

### Question 9 – February 2013 – Selected Answer 1

- 1) The home will be Kay's separate property but Marty will have an equitable claim for reimbursement.
- 2) The lake property be viewed by the court as 1/2 separate property and 1/2 community property.
- 3) The \$200,000 worth of stock will be Kay's separate property.
- 4) The cash dividends in the saving account will be community property.

Under TX Community Property Law, distribution of property depends on whether the property is separate or community property. Property will be considered separate property if it falls under one of the specific statutory categories including: (1) property acquired by gift or devise, or intestacy during the marriage; (2) property acquired before the marriage; (3) property acquired by exchange or partition of community property; (4) appreciation on separate property; (5) tort recovery funds-including pain and suffering and disfigurement but not medical expenses or reimbursement for lost wages; (6) property bought with separate funds. Community property is defined by the statute as any property that is not categorized as separate property. There is a strong presumption in Texas that any property owned or acquired during the marriage is community property. A party to the marriage can overcome this presumption, but must do so by clear and convincing evidence. Once property is classified, the court has discretion to distribute community property based on a "just and right" division of the estate. The court is given broad discretion and the decision cannot be overturned unless the distribution was an "abuse of discretion" or "manifestly unjust". However, a court has no authority to distribute the separate property of either spouse upon divorce.

#### 1. INTEREST IN THE HOME

Under Texas Community Property Law, the inception of title rule dictates that property takes on its character as either separate or community property at the time it is acquired. The character of property, once established, will not change based on subsequent events that occur during the marriage. Rather, in the event that community property is used to enhance or benefit separate property of one spouse, the non-owning spouse will be entitled to an equitable claim for reimbursement. The amount of the reimbursement claim will be the amount of the pay down in principal when the community property funds were used to pay down a secured debt. Alternatively, the amount of the reimbursement claim for additions or improvements will be the amount by which the property increased in value. Because each spouse has a 1/2 interest in the community estate, half of the reimbursement claim belongs to the estate and the other half will belong to the spouse who did not own the separate property. Here, Kay purchased the home before the marriage and thus the home will be considered separate property upon Kay and Marty's divorce. The court will have no discretion in allocating the home to Marty because Marty is not entitled to any of Kay's separate property. However, Marty will be entitled to an equitable claim for reimbursement. After they were married, both Marty and Kay paid the mortgage payments on the home from joint checking account. The joint checking account is community property because it consists of funds owned during the marriage and therefore there is a presumption it is community property. Because community property funds were used to make mortgage payments on Kay's separate property home, Marty will be entitled to reimbursement for the value that the principal on the mortgage was paid down during the marriage. Also, Marty and Kay built and addition to the home during the marriage. Again, there is a strong presumption the cost of the addition was paid for with community funds. Marty will also have a reimbursement claim for the added value to the house that resulted from the addition. Therefore, although the house must be distributed entirety to Kay, Marty will have an equitable claim for reimbursement for both payments made on the mortgage and the addition to the house.

## 2. LAKE PROPERTY

Under Texas Community Property Law, there is a strong presumption that all property acquired during the marriage is community property and therefore subject to "just and right" division upon divorce. However a party seeking to prove that property is separate can rebut the presumption by clear and convincing evidence, which is a high burden. This can be done by tracing the property back to its separate property source. If it can be shown that only separate funds were used to pay for the property, it can be designated as separate property. Here, there is a strong presumption that the lake property is community property. The fact that Kay didn't want Marty to purchase the property will not be enough to overcome the presumption. Rather, Marty will have to prove by clear and convincing evidence that the property is separate by tracing it back to separate property. Based on the fact of this case, it is unclear whether Marty earned the money as investment banker before or after the marriage. Income earned during the marriage is community property while income earned during the marriage is separate property. Assuming the income Marty earned from being an investment banker was income he earned during the marriage, the income will be considered community property. However, the \$50,000 Marty inherited from his father will be considered separate property. Therefore, Marty can likely prove that he owns only 1/2 of the house as separate property and 1/2 as community.

## 3. STOCK INTEREST

The Stock left to Kay by her uncle worth \$200,000 will be considered Kay's separate property upon her divorce from Marty. She will be able to overcome the presumption of community property because she acquired the stock by inheritance. Even though she inherited during the marriage, it will still be considered separate property and not subject to a "just and right" division by the court.

## 4. CASH DIVIDENDS KEPT IN THE SAVINGS ACCOUNT

The cash dividends totaling \$15,000 which Kay kept in a separate savings account will community property. Income earned on separate property during the marriage is community property, including delay rentals, interest, cash dividends. Here, even though the stock itself will be separate property, the dividends earned on the stock during the marriage will be community property. Even though Kay kept the property in a separate savings account, this will have no effect on the community or separate nature of the funds. Therefore, all the cash dividends in the saving account will be subject to "just and right" division by the court.

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### **Question 9 – February 2013 – Selected Answer 2**

1. The home of Kay and Marty should be categorized as Kay's separate property. The issue is the characterization of the home in relation to community and separate property principles under Texas law.

Under Texas law, property of a couple acquired during marriage is presumptively community property. However, this presumption can be overcome by clear and convincing evidence of the separate nature of the property. Under the inception of title rule, any property acquired prior to marriage or any property acquired (either during or before marriage) by either spouse through gift, devise, or descent is the separate property of that spouse. However, if the separate property of a spouse is improved or eventually paid for through community property funds, then the community estate is entitled to a claim for reimbursement.

Here, the home was acquired by Kay five years prior to her marriage. Under the inception of title rule, the home is therefore Kay's separate property. However, because the home was financed through a mortgage, the community estate is entitled to reimbursement. The mortgage payments were made from the couple's joint checking account that was established after marriage. Because all property acquired during marriage is presumptively community property, the checking account is presumptively community property. As a result, the mortgage was paid off through community property funds. Although the payment of the mortgage through community property funds does not modify the separate property characterization of the home, the divorce court should take into consideration the community estate's entitlement to reimbursement. The community estate is entitled to reimbursement because it was used to benefit Kay's separate property. Thus, the home is the separate property of Kay, but because the home was paid off with community property funds, the community estate is entitled to a claim for reimbursement.

Similarly, the community estate is entitled to a claim for reimbursement in relation to the improvement to the house. Marty may attempt to argue that the addition is not a part of the home (and therefore not an extension of Kay's separate property), but this argument is unlikely to succeed. Instead, the divorce court should find that the improvement is yet another instance of the community estate improving the separate property of Kay. Thus, the community estate is entitled to another claim for reimbursement for the costs of improving Kay's separate property, the home.

2. The lake property is characterized as 1/2 community property and 1/2 Marty's separate property. The issue is the characterization of the lake house in relation to community and separate property principles under Texas law. Under Texas law, property that is acquired solely in the name of one spouse is presumptively the spouse's separate property if the other spouse was present during the transaction. Thus, the presumption of separate property only applies if both spouses agree that the property is truly the other spouse's separate property. If one of the spouses does not consent to the property characterization, then the property is presumed to be jointly owned as community property by both spouses. However, Texas law allows a spouse to rebut the community property presumption through tracing. During the marriage, if property is obtained through gift, devise, or descent, then it is considered separate property. Under tracing principles, a spouse is able to trace the funds used to purchase the property. In the event a spouse is able to point, by clear and convincing evidence, that separate property was used to purchase the item, then the community property presumption will be overcome.

Here, Marty purchased the lake property solely in his name. Although this designation generally would create a presumption that the lake is the separate property of Marty, the presumption fails because Kay expressly communicated to Marty her disapproval of the transaction. Because the presumption fails, the general community property presumption in conjunction with the inception of title rule applies. As a result, the property is presumptively community property regardless of the name on the property because the property was acquired during Kay and Marty's marriage.

The facts also indicate that \$50,000 of the property cost was derived from cash Marty inherited from his father. Because these funds were obtained through Marty's inheritance, the funds are characterized as separate property. Thus, 1/2 of the lake house is characterized as separate property. However, the remaining half of the lake house is characterized as community property. Under Texas law, all income earned during the marriage by either spouse is community property. Although this

presumption can be changed through marital agreements, there is no indication Mary and Kay signed such an agreement. Thus, the default rule applies. Consequently, 1/2 of the property is characterized as community property because it was purchased with community property funds. In conclusion, the lake house is considered 1/2 separate property of Marty and 1/2 community property. As a result, the divorce court is only able to distribute 1/2 of the lake house because a divorce court cannot divest one spouse of its rightful separate property.

3. The stock is considered separate property. The issue is the characterization of the stock in relation to community and separate property principles under Texas law. Under Texas law, property obtained during the marriage is presumptively community property. However, if the property is obtained by a spouse through gift, devise, or descent, then it is considered separate property. Here, Kay's uncle devised the stock to Kay in his will. Thus, even though the stock was acquired by Kay during the marriage, it is Kay's separate property. Thus, the divorce court is not allowed to divest Kay of any portion of the stock.

4. The cash dividends from Kay's stock are considered community property. The issue is the characterization of the dividends in relation to community and separate property principles under Texas law. Under Texas law, income from separate property is categorized as community property. Texas courts have construed dividends as income from separate property. Alternatively, capital gains or stock splits are categorized as separate property of the spouse. Thus, all dividends received from a spouse's separate property or community property stock are characterized as separate property.

Here, the cash dividends from Kay's stock should be classified as income from separate property. Because the dividend income from Kay's separate property was generated during Kay and Marty's marriage, it is classified as community property. Notably, Kay's use of a separate savings account for the cash dividends does not change their community property character. However, if Kay had reinvested the dividends into the separate property stock, there would potentially have been a commingling issue. Thus, Kay maintained the separate property character of her stock by keeping the dividends in a separate account.

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### **Question 9 – February 2013 – Selected Answer 3**

1. The court should find that the home is Kay's separate property but that Marty is entitled to a reimbursement for the mortgage payments and the \$75,000 addition to the home. Under Texas law, a court may only divide community property upon divorce under the principles of a just and right division. The inception of title rule determines whether property is community property or separate property. Thus, property that is acquired during the marriage is presumed to be community property unless the disputing spouse can prove by clear and convincing evidence that the property was to be separate property. Property that is acquired before marriage is considered separate property. If separate property is funded with community property, the court may find that a spouse is entitled to a reimbursement for the community property that was expended. Here, Kay's home was purchased five years before she married Marty. Thus, under the inception of title rule, Kay's home is separate property. However, the separate property home has been funded with community property funds. The mortgage payments constitute community property as they were from the joint checking account during Kay and Marty's marriage. In addition, the addition to the home costing \$75,000 was built during the marriage and thus, the addition and the funds expended constitute community property. So, the court must find that the home is Kay's separate property. But, the court will also be entitled to issue a reimbursement

to Marty for this expenditures of community property funds on the home. Marty will likely be reimbursed for his community share of both the mortgage payments and the \$75,000 addition in order for the court to ensure that there has been a just and right division.

2. The court should find that the lake property is one-half community property and one-half Marty's separate property. At issue is the result produced by tracing the funds. As stated previously, under Texas law, the inception of title rule determines whether property is separate property or community property. Property acquired during the marriage is presumed to be community property. Property acquired through inheritance is considered separate property. In the event that property is purchased during the marriage using both separate property funds and community property funds, the court may use tracing of the funds to further characterize the property. The name on the title is irrelevant except as to whether or not the property was intended as a gift to the other spouse. If a spouse purchases property with his separate property and puts both spouse's names on the title, it is presumed that the purchasing spouse intended the purchased property to be a gift to the non-purchasing spouse and so it would become community property. Here, the lake property was purchased with \$50,000 inherited from Marty's father and \$50,000 from his income. The \$50,000 from Marty's father is separate property because Marty inherited it from his father. However, the \$50,000 used from his income is community property because the wages were earned during the marriage and income while married is considered community property. Thus, Marty purchased the lake property with one-half separate property funds and one-half community property funds. Using the method of tracing, the court will characterize the lake property as one-half Marty's separate property and one-half Marty and Kay's community property. The court will not be able to divide Marty's separate property, but they will be able to give a just and right division of the remaining one-half community property.

3. The stock is Kay's separate property. As stated previously, property that passes by inheritance is separate property. It does not matter that it was inherited during the marriage. Here, Kay's uncle bequested \$200,000 worth of stock to Kay in his will. This is a proper form of inheritance. The court should find that Kay's inheritance of the stock is her separate property.

4. The cash dividends kept in the savings account is Marty and Kay's community property. At issue is whether the cash dividends of separate property stock are considered still considered separate property. Under Texas law, cash dividends earned on stock are considered community property. It is essentially income that is earned on separate property. Although Texas law recognizes that an appreciation in value of stock such as stock dividends or stock splits remain separate property, cash dividends are found to constitute community property. It is irrelevant as to whether the cash dividends are kept in a separate savings account as the court doesn't characterize property according to the management power over the property. Therefore, the \$15,000 from the cash dividends on Kay's separate property stock constitutes community property. It does not matter that Kay kept the cash dividends in a separate savings account. The court should find that the cash dividends totaling \$15,000 in the savings account constitute Marty and Kay's community property and it should be subject to a just and right division.