

TRACING AND CHARACTERIZATION OF PROPERTY

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EDUCATION:

J.D. 1989 Southern Methodist University, Dallas, Texas
B.A. 1986 University of Texas at Tyler, Tyler, Texas, with Honors

PROFESSIONAL ACTIVITIES AND AFFILIATIONS:

Partner - Goranson Bain Ausley, PLLC
Board Certified Family Law - Texas Board of Legal Specialization (since 1995)

Fellow - American Academy of Matrimonial Lawyers (2004 - Present)
Board Member- American Academy of Matrimonial Lawyers (2015-2017)
Fellow - International Academy of Family Lawyers
Fellow - Texas Chapter of the Academy of Matrimonial Lawyers (Executive Committee (2006 - 2010; Past President)

Member - Texas Academy of Family Law Specialists (1995 - Present)
Member/Chair- Family Law Council, State Bar of Texas (2005 - Present)(Executive Committee, Chair 2016-2017)

Diplomate - American College of Trial Lawyers – Fellowship is extended by invitation only to those experienced trial lawyers who have mastered the art of advocacy and whose professional careers have been marked by the highest standards of ethical conduct, professionalism, civility, and collegiality.

Member - State Bar of Texas Board of Directors (3-year elected term beginning 2019)
Member - Collaborative Divorce Texas
Member - State Bar of Texas (Family Law Section)
Member - American Bar Association (Family Law Section)
Member - College of the State Bar of Texas
Member - Dallas Bar Association (Family Law Section)
Member - Collin County Bar Association (Family Law Section)
Member - Denton County Bar Association
Member - Plano Bar Association
Co-Chair - DAYL People’s Law School (1995 & 1996)
Instructor - Southeastern Paralegal Institute (1993-1996)
Member - Fee Dispute Committee - Dallas Bar Association (1998 - 2000)
Fellow - Collin County Bench Bar Foundation
Lifetime Fellow - Texas Family Law Foundation (State Bar of Texas)
Fellow - Texas Bar Foundation – Nominating Committee Member
Chair - Program Committee, Collin County Bench Bar Conference, 2000
Board Member- Past Board Member of the Advisory Board in CASA of Collin County
Member/Chair- Grievance Committee, District 1A (2002 - 2007); (Chair – 2006-2007)
Certificate - Advanced Mediation - Family Law (1995)
Member - Annette Stewart Inn of Court (Board Member 2005-2012)

AWARDS AND HONORS:

Named the “Best Lawyers in America” 2015, 2017 and 2019 Family Law “Lawyer of the Year” in Dallas – only a single lawyer in each practice area within a community is honored with this distinction.

Recipient of the Dan Price Award from the State Bar of Texas in 2018 – this award is presented to a lawyer who has had a significant impact on the Family Law Section for the past year – teaching, writing, and advancing the practice of family law.

Recipient of the Annette Stewart Inn of Court, Serjeant of the Inn Award in 2013 (awarded to an attorney who has significantly contributed to the profession and the community through his or her career).

Recipient of the University of Texas at Tyler, Alumni Association Distinguished Alumni Award (2016).

Best Family Law CLE Article, State Bar of Texas, 2004.

Named "Best Lawyers in Dallas" Family Law by D Magazine (2001, 2005, 2006, 2007, 2008, 2009, 2010, 2017, 2018, 2019, 2020).

Named “Best Female Lawyers in Dallas” by D Magazine (2010).

Named “Best Personal Lawyers in Dallas” by D Magazine (2009).

Named “The Best Lawyers in America” – Woodward and White Press (2003 - 2020).

Named “Top 50 Women Texas Super Lawyers” by Texas Monthly (2003 - 2020).

Named “Top 100 Texas Super Lawyers” by Texas Monthly (2004 - 2009; 2011; 2013-2019).

Named “Top 100 Dallas/Fort Worth Super Lawyers” by Texas Monthly (2003-2009; 2011-2020).

Named “Texas Super Lawyer” in Family Law by Texas Monthly (2003 - 2020).

PUBLICATIONS:

Co-Author, *Thomson Reuters Publishing Company, TEXAS FAMILY LAW PRACTICE GUIDE* (published March 2000, supplemented each year to the present) – This 3-volume set is written for lawyers and judges, and contains the substantive law regarding family law matters, including marital property (characterization, tracing, valuation), children and divorce. The treatise is updated each year to contain the current law on each topic.

Primary Author, *PROTECTING YOUR ASSETS FROM A TEXAS DIVORCE*, Professional Solutions Group (2005).

Co-Author, *Protecting Children from Incompetent Forensic Evaluations and Expert Testimony*, Journal of the American Academy of Matrimonial Lawyers (2006).

Author, *Family Law at Your Fingertips – Property*, Family Law Section, State Bar of Texas, 2015, 2016, 2019.

Author, *Family Law at Your Fingertips – Children*, Family Law Section, State Bar of Texas, 2018, 2019.

Author, *Family Law at Your Fingertips – Evidence*, Family Law Section, State Bar of Texas, 2019.

Author, *Evidentiary Issues in Family Law Cases*, Dallas Bar Headnotes, 2020.

Author, *Fraud on the Community and the Reconstituted Estate*, Family Law Section of the State Bar of Texas Winter Section Report, 2020.

PUBLICATIONS AND PRESENTATIONS:

CHARACTERIZING & VALUING ASSETS TO CREATE AN INVENTORY AND APPRAISEMENT THAT WORKS FOR YOUR CLIENT, Advanced Family Law Course, State Bar of Texas (August 2020)

DIRECT AND CROSS EXAMINATION OF A TRACING EXPERT, Advanced Family Law Course, State Bar of Texas (August 2019)

REIMBURSEMENT, FRAUD, WASTE AND THE RECONSTITUTED ESTATE, Marriage Dissolution Institute, State Bar of Texas (April 2019)

COLLABORATIVE LAW, State Bar of Texas (March 2019)

TRIAL OF A CUSTODY CASE, Innovations – Breaking Boundaries in Child Custody Litigation, State Bar of Texas (January 2019)

DRAFTING: ARE YOUR PLEADINGS AND DISCOVERY READY FOR TRIAL, State Bar of Texas (December 2018)

PROFESSIONALISM AND CIVILITY, American Academy of Matrimonial Lawyers (November 2018)

MARITAL AGREEMENTS, New Frontiers in Marital Property Law, State Bar of Texas (October 2018)

PREMARITAL AND POSTMARITAL AGREEMENTS, Advanced Family Law Course, State Bar of Texas (August 2018)

TRIAL PRESENTATION OF A CUSTODY CASE, Annual TAFLS Trial Institute, Texas Academy of Family Law Specialists (February 2018)

MARITAL PROPERTY AGREEMENTS, Advanced Family Law Course, State Bar of Texas (August 2017)

PROPERTY CASE LAW UPDATE, Marriage Dissolution Institute, State Bar of Texas (April 2017)

CHARACTERIZATION OF PROPERTY, Advanced Family Law Course, State Bar of Texas (August 2016)

PROFESSIONALISM – THE KEY TO A SATISFYING CAREER, Marriage Dissolution 101, State Bar of Texas (April 2016)

NEGOTIATION TECHNIQUES AND STRATEGIES, Advanced Family Law Course, State Bar of Texas (August 2015)

JUDGES PANEL, Innovations – Breaking Boundaries in Child Custody Litigation, State Bar of Texas (June 2015)

PROTECTIVE ORDERS AND FAMILY VIOLENCE, Southern Methodist University School of Law (October 2014)

NEGOTIATION TECHNIQUES AND STRATEGIES, 40th Annual Advanced Family Law Course, State

Bar of Texas (August 2014)

EXPERTS, EXAMINATIONS AND ETHICS – A GUIDE TO MENTAL HEALTH EXPERTS – DIRECT AND CROSS, ATTACKING AND DEFENDING RECOMMENDATIONS, DAUBERT CHALLENGES AND PRACTICAL APPROACHES, Innovations – Breaking Boundaries in Child Custody Litigation, The University of Texas School of Law (June 2014)

USING A COMPUTER FORENSIC EXPERT, Family Law Technology Course, State Bar of Texas (December 2012)

PROPERTY UPDATE, Advanced Family Law Course, State Bar of Texas (August 2012)

TURBO CHARGE YOUR COLLABORATIVE PRACTICE, Advanced Family Law Course, State Bar of Texas (August 2012)

ATTORNEY'S FEES AGREEMENTS, Advanced Family Law Course, State Bar of Texas (August 2011)

CHARACTERIZATION OF PROPERTY, Family Law on the Front Lines, The University of Texas School of Law (June 2011)

ELECTRONIC EVIDENCE WORKSHOP, Advanced Family Law Course, State Bar of Texas (August 2009)

THE ELECTRONIC EVIDENCE BIBLE, University of Texas School of Law (June 2009)

CHARACTERIZATION, Marriage Dissolution Institute, State Bar of Texas (April 2009)

PREMARITAL AGREEMENTS, Collin County Bar Association (February 2009)

ELECTRONIC EVIDENCE – CIVIL AND ETHICAL IMPLICATIONS, University of Texas School of Law, Parent-Child Relationships; Critical Thinking for Critical Issues (January 2009)

PREMARITAL AGREEMENTS, Collin County Bar Association, Estate Planning Section (September 2008)

RELOCATION, Advanced Family Law Course, State Bar of Texas (August 2006)

TEMPORARY SUPPORT, MAINTENANCE AND ALIMONY, Marriage Dissolution Institute, State Bar of Texas (April 2006)

CHILD SUPPORT UPDATE: WITHIN AND OUTSIDE THE GUIDELINES, Marriage Dissolution Institute (April 2006)

RELOCATION, American Bar Association, Section of Family Law, Spring CLE Conference, Washington D.C. (May 2006)

COLLABORATIVE LAW, “A Panel of Texas Authors on Texas Collaborative Law” (April 2006)

MARITAL PROPERTY 101, State Bar College “Spring Training” 2006, State Bar College (March 2006)

HIGH TECH EVIDENCE, Collin County Bar Association, Family Law Section (December 2006)

HIGH TECH EVIDENCE, WEBSITES, HARDDRIVES, E-MAILS, ETC., Advanced Family Law Drafting Course (December 2006)

CHILD SUPPORT, 31st Annual Advanced Family Law Course, State Bar of Texas (August 2005)

PSYCHOLOGICAL TESTING, American Academy of Matrimonial Lawyers (March 2005)

RELOCATION, Dallas Volunteer Attorney Program and Family Law Section, “Nuts and Bolts” Family Law Training (February 2005)

OPENING STATEMENTS AND CLOSING ARGUMENTS, Ultimate Trial Notebook – Family Law, State Bar of Texas (December 2004)

HIGH TECH EVIDENCE, WEBSITES, HARDDRIVES, E-MAILS, ETC., Williamson County (October 2004)

RELOCATION DEBATE, 30th Annual Advanced Family Law Course, State Bar of Texas (August 2004)

COLLABORATIVE LAW PANEL, Collaborative Law Spring Retreat (March 2004)

HIGH TECH EVIDENCE, WEBSITES, HARDDRIVES, E-MAILS, ETC., 29th Annual Advanced Family Law Course, State Bar of Texas (August 2003)

FAMILY LAW EVIDENCE, Collin County Bench Bar Conference (May 2003)

FAMILY LAW EVIDENTIARY ISSUES, 16th Annual Advanced Evidence & Discovery Course, State Bar of Texas (March 2003)

PARENTAGE: ESTABLISHING, ATTACKING & UNDOING, Texas Academy of Family Law Specialists (January 2003)

PARENTAGE: CURRENT ISSUES, University of Houston Law Center (October 2002)

OBJECTIONS AT TRIAL, American Bar Association, Section of Family Law, Fall CLE Conference, Orlando, FL (November 2002)

DIVISION OF PROPERTY AND DIVIDING SPECIFIC ASSETS, University of Houston Law Foundation (June 2002)

FAMILY LAW FOR THE NON-SPECIALIST, J. Reuben Clark Law Society (April 2002)

DIVISION OF PROPERTY ON DIVORCE, University of Houston Law Foundation (September 2001 and September 2002)

FAMILY LAW UPDATE, Ten Hot Topics in Family Law, Collin County Bench/Bar Conference (June 2000)

FAMILY LAW UPDATE, J. Reuben Clark Law Society (June 2000)

DIVISION OF PROPERTY ON DIVORCE, University of Houston Law Foundation (April 2000)

FAMILY LAW DISCUSSION, J. Reuben Clark Law Society (October 1999)

BUSINESS VALUATIONS IN DIVORCE AND CROSS-EXAMINATION OF A VALUATION EXPERT, American Bar Association, Family Law Section, San Diego (October 1999)

OPENING STATEMENT - JURY OR NONJURY, 25th Annual Advanced Family Law Course, State Bar of Texas (August 1999)

UPDATE ON FAMILY LAW, Dallas Women's Lawyers Association (December 1998)

FAMILY LAW FOR THE NON-SPECIALIST, Dallas Bar Association (December 1998)

OBTAINING RECORDS FROM NON-PARTIES, 24th Annual Advanced Family Law Course, State Bar of Texas (August 1998)

DISCOVERY UPDATE, Dallas Bar Association Friday Clinic (December 1996 and July 1998)

OPENING AND CLOSING THE FILE, Family Law Conference for the General Practitioner and Legal Assistant, South Texas College of Law (February 1998 and February 1999)

DISCOVERY UPDATE, 23rd Annual Advanced Family Law Course, State Bar of Texas (August 1997)

DISCOVERY UPDATE, 22nd Annual Advanced Family Law Course, State Bar of Texas (August 1996)

BUSINESS VALUATION IN DIVORCE, Dallas Chapter Texas Society of Certified Public Accountants Fifth Annual Divorce Conference (September 1996, September 1998)

DISCOVERY, Dallas Bar Association Family Law Training Seminar (October 1996)

ATTORNEY'S FEES, Family Law Practice Institute, University of Houston (September 1996)

CONTINUING LEGAL EDUCATION LEADERSHIP

CO-COURSE DIRECTOR, 39th Annual Advanced Family Law Course, State Bar of Texas (August 2013)

CO-COURSE DIRECTOR, INNOVATIONS – BREAKING BOUNDARIES IN CUSTODY LITIGATION, The University of Texas School of Law (January 2012)

COURSE DIRECTOR, Collaborative Law Course, State Bar of Texas (March 2011)

CO-COURSE DIRECTOR, New Frontiers in Marital Property Law, State Bar of Texas (October 2010)

ASSISTANT COURSE DIRECTOR, Collaborative Law Course, State Bar of Texas (2010)

MODERATOR, Collin County Bench/Bar Conference (2000)

CO-CHAIR, Collin County Bench/Bar Conference (2001)

I. INTRODUCTION

There are many approaches to take in overcoming the community property presumption to trace separate property. This article discusses characterization of assets, various approaches to tracing, the role of the tracing expert, and practical examples of tracing approaches and useful topics to assist in tracing assets.

II. DEFINITIONS

A. Characterization

In Texas, marital property may be characterized as separate property, community property, or mixed property. *Hilley v. Hilley*, 342 S.W.2d 565, 567 (Tex. 1961); *Gleich v. Bongio*, 99 S.W.2d 881 (Tex. 1937). The character of marital property is a mixed question of law and fact. See *Welder v. Welder*, 794 S.W.2d 420, 433 (Tex. App. – Corpus Christi 1990, no writ).

B. Separate Property

Separate property is property owned or claimed by the spouse before marriage; property acquired by the spouse during marriage by gift, devise, or descent; and the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage. TEX. FAM. CODE ANN. § 3.001.

Property a spouse owns or claims before marriage is that spouse's separate property. TEX. FAM. CODE ANN. § 3.001; *Langston v. Langston*, 82 S.W.3d 686 (Tex. App.– Eastland 2002, no pet.). This is true even if payments on the property were made during the marriage with community funds, although the other spouse may be entitled to reimbursement for part of the payments. TEX. FAM. CODE ANN. § 3.401-3.406; *Matter of Marriage of Jordan*, 264 S.W.3d 850, 856 (Tex. App. – Waco 2008, no pet.) (home was husband's separate property as it was purchased before marriage even though it was refinanced during marriage although there may be a possible claim for reimbursement).

The terms "**owned and claimed**" as used in the Family Code mean that where the right to the property accrued before the marriage, the property would be separate property, even though legal title or evidence of title might not be obtained until after marriage. **Inception of title** occurs when a party first has right of claim to the property by virtue of which title is finally vested. *Smith v. Smith*, 22 S.W.3d 140 (Tex. App.– Houston [14th Dist.] 2000, no pet.) (lawsuit proceeds were husband's separate property where he was defrauded by a 3rd party prior to marriage and filed suit and recovered a judgment after marriage).

All property held by either spouse before marriage remains the separate property of the spouse and the status of the property is to be determined by the origin of title to the property, and not by the acquisition of the final title. *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984). If a spouse took possession of property and began making payments on it before marriage, however, the spouse did not actually acquire title to the property until after the marriage, the property will be that spouse's separate property. *Wilkerson v. Wilkerson*, 992 S.W.2d 719 (Tex. App.–Austin 1999, no pet.).

C. Inception of Title

Under the inception of title rule, a property's character is based on the time and manner in which a person first acquires an ownership interest in the property. See *Jensen v. Jensen*, 665 S.W.2d 107, 109 (Tex. 1984).

Camp v. Camp, 972 S. W. 2d 906 (Tex. App.—Corpus Christi 1998, pet. denied); *Howe v. Howe* 551 S.W.3d 236 (Tex. App.—El Paso 2018, no pet.).

D. Community Property

Community property consists of the property, other than separate property, acquired by either spouse during the marriage. TEX. FAM. CODE ANN. § 3.002.

E. Mixed Property

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 estate are determined by the rule of inception of title. TEX. FAM. CODE ANN. § 3.006. Mixed property consists of both separate and community property.

When both separate and community funds are used to purchase property, the property has mixed character in proportion to the amount paid with separate and community funds. *Murray v. Murray*, 15 S.W.3d 202 (Tex. App.—Texarkana 2000, no pet.) (spouses own real property purchased by them before marriage in proportional percentage contributed by each to the total purchase price). 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, and each estate owns an undivided interest in the proportion that it supplies to the consideration. *Scott v. Scott*, 805 S.W.2d 835, 838 (Tex. App.—Waco 1991, writ denied).

See Section VII(F) and (G) below for examples of mixed character of real estate acquired during marriage.

F. Tracing

Tracing involves using evidence to show the time and means by which the spouse originally obtained possession of the property to establish the separate property origin. *Dickinson v. Dickinson*, 324 S.W.3d 653, 658 (Tex. App. – Fort Worth 2010).

III. CHARACTERIZATION

A. Community Property Presumption and the Burden of Proof

All property that is possessed by either spouse during the marriage or at dissolution is presumed to be community property. TEX. FAM. CODE ANN. § 3.003(a); *Matter of Marriage of Morris*, 123 S.W.3d 864 (Tex. App.—Texarkana 2003, no pet.); *Tarver v. Tarver*, 394 S.W.2d 780 (Tex. 1965); *Burgess v. Easley*, 893 S.W.2d 87 (Tex. App. – Dallas 1994, no writ); *Hopf v. Hopf*, 841 S.W.2d 898 (Tex. App. - Houston [14th Dist.] 1992, no writ). The introduction of contrary evidence ends the presumption of community property. *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 Dist.] 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); *Harrison v. Harrison*, 321 S.W.3d. 899 (Tex. App.—Houston [14th Dist.] 2010, no pet. h.).

A contrary presumption may displace the community property presumption. For instance, a presumption that property is separate arises where a deed recites that property is conveyed to one spouse as his or her

separate property, or that the consideration was paid from one spouse's separate estate, or both. *Kyles v. Kyles*, 832 S.W.2d 194 (Tex. App. – Beaumont 1992, no writ); *Pemelton v. Pemelton*, 809 S.W.2d 642 (Tex. App. - Corpus Christi 1991), *rev'd on other grounds*, 836 S.W.2d 145 (Tex. 1992); *Kyles v. Kyles*, 832 S.W.2d 194 (Tex. App.–Beaumont 1992, no writ)(property conveyed to spouse during marriage presumed to be community property, unless conveying instrument specifically states conveyed to spouse as his or her separate property, in which case prima facie proof the property is separate property of spouse to whom conveyed).

Parties claiming certain property as their separate property have the burden of rebutting the presumption of community property, and to do so, they must trace and clearly identify the property in question as separate by clear and convincing evidence. *Pearson v. Fillingim*, 332 S.W.3d 361 (Tex. 2011)(per curiam)(husband did not provide any evidence that mineral deeds were his separate property).

The spouse claiming that disputed property is his or her separate property must trace and identify the property to show that it was originally his or her separate property or that it was acquired with his or her separate property. *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973); *Barnard v. Barnard*, 133 S.W.3d 782 (Tex. App.– Fort Worth 2004, pet. denied); *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App.– Houston [14th Dist.] 2003, pet. denied); *In re Marriage of Moore*, 890 S.W.2d 821 (Tex. App. – Amarillo 1994, no writ); *Hopf v. Hopf*, 841 S.W.2d 898 (Tex. App. – Houston [14th Dist.] 1992, no writ). Tracing involves establishing the origin of the property through evidence showing how the spouse claiming the asset as separate property obtained possession of the property. *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.– Dallas 1985, no writ).

A spouse has the burden to provide clear and convincing evidence as to the exact nature of the portion of property that is his or her separate property, even though the other spouse concedes that some portion of property is the other spouse's separate property. *Zamarripa v. Zamarripa*, WL 1875580 (Tex. App.–Houston [14th Dist.] 2009, pet. denied)(not reported)(although wife conceded that some portion of a pension was husband's separate property, it remained husband's burden to provide clear and convincing evidence as to the exact nature of that portion and the trial court was not required to speculate about it; husband further was not entitled to rely on the statute characterizing retirement benefits); *see also Graves v. Tomlinson*, 329 S.W.3d 128 (Tex. App.–Houston [14th Dist.] 2010, pet. denied)(clear and convincing evidence standard is not satisfied when spouse's testimony is contradictory by the inventories in evidence or unsupported by documentary evidence).

B. Effect of Mischaracterization

If separate property is mischaracterized by the trial court as community property, the error requires remand, unless the mischaracterization had only a *de minimis* effect on the division. *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977); *In re Marriage of Taylor*, 992 S.W.2d 616 (Tex. App. – Texarkana 1999, no writ); *McElwee v. McElwee*, 911 S.W.2d 182 (Tex. App. – Houston [1st Dist.] 1995, no writ); *Robles v. Robles*, 965 S.W.2d 605 (Tex. App. – Houston [1st Dist.] 1998, no writ); *see also Matter of Marriage of Morris*, 123 S.W.3d 864 (Tex. App. – Texarkana 2003, no pet.)(court of appeals reversed a property division because the trial court mischaracterized as the husband's separate property two parcels that were part of the community estate); *Vandiver v. Vandiver*, 4 S.W.3d 300 (Tex. App. – Corpus Christi 1999, no pet.)(trial court's mischaracterization of \$500,000 in investment accounts as the wife's separate property did not require reversal for a redivision of the community estate because the trial court had found that its property division was just and right regardless of any mischaracterization).

C. Gifts

1. Gifts are Separate Property

Property acquired during marriage by gift is the separate property of the recipient spouse, whether the gift was from the other spouse or a third party. TEX. FAM. CODE ANN. § 3.001; *Powell v. Powell*, 822 S.W.2d 181 (Tex. App.– Houston [1st Dist.] 1991, writ denied). The gift must be absolute and may not be open to future reconsideration. *Soto v. First Gibraltar Bank, FSB San Antonio*, 868 S.W.2d 400 (Tex. App.– San Antonio 1993, writ ref'd).

2. Elements of a Gift

A gift is a voluntary transfer of property to another made gratuitously and without consideration. *Hilley v. Hilley*, 342 S.W.2d 565, 568 (Tex. 1961); *Hallum v. Hallum*, WL 4910232 (Tex. App.–Houston [1st Dist.] 2010, no pet. h.)(not reported). To show that a transfer of property was a gift, the spouse claiming the property as separate property must establish:

- a. Donor's intent to make a gift;
- b. Delivery of the property; and
- c. Acceptance of the property.

Dorman v. Arnold, 932 S.W.2d 225 (Tex. App.–Texarkana 1996, n.w.h.); *Scott v. Scott*, 805 S.W.2d 835, 839-40 (Tex. App.– Waco 1991, writ denied)(jury found wife did not make a gift of money to husband, even though she put a \$100,000 CD in his name alone since a gift cannot occur without the intent to make a gift).

The promise to give property in the future is generally not a gift. *Woodworth v. Cortez*, 660 S.W.2d 561, 564 (Tex. App.– San Antonio 1983, writ ref'd n.r.e.).

In the absence of an alternative presumption, the burden of proving a gift is on the party claiming the gift. *Woodworth v. Cortez*, 660 S.W.2d 561 (Tex. App.– San Antonio 1983, writ ref'd n.r.e.).

3. Delivery of Property

A donor delivers property when he or she releases all dominion or control over it. *Soto v. First Gibraltar Bank, FSB San Antonio*, 868 S.W.2d 400 (Tex. App.– San Antonio 1993, writ ref'd). Title to the property must pass immediately and unconditionally, and the transfer must be so complete that the donee spouse could maintain an action for conversion of the property. *Oadra v. Stegall*, 871 S. W.2d 882 (Tex. App.– Houston [14th Dist.] 1994, no writ). A valid gift of real estate must include transfer and receipt of the deed, and a gift of stock must include endorsement of the stock certificates. *Grimsley v. Grimsley*, 632 S.W.2d 174 (Tex. App.- Corpus Christi 1982, no writ). Delivery of a gift cannot be retroactive. *Pearson v. Pearson*, 2016 WL 240683 (Tex. App.–Austin 2016, no pet. h.).

4. Encumbered Property

The grantor may make a gift of encumbered property to a spouse, and the property will be a gift even if the grantee spouse assumes an obligation to extinguish the encumbrance. *Pemerton v. Pemerton*, 809 S.W.2d 642 (Tex. App. – Corpus Christi 1991), *rev'd on other grounds*, 836 S.W.2d 145 (Tex. 1992).

5. No Consideration

A transfer is not a gift if the recipient gave consideration in exchange for the transferred property. *Pankhurst v. Weitinger & Tucker*, 850 S.W.2d 726 (Tex. App.– Corpus Christi 1993, writ denied).

a. Minimal Consideration

If even minimal consideration is given in exchange for the property, the property may become part of the community estate. *Saldana v. Saldana*, 791 S.W.2d 316 (Tex. App.– Corpus Christi 1990, no writ)(lot transferred to husband and wife by husband's mother during marriage was community property, where wife paid mother \$10 at time she executed deed, and husband offered no evidence to rebut presumption that \$10 came from community estate).

However, there are cases that support the position that recitals in a deed are not conclusive as to consideration. *Hallum v. Hallum*, WL 4910232 (Tex. App.– Houston [1st Dist.] 2010, no pet. h.)(not reported); *see also Hall v. Barrett*, 126 S.W.2d 1045 (Tex. App.– Fort Worth 1939, no writ)(court stated that "much ado is made of the recited consideration of "Ten Dollars" paid to the grantor. All of us know that this is the usual and customary formal recitation used in a deed of gift.").

b. Parole Evidence

Some cases have allowed parole evidence to be admitted to show the true consideration or that there was no consideration given. *Bahr v. Kohr*, 980 S.W.2d 723 (Tex. App.– San Antonio 1998, no pet.). Other cases did not admit parole evidence in the circumstances of those cases. *See Massey v. Massey*, 807 S.W.2d 391, 405 (Tex. App.– Houston [1st Dist.] 1991, writ denied); *Johnson v. Driver*, 198 S.W.3d 359, 363 (Tex. App.– Tyler 2006, pet. denied)(citing *Massey*).

6. Gifts to Both Spouses

If a third party attempts to make a gift to the community estate, each spouse acquires an undivided one-half interest in the gift as his or her separate property. *Dutton v. Dutton*, 18 S.W.3d 849 (Tex. App.– Eastland 2000, pet. denied). Texas Family Code Section 3.001(2) and Article XVI, Section 15 of the Texas Constitution require that any property acquired by gift during the marriage is separate property, therefore gifts to the community are not possible.

7. Gifts from Parents or Grandparents

When a grantor conveys property to a natural object of the grantor's bounty, such as a parent to a child or grandparent to a grandchild, a **rebuttable presumption is created that the property conveyed is a gift**. The party claiming the property was not a gift has the burden of proving lack of donative intent by clear and convincing evidence. *Kyles v. Kyles*, 832 S.W.2d 194 (Tex. App.– Beaumont 1992, no writ)(parents' transfer of a property interest to a child is presumptively a gift but may be rebutted by evidence showing the facts and circumstances surrounding the conveyance).

Testimony from a spouse's parent that property is a gift to one spouse alone is sufficient to establish separate property without tracing. *Wells v. Wells*, 251 S.W.3d 834 (Tex. App.–Eastland 2008, no pet.). *Hallum v. Hallum*, WL 4910232 (Tex. App.– Houston [1st Dist.] 2010, no pet. h.)(not reported)(a stepfather considered husband "part of his bounty, thus giving rise to the presumption that the stepfather conveyed real property to husband as a gift); *In re Royal*, 107 S.W.2d 846 (Tex. App.– Amarillo 2003, no pet.)(grandparent's testimony that they forgave part of loan they made to spouses to buy a house was a gift to husband was

rebutted by contrary evidence of a gift to husband and wife); *Mahen v. McMahan*, 2014 Tex. App. Lexis 6154 (Tex. App.–Amarillo 2014)(mem. op.)(court found that wife’s parents’ annual gift checks to husband were intended to be gifts to husband and therefore his separate property at the time the gifts were made); *In re Marriage of Moncey*, 404 S.W.3d 701 (Tex. App.– Texarkana 2013, no pet.)(evidence presented by wife and others sufficient to establish there was no intent to make a gift to husband – trial court's finding that land was wife’s separate property was upheld).

8. Interspousal Gifts

a. Gifts of Interest in Community Property

One spouse may give the other his or her interest in community property, and the property becomes the recipient spouse's separate property. *Pankhurst v. Weitingger & Tucker*, 850 S.W.2d 726 (Tex. App.-Corpus Christi 1993, writ denied). A gift of property from one spouse to the other is presumed to include all of the income and property that may arise from the original gift property. *TFC 3.005*.

b. Presumption of Gift

If a spouse takes title to his or her separate real property in the names of both spouses, a presumption arises that the spouse who purchased the property with separate property intended to make a gift is made to the other spouse of an undivided one-half interest in the property. *Matter of Marriage of Morris*, 12 S.W.3d 877 (Tex. App.– Texarkana 2000, no pet.); *Long v. Long*, 234 S.W.3d 34 (Tex. App.– El Paso 2007, no pet.); (where husband took title of separate property lake lot in names of husband and wife, court held husband gifted undivided one-half interest in lake lot to wife); *Peterson v. Peterson*, 595 S.W.2d 889 (Tex. Civ. App.–Austin 1980, writ dismiss'd w.o.j.)(presumption overcome by husband's testimony that no gift was intended); *Whorall v. Whorall*, 691 S.W.2d 32, 35 (Tex. App.– Austin 1985, writ dismiss'd)(wife testified she did not intend a gift; trial court's finding of separate property was upheld).

c. Real Estate

A conveyance of real estate to one spouse during marriage generally creates a presumption of community property; however, if a deed recites that the conveyance is to the spouse as his or her separate property, this overrides the community presumption and creates a new presumption that the property is the separate property of grantee spouse. *Hodge v. Ellis*, 277 S.W.2d 900 (Tex. 1955); *Kyles v. Kyles*, 832 S.W.2d 194 (Tex. App.– Beaumont 1992, no writ). This shifts burden to the other spouse to rebut the separate property presumption, and failure to rebut results in a conclusive finding of separate property.

See In re Marriage of Skarda, 345 S.W.3d 665 (Tex. App. – Amarillo 2011, no pet.)(husband refinanced separate property house during marriage and signed deed conveying property to husband and wife as “joint tenants with a right of survivorship”– held that husband transferred a one-half separate property interest to wife by gift); *Motley v. Motley*, 390 S.W.3d 689 (Tex. App.– Dallas 2013, pet. denied)(court found refinance of wife’s separate property and conveyance to husband of undivided one-half interest in the property was a gift to husband and therefore his separate property); *Magness v. Magness*, 241 S. W. 3d 910 (Tex. App.– Dallas 2007, pet. denied)(wife signed a deed as part of refinancing and testified she did not intend the deed to be a gift transferring any ownership to husband; court held each spouse owned a one-half separate interest in home –"[a] deed for property from one spouse as grantor to the other spouse as grantee creates a presumption grantee spouse received the property as separate property by gift" – presumption may be rebutted by proof of fraud, accident, or mistake and wife did not testify to any facts indicating this); *Pace v. Pace*, 160 S.W.3d 706 (Tex. App.– Dallas 2005, pet. denied)(house titled in both spouse's name but wife was

able to trace purchase money to her separate funds and house determined to be wife's separate property); *Peterson v. Peterson*, 595 S.W.2d 889 (Tex. Civ. App.—Austin 1980, writ dismissed w.o.j.)(presumption overcome by husband's testimony that no gift was intended); *Harrison v. Harrison*, 321 S.W.3d 899 (Tex. App.—Houston [14th Dist.] 2010, no pet. h.)(court found gift of one-half of the property was intended).

E. Characterization of Various Assets

1. Real Property

Under the inception of title rule, real property acquired before marriage is separate property. TEX. FAM. CODE ANN. § 3.001; *Wilkerson v. Wilkerson*, 992 S.W.2d 719, (Tex. App.—Austin 1999, no pet.). If property is purchased during marriage in part out of one spouse's separate funds and in part out of community property, property will be held as tenants in common between the contributing spouse's separate estate and the community estate. *Gleich v. Bongio*, 99 S.W.2d 881, 883 (Tex. 1937); *In re Marriage of Daugherty*, 42 S.W.3d 331 (Tex. App.—Texarkana 2001, no pet.). Fixtures are characterized with the land. *Cantu v. Harris*, 660 S.W.2d 638, 640 (Tex. App.—Corpus Christi 1983, no writ).

The separate character of real property is not changed because the property was improved with funds borrowed on community credit, because both parties signed a note secured by a deed of trust on this property, or because both parties' names are on the deed of trust. *Leighton v. Leighton*, 921 S.W.2d 365 (Tex. App.—Houston [1st Dist.] 1996, no writ); see *Long v. Long*, 234 S.W.3d 34 (Tex. App.—El Paso 2007, no pet.) (deed to property purchased with husband's separate property taken in names of both spouses created a presumption of a gift).

If, prior to marriage, one spouse signed an earnest money contract and paid the earnest money on real property and, during the marriage, both spouses received the deed in the names of both spouses and both spouses signed the note and deed of trust, it has been held that the inception of title rule dictates that the real property 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); *Wierzchula v. Wierzchula*, 623 S.W.2d 730 (Tex. App.—Houston [1st Dist.] 1981, no writ).

However, if earnest money was paid before closing during the marriage, for example, from the community estate, and a spouse puts 40% of the purchase price down at closing from his or her separate estate, this spouse would only have a reimbursement claim under the inception of title rule. There are cases that have held that the inception of title rule related to the character of the real estate is fixed at closing. It is this author's opinion that if there is 1) a contract to purchase the property with earnest money paid by the community, then 2) a closing a month later with a mortgage, and a separate property down payment, the result is mixed title because the separate estate has *equitable* title since it provided the purchase money even if the contract was on behalf of the community. The separate estate is the beneficiary of a purchase money resulting trust. See *Deacetis v. Wiseman*, 2010 WL 2731040, at *1 (Tex. App.—Houston [14th Dist.] 2010, no pet.)(mem. op.)(court noted that equitable title is just as much a property interest as legal title, and it can be identified and characterized as separate property or community property); *Cockerham v. Cook*, 527 S.W.2d 162 (Tex. 1975); *Jacobs v. Jacob*, 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); *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-73 (Tex. App.—Amarillo 1994, writ denied).

The *Thurmond* case specifically refers to the "mixed title" created when both estates contribute to the purchase of property during marriage as being "equitable title." Equitable title created through a constructive or purchase money resulting trust is just as valid as legal title. In *Thurmond*, the court held:

"Equitable title is a property right greater than a right of reimbursement. It has been held that equitable title is a sufficient interest to permit execution by a creditor. As a property right, it may not be divested from a spouse at divorce without violating our state constitution." *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-73 (Tex. App.–Amarillo 1994, writ denied).

See Section VII(F) and (G) below for examples of mixed character of real estate acquired during marriage.

2. Crops

Crops planted during the marriage are characterized as community property. *McGarraugh v. McGarraugh*, 177 S.W.2d 296 (Tex. Civ. App.–Amarillo 1943, writ dismissed).

3. Timber

Timber grown on separate property is community property. *McElwee v. McElwee*, 911 S.W.2d 182 (Tex. App. – Houston [1st Dist.] 1995, no writ).

4. Minerals

Minerals in place are a part of the real property and therefore have the same character as the real property. *Norris v. Vaughan*, 260 S.W.2d 676 (Tex. 1953). When mineral interests are extracted from the land, the effect is a piecemeal sale of the underlying property. *Id.* The use of separate funds to develop or operate community property oil and gas interests, or of community funds to develop or operate separate interests, does not change the character of the property, but may give rise to a reimbursement claim. *Cone v. Cone*, 266 S.W.2d 480, 483 (Tex. Civ. App.–Amarillo 1953, writ dismissed), 266 S.W.2d 860 (Tex. 1954). Working interests on separate property land are separate property. *Matter of Marriage of Read*, 634 S.W.2d 343, 346 (Tex. App.–Amarillo 1982, writ dismissed).

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 estate. If separate funds were used, there could be a claim for reimbursement. *Matter of Marriage of Read*, 634 S.W.2d 343, 346 (Tex. App.–Amarillo 1982, writ dismissed). NOTE: If a spouse owns oil and gas interests, he or she should be cautious when transferring these interests to an entity. The royalties which otherwise be considered separate property could be community property when distributed from the entity.

Mineral royalties are considered to be the proceeds of the sale of part of real property, so if the real property is separate property, then the royalty payments are also separate property. *Norris v. Vaughan*, 260 S.W.2d 676 (Tex. 1953); *Welder v. Welder*, 794 S.W.2d 420 (Tex. App. – Corpus Christi 1990, no writ).

A bonus payment from an oil and gas lease belonging to a separate estate is separate property. *Lessing v. Russek*, 234 S.W.2d 891 (Tex. Civ. App.– Austin 1950, writ refused n.r.e.).

Delay rentals from separate property are community property. *Lessing v. Russek*, 234 S.W.2d 891 (Tex. Civ. App.– Austin 1950, writ refused n.r.e.); *McGarraugh v. McGarraugh*, 177 S.W.2d 296 (Tex. Civ. App.– Amarillo 1943, writ dismissed).

5. Financial Accounts

The deposit of community and separate funds to the same account does not divest the separate funds of their identity and establish the entire account as community property, as long as the separate funds can be traced and the trial court is able to determine the interest of each party in the account. *Welder v. Welder*, 792 S.W.2d 420 (Tex. App. – Corpus Christi 1990, no writ); *Norton v. Norton*, WL 2816212 (Tex. App.–Amarillo 2010, no pet. h.)(not reported)(even though \$6,000 of community funds were deposited into husband’s account containing his separate property, court held that husband traced his separate property funds). Where a joint bank account contains both community and separate funds, it is presumed that the community funds are withdrawn before the separate funds, and where there are sufficient funds at all times to cover the separate property balance in the account at the time of divorce, it is presumed that the balance remains separate property. *Welder v. Welder*, 792 S.W.2d 420 (Tex. App. – Corpus Christi 1990, no writ); see also *Hill v. Hill*, 971 S.W.2d 153 (Tex. App. – Amarillo 1998, no writ).

When separate and community funds are commingled in a manner defying segregation and identification, it is presumed that the entire fund consists of community property. *Estate of Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987); *Robles v. Robles*, 965 S.W.2d 605 (Tex. App. – Houston [1st Dist.] 1998, no writ); *McElwee v. McElwee*, 911 S.W.2d 182 (Tex. App. – Houston [1st Dist.] 1995, no writ). However, the presumption can be dispelled through proof illustrating that the separate properties which went in never came out. Thus, a showing that community and separate funds were deposited in the same account does not divest the separate funds of their identity and establish the entire amount as community when the separate funds can be traced and the trial court can accurately determine each party's interest. *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App.–Houston [14th Dist.] 2003, pet. denied); *Welder v. Welder*, 794 S.W.2d 420 (Tex. App. – Corpus Christi 1990, no writ); *Holloway v. Holloway*, 671 S.W.2d 51 (Tex. App. – Dallas 1983, writ dismissed).

One issue in tracing financial accounts today is the difficulty obtaining all of the statements from the financial institution. Many financial institutions will not have older statements available. However, there may be creative ways to trace a spouse’s separate property that will provide clear and convincing evidence. For example, if a spouse owned shares of stock before the marriage, it may be possible to prove separate property by clear and convincing evidence even if the spouse no longer has the brokerage statements. Perhaps the spouse’s tax returns that reflect dividends paid on the stock before the marriage can be compared to historical data to determine the shares of stock owned.

See Sections IV – VI below for tracing approaches and specific example of tracing methods.

6. Business Interests

An interest in a business may be community property, and thus may be divisible upon divorce, whether they are sole proprietorships, partnerships or corporations. *Smith v. Smith*, 836 S.W.2d 688 (Tex. App. – Houston [1st Dist.] 1992, no writ)(sole proprietorships); *Farley v. Farley*, 930 S.W.2d 208 (Tex. App. – Eastland 1996, no writ)(partnership interest); *McIntyre v. McIntyre*, 722 S.W.2d 53 (Tex. App. – San Antonio, 1986)(partnership interest); *Matter of Marriage of Thurmond*, 888 S.W.2d 269 (Tex. App. – Amarillo 1994, writ denied); *Rathmell v. Morrison*, 732 S.W.2d 6 (Tex. App. – Houston [14th Dist.] 1987, no writ). As with other property, a spouse attempting to claim that a business interest is his or her separate property must overcome the community property presumption by tracing the origin of the interest. *Hopf v. Hopf*, 841 S.W.2d 898 (Tex. App. – Houston [14th Dist.] 1992, no writ).

a. Goodwill

Goodwill is divisible upon divorce if it exists apart from a professional's personal skills, abilities, and reputation attached to a trade or business. *Parker v. Parker*, 897 S.W.2d 918 (Tex. App. – Fort Worth 1995, writ denied); *Finch v. Finch*, 825 S.W.2d 218 (Tex. App. – Houston [1st Dist.] 1992, no writ)(because goodwill attached to husband's automotive repair business in which other persons performed some of the work, and not to husband personally, goodwill was divisible upon divorce). Where the goodwill does not exist independently from one of the spouses, it is not subject to division. *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972) (medical practice); *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. App. – Corpus Christi 1992, writ denied) (CPA practice).

Personal goodwill which does not exist independently of the professional's skills is not property of the marital estate and is thus not subject to division upon divorce. *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972); *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. App. – Corpus Christi 1992, writ granted). Goodwill which exists independently of the professional's skills maybe subject to division. *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. App. – Corpus Christi 1992, writ granted); *Hirsch v. Hirsch*, 770 S.W.2d 924 (Tex. App. - El Paso 1989, no writ); *Finn v. Finn*, 658 S.W.2d 735 (Tex. App. - Dallas 1983, writ ref'd n.r.e.); *Allen v. Allen*, 704 S.W.2d 600 (Tex. App.–Fort Worth 1986).

Therefore, although goodwill is not a divisible portion of a spouse's individually owned private professional practice, goodwill in a professional corporation which exists independently of the spouse's professional skills may be subject to division upon divorce. *Grossnickle v. Grossnickle*, 935 S.W.2d 830 (Tex. App. – Texarkana 1996, writ denied); *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. App. – Corpus Christi 1992, writ denied); *Finn v. Finn*, 658 S.W.2d 735 (Tex. App. – Dallas 1983, writ ref'd n.r.e.)(goodwill existed independently of husband, who was attorney in 85-member firm that had been in business for ninety years); *Geesbreght v. Geesbreght*, 570 S.W.2d 427 (Tex. Civ. App. – Fort Worth 1978, writ dism'd) (doctor/husband's interest in medical corporation included goodwill as element of value, where corporation employed several doctors to render emergency medical services, and identity of particular doctors and relationships between doctors and patients were generally not significant to practice); *Nowzaradan v. Nowzaradan*, 2007 WL 441709 (Tex. App. – Houston [1st Dist.] 2007, no pet.)(memo op.).

b. Covenants Not to Compete

Whether the value of a covenant not to compete should be included as marital property may depend on the facts of each case. There is an argument that when a community property business is sold during marriage and a covenant not to compete is signed during the marriage, the covenant is a right arising during marriage and any payments received under the agreement could be characterized as 100% community property.

On the other hand, an argument can be made that the payments represent compensation for foregone wages, and wages after divorce are separate property. The right to compete after divorce is a separate property right. *Ulmer v. Ulmer*, 717 S.W.2d 665 (Tex. App.—Texarkana 1986, no writ).

Some have argued that the covenant not to compete represents the seller's personal goodwill, and as such, all payments attributable to the covenant not to compete are separate property under *Nail v. Nail*, whether received before or after divorce. *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972)(an individual's ability to practice his profession is not property subject to division by the court).

In *Austin v. Austin*, 619 S.W.2d 290, 292 (Tex. Civ. App.—Austin 1981, no writ), the husband sold his community property CPA business for \$60,000 and signed a covenant not to compete. The trial court sought to characterize the sales proceeds as separate and/or community property. There were two parts of

consideration received for the sale that were remaining at the time of the divorce: (1) \$45,000 in Treasury Bills (bought with sales proceeds) and (2) \$9,900 in a remaining note receivable from the buyer (related to the sale). The trial court held that the \$45,000 in Treasury Bills were community property and that the remaining \$9,900 note receivable was the husband's separate property. After discussing the line of Texas cases holding that personal goodwill is a spouse's separate property, the Court of Appeals held that, based on those cases, as well as a noncompete agreement, there was sufficient evidence to support the trial court's conclusion that the \$9,900 remaining note receivable was the husband's separate property. *See also Von Hohn v. Von Hohn*, 260 S.W.3d 631, 638 (Tex. App.—Tyler 2008, no pet.) (professional goodwill attaches to a person as a result of confidence in that person's professional skill or ability and is not divisible upon divorce). Therefore, even if a portion of a spouse's sales proceeds from the sale of his or her business could be allocated to a noncompete agreement, that portion would nevertheless be properly characterized as separate property because it results from his or her professional goodwill.

In *Collins v. Collins*, 904 S.W.2d 792 (Tex. App.—Houston [1st Dist.] 1995, writ denied), the court concluded that a noncompetition clause signed by the husband, as well as an unexecuted noncompetition agreement confirmed in the corporate minutes, were assets of the corporation. Therefore, error occurred when the jury was instructed to disregard the noncompete when valuing the corporation. The *Collins* case suggests that the noncompetition agreement belongs to the business entity and not to the individual. However, the husband had already surrendered his competitive rights and therefore no longer owned the "right to compete."

Hypothetical: During marriage, a husband sold his stock in a company he owned prior to the marriage. As part of the sale, he signed an agreement not to compete. The purchase agreement specifically allocated 100% of the sales proceeds to the shares of the stock that were sold, and none of the sale documents allocated any money to the noncompete. The letter of intent for the purchase of the business and the signed purchase agreement was the same price, even though there was a noncompetition agreement attached to the purchase agreement.

The husband argues that he never received any monetary consideration for the noncompete, and since no monetary consideration was received associated with the agreement not to compete, there is no property to trace, characterize as separate or community, or value for the divorce case associated with the agreement not to compete.

The husband's tax returns showed that the amount the seller paid for the company was all capital gains, and the tax returns did not reflect any ordinary income for the noncompete. There are tax cases that support the husband's position that he did not receive any value for the noncompete. If money is consideration for an agreement in the context of an agreement to not compete, then that money is ordinary income which must be reported for federal income tax purposes. Rev. Rul. 69-643, 1969-2 C.B. 10 (1969). Money received for the sale of stock is reported as a capital gain and taxed as such. *Patterson v. Comm'r*, 810 F.2d 562, 569 (6th Cir. 1987). In other words, if a person sells stock in a company and enters into an agreement not to compete, the portion of the sales price for the stock is reported as a capital gain and the portion received, if any, for the agreement not to compete, is reported as ordinary income. *See Becker v. Comm'r*, 92 T.C.M. (CCH) 481 (T.C. 2006)(entire price paid for redemption of taxpayer's stock was allocable to purchase, with zero allocable to non-compete covenant). Tax cases have held that generally the amount allocated by the parties' agreement is controlling, because they have competing and conflicting tax interests. *Theophelis v. United States*, 751 F.2d 165, 167 (6th Cir. 1984). If a contract to purchase a company includes a covenant not to compete, but there is no allocation between the parties of the purchase price to the noncompete agreement, then a finding that no money was paid for the noncompete could

be made. *Id.*; *Better Beverages, Inc. v. United States*, 619 F.2d 424 (5th Cir. 1980).

The husband could also argue that the noncompete is a mutation from his separate property. Proceeds from selling an interest in a business have the same character as the ownership interest, which is an application of the law of mutations. *Marriage of McNelly*, 2014 WL 2039855 (Tex. App.—Houston [14th Dist.] 2014, pet. denied)(memo op.)(where husband owned a partnership interest prior to marriage, proceeds from the sale of that interest were his separate property).

c. Alter Ego

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 (Tex. 1986)(holding that shareholders of corporation may be liable for debts of corporation under theory of constructive fraud).

The theory of alter ego has been applied to “characterize corporate assets as part of the community estate” in a divorce action. *Young v. Young*, 168 S.W.3d 276 (Tex. App. – Dallas 2005, no pet.); *Lifshutz v. Lifshutz*, 61 S.W.3d 511 (Tex. App. – San Antonio 2001, pet. denied); *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. Civ. App.—Fort Worth 1985, writ dismiss’d)(ruling that corporate assets were to be considered community property, as husband’s separate property corporation was his alter ego, where corporation owned such items as family home and its furnishings).

d. Sole Proprietorships

Where once spouse is the sole proprietor of a business before marriage which the spouse continues to operate after the marriage, or where one spouse begins a sole proprietorship with separate funds during the marriage, the profits earned during marriage are presumptively community property. *Tex. Fam. Code Ann. § 3.002*; *In the Matter of the Marriage of York*, 613 S.W.2d 764 (Tex. Civ. App.—Amarillo, 1981, no writ). The separate property invested in the business may be traceable; if it is not, the spouse who operates the business may wish to seek reimbursement for the separate property investment.

If a spouse started a business before his or her marriage and continued it afterward, the separate and community property components of the business are likely to be commingled, as assets the spouse owned before the marriage are separate property and the income of the business earned after the marriage is community property. *Hopf v. Hopf*, 841 S.W.2d 898 (Tex. App. – Houston [14th Dist.] 1992, no writ)(interest in building which husband owned before marriage was his separate property, but income and accounts receivable from his CPA business, which was located in the building, were community property). If the spouse is unable to trace the separate property part of the business upon divorce, he or she may nonetheless be entitled to reimbursement for the investment of the separate property in the community business. *Schmidt v. Huppman*, 73 Tex. 112, 11 S.W. 175 (1889); *Hartman v. Hartman*, 253 S.W.2d 480 (Tex. Civ. App.—Austin 1952, no writ); *Schechter v. Schechter*, 579 S.W.2d 502 (Tex. Civ. App.—Dallas 1978, no writ).

Usually, a sole proprietorship's assets will be awarded to one spouse or the other, usually the one who has been running the business, and other property or an equalizing judgment will be awarded to the other spouse. See *Farley v. Farley*, 930 S.W.2d 208 (Tex. App. – Eastland 1996, no writ); *Hopf v. Hopf*, 841 S.W.2d 898 (Tex. App. – Houston [14th Dist.] 1992, no writ). However, the court may award both spouses a percentage of the assets, liabilities, and profits of the business. *In re Marriage of Trujillo*, 580 S.W.2d 873

(Tex. Civ. App.- Texarkana 1979, no writ)(suggesting that it may not be wise to divide a going business between antagonistic parties).

e. Partnerships

Partnership property is not the property of the partners, but of the partnership, and neither a partner nor his or her spouse has an interest in partnership property that can be transferred, either voluntarily or involuntarily. *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.-- Houston [14th Dist.] 1989, writ denied); *Gibson v. Gibson*, 190 S.W.3d 821 (Tex. App. – Fort Worth 2006, no pet.). Partnership property is therefore neither separate nor community property. *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.-- Houston [14th Dist.] 1989, writ denied). Even if the spouses are the sole partners in the partnership, the court may not award specific partnership property upon their divorce, as the partnership property is not community property. *Roach v. Roach*, 672 S.W.2d 524 (Tex. App. – Amarillo 1984, no writ). The partner's interest in the partnership itself, however, is his or her personal property, and may be community property.

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, that is his or her right to receive a share of the partnership profits and surplus. *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.-- Houston [14th Dist.] 1989, writ denied); *Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.--Dallas 1987, writ ref'd n.r.e.).

Under the inception of title rule, if the interest in the partnership is acquired before marriage, the interest is separate property. *Welder v. Lambert*, 44 S.W. 281 (Tex. 1898); *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.-- Houston [14th Dist.] 1989, writ denied); *Cox v. Cox*, 439 S.W.2d 862 (Tex. Civ. App.--San Antonio 1969, no writ). The same is true where the interest (whether acquired as an assignee or by one who is accepted as a partner) is acquired by gift or inheritance. A partnership is formed by an agreement between two or more partners. See TEX. BUS. ORG. CODE § 154.001(b).

If the court awards a spouse a percentage of a partnership interest as part of the division of community property, the spouse is entitled to that percentage of the partnership's future revenue. *York v. York*, 678 S.W.2d 110 (Tex. App. – El Paso 1984, no writ).

Distributions of a partner's share of profits and income during marriage are community property, even if the partner's interest is separate property. *Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.--Dallas 1987, writ ref'd n.r.e.); *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.--Houston [14th Dist.] 1989, writ denied).

In *Marshall*, the husband owned a separate property interest in a partnership engaged in oil and gas exploration and production. The partnership acquired all of the oil and gas leases before the marriage. The partnership disbursed \$542,316 to the husband during the marriage. The husband argued that only the \$22,400 paid as salary was community property. The Court rejected the husband's argument and held that distributions of partnership income and profits were community property. The *Marshall* Court noted:

“A withdrawal from a partnership capital account is not a return of capital in the sense that it may be characterized as a mutation of a partner's separate property contribution to the partnership and thereby remain separate. Such characterization is contrary to the UPA and implies the partner retains an ownership interest in his capital contribution. He does not; the partnership entity becomes the owner, and the partner's contribution becomes partnership property which cannot be characterized as either separate or community property of the individual partners. Thus, there can be no mutation of a partner's separate contribution; that

rule is inapplicable in determining the characterization of a partnership distribution from a partner's capital account.”

The *Marshall* court held that all monies disbursed by the partnership were made from current income. The partnership agreement provided that “any and all distributions . . . of any kind or character over and above the salary here provided . . . shall be charged against any such distributee's share of the profits of the business.” The court held that on the facts of the case, all of the partnership distributions that the husband received were either salary under the partnership agreement or distributions of profits of the partnership and therefore community property.

The case of *Lifshutz v. Lifshutz*, 199 S.W.3d 9 (Tex. App.–San Antonio 2006, pet. denied) also addressed the issue of distributions from a partnership. In the facts of that case, the Court of Appeals held that the distributions of partnership income and profits were community property.

Profits earned but retained for reasonable needs of business remain part of “partnership property” (whether in the form of cash in the bank, increased inventory, or otherwise). *Jones v. Jones*, 699 S.W.2d 583 (Tex. App.–Texarkana 1985, no writ); *McKnight v. McKnight*, 543 S.W.2d 863 (Tex. 1976).

f. Corporations

Under the inception of title rule, stock in a corporation that was incorporated during the marriage is community property, and stock acquired before marriage, or during the marriage by gift, devise, or descent, is separate property. TEX. FAM. CODE ANN. § 3.001; *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984). 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 remain separate property. *Dillingham v. Dillingham*, 434 S.W.2d 459 (Tex. Civ. App.–Fort Worth 1968, writ dismissed). 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 right to reimbursement. TEX. FAM. CODE ANN. § 3.402(a)(2); *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984); *Lucy v. Lucy*, 622 S.W.3d 770 (Tex. App.–El Paso 2005, no pet. hist.).

A shareholder's interest in the corporation, symbolized by his or her shares in the corporation, does not change when the corporation acquires or disposes of assets; thus, if the shares are separate property, they remain so, even if they appreciate in value during the marriage. *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984).

Corporate shares are subject to the presumption that property possessed by a spouse upon dissolution of marriage is community property, but the presumption may be rebutted by a showing that the shares were separate property when they were acquired or were acquired with separate property under the inception of title rule. TEX. FAM. CODE ANN. § 3.003(a); *See Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App. – Houston [14th Dist.] 1975, writ dismissed). The interest in the corporation arises when the shareholder spouse acquires the right to receive the stock, not the date on which he or she actually acquires possession. *Fuhrman v. Fuhrman*, 302 S.W.2d 205 (Tex. Civ. App. – El Paso 1957, writ dismissed).

If a spouse shows that a corporation in which he or she holds shares was capitalized solely with his or her separate property, the corporate shares will be separate property. *Hunt v. Hunt*, 952 S.W.2d 564 (Tex. App. – Eastland 1997, no writ)(husband's interest in corporation formed during parties' marriage, but capitalized entirely with helicopters that husband and his father had owned as partners before father's death and before parties' marriage, was husband's separate property); *Allen v. Allen*, 704 S.W.2d 600 (Tex. App. - Fort Worth 1986, no writ); *Holloway v. Holloway*, 671 S.W.2d 51 (Tex. App. – Dallas 1983, writ

dism'd)(husband traced separate funds into his initial subscription to stock); *Vallone v. Vallone*, 644 S.W.2d 455 (Tex. 1982)(court found that capitalization was traceable to husband's separate estate).

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

If a spouse's interest in the corporation is separate property, the assets he or she receives upon dissolution are also separate property. *Hilliard v. Hilliard*, 725 S.W.2d 722 (Tex. App.- Dallas 1985, no writ).

Property or funds received in liquidation upon dissolution of a corporation belong to the estate of the original stock. If the original stock was separate, the liquidating dividend remains separate. *Legrand-Brock v. Brock*, 246 S.W.3d 318 (Tex. App. – Beaumont 2008, pet. denied); *Wells v. Hiskett*, 288 S.W.2d 257 (Tex. Civ. App.–Texarkana 1956, writ ref'd n.r.e.).

The increase in value of separate property stock due to market conditions is separate property. *Dillingham v. Dillingham*, 434 S.W.2d 459 (Tex. Civ. App.–Fort Worth 1968, writ dismissed). The legal title to stock in a corporation is not affected by the acquisition of additional assets by the corporation or by the fact that, in the absence of fraud, the directors of a corporation may, in their discretion, invest its earnings in such assets instead of distributing them to the shareholders. *Stringfellow v. Sorrells*, 18 S.W. 689 (Tex. 1891).

7. Stock in General

a. Cash Dividends

Dividends paid in cash on either separate or community property stock are community property. *Amarillo Nat'l Bank v. Liston*, 464 S.W.2d 395 (Tex. Civ. App.– Amarillo 1970, writ ref'd n.r.e.). Cash dividends received on mutual fund shares owned as separate property are community property. *Bakken v. Bakken*, 503 S.W.2d 315 (Tex. Civ. App.–Dallas 1973, no pet.).

b. Stock Dividends

Dividends paid in shares of stock on separate property are separate property. *Wohlenberg v. Wohlenberg*, 485 S.W.2d 342 (Tex. Civ. App.– El Paso 1972, no writ); *Tirado v. Tirado*, 357 S.W.2d 468 (Tex. Civ. App.–Texarkana 1962, writ denied)(stock dividends received during marriage on separate property stock are separate property).

c. Stock Splits

Stock splits on separate property stock are separate property. *Tirado v. Tirado*, 357 S.W.2d 468 (Tex. Civ. App.–Texarkana 1962, writ denied); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.–Houston [14th Dist.] 1975, writ dismissed w.o.j.).

8. Trusts

a. Trusts in General

A trust is defined as 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, Section 2, Definition of Trust*. 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, Section 2, Definition of Trust, comment b*. The person who creates a trust is the settlor (also trustor or grantor). The property held in trust is 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, Section 3*.

A trust generally involves two interests – ownership of the corpus of the trust (i.e. the property that makes up the trust); and ownership of the income from the trust. If a spouse is a trustee, he or she holds legal title, but not equitable title, to the trust property, and the trust property is neither the separate nor the community property of the trustee spouse.

If a spouse is the beneficiary of a trust, he or she holds equitable, but not legal, title to the trust property; the spouse has not "acquired" the property, and it is therefore not community property, unless the spouse has a present possessory right to the property. *Matter of the Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App. - Texarkana 1976, no writ); *Buckler v. Buckler*, 424 S.W.2d 514 (Tex. Civ. App. – Fort Worth 1967, writ dismissed w.o.j.).

Trusts can be a useful device in protecting separate property during a marriage, however, care must be used in creating the trust. This is also true if a spouse has a trust that was established prior to the marriage or has a trust interest received through gift, devise or descent.

If a trust was created prior to the marriage, or the spouse's interest in the trust was acquired by gift or inheritance, then the interest will likely be characterized as separate property. However, many trusts generate income and the question arises as to the character of the income generated by the trust. The type of distribution made (such as distribution of corpus or income) is also considered in characterization.

The current state of the law leaves much room for debate regarding the characterization of trust distributions and income from trusts.

b. Trust Corpus

If the corpus of the trust 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 (Tex. App.–Corpus Christi 1997, no writ); *Lemke v. Lemke*, 929 S.W.2d 662 (Tex. App. – Fort Worth 1996, writ denied)(corpus of trust created during marriage with traced separate property was separate property); *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. App. – Tyler 1996, no writ)(corpus of trust established before marriage was separate property, and income was also separate property); *Hardin v. Hardin*, 681 S.W.2d 241 (Tex. App.–San Antonio 1984, no writ)(corpus of trust created by gift was separate property).

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 (Tex. App.–Beaumont 1984, writ refused n.r.e.)(discretionary pay trust -- income and profits from the business that was part of the trust corpus intended by the trustors to be part of the corpus of the trust).

c. Trust Income

A spouse can be the beneficiary of trust income. When analyzing the character of trust income, several factors regarding the trust must be considered:

Was the income distributed or undistributed during the marriage;

Who created the trust – a third party or a spouse for his or her own benefit (self-settled trust);

Does the spouse have any interest in the corpus of the trust; and

If the income was undistributed, did the spouse have a right to compel a distribution during marriage (i.e. was the distribution discretionary or mandatory under the trust instrument).

d. Distributed Income

Income distributed during marriage from a third-party trust that a spouse has a beneficial interest in the corpus is considered community property. *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.–Corpus Christi 1997, no writ)(income distributed during marriage from third-party trust in which the wife 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.

However, it has been held that income distributed from trusts created by third parties, and the property purchased with that income, is the separate property of the beneficiary. *Hardin v. Hardin*, 681 S.W.2d 241 (Tex. App.–San Antonio 1984, no writ)(mandatory pay trust -- the right to receive the income was a gift and therefore the separate property of the beneficiary); *Taylor v. Taylor*, 680 S.W.2d 645 (Tex. App.–Beaumont 1984, writ ref'd n.r.e.)(discretionary pay trust -- income and profits from the business that was part of the trust corpus intended by the trustors to be part of the corpus of the trust). The rationale for this was that the grantor had expressed an intent to make any distributions from the trust to be the beneficiary's separate property.

There are no cases that have directly addressed the characterization of income distributed during the marriage from a self-settled trust. Under general characterization rules, it would seem that any income distributed from a self-settled trust during the marriage, regardless of whether the spouse retained a beneficial interest in the corpus, would be community property.

e. Undistributed Income

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 (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).

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.

Discretionary Pay Trust – If undistributed income earned during marriage is not required to be distributed under the terms of the trust agreement (i.e. it is a discretionary trust where the trustee has absolute discretion

as to the distribution of the income), the undistributed income in the trust is separate property. *In Re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.-- Texarkana 1978, writ dismissed)(undistributed income earned during marriage was separate property because beneficiary did not have past or present right to compel distribution); *Buckler v. Buckler*, 424 S.W.2d 514, 515 (Tex. App.--Fort Worth 1967, writ dismissed)(undistributed trust income is not community property if the trustee has the right to withhold it from the beneficiary); *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.--Corpus Christi 1997, no writ); *Lemke v. Lemke*, 929 S.W.2d 662 (Tex. App. – Fort Worth 1996, writ denied)(since neither spouse actually or constructively acquired the undistributed trust income during marriage, such income remained a part of the respective trust and was not subject to division by the court as it was not community property); *Currie v. Currie*, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dismissed)(undistributed trust income is not community property where there is no obligation to make a distribution).

Mandatory Pay Trust – Undistributed income on trust corpus that accrues during the marriage is community property if that income that should have been distributed from the trust to the beneficiary under the trust agreement (mandatory trust). *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ)(trust beneficiary became entitled to receipt of one-half of the trust corpus during the marriage and chose to leave the vested portion in the control of the trustee; held that the income from that vested portion was community property); *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. App. – Tyler 1996, no writ)(if the spouse has the right to distribution of income from the trust, the income is community property).

In *Dickinson v. Dickinson*, 324 S.W.3d 653 (Tex. App.--Fort Worth 2010, no pet. h.), the court held that where there was no evidence that the husband was entitled to receive, or that he did receive, any income from a trust during the marriage; his only interest is the remainder interest in the real property, which he was not entitled to until his father's death which was subject to another person's life estate. The Court held that the husband showed by clear and convincing evidence that his remainder interest in the trust corpus was obtained by devise and is, therefore, his separate property that the trial court was not entitled to award to the wife.

f. Undistributed Income Held in Self-Settled Trust

If undistributed income earned during a 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. 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. *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 (Tex. App. – Fort Worth 1996, writ denied)(corpus of trust created during marriage with traced separate property was separate property; undistributed income earned during marriage was separate property).

9. Private Employee Benefits

a. Retirement Benefits

Unmatured retirement benefits are a form of deferred compensation, and such benefits earned during the employee's marriage are community assets subject to division upon divorce. *Matter of Marriage of Wade*, 923 S.W.2d 735 (Tex. App.-- Texarkana 1996, writ denied). A court entering a divorce decree is required to determine the rights of both spouses in the parties' pensions, retirement plans, annuities, individual retirement accounts, employee stock option plans, stock options, or similar plans. *Tex. Fam. Code Ann. § 7.003*. Generally, retirement benefits that accrued prior to the parties' marriage are the employee's separate property,

while those that accrue during the marriage are community property, and the court can distribute only the portion of the benefits that accrued during marriage. *Wallace v. Fuller*, 832 S.W.2d 714 (Tex. App. – Austin 1992, no writ); *Sanderlin v. Sanderlin*, 929 S.W.2d 121 (Tex. App. – San Antonio 1996, writ denied); *Hopf v. Hopf*, 841 S.W.2d 898 (Tex. App. – Houston [14th Dist.] 1992, no writ).

(1) Defined Benefit Plans

A defined benefit plan is an employer-sponsored retirement plan in which the employer pays the employee a specific amount (generally a monthly benefit) beginning at the retirement of the employee or once the employee has attained retirement age. See *Shanks v. Treadway*, 110 S.W.3d 444, 445 n.1 (Tex. 2003). This benefit is usually based upon such factors as age, years of service, and salary. The investments and management of a defined benefit plan are typically controlled by the employer and not the employee.

The principles and formulas set forth in *Berry v. Berry*, 647 S.W.2d 945 (1983) and *Taggart v. Taggart*, 552 S.W.2d 422 (1977) are the benchmarks used by the courts in dealing with the character and division of defined benefit plans.

When benefits in a defined-benefit plan are in pay status or eligible for pay status at the time of divorce, the court should apply the *Taggart* formula to determine the community and separate interests in the plan. *In re Marriage of Ramsey*, 487 S.W.3d 762 (Tex. App. – Waco, 2016, pet. filed 6-28-16); *Prague v. Prague*, 190 S.W.3d 31, 39 (Tex. App. – Dallas 2005, pet. denied); *Stavinoha v. Stavinoha*, 126 S.W.3d 604, 616 (Tex. App – Houston [14th Dist.] 2004, no pet.).

The community estate's interest in the plan is calculated under the *Taggart* formula by dividing the number of months the parties were married during the employee spouse's employment (numerator) by the total number of months the employee spouse was employed at the time of retirement (denominator). See *Taggart*, 552 S.W.2d at 424.

When benefits in a defined-benefit plan are not fully matured at the time the spouses divorce, the *Berry* formula should be used to calculate the community interest in the plan. *Douglas v. Douglas*, 454 S.W.3d 591, 596 (Tex. App. – El Paso 2014, no pet.); *Stavinoha*, 126 S.W.3d at 616.

The community estate's interest in the plan is calculated under the *Berry* formula by dividing the number of months the parties were married during employment (numerator) by the total number of months worked at the time of divorce). See *Berry*, 647 S.W.2d at 947.

Defined benefit plans also sometimes make post-divorce adjustments to the participant spouse's benefits which include adjustments that apply to a spouse's post-divorce efforts and those that do not. One type of adjustment is a periodic cost-of-living adjustment (COLA). Postdivorce COLAs can be characterized as community property (depending on the character of the defined-benefit plan) because they are not based on postdivorce efforts of the participant. *Phillips v. Parrish*, 814 S.W.2d 501, 505 (Tex.App. – Houston [1st Dist.] 1991, writ denied); See *Stavinoha*, 126 S.W.3d at 612.

(2) Defined Contribution Plans

According to the Texas Family Code, a spouse's separate property interest in a defined contribution plan (such as 401(k) plans, employee stock ownership plans, profit-sharing plans and money-purchase plans) can be determined using the characterization rules that apply to non-retirement assets, namely the inception of title rule and tracing. TEX. FAM. CODE §3.007(c). The ability to trace through the account can be beneficial

to clients whose retirement accounts have grown significantly due to investments and growth of assets in the account. However, tracing through years of statements and transactions can be cost prohibitive and possibly impossible if statements are not available.

Another issue is that frequently defined contribution plan providers do not provide the appropriate data to perform a tracing with the statements they provide to plan participants. As a practical tip, sometimes the plan providers maintain information needed to perform a tracing elsewhere, so it does not hurt to ask the provider directly for this information. Since the statute states that a defined contribution retirement plan “may” be traced using tracing principles, other less costly methods could possibly also be used. Without the data to trace through the account, the subtraction method is available to show the balance of the account at the date of marriage. It may also be possible to try to show appreciation in the assets of the account by using growth tables.

Non-vested benefits in a defined contribution plan are subject to characterization as either separate or community property. *Dewey v. Dewey*, 745 S.W.2d 514, 518 (Tex. App.—Corpus Christi 1988, writ denied).

b. Stock Options and Restricted Stock

A stock option is the right to acquire a specific number of shares of a certain stock at a set price for a period of time. Employee stock options may constitute community property subject to division upon divorce if the options are a form of deferred compensation or an earned property right based on past service. *Demler v. Demler*, 836 S.W.2d 696 (Tex. App.—Dallas 1992, no writ); *Acosta v. Acosta*, 836 S.W.2d 652 (Tex. App.—El Paso 1992, writ denied). Whether the options are granted to provide compensation for past or present services, or whether they are used to provide incentive, they usually expire with termination of the employment.

The separate or community interest in employer provided stock option plans or restricted stock plans is determined using a formula set forth in Section 3.007 of the Texas Family Code as follows:

Section 3.007(d) - (e)

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

(1) if the option or stock was granted to the spouse before marriage but required continued employment during marriage before the grant could be exercised or the restriction removed, the spouse’s separate property interest is equal to the fraction of the option or restricted stock in which:

(A) the numerator is the sum of:

- (i) the period from the date the option or stock was granted until the date of marriage; and
- (ii) if the option or stock also required continued employment following the date of dissolution of the marriage before the grant could be exercised or the restriction removed, the period from the date of dissolution of the marriage until the date the grant could be exercised or the restriction removed; and

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

(2) if the option or stock was granted to the spouse during the marriage but required continued employment following the dissolution of the marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which:

(A) the numerator is the period from the date of dissolution of the marriage until the date the grant could be exercised or the restriction removed; and

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

(e) The computation described by Subsection (d) applies to each component of the benefit requiring varying periods of employment before the grant could be exercised or the restriction removed.

10. Non-Retirement Employee Benefits

a. Termination Payments

Termination payments may be community property. *Matter of Marriage of Wade*, 923 S.W.2d 735 (Tex. App. – Texarkana 1996, writ denied)(insurance agent husband's termination payments based on total commissions for year preceding retirement were community property; payments were deferred compensation earned throughout employment because largest component of commissions in any given year was attributable to policy renewals).

b. Early Retirement Incentives

A payment which is received during marriage as an incentive for early retirement and which is entirely discretionary with the employer is entirely community property. *Whorrall v. Whorrall*, 691 S.W.2d 32 (Tex. App. – Austin 1985, writ dismissed); but see *Henry v. Henry*, 48 S.W.3d 468 (Tex. App.–Houston [14th Dist.] 2001, no pet.)(severance package not a retirement benefit; it was an inducement for Henry to leave company, purely discretionary with company.)

11. Income from Work

a. Current Income

Depending on the inception of title of a spouse's current wages (i.e. when the wages were earned, not paid), the wages can be classified as either separate or community property. *Keller v. Keller*, 141 S.W.2d 308 (Tex. 1940); *Licata v. Licata*, 11 S.W.3d 269 (Tex. App. – Houston [14th Dist.] 1999, pet. denied) (income from attorney's completed and referred cases for which right to income had vested was community property); *Bell v. Moores*, 832 S.W.2d 749 (Tex. App. – Houston [14th Dist.] 1992, writ denied); *Moore v. Moore*, 192 S.W.2d 929 (Tex. App. – Fort Worth 1946, no writ).

b. Future Income

Future income of a spouse is that spouse's separate property. *Loaiza v. Loaiza*, 130 S.W.3d 894 (Tex. App.– Fort Worth 2004, no pet.)(court found that husband's "guaranteed" contract (future income) as a baseball player with the Toronto Blue Jays, executed during the marriage, was not community property.);

Von Hohn v. Von Hohn, 260 S.W.3d 631 (Tex. App.–Tyler 2008, no pet.)(a spouse is not entitled to a percentage of his or her spouse’s future earnings).

An insurance agent’s future renewal commissions on insurance policies written by the agent during marriage, but not acquiring 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); *See Vibrock v. Vibrock*, 561 S.W.2d 776, 777 (Tex. 1977)(Texas Supreme Court in refusing to grant writ due to no reversible error, stated that it neither approved nor disapproved of the suggestion by the court of appeals that renewal commissions are separate property).

c. Bonuses

Bonuses are typically paid to an employee for his or her work performed over a period of time. The equitable manner to characterize a bonus is to take the number of months (or days) the employee worked during the designated time period during the marriage, and divide it by the number of months (or days) in the relevant time period to determine the percentage for the community portion of the bonus. For example, if an employee’s bonus is \$100,000 for work performed in 2011, and the parties were divorced on July 1, 2011, then the community portion of the bonus would be \$50,000. Typically, bonuses are paid a few months after they are actually earned, so it is important to be aware that this is an asset of the marriage if the bonus is not paid until after the divorce.

Signing bonuses may not all be community property even if the monies are received during the marriage. *Loaiza v. Loaiza*, 130 S.W.3d 894 (Tex. App.– Fort Worth 2004, no pet.)(court found that husband’s “guaranteed” contract (future income) as a baseball player with the Toronto Blue Jays, executed during the marriage, was not community property.) There may be conditions on a signing bonus that make part of the bonus separate. In the *Loaiza* case, the Court found that certain post-divorce payments under an employment contract that was executed during the marriage was the husband’s separate property, because in order to receive the payments, the husband had to perform services after the date of the divorce. *Id.* at 906. Therefore, compensation earned by the efforts of a party prior to the date of a marriage or after the date of divorce are separate property, regardless of when the income is received.

d. Child’s Wages

The earnings of an unemancipated child of both spouses (when both spouses are conservators or if no other conservator is appointed), as well as property purchased from those earnings, are community property. *Insurance Co. v. Stratton*, 287 S.W.2d 320, 323 (Tex. App. – Waco 1956, writ ref’d n.r.e.)

e. Disability Payments and Texas Workers’ Compensation Payments

Disability payments and Texas workers’ compensation payments are community property to the extent they are payments to replace earnings lost during the marriage. The payments to replace earnings lost before marriage or after marriage are separate property. TEX. FAM. CODE ANN. §3.008(b). It is important to note, that compensation for personal injuries as provided by some disability insurance policies are characterized as separate property. TEX. FAM. CODE ANN. §3.001(3).

12. Life Insurance

The court must specifically divide or award the rights of each spouse in an insurance policy in a divorce decree. TEX. FAM. CODE ANN. § 7.004.

The proceeds of privately purchased life insurance purchased with community funds, or of privately purchased life insurance purchased during the marriage on the life of a third person with one of the spouses named as the beneficiary, are community property. *Jackson v. Smith*, 703 S.W.2d 791 (Tex. App. – Dallas 1985, writ ref'd n.r.e.); *Dent v. Dent*, 689 S.W.2d 521 (Tex. App. – Fort Worth 1985, no writ). The cash surrender value of a private life insurance policy acquired during marriage is also community property to the extent of the community funds used to create the cash surrender value. *Grost v. Grost*, 561 S.W.2d 223 (Tex. Civ. App. – Tyler 1977, writ dism w.o.j.).

As with real property, the inception of title rule governs the separate or community character of life insurance policies. *Barnett v Barnett*, 67 S.W.3d 107 (Tex. 2001); *Camp v. Camp*, 972 S.W.2d 906 (Tex. App. – Corpus Christi 1998, pet. denied); *McCurdy v McCurdy*, 372 S.W.2d 381 (Tex. Civ. App.-- Waco 1963, writ ref'd)(policy that insured first received as employment benefit before marriage was separate property).

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 estate 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.). A term insurance policy purchased prior to marriage is separate property under the inception of title rule. However, if during the marriage the term insurance policy expires and is replaced with another term life insurance policy, the replacement policy is not a mutation of the prior policy, but it is community property. *Barnett v Barnett*, 67 S.W.3d 107 (Tex. 2001); *Camp v. Camp*, 972 S.W.2d 906 (Tex. App. – Corpus Christi 1998, pet. denied).

An employer-provided life insurance policy provided as a part of a federal-employee benefit plan may be preempted by federal law from being characterized as community property. *Barnett v. Barnett*, 67 S.W.3d 107, 111 (Tex. 2001); 29 U.S.C. § 1003. An employer-provided life insurance policy that is not a part of an Employee Retirement Income Security Act (ERISA) employee benefit plan or a preempted federal employee benefit plan is characterized is either separate or community property based upon the inception of title rule. *Seaman v. Seaman*, 756 S.W.2d 56, 58 (Tex. App. – Texarkana 1988, no writ).

The fact that insurance policies are term policies with no cash value does not change their character as community or separate property. *In re Levi*, 183 B.R. 468 (Bkrtcy. N.D.Tex.1995). 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. *Camp v. Camp*, 972 S.W.2d 906 (Tex. App.–Corpus Christi 1998, writ denied).

13. Other Insurance

Any payment of insurance proceeds under a policy issued to the community, providing coverage for community property, and paid for by community assets, is community property. *Chubb Lloyds Ins. Co. of Texas v. Kizer*, 943 S.W.2d 946 (Tex. App. – Fort Worth 1997, writ denied). Casualty loss insurance proceeds take on the character of the asset that suffered the casualty. *Tex. Fam. Code Ann. §3.008(a)*.

Section 3.008(a) of the Texas Family Code provides as follows:

"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."

If the spouses' rights in an insurance policy are not divided upon divorce as required by § 7.004 of the Texas Family Code, the proceeds of a valid claim under the policy are payable as follows:

if the interest in the property insured was awarded solely to one former spouse by the decree, to that former spouse;

if an interest in the property insured was awarded to each former spouse, to the former spouses in proportion to the interests awarded; or

if the insurance coverage is directly related to the person of one of the former spouses, to that former spouse.

TEX. FAM. CODE ANN. § 7.005(b).

14. Personal Injury

The recovery for personal injuries sustained by a spouse is separate property, except for any recovery for lost earning capacity during marriage. TEX. FAM. CODE ANN. §3.001(3). However, it is important to evaluate the nature of the damages awarded in a personal injury suit to determine whether the recovery is characterized separate or community property (i.e. actual damages, exemplary damages, interest, or attorneys' fees and court costs). If the character of the damages is not specified, for example, if the injured spouse enters into a settlement agreement for a lump sum that does not specifically allocate the amounts awarded for the personal injury, then the community property presumption will apply to the entire recovery. *Slaton v. Slaton*, 987 S.W.2d 180, 183 (Tex. App. – Houston [14th Dist.] 1999, pet, denied); *Harrell v. Hochderffer*, 345 S.W.3d 652, 657 (Tex. App. – Austin 2011, no pet.).

The character of actual damages depends on the type of damage. For example, bodily injury is always characterized as separate property, this includes physical pain and suffering, mental anguish, disfigurement, loss of spousal consortium, and loss of parental consortium. *Graham v. Franco*, 488 S.W.2d 390, 395 (Tex. 1972); *Douglas v. Delp*, 987 S.W.2d 879, 883 (Tex. 1999); *Harrell v. Hochderffer*, 345 S.W.3d 652, 657 (Tex. App. – Austin 2011, no pet.); *Whittlesey v. Miller*, 572 S.W.2d 665, 669 (Tex. 1978); *Williams v. Steves Indus.*, 678 S.W.2d 205, 210 (Tex. App. – Austin 1984), aff'd, 699 S.W.2d 570 (Tex. 1985).

Damages which compensate for an economic damage, such as medical expenses, lost earning capacity, and lost services, are characterized by the estate incurring the loss. For example, recovery for medical expenses paid are characterized by the estate that paid the medical expenses (community or separate). *Graham v. Franco*, 488 S.W. 2d 390, 392 (Tex. 1972). Damages recovered by one spouse for the other spouse's "spousal services", which represent the household and domestic services of a spouse, are community property. *Whittlesey v. Miller*, 572 S.W.2d 665, 669 (Tex. 1978).

Exemplary damages are characterized as the injured spouse's separate property. *Harrell v. Hochderffer*, 345 S.W.3d 652, 659-660 (Tex. App. – Austin 2011, no pet.).

Texas courts have yet to address the characterization of prejudgment and post judgment interest recovered in a personal-injury suit and attorney fees and costs recovered by a spouse. However, it is likely that attorneys' fees and costs recovered are characterized by the estate that paid those expenses.

IV. TRACING

Tracing involves establishing the separate origin of property through evidence showing the time and means by which the spouse originally obtained possession of the property. *Slaton v. Slaton*, 987 S.W.2d 180, 182 (Tex. App. – Houston [14th Dist.] 1999, pet denied); *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App. – Dallas 1985, no writ). If 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. *Harris v. Harris*, 765 S.W.2d 798, 802 (Tex. App.– Houston [14th Dist.] 1989, writ denied).

A spouse claiming that property is his or her separate property must trace and clearly identify the property to show that it was originally his or her separate property or that it was acquired with separate property. *Pearson v. Fillingim*, 332 S.W.2d 361 (Tex. 2011)(per curium)(Husband did not provide any evidence that mineral deeds were his separate property).

Property, whether community property or separate property, will retain its character through a series of exchanges and mutations, so long as the party claiming the separate ownership can overcome the presumption of community property by tracing the assets back to property that, because of its time and/or method of acquisition, is separate in character. *Norris v. Vaughan*, 260 S.W.2d 676 (Tex. 1953); *Celso v. Celso*, 864 S.W.2d 652, 655 (Tex. App. – Tyler 1993, no writ).

Once the character of a property interest is determined, whether separate property or community property, the property interest will retain that character after undergoing a change in form and will not be changed by the sale, exchange, or substitution of the property interest. *Gleich v. Bongio*, 99 S.W.2d 881 (Tex. 1937).

Proceeds of the sale of separate property are the separate property of spouse whose property was sold. *Scott v. Scott*, 805 S.W. 2d 835 (Tex. App.– Waco 1991, writ denied).

Commingled Property – Separate property commingled with community property remains separate property so long as its identity can be traced, but where separate property has become so commingled with community property as to defy segregation and identification, the entire property is presumed to be community property. *Gutierrez v. Gutierrez*, 791 S.W.2d 659 (Tex. App.– San Antonio 1990, no writ)(entire herd of cattle was CP, even though some cattle may initially have been husband’s separate property); *In re Marriage of Stegall*, _____ S.W.3d _____ (Tex. App.—Amarillo 2017, _____)(minimum sum balance tracing method cannot apply to cattle in same way as cash because cattle are not fungible; because tracing theory failed to acknowledge significant number of cattle born during marriage which were community property and commingled with separate property cattle, the community property presumption applied).

Funds on Account -- So long as separate funds can be traced, they may be deposited in a joint account without losing their character as separate property. *Celso v. Celso*, 864 S.W.2d 652 (Tex. App.– Tyler, 1993, no writ). The deposit of community and separate funds into the same account does not divest the separate funds of their identity and establish the entire account as community property, as long as the separate funds can be traced and the trial court can determine each party's interest. *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App.– Houston [14th Dist.] 2003, pet. denied). When separate property and community property funds are commingled in a manner defying segregation and identification, it is presumed that the entire fund consists of community property. *Robles v. Robles*, 965 S.W.2d 605 (Tex. App.– Houston [1st Dist.]1998, no writ).

Exchanged Property -- Property acquired in exchange for separate property becomes the separate property of the spouse whose separate property was exchanged. *Ridgell v. Ridgell*, 960 S.W.2d 144, 148 (Tex. App. – Corpus Christi 1997, no writ); *Dixon v. Sanderson*, 10 S.W. 535, 536 (1888); *Newland v. Newland*, 529 S.W.2d 105, 107 (Tex. Civ. App. – Fort Worth 1975, writ dismissed). Furthermore, proceeds from the sale of separate property are the separate property of the spouse whose property was sold. *Scott v. Scott*, 805 S.W.2d 835 (Tex. App. – Waco 1991, writ denied); *Estrada v. Reed*, 98 S.W.2d 1042, 1044 (Tex. Civ. App. – Amarillo 1936, writ refused).

Mischaracterizing Community Property -- If community property is mischaracterized as separate property, then the property is not divided as part of the community estate. If the mischaracterized property has value that would impact the trial court's just and right division, then the mischaracterization is harmful and requires remand back to the trial court for a just and right division of the community estate. *Zeptner v. Zeptner*, 111 S.W.3d 727 (Tex. App. – Fort Worth 2003, no pet.). Alternatively, if the mischaracterized property had a *de minimis* effect on the trial court's just and right division, then the trial court's error is not an abuse of discretion. *Vandiver v. Vandiver*, 4 S.W.3d 300 (Tex. App. – Corpus Christi 1999, no pet.).

IV. METHODS OF TRACING

Texas courts have recognized several different tracing methods and approaches that can be utilized to prove separate property. Approaches to tracing may be covered by case law, accounting practices or logic. Which approach to use depends on the facts of the case. The following is not an exclusive list. So long as the spouse attempting to prove his or her separate property provides “clear and convincing evidence” of the separate property, any tracing approach may be used.

A. Item Tracing

Item tracing is used when tracing noncash assets. *Mortenson v. Trammell*, 604 S.W.2d 269, 274 (Tex. App. – Corpus Christi 1980, writ refused n.r.e.). In order to trace a noncash asset, a party must demonstrate how the original property was obtained and then trace each sale or exchange of it. *Id.*

B. Community Out First Method

The community out first method is applied when separate funds and community funds have been commingled in a single account. This method presumes that community funds are drawn out before any withdrawal of separate funds. *Sibley v. Sibley*, 286 S.W.2d 657, 659 (Tex. Civ. App. – Dallas 1955, writ dismissed); *Welder v. Welder*, 794 S.W.2d 420, 433 (Tex. App. – Corpus Christi 1990, no writ). This method requires each deposit and withdrawal be traced.

Separate funds deposited in a joint account sink to the bottom, and community funds are withdrawn first. *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App. – Houston [14th Dist.] 2003, pet. denied). Withdrawals are presumed to be from separate funds only when all community funds have been exhausted. *Sibley v. Sibley*, 286 S.W.2d 658 (Tex. 1955).

The community out first method may be rebutted by contrary evidence. *Smith v. Smith*, 22 S.W.3d 140, 146 (Tex. App. – Houston [14th Dist.] 2000, no pet.) (court held that the community out first presumption is rebuttable).

C. Minimum Sum Balance Method

The minimum sum balance method is useful for funds on account in which a portion can be conclusively proven to be separate property, such as an account balance immediately prior to marriage, and there have been few and identifiable transactions within the account. 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. *Huval v. Huval*, 2007 WL 1793771 (Tex. App.– Beaumont 2007, no pet.)(mem. op.).

D. Clearinghouse Method

The clearinghouse method is applied when separate funds are temporarily deposited into a community property account and then withdrawn, generally within a short time of each other with no other transactions. When this method is applied, a specific separate property sum is identified as being deposited and the same sum is identified as being withdrawn or exchanged for other property. *See Estate of Hanau v. Hanau*, 730 S.W.2d 663, 666-67 (Tex. 1987) (Probate case where \$6,021 from the sale of separate property stock was used to purchase shares of stock in another company on the same day for \$6,170. The court held \$6,170 in stock was separate property).

E. Identical Sum Inference Method

The identical sum inference method is similar to the clearinghouse method and frequently identified as identical to the clearinghouse method. The identical sum inference may be applied when there is a single deposit and a single withdrawal of an identical or near identical amount. *See McKinley v. McKinley*, 496 S.W.2d 540, 542-43 (Tex. 1973)(Probate case where \$9,500 separate property in an account grew to \$10,453.81 during marriage with no other deposits or withdrawals other than dividends -- those funds were used to purchase a \$10,400 CD; court held \$9,500 of CD was separate property.)

F. Pro Rata Method

The pro rata method is used when an account contains both community and separate funds and a party can prove the character of the account's original balance. If mixed funds are withdrawn from an account, the withdrawal should be pro rata in proportion to the respective balance of the separate property funds and community property funds in the account. Using this approach removes the necessity of analyzing the character of each withdrawal. *Marineau v. Gen. Am. Life Ins. Co.*, 898 S.W.2d 397 (Tex. App. – Fort Worth 1995, writ denied).

G. Exhaustion Method/Family Expense Method

The exhaustion method or family expense method assumes that all money from wages and other income is spent on family living expenses and that separate property is left to be used for the purchase of assets and investments. This method aggregates the community sources and compares them to community expenditures to determine the potential community estate. Cases where the family expense method may be appropriate are factually specific, and this approach may be considered if clear and convincing evidence of separate property is established.

Separate property can be established by showing that on a date that a withdrawal occurs, community property funds were already exhausted on payment of family living expenses. Under this method, the community property money will be used to pay family expenses before separate money will be used for

family expenses. The income figure is often taken from federal income tax information, such as tax returns, tax transcripts, and Social Security earnings records. Then, the amount of income tax on that income is subtracted. What is left is compared to the family living expenses.

In *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App. – Houston [14th Dist.] 2003, pet. denied), the wife challenged the trial court's determination that the husband had separate funds in a disputed account, and she asserted that the funds should have been community property since the account was commingled. The husband provided evidence showing the separate balance prior to marriage, the interest income earned from the account during marriage or \$115,000, and a listing of withdrawals made for living expenses during the same period of \$366,000. The court noted that the wife did not provide evidence rebutting the community out first presumption and decided that, because the withdrawals for community expenses depleted community funds in the account, the husband rebutted the community property presumption.

V. Reimbursement or Disproportionate Division an Alternative When Tracing Fails

A. Reimbursement

A spouse may be able to recover his or her original separate property through reimbursement even though his or her separate property cannot be traced to specific assets. *See Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ dism'd). In *Horlock*, the husband admitted that the proceeds of the sale of his separate property became completely commingled with the community estate. He made no attempt to trace the use of the proceeds of the sale of his separate property into any other transactions. The court determined that the husband was entitled to reimbursement by reason of using his separate funds to enhance, improve and increase the value of the community estate.

B. Disproportionate Division of the Marital Estate

In the event tracing fails, the spouse with the separate property claim could request a disproportionate division of the marital estate in her or her favor. The court in *Monroe v. Monroe*, 358 S.W.3d 711 (Tex. App.—San Antonio 2011, no pet. h.) upheld a disproportionate division of the marital estate in favor of the husband. The court found that without the husband's contributions of his separate property, the value of the community estate would be minimal and that an unequal division of the property was justified because virtually all the community estate was property owned by the husband prior to the marriage.

VI. Tracing Examples

A. Example of Identical Sum Inference Method

Line	Date	Description	Transaction	Total Balance	Transaction		Balance	
					SP	CP	SP	CP
1	12/28/15	Balance date of marriage		\$400,000			\$400,000	
2	01/10/16	Bought Apple 1,000 shares	(\$100,000)	\$300,000	(\$100,000)		\$300,000	
3	02/15/16	Dividend	\$500	\$300,500		\$500	\$300,000	\$500
4	02/20/16	Interest	\$100	\$300,600		\$100	\$300,000	\$600
5	03/01/16	Bonus	\$50,000	\$350,600		\$50,000	\$300,000	\$50,600
6	03/15/16	Bought Apple 500 shares	(\$45,000)	\$305,600		(\$45,000)	\$300,000	\$5,600
7	05/16/16	Property Taxes	(5,000)	\$300,600		(\$5,000)	\$300,000	\$600
8	05/16/16	Nordstrom	(\$600)	\$300,000		(\$600)	\$300,000	--
9	07/01/16	Sold Apple 500 shares	\$50,000	\$350,000	\$50,000	---	\$350,000	---
10	07/15/16	Dividend	\$200	\$350,200		\$200	\$350,000	\$200
11	08/01/16	Initial Capitalization of Entity	(\$50,000)	\$300,000	(\$50,000)	---	\$300,000	\$200
12	08/15/16	Dividend	\$200	\$350,200		\$200	\$350,000	\$200

RESULT – Entity is Separate Property

B. Example of Minimum Sum Balance

Date	Transaction	Credit	Debit	Community	Separate	Total
12/18/16	Date of Marriage				\$500,000	\$500,000
01/16/17	Salary	\$10,000		\$10,000	\$500,000	\$510,000
01/20/17	ATM		(\$400)	\$9,600	\$500,000	\$509,600
02/25/17	Property Taxes		(10,000)	---	\$491,600	\$491,600
02/26/17	Deposit	\$20,000		\$20,000	\$491,600	\$511,600
3/10/17	Nordstrom		(1,000)	\$19,000	\$491,600	\$510,600
4/01/17	Tuition		(\$25,000)	---	\$485,600	\$485,600
4/15/17	IRS		(\$20,000)	---	\$465,600	\$465,600

RESULT: Balance of account is Separate Property

C. Example of Clearinghouse Method

Line	Date	Description	Transaction	Total Balance	Transaction		Balance	
					SP	CP	SP	CP
1	12/28/15	Opening Deposit		\$400,000		\$400,000		\$400,000
2	01/10/16	Deposit Bonus	\$100,000	\$500,000		\$500,000		\$500,000
3	02/15/16	Dividend	\$500	\$500,500		\$500		\$500,500
4	02/20/16	Interest	\$100	\$500,600		\$100		\$500,600
5	03/01/16	Gift from Mom	\$50,000	\$550,600	\$50,000		\$50,000	\$500,600
6	03/15/16	Gift from Dad	\$50,000	\$600,600	\$50,000		\$100,000	\$500,600
7	05/16/16	Property Taxes	(10,000)	\$590,600		(\$10,000)	\$100,000	\$490,600
8	05/16/16	Nordstrom	(\$600)	\$590,000		(\$600)	\$100,000	\$490,000
9	07/01/16	Inheritance	\$100,000	\$690,000	\$100,000	---	\$200,000	- \$490,000
10	07/15/16	Dividend	\$200	\$690,200		\$200	\$200,000	\$490,200
11	08/01/16	Purchase of CD	(\$200,000)	\$490,000	(\$200,000)	---	---	\$490,200
12	08/15/16	Dividend	\$200	\$490,200		\$200	---	\$490,200

RESULT – CD is Separate Property

D. Example of Pro Rata Approach

Pro Rata Approach

Date	Description	Total	Transaction		Total	Cumulative		Sep Prop %
			Separate	Community		Separate	Community	
12/18/16	Opening Deposit	900,000.00	700,000.00	200,000.00	900,000.00	700,000.00	200,000.00	77.78%
01/16/17	Employment Bonus	75,000.00		75,000.00	975,000.00	700,000.00	275,000.00	71.79%
01/18/17	Pay Off Debts	(250,000.00)	(179,487.18)	(70,512.82)	725,000.00	520,512.82	204,487.18	71.79%
01/20/17	Lake House Purchase	(725,000.00)	(520,512.82)	(204,487.18)	0.00	0.00	0.00	

Debt payment was 71.79% separate property and 28.21% Community Property.

Lake House Purchase was 71.79% separate property and 28.21% Community Property.

Comparing Community Out First Approach to Pro Rata Approach

Date	Description	Total	Transaction		Total	Cumulative		Sep Prop %
			Separate	Community		Separate	Community	
12/18/16	Opening Deposit	900,000.00	700,000.00	200,000.00	900,000.00	700,000.00	200,000.00	77.78%
01/16/17	Employment Bonus	75,000.00		75,000.00	975,000.00	700,000.00	275,000.00	71.79%
01/18/17	Pay Off Debts	(250,000.00)	-	(250,000.00)	725,000.00	700,000.00	25,000.00	96.55%
01/20/17	Lake House Purchase	(725,000.00)	(700,000.00)	(25,000.00)	0.00	0.00	0.00	

Debt payment was 0% separate property and 100% Community Property.

Lake House Purchase was 96.55% separate property and 3.45% Community Property.

E. Example of Community Out First

SEE APPENDIX C – Tracing Report

F. Exhaustion Method/Family Expense Method

Example 1

H and W married 20 years. Premarital agreement provided earnings from employment would be CP. H's income from employment during marriage was \$5 Million.

Further Relevant Facts:

07/16/94 – Date of Marriage
02/16/98 – Purchased Marital Residence
06/16/04 -- Purchased investment in ABC stock for \$50,000
06/16/06 – Sold investment in ABC stock sold for \$14 Million
01/25/07 – Teton, LP formed – owns beach house purchased for \$4 Million

H's Arguments:

All assets were purchased his SP since community expenses exceeded community income.

Family expenses were estimated by reconstructing living expenses.

Teton, LP was capitalized with the beach house which was purchased with SP under the family expense method, and therefore Teton, LP is SP.

W's Arguments:

House is CP since it was purchased with H's income and a CP Note.

CP was available at time house and other investments were purchased.

Funds to purchase beach house came an account which contained presumptively CP funds.

Proceeds from ABC stock are CP since the stock was purchased with presumptively CP.

There are no SP funds in any account that were identified to be H's SP. There were multiple bank accounts that were used throughout the 20-year marriage.

Example 2

H came into the marriage with \$60 million in cash. H received wages for only the first 2 years of marriage and retired after that. Premarital agreement provided that income from SP was SP. The financial expert looked at wages and family expense for the first 2 years of marriage. H argues that there is no CP after the first 2 years of marriage, so only SP was used to purchase investments.

Community Sources	
Compensation	\$650,000
Community Debt Related to House	\$1,000,000
Total Sources from Date of Marriage	\$1,650,000
Select Community Uses for 1st 2 years of marriage	
Taxes and Withholding	(\$125,000)
Repay Community Debt Related to House	(1,000,000)
Credit Card payments for 1 st 2 years of marriage	(600,000)
Select Community Uses for 1st 2 years of marriage	(1,725,000)
Net Community Sources/(Uses) after 1st 2 years of marriage	(75,000)

VII. Tracing Issues and Scenarios

A. Tracing Stocks

Example:

W owns 100 shares of stock that are 80% her SP.

W purchased 100 shares that are CP.

Result – 200 shares that are, on average, 40% SP.

Possible tracing approaches:

Weighted Average – The shares are on average 40% W's SP, but they are indistinguishable so each share is 40% W's SP.

If 50 shares are sold, they are 40% W's SP.

If 100 shares are sold, they are 40% W's SP.

If 150 shares are sold, they are 40% W's SP.

Community Out First – Using community out first, if 160 shares are sold, the first 120 shares sold are CP. 40 shares are W's SP, and the remaining 40 shares are W's SP.

Looking at Cost Basis – The IRS requires reporting of the cost basis of shares sold in addition to the sales prices of shares sold. Many brokerage firms have a default that will use the oldest shares sold first. Are you required to use the basis reported by the brokerage company on your tax returns, or can you enclose a note explaining why you are doing something different? Mutual funds have capital gain and income reinvestments every quarter which could make this process difficult. Selling 100 shares and matching the tax basis could be a difficult.

B. Line Item Tracing – Is it Always Necessary?

Is it always necessary to do an expensive line item tracing? With a line item tracing, a running balance of the CP and SP within an account is created. However, there are other alternatives that may meet the clear and convincing standard.

Example: \$1 Million is deposited into a new brokerage account – it is 45% SP.

In the first month, the \$1 Million is invested in 200 different stocks – there were 500 transactions because the stock was purchased in small increments.

During the month there was \$6,000 of interest and dividends.

During the month the stock portfolio increased in value by \$3,333.

Rather than an expensive line item tracing, the following **weighted average approach** is another option:

	Transaction			Cumulative			
	Total	Separate	Community	Total	Separate	Community	
Beginning Balance				-	-	-	
Deposits	1,000,000.00	450,000.00	550,000.00	1,000,000.00	450,000.00	550,000.00	45.0%
Increase in Value	3,333.00	1,499.85	1,833.15	1,003,333.00	451,499.85	551,833.15	45.0%
Interest & Dividends	6,000.00		6,000.00	1,009,333.00	451,499.85	557,833.15	44.7%
Withdrawals							

The result is the entire brokerage account is 44.7% SP. The result could be close to a line item tracing looking at the diversified portfolio.

Looking at the second month -- same situation where several stocks were bought and sold. The increase in value is the same and the dividends are the same, however, \$15,000 is withdrawn.

Deposits	-	-	-	1,009,333.00	451,499.85	557,833.15	44.7%
Increase in Value	3,333.00	1,490.93	1,842.07	1,012,666.00	452,990.78	559,675.22	44.7%
Interest & Dividends	6,000.00		6,000.00	1,018,666.00	452,990.78	565,675.22	44.5%
Withdrawals	(15,000.00)	(6,670.35)	(8,329.65)	1,003,666.00	446,320.43	557,345.57	44.5%

Note that community out first is not used to take the cash, which would be an advantage to the SP estate. However, the tracing is done at a fraction of the cost.

Some brokerage firms have many transactions in the accounts which makes tracing complicated. For example, if a client invests \$1 Million with a brokerage firm, rather than buy 20 different stocks for \$50,000 each, they buy 500 stocks for \$2,000 each.

C. Transactions Occurring on the Same Day

In tracing separate property within an account, assume that on the same day the following occurs:

1. Cash is deposited to an account;
2. Stock is sold;
3. Stock is purchased;
4. Interest is paid;
5. Dividends are paid; and
6. Withdrawals were made from the account.

If the brokerage statement does not give the specific order of the transactions, what should be the order of the transactions when doing a tracing? Should it matter if the order greatly favors the community estate or a party's separate estate?

Some experts look at the money coming in first: cash, stock purchases, interest and dividends. Then sales and withdrawals are considered. Can experts "reorder" transactions for a particular outcome? What supporting evidence is required? If using community out first, the cash withdrawals occur before the stocks are purchased. This would result in a higher likelihood that the community would leave the account and only separate property would be reinvested.

D. Margin Loans

Can the securities that a spouse purchases on a margin loan be considered SP if the securities in that account are SP? If the bank looked only to the spouse's SP to repay the loan, it seems the loan and the purchased securities should be considered SP, especially if the margin account agreement was signed prior to the marriage. If collecting the margin debt is limited to the funds and assets in the account, an argument can be made that the credit is separate credit. If the margin loan is CP, when the loan is paid off with SP, the spouse claiming the SP may have a reimbursement claim.

This is similar to a spouse who uses SP funds for a down payment on real estate and the creditor looks only to that spouse's SP estate for repayment, then that property's character is SP even though purchased during the marriage.

E. Lost Brokerage Account Statements

If a spouse believes that he or she owned shares of stock before the marriage, it may be possible to prove SP by clear and convincing evidence even if the spouse no longer has the brokerage statements. Perhaps the spouse's tax returns that reflect dividends paid on the stock before the marriage can be compared to historical data from the time before the marriage to reflect dividend rates, and these rates can be used to match the dividend income.

F. Example of Mixed Character of Real Estate Acquired During Marriage

During marriage, H and W buy a house for \$800,000 as follows:

Down Payment from H's SP:	\$160,000 (20%)
Note – CP	<u>\$640,000</u> (80%)
Total Value When Acquired:	\$800,000

The house is characterized as 20% H's SP, and 80% CP.

House sells 10 years later for \$900,000.

H's 20% interest (20% x \$900,000):	\$180,000
CP 80% interest (80% x \$900,000):	\$720,000
Balance of CP note:	\$500,000

Closing costs = 8% x \$900,000 = \$ 72,000

Pro Rata of Closing Costs:

SP share – 20% x \$72,000 =	\$ 14,400
CP share – 80% x \$72,000 =	\$ 57,600

Amount due to H's SP estate:	\$180,000
Less share of closing costs:	<u>-\$ 14,400</u>
Net to H's SP estate:	\$165,600

Amount due to CP estate:	\$720,000
Less share of closing costs:	-\$ 57,600
Less balance owed on CP Note:	<u>-\$500,000</u>
Net to CP:	\$162,400

Summary:

Sales Price:	\$900,000
Less closing costs:	-\$ 72,000
Less Note Balance:	<u>-\$500,000</u>
Net Sales Proceeds:	\$328,000

Portion of Net Proceeds to H

H's SP	\$165,600
One-half of CP	<u>\$ 81,200</u>
Total to H:	\$246,800

Portion of Net Proceeds to W

One-half of CP	\$ 81,200
Total to W:	\$ 81,200

G. Example of Mixed Character of Real Estate Acquired During Marriage – No Change in Values

Same example as above, except that house sells for the **exact same amount as the purchase price and the mortgage remains the same. Closing costs are not included for illustration purposes.**

During marriage, H and W buy a house for \$800,000 as follows:

Down Payment from H's SP:	\$160,000 (20%)
Note – CP	<u>\$640,000</u> (80%)
Total Value When Acquired:	\$800,000

The house is characterized as 20% H's SP, and 80% CP.

House sells 10 years later for \$800,000.

H's 20% interest (20% x \$800,000):	\$160,000
CP 80% interest (80%x \$800,000):	\$640,000
Balance of CP note:	\$640,000

Summary:

Sales Price:	\$800,000
Less Note Balance:	<u>-\$640,000</u>
Net Sales Proceeds:	\$160,000

Portion of Net Proceeds to H

H's SP	\$160,000
Total to H:	\$160,000

Portion of Net Proceeds to W

One-half of CP	\$0
Total to W:	\$0

NOTE: This example is included due to the mistake this author has seen others make where the separate property percentage is taken from the **net proceeds**, rather than the **gross proceeds**. Obviously, this would create an inequitable result for the spouse who used his or her separate property for the down payment.

H. Annuities

Example – H acquired an annuity contract for \$340,000 during marriage using separate property. The annuity has a value of \$370,000 on the date of divorce. If the contract is SP, does the increased investment value remain SP?

Investments in annuities do not distinguish between capital gains, dividends and interest. All income and increase in value simply increase the value of each unit.

Is the subtraction method available where the CP portion is the difference between the value at the date of the marriage and the value at the date of divorce?

I. Creation of New Entity During Marriage

How can a new entity be created during marriage with a SP entity such that the new entity will also be SP? The formation documents should indicate that the entity interest is received in exchange for an identified payment which is SP or that it is capitalized with SP. The CP presumption is applicable to the acquisition of an interest in an entity. Absent clear and convincing evidence, tracing the funds or assets used to acquire an interest in an entity, it will be presumed to be CP.

Example:

H owned an interest in a partnership before marriage, and during the marriage the assets of the were transferred to a newly-created corporation. The corporate documents provide that H is to receive 100% of the shares in exchange for \$1,000. Is the stock in the new corporation SP or CP. What if there is no record of the check?

J. 401k Plans

According to the Texas Family Code, a spouse's separate property interest in a defined contribution plan (such as 401(k) plans, employee stock ownership plans, profit-sharing plans and money-purchase plans) can be determined using the characterization rules that apply to non-retirement assets, namely the inception of title rule and tracing. Tex. Fam. Code §3.007(c). The ability to trace through the account can be beneficial to clients whose retirement accounts have grown significantly due to investments and growth of assets in the account. However, tracing through years of statements and transactions can be cost prohibitive and possibly impossible if statements are not available.

Another issue is that frequently defined contribution plan providers do not provide the appropriate data to perform a tracing with the statements they provide to plan participants. Since the statute states that a defined contribution retirement plan "may" be traced using tracing principles, other less costly methods could possibly also be used. Without the data to trace through the account, the subtraction method is available to show the balance of the account at the date of marriage. It may also be an option to try to show the appreciation by tying it to growth tables.

Example:

H and W each have a 401k at time of marriage with approximately \$300,000 in each. Neither spouse made contributions during the marriage. Both are worth \$500,000 today. H traced \$450,000 to be his SP, however, W could not trace so she could only use the subtraction method.

Example:

Value of 401k at date of marriage: \$200,000.

Contributions during marriage: \$200,000.

Value at date of Divorce: \$800,000.

If the data is not available to do a line item tracing, the separate estate is limited to \$200,000. If the data were available, a simple tracing could yield 400,000 to \$500,000 of SP.

VIII. BURDEN OF PROOF TO ESTABLISH SEPARATE PROPERTY: CLEAR AND CONVINCING EVIDENCE

Property possessed by either spouse during the marriage is presumed to be community property. TEX. FAM. CODE ANN. § 3.003(a). The burden of proof required to establish separate property is clear and convincing evidence. TEX. FAM. CODE ANN. § 3.003(b).

Clear and convincing evidence is defined as that measure or degree of proof that will produce in the mind of the trier of fact, a firm belief or conviction as to the truth of the allegations sought to be established. *D.B. v. K.B.*, 176 S.W.3d 343 (Tex. App. – Houston [1st Dist.] 2004, pet. denied); *Stavinoha v. Stavinoha*, 126 S.W.3d 604 (Tex. App. – Houston [14th Dist.] 2004, no pet.); *Tate v. Tate*, 55 S.W.3d 1 (Tex. App. – El Paso 2000, no pet.).

Mere testimony that property purchased with separate property funds without any tracing of the funds, has been held to be insufficient to rebut the community property presumption. *McElwee v. McElwee*, 911 S.W.2d 182, 188 (Tex. App. – Houston [1st Dist.] 1995, no writ). Because all property possessed by either spouse during or upon dissolution of the marriage is presumed to be community property, a party making a separate property claim must trace and clearly identify the claimed separate property. *Cockerham v. Cockerham*, 527 S.W.3d 162, 167 (Tex. 1975); *Tarver v. Tarver*, 394 S.W.2d 780 (Tex. 1965).

The existence of separate property may be presented by lay testimony, expert testimony, documentation, or a combination thereof. However, it is up to the trier of fact to determine whether the evidence presented will be sufficient to constitute clear and convincing evidence.

IX. LAY TESTIMONY

A spouse is competent to testify about the character of his or her property, but, because the spouse is an interested witness, the testimony will generally require corroboration by other evidence, such as testimony of another witness or documentation. *Burgess v. Burgess*, No. 09-06-301 CV (Tex. App. – Beaumont 2007, no pet.) (memo op.; 5-24-07); *Warriner v. Warriner*, 394 S.W.3d 240, 248 (Tex. App. – El Paso 2012, no pet.) (sworn inventory without other documentation of inheritance was insufficient because inventory was a form of testimony); *Robles v. Robles*, 965 S.W.2d 605, 619-20 (Tex. App. – Houston [1st Dist.] 1998, pet. denied) (testimony that property was inherited was insufficient without copy of will).

Merely asserting on sworn inventory property is SP is insufficient to establish that fact – additional evidence is required. *Warriner v. Warriner*, 394 S.W.3d 240 (Tex. App.– El Paso 2012, no pet.). An Inventory is hearsay, however, TRE 803(15) establishes a hearsay exception for “a statement contained in a document that purports to establish or affect an interest in property if the matter stated was relevant to the documents purpose – unless later dealings with the property are inconsistent with the trust of the statement or purport of the document.” *Howe v. Howe* 551 S.W.3d 236 (Tex. App.—El Paso 2018, no pet.). The *Howe* court further points out that TRC 6.502(a)(1) requires the parties to file sworn inventories.

Uncorroborated and contradicted testimony will generally not constitute clear and convincing evidence. *Monroe v. Monroe*, 358 S.W.3d 711, 718 (Tex. App. – San Antonio 2011, pet. denied); *Pace v. Pace*, 160 S.W.3d 706, 714 (Tex. App. – Dallas 2005, pet. denied); *Boyd v. Boyd*, 131 S.W.3d 605, 615-17 (Tex. App. – Fort Worth 2004, no pet.); *Kirtley v. Kirtley*, 417 S.W.2d 847, 853 (Tex. App. – Texarkana 1967, writ dismissed); *Sink v. Sink*, 364 S.W.3d 340 (Tex. App.– Dallas 2012, no pet.) (mere testimony that certain property is separate property insufficient to overcome community property presumption – a spouse claiming separate property must point to specific evidence to support separate property claims).

However, some courts have held that the uncorroborated and uncontradicted assertion of a spouse that property is his or her separate property will rise to the level of being clear and convincing evidence and support a finding of separate property. *Celso v. Celso*, 864 S.W.2d 652, 655 (Tex. App. – Tyler 1993, no writ) (finding that when evidence is uncontroverted that husband’s separate assets were used to purchase house, then evidence is clear and convincing that husband traced the purchase of the house to his separate property assets); *Faram v. Gervitz-Faram*, 895 S.W.2d 839, 843 (Tex. App. – Fort Worth 1995, no writ) (Wife’s testimony sufficient to trace investment account and treasury bill when no contradicting evidence existed).

Most circumstances require documentation, in addition to competent testimony, to meet the clear and convincing evidence burden. *Bahr v. Kohr*, 980 S.W.2d 723, (Tex. App. – San Antonio 1998, no pet.) (Appellee “provided no documentation showing the date the money market account was opened, the beginning balance, or debits and credits to the account. Thus, the [appellee] failed to trace, by clear and convincing evidence”); *Robles v. Robles*, 965 S.W.2d 605, 620 (Tex. App. – Houston [1st Dist.] 1998, pet. denied) (testimony and a cancelled check was not sufficient to prove property was purchased from an inheritance since a will was not introduced into evidence).

X. EXPERT TESTIMONY

A. Court as the Gatekeeper

In Texas, the trial court has the discretion to admit or exclude expert testimony. *Exxon Pipeline v. Zwahr*, 88 S.W.3d 623, 629 (Tex. 2002). When expert testimony is involved, courts are to rigorously examine the validity of facts and assumptions on which the testimony is based, as well as the principles, research, and methodology underlying the expert’s conclusions and the manner in which the principles and methodologies are applied by the expert to reach the conclusions. *Whirlpool Corp. v. Comacho*, 298 S.W.3d 631, 637 (Tex. 2009).

B. Admissibility of Expert Testimony in Characterizing and Tracing Property

An expert witness may testify regarding scientific, technical, or other specialized matters if the expert is qualified, the expert’s opinion is relevant, the opinion is reliable, and the opinion is based on a reliable foundation. See TEX. R. EVID. 702; *Whirlpool Corp. v. Comacho*, 298 S.W.3d 631, 637 (Tex. 2009). Expert testimony can be used to establish the character of property. See *Beard v. Beard*, 49 S.W.3d 40, 61-62 (Tex. App. – Waco 2001, pet. denied) (CPA traced party’s separate property by using the community-out-first method). Experts are frequently used in cases when assets have been commingled and when the property itself is unique in nature. See, e.g., *Welder v. Welder*, 794 S.W.2d 420, 428-29 (Tex. App. – Corpus Christi 1990, no writ.) (experts traced deposits and withdrawals from spouses’ joint account). Experts must satisfy the qualification rules set forth in TEX. R. EVID. 702.

Specifically, expert testimony is admissible if (1) the expert is qualified, (2) it helps the factfinder determine a fact in issue, (3) it is relevant, (4) it is reliable, (5) it is based upon a reliable foundation, and (6) it does not violate Texas Rule of Evidence 403. See TEX. R. EVID. 402, 403, 702; *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 588-592 (1993); *Whirlpool Corp. v. Comacho*, 298 S.W.3d 631, 637-38 (Tex. 2009); *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 718 (Tex. 1998); *E.I. du Pont de Nemours & Co. v. Robinson*, 923 S.W.2d 549, 554-57 (Tex. 1995). The requirements listed above must be met by a preponderance of evidence. See *Bourjaily v. U.S.*, 483 U.S. 171, 175 (1987).

The proponent of the testimony has the burden to lay the proper predicate to establish the expert is qualified and reliable and the expert testimony will assist the factfinder in determination of the issue at hand. *Broders v. Heise*, 924 S.W.2d 148, 153 (Tex. 1996).

In *Gammill*, the Court set out six factors to test the reliability of the underlying scientific technique or principle of an expert's testimony, as follows: (1) the extent to which the theory can be tested, (2) the extent to which the technique relies upon the subjective interpretation of the expert, (3) whether the theory has been subjected to peer review or publication, (4) the potential rate of error of the technique, (5) whether the underlying theory or technique has been generally accepted as valid by the relevant scientific community, and (6) the non-judicial uses which have been made of the theory or technique. *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 720 (Tex. 1998).

C. Expert Testimony and the Law

A witness is not authorized to offer an opinion on a pure question of law. *See Birchfield v. Texarkana Memorial Hosp.*, 747 S.W.2d 361, 365 (Tex. 1987); *Mega Child Care, Inc. v. Texas Dep't of Protective & Reg. Servs.*, 29 S.W.3d 303, 309 (Tex. App. – Houston [14th Dist.] 2000, no pet.). The reasoning behind this distinction is because the trial judge, because of the judge's specialized training and experience, is better equipped to determine questions of law and instruct the jury accordingly. *Withrow v. Shaw*, 709 S.W.2d 759, 760 (Tex. App. – Beaumont 1986, writ ref'd n.r.e.); *Collins v. Gladden*, 466 S.W.2d 629 (Tex. Civ. App. – Beaumont 1971, writ ref'd n.r.e.).

An expert witness may state an opinion on a mixed question of law and fact if the opinion is limited to the relevant issues and based on proper legal concepts. *GTE Southwest, Inc. v. Bruce*, 998 S.W.2d 605, 619-20 (Tex. 1999); *Greenberg Traurig of New York, P.C. v. Moody*, 161 S.W.3d 56, 94 (Tex. App. – Houston [14th Dist.] 2004, no pet.). An issue involves a mixed question of law and fact when a standard or measure has been fixed by law and the question is whether the person or conduct measures up to that standard. *Mega Child Care, Inc. v. Texas Dep't of Protective & Regulatory Servs.*, 29 S.W.3d 303, 309 (Tex. App. – Houston [14th Dist.] 2000, no pet.).

An expert may refer to the underlying legal principle used in tracing property, but the expert may not testify regarding the expert's understanding or interpretation of case law concerning the legal principle. *Welder v. Welder*, 794 S.W.2d 420, 433 (Tex. App. – Corpus Christi 1990, no writ).

XI. DOCUMENTATION NEEDED TO REBUT COMMUNITY PROPERTY PRESUMPTION

The evidence necessary to support a separate property claim depends on the specific facts of each case. In most circumstances, documentation, lay witness testimony, and expert witness testimony, will be necessary to rebut the community property presumption by clear and convincing evidence.

The most important documents necessary to rebut the community property presumption are those which establish the time and manner which the property was acquired and any later sales or exchanges of the property. *See, e.g., Phillips v. Phillips*, 296 S.W.3d 656, 677 (Tex. App. – El Paso 2009, pet. denied) (to prove character of CD, husband provided financial documents reflecting deposits to and withdrawals from separate property accounts); *Bahr v. Kohr*, 980 S.W.2d 723, 730 (Tex. App. – San Antonio 1998, no pet.) (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 into account); *Robles v. Robles*, 965 S.W.2d 605, 619-20 (Tex. App. – Houston [1st Dist.] 1998, pet. denied) (testimony that property was inherited was insufficient without copy of will); *Tucker v. Tucker*, No. 13-11-00056-CV (Tex. App. – Corpus Christi 2013,

pet. denied) (memo op.) (to prove character of ownership interest in company, husband provided dated promissory note and updated stockholders' ledger).

Financial experts may use accounting schedules, charts, or other demonstrative evidence to help the jury follow the tracing of property. *Boyd v. Boyd*, 131 S.W.3d 605, 609 (Tex. App. – Fort Worth 2004, no pet.).

XV. CONCLUSION

In conclusion, there are many approaches to trace separate property, and a tracing expert has an important role in assisting parties to prove his or her separate property by clear and convincing evidence.