SELECTED ISSUES REGARDING TRACING AND CHARACTERIZATION

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State Bar of Texas Continuing Legal Education Committee, Former Member
Houston Bar Foundation - Fellow
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Founder and President, Ferguson Camp Poll, P.C., Certified Public Accountants, Analysts & Consultants - 1977 to Present. Perform determinations of economic damages, valuations, tracing of assets and liabilities, and forensic analysis to litigants, attorneys and Courts on matters including breach of contract and fiduciary duties, marital property, and property settlement issues. Engagements have involved various industries, and include business consulting and tax planning services.

Accountant, Ernst & Ernst - Four years on the tax staff.

Speaking and Writing Credits, including:

American Bar Association *Family Law Quarterly*, Volume 5, Number 2, Summer 2001, "Valuation Basics and Beyond: Tackling Areas of Controversy" (co-authored with John E. Camp, CPA/ABV, CFA)

American Academy of Matrimonial Lawyers, *Mid-Year Meeting*, March 2002, "Valuation Issues Related to 'Hard to Value' Entities"

State Bar of Texas, "*Marriage Dissolution Institute*, May 2002, "Slam Dunk the Mediation (Preparing for Effective Mediation of Property and Custody Issues in Divorce)" (co-authored and presented with Jan DeLipsey, JD and Randall B. Wilhite, JD, CPA)

State Bar of Texas, *Marriage Dissolution Institute*, May 2003, "Demystifying Tax Returns (Using Tax Returns as a Discovery Tool)"

State Bar of Texas, *Advanced Family Law Course*, August 2003, "Tax Issues - Significant Income Tax Developments" (presented with Edwin W. Davis, JD and Randall B. Wilhite, JD, CPA)

Practising Law Institute, *Basics of Accounting & Finance Summer 2003: What Every Practicing Lawyer Needs to Know*, "How Lawyers Use Financial Information—Mergers, Acquisitions, Valuations and Other Transactions and Their Impact on Reported Financial Results"

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2003, "Has the Golden Gate Rusted?" (presented with Mike Gregory, JD; J. Kenneth Huff, Jr., CPA/ABV; and Randall B. Wilhite, JD, CPA)

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State Bar of Texas, *Advanced Family Law Drafting and Advocacy: Art and Form 2003*, December 2003, "Drafting for Tax Issues" (co-authored with Cynthia Phuong Nguyen, CPA, JD)

State Bar of Texas, *Advanced Expert Witness Course*, February 2004, "Difficult Issues Relating to Lost Profits (Including Start-Up Businesses): Discussion and Demonstration" (co-authored with Cynthia Phuong Nguyen, CPA, JD; presented with Robert S. Harrell, JD)

State Bar of Texas, *Advanced Family Law Course*, August 2004, "Property Trial Demonstration" (presented with Gary L. Nickelson, JD, Melissa Nickelson, Hon. Mary Ellen W. Hicks, Brian L. Webb, JD, and G. Thomas Vick, Jr., JD)

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2004, "Sophisticated Corporate Structures" (co-authored with Cynthia Phuong Nguyen, CPA, JD; presented with Randall B. Wilhite, JD, Robert J. Piro, JD, and William W. Rucker, JD)

State Bar of Texas, *Advanced Family Law Course*, August 2005, "Employment Compensation & Benefits" (co-authored with Cynthia Phuong Nguyen, CPA, JD and Geoffrey S. Poll, CPA, JD; presented with Jeffrey Owen Anderson, JD, Jack W. Marr, JD, Jimmy Stewart, JD, and Thomas P. Goranson, JD)

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2005, "Help Us, Frank Lloyd!! The Heck with the Division–Is the Valuation Just and *Wright*?" (presented with Randall B. Wilhite, JD, Joan F. Jenkins, JD, and Stewart W. Gagnon, JD)

State Bar of Texas, *Advanced Family Law Drafting Course*, December 2005, "Tax Considerations and Drafting" (co-authored with Cynthia Phuong Nguyen, CPA, JD)

State Bar of Texas, *Advanced Family Law Course*, August 2006, "Business Valuation–Concepts, Issues, and Trends" (co-authored with John E. Camp, CPA/ABV, CFA, ASA and Cynthia Phuong Nguyen, CPA/BV, JD, NACVA)

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2006, "Selected Valuation Topics: Limitations on Use of RMA Data and Understanding the Build-up Method for Deriving Discount Rates" (author) and "Ghiradelli of a Lawyer If You Understand Goodwill" (presenter, with Joan F. Jenkins, JD, Stewart W. Gagnon, JD, Cheryl L. Wilson, JD, and Richard R. Orsinger, JD)

Association of Women Attorneys, November 2006, "Business Valuation–Concepts, Issues, and Trends" (co-authored with John E. Camp, CPA/ABV, CFA, ASA and Cynthia Phuong Nguyen, CPA/BV, JD, NACVA)

Houston Bar Association Family Law Section, March 2007, "Qualified Business Appraisers – Different Conclusions" (co-presented with Haran Levy, CPA/ABV, CVA)

State Bar of Texas, *Advanced Family Law Course*, August 2007, "Mi Casa Es Su Casa–Unless I Prove Otherwise" (co-authored Cynthia Phuong Nguyen, CPA/BV, JD, NACVA and co-presented with Michelle May O'Neil, JD) and panelist on "Looking Ahead: Long-Term Financial Planning In Connection with Divorce" (moderated by Jim Penn, CPA with Mark McLeland, CFM, CIMA; Paul A. Premack, JD, CELA, and Wesley E. Wright, JD, CELA)

State Bar of Texas, *New Frontiers in Marital Property Law Course*, October 2007, "Tracing, Economic Contribution, and Reimbursement Claims in Brokerage Accounts," (moderated by Donn Fullenweider, JD, and co-presented with Richard Orsinger, JD, and Stewart Gagnon, JD)

State Bar of Texas, *Representing Small Businesses*, March 2008, "Select Valuation Topics" (co-authored with John E. Camp, CPA/ABV, CFA, ASA) as part of "Valuation of Small Business" presentation (moderated by John Palter, JD and co-presented with David Fuller, CFA, ASA)

State Bar of Texas, *Advanced Family Law Course*, August 2008, "Effect of Choice of Entities: How Organizational Law, Accounting, and Tax Law for Entities Affect Marital Property Law" (co-authored and co-presented with Richard Orsinger, JD)

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2008, "Dealing with Complex Business Entities on Divorce" (moderated by Warren Cole, JD and co-authored and presented with Joan F. Jenkins, JD, Stewart Gagnon, JD, Jim Loveless, JD)

State Bar of Texas, *Marital Dissolution Institute*, April 2009, "Avoiding Financial Pitfalls"

State Bar of Texas, *Advanced Family Law Course*, August 2009, "Dealing with Complex Business Entities in a Divorce (Supplement)" (moderated by J. Lindsey Short, JD and co-authored and presented with Mike Gregory, JD and Jim Loveless, JD)

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Law Clerk, Harris County 270th Civil District Court, Houston, Texas - April 1999 to May 2000. Reviewed summary judgment motions filed with the court and presented the issues to the Judge.

Senior Accountant, Cemex Corporation (formerly Southdown, Inc.), Houston, Texas - April 1996 to April 1999. Prepared consolidated financial statements and other executive reports and supervised the accounts payable department.

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South Texas Law Review, Summer 2000, "An Ounce of Prevention is Worth a Pound of Cure?: Frivolous Litigation Diagnosis Under Texas Government Code Chapters 9 and 10 and Texas Rule of Civil Procedure 13"

State Bar of Texas, *Advanced Expert Witness Course*, February 2001, Co-author of "Lost Profits in Business Litigation"

Association of Legal Administrators, February 2002, author and co-presenter of "Cash, Modified, and Accrual Accounting"

State Bar of Texas, *Advanced Family Law Course*, August 2003, Co-author of "Tax Issues: Significant Income Tax Developments"

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2003, Co-author of "Has the Golden Gate Rusted?"

Houston Bar Association CLE, *2004 Family Law Institute*, March 26, 2004, Presenter and Co-author of "Using Tax Returns as a Discovery Tool"

State Bar of Texas, *Advanced Family Law Conference*, August 09-12, 2004, Co-author of "Property Trial Demonstration"

State Bar of Texas, *New Frontiers in Marital Property Law*, October 2004, Co-author of "Sophisticated Corporate Structures"

State Bar of Texas, *Marital Dissolution Institute,* April 2005, Co-author of "A Walk Through a Tax Return"

State Bar of Texas, *Advanced Family Law Course,* August 2005, Co-author of "Employment Compensation & Benefits"

State Bar of Texas, *Advanced Family Law Drafting Course,* December 2005, Co-author of "Tax Considerations and Drafting"

State Bar of Texas, *Advanced Family Law Course,* August 2006, "Business Valuation–Concepts, Issues, and Trends" (co-authored with Patrice Ferguson, CPA/ABV, JD and John E. Camp, CPA/ABV, CFA, ASA)

Association of Women Attorneys, November 2006, "Business Valuation–Concepts, Issues, and Trends" (co-authored with Patrice Ferguson, CPA/ABV, JD and John E. Camp, CPA/ABV, CFA, ASA)

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SELECTED ISSUES REGARDING TRACING AND CHARACTERIZATION

I. INTRODUCTION

Our goal is to address characterization and tracing of various assets which may be more common in moderate-sized estates. We hope to provide a basic understanding of information and documents involved in assessing a client's separate property claim(s), as well as to discuss the various tracing methods or approaches. The applicability of a particular holding, statute, or other authority, as well as the tracing analyses undertaken, varies with each fact pattern; therefore, the conclusions may differ with each change in fact, authority, or interpretation of an authority. This paper is not intended as a panacea for property disputes, nor a general treatise on characterization (which are available as part of the State Bar's online library), but a tool to assist you in determining the right questions to ask and where you may go to search for answers. The cases cited below are illustrative of a court's approach or conclusion regarding a particular fact pattern or issue; there may be other cases which we have not cited. The cited cases are not an exhaustive list of all possible cases dealing with the particular issues and our citation (or lack of citation) of a case is not because we believe that the case is more or less authoritative. This paper and our comments are for educational purposes only.

We have omitted the discussion regarding economic contribution and reimbursement (we understand that these issues will be addressed by Jonathan J. Bates) and discussions regarding defined benefit and contribution plans (topics will be addressed by Mark Gregory).

Though not technically tracing and characterization, we include a limited discussion regarding liquidity analysis and alimony treatment requirements under the Internal Revenue Service as we receive frequent inquiries regarding these areas.

II. ACKNOWLEDGMENTS

We wish to thank Richard Orsinger for use of his paper "Different Ways to Trace Separate Property" regarding tracing methodologies which was presented at the 35th Annual Advanced Family Law Course in August 2009.

III. GETTING STARTED

Property owned during or on divorce is presumed to be community. To overcome the community property presumption, the spouse claiming the separate property must clearly identify and trace the property.[1]

A. Characterizing Separate Property

What are the sources of separate property? Assets that are a spouse's separate property include, but are not limited to:

1. Assets owned or claimed prior to marriage[2]
2. Gifts[3]
3. Property acquired by devise or descent[4]
4. Partitioned property/income[5]
5. Personal injuries sustained during marriage, except loss of earning capacity during marriage[6] – to the extent that any insurance payment or workers compensation is intended to replace earnings while the disabled or injured person is not married, the recovery is the separate property of the disabled/injured spouse[7]
6. Assets acquired from advances of separate debt
7. Mutations or exchanges of separate property[8]

B. Proving Up Separate Property

Once you have identified the source of separate property, you must trace the separate property. 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.[9] In the marital dissolution context, tracing the property means that you must follow the separate property asset from the time it is identified (at the date of marriage or when received if during marriage) through the date of divorce. For example, Mom gifted W cash which was deposited in a bank account; a portion of the cash gift was used to acquire stock; the stock was then sold and the sales proceeds were expended to acquire the parties' current residence. W has the burden to prove that the funds used to acquire the residence stemmed from the original cash gift.

The party seeking to prove an asset as his/her separate property has to prove it by *clear and convincing evidence.*[10] The "clear and convincing" standard is something greater than the "preponderance of evidence" standard, but less than "beyond a reasonable doubt." *Clear and convincing* is the degree of evidence necessary to produce in the mind of the trier of fact a firm belief or conviction about the allegations sought to be established.[11] The requirement of clear and convincing evidence is way of stating that the assertion(s) must be supported by factually sufficient evidence.[12]

D. Insufficient Proof

A spouse is competent to testify about the character of his/her property; however, his testimony usually must be corroborated by other testimonial or documentary evidence, although a spouse's uncorroborated and uncontradicted testimony may be sufficient to constitute *clear and convincing* evidence.[13]

For example, *In re Marriage of Smith*, 2003 WL 22715581 (Tex. App. - Amarillo, 2003), documentation

was provided which showed that H had brought separate property into the marriage, and his testimony showed that during marriage, he received gifts from his parents. In support of his separate property claims, H provided a December 1992 account statement, an account application dated May 1992, a request for the transfer of assets dated May 1992, and retirement statements marked "closed out June 1992." The documents were almost six years after the marriage and did not provide any information identifying the source or origin of the property or when it was originally obtained. W challenged the trial court's finding that $15,111 of an American Funds account and $26,623 of the American Funds IRA account were H's separate property. The court stated that the testimony of the spouse claiming that the property was acquired with separate property funds, without any tracing of the funds, is generally insufficient to rebut the community presumption.

To put your best foot forward, attempt to obtain documentation from third parties, acknowledged documents, or those filed under penalties of perjury (e.g., tax returns). The more objective the information, the more likely the trier of fact will view the separate property claims as credible and supportable. Sometimes, the client may have documents which will show when and how the separate property was acquired; other times, the information may need to be requested from third parties or reverse-engineered. Of course, do not overlook persons with knowledge that would be able to testify about the property of interest. Below are documents which will assist in the proof of separate property.

1. Real Estate

Realty is characterized based upon when the party's right to the acquire the property was established, i.e. when he signed the earnest money contract/paid the down payment. *Carter v. Carter*, 736 S.W.2d 775. However, if the earnest money contract was executed after the date of marriage, *Gleich vs Bongio*, 128 Tex. 606, 99 S.W.2d 881 (Tex. 1937) applies and the character of the property is determined based upon the dollars used to acquire the property.

Ownership can be shown via deed and/or settlement statement from the title company. Other records which may reflect ownership are property tax receipts or the ownership history from the county appraisal district website which assessed property taxes. The appraisal district's website will often allow you to search by address, property tax identification number, owner name, etc. After the property information has been accessed, some districts will provide ownership history for a number of owners or multiple years.

If not listed below, use your favorite search engines to locate the county appraisal district website. For example:

- Harris County Appraisal District (http://www.hcad.org) – select ownership history on the top portion of the screen, it provides the ownership history for multiple years.
- Dallas Central Appraisal District (http://www.dallascad.org) – click the history option at the bottom of the page and it provides the ownership history for multiple years.
- Tarrant Appraisal District (http://www.tad.org) – after you access the property description, the site will provide you with the three prior owners.

2. Bank or Brokerage Accounts

Request copies of statement close-in-time to the date of marriage. Banks or brokerage houses will have limited time periods during which the information is available on line and on microfiche. See the bank account discussion below.

3. Stocks

Stocks owned prior to marriage are that spouse's separate property. Characterization of stocks acquired after the date of marriage is based upon the consideration paid to acquire the shares. Texas community property law treats stock dividends and stock splits the same: shares received from stock splits or stock dividends are the same character as the underlying shares.[14]

If a company has a sizeable amount of retained earnings, the market value of its shares is likely to increase. The higher the price of stock, the less readily it can be purchased, i.e. reduces the company's ability to raise additional capital. A stock split is the result of a company's decision to increase the number of shares that are outstanding with the general goal of reducing the stock price in order to attract additional investors. For example, H had 1,000 shares of Company stock. Company had 5,000,000 shares outstanding which were priced at $50 per share. Company decides to effect a 2:1 stock split, so H now owns 2,000 shares and Company has 10,000,000 shares outstanding and the share price is reduced to $25 per share. Before the split, H's 1,000 shares were worth $50,000; after the split, H's 2,000 shares are still worth $50,000.

When a company wants to capitalize a portion of its earnings (reclassify retained earnings to contributed capital) and thereby allow the company to retain its earnings instead of paying out cash dividends, the company may issue stock dividends to its shareholders. As in the stock split, after the stock dividend, each shareholder retains his/her proportionate interest in the corporation.

To prove up the separate estate ownership, request organizational documents, corporate records, or minutes

for closely-held entities which may report the number of shares owned by Spouse. If publicly-traded, look to brokerage statements or trade confirmations. If the shares are not certificated, or if the brokerage statements or trade confirmations are not available, you may be able to "reverse engineer" the number of shares a spouse owned at a particular time based upon the dividends received. For example, assume that Spouse owns shares of a publicly-traded stock and the stock pays dividends. The dividends will be evidenced by deposits, Form 1099-DIV which reports dividends paid to Spouse, and dividend income reported on Schedule B of Spouse's federal income tax return Form 1040. Divide the dividend income by the dividend paid-per-share to calculate the number of shares held at a particular time. The dividend history can be obtained online via Yahoo! Finance or other similar website, via investor reports of the company, financial statements issued by the company, or Standard & Poor's Annual Dividend Records.

4. Oil and Gas Properties or Interests

Assuming that mineral interest is separate property:

- royalty income is separate property because the revenue from the extraction of oil or gas is equivalent to a piecemeal sale of the separate corpus;[15]
- delay rentals are community property because they do not depend upon the finding or production of oil and gas and do not exhaust the separate corpus.[16]

Ownership may be shown via mineral deeds and division orders which may be obtained via the property records or, if the interest is significant, consider retaining a landman who will do a search for you. Royalties may also be reported on Form 1099-MISC and detail of the interests may be included on royalty checks issued by the operator. Expenses on interests for drilling/depreciation may be reported on income tax returns. The date that royalties were earned or expenditures were incurred may show the interests were acquired prior to marriage.

5. Gifts

A gift is a transfer of property made voluntarily and gratuitously, without consideration.[17] Keep in mind that the three elements necessary to have a gift: (i) intent to make a gift; (ii) delivery of property; and (iii) acceptance of the property.[18]

Gifts may be evidenced by trust agreements, notes or cards written when the gifts were made, testimony, and they may be reflected in Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return. Gifts may not be reported on the returns because the gifted amount was valued below the exclusionary amount or the donor may not have filed the return.

6. Inherited Property

Generally, when a person dies the heirs/legatees/devisees' interest in the estate of the deceased vests immediately, although their interest is subject to the debts of the testator or intestate.[19] Upon the issuance of letters testamentary or administration of the estate, the executor or administrator shall have the right to possess the estate.[20] The executor/administrator holds legal title and a superior right to possess estate property and to dispose of it as necessary to pay debts of the estate.[21] Until the administrator pays all debts owned by the estate and distributes the property, beneficiaries do not actually hold legal title to the devised property.[22] Thus, if the administrator exercises his power to dispose of estate property to pay debts of the estate, the sale of the property divests the beneficiary of his interests in the property.[23]

Inherited property may be evidenced by testamentary trusts, wills, other probate documents, Form 706 United States Estate (and Generation-skipping Transfer) Tax Return, and testimony from persons with knowledge.

7. Separate Debt Advances

If the debt is a separate obligation, the assets purchased from the loan proceeds would also be separate property. 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 contracting spouse for satisfaction.[24] Different cases have differing views on whether a specific recital that the creditor agreed to look to the separate estate for repayment is required or if separate property collateral secured the obligation was sufficient to create separate property debt.

Brazosport Bank of Texas v. Robertson, 616 S.W.2d 363 (Tex. Civ. App. - Houston [14th Dist], 1981, no writ) is an interesting case. In this case, W signed a note to purchase a car despite H's open objections. He refused to sign–only W signed the note. After divorce, the loan became delinquent, and Brazosport Bank sued both former spouses to recover the deficiency on the note after applying the sales proceeds from the vehicle which had been repossessed. The bank urged that H failed to show that the bank agreed to look solely to the separate property of W. The appellate court disagreed. The appellate court noted there was evidence that H refused to sign the note when asked to by the bank, that H informed the bank that "he wanted no part" in the purchase of the vehicle, that the bank was aware that the parties were arguing and during the argument, the bank personnel heard W repeatedly say to H that she would

work and make the car payments, that the bank was aware W had substantial income, and that the bank listed W's business address as the address for the note. The court also noted that the car was titled solely in W's name. The court stated:

> [w]e hold the Bank, by loaning the money to Mrs. Robertson despite Mr. Robertson's objections and his refusal to sign, in effect agreed with Mrs. Robertson to look to her alone for satisfaction of the note. We are mindful of the Texas Supreme Court decision in *Broussard v. Tian*, 156 Tex. 371, 295 S.W.2d 405 (1956) where the Court set forth criteria for determining the nature of a debt entered into during marriage.***367** We do not read *Broussard* as saying a debt entered into by one spouse during marriage is community in nature, even though the creditor is aware of strenuous objections from the other spouse and of that spouse's refusal to obligate himself on the debt. In our view *Broussard* does not prevent us from holding a creditor, by its action and conduct under these circumstances has agreed with the borrowing spouse to look only to that spouse's separate properties to satisfy the debt. Admittedly, the *Broussard* court was not faced with the situation we are here faced with; that is, a spouse specifically notifying the creditor beforehand of his objection and refusal to sign on the indebtedness. In this respect the cases are distinguishable, and we feel this factual difference is adequate support for the different result reached by us today.

In *Broussard v. Tian*,[25] H acquired property during marriage by paying $480 separate property cash and a $1,600 note. There was no written purchase contract, the deed listed H as grantee, and the vendor's lien note and deed of trust were executed by H and not W. The note and the deed of trust contained no recitals regarding the community or separate status of the purchase or source of consideration. The Texas Supreme Court in *Broussard* stated:

> ...nothing in the note or related instruments to the contrary, the note is by presumption and in legal effect a community obligation, unless somehow lawfully shown to be otherwise. In the absence of any such showing, the result would necessarily be that, to the extent of the face of the note, the community furnished the original consideration for the purchase and thereby acquired a *pro tanto* ownership in the property... The fact that the actual payment of all or some of the installments of the note were later made out of separate funds of the husband would not affect the community ownership, but would merely give rise to a debt or charge in favor of his estate against the community enforceable by appropriate proceedings...assuming the above-mentioned showing as to the noncommunity character of the note could be made by parol, as, under the facts here, it would have to be if made at all, the respondents-defendant had the burden of making it. In this connection, they introduced testimony of Tian which, when taken with other circumstances in evidence, they contend to be proof an agreement between the grantor, Federal Lands Bank, and Tian, sufficient under the above cited decisions, to make the note a separate property obligation of Tian and the property therefore entirely his separate estate. The single jury issue in the case was submitted under this theory, in response to which the jury had found that there was such an agreement that the note 'would be paid out of the separate property of M.J. Tian...the petitioner-plaintiff asserts, in addition to other contentions, that the finding is wholly unsupported by the proof tendered by the respondents-defendant, even if parol evidence of such an agreement were admissible.'

We agree with this contention.

The Court reviewed the testimony proffered by husband and stated:

> [p]ossibly the proof does amount to an 'understanding' in the sense that both parties considered the existence of the oil properties in question as a factor favorable to due discharge of the note. But it does not reflect a contract that it was to be paid out of those properties in particular, still less out of the separate property of Tian generally. The tenor of the discussion was simply that of an enquiry by the bank into the general prospects of the note being ultimately paid and an answer to that enquiry. The account of the conversation includes no statement from the bank representatives that they would make or recommend the sale on the strength of Tian's statement about his oil property or that the sale was to be conditioned on such property being retained by him or devoted to payment of the note, which was, of course, already secured by the vendor's lien. Still less is there anything to suggest that the bank, which initiated the discussion, had any interests in whether the source of payment of the note should be separate or community. The events subsequent to the conversation do not modify or amplify the words favorably to Tian's contention. Considering that the grantor was an institution specializing in land loans and related transactions, the actual consummation of

the sale without written references to the oil properties or to the separate or community character generally of the purchase suggests that there was not a special contract in this behalf rather than that there was.

8. Mutations

To maintain the character of separate property, it is not necessary that the property be preserved *in specie* or in-kind; it may undergo mutations and changes and still remain separate property–so long as it can be clearly and satisfactorily traced and identified to its separate origin, its distinctive character will remain.

Example: H owned a separate property house (House 1) which had an outstanding mortgage balance. W acknowledges that the property was owned by H prior to marriage. The home was insured, which was fortunate, because during marriage a flood occurred and damaged the home. Insurer pays funds to H. H sells the separate property house; he uses the sales proceeds along with a portion of the insurance proceeds to purchase House2. What is the character of House 2? House 2 would be H's separate property.

The court in *Burgess v. Burgess*, 2007 WL 1501117 (Tex. App. - Beaumont, 2007) dealt with this issue. There, the court found that the residence was separate property because the evidence was sufficient to demonstrate that the residence was H's separate property.[26] Citing Texas Family Code §3.008,[27] the court opined that the proceeds were also H's separate property because the proceeds from a casualty insurance payment takes on the character of the insured property. Would the payment of the insurance premiums create reimbursement?

C. Bank Accounts and CDs

Most separate property assets, either when initially acquired or sometime later in the chain of exchanges, takes the form of cash, and almost inevitably the cash is deposited in a bank or brokerage account. A few issues to keep in mind regarding bank accounts and certificates of deposits:

1. There is a presumption (though it may be rebutted) that when a spouse uses separate property to acquire an asset during marriage and takes title to that property in the names of both spouses, a presumption arises that the purchasing spouse intended to make a gift of one-half of the separate funds to the other spouse.[28] The common law presumption of gift was applied to purchase of real estate and homesteads, though it was later broadened to other types of assets where there is a title or owner or record, i.e. bank accounts[29] In 1979, the Nontestamentary Transfers Chapter of the Texas Probate Code was adopted and it had the effect of overriding the common law gift presumption on accounts: it provided that money in joint accounts belongs to the parties in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent;[30]

2. A pay on death (POD) account belongs to the original payee during his lifetime and not to the POD payee(s);[31] and,

3. The mere deposit of community funds in a joint account does not effectuate a partition of community funds.[32]

D. Tracing Methods Applicable to Cash

If separate property funds were deposited in an account that also contains community property funds, is all lost for the spouse asserting separate property? No. A showing of community and separate funds deposited in the same account does not divest the separate funds of their identity and establish the amount as community when the separate funds may be traced.[33] Fortunately for all of us, this does not mean that you or the client will have to track the serial number of each bill. 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 is known.[34] Cash is a fungible item but it can be traced, even though separate property cash is deposited in an account that also had community property funds.[35] Experts can use various methods to trace the separate property cash. Generally, cash can be traced in a detailed approach, as in a *line item tracing*, or a more aggregate approach, as in *minimum sum balance*. Under the *line item tracing method*, the deposits and withdrawals reported on bank and brokerage statements are entered line-by-line, presented in date order, and deposits are usually shown before disbursement for transactions in a particular day. Transactions are entered based upon when cash clears the account or the reported settlement date.

Bank and brokerage statements are usually available online or may be requested from the bank or brokerage house if the client does not have those documents. Be aware that there are fees associated with requesting the information from the bank; we are noting that more and more institutions are shortening the amount of time documents are retained, so some of the statements for longer-term marriages may not be available. When statements are not available, check registers, check copies, deposit slips, wire transfer records and other records may be used to recreate the account activity.

Example: Assume a joint bank account contained $50,000 community property on Day 1–

+ On Day 2 $100,000 of community property was deposited in the account.
+ On Day 3, $125,000 cash gift (separate property) was transferred into the account.
= At the end of Day 3, the account had a balance of $275,000.
– On Day 4, $100,000 was withdrawn from the account to purchase shares of ABC, Inc.
= The balance in the account after the withdrawal is $175,000.

What would be the character of the ABC, Inc. shares and the character of the $175,000 remaining in the account after the withdrawal? The answers depends upon which method of tracing is used.

1. Community Out First

This is the most common method of tracing we encounter. *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App. – Dallas 1955, writ dism'd) (*per curiam*) is the often-cited case and viewed by some as the case which established the acceptability of such a method. In *Sibley*, H deposited W's separate property cash in an account that contained community property funds. On October 11, a 160-acre farm was acquired with $1,929.08 cash withdrawn from the account and a note for the balance. In determining the character of the farm, the court had to determine which funds were withdrawn. The court stated that "[e]quity impresses a resulting trust on such funds in favor of the W and where a trustee [H] draws checks on a fund in which trust funds are mingled with those of the trustee, the trustee is presumed to have checked out his own money first,..."[36] "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."[37]

Under the hypothetical, if the *community out first* method is used, the ABC, Inc. shares would be 100% community property; the remaining balance is $50,000 community property and $125,000 separate property.

2. Separate Out First

In *Smith v. Smith*, 22 S.W.2d 140 (Tex. App. - Houston [14th District], 2000) the *separate out first* method was referenced. The court there appears to suggest that the party seeking to use a method other than *community out first* has the burden of citing evidence to apply another method. What evidence or factors would a court consider sufficient to justify using something other than *community out first* method? Would it matter to the court what the account was primarily used for, i.e. to pay living expenses? If *separate out first* is used, then the spouse loses his/her separate property if there is no reimbursement for living expenses.

In *Smith*, the court stated that evidence revealed that the account in dispute received both community funds and H's separate funds.[38] In determining that the balance in the account was H's separate property, the court stated:

> [g]enerally, when separate property and community property are commingled in a single bank account, we presume that the community funds are drawn out first, before separate funds are withdrawn, and where there are sufficient funds at all times to cover the separate property balance in the account at the time of divorce, we presume that the balance remains separate property. The only requirement for tracing and the application of the community out first presumption is that the party attempting to overcome the community presumption is that the party attempting to overcome the community presumption produce clear evidence of the transactions affecting the commingled account.[39]

The court further stated that the *community out first* presumption is a rebuttable one; however, W did not cite evidence to rebut the presumption.[40] In a footnote, the court also stated:

> ...a blind application of the community out first presumption does not uphold the policy reason for the presumption's original application...In *Sibley*, the question involved the Husband's spending funds from an account in which community funds had been commingled with the Wife's separate funds. The application of the community out first presumption thus preserved the Wife's separate estate. Here, however, mechanical application of the community out first presumption leads to the Husband preserving his separate estate at the expense of the community. Were we to view Husband as a trustee acting in the best interest of the beneficiary, we would apply not the community out first presumption, but a separate out first presumption. We would presume Husband spent his own funds before spending the community funds thus leaving community funds in the account for possible disbursement to the beneficiary–the Wife–upon dissolution of the marriage. Husband would have the burden of rebutting the separate out first presumption. We apply the community out first presumption because it seems to be established law.[41]

Under the hypothetical, the ABC shares would be 100% separate property, and the remaining balance in the account would be $150,000 community property and $25,000 separate property.

3. Pro Rata

Under the *pro rata approach*, when an account contains both community funds and separate funds, the withdrawals are presumed to be made pro rata in proportion to the balance in the account.[42]

In the hypothetical, the balance in the account prior to the withdrawal was 55% community property ($150,000/$275,000) and 45% separate property. The ABC shares would be a mixed character asset: 55% community property and 45% separate property; the percentages also apply to the remaining cash balance: $95,455 community property and $79,545 separate property. Assume also that the next deposit of $25,000 was separate funds. After the deposit, the account balance is $200,000, of which the community amount is still $95,455 and the separate amount is $104,545 (48% and 52%, respectively). The withdrawal that immediately follows the transaction would be in the same proportion, i.e 48% community property and 52% separate property.

4. Intent

See Richard Orsinger's paper for citations of cases regarding the consideration of a spouse's intent.

Under this approach, the client and/or the expert would determine the characterization of the withdrawals based upon the client's intent. To lend credibility to a spouse's testimony regarding intent, attempt to obtain supporting documents such as written notes around the time of the transaction, communications with third parties, or other evidence which supports the intent. The challenge in relying on intent is that the client or your expert will need to explain the story(ies) regarding the various types of withdrawals that occurred–why the other withdrawals were intended or not intended to be funded with separate funds. In our simple hypothetical, it may be easy to explain the intent or the history of the account since it contains limited transactions; however, where there are thousands of transactions in a single account used for multiple purposes, the task is more challenging.

5. Clearing House and Identical Sum Inference

Under the *clearinghouse method*, after one or more identifiable sums of separate funds are temporarily deposited into one account and then those identifiable sums are withdrawn, the withdrawals (and whatever was acquired with those funds) are treated as separate property. Similar to the *clearinghouse method*, the *identical sum inference method* involves only one deposit rather than a group or series of deposits. Issues arise in this method when the *amounts* of the deposit or the withdrawal are not exact or when the deposit and the asserted related withdrawal do not occur *close in time*. In our example, the ABC shares would be entirely community property if the $100,000 withdrawal is associated with the $100,000 deposit on Day 2. What if the other spouse asserts instead that the $125,000 deposit of separate funds on Day 3 was made in anticipation of, and was for the sole purpose of, the purchase of the shares on Day 4–should the shares be characterized as separate property instead? "Identical sum" does not always mean exact amount.

6. Minimum Sum Balance

The *minimum sum balance method* would likely be the least expensive method of tracing cash (in terms of professional fees) because as long as the cash balance in the bank account does not fall below the separate property cash deposited into the account, the separate property funds are presumed to remain in the account. This method should result in the same characterization as the *community out first method* because the community funds are drawn out first, and as long as the balance remaining in the account is equal to or less than the separate fund deposited, the balance has to be the separate funds.

A disadvantage of using the *minimum sum balance method* is that if the separate property deposit(s) exceeded the remaining balance in the account, the separate property cash withdrawn is not accounted for. Additionally, if statements for the relevant periods are missing or otherwise unavailable, the *minimum sum balance method* may not be successful in showing that the separate funds were not depleted during the missing period(s) and therefore the remaining separate funds may not be proven to the satisfaction of the trier of fact.

7. Exhaustion Method/Family Expense Method[43]

The approach assumes that all family living expense are to be charged against community funds. The separate characterization can be established by showing that on a particular date a withdrawal occurs, the community funds were already exhausted on payment of family living expenses. Under this method, the community money will be used to pay family expenses before separate money will be used for family expenses. Therefore, it is not necessary to document every deposit and every expenditure as it occurred–no running balance is required. All of the family money that went into the account, up to the date in question, is calculated. Then all of the family expenses that were paid out of the account in the same time period are computed. If the family expenses are equal to, or greater than, the family income, what is left is separate property. Hence, the remainder of the account at the date or the asset purchased on that date with the "leftover" separate money is separate property.

In *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App. - Houston [14th Dist.] 2003, pet denied), W challenged the trial court's determination that H had separate funds

in a disputed account, and she asserted that the funds should have been community property since the account was commingled. H provided evidence showing the separate balance prior to marriage, the interest income earned from the account during marriage of $115,000, and a listing of withdrawals made for living expenses during the same period of $366,000.[44] The court noted that W did not provide evidence rebutting the *community out first* presumption and decided that, because the withdrawals for community expenses depleted community funds in the account, H rebutted the statutory presumption that the account was a community asset.[45]

What is considered a living expense? "Needs" are arguably a living expense, but are "wants" or luxuries considered living expenses? Would there be a limit on the number of vehicles? Are charitable donations considered living expenses? Are there limits on spending for clothing or other items–does it vary with the size of the potential community estate?

8. Maximum Community

Duncan v. United States, 247 F.2d 845 (5th Cir. 1957) involved an action where co-executors sought recovery of a portion of the estate taxes paid. The Commissioner of the Internal Revenue Service determined that various assets were separate property. The estate asserted that the records did not indicate how the disputed assets were acquired and, therefore, the community presumption should apply and the disputed assets should be characterized as community property. It was acknowledged that H had significant separate property. The records reflected that for the period between 1947-1949, the total possible community sources of income totaled approximately $17,000 after deductions for income taxes. Information regarding disbursements for living and household expenses was not established. The court stated that there was no other source whatever from which presumed community property funds were available to acquire the disputed assets; therefore, the total community interest in the disputed assets could not exceed the approximate $17,000, assuming that all of the income available for spending was used to accumulate the assets in question.

E. Characterization Of Restricted Stock and Options

Texas Family Code §3.007 in relevant parts provides:

> (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:
>
> (A) the numerator is the sum of:
>
> (i) the period from the date the option or stock was granted until the date of marriage; and
>
> (ii) if the option or stock also required continued employment following the date of dissolution of the marriage before the grant could be exercised or the restriction removed, the period from the date of dissolution of the marriage until the date the grant could be exercised or the restriction removed; and
>
> (B) 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 following the date of dissolution of the 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:
>
> (A) the numerator is the period from the date of dissolution of the marriage until the date the grant could be exercised or the restriction removed; and
>
> (B) 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.
>
> (e) The computation described by Subsection (d) applies to each component of the benefit requiring varying periods of employment before the grant could be exercised or the restriction removed.

Example: Parties were married January 1, 1980. On November 28, 2006, W's employer awarded her 80,000 shares of restricted stock. The restrictions lifted on 40,000 shares after her employment 5-year anniversary (November 28, 2011) and on the remaining 40,000 shares on November 28, 2016. Assume the parties were divorced January 1, 2010. Apply Texas Civil Code §3.007(d)(1) to determine characterization. §3.007(e) instructs that the computation should be

applied to each component with different dates on which the restrictions are removed.

The documents needed to perform the analysis will be information regarding the plan and/or the document awarding the restricted stock or options.

11/28/06 Award	80,000	
	/	\
Units Not Vested	40,000	40,000
Date of Divorce	01/01/10	01/01/10
Date Restriction Removed	11/28/11	11/28/16
Numerator	696	2,523
Date of Grant	11/28/06	11/28/06
Date Restriction Removed	11/28/11	11/28/16
Denominator	1,826	3,653
Separate Percentage	38.12%	69.07%
Community Percentage	61.88%	30.93%
Separate Shares	15,246	27,627
Community Shares	24,754	12,373
Restricted Units	40,000	40,000

F. Characterization of Retirement Plans

Defined Benefit and Defined Contribution Plans are covered in this course by Mike Gregory, so we limit our discussion. In order to address the retirement plans, your client should provide you information regarding the plans, when the client began participation in the plan, statements issued related to the plan holdings, and statements disclosing benefit amounts.

1. Defined Contribution Plan

The typical contribution plan is funded with an employee's pre-tax and/or post-tax earnings. Individual accounts are established for employees. Oftentimes, the employer also contributes to the plan. After funds are contributed into the plan, the cash is usually invested in municipal funds, bonds, stocks, or a combination thereof. The benefits payable to the employee are based upon the contributions and the growth or losses of the assets/investments in the account. Under Family Code §3.007(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 non-retirement asset.

2. Defined Benefit Plan

A *defined benefit plan* is an employer-sponsored retirement plan in which an employee's benefit will be based upon a formula which usually accounts for the employee's terminal earnings (average earnings of a certain number of years close-in-time to the employee's projected termination/retirement), service period or period of employment, and age, rather than on investment returns as in the defined contribution plan. The investments and management of the plan are controlled by the employer and not the employee**.**

Family Code §3.007 (a) and (b) which dealt with characterization of the defined benefit plans were repealed effective as of September 1, 2009. Due to the repeal, it appears that the *Taggart*[46] and *Berry*[47] formulations now apply.

G. Settlement Considerations

Example: Assume that the parties have determined the assets are community property and subject to division. Assume further that H is degreed and has employment, whereas W (your client) has been out of the workplace due to the spouses' joint decision for her to stay home the past five years to raise their kids.

H and W had $20,000 cash in a bank account, $100,000 in gain (FMV–purchase price) on principal residence, a $15,000 vehicle, and $65,000 in a retirement plan. H and his attorneys suggest that the parties split the value of their assets 50/50 in the following manner:

	Community	To W	To H
Bank account	$ 20,000	$ 20,000	$
Retirement plan	65,000	65,000	–
Home (FMV-basis)	100,000	–	100,000
Vehicle	15,000	15,000	–
Total	$200,000	$100,000	$100,000
	100%	50%	50%

Trial courts have wide latitude and discretion in dividing community property. The court may consider many factors, including earning capacity of the spouses, abilities, education, business opportunities, physical health, financial condition, age, separate estates of the spouses, future needs for support, expected inheritances, custody of children, reimbursements, gifts during marriage, fault in break up of the marriage, length of the marriage, attorney's fees, spouse's dissipation of the estate and tax consequences.[48]

What recommendations would you have for your client regarding which assets should be awarded to her?

1. Award of Assets with Tax Consequences

Under Texas Family Code Section 7.008 (effective September 1, 2005), in ordering the division of the estate of the parties to a suit for dissolution of a marriage, the court may consider:

(1) whether a specific asset will be subject to taxation; and

(2) if the asset will be subject to taxation, when the tax will be required to be paid.

Prior to the enactment of this statute, it was questionable as to whether or not a court could consider tax consequences associated with the various components of a marital estate in its property division. The statute answers in the affirmative: courts are allowed to consider the potential future, as well as currently existing, tax liabilities. The statute offers a means for the attorney to show the court the impact that taxes may have on the amounts that one spouse may realize in a division versus another. At a conference we've previously attended where the matter was discussed, a showing of participants' hands suggested that most attendees have not proffered this information to the court. In practice, the determination of the tax liabilities and their timing may be a challenge. While the weight attached to the calculations may vary with each circumstance, advocates and parties can be assured that the issue will in the very least be heard.

Even if the matter does not go to trial, the tax impact should be considered in settlement negotiations. In the example, it turns out the "equal" division is not so equal. If potential tax effects are considered, the retirement plan awarded to W is subject to ordinary income taxation upon withdrawal, reducing the after-tax value and causing cash to W to be less than $65,000, i.e. $45,500. H could realize the full $100,000 in equity on the sale of the home because the gains may not be subject to taxation if he meets IRC §121 non-recognition treatment.

	Community	To W	To H
Bank account	$ 20,000	$ 20,000	$ –
Retirement plan	45,500	45,500	–
Home (FMV-basis)	100,000	–	100,000
Vehicle	15,000	15,000	–
Total	$180,500	$ 80,500	$100,000
	100%	45%	55%

Except for *Robbins*, cases prior to the enactment of the statute suggest that the courts have been hesitant to consider potential tax liabilities associated with a marital estate.

a. *Robbins v. Robbins*, 601 S.W.2d 90, 92 (Tex. Civ. App. - Houston [1st Dist.] 1980, no writ)

In the trial court's decree, the court found that the proceeds from the sale of the parties' residence were not reinvested in another house within the period of time provided by the then-effective income tax laws, so that a capital gains tax liability may occur; the court then decreed that the H should assume and hold harmless W with respect to 60% of such tax liability. H contended that the court abused its discretion by ordering him to hold W harmless against such income tax liability. The appellate court opined that the trial court properly considered the income tax liabilities of the parties in dividing their community estate–the gains realized on the sale was recognized and the fact that the tax liability may be later reduced through a rollover into another residence did not render the parties' potential tax liability incapable of determination. [Note the income tax provisions regarding taxation on the sale of a residence has changed.]

b. *Freeman v. Freeman*, 497 S.W.2d 97 (Tex. Civ. App. - Houston [14th Dist.] 1973, no writ)

The trial court erred in valuing a pension plan because it deducted a hypothetical tax liability that would be incurred if the plan were immediately liquidated–there was no evidence that H intended on immediately liquidating the plan and the accountant failed to calculate the present value of the future tax liability.

c. *Simpson v. Simpson*, 679 S.W.2d 39 (Tex. App. - Dallas 1984, no writ)

The trial court erred in reducing the face value of the deferred compensation plans for the hypothetical present tax liability assuming present liquidation and H's current income tax rate. The appellate court suggested that, absent proof of a reasonable deduction for future tax liability, the plans had a *prima facie* value equal to their face value. The court did not expound on what would be considered "a reasonable deduction" for future tax liability.

d. *Harris v. Holland*, 867 S.W.2d 86 (Tex. App. - Texarkana 1993, no writ)

The trial court erroneously credited H for future tax consequences in the event of sales of cattle, supplies, and farm equipment when the accountant testified that he was unaware of any plans to dispose of those assets. The accountant also failed to adjust his calculations to reflect the present value of the future tax liability. The appellate court stated that it may be appropriate for a trial court to consider taxes associated with the sale of capital assets which had been realized by the parties at the time of divorce, i.e. existing tax liabilities; but where the question of whether the property will ever be subject to capital gains tax or not can be answered only by engaging in speculation or surmise, a trial court errs in allowing a credit for the "tax."

e. *Grossnickel v. Grossnickel*, 935 S.W.2d 830, Tex. App. - Texarkana 1996, writ denied)

W urged that the trial court erred by failing to reduce the face value of a retirement plan awarded to her in order to account for the 10% early withdrawal penalty and to account for the 31-33% estimated federal income

tax amount. The appellate court disagreed, observing that the early withdrawal option will be at the W's election after divorce and the tax consequence will depend on the applicable tax bracket and the income tax law in effect at the time. The court noted that under W's theory, there would a discount on every piece of property because there "might" be tax consequences if sold at a profit. It held that trial court did not abuse its discretion by not considering the potential tax liability if the assets are withdrawn from the plan.

2. Liquidity Issues

If the spouse you represent does not have the means to generate a steady flow of cash, it may be in his/her best interest to be awarded as much cash as possible. An assessment would need to be made:

- If spouse is awarded shares, can spouse realize that value or there restrictions on sales and transferability?
- Does spouse's interest in entity or fund require cash calls?
- What income/distributions were historically paid from entities or funds and what is the likelihood they will continue?
- Is there rental property which would provide monthly cash inflow?
- What are the costs associated with maintaining the rental property: fees, insurance, and taxes?

We recommend that you/client prepare a budget to assess the cash flow needs. Consider packaging the property settlement to include annuity payments or alimony payments.

3. Contractual Taxable Alimony

Contractual alimony may be subject to taxation: deductible by the spouse making the payments and taxable to the spouse that is receiving it. H may not have the wherewithal to make a lump sum cash payment to W, but he may wish to structure an alimony package as a means to provide cash flow in exchange for a particular interest. W, in return, benefits from a constant stream of income (be sure to secure the alimony payments) and may be able to negotiate a package that may be greater in value than the asset she is giving up. Often, W is in a lower tax bracket for income inclusion purposes than H, which means his alimony deductions for tax purposes shelter his regular income at a higher tax rate for the "savings" to him. In determining if the payments will constitute alimony, the parties' intent is irrelevant. For federal income tax purposes, alimony is a payment:

1. made in cash;[49]
2. that is received by (or on behalf) of a spouse under a divorce or separation instrument;[50]
3. that the divorce or separation agreement does not designate non-alimony treatment;[51]
4. if the spouses are divorced or legally separated, they reside in separate households when the payments are made;[52]
5. the payor's liability to make the payment does not continue for any period after payee's death.[53]

For the spouse receiving taxable alimony, prudent financial budgeting includes setting aside a portion of the payments received each month in an account to pay the income taxes on the payments on a quarterly basis as required by the IRS.

END NOTES

1. *Smith v. Smith*, 22d S.W.3d 140, 144 (Tex. App. - Houston [14th Dist.], 2000, no pet.).

2. Tex. Fam. Code §3.001(1).

3. Tex. Fam. Code §3.001(2).

4. Tex. Fam. Code §3.001(2).

5. Tex. Fam. Code §4.102 "At any time, the spouse may partition or exchange between themselves all or part of their community property, then existing or to be acquired, as the spouse may desire. Property or a property interest transferred to a spouse by a partition or exchange agreement becomes that spouse's separate property. The partition or exchange may also provide that future earnings and income arising from the transferred property shall be the separate property of the owning spouse."

6. Tex. Fam. Code §3.001(3).

7. Tex. Fam. Code §3.008(b).

8. *Norris v. Vaughan*, 152 Tex. 491 260 S.W.2d 676 (Tex. 1953).

9. *Smith v. Smith*, 22d S.W.3d 140, 144 (Tex. App. - Houston [14th Dist.], 2000, no pet.).

10. Tex. Fam. Code §3.003(b).

11. *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex.1965).

12. *Carter v. Carter*, 736 S.W.2d 775 (Tex. App. - Houston [14th Dist.], 1987, no writ) citing *Meadows v. Green*, 524 S.W.2d 509, 510 (Tex. 1975).

13. *Burgess v. Burgess*, 2007 WL 1501117 (Tex. App. - Beaumont, 2007) citing *Barh v. Korh*, 980 S.W.2d 723, 730 (Tex. App. - San Antonio 1998, no pet); *Robles v. Robles*, 965 S.W.2d 605, 620 (Tex. App. - Houston [1st Dist.] 1998, pet denied; *Pace v. Pace*, 160 S.W.d 3d 706, 714 (Tex. App. - Dallas 2005, pet. Denied).

14. *Tirado v. Tirado*, 357 S.W.2d 468 (Tex. Civ. App - Texarkana 1962, writ dism'd).

15. *Norris v. Vaughn* 152 Tex. 491, 260 S.W.2d 676, 679 (1983).

16. *McGarragugh v. McGarraugh*, 177 S.W.2d 296, 301(Tex. Civ. App. - Amarillo 1943, writ dism'd).

17. *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565, 569 (Tex. 1961); *Ellebracht v. Ellebracht*, 735 S.W.2d 658, 659 (Tex. App. - Austin 1987, no writ).

18. *Hayes v. Rinehart*, 65 S.W.3d 286, 289 (Tex. App. - Eastland 2001, no pet.).

19. Texas Probate Code §37.

20. Texas Probate Code §37.

21. *Gorham v. Gates ex rel. Estate of Baouh*, 82 S.W.3d 359, 365 (Tex. App. - Austin, 2002, pet. denied).

22. *Woodward v. Jaster*, 933 S.w.2d 777 (Tex. App. - Austin 1996, no writ).

23. *Gorham v. Gates ex rel. Estate of Baouh*, 82 S.W.3d 359, 365-366 (Tex. App. - Austin, 2002, pet. denied).

24. *Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975) citing *Broussard v. Tian*, 156 Tex. 371, 295 S.W.2d 405 (1956) and *Gleich vs Bongio*, 128 Tex. 606, 99 S.W.2d 881 (Tex. 1937).

25. *Broussard v. Tian*, 156 Tex. 371, 295 S.W.2d 405 (1956).

26. *Burgess v. Burgess*, 2007 WL 1501117 (Tex. App. - Beaumont, 2007).

27. Texas Family Code § 3.008(a) provides that 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.

28. *Cockerham v. Cockerham*, 527 S.W.2d 162, 168 (Tex. 1975).

29. *In re Marriage of Case*, 28 S.W.3d 154, 158 (Tex. App. - Texarkana 2000, no pet.).

30. *Id* at 159, citing Texas Probate Code §438 (a).

31. Texas Probate Code §438 (b).

32. *Tuttle v. Simpson*, 735 S.W.d 2d 539 (Tex. App. - Texarkana 1987, no writ).

33. *Holloway v. Holoway*, 671 S.W.d2 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).

34. *Welder v. Welder*, 794 S.W2d 420 (Tex. App. - Corpus Christi, 1990) citing *Trawick v. Trawick*, 671 S.W.2d 105, 110 (Tex. App. - El Paso 1984, no writ) and *Farrow v. Farrow*, 238 S.W.2d 255, 257 (Tex. Civ. App. - Austin 1951, no writ).

35. *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App. - Dallas 1995, writ dism'd, no pet.)

36. *Sibley* at 659.

37. *Id.*

38. *Smith v. Smith*, 22d S.W.3d 140, 145-146 (Tex. App. - Houston [14th Dist.], 2000, no pet.).

39. *Id*, citing *Welder v. Welder*, 794 S.W.2d 420, 433-434 (Tex.App. - Corpus Christi 1990, no writ); *Horlock v. Horlock*, 533 S.W.2d 52, 58 (Tex. Civ. App. - Houston [14th Dist.] 1975, writ dism'd w.o.j.; *but cf. Goodridge v. Goodrige*, 591 S.W.2d 571, 573 (Tex. Civ. App. - Dallas 1979, writ dism'd wo.o.j).

40. *Smith v. Smith*, 22d S.W.3d 140, 147 (Tex. App. - Houston [14th Dist.], 2000, no pet.).

41. *Id.*

42. Shelly D. Merritt, *Planning for Community Property in Colorado*, 31 Jun Colaw 79,80 (2002).

43. Joan F. Kessler, Allan R. Koritzinsky, Marta T. Meyers, *Tracing to Avoid Transmutations*, 17 JAMAML 371, 375 (2001). See also Richard Orsinger's paper in Acknowledgment section of this paper.

44. *Zagorski v. Zagorski*, 116 S.W.3d 309,320 (Tex. App. - Houston [14th Dist.] 2003, pet denied).

45. *Id.* at 321.

46. *Taggart v. Taggart*, 544 S.W.2d 661 (Tex. 1977).

47. *Berry v. Berry*, 647 S.W.2d 945 (Tex. 1983).

48. *Coleman v. Coleman*, 2007 WL 1793756 (Tex. App. - Beaumont, 2007) citing *Schleuter v. Schleuter*, 975 S.W.2d 584, 589 (Tex. 1998); Tex. Fam.Code Ann. § 7.008 (Vernon 2006) (tax consequences); *Murff*, 615 S.W.2d at 699;*Hailey v. Hailey*, 176 S.W.3d 374, 380 (Tex.App.-Houston [1st Dist.] 2004, no pet.); *Alsenz v. Alsenz*, 101 S.W.3d 648, 655 (Tex.App.-Houston [1st Dist.] 2003, pet. denied); *Vannerson v. Vannerson*, 857 S.W.2d 659, 669 (Tex.App.- Houston [1st Dist.] 1993, pet. denied); *Baccus v. Baccus*, 808 S.W.2d 694, 700 (Tex.App.-Beaumont 1991, no writ); *Massey v. Massey*, 807 S.W.2d 391, 398 (Tex.App.-Houston [1st Dist.] 1991, writ denied).

49. I.R.C. §71(b)(1).

50. I.R.C. §71(b)(1)(A).

51. I.R.C. §71(b)(1)(B).

52. I.R.C. §71(b)(1)(C).

53. I.R.C. §71(b)(1)(D).