

NONPROBATE AND PROBATE DISPOSITIONS OF MARITAL PROPERTY

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NONPROBATE AND PROBATE DISPOSITIONS OF MARITAL PROPERTY

Thomas M. Featherston, Jr.

I. INTRODUCTION

Historically, Texas law did not encourage nonprobate dispositions of property upon the owner’s death. In 1848, the Texas legislature “abolished” joint tenancies. Law of March 18, 1848, ch. 103, Sec. 12, 1848 Tex. Gen. Laws 129. Anglo-American common law at the time presumed that co-ownership of property included the “right of survivorship” (i.e., upon the death of one co-owner, the property vested in the surviving co-owner). Texas law, however, created a presumption of “tenancy in common” rather than “joint tenancy.” Co-owners, however, could agree to create survivorship rights (i.e., convert a tenancy in common into a joint tenancy with rights of survivorship). *Chandler v. Kountze*, 130 S.W.2d 327 (Tex. Civ. App.-1939, writ ref’d). In 1955, the Texas concept of co-ownership described above was incorporated into the Texas Probate Code with the enactment of Sec. 46 of the Texas Probate Code. Until 1989, Sec. 46 was even captioned as “Joint Tenancies Abolished.”

A. Community Property

This Texas approach to co-ownership merged nicely with its community property system which creates a form of co-ownership between spouses as to their community property. Historically, when the first spouse died, the “community” ceased to exist and the deceased spouse’s one-half interest in the community property passed *probate* to the decedent’s heirs/devisees. The surviving spouse retained an undivided one-half interest in the community property, thereby creating a tenancy in common between the surviving spouse and the decedent’s heirs/devisees, unless the surviving spouse was the sole heir or devisee. Until 1987, it was unconstitutional for spouses to create survivorship rights in their community property. *Hilley v. Hilley*, 342 S.W.2d 565 (Tex. 1961).

B. Texas Two-Step

Hilley v. Hilley, *supra* and *Williams v. McKnight*, 402 S.W.2d 505 (Tex. 1966) both held that the spouses could not create “rights of survivorship” among themselves with their community property (i.e., a joint tenancy) without first partitioning the community property into their separate properties because the Texas Constitution did not authorize that type of transaction. In 1987, Art. XVI, Sec. 15 was amended to authorize spouses to create “rights of survivorship” among themselves with their community property.

C. Post 1987 Law

Today it is common for property (even community property) to avoid *probate* (i.e., pass nonprobate) upon the death of its owner. The legislature has even encouraged “non-testamentary” transfers. See Tex. Prob. Code Sec. 450. Revocable trusts have been approved by the

legislature. See Texas Trust Code § 112.033. However, some courts appear to not always properly apply the principles that have evolved from a merger of Texas community property law and the rules relating to nonprobate dispositions generally. For example, in *Haas v. Voight*, 940 S.W.2d 198 (Tex.App.—San Antonio, 1997, writ. denied), the court of appeals relied on two pre-1987 cases, *Hilley* and *Williams*, *supra*, that had not only been effectively overruled by a later amendment to the Texas Constitution but were not good precedent for the facts before the court, even if *Hilley* and *Williams* had not been overruled by the 1987 amendment. See I, E, *infra*.

D. *Street v. Skipper*

In *Street v. Skipper*, 887 S.W.2d 78 (Tex. App. - Ft. Worth 1995, writ denied) a special community property life insurance policy was payable to the insured spouse’s probate estate, and his wife correctly argued that the husband did not have the power to devise her one-half of the policy proceeds to a third party, his devisees (an estate is not an entity). In effect, the wife was arguing that the proceeds payable to the estate were probate assets and she was entitled to one-half of the proceeds without needing to prove fraud on the community (the partition approach). In other words, the husband did not have the authority to devise the wife’s one-half interest in the community, which is a fundamental concept. See III, D, *infra*.

However, the court held that the controlling issue was whether or not the husband had committed fraud on the community. It then considered the fact that the value of the total community estate, including the life insurance policy, was approximately \$4,600,000 and that under the will the wife would retain and/or inherit more than half of that amount by reason of her husband’s death. In addition, she received a portion of the husband’s separate property, including her homestead rights in his separate property home. The court concluded that a fraud on the community had not occurred. The result may have been correct, but the reasoning was not. While the husband did not have the authority to devise his wife’s one-half of the proceeds, perhaps it was her “election” to take under the will that estopped her from asserting her right to her one-half of the proceeds.

1. THIRD PARTY DESIGNATION?

Would the result in *Street* be different had the husband designated the third party as the direct beneficiary of the policy rather than designating his estate? Arguably not. Such a change in facts raises the issue of fraud on the community, and assuming the wife still retained or inherited in excess of one-half of the value of the community by reason of her husband’s death, the result would depend on the overall “fairness” of the situation. See *Jackson v. Smith*, *supra* and *Readfern v. Ford*, 579 S.W.2d 295 (Tex. App.—Dallas 1979, writ

ref'd n.r.e.). See II, F, 4, *infra*.

2. TWEAKING THE FACTS

Would the result in *Street* be different had the wife not received at least one half of the total community estate and a significant devise of the husband's separate property? For example, assume that the third party had been designated the beneficiary of the community-owned insurance and was also the sole devisee under the husband's will. In other words, the wife retained only her one-half of the community probate assets and her homestead right of occupancy in the husband's separate property home. Obviously, that situation is the classic example of the commission of a fraud on the community.

3. ELECTION?

However, how would the analysis differ had the husband devised to his wife a portion of his half of the community property or some of his separate property, but the value of what was devised to the wife was less than the value of her one half of the insurance proceeds payable to a third party? Absent actual fraud, the answer appears to depend in part on the fairness factors to be considered in determining if the insurance designation amounted to a constructive fraud on the community. See II, F, 4, *supra*.

The tougher theoretical question may be whether the wife can assert her claim of fraud on the community (or her right to one-half of the proceeds under the partition approach) and still retain the property devised to her in the will. In other words, will she be required to, in effect, "elect against the will" in order to pursue her community interests devised to a third party or the husband's estate? See III, E, *infra*.

E. *Haas v. Voight*

In *Haas*, *supra*, the question was whether the husband could make a nonprobate disposition of a community asset to a third party by depositing community funds into a "joint account with rights of survivorship" with his son. The son did not acquire an ownership interest in the account by his father making the deposit since the son had not contributed to the account. Tex. Prob. Code Sec. 438(a). The account remained the community property of the husband and wife until the husband's death when, according to the terms of the account agreement, ownership of the account passed from the husband to the son. Tex. Prob. Code Sec. 439(a).

1. THE DECISION

Ignoring Chapter 3, Subchapter B of the Texas Family Code and Chapter XI of the Texas Probate Code, the court of appeals held that this disposition failed because the community asset – "the account" – had not been partitioned by the spouses before the account was opened, referring to *Hilley* and *Williams*. See I, B and C, *supra*.

2. THE REAL ISSUE

The issue should have been whether the husband had properly exercised his power of management granted by the Texas Family Code. His entering into the survivorship agreement with the bank was either (i) within the husband's authority because the community funds were subject to his "sole management, control and disposition" or (ii) not within his authority, and therefore, void because the community funds so deposited were subject to the "joint management, control and disposition" of the husband and wife.

If the community funds were subject to the husband's "sole management, control and disposition," the question should have been whether he had committed a "fraud on the community." See II, F, *infra*. In any event, the failure of the husband and wife to have partitioned the funds should not have been the determinative factor.

F. *Holmes v. Beatty*

While *Haas* involved an attempted nonprobate disposition of community property to a third party, the recent Texas Supreme Court case of *Holmes v. Beatty*, 2009 WL 1817398 (Tex.) involved a nonprobate disposition of community property from the deceased spouse to the surviving spouse. In *Holmes*, the couple had acquired over ten million dollars in brokerage accounts and acquired securities certificates issued from those accounts. The investments were community property.

1. THE INVESTMENT ACCOUNTS

The investment accounts were variously listed as "JT TEN"; "Joint Tenancy"; and "Joint (WROS)." The question presented was whether these acronyms and definitions established a right of survivorship in favor of the surviving spouse. After an in-depth discussion of the *Hilley* and *McKnight* cases, the 1987 amendment to Article XVI, Sec. 15, and *Texas Probate Code* §§ 46(b), 451, 452 and 453, the court ruled as follows:

- a. "JT TEN" or "Joint Tenancy" – Such a designation in an account agreement signed by both spouses is sufficient to create rights of survivorship.
- b. "Joint (WROS)" – Such a designation in an account agreement signed by both spouses is sufficient to create a right of survivorship.

A critical factor in the court's analysis of the accounts was the fact that both spouses had signed the account agreement forms provided by the financial institutions. *However, the securities issued in certificate form were not signed by the couple,*

2. THE CERTIFICATES

Eventually, some of the couple's investments acquired in the "survivorship" accounts were distributed to them in certificate form with various designations, such as

“JT TEN”; “JT TEN – as joint tenants with right of survivorship” and not as “tenants in common”; and “JTWROS.” The Court held that these certificates passed nonprobate to the surviving spouse at the deceased spouse’s death because the issuance of the certificates did not revoke the accounts’ survivorship agreements. Thus, the certificates carried forward the rights of survivorship created in the account agreements, even though neither spouse had signed any of the certificates.

3. AFFIRMATION

The court noted that all of the certificates included some type of “survivorship” language that reflected the couple’s expectations initially established in the account agreements. Once the account agreements established a right of survivorship, the survivorship agreements could be revoked only by a subsequent written agreement or a disposition of the assets covered by the agreement. Texas Probate Code § 455. The issuance of the certificates to a couple with the confirming language was held not to be a disposition that revoked the survivorship agreements.

4. QUESTIONS

Holmes seems to raise more questions than it answers. What if the certificates had been issued in their names as “tenants in common” or as “Ten Com” or in their names without any designation? Would that have been a “revoking disposition?” What if the certificates were issued in only one spouse’s name? What if an investment is purchased with a check written on joint account with rights of survivorship? See VI, C, 6, *infra*.

II. MANAGEMENT OF MARITAL PROPERTY

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 Sec. 3.101.

2. SPECIAL COMMUNITY PROPERTY

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 Sec. 3.102(a).

3. JOINT COMMUNITY PROPERTY

All other community property is subject to both spouses’ joint management, control and disposition – “the joint community property.” Tex. Fam. Code Sec. 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.”

D. Presumptions

Notwithstanding 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 special community property.

E. Other Factors

1. POWER OF ATTORNEY

The Texas Family Code’s powers of management can be modified by the parties through a power of attorney or other agreement. Tex. Fam. Code Sec. 3.102. There is authority that suggests that such an agreement

can be oral. *LeBlanc v. Waller*, 603 S.W.2d 265 (Tex. App.—Houston 1980, no writ). A written power of attorney can be made to continue the authority of the agent even if the principal becomes incapacitated. See Tex. Prob. Code Secs. 482 and 484.

2. HOMESTEAD

An important statutory exception prohibits the managing spouse from selling, conveying or encumbering the homestead without the joinder of the other spouse, even if the homestead is the managing spouse's separate property or special community property. Tex. Fam. Code Sec.5.001.

3. INCAPACITY

In the event of the incapacity of the managing spouse as to special community, or of one of the spouses as to joint community property, the competent spouse may petition the probate court pursuant to Sec. 883 of the Texas Probate Code for authority to manage the entire community estate without a guardianship. A guardianship may be needed for the incapacitated spouse's separate property.

F. **Fraud on the Community**

The Texas Family Code generally grants to the managing spouse the power, with or without consideration, to transfer to a third party 100% of that spouse's special community property without the joinder, the consent or even the knowledge of the other spouse. *Massey v. Massey*, 807 S.W.2d 391 (Tex. App.—Houston [1st Dist] 1991, writ denied).

1. MANAGING SPOUSE AS TRUSTEE

In what is arguably the most significant community property case ever decided by the Texas Supreme Court, *Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925), 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).”

2. FIDUCIARY OBLIGATION

As to the special community property, the managing spouse's power is limited by a fiduciary obligation owing to the other spouse due to the existence of the marital relationship. A trust relationship exists between the spouses as to the special community property controlled by each spouse. See *Carnes v. Meador*, 533 S.W.2d 365 (Tex. App.—Dallas 1975, writ ref'd n.r.e.). This special relationship has many of the characteristics of a private express trust: (i) identifiable property – a spouse's special

community property; (ii) separation of legal and equitable title – the managing spouse has legal title and the equitable titled is owned equally by both the spouses; and (iii) fiduciary duty. While not defined by the intent of a settlor, the Texas Trust Code or the common law, and while not the same, nor nearly as extensive, as the duties generally imposed on trustees of express trusts, the managing spouse's power of management is limited by the duty not to commit “fraud on the community.”

3. THE MANAGING SPOUSE'S DUTY

The managing spouse has the duty not to commit a fraud on the community property rights of the other spouse (i.e., not to dispose, transfer or diminish that spouse's special community property in fraud of the other spouse's rights to that property). See *In Re Marriage of Moore*, 890 S.W.2d 821 (Tex. App.—Amarillo 1994, no writ) and *Jackson v. Smith* 703 S.W.2d 791 (Tex. App.—Dallas 1985, no writ), where the court refers specifically to the fiduciary relationship that exists between spouses.

4. BURDEN OF PROOF

Because the managing spouse has the power under the Texas Family Code to dispose of that spouse's special community property, the burden is on the other spouse to raise the issue of fraud on the community when the marriage terminates. That spouse may seek to establish that the managing spouse's action with respect to the managing spouse's special community property amounted either to “actual” or “constructive” fraud.

For example, to establish that the managing spouse's gift to a third party amounted to actual fraud, the other spouse must prove that the gift was made with the primary purpose of depriving the other spouse of that asset. Constructive fraud is established where a gift is found to be “unfair” to the other spouse. See *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App. —Houston [14th] 1975, writ dism'd w.o.j.). Texas courts have also set aside a gift as constructively fraudulent if the gift was capricious, excessive or arbitrary. See *Carnes v. Meador, supra*, and *Street v. Skipper*, 887 S.W.2d 78 (Tex. App.—Ft. Worth 1995 writ denied).

Once the issue of constructive fraud is raised, the cases suggest the burden switches to the managing spouse to prove that the gift was fair to the other spouse. See *Murphy v. Metropolitan Life Ins. Co.*, 498 S.W.2d 278 (Tex. App.—Houston [14th] 1973, writ ref'd n.r.e.), and *Givens v. The Girard Life Ins. Co.*, 480 S.W.2d 421 (Tex. App.—Dallas 1972 writ ref'd n.r.e.). *Jackson v. Smith, supra*. Factors to be considered in determining whether there has been a constructive fraud include (i) the size of the gift in relation to the total size of the community estate, (ii) the adequacy of the remaining community assets to support the other spouse, and (iii) the relationship of the managing spouse to the donee. See *Horlock v. Horlock, supra*. Another court described the factors to be considered as (i) whether special circumstances justify the gift and (ii) whether the

community funds used were reasonable in proportion to the remaining community assets. *Givens, supra*. Most of the cases in this area involve excessive or capricious consumption of community assets, or gifts of community assets to third parties as the basis of constructive fraud on the community. See Stewart Gagnon, Kathryn Murphy, Ike Vanden Eykel, Texas Practice Guide - Family Law, Secs. 16:8–16:95 (West).

5. REMEDIES, GENERALLY

The managing spouse's abuse of managerial powers of community assets affects not only the equitable division of the remaining community estate upon divorce but can result in the awarding of a money judgment for damages to the other spouse when the marriage terminates in order to recoup the value of the other spouse's share of the community lost through the managing spouse's wrong doing. See *Mazique v. Mazique*, 742 S.W.2d 805 (Tex. App.—Houston [1st Dist.], no writ). *Massey v. Massey*, 807 S.W.2d 391 (Tex. App.—Houston [1st Dist.] 1991, writ denied); *In re Marriage of Moore*, 890 S.W.2d 821 (Tex. App.—Amarillo 1994, no writ). A judgement for money damages against the transferee may also be possible. See *Madrigal v. Madrigal*, 115 S.W.3d 32, 35 (Tex. App.—San Antonio 2003, no pet.) (Citing Estate of *Korzekwa v. Prudential Ins. Co.*; 669 S.W.2d 775,778 (Tex. App. -San Antonio 1984, writ dismissed); *Hartman v. Crain* 398 S.W.2d 387, 390 (Tex. App.—Houston 1966, no writ). Courts have also used their equitable powers to impose a constructive trust on community assets given to third parties. See *Carnes v. Meador, supra* and *In re Murrell*, 1998 Tex. App. LEXIS 7603 (Tex. App. Amarillo 1998, no writ) where the court found constructive fraud and explains that the equitable title to the property transferred to a third party was still community property.

6. THE SCHLUETER CASE

In *Schlueter v. Schlueter*, 975 S.W.2d 584 (Tex. 1998), the Texas Supreme Court emphasized that fraud on the community is not a separate tort cause of action but is a form of fraud cognizable within the equitable division of the community estate. Consequently, punitive damages are not appropriate. According to *Schlueter*, a money judgment for actual damages can be entered to allow the wronged spouse to recoup the community estate lost due to the other spouse's fraud on the community; the amount of the judgment is specifically referable to the value of the lost community and cannot exceed the total value of the community estate.

Relying on *Schlueter*, the Texas Supreme Court has recently ruled that a wife, whose husband had committed a fraud on the community prior to their divorce, was not able to hold a lawyer liable for conspiracy with the husband to commit the fraud. The court reaffirmed the *Schlueter* rationale (i.e., there is no independent tort cause of action for wrongful disposition by a spouse), noting that it is hard to see how the community has been

damaged if one spouse retains the fruits of the fraud, and finally held that, if the spouse cannot be held liable for the tort and punitive damages, neither can a co-conspirator. *Chu v. Hong*, S.W.3d 441 (Tex. 2008), *rev'g* 185 S.W.3d 507 (Tex. App. – Fort Worth 2005, no pet.). The fraudulent sale was found to be void and the buyers were divested of ownership; interestingly, the lawyer represented the buyer.

G. Death of a Spouse

In the event the marriage terminates by reason of the death of a spouse, the managing spouse should be liable to the estate of the other spouse, or the estate of the managing spouse should be liable to the other spouse, for any actual damages suffered by the other spouse arising from a fraud on the community. For example, if \$100,000 of community assets were wrongfully transferred by the managing spouse to a third party, the other spouse, or that other spouse's estate, has a claim for money damages in the amount of \$50,000, an amount equal to the other spouse's one-half community interest in the \$100,000 wrongfully transferred. If the managing spouse, or the managing spouse's estate, does not have sufficient assets to satisfy the claim for damages, the court may impose a constructive trust on the third party donee in order to retrieve one-half the community asset that had been wrongfully transferred to the donee. *Carnes v. Meador, supra*. See *Osuna v. Quintana*, 993 S.W.2d 201, 209 (Tex. App.—Corpus Christi 1999, no pet.) discussing the difference in remedies in death and divorce situations.

1. THE HARPER CASE

In *Harper v. Harper*, 8 W.S.3d 783 (Tex. App.—Ft. Worth 1999 pet. den.), the court cites *Schlueter* for the holding that “. . . fraud on the community exists outside the realm of tort law and cannot be brought as an independent cause of action . . .” before holding that punitive damages are not recoverable. The only damages being sought against the managing spouse in *Harper* were punitive damages since the estate of the other spouse had already received half of the sales proceeds (plus interest) in satisfaction of the other spouse's interest in the property at issue. *Harper* and *Schlueter* do not hold that the other spouse cannot seek actual damages where the managing spouse commits a fraud on the community. See *Barnett v. Barnett*, 67 S.W.3d 107 (Tex. 2001) where the Texas Supreme Court confirmed that the other spouse had a cause of action under Texas law for constructive fraud on the community after the managing spouse died, but because of the facts of *Barnett*, the claim was preempted by federal law. See II, H, *infra*.

2. EXAMPLES

Assume that a husband gives his mother his special community car, or a husband designates his child by a previous marriage as beneficiary of an insurance policy which is the husband's special community property, or a husband deposits special community cash into a bank

account payable at his death to his paramour. Upon the husband's death, the car is still owned by the husband's mother and the proceeds of the policy and the funds on deposit belong to the designated third party beneficiary unless the transfer to the mother, child or paramour is set aside as to the wife's one-half interest because the transfer is found to have been in fraud of the surviving spouse's rights. The court should, however, first attempt to make the wife whole by an award of money damages out of the husband's estate, if fraud on the community is established.

H. Federal Preemption

In *Barnett v. Barnett*, 67 S.W.3d 107 (Tex. 2001), the Texas Supreme Court held that a wife's claim for constructive fraud on the community and her corresponding claim for the imposition of a constructive trust following her husband's death were preempted by ERISA. In that case, a husband had designated a third party as the beneficiary of a life insurance policy that was part of an employee benefit plan covered by ERISA.

Although the policy was community property, the wife's claim in *Barnett* was based on Texas law (i.e., "fraud on the community") that had a connection with an ERISA plan and was, accordingly, preempted. The court explained that the application of Texas community property laws would interfere with the national uniformity of a matter central to ERISA plan administration. Thus, in the absence of actual common law fraud, the court found that Texas' concept of "fraud on the community" had no counterpart in federal common law.

I. Illusory Transfers

In *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968), the Texas Supreme Court held that a husband's creation of a revocable trust with his special community property was illusory as to his wife's one-half community interest therein since the husband had, in effect, retained essential control over the trust assets. The key factor was the revocability of the trust. Accordingly, the wife was able to set aside the trust as to her one-half interest upon her husband's death.

Query: To date, the illusory transfer argument has been applied only to revocable trusts. Would it also apply in theory to any revocable nonprobate disposition (e.g., a POD bank account)?

J. Void Transfers

The Texas Supreme Court has not yet definitively determined whether one spouse can assign his or her own undivided one-half interest in joint community property to a third party without the joinder of the other spouse. The view more consistent with the overall statutory scheme would void such a unilateral attempt as an attempt to unilaterally partition; partitions require the joinder of both spouses. The courts of appeals are divided. See *Williams v. Portland State Bank*, 514 S.W.2d 124 (Tex. Civ. App.—Beaumont, 1974, writ dismissed); *Vallone v. Miller*, 663 S.W.2d 97 (Tex. App.—Houston [14th Dist.] 1983,

writ refused n.r.e.); *Dalton v. Jackson*, 691 S.W.2d 765 (Tex. App.—Austin 1985, writ refused n.r.e.). It would certainly follow that such a transaction would be void as to the other spouse's one-half interest. Compare *In the Matter of the Marriage of Morrison*, supra.

K. Fraud on Creditors

Certain transfers between spouses and transfers to third parties may be set aside by creditors under both Texas and federal law. See the Uniform Fraudulent Transfer Act. Tex. Bus. & Comm. Code Secs. 24.001-24.013 and the U.S. Bankruptcy Code, 11 U.S.C. Sec. 544(b).

Note: The definition of creditor includes a spouse who has a claim.

III. MARITAL PROPERTY IN PROBATE

When a married resident of Texas dies, the marriage terminates and community property ceases to exist. 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 an undivided one-half interest therein. There is not a "just and right" division of the community as in the divorce court; neither is the concept of quasi-community recognized. See *Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987).

A. Probate v. Nonprobate

The estate of a decedent must initially be divided into two separate and distinct categories. Certain assets fall within the probate class and others are classified as nonprobate assets.

1. NONPROBATE

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. Many nonprobate dispositions are contractual arrangements with third parties or the intended beneficiaries, and the terms of the contracts control the dispositions. Common examples of these types of contractual arrangements include three of the multiple-party bank accounts discussed in Chapter XI of the Texas Probate Code, most life insurance policies and certain employee benefits. Tex. Prob. Code Sec. 450. In other nonprobate dispositions, the ownership of a future interest in the property is transferred to the intended beneficiary during the owner's lifetime, and the future interest becomes possessory upon the death of the owner. Revocable trusts and springing executory interests are examples of these types of nonprobate dispositions. Of course, an inter vivos gift of the ownership and possession of an asset prior to the owner's death can be considered a nonprobate disposition.

Note: If the deceased spouse made a nonprobate disposition of his/her specific community property to a

third party, see II, F, supra.

2. PROBATE

Probate assets are those assets which are not controlled by an inter vivos arrangement and pass at the owner's death through probate administration and on to the owner's heirs or devisees. A married individual's probate estate consists of the decedent's separate probate assets and his or her 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 one-half interest in the community probate assets.

B. 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 includes 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 an 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. Absent the opening of a formal administration, the surviving spouse administers the community and can discharge the "community obligations." See Tex. Prob. Code Sec. 160.

Note: If the deceased spouse died intestate and the surviving spouse is the sole heir, there is no need for any type of formal administration. Tex. Prob. Code Sec. 155.

C. 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 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 one-half interest in the community probate assets passes to the decedent's descendants per capita with right of representation. Tex. Prob. Code Secs. 43, 45. 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 Sec. 45. The rules relating to "representation" were modified to be effective September 1, 1991. Tex. Prob Code Sec. 43.

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. Prob. Code Sec. 38.

D. Testate Death

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. Prob. Code Secs. 57 and 58. This broad grant of testamentary authority is, however, effectively limited to the testator's separate probate property and his or her one-half interest in the community probate property. *Avery v. Johnson*, 108 Tex. 294, 192 S.W. 542 (1917). Not even the divorce court can enjoin a spouse from exercising the spouse's testamentary power. See Tex. Prob. Code Sec. 69A.

E. Texas "Widow's" Election

It is fundamental that the deceased spouse has testamentary power over only one-half of the community probate assets, whether the community assets are held in the husband's name, the wife's name, or both of their names. An attempt to dispose of both halves of the community is ineffective unless the attempt triggers the application of "equitable election." In Texas, this doctrine has been termed the "widow's election" whether the survivor is a widow or widower.

1. EQUITABLE ELECTION

Whenever any devisee is entitled to a benefit under a will and asked to suffer a detriment under the will, the devisee cannot accept the benefit without suffering the detriment. The choice is left to the devisee who can elect to accept under the will or elect against the will. The most common example of an election is when the testator attempts to dispose of property which the testator does not own while at the same time devising other property to the actual owner. See *Wright v. Wright*, 154 Tex. 138, 274 S.W.2d 670 (1955). *Dunn v. Vinyard*, 251 S.W. 1043 (Tex. Com. App. 1923, opinion adopted).

2. COMMUNITY PROPERTY ELECTION

It is common for one spouse to attempt to leave a community asset to a third party while leaving the surviving spouse another asset. Such a disposition would put the surviving spouse to an election. The surviving spouse is also put to an election when the decedent gives the surviving spouse a life estate in the entire community estate while expecting the survivor to allow her or his one-half of the community to pass under the decedent's

will. *United States v. Past*, 347 F.2d 7 (9th Cir. 1965); *Vardell's Est. v. Comm.*, 307 F.2d 688 (5th Cir. 1962). Compare with the "illusory" inter vivos transfer concept. See III, E., *supra*.

3. THE TEXAS RULE

In *Wright v. Wright*, *supra*, the Texas Supreme Court explained the Texas rule. First, the will must dispose of property owned by the surviving spouse while at the same time granting some benefits to the surviving spouse. Second, the surviving spouse must elect to allow all or part of his or her property to pass as provided in the will before accepting the benefits conferred. Third, the will must clearly put the survivor to an election.

4. PROCEDURE

The surviving spouse may be put to either an express or an implied election. In other words, the language of the will may specifically and expressly set forth the intent to require an election. *Calvert v. Ft. Worth Nat. Bank*, 348 S.W.2d 19 (Tex. Civ. App.—Austin, 1961), affirmed 163 Tex. 405, 356 S.W.2d 918 (Tex. 1962). In other situations, the election is implied from the language of the will. The question of whether the survivor is put to an election is one of law for the court. *Wright, supra*. The question of whether the survivor has made an election is one of fact. Generally, two factors are involved. First, the survivor must have been aware of the choice. Second, the survivor must intend to so elect; however, the totality of the circumstances are considered in making this determination. *Dunn v. Vinyard, supra*. Mere acceptance of benefits may be deemed an election to take under the will. See Dougherty, "Election", Texas Estate Administration Secs. 8.1, 8.2.

5. TAX CONSEQUENCES

The decision to elect or not can have significant transfer and income tax consequences which are beyond the scope of this article. For a discussion of these matters and an in depth study of the Texas widow's election, see Kinnebrew and Morgan, "Community Property Division at Death," 39 *Baylor Law Review* 1037, 1072-1079 (1987).

6. SUPER ELECTION

Traditionally, the doctrine of election has required the electing spouse's benefit and detriment to be found in the same disposition (e.g., the deceased spouse's will or revocable trust). Perhaps it is time to consider the "super election" in view of the prevalent use of probate and nonprobate dispositions as part of a comprehensive estate plan. For example, a husband designates his wife as beneficiary of a \$1 million life insurance policy, but purports to specifically devise in his will both halves of a certain \$100,000 community asset to his kids by a prior marriage, without naming his wife as a beneficiary in the will. Should she be able to accept the \$1 million and also assert her rights to one-half of the community asset specifically devised to the kids? Or, if she accepts a

significant benefit in the comprehensive plan, shouldn't she be deemed to have accepted the detriment in another part of the plan?

F. 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 protect 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. 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. Prob. Code Sec. 273.

2. 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. Prob. Code Secs. 271 and 281. 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 \$60,000. Tex. Prob. 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. Prob. Code Sec. 278. There is also an allowance in lieu of exempt personal property. Tex. Prob. Code Sec. 273.

3. 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 and minor children may be established by the probate court. Tex. Prob. Code Secs. 286 and 287. 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. Prob. Code Sec. 288; *Noble v. Noble*, 636 S.W.2d 551 (Tex. App.—San Antonio 1982, no writ).

IV. ADMINISTRATION OF COMMUNITY

PROPERTY

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 includes 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. Types of Administration

1. FORMAL AND INFORMAL ADMINISTRATION

Whether the decedent died testate or intestate, it is possible in Texas for the decedent's surviving spouse and distributees to informally administer the decedent's estate. In other words, the assets can be collected, the debts paid and the balance properly distributed without a court appointed personal representative. It may be necessary to admit the decedent's will to probate as muniment of title, or to have a judicial determination of heirship and order of no administration entered by the probate court, in order to establish the distributees' title. Tex. Prob. Code Sec. 89 and Tex. Prob. Code Secs. 48-56. Other situations will require the appointment of a personal representative to formally administer the estate. The personal representative can either be (i) an administrator or executor or (ii) an independent administrator or independent executor. In any event, it is the personal representative's function to accomplish the purposes of estate administration.

2. NECESSITY OF ADMINISTRATION

In order to open a formal administration, the need for an administration must be established to the satisfaction of the probate court. A necessity is deemed to exist if two or more debts against the estate exist, or it is desired that the probate court partition the estate among the distributees. These two statutory provisions are not exclusive. Tex. Prob. Code Sec. 178. The decedent's designation of an executor in his or her will is sufficient cause for the opening of a formal administration.

3. PRIORITIES

If there is a need for formal administration, the persons named as executors in the will are given priority in the selection process of the personal representative. If the named executors are not able to qualify, the surviving spouse, then others, are given priority. If the decedent dies intestate, letters of administration are first granted to the surviving spouse, then others. Tex. Prob. Code Sec. 77.

4. DEPENDENT AND INDEPENDENT ADMINISTRATIONS

The personal representative appointed by the court will be designated either (i) the independent administrator or independent executor or (ii) the executor or administrator. An independent administration is created by will or pursuant to certain specified procedures and allows the independent personal representative to administer the estate free of routine supervision by the probate court. Tex. Prob. Code Secs. 145-154A. If the court fails to grant an independent administration, the personal representative's actions are supervised on a routine basis, and the personal representative must seek the court's authority prior to entering into many transactions. Sec. 145(r) permits an independent executor named in the will who refuses to so act or resigns to qualify as a dependent personal representative.

5. ACCOUNTABILITY

During a dependent administration, the personal representative must file (i) an inventory and list of claims, (ii) annual accountings and (iii) final accountings. These documents must be approved by the probate court. An independent personal representative must file and have approved his inventory and list of claims but has no other formal accounting requirements; however, the representative is accountable to the distributees as is any fiduciary.

6. THE INVENTORY

While there is disagreement among the commentators, it is this author's opinion that the inventory and list of claims should list the assets of the estate which are subject to administration by the personal representative, identifying which assets were community. Since both halves of the certain community probate assets are subject to administration, the inventory and list of claims should account for both halves of the community probate assets, as well as the decedent's separate probate assets. *Cain v. Church*, 131 S.W.2d 400 (Tex. Civ. App. 1939, no writ). It may be appropriate to identify the decedent's one-half interest in the survivor's special community as a claim. The decedent's nonprobate assets and the surviving spouse's separate property are not subject to administration and do not belong on the inventory. Tex. Prob. Code Sec. 250. See Ikard and Golden, Administration of Community Property, 1996 Adv. Est. Planning and Probate Course (State Bar of Texas).

B. Distribution of Powers Among Personal Representative And Surviving Spouse

During formal administration, the personal representative is entitled to possession of not only the deceased spouse's separate property but also the couple's joint community property and the decedent's special community property. The surviving spouse may retain possession of the survivor's special community property

during administration or waive this right and allow the personal representative to administer the entire community probate estate. Tex. Prob. Code Sec. 177. 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 grants to the representative more extensive powers over the decedent's separate assets and one-half interest in the community. 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. See III, E, *supra*.

1. COMPARISON WITH FAMILY CODE PROVISIONS

This 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 his or her debts. Tex. Fam. Code Secs. 3.102 and 3.202. Of course, both the personal representative and surviving spouse should eventually account for both halves of the community in order to settle the estate. If the community assets in possession of the personal representative and available to satisfy the deceased spouse's creditors are insufficient for that purpose, Tex. Prob. Code Sec. 156 indicates that the deceased spouse's one-half interest in the surviving spouse's special community property can be reached to satisfy the deceased spouse's creditors; these assets were generally exempt from the claims of the deceased spouse's non-tortious creditors during the marriage. Both halves of those community assets are liable for any tortious debts of the deceased spouse.

2. AUTHORITY OF SURVIVING SPOUSE – NO PERSONAL REPRESENTATIVE

When there is no personal representative for the estate of the deceased spouse, Sec. 160(a) 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. Prob. Code Secs. 156 & 168 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 directs the surviving spouse to "preserve the community property, discharge community obligations and wind up community affairs."

3. AUTHORITY OF THE SURVIVING SPOUSE – PERSONAL REPRESENTATIVE

When a personal representative is administering the estate of the deceased spouse, including the surviving spouse's one-half of the decedent's special community and the couple's joint community, the surviving spouse's fiduciary authority over the survivor's special community property enables the survivor to exercise all the powers granted to the surviving spouse where there is no administration pending. Tex. Prob. Code Sec. 177. 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. Prob. Code Sec. 156.

C. Allocation of Liabilities After Death

1. PROBATE ASSETS

As pointed out previously, the Texas Probate 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 resolve all the issues related to which assets are liable for which debts.

2. NONPROBATE ASSETS

In the past, practitioners could follow a general "rule of thumb": 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 this old "rule of thumb." See Tex. Prob. Code §§ 442, 450(b) and 461.

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

Despite the growing need for a comprehensive statute which would complement Sec. 450(b) 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. Sec. 322B of the Texas Probate Code does not apply to death taxes.

5. ABATEMENT AMONG COMMUNITY AND SEPARATE ASSETS

Sec. 322B also failed to give direction to the personal representative who has both non-exempt separate and community assets in its possession and control in order to satisfy the decedent's debts. The potential conflict of interest is obvious; the expenditure of separate funds to satisfy the 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? The author is not aware of any definitive cases on point that offer the personal representative any clear guidance. Accordingly, the personal representative should pay certain claims 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. Other debts, like credit cards, utilities, and community property purchase money indebtedness, and should be paid out of the community funds being administered by the personal representative.

D. 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 entitled to their respective one-half interests in each and every community probate asset.

1. NON PRO RATA DIVISION

Accordingly, can the survivor 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. The authority of an executor to enter into such a transaction should depend on the powers granted to the executor in the decedent's 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. However, the surviving spouse may have already agreed by accepting benefits under the will through either an express or equitable election. See XI, E, *supra*. The real issue is whether any such agreement will be considered a taxable exchange, subjecting the parties to capital gain exposure to the extent the assets have appreciated in value since the decedent's date of death.

2. I.R.S. POSITION

Three private letter rulings suggest that such an exchange is not taxable. In one, PLR 8037124, 1980 WL 134564, a husband and wife proposed to divide into two equal, but non pro rata shares, certain community assets in order to create liquidity for one to pay estate taxes upon an anticipated death; relying in part on Rev. Rul 76-85, 1976-L C.B. 215, 1976-WL 36350, the memorandum concludes that such a partition would not result in a taxable event.

In the second, PLR 8016050, 1980 WL 132102, where a husband and the executor of his wife's estate proposed an equal, but non-pro rata division, again 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 property as an entity. The legal entity principle relied on in the memorandum is, however, only mentioned in the context of Rev. Rul. 76-83, 1976-1 C.B. 213, 1976 W.L. 36350. Rev Rule. 76-83 ruled that a divorce non prorata division of community transaction was a non-taxable transaction with no gain or loss being recognized. This author has not found any definitive reference in the ruling to the community being an entity under California law. The main point of the ruling was, while a division of the community in a divorce settlement may result in a taxable event, such a division is not considered taxable when there is an equal division of the value with some assets going to the wife and other assets going to the husband. In Texas, for most purposes, community property principles do not create an entity. Community property is a form of

co-ownership among a husband and wife that ceases to exist when the marriage terminates.

Note: The 1980 private letter rulings were issued prior to the enactment of 26 U.S.C.A. Sec. 1041, which provides that no gain or loss is recognized on a transfer between spouses incident to a divorce.

In the third, 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.

3. THE LAW

Do these three rulings really support the legal conclusion that a non pro rata division of assets in Texas among the surviving spouse and the heirs and/or devisees of the deceased spouse is not a taxable event, or is Texas substantive law different enough to generate a different tax result? However, as discussed below, California law may not be as different as PLR 8016050 suggested.

Perhaps PLR 9422052 suggests a possible planning advantage a revocable trust may have over a traditional testamentary plan. In a traditional testamentary plan, a safe harbor approach may be for the personal representative with appropriate authority granted in the will to enter into a partition and exchange agreement 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: 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 whose agreement to the division will be necessary to complete the exchange.

E. The California Approach

Notwithstanding the comfort that the above described rulings would appear to give California couples, on Jan. 1, 1999, California amended its Probate Code. Section 100 now provides: (a) upon the death of a married person, one-half of the community property belongs to the surviving spouse and the other half belongs to the decedent, (b) notwithstanding subdivision (a), a husband and wife may agree in writing to divide their community property on the basis of a non pro rata division of the aggregate value of the community property or on the basis of a division of each individual item or asset of community property, or partly on each basis. Nothing in this subdivision shall be construed to require this written agreement in order to permit or recognize a non pro rata division of community property.

Thus, it appears that, absent an agreement of the couple, California law is similar to Texas law; at death, the surviving spouse retains an undivided one-half (½) interest in each and every community asset, and the deceased spouse's undivided one-half (½) interest passes to his or her heirs/devisees. California law differs because of the statute that expressly authorizes the couple to agree to a non pro rata division of the aggregate value of the community property. Further, Cal. Prob Code Sec. 104.5, which became effective on Jan. 1 2000, permits Sec 100b agreements to be incorporated into revocable trusts.

F. The Texas Response

Since Texas does not have a statute expressly authorizing such an agreement, the question is whether Texas couples can enter into such an agreement. Would such an agreement be valid under existing Texas statutes and Art. XVI, Sec. 15 of the Texas Constitution? Arguably, such an agreement is valid under existing Texas law. Both Tex. Fam. Code Sec. 4.102 and Art. XVI, Sec. 15 of the Texas Constitution authorize spouses to partition between themselves all or part of their community property, then existing or to be acquired, as they may desire. It is not too much of a stretch to imagine this statutory language includes an agreement to divide the community property on the basis of a non pro rata division upon the death of the first spouse.

On the other hand, a strict construction of the constitutional and statutory language suggests that only spouses, *during the marriage*, can partition, then existing community property, or community property to be acquired in the future. The California type agreement seems to contemplate an agreement during the marriage to partition in a certain way after the marriage terminates. Thus, such an agreement may violate Art. XVI, Sec. 15.

In *Hilley v. Hilley*, a case decided prior to 1980 amendment to Art. XVI, Sec. 15 that liberalized the spousal partition rules, the Texas Supreme Court held it was unconstitutional for a couple to enter into an agreement during marriage that would avoid a pro rata partition of the community upon the first spouse's death. The couple in that case tried to attach "survivorship" rights to certain community assets. *Hilley v. Hilley*, 342 S.W.2d 565 (Tex. 1961). Of course, survivorship rights were later authorized by the 1987 amendment to Art. XVI, Sec. 15.

Lending support to the argument that the agreement may not violate Art. XVI, Sec. 15 is the old case of *Gorman v. Gause* 56 S.W.2855 (Tex. Comm. Of Appeals 1933) where the court, in the context of a pre-marital agreement, stated that ". . . it might be agreed by such parties that...a certain portion of the community estate, when acquired, would be conveyed by him to the wife and made her separate property. . . . Such an agreement would not violate either the Texas Constitution or statutes of this state. . ." Accordingly, perhaps an agreement of the spouses to partition community in a certain way following the first spouse's death would not violate existing Texas law.

V. NONPROBATE DISPOSITIONS BETWEEN SPOUSES

It has become commonplace for spouses to arrange certain marital assets so that prior to the death of the first spouse, or upon the death of the first spouse, the asset belongs to the donee spouse without going through probate administration.

A. Inter Vivos Gift

One spouse may give to the other spouse either the donor's separate property or the donor's interest in their community property, thereby making the asset the donee spouse's separate property. *Bradley v. Love*, 60 Tex. 472 (Tex. 1883). Since 1980, such a spousal gift raises a presumption that the future income generated by the donated property will also be the donee spouse's separate property. Tex. Fam. Code Sec. 3.005. A spouse may transfer to the other spouse the transferor spouse's one-half community interest in community property held in either spouse's name or in both names without going through the steps of a "partition and exchange." *In re Marriage of Morrison*, 913 S.W.2d 689 (Tex. App.—Texarkana 1995 writ denied).

B. Partition

Spouses may partition or exchange between themselves all or any part of their community property then existing, or to be acquired, into their respective separate properties. A 2005 amendment corrected some confusion created by a 2003 amendment and now confirms that the spouses may also partition the future income generated by the property that has been partitioned. Tex. Fam. Code Sec. 4.102.

C. Income Agreement

Since 1980, spouses may agree that income from separate property will be the separate property of the owner spouse. Tex. Fam. Code Sec. 4.103.

D. Life Insurance

A spouse can purchase a life insurance policy on his or her own life and designate the other spouse as beneficiary. Whether the policy was community or separate, the proceeds belong to the survivor upon the insured's death. *Martin v. McAllister*, 63 S.W. 624 (Tex. 1901).

E. Employee Benefits and Other Retirement Accounts

A married employee can designate the other spouse as beneficiary of the employee's retirement plans whether the employee's interest in the plan is community or separate property. This result is even mandated by federal law for certain qualified retirement plans. I.R.C. Sec. 417(b).

F. Sec. 450 of the Texas Probate Code

Section 450 of the Texas Probate Code can apparently be utilized by spouses, as well as other individuals. This section confirms traditional nonprobate dispositions and opens the door for other creative nonprobate dispositions. Tex. Prob. Code Sec. 450. Mutual fund accounts were added to the list in 2001.

G. C.P.W.R.O.S.

Prior to Nov. 3, 1987, in order to create a right of survivorship of their community property for the surviving spouse, the married couple had to first partition their community property into separate property and then enter into the survivorship arrangement. *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565 (1961). The 1987 amendment to Art. XVI, Sec. 15 of the Texas Constitution permitted spouses to agree in writing that all or any part of their community property shall belong to the surviving spouse without going through probate upon the death of the first spouse. Now, married couples can create survivorship rights without first partitioning the community. All that is required is a written agreement; there is no specific signature requirement in the Constitution.

1. AMENDMENTS TO THE TEXAS PROBATE CODE

The 1987 legislature amended Sec. 46 of the Texas Probate Code in anticipation that the amendment would pass. Amended Sec. 46 provided that spouses may agree in writing "that all or any part of their community property which is titled or held with indicia of title becomes the property of the surviving spouse on the death of a spouse." The highlighted language presented possible conflicts with the Constitution, most of which conflicts may have become moot because in 1989 Sec. 46 was amended again to state that Sec. 46 does not apply to any agreements between spouses regarding their community property which are now to be governed by new Part 3 of Chapter XI of the Probate Code, which was added to the Probate Code in 1989, and which has been held by the Texas Supreme Court to be the exclusive means of establishing rights of survivorship in community property. See *Holmes, supra*.

2. PART 3, CHAPTER 11 OF THE TEXAS PROBATE CODE

This part of the Texas Probate Code purports to provide a comprehensive approach to community property with survivorship rights.

a. FORMALITIES

Sec. 452 requires that the survivorship agreement be in writing and signed by both parties and includes nonexclusive "safe harbor" language for the proper manifestation of intent. It should be noted that neither the Constitution nor old Sec. 46 required a signature. Can the legislature require the signature of both parties when the Constitution does not? Can an

agent sign on behalf of a party, or is this a nondelegable privilege?

Note: See I, F, supra, for a discussion of the Texas Supreme Court's most recent holding on what is required to create CPWROS.

b. OWNERSHIP AND MANAGEMENT

Sec. 453 provides that the property subject to the valid survivorship agreement will remain community property during the remainder of the marriage. It also provides that such an agreement in and of itself does not alter the rights of management. In other words, special community property does not automatically become joint community property, which would appear to mean the managing spouse can make a valid inter vivos disposition of the same. If so, are the proceeds subject to the survivorship agreement?

c. DEATH OF FIRST SPOUSE

In the event of divorce, the rights of the parties will not be affected by the survivorship agreement, but upon the death of the first spouse, the community property subject to the survivorship agreement becomes the property of the surviving spouse through a nonprobate means. (It can be assumed that Sec. 47(d) will require the surviving spouse live for 120 hours.) If the spouses have not recorded their survivorship agreement and/or have not titled their property to reflect the survivorship agreement, the survivor will need to prove his/her ownership of the property, which will still appear on record to have been partitioned upon the death of the first spouse like any other community property asset. Accordingly, Sec. 456 creates a new judicial process whereby the survivor can establish the validity of the survivorship agreement. Accordingly, upon application, citation and proof, the survivor can avoid probate.

3. CREDITOR'S CLAIMS

Will the property still be liable for the deceased spouse's debts since the property passes nonprobate to the survivor? Common law joint tenancies, like life insurance, avoid probate and the claims of creditors, but joint bank accounts per Tex. Prob. Code Sec. 442 have second tier liability. Now Sec. 461 provides that spousal multi-party bank accounts shall be governed by Sec. 436 and that other community assets subject to survivorship rights will continue to be liable for debts as if the survivorship agreement was not in effect.

4. ESTATE TAXES

The deceased spouse's one-half interest in the community property subject to survivorship rights will be included in the deceased spouse's gross estate but will qualify for the marital deduction so that such assets are not taxed upon the death of the first spouse. Will both halves receive a step up in income tax basis under Sec. 1014(b)(6) of the Internal Revenue Code? Presumably so, see I.R.S. Rev. Rul. 87-98 1987-39 I.R.B. 15. However,

to the extent that such assets are not consumed or otherwise removed from the tax base of the surviving spouse, such assets will be included in the surviving gross estate at the survivor's death. This result can disrupt sound marital estate planning, waste the first spouse's exemption equivalent and cause the family to pay additional death taxes.

5. SUBSTANTIVE QUESTIONS

Notwithstanding a comprehensive set of statutes, there are issues related to survivorship agreements that cause many to question its advisability in many situations.

a. REVOCABILITY

Can one spouse unilaterally rescind the agreement? Prior to the 1989 legislation, commentators argued the negative in that the property was probably joint community which required joint action of the spouses; in addition, the spouses were perhaps bound by a contract. Perhaps the survivorship arrangement itself is revocable, and breach of contract is the remedy. On the other hand, perhaps all that has been created is a non-testamentary transfer, revocable by either spouse. Added in 1989, Sec. 455 provides that one spouse may revoke by a written instrument signed by the revoking spouse and delivered to the other spouse. But, could there still be a breach of contract action?

Note: See I, F., supra, for a discussion of the Texas Supreme Court's most recent discussion on what it takes to revoke a CPWROS agreement.

b. PROPERTY SUBJECT TO SURVIVORSHIP

Assuming a married couple desires survivorship rights for all of their community property, can they execute an agreement simply referring to "all of their community property in existence at the time of the agreement"? Can they agree to survivorship rights as to community property not yet in existence? The answer may depend in part on the proper interpretation of Art. XVI, Sec. 15 and the constitutionality and the interpretation of Sec. 46 of the Texas Probate Code prior to the effective date of the 1989 legislation, but Sec. 451 appears to contemplate an "any and all property agreement."

c. RETROACTIVITY

Assume a married couple entered into a community survivorship agreement prior to Nov. 3, 1987, and the first spouse dies after Nov. 3, 1987, will the survivorship rights be effective? This is a particularly troublesome question as it relates, for example, to a community property joint bank account with survivorship rights which the couple signed years ago without an understanding of the legal significance of their agreement. If the first spouse died prior to Nov. 3, 1987, the spouse's one-half interest then would have passed to his heirs and devisees; now, does it pass to the surviving spouse? Sec. 3 of SB 1643 provides that the amendments made by SB

1643 apply to all community property survivorship agreements entered into on or after November 3, 1987, and to any earlier agreements, if both spouses were living on that date and the agreement complies with Part 3 of Chapter XI of the Texas Probate Code. See *Estate of Stripling v. Stripling*, 812 S.W.2d 397 (Tex. App.—Eastland 1991, no writ).

d. FURTHER APPLICATION

Does new Part 3 of Chapter XI of the Texas Probate Code apply to every nonprobate disposition of community assets between spouses or only those where the agreement is for the property to pass to whomever is the surviving spouse? It is the author's opinion that Part 3 applies only to those transactions previously voided by the *Hilley* rule.

6. FREE V. BLAND

In *Free v. Bland*, 369 U.S. 663, 82 S.Ct. 1089, 8 L.Ed 2d 180 (1962), a husband and wife purchased United States savings bonds with community funds. The wife died, and Texas law directed that the wife's one-half interest passed to her heirs; however, a federal treasury regulation provided that when one co-owner died, the other would become the "sole and absolute owner." Following the wife's death, her heirs sued the surviving husband for an accounting and obtained a judgment for one-half the value of the bonds. The United States Supreme Court held that the federal regulations preempted Texas community property law. Further, the Supreme Court held that the heirs could not circumvent preemption by obtaining a judgment for one-half the value of the bonds rather than title to one-half interest in the bonds themselves.

7. THE POWER OF PREEMPTION

In an attempt to avoid the consequence of preemption, state law awarded full title to the husband but required him to account for half of the value of the bonds to the decedent's estate. The Court in *Free v. Bland* noted: "Viewed realistically, the State has rendered the award of title [by the federal regulations] meaningless.... If the State can frustrate the parties' attempt to use the bonds' survivorship provision through the simple expedient of requiring the survivor to reimburse the estate of the deceased co-owner as a matter of law, the State has interfered directly with a legitimate exercise of the power of the Federal Government to borrow money."

VI. MULTIPLE PARTY ACCOUNTS

The most common forms of marital agreements and nonprobate dispositions are multiple-party accounts that are frequently opened by spouses during a marriage. The marital property character of multiple-party accounts are determined in part by the form of account used by the depositing spouse. The form of the account will also dictate the disposition of the funds on dissolution.

A multiple-party account is defined as a contract of deposit of funds between a depositor and a financial institution. It includes checking accounts, savings accounts, certificates of deposit, share accounts and *other like arrangements*. The term "financial institution" now includes "brokerage firms that deal in the sales of and purchases of stocks, bonds, and other types of securities." See Tex. Prob. Code Sec. 436 (1) and (3).

Note: The question remains as to whether the multiple-party account rules apply to all joint-type accounts at brokerage firms (i.e., securities held in street name) or only those which are, effectively, checking or savings accounts. The Texas Supreme Court in Holmes, supra, indicated that Sections 451-462 of the Texas Probate Code were the exclusive means of establishing rights of survivorship in community property. See 1, F, supra.

A. Chapter XI

Subject to the 900 lb. Gorilla rule (see VI, C2, *infra*) Chapter XI of the Texas Probate Code now authorizes five different multiple-party accounts. Chapter XI does not use the term "joint tenancy" account or "joint tenancy with right of survivorship" account. Sec. 46 governs joint tenancies; Chapter XI governs multiple-party accounts.

1. JOINT ACCOUNTS

Such accounts belong, during the joint lifetimes of the parties, to the parties in proportion to their "net contributions" to the account, and at the death of a party, the surviving party and the heirs or devisees of the deceased party continue to own the account in proportion to their "net contributions." There is no right of survivorship. Tex. Prob. Code Secs. 438(a) and 438A.

2. CONVENIENCE ACCOUNTS

Such accounts are established by the depositor and are owned by the depositor, even if additional funds are added to the account. A "co-signer" may withdraw funds from the account "for the convenience" of the owner of the account but does not acquire ownership of the account during the owner's lifetime or at the owner's death. In other words, there is no right of survivorship. Tex. Prob. Code Sec. 438A.

Note: H.B. 3075 (2009) provides for the addition of "convenience signers" to different account types

3. SURVIVORSHIP ACCOUNTS

A "joint account with survivorship rights" belongs to the parties during their joint lifetimes in the same manner as the previously described joint account. However, at one party's death, the entire account belongs to the surviving party. Tex. Prob. Code Sec. 439(a).

4. P.O.D. ACCOUNTS

A "P.O.D. account" belongs to the depositor during the depositor's lifetime but passes to the "P.O.D. payee"

upon the depositor's death, provided such payee survives the depositor. Tex. Prob. Code Secs. 438(b) and 439(b).

5. TRUST ACCOUNTS

A "trust account" belongs to the depositing "trustee" during the trustee's lifetime and passes to the beneficiary of the account at the trustee's death, provided the beneficiary survives the trustee. The existence of such an account depends on the nonexistence of an express trust. A trust account under Chapter XI is not a private express trust. Tex. Prob. Code Secs. 438(c) and 439(c).

6. DEPOSITOR INTENT

Sec. 439(a) of the Probate Code was amended to provide that an agreement is sufficient to confer survivorship in a joint account if the account states substantially that all funds or deposits of one party shall vest in and become the property of the surviving party. The question of what is necessary to "make an account survive" is still being litigated and is a subject beyond the scope of this outline. *See, however, Glenn Karisch's excellent outline, "Multi-Party Accounts in Texas," (2000), accessible to view at www.texasprobate.com/articles/accounts.htm.*

B. Marital Property Problems

The deposit of community property into a multiple-party account raises several substantive issues in the estate practice, the resolution of which will depend in part on the form of account used by the depositing spouse.

1. P.O.D. AND TRUST ACCOUNTS

Special community property of a spouse is deposited by that spouse into a "P.O.D. account" or "trust account" with the depositing spouse as the original payee or trustee.

a. The account remains community property during the existence of the marriage. An asset purchased with funds in the account would be community property.

b. Upon the death of the depositing spouse, the account belongs to the P.O.D. payee or the trust account beneficiary; provided that, if that person is not the depositor's surviving spouse, the surviving spouse may assert a claim equal to one-half of the funds by alleging that the depositing spouse committed actual or constructive fraud on the community interest of the surviving spouse. Could *Land v. Marshall's* illusory transfer argument apply? Arguably, see II, I, *supra*.

c. Upon the death of the non-depositing spouse, the account is a probate asset and belongs one-half to the surviving depositing spouse and one-half to the heirs or devisees of the deceased spouse, subject to administration, since the account is not controlled by a contract provision in that event.

d. Upon the death of the P.O.D. payee or the trust account beneficiary who is not the non-depositing spouse,

the account remains community property since the P.O.D. payee or trust account beneficiary must survive the depositing spouse to receive the account.

2. JOINT ACCOUNTS/CONVENIENCE ACCOUNTS

Community property is deposited into such an account of the spouses.

a. The account is community property, and assets purchased with funds in the account are presumptively community property. Depending on the circumstances, one spouse's withdrawal of funds may be considered to be a gift by the other spouse so that an asset purchased with the withdrawn funds is the donee spouse's separate property, but the burden of proof will be on the "donee" to prove the donative intent of the other spouse.

b. Upon the death of either spouse, the account is a probate asset and belongs one-half to the surviving spouse and one-half to the heirs or devisees of the deceased spouse, subject to administration.

3. JOINT ACCOUNTS WITH SURVIVORSHIP RIGHTS

Community property is deposited into a "joint account with survivorship rights" between the spouses.

a. During the existence of the marriage, the marital property character of the account and assets purchased with such funds will be community, unless the account is a "46b special account" - an account which partitioned the account into the spouses' separate properties. *See VI, C.5, infra*.

b. Upon the death of either spouse prior to the 1987 amendment, the community account was a probate asset subject to administration and belonged one-half to the surviving spouse and one-half to the heirs or devisees of the deceased spouse subject to administration unless the account was a "46b special account"; in which event, the separate account belonged entirely to the surviving spouse.

c. Upon the death of either spouse subsequent to the 1987 amendment, the community account belongs to the surviving spouse, if the survivorship agreement was signed after Nov. 3, 1987.

4. JOINT ACCOUNTS AND THIRD PARTIES

Special community funds of a spouse are deposited into a "joint account" or a "joint account with survivorship rights" of one spouse and a third party who has not made any deposits.

a. During the existence of the marriage, the account remains community property. Withdrawal of funds by the third party may be a gift by the depositing spouse, if donative intent is established. Any such

withdrawal may be in fraud of the non-depositing spouse's community property rights.

b. Upon the death of the depositing spouse, the account is a probate asset and belongs one-half to the surviving spouse and one-half to the heirs or devisees of the deceased spouse subject to administration, if there is not a survivorship agreement.

c. If there is a survivorship agreement, upon the death of the depositing spouse, the account belongs to the third party but subject to the imposition of a constructive trust to remedy a possible fraud on the community property rights of the non-depositing spouse. Could *Land v. Marshall's* illusory transfer argument apply? Arguably, see II, I, *supra*.

d. Upon the death of the non-depositing spouse, the account is a probate asset and belongs one-half to the surviving spouse and one-half to the heirs or devisees of the deceased spouse subject to administration, thereby effectively terminating the contractual survivorship rights of the third party as to the deceased spouse's one-half.

e. The death of the third party prior to the death of either spouse would not affect the ownership of the account since, the third party must survive the depositor to assume ownership of the account. It remains the spouses' community property.

f. An attempt by one spouse to unilaterally deposit joint community funds into such an account may be void insofar as the survivorship rights of the third party are concerned. See II, J, *supra*.

C. Conclusions and Observations

1. IMPORTANCE OF SIGNATURE CARDS

It is readily apparent that to properly characterize the community or separate nature of the assets of a husband and wife, the attorney must closely examine the couple's existing signature cards, as well as their signature cards of the past, in order to accurately trace the ownership of their accounts, as well as assets purchased with funds from those funds deposited into multiple-party accounts.

2. 900 LB GORILLA RULE

The terms of the deposit agreement provided by the financial institution may even negate some, if not all, of the rules promulgated by Chapter XI and change the ownership interests and relative rights of the parties to the account. Further, the parties to the account may have no choice other than to accept the financial institution's forms.

3. IMPACT AT DIVORCE

The marital character of bank accounts and assets purchased with funds out of the accounts will be of vital

importance in the event of divorce since the divorce court cannot award one spouse's separate property to the other spouse. See *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977) and *Cameron v. Cameron*, 641 S.W.2d 210 (Tex. 1982).

4. IMPACT AT DEATH

The marital property character of joint accounts is not as important today as it was in the past in determining the effectiveness of non-testamentary transfers at death since *Hilley* has been overruled by constitutional amendment. In other words, the 1987 amendment dismissed the need for partitioned bank accounts.

5. THE 46b TRAP

The impact of the "46b trap" should be considered. Assume a married couple deposited community property into a "46b special account" - an account which contained both partition and survivorship language per Sec. 46 prior to the 1987 amendment. Subsequently, they purchased Blackacre with funds in the account, and the land appreciated in value during the marriage.

a. In the event of divorce, Blackacre would not be subject to a "just and right" equitable division by the divorce court since it would not be community property since it was a mutation of the "46b account."

b. In the event of a spouse's death, only the deceased spouse's interest in Blackacre would receive the tax free "step up" in income tax basis. The surviving spouse's interest would not receive the "step up" since Blackacre was not community property.

6. THE HOLMES TRAP

If the couple's joint checking account is a valid survivorship account and a check is written to purchase an asset in both spouses' names, does the account's right of survivorship attach to the newly acquired asset? In the *Holmes* case, stock certificates issued from a brokerage account "carried the rights of survivorship established by those accounts' agreements." The *Holmes* court held that the issuance of the certificates was not a "disposition" under Section 455 which revoked the account's survivorship agreement. See I, F, *infra*. It is the author's opinion that writing a check to acquire a new asset should be treated as a "disposition" under Section 455. Thus, no rights of survivorship should be carried forward to the newly acquired asset absent a new agreement among the spouses to create the survivorship rights.

VII. 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 Sec. 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." Scott, Trusts 3, 4 (3rd 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 Trust (Third) Sec. 2. (2003)

2. CREATION

According to Sec. 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 which 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. Sec. 112.051. See Restatement (Second) Trusts, Sec. 330; Bogert, Law of Trusts and Trustees, Sec. 998 (1983).

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 Sec. 101.002 and Tex. Trust Code Sec. 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 can 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 II, F, *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 which 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 or appointment over the entire trust estate, creditors can reach the entire trust estate. See *Bank of Dallas v. Republic Nat. Bank*, 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*, 1992 WL 297338 (Tex. App. Dallas 1992). The inclusion of a spendthrift provision will not insulate the settlor's retained interest from the settlor's creditors. See Tex. Trust Code Sec. 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.—Ft. Worth 1996, writ denied) and *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. App.—Texarkana 1978, writ dismissed w.o.j.). Some older cases support that same result. See *Shefflin v. Small*, 23 S.W. 432 (Tex. Civ. App., no writ 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 II, 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. Civ. 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 *In re Marriage of Long*, 542 S.W.2d 712 (Tex. App.—Texarkana 1976, no writ), and *Wilmington Trust Company v. United States*, 753 F.2d 1055 (5th Cir. 1985).

4. UNDISTRIBUTED INCOME

Undistributed income is normally neither separate nor community property. See *In re Burns*, *supra*; *Buckler v. Buckler*, 424 S.W.2d 514 (Tex. App.—Ft. Worth 1967, writ dismissed w.o.j.), and *McClelland v. McClelland*, 37 S.W. 350 (Tex. Civ. App., 1896, writ ref'd). 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. But, *see VII, E, 3, supra*.

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 Sec. 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?

VIII. COMMUNITY PROPERTY IN THE REVOCABLE TRUST

If a married individual or couple places community property into a revocable trust, the relative marital property rights of the husband and wife 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 the couple should be alert for possible conflicts of interests and to 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:

1. Is not deemed fraudulent or even "illusory" under *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968). In this case, the 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.

3. Does not amount to a "mixing" of the different types of community property so that special community assets become joint community property.

4. Does not work a commingling of community and separate funds as to risk losing the separate character of the separate property.

5. Does not amount to, nor was it intended to be, a partition of community property into their respective separate estates. In other words, precautions should generally be taken in the drafting and funding of the trust to document that the retained equitable interest in community assets placed in the trust remain community during the balance of the marriage, and if an asset was a spouse's special community property, that it maintains that character as well unless a different result is intended after due consideration of the consequences. Of course, a spouse's retained interest in any separate property should remain separate in most situations.

C. Power of Revocation

When a husband and wife fund a revocable trust with community property, should the power of revocation be exercised 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. JOINTLY REVOCABLE

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 special community property prior to funding. Converting special community property into joint community property affects the relative marital property rights of the husband and wife. 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, no writ.).

2. UNILATERAL PARTITION

To avoid converting special 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. 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 would 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).

3. JOINT AND SEVERAL REVOCATION

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

D. 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? Or, is the power of revocation a non-delegable power? *See Weatherly v. Byrd*, 566 S.W.2d 292 (Tex. 1978). The questions evolve even further if the settlor is married and the trust is funded with the incapacitated spouse's special community property or joint community property. Does Sec. 883 of the Texas Probate Code permit the other spouse to revoke the trust on behalf of the incapacitated spouse? There appear to be no clear cut answers to these questions, but these issues should be addressed in the document.

E. Rights of Creditors

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 creditors. If (i) the trust is irrevocable, (ii) the settlor has not retained an equitable interest in the trust estate and (iii) the transfer of assets into the trust was not in fraud of creditors, the assets of the trust belong to the beneficiaries and are not generally liable for the debts of the settlor. If the transfer of assets in order to fund the trust is found to have been in fraud of creditors, creditors can reach the assets in trust like any

other assets transferred free of trust.

1. REVOCABLE TRUSTS

Most of the assets transferred by the settlor to the trustee of a Texas revocable trust will in all probability continue to be liable for the settlor's debts both during the settlor's lifetime and following the settlor's death. There is, however, authority to the contrary. *Jones v. Clifton*, 101 U.S. 225 (1980); 92 A.L.R. 282 (1934); Scott, Sec. 330.12; Bogert, Sec. 41. But the modern trend appears to adopt the premise: *if one can claim the assets at any time, they should be available to one's creditors*. See *State Street Bank v. Reiser*, 389 N.E.2d 768 (Mass. 1979).

2. TEXAS AUTHORITY

In Texas, the provisions of the Uniform Fraudulent Transfer Act give creditors theories whereby assets placed in the revocable trust can be reached to satisfy the settlor's debts. See Tex. Bus. & Comm. Code Secs. 24.001 through 24.013. 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 revocable trust assets within its coverage and thereby subject the property in question to the liabilities of the settlor/donee of the power, either during the settlor's lifetime or at the settlor's death. A general power includes "the authority to...alter, amend or revoke an instrument under which an estate or trust is created or held, and to terminate a right or interest under an estate or trust..." Tex. Prop. Code Sec. 181.001(2). The Restatement provides that appointive assets covered by a general power can be subjected to the claims of the donee or claims against the donee's estate. Restatement (Second) Property Sec. 13.1(1984). In *Bank of Dallas v. Republic National Bank*, 540 S.W.2d 499 (Tex. Civ. App. Waco 1976, writ ref'd n.r.e.), the court, after adopting the general restatement approach, stated: "If the settlor reserves for his own benefit not only a life estate but also a general power...his creditors can reach the principal." In addition, the fact that the trust is a spendthrift trust would not afford any protection from the settlor's creditors. Tex. Prop. Code Sec. 112.035(d). However, Texas courts have not specifically addressed whether the settlor's creditors can reach the assets of the settlor's revocable trust after the settlor's death. See *FCLT Loans, L.P. v. Estate of Bracher*, 93 S.W.3d 469 (Tex.App.—Houston [14th Dist.] 2002, no pet.). However, as explained above, Texas law does define a general power of appointment to include a power of revocation, and it's this author's opinion that non-exempt assets placed in the revocable trust should remain liable for the settlor's debts before and after the settlor's death.

F. Effect of Divorce

Community assets and quasi-community property held in trust where one, or both, of the spouses hold a power of revocation should be 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 equivalence of ownership over the assets subject to the power. See Tex. Prop. Code, Sec. 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*, *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. See II, I, *supra*.

3. SEPARATE TRUST ESTATE

If the settlor spouse transfers 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 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. TRANSFERS TO THIRD PARTIES

Any trust income, or any other community assets held in the trust, distributed by the trustee to a third party, such as a child of the settlor from the settlor's prior marriage, is usually deemed to be a completed gift by the settlor to the third party for tax purposes (unless the distribution satisfied the settlor's legal obligation of the support) and 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 trusts own 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

The income generated by the assets of a revocable trust is taxable to the settlor whether or not the income is distributed to the settlor, retained in the trust or distributed

to another beneficiary of the trust. Since the income either retained in the trust or distributed to a third party is still reported on the settlor's individual income tax return (typically a joint return with the settlor's spouse), the payment of the consequential income tax liability with community funds could adversely affect the rights of the other spouse.

G. Death of First Spouse

Upon the death of the first spouse, the decedent's separate property and one-half interest in the community assets are normally placed in a continuing decedent's trust or are distributed in accordance with the provisions of the trust document. However, the surviving spouse's separate property and one-half interest in the community property generally 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, supra.*

H. Planning Considerations

When drafting the trust document, separate trusts may be desirable for the husband's separate property, the wife'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 the husband's sole management community property, one for the wife'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 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.

I. Community Property Basis

Since the 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 a married couple is creating the revocable trust and plan on placing community property in the trust, care should 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 so that both halves of the community can receive a step up in income tax basis upon the death

of the first spouse. *See Rev. Rul. 66-283, 1966-2 C.B. 297.*

J. Settlor's Homestead Protection

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 ref'd 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 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. Edzards*, 399 S.W.2d 935 (Tex. Civ. App.—Texarkana 1966, writ ref'd 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. Ft. Worth 1895, no writ). Thus, it appears as if the homestead continues to be exempt from most creditors so long as the settlor is alive. Tex. Prop. Code Sec. 41.001. H.B. 3767 (2009) confirms that the homestead exemption is not lost because it has been transferred into a revocable trust. The same would appear to be true for exempt personal property. Tex. Prop. Code Sec. 42.001.

K. Protection of Family

However, upon the settlor's death, 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 settlor's creditors (i.e., the probate homestead, exempt personal property, widow's allowance and the claims procedures followed in probate administration) following a decedent's death.

1. PROBATE HOMESTEAD

The Texas Constitution provides that on the death of a homestead owner, the 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. Sec. 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 Probate Code provides that

following the owner's death, if the owner is survived by a spouse, minor children or unmarried child remaining at home, 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. Prob. Code Sec. 270. Further, the probate code directs the probate court to set apart for the use and benefit of the surviving spouse and minor children all such property of the estate as is exempt from execution or forced sale by the constitution and laws of the state.

2. RIGHT OF OCCUPANCY

Will the surviving spouse have a right to occupy the home following the death of the owner when it had been 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. First, whether the home was community property or not, 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 void. Tex. Fam. Code Sec. 5.81. Second, 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, no writ). Consideration should be given to the effect of Sec. 113.022 of the Texas Trust Code which states that a trustee may permit real estate held in trust to be occupied by a current beneficiary of the trust.

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, the survivor's right of occupancy may never have even come into existence since the right can attach only 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*, 426 S.W.2d 841 (Tex. 1968).

This probable loss of the right of occupancy is consistent with the constitutional and statutory homestead provisions since 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 remainderman's interest becomes possessory upon the death of the settlor instead of going

through probate.

3. CREDITOR'S ARGUMENTS

Assuming the settlor is survived by a constituent family member, will the home placed in a revocable trust continue to be exempt from most 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; since 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 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.

4. 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. Prob. Code Sec. Sec. 271 and 281. 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 \$60,000. Tex. Prop. Code Sec. 42.002. In addition, during administration, the family members 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 heirs and/or devisees when the administration terminates. Tex. Prob. Code Sec. 278. The arguments "pro" and "con" as to whether these rights exist if these items of property which would otherwise be exempt are placed in a revocable trust would seem to parallel the above homestead discussion.

5. 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 minor children may be established by the probate court. Tex. Prob. Code Secs. 286 and 287. 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 family allowance would be lost if all of the decedent's assets have been placed in a revocable trust.

6. CLAIMS PROCEDURES

The probate code also 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.

IX. OTHER SPOUSE'S INTEREST IN THE EMPLOYEE'S RETIREMENT PLAN

In *Allard v. Frech*, 754 S.W.2d 111 (Tex. 1988), the Texas Supreme Court confirmed that an employee's spouse has a community property interest in the employee spouse's employee benefit package. See also *Valdez v. Ramirez*, 574 S.W.2d 748 (Tex. 1978). The employee benefit package of a working spouse is a form of compensation and acquires a community character during marriage.

A. Application of the Apportionment Rule

Texas cases have consistently held that the community or separate character of an employee's retirement plan depends on an "apportionment" approach rather than the "inception of title rule". The "apportionment" approach gives the non-employee spouse an increasing community property interest in the employee's plan during marriage. *Berry v. Berry*, 647 S.W.2d 945 (Tex. 1983) and *Dessommes v. Dessommes*, 543 S.W.2d 165 (Tex. Civ. App.—Texarkana 1976, writ ref'd n.r.e.). While the apportionment approach should preserve an employee's separate interest in a retirement plan owned prior to marriage, the application of the rule over the years has resulted in the loss by employees of significant portions of their defined contribution plans. For example, in *McClary v. Thompson*, 65 S.W.3d 829 (Tex.App.—Ft. Worth 2002, pet. denied), the court of appeals stated that... "to determine the portion as well as the value of a defined contribution plan that is community property, courts subtract the amount contained in the plan at the time of the marriage from the total contained in the account at divorce." See also West Group, Texas Family Law Service, Sec. 22:29 (2004). In other words, if this statement is accurate, any appreciation in value during the marriage of what was originally a separate 401K plan, a profit-sharing plan, or an ESOP becomes community property because the employee is not permitted to trace the assets in any such plan at the beginning of the marriage into what is still in the plan at the time of divorce.

B. Tracing the Separate Interest

It has been this author's opinion that the employee should be permitted to trace the assets in the plan on the date of the marriage into their "traceable mutations" in existence at the time of divorce. Definitive case authority for this position is lacking since most authority is found in court decisions involving defined benefit plans and not

defined contribution plans. See *Berry v. Berry*, 647 S.W.2d 945 (Tex. 1983); *Taggart v. Taggart*, 552 S.W.2d 422 (Tex. 1977); and *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976) (defined benefit plans are to be apportioned based on the relative time periods). Subsequent courts of appeals have failed to consistently distinguish defined contribution and defined benefit plans. *Iglinsky v. Iglinsky*, 735 S.W.2d 536 (Tex.App.—Tyler 1987, no writ) and *Hatteberg v. Hatteberg*, 933 S.W.2d 522 (Tex.App.—Houston [1st Dist.] 1994, no writ), recognized the differences

However, *Pelzig v. Berkebile*, 931 S.W.2d 398 (Tex.App.—Corpus Christi, 1996, no writ), *Baw v. Baw*, 949 S.W.2d 764 (Tex.App.—Dallas 1997, no pet), and *Smith v. Smith*, 22 S.W.3d 140 (Tex.App.—Houston [14th Dist] 2000, no pet.) have all taken the position that the community interest in a defined contribution plan is calculated by subtracting the value of the plan as of the date of the marriage from the value of the plan as of the date of the divorce. It is important to note that the tracing rules do apply to mutual funds in general. See *Bakken v. Bakken*, 503 S.W.2d 315 (Tex.App.—Dallas 1977, no writ), which recognized that increases in mutual fund shares as either separate or community property depend on whether the increases were due to dividends or capital gain distributions.

C. Sec. 3.007

A 2005 addition to the Texas Family Code had hoped to resolve many of the tracing issues described above. A spouse, who was a participant in a defined benefit retirement plan, was deemed to have a separate property interest in the monthly accrued benefit the spouse had a right to receive on normal retirement age, as defined by the plan, as of the date of marriage, regardless of whether the benefit had vested. The community property interest in that same plan was to be determined as if the spouse began to participate in the plan on the date of marriage and ended that participation on the date of dissolution or termination of the marriage, regardless of whether the benefit had vested. Tex. Fam. Code Sec. 3.007(a) and (b). However, in 2009, HB 866 repealed subsections (a) and (b) of Sec. 3.007, effective September 1, 2009, and apparently returns the application of the apportionment approach to defined benefit plans back to case law.

A defined contribution plan is presumed to be entirely community property. However, the separate property interest of a spouse in a defined contribution retirement plan may be traced using the tracing and characterization principles that apply to nonretirement assets. Tex. Fam. Code Sec. 3.007(c). Subsection (c) was left unchanged by HB 866 (2009).

Even more details are involved if the plan is an employer provided stock option plan or an employer provided restricted stock plan. See Tex. Fam. Code Sec. 3.007(d) and (e). Subsection (d) was amended by HB 866 (2009), which also repealed subsection (f).

D. Divorce

Upon a divorce of the spouses, the community portion, and presumably “quasi-community” portion, of the employee’s interest in the plan, just like any other community property asset, are subject to a “just and right” equitable division by the divorce court. However, the separate or “quasi-separate” portion is not divisible. Any separate property lost due to the employee’s inability to trace may result in a separate claim for reimbursement. A QDRO (Qualified Domestic Relations Order) is necessary for the enforcement of the division of an ERISA plan.

X. EFFECT OF DEATH ON RETIREMENT PLANS

As explained in IX, *supra*, unlike most marital assets, the separate or community character of an interest in a retirement plan is determined using the “apportionment theory” instead of the traditional “inception of title rule.” Under Texas law, the community property interest of a participant is defined as the participant’s community property subject to the participant’s “sole management and control.” *See* II, B, *supra*.

A. Federal v. Texas Law

Upon the death of the employee spouse, Texas case law has held that the other spouse retains an interest in the community portion of the employee spouse’s retirement plan. In addition, federal law mandates that the other spouse be the beneficiary of a “qualified preretirement survivor’s annuity” for many ERISA plans.

Upon the death of the employee’s spouse, before the employee’s retirement, the Texas Supreme Court has held that the deceased spouse’s heirs and devisees succeed to that spouse’s one-half of the community portion of the employee spouse’s interest in the plan, if there has not been a valid nonprobate disposition of the same. *See Valdez and Allard, supra*.

However, while ERISA does not expressly address what happens when the spouse dies before the employee retires, the Retirement Equity Act of 1984 (“REA”) amended ERISA in order to introduce mandatory spousal rights in many retirement plans so the choice of the form of benefit received from such a plan is no longer solely the employee’s choice under federal law.

The *Valdez* and *Allard* cases involved federal civil service retirement benefits and a private company’s retirement plan. Accordingly, a little know section of the Texas Government Code was not applicable. That section states that the death of a spouse of a member or retiree of the Texas public retirement system terminates the spouse’s interest in that retirement system. Tex. Gov’t Code Sec. 804.101. A federal court has interpreted the statute to define the spouse’s statutory property interest as one that terminates upon the death of the spouse and for that reason held that the statute does not violate Art. XVI, Sec. 15 of the Texas Constitution. *Kunin v. Feofanov*, 69 F.3d 59 (5th Cir. 1995). No Texas cases discussing that

section of the Government Code were found.

B. Retirement Equity Act of 1984

Prior to REA, federal law granted the participant’s spouse very few rights to share in the participant’s retirement benefits. REA’s legislative history reflects Congress’ “community property type” view that marriage is a partnership and that retirement benefits are derived from the contributions of both spouses. For example, REA requires that the participant’s retirement benefit in a pension plan be paid in the form of a “qualified joint and survivor annuity” (“QJSA”), if the participant survives until retirement age. If a vested participant in such a plan dies before retirement, REA makes the surviving spouse a plan beneficiary with an interest called a “qualified preretirement survivor annuity” (“QPSA”). The mandatory spousal rights mandated by REA can be waived by the participant’s spouse. *See* IRC Secs. 401(a) and 417.

C. Covered Plans

The QJSA and QPSA requirements apply to all defined benefit plans, money purchase plans, any defined contribution plan to which IRC Sec. 412 applies (excluding profit sharing plans), some 403(b) annuity arrangements (excluding IRAs and SEPs), and certain other defined contribution plans (profit sharing and stock bonus plans) that either do not satisfy the conditions delineated in IRC Sec. 401(a)(11)(B)(iii) or are considered to be a “transfer plan” under Reg. 1.401(a)-20, Q & A 5. *See* IRM 4.72.9(3-1-02), I.R.S.

Caveat: The “ERISA rights” of the participant’s spouse are governed by not only ERISA (USCA Title 29) but also the Internal Revenue Code (USCA Title 26), as well as I.R.S., Departments of Labor and Treasury interpretations of the two. The result is an incredibly complicated set of rules that do not lend themselves to easy explanation. Accordingly, a participant should inquire as to what are the spouse’s rights in the participant’s particular plan. The plan itself may even mandate a result different from the one prescribed by federal law.

D. Defined Contribution Plans

As explained above, some defined contribution plans, like 401K plans, are not subject to the QJSA and QPSA requirements. Accordingly, most do not offer a survivor’s annuity, but if the participant dies before retirement, the participant’s spouse is the presumed beneficiary of the entire death benefit, unless the spouse has waived this right. However, if the participant retires prior to death or termination, the participant can elect any option that is available under the plan without spousal consent. If the defined contribution plan is subject to the QJSA and QPSA requirements, spousal consent is necessary in order to retire and elect an option other than a QJSA, and if the participant dies prior to retirement, the spouse, absent a waiver, is entitled to an annuity for life, the actuarial equivalent of which is not less than 50% of

the portion of the account balance of the participant to which the participant had a non-forfeitable right. *See* 29 USCS Sec. 1055(e)(2).

E. Defined Benefit and Money Purchase Plans

Since defined benefit and money purchase plans are subject to the QJSA and QPSA rules, a spousal waiver is required in order for the participant to elect out of either requirement. If not waived, the spouse is, generally, entitled to an annuity for life. If it is a QPSA, the payments cannot be less than the amounts which would be payable as a survivor's annuity under the QJSA rules under the plan. If the participant dies after retirement, the spouse's annuity cannot be less than 50% (or greater than 100%) of the annuity that would be payable during the joint lives of the participant and spouse and which is the actuarial equivalent of a single annuity for the life of the participant. *See* 29 USCS Sec. 1055(d) and (e).

F. IRAs and SEPs

Individual retirement accounts ("IRAs") and simplified employee pensions ("SEPs") are not subject to the QJSA and QPSA requirements. Reg. 1.401(a)-20, Q & A 3(d). However, the participant's agreement with the financial institution serving as custodian may require spousal consent to the beneficiary designation in the event of the participant's death.

G. Spouse's Death

As explained above, an employee spouse is, in effect, required to select a "qualified joint and survivor annuity" for all pension plans and some other types of plans, unless the employee and the employee's spouse agree to another beneficiary designation. The employee's spouse is also the presumed beneficiary for other plans. ERISA also provides that retirement benefits may not be assigned or alienated. 29 U.S.C. Sec. 1056(d). Sec. 401(a)(2) of the Internal Revenue Code also provides that the benefits must be for the exclusive benefit of the employee.

While Texas courts have not yet definitely resolved the question of whether federal law preempts Texas law upon the death of the non-employee spouse, it can be assumed that *Allard* and *Valdez* have been preempted by federal law. *See Ablamis v. Roper*, 937 F.2d 1450 (9th Cir. 1991); *Meek v. Tullis*, 791 F.Supp 154 (W.D. L.A. 1992), finding preemption. On the other hand, in *Boggs v. Boggs*, 82 F. 3d 90 (5th Cir. 1996), the Fifth Circuit agreed with the lower court and found that Louisiana community property law was not preempted. However, the United States Supreme Court ruled on June 2, 1997 that Louisiana law was preempted by federal law. *Boggs v. Boggs*, 117 S.Ct. 1754, 79 AFTR 2d 97-960 (1997).

H. *Boggs v. Boggs*

In *Boggs*, the participant, Boggs, a resident of Louisiana, was married to Dorothy until her death in 1979. At her death, two-thirds of her estate passed to

their sons. Boggs married his second wife, Sandra, in 1980 and retired in 1985. At retirement, Boggs received: (i) a lump sum distribution that was "rolled over" into an IRA; (ii) shares of stock from an employee stock option plan ("ESOP"); and (iii) a monthly lifetime annuity. After Boggs died in 1989, his sons filed an action under Louisiana's community property laws to obtain their share of Dorothy's interest in Boggs's retirement benefits. The U.S. Supreme Court ruled that, notwithstanding state law that allowed Dorothy to devise to her sons her community interest in Boggs's retirement benefits prior to his retirement, Dorothy's testamentary transfer was a prohibited assignment or alienation under 29 USC Sec.1056(d)(1).

Had Boggs and Dorothy's marriage ended in divorce, the Court acknowledged that a state divorce court's division of the participant's ERISA benefits would have been effective since ERISA's QDRO provisions allow such a division. The dissent even noted that, after divorce and the entry of the QDRO, the employee's spouse can devise that spouse's interest. The Court did not hold that ERISA preempts a state's community property laws in general. The Court's holding is that the heirs and devisees of a non-participant spouse cannot succeed to that spouse's community interest in the participant's ERISA benefits when the spouse died before the participant retires.

The purpose of the anti-alienation provisions of ERISA are to ensure the economic security of the surviving spouse. Therefore, if the participant's spouse dies under these circumstances, the spouse's interest in the participant's ERISA plan is effectively terminated.

I. Post-Retirement Benefits

Assume a Texas participant retired prior to the non-participant's death and received (i) a lump sum distribution which was "rolled over" into an IRA, (ii) shares of stock from an ESOP, and (iii) a monthly annuity and further assume the participant and the participant's spouse had been married during the entire period of the participant's employment. It is this author's belief that all of the post-retirement benefits are community property subject to the participant's sole management and control under Texas law. If the couple then divorces, all of the post-retirement benefits would be subject to just and right division by the Texas divorce court. *Boggs* does not mandate a different result. In fact, the *Boggs*' holding supports that conclusion since, after retirement, the benefits are not subject to ERISA's anti-alienation provisions. The justification for federal preemption in *Boggs* is not applicable following the employee's retirement and the distribution of the retirement benefits.

1. NON-PARTICIPANT'S DEATH

If the marriage terminates not in divorce, but because of the non-participant's death, her interest in the annuity, if any, terminates by the very nature of the annuity. *See* VI, B-E, supra. The non-participant's one-

half interest in the ESOP stock should pass to her heirs or devisees, absent some nonprobate contractual arrangement. Likewise, her one-half of the IRA should pass to her heirs or devisees, absent some nonprobate contractual arrangement. The anti-alienation rules of ERISA do not apply to IRAs. Some argue that *Boggs* extends ERISA's anti-alienation rules to IRAs, but it does not. The IRA in *Boggs* was funded after the death of the non-participant spouse when the participant later retired. At the time of Dorothy Bogg's death, the ERISA benefits were still undistributed and in the possession of the plan administrator. The Supreme Court even noted that, had they divorced, Dorothy could have devised to her sons any interests she may have acquired in the benefits through a QDRO.

2. PARTICIPANT'S DEATH

If the marriage terminates because of the participant's death after retirement, the participant's interest in the annuity terminates, but the annuity may continue for the spouse's benefit. *See* XX, B-E, *supra*. The participant's community one-half interest in the ESOP stock passes to his heirs or devisees, and the non-participant spouse retains her half, absent some contractual nonprobate disposition. His interest in the rollover IRA likely passes to the designated beneficiary of the IRA, if any, otherwise she retains her one-half interest, and the participant's one-half passes to his heirs or devisees. Any attempt by the participant to assign more than his half of the stock or the IRA to someone else would be subject to the "fraud on the community" rule. *See* III, E, *supra*.

J. Non-Rollover IRAs

Such IRAs are not subject to ERISA's anti-alienation rules and are not subject to the *Boggs* ruling. At the participant's death, her interest in the rollover IRA likely passes to the designated beneficiary of the IRA, subject to the "fraud on the community rule," otherwise, the non-participant spouse retains his one-half interest, and the participant's one-half passes to her heirs or devisees.

K. Conclusions

Although an IRA or other assets may be traceable to an ERISA plan distribution, the participant's retirement and subsequent distribution by the plan administrator to the participant or the participant's custodian terminates ERISA's control and *Boggs* application. *See* Patricia Brown, "The Mind Boggling Bog Broadened by Boggs – A Practitioner's Approach," ALI-ABA, Feb. 25, 1999; S. Andrew Pharies, "Community Property Aspects of IRAs and Qualified Plans," Probate & Property (Sept/Oct 1999); Steven E. Tritten, "The Better Half of Your Retirement Plan Distributions," ALI-ABA, May 20, 1995. All three agree with this author's conclusions. Thus, free of federal preemption, the marital property rights of the participant and the participant's spouse in the distributions after retirement are governed solely by Texas law.