CHARACTERIZATION CHALLENGES

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By
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I. DEFINITION OF SEPARATE PROPERTY.

Separate property is defined by the Texas Constitution, Art. XVI, § 15, as follows:

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

A. The Constitution (not the Legislature) Governs the Characterization of Property.

In 1917, the Legislature defined and income from separate property to be the separate property of the owner spouse.
Act of April 4, 1917, ch. 194, § 1, 1917 Tex. Gen. Laws 436. The Texas Supreme Court, however, reminded the Legislature that the constitution defined the marital character of property, not the Legislature. In *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799 (1925), the supreme court held that the Legislature did not have the constitutional authority to characterize the income from separate property as the owner's separate property. The court explained that the Legislature's authority was limited to enacting laws regulating the management and liability of marital property, not its separate or community character. *Id*. at 805. This landmark decision strengthened the constitutional principle that the Legislature may not define what is community and separate property in a manner inconsistent with article 16, section 15 of the Texas Constitution. *See generally, e.g.*, Thomas M. Featherston, Jr. & Julie A. Springer, *Marital Property Law in Texas: The Past, Present and Future*, 39 BAYLOR L. REV. 861 (1987) (tracing, throughout the entire article, the evolution of marital property law from 1845 to 1987). As to the rule of 'implied exclusion,' the court stated:

> [I]t is a rule of construction of Constitutions that ordinarily, when the circumstances are specified under which any right is to be acquired, there is an implied prohibition against the legislative power to either add to or withdraw from the circumstances specified. . . . Hence, when the Constitution says that as to property, not owned or claimed by the wife at marriage, it becomes her separate property when acquired in one of three specified modes, the legislature is prohibited from saying that property acquired after marriage in some other mode may also become the wife's separate property.

Id. at 802. "In nullifying the 1917 reform, which made income from separate property separate, the court held that the constitutional provision on marital property was the sole source of the definition of that estate. By necessary implication, the constitution thus required that any property not specifically defined as separate property was community." Joseph W. McKnight, *Texas Community Property Law: Conservative Attitudes, Reluctant Change*, 56 LAW & CONTEMP. PROBS. 71, 71 (1993) (stating that "[r]eform of Texas family property law has been significantly restrained by the conclusion of the Supreme Court of Texas in 1925 that the marital property system is constitutionally defined" and that "[w]ithout the decision of 1925, ... the system could have developed very differently"). **"**The decision [in *Arnold v. Leonard*] that the [statutory enlargement of separate property was] in part invalid was based upon the conclusion that the people intended in adopting the Constitution to put the matter of the classes of property constituting [a spouse's] separate estate beyond legislative control and that the Legislature can neither enlarge nor diminish that property as defined in the Constitution." *Bearden v. Knight*, 228 S.W.2d 837 (Tex. 1950).

B. The Acquisition of Separate Property in Defiance of Article 16, Section 15.

In the case of *Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972), the Texas Supreme Court cast a great deal of doubt on the doctrine of 'implied exclusion' by limiting *Arnold* to its specific holding. *Id*. at 392. In any event, it has long been recognized that there are numerous means by which separate property may be acquired in defiance of the article 16, section 15 definition stated above. A partial list includes mutations of separate property, increases in value of separate land and personalty, recovery for personal injury not measured by loss of earning power, improvements of separate land with an unascertainable amount of community funds, and United States securities purchased with community funds. *See* McKnight, Book Review, 46 TEX. L. REV. 297, 301-02 (1967) (reviewing W. Huie, *Texas Cases and Materials on the Law of Marital Property Rights* (1966).

C. If Traced, Mutations of Separate Property are Separate Property.

Although such property may undergo changes or mutations, as long as it is traced and properly identified it will remain separate property. *Norris v. Vaughan*, 260 S.W.2d 676, 679 (Tex. 1953). *See also Beck v. Beck*, 814 S.W.2d 745 (Tex. 1991), cert. denied, 503 U.S. 907 (1992); *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984); *Vallone v. Vallone*, 644 S.W.2d 455 (Tex. 1982); *Daniel v. Daniel*, 779 S.W.2d 110 (Tex. App.-Houston [1st Dist.] 1989, no writ); *Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.-Dallas 1987, writ ref'd n.r.e.).

D. Tex. Fam. Code § 3.001.

"A spouse's separate property consists of:

(1) the property owned or claimed by the spouse before marriage;

(2) the property acquired by the spouse during marriage by gift, devise, or descent; and

(3) the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage."

E. Property Owned or Claimed Before Marriage, Inception of Title.

The terms "owned and claimed" as used in the Constitution and the Tex. Fam. Code mean that where the right to the property accrued before the marriage, the property would be separate, even though the legal title or evidence of the title might not be obtained until after marriage. Inception of title occurs when a party first has a right of claim to the property by virtue of which title is finally vested. *Welder v. Lambert*, 44 S.W. 281 (Tex. 1898). Under the Inception of Title Doctrine, the character of property, whether separate or community, is fixed at the time of acquisition. *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426 (Tex. 1970). Acquiring an ownership interest or claim to property refers to the inception of the right, rather than the completion or ripening thereof. The existence or non-existence of the marriage at the time of incipiency of the right of which title finally vests determines whether property is community or separate. *Creamer v. Briscoe*, 109 S.W. 911 (Tex. 1908). Inception of title occurs when a party first has a right of claim to the property. Thus, land acquired by an earnest money contract that is signed prior to the marriage but the deed is not acquired until after the marriage, is separate property.

F. The Inception of Title Rule has been codified by Tex. Fam. Code § 3.006.

"If the community estate of the spouses and the separate estate of a spouse have an ownership interest in property, the respective ownership interests of the marital estates are determined by the rule of inception of title." Tex. Fam. Code § 3.006. Section 3.006 does not change the law about the inception of title rule, but simply codifies the inception of title rule as it has evolved from Texas case law over many years of Texas jurisprudence.

II. COMMUNITY PROPERTY.

There is no definition of community property in the Texas Constitution. The Tex. Fam. Code and case law define community property as follows: "Community

property consists of the property, other than separate property, acquired by either spouse during marriage." Tex. Fam. Code § 3.002; *Douglas v. Delp*, 987 S.W.2d 879, 882 (Tex. 1999).

A. Presumption of Community.

Tex. Fam. Code § 3.003 states that all property possessed by either spouse during or at the dissolution of the marriage is presumed to be community property and that the degree of proof necessary to establish that property is separate property, rather than community property, is clear and convincing evidence. Clear and convincing evidence is defined as that measure or degree or 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. *Tate v. Tate* 55 S.W.3d 1, 4 (Tex. App.-El Paso 2000, no pet.); *Faram v. Gervitz-Faram*, 895 S.W.2d 839, 842 (Tex.App.-Fort Worth 1995, no writ). Based on the fact that the Texas Constitution and the Tex. Fam. Code specifically delineate and define what is separate property, if property cannot be proved to be separate property within the definition by clear and convincing evidence, it is community property. By deductive reasoning, if property does not fit the definition of separate property, it is community property.

B. Quasi-Community Property.

Tex. Fam. Code § 7.002 deals with quasi-community property and requires that a court divide property at divorce or annulment as community property, wherever the property is situated, if (1) the property was acquired by either spouse while domiciled in another state and the property would have been community property if the spouse who acquired the property had been domiciled in Texas at the time of the acquisition; or (2) property was acquired by either spouse in exchange for real or personal property and that property would have been community property if the spouse who acquired the property so exchanged had been domiciled in Texas at the time of the acquisition. Sometimes this property is referred to as quasi-community property. It is treated as community property for purposes of division in a divorce or annulment, even though it is considered separate property for probate purposes. Quasi-community property is inapplicable in probate proceedings. *Estate of Hanau*, 730 S.W. 2d 663 (Tex. 1987).

III. CHARACTERIZATION GENERALLY.

Characterization of property is a process of identifying the property owned by the spouses as separate property or community property. Property possessed by either spouse during or on dissolution of marriage is presumed to be community property. Tex. Fam. Code § 3.003(a). *Tate v. Tate*, 55 S.W.3d 1, 4 (Tex.App.-El Paso 2000, no writ). The degree of proof necessary to rebut the community property presumption and establish that property as separate property is clear and convincing evidence. § 3.003(b). Only community property is subject to the trial court's "just and right" division. *Cameron v. Cameron*, 641 S.W.2d 210, 220 (Tex. 1982). Separate property is confirmed to the owner of the separate property. The court shall divide the community property of the parties in a manner that the court deems just and right, having due regard for the rights of each party and any children of the marriage. Tex. Fam. Code § 7.001. The appellate court will reverse a trial court if a trial court mischaracterizes separate property as community property and does not award separate property to the owner thereof. Eggemeyer v. Eggemeyer, 554 S.W.2d 137, 140 (Tex. 1977). Tate v. Tate, supra at p. 6.

A. The Burden of Proof.

To rebut the community-property presumption, a party must present "clear and convincing" evidence of the property's separate character. Tex. Fain. Code §3.003(b); *see McKinley v. McKinley*, 496 S.W.2d 540, 543-44 (Tex. 1973). The clear-and-convincing standard requires evidence on which "a reasonable trier of fact could have formed a firm belief or conviction that its finding was true." *Stavinoha v. Stavinoha*, 126 S.W3d 604, 607 (Tex.App.—Houston [14th Dist.] 2004, no pet.). Because of this heightened evidentiary standard, a spouse generally will have to use both testimonial and documentary evidence to support her claim of separate property. *See, e.g., Boyd v. Boyd*, 131 S.W.3d 605, 616-17 (Tex.App.—Port Worth 2004, no pet.) (H's testimony, without specific tracing or corroborating evidence, was not clear and convincing evidence). The evidence presented should establish the time and manner the property was acquired (inception of title) and all of its mutations (tracing). But minor gaps in the tracing and corroboration of an asset's transactional history will not necessarily prevent a spouse from establishing her separate-property claim by clear and convincing evidence. *See, e.g., Faram v. Gervitz-Faram*, 895 S.W.2d 839, 843-44 (Tex.App.—Fort Worth 1995, no writ) (incomplete records on investment accounts); Newland v. Newland, 529 S.W.2d 105, 108-09 (Tex.App.—Fort Worth 1975, writ dism'd) (documentary evidence of "factual resegregation" of separate property existed only for most of period involved). Above text quoted from Beckman, Sydney Aaron and Wilhite, Randall Benton, *O'Conner's Texas Family Law Handbook*, ch. 2A §6, p 80 (Jones McClure Publishing 2006-07) (hereinafter *"O'Conner's Texas Family Law Handbook"*).

1. Expert Testimony.

Expert testimony can be used to establish the character of property. *See, e.g., Beard v. Beard*, 49 &W.3d 40, 61-62 (Tex.App.—Waco 2001, pet. denied) (CPA traced and characterized W's separate property by using community-out-first method). Experts are often used to characterize property in complex cases when cash assets have been commingled in different financial accounts with community property and when the property itself is of a unique nature. *See, e.g., Loaiza a Loaiza*, 130 S.W.3d 894, 906-07 (Tex.App.—Fort Worth 2004, no pet.) (expert testified about character of baseball contract); *Welder v. Welder*, 794 S.W.2d 420, 429 (Tex.App. – Corpus Christi 1990, no writ) (experts used to trace deposits and withdrawals from spouses' joint account). Experts used to characterize marital property are subject to the same qualification rules that apply to experts in civil cases generally. *See* Tex. R. Evid. 702. Above text quoted from *O'Conner's Texas Family Law Handbook* ch. 2A §6.1, p 80.

2. Lay testimony.

A spouse is competent to testify about the character of her property. Because a spouse is an interested witness, in most cases the testimony of a spouse will have to be corroborated by other evidence (i.e., the testimony of another witness or documentation) to rebut the community property presumption. *See, e.g., Bahr v. Kohr*, 980 S.W.2d 723, 730 (Tex.App. – San Antonio 1998, no pet.) (testimony that proceeds from bank account were separate was insufficient without documentation showing date account was opened, its beginning balance, and debits and credits to account); *Robles v. Robles*, 965 S.W2d 605, 620 (Tex.App. – Houston fist Dist.J 1998, pet. denied) (testimony that property was purchased with inheritance was insufficient without copy of will); *Johnson v. Johnson*, 804 S.W2d 296, 300 (Tex.App. – Houston fist Dist.) 1991, no writ) (testimony that guns were inherited from father was insufficient without documentation distinguishing those guns from other guns listed on inventory). Whether uncorroborated testimony of a spouse will be sufficient to constitute clear and convincing evidence depends on whether the spouse's testimony is contradicted and how clear, direct, and positive the spouse's testimony is. Above text quoted from *O'Conner's Texas Family Law Handbook* ch. 2A §6.1, p 81.

a. Uncorroborated & Contradicted.

A spouse's uncorroborated testimony that is contradicted will not be sufficient to constitute clear and convincing evidence. *See Pace v. Pace*, 160 S.W3d 706, 714 (Tex. App.—Dallas 2005, pet. denied); *Robles*, 965 S.W2d at 620. Above text quoted from *O'Conner's Texas Family Law Handbook* ch. 2A §6.1, p 81.

b. Uncorroborated & Uncontradicted.

Generally, a spouse's uncorroborated and uncontradicted testimony will not be sufficient to constitute clear and convincing evidence. *See Boyd*, 131 S.W3d at 617; *Robles*, 965 S.W2d at 620; *Kirtley v. Kirtley*, 417 S.W2d 847, 853 (Tex.App. – Texarkana 1967, writ dism'd). But when the testimony of an interested party is uncontradicted and is clear, direct, positive, and free from inaccuracies, and when there are no circumstances tending to cast suspicion on it, the testimony is taken as true as a matter of law. *Cochran v. Wool Growers Central Storage Co.*, 166 S.W2d 904, 908 (Tex.1942). This exception to the interested-witness rule is more compelling when the opposing party has the means and opportunity of refuting the testimony but does not do so. *See Collora v. Navarro*, 574 S.W2d 65, 69 (Tex.1978). Several appellate courts have found a spouse's uncorroborated and uncontradicted testimony to be sufficient to constitute clear and convincing evidence. *See Pace*, 160 S.W.3d at 714; *Vannerson v. Vannerson*, 857 S.W2d 659, 668 (Tex.App. – Houston [1st Dist.] 1993, writ denied). Above text quoted from *O'Conner's Texas Family Law Handbook* ch. 2A §6.1, p 81.

c. Specific Examples.

A witness may testify concerning the source of funds in a bank account without producing bank records of the deposits. *Holloway v. Holloway*, 671 S.W.2d 51, 56 (Tex.App.-Dallas 1983 writ dism'd).

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

Mere testimony that property purchased with separate property funds, without any tracing of the funds, is generally insufficient to rebut the community property presumption. *McElwee v. McElwee*, 911 S.W.2d 182, 188 (Tex.App.-Houston [1st Dist.] 1995, writ denied).

In *Harris v. Venture*, the only evidence in the record with reference to two disputed accounts by the party claiming the funds were her separate property was her statement that the source of the funds was "some was gifts and some may have been my social security check. I don't remember." The court held that this testimony was no more than a scintilla of proof of the vital fact needed to be provided, i.e., that the accounts consisted of

money acquired in one of the ways recognized to create separate property, and therefore the proponent did not carry her burden of proof. *Harris v. Venture*, 582 S.W.2d at 856. Note also that the testimony of an interested witness without corroboration, even when uncontradicted, only raises an issue of fact and is not conclusive. *Purser v. Purser*, 604 S.W.2d 411, 413 (Tex.Civ. App.-Texarkana 1980, no writ). *See also Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex.App.-Dallas 1985, no writ);

3. Documentation.

In most cases, documentation will need to be presented in addition to expert and lay testimony to rebut the community-property presumption. The most important documents are those establishing the time and manner in which the property was acquired and any later sales or exchanges of the property *See, e.g., Balir*, 980 S.W2d at 730 (to prove character of proceeds in bank account, spouse should have provided documentation showing date account was opened, its beginning balance, and debits and credits to account); *Robles*, 965 S.W2d at 620 (to prove property was purchased with inheritance, spouse should have provided copy of will). Above text quoted from *O'Conner's Texas Family Law Handbook* ch. 2A §6.1, p 81.

IV. MIXED TITLE PROPERTY.

When property is acquired during the marriage partly with community property funds and partly with separate property funds (which can be clearly traced) the property is of mixed characterization, being partially separate property and partially community property, to the extent and in the proportion that the property was purchased with separate property funds and with community property funds. *Cook v. Cook*, 679 S.W.2 581, 583 (Tex.App.-San Antonio 1984, no writ). Similarly, if a purchase is made partly with separate property and partly with community property credit, the separate and community estates own the property as tenants in common. *Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975). Each estate owns an undivided interest in the proportion that it supplies to the consideration. *Gleich v. Bongio*, 99 S.W.2d 881, 883 (Tex. 1937); *Jacobs v. Jacobs*, 669 S.W.2d 759, 763 (Tex.App.-Houston [14th Dist.] 1984, aff'd in part, 687 S.W.2d 731 (Tex. 1985)); *Scott v. Scott*, 805 S.W.2d 835, 838 (Tex.App.-Waco 1991, writ denied).

V. COMMINGLING.

Many cases have found a fiduciary or trust relationship to exist between spouses when the managing spouse has gifted or squandered the community assets. *Reaney v. Reaney*, 505 S.W.2d 338 (Tex.Civ.App.-Dallas 1974, no writ) (wife given money judgment for $9,062.87 against husband for "abuse of his managerial powers", which resulted in dissipation of community assets squandered in gambling and gifts); *Pride v. Pride*, 318 S.W.2d 715, 718 (Tex.Civ.App.-Dallas 1958, no writ) (wife given money judgment for her share of $3,000 cash concealed in hole in floor and not accounted for); *Swisher v. Swisher*, 190 S.W.2d 382 (Tex. Civ. App.-Galveston 1945, no writ); *Givens v. Girard Life Ins. Co. of Am.*, 480 S.W.2d 421 425 (Tex.Civ.App.-Dallas 1972, writ ref'd n.r.e.) (wife had no burden to establish fraudulent intent to protect her interest in the community from "abuse of husband's managerial powers.")

A. Burden to Produce Records.

Once the trust relationship is established, the managing spouse has the burden to produce records and to show fairness in dealing with the interests of the other spouse. *Morrison v. Morrison*, 713 S.W.2d 377, 380 (Tex.App.-Dallas 1986, writ dism'd) (burden on husband manager of community assets to produce records to justify expenditures on other women); *Spruill v. Spruill*, 624 S.W.2d 694, 697 (Tex.App.-El Paso 1981, writ dism'd) (trust relationship exists between husband and wife as to that community property controlled by each spouse. Burden of proof is upon the disposing spouse to show fairness). If the managing spouse is in fact handling both community property and the other spouse's separate property, then the managing spouse has the burden of producing records and tracing the community portion. If he fails to meet his burden, then under the trust principles announced in *Farrow v. Farrow, supra*, and *Sibley v. Sibley, supra*, the interests of the managing spouse in the community are lost and the mixture becomes the other spouse's separate property.

B. Background in Trust Accounting Rules.

Farrow v. Farrow, 238 S.W.2d 255 (Tex.Civ.App.-Austin 1951, no writ) was the first of the modern tracing cases to apply trust doctrine to the tracing or commingling of community and separate funds in a marriage:

(a) If a man mixes trust funds with his own, the whole will be treated as trust property, except so far as he may be able to distinguish what is his own.

(b) An owner who wrongfully permits the property of another to become so intermingled and confused with his own property as to render impossible the identification of either, is under the burden of disclosing such facts as will insure a fair division, and if he fails or refuses to do so, the combined property or its value will be awarded to the injured party.

(c) But there must be a willful or wrongful invasion of rights in order to induce the merited consequences of forfeiture.

(d) If the goods are of the same nature and value and the portion of each owner is known or if a division can be made of equal proportionate value, as in the case of a mixture of corn, coffee, tea, wine or other article of the same kind and quality, then each owner may claim his proportionate part.

Under *Sibley v. Sibley*, 286 S.W.2d 657, 659 (Tex.Civ.App.-Dallas 1955, writ dism'd), the application of the trust doctrine in a divorce case meant that "the trustee (husband) is presumed to have checked out his money first."

From these general trust principles, a number of separate accounting rules permitting tracing have developed, some of which have a life independent of their source in trust law. The primary concern in tracing cases applying trust doctrine is to see that a wrongdoer does not prosper by his actions. Most of the cases address situations where a person mixes trust funds with his or her property.

C. Community Out First.

The "community out first" rule of tracing is now firmly established in our Texas jurisprudence. Though criticized, this rule has seemingly taken on a "life of its own" and no longer relies on trust law. *Welder v. Welder*, 794 S.W.2d 420 (Tex.App.-Corpus Christ 1900, no writ); *DePuy v. DePuy*, 483 S.W.2d 883 (Tex.Civ.App.-Corpus Christi 1972, no writ); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex.Civ.App.-Houston [14th dist.] 1975, writ dism'd); *Harris v. Venture*, 582 S.W.2d 853 (Tex.Civ. App.-Beaumont 1979, no writ); *Snider v. Snider*, 613 S.W.2d 8 (Tex.App.-Dallas 1981, no writ); *Gibson v. Gibson*, 614 S.W.2d 487 (Tex.Civ.App.-Tyler 1981, no writ); *Kuehn v. Kuehn*, 594 S.W.2d 158 (Tex.Civ.App.-Houston [14th Dist.] 1980, no writ).

VI. ENTITIES.

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

A. Alter Ego.

Alter ego, which applies if there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice, is one basis for disregarding the corporate fiction. Other situations in which the corporate fiction may be disregarded even though corporate formalities have been observed and corporate and individual properties have been kept separate include those in which the corporation is used as a means for perpetrating a fraud; the corporation is organized and operated as a mere "tool" or "business conduit" of another corporation; the corporate fiction is used to avoid an existing legal obligation, to achieve or perpetuate a monopoly, or to circumvent a statute; or the corporate fiction is invoked to protect crime or justify a wrong. *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex. 1987); see also *Zisblatt v. Zisblatt*, 693 S.W.2d 944, 950 (Tex. App.-Fort Worth 1985, writ dism'd).

1. Entity Disregarded.

To establish that a corporation is the alter ego of a controlling shareholder, it is necessary to show that a corporate entity was disregarded, thereby making the corporation a shell for the individual's private business, further losing the separate nature of the corporation. *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335, 345 (Tex. Civ. App.- Corpus Christi 1979, no writ); *Manney & Co. v. Texas Reserve Life Insurance Co.*, 407 S.W.2d 345, 350 (Tex. Civ. App.-Dallas 1966, no writ).

2. Only in Extraordinary Circumstances.

A corporate veil may be pierced on the basis of alter ego only in extraordinary circumstances. Such circumstances may exist if an individual controls and manages the corporation in such a manner that its affairs are indistinguishable from the individual's personal affairs and it has thus become his alter ego. Such a situation may not be inferred simply because a person is a major stockholder or even the sole stockholder of the corporation. *Keith v. Woodul*, 616 S.W.2d 375, 377 (Tex. Civ. App.-Texarkana 1981, no writ). There must be such unity between the individual and the corporation that the separateness of the individual from the corporation has

ceased to exist. *Humphrey v. Humphrey*, 593 S.W.2d 824, 826 (Tex. Civ. App.-Houston [14th Dist.] 1980, writ dism'd).

3. Pleadings and Burden of Proof

The alter ego theory must be pleaded and proved. *Keith*, 616 S.W.2d at 377. The party pleading alter ego has the burden of proof. *Torregrossa*, 603 S.W.2d at 804. To meet the burden of proof, there must be direct evidence of a sham corporate structure or of a failure to follow corporate formalities and that the principals acted in their individual capacities. *See Torregrossa*, 603 S.W.2d at 804.

B. Characterization of Pierced Entity.

If the corporate veil is pierced, the corporate assets will be presumed to be community property, subject to division by the court, if no separate-property claim has been preserved. *See Zisblatt*, 693 S.W.2d at 955.

C. Partnerships.

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

1. No Piercing of Partnerships.

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

2. Co-Ownership of Property Not Necessarily a Partnership.

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

3. Profits Distributed From Partnership

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

VII. CHARACTERIZATION OF STOCK OPTIONS.

Texas case law that has developed somewhat slowly in comparison to other jurisdictions. Early leading cases came from California, which does not share the inception of title rule with Texas. Those cases, which will be discussed infra developed theories whereby the employee spouse "earned" and "accrued" community property rights based on a coverture fraction, the elements of which varied depending on specific facts of the granted option. Early Texas cases, on the other hand, seemed to blindly apply the inception of title rule without regard to the obvious fact that, for unvested options, further post-divorce work had to be done to secure an entitlement to the option. Below is a listing of the key Texas cases in chronological order.

A. Myklebust v. Myklebust.

In *Myklebust v. Myklebust*, 605 S.W.2d 397, 397 (Tex.Civ.App.–Houston [14th Dist.] 1980), rev'd on other grounds, 615 S.W.2d 187 (Tex. 1981), the ex-wife appealed the grant of summary judgment against her in a post-divorce enforcement action in which she alleged that the former husband had concealed the existence of valuable stock options received in the course of this employment during marriage. Without further [any] analysis, the Houston Fourteenth Court of Appeals stated that "[t]he options were earned during coverture, and thus were community property." Id. It would appear that, in 1980, the complexities of stock options, at least in the context of community property law, had not yet reared its ugly head.

B. Marriage of Joiner.

In *Matter of Marriage of Joiner*, 755 S.W.2d 496, 498 (Tex.App.–Amarillo 1988), on reh'g, 766 S.W.2d 263 (Tex.App.–Amarillo 1988, no writ), the Amarillo Court of Appeals considered the proper characterization and division of the husband's stock plan. Under the terms of the husband's plan, a 20% interest in the employee's account vested after six years of service, i.e., after the first fiscal year of participation in

the plan, and a 20% interest vested each year thereafter until the tenth year of service, i.e., the fifth fiscal year of participation in the plan, when the account became 100% vested. Prior to marriage, the husband had worked six and one-half years for his employer. Id.

On appeal of the parties divorce decree, the appellate court distinguished the husband's stock plan from military retirement or pension plans under which benefits are earned by reason of years of service, on the grounds that the husband's stock plan provided that benefits were not earned during the five-year period of employment required for participation in the plan, but rather provided that an employee first acquired a vested interest in the benefits of the plan at the end of the sixth fiscal year of employment. Id. at 698. Thus, according to the Amarillo Court of Appeals, the initial five-year employment period only generated a mere expectancy which, by not fixing any benefit in any sums at any future date, was not a property interest to which property laws apply. Id. Since the character of property as separate or community is fixed at the very time of acquisition, the appellate court continued, the crucial time for determining the character of interests in and benefits of the plan was the time when the vested interests were acquired. Id.

Thus, held the Amarillo Court of Appeals, a 20% interest in the benefits of the husband's plan was acquired and vested at the end of the husband's sixth year of employment (prior to marriage), and a similar 20% interest was acquired and vested on each year thereafter for four more years, at which time the plan account was fully vested. Id. Because the initial 20% interest was acquired and vested while the husband was a single man, it was his separate property, and the remaining 80% was acquired and vested during the marriage, and thus was community property. Id. In Joiner, then, the appellate court adopted and advocated a time rule formula to determine the community's interest in a profit-sharing stock plan.

On rehearing, the wife contended that the inception of title doctrine–i.e., the character of property interests in the plan as separate or community is fixed at the time the vested interests are acquired–was not applicable to situations involving retirement or pension benefits. 766 S.W.2d 263. Rejecting the wife's argument, and reaffirming that the inception of title doctrine was applicable to the husband's stock plan, the Amarillo Court of Appeals noted that its focus was on the characterization of the separate property-community property interests in the husband's plan, which was relevant to the trial court's decision in dividing the community estate in a manner deemed just and right. *Id*. The appellate court stated that it did not measure the monetary value of the interests, a matter to be proved in the trial court, nor prejudge an apportionment of the value of the community interest, a matter reserved to the discretion of the trial court. Id. at 263-264. The Amarillo court also stated that its decision did prevent a party from offering proof that under the peculiarities of the plan–i.e., the amount of annual contributions being dependent upon the company's profits and the husband's salary, as well as upon the performance of the stock purchased with the contributions–there was an increase in the value of the husband's separate property interest which was attributable to his employment during marriage, giving the community an interest in the increased value which was subject to division by the trial court. *Id*. at 264.

C. Demler v. Demler.

In *Demler v. Demler*, 836 S.W.2d 696, 699 (Tex. App.–Dallas 1992, no writ), the Dallas Court of Appeals recognized that stock options earned during the marriage may constitute community property subject to a "just and right" division upon divorce. For such proposition, the Fifth Court of Appeals cited none other than *Myklebust*. Since the husband testified that the options at issue had been awarded to him during marriage, the Dallas appellate court held that the trial court erred in failing to divide the options. *Id*.

Demler is of little guidance in determining how to handle the division of stock options. It is unclear in Demler whether the options were vested or unvested. Moreover, it is not apparent what authority, if any, was offered to the trial court on the issues of characterization and allocation of the options.

D. Bodin v. Bodin.

In *Bodin v. Bodin*, 955 S.W.2d 380 (Tex.App.–San Antonio 1997, no writ) the appellate court affirmed the property division awarding the wife an interest in unvested stock options holding that "the unvested options constitute a contingent interest in property and are a community asset subject to consideration along with other property in the disposition of the parties estate." In Bodin, the husband argued that because the stock options were unvested, could not be exercised at the time of divorce, and were contingent on his continued employment after the divorce, they constituted his separate property. In rejecting the husband's argument, the appellate court compared the unvested options to unvested retirement benefits in *Cearly v. Cearly*, 544 S.W.2d 661 (Tex. 1976), and found that the options were community property. Citing *In re Marriage of Hug*, 154 Cal. App.3d 780, 201 Cal. Rptr. 676, (1984), as well as a multitude of cases from other

jurisdictions, the court indicated that the conclusion that the options were community property was supported by the decisions of the majority of courts that have considered the question.

E. Charriere v. Charriere.

In *Charriere v. Charriere*, 7 S.W.3d 217, 218 (Tex.App.–Dallas 1999, no writ), the wife was granted options to purchase 80,000 shares of stock at $2.50 a share. Id. According to the stock option agreement, the options were "exercisable [at] any time"; however, the stock was subject to various transfer restrictions that prohibited the wife from selling it without the company's consent. Id. The transfer restrictions lapsed gradually over time (at the rate of ten percent per year) and, as a result, acted as an incentive for the wife to remain employed with the company. *Id.* Further, under the agreement, if the wife terminated her employment with the company, two things would happen: (1) she would have three months from the date of her termination to purchase any options that were no longer subject to the transfer restrictions; and (2) her option to purchase those shares still subject to the transfer restrictions would terminate immediately. Id. at n. 2. If the wife had previously exercised her option to purchase any shares still subject to the transfer restrictions, the company had the right to "repurchase all or any portion" of those options at the wife's cost. *Id.*

When, some years later, the husband sued for divorce, 64,000 shares remained subject to the transfer restrictions. Id. Following a trial on the merits, the trial court (1) determined that the wife's options to purchase the shares were community property, and (2) divided them equally between the husband and wife. Id. The wife appealed the award of one-half of the 64,000 stock options on the grounds that (1) the options could not be classified as community property; and (2) their value, if any, was dependent on her post-divorce activity (i.e., employment with the company). Id. On appeal, the Dallas Court of Appeals affirmed the trial court's finding that all 64,000 stock options belonged to the community estate, as well as its award of half of the options to the husband. *Id.*

The Fifth Court of Appeals begin its analysis by noting that in *Demler*, 836 S.W.2d at 699, it had held that stock options earned during marriage may be community property subject to a "just and right" division upon divorce, but noted further that, in Demler, it was not faced with the precise issue presented in *Charriere, i.e.*, whether stock options that depend for their value, at least in part, on one spouse's post-divorce employment are still community assets. 7 S.W.3d at 219.

The option agreement provided that the options granted to the wife were exercisable any time after the grant date and before the "option termination date," and thus were exercisable during the marriage. *Id*. at 220. In addition, once the wife exercised her option, she enjoyed "ownership of the shares," including the right to vote the shares and receive dividends. Id. According to the Dallas Court of Appeals, therefore, the optioned shares were available for purchase during the marriage, and, once purchased, included potentially valuable rights. Id.

The appellate court concluded that the options, which were acquired and exercisable during marriage, were community property subject to division as part of the parties' community estate, and that the wife presented no clear and convincing evidence to the contrary. Id. The Fifth Court of Appeals reached such conclusion even though the wife, to the extent the value of the options was dependent on her post-divorce employment, effectively controlled the value of those options to the husband (she could terminate her employment and effectively deprive him–and herself–of any value those options would have had over time). Id. at n. 6. However, stated the appellate court, the fact that the value associated with some or all of the options could be forfeited by the occurrence of certain contingencies (the wife's termination of employment with the company) did not divest the options of their status as community property. *Id*.

To the Dallas Court of Appeals, there was "no question" that the community owned the stock options at the time of the divorce. *Id*. at 220. The appellate court cited Bodin as support for its position, noting that, like the options in Bodin, the options in Charriere were received during the marriage and their value was, in large part, contingent on post-divorce employment. Id. at 220-221. However, unlike the options in Bodin–and persuasive to the Fifth Court of Appeals–the options in Charriere were completely exercisable during the marriage. Id. at 221.

The Dallas appellate court necessarily rejected the wife's argument that classifying the options as community property was improper because the options had no value apart from her post-divorce personal services (due to the "admittedly"onerous transfer restrictions). *Id*. Although the wife analogized the options to "professional goodwill" and "professional degrees," in that their "value" depends upon post-divorce efforts (an analogy the appellate court rejected by remarking that

options are "fundamentally different" from goodwill or degrees, which were intangible property), Id. at n. 7, she cited no authority, and the Fifth Court of Appeals found none, for the proposition that the characterization of property as either community or separate is somehow dependent on the value of the property at the time of divorce. Id. at 221. Rather, according to the Dallas appellate court, in Texas, property is characterized as "separate" or "community" based on the time title to the property is acquired. Id. To hold otherwise would require trial courts to engage in some type of "value analysis" when classifying property as either "community" or "separate," and such an approach, unsupported by any legal authority, in the view of the Dallas Court of Appeals, would unnecessarily complicate the already difficult determination of the proper characterization of options. *Id*. at n. 8.

The appellate court also rejected the wife's suggestion that it analogize the stock options to retirement benefits and, as with retirement benefits, allocate them proportionally between the parties on a "time rule" basis because, unlike retirement benefits, the stock options were not benefits earned over the entire period of the wife's employment, but had already been earned. Id. at 221-222. Since the value of the options was fixed and could not be changed except by market forces, the Dallas appellate court concluded that (1) the options were distinguishable from retirement benefits, and (2) treating them the same would therefore be improper. Id.

F. Kline v. Kline.

In *Kline v. Kline*, 17 S.W.3d 445, 446 (Tex.App.–Houston [1st Dist.] 2000, pet. denied), the Houston First Court of Appeals affirmed the trial court's determination that unvested stock options were community property. The appellant argued on appeal that the trial court had divested him of his separate property because the right to receive the unvested options was conditioned upon the appellant's continued employment post-divorce. Id.

The appellant conceded that if stock options are awarded in consideration for past services, the options are community property and are subject to being divided upon divorce. Id. The appellant argued, however, that if options are awarded as an incentive for continuing employment, the options are separate property. *Id.*

Relying on the opinion of the San Antonio Court of Appeals in *Bodin*, the First Court of Appeals held that the although the stock options were contingent on the husband's continued employment, the options were a community asset subject to division by the trial court. *Id*. at 446-447.

The appellant in *Kline* attempted to distinguish *Bodin* on the grounds that at trial he presented uncontroverted expert testimony that the options had not been granted for past services. Id. at 446. In addressing such argument, the Houston appellate court noted that, in the absence of findings of fact and conclusions of law, the fact that the recitals in the stock agreements themselves reflected that the option were given for past service was sufficient to support the trial court's judgment. Id. at 447.

G. Boyd v. Boyd.

In *Boyd v. Boyd*, 67 S.W.3d 398 (Tex. App. – Fort Worth 2002, no petition), Randall Boyd complained on appeal that the trial court improperly characterized his stock options as 100% community property when they were actually partly his separate property. Randall purchased all of the stock options while he and his wife, Ginger Boyd, were married. Also, none of the stock options were awarded for work done outside of the parties' marriage. Randall was given the opportunity to purchase the stock options because of his management position with his company. The stock option plan recited that management employees were given this opportunity in order to motivate them to exert their best efforts on behalf of the company. The Court in Boyd cited *Kline v. Kline*, 17 S.W.3d 445, 446 (Tex. App. – Houston [1st Dist.] 2000, pet. denied); *Charriere v. Charriere*, 7 S.W.3d 217, 219 (Tex. App. – Dallas 1999, no pet.); Bodin v. Bodin, 955 S.W.2d 380, 381 (Tex. App. – San Antonio 1997, no pet.); and Demler v. Demler, 836 S.W.2d 696, 699 (Tex. App. – Dallas 1992, no writ) for the proposition that "Texas courts have consistently held that stock options acquired during marriage are a contingent property interest and a community asset subject to division upon divorce." *Boyd*, 67 S.W.3d at 410.

The Court further held that the fact that stock options are not fully vested by the time of divorce does not affect their character as community property, as long as the options were acquired during the marriage, citing *Kline*, 17 S.W.3d at 446; *Bodin*, 955 S.W.2d at 381; and *Cearley*, 544 S.W.2d at 665-66 (holding that employee spouse's accrued but unvested retirement benefits are a contingent property interest and a community asset). The Court conluded that because "Randall's fair value stock options were acquired during the marriage, they were a contingent community property interest, and the trial court did not abuse its discretion by dividing all of the

options between Randall and Ginger." *Boyd*, 67 S.W.3d at 410.

Randall also contended on appeal that the trial court should have valued the stock options as of the date of divorce rather than giving Ginger the benefit of the value of the options attributable to his post-divorce employment. Randall's company was privately held, not publicly traded. If Randall left his employment before he was 100% vested in his stock options, he could sell the options to the company for the price he paid for them. But Randall's ability to exercise his stock options for a profit was contingent upon his employer becoming a publicly traded company or being wholly or partially acquired by a third party. In either of these circumstances, Randall would have the opportunity to sell his stock options for the price the company received for its shares.

Randall's stock options vested at the rate of 1% per year for 8 years, after which time they became entirely vested. However, if Randall's company went public or was substantially acquired by a third party, vesting was accelerated to 20% per year. If there was a total sale of the company, Randall would be treated as if he were 100% vested. Boyd, 67 S.W.3d at 411.

The trial court determined that Randall's fair value stock options had a contingent value at divorce of $5,628,776. This value was determined by using a formula that did not take into account Randall's post-divorce work for his company or the company's future productivity. The formula was fixed at the time of the divorce. Boyd, 67 S.W.3d at 411.

The Court in Boyd noted that, to date, "no Texas court has considered how to determine the community property value of stock options at divorce. The cases have only addressed whether stock options are community property." Boyd, 67 S.W.3d at 411. See Kline, 17 S.W.3d at 446; Bodin, 955 S.W.2d at 381; Demler, 836 S.W.2d at 699; see also Charriere, 7 S.W.3d at 220 n. 6 (holding that stock options that could be purchased but not sold without company consent during marriage were community property, even though value of options was dependent upon employee spouse's post-divorce employment).

The factors before the *Boyd* court caused the court to conclude that the contingent value of the stock options was community property. The method for calculating this contingent value was fixed at divorce, and the minimum price for the stock options was also fixed. Randall would either be able to exercise the stock options in the future for their contingent value (if he was employed and the stock sale took place or the company went public), or he would only be able to recover what he paid for them. Further, the contingent value of the options was not dependent on Randall's post-divorce work for his company, even though he had to be employed to receive it. *Boyd*, 67 S.W.3d at 411,412.

The trial court awarded Ginger one half of the contingent value of the stock options as her 50% share of the community estate. The Court reasoned that if Randall is no longer employed when the stock options are sold, Ginger's contingent community property interest will be extinguished. *Boyd*, 67 S.W.3d at 412. The Court further found that any post-divorce increases or decreases in the value of these stock options that are not attributable to Randall's post-divorce work will not be his separate property; and that Ginger will be entitled to 50% of the increases, and the contingent value of her interest will be reduced by any decreases.

H. Texas Family Code 3.007(d).

> (d) A spouse who is a participant in an employer-provided stock option plan or an employer-provided restricted stock plan has a separate property interest in the options or restricted stock granted to the spouse under the plan as follows:
>
> (1) if the option or stock was granted to the spouse before marriage but required continued employment during marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which the numerator is the period from the date the option or stock was granted until the date of marriage and the denominator is the period from the date the option or stock was granted until the date the grant could be exercised or the restriction removed; and
>
> (2) if the option or stock was granted to the spouse during the marriage but required continued employment after marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which the numerator is the period from the date of dissolution or termination of the marriage until the date the grant could be exercised or the

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

I. Tex. Fam. Code 3.007(f).

"The characterization of the marital property interest in an option … described by Subsection (d) must be recalculated if, after the initial division of the option or stock, the vesting occurs on a date earlier than the vesting date stated in the original grant of the option or stock. The recalculation required by this subsection must adjust for the shortened vesting period and applies to options … granted before and during marriage."

J. Phantom Stock Plans, Performance Share Units and Other Such Plans.

There is some dispute and no indication as to whether Tex. Fam. Code § 3.007 determines the characterization of other employment-related option-like grants.

VIII. ECONOMIC CONTRIBUTION: IS IT CONSTITUTIONAL?

The authors wish to acknowledge the excellent scholarship contained in the following articles on the Texas Economic Contribution Statute. Many of the ideas and much of the substance of the following article was derived from these articles. Pergova, *Can the Texas Economic Contribution Statute be Reconciled with the Inception of Title Doctrine?*, TEXAS WESLEYAN LAW REVIEW SPRING 2006; and Cole, Fuller, Schwartz & Huff, *Economic Contribution and Reimbursement What Now?*, State Bar of Texas New Frontiers in Marital Property Law 2001.

A. Origins of Economic Contribution

An examination of the history of the evolution of economic contributions claims in Texas is helpful in trying to understand the logic of such claims as they currently exist under the Texas Family Code. In Texas, community property laws have recognized that one marital estate should have the right to compensation for the expenditure of funds or efforts that result in a benefit or enhancement of another marital estate. Historically, equitable interests were addressed by Texas courts solely through reimbursement claims. Reimbursement has always been considered as an equitable doctrine with the court of equity being bound to look at all of the facts and circumstances of the case and determine what is fair, just and equitable. Penick v. Penick, 783 S.W.2d 194, 197 (Tex. 1988).

The right of reimbursement usually arose in cases where (1) one marital estate used funds to make improvements on the other marital estate, and (2) one estate made expenditures on purchase money obligations of the other. While the doctrine of equitable reimbursement to the contributing estate has always been recognized, the issue of whether the amount of that reimbursement should be "offset" by benefits received by the contributing estate has been the subject of many conflicting opinions.

Prior to 1999, the equitable concept of reimbursement was used to compensate one marital estate when funds or efforts from that estate were used to benefit or enhance another marital estate.
Another important factor that the court would consider is if the benefitted estate provided something in return to the contributing estate which would give rise to an equitable offset. The economic contribution legislation precludes offsets.

By enacting Subchapter E in 1999, the Texas Legislature thought that this legislation would not only eliminate the confusion of various applicable rules to the equitable right of reimbursement, but also eliminate the inequities that occasionally can arise from the application of the Texas inception of title rule when one estate contributes for the benefit of the other. Needless to say, the legislation did not succeed with its intended purpose. Believing that repealing the new law could not be accomplished due to the continued support of several members of the legislature that been instrumental in the passage of the economic contribution claim in 1999, they set out to draft new legislation to amend and correct the flaws and incorporate what we currently have as the economic contribution statute.

At the end of 1999 legislation session, there was an outcry among many Texas family lawyers who had been unaware that a handful of professors and lawyers had infiltrated the legislative process resulting in the legislation now known as the economic contribution statute. Certainly as originally drafted the statute was the legislated formula to calculate the claim was defective. By adding Subchapter E to Chapter 1 of the Family Code, the legislature codified the creation of a new form of reimbursement claim. As a result of wide spread complaints the economic contribution claim statute was amended during the 77th Legislative session in 2001.

In 2001, the Texas Legislature enacted the economic contribution statutes for the first time. Tex. Fam. Code Ann. Title 1, Chapter 3, Subchapter E, § 3.401 et seq., added by Acts 2001, 77th Leg., R.S. ch.

838, § 2, eff. Sept. 1, 2001. The economic contribution provisions are incorporated in the Texas Family Code under Subchapter E, Chapter 3. Today such claims are found in Texas Family Code §§ 3.4.01 - 3.406. The new concept of economic contribution applies to all cases pending as of September 1, 2001, and all cases filed thereafter.

Generally speaking, these amendments were not well received by family law practitioners and both bench and bar have struggled with their application. Garcia v. Garcia, 170 S.W.3d 644, 649 (Tex.App.– El Paso 2005, no pet). Although, the new statutes hoped to address the prior problems with the 1999 statute, the changes and modifications to Subchapter E, Chapter 3 of the Texas Family Code caused even more.

B. Are Reimbursement Claims and Economic Contribution Claims Constitutional?

The Texas Constitution provides:

> [a]ll property, both real and personal, of a spouse owned or claimed before marriage, and that acquired afterward by gift, devise or descent, shall be the separate property of that spouse; and laws shall be passed more clearly defining the rights of the spouses, in relation to separate and community property . . . .

Tex. Const. Art. XVI, § 15.

While the Constitution does not define what community property is, it is presumed that everything possessed by the spouses at dissolution of the marriage is community property. If a spouse claims property to be separate, then he or she bears the burden to overcome the presumption by clear and convincing evidence. Tex. Fam. Code Ann. § 3.003(a). A trial court has no authority to divest a spouse's interest in separate property. See Cameron v. Cameron, 641 S.W.2d 210, 213 (Tex.1982) (stating that a divestiture of separate property is unconstitutional). Once property is characterized as separate property, that character does not change although the property is improved with community funds. Leighton v. Leighton, 921 S.W.2d 365, 367 (Tex.App.-Houston [1st Dist.] 1996, no writ). Marital property may be mixed property, consisting of part separate property and part community property in proportion to the amount of separate and community property. See generally Gleich v. Bongio, 128 Tex. 606, 99 S.W.2d 881, 883 (Tex.1937) (holding that property purchased partly with community funds and partly with separate funds has the effect of creating a tenancy in common between the separate and community estates with each estate owning an interest in the proportion that it supplied the funds). Although courts are given broad discretion in the division of community property in a divorce action, that discretion does not enable the trial court to divest one spouse of separate property and award it to the other spouse. Langston v. Langston, 82 S.W.3d 686 (Tex.App.--Eastland 2002, no pet.).

Although case law is replete with references to a "right" of reimbursement, the rule of reimbursement is purely an equitable one. Vallone v. Vallone, 644 S.W.2d 455, 458 (Tex.1982), citing Colden v. Alexander, 141 Tex. 134, 171 S.W.2d 328 (1943); Garcia, 170 S.W.3d at 650. It is not an interest in property or an enforceable debt, per se, but an equitable right which arises upon dissolution of the marriage through death, divorce or annulment. Id., citing Burton v. Bell, 380 S.W.2d 561 (Tex.1964); Dakan v. Dakan, 125 Tex. 305, 83 S.W.2d 620 (1935). An equitable right of reimbursement arises when the funds or assets of one estate are used to benefit and enhance another estate without itself receiving some benefit. Reimbursement is not available as a matter of law, but lies within the discretion of the court. The party claiming the right of reimbursement has the burden of pleading and proving that the expenditures and improvements were made and that they are reimbursable. Vallone, 644 S.W.2d at 459. The right accrues when the community estate in some way improves the separate estate of one of the spouses (or vice versa).

Economic contribution is one type of statutory reimbursement for contributions by one marital estate to another. Nelson v. Nelson, 193 S.W.3d 624, 628 (Tex.App.-Eastland 2006, no pet.). For section 3.402(a)(3) of the Texas Family Code to apply, there must have been a reduction of the principal amount of a debt incurred during marriage, secured by a lien on property, and incurred for the acquisition of the property. Tex. Fam. Code Ann. § 3.402. On dissolution of a marriage, the court shall impose an equitable lien on property of a marital estate to secure a claim for economic contribution in that property by another marital estate. Prior to the economic contribution statute, a trial court could impose an equitable lien on separate property to secure a reimbursement claim, only if the claim directly benefitted that particular separate property (i.e., principal debt reduction of the note on the separate property). See Heggen v. Pemelton, 836 S.W.2d 145, 146 (Tex. 1992). The court, subject to homestead restrictions, is now mandated to impose a lien, not only on the benefitted property but is not limited to the item of property that benefitted from an economic contribution. Tex. Fam. Code Ann. § 3.406. The "lien" requirement

has been interpreted to mean "more than an obligation to repay a debt ... some instrument, agreement, or act giving one creditor superior rights to collateral over all other unsecured creditors or creditors with a subsequently obtained judicial lien." Nelson, 193 S.W.3d 628-29. To enforce this claim, the courts are required to impose an equitable lien on the property.

The difference between economic contribution and reimbursement is in the result: if the trial court determines that there is a claim for economic contribution, it "shall order that a claim for an economic contribution by one separate marital estate of a spouse to the community marital estate of the spouses be awarded to the owner of the contributing separate marital estate." Tex. Fam. Code Ann. § 7.007(a)(2) (Vernon 2006). If, however, the trial court determines that there is a claim for reimbursement, it "shall apply equitable principles to determine whether to recognize the claim." Id. at § 7.007(b)(1).

When dividing marital property on divorce, it has been held that trial courts may impose equitable liens on one spouse's separate real property to secure the other spouse's right of reimbursement for community improvements to that property. Heggen, 836 S.W. 2d at 146; see, e.g., Dakan v. Dakan, 125 Tex. 305, 83 S.W.2d 620, 627 (1935); Smith v. Smith, 715 S.W.2d 154, 160 (Tex.App.-Texarkana 1986, no writ); Eggemeyer v. Eggemeyer, 623 S.W.2d 462, 466 (Tex.App.-Waco 1981, writ dism'd) on remand from, 554 S.W.2d 137 (Tex.1977). Although courts may impose equitable liens on separate real property to secure reimbursement rights, they may not impose such liens, absent any compensable reimbursement interest, simply to ensure a just and right division. Compare Mullins v. Mullins, 785 S.W.2d 5, 11 (Tex.App.-Fort Worth 1990, no writ) and Smith, 715 S.W.2d at 157 with Eggemeyer, 554 S.W.2d at 141 and Johnson v. Johnson, 804 S.W.2d 296, 299-300 (Tex.App.-Houston [1st Dist.] 1991, no writ).

In the Eggemeyer case a constitutional problem arose from the trial court's decree that the husband's separate property shall become the separate property of the divorced wife. Eggemeyer v. Eggemeyer, 554 S.W.2d at 140. The Eggemeyer court pointed out that it previously held in Graham v. Franco, that the constitutional definition of separate property was intended to be exclusive and that it may not be altered or enlarged by an act of the legislature. Id.; 488 S.W.2d 390, 392 (Tex.1972). The court also held that the legislature cannot transform one type of constitutionally defined property into another type of property. Williams v. McKnight, 402 S.W.2d 505 (Tex.1966). The protection of one's right to own property is said to be one of the most important purposes of government. That right has been described as fundamental, natural, inherent, inalienable, not derived from the legislature and as preexisting even constitutions. Id., 554 S.W.2d at 140.

First, referencing Article XVI, section 15, the court said: "[i]f one spouse's separate property may by a divorce decree be changed from the separate property of the one spouse into the separate property of the other, there is a type of separate property which is not embraced within the constitutional definition of the term." Eggemeyer, 554 S.W.2d at 140. The imposition of a lien on the separate property does not change the nature or definition of the property. Second, the Eggemeyer court observed that divesting one spouse's separate property by divorce decree violated Tex. Const. Art. I, § 15 which provides that no citizen of this state shall be deprived of his property except by due course of law of the land, that being both procedural and substantive due course. Id.

Does the imposition and foreclosure of an equitable lien against a spouse's separate property divest that spouse of his separate property? The Eastland Court doesn't think so. Langston, 82 S.W.3d at 690. The Court reasoned that although a court cannot divest a spouse of his separate property, the trial court must impose an equitable lien on that spouse's separate property to secure the other spouse's claim for economic contribution. Under the concept of economic contribution, however, one party has a statutory right to make a claim against the other party's separate estate, which was owned or claimed before the marriage. By making a claim under this section, however, a marital estate has a claim for economic contribution with respect to the benefitted state. Tex. Fam. Code Ann. § 3.003(a).

Under the new statutory scheme the former claim for reduction of a purchase money debt known by all as reimbursement, is now a claim for economic contribution. Tex. Fam. Code Ann. § 3.401(1). Applying these statutes, a house that is deemed to be the separate property of the party who owned the house prior to marriage and who has legal ownership, could possibly be jeopardized of house's separate property interest because the other marital estate may have an economic claim for 100% of the home equity. In the past, courts have been reluctant to impose such equitable liens on separate property to secure a claim. A claim for economic contribution does not necessarily create an ownership interest in the property; it merely creates a claim against the property of the benefitted estate which matures upon the termination of the marriage. See Tex.

Fam. Code Ann. § 3.404(b). In making its just and right division of property upon divorce, the trial court may also be required to make a division of a claim for economic contribution of the community marital estate in the separate marital estate of a spouse. Tex. Fam. Code Ann. § 7.007 (Vernon Supp.2002). In making this division upon termination of the marriage, the court shall impose an equitable lien on property of a marital estate to secure a claim for economic contribution in that property by another marital estate. Tex. Fam. Code Ann. § 3.406.

C. Retroactive Application and Due Process interpreted in California

The California Courts have also examined the constitutionality of similar statutes. The California Courts have determined that the key problem with the equitable contribution statute is that it applies to suits "pending on the effective date of this act or filed on or after" September 1, 2003. By making the statute apply retroactively, the statute is subject to constitutional challenge, because it deprives a person of property without due process of law. It is unfair and inequitable to deprive someone of their separate property simply because their case was pending or filed after the retroactive application of the economic contribution statute.

The State of California addressed the constitutionality of a retroactive application in relation to California's reimbursement statute. In the case In re Marriage of Cairo, the First District Court of Appeals for California held that the application of the statute mandating reimbursement of separate property contributions to community assets upon dissolution to cases pending on its effective date was unconstitutional as it impaired vested property rights without due process. In re Marriage of Cairo (App.1Dist. 1988) 251 Cal.Rptr. 731, 204 Cal.App.3d 1255.

The Cairo court reviewed a California Supreme Court case which held the application of the reimbursement statute to cases pending on its effective date "impairs vested rights without due process of law and is thus constitutionally impermissible." Cairo at 1262; see also In re Marriage of Fabian, 41 Cal.3d 440, 451. The California Supreme Court in Fabian held that, "[r]etroactivity is barred only when such impairment violates due process of law." Fabian at 448. The Court considered several factors in order to determine whether application of the statute violated due process. The factors were:

1. The significance of the state interest served by the law;
2. The importance of retroactive application to effectuate that interest;
3. The extent and legitimacy of reliance upon the former law;
4. The disruption which would be caused by retroactivity.

Cairo at 1263, analyzing Fabian.

The California Supreme Court found that the legislative interest was not sufficiently significant to mandate making the statute apply retroactively. The court also noticed that changing the law did not cure any "rank in justice or patented unfairness." Although the court did recognize a state interest in the equitable dissolution of the marriage, it did not find any benefit to applying the statute to pending proceedings. Cairo at 1263.

In addressing the effect of retroactive application to pending cases, the California Supreme Court found it "difficult to imagine greater disruption than retroactive application of an about-face in the law, which directly alters substantial property rights to parties who are completely incapable of complying with the dictates of the new law." (Emphasis added) Fabian at 450.

In a separate case, the California appellate court found that the reimbursement statute could not be constitutionally applied to a case filed after the effective date of the statute to property acquired before the date of the statute. In re: Marriage of Griffis (1986) 187 Col. App. 3d 156 (review den. Feb. 5, 1987). The Cairo court wrote, "The Griffis court recognized that the nonretroactive application of the two sections had caused some confusion and frustrated legislative intent, but held that those factors did not provide a sufficient basis from impairing vested property rights." Cairo at 1265.

IX. INSURANCE PROCEEDS AND THE INCEPTION OF TITLE RULE

Tex. Fam. Code § 3.008. Property Interest in Certain Insurance Proceeds.

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

(b) If a person becomes disabled or is injured, any disability insurance payment or workers' compensation

payment is community property to the extent it is intended to replace earnings lost while the disabled or injured person is married. To the extent that any insurance payment or workers' compensation payment is intended to replace earnings while the disabled or injured person is not married, the recovery is the separate property of the disabled or injured spouse.

X. TRACING: NEW VISIONS OF OLD STANDARDS

A. TRACING: COMMUNITY OUT FIRST OR COMMUNITY OUT LAST?

The character of separate property is not changed by the sale, mutation, exchange, substitution or change in form of separate property. *Gleich v. Bongio*, 99 S.W. 2d 881 (Tex. 1937). If separate property can be definitely and accurately traced and identified, it remains separate property regardless of the fact that the separate property undergoes mutations or changes in form. To overcome the presumption of community, the party asserting separate property must trace and clearly identify the property which is claimed to be separate property by clear and convincing evidence. *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965). The materials in this section were excerpted from teaching materials provided by Professor Jack Sampson to his students taking Texas Marital Relations & Divorce at the University of Texas School of Law.

1. Trace & Identify.

The Court of Appeals in *Faram v. Gervitz-Faram*, 895 S.W.2d 839, 842 (Tex.App.-Fort Worth 1995, no writ) explained tracing as follows:

> "...the party claiming separate property must trace and identify the property claimed as separate property by clear and convincing evidence. Tracing involves establishing the separate origin of the property through evidence showing the time and means by which the spouse originally obtained possession of the property. *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App. – Dallas 1985, no writ). Separate property will retain its character through a series of exchanges so long as the party asserting separate property ownership can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character. *Cockerham v. Cockerham*, 527 S.W.2d 162, 168 (Tex. 1975)..."

2. Rebutting the Presumption.

In order to rebut the community property presumption, the party claiming separate property must trace and identify the property claimed as separate property by clear and convincing evidence. Tex. Fam. Code § 3.003(b); *Cockerham* 527 S.W.2d at 167; *Celso*, 864 S.W.2d at 655. 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. Separate property will retain its character through a series of exchanges so long as the party asserting separate ownership can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character. *Cockerham*, 527 S.W.2d at 167; Celso, 864 S.W.2d at 654.

As long as separate property can be definitely traced and identified, it remains separate property regardless of the fact that it may undergo mutations and changes. *Estate of Hanau v. Hanau*, 730 S.W.2d 663, 667 (Tex. 1987); *Norris v. Vaughn*, 260 S.W.2d at 679; *Harris v. Harris*, 765 S.W.2d 798, 802 (Tex.App.- Houston [14th Dist.] 1989, writ denied). However, if separate property and community property have been so commingled as to defy segregation and identification, the statutory community property presumption applies. *Estate of Hanau*, 730 S.W.2d at 667. Also *see Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975). When tracing separate property, it is not enough to show that separate funds could have been the source of a subsequent deposit of funds. *Gibson v. Gibson*, 614 S.W.2d 487, 489 (Tex. Civ. App. – Tyler 1981, no writ).

3. Purposes of Tracing

The most common reasons for tracing are:

a. to establish the separate character of funds or assets held on account during marriage;
b. to establish the separate character of an asset acquired during marriage from separate funds or assets;
c. to support an economic contribution claim by demonstrating the use of funds or assets of one marital estate to benefit or enhance another marital estate; and economic contribution.
d. to defeat an economic contribution claim from one marital estate to another by demonstrating that the benefit or enhancement was paid by the estate receiving the benefit.

4. Tracing Rules

There are six principal rules for tracing and clearly identifying separate property. Commentators have

labeled these theories as: the clearinghouse method of tracing or the identical sum inference; the minimum sum balance method; the community out first rule; pro-rata approach; item tracing; and value tracing. The persuasiveness of a particular tracing rule or theory depends upon the facts of the case and the appropriateness of the tracing rule to those facts.

a. Clearinghouse and Identical Sum Inference Methods

The clearinghouse method is useful if a party had an account into which separate funds were temporarily deposited and then withdrawn (and possibly then used to acquire assets that are claimed as separate property). The clearinghouse method assumes that after one or more identifiable sums of separate funds went into the account, identifiable withdrawals were made that are clearly the withdrawals of the separate funds and are therefore separate property themselves. *See e.g. Estate of Hanau v. Hanau*, 730 S.W.2d 664 (Tex. 1987); *Peterson v. Peterson*, 595 S.W.2d 889 (Tex. Civ. App. – Austin 1980, writ dism'd w.o.j.); *Latham v. Allison*, 560 S.W.2d 481 (Tex. Civ. App. – Fort Worth 1978, writ ref'd n.r.e.) (unsuccessful tracing); *Beeler v. Beeler*, 363 S.W.2d 305 (Tex. Civ. App. – Beaumont 1962, writ dism'd). The clearinghouse method loses its persuasiveness if long periods of time separate the transactions.

The identical sum inference method is similar to the clearinghouse method except that it involves only one deposit, rather than a series of deposits, followed by an identical withdrawal, usually a short time later. *See e.g., McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973). The identical sum inference method is sometimes referred to as identification of specific transaction method.

b. Minimum Sum Balance Method

The minimum sum balance method is used when you have an account with separate property funds in it, into which community funds are deposited and when there have only been a few identifiable transactions. The party seeking to prove the amount of separate funds traces the account through each transaction to show that the balance of the account never went below the amount proven to be separate property. This theory presumes that only separate property remains after all other withdrawals are made. *See Pardon v. Pardon*, 670 S.W.2d 354, 357 (Tex.App.-San Antonio 1984, no writ). Snider v. Snider, 613 S.W.2d 8, 11 (Tex. Civ. App. – Dallas 1981, no writ) (probate suit).

c. Community Out First Rule

Under this rule, withdrawals from a mixed separate and community fund are presumed to be community to the extent that community funds exist. Withdrawals are presumed to be from separate funds only when all community funds have been exhausted. See, e.g., Sibley v. Sibley, 286 S.W.2d 658 (Tex. 1955); *Welder v. Welder*, 794 S.W.2d at 428-29; Gibson, 614 S.W.2d at 489 (court required proponent to prove separate character of funds by community out first theory); *Harris v. Venture*, 582 S.W.2d 853 (Tex. Civ. App. – Beaumont 1979, no writ). The only requirement for tracing in the application of the community-out-first presumption is that the party attempting to overcome the community presumption must produce clear evidence of the transactions affecting the commingled account. *Welder v. Welder*, 794 S.W.2d at 434.

d. Pro Rata Approach

Under the pro rata approach, if mixed funds are withdrawn from an account, the withdrawal should be pro rata in proportion to the respective balances of separate and community funds in the account. By using the pro rata approach, it would not be necessary to analyze the character of each withdrawal.

The Fort Worth Court of Appeals used the pro rata approach in an embezzlement case in which the deceased employee's wife had to prove what funds belonging to her husband (as opposed to his employer) flowed into each asset to which the employer had traced its embezzled funds. The husband had deposited the embezzled funds into an account and used that account to pay incrementally the premiums of a life insurance policy. When he killed himself, his employer and his wife disputed who owned the policy proceeds. *Marineau v. Gen. Am. Life Ins.*, 898 S.W.2d 397, 400, 403 (Tex. App. – Fort Worth 1995, writ denied). The employer contended that the wife failed to meet her burden of proof because she only offered evidence of the proportion of embezzled money to personal money deposited into the account used to pay the insurance premiums. The employer argued that the wife had to prove the ownership proportion of each payment to calculate the ownership of the policy, and absent such proof, the presumption is that all of the commingled funds are held in trust for the employer.

The court of appeals disagreed. The court relied on *G & M Motor Co. v. Thompson*, 567 P.2d 80, 84 (Okla. 1977), in which the Oklahoma Supreme Court held that the employer of the embezzling employee was entitled to a pro rata share of the life insurance policy proceeds where the wrongfully acquired funds were partially used to pay the premiums.

e. Item Tracing

An item of separate property on hand at dissolution of marriage must be traced to its inception of title.

Proponent of the separate property characterization must establish by clear and convincing evidence that the item on hand was either acquired as separate property before marriage or by gift, devise or descent during marriage, or by the use of separate property funds or separate property credit. *Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975).

f. Value Tracing

Value tracing is used to trace cash assets in order to determine the character of cash on hand at the dissolution of marriage. The proponent of separate property must trace all funds brought into and out of an account. Each deposit and each check must be accounted for. *In re Marriage of Tandy*, 532 S.W.2d 714 (Tex. Civ. App. – Amarillo 1976, no writ).

5. Bidirectional Commingling, Application of Trust Law

Commingling refers to a process by which community property and separate property are mixed together so that they cannot be separately identified or resegregated, commonly resulting in treatment of the entire mass as community property. In other words, if separate property gets too commingled with community property that the separate property loses its identity, separate property is treated as community property. *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973); *Jackson v. Jackson*, 524 S.W.2d 308 (Tex. Civ. App.-Austin 1975, no writ).

The source of the commingling rule is from trust law. If a trustee mixes his personal property with the corpus of the trust so that it can no longer be identified, the trustee's personal property becomes a part of the trust corpus.

a. Normal Commingling

Normal or regular commingling occurs when community property and separate property have been mixed, causing the entire mass to become community property. If community and separate property have been hopelessly commingled as to defy resegregation and identification, the presumption of community property controls and the entire amount is community property. *Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975).

b. Reverse Commingling

Reverse commingling occurs when community property and separate property have been hopelessly mixed, and the entire mass becomes separate property. In *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App. – Dallas 1955, writ dism'd), husband commingled community property with wife's separate property to the extent that the community property and wife's separate property became so commingled as to defy resegregation and identification. Based on the application of trust principles, husband had a fiduciary duty to protect wife's separate property, thus the entire mass became wife's separate property. Therefore, commingling can be bidirectional, where separate property and community property funds are commingled and the entire mass becomes community property (normal or regular commingling) or where separate funds and community funds are commingled and the entire mass becomes separate property (reverse commingling).

c. Important Exception

Sibley v. Sibley, 286 S.W.2d 657 (Tex. Civ. App.-Dallas, 1955, writ dism'd) sets out the general rule and the exception. The presumption is that where funds are commingled so as to prevent their proper identity as separate or community funds, they must be held to be community funds. However, there are exceptions to rules or presumptions. In divorce proceedings our courts have found no difficulty in following separate funds through bank accounts. *Farrow v. Farrow*, 238 S.W.2d 255 (Tex. Civ. App. – Austin, 1951, no writ); *Coggin v. Coggin*, 204 S.W.2d 47 (Tex. Civ. App. – Amarillo 1947, no writ). Equity impresses a resulting trust on such funds in favor of the wife and where a trustee draws checks on a fund in which trust funds are mingled with those of the trustee, the trustee is presumed to have withdrawn his own money first, and is therefore an exception to the general rule.

The rule is that if the commingler would benefit and the innocent spouse would suffer, then the presumption is against the wrongdoer's interest, regardless of whether that interest is community or his separate property.

Under the case law that establishes community out first rule of tracing to overcome commingling, if this rule worked to the financial advantage of the "bad actor" (the spouse who manages the accounts) and to the detriment of the other spouse (the beneficiary under trust law), then the burden of tracing would shift to the managing spouse in order to protect the estate of the other spouse, as recognized in *Farrow v. Farrow*, 238 S.W.2d 255, 256 (Tex.Civ.App.-Austin 1951, no writ).

In *Andrews v. Brown*, 10 S.W.2d 707 (1928), cited with approval in *Mooers v. Richardson Petroleum Company*, 146 Tex. 174, 204 S.W.2d 606 (Tex. 1947), the following appears:

> "'If a man mixes trust funds with his own,' it is said, 'the whole will be treated as trust

> property, except so far as he may be able to distinguish what is his own.' ..., That principle seems to have recognition in most, if not all, American jurisdictions...
>
> "Analogous doctrines are part of the law of accession and specification..., and of confusion of goods ... The principle, we apprehend is but a part of equity's declination to extricate the wrongdoer from self-imposed hard conditions, or to tax the innocent, where one of two not in pari delicto must suffer."

If a managing spouse mixes his separate funds with community funds and fails to meet his burden to trace and prove what portion belongs to his separate estate, then the whole will become community property (normal commingling). On the other hand, if the managing spouse mixes his wife's separate funds with community funds and fails to meet his burden to trace and prove what portion is her separate property and what portion is the community estate (in which he owns an interest), then the whole will become the wife's separate property (reverse commingling).

The loss of the managing spouse's separate estate to commingling is consistent with the general rule that a "trust relationship" exists between a husband and wife as to property controlled by the managing spouse. *Mazique v. Mazique*, 742 S.W.2d 805, 807 (Tex. App. – Houston [1st Dist.] 1987, *mand. overruled*); *Carnes v. Meador*, 533 S.W.2d 365, 370 (Tex. Civ. App. – Dallas 1975, writ ref'd n.r.e.); *Brownson v. New*, 259 S.W.2d 277, 281 (Tex. Civ. App. – San Antonio 1953, writ dism'd w.o.j.). The burden is on the managing spouse to prove that a gift or disposition of community funds was not unfair to the other spouse. *Mazique v. Mazique*, 742 S.W.2d at 808; *Jackson v. Smith*, 703 S.W.2d 791, 795 (Tex. App – Dallas 1979, writ ref'd n.r.e.). "Thus, constructive fraud will usually be presumed unless the managing spouse proves that the disposition of the community funds was not unfair to the other spouse." *Mazique*, 742 S.W.2d at 808; *Carnes*, 533 S.W.2d at 370. "Where the managing spouse has received community funds and the time had come to account for such funds, the managing spouse has the burden of accounting for their proper use." *Mazique*, 742 S.W.2d at 808; *Maxell's Unknown Heirs v. Bolding*, 36 S.W.2d 267, 268 (Tex. Civ. App. – Waco 1931, no writ).

B. Fiduciary Duty is Owed by Managing Spouse

Many cases have found a fiduciary or trust relationship to exist between spouses when the managing spouse has gifted or squandered the community assets. *Reaney v. Reaney*, 505 S.W.2d 338 (Tex. Civ. App. – Dallas 1974, no writ) (wife given money judgment for $9,062.87 against husband for "abuse of his managerial powers", which resulted in dissipation of community assets squandered in gambling and gifts); *Pride v. Pride*, 318 S.W.2d 715, 718 (Tex.Civ.App.-Dallas 1958, no writ) (wife given money judgment for her share of $3,000 cash concealed in hole in floor and not accounted for); *Swisher v. Swisher*, 190 S.W.2d 382 (Tex. Civ. App.-Galveston 1945, no writ); *Givens v. Girard Life Ins. Co. of Am.*, 480 S.W.2d 421 425 (Tex.Civ.App.-Dallas 1972, writ ref'd n.r.e.) (wife had no burden to establish fraudulent intent to protect her interest in the community from "abuse of husband's managerial powers.")

Once the trust relationship is established, the managing spouse has the burden to produce records and to show fairness in dealing with the interests of the other spouse. *Morrison v. Morrison*, 713 S.W.2d 377, 380 (Tex. App. – Dallas 1986, writ dism'd) (burden on husband manager of community assets to produce records to justify expenditures on other women); *Spruill v. Spruill*, 624 S.W.2d 694, 697 (Tex. App. – El Paso 1981, writ dism'd) (trust relationship exists between husband and wife as to that community property controlled by each spouse. Burden of proof is upon the disposing spouse to show fairness).

If the managing spouse is in fact handling both community property and the other spouse's separate property, then the managing spouse has the burden of producing records and tracing the community portion. If he fails to meet his burden, then under the trust principles announced in Farrow v. Farrow, supra, and *Sibley v. Sibley, supra*, the interests of the managing spouse in the community are lost and the mixture becomes the other spouse's separate property.

a. Background in Trust Accounting Rules

Farrow v. Farrow, 238 S.W.2d 255 (Tex.Civ.App.-Austin 1951, no writ) was the first of the modern tracing cases to apply trust doctrine to the tracing or commingling of community and separate funds in a marriage:

> (a) If a man mixes trust funds with his own, the whole will be treated as trust property, except so far as he may be able to distinguish what is his own.
>
> (b) An owner who wrongfully permits the property of another to become so intermingled and confused with his own property as to render impossible the

identification of either, is under the burden of disclosing such facts as will insure a fair division, and if he fails or refuses to do so, the combined property or its value will be awarded to the injured party.

(c) But there must be a willful or wrongful invasion of rights in order to induce the merited consequences of forfeiture.

(d) If the goods are of the same nature and value and the portion of each owner is known or if a division can be made of equal proportionate value, as in the case of a mixture of corn, coffee, tea, wine or other article of the same kind and quality, then each owner may claim his proportionate part.

Under *Sibley v. Sibley*, 286 S.W.2d 657, 659 (Tex. Civ. App. – Dallas 1955, writ dism'd), the application of the trust doctrine in a divorce case meant that "the trustee (husband) is presumed to have checked out his money first."

b. Accounting Principles

From these general trust principles, a number of separate accounting rules permitting tracing have developed, some of which have a life independent of their source in trust law. The primary concern in tracing cases applying trust doctrine is to see that a wrongdoer does not prosper by his actions. Most of the cases address situations where a person mixes trust funds with his or her property.

The "community out first" rule of tracing is now firmly established in our Texas jurisprudence. In other words, this rule has taken on a "life of its own" and no longer relies on trust law. *Welder v. Welder*, 794 S.W.2d 420 (Tex.App.-Corpus Christ 1900, no writ); *DePuy v. DePuy*, 483 S.W.2d 883 (Tex. Civ. App. – Corpus Christi 1972, no writ); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App. – Houston [14th dist.] 1975, writ dism'd); *Harris v. Venture*, 582 S.W.2d 853 (Tex. Civ. App. – Beaumont 1979, no writ); *Snider v. Snider*, 613 S.W.2d 8 (Tex. App. – Dallas 1981, no writ); *Gibson v. Gibson*, 614 S.W.2d 487 (Tex. Civ. App. – Tyler 1981, no writ); *Kuehn v. Kuehn*, 594 S.W.2d 158 (Tex. Civ. App. – Houston [14th Dist.] 1980, no writ).

Similarly, if a person has been given managerial powers over the other spouse's estate and uses the separate funds as collateral to obtain loans to purchase assets and the lender intends to only look to the separate funds for repayment, should not all of the assets be the separate property of the wife? What if her separate estate paid off that loan? Would this create a constructive or resulting trust?

The Court of Appeals in *Farrow v. Farrow*, 238 S.W.2d 255 (Tex. Civ. App. – Dallas 1955, writ dism'd) cited 9 Tex.Jur. Confusion of Goods, Sec. 2 for the principle that, "(A)n owner who wrongfully permits the property of another to become so intermingled and confused with his own property as to render impossible the identification of either is under the burden of disclosing such facts as will insure a fair division, and if he fails or refuses to do so, the combined property or its value will be awarded to the injured party." *Farrow*, 238 S.W.2d at 257.

Applying this principle to the situation described above would indicate that the burden would be on the managing spouse to disclose facts insuring a fair division, or risk forfeiture of the property in which he has an interest whether community or separate, and awarding the property or its value to the injured party.

XI. ARE PROFESSIONAL DEGREES & LICENSES "PROPERTY" SUBJECT TO DIVISION?

A majority of the courts that have addressed this question have answered negatively. In community property states, where all marital property is divided evenly upon divorce, the consensus is that professional degrees and licenses are not marital property. *See Pyeatte v. Pyeatte*, 135 Ariz. 346, 661 P.2d 196 (1982) (legal education not community property); *Wisner v. Wisner*, 129 Ariz. 333, 631 P.2d 115 (1981) (medical license not community property); *In re Marriage of Aufmuth*, 89 Cal. App. 3d 446, 152 Cal. Rptr. 668 (1979) (law degree not community property); *Todd v. Todd*, 272 Cal. App. 2d 786, 78 Cal. Rptr. 131 (1969) (law degree not community property); *In re Marriage of Graham*, 194 Colo. 429, 574 P.2d 75 (1978) (educational degree not community property); *Muckleroy v. Mcukleroy*, 84 N.M. 14, 498 P.2d 1357 (1972) (medical license not community property); *Frausto v. Frausto*, 611 S.W.2d 656 (Tex. Ct. App. 1980) (medical education not community property).

Furthermore, a majority of jurisdictions that have interpreted their respective equitable distribution statutes with regard to this issue have reached a similar conclusion. *See Hughes v. Hughes*, 438 So. 2d 146 (Fla. Dist. Ct. App. 1983) (educational degree not marital property); *In re Marriage of Goldstein*, 97 Ill. App. 3d 1023, 423 N.E.2d 1201 (1981) (enhanced earning capacity represented by medical degree not marital

property); *In re Marriage of McManama*, 272 Ind. 483, 399 N.E.2d 371 (1980) (enhanced earning capacity represented by law degree not marital property); *Wilcox v. Wilcox*, 173 Ind. App. 661, 365 N.E.2d 792 (1977) (enhanced earning capacity represented by doctoral degree not marital property); *Leveck v. Leveck*, 614 S.W.2d 710 (Ky. Ct. App. 1981) (medical degree and license not marital property); *Moss v. Moss*, 80 Mich. App. 693, 264 N.W.2d 97 (1978) (medical degree not marital property); *Ruben v. Ruben*, 123 N.H. 358, 461 A.2d 733 (1983) (enhanced earning capacity represented by doctoral degree not marital property); *Mahoney v. Mahoney*, 91 N.J. 488, 453 A.2d 527 (1982) (Masters of Business Administration degree not marital property); *Stern v. Stern*, 66 N.J. 340, 331 A.2d 257 (1975) (earning capacity represented by law degree not marital property); *Hill v. Hill*, 182 N.J. Super. 616, 442 A.2d 1072 (App. Div.), *aff'd*, 91 N.J. 506, 453 A.2d 537 (1982) (license to practice dentistry not marital property); *Hubbard v. Hubbard*, 603 P.2d 747 (Okla. 1979) (professional degree and license not marital property); *DeWitt v. DeWitt*, 97 Wis. 2d 44, 296 N.W.2d 761 (Ct. App. 1980) (law degree not asset of marital estate).

A summary of the traditional view that an educational degree is not property can be found in the Colorado Supreme Court's often quoted statement that the degree, *In re Marriage of Graham*, 194 Colo. 429, 574 P.2d 75 (1978):

– does not have an exchange value or any objective transferable value on an open market
– is personal to the holder
– terminates on death of the holder and is not inheritable
– cannot be assigned, sold, transferred, conveyed, or pledged
– is the cumulative product of many years of previous education, combined with diligence and hard work
– may not be acquired by the mere expenditure of money
– is simply an intellectual achievement that may potentially assist in a future acquisition of property

A few courts, however, have held that their respective equitable distribution statutes do permit professional degrees and licenses to be considered marital property under appropriate circumstances. *See In re Marriage of Horstmann*, 263 N.W.2d 885 (Iowa 1978) (future earning potential represented by law degree is marital property); *Inman v. Inman*, 578 S.W.2d 266 (Ky. Ct. App. 1979) (medical license is marital property); *Woodworth v. Woodworth*, 126 Mich. App. 258, 337 N.W.2d 332 (1983) (law degree is marital property).

A. *Frausto v. Frausto*, 611 S.W.2d 656 (Tex. Ct. App. 1980).

Manuel and Maria Frausto were married for over ten years. In the early stages of their marriage, both were school teachers. Eventually, both agreed that Manuel would attend medical school while Maria would continue *898 her work in education. Following Manuel's completion of his medical education, the couple had two children. However, the Frausto's subsequently divorced. Although there was no disagreement regarding custody of the children, the trial court's division of the marital estate was contested. On appeal, the husband asserted that the trial court's order requiring him to pay $20,000 in future payments to Maria as reimbursement for educational expenses was invalid. The court of appeals reversed the trial court and held that the wife was not entitled to the $20,000 as reimbursement because the husband's education was not community property subject to division on divorce. The Frausto court acknowledged the reasoning used by courts of other jurisdictions, but ultimately relied on the Texas Supreme Court's decision in *Nail v. Nail* to declare that an educational degree is not property.

B. Property Rights.

Property may be characterized as either real or personal property. *Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976) (personal income of spouses during marriage community property); *Branecky v. Seaman*, 688 S.W.2d 117, 120 (Tex. App.--Corpus Christi 1984, no writ) (improvements to realty held community property). Further, an interest in personal property may be tangible or intangible. *See generally* Castleberry, *Constitutional Limitations on the Division of Property Upon Divorce*, 10 ST. MARY'S L.J. 37, 65 (1978) (earning capacity is recognized property right); McKnight, *Divison of Texas Marital Property on Divorce*, 8 ST. MARY'S L.J. 413, 426 (1976) (discusses divisible and nondivisible property interests); Schaefer, *Wife Works So Husband Can Go to Law School: Should She Be Taken in as a 'Partner' when 'Esq.' Is Followed by Divorce? Or Can You Have a Community Property Interest in a Professional Education?*, 2 COMM. PROP. J. 85, 86 (1975) (education acquired during marriage should be community property). It is well established that personal wages of a husband and wife are community property. *Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976) (income of either spouse during marriage is community property); *Norris v. Vaughan*, 152 Tex. 491, 501, 260 S.W.2d 676, 682 (1953) (rights or property acquired while married community property); *Maben v. Maben*, 574 S.W.2d 229, 232 (Tex. Civ. App.--Fort Worth 1978, no writ) (earnings of wife and salary of husband both community property). *See generally McKnight*, Family Law--Husband and

Wife, 34 SW. L.J. 115, 126 (1980) (property obtained during marriage presumed community); Comment, *Community Property Rights and the Business Partnership*, 57 TEX. L. REV. 1018, 1039 (1979) (business profits community property). Personal wages or money is a property interest that is readily identifiable, able of valuation, and therefore, easily divisible upon divorce. In contrast, an education is an intangible interest that does not have traditional property characteristics and, upon divorce, is difficult to identify and value. *See generally* Chastin, Henry & Woods, *Determination of Property Rights Upon Divorce in South Carolina: An Exploration and Recommendation*, 33 S.C.L. REV. 227, 230 (1981) (problems with valuing intangible rights); Krauskopf, *Classifying Marital and Separate Property--Combinations and Increase in Value of Separate Property*, 89 W. VA. L. REV. 997, 1009 (1987) (valuing marital contributions); Mullenix, *The Valuation of an Educational Degree at Divorce*, 16 LOY. L.A.L. REV. 227, 259 (1983) (in depth discussion of valuing degrees).

1. Intellectual Property Rights.

Intangible property interests include, but are not limited to, intellectual property rights. *See, e.g.*, 35 U.S.C. § 101 (1982) (patentable inventions); id. § 154 (1982) (grants exclusive rights to patent owner). Another type of intellectual property is a copyright. *See* 17 U.S.C. § 102(a) (1982) (protects mediums of expression); see also Comment, *Copyright Protection for the Intellectual Property Rights to Recombinant Deoxyribonucleic Acid: A Proposal*, 19 ST. MARY'S L.J. 1083, 1096 (1988) (discussion of protection of copyrights by statute and case law). Service marks are also property rights capable of protection. *See* 17 U.S.C. § 1053 (1982) (registrable service marks); *see also Application of Radio Corp. of Am.*, 205 F.2d 180, 182 (C.C.P.A. 1953) (purpose of service mark to protect intangible property rights such as services). *See generally* Armstrong, *From the Fetishism of Commodities to the Regulated Market: The Rise and Decline of Property*, 82 NW. U.L. REV. 79, 83 (1988) (historical perspective of intellectual property rights); Lee & Livington, *The Road Less Traveled: State Court Resolution of Patent, Trademark, or Copyright Disputes*, 19 ST. MARY'S L.J. 703, 713 (1988) (general discussion of intellectual rights under state law).

2. **Choses in Action and Goodwill.**

Choses in action and goodwill are also intangible property rights that are recognized in Texas Law. *See Whittlesey v. Miller*, 572 S.W.2d 665, 667 (Tex. 1978) (loss of consortium cause of action); *Renger Memorial Hosp. v. State*, 674 S.W.2d 828, 830 (Tex. App.--Austin 1984, no writ) (cause of action property right). *Eikenhorst v. Eikenhorst*, 746 S.W.2d 882, 888-87 (Tex. App.--Houston [1st Dist.] 1988, no writ) (goodwill in form of stock appreciation); *Rathmell v. Morrison*, 732 S.W.2d 6, 17 (Tex. App.--Houston [14th Dist.] 1987, no writ) (goodwill of professional partnership); *Geesbreght v. Geesbreght*, 570 S.W.2d 427, 436 (Tex. Civ. App.--Fort Worth 1978, writ dism'd) (goodwill of medical practice); *Nail v. Nail*, 486 S.W.2d 761, 764 (Tex. 1972) (personal goodwill not divisible).

C. Valuation Theories.

In *O'Brien v. O'Brien*, 489 N.E.2d 712, 713 (N.Y. 1985), the New York Court of Appeals held that a medical degree was marital property, and reasoned that the value of a degree was 'the enhanced earning capacity it affords the holder . . ..'

A New Jersey court, in *Lynn v. Lynn*, 7 Fam. L. Rptr. (BNA) 3001, 3001 (N.J. Sup. Ct. 1980), reasoned that the value of a medical degree could be determined by taking the present value of the future interest, in essence discounting future earnings.

In Massachusetts, one court, in holding that an orthodontist's license was an asset, valued the degree at $800,000. *See Reen v. Reen*, 8 Fam. L. Rptr. (BNA) 2193, 2193 (Mass. Prob. & Fam. Ct. 1981).

In *In re Marriage of Sullivan*, 184 Cal. Rptr. 796, 797 (Ct. App. 1982), *vacated*, 691 P.2d 1020, 1023 (Cal. 1984) (property settlement regarding contributions to education not final as of January 1, 1985, retroactively governed by section 4800.3 of California Civil Code), a California court discussed four ways for valuing an educational degree. The first approach compared the degree holder's pre-degree income to post-degree earnings. A second method calculated the number of hours worked by the degree holder and the amount of the community's income contributed to the education. The third approach was based on the lost opportunity of the working spouse. Finally, the court proposed that it could adopt the rationale applied when community funds are used in improving separate property of a spouse. It is apparent that many of the above mentioned methods incorporate a great deal of speculation by relying upon expert testimony in anticipating future earnings. Other jurisdictions have instituted a more rational basis for reaching the value of a degree by applying a cost analysis.

The Supreme Court of Minnesota in *In re Marriage of De La Rosa*, 309 N.W.2d 755 (Minn. 1981), held that the supporting spouse was entitled to be compensated only for direct educational costs paid by her.

In *Inman v. Inman*, 648 S.W.2d 847 (Ky. 1982), the Kentucky Supreme Court reasoned that the wife, who supported the family and paid for her husband's medical schooling, should receive compensation for educational *919 expenses only.

In *Hubbard v. Hubbard*, 603 P.2d 747 (Okla. 1979), the Oklahoma Supreme Court adopted a cost analysis approach, similar to that in Inman, in valuing a degree.

Likewise, the Wisconsin Supreme Court, in *In re Marriage of Lundberg*, 318 N.W.2d 918 (Wis. 1982), valued a husband's medical degree based on costs incurred by the supporting spouse.

The Supreme Court of Iowa in *In re Marriage of Horstmann*, 263 N.W.2d 885 (Iowa 1978), concluded that the supporting spouse should be reimbursed for costs expended on the husband's degree.

See generally, Comment, Silvera, Darryl J., *Should Your Spouse Be Compensated for Putting You Through School? Texas Says No; Just and Right?*, 20 STMLJ 897, from which much of the above text and citations were derived.

D. Options and Arguments for Texas.

Based on *Frausto v. Frausto*, an educational degree earned during marriage in Texas is not property and, therefore, is not part of the divisible marital estate. Although Texas courts may consider the education of a spouse as a factor in dividing the state, [*see Murff v. Murff*, 615 S.W.2d 696, 699 (Tex. 1981) (education factor considered by trial court in making just and right property division); and *Cooper v. Cooper*, 513 S.W.2d 229, 233-34 (Tex. Civ. App.--Houston [1st Dist.] 1974, no writ) (court considered husband's education and medical degree in dividing parties' community estate)], equity supports the consideration or recognition of an educational degree as a real economic benefit to the spouse who obtains the degree. A right of reimbursement applied to educational degrees would be an extension of current law allowing reimbursement where separate property is improved by community contributions. This right of reimbursement, if adopted, would compensate spouses for the contributions made during marriage to the other spouse's education.

The inequities that may result from the failure to compensate the spouse who supports the other spouse through college or professional school are well recognized, and this issue is one that has evoked much comment and controversy around the nation. The court in *Frausto* pointed out that in an attempt to overcome such difficulties the trial court has wide discretion in dividing the estate of the parties in a divorce decree and may consider many factors including the difference in earning capacity, education and ability of the parties, probable future need for support, fault in breaking up the marriage, and the benefits an innocent spouse may have received from a continuation of the marriage. The court also suggested that, if properly pleaded, reimbursement might be the solution to this inequity. However, in order to argue in favor of reimbursement, the attorney must first convince the court that the degree or license is in fact property or else come up with a new concept of reimbursement. Melley, Anne E., Texas Family Law Service (2006), *Marital Property, Chapter 18. Characterization of Property.*

XII. THE INCREASE IN THE VALUE OF CORPORATE STOCK DURING MARRIAGE AS A RESULT OF TIME, TOIL AND TALENT.

The best argument for holding that the increase in the value of corporate stock during marriage is community property is found in Justice Sondock's dissenting opinion in *Vallone v. Vallone*, 644 S.W.2d 455 (Tex.1982), which is hereafter reprinted in its entirety.

SONDOCK, Justice, *dissenting*.

I respectfully dissent. I believe that the majority has done the Bar a disservice by deciding this case on the basis of abuse of discretion. In applying this principle, the majority has confused discretion in *division* of property with discretion in *classifying* property. I recognize that a trial court has broad discretion in ordering a division of the property of the parties and that the division does not have to be on a 50/50 basis. A trial court, however, has no discretion in classifying property. I respectfully submit that it is impossible to decide whether there has been an abuse of discretion in division of the estate of the parties until this Court determines that a proper classification of the marital property has been made by the trial court.

The question presented by this case is: If during marriage, corporate stock owned by one spouse as separate property increases in value due to the time, talent, and toil of one or both spouses, does that increased value belong to the community estate or is it the separate property of the spouse who owns the stock? The increase is community property.

The majority recognizes as "fundamental" the proposition that "any property or rights acquired by one of the spouses after marriage by toil, talent, industry or

other productive faculty belongs to the community estate." However, contrary to the mandate of *Norris v. Vaughan,* 152 Tex. 491, 260 S.W.2d 676 (1953), the majority indicates that the increase in the value of the stock in Tony's Restaurant, Inc., which the lower courts attributed to the time, talent, and toil of the spouses, is the separate property of the husband. The majority refuses to address this issue directly. They obviously have concluded, however, that the increase is the husband's separate property because they hold that the trial court did not abuse its discretion in dividing the property of the parties.

The majority further states that "when separate property is combined with community time, talent, and labor, and both the community and the separate estate make claim upon the increment, the courts are confronted with conflicting principles of marital property law." What the majority considers to be conflicting principles are the provisions in *Norris v. Vaughan, supra,* that: (1) classify all property acquired by time, talent, and toil, and (2) permit a spouse to expend a reasonable amount of time in the preservation of a separate estate. I submit that these are not conflicting principles of law. The provision that a spouse may preserve his separate property is simply a limitation on the general rule that requires spouses to direct their energy toward building the community estate rather than benefiting their individual interests. It defies logic to state that this Court in *Norris v. Vaughan, supra,* intended the definition of reasonable time to be interpreted to allow a spouse to spend 47% of his time building his separate estate. During marriage, the law will not permit a spouse to devote 100% of his time, talent, and toil on his own behalf in the operation of a sole proprietorship or a partnership and then claim 47% of the benefits as separate property. This conduct does not become acceptable in the eyes of the law merely because the same spouse does the same act through a corporate vehicle of his own creation.

The majority has attempted to blend two distinct rules of law into one: 1) all earnings of the spouses belong to the community, *Norris v. Vaughan, supra;* and 2) one estate does not have the right to benefit at the expense of the other estate without providing reasonable compensation for the benefit derived, *Colden v. Alexander,* 141 Tex. 134, 171 S.W.2d 328 (1943); *Dakan v. Dakan,* 125 Tex. 305, 83 S.W.2d 620 (1935). The distinction between these rules may be described as the difference between a right of ownership and a right of reimbursement. The former is a legal right involving only the community estate and its ownership of all the earnings of the spouses; the latter is an equitable right involving both estates and the equities that exist between them.

In this case, the community estate owns all the profits and earnings of the business regardless of whether the community receives some of the profit as salary because the laws of this State mandate that every dollar that either spouse earns is community property. The majority apparently finds solace in its determination that the community received "adequate compensation." However, what is adequate compensation is not the issue and is irrelevant here. Most people would agree that $200,000 annual salary is adequate compensation for a successful basketball player, actress, or restauranteur. When these individuals actually earn $1,000,000 per year, the entire $1,000,000 belongs to the community estate, not just the amount an appellate court may deem "adequate compensation." The rule is not that a portion of the earnings found to be adequate compensation for labor belongs to the community estate. The rule always has been that earnings of a spouse-all of the earnings-are community property. The result in this case should be no different.

The position of the majority ignores the basic principles underlying the community property system. Although the specific question presented by this case has never been answered by this Court, the underlying principle has been addressed many times. The only difference here is that the property involved-earnings/profits of the business-has been cloaked in corporate form.

During the marriage, Tony's Restaurant was started as a sole proprietorship. Later, the business was incorporated. Unidentified used restaurant equipment, which had a depreciated value of $9,365 in 1969, was transferred to the corporation as a part of the initial capitalization of $19,663. The trial court found that this used equipment was a gift to the husband from his father.[FN1] All of the stock was registered in the name of the husband and issued in one certificate, which does not bear the "sole and separate property" legend. At the time of divorce, the trial court upheld the husband's claim that 47% of the stock *at its present value* of $470,000 belonged to him as his sole and separate property.

> FN1. The record does not support the majority's statement that the "assets of the restaurant were transferred to Tony."

Assuming that the evidence is sufficient to support the finding that 47% of the stock belonged to the husband as his sole and separate property,[FN2] the trial court erred in classifying the *increase in value* of that stock from $9,365 to $470,000 as the husband's separate property. Even though a business is created during the marriage

from separate funds, the earnings of the business that result from a spouse's devotion of 100% of his or her time, talent, and toil belong to the community estate.

> FN2. 618 S.W.2d at 822. The court of civil appeals refers to the evidence as being "scant." This is a classification that this opinion should not be construed as approving.

The issue of classifying the increase in the value of separate property as community property has been addressed by the Texas courts in various contexts. [FN3] The increase from a spouse's operation of a business always has been considered community property, even when the business itself was owned by one spouse prior to the marriage and thus was the separate property of that spouse. [FN4] *Epperson v. Jones,* 65 Tex. 425 (1886). In *Epperson,* this Court held that profits from the operation of a business are "community property, and cannot, therefore, be said to increase ... [spouse's] separate estate to the extent of a single dollar." *Id.* at 428. *See Moss v. Gibbs,* 370 S.W.2d 452 (Tex.1963); *Hardee v. Vincent,* 136 Tex. 99, 147 S.W.2d 1072 (Tex.1941); *Smith v. Bailey,* 66 Tex. 553, 1 S.W. 627 (1886); *Cleveland v. Cole,* 65 Tex. 402 (1885); *Green v. Ferguson,* 62 Tex. 525 (1884).

> FN3. *See Arnold v. Leonard,* 114 Tex. 535, 273 S.W. 799 (1925) (rents and revenues from separate property); *Dixon v. Sanderson,* 72 Tex. 359, 10 S.W. 535 (1888) (profits); *Craxton, Wood & Co. v. Ryan,* 3 Tex.Civ.Cas. 439 (1888) (bricks produced from a spouse's separate property); *Braden v. Gose,* 57 Tex. 37 (1882) (interest received on money in a separate bank account); *White v. Lynch & Co.,* 26 Tex. 195 (1862) (timber produced from trees grown on separate real property); *DeBlane v. Lynch,* 23 Tex. 25 (1859) (crops grown on separate realty).

> FN4. The increase in the instant case is distinguishable from an "inherent" increase in the value of separate property. The court of civil appeals noted: "The increase in the value of the stock ... was directly attributable to the labors of one or both of the community partners.... All of the increase is attributable to the labor and skill of one (and probably both) of the spouses. This is clearly distinguishable ... [from a situation where] separate property ... increased in value because of reasons other than the time and effort of one or both of the spouses." 618 S.W.2d at 823-24.

As this Court explained as early as 1848, "[U]nder the laws, the services of the family are always to be rendered for the benefit of the community, and not for its individual members...." *Yates v. Houston,* 3 Tex. 433, 455 (1848). *See Cleveland v. Cole, supra,* at 405. In *DeBlane v. Lynch & Co.,* 23 Tex. 25 (1859), the Court stated:

> The principle which lies at the foundation of the whole system of community property is, that whatever is acquired by the joint efforts of the husband and wife, shall be their common property. It would be unnecessary consumption of time, to quote authorities for this proposition.

Id. at 29. Over 100 years ago, therefore, this Court acknowledged as well-established law in Texas the rule that property acquired by the joint effort of a husband and wife is community property. Additionally, the *DeBlane* Court concluded that to hold otherwise would "lead to results wholly inconsistent with the recognized principles of law upon which the system of community property is based," and would lead to "inequitable and unreasonable" results. *Id.* at 28. *See also First National Bank of Lewisville v. Davis,* 5 S.W.2d 753 (Tex.Comm'n App.1928, judgm't adopted). This position was affirmed in *Norris v. Vaughan,* 152 Tex. 491, 260 S.W.2d 676 (Tex.1953). "Any property or rights acquired by one of the spouses after marriage by toil, talent, industry or other productive faculty is community property." *Id.* at 501, 260 S.W.2d at 682. *See also In re Marriage of York,* 613 S.W.2d 764 (Tex.Civ.App.-Amarillo 1981, writ ref'd w.o.j.); *Logan v. Logan,* 112 S.W.2d 515 (Tex.Civ.App.-Amarillo 1937, writ dism'd).

Later, in *Graham v. Franco,* 488 S.W.2d 390 (Tex.1972), this Court recognized that *Norris v. Vaughan, supra,* applied:

> [T]he affirmative test; i.e., that property is community which is acquired by the work, efforts or labor of the spouses or their agents, as income from their property, or as a gift to the community. Such property, acquired by the joint efforts of the spouses, was regarded as acquired by 'onerous title' and belonged to the community.

Id. at 392. See *Epperson v. Jones, supra; DeBlane v. Lynch, supra; Smith v. Strahan,* 16 Tex. 314 (1856); W. DeFuniak, *Principles Of Community Property* § 62 (1971); C. Moynihan, *Community Property,* 2 *American Law Of Property* § 7.16 (1952).

Texas courts have considered this principle so essential to the community property system that even fringe benefits arising from a spouse's labor, such as profit sharing, pension and retirement plans, including those that are noncontributing or are not vested or reduced to possession at the time of divorce, are considered community property. *Cearley v. Cearley,* 544 S.W.2d 661 (Tex.1976); *Busby v. Busby,* 457 S.W.2d 551 (Tex.1970); *Herring v. Blakeley,* 385 S.W.2d 843 (Tex.1965); *Mora v. Mora,* 429 S.W.2d 660 (Tex.Civ.App.-San Antonio 1968, writ dism'd); *Kirkham v. Kirkham,* 335 S.W.2d 393 (Tex.Civ.App.-San Antonio 1960, no writ).

Petitioner in this case, the husband, argues that the case of *Scofield v. Weiss,* 131 F.2d 631 (5th Cir.1942), is authority for the proposition that the increase in a business that is due to time, talent, and toil is not community property. *Scofield* does indicate that "under Texas law" the increase in value of corporate stock owned as separate property remains separate even though the increased value is attributable to the efforts of a spouse. The *Scofield* case, however, fails to cite any "Texas law" and only amounts to "an *Erie*-educated guess." *See Allstate Ins. Co. v. Mole,* 414 F.2d 204, 205 (5th Cir.1969). In the instant case, any reliance by Petitioner on a Fifth Circuit case that purports to enunciate a principle of law that is unsupported by Texas case authority is misplaced.

The majority justifies its holding that the trial court did not abuse its discretion in dividing the property by relying on the court of civil appeals' statement that the trial court awarded the wife 51.4% of the community estate. This overlooks the fact that the court of civil appeals remanded this case to permit the trial court to correct its error in excluding the increase in the value of the separate stock from the property to be divided. The majority does not recognize that if the trial court had properly classified the increase in the value of the stock, then the community property awarded to the wife would only represent approximately 30% of the parties' estate.

I cannot agree that awarding the wife 30% of the community property comports with the "just and right" requirement of section 3.63 of the Texas Family Code in a case in which the divorce was granted on a no-fault basis and the parties agreed on child custody. Two other material factors that the trial court should have considered in making its division were the respective earning capacities and business opportunities of the parties. In this case, the husband has an earning capacity of more than twenty times that of the wife and the difference in the business opportunities available to the respective parties is incalculable. More important, however, is the fact that included in the property awarded to the husband is the "goose that lays the golden egg"-Tony's restaurant itself. Additionally, under the trial court's classification, the husband has a separate estate of over $470,000 while the wife has none except gifts of personal effects.

When a trial court misclassifies over $450,000, or almost half of what the court of civil appeals noted was the largest community asset, it is impossible to conclude that the court did not commit reversible error. In effect, the trial judge eliminated over $450,000 from consideration as community property. This situation is not unlike the recent case of *In re Marriage of York,* 613 S.W.2d 764 (Tex.Civ.App.-Amarillo 1981, writ dism'd w.o.j.). In *York,* the court of civil appeals concluded that the trial court had misclassified profits in a closely-held corporation operated by the husband and reversed the trial court's division *solely* on that basis, holding: "because ... [the court divided the property] on an erroneous theory and excluded from consideration a significant amount of community property, it abused its discretion." 613 S.W.2d at 771.

If Tony's Restaurant, Inc., had continued its operation as a sole proprietorship, the form in which it was originally organized during the marriage,[FN5] there could be no doubt that the entire increase in the value of the business would be community property. *See Hardee v. Vincent, supra; Smith v. Bailey, supra; Epperson v. Jones, supra; Green v. Ferguson, supra.* Furthermore, in that situation, if the husband had alleged that part of the business was his separate property, it would be incumbent upon him to prove so by tracing. The principle of tracing enables a spouse to identify and preserve his separate property and prevent forfeiture. Tracing, however, cannot be permitted to allow a spouse to alter the form of ownership and thereby change community property to separate property to the detriment of the community.

> FN5. After incorporation, the business continued for all practical purposes to be operated as a sole proprietorship. 618 S.W.2d at 824.

Section 5.02 of the Family Code provides that all property possessed by either spouse during or on dissolution of marriage is presumed to be community property. The spouse asserting otherwise must prove the contrary by satisfactory evidence. *Tarver v. Tarver,* 394 S.W.2d 780, 783 (Tex.1965); *Schmidt v. Huppman,* 73 Tex. 112, 11 S.W. 175 (1889); *Chapman v. Allen,* 15 Tex. 278, 284 (1855). The burden of proof in this case rested on the husband to trace that which he claimed as his separate property. The court of civil appeals' holding that the husband's "duty to trace extended no

farther than to prove that his separate property was exchanged for a certain percentage of the total of the capital stock and ... [that] the stock was held by him since the time of issuance" [FN6] should apply only to the original value of the separate stock. The husband failed to meet his tracing burden with respect to the increased value of the stock.[FN7]

> FN6. 618 S.W.2d at 822-23.
>
> FN7. The husband's records reflect that over $700,000 of the corporation's $1,000,000 value consisted of retained earnings.

In *Hardee v. Vincent*, 136 Tex. 99, 147 S.W.2d 1072 (Tex.1941), the Court noted that classification of the increased stock of merchandise and fixtures in the family business depended on whether items were purchased with profits from the business or capital investment. *Id.* at 102, 147 S.W.2d at 1073. The Court held that the burden to trace rested on the spouse claiming the business as separate property:

It was incumbent upon ... [the wife] to show that the money used in the purchase of additional stocks of merchandise and fixtures came out of her separate estate. She attempted to do this by showing that the business belonged to her separate estate at the time of conveyances to her.... The case was tried ... some two years and three months after the conveyances from ... [her husband.] During such time, the stocks of merchandise and fixtures were bought and sold, thus presenting the all important issue as to whether the money used in the purchases of such additional stocks of merchandise and fixtures was profits from the business or capital investment.

Absent proof that the money so used came out of the capital investment, ... the presumption of the law, that property acquired by either husband or wife during marriage belongs to the community estate of the husband and wife, controls in the present case.

Id. at 102-03, 147 S.W.2d at 1074.

In *Blumer v. Kallison*, 297 S.W.2d 898, 900-01 (Tex.Civ.App.-San Antonio 1956, writ ref'd n.r.e.) the court observed that a "modern and accurate" bookkeeping system distinguished profits and rents belonging to the community from the wife's separate property in a manner that made her capital "readily traceable." *Id.* at 900-01. The separate property could be identified and calculated separately from the community property.[FN8]

> FN8. The majority cites *Humphrey v. Humphrey*, 593 S.W.2d 824 (Tex.Civ.App.-Houston [14th Dist.] 1980, writ dism'd), for the proposition that no abuse of discretion occurred in this case. In *Humphrey*, the court noted that the husband kept detailed business records and could, therefore, trace his separate property. *Id.* at 826. Moreover, the case did not involve a misclassification problem because the business was not run like a sole proprietorship. The husband was not the only corporate officer and others were actively involved in the business.

In the instant case, the husband did not keep business records similar to those in *Blumer*. Here, the court of civil appeals expressly noted:

> There is little doubt that in many respects the financial and business end of the corporation was operated with great informality. Cash was taken from the business when it was needed for personal expenses; neither officer nor directors' meetings were held on a regular basis; and the corporation was run by the husband, rather than by its officers or a board of directors.

618 S.W.2d 824. In short, the husband made no attempt to trace the increase in his separate property, either in specie, through mutation, or by keeping detailed business records. Instead, in this case, the simple act of incorporation has been treated as a substitute for the well-recognized tracing requirement.

This cannot be done.

A spouse who incorporates a family business with capital claimed as his or her separate property cannot change the community character of profits later earned and retained. By electing to elevate form over substance, the majority has created an option of election for a spouse, who by a simple ex parte paper transaction will be able to transform community earnings into separate property. Clearly, such an unauthorized mode of reclassifying property is contrary to the laws of this State.

Texas courts have prohibited spouses from changing community property into separate property by contract, *King v. Bruce*, 145 Tex. 647, 201 S.W.2d 803 (1947), or agreement, *Strickland v. Wester*, 131 Tex. 23, 112 S.W.2d 1047 (1938); *Gorman v. Gause*, 56 S.W.2d 855 (Tex.Comm'n App.1933, judgm't adopted); *Cox v. Miller*, 54 Tex. 16 (1880), or disclaimer, *Hardee v. Vincent, supra.* Until the 1948 amendment to article XV, section 16 of the Texas Constitution, spouses could not even partition community property. To the extent that the parties today can effectuate a change in the

character of property from community to separate, such can be done only by strict compliance with the law. *Maples v. Nimitz,* 615 S.W.2d 690 (Tex.1981); *Hilley v. Hilley,* 161 Tex. 569, 342 S.W.2d 565 (1961). Allowing a spouse to make the type of election the majority opinion creates will have ramifications of considerable magnitude given the widespread use of the corporate entity in the modern business world.

Basic principles and policies of community property support the proposition that the earnings of a spouse-owned business to which one or both spouses devote time, talent, and toil should be subject to division on divorce. The majority attempts to justify its contrary holding by relying on a well-recognized authority in this field. L. Simpkins, *Texas Family Law* (Speer's 5th Ed.1976). The language quoted by the majority, however, is incomplete, inapplicable, and misleading. In fact, this treatise irrefutably classifies the increase in the value of the stock in a closely-held corporation in the same manner I advocate:

> It would appear, in the case of either a partnership or a closely held corporation, that an increase in the value of the corporate stock, or in the value of the partnership, should be attributable to and become a part of the community estate, if the increase in value is a result of the time, effort, and talent of the community expended on such corporate or partnership business. Although this would necessitate an inquiry into the value of the corporation or partnership, as well as an inquiry into the reasons for the increase in value, it is suggested that in order to protect and preserve the community interest of the spouses such inquiries are necessary.

L. Simpkins, *Texas Family Law* § 15:50, at 115 (Speer's 5th Ed.1976).

Section 3.63 of the Family Code mandates that in a property division involving a business that for practical purposes is no different from a sole proprietorship, no reason exists to treat the corporation as anything other than "merely the husband's instrumentality for the conduct of his business affairs or a method of operation therefor; indeed that it might be viewed as no more than a method of accounting." *Dillingham v. Dillingham, supra,* at 462. (Emphasis added). Consequently, I would hold that in a divorce case where a non-owner spouse proves that a spouse's time, talent, and toil are primarily responsible for the increase in the value of a business operated as a corporation, *the increase in the value* is community property, even though a business or a part thereof is separate property.[FN9]

> FN9. Since no point of error was granted on the alter ego issue, I deem it inappropriate to discuss the conflict currently existing among courts of appeals in this area. *Compare Goetz v. Goetz,* 567 S.W.2d 892 (Tex.Civ.App.-Dallas 1978, no writ) *and Humphrey v. Humphrey,* 593 S.W.2d 824 (Tex.Civ.App.-Houston [14th Dist.] 1980, writ dism'd) *with Dillingham v. Dillingham,* 434 S.W.2d 459 (Tex.Civ.App.-Ft. Worth 1968, writ dism'd) *and Bell v. Bell,* 504 S.W.2d 610 (Tex.Civ.App.-Beaumont), *rev'd on other grounds,* 513 S.W.2d 20 (Tex.1974). However, in response to the majority's statements in this area, I feel compelled to suggest that this Court adopt a legal standard that does not revolve around a factual finding of fraud for divorce cases in which a business would be classified as a sole proprietorship but for the fact of incorporation. This is obviously one of the "exceptional situations" referred to in *Pace Corp. v. Jackson,* 155 Tex. 179, 284 S.W.2d 340 (1955).

Rather than address the central issue of whether the form in which a spouse transacts business can prevail over substantive community rights in profits earned by community labor, the majority, instead, has focused on two non-existent procedural technicalities. First, I disagree with the majority opinion in its discussion of the pleadings in this case. In my opinion, the wife's nineteen page pleading sufficiently sets forth her claims for relief. Even if this were not the case, the husband failed to file special exceptions and made no objection to the introduction of evidence in the trial of the cause. In short, if the wife's pleadings in this cause were insufficient, the husband has failed to preserve this error. *Pruske v. Pruske,* 601 S.W.2d 746, 749 (Tex.Civ.App.-Austin, 1980 writ dism'd), cited by the majority, together with the authorities cited in *Pruske* do not support the majority opinion.

Further, the other authorities cited by the majority are clearly distinguishable from the facts of this case. Neither *Lindsay v. Clayman, supra,* nor *Burton v. Bell, supra,* were divorce cases and insufficiency of pleadings was neither dispositive of the issues involved in those cases nor was it a cause for rendition in either. In both *Burton* and *Lindsay,* it is clear that it was, in fact, the lack of proof (*Burton v. Bell, supra*) or failure to secure a proper jury finding (*Lindsay v. Clayman, supra*) and not

any pleading insufficiency that formed the basis of the court's holding.

Although the majority cites *West v. Austin National Bank,* 427 S.W.2d 906 (Tex.Civ.App.-San Antonio 1968 writ ref'd n.r.e.) as authority for its statement that "the party claiming the right of reimbursement has the burden of pleading and proving that the expenditures and improvements were made and that they are reimbursable," I respectfully submit that the case has no application here and that the word "pleading" does not even appear in the opinion.

Wachendorfer v. Wachendorfer, 615 S.W.2d 852 (Tex.Civ.App.-Houston [1st Dist.] 1981, no writ) is a family law case which espouses the rule of specific pleading which the majority has apparently adopted today. *Wachendorfer,* however, is clearly distinguishable on its facts in that the court expressly noted that "during the trial, the [husband's] lawyer objected to the admission of ... testimony ... but the wife did not amend her pleadings. [The husband's] counsel also preserved error by objecting to the submission [of an] issue ... on the ground that [wife's] pleadings did not contain any allegation as to reimbursement." *Id.* at 854.

Furthermore, I submit that this Court, in enunciating a rule requiring specific pleadings in family law matters, has effectively overruled what I believe has been the generally accepted rule for pleading in this area. The attitude toward pleading in divorce cases always has been liberal. Tests of sufficiency of pleadings in divorce cases have differed from that of cases in other areas. "The general rule as to the sufficiency of pleadings and quantum of proof applicable to civil cases generally does not apply to divorce cases in this state." *Cohen v. Cohen,* 194 S.W.2d 273, 275 (Tex.Civ.App.-Austin 1946, no writ). *See Uranga v. Uranga,* 527 S.W.2d 761, 763 (Tex.Civ.App.-San Antonio 1975, writ dism'd); *Zaruba v. Zaruba,* 498 S.W.2d 695, 698 (Tex.Civ.App.-Corpus Christi 1973, writ dism'd); *Lindsey v. Lindsey,* 228 S.W.2d 878, 879 (Tex.Civ.App.-Amarillo 1950, no writ). Further, in a divorce suit, the trial court may construe the pleadings of the parties with regard to property division more liberally than in other civil cases. *Lindsey v. Lindsey,* 564 S.W.2d 143, 145 (Tex.Civ.App.-Austin 1978, no writ); *Poulter v. Poulter,* 565 S.W.2d 107, 110-11 (Tex.Civ.App.-Tyler 1978, no writ); *Bagby v. Bagby,* 186 S.W.2d 702, 704 (Tex.Civ.App.-Amarillo 1945, no writ); *Fain v. Fain,* 6 S.W.2d 403, 406 (Tex.Civ.App.-Galveston 1928, writ dism'd).

There is a reason for the difference. For example, there is no true default judgment in a divorce suit. Even though the defendant fails to answer, full and satisfactory evidence must still be presented to warrant the granting of a divorce. General pleadings are encouraged and allegations of evidentiary facts are to be stricken from the pleadings. Tex.Fam.Code Ann. § 3.52 (1975). A defendant (respondent) "need not answer on oath, and the petition shall not be taken as confessed for want of an answer." Tex.Fam.Code Ann. § 3.53 (1975). The majority's holding will create confusion with the provisions of § 3.52 and § 3.53 of the Family Code and make it extremely difficult, if not impossible, for trial judges to continue to follow the mandate of § 3.63 of the Family Code.

Second, I cannot agree with the formalistic proposition that the wife's arguments do not adequately preserve the legal question of disregarding a wholly-owned corporation to divide community profits. This Court has always had a strong policy against elevating form over substance when construing points of error. The seminal case in this area, *Fambrough v. Wagley,* 140 Tex. 577, 169 S.W.2d 478 (Tex.1943), provides a clear mandate for construing the parties' points of error and arguments liberally in order to reach the merits of an issue. In *Fambrough* the Court stated:

> Our present briefing rules were adopted for the purpose of simplifying the briefing of cases so that greater attention will be devoted to the presentation of the merits of the appeal, and less attention given to the mechanics of the brief. The object of a "point" in the brief, as provided for in Rule 418, is to call the Court's attention to the questions raised and discussed in the brief. It is intended that the "point" shall be short or in few words. It is not necessary that a "point" be complete within itself, in the sense that it must, on its face, show that the matter complained of presents reversible error. If a "point" is sufficient to direct the Court's attention to the matter complained of, the Court will look to the "point" and the statement and argument thereunder to determine the question of reversible error. *Simply stated, the Court will pass on both the sufficiency and the merits of the "point" in the light of the statement and argument thereunder.*

169 S.W.2d at 482. (Emphasis added.)

As recently as 1980, the Tyler Court of Appeals, for example, considered the *Fambrough* directive as requiring that court to reach the merits in a divorce case

not unlike the case at bar. In *Gaston v. Gaston,* 608 S.W.2d 332 (Tex.Civ.App.-Tyler 1980, no writ), a case cited in the majority opinion, the Tyler court noted that the wife neither pleaded a potential right to reimbursement nor asserted such a right before the court of appeals. Nonetheless, the Tyler court considered the claim, stating: "Since, after reading appellant's brief, appellant's first point could be liberally construed as making a possible claim for reimbursement, we feel that, in accordance with our supreme court's directive in *Fambough* ... [sic], we should at least address the question." 608 S.W.2d at 335.

The legal arguments in the instant case have been properly preserved and well presented. In fact, one of the wife's cross-points in this Court presents the argument, part of which is the synthesis of my dissenting opinion: CROSS-POINT I: The trial court and the Court of Appeals both erred in their finding that 47% of the stock in Tony's Restaurant, Inc., as well as the total value thereof, is the separate property of TONY VALLONE.

It is inconceivable that the majority could possibly construe this Cross-Point as presenting only "factual insufficiency" questions.

An integral part of the foundation of the community property system is the principle that "under the laws, the services of the family are always rendered for the benefit of the community, and not for its individual members." *Yates v. Houston, supra,* at 435. The community property system cannot continue to function as the framework for adjusting marital rights and responsibilities if Texas courts ignore this principle, either directly or through procedural technicalities. "[C]ommunity interests ... [must be] protected with jealous vigilence." *Id.* The mere formation of a corporate entity, a legal fiction, cannot be permitted to create an obstacle to a critical, equitable or proper analysis of the status of marital property. Ownership of a business in corporate form may permit ownership of the stock as separate property, but it does not follow that the increase in the value of the stock that is due to time, talent and toil of a spouse is also the separate property of the spouse.

The error of the trial court in this case was in failing to classify properly the increase in the value of the restaurant stock as community property. The increase in the stock's value from $9,365 to $470,000 constituted 47% of what the court of civil appeals indicated was "by far the largest asset of the community." Since the trial court failed to classify property with a value of over $450,000 as community property, it follows that the trial court's division of the parties' community property was erroneous.

I would affirm the judgment of the court of civil appeals and reverse and remand the cause to the trial court for a division of the community estate in accordance with the principles of law set out in this opinion.

APPENDIX – CHARACTERIZATION SILVER BULLETS

Gifts Between Spouses Presumed to Include Income

If one spouse makes a gift of property to the other spouse, the gift is presumed to include all the income and property that may arise from that property.

Tex. Fam. Code § 3.005.

Proportional Ownership of Property by Marital Estates

If the community estate of the spouses and the separate estate of a spouse have an ownership interest in property, the respective ownership interests of the marital estates are determined by the rule of inception of title.

Tex. Fam. Code § 3.006.

Tracing Generally

"The character of separate property is not changed by the sale, exchange, or change in form of the separate property. If the separate property can be definitely traced and identified, it remains separate property regardless of the fact that the separate property may undergo mutations or changes in form."

Texas Pattern Jury Charges - Family, PJC 202.4.

Separate Property Defined

Tex. Fam. Code § 3.001 defines separate property as follows:

"A spouse's separate property consists of:

(1) the property owned or claimed by the spouse before marriage;
(2) the property acquired by the spouse during marriage by gift, devise, or descent; and
(3) the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage."

Partition of Property

Tex. Fam. Code § 4.102 states that,

"At any time, the spouses may partition or exchange between themselves any part of their community property, then existing or to be acquired, as the spouses may desire. Property or a property interest transferred to a spouse by a partition or exchange agreement becomes that spouse's separate property."

Agreement that Income From Separate Property is Separate Property

Tex. Fam. Code § 4.103 states that,

"At any time, the spouses may agree that the income or property arising from the separate property that is then owned by one of them, or that may thereafter be acquired, shall be the separate property of the owner."

Property Owned or Claimed Before Marriage

Inception of title occurs when a party first has a right of claim to the property by virtue of which title is finally vested.

Welder v. Lambert, 44 S.W. 281 (Tex. 1898).

Under the Inception of Title Doctrine, the character of property, whether separate or community, is fixed at the time of acquisition

Henry S. Miller Co. v. Evans, 452 S.W.2d 426 (Tex. 1970).

Inception NOT Completion

Acquiring an ownership interest or claim to property refers to the inception of the right, rather than the completion or ripening thereof.

Creamer v. Briscoe, 109 S.W. 911 (Tex. 1908).

Inception of Title

Tex. Fam. Code § 3.006 states,

"If the community estate of the spouses and the separate estate of a spouse have an ownership interest in property, the respective ownership interests of the marital estates are determined by the rule of inception of title."

Property Acquired by Gift is Separate Property

Property acquired by gift during the marriage is separate property. Texas Constitution, Art. XVI, § 15.

Tex. Fam. Code § 3.001(2).

Elements of a Valid Gift

The elements of a valid gift are:

an intent by the donor to make a gift;
delivery of the property;
acceptance of the property.

Pankhurst v. Weitinger and Tucker, 850 S.W.2d 726, 730 (Tex.App.-Corpus Christi 1993, writ denied).

Property Acquired by Gift - Burden of Proof

The burden of proving a gift is on the party claiming the gift.

Woodworth v. Cortez, 660 S.W.2d 561, 564 (Tex.App.-San Antonio 1983, writ ref'd n.r.e.).

Promise to Make Gift Not a Gift

The promise to give property in the future is generally not a gift, being unenforceable without consideration.

Woodworth v. Cortez, 660 S.W.2d 561, 564 (Tex.App.-San Antonio 1983, writ ref'd n.r.e.).

Lack of Consideration Essential

Lack of consideration is an essential characterization of a gift. An exchange of consideration precludes a gift.

Pemelton v. Pemelton, 809 S.W.2d 642, 647 (Tex.App.-Corpus Christi 1991)

Gift of Encumbered Property

A grantor may make a gift of encumbered property and the conveyance may be a gift even if the grantee assumes an obligation to extinguish the encumbrance.

Kiel v. Brinkman, 668 S.W.2d 926, 929 (Tex.App.-Houston [14th Dist.] 1984, no writ).

Conveyance to One Who is Natural Object of Bounty

When a person conveys property to a natural object of the grantor's bounty, such as a parent to a child or a grandparent to a grandchild, it creates a rebuttable presumption that the property conveyed is a gift. The person claiming the property was not a gift must prove lack of donative intent by clear and convincing evidence.

Kyles v. Kyles, 832 S.W.2d 194, 197 (Tex.App.-Beaumont 1992, no writ).

Gifts Between Spouses Presumed to Include Income

If one spouse makes a gift of property to the other spouse, the gift is presumed to include all of the income and property that may arise from that gift.

Tex. Fam. Code § 3.005.

Gifts to the Community Not Possible

Spouses own an equal undivided one-half separate property interest in gifts made to both spouses.

Roosth v. Roosth, 889 S.W.2d 445, 457 (Tex.App.-Houston [14th Dist,] 1994, no writ).
Marshall v. Marshall, 735 S.W.2d 587, 597 (Tex.Civ.App.-Dallas 1987, writ ref'd n.r.e.).

The concept of a gift to the community directly conflicts with Tex. Fam. Code § 3.001(2) and with Art. XVI, § 15 of the Texas Constitution, which mandate that any property acquired by gift during the marriage is separate property.

"Conversion" of Separate Property to Community Property

Spouses may convert separate property to community property by agreement, if certain formalities are followed.

See Tex. Fam. Code Sections 4.201-4.206.

Property Acquired by Devise or Descent

Texas Constitution, Art. XVI, § 15 and Tex. Fam. Code § 3.001(2) provide that property acquired during marriage by devise or descent is separate property. "Devise" means the acquisition of property by last will and testament. "Descent" means the acquisition of property by inheritance without a will.

Property Acquired by Devise or Descent Vests Upon Death of Decedent

Whether by devise or descent, legal title vests in beneficiaries upon the death of the decedent.

Texas Probate Code § 37
Dyer v. Eckols, 808 S.W.2d 531 (Tex.App.-Houston [14th Dist.] 1991, writ dism'd by agr).

Property Acquired by Recovery from Personal Injuries

The recovery from personal injuries sustained by a spouse during the marriage, except any recovery for loss of earning capacity during the marriage, is the injured spouse's separate property.

Graham v. Franco, 488 S.W.2d 390 (Tex. 1972)
Tex. Fam. Code § 3.001(3).)

Punitive Damages

The Texas Supreme Court has held that a recovery of exemplary damages by a spouse for a wrong committed during marriage is community property.

Rosenbaum v. Texas Building & Mortgage Co., 140 Tex. 325, 167 S.W.2d 506, 508 (1943)

Personal Injury Settlements

When a spouse receives a settlement from a lawsuit during the marriage, some of which may be community property and some of which may be separate property, it is the spouse's burden to demonstrate what portion of the settlement is his or her separate property. In the absence of sufficient proof, everything is community

Kyles v. Kyles, 832 S.W.2d 194 (Tex.App.-Beaumont 1992, no writ);
Licata v. Licata, 11 S.W.3d 269, 273 (Tex.App.-Houston [14th Dist.] 1999, no pet.);

Quasi-community Property

Texas divorce courts are permitted to treat property acquired in another state that would have been separate property in such other state as community property if, at the time of acquisition, the property would have been community property in Texas.

Tex. Fam. Code § 7.002.

Mutations

Once the character of a property interest is determined, whether separate or community, the property interest will retain that legal character after undergoing a change in form and shall not be altered by the sale, exchange or substitution of the property interest.

Gleich v. Bongio, 99 S.W.2d 881 (Tex. 1937).

Mixed Character Property

When property is acquired during the marriage partly with community property funds, and partly with separate property funds, the property is of mixed characterization, being partially separate property and partially community property, in the proportion that the property was purchased with separate property funds and with community property funds.

Cook v. Cook, 679 S.W.2 581, 583 (Tex.App.-San Antonio 1984, no writ).

Mixed Character Property

If a purchase is made partly with separate property and partly with community credit, the separate and community estates own the property as tenants in common.

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

Each Estate Owns an Undivided Interest in the Proportion That it Supplies to the Consideration

Gleich v. Bongio, 99 S.W.2d 881, 883 (Tex. 1937)

Presumptions

The introduction of contrary evidence ends the presumption of community.

Dawson v. Dawson, 767 S.W.2d 949, 950 (Tex.App.-Beaumont 1989, no writ);
Harris v. Harris, 765 S.W.2d 798, 802 (Tex.App.-Houston [14th District] 1989, writ denied).

Once contrary evidence is introduced, the trier of fact should not weigh the presumption of community property nor treat it as evidence.

Roach v. Roach, 672 S.W.2d 524, 530 (Tex.App.-Amarillo 1984, no writ).

Specific Presumptions – Transfer to a Child

A parent's conveyance of title to a child is presumed to be a gift, but the presumption is rebuttable.

Woodworth v. Cortez, 660 S.W.2d 561, 564 (Tex. App.-San Antonio 1983, writ ref'd n.r.e.).

Specific Presumptions – Acquisition of Property by Debt

If an item of property is acquired on credit, the item takes the character of the credit.

Property acquired on community credit is community property.
Property acquired on separate credit is separate property.

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

Specific Presumptions – Acquisition of Property by Debt

Debts contracted during the marriage are presumed to be on the credit of the community and thus are community debt, unless it is shown that the creditor agreed to look solely to the separate estate of the contracting spouse.

Cockerham v. Cockerham, 527 S.W.2d 162 (Tex. 1975);
Brooks v. Sherry Lane National Bank, 788 S.W.2d 874, 876 (Tex.App.-Dallas 1990, no writ).

Specific Presumptions – Acquisition of Property by Debt

Property purchased on credit during a marriage is community property unless there exists an express agreement on the part of the lender to look solely to the separate estate of the purchasing spouse for satisfaction of the indebtedness.

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

Specific Presumptions – Putting Separate Property Money in a Joint Account

The act of placing separate property funds in a joint account containing community funds does not make separate property funds community funds nor change the characterization of the separate property funds placed in the account.

Celso v. Celso, 864 S.W.2d 652, 655 (Tex.App.-Tyler 1993, no writ).
Higgins v. Higgins, 458 S.W.2d 498, 500 (Tex.Civ.App.-Eastland 1970, no writ).

Specific Presumptions – Inextricable Commingling

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

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

Tracing

The character of separate property is not changed by the sale, mutation, exchange, substitution or change in form of separate property.

Gleich v. Bongio, 99 S.W. 2d 881 (Tex. 1937).

Tracing

If separate property can be definitely and accurately traced and identified, it remains separate property regardless of the fact that the separate property undergoes mutations or changes in form.

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

Tracing

Tracing involves establishing the separate origin of the property through evidence showing the time and means by which the spouse originally obtained possession of the property.

Hilliard v. Hilliard, 725 S.W.2d 722, 723 (Tex.App.-Dallas 1985, no writ).

Case Law – Clearinghouse Method & Identical Sum Inference

Estate of Hanau v. Hanau, 730 S.W.2d 664 (Tex. 1987);
Peterson v. Peterson, 595 S.W.2d 889 (Tex.Civ.App.-Austin 1980, writ dism'd w.o.j.);
Latham v. Allison, 560 S.W.2d 481 (Tex.Civ.App.-Fort Worth 1978, writ ref'd n.r.e.) (unsuccessful tracing);
Beeler v. Beeler, 363 S.W.2d 305 (Tex.Civ. App.-Beaumont 1962, writ dism'd).
McKinley v. McKinley, 496 S.W.2d 540 (Tex. 1973).

Minimum Sum Balance

Useful for funds on account in which a portion can be conclusively proved to be separate.
Show that the balance of the account never went below the amount proven to be separate.
This theory presumes that only separate property remains after all other withdrawals are made.

Pardon v. Pardon, 670 S.W.2d 354, 357 (Tex.App.-San Antonio 1984, no writ).
Snider v. Snider, 613 S.W.2d 8, 11 (Tex.Civ.App.-Dallas 1981, no writ)

Community Out First

Withdrawals from a mixed separate and community fund are presumed to be community to the extent that community funds exist.

Withdrawals are presumed to be from separate funds only when all community funds have been exhausted.

The party attempting to overcome the community presumption must produce clear evidence of the transactions affecting the commingled account.

Community Out First

Sibley v. Sibley, 286 S.W.2d 657 (Tex.Civ.App.-Dallas 1955, writ dism'd):

Husband managing wife's separate funds.
He commingled them with community funds.
Monies were spent from the commingled account.
Utilizing trust principles, the Court held that the funds held by the husband for his wife were in the nature of trust funds, meaning that he was deemed to have spent his own (i.e., the community) funds first.

Pro Rata Approach

If mixed funds are withdrawn from an account, the withdrawal should be pro rata in proportion to the respective balances of separate and community funds in the account.

By using the pro rata approach, it would not be necessary to analyze the character of each withdrawal.

Item Tracing

Item tracing follows a particular asset from one form to another.
It has limited application (bartering, trading).
The original property must be shown to be separate.
The existence or mutation of that property must be shown.
Bidirectional Commingling
Normal Commingling
Normal or regular commingling occurs when community property and separate property have been mixed, causing the entire mass to become community property.

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

Bidirectional Commingling – Reverse Commingling

Reverse commingling occurs when community property and separate property have been hopelessly mixed, and the entire mass becomes separate property.

Sibley v. Sibley, 286 S.W.2d 657 (Tex.Civ.App.-Dallas 1955, writ dism'd),

Bidirectional Commingling – Exception to Burden to Trace

If the "community-out-first" rule worked to the financial advantage of the "bad actor" (the spouse who manages the accounts) and to the detriment of the other spouse (the beneficiary under trust law), then the burden of tracing would shift to the managing spouse in order to protect the estate of the other spouse.

Farrow v. Farrow, 238 S.W.2d 255, 256 (Tex.Civ.App.-Austin 1951, no writ).

Manager of Property Must Account for Proper Use

"Where the managing spouse has received community funds and the time ha[s] come to account for such funds, the managing spouse has the burden of accounting for their proper use."

Mazique v. Mazique, 742 S.W.2d 805, 807 (Tex.App.-Houston [1st Dist.] 1987, mand. overruled);

Maxell's Unknown Heirs v. Bolding, 36 S.W.2d 267, 268 (Tex.Civ.App.-Waco 1931, no writ).

Fiduciary Duty

Many cases have found a fiduciary or trust relationship to exist between spouses when the managing spouse has gifted or squandered the community assets.

Reaney v. Reaney, 505 S.W.2d 338 (Tex.Civ.App.-Dallas 1974, no writ) (wife given money judgment for $9,062.87 against husband for "abuse of his managerial powers", which resulted in dissipation of community assets squandered in gambling and gifts);

Pride v. Pride, 318 S.W.2d 715, 718 (Tex.Civ.App.-Dallas 1958, no writ) (wife given money judgment for her share of $3,000 cash concealed in hole in floor and not accounted for);

Givens v. Girard Life Ins. Co. of Am., 480 S.W.2d 421 425 (Tex.Civ.App.-Dallas 1972, writ ref'd n.r.e.) (wife had no burden to establish fraudulent intent to protect her interest in the community from "abuse of husband's managerial powers.")

Trust Relationship

Once the trust relationship is established, the managing spouse has the burden to produce records and to show fairness in dealing with the interests of the other spouse.

Morrison v. Morrison, 713 S.W.2d 377, 380 (Tex.App.-Dallas 1986, writ dism'd)

Trust Accounting Rules

Farrow v. Farrow, 238 S.W.2d 255 (Tex.Civ.App.-Austin 1951, no writ)

If a trustee mixes trust funds with his own funds, the whole will be treated as trust property, except so far as he may be able to distinguish what is who's.

A willful or wrongful invasion of rights is required.

If the goods are of the same nature and value and the portion of each owner is known or if a division can be made of equal proportionate value, as in the case of a mixture of corn, coffee, tea, wine or other article of the same kind and quality, then each owner may claim his proportionate part.

"Community Out First"

Welder v. Welder, 794 S.W.2d 420 (Tex.App.-Corpus Christ 1900, no writ);
DePuy v. DePuy, 483 S.W.2d 883 (Tex.Civ.App.-Corpus Christi 1972, no writ);
Horlock v. Horlock, 533 S.W.2d 52 (Tex.Civ.App.-Houston [14th dist.] 1975, writ dism'd);
Harris v. Venture, 582 S.W.2d 853 (Tex.Civ. App.-Beaumont 1979, no writ);
Snider v. Snider, 613 S.W.2d 8 (Tex.App.-Dallas 1981, no writ);
Gibson v. Gibson, 614 S.W.2d 487 (Tex.Civ.App.-Tyler 1981, no writ);
Kuehn v. Kuehn, 594 S.W.2d 158 (Tex.Civ.App.-Houston [14th Dist.] 1980, no writ).

Mere Testimony is Usually Insufficient to Trace

Mere testimony that property purchased with separate property funds, without any tracing of the funds, is generally insufficient to rebut the community property presumption.

McElwee v. McElwee, 911 S.W.2d 182, 188 (Tex.App.-Houston [1st Dist.] 1995, writ denied).

Tracing By Testimony Alone (When it Works)

Evidence that is uncontroverted may rise to the level of being clear and convincing evidence even if no document shows the source.

Pace v. Pace, 160 S.W.3d 706 (Tex. App.-Dallas 2005)
Celso v. Celso, 864 S.W.2d 652, 655 (Tex.App.-Tyler 1993, no writ) (where evidence is uncontroverted that husband's separate property assets were used to purchase house then evidence is clear and convincing that husband traced purchase of house to his separate property assets);

Holloway v. Holloway, 671 S.W.2d 51, 55 (Tex.App.-Dallas 1983, writ dism'd) (party's uncontroverted testimony alone is sufficient to establish separate property nature of asset).

Earnest Money Contracts

If, before marriage, one person signed an earnest money contract and paid the earnest money, and thereafter the couple received the deed in both their names during the marriage, and both spouses signed the note and deed of trust during the marriage, the inception of title rule dictates that the realty is the separate property of the spouse who signed the earnest money contract.

Carter v. Carter, 736 S.W.2d 775, 779 (Tex.App.-Houston [14th Dist.] 1987, no writ).

Contract for Deed

If realty is acquired under a contract for deed, the inception of title relates back to the time the contract was entered into, not when the title was ultimately conveyed.

Riley v. Brown, 452 S.W.2d 548, 551 (Tex.Civ.App.-Tyler 1970, no writ).

If one spouse begins the purchase of the property under a contract for deed before the marriage, the realty is that spouse's separate property even if the spouses receive the warranty deed in both their names during the marriage.

Dawson v. Dawson, 767 S.W.2d 949, 951 (Tex.App.-Beaumont 1989, no writ).

The Inception of Title Dates Back to the Contract for Deed Even If the Contract Is Oral

Evans v. Ingram, 288 S.W. 494, 496 (Tex.Civ.App.-Waco 1926, no writ).

Adverse Possession – Trespasser with no claim = The inception of title occurs only when title by limitations is perfected and not before

Scott v. Washburn, 324 S.W.2d 957, 959-60 (Tex.Civ.App.-Waco 1959, writ ref'd n.r.e.)
Strong v. Garrett, 224 S.W.2d 471, 474 (Tex. 1949)(dictum).

Adverse possessor has an equitable right to the property before marriage = Separate property (inception of title governs, even if faulty).

Strong v. Garrett, 224 S.W.2d 471, 474 (Tex. 1949)(dictum).

Fixtures

Whatever is affixed to the land becomes part of the land.

Cantu v. Harris, 660 S.W.2d 638, 640 (Tex.App.-Corpus Christi 1983, no writ).

Three Part Test for Fixtures

Annexation of the property in question to the realty.
Fitness or adoption of the article to the uses or purposes of the realty.
Intention of the party making the annexation that the chattel should become a permanent accession.

Fenion v. Jaffe, 553 S.W.2d 422, 428 (Tex.Civ.App.-Tyler 1977, writ ref'd n.r.e.).
Capitol Aggregates, Inc. v. Walker, 448 S.W.2d 830, 834 (Tex.Civ.App.-Austin 1969, writ ref'd n.r.e.).

Improvements on Separate Property

The use of community funds to improve separate property does not change the character of the property or give the community estate an ownership interest in the property.

Carter v. Carter, 736 S.W.2d 775, 780 (Tex.App.-Houston [14th Dist.] 1987, no writ).

The community estate is entitled only to a claim for economic contribution from the separate estate for the community funds used for the improvement.

Tex. Fam. Code Section 3.402.

Crops & Timber

Crops planted during the marriage are community property.

McGarraugh v. McGarraugh, 177 S.W.2d 296 (Tex.Civ.App.-Amarillo 1943, writ dism'd);
Cleveland v. Cole, 65 Tex. 402 (1886);
Kreisle v. Wilson, 148 S.W. 1132 (Tex.Civ. App.-San Antonio 1912, no writ);
Coggin v. Coggin, 204 S.W.2d 47 (Tex.Civ.App.-Amarillo 1947, no writ).

Timber grown on separate property is community property.
McElwee v. McElwee, 911 S.W.2d 182 (Tex.App.-Houston [1st Dist.] 1995, writ denied).

Oil, Gas & Mineral Interests

Minerals in place are a part of the realty and thus impressed with the same character as the realty.

Norris v. Vaughn, 260 S.W.2d 676 (Tex. 1953).

When mineral interests are extracted from the fee simple, the effect is a piecemeal sale of the underlying property.

Norris v. Vaughn, supra.

Oil, Gas & Mineral Interests - Funds Expended

Community funds expended in developing and equipping the lease do not change the character of the oil and gas produced, but give rise to a claim for reimbursement.

Cone v. Cone, 266 S.W.2d 480, 483, (Tex.Civ. App.-Amarillo 1953), writ dism'd, 266 S.W.2d 860 (Tex. 1954).
Norris, 260 S.W.2d at 682.

Acquisition of Minerals as a Business

When a spouse owns a business the purpose of which is the acquisition and development of oil and gas interests, the profits from that business belong to the community. If separate funds were used, there could be a claim for reimbursement.

Matter of the Marriage of Read, 634 S.W.2d 343, 346 (Tex.App.-Amarillo 1982, writ dism'd).

Different Mineral Interests on Separate Property Land

Working interests on separate property land are separate property.

Matter of the Marriage of Read, 634 S.W.2d at 346; Cone, 266 S.W.2d at 481.

Royalty interests on separate property land are separate property.

Norris, 260 S.W.2d at 679.

Bonus payments on separate property land are separate property.

Lessing v. Russek, 234 S.W.2d 891 (Tex.Civ.App.-Austin 1950, writ ref'd n.r.e.).

Delay rentals earned during the term of the marriage are community property regardless of the character of the underlying mineral estate.

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

Rents and Other Income from Separate Property

Rent, revenue, interest on and other income from separate property that accrues during the marriage is community property.

Arnold v. Leonard, 273 S.W. 799, 803 (Tex. 1925);
McElwee, 911 S.W.2d at 188-189;
Taylor v. Taylor, 680 S.W.2d 645, 648 (Tex.App.-Beaumont 1984, writ ref'd n.r.e.);
Uranga v. Uranga, 527 S.W.2d 761, 764 (Tex.Civ.App.-San Antonio 1975, writ dism'd).
Mortenson v. Trammell, 604 S.W.2d 269, 275 (Tex.Civ.App.-Corpus Christi 1980, writ ref'd n.r.e.).

Earnings Of Spouse Are Community Property

Vallone v. Vallone, 644 S.W.2d 455, 458;
Moss v. Gibbs, 370 S.W.2d 452, 455 (Tex. 1963).

Loss Of Earning Capacity During Marriage Is Community Property

Tex. Fam. Code § 3.001(3).

If a claim for lost earning capacity arises during marriage, the claim is entirely community property, even if the marriage ceases to exist the next day.

Dawson v. Garcia, 666 S.W.2d 254, 267 (Tex.App.-Dallas 1984, no writ).

Lottery Prizes

During the marriage, a prize from a lottery ticket purchased with separate funds is community property.

Dixon v. Sanderson 10 S.W. 535, 536 (Tex. 1888).

Professional Degree Not Property Subject to Division

A professional degree earned during marriage is not property subject to division upon divorce.

Frausto v. Frausto, 611S.W.2d 656, 659 (Tex.Civ.App.-San Antonio 1980, writ dism'd).

Trusts Defined

A fiduciary relationship …
With respect to property …
Arising from a manifestation of intention to create that relationship and
Subjecting the person who holds title to the property to duties to deal with it
For the benefit of … someone else.

RESTATEMENT 3d TRUSTS § 2 Definition Of Trust

Trusts – Fiduciary Relationship

A person in a fiduciary relationship to another is under a duty to act for the benefit of the other as to matters within the scope of the relationship.

RESTATEMENT 3d TRUSTS § 2 Definition Of Trust, comment b.

Settlor, Trust Property, Trustee And Beneficiary

The person who creates a trust is the settlor. (Also trustor or grantor).
The property held in trust is the trust property.
The person who holds property in trust is the trustee.
A person for whose benefit property is held in trust is a beneficiary.

RESTATEMENT 3d TRUSTS § 3.

Characterization of Trusts

A spouse's interest in a trust can be characterized as separate or community property. A trust generally involves two interests that can be characterized:

(1) ownership of the corpus of the trust (i.e., the property that makes up the trust), and
(2) ownership of the income from the trust.

Characterization of Trust Corpus

If the corpus is funded by separate property, the corpus will be separate property; if the corpus is funded with community property, the corpus will be community property.

Ridgell v. Ridgell, 960 S.W.2d 144, 149-150 (Tex.App.-Corpus Christi 1997, no pet.) (corpus of trust created during marriage with traced separate property was separate property);

Cleaver v. Cleaver, 935 S.W.2d 491, 493-94 (Tex.App.-Tyler 1996, no writ) (corpus of trust established before marriage was separate property);

Hardin v. Hardin, 681 S.W.2d 241, 243 (Tex.App.-San Antonio 1984, no writ) (corpus of trust created by gift was separate property).

Character Of Distributed Corpus

A distribution of the trust's corpus to a spouse during marriage retains the character of the corpus.

Taylor v. Taylor, 680 S.W.2d 645, 649-50 (Tex.App.-Beaumont 1984, writ ref'd n.r.e.) (distributions of separate property corpus remained separate property).

Characterization of Income Distributed from a Third-Party Trust When Beneficiary Has No Interest in the Corpus

Income distributed during marriage from a third-party trust to a spouse who has no beneficial interest in the corpus is considered separate property. *Wilmington Trust Co. v. U.S.*, 4 Cl.Ct. 6, 14 (1983), *aff'd*, 753 F.2d 1055 (1985).

In this situation, because the spouse has no ownership interest in the corpus of the trust, the corpus itself is not considered community or separate property. *Id*.
Thus, any income distributed from the corpus is considered a gift from a third party (separate property)-not income that derived from separate property (community property). *Id*.

Characterization of Income Distributed from a Third-Party Trust

When the Beneficiary Has an Interest in the Corpus.

Income distributed during marriage from a third-party trust that a spouse has a beneficial interest in the corpus is considered community property. *E.g.*, *Ridgell*, 960 S.W.2d at 149 (income distributed during marriage from third-party trust in which W had an expectancy interest in the corpus was community property).

In this situation, even if the corpus of the trust is considered the spouse's separate property, any income generated from the corpus during marriage is considered community property.

Characterization of Income Distributed from a Third-Party Trust

In characterizing income distributed during marriage from a third-party trust, another approach courts have taken is to look at the language of the trust instrument to determine whether the grantor had expressed an intent to make any distributions from the trust to be the beneficiary's separate property.

McClelland v. McClelland, 37 S.W. 350, 358-59 (Tex.App.-1896, writ ref'd); Ridgell, 960 S.W.2d at 149;

Commissioner of Internal Revenue v. Porter, 148 F.2d 566, 568 (5th Cir.1945) (if trust instrument is to alter general rule that income from separate property is community property, the instrument must, in most precise and definite way, make that desire and intention clear).

Characterization of Income Distributed from a Self-Settled Trust

Income Distributed from a Self-Settled Trust.

No cases have directly addressed the characterization of income distributed during marriage from a self-settled trust. It would seem that under general rules of characterization, any income generated and distributed from a self-settled trust during marriage-regardless of whether the spouse retained a beneficial interest in the corpus-would be community property.

Otherwise, a spouse could circumvent the established methods for changing the character of income from separate property by simply placing the property into a trust.

Characterization of Undistributed Income Retained in a Third-Party Trust When Beneficiary Has no Interest in the Corpus

If a spouse has no interest in the corpus of a third-party trust, then any undistributed income that is earned during the marriage from the trust is separate property.

Cleaver v. Cleaver, 935 S.W.2d 491, 493 (Tex.App.-Tyler 1996, no writ) (third-party-discretionary trust in which wife had no interest in corpus; undistributed income earned during marriage was separate property);
Currie v. Currie, 518 S.W.2d 386, 389 (Tex.App.-San Antonio 1974, writ dism'd) (same).

Characterization of Undistributed Income Retained in a Third-Party Trust When Beneficiary Has an Interest in the Corpus

If a spouse has an interest in the corpus of a third-party trust, then the character of any undistributed income that is earned during marriage from the trust will depend on whether the distribution was mandatory or discretionary.

Characterization of Undistributed Income Retained in a Third-Party Trust

Mandatory. If undistributed income earned during marriage is required to be distributed under the terms of the trust agreement (i.e., mandatory trust), the undistributed income is considered community property.

In re Marriage of Long, 542 S.W.2d 712, 718 (Tex.App.-Texarkana 1976, no writ) (undistributed income that was earned during marriage and required to be distributed to H was community property);

See also Cleaver, 935 S.W.2d at 494 (income earned during marriage on undistributed income is community property if that income was required to be distributed).

Characterization of Undistributed Income Retained in a Third-Party Trust

Discretionary. If undistributed income earned during marriage is not required to be distributed under the terms of the trust agreement (i.e., discretionary trust where income distributions are left to the sole discretion of trustee), the undistributed income in the trust is separate property.

In re Marriage of Burns, 573 S.W.2d 555, 557-58 (Tex.App.-Texarkana 1978, writ dism'd) (third-party-discretionary trust in which H was sole beneficiary of corpus; undistributed income earned during marriage was separate property);

Buckler v. Buckler, 424 S.W.2d 514, 515 (Tex.App.-Fort Worth 1967, writ dism'd) (third-party discretionary trust; undistributed income earned during marriage was separate property; court did not state what beneficial interest H had in corpus).

Characterization of Undistributed Income Retained in a Self-Settled Trust

No interest in corpus. No cases have addressed the characterization of undistributed income from a self-settled trust in which the spouse has no interest in the corpus of the trust.

Interest in corpus. If a spouse has an interest in the corpus of a self-settled trust, then the character of any undistributed income that is earned during marriage from the trust will depend on whether the distribution was mandatory or discretionary.

Characterization of Undistributed Income Retained in a Self-Settled Trust

Mandatory. If undistributed income earned during marriage is required to be distributed under the terms of the trust agreement (i.e., mandatory trust), the undistributed income should be considered community property.

Discretionary. If undistributed income earned during marriage is not required to be distributed under the terms of the trust agreement, the undistributed income in the trust retains the character of the corpus.

Characterization of Undistributed Income Retained in a Self-Settled Trust

Lipsey v. Lipsey, 983 S.W.2d 345, 350-51 (Tex.App.-Fort Worth 1998, no pet.) (self-settled-discretionary trust in which husband was sole beneficiary of separate-property corpus; undistributed income earned during marriage was separate property);

Lemke v. Lemke, 929 S.W.2d 662, 664 (Tex.App.-Fort Worth 1996, writ denied) (same).

But see Mercantile Nat'l Bank v. Wilson, 279 S.W.2d 650, 653-54 (Tex.App.-Dallas 1955, writ ref'd n.r.e.) (self-settled-discretionary trust in which wife was sole beneficiary of separate-property corpus; court stated in dicta that undistributed income earned during marriage was community property).

Illusory Trusts

Land v. Marshall, 426 S.W.2d 841 (Tex. 1968).

Husband had put almost all of the community property in a trust but he had retained
The power to revoke the trust,
The right to consume the principal,
The right to control the trustee, and
Other beneficial interests.

Alter Ego Trusts

In re Marriage of Burns, 573 S.W.2d 555, 557 (Tex.Civ.App. - Texarkana 1978, writ dism'd) (acknowledged possibility of alter ego trust).

Zander v. Comm'r of Internal Revenue Service, 173 F.2d 624, 627 (5th Cir. 1949)(elements of trust not established).

Matter of Mobile Steel, Inc., 563 F2d 692, 695 (5th Cir. 1977) (bankruptcy Judge finds that trust alter ego of husband).

Matter of Lawler, 807 F.2d 1207, 1209 (5th Cir. 1987) (transfers to trust to avoid creditor's rights held void).

Stock Dividend

Stock dividends received during the marriage on separate property stock are separate property.

Tirado v. Tirado, 357 S.W.2d 468, 473 (Tex.Civ.App.-Texarkana 1962, writ dism'd).

Stock Splits

New stock created as a result of a stock split during a marriage from separate property stock is separate property.

Tirado v. Tirado, 357 S.W.2d 468, 473 (Tex.Civ.App.-Texarkana 1962, writ dism'd).

Cash Dividend

A cash dividend received during the marriage from separate property marriage is community property.

Amarillo Nat'l. Bank v. Liston, 464 S.W.2d 395, 406 (Tex.Civ.App.-Amarillo 1970, writ ref'd, n.r.e.)

Stock Options

Tex. Fam. Code 3.007:

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

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

Personal Goodwill

Personal goodwill of a professional is not community property that can be divided upon divorce.

Nail v. Nail, 486 S.W.2d 761, 764 (Tex. 1972).
Rathmell v. Morrison, 732 S.W.2d 617 (Tex.App.- Houston [14th Dist.] 1987, no writ).

Commercial Goodwill

Commercial goodwill in a professional corporation that exists independently of a professional's personal skills may be subject to division.

Finn v. Finn, 658 S.W.2d 735, 742 n.3. (Tex.App.-Dallas 1983, writ ref'd n.r.e.)

Partnerships

The only partnership property right a partner has that is subject to a community or separate property characterization is the partner's interest in the partnership.

Harris v. Harris, 765 S.W.2d 798, 802 (Tex.App.-Houston [14th Dist.] 1989, writ denied).

Property Owned by the Partnership

Partnership property is owned by the partnership entity, not by the partners. Neither a partner nor a partner's spouse has an interest in partnership property.

TEX.REV.CIV.STAT. ANN. art. 6132b-2.04.

Partnership property is therefore neither separate nor community in character.

Harris v. Harris, 765 S.W.2d 798, 802 (Tex.App.-Houston [14th Dist.] 1989, writ denied).

Partnership Distributions

Distributions of a partnership profits and surplus received during marriage are community property regardless of whether the partner's interest in the partnership is separate or community property.

Harris v. Harris, 765 S.W.2d at 802;
Marshall v. Marshall, 735 S.W.2d 587, 594 (Tex.Civ.App.-Dallas 1987, writ ref'd n.r.e.).

Corporations

The inception of title rule is applied to a corporation as of the date the stock is acquired.
Vallone v. Vallone, 644 S.W.2d 455, 457 (Tex. 1982).

Under Texas law, a corporation does not exist until the issuance of a certificate of incorporation.

TEX. BUS. CORP. ACT ANN. art. 3.04;
Allen v. Allen, 704 S.W.2d 600, 604 (Tex.App.-Fort Worth 1986, no writ).

There can be no title to a corporation until it actually exists. Consequently, the inception of title doctrine only applies to a corporation as of the date of incorporation.

Allen, 704 S.W.2d at 604.

Increase in Value of Stock

An increase in the value of corporate stock belonging to a separate estate that is due to natural growth or the fluctuations of the market remains separate property.

Dillingham v. Dillingham, 434 S.W.2d 459, 461-62 (Tex.Civ.App.-Fort Worth 1968, writ dism'd).

If the increase in value is due, at least in part, to the time, toil and talent of either or both spouses, the stock remains separate property, but the community estate may have a claim to reimbursement.

Jensen v. Jensen, 665 S.W.2d 107, 109 (Tex. 1984).

Quasi-Community Property

Property that spouses acquire during marriage, except for property acquired by gift, devise, or descent, is divided on divorce in Texas in the same manner as community property, regardless of the domicile of the spouses when they acquired the property.

Cameron v. Cameron, 641 S.W.2d 210 (Tex. 1982)],

This rule applies regardless of the legal system of the previous domicile, and whether the property was acquired before the enactment of the quasi-community property statute.

Ismail v. Ismail, 702 S.W.2d 216 (Tex. App. Houston 1st Dist. 1985).

Quasi-Community Property

Tex. Fam. Code § 7.002.

Property acquired in another state that would have been community property in Texas will be treated as community property.

Property acquired in another state that would have been separate property in Texas will be treated as separate property.

Quasi-Community Property Not Applicable to Estates at Death

The concept of quasi-community property exists only within the context of divorce or annulment proceedings. The Texas Supreme Court has declined to extend the principle of Tex. Fam. Code Ann. § 7.002 to the dissolution of marriage by death.

Estate of Hanau v. Hanau, 730 S.W.2d 663 (Tex. 1987).

Property Interest in Certain Insurance Proceeds

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.

Tex. Fam. Code § 3.008(a)

Property Interest in Certain Insurance Proceeds

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

Tex. Fam. Code § 3.008(a)

Disposition of Rights in Insurance

In a decree of divorce or annulment, the court shall specifically divide or award the rights of each spouse in an insurance policy.

Tex. Fam. Code § 7.004.

Insurance Coverage Not Specifically Awarded

If in a decree of divorce or annulment the court does not specifically award all of the rights of the spouses in an insurance policy other than life insurance in effect at the time the decree is rendered, the policy remains in effect until the policy expires according to the policy's own terms.

Tex. Fam. Code § 7.005.

Insurance Renewal Commissions

An insurance agent's future renewal commissions on insurance policies written by the agent during marriage but not accruing to him until after divorce are a mere expectancy and therefore are not divisible upon divorce.

Cunningham v. Cunningham, 183 S.W.2d 985, 986 (Tex. Civ. App.-Dallas 1944, no writ).

Life Insurance

A life insurance policy issued to a spouse before marriage is separate property. The policy, however, is subject to a claim of reimbursement to the community for the premiums paid by the community during the marriage.

Pritchard v. Snow, 530 S.W.2d 889, 893 (Tex. Civ. App.-Houston [1st Dist.] 1975, writ ref'd n.r.e.).

Community property funds used to pay premiums on a separate property life insurance policy probably fall under Tex. Fam. Code § 3.408(b)(1).

Term Life Insurance

Even if a life insurance policy provides only for term insurance and has no cash value, it is still a property right that can be awarded to one of the spouses on divorce.

Seaman v. Seaman, 756 S.W.2d 56, 58 (Tex. App.-Texarkana 1988, no writ).
Camp v. Camp, 972 S.W.2d 906 (Tex. App.-Corpus Christi 1998, writ denied).
Also see Tex. Fam. Code § 7.004.