

HANDBOOK ON TEXAS MARITAL PROPERTY LAW FOR ESTATE ADMINISTRATION AND PLANNING

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. MARITAL PROPERTY CHARACTERIZATION 1

 A. Article XVI, Sec. 15 1

 B. The Test for Community 2

 C. Community Presumption..... 2

 D. Traditional Means of Creating Separate Property 3

 E. 1980 Amendment 3

 F. Mixed Characterization..... 4

 G. Commingling..... 4

 H. Life Insurance..... 5

 I. Quasi-Marital Property 5

 J. Personal Injury Recoveries 5

 K. Observations..... 6

III. MARITAL PROPERTY MANAGEMENT 6

 A. Matrimonial Property Act, 1967 6

 B. Texas Family Code..... 6

 C. Special Community Property 6

 D. Presumptions 7

 E. Record Title..... 7

IV. MARITAL PROPERTY LIABILITY 8

 A. Statutory Rules 8

 B. Other Factors 9

 C. Child Support 9

 D. The Necessaries Doctrine..... 10

 E. Spousal Necessaries Cases 10

 F. No Community Debt 11

 G. Summary 11

 H. Key Questions 11

V. EFFECT OF DIVORCE 12

 A. Claims for Reimbursement..... 12

 B. Fraud on the Community..... 12

 C. Liabilities..... 13

 D. Court Ordered Child Support 13

 E. Redesignation Statutes 13

**Handbook on Texas Marital Property Law
For Estate Administration and Planning**

VI.	DEATH OF SPOUSE.....	13
A.	Marital Liabilities.....	14
B.	The Court’s Explanation	14
C.	Probate v. Nonprobate.....	15
D.	Chapter 101	16
E.	Deceased Spouse’s Debts.....	16
F.	Administration of Community Property	17
G.	Intestate Death.....	17
H.	Testamentary Power.....	18
I.	Express or Implied Election.....	18
J.	Protection for Surviving Spouse	18
K.	Authority of Surviving Spouse – No Personal Representative	19
VII.	ADMINISTRATION OF DECEASED SPOUSE’S ESTATE.....	20
A.	Section 453.009.....	20
B.	Authority of Representative	20
C.	Executor’s Elective Power	20
D.	Comparing Family Code and Estates Code Provisions.....	20
E.	Authority of the Surviving Spouse.....	21
F.	Allocation of Liabilities after Death	21
G.	Closing the Estate	22
VIII.	SURVIVING SPOUSE’S DEBTS	23
A.	Section 101.052.....	23
B.	Secured Debts.....	23
C.	Unsecured Debt.....	24
D.	The Rationale	24
E.	Summary	24
F.	Another Argument	25
IX.	CREDITORS’ RIGHTS DURING THE MARRIAGE.....	25
A.	Joint and Several Liability.....	25
B.	Tort Debt of One Spouse.....	25
C.	Contract Debt of One Spouse.....	25
D.	Observations.....	26
E.	Equitable Principles.....	26

**Handbook on Texas Marital Property Law
For Estate Administration and Planning**

X.	KEY MARITAL PROPERTY CONCEPTS	26
A.	The Community Presumption	26
B.	Community Claims for Reimbursement	26
C.	Special Community Property	27
D.	Fraud on the Community.....	27
E.	Marital Liabilities.....	27
F.	Death of a Spouse	27
G.	Fraud/Reimbursement Claims.....	28
H.	Claimant as the Surviving Spouse.....	28
I.	Closing the Estate	28
J.	Non-Pro Rata Distributions.....	29
XI.	CONSEQUENCES OF MARRIAGE.....	29
A.	Existing Assets	29
B.	Future Acquisitions	29
C.	Unilateral Gifts/"Fraud"	29
D.	Reimbursement Issues.....	29
E.	Debts.....	29
F.	The Necessaries Doctrine.....	30
G.	Possible Divorce.....	30
H.	Eventual Death of First Spouse.....	30
I.	Portability.....	30
J.	To He_ _ (Double Hockey Sticks) With This!	31
XII.	UNILATERAL PLANNING.....	31
A.	Segregated Accounts	31
B.	Avoid Inadvertent Commingling	31
C.	401(k) Plans.....	32
D.	Earmark Future Holdings.....	32
E.	Family Entities	32
F.	Closely Held Business Interests.....	32
G.	Asset Protection Trusts.....	32
H.	Fraud on the Community/Reimbursement Issues	33
I.	Take Advantage of Portability	33
J.	Legal Fees	33
XIII.	PREMARITAL AGREEMENTS – FORMALITIES.....	33
A.	Uniform Premarital Agreement Act.....	33
B.	Formalities.....	34
C.	Burden of Proof.....	34
D.	The Opponent’s Burden	34
E.	Statute of Limitations.....	35
F.	Disclosure/Assistance of Counsel.....	35
G.	Re-execution Once Married	35

**Handbook on Texas Marital Property Law
For Estate Administration and Planning**

XIV. PREMARITAL AGREEMENTS – SUBSTANCE.....	36
A. Mere Agreement Rule	36
B. Constitutional Amendments.....	36
C. Sec. 4.003, Texas Family Code.....	36
D. Standard Provisions.....	37
E. Income from Separate Property.....	37
F. Wages, Salaries, Personal Earnings.....	37
G. Partition and Exchange.....	38
H. Community Free Marriage.....	38
I. Division of Property upon Divorce.....	40
J. Contracts Concerning Succession.....	40
K. Homestead, Exempt Personal Property and Allowances	40
L. The Universal Community.....	41
M. Preserving Portability.....	41
N. Addressing the Mutual Duty of Support	42
XV. EFFECTIVENESS OF THE PRENUPTIAL AGREEMENT.....	42
A. Necessaries	42
B. Child Support	42
C. Tax Liability.....	42
D. Spousal Torts.....	42
E. Joint Ventures.....	43
F. Preexisting Creditors.....	43
G. U.F.T.A. and the Bankruptcy Code.....	43
H. ERISA Plans.....	43
I. Trap for the Unwary.....	44
J. Future Legislative Changes.....	44
K. Lost Income Tax Basis.....	44
XVI. WAIVING SPOUSAL SUPPORT	44
A. Texas Premarital Agreement Act.....	45
B. The Community-Free Marriage	45
C. Effect of Support Waiver	45
D. Reimbursement Between Spouses	46
E. “Spousal Support”	46
F. But Texas Doesn’t Have Alimony!.....	46
G. Texas Maintenance.....	46
H. UPAA Comments.....	47
I. Other States’ Laws.....	47
J. UPAA – Texas Version	47

**Handbook on Texas Marital Property Law
For Estate Administration and Planning**

XVII. AGREEMENTS DURING MARRIAGE.....	48
A. 2003 and 2005 Legislation	48
B. Formalities.....	49
C. Transmutation.....	49
D. Survivorship Agreements.....	51
XVIII.FAMILY BUSINESS PLANNING.....	51
A. Entity Theory.....	51
B. Distributed Profits	52
C. Comparison to Corporations	52
D. Corporate Veil Piercing.....	52
E. Texas Pattern Jury Charge.....	53
F. Convert Sole Proprietorships	53
G. Partnership Formation	53
XIX. MARITAL PROPERTY RIGHTS IN IRREVOCABLE TRUSTS	54
A. The Private Express Trust	54
B. Beneficial Ownership.....	55
D. Settlor’s Retained Interest	56
E. Interests of the Non-Settlor Beneficiary.....	57
F. Spendthrift Trust	58
G. Powers of Appointment.....	58
XX. PLANNING FOR DESCENDANTS	59
A. Segregated Accounts	59
B. Avoid Inadvertent Commingling	59
C. Separate Investments.....	59
D. Family Entities	60
E. Asset Protection Trusts.....	60
XXI. NON-PRO RATA DISTRIBUTION OF THE COMMUNITY	60
A. Non-Pro Rata Division	61
B. Effect on Nonprobate Assets.....	61
C. Tax Consequences.....	61
D. IRS Income Tax Position	61
E. Marital Agreement Approach.....	62
F. The Revocable Trust Approach	62
G. Safe Harbor Approach.....	62

**Handbook on Texas Marital Property Law
For Estate Administration and Planning**

XXII	COMMUNITY PROPERTY IN.....	63
	THE REVOCABLE TRUST	63
A.	Professional Responsibility	63
B.	Creation and Funding	63
C.	Distributions	64
D.	Power of Revocation	64
E.	Subsequent Incapacity of a Settlor	65
F.	Effect of Subsequent Divorce	66
G.	Death of First Spouse	67
H.	Survivor's Interests	67
I.	Planning Considerations	67
J.	Community Property Basis	68
K.	Non-Pro Rata Division	68
XXIII.	PLACING THE HOMESTEAD AND OTHER EXEMPT PROPERTY IN	
	A REVOCABLE TRUST	68
A.	Exemption from Creditors.....	68
B.	Survival of the Separate Property Homestead.....	69
C.	Creditor's Rights	70
D.	Community Property Homestead	70
E.	Exempt Personal Property	71
F.	Allowances	71
G.	Probate Claims Procedures.....	72

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I. INTRODUCTION

Preparing a handbook for marital property issues from a Trust & Estates perspective is a real challenge in view of the many possible situations that can arise in estate planning and administration. The approach taken starts with a substantive review of the foundational principles of Texas marital property law (Chapter II, characterization, Chapter III, management, and Chapter IV, liabilities).

The next part of this paper, Chapters V through VIII, gives an overview of what happens when a marriage terminates by divorce or death. The following three chapters, Chapters IX through XI, address areas of the law unique to Texas to be considered prior to marriage. Chapters XII through XVII discuss premarital and marital planning opportunities.

Chapters XVIII and XIX discuss family businesses and irrevocable trusts.

The outline concludes with chapters dealing with unique planning opportunities, including non-pro rata distributions, revocable trusts and the Texas homestead.

II. MARITAL PROPERTY CHARACTERIZATION

The Supreme Court of Texas in *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799 (1925) and *Kellett v. Trice*, 95 Tex. 160, 66 S.W. 51 (1902) made it clear to practitioners and the legislature that it is the Texas Constitution which ultimately defines what is separate or community property and not the legislature or the parties involved. Accordingly, in order to properly characterize marital assets in Texas, it is

necessary to understand the relevant provision of the Texas Constitution, Article XVI, Sec. 15 (eff. Jan 1, 2000).

A. Article XVI, Sec. 15

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

or both of them shall be the spouses' community property.

B. The Test for Community

It is important to note that the Constitution does not define community property. *Arnold v. Leonard, supra*, explained the significance of the Texas constitutional approach to characterization: if an asset does not fall within the constitutional definition of separate property, it must be community property — "the rule of implied exclusion." A logical extension of this rule leads to a more practical definition for the term "community property": *that property of the marriage which is not proven to be separate property. See II, C, infra.*

1. *Graham v. Franco*

The court in *Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972), resorted to a more historical Spanish/Mexican approach and affirmatively defined community property as ". . . that property is community which is acquired by the works, efforts, or labor of the spouses. . . ." *See also Whittlesey v. Miller*, 572 S.W.2d 665 (Tex. 1978); *Bounds v. Caudle*, 560 S.W.2d 925 (Tex. 1977).

2. Income from Separate

The rationale of *Graham v. Franco, supra*, would suggest that any income generated by a spouse's separate property would be the owner's separate property. However, the general rule concerning income from separate property is that it is community property, placing Texas in a minority position among the community property states.

3. Traceable Mutations

Arnold v. Leonard's "rule of implied exclusion" would suggest that property

purchased with separate property during a marriage would be community property. However, Texas courts, going all the way back to *Love v. Robertson*, 7 Tex. 6 (1855) and *Rose v. Houston*, 11 Tex. 323 (1854), have consistently held that such property is a "traceable mutation" of the consideration used to acquire the property. Thus, the character of separate property is not changed by a sale, exchange or change in form. *Texas Pattern Jury Charges*, PJC 202.4 (2016).

Note: Absent an agreement of the parties and notwithstanding some of these cases, the author is of the opinion that "the rule of implied exclusion" remains the general rule for determining what is community property.

C. Community Presumption

Generally, all assets of the spouses on hand during the marriage and upon its termination are presumed to be community property, thereby placing the burden of proof on the party (e.g., a spouse, or that spouse's personal representative, or the heirs/devisees of the spouse) asserting separate character to show by "clear and convincing evidence" that a particular asset is, in fact, separate. Tex. Fam. Code § 3.003.

1. Management Presumption

The fact that an asset is held in one spouse's name only, or is in the sole possession of a particular spouse, is not determinative of its marital character and only raises a presumption that the asset is subject to that spouse's sole management and control while the community presumption dictates it is presumptively community. Tex. Fam. Code § 3.104.

2. Form of Title

The fact that record title is held in a particular way due to certain circumstances may cause the community presumption to vanish in favor of a rebuttable separate presumption. See *Smith v. Strahan*, 16 Tex. 314 (1856); *Higgins v. Johnson's Heirs*, 20 Tex. 389 (1857); *Story v. Marshall*, 24 Tex. 305 (1859). The other spouse may not be allowed to rebut the presumption if that spouse was a party to the transaction. *Lindsay v. Clayman*, 151 Tex. 593, 254 S.W.2d 777 (1952).

D. Traditional Means of Creating Separate Property

Consequently, the first step of characterization is ascertaining the facts and circumstances surrounding the acquisition of an asset – “the inception of title rule.” *Creamer v. Briscoe*, 109 S.W. 911 (Tex. 1908). The second step is determining whether evidence of those facts and circumstances place the asset within the definition of separate property. Prior to the 1980 Amendment to Art. XVI, Sec.15, there were limited means of creating separate property in Texas. Generally, separate property was limited to:

1. Previously Existing

Property owned prior to marriage. Tex. Fam. Code § 3.001.

2. Gratuitous Transfers

Property acquired during marriage by gift, devise or descent. Tex. Fam. Code § 3.001.

3. Marital Partitions

Property resulting from the partition of presently existing community property. Tex. Fam. Code § 4.102.

4. Certain Credit Acquisitions

Property acquired on credit during marriage is separate property if the creditor agreed to look only to separate property for repayment. *Broussard v. Tian*, 156 Tex. 371, 295 S.W.2d 405 (1956).

5. Personal Injury Recoveries

Certain personal injury recoveries (other than for loss of earning capacity). Tex. Fam. Code § 3.001. See II, I, *infra*.

6. Traceable Mutations

Property acquired during marriage which is traceable as a mutation of previously owned separate property. *Tarver v. Tarver*, 394 S.W.2d 780 (Tex. 1965).

Note: Casualty insurance proceeds traceable to separate property are separate property even if the premiums were paid with community. Tex. Fam. Code § 3.008.

E. 1980 Amendment

The 1980 amendment to Art. XVI, Sec. 15 authorized the creation of separate property in new ways:

1. Premarital Partitions

Persons intending to marry can partition and exchange community property not yet acquired. Tex. Fam. Code § 4.003.

2. Spousal Partitions

Spouses can partition and exchange not only presently existing community property but also community property not yet in existence into the spouses' separate properties. Tex. Fam. Code § 4.102.

Handbook on Texas Marital Property Law For Estate Administration and Planning

3. Income from Separate Property

Spouses may also agree that income from one spouse's separate property will be that spouse's separate property. Tex. Fam. Code § 4.103.

4. Spousal Donations

A gift by one spouse to the other spouse is presumed to include the income generated by the donated property so that both the gift and the future income from the gift can be the donee spouse's separate property. Tex. Fam. Code § 3.005.

F. **Mixed Characterization**

Property acquired during marriage may be part separate property of one or both spouses and part community property. Such an item may be part separate property of each spouse. Certain assets, like bank accounts, may be brought into a marriage, but take on mixed characterization during marriage.

1. Inception of Title

If the community estate of the spouses and the separate estate of a spouse have an ownership interest, the respective ownership interests are determined by the inception of title rule. Tex. Fam. Code § 7.006. For example, when the consideration used to acquire an item of property consists of both community property and traceable separate property, the item is both separate and community property.

2. Calculation

The part that is separate property is the percentage of the purchase price paid with separate property or “separate credit” (i.e., the creditor agreed to look to separate property for payment. *See* II, D, 4, *supra*.) To calculate a separate property interest, one can divide the separate property contribution

by the total purchase price. The percentage interest remaining after all separate property interests have been deducted is community property. *Texas Pattern Jury Charges*, PJC 202.6 (2016).

3. Part Gift, Part Purchase

Property may be acquired partly by *gift* and partly by purchase. In such a case, the portion acquired by *gift* is separate property. The portion acquired by purchase can be separate, community or both, depending on the source of the funds or credit used to make the purchase. *Texas Pattern Jury Charges*, PJC 202.6 (2016). For calculation, see II, F, 2, *supra*.

G. **Commingling**

An item of property that might have mixed characterization is presumptively community, meaning the party asserting the separate character of an interest in the item must prove the separate interest is separate property by clear and convincing evidence. The failure to meet that burden of proof results in the interest being community property.

Certain types of assets are particularly susceptible to this result. They are bank accounts, brokerage accounts, IRA accounts and even ERISA defined contribution retirement plans. Texas Family Code Section 3.007 provides that the separate property interest in a defined contribution retirement plan may be traced using the same tracing and characterization rules that apply to other assets.

In these types of assets, the failure to meet the burden of proof results in a “commingling” and the accounts and/or plans being community property.

H. Life Insurance

Unlike the defined contribution plans and financial accounts discussed in II, G, *supra*, the characterization of most life insurance policies is dependent on the application of the inception of title rule.

If a policy was acquired before marriage or the initial premium was paid during marriage with separate property, the policy is separate property, even if subsequent premiums were paid with community property. *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App. Waco 1963 writ ref'd). The payment of premiums with community property may give the non-owner spouse a claim for reimbursement.

Note: If the policy is a group life policy offered by an employer for employees, the policy is a form of compensation and likely to be found to be community property once the employee is married; similarly, a simple term policy may also take the characterization of the last premium paid.

I. Quasi-Marital Property

According to the Texas Family Code, the separate property of a spouse which was acquired while the spouses were not residing in Texas, but what would have been community had they resided in Texas at the time of acquisition, will be treated in a divorce proceeding as if it were community property. Tex. Fam. Code § 7.002. See *Cameron v. Cameron*, 641 S.W.2d 210 (Tex. 1982). A 2003 amendment to Sec. 7.002 treats as separate property any community property that was acquired while the couple resided in another state that would have been separate had they resided in Texas at the time of its acquisition. Quasi-community property is still treated as separate if the marriage terminates by reason

of a spouse's death. *Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987). Presumably "quasi-separate" property would be treated as community property if the marriage terminates by reason of a spouse's death, if the reasoning of the *Hanau* case, *supra*, is followed.

J. Personal Injury Recoveries

Personal injury recoveries for loss of earning capacity during marriage are defined as community property. Tex. Fam. Code § 3.001(3). Notwithstanding this statutory provision, the author is of the opinion that actual "lost earnings" should be deemed community property while "loss of earning capacity" should be considered separate property. Lost earnings are properly characterized as community property since the community estate will be liable for payment of medical expenses and will suffer as a result of losing one spouse's community earnings.

However, characterizing the recovery for lost earning capacity as community property requires a presumption that the husband and wife will remain married indefinitely. In reality, should the spouses divorce following the injury, community recoveries will be divided on a just and right basis; or should the non-injured spouse die, his estate will be entitled to one-half of the entire recovery. Since the primary purpose of a personal injury recovery is to compensate the injured spouse, classifying lost earning capacity as community property and giving the non-injured spouse a one-half interest therein may leave the injured spouse with only a fraction of the amount awarded. The potential for such a situation clearly warrants a distinction between lost earnings and lost earning capacity which characterizes the former as community and the latter as separate.

Note: The same rationale suggests a distinction should also be made for incurred medical expenses and future medical expenses.

K. Observations

Today, in order to properly characterize the assets of a marriage in either an estate planning or administration situation, the practitioner will need to be thoroughly familiar with the ever changing rules of characterization and be alert to the possibility that in either a premarital or marital agreement the parties changed the legal result. For example, income from separate property is not always community property. *See* II, E, *supra*.

III. MARITAL PROPERTY MANAGEMENT

Unlike characterization, rules relating to the management of marital property are within the rulemaking authority of the legislature. *Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925). The Texas Family Code now prescribes which spouse has management powers over the marital assets during the marriage.

A. Matrimonial Property Act, 1967

Historically in Texas, the husband managed not only the community property of the marriage but also the separate property of both spouses. A women's rights reform movement began in 1913 with the gradual expansion over the next fifty years of the wife's right to manage her own separate property and personal earnings. One of the early changes was to grant to the wife the right to manage her own personal earnings and the income from her separate property. This reform movement

culminated when both spouses were granted separate but equal rights in the management of their respective separate properties in the Matrimonial Property Act of 1967. The Act also granted women for the first time equal rights with their husbands in the management of their community property. These concepts were then codified as Sections 5.61 and 5.62 of the Texas Family Code enacted in 1969, effective Jan. 1, 2000, and are codified currently as Sections 3.201, 3.202 and 3.203 of the Texas Family Code. *See* Joseph W. McKnight, "Recodification and Reform of the Law of Husband and Wife" (Texas Bar Journal, Jan. 1970).

B. Texas Family Code

1. Separate Property

Each spouse has sole management, control and disposition of his or her separate property. Tex. Fam. Code § 3.101.

2. Sole Management Community

Each spouse has sole management, control and disposition of the community property that he or she would own, if single, including personal earnings, revenue from separate property, recoveries for personal injuries and increases and revenues from his or her "special community property." Tex. Fam. Code § 3.102(a).

3. Joint Management Community

All other community property is subject to both spouses' joint management, control and disposition – "the joint community property." Tex. Fam. Code § 3.102(b).

C. Special Community Property

The term "special community property" was originally defined by Texas

courts as that portion of the community estate which was under the wife's exclusive control and not liable for the husband's debts following the landmark decision of *Arnold v. Leonard, supra*, where the Texas Supreme Court held that the legislature could not define the rents and revenue from the wife's separate property and her personal earnings as her separate property, but could exempt those assets, her "special community property," from his debts. *Moss v. Gibbs*, 370 S.W.2d 452 (Tex. 1963). Today, it is common practice to refer to the community assets subject to either spouse's "sole management, control and disposition" under Section 3.102(a) as his or her "special community property."

Note: In this outline, the terms "special community property" and "sole management community property" are used to refer to the same community assets.

D. Presumptions

In addition to the community presumption of Section 3.003, an asset titled in one spouse's name (or untitled but in the sole possession of one spouse) is presumed to be subject to that spouse's sole management and control. Tex. Fam. Code § 3.104. Thus, an asset held in either spouse's name is presumed to be that spouse's sole management community property. However, the actual definition of "sole management community property" is found in Tex. Fam. Code § 3.102(a). If an asset does not fall within the statutory definition of "sole, management community," it is "joint community," even if held in one spouse's name.

E. Record Title

Whether an asset is held in one spouse's name or in both spouses' names, it is presumptively community property, thereby placing the burden on a spouse claiming separate status to prove why it is separate property.

1. Presumption

The fact that title is held in one spouse's name (or it's untitled, but in the sole possession of one spouse) creates a rebuttable presumption that the asset is the spouse's sole management community property. Tex. Fam. Code §

2. Rebutting the Presumption

If the facts indicate that a community asset is not property the "titled" spouse would have owned, if single (e.g., personal earnings, income from separate property, increases and expenses from special community property), Section 3.102(c) indicates it is joint community.

3. Mixing Sole Management Community

If one spouse's sole management community is "mixed" with the other spouse's sole management community (or presumably their joint community), the "mixed" community is converted into joint community and subject to both spouses' debts. This result typically occurs when the spouses deposit their respective salaries into a joint account. If an asset is subsequently purchased with funds from the joint account and placed in one spouse's name (absent donative intent of the other spouse), the asset is presumptively subject to that spouse's sole management, but may be found to be joint community for liability purposes due to its traceable "joint" source.

4. The “Sole Management” Joint Account

If only one spouse deposits his or her special community funds into a joint account, the account is community property, and the account agreement will dictate who can write the checks or otherwise make withdrawals (typically, either spouse can write a check or make a withdrawal). However, if the other spouse’s creditors attempt to subject it to the contractual debts of the non-depositing spouse, the depositing spouse has a good argument that the account is still the depositing spouse’s special community property and exempt from other spouse’s non-tort and any premarital creditors. A joint account belongs to the party who deposited the funds. Tex. Est. Code § 113.102.

**IV. MARITAL PROPERTY
LIABILITY**

The Legislature's basic rules of marital property liability are found in Sections 3.201, 3.202 and 3.203 of the Texas Family Code.

A. Statutory Rules

1. Separate Property Exemption

As a general rule, a spouse's separate property is not subject to the debts of the other spouse. Tex. Fam. Code § 3.202(a).

2. Special Community Exemption

As a general rule, a spouse's sole management community property is not subject to any debts incurred by the other spouse prior to the marriage or any nontortious debts of the other spouse incurred during the marriage. Tex. Fam. Code § 3.202(b).

3. Other Rules of Law

These two exemptions exist unless both spouses are personally liable under "other rules of law." Tex. Fam. Code § 3.201. *See* III, B, *infra*.

4. Exempt Property

Of course, the family homestead and certain items of personal property are generally exempt from the debts of both spouses, regardless of the marital character of the property. Tex. Prop. Code §§ 41.001 and 42.001. The Texas Property Code and Texas Insurance Code also create exemptions for retirement benefits and life insurance.

5. Creditors’ Rights

Accordingly, a spouse’s nonexempt separate property and sole management community property are subject to any liabilities of that spouse incurred before or during the marriage. Nonexempt joint community is liable for the debts of both spouses. In addition, the nonexempt sole management community properties of both spouses are subject to the tortious liabilities of either spouse incurred during marriage. Tex. Fam. Code § 3.202 (c) and (d). *See* IX, *infra*.

6. Order of Execution

A court may determine, as deemed just and equitable, the order in which particular separate or community property is subject to execution and sale to satisfy a judgment. In determining the order, the court is to consider the facts and circumstances surrounding the transaction or occurrence on which the debt is based. Tex. Fam. Code § 3.203.

B. Other Factors

The general rules described in III, A, *supra*, apply unless both spouses are personally liable under “other rules of law.”

1. Joint Obligations

Of course, both spouses may sign a contract or commit a tort which would make them jointly and severally liable and thereby subjecting the entire nonexempt marital estate to liability. “Generally, both spouses are jointly and severally liable for the tax due on a joint return. Thus, a spouse may be liable for the entire tax liability, although the income was totally earned by the other spouse.” *Kimsey v. Kimsey*, 915 S.W.2d 690, 695 (Tex. App.—El Paso 1998, pet denied).

2. “Necessaries”

Each spouse has a duty to support the other spouse and a duty to support a child generally for so long as the child is a minor and thereafter until the child graduates from high school. Tex. Fam. Code Secs. 2.501 and 154.001. Accordingly, all nonexempt marital assets (separate and community) are liable for such “necessaries.” *See*, III, D, *infra*.

3. Principal-Agent

The law also defines other situations where any person can be held personally liable for debts of another. These situations include the following relationships: respondeat superior, principal/agency, partnership, joint venture, etc. These special relationships can exist between husband and wife and can impose vicarious liability on an otherwise innocent spouse. *See Lawrence v. Hardy*, 583 S.W.2d 795 (Tex. App.—San Antonio 1979, writ ref’d n.r.e.). The Texas Family Code has codified this concept. Tex. Fam. Code § 3.201(a)(1). However, the

marriage relationship, in and to itself, is not sufficient to generate vicarious liability. Tex. Fam. Code § 3.201(c). *See also Wilkinson v. Stevison*, 514 S.W.2d 895 (Tex. 1974).

4. Points of Clarification

Except as provided in III(C)(1), (2) and (3), community property is not subject to a liability that arises from act of a spouse. Tex. Fam. Code §3.201(b). Retirement allowances, annuities, accumulated contributions, optional benefits and money in the various public retirement system accounts *which are one spouse’s sole management community property* are generally not subject to a claim of a criminal restitution judgment against the other spouse. Tex. Fam. Code § 3.202(e).

C. Child Support

Prior to 2007 legislation, unless otherwise agreed in writing or ordered by a court, a parent’s child support obligation ended when the parent died; now the Family Code provides that court-ordered child support obligations survive the obligor’s death. Tex. Fam. Code § 154.006. Subsequent amendments to the Family Code also provide that the obligor’s child support obligations can be accelerated upon the obligor’s death and a liquidated amount will be determined using discount analysis and other means. Tex. Fam. Code § 154.015. An amendment to the probate code makes the liquidated amount a class 4 claim. Tex. Est. Code § 355.102. The court can also require that the child support obligation be secured by the purchase of a life insurance policy. Tex. Fam. Code § 154.016.

D. The Necessaries Doctrine

A spouse's duty of support extends beyond the marital relationship itself. A spouse who fails to discharge this duty is liable to others who provide necessaries to the other spouse. Tex. Fam. Code § 2.501(b). Accordingly, when third parties (e.g., doctors, hospitals, nursing homes – perhaps even lawyers) provide services deemed reasonably necessary for one spouse's support, both spouses are personally liable for the costs of such services. While the spouse who actually incurs the debt may be deemed to be "primarily liable," both spouses are "jointly and severally" liable to the third party under the necessaries doctrine. Tex. Fam. Code § 3.201(a)(2). A debt incurred for necessaries exposes the entire nonexempt marital estate (separate and community) to liability. Tex. Fam. Code § 3.202.

Note: Parents are legally obligated to support their children until the children attain the age of 18 or graduate from high school. Tex. Fam. Code § 154.001.

E. Spousal Necessaries Cases

1. *Approved Personnel Serv. v. Dallas*, 358 S.W.2d 150 (Tex. App.—Texarkana 1962, no writ) ("No case is cited holding a contract for services of the nature rendered here to be a necessary. There are numerous cases in which courts have, on the basis of facts of the particular case, held medical, dental and legal services to be necessaries. . . . The facts and circumstances of a case control and mold the meaning of the term as here used and the formulation of a comprehensive definition is difficult. Decision in this case must be made on the basis that the term encompasses such services as the husband is financially

able to and should provide for the wife's benefit and that are suitable to the maintenance of the condition and station in life the family occupies").

2. *Finney v. State*, 308 S.W.2d 142 (Tex. Civ. App.—Austin 1957, writ ref'd n.r.e.) (court held deceased wife's estate liable for medical bills incurred by deceased husband while he was a patient at three state facilities).

3. *Fleming v. Oring*, Civil Action No. 3:04-CV-1303-B, 2005 U.S. Dist. LEXIS 5062 (N.D. Tex. Mar. 29, 2005) (facts of case concern suit against husband for funds that caretakers spent in order to provide for basic needs of husband's wife; case was dismissed for lack of personal jurisdiction.)

4. *Jarvis v. Jenkins*, 417 S.W.2d 383 (Tex. Civ. App.—Waco 1967, no writ) (husband ordered to reimburse wife's attorney, who paid for her groceries and an airline ticket for her to travel to Virginia to visit family and seek medical treatment; items considered to be necessities).

5. *Turner v. Lubbock County Hospital District*, No. 07-96-0272-CV, 1998 Tex. App. LEXIS 53 (Tex. App.—Amarillo 1998, no pet.) (court found that as a matter of law, medical services are necessaries).

6. *White v. Lubbock Sanitarium Co.*, 54 S.W.2d 1058 (Tex. Civ. App.—Amarillo 1932, writ dism'd w.o.j.) (wife's medical expenses held to be necessaries; husband and wife found to be jointly liable for the medical debt).

Note: The author's research discovered statements from various sources suggesting that once one spouse has qualified for Medicaid nursing care the other spouse no longer has any personal liability for the nursing care. The author appreciates Clyde Farrell confirming this general understanding of this complex set of Medicaid rules. Clyde also explained that, while the community spouse is still generally liable for other "necessaries," when the other spouse is in the nursing home, Medicaid covers most of the needs of the other spouse. If the other spouse is receiving Medicaid home care, Medicaid does not pay for "necessaries" other than medical care (including personal attendant care). However, for the purpose of this paper, it will be assumed that neither spouse has qualified for Medicaid nursing care.

F. No Community Debt

The Texas Family Code's liability rules do not support the notion of a "community debt." See *Tedder v. Garner Aldrich, LLP*, 421 S.W.3d 651 (Tex. 2013). That term suggests that (i) both spouses have personal liability for the debt and (ii) all non-exempt community property can be reached to satisfy the debt. Neither statement is necessarily true. Please also refer to *Marital Property Liabilities: Dispelling the Myth of the Community Debt*, State Bar of Texas, Advanced Estate Planning and Probate Course, June, 2009, and the *Marital Property Liabilities: Dispelling the Myth of Community Debt*, Featherston and Dickson, *Texas Bar Journal*, January, 2010.

G. Summary

Accordingly, absent a statutory exemption, a spouse's separate property and sole management community property, as

well as the joint community property, are liable for that spouse's debts during the marriage. If the liability is a tort debt incurred during the marriage, the other spouse's sole management community property is also liable for the debt (the other spouse's separate property may be exempt depending upon the circumstances).

If the debt is not a tort debt incurred during the marriage, the other spouse's separate property and sole management community property are exempt during the marriage from the debt unless the other spouse is personally liable under other rules of law. In which event, the other spouse's property (i.e., that spouse's sole management community and separate) is liable as well.

However, if the debt was incurred as a reasonable expense for the support of either spouse, each spouse has personal liability, and the entire nonexempt marital estate (each spouse's separate property and their community property) is liable.

H. Key Questions

The Texas Legislature has enacted a logical liability process that utilizes a multiple-step process to determine which nonexempt marital assets of a husband and wife are liable for which debts during the marriage. Texas courts are finally getting it right. See *Beal Bank v. Gilbert*, 417 S.W. 3d 704 (Tex. App.—Dallas 2013, no pet. h.). The process is dependent upon the answers to four questions:

1. When was the debt incurred? *It was incurred either prior to or during the marriage.*
2. Whose debt is it? *It is either the debt of the husband, the debt of the wife or both spouses' debt.*

3. What type of debt is it? Or was it tortious or contractual in nature or was it incurred for a “necessity”?
4. If not a “necessity,” was the spouse who incurred the debt acting as the other spouse’s agent?

The ultimate answer depends on the relevant facts and circumstances and the specific answers to these four questions.

Note: However, the statutory liability rules change when the first spouse dies. See VII and VIII, *infra*.

V. EFFECT OF DIVORCE

In the event of a divorce, generally any community property will be subject to an equitable division by the divorce court but separate property is not. In addition, any “quasi-community” property is subject to an equitable division. Tex. Fam. Code §§ 7.001, 7.002. While contractual alimony can be incorporated into a divorce decree, absent such an agreement, the Texas divorce court cannot award alimony to a spouse. Alimony is still contrary to Texas public policy. A limited form of alimony, “maintenance,” is available in certain defined situations. See Tex. Fam. Code §§ 8.001-8.059.

Note: If the other spouse is awarded an interest in the participant’s ERISA regulated plan, a Q.D.R.O is needed. Tex. Fam. Code. § 9.101.

A. Claims for Reimbursement

Reimbursement between the marital estates usually arises when a spouse’s pre-

marriage debt is later paid with community funds or one spouse’s separate property is improved through the expenditure of community funds. Reimbursement may also be applicable if separate funds are expended to benefit community property. In addition, the expenditure of community time, talent and labor in excess of what is necessary to reasonably manage one’s separate property can give rise to a community claim for reimbursement to the extent that excess time, talent or labor is not compensated. *Jensen v. Jensen*, 685 S.W.2d 107 (1984). Another common reimbursement situation is where one spouse owns separately an insurance policy on that spouse’s life and uses community property to pay the premiums, and upon the insured spouse’s death, the proceeds are payable to a third party. See Tex. Fam. Code §§ 3.401-3.410. The Texas Family Code directs the divorce court on how to handle such claims. Tex. Fam. Code § 7.007.

B. Fraud on the Community

In *Arnold v. Leonard*, *supra*, the Court explained, “. . . that the statutes empowering the husband to manage the . . . community assets made the husband essentially a trustee, accountable as such to the . . . community.’ See also *Howard v. Commonwealth Building and Loan Ass’n.*, 94 S.W.2d 144 (Tex. 1936), where the court explained that where title to a community asset is held in one spouse’s name, that spouse has legal title and the other has equitable title, explaining: “That one in whose name the title is conveyed holds as trustee for the other. *Patty v. Middleton*, 82 Tex. 586, 17 S.W. 909 (Tex. 1891).” A breach of that fiduciary duty will likely result in a “fraud on the community” claim when the marriage terminates. Such a claim may follow a gift of sole management

community property to a child of a prior marriage. The Texas Family Code, Section 7.009, describes the divorce court process for handling fraud claims and creates what is defined as the “reconstituted estate.” Tex. Fam. Code § 7.009.

C. Liabilities

Allocation of the responsibility of the debts of the parties is part of the “just and right division” of the estate. Tex. Fam. Code § 7.001. The effect of the divorce on the rights of the creditors is uncertain. Professor Paulsen, in his excellent article on post-divorce liability, challenges what most have assumed to be established Texas law; divorce cannot prejudice the rights of preexisting creditors. He argues that such a rule “. . . lacks any modern legal justification and subverts the intent of the Texas Constitution and Family Code.” He encourages the Texas Supreme Court to declare that “. . . an unsecured creditor . . . has no special rights against a former spouse or that spouse’s property once the marriage ends.” See James W. Paulsen, *The Unsecured Texas Creditor’s Post-Divorce Claim to Former Community Property*,” 63 Baylor Law Review 781 (2011).

D. Court Ordered Child Support

A court may order the trustees of a spendthrift or other trust to make disbursements for the support of a child to the extent the trustees are required to make payments to a beneficiary who is required to make child support payments as provided by the Texas Family Code. If disbursement of the assets of the trust is discretionary, the court may order child support payments from the income of the trust, but not from the principal. Tex. Fam. Code § 154.005.

Delinquent child support and child support arrearages are treated as Class 4

claims against the estate of a deceased parent. Tex. Est. Code § 355.102.

E. Redesignation Statutes

Sections 9.301 and 9.302 of the Texas Family Code purport to void a life insurance policy or retirement plan beneficiary designation in favor of a former spouse. However, in *Egelhoff v. Egelhoff*, 532 U.S. 141, 121 S. Ct. 1322 (2011), the Supreme Court held that ERISA preempts state redesignation statutes, like Sections 9.301 and 9.302, if the designations are pursuant to ERISA regulated retirement plans or group life insurance policies. See also *Keen v. Weaver*, 121 S.W.3d 721 (Tex. 2003), abrogated by *Kennedy v. Plan Adm’r*, 555 U.S. 285, 129 S. Ct. 865 (2009). Preemption also applies for federally created plans and insurance. *Hillman v. Maretta*, 133 S. Ct. 1993 (2013).

Note: The Texas Estates Code voids testamentary devises to former spouses and relatives of the former spouse who are not related to the testator. This rule has been expanded to cover revocable trusts, certain powers of appointment and multiple-party accounts. See Tex. Est. Code §§ 123.001, 123.002, 123.051 – 112.055.

VI. DEATH OF SPOUSE

When a married resident of Texas dies, the marriage terminates and their community property technically ceases to exist because only spouses can own community property. As a general rule, nonprobate assets pass to the surviving spouse or other third party beneficiaries. Death generally works a legal partition of the *community probate assets*; the deceased spouse's undivided one-half interest passes to the deceased spouse’s heirs and/or

devises, and the surviving spouse retains his/her undivided one-half interest therein. Presumably, the spouse's mutual obligation of support also terminates. The surviving spouse does not even have the legal duty to bury the deceased spouse. See Tex. Est. Code § 355.110.

Note: The general rules described above have their exceptions. The Texas Estates Code voids certain devises to a former spouse and the former spouse's relatives who are not related to the testator. That provision has been expanded to include multiple-party accounts, revocable powers of appointments, testamentary trusts and revocable trusts. See V, E, *Note*, supra. Section 804.001(3) of the Texas Government Code terminates the community interest of a deceased spouse in a state employee's retirement plan. See *Rogers v. Foxworth*, 214 S.W.3d 196 (Tex. App.—Tyler, 2007, no pet.), involving teacher retirement. Sections 9.3001 and 9.3002 of the Texas Family Code void life insurance and retirement plan designations in favor of a former spouse.

However, as to federal preemption of Sections 9.3001 and 9.3002, as applied to ERISA regulated retirement plans and group life insurance, see V, E, supra.

Note: More importantly, upon the death of a participant in an ERISA regulated retirement plan, the surviving spouse may have an ERISA mandated right that overrides the participant's beneficiary designation. If the spouse predeceases the participant, the spouse may not be able to transfer the spouse's community interest in the participant's plan. See *Boggs v. Boggs*, 570 U.S. 833, 117 S. Ct. 1754 (1997). Federal law may also preempt state law if the decedent or spouse participated in a federally created plan.

A. Marital Liabilities

But what happens to the existing debts of a married couple when the first spouse dies? The question sounds simple enough. It is obvious that the debts don't go away. There are no community debts. Not all of the debts were the debts of both spouses. Prior to the first spouse's death, the surviving spouse may or may not have had personal liability for the debts of the deceased spouse, and the deceased spouse may or may not have had any personal liability for the debts of the surviving spouse.

The deceased spouse's death does not create any personal liability on any party that did not exist prior to the deceased spouse's death. The surviving spouse is still personally liable for the debts of the surviving spouse. The surviving spouse does not assume personal liability for any debts of the deceased spouse for which the survivor did not have preexisting personal liability. It is the deceased spouse's "estate" that may be liable for the deceased spouse's debts.

B. The Court's Explanation

The Texas Supreme Court has explained the legal effect of the transition of ownership and liability by reason of the owner/debtor's death by and through the decedent's "estate." "A suit seeking to establish the decedent's liability on a claim and subject property of the estate to its payment should ordinarily be instituted against the personal representative or, under certain circumstances, against the heirs or beneficiaries." *Price v. Estate of Anderson*, 522 S.W.2d 690, 691 (Tex. 1975). "Debts against an estate constitute a statutory lien. This lien arises at the moment of death." *Janes v. Commerce Fed. Savings & Loan Ass'n*, 639 S.W.2d 490, 491 (Tex. App. –

Texarkana 1982, writ ref'd n.r.e.). "Possession, then, by an heir does not subject him to liability. He holds the property with the encumbrance, but he cannot be required to relieve the estate of the burden [sic]." *Blinn v. McDonald* 50 S.W. 931, 931 (Tex. 1899), *Van v. Webb* 215 S.W.2d 151, 154 (Tex. 1998).

C. Probate v. Nonprobate

The assets of a decedent should initially be divided into two separate and distinct categories. Certain assets fall within the *probate* class and others are classified as *nonprobate* assets. An asset is nonprobate if during the decedent's lifetime, the decedent entered into an inter vivos transaction, as opposed to a testamentary transaction, that controls the disposition of the asset at death.

1. Nonprobate Transfers

Many nonprobate dispositions are contractual arrangements with third parties or the intended beneficiaries, and the terms of the contracts control the dispositions. Tex. Est. Code § 111.052. Common examples of these types of contractual arrangements include joint accounts with rights of survivorship, P.O.D./T.O.D. accounts and trust accounts as defined in Chapter 113 of the Texas Estates Code, most life insurance policies and certain employee benefits. Nonprobate assets remain liable for the decedent's debts unless there exists a statutory exemption like the one for life insurance policies under the Texas Insurance Code or the one for retirement benefits under the Texas Property Code. Tex. Est. Code § 111.053(b).

Note: The surviving spouse is frequently the designated beneficiary of the nonprobate disposition. For example, the surviving spouse is the named beneficiary of a life

insurance policy, a retirement account or a multiple-party account. The couple may have owned separate property as joint tenants with rights of survivorship or community property with rights of survivorship. On the other hand, if the deceased spouse makes a nonprobate disposition of his/her sole management community property to a third party, fraud on the community issues are raised. But ERISA may mandate the surviving spouse be the beneficiary of an ERISA regulated retirement plan. If it is a group life insurance payable to a third party, the spouse must plead and prove actual fraud. Barnett v. Barnett, 67 S.W.3d 107 (Tex. 2001).

2. Inter Vivos Gifts

In other nonprobate dispositions, the ownership of a future interest in the property (e.g., a remainder interest) is transferred to the intended beneficiary during the owner's lifetime, and the future interest becomes possessory upon the death of the owner. Of course, the typical inter vivos gift of the ownership and possession of an asset prior to the owner's death can be considered a nonprobate disposition and also subject to a fraud on the creditors' analysis.

Note: Likewise, such a gift of a spouse's sole management community could be subject to a fraud on the community analysis.

3. Transfer on Death Deeds

T.O.D. deeds were authorized by the legislature in 2015. According to Sections 114.000 – 114.151 of the Texas Estates Code, such deeds are effective to convey the grantor's interest to the grantee upon the death of the grantor.

Note: The statute's language suggests that a spouse could only transfer that spouse's undivided one-half interest in that spouse's sole management community property. The Texas Family Code suggests that a spouse may not be able to use a T.O.D. deed to transfer that spouse's interest in the couple's joint management community or the other spouse's sole management community. Tex. Fam. Code § 3.102.

4. Probate

Probate assets are those assets which are not controlled by an inter vivos or nonprobate arrangement and pass at the owner's death to the owner's heirs or devisees, subject to possible probate administration. A married individual's probate estate consists of the decedent's separate probate assets and his or her undivided one-half of the community assets which are not subject to an inter vivos or nonprobate arrangement. The surviving spouse retains, not inherits, his or her undivided one-half interest in the community probate assets.

5. Survivorship Rights

Joint tenancies (with rights of survivorship) are created in Texas when co-owners of property agree to create survivorship rights. Tex. Est. Code § 111.001. Absent such an agreement, co-owners are tenants in common (without survivorship). Both joint tenants and tenants in common are presumed to own their individual undivided interests equally. Tex. Est. Code § 101.002. Spouses may own separate property as tenants in common or joint tenants. Spouses may own community property with rights of survivorship. Tex. Est. Code § 112.051.

Joint accounts (with or without survivorship rights) defined in Chapter 113

of the Texas Estates Code are not joint tenancies. Such joint accounts are owned by the parties in accordance with their "net contributions." Tex. Est. Code § 113.102

D. Chapter 101

The deceased spouse's probate "estate" generally passes to the deceased spouse's heirs and/or devisees *subject to the deceased spouse's debts*. Tex. Est. Code §§ 101.001, 101.053. Thus, the deceased spouse's separate property and undivided one-half interest in the community property are generally liable for the payment of the debts of the decedent. Tex. Est. Code § 101.052. *As to the liability of the surviving spouse's interest in the community property, see VI, E, infra.*

If appointed and qualified, the personal representative of the deceased spouse's estate shall recover possession of the decedent's "estate" and hold it in trust to be disposed of in accordance with the law. Tex. Est. Code § 101.003. "As trustee, the executor is subject to the high fiduciary standards applicable to all trustees." *Humane Society v. Austin National Bank*, 531 S.W.2d 574,577 (Tex. 1975). If the decedent was married at the time of death, see VIII, *infra*.

E. Deceased Spouse's Debts

Section 101.052 of the Texas Estates Code states that the one-hundred percent (100%) of the community property subject to the sole control of the deceased spouse or joint control of both spouses during the marriage continues to be subject to the *debts of the deceased spouse*. In addition, the decedent's one-half interest in the community property subject to the sole control of the surviving spouse passes to the deceased spouse's successors charged with

the *deceased spouse's debts*. Tex. Est. Code § 101.052.

Note: It is significant that Section 101.052 does not refer to the surviving spouse's debts. There is a reference to "the liabilities of that spouse." See VIII, infra.

F. Administration of Community Property

In addition to collecting the probate of the estate, paying the decedent's debts and distributing the remaining assets to the decedent's heirs and/or devisees, the administration of a married decedent's estate may include the actual partition of the community probate property. While death may work a legal partition of the community probate assets, it is often necessary to open a formal administration to effectively handle the claims of creditors and/or divide the community probate property among the surviving spouse and the decedent's heirs and/or devisees. *See VII, infra.*

Note: Absent the opening of a formal administration, the surviving spouse can administer the community and can pay "community debts" and discharge the "community obligations." See Tex. Est. Code Sec. 453.003. That term traces its roots back to the Texas Probate Code in effect prior to the Matrimonial Property Act of 1967.

Note: If the deceased spouse died intestate and the surviving spouse is the sole heir, there may not be a need for any type of formal administration. Tex. Est. Code Sec. 453.002.

G. Intestate Death

1. Community Probate Property

If a spouse dies intestate, the surviving spouse continues to own (not inherits) an undivided one-half interest in the community probate assets. If there are not any descendants of the deceased spouse surviving, or all surviving descendants are also descendants of the surviving spouse, the decedent's one-half undivided interest passes to the surviving spouse, who would then own the entire community probate estate. If there are any descendants surviving who are not descendants of the surviving spouse, the decedent's undivided one-half interest in the community probate assets passes to the decedent's descendants per capita with right of representation. Tex. Est. Code § 201.003. Prior to September 1, 1993, the surviving spouse inherited the deceased spouse's one-half of the community only if no descendants of the deceased spouse were then surviving. Tex. Prob. Code § 45 (now repealed). The rules relating to "representation" were modified to be effective September 1, 1991. Tex. Prob Code § 43 (now repealed). *See Tex. Est. Code § 201.101.*

2. Separate Probate Property

If a spouse dies intestate, the decedent's separate probate assets are divided in the following manner: (i) one-third of the personal property passes to the surviving spouse and two-thirds thereof to the decedent's descendants and (ii) the surviving spouse receives a life estate in one-third of the separate real property and the descendants of the decedent receive the balance of the separate real property. If there are no descendants, the surviving spouse receives all of the personal property and one-half of the real property. The other

one-half of the real property passes in accordance with the rules of intestate succession. Tex. Est. Code § 201.002.

H. Testamentary Power

Every person who is or has been married has received a broad grant of authority from the Legislature to dispose of his or her probate property. There is no forced heirship in Texas. Tex. Est. Code §§ 251.001, 251.002. This broad grant of testamentary authority is, however, effectively limited to the testator's separate probate property and his or her undivided one-half interest in the community probate property. *Avery v. Johnson*, 108 Tex. 294, 192 S.W. 542 (1917).

I. Express or Implied Election

If the surviving spouse is a beneficiary under the will, the testator may be able to effectively expand his or her testamentary power to the entire marital estate through an express election or the doctrine of implied election. But the surviving spouse's consent is required. *See Wright v. Wright*, 274 S.W. 2d. 670 (Tex. 1955).

J. Protection for Surviving Spouse

Despite the very broad general grant of testamentary power given a married testator and the limited rights of inheritance given the surviving spouse when the decedent dies intestate, there exists certain constitutional and statutory provisions which exist for the benefit of the surviving spouse, whether the decedent died testate or intestate.

1. Homestead

The Texas Constitution still exempts the homestead from the claims of some of the decedent's creditors. Tex. Const. Art.

XVI, Sec. 50. In addition, notwithstanding the provisions of the decedent's will or the rules of intestate succession, the surviving spouse is given an exclusive right of occupancy of the homestead so long as he or she elects to occupy it as his or her home. Tex. Const. Art. XVI, Sec. 52. This right of occupancy exists whether the home is separate property of the deceased spouse or the couple's community property. *See* Ch. 102, Texas Estates Code. In the event there is not a family home, the probate court is required to set aside an allowance in lieu of a homestead. Tex. Est. Code § 353.053.

2. Homestead Responsibilities

While exercising the homestead right of occupancy, the surviving spouse is treated like a "life tenant" and owes the decedent's successors in interest a duty not to commit waste. *Sargent v. Sargent*, 15 S.W.2d 589 (Tex. 1929). Accordingly, the surviving spouse is responsible for utilities, property taxes and ordinary maintenance and repairs. *Sargent, supra*, and *Dakan v. Dakan*, 85 S.W.2d 620 (Tex. 1935). If the homestead is encumbered, the surviving spouse is responsible for the interest payments, but the underlying owners of the property (the surviving spouse and the decedent's successors or the decedent's successors in interest) should be responsible for each owner's proportionate share of principal payments. Insurance premiums should be paid by the party with the insurable interest in the ownership of the property. The last two, principal payments on a mortgage and insurance premiums, depend on whether the homestead was separate property or community property and whether the deceased spouse died testate or intestate (i.e., who owns the homestead. *See* Tamborello, "A House Divided: The Rights and Duties of Homesteaders, Life

Tenants and Remaindermen,” 2016 Advanced Estate Planning and Probate (S.B.O.T.)

3. Exempt Personal Property

Certain items of tangible personal property are exempt from creditors of the decedent if the decedent is survived by a spouse. Tex. Est. Code §§ 353.051, 353.052. These items are described in the Texas Property Code and generally include the household furnishings, personal effects and automobiles in an amount that does not exceed \$100,000. Tex. Prop. Code Sec. 42.002. In addition, during administration, the surviving spouse can retain possession of these items and will receive ownership of these items if the decedent's estate proves to be insolvent; otherwise the decedent's interest in these items passes to his or her heirs and/or devisees when the administration terminates. Tex. Est. Code §§ 353.152, 353.153. There is also an allowance in lieu of exempt personal property. Tex. Est. Code § 353.053.

4. Family Allowance

In addition to the allowances in lieu of homestead and exempt personal property, an allowance for one year's maintenance of the surviving spouse may be established by the probate court. Tex. Est. Code §§ 353.101, 353.102. The allowance is paid out of the decedent's property subject to administration. *Ward v. Braun*, 417 S.W.2d 888 (Tex. Civ. App.—Corpus Christi, 1967, no writ). The amount is determined in the court's discretion and is not to be allowed if the surviving spouse has a sufficient separate estate. Tex. Est. Code Sec. 353.101(d); *Noble v. Noble*, 636 S.W.2d 551 (Tex. App.—San Antonio 1982, no writ).

5. Waiver/Election

The surviving spouse may have waived these rights in a marital or premarital agreement. See XIV, K, *infra*. A surviving spouse may be put to an election concerning these rights. See VI, I, *supra*.

**K. Authority of Surviving Spouse –
No Personal Representative**

When there is no personal representative for the estate of the deceased spouse, Sec. 453.003 enables the surviving spouse to sue in order to recover community property, to sell or otherwise dispose of community property to pay debts payable out of the community estate, and to collect claims owing to the community estate. The survivor may be sued by a third party in a matter relating to the community estate. That section also grants to the surviving spouse the authority needed under the circumstances to exercise such other powers as are necessary to preserve the community estate, to discharge obligations payable out of community property and to generally "wind up community affairs."

The survivor is entitled to a "reasonable commission" for administering the community and can incur reasonable expenses in the management of the estate. Like any other fiduciary, the surviving spouse is accountable to the deceased spouse's heirs and/or devisees who are entitled to their share of the remaining community assets after the debts properly payable out of the community assets have been paid. See Tex. Est. Code §§ 453.006-453.008 and *Grebe v. First State Bank*, 150 S.W.2d 64 (Tex. 1941).

Note: In 2007, the Legislature repealed the provisions of the Probate Code relating to the creation, administration and closing of an administration by a "qualified

community administrator.” Repealed Sec. 169 directed the community administrator to pay debts within the time, and according to the classification, and in the order prescribed for the payment of debts as in other administrations. Section 160(a) simply directed the surviving spouse to “preserve the community property, discharge community obligations and wind up community affairs.”

VII. ADMINISTRATION OF DECEASED SPOUSE’S ESTATE

The purposes of a decedent's estate administration are to collect the assets of the estate, to pay the decedent's debts and to distribute the remaining assets to the decedent's heirs and/or devisees. In addition, the administration of a married decedent's estate may include the actual partition of the community probate property. As discussed previously, death works a legal partition of the community probate assets, but it is often necessary to open an administration to effectively set aside the homestead, exempt property and family allowance, handle the claims of creditors and/or divide the community probate property among the surviving spouse and the decedent's heirs and/or devisees.

A. Section 453.009

During formal administration, the personal representative is granted authority to administer not only the deceased spouse's separate property but also the couple's joint community property and the decedent's sole management community property. The surviving spouse may retain possession of the survivor's sole management community property during administration or waive this right and allow the personal representative

to administer the entire community probate estate. Tex. Est. Code § 453.009.

B. Authority of Representative

The authority of the personal representative over the survivor's one-half of the community should be limited to what is necessary to satisfy the debts of the deceased spouse properly payable out of such community assets even if the decedent's will purports to grant to the representative more extensive powers over the decedent's separate assets and one-half interest in the community.

C. Executor’s Elective Power

However, if there is a will and the surviving spouse is a beneficiary of the will, the surviving spouse who accepts any benefits under the will may have elected to allow the executor to exercise more extensive powers over his or her share of the community assets during administration.

D. Comparing Family Code and Estates Code Provisions

The Estates Code’s division of authority dovetails with the contractual management and liability rules of the Texas Family Code and facilitates the personal representative's or ability to step into the decedent's shoes and satisfy the deceased spouse’s debts in most situations. *See* Tex. Fam. Code §§ 3.102 and 3.202.

1. Contract Debts

However, if the deceased spouse’s sole management community and the joint management community assets in possession of the personal representative and available to satisfy the deceased spouse’s contractual creditors are insufficient for that purpose, Tex. Est. Code § 101.052 indicates that the deceased

spouse's one-half interest in the surviving spouse's sole management community property can be reached to satisfy those creditors.

Note: One hundred percent of the other spouse's sole management assets had been generally exempt from the claims of the deceased spouse's non-tortious creditors during the marriage (as well as any premarriage debts).

2. Tort Debts

Prior to the deceased spouse's death, all nonexempt community property was liable for the tort debts of either spouse. Section 101.052 suggests that only the decedent's one-half interest in the surviving spouse's sole management community may continue to be liable for any tort debts of the deceased spouse. *In other words, an argument can be made that the surviving spouse's one-half interest in the survivor's sole management community may no longer be liable for any tort debts of the deceased spouse.*

E. Authority of the Surviving Spouse

Generally, when a personal representative is administering the estate of the deceased spouse, including the surviving spouse's one-half of the decedent's sole management community and the couple's joint community, the surviving spouse's fiduciary authority over the survivor's sole management community property enables the survivor to exercise all the powers granted to the surviving spouse where there is no administration pending. Tex. Est. Code § 453.009. This statutory language suggests that the survivor can deduct from the special community being administered "necessary and reasonable expenses" and a "reasonable commission." The survivor

shall keep a distinct account of "all community debts" allowed or paid. See Tex. Est. Code § 453.006.

Note: Like their predecessors in the Texas Probate Code, Sections 160 and 168, Texas Estates Code Sections 453.003 and 453.006 still refer to "community debts" and "community obligations," carry forward from pre-1967/1971 law; however, as Professor McKnight explained, a "community debt" or "community obligation" should be interpreted to mean nothing more than some community property, or a portion thereof, is liable for its satisfaction, the same meaning given by the Supreme Court in Tedder. See IV, G, supra.

F. Allocation of Liabilities after Death

1. Probate Assets

As pointed out previously, the Texas Estates Code's division of authority tracks the contractual management and liability rules of the Texas Family Code and facilitates the personal representative's ability to step into the decedent's shoes and satisfy primarily the deceased spouse's contractual debts, but it does not specifically address the debts of the surviving spouse which are not debts of the deceased spouse. It also does not address the issues related to which assets subject to administration are liable for which debts.

2. Nonprobate Assets

In the past, many believed in the "urban myth": probate assets pass subject to the decedent's debts whereas nonprobate assets pass to their designated beneficiaries, free of the decedent's debts. Today, there is a growing body of statutory rules and

common law which negates the application of that myth. *See* Tex. Est. Code §§ 111.053, 113.252, 114.006.

3. General Power Theory

Even if the Uniform Fraudulent Transfer Act is not violated, the Texas definition of a general power of appointment would seem broad enough to capture most nonprobate dispositions, including joint tenancies and revocable trusts, within its coverage and, thereby, subject the property in question to the liabilities of the donee of the power, either during the donee's lifetime or at death, unless there is a specific statutory exemption.

4. Abatement Generally

Despite the growing need for a comprehensive statute which would complement Sec. 111.053 of the Texas Probate Code and define the rights of creditors in and to the probate and nonprobate assets of a deceased debtor, the Legislature has only codified the order in which property in the probate estate would be liable for debts and expenses properly chargeable to the probate estate. Tex. Est. Code § 355.109.

5. Abatement Among Community and Separate Assets

Sec. 355.110 of the Texas Estates Code directs a representative to pay the deceased spouse's *funeral expenses* out of the decedent's separate and one-half of the community, but gives directions on how to pay the deceased spouse's debts. The potential conflict of interest is obvious; the expenditure of separate funds to satisfy a debt will inure to the benefit of the surviving spouse while using community funds would accrue to the benefit of the decedent's estate. Presumably Sec. 3.203 of the Texas Family

Code would be relevant, and the facts and circumstances surrounding the source of the debt should be considered. For example, is it a purchase money indebtedness? Is it tortious or contractual in nature?

6. General Guidelines

The author is not aware of any definitive cases on point that offer any clear guidance. Accordingly, it is the author's opinion that certain claims should be paid out of the decedent's separate property or the decedent's one-half of community assets. These claims would include funeral expenses, separate property's purchase money indebtedness, and tort claims against the deceased spouse only. Other claims, like debts incurred for living expenses (e.g., credit cards and utilities), or for community property purchase money indebtedness, should be paid out 100% of the community property under administration.

Note: If there is a will, language in the will may direct the executor to pay the decedent's debts out of the decedent's "residuary estate." This may be interpreted to require the executor to pay any and all debts for which the deceased spouse had personal liability out of the deceased spouse's separate property and one-half of the community. Absent that language, certain debts should be paid out of both halves of the community property under administration.

G. Closing the Estate

Upon the death of the first spouse and while record legal title still reflects that some community assets are held in the decedent's name, some are held in the survivor's name and others are held in both names, the surviving spouse and the heirs and/or devisees of the deceased spouse are,

in effect, tenants in common as to each and every community probate asset, unless the surviving spouse is the sole distributee of some or all of the deceased spouse's one-half interest in such assets.

Assuming that the decedent's one-half community interest has been left to someone other than the surviving spouse, the respective ownership interests of the survivor and the decedent's distributees are subject to the possessory rights of either a court appointed personal representative or the surviving spouse for administration purposes. When administration is completed, the survivor and the distributees are generally entitled to their respective undivided one-half interests in each and every community probate asset. Tex. Est. Code § 101.001.

Note: A non-pro rata distribution of the community following the first spouse's death is a frequent topic of discussion. That issue is addressed in XXI, *infra*.

VIII. SURVIVING SPOUSE'S DEBTS

This outline focuses primarily on the Legislature's statutory design for handling the debts of the spouses during the marriage and the debts of the deceased spouse during the probate administration of the deceased spouse's estate. As noted earlier, the Texas Estates Code does not specifically address the *debts of the surviving spouse* (defined herein to mean a debt for which the deceased spouse did not have personal liability). Many lawyers have assumed that the death of the first spouse should not affect the substantive rights of the spouses' creditors. But, it does! Borrowing a phrase from Professor Paulsen, an unsecured creditor of the surviving spouse may not

have any special rights against the deceased spouse's estate. See Note V(D), *supra*.

A. Section 101.052

Section 101.052 of the Texas Estates Code is captioned: *Liability of Community Property for Debts of Deceased Spouse*. Subsection (a) states that community property subject to sole or joint control of "a spouse" continues to be subject to the liabilities of "that spouse." Does the term "a spouse" refer only to the deceased spouse or to either spouse? In view of the caption, it is arguable the reference is only to the deceased spouse.

B. Secured Debts

If Section 101.052 only refers to the debts of the deceased spouse, that construction suggests that a creditor of the surviving spouse who has a security interest in former community property which is not subject to administration (i.e., the surviving spouse's sole management community property) does not have a claim against the deceased spouse's estate, if the deceased spouse did not otherwise have personal liability for the debt. The surviving spouse still has personal liability; her nonexempt separate property and undivided one-half interest in the couple's former community property (plus whatever nonexempt property she inherits) can be reached to satisfy the debt. The creditor's security interest in the survivor's former sole management property remains attached to the property. However, except to the extent of the security interest, the decedent's property (i.e., the deceased spouse's separate property and one-half interest in the joint management community or sole management community) may not be reachable by the surviving spouse's creditors.

C. Unsecured Debt

If the creditor is an unsecured creditor of only the surviving spouse (i.e., the deceased spouse did not have any personal liability), obviously the surviving spouse's nonexempt separate property and one-half interest in the former community property (plus whatever the surviving spouse inherits) remain liable for the debt. However, the statutory framework suggests that the decedent's separate property and one-half interest in the former community property may not be reachable by the creditor unless (and to the extent) such property passes to the surviving spouse by reason of the deceased spouse's death. Other distributees of the deceased spouse's estate would appear to acquire their inheritance, free of the surviving spouse's debts.

D. The Rationale

Consistent with Professor Paulsen's approach (*see* Note V(D), *supra*), the essential argument is that the Texas Family Code's liability rules only apply during the marriage. Once the marriage terminates by reason of the first spouse's death or divorce, the rules change. Sometimes the changes work in favor of a creditor. For example, the deceased spouse's contract creditors can reach the decedent's one-half of the surviving spouse's former special community property. During marriage, they could not.

Sometimes the change works against the creditor. Under Section 101.052 only the decedent's one-half interest in the surviving spouse's former special community is liable for the decedent's tort debts. During marriage, all of the community was liable for either spouse's tortious debts.

The Legislature's failure to expressly address the debts of the surviving spouse implies that the creditors of the surviving spouse do not have claims against the deceased spouse's estate. Such creditors were not creditors of the deceased spouse. The deceased spouse's estate (the decedent's separate property and one-half of the former community property) passes subject to the deceased spouse's debts, not the surviving spouse's debts.

E. Summary

Using this rationale, following the death of the first spouse, the proper analysis should begin with the answers to the following questions:

1. Whose debt was it? *The deceased spouse's? The surviving spouse's? Or both spouses'?*
2. Is the debt secured? *Yes or no? If yes, is the property securing the debt subject to administration?*
3. If an unsecured debt was incurred by the deceased spouse, was it a debt for a "necessity"? Or, was the deceased spouse acting as the agent of the surviving spouse?
4. If an unsecured debt was incurred by the surviving spouse, was it a debt for a "necessity"? Or, was the surviving spouse acting as the agent of the deceased spouse?
5. If the debt was for a necessity of either spouse incurred before the first spouse's death, the surviving spouse is still personally liable to the creditor, and the creditor has a legitimate claim against the estate of the deceased spouse.

6. If a debt was incurred during the marriage while one spouse was acting as the agent of the other spouse, the surviving spouse is still personally liable to the creditor, and the creditor has a legitimate claim against the estate of the deceased spouse.

Recall, the marital relationship, in and to itself, does not make one spouse the agent of the other spouse.

F. Another Argument

However, if the reference in Section 101.052(a) to “a spouse” is to either spouse, that section can be interpreted to mean that the couple’s joint community property and the survivor’s sole management community property remains liable for the surviving spouse’s debts. Subsection (b) still suggests that the decedent’s sole management community property would not be liable for the surviving spouse’s debts.

IX. CREDITORS’ RIGHTS DURING THE MARRIAGE

During the marriage, the rights of the couple’s creditors are more clearly defined. If both spouses have personal liability, the entire nonexempt marital estate, his separate, her separate and their community estate, can be attached by the creditor during the existence of the marriage. Generally, excluded from this grouping of marital assets would be those assets exempt from creditors’ claims under the Texas Property Code §§ 41.001– 42.0022 (the homestead, certain items of personal property and certain savings plans) and the Texas Insurance Code §§ 1108.51-1108.53

(insurance policies and proceeds). For the rule, refer to IV, *supra*.

A. Joint and Several Liability

The entire nonexempt marital estate is at risk if the debt is the debt of both spouses because (i) they both signed the contract; or (ii) they both committed the tort. In addition, both spouses may have personal liability for the debt incurred by one spouse because the spouse who actually incurred the debt was acting as the agent of the other spouse – the *Principal-Agent Rule*. Even if the *Principal-Agent Rule* is not applicable, if the debt is owing to a creditor who provided goods or services deemed reasonable necessities for the support of one spouse (or a child under Tex. Fam. Code § 154.001), both spouses also have personal liability – the *Necessaries Doctrine*.

B. Tort Debt of One Spouse

If the debt is, in fact, the tort debt of only one spouse (i.e., the other spouse does not have personal liability pursuant to III, A, *supra*), the nonexempt separate property of the spouse who committed the tort and the entire nonexempt community estate (their joint community property, his special community property and her special community) are at risk. Only the other spouse’s separate property is exempt. If the tort was actually committed prior to the marriage, all of the other spouse’s special community property is not subject to execution.

C. Contract Debt of One Spouse

If the debt is, in fact, a contract debt by only one spouse and the other spouse does not have personal liability under III, A, *supra*, the nonexempt separate property of the spouse who incurred the debt and the nonexempt special community property of

that spouse and the joint community property are at risk. The other spouse's separate property and all of the other spouse's special community property are not at risk.

D. Observations

In many situations, the entire community estate is going to be at risk of execution because of either the nature of the debt itself or the type of community property owned by the spouses. Even if the debt was incurred during the marriage by only one spouse, the *Principal-Agent Rule* or the *Necessaries Doctrine* may be applicable, creating joint and several liability. Even if neither the *Principal-Agent Rule* nor the *Necessaries Doctrine* is applicable, most, if not all, of the community assets may be their joint community property, even if certain assets are held in one spouse's name. *See* IV and III, E, *supra*. Perhaps more importantly, even the other spouse's separate property is at risk if that spouse cannot prove by clear and convincing evidence that a separate asset is separate property due to the community property presumption. Tex. Fam. Code § 3.003. Recall that creditors can rely on the community presumption.

E. Equitable Principles

A court is, however, directed to determine, as deemed just and equitable, the order in which particular assets are subject to execution. Tex. Fam. Code § 3.203.

X. KEY MARITAL PROPERTY CONCEPTS

Accordingly, an understanding of the characterization/reimbursement rules and the management/liability rules is essential when doing joint estate planning for a married couple, independently for either

spouse or an individual planning to marry. However, there are, in the author's opinion, nine key concepts that should be considered and perhaps even explained to the client during the planning process.

A. The Community Presumption

Generally, all assets of the spouses on hand during the marriage and upon its termination are presumed to be community property, thereby placing the burden of proof on the party (e.g., a spouse, or that spouse's personal representative, or the heirs/devisees of the spouse) asserting separate character to show by "clear and convincing evidence" that a particular asset is, in fact, separate. Tex. Fam. Code §§ 3.001, 3.003.

B. Community Claims for Reimbursement

Reimbursement between the marital estates usually arises when one spouse's separate property is improved through the expenditure of community funds. Reimbursement may also be applicable if separate funds are expended to benefit community property. In addition, the expenditure of community time, talent and labor in excess of what is necessary to reasonably manage one's separate property can give rise to a community claim for reimbursement to the extent that excess time, talent or labor is not compensated. Another common reimbursement situation is where one spouse owns separately an insurance policy on that spouse's life and uses community property to pay the premiums, and upon the insured spouse's death, the proceeds are payable to a third party. Tex. Fam. Code §§ 3.401 – 3.410.

C. Special Community Property

The term “special community property” was originally defined by Texas courts as that portion of the community estate which was under the wife’s exclusive control and not liable for the husband’s debts following the landmark decision of *Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925), where the Texas Supreme Court held that the legislature could not define the rents and revenue from the wife’s separate property as her separate property, but could exempt those assets, her “special community property,” from his debts. *Moss v. Gibbs*, 370 S.W.2d 452 (Tex. 1963). Today, it is common practice to refer to the community assets subject to either spouse’s “sole management, control and disposition” under Section 3.102(a) as his or her “special community property.”

D. Fraud on the Community

In *Arnold v. Leonard*, *supra*, the Court explained “. . . that the statutes empowering the husband to manage the . . . community assets made the husband essentially a trustee, accountable as such to the . . . community.” See also *Howard v. Commonwealth Building and Loan Assn.*, 94 S.W.2d 144 (Tex. 1936), where the court explained that, where title to a community asset is held in one spouse’s name, that spouse has legal title and the other has equitable title, explaining: “That one in whose name the title is conveyed holds as trustee for the other. *Patty v. Middleton*, 82 Tex. 586, 17 S.W. 909 (Tex. 1891).” A breach of that fiduciary duty will likely result in a “fraud on the community” claim when the marriage terminates. See Tex. Fam. Code § 7.009.

E. Marital Liabilities

The Texas Family Code creates an “in rem” system of marital property liability. Tex. Fam. Code §§ 3.201 – 3.203. A spouse’s separate property and special community property, as well as the joint community property, are liable for that spouse’s debts during the marriage. If the liability is a tort debt incurred during the marriage, the other spouse’s special community property is also liable for the debt (the other spouse’s separate property is exempt).

If the debt is not a tort debt incurred during the marriage, the other spouse’s separate property and special community property are exempt during the marriage from the debt unless the other spouse is personally liable under other rules of law (e.g., the “necessaries rule”). In which event, the other spouse’s property (i.e., that spouse’s special community and separate) is liable as well.

Note: The marriage relationship, in and to itself, does not make one spouse personally liable for the debts of the other spouse unless it is a debt for a “necessary.” Tex. Fam. Code § 3.201.

F. Death of a Spouse

When a married resident of Texas dies, the marriage terminates and community property ceases to exist. Nonprobate assets pass to the designated beneficiaries. Tex. Prob. Code § 450. Death works a legal partition of the community probate assets; the deceased spouse’s undivided one-half interest passes to his heirs and/or devisees, and the surviving spouse retains her undivided one-half interest therein. Tex. Est. Code § 101.001. A spouse’s testamentary power is generally limited to that spouse’s separate

property and undivided one-half interest in the community property. *Avery v. Johnson*, 108 Tex. 294, 192 S.W. 542 (1917).

G. Fraud/Reimbursement Claims

Upon the death of the spouse who has a reimbursement claim or claim for fraud on the community against the surviving spouse, the claimant spouse's one-half interest in the claim passes to that spouse's heirs or devisees.

1. Duty of Personal Representative

If the heir or devisee is not the other spouse (or if the estate is insolvent), the personal representative has a duty to pursue the claim against the surviving spouse.

2. Liquidity Problems

The existence of the claim may result in a much larger estate than had been anticipated. The deceased spouse's interest in the claim is included in the deceased spouse's gross estate for estate tax purposes and may cause an immediate liquidity problem.

3. Conflict of Interests

The existence of the claim may create a conflict of interest for both the personal representative and the attorney who are attempting to represent the entire family.

H. Claimant as the Surviving Spouse

Upon the death of the other spouse, the asset which is the subject of the community claim for reimbursement will remain the owner's separate property and pass under the owner's will or by intestate succession; however, the claim of the surviving spouse continues to exist, as does any claim that the deceased spouse committed a fraud on the community or

attempted to unilaterally transfer joint community property prior to death, or at death, pursuant to a nonprobate disposition.

1. Conflict of Interests

Either situation can create a conflict of interest (i) between the surviving spouse and the decedent's heirs or devisees or (ii) between the heirs or devisees where the heirs or devisees of the separate property are not the same as the heirs or devisees of the community property. This potential conflict can be particularly troublesome for the personal representative or attorney who attempts to represent all members of the family.

2. Election

The doctrine of equitable election may force the surviving spouse to (i) assert the claim and waive any and all benefits under the will or (ii) accept the benefits conferred in the will and forego the claim. The doctrine of equitable election is applied where any devisee receives a benefit and suffers a detriment in a will. Accordingly, the election concept might work against any party involved.

3. Other Problems

The existence of such a claim with an uncertain value is likely to delay the administration of the estate and create liquidity problems.

I. Closing the Estate

Upon the death of the first spouse and while record legal title still reflects that some community assets are held in the decedent's name, some are held in the survivor's name and others are held in both names, the surviving spouse and the heirs and/or devisees of the deceased spouse are, in effect, tenants in common as to each and

every community probate asset, unless the surviving spouse is the sole distributee of some or all of the deceased spouse's one-half interest in such assets. When administration is completed, the survivor and the distributees are generally entitled to their respective one-half interests in each and every remaining community probate asset. Tex. Est. Code § 101.001.

J. Non-Pro Rata Distributions

A non-pro rata distribution of the community following the first spouse's death is a frequent topic of discussion. That issue is addressed in XXI, *infra*.

**XI. CONSEQUENCES OF
MARRIAGE**

Absent a pre-marital agreement, what effect is a marriage going to have on the client's "estate." The first response may be that, even absent effective planning, any property the client owned before the marriage can (but not necessarily will) remain his or her separate property.

A. Existing Assets

Generally, as soon as the client marries, each and every item of property of either spouse will be presumed to be community property. Each traceable asset acquired prior to marriage, as well as any property acquired during the marriage as separate property (e.g., a gift or inheritance), can remain the client's separate property, if the community property presumption can be overcome by clear and convincing evidence.

B. Future Acquisitions

However, the spouses' respective salaries and other forms of compensation (i.e., employer contributions to retirement plans) will be community property. The

income being generated by their respective separate properties will be community property. Any other assets acquired by either spouse during the marriage will be presumed community property unless proven to be separate property (e.g., traceable to clearly identifiable separate property). Tex. Fam. Code §§ 3.001 - 3.002.

C. Unilateral Gifts/"Fraud"

In addition, the client needs to understand that any unilateral gifts (inter vivos or nonprobate) of the client's sole management community property by the client to a child, a child by a prior marriage, or other third party may later be found by a probate or divorce court to have been a breach of a duty owing by the donor spouse to the other spouse and a "fraud on the community."

Note: A unilateral attempt to transfer joint community property may be void as a matter of law. See Tex. Fam. Code § 3.102.

D. Reimbursement Issues

Whether the marriage eventually terminates in death or divorce, its dissolution will be even more complicated due to the possibility of reimbursement issues accruing during the marriage and maturing upon its termination. See II, B, and II, D, *supra*.

E. Debts

Further, if the spouse incurs a tort debt during marriage, the creditor may be able to enforce any resulting judgment against any and all community property, even if the client does not have personal liability for the debt, and the creditor can take advantage of the community presumption. A breach of contract claim will expose the client's one-half interest in the

joint community and the spouse's special community to liability as well. A debt, contract or tort, incurred before marriage by the spouse will expose the client's interest in any joint or the spouse's special community property to liability.

F. The Necessaries Doctrine

A spouse who fails to discharge his or her duty of support of the other spouse is liable to others who provide necessities to the other spouse. Tex. Fam. Code § 2.501(b). Accordingly, when third parties (e.g., doctors, hospitals, nursing homes – perhaps even lawyers) provide services deemed reasonably necessary for one spouse's support, both spouses become personally liable for the costs of such services. While the spouse who actually incurs the debt may be deemed to be "primarily liable," both spouses are "jointly and severally" liable to the third party under the necessities doctrine. Tex. Fam. Code § 3.201(a)(2). A debt incurred for necessities will expose the entire non-exempt marital estate to liability. Tex. Fam. Code § 3.202.

G. Possible Divorce

In the event of a divorce, generally any community property will be subject to an equitable division by the divorce court and separate property will not. See Tex. Fam. Code § 7.001. Sections 7.006 and 7.009 explain how the divorce court will deal with any reimbursements or fraud on the community claims.

Note: While contractual alimony can be incorporated into a divorce decree, absent such an agreement, the Texas divorce court cannot award alimony to a spouse. Alimony is contrary to Texas public policy. A limited form of alimony, "maintenance," is

available in certain defined situations. See Tex. Fam. Code §§ 8.001 – 8.059.

H. Eventual Death of First Spouse

Upon the first spouse's death, the deceased spouse will only have testamentary power over the decedent's separate property and one-half of the community property. The surviving spouse can retain his or her own separate property and one-half of the community after the deceased spouse's debts are paid. The surviving spouse may have homestead rights and/or rights to an "allowance" or to certain exempt personal property.

I. Portability

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 introduced the concept of "portability" to estate and gift taxation. Portability creates the possibility that the surviving spouse can take advantage of the unused tax applicable exemption amount for estate and gift tax purposes from the estate of a pre-deceased spouse. For a complete discussion, see Marc Bekerman, *Portability of Estate and Gift Tax Exemptions Under TRA 2010*, Tax Management Estates, Gifts and Trusts Journal, May/June 2011. The American Taxpayer Relief Act of 2012 made portability "permanent."

1. **"Applicable Exclusion Amount"**

The "applicable exclusion amount" is the sum of a decedent's basic exclusion amount (currently \$5 million *plus* and indexed for inflation) plus, in the case of a surviving spouse, the "deceased spousal unused exclusion amount" – the basic exclusion amount of the deceased spouse, less the amount exemption actually used at the deceased spouse's death (the "DSUE amount").

2. Limitations

The surviving spouse's estate is limited to the unused exclusion amount of his/her most recent deceased spouse. The surviving spouse's estate cannot take advantage of the deceased spouse's unused exclusion unless the deceased spouse's estate timely filed U.S. Estate Tax Return reflecting the amount of the unused exclusion amount.

3. Effect on Gift Tax and GST Tax

While it appears that a surviving spouse will be able to utilize the deceased spouse's unused exclusion amount in making inter vivos gifts, there are a number of unanswered questions concerning its application, which are beyond the scope of this paper. Portability does not apply to the generation-skipping transfer tax. Any unused generation-skipping transfer tax exemption cannot be used to increase the surviving spouse's exemption.

4. Overlooked Resource

Going into a second marriage, a surviving spouse should consider any DSUE amount from a deceased spouse as a separate and valuable resource to be utilized like any other separate property resource. In addition, if the value of the prospective spouse's estate is likely to be less than the basic exclusion amount, the potential benefit of the prospective spouse's DSUE amount should not be ignored in the event the client survives the prospective spouse.

**J. To He__ (Double Hockey Sticks)
With This!**

In view of all of these complications, the client may wish to "opt out" of the Texas community property regime, a result that can be accomplished in a well-crafted pre-marital agreement. Through such an

agreement, parties intending to marry can address these issues, perhaps even create a "community free" marriage where all property is the separate property of one spouse or both spouses and possibly eliminate other spousal rights. See XIII, XIV, *infra*.

XII. UNILATERAL PLANNING

Even in the absence of a pre-marital agreement, the client unilaterally can take steps prior to and during the marriage to minimize the complications of a subsequent marriage to maintain the separate character of the client's separate property and avoid many other issues that would otherwise arise during the subsequent marriage.

A. Segregated Accounts

At a minimum, the client should be advised to "keep separate, separate" by maintaining existing assets in the client's name and opening bank and brokerage accounts in the client's individual name (perhaps with a designation "separate account") and only depositing into the accounts separate property. Contemporaneous business records showing the source of any and all separate deposits should be retained in the event proof of separate character of the account is later needed.

Note: The creation and funding of a revocable trust prior to marriage may be an effective way to maintain the separate character of the settlor's assets

B. Avoid Inadvertent Commingling

Since income from separate property is generally community property, any interest (or other income generated by a separate investment) should be paid into a "special community account" in order to

avoid a “commingling” of community and separate funds in the same account. If an account is “commingled,” the account becomes community property.

Note: Prior to the marriage, the client may want to consider creating an entity, like a family limited partnership, and exchange some portion of the client’s estate for interests in the partnership. The partnership interest remains the client’s separate property; the assets of the partnership should be treated as partnership assets if the partnership is properly administered. Paying a reasonable salary for services rendered should avoid Jensen claims. Not making community contributions during the marriage can avoid reimbursement and fraud on the community claims.

C. 401(k) Plans

While Texas generally follows the “apportionment” approach to determine the marital property character of defined benefit and contribution retirement plans, the separate nature of such a defined contribution plan brought into a marriage can easily be lost during the marriage through commingling. To maintain the separate character of the plan as it existed on the date of the marriage, the separate property interest will have to be traced using the same tracing rules that apply to non-retirement assets. See Tex. Fam. Code § 3.007(a). For employer-provided stock option plans and restricted stock plans, see Tex. Fam. Code § 3.007(d). Defined benefit plan characterizations depend on case law.

D. Earmark Future Holdings

Any future gift to or inheritance by the client, or property purchased with separate funds, should be held in the client’s name only. Further, titled assets, especially

real estate, should be conveyed to the client “as separate property.” Again, contemporaneous business records can serve as evidence of the nature of the transaction and the separate character of the asset and should be retained.

E. Family Entities

If the client is to become a partner in a family partnership, a member in a family-oriented limited liability company or a shareholder in a closely-held corporation, the client’s interest should be given to the client as a gift (or purchased by the client with traceable separate property). Again contemporaneous business records of the nature of the transaction should be retained. See XVIII, *infra*, Family Business Planning.

F. Closely Held Business Interests

Capital contributions to any existing or subsequently acquired separately owned closely held business interest should be funded with clearly documented separate funds or structured in the form of a loan from community funds. If the client expends any “time, talent or labor” in the management of the entity, reasonable documented compensation for those services can hopefully avoid a later reimbursement claim by the client’s spouse. See XVIII, *infra*, Family Business Planning.

G. Asset Protection Trusts

Any and all of future inter vivos or testamentary gifts to the client by others could be placed by the donor in an asset protection trust for the client’s benefit. The spendthrift provisions will help not only insulate the interest from the claims of the client’s creditors, but also any community property claims of the spouse, the spouse’s successors or creditors. The inclusion of a statement in the trust agreement that it is the

settlor's intent that any and all interests of the client, as well as any and all distributions of the trust, are the client's separate property may not be conclusive, but may prove to be persuasive in future litigation. Limiting distributions of income and/or principal to an ascertainable standard (health, education, maintenance, or support) is especially important if the client is going to be the trustee or is going to be given general power of appointment. If a third party is going to serve as trustee, income distributions to the client could be at the discretion of the trustee or pursuant to an ascertainable standard. Caution should be exercised in granting any other powers to the client over the trustee or the trust estate. Carefully planning, drafting and administering the trust could prove to be persuasive in maintaining the client's interests in the trust, as well as distributions from the trust, as separate property. *See* XIX, *infra*, Marital Property Rights in Irrevocable Trusts.

**H. Fraud on the Community/
Reimbursement Issues**

An understanding of the concepts of "wrongful transfers" and "reimbursement" can minimize the risks that such issues will become material issues when the marriage eventually terminates. For example, the client can avoid using community property to make improvements to separate property or to make principal and interest payments on indebtedness secured by separate property or to pay the premiums on any separately owned life insurance policies. Gifts to children by a prior marriage and others should be given from separate sources or with documented approval of the spouse if community property is given.

I. Take Advantage of Portability

If the previous marriage ended in the prior spouse's death, portability allows for the DSUE amount from the deceased spouse's estate to be used during the lifetime of the surviving spouse or at the surviving spouse's death. Thus, portability is another reason gifts to or for the benefit of the client's descendants should be considered.

J. Legal Fees

Legal fees paid by the client during the marriage for this type of planning should be paid by the client with separate property to avoid any claim by the spouse that the client misused their community property to the spouse's detriment.

**XIII. PREMARITAL AGREEMENTS –
FORMALITIES**

If the couple is open to pre-marital planning, Texas law permits persons intending to marry to enter into property agreements that can result in a *community free marriage*. The ability to accomplish this result depends initially on satisfying the formality requirements specified in the Texas version of the Uniform Premarital Agreement Act.

**A. Uniform Premarital Agreement
Act**

The 1987 Legislature enacted the Texas version of the Uniform Premarital Agreement Act. This legislation attempted to define what parties intending to marry could accomplish in a premarital agreement. However, the power to contract in these matters is ultimately controlled by the Texas Constitution. *See* XIV, *infra*. The Uniform Premarital Agreement Act did affect the formal requirements and enforceability of premarital agreements. Among other

technical changes, there was a dramatic shift in the burden of proof when the validity of an agreement is placed in question.

B. Formalities

As under prior law, a premarital agreement must be in writing and signed by the parties. It need not be witnessed, acknowledged or sworn to. It is enforceable without consideration. Tex. Fam. Code § 4.002. It becomes effective on marriage. Tex. Fam. Code § 4.004. It can be amended by a written agreement of the parties. Tex. Fam. Code § 4.005.

C. Burden of Proof

Under prior law, the burden of proof was imposed on the party seeking to enforce the agreement to establish by clear and convincing evidence that the other party gave “informed consent” and that the agreement was not obtained by fraud, duress or overreaching. Now, the burden of proof is placed on the party asserting the agreement’s invalidity. Tex. Fam. Code § 4.006.

D. The Opponent’s Burden

The party opposing the agreement must now prove that (i) the agreement was not entered into voluntarily, or (ii) it was unconscionable when it was executed and the opponent was not provided with a fair and reasonable disclosure of the proponent’s financial situation, or did not waive such disclosure and did not have adequate knowledge of such situation. In other words, there is a statutory presumption of validity.

1. Involuntariness

The issue of involuntariness (i) relates to the issue of whether the opponent entered into the agreement “freely” and (ii) incorporates effectively the possible

contractual defenses of competency, fraud, misrepresentation, duress and coercion as evidenced by the terms of the agreement or the surrounding facts and circumstances. Other relevant factors may be the opponent’s understanding of the agreement at the time it was executed and whether the opponent had adequate time to consider the terms of the agreement prior to execution. See Fullenweider and Rainey, “Litigating Premarital Agreements,” Advanced Family Law Course, State Bar of Texas (1988).

2. Unconscionability

Section 4.006(b) of the Texas Family Code provides that the issue of unconscionability is a question of law to be decided by the court, not the jury. The relevant factors for the court to consider may include the negotiating atmosphere, the relative bargaining abilities of the parties, and over-reaching by a party, as well as the legality of the contract and whether or not it violates public policy. Fullenweider and Rainey refer to the Uniform Premarital Agreement Act, 9(b) UCA 20, to include factors such as concealment of assets and sharp dealing not consistent with the obligation of marital partners to deal fairly with each other. See Fullenweider, *supra*. However, it is important to remember that, according to Sec. 4.006(b), even an unconscionable agreement can be enforced if it was entered into voluntarily by an opponent who was either provided fair and reasonable disclosure or who waived such disclosure or who did not already have adequate knowledge of the financial situation of the proponent.

3. Waiver

Generally, in order to be valid, a waiver of a statutory right must be a voluntary and intentional release of the

right. It must be clear, specific and unequivocal. The party signing the waiver must have full knowledge of its consequences.

4. Fairness

Notwithstanding the discussion of involuntariness and unconscionability, it is important to remember that there is no requirement that a premarital agreement be fair to be enforced. In *Chiles v. Chiles*, 779 S.W.2d 127 (Tex. App.–Houston [14th Dist.] 1989, writ denied), overruled on other grounds by *Twyman v. Twyman*, 855 S.W.2d 619 (Tex. 1993), the court held: “Parties should be free to execute agreements as they see fit and whether they are ‘fair’ is not material to validity.” Accordingly, Texas law currently appears to require only that a premarital agreement be fairly entered into and not that it be fair in application to both parties.

5. Common Law Defenses

In *Daniel v. Daniel*, 779 S.W.2d 110 (Tex. App.–Houston [1st Dist.] 1989, no writ), the court discussed whether old Sec. 5.46’s comparable section for marital agreements, old Sec. 5.55, abolishes common law contract defenses (e.g. such as fraud, duress and competency), and concluded that it did not. However, the predecessor to Sec. 4.006 eliminated the common law defenses for agreements executed on or after September 1, 1993, but they still appear to be incorporated into the concepts of involuntariness or unconscionability.

6. Cases

In *Sheshunoff v. Sheshunoff*, 172 S.W.3d 686 (Tex. App.–Austin 2005, pet. denied), the court discussed the premise that premarital agreements are presumptively

enforceable, even if they are unconscionable, unless they were entered into unfairly. Other courts have followed this presumption that premarital agreements are enforceable. See *Larson v. Prigoff*, 2001 WL 13352 (Tex. App.—Dallas, Jan. 8, 2011).

E. Statute of Limitations

The statute of limitations applicable to any breach of the agreement is tolled until the marriage is terminated. Equitable defenses, such as laches and estoppel, are, however, preserved. Tex. Fam. Code § 4.008.

F. Disclosure/Assistance of Counsel

The law does not require that the parties be represented by separate legal counsel at the time of the agreement; however, the lack of independent counsel representing the party opposing the agreement’s enforcement is likely to be an important factor in determining an agreement’s enforceability. Failing to fully disclose the client’s financial situation can be problematic even if a waiver of such information is obtained from the other party.

G. Re-execution Once Married

Some practitioners follow the practice of having the couple re-execute the premarital agreement following the wedding, a practice which is not necessary, in the author’s opinion, if the original agreement is a properly drafted “partition and exchange agreement.” Further, the Texas Family Code states that a premarital agreement actually becomes effective upon marriage.

**XIV. PREMARITAL AGREEMENTS –
SUBSTANCE**

Prior to 1987, the Texas Family Code granted blanket authority to parties to enter into such agreements as they desired, subject, of course, to the limitations of the Texas Constitution and other public policy concerns. The Uniform Premarital Agreement Act, which includes a laundry list of subjects that can be addressed in a premarital agreement, was adopted in 1987. Today, the parties can still enter into such property agreements as they may desire, but the agreement is still subject to the limitations of the Texas Constitution and certain public policy concerns.

A. Mere Agreement Rule

In 1902 the Texas Supreme Court announced what became known as the mere agreement rule: “The question whether particular property is separate or community must depend upon the existence or nonexistence of the facts, which, by the rules of law, give character to it, and not merely upon the stipulations by the parties that it shall belong to one class or the other.” *Kellet v. Trice*, 95 Tex. 160, 66 S.W. 51 (1902). The net effect of the mere agreement rule is that the constitutional definition of separate property limits the flexibility of spouses and those about to marry in their property agreements.

Note: The mere agreement rule today can be summarized as follows: The provisions of an agreement which attempt to change the character of property in a manner not authorized by Art. XVI, Sec. 15, are void.

B. Constitutional Amendments

The 1948 amendment to Art. XVI, Sec. 15, permitted spouses to partition and exchange presently existing community

property. The 1980 amendment to Art. XVI, Sec. 15 authorized the creation of separate property in more ways:

1. **Premarital Partitions**

Persons intending to marry can partition and exchange community property not yet acquired. *See also* Tex. Fam. Code § 4.003.

2. **Spousal Partitions**

Spouses may now partition and exchange not only presently existing community property but also community property not yet in existence into the spouses' separate properties. *See also* Tex. Fam. Code § 4.102.

3. **Income from Separate Property**

Spouses may also agree that income from one spouse's separate property will be that spouse's separate property. *See also* Tex. Fam. Code § 4.103.

4. **Spousal Donations**

A gift by one spouse to the other spouse will be presumed to include the income generated by the donated property so that both the gift and the future income from the gift are the donee spouse's separate property. *See also* Tex. Fam. Code § 3.005.

Note: The 1999 amendment to Art., XVI, Sec. 15 permitted spouses to convert by agreement separate property into community property beginning on January 1, 2000.

C. Sec. 4.003, Texas Family Code

Currently, parties to a premarital agreement are authorized by statute to contract with respect to:

1. The rights and obligations of each of the parties in any of the property of either or both of them whenever and wherever acquired or located.
2. The right to buy, sell, use, transfer, exchange, abandon, lease, consume, expend, assign, create a security interest in, mortgage, encumber, dispose of, or otherwise manage and control property.
3. The disposition of property on separation, marital dissolution, death, or the occurrence or nonoccurrence of any other event.
4. The modification or elimination of spousal support.
5. The making of a will, trust, or other arrangement to carry out the provisions of the agreement.
6. The ownership rights in and disposition of the death benefit from a life insurance policy.
7. The choice of law governing the construction of the agreement.
8. Any other matter, including their personal rights and obligations, not in violation of public policy or a statute imposing a criminal penalty.

D. Standard Provisions

It is common for premarital agreements to simply confirm the status of certain assets under Texas law. For example, the parties agree that certain itemized assets brought into the marriage and their mutations are to remain the owner's separate property. They may also

confirm that anything acquired during marriage by gift, devise or descent will be separate property. They may even agree that such separate property will not be subject to an equitable division at divorce. *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977) and *Cameron v. Cameron*, 641 S.W.2d 210 (Tex. 1982).

E. Income from Separate Property

Parties may wish to agree that income from separate property is the owner's separate property. Since the Constitution expressly authorizes only spouses to make such agreements and not persons intending to marry, it may be advisable to draft such an agreement as a partition, since both spouses and persons intending to marry can partition community property not yet in existence (i.e., future income from separate property). Accomplishing this result through a partition, however, may not be necessary since by statute a premarital agreement becomes effective on marriage; thus, spouses are really making the agreement. Tex. Fam. Code § 4.004. On the other hand, the Constitution does distinguish between parties intending to marry and spouses. See *Fanning v. Fanning*, 828 S.W.2d 135 (Tex. App.–Waco 1992), rev'd in part on other grounds, 847 S.W. 2d 225 (Tex. 1993); *Dokmanovic v. Schwarz*, 880 S.W.2d 272 (Tex. App.–Houston [14th Dist.] 1994, no writ).

F. Wages, Salaries, Personal Earnings

Following the passage of the 1980 amendment, some practitioners questioned whether the parties to a premarital agreement could agree that wages and salaries and other personal earnings would

be the acquiring spouse's separate property. For example, Professor Sampson noted:

It remains to be seen whether revising the type of agreement entered into here to contemplate a present partition of future earnings will suffice to take the parties completely out of the community property system. Generally, I hope not, although I also tend to believe that folks ought to be able to do what they want with their property. On the other hand, an agreement such as this between a doctor and his to be housewife seems clearly abusive and overreaching. Editor's note, Family Law, State Bar Section Report, Vol. 87-6, Fall 1987, pp. 35-36.

Professor Sampson's comments followed a discussion of *Bradley v. Bradley*, 725 S.W.2d 503 (Tex. App.—Corpus Christi 1987, no writ), where the court held that a particular premarital agreement did not effectively partition the parties' future earnings. It should be noted that the Bradley agreement itself was not drafted to accomplish a direct partition of future earnings, but was an agreement to partition future earnings once the earnings came into existence.

G. Partition and Exchange

Notwithstanding these initial concerns, Art. XVI, Sec. 15 of the Texas Constitution appears to clearly authorize the partition and exchange of any and all community property not yet in existence, including, but not limited to, personal earnings, retirement benefits, I.R.A.s, trust income, income from separate property, and property acquired on credit; so does the legislature. See Sec. 4.001(2) of the Texas

Family Code. The cases of *Fanning v. Fanning*, *supra*, and *Winger v. Pianka*, 831 S.W.2d 853 (Tex. App.—Austin 1992, writ denied) have confirmed this viewpoint.

H. Community Free Marriage

It is, therefore, the "partition and exchange" agreement which can be effectively used to create the "community free marriage." By eliminating community property from the marriage, wrongful transfer issues, like "fraud on the community" are also eliminated. This type of agreement also allows the couple to address some otherwise troubling issues.

1. Reimbursement

If there still exists the possibility of a community claim for reimbursement, it would be advisable to address specifically any such potential claim in the premarital agreement. For example, perhaps the nonowner spouse could agree to waive the claim for reimbursement. *Stoker v. Stoker*, 2008 WL 4837084 (Tex. App.—Houston [1st Dist.] 2008), involved a premarital agreement that waived economic contribution claims by the nonowner spouse. The court held that this was permissible under Tex. Fam. Code § 3.410. However, it may be advisable for the couple to "partition and exchange" claim in a manner which would at least limit the exposure the owner spouse would have by reason of the community claim for reimbursement.

Note: Even if a community-free marriage is created, a spouse may have a "separate claim for reimbursement." This possibility could be addressed in the pre-nup.

2. Quasi-Community Property

Separate property acquired by a couple while residing in a common law state

that would have been community had they been residing in Texas can be divided by a Texas divorce court on a just and right basis. Tex. Fam. Code § 7.002. The Family Code does not convert such asset into community property, but allows for it to be treated as such in a divorce proceeding. This concept is not available in probate. See *Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987). Since such property is merely quasi-community and not actually community property, can it be subject to a partition and exchange agreement as authorized by the constitution and the statutes? Is this a right that the nonowner spouse can waive in a premarital agreement? There does not appear to be a good answer to this question, but it is an issue that should be addressed specifically in this agreement, if relevant.

3. Quasi-Separate Property

A 2003 amendment to Sec. 7.002 treats as separate property any community property that was acquired while the couple resided in another state that would have been separate, had they resided in Texas at the time of its acquisition. Presumably “quasi-separate” property would be treated as community property if the marriage terminates by reason of a spouse’s death, if the reasoning of the *Hanau* case, *supra*, is followed. Since such property is merely quasi-separate and not actually separate property, this category of community property should be subject to a partition and exchange agreement.

4. Professional Degrees, Licenses

In view of the trend in some states to treat professional degrees and licenses as property and therefore capable of division by the divorce court and possible partition by the probate court, the possibility of such a result in Texas should be anticipated

although the only case in Texas to date on point has held to the contrary. See *O’Brien v. O’Brien*, 489 N.E.2d 712 (N.Y. 1985) and *Frausto v. Frausto*, 611 S.W.2d 656 (Tex. Civ. App.–San Antonio 1980, writ dismissed w.o.j.). If professional degrees and licenses are eventually found to be property in Texas and consequently community property, if acquired during marriage, they should be treated as such in the agreement and could be subjected to a partition and exchange, if the parties so agree.

5. Certain Personal Injury Recoveries

Personal injury recoveries for loss of earning capacity during marriage are defined as community property. Tex. Fam. Code § 3.001(a)(3). Notwithstanding this statutory provision and *Graham v. Franco*, *supra*, the author is of the opinion that actual “lost earnings” should be deemed to be community property, while “loss of earning capacity” should be considered separate property. Lost earnings are properly characterized as community property since the community estate will be liable for payment of medical expenses and will suffer as a result of losing one spouse’s community earnings. However, characterizing the recovery for lost earning capacity as community property requires a presumption that the couple will remain married indefinitely. In reality, should the spouses divorce following the injury, community recoveries will be divided on a just and right basis; or should the non-injured spouse die, the estate will be entitled to one-half of the entire recovery. Since the primary purpose of a personal injury recovery is to compensate the injured spouse, classifying lost earning capacity as community property and giving the non-injured spouse a one-half interest therein may leave the injured spouse with only a fraction of the amount awarded.

The potential for such a situation clearly warrants a distinction between lost earnings and lost earning capacity which characterizes the former as community and the latter as separate. In view of current law possibly creating such an inequitable result, possible personal injury recoveries could be addressed in a partition and exchange agreement.

Note: The same distinction can be made between actual medical expenses and future medical expenses.

6. Personal Service Contracts

About a “pre-nup,” wages and salaries earned during the marriage are clearly community property, but the characterization of money earned during the marriage pursuant to a contract signed before marriage, or money received after the marriage pursuant to a deferred compensation agreement signed during the marriage, can be complicated. Even if wages and salaries generally are not going to be partitioned, these other issues could be addressed in the premarital agreement to avoid future confusion and litigation.

I. Division of Property upon Divorce

The parties should be able to agree as to a certain division of any community and their respective separate properties in the event of divorce instead of awaiting an “equitable division” of the community by the divorce court. Of course, such an agreed to division cannot affect a parent’s child support obligations. Such an agreement may also affect the determination of whether an agreement is unconscionable or not.

J. Contracts Concerning Succession

The parties to a premarital agreement may also agree that they will not assert

inheritance rights upon the first spouse’s death or that one spouse is to leave to the other spouse certain assets in the event the marriage terminates by reason of the obligor’s death. Sec. 59A of the Texas Probate Code was amended in 2003 in order to confirm that a contract to make a will or devise can be established by either (i) provisions in a will stating that the contract exists and the material provisions of the contract, or (ii) the provisions of a written agreement that is binding and enforceable. Even without the addition of the latter provision, this author is of the opinion that Section 59A, currently Section 254.004 of the Texas Estates Code, was never intended to apply to an agreement whereby a spouse is required to leave property to the other spouse pursuant to a premarital agreement. This situation is not one where there are reciprocal testamentary promises but one where there is current consideration in exchange for a testamentary promise.

K. Homestead, Exempt Personal Property and Allowances

In *Williams v. Williams*, 569 S.W.2d 867 (Tex. 1978), the Texas Supreme Court approved the provisions of a premarital agreement whereby one party waived his right following the first spouse’s death to occupy the other party’s separate property home, to utilize the exempt personal property and to claim a family allowance.

1. Selection and Abandonment

The premarital agreement presents the opportunity for a couple to agree which of their homes will be the homestead and what process should be followed to abandon and select a new one.

2. Sale or Encumbrance

The *Williams* case involved the surviving spouse's rights following the owner's death. Sec. 5.001 of the Texas Family Code prohibits the owner of the homestead from selling or encumbering it during the marriage without the joinder of the non-owner spouse. Can this right of the non-owner be waived in a premarital agreement? Sec. 4.003(a)(2) appears to authorize it.

3. Liability

So long as the owner is alive, the homestead and certain items of personal property continue to be exempt from the claims of certain creditors. Tex. Prop. Code §§ 41.001 and 42.002. However, if the non-owner has waived the right of occupancy and possession upon the death of the owner, will such property continue to be exempt from most creditors following the owner's death? Presumably yes, if the owner also was survived by a minor child. But if the only constituent family member surviving the owner is the spouse who previously waived these rights, the answer is not so clear.

Note: Prior to 2005, Texas case law appeared to grant the exemption from creditors if the owner was survived by an unmarried child living at home. 2005 amendments to Sections 271 and 272 eliminated that exemption. See Tex. Est. Code § 102.005.

L. The Universal Community

Can the parties to a premarital agreement agree that the property they are bringing into the marriage and/or the property to be acquired during marriage by gift, devise or descent are to be community property? In other words, can those

intending to marry agree to an "all community" marriage? Notwithstanding the 1999 amendment, such an agreement would still appear to violate the Texas Constitution, which does not expressly offer a procedure for parties intending to marry to accomplish the result. *Tittle v. Tittle*, 148 Tex. 102, 220 S.W.2d 637 (1949). Of course, once married, one spouse may give the other spouse one-half of the donor's separate property, thereby making them tenants in common, and spouses over a period of time can allow their separate estates to become commingled and, therefore, community property. In addition, since January 1, 2000, spouses can enter into a transmutation agreement once they are married. Or, is a premarital agreement really a marital agreement since it becomes effective upon marriage?

M. Preserving Portability

The parties should consider a provision in the agreement that requires that the first spouse to die is to direct the personal representative of his or her estate to elect to transfer to the surviving spouse the deceased spouse's DSUE amount by filing a United States Estate Return whether one is otherwise required to be filed or not. As consideration for the agreement, the surviving spouse may be required to reimburse the estate of the deceased spouse for any expenses that would not otherwise be incurred by the deceased spouse's personal representative. See *Portability and Prenuptials: A Plethora of Preventative, Progressive and Precautionary Provisions*, George K. Karibjanian and Lester B. Law, *Probate Property* (May/June 2013).

N. Addressing the Mutual Duty of Support

Notwithstanding a spouse's duty of support and the necessities doctrine, increasingly lawyers with clients considering marriage but concerned with the potential overwhelming costs of caring for an elderly spouse are focused on the Texas version of the Uniform Premarital Agreement Act, specifically Section 4.003(a)(4) of the Texas Family Code, which states that the parties to a premarital agreement may contract with respect to "the modification or elimination of *spousal support*." Can a Texas couple by an agreement eliminate the spouses' mutual obligation of support and a third party's rights under the necessities doctrine? See XVI, *infra*.

XV. EFFECTIVENESS OF THE PRENUPTIAL AGREEMENT

Assuming a valid, enforceable agreement has been executed in order to create a "community free marriage," have the goals of insulating each spouse's separate estate from the claims of the other spouse and the other spouse's creditors and successors been accomplished? The answer: "Maybe!"

For one thing, since everything is his or her separate property, each spouse is free generally to manage his or her property without interference from the other spouse. However, absent an effective waiver, the homestead rules will still prohibit a transfer or encumbrance of the home without the joinder of the other spouse.

Further, the separate assets of one spouse are generally exempt from the creditors of the other spouse. In the event of divorce, there is no community property to divide on a just and right basis; and upon the

death of a spouse, the decedent's estate passes to the decedent's heirs and devisees, and the surviving spouse retains his or her estate untainted by the claims of the decedent's heirs and devisees.

However, the situation may not be as perfect as it may appear.

A. Necessaries

Generally, each spouse still has the legal duty to support the other spouse and their children for so long as the children are minors and thereafter until they graduate from high school. Tex. Fam. Code §§ 2.501 and 154.001. Therefore, both spouses' separate properties are liable for such necessities unless the mutual duty of support can be waived by the spouses in the agreement. See XVI, *infra*.

B. Child Support

As would be expected, an agreement between spouses to limit either's child support obligations would be against public policy. This concept has been codified in Sec. 4.003 of the Texas Family Code.

C. Tax Liability

For any tax year that the spouses file joint income tax returns, each spouse remains jointly and severally liable for any tax liability arising from that year's tax.

D. Spousal Torts

Will public policy prevent the anticipatory waiver of spousal tort claims in premarital agreement? Should there be a different rule for negligence and intentional torts? In general, see "Releases: An Added Measure of Protection from Liability," 39 *Baylor L. Rev.* 487 (1987).

E. Joint Ventures

A spouse remains personally liable for the acts of the other spouse if the other spouse is an agent or otherwise innocent spouse. Tex. Fam. Code § 3.201. Although the marital relationship itself does not create a principal/agency relationship among the married couple, their being engaged together in a business venture or other joint action can create vicarious liability and expose each spouse's separate property to any liability arising therefrom.

F. Preexisting Creditors

Section 4.106 of the Family Code says that a partition and exchange agreement is void with respect to the rights of preexisting creditors whose rights are intended to be defrauded therein. It is interesting to note that it is not clear whether this provision applies to premarital partition and exchange agreements. Also, such provision does not by its own terms apply to spousal income agreements under Sec. 4.102.

G. U.F.T.A. and the Bankruptcy Code

Creditors may avoid and recover fraudulent transfers. The trustee in bankruptcy can avoid transfers deemed fraudulent under the Texas version of the Uniform Fraudulent Transfer Act. This means that certain prepetition transfers of community property by a filing spouse to a nonfiling spouse, by way of gift or partition, can be avoided because the transfer acted to deprive creditors of property that would otherwise be available to creditors as part of the bankruptcy estate. But do these concepts apply in a premarital partition and exchange situation?

Each type of transfer must be analyzed under the fraudulent transfer

theory to determine if assets otherwise within the reach of a creditor have been pulled beyond the creditor's reach by virtue of the challenged transfer. For example, a spouse might impermissibly transfer his own interest in existing community property by way of a partition. Yet the same spouse could probably renounce, by way of a premarital partition, an interest in community property to be acquired in the future since the parties to the partition had no vested interest in the future community property absent the partition. Of course, these sections of the U.F.T.A. and the Bankruptcy Code also invalidate transfers involving actual or constructive fraud.

H. ERISA Plans

ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan..." 29 U.S.C.A. Sec. 1144. Further, ERISA requires for many qualified retirement plans that the participant's spouse receive a mandatory death benefit upon the death of the participant or a joint and survivor annuity upon the retirement of the participant, regardless of the marital property character of the participant's interest in the plan. Of course, the spouse may waive these statutory rights in a consent procedure described by statute. 29 U.S.C.A. Sec. 1055(c).

Several cases have held that these ERISA granted rights of the participant's spouse cannot be waived in a premarital agreement. In *Manning v. Hayes*, 212 F.3d. 866 (5th Cir. (Tex.) 2000), cert. denied, 121 S.Ct. 1401 (2001), language in a premarital agreement was not sufficiently explicit to result in a waiver of an ex-wife's beneficiary status under an ERISA plan. In *Hurwitz v. Sher*, 789 F.Supp. 134 (S.D.N.Y. 1992), aff'd by 982 F.2d. 778 (2nd Cir. 1992), cert.

denied 508 U.S. 912 (1995), the decedent and his spouse executed a premarital agreement waiving any rights with respect to the other's separate property and the court held that the wife had not waived her rights to the plan benefits to which she was entitled because only a spouse, not a fiancé, can waive such rights under federal law. A similar result was reached in *Nellis v. Bowing Co.*, 1992 WL 122773, 15 Employee Benefits Vas. 1651 (D. Kan. 1992); further, the court noted that language in the agreement stating that the agreement was to take effect upon marriage did not save the agreement. In *Zinn v. Donaldson Co.*, 799 F.Supp. 69 (D. Minn. 1992), the court even held that a constructive trust could not be imposed on the surviving spouse to equitably enforce the premarital agreement. A similar result was affirmed by the Sixth Circuit in *Howard v. Branham & Baker Coal Co.*, No. 91-5913, 968 F.2d 1214 (table), (6th Cir. 1992) (text in Westlaw).

I. Trap for the Unwary

Accordingly, a properly prepared or premarital agreement under Texas law may ensure that the employee's interest in the retirement plan is separate property in the event of divorce, but such a result, in and of itself, does not negate whatever rights the spouse may have under ERISA at the time of the employee's retirement or death absent an effective ERISA waiver of those rights.

J. Future Legislative Changes

The potential impact of future state and federal legislation (e.g., amending ERISA or adopting the concepts of quasi-community property at death, or a statutory share system, or even permanent alimony) should be considered and addressed in the agreement. Of course, these potential rights

could be expressly waived in the premarital agreement, but is the waiver of a right that is not yet in existence enforceable? Generally, to be enforceable, a waiver of statutory rights must be clear, specific and unequivocal, and given by a party who has full knowledge of its consequences. In any event, the issues should be addressed and identified as specifically as possible.

K. Lost Income Tax Basis

To the extent property is held as community property, both halves receive a new income tax basis upon the death of the first spouse under Sec. 1014(b)(6) of the Internal Revenue Code. This tax advantage is lost if community property has been partitioned into separate property. Of course, during the marriage, the couple can enter into a transmutation agreement and convert separate property into community property. *See XVII, C, infra.*

XVI. WAIVING SPOUSAL SUPPORT

Some commentators have suggested that a couple can, by agreement, avoid joint and several liability by waiving their mutual duty of support. The treatise *Texas Family Law: Practice and Procedure*, VI, 130, Waiver of Spousal Support During Marriage (Matthew Bender & Company 2012), states that the parties to a premarital agreement can modify or eliminate "the duty of spousal support." It further states that, in the premarital agreement, the parties ". . . may waive the right of *spousal support*, limit it to a certain amount, or provide that the *duty of support* arises only if one spouse becomes disabled or unemployed." Similar language is found in Matthew Bender's *Texas Transaction Guide – Legal Forms*, § 93.230 (2012). Unfortunately, the only authority

cited for the assertions is Tex. Fam. Code § 4.003(a)(4).

A. Texas Premarital Agreement Act

Section 4.003(a)(4) of the Texas Family Code states that the parties to a premarital agreement may modify or eliminate *spousal support*. It does not state that the parties can modify or eliminate the *duty of support*. In addition, a review of the annotations under Section 4.003 does not reveal any real authority to support the argument that such an agreement can eliminate or modify a spouse's *duty of support* of the other spouse during the marriage, or a third party's rights under the necessities doctrine. Section 4.003's laundry list of matters which can be addressed in a premarital agreement suggests that the parties can contract with each other concerning their mutual rights and obligations, and the contract is enforceable among themselves and their successors in interest as long as the agreement does not violate public policy. A matter which extends beyond the parties' mutual rights and obligations and which affects third parties should be subject to a more stringent public policy examination prior to being enforceable against a third party, especially a third party creditor that provided services deemed reasonably necessary for either spouse's support.

Note: It is important to note that Subchapter B of Title 1, Chapter 4 of the Texas Family Code, which relates to agreements between spouses during the marriage, does not contain similar language. This omission suggests that, once married, spouses may not be able to enter into a contract that modifies or eliminates spousal support.

B. The Community-Free Marriage

Texas public policy does allow the parties to the premarital agreement to create a "community-free marriage" – a marriage where all assets are either the separate property of one spouse, or the other, or both spouses. Art. XVI, § 15, Texas Constitution. Even existing spouses can create a community-free marriage. Tex. Fam. Code § 4.102. Such a marital agreement cannot prejudice the rights of pre-existing creditors. Tex. Fam. Code § 4.106. Subject to the provisions of Section 4.106, creating a community-free marriage is a valid means of affecting the rights of third parties, including the spouses' creditors, since generally one spouse's separate property is not liable for the contract debts or tort debts of the other spouse. Tex. Fam. Code § 3.202(a).

Even if the parties have a community-free marriage, each spouse is still personally liable for a debt of the other spouse if (i) the other spouse acted as the spouse's agent when incurring the debt or (ii) the other spouse incurred a debt for necessities. Accordingly, that spouse's separate property is reachable by the creditor of the other spouse that provided services that are deemed to have been reasonably necessary for the other spouse's support. Tex. Fam. Code § 3.201.

C. Effect of Support Waiver

If the terms of an otherwise valid, enforceable premarital agreement purport to eliminate or modify the spouses' mutual obligation of support, its effectiveness should be limited to the relative rights and obligations between the parties themselves and their successors. Public policy considerations suggest that the agreement should not affect the rights of a third party who provided uncompensated services

deemed reasonably necessary for the other spouse's support. Those same public policy considerations suggest that a spouse's *duty of support* during the marriage still exists notwithstanding the agreement; consequently, the agreement should be able to only affect "reimbursement" claims among the spouses upon termination of the marriage. Tex. Fam. Code §§ 3.401-3.410.

D. Reimbursement Between Spouses

Absent such an agreement when the marriage terminates, a spouse is not entitled to reimbursement from the other spouse for expending separate funds during the marriage for the support of the other spouse because of the spouses' mutual duty of support. *Burney v. Burney*, 225 S.W.3d 208 (Tex. App.—El Paso 2006, no pet.); *In re Marriage of Case*, 28 S.W.3d 154 (Tex. App.—Texarkana 2000, no pet.). However, if a premarital agreement contains a "waiver of support," the spouse who is required to pay a third party under the necessities doctrine should be able to seek reimbursement from the other spouse upon the termination of the marriage. Notwithstanding the terms of the agreement, the bottom line is each spouse still has a duty to support the other spouse during the marriage, even if they have agreed, in effect, that each spouse is primarily liable for his/her own necessities.

E. "Spousal Support"

Critics of this position will point out that both the Uniform Premarital Agreement Act and its Texas version specifically state that a premarital agreement can modify or eliminate *spousal support*; however, neither expressly states that the agreement can modify or eliminate the parties' mutual *duty of support* that attaches during their marriage. The *duty of support* is not the

same concept as *spousal support*. The term "*spousal support*," as used in both the Uniform Premarital Agreement Act and the Texas version, was intended to refer to the more politically correct equivalence of "alimony" – *spousal support*. *Spousal support* is the generally accepted term used to describe payments required from one spouse to another after divorce. It is synonymous with the terms "alimony" and "maintenance."

F. But Texas Doesn't Have Alimony!

Accordingly, it is likely that a Texas court would interpret the term "*spousal support*" within the context of Section 4.003(a)(4) to be its generally accepted meaning – a legal obligation on a person to provide financial support to an ex-spouse after divorce. Critics of this interpretation will argue that Texas does not recognize alimony; thus, the Legislature must have retained that specific provision from the uniform act for a reason. The counter to that argument is that, while Texas (then and now) maintains its policy prohibiting court-ordered permanent alimony, (i) the parties to the agreement may marry and then move to a state that has more traditional spousal support statutes or (ii) the Legislature may in the future adopt a more traditional spousal support statute. Accordingly, it is likely that the Legislature retained Section 4.003(a)(4) anticipating that the parties intending to marry in Texas may wish to address those situations in their premarital agreements.

G. Texas Maintenance

In 1997, a limited form of post-divorce spousal support was enacted. See Chapter 8, Court-Ordered Maintenance, Title 1, Subchapter C, of the Texas Family Code. However, the Texas Family Code

does not expressly address whether court-ordered maintenance can be waived in a premarital or marital agreement although Sec. 4.003 does refer to the waiver of spousal support in premarital agreements. Since court-ordered maintenance was created as part of a welfare reform package, such a waiver may be against Texas public policy, notwithstanding the language to the contrary in the premarital agreement act.

H. UPAA Comments

The official comment of the uniform act states:

Paragraph (4) of subsection (a) specifically authorizes the parties to deal with *spousal support* obligations. There is a split in authority among the states as to whether a premarital agreement may control the issue of *spousal support*. Some few states do not permit a premarital agreement to control this issue (see, e.g., *In re Marriage of Winegard*, 278 N.W.2d 505 (Iowa 1979); *Fricke v. Fricke*, 42 N.W.2d 500 (Wis. 1950)). However, the better view and growing trend is to permit a premarital agreement to govern this matter if the agreement and the circumstances of its execution satisfy certain standards (see, e.g., *Newman v. Newman*, 653 P.2d 728 (Colo. Sup. Ct. 1982); *Parniawski v. Parniawski*, 359 A.2d 719 (Conn. 1976); *Volid v. Volid*, 286 N.E.2d 42 (Ill. 1972); *Osborne v. Osborne*, 428 N.E.2d 810 (Mass. 1981); *Hudson v. Hudson*, 350 P.2d 596 (Okla. 1960); *Unander*

v. Unander, 506 P.2d 719 (Ore. 1973)).

All of the cases mentioned in this official comment involve post-divorce alimony, maintenance or support. It seems obvious that the relevant section of the uniform act was not intended to address the spouses' mutual duty of support or third party rights under the necessities doctrine.

I. Other States' Laws

Surprisingly, there is very little authority in other jurisdictions addressing whether a "waiver of support" can eliminate the necessities doctrine. Most of the cases that have discussed the waiver of spousal support were references to it in the context of post-divorce alimony and not in terms of the spouses' *duty of support* during marriage. In *Rathjen v. Rathjen*, No. 05-93-00846-CV, 1995 Tex. App. LEXIS 3759 (Tex. App.—Dallas May 30, 1995, no pet.), the Texas court, applying the law of Hawaii, refers to the Hawaiian Supreme Court decision of *Lewis v. Lewis/Reese v. Reese*, 60 Haw. 497, 748 P.2d 1362 (1988) and noted that other states have held that a premarital agreement is unenforceable if its application would result in public assistance. This rationale is sound public policy that should be followed absent clear statutory authority to the contrary.

J. UPAA – Texas Version

When the Legislature adopted the Uniform Premarital Agreement Act, deleted from the uniform act's "enforceability" provisions language stating that, even if the agreement eliminated or modified the *spousal support*, and if such a provision causes a spouse to be eligible for public assistance, a court, upon divorce, could still require the other spouse to provide support

to the extent necessary to avoid that eligibility. In a comment, the author suggests that this change in the Texas statute suggests that a Texas court cannot change the terms of a premarital agreement just because it results in a spouse's eligibility for public assistance. Amberlyn Curry, *The Uniform Premarital Agreement Act and Its Variations Throughout the State*, 23 J. Am. Acad. Matrimonial Law, 335 (2010). The more likely reason for the deletion was Texas' prohibition of post-divorce court-ordered permanent alimony.

XVII. AGREEMENTS DURING MARRIAGE

During marriage, spouses can generally accomplish the same results that could have been generated in a premarital agreement. Such agreements are also subject to the "mere agreement rule." *See* XIV, A, *supra*. They can partition or exchange among themselves their existing community property and any community property to be acquired in the future. Tex. Fam. Code § 4.102. Spouses may also agree that income from a spouse's separate property will be separate property. Tex. Fam. Code § 4.103. Accordingly, spouses, like persons intending to marry, have the legal ability to create a "community free marriage."

A. 2003 and 2005 Legislation

Section 4.102 was amended in 2003 to provide that, if community property is partitioned, the income the partitioned property thereafter generates is also partitioned into separate property unless the parties agree such income will be community property. HB 885 (2003). However, due to concerns that the 2003 amendment may have been unconstitutional,

HB 202 (2005) amended Sec. 4.102 again to negate the presumption that future earnings and income would be separate property so that now Sec. 4.102 only authorizes such an agreement.

Accordingly, the parties to a partition and exchange agreement now have the express statutory authority to partition and exchange the future earnings and income from the property they had agreed to partition, a right already granted to them by the 1980 amendment to Art XVI, Sec. 15 of the Texas Constitution and Sec. 4.102 as originally enacted.

1. Pre-2005 Partitions

Unfortunately, it can be anticipated that someone will argue and perhaps even convince a court that Texas spouses did not have until the effective date of the 2005 amendment the right to partition the future earnings of income of the community property being partitioned, thereby casting doubt on the effectiveness of any such agreements entered into prior to that time. Hopefully, the courts will rule that spouses have had the constitutional right to enter into these types of agreements since November 4, 1980, and that the legislature was not even trying to take this right away in their later legislation. Nevertheless, there also remains the question of the effectiveness of partition and exchange agreements entered into between the effective dates of the 2003 and 2004 amendments that do not expressly divide the future earnings and income of the property being partitioned.

2. Partitions Without Consideration

HB 202 (2005) also amended Sec. 4.104 by adding a sentence that provides: "Either agreement (referring to both Sec. 4.103 and Sec. 4.102 agreements) is enforceable without consideration." This

sentence makes sense as applied to Sec. 4.103 agreements but may be unconstitutional as to Sec. 4.102 partition and exchange agreements. A partition and exchange agreement contemplated by Art. XVI, Sec. 15 requires some type of consideration received by both parties to the agreement, otherwise the agreement is, in reality, a gift if one party receives 100% of the property being partitioned.

The court in *Byrnes v. Byrnes*, 19 S.W.3d 556, 559 (Tex. App.–Ft. Worth 2000, no pet.), stated the obvious:

The term “partition” as used in this section contemplates a division of property among the parties, not a complete forfeiture or assignment. See *McBride v. McBride*, 797 S.W.2d 689, 692 (Tex. App.–Houston [14th Dist.] 1990, writ denied). Absent a specific reference to a partition or language indicating that such a division was intended, Texas courts have refused to uphold transactions between spouses as partitions. See *Maple v. Nimitz*, 615 S.W.2d 690 (Tex. 1981); *Collins v. Collins*, 752 S.W.2d 636, 637 (Tex. App.–Ft. Worth 1988, writ ref’d).

Of course, a gift by one spouse to the other of presently existing community property is permissible under Art. XVI, Sec. 15, but that section may not allow such a gift of any and all community property to be acquired in the future. Other than income from separate property, other future community acquisitions (e.g., future personal earnings) can only be partitioned under Art. XVI, Sec. 15. Of course, a gift of presently existing community property by one spouse to the other is presumed to include any future income generated by the gift. Tex. Fam. Code § 3.005, as authorized by Art. XVI, Sec. 15.

3. Form Over Substance

This 2005 amendment implies that spouses could “partition” an item of

community property so that it becomes one spouse’s separate property. Accordingly, without an express partition of the future income, the future income the partitioned property generates would be community property. However, if one spouse gives to the other spouse an item of community property, the property is the donee spouse’s separate property, and the future income it generates will also be separate property, unless the donor spouse expressly retains a community income interest. Form over substance should not prevail; if a “partition” results in one spouse receiving 100% of the property being “partitioned,” it’s not a partition, but rather, it is a gift. Why create confusion by enacting a statute that says a partition does not need consideration?

B. Formalities

The formalities required and the rules of enforcement for marital agreements are essentially the same as for premarital agreements. Tex. Fam. Code §§ 4.104 and 4.105. On the other hand, these agreements would appear to be particularly susceptible to charges of involuntariness and unconscionability. Further, any such agreement cannot prejudice the rights of preexisting creditors. Tex. Fam. Code § 4.106.

Note: An agreement in order to settle property rights incident to a divorce requires the approval of the divorce court. Tex. Fam. Code § 7.006. In other words, a divorce settlement cannot be disguised as a marital agreement to avoid court involvement in property division at divorce.

C. Transmutation

Prior to January 1, 2000, it was unconstitutional for a married couple to convert by agreement separate property into

community property. Many believed that couples should have that flexibility since they had the ability to convert community into separate by agreement. They already had the ability to allow their separate assets to become commingled and therefore community property. They could also exchange a separate asset for a community asset. So why not allow the conversion of separate into community by agreement? Perhaps a couple would like to take advantage of the “step up in basis” community property enjoys upon the death of one spouse. Perhaps they wish to rescind an earlier agreement to convert community into separate so that property which was community is community again. There are any number of legitimate reasons why a couple should have the ability to change the character of their marital assets from community to separate, or separate to community.

1. Formalities

An agreement to convert separate property into community property must be in writing and: (a) be signed by the spouses; (b) identify the property being converted; and (c) specify that the property is being converted into the spouses’ community property. Tex. Fam. Code § 4.203.

2. Management

An agreement to convert a spouse’s separate property into community does not necessarily mean that the newly created asset is subject to joint management. Management still depends on record title or possession. Tex. Fam. Code § 4.204.

3. Enforceability

The agreement is not enforceable if the spouse against whom enforcement is sought proves that the spouse did not: (a)

execute the agreement voluntarily; or (b) receive a fair and reasonable disclosure of the legal effect of converting the property into community property. Tex. Fam. Code § 4.205.

4. Presumption of Fair Disclosure

An agreement that contains the following statement, or substantially similar words, prominently displayed in bold-faced type, capital letters, or underlined, is rebuttably presumed to provide a fair and reasonable disclosure of the legal effect of converting property to community property:

This instrument changes property to community property. This may have adverse consequences during marriage and on termination of the marriage by death or divorce. For example:

Exposure to creditors. If you sign this agreement, all or part of the separate property being converted to community property may become subject to the liabilities of your spouse. If you do not sign this agreement, your separate property is generally not subject to the liabilities of your spouse unless you are personally liable under another rule of law.

Loss of management rights. If you sign this agreement, all or part of the separate property being converted to community property may become subject to either the joint management, control and disposition of you and your spouse or the sole management, control and disposition of your spouse alone. In that event, you will lose your management rights over the property. If you do not sign this agreement, you will generally retain those rights.

Loss of property ownership. If you sign this agreement and your marriage is subsequently terminated by the death of either spouse or by divorce, all or part of the

separate property being converted to community property may become the sole property of your spouse or your spouse's heirs. If you do not sign this agreement, you generally cannot be deprived of ownership of your separate property upon termination of your marriage, whether by death or divorce. See Tex. Fam. Code § 4.205(b).

5. Preexisting Creditors

A conversion of separate property to community property does not affect the rights of a preexisting creditor of the spouse whose separate property is being converted. Tex. Fam. Code § 4.206. After all, a transmutation agreement is a “transfer” of property from one spouse to the other.

D. Survivorship Agreements

Prior to the 1987 amendment to Art. XVI, Sec. 16 of the Texas Constitution, spouses could not generally own community property with rights of survivorship. See *Hilley v. Hilley*, 342 S.W.2d (Tex. 1961) and *Free v. Bland*, 82 S. Ct. 1089 (1962). Since that amendment, they can. See Tex. Fam. Code §§ 112.002, 112.051-112.252. Concerning retroactive application of the change in the law, the legislation that passed after the 1987 amendment states that the survivorship agreement is retroactive if in writing and signed by the parties.

XVIII. FAMILY BUSINESS PLANNING

The use of modern business entities, such as corporations, partnerships and limited liability companies, has become an integral part of family estate planning. One popular technique is for family members to contribute assets to a family limited partnership in exchange for interests in the partnership. A client intending to marry can also take advantage of this planning

opportunity to preserve the assets contributed to the family limited partnership for the client and the children of a prior marriage. The client's partnership interest should remain the client's separate property during the marriage. In other words, the assets contributed to the partnership, as well as assets acquired by the partnership, should remain partnership assets and not become marital assets of the owner and the owner's spouse during the subsequent marriage.

Note: In any separately-owned, closely-held business enterprise where a spouse is involved in the management, Jensen v. Jensen must be factored into the planning. See V, A, supra. The short answer is to pay reasonable compensation for services rendered by the owner during marriage and maintain contemporaneous business records of the reasonableness of the compensation paid.

A. Entity Theory

The assets contributed to the partnership become the assets of the partnership, and the partners receive partnership interests. The marital character of a spouse's interest in a partnership created during marriage should depend on the separate or community nature of the assets contributed in exchange for the interest itself. If an interest in the partnership was acquired as a gift, the interest itself is, of course, the separate property of the donee spouse. The assets of the partnership, including undistributed income and profits, belong to the entity and do not take on a separate or community character under normal circumstances. See Sec. 152.056 of the Texas Business Organizations Code and see also *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.–Houston [14th Dist.] 1989, writ denied). Caution should be taken in the day-

to-day management of the partnership to avoid claims for reimbursement because of the expenditures of uncompensated time, talent or labor or contributions of community property to the separate property business. See V, A, *supra*.

B. Distributed Profits

When the partnership distributes its profits to its partners, the profits distributed to a married partner are community property, whether the partner's partnership interest is separate or community property. This result can work a conversion of what would ordinarily be the separate property into community property. For example, if a spouse contributes separately owned oil and gas royalty interests into a partnership, the royalties collected by the partnership and then distributed to the partners as partnership profits are community property. Had the spouse not contributed the royalty interest to the partnership, the royalties received would have been the owner's separate property. See *Marshall v. Marshall*, 735 S.W.3d 587 (Tex. App.—Dallas 1987, writ ref'd n.r.e.). The *Marshall* case has been cited for the proposition that all partnership distributions during marriage are community property. However, some commentators argue that a distribution in excess of current or retained earnings or other distributions of capital should be separate property. See Jack Marr, *Business and Divorce*, 34th Annual Marriage Dissolution Institute (2011).

C. Comparison to Corporations

Partnerships, limited partnerships and limited liability companies are treated as entities under Texas law. The owners do not own the entity's assets; they own interests in the entity similar to shares of stock in a corporation. A divorce court cannot award

specific partnership assets to the other spouse. *Gibson v. Gibson*, 190 S.W. 3d 821 (Tex. App.—Ft. Worth 2006, no pet.). Non-liquidating distributions by the entity to the owners generally take on a community character like ordinary cash dividends distributed by a corporation to its shareholders. But, do established corporate law concepts, like the alter ego/reverse veil piercing, *Dillingham v. Dillingham*, 434 S.W.2d 459 (Tex. Civ. App.—Ft. Worth 1968, writ dism'd w.o.j.) and reimbursement for the expenditure of community time, talent and labor like in *Jensen* apply to these new entities as well?

Reverse veil piercing has been held to be inapplicable to partnerships. See *Lifshutz v. Lifshutz*, 61 S.W. 3d 511 (Tex. App.—San Antonio, 2001, pet. denied) and *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners' Association*, 77 S.W. 3d 487 (Tex. App.—Texarkana, 2002, pet. denied). Marr notes that the same rule may apply to limited partnerships and limited liability partnerships. See Marr, *supra*. However, he notes that the concept has been applied to limited liability companies. See *McCarthy v. Wani Venture, A.S.*, 251 S.W. 3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied).

The concepts of fraud on the community and reimbursement would appear to apply to any entity situation.

D. Corporate Veil Piercing

Notwithstanding the "entity" rule, the assets of a separately owned corporation have been held by Texas courts to be part of the community estate and subject to a just and right division by the divorce court in some situations. See *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App.—Ft. Worth 1985, writ dism'd w.o.j.); *Spruill v. Spruill*, 624 S.W.2d 694 (Tex. App.—El Paso 1981, writ

dism'd w.o.j.); *Dillingham v. Dillingham*, 434 S.W.2d 459 (Tex. Civ. App.—Ft. Worth 1968, writ dismissed w.o.j.).

While the cases are not numerous and the theories used to justify the result are not always consistent, reverse veil piercing is a reality. In its landmark case, *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986), the Texas Supreme Court explained the basic theories that can be used to disregard a corporate entity: alter ego, sham to perpetrate a fraud, or actual fraud. The court further explained that veil piercing is an equitable doctrine that can be used to prevent an unfair and unjust result.

In *Lifshutz v. Lifshutz*, 61 S.W.3d 511 (Tex. App.—San Antonio 2001, pet. denied), the court purported to explain the elements necessary to disregard the corporate entity. First, there must be a finding that the corporation is the alter ego of the shareholder (i.e., there is a unity between the corporation and the shareholder). Second, the shareholder's use of the corporation damaged the community estate beyond that which could be remedied by a claim of reimbursement. While some courts have required that the shareholder must be the sole shareholder, other courts have not. See *Zisblatt, supra*.

The *Lifshutz* court also suggested that the use of the corporation must also have had a negative impact on the community estate. In other words, even if the corporation is the shareholder's alter ego, the corporation may not be disregarded unless community property was transferred to the corporation.

E. Texas Pattern Jury Charge

The Texas Pattern Jury Charges provide that the distinct corporate identity of a corporation may be disregarded if there is unity between the corporation and a

shareholder so that the separateness of the corporation has ceased and the improper use of the corporation has damaged the community estate. The corporate identity may be disregarded even though the corporate formalities have been observed and corporate assets have been kept separated from individual property. See Texas Pattern Jury Charges, 205.1, 205.2 (2016).

F. Convert Sole Proprietorships

Even if the client is not willing to share a business enterprise with other members of the family, a sole proprietorship could be converted into an entity, like a corporation, prior to the marriage. Proper management and record keeping can maintain the client's stock in the corporation as separate property and the assets of the corporation as corporate assets, not marital assets. Continuing to operate the "business" as a sole proprietorship during the marriage is likely to result in a commingling of separate and community assets so that over time the "business" becomes community property because of the client's inability to trace which of the business assets were owned prior to marriage or traceable to assets owned prior to marriage. Caution should be taken in the day-to-day management of the corporation to avoid claims for economic contribution and reimbursement.

G. Partnership Formation

Some divorce lawyers take the position that a general partnership interest acquired during marriage is always community property. See Marr, *supra*, citing one case decided over twenty-five years ago, *York v. York*, 678 S.W. 2d 110 (Tex. App.—El Paso 1984, writ refused n.r.e.). Marr's article does state that the regular

rules of characterization do apply to shares of corporate stock, limited partnership interest, interests in limited liability partnerships and interest in limited liability companies. The better view is that the separate or community character of the partner's interest (like shares of stock) should depend on the character of the consideration used to acquire the interest (i.e., capitalize the entity), if any. If separate consideration, the investment should be separate.

For example, if a general partnership is created at the time of the partners' "handshake" rather than at the time the partnership agreement is signed, the individual partner's interest in the partnership becomes property at that time and is likely to be community property under the inception rule. It was not acquired by gift, devise or descent; and if the "idea" or "concept" was an intangible that did not have a separate or community charter, the partnership interest would appear not to be traceable back to any separate property of the partner.

On the other hand, if the general partnership is not created until the partnership agreement is signed, the partner's interest is more like a shareholder's stock in a corporation, and it should be the partner's separate property, if separate property was contributed by the partner to the partnership in exchange for the partner's interest.

XIX. MARITAL PROPERTY RIGHTS IN IRREVOCABLE TRUSTS

The private express trust is a unique concept and one that is frequently misunderstood by members of the public and practitioners alike. The common law established that the trust is not an entity; it

cannot own property; it cannot incur debt. Although it may be treated as if it were an entity for some purposes, it remains today a form of property ownership. *See* Tex. Trust Code § 111.004(4). Certain other common law principles remain relevant today. For example, a person serving as trustee is not a legal personality separate from such person in his or her individual capacity. A person serving as trustee is not the agent of either the trust, the trust estate or the beneficiaries of the trust. Finally, the trust assets are not considered to be the property of the person serving as trustee; such assets belong in equity to the beneficiary. These principles can affect the marital property rights of the parties.

A. The Private Express Trust

One noted authority describes the private express trust as ". . . a device for making dispositions of property. And no other system of law has for this purpose so flexible a tool. It is this that makes the trust unique. . . . The purposes for which trusts can be created are as unlimited as the imagination of lawyers." III, IV, *Scott on Trusts* (3d. ed. 1967).

1. Definition

A trust, when not qualified by the word "charitable," "resulting" or "constructive," is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of the intention to create the relationship. Restatement (Third) of Trust § 2. (2003)

2. Creation

According to Section 112.002 of the Texas Trust Code, a trust may be created by:

(i) a property owner's declaration that the owner holds the property as trustee for another person; (ii) a property owner's inter vivos transfer of the property to another person as trustee for the transferor or a third person; (iii) a property owner's testamentary transfer to another person as trustee for a third person; (iv) an appointment under a power of appointment to another person as trustee for the donee of the power or for a third person; or (v) a promise to another person whose rights under the promise are to be held in trust for a third person.

3. Revocable or Irrevocable

Inter vivos trusts are further divided into two categories: revocable and irrevocable. A revocable trust is one that can be amended or terminated by the settlor. An irrevocable trust, in contrast, is one that cannot be amended or terminated by the settlor for at least some period of time. The presumption regarding the revocability of inter vivos trusts varies by jurisdiction. For example, in Texas all inter vivos trusts created since April 19, 1943, are revocable unless the trust document expressly states otherwise; while in some other states, trusts (including Texas trusts created prior to April 19, 1943) are deemed irrevocable unless the trust document states otherwise. Tex. Prop. Code Ann. § 112.051. *See* Restatement (Second) of Trusts, § 330; Bogert, *Law of Trusts and Trustees*, § 998 (1983).

Note: If the trust is revocable, it is deemed “illusory” and is effectively ignored for marital property purposes (i.e., the “trust veil” is pierced). See Land v. Marshall, 426 SW.2d 841 (Tex. 1968). See XXII, B, infra.

B. Beneficial Ownership

While record legal title to the assets of the trust is held by the trustee, equitable

title — true ownership — belongs to the beneficiaries. For example, trust law generally exempts the assets of the trust from any personal debt of the trustee not related to the administration of the trust. This exemption even applies if the trust property is held by the trustee without identifying the trust or the beneficiaries. The rationale behind this exemption is the concept that the assets of the trust really belong to the beneficiaries. *See* Tex. Prop. Code § 101.002 and Tex. Trust Code § 114.0821. These principles confirm that trust assets belong to the beneficiaries and not the trustees. Accordingly, a trustee's spouse generally does not acquire any marital property interest in trust property, but spouses of the beneficiaries may, depending on the circumstances.

C. Interests of the Settlor's Spouse

The creation and funding of an inter vivos trust by a settlor may or may not remove the trust assets from the reach of the settlor's spouse. If (i) the trust is irrevocable and (ii) the settlor has not retained an equitable interest in the trust estate, the assets of the trust really belong to the beneficiaries and no longer have either a separate or community character insofar as the settlor's spouse is concerned. If the transfer of community assets in order to fund the trust is found to have been in fraud of the interests of the settlor's spouse, the spouse may be able to reach the assets of the trust like any other assets transferred to a third party, free of trust, but in fraud of the community interests of the wronged spouse. *See* VIII, *supra*.

D. Settlor's Retained Interest

If the settlor creates an irrevocable trust and retains a beneficial interest in the trust assets, the rights and remedies of the settlor's spouse would appear to be similar to the rights of the settlor's creditors. Creditors can generally reach the maximum amount that the trustee can pay or distribute to the settlor under the terms of the trust agreement, even if the initial transfer into the trust was not in fraud of creditors. For example, if the settlor retains an income interest in the trust assets for the rest of the settlor's life, creditors can reach the retained income interest, and if the settlor retains a general power of appointment over the entire trust estate, creditors can reach the entire trust estate. *See Bank of Dallas v. Republic Nat. Bank of Dallas*, 540 S.W.2d 499 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.). If the settlor retains an income interest for the remainder of the settlor's lifetime, the creditors can reach the income interest, but not the fixed remainder interest already given to the remaindermen. If the trustee has the discretion to invade the principal for the settlor, the extent of the settlor's retained interest will probably be the entire trust estate. *See Cullum v. Texas Commerce Bank Dallas, Nat. Ass'n.*, 05-91-01211-CV, 1992 WL 297338 (Tex. App.—Dallas Oct. 14, 1992) (not designated for publication). The inclusion of a spendthrift provision will not insulate the settlor's retained interest from the settlor's creditors. *See Tex. Trust Code § 112.035 and Glass v. Carpenter*, 330 S.W.2d 530 (Tex. Civ. App.—San Antonio 1959, writ ref'd n.r.e.).

1. Marital Property Issues

The application of these principles in the marital property context would suggest that any income generated by the trust estate would still be deemed community property

if the settlor retained an income interest in the trust which, for example, was funded with the settlor's separate property. However, in a recent case where the trust was funded with the settlor's separate property prior to marriage and the trustee was a third party who had discretion to make income distributions to the settlor, the trustee's discretion prevented the trust's income from taking on a community character until the trustee exercised its discretion and distributed income to the settlor. The wife in a divorce action had claimed that all of the trust assets were community property since the income generated during the marriage had been commingled with the trust corpus. *See Lemke v. Lemke*, 929 S.W.2d 662 (Tex. App.—Fort Worth 1996, writ denied) and *Matter of Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.—Texarkana 1978, writ dism'd w.o.j.). Some older cases support that same result. *See Shepflin v. Small*, 4 Tex. Civ. App. 493, 23 S.W.432 (1893, no writ) and *Monday v. Vance*, 32 S.W. 559 Tex. Civ. App. 1895 no writ).

2. Other Factors

Had the trust been funded with community property without the consent of the other spouse, the other spouse could challenge the funding of the trust as being in fraud of the community. Had the assets been subject to the spouses' joint control, the other spouse could argue that the transfer was void since the other spouse did not join in the transfer. Had the settlor retained a general power of appointment, the other spouse could argue that the transfer of community property into the trust was "illusory" as to her community interests therein. *See VIII, I, supra*. Accordingly, the only safe conclusion to reach is that the proper application of marital property

principles should depend on the nature and extent of the retained interest and perhaps the timing of the creation of the trust.

E. Interests of the Non-Settlor Beneficiary

Because a beneficiary of a trust owns a property interest in the trust estate created by a settlor who is not the beneficiary, the ability of the spouse of the beneficiary to establish a community interest in certain assets of the trust should depend on the nature of the beneficiary's interest. Equitable interests in property, like legal interests, are generally "assignable" and "attachable," but voluntary and involuntary assignees cannot succeed to an interest more valuable than the one taken from the beneficiary.

1. Comparison to Creditors' Rights

Again, a review of the rights of creditors of the beneficiary appears relevant. For example, if the beneficiary owns a remainder interest, a creditor's attachment of the beneficiary's remainder interest cannot adversely affect the innocent life tenant's income interest. On the other hand, if the beneficiary is only entitled to distributions of income at the discretion of the trustee for the beneficiary's lifetime, a creditor of the beneficiary cannot attach the interest and require the trustee to distribute all the income. In fact, a creditor may not be able to force the trustee to distribute any income to the creditor since it would infringe on the ownership interests of the remaindermen.

2. Principal

The original trust estate (and its mutations and income generated prior to marriage) clearly is the beneficiary's separate property as property acquired by gift, devise or descent, or property acquired

prior to marriage. Distributions of principal are likewise the beneficiary's separate property. *See Hardin v. Hardin*, 681 S.W.2d 241 (Tex. App.—San Antonio 1984, no writ).

3. Distributed Income

If the discretionary income beneficiary is married, it would logically follow that distributed income should be considered separate. The exercise of discretion by the trustee, in effect, completes the gift. The result may be different if the beneficiary is the trustee or can otherwise control the distributions. On the other hand, if the trustee is required to distribute the trust's income to the married beneficiary, the income could be considered community once it is distributed since it arguably could be considered income from the beneficiary's equitable separate property. *See Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.—Corpus Christi 1997, no pet.). However, there is recent case authority that holds that trust income required by the trust document to be distributed to the beneficiary is the beneficiary's separate property, at least where the trust was created prior to the marriage. *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. App.—Tyler 1996, no writ). *See also Matter of Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.—Texarkana 1976, no writ), and *Wilmington Trust Co. v. United States*, 753 F.2d 1055 (5th Cir. 1985).

4. Undistributed Income

Undistributed income is normally neither separate nor community property. *See Matter of Marriage of Burns, supra; Buckler v. Buckler*, 424 S.W.2d 514 (Tex. Civ. App.—Fort Worth 1967, writ dismissed w.o.j.), and *McClelland v. McClelland*, 37 S.W. 350 (Tex. Civ. App. 1896, writ refused).

However, if the beneficiary has the right to receive a distribution of income but does not take possession of the distribution, such retained income may create marital property rights in the beneficiary's spouse. *See Cleaver, supra*. Depending on the intent of the beneficiary in allowing the distribution to remain in the trust, such income (and income generated by the retained income) may be considered to have taken on a community character or may be considered to have been a transfer to the other beneficiaries of the trust and subject to possible fraudulent transfer on the community scrutiny.

F. Spendthrift Trust

Texas law permits the settlor of a trust to prohibit both the voluntary and involuntary transfer of an interest in trust by the beneficiary prior to its actual receipt by the beneficiary. In fact, the settlor may impose this disabling restraint on the beneficiary's interest by simply declaring that the trust is a "spendthrift trust." Such a restraint is not effective if the beneficiary has a mandatory right to a distribution, but simply has not yet accepted the interest. Further, such a restraint is not effective to insulate a settlor's retained interest from the settlor's creditors. *See* Tex. Trust Code § 112.035. This rationale suggests that the settlor's intent as to the nature of the beneficiary's interest may be relevant in determining whether the beneficiary's spouse acquires a community interest in the trust estate, the undistributed income or any distributed income.

G. Powers of Appointment

If the beneficiary has the absolute authority under the trust agreement to withdraw trust assets or to appoint trust assets to the beneficiary or the beneficiary's

creditors, the beneficiary is deemed to have the equivalence of ownership of the assets for certain purposes. For example, such beneficiary would appear to have such an interest that cannot be insulated from the beneficiary's creditors by either the non-exercise of the power or a spendthrift provision. An appointment in favor of a third party could be found to have been in fraud of creditors. *See Bank of Dallas, supra*. While inconsistent with the common law, which treated the assets over which a donee had a general power as belonging to others until the power was exercised, application of this modern view may treat the assets over which a married donee has a general power as the separate property of the donee, but any income generated by those assets may be community property.

1. Special Powers

Many beneficiaries are given limited general powers (i.e., "Crummey" and the so-called "Five or Five" power, both of which permit the beneficiary to withdraw a certain amount from the trust estate at certain periods of time).

2. Lapse of Powers

If the beneficiary allows the withdrawal power to lapse, can the creditors still go after that portion of the estate that could have been withdrawn or can the beneficiary's spouse claim either a possible community interest in the assets allowed to continue in trust, or the income thereafter generated? In other words, does the lapse of the power make the beneficiary "a settlor" of the trust? The Legislature has answered some of these questions. Section 112.035 of the Texas Trust Code was amended by the Legislature in 1997 to confirm that a beneficiary of a trust is not to be considered a settlor of a trust because of a lapse, waiver

or release of the beneficiary's right to exercise a "Crummey right of withdrawal" or "Five or Five" power.

3. Ascertainable Standard

If the beneficiary's power of withdrawal is limited to an ascertainable standard (i.e., health, support, etc.), creditors who provided goods or services for such a purpose should be able to reach the trust estate, but not other creditors. Further, it follows that any income distributed for such purposes, but not so expended, may be community since such expenses are normally paid out of community funds. See VII, E, *supra*.

4. Non-General Powers

A beneficiary's power to appoint only to persons other than the beneficiary, the beneficiary's creditors and the beneficiary's estate are generally deemed personal to the beneficiary and not attachable by the beneficiary's creditors. It would also follow that such a power would not give the spouse any interest in the trust estate. However, if the power is exercised to divert community income from the beneficiary, could it be subject to possible fraud on the community scrutiny?

Note: See Sharma v. Routh, 302 S.W.3d 355 (Tex. App.—Houston [14th Dist] 2009, no pet.), for an example of a divorce case where the court examines the nature of the spouse's interests in irrevocable trusts to determine their marital character.

XX. PLANNING FOR DESCENDANTS

In the client's estate plan, the client should consider possible marital property planning for the client's descendants, especially if they reside in a community

property state. For example, whether or not the client trusts the son-in-law, steps can be taken to hopefully enable the daughter to maintain the separate character of any inter vivos or testamentary gifts.

A. Segregated Accounts

At a minimum, the daughter should be advised to "keep her separate, separate" by opening bank and brokerage accounts in her individual name (perhaps with a designation "separate account") and only depositing into the account her separate property. Contemporaneous business records showing the source of any and all separate deposits should be retained in the event proof of separate character of the account is later needed.

B. Avoid Inadvertent Commingling

In a state like Texas, where income from separate property is community property, any interest (or other income generated by the account) should be paid into a different account in her name (perhaps with a designation of "special community account") in order to avoid a "commingling" of community and separate funds in the separate account. If an account is "commingled," it becomes community property.

C. Separate Investments

Any investment given to her, purchased with funds in her "separate account" or certificates issued out of her separate account, should be held in her name only. Further, real estate conveyed to her should be conveyed to her "as her separate property." Again, contemporaneous business records can serve as evidence of the nature of the transaction and the separate character of the asset and should be retained.

D. Family Entities

If the daughter is to be a partner in a family partnership, a member in a family-oriented limited liability company or a shareholder in a closely-held corporation, her interest should be given to her as a gift (or purchased with traceable separate property). Again contemporaneous business records of the nature of the transaction should be retained. If she expends any “time, talent or labor” in the management of the entity, paying her a reasonable compensation for those personal services should be considered to hopefully avoid a later reimbursement claim by her husband.

E. Asset Protection Trusts

Any and all of the inter vivos or testamentary gifts could be placed in an asset protection trust for the daughter’s benefit during her lifetime. The spendthrift provisions will help not only insulate the daughter’s interest from the claims of her creditors, but also any community property claims of the son-in-law. Including a statement in the trust agreement that it is the settlor’s intent that any and all interests of the daughter, as well as any and all distributions to her out of the trust, are her separate property may not be conclusive, but may prove to be persuasive in future litigation.

Limiting distributions of income and/or principal to an ascertainable standard (health, education, maintenance, or support) is especially important if the daughter is going to be the trustee or is going to be given general power of appointment. If a third party is going to serve as trustee, income distributions to her could be at the discretion of the trustee or pursuant to an ascertainable standard. Caution should be exercised in granting any other powers to the daughter over the trustee or the trust

estate. Carefully planning and drafting the terms of the trust could prove to be persuasive in maintaining the trust as her separate property.

F. Daughter’s Counsel

Counsel can be retained to advise the daughter on what other planning tools are available to her in order to insulate “her estate” from any possible community property claims of her husband (or his successors or creditors) and/or to review the daughter’s planning to ensure that what can be done has been done to insulate the daughter’s inheritance from any possible claims of the son-in-law (or his successors or creditors).

Finally, the fees of the daughter’s counsel should be paid by the daughter with her separate property or by the client to avoid any claim by the son-in-law that the daughter misused their community property to his detriment.

**XXI. NON-PRO RATA
DISTRIBUTION OF THE
COMMUNITY**

Upon the death of the first spouse and while record legal title to the probate assets still reflects that some community assets are held in the decedent’s name, some are held in the surviving spouse’s name and others are held in both names, the surviving spouse and the heirs and/or devisees of the deceased spouse are, in effect, tenants in common as to each and every community probate asset, unless the surviving spouse is the sole distributee of some or all of the deceased spouse’s one-half interest in such assets.

Assuming that the decedent’s one-half community interest has been left to someone other than the surviving spouse,

the respective ownership interests of the surviving spouse and the decedent's distributees are subject to the possessory rights of either a court appointed personal representative or the surviving spouse for administration purposes. When probate administration is completed, the surviving spouse and the distributees are entitled to their respective undivided one-half interests in each and every remaining community probate asset. Tex. Est. Code § 101.001.

Note: Why? Under our Texas community property system, the surviving spouse owned an undivided one-half interest in each item of community property prior to the decedent's death and retains that one-half interest upon the decedent's death.

A. Non-Pro Rata Division

Under these circumstances, can the surviving spouse and the personal representative (or the decedent's distributees) agree to make a non-pro rata division of the community estate so that the surviving spouse receives 100% of some of the assets and the distributees receive 100% of other community assets? The answer is an obvious yes, although the authority of a personal representative to enter into such a transaction should depend, in part, on if there is a probated will, the terms of the will and the powers granted to the executor in the will.

Of course, even if the will purports to enable the executor to make a non-pro rata division of the community, the surviving spouse's agreement is still required.

B. Effect on Nonprobate Assets

The surviving spouse is likely to be the beneficiary of nonprobate dispositions like retirement plans, life insurance and multiple-party accounts. Can the will of the

deceased spouse or the executor of the deceased spouse's estate (or the devisees of the deceased spouse) require the surviving spouse to accept the nonprobate disposition in lieu of the surviving spouse's one-half of all or part of the community probate estate? The answer is an obvious "no" without the surviving spouse's agreement.

Note: Regarding XXI, A and B, supra, the surviving spouse may have already agreed to the non-pro rata division by accepting some benefit in exchange for giving up other benefits, powers or rights through either an express or equitable election.

C. Tax Consequences

Accordingly, the real issue may be whether any such resulting non-pro rata division of the community will be considered a taxable event, subjecting the parties to, for example, capital gain exposure to the extent the assets have appreciated in value since the decedent's date of death, or whether one party gives up more in value than received, creating a taxable gift situation. The gift tax issue is obvious. As to the risk of the division being a taxable event for income tax purposes, the answer is a probable "yes."

D. IRS Income Tax Positions

To deal with the risk of a taxable event in the event of a non-pro rata division of the community following the first spouse's death, for years Texas lawyers have looked to old three private letter rulings.

1. In PLR 8016050, 1980 WL 132102, where a husband and the executor of his wife's estate proposed an equal, but non-pro rata division in California, the Service ruled the exchange was not a taxable

event. In California, the ruling noted, the right of partition is to the entire community estate and not merely to some specific part, relying in part on the legal principle that the marital property interest of each spouse is an interest in the community, as if the community were an “entity” like a partnership. However, in Texas, community property principles do not create a “community entity.” Community property is a form of co-ownership of each and every community asset that ceases to exist when the marriage terminates. This substantive difference in Texas law may make this ruling inapplicable to Texas estates. Thus, the risk still exists.

2. In PLR 8037124, 1980 WL 134564, a couple proposed to divide community property into two equal but non-pro rata shares in order to create liquidity for the deceased spouse’s estate to pay estate taxes upon an anticipated death. The ruling concluded that such a partition would not result in a taxable event. The ruling was issued prior to the enactment of 26 USCA Sec. 1091, which provides that no gain or loss on such a division in the event of divorce.

3. In PLR 9422052, 1994 WL 237304 community assets had been placed in a revocable trust arrangement prior to the first spouse's death, and the trust agreement authorized the trustee to make non-pro rata distributions following the first spouse's death among the survivor's trust and the deceased spouse's marital deduction and bypass trusts, negating the taxable exchange consequences.

E. Marital Agreement Approach

Even if the will of the deceased spouse authorized the executor to make non-

pro rata distributions, it is doubtful such mandate is binding on the surviving spouse unless the couple had agreed to a non-pro rata division in a valid marital agreement. The second 1980 ruling suggests that such a marital agreement may not result in a taxable event following the first spouse’s death. Accordingly, the real question is whether such an agreement is valid under the Texas “mere agreement rule.” See XIV and XVII, *supra*. The author is not aware of any cases specifically addressing this issue, but is of the opinion such an agreement should be valid under Texas law (i.e., not violate the mere agreement rule).

F. The Revocable Trust Approach

The 1994 ruling offers another approach – a planning advantage a revocable trust may have over a traditional testamentary plan when the settlor spouses have agreed in the revocable trust agreement to a non-pro rata distribution of the trust estate upon the first spouse’s death. Most commentators, including this author, seem to agree that such an agreement among the settlor spouses in the trust agreement should be valid under Texas law (i.e., it does not violate the mere agreement rule). See *Note* following XXII, K, *infra*.

G. Safe Harbor Approach

Until there is express authority under Texas law for the spouses to enter into such a non-pro rata division agreement in a marital agreement or through a joint revocable trust in, in order to minimize the tax risks the safe harbor approach may be for an independent executor with appropriate authority granted in the will to enter into a partition of the community assets with the surviving spouse shortly after the first spouse's death and prior to any significant appreciation in value to the

community assets. Care should then be taken to track the income from the partitioned assets so that the income is properly reported on the income tax returns of the survivor and the estate (or its successors).

Note: Without specific authority granted in the will, even an independent executor does not have the authority to partition undivided interests in the deceased spouse's estate (the decedent's interest in the community property and the decedent's separate property) among the devisees (or to sell an interest which is incapable of fair partition). Tex. Est. Code § 405.008. An independent executor can make partial distributions before the estate closes. Tex. Est. Code §§ 360.002, 402.052. But only the surviving spouse can seek a "partition" of the community property during administration by applying to the court for the partition even in an independent administration. Tex. Est. Code § 360.253. See In Re Estate of Furr, 553 S.W.2d 671 (Tex. Civ. App.—Amarillo 1977, writ ref'd, n.r.e). Such authority is not granted to the decedent's personal representatives or distributees.

Accordingly, it seems reasonable to assume following the death of the first spouse, the surviving spouse is in a position to initiate the partition of community assets and an independent executor with the appropriate authority granted in the will should be able to partition and exchange community assets with the surviving spouse without a court proceeding. Absent authority in the will, the consent of the distributees of the deceased spouse's estate is needed. But the tax risk remains.

XXII COMMUNITY PROPERTY IN THE REVOCABLE TRUST

If a married individual or couple places community property in a revocable trust, the relative marital property rights of the spouses could be adversely affected. For example, separate and community could be commingled; community property subject to a spouse's sole management and control could become subject to the couple's joint control. Community property may be deemed partitioned.

A. Professional Responsibility

It is obvious, therefore, that the practitioner advising both spouses should be alert for possible conflicts of interests and make sure the couple understands the effect revocable trust planning could have on their marital property rights during the remainder of the marriage and on its dissolution either by death or divorce.

B. Creation and Funding

Generally, when marital property is to be placed into a revocable trust, steps should be taken to insure that the planning is marital property neutral. That the planning:

1. Is not deemed fraudulent or even "illusory" under *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968). (husband placed his sole management community property into a revocable trust; upon his death, the wife disrupted the plan by pulling her one-half interest out of the trust under the "illusory" transfer doctrine);
2. Is not deemed void because one spouse unilaterally attempted to transfer community property subject to joint control into the trust under Tex. Fam. Code § 3.102;

3. Does not amount to a partition of community property under Section 4.102 of the Texas Family Code unless that is desired by the parties;
4. Does not work a commingling of community and separate funds as to risk losing the separate character of the separate property, unless that is desired by the parties;
5. Does not convert one spouse's retained equitable interest in his or her sole management community property into joint community property and thereby expose it to liability for the contractual debts of the other spouse; and
6. Defines which assets the trustee should use to provide for, and pay the debts of, the spouses while both are alive, and to satisfy claims of creditors upon the first spouse's death.

Note: Texas community property law may create a unique planning opportunity when one spouse is incapacitated. Following a judicial declaration of incapacity, the other spouse, in the capacity of the community administrator, is granted the sole power of management, control and disposition of the entire community estate. Does this authority give the managing spouse the power to create and fund a revocable trust as a planning technique to avoid a guardianship in the future? In Land v. Marshall, the Texas Supreme Court held that the husband's creation of a revocable trust with community subject to his management and control, even without his wife's joinder was not void as to the wife's one-half interest, but voidable at her election under the "illusory transfer" doctrine.

C. Distributions

Careful consideration should be given to the trustee's duty to support the couple while both are still surviving. Generally, the terms of the trust should specify whether trust income is to be distributed or retained and if distributed, whether distributions to a spouse, or both, are appropriate. It may be advisable to distribute what would otherwise be a spouse's sole management community income (income from separate property or existing sole management community property) to that particular spouse. If such income is retained, it may be advisable to hold and invest it, in trust, as "sole management community." When the trustee is authorized to distribute income or principal for the spouses pursuant to an ascertainable standard, the terms of the trust need to specify what sources are to be exhausted first (i.e., use separate before community, or use community before separate and which type of community is expended first—sole management or joint). A different set of distribution criteria may be appropriate during those periods the spouses are incapacitated.

D. Power of Revocation

When spouses fund a revocable trust with community property, should the power of revocation be retained "jointly" or "severally"? If the document directs that either spouse can revoke the trust unilaterally, should the power extend to the whole community asset being withdrawn from the trust or only to the revoking spouse's undivided one-half interest therein?

1. Joint Revocation

If the power to revoke is retained jointly by the couple, the couple's equitable interest in the trust would appear to be their joint community property even though some

of the community assets in the trust were a spouse's sole management community property prior to funding. Converting sole management community property into joint community property affects the relative marital property rights of the spouses. For example, an asset which would have been exempt from certain debts of a particular spouse would become liable. See *Brooks v. Sherry Lane National Bank*, 788 S.W.2d 874 (Tex. App.—Dallas 1990).

2. Unilateral Revocation

To avoid converting sole management community property into joint community property, the document could be drafted to permit either spouse to withdraw from the trust that spouse's community one-half interest in any community asset placed in the trust. However, this approach has several problems. Such a power would, in effect, permit either spouse to unilaterally partition the couple's community property interests, a result which does not appear to be authorized by Art. XVI, Sec. 15 of the Texas Constitution. Only jointly can spouses partition community property into their respective separate estates. Even an agreement by the spouses to authorize such a unilateral partition might appear to violate the "mere agreement" rule of marital property. See *Kellet v. Trice*, 95 Tex. 160, 66 S.W. 51 (1902); *King v. Bruce*, 145 Tex. 647, 201 S.W.2d 803 (1947); *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565 (1961).

Accordingly, if unilateral revocation is desired, the more considered solution is to allow one spouse, with notice to the other, to withdraw their sole management community and any joint community property with the joint community property being distributed in both names.

3. "Joint and Several" Revocation

Accordingly, the safe harbor approach would be for the couple to retain power of revocation (i) jointly for some assets of the trust (the joint community property assets) and (ii) unilaterally as to other assets in the trust (sole management community property and separate property) after giving notice to the other spouse. If a power of revocation is exercised as to a sole management community asset, the withdrawn asset should remain the couple's community property, but still subject to the withdrawing spouse's sole management and control.

Note: If the couple so agrees, allowing either spouse to revoke as to a joint community asset would not appear to have any adverse consequences from a constitutional, liability or tax perspective so long as the asset in its entirety is revested as community property.

E. Subsequent Incapacity of a Settlor

As with any revocable trust, the trust document should address the effect the possible incapacity of a settlor will have on the power of revocation. Can an agent under a durable power of attorney revoke on behalf of the settlor/principal? Can a guardian revoke the ward's revocable trust? Is the power of revocation a non-delegable power? See *Weatherly v. Byrd*, 566 S.W.2d 292 (Tex. 1972). The questions evolve even further if the settlor is married and the trust is funded with the incapacitated spouse's sole management community property or joint community property. Do Sec. 1353.002 of the Texas Est. Code and Sec. 3.301 of the Texas Family Code permit the other spouse to revoke the trust on behalf of the incapacitated spouse? Texas law provides no clear answers to these questions,

thus, the document should address all of them.

F. Effect of Subsequent Divorce

Community assets and quasi-community property held in trust where one or both of the spouses hold a power of revocation are likely part of the "estate of the parties" subject to division by the divorce court in a just and right manner pursuant to Sec. 7.001 of the Texas Family Code.

1. Powers of Appointment

A power of revocation is defined in the Texas Property Code as a general power of appointment, giving the holder thereof the equivalents of ownership over the assets subject to the power. See Tex. Prop. Code, § 181.001.

2. Void and Voidable Transfers

If only one spouse is the settlor of a trust funded with the settlor spouse's special community property, the transfer of such community assets into the trust is deemed "illusory" as to the other spouse. See *Land v. Marshall*, XXII, B, *supra*. If the sole settlor spouse attempted to transfer into the trust joint community assets without the joinder of the other spouse, the transfer should be found to be void as to the other spouse.

3. Separate Trust Estate

If the settlor spouse transferred separate property into a revocable trust arrangement, (a) the original trust estate and its traceable mutations should retain the separate character of the separate property contributed to the trust, (b) trust income distributed to the settlor is still community property and (c) any undistributed income and its mutations should be deemed to be

community due to the settlor's power of revocation.

4. Transfer to Third Parties

Any trust income or any other community assets held in the trust and distributed by the trustee to a third party, such as a child of a settlor from the settlor's prior marriage, is likely to be treated as a completed gift by the settlors to the third party for tax purposes. If the gift is made unilaterally by one spouse, the gift is subject to attack by the other spouse as being a transfer in fraud of the other spouse's community property rights.

5. Revocable Trusts Becoming Irrevocable

If, during the marriage, a revocable trust becomes irrevocable due to a modification by the settlor, or due to the trust terms (e.g., the trust provides that it becomes irrevocable upon the settlor's incapacity or death), (a) the interests of the non-settlor beneficiaries may become fixed, vested and/or ascertainable, (b) the settlor may be deemed to have made a completed gift for tax purposes and (c) the now completed transfers to the non-settlor beneficiaries are subject to scrutiny as being transfers in fraud of the other spouse's community property rights.

6. Income Taxes

Capital gains taxes generated by the sale of revocable trust assets traceable to a settlor's separate property is taxable to the settlor and is reported on the settlor's income tax return (typically a joint return with the settlor's spouse). The payment of the consequential tax liability with community funds could adversely affect the rights of the other spouse, possibly creating a

reimbursement claim when the marriage terminates.

7. Planning for Divorce

While Section 123.052 of the Texas Estates Code voids provisions in favor of the former spouse and the former spouse's relatives, in the event of a subsequent divorce, other problems exist if the trust is a joint revocable trust that provides for "joint revocation" and does not address what happens to the power of revocation in the event of a divorce. Further, it is not difficult to imagine the problems trying to interpret and construe the remaining terms of the trust.

In that situation, it would likely serve both settlors to address these issues in the divorce settlement. Awkward as it might be, it would be even better to address the possibility of a subsequent divorce in the trust agreement and how it would impact the power of revocation and the other terms of the trust. Hopefully, the trust agreement would not be subject to scrutiny by the divorce court; but Section 7.006 of the Texas Family Code should be considered.

G. Death of First Spouse

Upon the death of the first spouse to die, the decedent's separate property and one-half interest in the community assets pass pursuant to the terms of the trust agreement (e.g., perhaps some specific or general gifts outright to certain beneficiaries), with most of these assets continuing in one or more trusts (e.g., bypass and/or Q-Tip trusts) for the benefit of the surviving spouse and the remainder beneficiaries.

H. Survivor's Interests

Upon the death of the first spouse, the surviving spouse's separate property and

one-half interest in the community property typically should be delivered to the surviving spouse or segregated into a "survivor's trust" that continues to be revocable by the surviving spouse unless a different result is desired after considering the consequences of it becoming irrevocable. In addition to the substantive advantages for the surviving spouse, continuing revocability prevents an unintended taxable gift on the part of the surviving spouse. If the surviving spouse is not a settlor of the trust (or did not otherwise agree to the terms of the trust) and does not receive the survivor's one-half interest in the community property, the settlor spouse can use the "illusory trust" argument to reclaim the survivor's one-half interests in the community trust assets. See *Land v. Marshall* at XXII, B, *supra*.

I. Planning Considerations

When drafting the trust document, separate trusts may be desirable for each spouse's separate property and their community property. In fact, it may be advisable to segregate the community property further into three separate sub-trusts, one for each spouse's sole management community property and one for their joint community property in order to maintain their relative marital property rights, to facilitate the management rules of Sections 3.101 and 3.102 of the Texas Family Code and to continue the liability exemption rules of Section 3.202 of the Family Code, otherwise the couple's relative rights are affected and the attorney is placed in a conflict of interest by trying to represent both spouses in the planning. Finally, the trustee should be instructed to pay debts and other expenses in a manner consistent with the liability rules of the Texas Family Code.

J. Community Property Basis

Because a decedent's interest in the revocable trust assets is included in the gross estate, such assets will receive a new income tax basis. However, if community property is placed in a revocable in the trust, care should generally be taken in the drafting of the trust agreement and the other transfer documents to make sure that the funding of the trust with community property does not amount to a partition of the community property that would jeopardize the new income tax basis both halves of the community can receive upon the death of the first spouse. See Rev. Rul. 66-283, 1966-2 C.B. 297.

K. Non-Pro Rata Division

Notwithstanding the typical distribution of what was community property trust assets upon the death of the first spouse that was described in XXII, G, H, *supra*, the couple, as joint settlors, in the trust agreement could agree to have the trustee make a non-pro-rata division of any community property assets held in the trust or added to the trust by reason of the first spouse's death. Assuming it does not violate the mere agreement rule, such an agreement might generate significant tax savings when compared to a non-pro-rata distribution of the community probate estate. See XXI, D, F, *supra*

**XXIII. PLACING THE HOMESTEAD
AND OTHER EXEMPT
PROPERTY IN A REVOCABLE
TRUST**

A homestead exemption from the owner's general creditors can only exist in a possessory interest in land. See *Capitol Aggregates v. Walker*, 448 S.W.2d 830 (Tex. Civ. App.-Austin 1969, writ refd

n.r.e.); *Texas Commerce Bank v. McCreary*, 677 S.W.2d 643 (Tex. App. – Dallas 1984, no writ). In revocable trust planning, where legal title in the home is transferred to the trustee, the settlor usually retains the equitable title at least for the remainder of the settlor's lifetime. In addition, there is case law authority for the proposition that an "equitable interest" will support a homestead claim. See *Rose v. Carney's Lumber Co.*, 565 S.W.2d 571 (Tex. Civ. App.—Tyler 1978, no writ); *White v. Edwards*, 399 S.W.2d935 (Tex. Civ. App.—Texarkana 1966, writ refd n.r.e.). In fact, one early case held that the property retained its homestead character during the settlor's lifetime notwithstanding the fact it had been conveyed to a trustee where the settlor had continued to occupy the property and the purpose of that trust was to prevent the premises from being taken by creditors. See *Archenhold v. B.C. Evans Co.*, 32 S.W. 795 (Tex. Civ. App. 1895, no writ).

A. Exemption from Creditors

Thus, it appears as if the homestead continues to be exempt from most creditors so long as the settlor of a revocable trust is alive. Tex. Prop. Code § 41.001. The same would hopefully be true for exempt personal property. Tex. Prop. Code § 42.001. In 2009 the Texas Legislature added Property Code Section 41.0021, confirming that the transfer of a homestead to a qualifying trust does not affect the homestead protections of the Texas Constitution Section 50, Article XVI and Texas Property Code Section 41.001.

Note: Amendments to the property tax code also provide that the homestead ad valorem tax exemption can remain even if the residence is placed in a "qualifying" trust. See Tex. Property Tax Code § 11.13.

B. Survival of the Separate Property Homestead

The transfer of assets to the revocable trust may result in the loss of certain probate provisions which protect the surviving members of the family from the decedent's creditors (i.e., the probate homestead, exempt personal property, family allowance and the claims procedures followed in probate administration) following a decedent's death. Section 41.0021(e), says, "This section does not affect the rights of a surviving spouse or surviving children under Section 52, Article XVI, Texas Constitution, or Part 3, Chapter VIII, Texas Probate Code" (Homestead, Family Allowance and Other Exempt Property).

1. Probate Homestead

The Texas Constitution provides that, on the death of a homestead owner, the separate property homestead is to descend and vest in like manner as other real property of the deceased but that it shall not be partitioned among the heirs of the deceased during the lifetime of the surviving spouse for so long as the survivor elects to use or occupy the same as a homestead, or so long as the guardian of the minor children of the deceased may be permitted, under the order of the proper court having the jurisdiction, to use and occupy the same. Tex. Const. Art. XVI. § 52 (1987). The effect of this constitutional mandate is to vest a "life estate" in the surviving spouse until abandonment, or a right to receive an estate until majority for minor children. *Thompson v. Thompson*, 236 S.W.2d 779 (Tex. 1951). In addition, the Texas Estates Code provides that

following the owner's death, the homestead will not be liable for any debts, except for the purchase money thereof, the taxes due thereon, or work and material used in constructing improvements thereon. Tex. Est. Code § 102.004. Further, the Texas Estates Code directs the probate court to set apart for the use and benefit of certain family members, all such property of the estate as is exempt from execution or forced sale by the constitution and laws of the state. Tex. Est. Code § 353.051.

2. Right of Occupancy

Will the surviving spouse have a right to occupy the home following the death of the owner if it was placed in a revocable trust prior to its owner's death? While there are no definitive cases on point, it appears that the surviving spouse may not have such a right unless the trust document so provides. If the home was placed in the revocable trust during marriage, both spouses would have had to join in the transaction or the conveyance would have been ineffective. Tex. Fam. Code § 5.001. *See also* Tex. Prop. Code § 41.0021(c). Further, the Texas Supreme Court has approved provisions in premarital agreements that allow one to waive his/her homestead right of occupancy. However, it has also been held that such waivers must be clear and unambiguous and with full disclosure. *See Williams v. Williams*, 569 S.W.2d 867 (Tex. 1978) and *Hunter v. Clark*, 687 S.W.2d 811 (Tex.App.—San Antonio 1985).

In addition, if the home had been placed into the revocable trust by its owner before the marriage, or if the owner places it in trust during the marriage but before it is used as the home, in either situation, the survivor's right of occupancy may never come into existence because the right may

only attach to the actual property interest owned by the owner, which in the revocable trust situation is an equitable life estate that terminates upon the settlor's death. This same rationale may even defeat the possession rights of the owner's minor children.

On the other hand, perhaps public policy in favor of the surviving spouse and minor children will lead the courts to extend the "illusory transfer" concept to such a situation to protect the rights of the surviving spouse and minor children to occupy the home like it did to protect the surviving spouse's community one-half interest unilaterally placed in a revocable trust in *Land v. Marshall*, discussed at XXII, *supra*.

Note: It should be noted that Section 41.0021(e) was an amendment to the exemption from creditors' section of the Texas Property Code and not intended to address "the right of occupancy" under the Texas Constitution. See Tex. Const. Art XVI, § 52 (1987).

This possible loss of the right of occupancy is consistent with the constitutional and statutory homestead provisions because both contemplate the homestead being a probate asset upon the death of the owner. If the home has been placed into a revocable trust, the settlor's life estate terminates and the remainder beneficiary's interest becomes possessory upon the death of the settlor instead of going through probate.

C. Creditor's Rights

Assuming the settlor is survived by a "constituent family member" (surviving spouse or minor child), will the separate property home placed in a revocable trust continue to be exempt from the general

creditors of the settlor upon the settlor's death? Again, there are no definitive cases and the likely result is not very clear. First, a creditor could argue that, if the constituent family members have lost their right of occupancy, the purpose in exempting the property is frustrated and, therefore, the creditors should be able to reach the asset like any other revocable trust asset. Second, the creditors will point out that the exemption from creditors is found in the probate code and is directed at probate assets; thus, where the owner elected to take the home out of probate, its exemption is lost. On the other hand, the basic theory that supports the creditor's position, in effect, ignores the existence of the trust, thereby revesting the settlor with the property and returning it to his/her probate estate where it would have been exempt from the claims of the creditors in the first place. In other words, the creditors have essentially forced the settlor to revoke the trust thereby making the home probate property again and, therefore, entitled to probate protection. The 2009 amendment to the Texas Property Code, Section 41.0021(c), does not expressly address this issue.

D. Community Property Homestead

The homestead rights of the surviving spouse are the same whether the homestead was the decedent's separate property or was community property. Tex. Est. Code § 102.002. During the surviving spouse's lifetime, the homestead may not be partitioned as long as the surviving spouse elects to use it as a homestead. Tex. Est. Code § 102.005.

(i) Only Probate?

However, Section 102.003 states that the homestead "descends and vests" upon the death of an owner in the same manner as

other real property. This language seems to suggest that the homestead must be a probate asset. The relevant provisions of the Texas Constitution also seem to imply that the surviving spouse's rights to occupy the homestead depend on the homestead being part of the deceased spouse's probate estate. Tex. Const. Art XVI, Sec. 52.

(ii) Transfer into Revocable Trust

So, if the couple transfers the community property homestead into a revocable trust, does the surviving spouse retain the "right of occupancy" or is the surviving spouse's rights dependent on the terms of the revocable trust agreement? While the author is not aware of any cases that specifically address this issue, it is the author's opinion that the specific terms of the revocable trust should control. In *Williams v. Williams*, the Supreme Court confirmed that homestead rights can be waived. *Williams v. Williams*, 569 S.W.2d 867 (Tex. 1978). The transfer into the revocable trust required the couple's joinder. Tex. Fam Code § 5.001. See also Tex. Prop. Code. § 41.004.

(iii) Rights of Creditors

Is the protection from creditors granted by Tex. Con. Art XV, Sec. 51 and Tex. Est. Code § 102.004 following the death of the deceased spouse lost by the transfer of the community property homestead into the revocable trust? Arguably, yes, if the surviving spouse has waived the right of occupancy. By reason of the transfer into the revocable trust, the homestead is no longer a probate asset and the stated exemptions appear to assume that an exempt homestead is probate property unless perhaps the trust continues to meet the requirements of a qualifying trust under Tex. Prop. Code § 41.0021.

E. Exempt Personal Property

Normally, certain items of tangible personal property are exempt from most of the decedent's creditors if the decedent is survived by a constituent family member. Tex. Est. Code §§ 355.051–353.056. These items are described in the Texas Property Code and generally include the household furnishings, personal effects and automobiles in an amount that does not exceed \$100,000. Tex. Prop. Code § 42.002. In addition, during probate administration, the constituent family members can retain possession of these items and will receive ownership of them if the decedent's estate proves to be insolvent; otherwise the decedent's interest in these items passes to his/her heirs and/or devisees when the administration terminates. Tex. Est. Code §§ 353-152–353-154. The arguments "pro" and "con" as to whether these rights exist if these otherwise exempt items are placed in a revocable trust would seem to parallel the above homestead discussion.

F. Allowances

In addition to the allowances in lieu of homestead and exempt personal property, an allowance for one year's maintenance of the surviving spouse and certain children may be established by the probate court out of a decedent's probate estate. Tex. Est. Code §§ 353.101–353.107. The allowance is paid out of the decedent's property subject to administration. *Ward v. Braun*, 417 S.W.2d 888 (Tex. Civ. App.—Corpus Christi 1967, no writ). Thus, it appears that the right to a family allowance or an allowance in lieu of homestead or exempt personal property may be lost if all of the decedent's assets have

been placed in a revocable trust prior to the decedent's death.

G. Probate Claims Procedures

The Texas Estates Code describes a very elaborate statutory scheme for the handling of secured and unsecured claims against a probate estate. These procedures afford protection and guidance to the persons charged with administering the decedent's estate and assure the creditors of fair treatment. It does not appear that these procedures would apply to a trust administration. For example, unlike in a decedent's dependent administration where the probate code prohibits a secured creditor from foreclosing on probate property during administration, a creditor with a security interest in trust property could in fact foreclose. In addition, the probate code directs the personal representative regarding which debts to pay but the trustee has no such guidelines in the trust code, thereby possibly exposing the trustee to personal liability if the trustee pays the wrong creditor at the wrong time.

Note: In order to give the trustee the opportunity to invoke the procedures of the probate code following the settlor's death, consider authorizing the trustee to terminate the trust and distribute the trust assets to the personal representative of the settlor's probate estate, if (i) such action would be in the best interests of the beneficiaries and (ii) the beneficiaries of the trust are the same as the beneficiaries under the will. Alternatively, the settlor should consider not placing otherwise exempt assets in the trust if possible insolvency is a concern.