

Question 6 – February 2018 – Selected Answer 1

All property owned prior to marriage is separate property, as well as, property received by gift, devise, or for tort damages. All other property is community property. Through clear and convincing evidence a party may show community property is actually separate property. Income from separate property is community property.

Assets of a corporation are property of the corporation. Shareholders do not own corporate property, but own shares of the corporation, reflecting corporate property. The court may pierce the corporate veil if a shareholder uses a corporation entity in a fraudulent manner.

In a divorce, the court divides community property in a just and right manner. The court will not divide separate property. Reimbursement is not a right, but an action in equity.

1)

a) HHH - Hank will claim HHH is separate property not subject to division in a divorce proceeding.

Here, Hank owned all shares of the closely held corporation before his marriage to Whitney. Hank will therefore claim his HHH stock is separate property and not subject to court division during the divorce.

b) Here, Hank will claim HotDog Heaven is a corporate asset. As a corporate asset, neither he nor Whitney have a direct claim on the restaurant. As a corporate asset, Hank's interest in the restaurant is secured through his HHH stock. Therefore, Hotdog Heaven, as a corporate asset, should not be subject to a just and right division by the court.

c) Here, Hank will also claim Land is a corporate asset. The Land was purchased by HHH to allow for tax advantages. Like HotDog Heaven, the Land as corporate asset should not be subject to a just and right division by the court.

2)

a) HHH - Whitney will attempt to pierce the corporate veil of HHH.

Here, Henry has used the corporate entity in a fraudulent manner. Income from stock is community property. He used excess HHH funds to make additional payments toward the Note.

b) Hotdog Heaven - Whitney will attempt to pierce the corporate veil and seek reimbursement for community funds used to enhance the separate/corporate estate.

Here, Hank used excess funds from Hotdog Heaven to pay for his truck, the couples vehicle insurance, vacations, and personal credit card expenses. These activities demonstrate Hank is using the corporate entity in an inappropriate manner. He is being unjustly enriched. Whitney will be able to demonstrate that Hank is exploiting the corporate entity status of Hotdog Heaven and the court should pierce the corporate veil.

Here, Whitney will seek reimbursement for her work done for Hotdog Heaven and for community funds used to enhance the estate of Hank and the corporation. Whitney assisted with bookkeeping and clerical duties without compensation. Hank used excess funds from Hotdog Heaven to enhance his marital estate.

c) Land - Whitney will attempt to pierce the corporate veil and seek reimbursement for community funds used to enhance the estate of Hank and the corporation.

Here, Whitney may pursue a fraud claim for the Land investment. Hank represented the purchase would be for "their retirement." However, HHH (Hank's separate property) purchased the Land. Their retirement should be financed from community property. Similarly, Hank and Whitney were required to sign personal guarantees for the Land Note. Hank induced Whitney to be on the hook for separate property.

The court should pierce the corporate veil. Hank's HHH shares should be considered separate property and not subject to the court's just and right division. However, the assets of HHH should be viewed as community property. The value of Hotdog Heaven increased due to Whitney's efforts. The Land increased in value due to growth in the area. Whitney should be able to claim her share since community property in the form of income went into both Hotdog Heaven and repayment of the Note for Land.

Question 6 – February 2018 – Selected Answer 2

1(a) Hank can assert that HHH is his separate property and should be awarded solely to him. In Texas, property acquired during marriage is presumed to be community property. A party claiming that property should be labeled as separate property must show by clear and convincing evidence that such property was obtained prior to marriage, by gift or devise, or as compensation for personal injuries. Here, Hank owned HHH Inc. prior to his marriage to Wendy. However, when separate property and community property are commingled, clear and convincing evidence is required to show a tracing of the value of such property to know what proportion remains separate property – this must be documentary proof. Hank will have to show his accounting for corporate funds and assets, but in general, ownership of the corporation as a whole may still be deemed Hank's separate property.

1 (b) Hank may assert that HotDog Heaven is an asset that belongs to HHH, Inc. A corporation is an entity that can hold its own property. HHH, Inc. owned HotDog Heaven even prior to the marriage. Hank may have to show that he is not using the corporation as an alter ego (more below), but otherwise show C+C evidence that the asset belongs to the corporation and not to him or Wendy.

1(c) Hank may (try to) assert that the land belongs to HHH, Inc. Assets that are purchased in the name of a corporation, using corporate funds or accounts are generally property of the corporation as an entity and not property of its shareholders. Here, the land was purchased in the name of the corporation (for “tax advantages”) and secured by a loan and DOT obtained in the name of HHH. Hank will attempt to claim this asset belongs to the corporation, but likely Wendy’s claim will be more successful.

2(a) Wendy can make a claim for reimbursement from HHH. HHH was clearly begun before the marriage. So Wendy can’t claim it is all community property. However, when a spouse uses a corporation as an “alter ego”, a court may pierce the corporate veil to reach assets in order to satisfy personal claims on its only Shareholder/Director. Factors to consider when deciding whether to pierce the corporate veil include: siphoning of funds, personal use of assets, loans to self, whether it’s a close-held corporation, whether the SH fraudulently used the corporation as a front; whether it was properly capitalized etc. Here, Hank is the only shareholder and director of the closely held corporation. He appears to have used corporate funds to pay personal debts, like his truck, the couples car insurance, vacations, personal credit cards, etc. He even used the corporation as a front to purchase land for tax advantages when he intended it “for retirement”. A small corporation doesn’t usually have to follow all the formalities as a large corp, like board meetings, etc. – but here it still appears that the corp. was used as an alter ego for Hank so Wendy can ask the court to pierce the veil to divide some of its assets.

2(b) Wendy can assert a claim of reimbursement for HotDog Heaven HDH or a division of assets. As above, HDH was an asset of HHH, but there was evidence of commingling of assets so Wendy may ask the court to reach through the corporate veil to divide some of the assets. In addition, both Wendy and Hank worked for HDH w/out receiving compensation. Wendy may make a claim for reimbursement to the community estate for the reasonable time, toil and talent she and Hank expended on both HHH and HDH.

2(c) Wendy may assert a claim for just and right division of the land as CP. If a court finds that a spouse used a corp. as an alter ego and commingled CP with SP and/or committed fraud on the community, the court may find that the assets are community property or may create a constructive trust for the other spouse. Here, though HHH purchased the land, H&W gave personal guarantees on it, and H expressed his intent to use it as “their retirement.” As above, H’s actions may be found as an alter ego allowing the court to pierce the corporate veil to either reimburse the comm. estate or find the property commingled so much as to be comm. assets. The court could also create a constructive trust for Wendy to receive compensation from a sale or use of the land for H’s fraud on the community.

Question 6 – February 2018 – Selected Answer 3

1. Hank will claim that HHH is his separate property and claim that Hotdog Heaven and the Land are non-marital property rightfully belonging to HHH.

1a. Hank will claim HHH is his separate property.

Under TX law, all property acquired during marriage is presumptively community property. The community property presumption is rebuttable. To show property should be characterized as separate property requires clear and convincing evidence that the property was acquired (1) before marriage, (2) by gift, descent or devise, or (3) as a certain part of a personal injury tort recovery. The inception of title rule states that property is characterized at the time it is first acquired.

Here, HHH was a corporation in existence before marriage. Hank owned and acquired title to all the stock in HHH before marriage, thus it is Hank's separate property.

1b. Hank will claim that Hotdog Heaven should not be characterized because it is not part of the marital estate.

By law, partnership or corporate assets belong to the business entity, not to any individual owner or shareholder. These assets are not part of a marital estate. Here, the restaurant Hotdog Heaven is an asset owned by the corporation HHH. It is not marital property and should not be included or characterized as part of Hank's and Whitney's marital estate.

1c. Hank will claim that Land should not be characterized because it is not part of the marital estate.

When a corporation purchases assets in its own name, it is presumptively corporate property. Here, HHH took the loan and took title to Land in its own name. Thus Hank will argue it is presumptively corporate property and should not be included in the marital estate.

2. Whitney can assert claims for fraud on the community and reimbursement, and is also likely to be able to pierce HHH's corporate veil.

2a. Whitney can likely pierce HHH's corporate veil and have will claim some of HHH's assets should be properly characterized as community property. The issue is whether HHH was Hank's alter ego.

When a shareholder manager of a close corporation uses the corporation's assets as his own, a claimant may pierce the corporate veil (PCV). The PCV standard is used when a person abuses the corporate privilege and limited liability would be unfair. The corporate liability shield is to allow only the corporation and its assets to be liable for any debts or obligations. Corporate

ownership of property also means the property is not jointly owned by any person, shareholder, officer or director, and not part of any marital estate.

Here, Hank has abused the privilege of incorporation by treating the corporate assets as his own personal assets. Hank used excess funds to buy a personal vehicle, pay for vacations, to pay personal credit card expenses, and to pay for marital vehicle insurance premiums. This is known as the alter ego doctrine--where a spouse uses the corporation as his personal source of payment and banking. Limited liability would be unfair to Whitney. HHH is the only real asset noted in the facts and Hank will try to hold it all as separate property. Thus Whitney can likely pierce the corporate veil and reach the corporate assets.

2b. Whitney can assert community estate reimbursement claims against Hotdog Heaven.

The community estate is entitled to the benefits of each spouse's time, toil, talent, and efforts. Usually that is reflected in income and wages, all of which are characterized as community property when earned during the marriage. When one spouse is not properly compensated for efforts, the community has a reimbursement claim. Time, toil, talent, and effort expended in support of separate property is reimbursable to the extent that it went beyond the reasonable amount to maintain that property.

Here, both Whitney and Hank worked for Hotdog Heaven without being compensated as manager, bookkeeper, and clerk. Both expended time, toil, talent, and effort beyond what was reasonably necessary to maintain the business without being compensated. Thus the community should be reimbursed for those efforts.

2c. Whitney will claim that Land is community property. In the alternative she will have a reimbursement claim on Land for Hank's fraud on the community.

Fraud on the community is a theory that allows for community reimbursement. When one spouse makes false representations to the other spouse and seeks to hide the asset or profit unjustly, the court may reimburse the community for the loss. To show fraud, you must show actual deception or misrepresentation and prove the loss and unfairness to the other spouse.

Here, Hank and Whitney both personally guaranteed the Land purchase. Although title was taken in HHH's name, Hank made affirmative representations to both Whitney and Hank that Land would be "their retirement." Normally any land acquired during marriage would be community property. But HHH took title and also assumed primary liability on the loan. Thus it appears that Land is an HHH asset and not part of the marital estate. Because Hank represented to Whitney that Land would ultimately be their retirement and they both co-signed the note personally, the court may hold that Hank is now committing fraud on the community require Hank or HHH to reimburse the community for Whitney's loss.

If Whitney can successfully pierce the veil of HHH and show Hank's fraud on the community, the court could characterize Land as community property or simply require HHH, Hank or Hotdog Heaven to reimburse Whitney for her portion of the Land's value.