"CHARACTERIZATION AND TRACING – A NEW SPIN ON AN OLD TOPIC"

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• Organizing and Using the Trial Notebook	Ultimate Trial Notebook: Family Law (2010)
• Evaluating Property Issues Amid Fairness Issues	New Frontiers in Marital Property (2009)
• Effective Presentation: What Good Lawyers Forget When Presenting Your Case on Temporary and Final	Advanced Family Law Course (2009)
• Representing And Defending Against the Impaired Parent	U.T. Family Law on The Front Lines (2008)
• Giving the Kids A Voice In The Courtroom	Advanced Family Law Course (2008)
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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Case Law **Page**

Statutes

Papers Referenced

Other References

CHARACTERIZATION AND TRACING: A NEW SPIN ON AN OLD TOPIC

I. INTRODUCTION.

The area of "Characterization and Tracing" is a basic topic that is covered in every Marriage Dissolution Course, as well as every Advanced Family Law Course. The topic is overwhelming as it also is featured in every New Frontiers in Marital Property seminar and will continue to be a "hot" and "essential" topic for the duration of time.

With that said, the author cannot attempt any discussion without referencing the following "treatises" from those attorneys who are much more scholarly and more distinguished than this author. Basic reading of Richard Orsinger's articles, including the recent "*Troubling Issues of Characterization, Reimbursement, Valuation and Division Upon Divorce*" from the 36th Annual Advanced Family Law Course 2010 (Chapter 36) as well as a paper authored by Chris Nickelson. These will enlighten the reader of the basic issues as well as the complex issues in this topic. Specifically, the author suggests you study Chris Nickelson's paper "*Proving Separate Property: An Argument for More Use of Summary Judgment Practice in Family Law Cases"* from the 36th Annual Advanced Family Law Course 2010 (Chapter 25). His paper acts as a comprehensive resource on what evidence will help you in proving up the separate character nature of several types of property.

This paper will try to tackle some 21st century recurring scenarios. The author stresses that the paper is also a suggestion only as it pertains advice on what courts may or may not do as the courts are split on some areas discussed herein. Most of our property cases do settle, and it is the gray area of these recurring scenarios that make the subject relevant to every family law practitioner and to every family law seminar!

The author thanks all those who have written on the topic, as well a Linda Hinds and Chris Nickelson, for their scholarly assistance.

II. THE BASICS.

All property possessed by either spouse during the marriage shall be divided upon divorce. Each spouse has an interest in that property. All such property is presumed to be community property. TEX. FAM. CODE 3.003(a). In order to rebut the presumption of community, the evidence must be "clear and convincing" that the property falls under one of the following:

a. Assets owned prior to the marriage;
b. Gifts;
c. Property acquired by devise or descent;
d. Partitioned property or income;
e. Personal injuries sustained during the marriage (excluding loss of earning capacity during the marriage);
f. Asset acquired from advances of separate debt; and
g. Mutations or exchanges of separate property.

The "clear and convincing standard" is something that is more than simply the "preponderance of evidence" but less than "beyond a reasonable doubt." The requirement of clear and convincing evidence is the way of stating that the assertion must be supported by factually sufficient evidence. *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). The definition provided in the TEXAS FAMILY CODE §101.007 for clear in convincing evidence, al beit for children's issues rather than property issues, is: "the measure or degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established." Appellate courts have clearly used this definition, "firm belief or conviction" for property cases as well. See *Long v. Long*, 234 S.W.3d 34, 40 (Tex. App. – El Paso 2007, no pet.).

The attempt to characterize the asset as "separate" must begin with identifying the legal basis for the assertion, how it falls into the categories listed above. Once you have identified that source of separate property, then you must "trace" the asset. 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. *Smith v. Smith*, 22 S.W.3d 140, 144 (Tex. App.-Houston [14th Dist.] 2000, no pet).

The recurring problem is the tracing of the financial "morphs" of the original separate property. By way of example, cash may have been gifted by a spouse's parent to the spouse and then immediately deposited in a bank account. The spouse could use those funds to purchase stock, and then years later that stock may have been sold, after the stock has split

multiple times. The stock may have then been sold and the proceeds from the sale of the stock could be used as part of a down payment for the family residence. The recipient of the original cash gift must not only prove that the acquisition was in fact a "gift," but further must prove that the money in the residence was the "same" money as that original gift.

Financial institutions used to always issue statements and cancelled checks. In the case of long term marriages of twenty five years or more, the tracing was accomplished by ordering the statement and cancelled check and going from there. Now, in the 21st century, the "paper" is not available as the entire group of such transactions could be done through internet transfers – online banking – and the records may not be readily available for the client to procure.

> *TIP: Always consider the cost of the endeavor. A separate property claim of $10,000.00 may truly exist, but the cost for procuring the records may be up to $9,500.00. The time and efforts for that $500.00 may hardly be a smart investment.*

The procurement of the records is the most recurring roadblock to the tracing, and unfortunately, we family lawyers have little control over banking procedures and policies. These tracing obstructions flow over into many different separate property scenarios, a handful which are discussed below.

III. REAL PROBLEMS WITH REAL PROPERTY.

At times a client will indicate during your initial meeting that they have been the recipient of a parcel of real property that was gifted to them by a family member. Some common issues arise with this situation.

A. WAS THE TRANSFER A GIFT?

In order for a party to prove his or her claim of gift, that party must prove donative intent, delivery, and acceptance. The gift must be voluntary and gratuitous. Most deed recitals in Texas that we see contain the terms, "For $10.00 and other good and valuable consideration…" Does this statement in the deed recital rebut your client's assertion that the property was a gift? One may argue that because a deed recites consideration that a party did in fact tender consideration in exchange for the donor deeding the property to them. Fortunately, there is case law to support the position that recitals in a deed are not conclusive as to consideration. See *Galvan v. Galvan*, 243 S.W.2d 398, 400 (Tex. App. – Austin 1976, writ dism'd). In 1918, the San Antonio Court of Appeals in *Burns v. Nichols***,** 207 S.W. 158 (Tex. App. – San Antonio 1918, no writ history) explained that the recital of consideration in a deed does not preclude a party from showing that the property was actually intended to be a gift to the grantee. In apparent frustration over this same line of argument, the Fort Worth Court of Appeals in *Hall v. Barrett*, 126 S.W.2d 1045 (Tex. App.- Fort Worth 1939, no writ) addressed the issue by stating, "Much ado is made of the recited consideration of "Ten Dollars" paid to the grantor. All of us know that this is the usual and customary formal recitation used in a deed of gift." Courts do not accept the recitation of consideration as determinative. Evidence is allowed to show the true consideration. *Carter v. McDonald*, 172 S.W. 2d 767 (Tex. App. – El Paso 1942, writ ref'd); *Roberts v. Roberts*, 999 S.W. 2d 424, FN 8 (Tex. App. – El Paso, 1999, no pet.). In determining whether a gift was intended by the execution of a deed, you must look to the facts and circumstances that surrounded the execution of the document in addition to the recitations in the deed. *Panhandle Baptist Foundation, Inc. v. Clodfelter*, 54 S.W. 3d 66 (Tex. App. – Amarillo 2001, no pet.) The admissibility of parol evidence in the context of a land conveyance is enunciated in our case law. In *Tarrant v. Schultz***,** 441 S.W.2d 868, 870 (Tex. App. – Houston [14th Dist.] 1969, writ ref'd. n.r.e.) the deed by which Schulz conveyed a tract of land to Tarrant recited a consideration of $10.00 and other good and valuable consideration. The issue before the Court was whether the grantor had actually received any real consideration for the conveyance because the receipt of actual consideration impacted the application of the deed warranties. The Houston Court of Appeals held that "[u]nder such circumstances parol evidence was admissible to show the true consideration or that there was no consideration given." In *Bahr v. Kohr***,** 980 S.W.2d 723 (Tex.App. – San Antonio 1998, no pet.) the issue the court was called upon to determine pertained to the actual consideration paid for certain real property. The deed for land clearly recited that both husband and wife paid consideration for the land and the title was taken in both parties' names. The San Antonio Court of Appeals held that parol evidence was admissible to rebut the presumption of community property and based upon the proffered parol evidence ultimately held that the property was the wife's separate property. Although case law exists supporting the admissibility of parol evidence in these circumstances, be mindful that, while the fact scenarios

are distinguishable, other case supports the opposite position. See *Massey v. Massey*, 807 S.W.2d 391, 405 (Tex. App. – Houston [1st Dist.] 1991, writ denied); *Johnson v. Driver*, 198 S.W.3d 359, 363 (Tex. App. – Tyler 2006, pet. denied) (citing *Massey*).

B. LENDER'S REQUIREMENT FOR SPOUSE'S NAME TO BE ON DEED.

Another problem arises when the couple takes out a loan to build a home on the property that was gifted to one spouse as financial institutions in many states often require that both parties' names must be on the deed to the property in order for the loan to be approved. If your client puts the spouse's name on the deed, have they gifted a portion of the property to their spouse? A deed for property from one spouse as grantor to another spouse as grantee creates a presumption the grantee spouse received the property as separate property by gift. *Magness v. Magness***,** 241 S.W. 3d 910, 912-913 (Tex. App. – Dallas 2007, pet. denied). In *Cokerham v. Cokerham***,** 527 S.W.2d 162 (Tex. 1975), the Texas Supreme Court held that the presumption of a gift between spouses can be rebutted by evidence clearly establishing there was no intention to make a gift. Additionally, the presumption of gift may be rebutted by proof the deed was procured by fraud, accident, or mistake. *Powell v. Powell***,** 822 S.W.2d 181, 183 (Tex. App.- Houston [1st Dist.] 1991 writ denied). This author suggests you educate yourself on fraud, accident, and mistake, so that you are adequately prepared to argue such positions, in the alternative, to your gift claim as applicable. See *2 Pomeroy's Equity* for the definitions of mistake and accident, sections 839 and 823, respectively.

C. DOCUMENTS AND TESTIMONY SUPPORTING GIFT CLAIM AND/OR REBUTTAL OF GIFT PRESUMPTION.

When you first become aware that your client may have a separate property claim to real property, take the time to evaluate what documents can support your claim. Obviously, your opposing counsel will try to limit the parol evidence you enter in as evidence. However, you need to have as much documentation supporting your position as possible, so that if/when the Court overrules the opposition's objection, you have the necessary support to prove your claim. As mentioned earlier, you may run into roadblocks in obtaining documents from third parties, particularly financial institutions. While your client may have a copy of a letter wherein the financial institution communicated the institution's requirement that the spouse's name must be on the deed in order to complete the financing for the home construction loan, you need to get a business records affidavit from that institution in order to avoid a hearsay objection. The author's firm faced a roadblock when the financial institution claimed to not have a copy of that letter in their file, even after we provided a copy of the letter to the institution. You may not always be able to obtain an admissible copy of such letter (via business records affidavit), but you should make the effort in order to show the Court that you have taken all steps possible to obtain the records.

Remember that parol evidence is not limited to documents, it could be the testimony of a family member, friend, or colleague that supports your claim. Contact these witnesses to confirm that their intention was to gift the property to your client. Additionally, prepare to argue to the Court why their testimony should be admissible. As mentioned in the previous subsection, case law exists supporting that parol evidence shall not be admitted under certain circumstances to contradict the terms of a deed.

IV. GIFTS.

When we carve out our exceptions to community property, one of the more troubling of such can be the "gift." We've already addressed some gift issues as it relates to real property, but what happens with personal property and other scenarios with real property? On its face the idea that a gift is separate property is simple, "I gave it to you, and so it is yours," or "My parents gave it to *me* not us." However, we now see that this can be a very complex concept as well. The "gift" may include a tangible item with no title (such as jewelry) or a more concerning item that involves title, such as an automobile or even a dog. The gift can be from those outside the marriage and from family members. The gift can also be from one spouse to the other. All these scenarios raise different presumptions and sensitive issues.

The most elementary requirements for a transfer of property to be a gift is that the transfer was made voluntarily and gratuitously, without consideration. *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). The three standard elements necessary to prove a gift transfer are: (i) the intent to make the gift; (ii) delivery of

property; and (iii) acceptance of that property. *Hayes v. Rinehart*, 65 S.W. 3rd, 286, 289 (Tex. App.- Eastland 2001, no pet.). However, other presumptions may come into play, one of which is addressed below in section B.

A. THE GIFT OF 'STUFF.'

The gift of jewelry, clothing, and other tangible items that do not involve title should be rather simple. Unless there is a claim that the item was taken without agreement, there is a donor who "gave" the item—that item is clearly in the possession of the person claiming the gift. Only the element of intent might be challenged and every case will develop its own facts as to that intent.

For example, husband "delivers" a BMW to wife for her birthday. He sends a card and the card reads "Happy Birthday, hope you love this!" We clearly have "intent"- but since it is a BMW, it may not be entirely paid for as most vehicles are financed, resulting in that party not having clear title. Does that make the car a conditioned gift (one that is a gift after the condition that it is paid for)? If it is paid for and yet husband titles in his name rather than in wife's name, has it truly been delivered to the wife? One could argue that the donor husband has done everything to show his intent, and if his intent was not to gift the car, then the card might be construed as a fraud….. We all know that the wife will get the car, but the characterization of the car as a gift removes it from the community property division and in the context of luxury items (such as vehicles, art, collectibles, a vacation home, etc.), that money may be deemed significant. Depending on how the Court characterizes such gifts, your client or their spouse may have an alternate argument of the need for a disproportionate division of the community estate due to the size of each party's separate estate, and the nature of the assets and debts left to be divided in the community estate.

B. THE PRE-MARRIAGE LOTTERY SCENARIO.

What happens if one party wins the lottery shortly before the parties marry one another, but then subsequently, the lottery winner puts title of virtually all property in both parties' name?

When a spouse uses separate property funds, in this example his pre-marriage lottery winnings, to purchase a piece of real property and puts title into both spouses names, then a presumption arises that a gift to the paying party's spouse is intended. *Cockerham v. Cockerham*, 527 S.W.2d 162, 168 (Tex. 1975). However, this presumption may be rebutted by evidence proving that no gift was intended. *Id.*; *Peterson v. Peterson*, 595 S.W.2d 889 (Tex. Civ. App. – Austin 1980, writ dism'd). In *Peterson*, the Court upheld the trial court's ruling that the presumption of gift was overcome by the husband's testimony that he did not intend to deed half interest of the property to his wife – he merely included her name on title of the property to consummate the sale. *Id*. at 892. Conversely, in *Long v. Long*, 234 S.W.3d 34 (Tex. App. – El Paso 2007, no pet), the trial court found that Mr. Long failed to rebut the presumption of gift and therefore awarded one-half undivided interest in the property to each spouse. In his appeal, Mr. Long relied on *Peterson* in his efforts to argue that he rebutted the presumption of gift. *Id*. at 41. The Court of Appeals held that Peterson was not controlling in this instance because the *Peterson* trial court found the presumption to be rebutted and there was evidence to support such a finding on appellate review. *Id*. at 41-42.The opposite was true in *Long* in that the trial court found the presumption was not rebutted and there was evidence supporting the court's finding. *Id*. In reviewing of the cases, one can distinguish the facts to see how each trial court came to their decision, and why each appellate court felt the need to uphold the trial court. In particular, Mr. Long communicated to Ms. Long that the land was going to be "theirs," and he admitted, "I thought what was hers is mine and mine is hers." Remember, ignorance of the law is not a defense or an excuse to say that you did not intend a transfer to be a gift. The relevant time of the donor's intent is at the time of the transfer, not the time of divorce. *Wells v. Wells*, 251 S.W.3d 834, 839 (Tex. App. – Eastland 2008, no pet.). In this author's opinion, the donor spouse's actions and words leading up to the transfer (to the donee spouse and other individuals) and how long the transfer was contemplated and planned for are key factors. One should focus on these facts and what evidence you have supporting these facts while preparing his or her case.

Another case worth reading is *Harrison v. Harrison*, 321 S.W.3d 899 (Tex. App. – Houston [14th Dist.] 2010). The court upheld the trial court's finding that although the husband rebutted the presumption that he gifted one-half interest in a piece of property to his wife by putting title in her name, that once the presumption is rebutted, it is still in the hands of the trier of fact to decide on whether or not a gift was intended. The court highlights the significance of the credibility of the parties when testifying and that an appellate court will give deference to the finder of fact when contradicting facts are presented.

Back to our lottery winner. When the parties married, not only did the winner Husband purchase real property titled in both parties name but he also put many financial accounts and other investments in both parties names or the wife's name alone. Throughout the marriage he constantly refers to the wealth resulting from the lottery as "their" wealth, "their" money, "their" property. These references were made to the donee spouse as well as other individuals – friends, investors, family, colleagues, etc. In his divorce case, he claims that any and all property acquired during the marriage with his winnings, or mutations, thereof are his separate property and he can trace every last penny, darnit! This author's believes the fact that almost all property (personal or real), financial accounts, and investments were put in both parties names, husband is going to be very hard pressed to rebut the presumption that he did not intend at the time of each of these transfers or transactions that his wife have an interest in such property. One piece of property may be easy to explain away why a gift wasn't intended, but when a spouse habitually puts everything in both parties' names and refers to the assets as "their" wealth or "their" property over and over again, the denial of a gift seems more disingenuous and incredulous.

C. PARENTS' GIFTS TO CHILDREN.

Two other gift issues that come up quite often are: (1) "gifts" from a parent to a child and whether or not consideration was paid, and (2) transfers that were undisputedly gifts but whether or not the gift was intended to be a gift only to one spouse or to both spouses.

1. Was consideration exchanged?

When a party is claiming his or her parent "gave" them something (land, art, collectible, furniture, cash, etc.), you need to investigate whether or not consideration was exchanged during the marriage because if it was, the "gift" could now be community property if community funds purchased the property. For example, the husband's mother is in bad health and ask for husband to manage her daily affairs for her, which if husband was not performing such duties, husband's mother would have to pay another person to do such duties. Husband ends up working less hours at his regular job to handle such affairs. Husband's mother's promises husband that he will be rewarded for his kind services. A couple months into his service, his mother gives husband a value piece of art or deeds him a piece of unimproved real property. Is this art/property intended to be a gift for his kindness or rather intended to be compensation for his hours serving as her personal assistant, care taker, and financial advisor? Depending on the size of the parties' estate, it may be worth looking into.

2. Was the gift to only the donor's relative or to both spouses?

While case law supports the presumption that a conveyance of property from parent to child is presumed to be a gift, this presumption as others, is rebuttable. *Woodworth V. Cortez*, 660 S.W.2d 561, 564 (Tex. App.— San Antonio 1983, writ ref'd n.r.e.). If one wants to rebut the presumption of gift, one must do so by proving lack of donative intent by clear and convincing evidence. *Somer v. Bogart*, 762 S.W.2d 577 (Tex. 1998) (per curium). We see quite often that a spouse's parent, grandparent, sibling, or aunt/uncle will give the spouse (or both spouses) a gift of cash or will later forgive a debt that both parties were presumably liable, and at the time of divorce the relative spouse wants to claim certain property as separate or wants to make a reimbursement claim that his separate estate paid down/off a community debt. If the donor fails to clearly communicate, whether orally or in writing, at the time of the gift, that his/her intent is to gift the cash/property to only his/her relative spouse, the trier of fact may likely find the gift was intended to be for both spouses. In the case *In Re Royal*, 107 S.W.3d 846, Tex. App. – Amarillo 2003, no pet.), the Amarillo Court of Appeals upheld the trial court's ruling that enough evidence was presented rebutting the grandparent's testimony that the gift was solely for the grandson/husband. This case involved a cash gift as well as forgiveness of debt. The court's opinion includes interesting analysis on the elements of proving a gift – intent, delivery, and acceptance. *Id*. at 852. Ultimately, the court found that wife presented sufficient evidence to support the trial court's finding that the gift (forgiveness of debt) in the amount of $40,000.00 was a gift to both parties, rather than solely to the grandson.

V. COMPENSATION ISSUES.

Three issues relating to compensation that warrant attention are (1) defined contribution plans; (2) bonuses, and (3) stock options/restricted stock.

A. DEFINED CONTRIBUTION PLANS.

In 2005, the legislature passed §3.007(c), which provides: "The separate property interest of a spouse in

a defined contribution retirement plan may be traced using the tracing and characterization principles that apply to a nonretirement asset." For years prior to this provision being passed, attorneys simply used the amount in the defined contribution plan on the date of marriage for value of the separate property interest in the account, and then they simply subtracted the value of the account on the date of marriage from the value on the date of divorce to calculate the community interest in the account. Now, the law allows us to use regular characterization and tracing principals to calculate a party's separate interest. While this could be very beneficial to clients whose retirement account had significant growth due to wise investments and market growth, tracing through years of the transactions within the retirement account could be tedious and very expensive, especially if the plan is made up of several different stocks and many transactions were made during the marriage. Does the new statute force us to prove our client's separate property claim through tracing? The law is unclear; however, this author thinks you don't necessarily have to trace every asset in order for a court to confirm a client's separate property interest in a defined contribution plan. The operative word in §3.007(c) is "may" – the section does not say "shall be traced…" Furthermore, many estates do not warrant the time and expense of tracing every single transaction, and those cases can be proven up by the amount on the date of marriage = separate property interest. However, beware if you are representing the party who is not claiming the separate interest because depending on the investment decisions and market throughout the marriage, the "value" of the separate property interest could be less than the value of the account on the date of marriage. Under these circumstances, you may want to argue to the court that it is inequitable to the community estate to allow the party to claim that the value on date of marriage = his/her separate property interest. You may, depending on the cost, have an expert do the detailed tracing of the account to show the opposing party's separate property interest is in fact less than the value of the account on the date of marriage.

B. BONUSES.

Three types of bonuses regularly appear in divorce cases: (1) regular year-end bonuses, (2) incentive bonuses (monthly, annually, or quarterly), and (3) signing bonuses. The first two can be addressed simultaneously while the third is a different animal altogether.

1. Year-end Bonuses and Incentive Bonuses.

Many employers regularly give bonuses as a part of an employee's compensation package. The bonuses may be issued monthly, quarterly, semi-annually, or annually. If we simply follow the inception of title rule, then the date the employer paid the bonus to the employer would define the character of the bonus – if the bonus was paid during marriage, then it would be community, and if the bonus was paid prior to the date of marriage or after the date of the dissolution of the marriage, then the bonus would be separate in nature. See *Echols v. Austron, Inc.*, 529 S.W.2d 840 (Texas Civ. App. – Austin 1975, writ ref'd n.r.e.). However, as we all know, bonuses are typically paid to an employee for his or her work over a period of time, not for the work on the date the bonus was tendered. Therefore, the more equitable manner to characterize a bonus is to calculate the number of days the employee worked during the designated time period that occurred during the marriage vs. the number of days the employee worked that did not occur during the marriage. Obviously, this is a rather basic computation if, by the compensation structure, it is clear to you that the designated time period for which the employee earned the bonus is definite, i.e. a month, a quarter, or a year. For example, if an employee's bonus for the applicable year is $10,000.00, and the parties were married for 120 days of that year, then you divide 120days/365days and multiply that fraction by $10,000.00 to calculate the community portion of the bonus: $3,287.67. You can argue the remaining amount of the bonus should be characterized as separate as the employee worked 245 days of that year while being single, and as such, that employee's separate estate should be compensated for his or her work for those days. The calculation may be more challenging if the bonus structure proves to be more undefined or sporadic.

This author suggests you intently review the parties' tax returns, W-2s, pay stubs, and bank records in order to craft your argument detailing why a portion of your client's bonus should be characterized as separate, or on the flipside, why the opposing parties' bonus, whether already paid or not, should be characterized as community property. Additionally, be aware that a company's fiscal year may not be January 1st – December 31st; it could very well be October 1st – September 30th. Also, remember that an incentive bonus or a bonus based on the company's income that year could be paid months after it is actually earned. For example, an executive's bonus may be based on his performance and the company's performance from

January 1 – December 31, but the bonus is not actually paid out until March 15th of the following year. The nonemployee spouse could likely be extremely ignorant to his or her spouse's compensation plan and the structure of such plan, so be diligent in researching the history of that employee's compensation. If a party fails to be forthcoming with the information, this author suggests you look into obtaining the employee's employment records directly. You do not want to be caught leaving thousands of dollars on the table, for the community estate or for your client's separate estate.

2. Signing Bonuses.

Generally, signing bonuses prove to be trickier. Sometimes, the bonus paid is truly a signing bonus, no strings attached; your client commits to begin his/her employment and the money is in the bank, free from possible retraction from the employer. However, many times signing bonuses, especially hefty size bonuses, come with conditions. These conditions may be an amount of months or years of employment or may be a certain amount of sales in a given time period. It is your duty to research any possible conditions, so you can do your best at estimating what a court may likely find as community vs. separate. In *Loazia v. Loazia*, 130 S.W.3d 894 (Tex. App. – Fort Worth 2004, pet. denied), the Court found that certain post-divorce payments under an employment contract, executed during the marriage, were husband's separate property because in order to receive said payments, husband had to perform services post-divorce. *Id*. at 906. The key when analyzing these types of bonuses is recalling one of the most basic marital property principals, the compensation for a party's employment during the marriage is community property, regardless of when the income was actually received by the party. Similarly, the compensation earned by the efforts of a party prior to marriage or post-divorce is separate property, regardless of when the income is received.

C. STOCK OPTIONS/RESTRICTED STOCK.

Other common forms of compensation are stock options and restricted stock. While the author has little new insight on the topic, it's one that often rears its head in our cases, and as such it's a topic worth mentioning. The applicable statute is TEX. FAM. CODE §3.007(d)-(e) which states:

> (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.

For those of you who comprehend equations with numbers more easily than statutory written form, the equations are as follows:

Under §3.007(d)(1) [granted ***prior*** to marriage but required work ***during*** marriage], an employee's separate property interest is equal to:

period from the date of the option or stock was granted until the date of marriage	+	period from the date of dissolution of the marriage until the date the grant could be exercised or restriction removed (if applicable)

the period from the date the option or stock was granted until the date the grant could be exercised or the restriction removed

EXAMPLE 1

Date of Marriage = August 17, 2008
Date Options Granted = June 28, 2006
Date Options May Be Exercised = June 28, 2010
Date of Divorce = April 1, 2011

# of days between 6/28/06 and 8/17/08 (781 days)	+	not applicable (0 days)

# of days between 6/28/06 and 6/28/10 (1738 days)

Percentage of Separate Property Shares = 44.9367%

EXAMPLE 2

Date of Marriage = August 17, 2008
Date Options Granted = June 28, 2006
Date Options May Be Exercised = June 28, 2013
Date of Divorce = April 1, 2011

# of days between 6/28/06 and 8/17/08 (781 days)	+	# of days between 4/1/11 and 6/28/13 (819 days)

# of days between 6/28/06 and 6/28/13 (2557)

Percentage of Separate Property Shares = 62.5733%

Under §3.007(d)(2) [granted *during* to marriage but required work *after* the dissolution of marriage], an employee's separate property interest is equal to:

the period from the date of the dissolution of the marriage until the date the grant could be exercised or the restriction removed

the period from the date the option or stock was granted until the date the grant could be exercised or the restriction removed

EXAMPLE 3

Date of Marriage = August 17, 2008
Date Options Granted = June 28, 2009
Date Options May Be Exercised = June 28, 2013
Date of Divorce = April 1, 2011

# of days between 4/1/11 and 6/28/13 (819 days)

# of days between 6/28/09 and 6/28/13 (1461 days)

Percentage of Separate Property Shares = 56.0575%

For the examples in spreadsheet format see Appendix A and Appendix B (formulas).

Once, you have calculated the percentage of separate vs. community, you must then calculate the value of such options. The value of the shares are an ever changing number as most stock prices vary, at least a little, each day. The author suggests you create a spreadsheet in which you can simply modify the stock price, and in turn, the spreadsheet automatically recalculates the actual value of the options for each estate. Keep in mind that depending on the strike price and the stock price on the date of valuation, the stock options could very well be valueless.

VI. SEPARATE DEBT ADVANCES.

We are all aware that any debt taken out during the marriage is presumed to be on community credit therefore the proceeds of the loan are community in nature. Additionally, we know the long lived case law that provides if a spouse uses separate property funds for a down payment on real estate and the creditor looks only to that spouse's separate estate for repayment, then that property's character is separate although purchased during the marriage. Would this same analysis apply to a spouse who takes out a loan against a margin account that can be proved that spouses separate property? Case law tells us that if the spouse has significant documentation/evidence proving the lender only looked to the spouse's separate estate, then the proceeds of the debt can be separate property. See *Jones v. Jones*, 890 S.W.2d 471, 474-476 (Tex. App.—Corpus Christi 1994, pet. denied) (Court of Appeals reversed trial court because it found no evidence indicating that the bank had in anyway limited itself to looking solely to the certificate of deposit or husband's separate estate for repayment of the loan); *Holloway v. Holloway*, 671 S.W.2d 51, 56-57 (Tex. App. – Dallas 1983, writ dism'd) (Court of Appeals affirmed the trial court holding that when the loan papers did not include an express agreement

wherein the bank promised to look solely to husband's separate estate for repayment, but the loan papers included several pieces of evidence indicating that the bank agreed to look to the separate property estate of husband for repayment of the loan)(see case for specific evidence provided).

When a client desires to salvage funds or assets which were acquired with proceeds of a "separate" loan, take the time to review all documents relating to the loan, so you can put forward the best case possible for preserving your client's separate property.

VII. CONCLUSION.

As stated earlier, there have been many articles written and presented on the topic of "Characterization and Tracing." The identification of property as being separate or community is essential in every divorce case. From the first meeting to the last meeting with any client, the issue of "what is mine" v. "what is ours" is *the* primary issue in any property division, as the Court can only divide what is "ours."

The tracing cases of the 21st century will continue to be an area of appellate review. The "new" tracing cases, when and as they evolve, will focus on our electronic age as well as the emergence of the generation of children born of baby boomers. The issues dealing with gift and real estate will change as the process of buying property and the exchange of property change as well. The "areas" discussed in this paper are just the handful that seem to be recurring at this time. Again, most of the property cases settle in mediation as the documentation necessary to beat the presumptive burden becomes more complex and not so available. The litigation will continue, and hopefully, this article will assist the reader as he develops his case.

APPENDIX A

Examples for Calculating Separate Interest in Stock Options/Restricted

EXAMPLE 1

Operative Dates

Date of Marriage	17-Aug-08
Date Options Granted	28-Jun-06
Date Options Can Be Exercised	28-Jun-10
Date of Divorce	1-Apr-11

Equation

$$\frac{\text{\# of days between 6/28/06 and 8/17/08} + \text{\# of days between date of divorce and date the grant could be exercised or restriction removed (not applicable under these facts)}}{\text{\#of days between 6/28/06 and 4/1/11}}$$

$$\frac{781 + 0}{1738}$$

Percentage of Separate Shares = 0.449367089

EXAMPLE 2

Operative Dates

Date of Marriage	17-Aug-08
Date Options Granted	28-Jun-06
Date Options Can Be Exercised	28-Jun-13
Date of Divorce	1-Apr-11

$$\frac{\text{\# of days between 6/28/06 and 8/17/08} + \text{\# of days between 4/1/11 and 6/28/2013}}{\text{\#of days between 6/28/06 and 6/28/2013}}$$

$$\frac{781 + 819}{2557}$$

Percentage of Separate Shares = 0.625733281

EXAMPLE 3

Operative Dates

Date of Marriage	17-Aug-08
Date Options Granted	28-Jun-09
Date Options Can Be Exercised	28-Jun-13
Date of Divorce	1-Apr-11

$$\frac{\text{\# of days between 4/1/11 and 6/28/13}}{\text{\#of days between 6/28/09 and 6/28/2013}}$$

$$\frac{819}{1461}$$

Percentage of Separate Shares = 0.560574949

APPENDIX B

Examples for Calculating Separate Interest in Stock Options/Restricted Stock

EXAMPLE 1

Operative Dates

Date of Marriage	39677
Date Options Granted	38896
Date Options Can Be Exercised	40357
Date of Divorce	40634

Equation

$$\frac{\text{\# of days between 6/28/06 and 8/17/08} + \text{\# of days between date of divorce and date the grant could be exercised or restriction removed (not applicable under these facts)}}{\text{\#of days between 6/28/06 and 4/1/11}}$$

$$\frac{\text{=D6-D7} + 0}{\text{=D9-D7}}$$

Percentage of Separate Shares = =B17/B19

EXAMPLE 2

Operative Dates

Date of Marriage	39677
Date Options Granted	38896
Date Options Can Be Exercised	41453
Date of Divorce	40634

$$\frac{\text{\# of days between 6/28/06 and 8/17/08} + \text{\# of days between 4/1/11 and 6/28/2013}}{\text{\#of days between 6/28/06 and 6/28/2013}}$$

$$\frac{\text{=D26-D27} + \text{=D28-D29}}{\text{=D28-D27}}$$

Percentage of Separate Shares = =(B35+D35)/B37

EXAMPLE 3

Operative Dates

Date of Marriage	39677
Date Options Granted	39992
Date Options Can Be Exercised	41453
Date of Divorce	40634

$$\frac{\text{\# of days between 4/1/11 and 6/28/13}}{\text{\#of days between 6/28/09 and 6/28/2013}}$$

$$\frac{\text{=D46-D47}}{\text{=D46-D45}}$$

Percentage of Separate Shares = =B53/B55