). ***Alsenz v. Alsenz***, 101 S.W. 3d 548 (Tex. App. 2003).

2. Personal Injury Recoveries

Amounts received by a spouse as a result of personal injury are separate property of that spouse except to the extent that the amount received represents reimbursement for medical expenses and loss of earning capacity. Tex. Fam. Code § 3.001; ***Graham v. Franco***, 488 S.W. 2d 390 (Tex. 1972).

Damages recovered in a survival action are not community property, because they are limited to damages to the decedent before the decedent's death for injury to his health, reputation or person, and funeral expenses. Tex. Civ.

Prac. & Rem. Code § 71.021; ***Russell v. Ingersoll-Rand Co.***, 841 S.W.2d 343,345 (Tex. 1992). Loss of future earnings is not recoverable in a survival action. ***Yowell v. Piper Aircraft Corp.***, 703 S.W.2d 630, (Tex. 1986).

If the judgement or settlement document does not apportion the recovery, the entire amount will be classified as community property. ***Kyles v. Kyles***, 832 S.W. 2d 194 (Tex. App. 1992).

No Texas court has considered whether punitive damages should be classified as separate property or community property - perhaps they should be classified in proportion to the underlying award.

Recovery for loss of consortium is the separate property of the plaintiff spouse. ***Reed Tool Co. V. Copelin***, 610 S.W. 2d 736 (Texas 1980).

3. Life Insurance Policies

The "inception of title" rule applies in determining whether a whole life insurance policy is separate property or community property. Under that rule, the first premium payment determines ownership. ***McCurdy v. McCurdy***, 372 S. W. 2d 281 (Tex. Civ. App. 1963); see also ***Parson v. United States***, 460 F.2d 228 (5th Cir. 1972) [policy acquired during marriage but while domiciled in a common law state]. The same rule applies to term policies if the policy has a guaranteed-renewable feature and a guaranteed-convertible feature. ***Estate of Cavenaugh v. Commissioner***, 51 F.3d 597 (5th Cir. 1995).

If community funds are expended on a separate property policy, the community may have a claim for equitable reimbursement.

4. Retirement Benefits

The "inception of title" rule is ***not*** used to determine a spouse's interest in an employee spouse's retirement plans. The employee benefits are a form of compensation and, thus, are community property during a marriage. The nonemployee spouse's interest (at divorce or death) is determined using the "apportionment theory", which is based upon the percentage of contributions to the plan during the marriage. ***Berry v. Berry***, 647 S.W. 2d 945 (Tex. 1983); ***Dessommes v. Dessomes***, 544 S.W. 2d 165 (Tex. Civ. App.–Texarkana 1976; writ ref'd n.r.e.); ***Dewey v. Dewey***, 745 S.W. 2d 514 (Tex. App. 1988).

If the employee spouse's participation in the benefit plan begins ***during*** marriage, *all* of the assets in the plan are community property subject to division upon divorce. If the employee spouse's participation in the benefit

plan begins ***before*** the marriage, the plan assets/benefits are part separate property and part community property. ***Dewey v. Dewey***, ***supra***. The determination of the nonemployee spouse's portion is fairly simple when the plan is a defined contribution plan. Tracing rules are used to determine contributions to the plan, dividend and interest income received by the plan and appreciation in plan assets. Tex. Fam. Code § 3.007(c). In a defined benefit plan, the spouse's community property portion is calculated as the value the spouse would receive if he began participation in the plan on the date of marriage and was eligible to retire as of the date of divorce (or death). ***Berry v. Berry, supra.*** Tex. Fam. Code § 3.007(a) and (b).

See further discussion of division of retirement benefits and life insurance policies at Section V.D, "Divorce" and Section VI.C, "Death".

5. Corporations, Partnerships, Sole Proprietorships

a. Corporations

A corporation owned before by one spouse before marriage or capitalized with one spouse's separate property during marriage is separate property of that spouse***. Holloway v. Holloway,*** 671 S.W. 2d 5 ((Tex. App.–Dallas 1983, writ dism'd); ***Jensen v. Jensen***, 665 S.W. 2d 107 (Tex. 1984).

The Supreme Court in ***Jensen*** did recognize that the community has an ***equitable claim for reimbursement*** for the value of the time, toil, talent and effort expended by either spouse to enhance his separate property business, other than that reasonably necessary to manage and preserve the separate estate, less the remuneration received for that time, toil and effort in the form of salary and other benefits.

Dividends received from corporations, absent a valid agreement to the contrary, are community property income, as well as interest on bonds. ***Amarillo National Bank v. Liston***, 464 S.W. 2d 395,406(Tex. Civ. App. - Amarillo 1970, writ ref'd, n.r.e.) Stock received due to stock splits or stock dividends is separate property (it is a mere change in corporate structure). ***Tirado v. Tirado***, 357 S.W. 2d 468 (Tex. Civ. App.–Texarkana 1962, writ dism'd). A capital gain with respect to stock is that is separate property is also separate property. ***Bakken v. Bakken***, 503 S.W. 2d 315 (Tex. Civ. App.–Dallas 1975, no writ).

For stock options or restricted stock owned by one spouse, a proration rule similar to that used for interests in defined benefit plans and defined contribution plans may be applied determine separate and community interests. Tex. Fam. Code § 3.007(d). In ***Demler v. Demler***, 836 S.W. 2d

696, 699 (Tex. App. --Dallas 1992, no writ), options earned during the marriage from separate property stock were held to be community property. In ***Bodin v. Bodin***, 955 S.W.2d 380 (Tex. App. -- San Antonio 1997, no writ), unvested stock options were held to be a contingent interest in property and community property.

b. Partnerships

The "inception of title" rule determines whether a partnership interest is separate or community property. ***Harris v. Harris***, 765 S.W.2d 798 (Tex.App.–Houston [14th District] 1989, writ denied. Distributions from a partnership are community property, whether the partnership interest is separate or community in nature. ***Marshall v. Marshall***, 735 S.W. 2d 587 (Tex.App.–Dallas 1987, no writ).

NOTE TO ESTATE PLANNERS: In a family limited partnership situation, carefully consider the contribution of separate property of either spouse to the partnership. While the limited partnership interest itself can be separate or community property, the character of the income could "change" from separate to community (depending on whether it was separate or community income before the property was contributed to the partnership).

c. Sole Proprietorships

Profits earned by a spouse from the operation of a sole proprietorship are community property even if the capital of the business is a spouse's separate property. Tex. Fam. Code § 3.001.

III. Managing the Assets

A. Purpose of Management Rules

The rules for "managing" marital property determine each spouse's power to deal with assets on behalf of the community, including buying, selling, leasing, encumbering assets.

B. Separate Property

Each spouse has the sole power to manage, control, and dispose of his or her separate property without the other spouse's consent. Tex. Fam. Code § 3.101. The major exception to this rule is homestead property, as both spouses must join in any transfer or other conveyance. Tex. Fam. Code § 5.001.

C. Sole Management Community Property

Each spouse has the sole power to manage, control and dispose of community property he or she would have owned if single, including personal earnings, revenue from separate property, recoveries for personal injuries, and the increase in and income from all sole management community property. Tex. Fam. Code § 3.102. Property held in the name of one spouse is presumed to be sole management property of that spouse. Tex. Fam. Code § 3.104.

D. Joint Management Community Property

1. General Rule

If sole management community property of one spouse is combined with the other spouse's sole management community property, the combined property is subject to joint management and control of the spouses, unless the spouses provide otherwise by a power of attorney in writing or other agreement. The most common example of joint management community property is a joint bank account where each spouse deposits their earnings.

2. Title taken in Both Names

If title is taken in both names, a presumption arises that the property is joint management community property. ***Cooper v. Texas Gulf Industries***, 513 S.W. 2d 200 (Tex. 1974).

E. Special Rules

1. Court Order

One spouse may obtain managerial control over what would be sole management community property of the other spouse by court order where the other spouse disappears, is missing in action or a prisoner of war, is abandoned by the other spouse or the spouses are permanently separated. Tex. Fam. Code § 3.101 and 3.102.

2. Incapacity of Spouse

If one spouse is declared judicially incompetent, the other automatically becomes community administrator with respect to all sole management and community management property. Tex. Prob. Code § 883. If the incapacitated spouse has any separate property, a guardian of the estate must be appointed, but the other spouse still has the right to manage the community estate. Tex. Prob. Code § 677. The court may order an inventory or accounting to be filed by the community administrator or remove a

community administrator and appoint a guardian in certain circumstances. Tex. Prob. Code § 883(c).

IV. Liability for Debts

A. Spousal Liability

Spousal liability rules are set forth in Texas Family Code § 3.201. Pursuant to Section 3.201, a person is personally liable for the acts of the person's spouse if the spouse acts as agent for the person or if the spouse incurs a debt for necessaries (medicine, food, rent, etc.) under Texas Family Code § 2.501. Except as provided in Texas Family Code §§ 3.201-3.203 (Subchapter C, Chapter 3, Subtitle B, Title 1 of the Texas Family Code), entitled "Marital Property Liabilities", community property is not subject to a liability that arises from an act of a spouse. Tex. Fam. Code § 3.201(b). Finally, a spouse is not an agent for the other spouse solely because they are married. Tex. Fam. Code § 3.201(c).

B. Marital Property Liability

Section 3.202 of the Texas Family Code provides rules of marital property liability. A spouse's separate property is not subject to liabilities of the other spouse unless both spouses are liable under some other rule of law. For example, due to the duty of support one spouse owes to the other under Texas Family Code § 2.501, all categories of marital property can be reached by creditors who provided necessaries - each spouse's separate property, each spouse's sole management community property and the joint management community property.

The next rule in Section 3.202 states that unless both spouses are personally liable, one spouse's sole management community property is not subject to liabilities incurred by the other spouse ***before marriage*** or ***nontortious*** liabilities that the other spouse incurs during marriage.

Section 3.202 also provides that community property subject to a spouse's sole or joint management community property is subject to liabilities incurred by that spouse before or during marriage.

Finally, Section 3.202 provides that ***all*** community property is subject to liability of the torts of either spouse committed during marriage.

To state the rules another way, for ***contracts*** that do not involve necessaries, the creditor can reach only the contracting spouse's separate property and his sole management community property and all of the joint management community property. The creditor cannot reach the other spouse's separate property or sole management community property.

Exception: if one spouse entered into a contract while acting as agent for the other spouse, joint liability of the spouses exists and the creditor can reach all the property of both spouses. An

actual agency relationship must be shown to have existed. One spouse is not automatically the agent of the other solely because they are married. Tex. Fam. Code § 3.201(c); ***Nelson v. Citizens Bank & Trust Co.***, 881 S.W. 2d 128 (Tex. App. 1994).

With respect to ***tort liabilities***, for torts committed before marriage by one spouse, the creditor cannot reach the other spouse's separate property or sole management community property. With respect to torts committed during marriage, the creditor can reach all the community property, but not the other spouse's separate property. Tex. Fam. Code § 3.202; see ***Carlton v. Estate of Estes,*** 664 S.W. 2d 322 (Tex. 1983).

Divorce does not affect the right of preexisting creditors against assets that could have been used to satisfy the liability before the debt, no matter who is awarded the asset in the divorce. See ***Stewart Title Company v. Huddleston***, 598 S.W. 2d 321 (Tex. App.–San Antonio 1980) aff'd, 608 S.W. 2d 611 (Tex. 1980) per curium.

As noted above at Section II.A.4, an asset purchased on community credit is presumed to be a community property asset, unless the evidence shows that the creditor agreed to look solely to the separate estate of the contracting spouse for payment of the debt. Some case law which discusses the concept of "community debt" appears to be inconsistent with the legislative scheme set forth in Tex. Fam. Code §§ 3.201 and 3.202, in that some of the cases suggest that "community debt" is the same as "joint liability" of H and W.[3] The better approach appears to be an analysis of the liability of H or W using the statutory scheme.

Under a line of cases including ***Cockerham v. Cockerham***, 527 S.W. 2d 162 (Tex.1975), certain factors can be considered to determine whether a non-contracting spouse's separate property will be subject to liability on a community debt incurred by the other spouse and focus on a determination of whether the non-contracting spouse either expressly or impliedly agreed to be jointly liable on a community debt incurred by the contracting spouse. ***Latimer v. City National Bank of Colorado City***, 715 S.W. 2d 825 (Tex. App.–Eastland 1986 no writ); ***Miller v. City National Bank***, 594 S.W.2d 823 (Tex. Civ. App.–Waco 1980 no writ); ***Humphrey v. Taylor***, 673 S.W. 2d 954 (Tex. App.–Tyler 1984 no writ).

A special rule applies for funeral and burial expenses; such expenses are charged against the deceased spouse's share of community property only. Tex. Prob. Code § 320A. The purpose of this provision is to make the expenses 100% deductible for federal estate tax purposes.

V. Divorce

A. No Alimony

1. What is Alimony?

Court-ordered permanent alimony is against public policy in Texas. ***Francis v. Francis***, 412 S.W. 2d 29 (Tex. 1967). Texas is the only state in the country that does not provide for alimony.

Alimony consists of future periodic payments that are for the support of a spouse, imposed by court order and a personal obligation of the payor spouse. ***Francis v. Francis***, ***supra***.

While a court may not order alimony payments, parties may provide for contractual alimony in a property settlement agreement that involves periodic payments from one spouse to the other for a period of time. The fact the agreement is included as part of the divorce degree does not make the payments prohibited alimony payments. ***Francis v. Francis***, **supra**.

If a claim for alimony has been reduced to judgment in another state, the judgment for unpaid alimony is enforceable in Texas under the Full Faith and Credit Clause. ***Rumpf v. Rumpf***, 242 S.W. 2d 416 (Tex. 1951).

2. Spousal Maintenance

Spousal maintenance payments may be ordered in certain narrow circumstances, but payments may only be made for up to three years. Tex. Fam. Code § 8.051. Maintenance payments may be ordered if (i) the marriage lasted 10 years or longer, (ii) the spouse seeking maintenance does not have sufficient property to provide for her needs and (iii) the spouse seeking maintenance has an incapacitating disability, is the custodian of a child who needs special care, or lacks earning ability adequate to provide support for her minium reasonable needs. Tex. Fam. Code § 8.051(2).

Spousal maintenance may also be ordered where the marriage did not last 10 years if the payor spouse was convicted of family violence within two years before the divorce action was filed or during the pendency of the action. Tex. Fam. Code § 8.051 (1).

The payments may not exceed $2,500 per month or 20% of the payor's monthly income. Various factors such as age and employment history will be considered by the court. The spouse seeking the payment must have exercised diligence in seeking employment. Tex. Fam. Code § 8.053.

B. "Just and Right" Division of Property

1. Community Property

Section 7.001 of the Texas Family Code directs the court in a divorce proceeding to award child custody, provide for child support, and divide the "estate of the parties" in a just and right manner. The Texas Supreme Court has held that the "estate of the parties" is community property only. ***Eggemeyer v. Eggemeyer***, 554 S.W. 2d 137 (Tex. 1977); ***Cameron v. Cameron***, 641 S.W. 2d 210 (Tex. 1982).

The factors to be considered by the court include disparity of incomes and earning capacities, including the parties' probable respective needs for future support, the spouses' business opportunities and relative financial conditions, the spouses' educations, the spouses' ages and relative physical conditions, the amount of separate property of each spouse, the nature of the property, the length of the marriage, which party was at fault, and whether one party has wasted community assets. ***Murff v. Murff***, 615 S.W. 2d 699 (Tex. 1981); ***Young. v. Young***, 609 S.W. 2d 758 (Tex. 1980). The cases conflict as to whether fault in the breakup of the marriage can be considered in a no-fault divorce. ***Eikenhorst v. Eikenhorst***, 746 S.W. 2d 882 (Tex. App. 1988); ***Phillips v. Phillips***, 75 S.W. 3d 564 (Tex. App. 2002). The court can make an unequal division of community liabilities. ***Goren v. Goren***, 531 S.W. 2d 897 (Tex. Civ. App. 1975).

The court can consider the needs of a disabled adult child under the "just and right" division. ***Young v. Young***, ***supra***.

A finding of just and right division of property can only be overturned by a finding that the division was manifestly unjust. ***Law v. Law***, 517 S.W. 2d 379 (Tex. Civ. App. 1975). The Court of Appeals, upon such a finding, can only remand to the trial court for a new trial. ***McKnight v. McKnight***, 543 S.W. 2d 863 (Tex. 1976).

If the spouses agree in writing, the court can classify earnings of each spouse during the year of divorce (and income from spouse's separate property) as separate property of each spouse for the entire year. Tex. Fam. Code § 7.002(c). Otherwise, each spouse must report one-half of all community property income up to the date of divorce along with their income after the date of divorce.

Generally, a homestead is not subject to forced sale. However the divorce court can order that the community homestead be sold and the proceeds partitioned between the spouses. ***Kirkwood v. Domnan,*** 80 Tex 645 (1891).

2. Separate Property

The court cannot divest either spouse of title to his or her separate property. ***Eggemeyer v. Eggemeyer***, 554 S.W. 2d 137 (Tex. 1977); ***Cameron v. Cameron***, 641 S.W. 2d 210 (Tex. 1982).

The court may order a parent obligated to pay child support to set aside separate property, such as a homestead, to be administered for the child's support. Tex. Fam. Code § 7.002(c)**;** ***Gerami v. Gerami*****,** 66 S.W. 2d 241 (Tex. Civ. App. 1984).

3. Quasi-Community Property

One exception to the rule that each party receives his separate property in a divorce is for "quasi-community" property. If one Texas spouse owns separate property acquired during marriage in a common law state that would have been community property ***if*** the spouses had been residing in Texas, such property is subject to division in a divorce as community property. Tex. Fam. Code § 7.002(1) and (2); see ***Cameron v. Cameron***, 641 S.W. 2d 210 (Tex. 1982). (This rule only applies upon divorce, not at death.)

The application of this rule is complicated by "conflicts of law" principles and whether the property involved is real property or personal property.

C. Rights of Creditors

While the divorce court can rule that one spouse should pay a particular liability, the court cannot protect the other spouse from any creditor for whose debt the spouse is personally liable.

Also, as noted above at Section IV.B, the assets that could be reached by the creditor before the divorce can still be reached by the creditor after the divorce.

Therefore, if the creditor collects from the spouse who is ***not*** ordered to pay the liability pursuant to the divorce decree, that spouse has only a claim of indemnification against the responsible spouse. See ***Stewart Title Company v. Huddleston***, 598 S.W. 2d 321 (Tex. App.–San Antonio 1980) aff'd, 608 S.W. 2d 611 (Tex. 1980) per curium; ***Anderson v. Royce***, 624 S.W. 2d 621 (Tex.App.–Houston [14th Dist.] 1981, writ ref'd n.r.e.).

A common example of this situation is where one spouse is ordered to pay a joint federal income tax liability. The Internal Revenue Service can collect from the second spouse and the only recourse for the second spouse is to sue the first spouse under the divorce decree.

D. Interests in Retirement Benefits/Life Insurance

In a divorce, the court must determine the rights of both spouses in all insurance policies and employee benefit plans. Tex. Fam. Code §§ 7.003 and 7.004.

To effectively divide retirement plan assets in a "qualified" plan governed by ERISA, the divorce court must award benefits to the nonemployee spouse in a special form of order, called a "qualified domestic relations order" and comply with detailed federal rules regarding the terms and conditions of the order. The court has jurisdiction over the order under Tex. Fam. Code § 9.101.

The statutory formula for dividing the plan assets is set forth in Section II.D.4, "Retirement Benefits", ***infra***.

As a practical matter, the spouse is often cashed out of the retirement plan by an award of other assets.

Revocation rule: If a ***former*** spouse is still named as beneficiary on a life insurance policy or a retirement plan after the marriage, the designation of the spouse is revoked and the proceeds or benefits will go to the contingent beneficiary. Tex. Fam. Code §§ 9.301 and 9.302.

Exceptions to revocation rule: The rule revoking the beneficiary designation does not apply if the divorce decree designates the former spouse as beneficiary, or the insured/employee redesignates the former spouse after the divorce, or if the former spouse is to receive the benefits in trust for a child of the insured or the former spouse. Tex. Fam. Code §§ 9.301 and 9.302.

If the insurer or employee pays the former spouse, they are not liable for improper payment unless the payor received notice before payment that the designation was invalidated by the statute, and, upon receiving notice, failed to pay the proceeds into the court registry. Tex. Fam. Code §§ 9.301(c) and 9.302(c).

Preemption of state revocation rule: The revocation statute is preempted by federal law (ERISA) for any "qualified" employee plan (for retirement benefits and insurance benefits). ***Egelhoff v. Egelhoff***, 532 U.S. 141 (2001) (involving a Washington statute similar to the Texas revocation statute). Also see ***Kennedy v. Plan Administrator for Dupont Savings and Investment Plan***, 497 F. 3d 426, affirmed (U.S. Supreme Court 2009). As most IRA's are not governed by ERISA, the Texas revocation statute would still be applicable to IRA beneficiary designations. (Note that SEP-IRAs may be subject to ERISA in some cases.)

(The divorce also revokes gifts made in a revocable living trust, appointments under medical powers of attorney and financial powers of attorney, and the appointment of a spouse as trustee under a revocable trust. It does not affect gifts or trustee appointments under an irrevocable trust, certain bank accounts such as "JTWROS" accounts, and annuities.)

E. Military retirement benefits/Social Security Benefits/VA Disability

With respect to military retirement benefits, the Uniformed Services Former Spouses' Protection Act, 10 U.S.C. §1408(c), provides that military retirement benefits may be paid to a divorced spouse pursuant to a court order providing for a division of property (including community property). Post- divorce increases in payment are not separate property of the retired military spouse; the divorced spouse will share in the increase in benefits. Anderson v. Anderson, 707 S.W. 2d 166 (Tex. App.–Corpus Christi 1986, writ ref'd n.r.e.). However, the United States Supreme Court held in 1989 that the Act applies only to regular benefits and not disability benefits. ***Mansell v. Mansell***, 490 U.S. 581 (1989). Texas courts have also ruled that military disability benefits are not subject to division in a divorce proceeding. ***Wallace v. Fuller***, 832 S.W. 2d 714 (Tex. App. 1992).

Social security disability benefits are not subject to division on divorce because of federal preemption. ***Richard v. Richard***, 659 S.W. 2d 746 (Tex. Civ. App. 1983).

Railroad Retirement benefits and Veterans Administration disability benefits have been held not to be subject to division under community property laws dues to federal preemption. ***Hisquierdo v. Hisquierdo***, 439 U.S. 572, 99 S. Ct. 802, 59 L.Ed.2d 1 (1979); ***Ex parte Johnson***, 591 S.W.2d 453,456 (_____).

F. Goodwill, Professional Degrees

1. Goodwill

The goodwill of a professional practice is not property subject to division on divorce. It does not possess value or constitute an asset separate and apart from the practitioner himself. It would be extinguished in the event of his death, retirement or disability, as well as in the event of the sale of his practice or the loss of his business. ***Nail v. Nail***, 486 S.W. 2d 761 (Tex. 1972).

<u>Exception</u>: If a group of doctors or attorneys incorporate their practice as a professional corporation, the stock is an asset that is subject to division on divorce. The stock should be valued in accordance with customary methods for valuing closely held stock, even if the value includes an amount for goodwill. ***Geesbreght v. Geesbreght,*** 570 S.W. 2d 427 (Tex. Civ. App. 1978).

Exception: Where a certified public accountant entered into a contract to sell his community property practice, the value of his practice was fixed by the sale price and subject to division on divorce. ***Austin v. Austin***, 619 S.W. 2d 290 (Tex. Civ. App. 1981).

2. Professional Degree

A professional education degree, such as a medical degree, is not a property right and is not divisible on divorce in Texas. ***Fraustro v. Fraustro***, 611 S.W. 2d 656 (Tex. Civ. App. 1981). In that case, W was a teacher who worked to put H through medical school and then they were divorced.

Because the degree is not "property", W could not make a claim for equitable reimbursement for her financial contribution to H's educational expenses.

G. Frozen Embryos

A recent Texas Appeals case held that although frozen embryos were community property subject to a "just and right and a fair and equitable division" upon divorce, the parties had entered into an agreement when freezing the embryos that directed that the embryos should be discarded in case of divorce. The Appeals Court held that the agreement was an enforceable contract. ***Roman v. Roman***, 193 S.W.3d 40 (Tex. App.----Houston[1st Dist.] 2006, pet. filed).

H. Lifetime Gifts

Either spouse can make gifts of their own separate property to anyone without the spouse's consent and can give his or her one-half community property interest **to the other spouse.** With respect to lifetime gifts of a community property interest to a third party, Texas allows reasonable gifts without the other spouse's consent, such as small gift to siblings of the decedent.. Gifts to a third party that are excessive are voidable. Gifts to an *unrelated* party, such as a girlfriend, are presumptively fraudulent.

VI. Death

A. Intestacy

If one spouse dies intestate (without a will), a different set of rules applies to the intestate distribution of separate and community property. The "just and right" division of divorce is not applicable in probate matters.

1. Separate Real Property

The surviving spouse inherits a life estate in one-third of the separate real property of the decedent's separate real property. Tex. Prob. Code § 38**.** The remaining interest in the separate real property is inherited by the decedent's children. The remaining interest would be outright ownership in two-thirds of the property and a remainder interest in the other one-third.

Example: If H died owning a ranch that he owned before marriage (his separate property), W would inherit a 1/3 life estate in the ranch and the decedent's children, A and B (not necessarily W's children), would inherit the remaining interest.

2. Separate Personal Property

The surviving spouse inherits one-third outright and the other two-thirds passes to the decedent's children. Tex. Prob. Code § 38**.** In the example above, W takes 1/3 of the personal property outright and A and B each take 1/3 of the personal property outright.

3. Community Property

Since 1994 in Texas, if all of the decedent's children are also the surviving spouse's children, the surviving spouse takes all of the community estate (the surviving spouse keeps his or her 1/2 of the community and inherits the deceased spouse's 1/2 of the community estate). If decedent had any children from a prior marriage, the decedent's one-half community property interest would pass to all of his children. Tex. Prob. Code § 45. In the example above, if A and B were children of a prior marriage, they would inherit H's 1/2 community property interest and W would not inherit any community property (she already owns her 1/2 of the community estate).

CAVEAT TO INTESTACY RULES: As with the divorce situation, in Texas be careful of situations where a live-in partner makes a claim of common-law marriage. With nothing in writing, a live-in can take all the property of the decedent by proving that they lived together and were holding themselves out as married. This rule can produce harsh results for the person's actual relatives and, unlike a divorce, both people aren't around to testify.

B. By Will

Each spouse has the power of disposition over his or her separate property at death, as well has his or her one-half of the community estate and can leave these assets by will to whomever the spouse chooses. Tex. Prob. Code § 57**; see *Avery v. Johnson*,** 108 Tex. 294, 192 S.W. 542 (1917). There is no dower, curtesy or forced share of the decedent's property, as you might find in common law states.

If the decedent's will purports to dispose of both halves of community property, the survivor may have the option of making a 'widow's election". For this rule to apply, the decedent must attempt to dispose of property belonging to the surviving spouse while granting some benefits to the surviving spouse. Also, the surviving spouse must elect to allow his property to pass according to the will provisions before accepting the benefits under the will. Finally, the will must clearly put the survivor to an election (either expressly or by implication). ***Wright v. Wright***, 154 Tex. 138, 274 S.W. 2d 670 (1955); ***Calvert v. Forth Worth National Bank***, 348 S.W. 2d 19 (Tex. Civ. App–Austin 1961).

The decedent might purport to make a disposition of 100% of one asset only in his will, as if he owned the asset as his separate property. In such a case, the surviving spouse's election extends to the entire will and not just the one devise. The spouse must either claim under the will in its entirety (giving up rights in the single asset) or "renounce" the will in its entirety and take her 1/2 community share. ***Chace v. Gregg***, 88 Tex. 552 (1895).

C. Nonprobate Assets

1. Retirement Benefits

Upon the death of a ***nonemployee*** spouse, Texas law clearly holds that the nonemployee spouse retains an interest in the community property portion of the ***employee*** spouse's retirement plan that can be devised by will of the nonemployee spouse. ***Allard v. Frech***, 754 S.W. 2d 111 (Tex. 1988); see also ***Valdez v. Ramirez***, 574 S.W. 2d 748 (Tex. 1978).

The United States Supreme Court has held that state community property laws are preempted by federal law with respect to interests in "qualified" plans upon the death of the nonemployee spouse and, therefore, the nonemployee spouse does not have a devisable interest in the "qualified" plan. ***Boggs v. Boggs***, 520 U.S. 823 (1997). Also see ***Kennedy v. Plan Administrator for Dupont Savings and Investment Plan***, 497 F. 3d 426, affirmed (U.S. Supreme Court 2009). "Qualified" plans are those governed by the Employee Retirement Income Security Act of 1974 ("ERISA"). The reasoning in the ***Boggs*** case was that the purpose of ERISA is to provide retirement benefits for the living and that it would be contrary to that purpose

to allow testamentary beneficiaries of the nonemployee spouse to acquire an interest in the pension benefits. But see the dissent in ***Boggs v. Boggs*** which notes that a nonparticipant spouse that divorces the participant spouse can receive her share of the benefits, but if the nonparticipant spouse stays married and just dies, her estate gets nothing.

Boggs v. Boggs involved Louisiana community property laws and in ***Kennedy v. Plan Administrator for Dupont Savings and Investment Plan, supra***, the Supreme Court ruled the same way with respect to Texas community property laws.

IRA's are not governed by ERISA and, therefore, ***are*** subject to Texas community property laws. Therefore, a nonemployee spouse has a community interest in the employee spouse's IRA upon divorce or death. ***Allard v. Frech, supra***. (However, note that in some cases SEP-IRAs may be governed by ERISA.)

2. Life Insurance Benefits

As noted above, the "inception of title" rule applies in determining whether a whole life insurance policy on either spouse, is separate property or community property. See cases at Section II.D.4, "'Retirement Benefits", ***infra***.

If the policy is purchased on the life of one spouse with community property funds and the insured spouse dies, one-half of the proceeds belongs to the surviving spouse and 1/2 of the proceeds belongs to the deceased spouse's estate.

Federal tax regulations are consistent with this rule; the regulations provide that if the proceeds of the policy are paid to a third party (a child for instance) named by the deceased spouse, it is considered a gift by the other spouse of one-half of the proceeds under the regulations. See Treas. Reg. §2042-1(c)(5).

One Tax Court case (which has been questioned) held otherwise - holding that 100% of the proceeds was includible in the deceased spouse's taxable estate - but apparently based that holding on the fact that the surviving spouse did not prove fraud on the community in the purchase of the policy with community property. ***Street v. Commissioner***, 73 T.C.M. (CCH) 1787 (1997).

If the deceased spouse names someone other than the surviving spouse as the beneficiary of a life insurance policy that is a community property asset, the surviving spouse can assert fraud on the community in a litigation proceeding and perhaps obtain her 1/2 of the policy proceeds. The cases go both ways. See ***Madrigal v. Madrigal***, 115 S.W.3d 32 (Tex.App.-San Antonio 2003, no writ), for an analysis of the "fraud on the community" arguments.

If the beneficiary named is the child of the deceased spouse and the surviving spouse, for example, fraud is harder to prove. If the beneficiary named is the mistress of the deceases spouse, fraud is easier to prove.

In a case where the surviving spouse chooses to allow the benefits to flow to the children without a challenge, she has probably made a taxable gift that must be reported under federal gift tax laws.

FOOTNOTES

1. 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-existing 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; 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; and spouses may agree in writing that all or part of the separate property owned by either or both of them shall be the spouses' community property. Tex. Const. art. XVI, § 15, as amended Nov.2, 1948, Nov. 4, 1980, Nov. 3, 1987, and Nov. 2, 1999.

2. See Footnote 1, ***supra***.

3.