

**TRACING, REIMBURSEMENT AND
ECONOMIC CONTRIBUTION CLAIMS
IN BROKERAGE ACCOUNTS**

Richard R. Orsinger
richard@momnd.com
<http://www.orsinger.com>

McCurley, Orsinger, McCurley,
Nelson & Downing, L.L.P.

Dallas Office:
5950 Sherry Lane, Suite 800
Dallas, Texas 75225
214-273-2400

and

San Antonio Office:
1616 Tower Life Building
San Antonio, Texas 78205
210-225-5567

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by
Richard R. Orsinger

*Board Certified in Family Law
and Civil Appellate Law
Texas Board of Legal Specialization*

I. INTRODUCTION. Applying the familiar rules of tracing can be a challenge when tracing and calculating reimbursement and economic contribution claims in connection with brokerage accounts. This article starts with an overview of established principles of marital property and the tracing rules that have developed in the context of bank accounts. Then the article discusses the types of financial transactions that frequently occur in connection with brokerage accounts. Finally, the article discusses how tracing might be done in brokerage accounts, and how one might go about calculating reimbursement and economic contribution claims related to brokerage accounts.

II. GENERAL PRINCIPLES OF CHARACTERIZING MARITAL PROPERTY.

A. SEPARATE VS. COMMUNITY CHARACTER. “[T]he question whether particular property is separate or community must depend upon the existence or nonexistence of the facts, which, by the rules of law, give character to it’” *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565, 568 (Tex. 1961).

Property owned before marriage, or acquired during marriage by gift, devise or descent, is separate property. Tex. Const. art. XVI, § 15; TEX. FAM. CODE (TFC) § 3.001. Property acquired during marriage, other than separate property, is community property. Tex. Const. art. XVI, § 15; TFC § 3.002. All property on hand during and on dissolution of marriage is presumed to be community property. TFC § 3.003(a). This presumption is rebuttable, but the degree of proof necessary to establish that property is separate property is clear and convincing evidence. TFC § 2.002(b). Courts sometimes borrow the definition of “clear and convincing evidence” set out in Title 5 of the Family Code relating to parent-child suits: “‘Clear and convincing evidence’ means the measure or degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established.” TFC § 101.007. See *Huval v. Huval*, 2007

WL 1793771 (Tex. App.--Beaumont 2007, no pet.) (memo. opinion) (citing Section 101.007 in a tracing case).

B. STOCK OWNERSHIP. If a spouse owns stock in a corporation at the time of marriage, the stock is that spouse's separate property. *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ). Any increase in value of the separate property corporation is the owning spouse's separate property, and the community estate has no ownership claim over that increase in value. *Jensen v. Jensen*, 665 S.W.2d 107, 109 (Tex. 1984). Shares of stock acquired through stock splits have the same character as the original stock. *Harris v. Harris*, 765 S.W.2d 798, 803 (Tex. App.--Houston [14th Dist.] 1989, writ denied); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dismissed). Shares of stock acquired during marriage are community property. TFC § 3.002.

C. INVESTMENT INCOME. Cash dividends from corporate stock are community property. See *Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ); *Bakken v. Bakken*, 503 S.W.2d 315, 317 (Tex. Civ. App.--Dallas 1973, no writ). However, stock dividends deriving from separate property stock are separate property. See *Duncan v. U.S.*, 247 F.2d 845, 855 (5th Cir. 1957). Interest income is community property. *Braden v. Gose*, 57 Tex. 37 (1882).

D. COMMINGLING. Commingling is the mixing of separate and community property assets, often money. The Supreme Court of Texas said this about commingling, in *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965):

The plain wording of the statute [Art. 4619] creates a rebuttable presumption that all property possessed by a husband and wife when their marriage is dissolved is their community property and imposes the burden upon one asserting otherwise to prove the

contrary by satisfactory evidence. . . . The general rule is that to discharge the burden imposed by the statute, a spouse, or one claiming through a spouse, must trace and clearly identify property claimed as separate property, *Schmeltz v. Garey*, 49 Tex. 49, 61 (1878); *Chapman v. Allen*, 15 Tex. 278, 283 (1855); . . . and that when the evidence shows that separate and community property have been so commingled as to defy re-segregation and identification, the burden is not discharged and the statutory presumption that the entire mass is community controls its disposition. *Hodge v. Ellis*, 154 Tex. 341, 277 S.W.2d 900, 907 (1955). . . .

The Supreme Court reiterated in *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973), that “when the evidence shows that separate and community property have been so commingled as to defy re-segregation and identification, the burden is not discharged and the statutory presumption prevails.”

E. CREDIT TRANSACTIONS. Credit obtained by a spouse during marriage is community credit unless the lender agrees to look solely to the borrowing spouse's separate estate for repayment. *Cockerham v. Cockerham*, 527 S.W.2d 162, 171 (Tex. 1975).

F. WHERE SPOUSE IS TRUSTEE. Where a spouse holds legal title to property as a trustee, without a beneficial interest in the property, the property is not property of a spouse to be characterized as separate or community property.

G. WHERE SPOUSE IS BENEFICIARY. Where a spouse is the beneficiary of a trust, the beneficial interest is separate or community depending on whether the beneficial interest was acquired prior to marriage or acquired during marriage by gift, descent, or devise (i.e., separate property) or was acquired during marriage in some other manner (i.e., community property).

III. GENERAL PRINCIPLES OF TRACING.

A. DEFINITIONS OF TRACING.

The Author's definition: Tracing is the process of proving that assets owned or possessed during marriage are separate property. Sometimes tracing involves proving that an asset was acquired prior to marriage, or was received during marriage by gift or inheritance. At other times tracing involves following separate property

wealth through exchanges or changes in form.

Boyd v. Boyd, 131 S.W.3d 605, 612 (Tex. App.--Fort Worth 2004, no pet.): “Tracing involves establishing the separate origin of the property through evidence showing the time and means by which the spouse originally obtained possession of the property.”

Martin v. Martin, 759 S.W.2d 463,466 (Tex. App.--Houston [1st Dist.]1988, no writ):

Although the proceeds from the sale of separate property remain separate property, *Bantuelle v. Bantuelle*, 195 S.W.2d 686, 689 (Tex. Civ. App.-Texarkana 1946, no writ), a party asserting separate ownership must clearly trace the original separate property into the particular assets on hand at the dissolution of marriage. *Cockerham v. Cockerham*, 527 S.W.2d 162, 167 (Tex.1975); see also *Coggin v. Coggin*, 204 S.W.2d 47 (Tex. Civ. App.-Amarillo 1947, no writ). Unless there is clear and convincing evidence tracing and identifying the resulting property as being separately owned, it will be presumed that the entire mass is community property. *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex.1965). Mere proof that a property was separate property does not discharge the burden of tracing where separate and community property have become so commingled that they defy re-segregation and identification. *Id.*; *Bilek v. Tupa*, 549 S.W.2d 217, 220 (Tex. Civ. App.-Corpus Christi 1977, writ ref'd n.r.e.); *Hudspeth v. Hudspeth*, 198 S.W.2d 768, 771 (Tex. Civ. App.-Amarillo 1946, writ ref'd n.r.e.).

Pace v. Pace, 160 S.W.3d 706, 711 (Tex. App.--Dallas 2005, pet. denied): “Where an asset is purchased during marriage with monies traceable to a spouse's separate estate, the asset may appropriately be characterized as separate property.”

B. SAMPLE CASES. In the following cases appellate courts have considered the weight of the evidence support of a tracing claim. In some instances the issue on appeal was whether the evidence supported the trial court's finding regarding the characterization of property. In others, the issue was whether the evidence presented in the trial court was so strong or so weak that the appellate court would reverse the trial court's

finding on character.

Cases Where Tracing Failed

- *Bahr v. Kohr*, 980 S.W.2d 723, 728-29 (Tex. App.--San Antonio 1998, no pet.) (reversing the trial court's finding of separate property because the evidence was factually insufficient): in this creditor's rights case, the appellate court held that wife's testimony failed to establish certain property as her separate property because the documentary evidence offered to support claim that property was purchased with monies from a separate property account did not show the date the account was opened, the running balance of the account, or identify the party receiving the wire transfer for alleged purchase of property at issue.

- *Boyd v. Boyd*, 131 S.W.3d 605, 616 (Tex. App.--Fort Worth 2004, no pet.) (finding the evidence factually insufficient to support the trial court's finding of separate property):

David did not present specific tracing testimony or corroborating testimony or evidence, similar to evidence presented in cases where courts have determined that the separate nature of the property was established by clear and convincing evidence. . . . As a result, the trial court was left to surmise or speculate, based on David's testimony alone, that the proceeds from the sale of David's separate property were the source of funds that created his claim for economic contribution.

- *Brehm v. Brehm*, 2000 WL 330076 *3 (Tex. App.--Houston [14th Dist.] 2000, no pet.) (not for publication) (affirming the trial court's finding of community property):

Here, the only testimony presented by Ralf that this CD was his separate property was his own testimony that it was purchased with proceeds from the sale of property he inherited from his uncle. Ralf testified that he inherited the property, sold it, deposited the proceeds into the joint account he shared with Angela, and purchased the CD four months later. Ralf introduced no bank records which would clearly trace the money used to buy the CD to the proceeds from his inheritance, nor did he introduce any other evidence which would show deposits and

withdrawals from the account over the four month period. . . . Because Ralf failed to provide clear and convincing evidence that the CD was his separate property, we find the trial court did not abuse its discretion in dividing it with the community estate.

- *Ganesan v. Vallabhaneni*, 96 S.W.3d 345, 354 (Tex. App.--Austin, 2002, pet. denied) (affirming the trial court's denial of a separate property claim), holding that husband's testimony failed to establish that certain brokerage accounts were separate property because neither his testimony nor the exhibits offered "provid[ed] account numbers, statements of accounts, dates of transfers, amounts transferred in or out, sources of funds or any semblance of asset tracing".

- *Garza v. Garza*, 217 S.W.3d 538, 548 (Tex. App.--San Antonio 2006, no pet.) (reversing the trial court because the evidence was factually insufficient to support the trial court's finding of separate property): "As a general rule, testimony that funds are separate property without any tracing of the funds is insufficient to rebut the community presumption."

- *Klein v. Klein*, 370 S.W.2d 769 (Tex. Civ. App.--Eastland 1963, no writ) (affirming the trial court's finding of community property): the wife testified that she made a \$3,000.00 separate property cash payment for a house acquired during marriage. She said that she got the money from a safety deposit box in an unnamed bank. The trial court nonetheless found that the house was community property. The appellate court affirmed, saying that the wife's testimony was not binding. *Id.* at 773.

- *McElwee v. McElwee*, 911 S.W.2d 182, 188 (Tex. App.--Houston [1st Dist.] 1995, writ denied) (reversing trial court's characterization of certain assets as husband's separate property):

At trial, Bobby testified that he received a personal injury settlement in 1988 and deposited the proceeds in a separate account. He stated further that he purchased the residence with a portion of the proceeds. Pauline was asked if the money used to purchase the residence came from Bobby's settlement, to which she answered "I suppose so." This testimony shows that the residence was purchased with a portion of Bobby's settlement proceeds. Bobby did not, however, introduce any evidence to show

what portion of the settlement was allocated to his loss of earning capacity during the marriage. Therefore, Bobby did not establish what portion of the settlement proceeds was his separate property.

When an account contains intermingled separate and community funds, it is presumed that the funds first spent are community funds. See *Hill v. Hill*, 971 S.W.2d 153, 158 (Tex.App.-Amarillo 1998, no pet.); *Welder v. Welder*, 794 S.W.2d 420, 433 (Tex.App.-Corpus Christi 1990, no writ). This presumption exists until all community funds have been exhausted from the account. See *id.* Absent a showing that all community funds had been exhausted before Bobby and Pauline purchased the residence, any funds spent are presumed to be community funds. See *id.* Because Bobby did not establish what portion of the settlement was his separate property, he was unable to show that the account contained only his separate property funds at the time the residence was purchased. Consequently, he failed to overcome the community property presumption. Because the purchase money for the residence was presumed to be community property, the trial court did not err in its finding that the residence was community property.

- *Merrell v. Merrell*, 527 S.W.2d 25, 255 (Tex. Civ. App.--Tyler 1975, writ ref'd n.r.e.) (affirming the trial court's finding of community property):

Appellant testified that he inherited some corporate stocks from the estate of his mother, and that he sold stocks worth approximately \$ 100,000.00, and that such funds were used to finance the purchase of the duplexes. Under the record we are unable to conclude that such funds were properly traced as appellant's separate property and not commingled with appellee's separate property or the community property.

The record shows that appellant had many stock and bond transactions during the marriage. He bought and sold many shares of stock and some were bought short or on margin. Bonds were also bought on margin. Sometimes he would owe his brokerage firm

several thousand dollars, and at other times he would have a credit with them.

- *Mock v. Mock*, 216 S.W.3d 370, 373 (Tex. App.--Eastland 2006, pet. denied) (affirming the trial court's finding of community property):

Appellant did not produce any records tracing the deposits to the account or the withdrawals from the account. As a general rule, testimony that funds are separate property without any tracing of the funds is insufficient to rebut the community presumption. *Boyd*, 131 S.W.3d at 612. Appellant failed to trace the assets in the account with any documentary evidence. In the absence of such evidence, appellant did not meet her burden of establishing by clear and convincing evidence that the balance in the savings account was her separate property.

- *Osorno v. Osorno*, 76 S.W.3d 509, 512 (Tex. App.--Houston [14th Dist.] 2002, no pet.) (affirming trial court's finding of community property): "Henry argues that accounts listed in the decree totaling almost \$100,000 were designated his separate property in the parties' premarital agreement. But the only evidence as to the source of funds placed in those accounts was Henry's testimony; no deposit slips or bank records were offered tracing the money to support Henry's claim. Without tracing, Henry's testimony cannot overcome the community property presumption."

- *Robles v. Robles*, 965 S.W.2d 605,616 (Tex. App.--Houston [1st Dist.] 1998, pet. denied) (affirming the trial court's finding of community property):

Gus testified he purchased the lot at 2319 Freeman for \$27,000 with money he received as a gift from Thomas while she was alive. Irene again stated she listed the 2319 Freeman property as community property because Gus told her it was community property. Richard Sedgeley stated that, in his opinion, the 2319 Freeman lot was Gus's separate property because Gus purchased the property with money he inherited from Thomas's estate. The deed for this property does not appear to be included in the record before this Court. No documentary evidence was presented to trace the money used to purchase this property.

Generally, the testimony of an interested party, when not corroborated, does not conclusively establish a fact even when uncontradicted. . . . Uncontradicted evidence coming from one party is not conclusive.

Cases Where Tracing Was Successful

- In *Beeler v. Beeler*, 363 S.W.2d 305 (Tex. Civ. App.--Beaumont 1962, writ dismissed) (reversing the trial court's finding that all of the parties' home was husband's separate property), the spouses purchased real property, partly with a separate property down payment made by the husband, and partly with a community loan. The collateral for the loan was a separate property promissory note of the husband. Payments on the community loan were made to coincide with payments received by the husband on the separate property note, in time and amount. During the marriage, the husband deposited his separate property note payments into a joint account, then wrote checks to make the payments on the community note. Husband sought reimbursement for his separate funds used to pay a community debt. Wife opposed the reimbursement claim, saying that the payments from the separate property note were commingled when they were deposited into the bank account. The trial court found, however, that the parties had agreed to pay the new note with the proceeds from the old note, and that "it was not the intention of the parties to commingle such funds with the community funds of the parties." The appellate court found that the momentary deposit of such funds into a joint bank account did not convert "the \$2,500.00, plus interest" into community funds. "Such sum, in each instance, was, in effect, earmarked a trust fund, in equity already belonging to the bank from the moment collected by appellee This being so, the installments paid upon the bank note were paid from the separate funds of appellee and his separate estate is therefore entitled to reimbursement therefor." *Id.* at 308.

- *Carter v. Carter*, 736 S.W.2d 775, 777-80 (Tex. App.--Houston [14th Dist.] 1987, no writ) (affirming the trial court's findings that various assets were separate property):

The parties were married on December 7, 1974. Appellee testified that in April 1970 his father made a gift to him of 159 shares of Milk Proteins, Inc. (MPI) stock. MPI appears to have been a small, family-owned

company that also employed appellee. In 1976, Stauffer Chemical Company bought MPI, employed appellee and converted his 159 shares of MPI stock into 4,645 shares of Stauffer stock. Appellee testified that in 1979 Stauffer had a two-for-one stock split, which doubled his shares to 9,290.

In January and April of 1981, appellee sold 1,156 and 1,000 shares of Stauffer stock, and, in 1982, he sold an additional 1,000 shares. The proceeds from those three sales went into community assets to pay community debts and living expenses. Appellee also traded in Stauffer stock apart from the converted shares, acquiring 166 shares as a Christmas gift from his father in 1981 and participating in six short sales in 1982 and 1983. The 166 shares were sold on June 13, 1984, and one-half of the proceeds went to appellant.

After he retired from Stauffer, appellee went to work for a securities firm. When he obtained his broker's license, appellee opened a margin account at the firm in his name only. He bought and sold stock on credit through that account, using his remaining Stauffer stock (some 6,134 shares) as collateral for the debt created within the account. On February 22, 1985, appellee sold 500 Stauffer shares to reduce the debt in his margin account. Shortly thereafter, he tendered 900 shares and then an additional 4,700 shares to Chesebrough-Pond's Inc. He accounted for all except thirty-four of the original 9,290 shares. Appellee used most of the \$156,800 he received for the tender to pay off the debt within his separate margin account, to buy additional stock listed on his inventory (which he kept in his separate account) and to buy a van.

* * *

Appellee testified at length about the 159 shares of MPI stock and its subsequent metamorphosis. A 1974 income tax return was offered into evidence to show that dividends on the stock were reported for that year. Appellee testified that MPI dividends generally were declared at the end of the year and then dated the following year. This

testimony lends credence to his claim of ownership of the stock in 1973 (and thus prior to the December 7, 1974, marriage). The parties' tax returns for the years 1975 through 1983 were also placed in evidence to reflect the trading that occurred in the Stauffer stock. Finally, on both the 1976 and 1977 tax returns, the notation (H) appears beside the Stauffer Chemical Company dividends reported on Schedule B. Schedule B instructs one to write (H), (W) or (J) to denote stock held separately by the husband or wife, or stock held jointly.

Appellant offered no evidence to refute appellee's testimony concerning the acquisition of the MPI stock. She merely concluded the shares "could have been acquired during the marriage." She argues, however, that appellee did not meet his tracing burden with clear and convincing evidence and that the uncorroborated testimony of an interested witness is not conclusive.

* * *

We hold that the evidence was factually sufficient to support the trial court's characterization of the stock as separate property. We find further that most of appellee's testimony is corroborated. We must recognize that in a case of this nature there is rarely a third person to corroborate material agreements between spouses or actions by one spouse without the participation of the other. In these instances we must rely upon the fact finder to make findings based upon his belief or disbelief of the testimony before him.

- In *Celso v. Celso*, 864 S.W.2d 652, 654-55 (Tex. App.--Tyler 1993, no writ) (trial court reversed for failing to find that husband successfully traced CD funds into purchase of house), the court said:

The Appellant insists that he traced the CD funds to his separate property by clear and convincing evidence. The relatively short record shows that Brian testified to the following facts. Before the marriage, Brian purchased from his father Celso's Dry Cleaners. After Brian and Kimberly were married, the business was sold for \$16,000.

The couple then moved to Springfield, Missouri, where they purchased a house with the proceeds from the sale of the dry cleaner business and approximately \$13,000 from a CD purchased by Bryan prior to the marriage from a New York bank. The couple then sold their house and moved to Tyler, Texas, where the proceeds of the sale were placed into a CD with First National Bank of Winnsboro. The Tyler CD was worth approximately \$25,000, half of which was withdrawn by Kimberly immediately prior to Brian's filing for divorce. The Springfield house was deeded to Brian and Kimberly Celso and the proceeds from the sale were paid via check to Brian and Kimberly.

Kimberly did not dispute any of Brian's testimony. . . . The evidence is uncontroverted that the sole source of purchase money to buy the Springfield house was from Brian's separate property assets. . . . The evidence was clear and convincing that the funds used to purchase the Springfield house were traced to Brian's separate assets. The trial court, therefore, erred in concluding that the Springfield, Missouri house was the couple's community property. The evidence does not support the court's conclusion that the Springfield house was the couple's community property.

- *Estate of Hanau v. Hanau*, 730 S.W.2d 664, 666-67 (Tex. 1987) (Supreme Court ruled that tracing was successful, as a matter of law, when it overturned the court of appeals which had reversed the trial court's summary judgment that stock was separate property):

[W]e must address whether the court of appeals erred in holding that the 200 shares of TransWorld stock were not properly traced.

The stipulations of the parties provided the following:

- (1) Both parties owned considerable amounts of property before entering the marriage.
- (2) After the marriage, both Robert and Dorris continued to keep their respective

stock, bond and mutual funds accounts in their own names.

(3) During all times pertinent to this lawsuit, all transactions in Robert's account were from his income, and all transactions in Dorris' account were from her income.

(4) That the following transactions took place in the stock brokerage account of Robert:

A) On the date of marriage, there were 200 shares of Texaco stock in the account.

B) That while married and living in Illinois, the Texaco stock was sold for \$5,755.00 and on the same date 200 shares of City Investing stock were purchased for \$5,634.00.

C) After moving to Texas, the City Investing stock was sold for \$6,021.00 and on the same date 200 shares of TransWorld stock were bought for \$6,170.00.

The court of appeals held that the above stipulations did not constitute sufficient evidence to overcome the community property presumption. The court held that it is not sufficient "to show that the separate funds could have been the source of a subsequent deposit of funds," citing *Lantham v. Allison*, 560 S.W.2d 481, 485 (Tex.Civ.App.-Fort Worth 1978, writ ref'd n.r.e.) (emphasis in original).

In *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex.1965), this court held that all property possessed at the time of dissolution of the marriage is presumed to be community property. To show otherwise, the spouse must trace and clearly identify the property claimed as separate property. While the burden is difficult, it is not an impossible one to bear. *Lantham*, at 484. But if the evidence shows that the separate property and community property are commingled so as to defy segregation and identification, the burden is not discharged and the statutory presumption prevails. *Lantham*, at 484.

The account here has not been commingled, as it was stipulated that the decedent had always kept the property in his own name and that his wife had no power over the account. It certainly does not appear that the property has so radically changed as to "defy resegregation and identification" as said by this court in *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex.1973). Further, the petitioner has shown the chain of events leading from the Texaco stock to the TransWorld purchase and shown that no other transactions occurred on the days in question, which would have planted the seeds of doubt upon the possible source of the funds used to buy the stocks. Because the court of appeals' holding that the TransWorld stock was not properly traced was erroneous, we reverse the judgment of the court of appeals and render judgment that the TransWorld stock be transferred to Steven Hanau. The judgment is in all other things affirmed.

- *Faram v. Gervitz-Faram*, 895 S.W.2d 839, 843-44 (Tex. App.--Fort Worth 1995, no pet.) (upholding trial court's finding of separate property):

At trial, Gervitz testified that the investment accounts and Treasury bill in question were either gifts from her father or proceeds from the sale of real estate that she owned prior to her marriage to Faram. With no contradictory evidence, Gervitz' testimony alone provides at least some evidence of the character of the disputed property. See *Vannerson v. Vannerson*, 857 S.W.2d 659, 668 (Tex. App.-Houston [1st Dist.] 1993, writ denied). Her testimony notwithstanding, Gervitz had no records of the transactions with which to trace or document the origin of the property. However, on the second day of trial, Faram revealed that he possessed records that would potentially corroborate Gervitz' testimony. Faram also conceded that Gervitz had previously requested the documents during discovery. Faram apparently acquired the documents from the couple's home in the summer of 1992 following their separation and then knowingly failed to produce them prior to trial.

With records in hand, Gervitz was first able to trace the source of funds used to purchase

the Treasury bill back to a USAA savings account designated in the couple's pre-marital property agreement as Gervitz' separate property. Although the remaining records were incomplete, Gervitz was then able to trace the origin of the Merrill Lynch and Prudential-Bache investment accounts to a pre-marriage point in time. All account transactions were performed by stockbrokers and funds were never withdrawn during marriage. There was also no evidence of commingling of account funds. Accordingly, we conclude there is both legally and factually sufficient evidence to support the trial court's characterization of the two investment accounts and the Treasury bill as Gervitz' separate property. Points of error one and two are overruled.

- *Holloway v. Holloway*, 671 S.W.2d 51, 56 (Tex. App.--Dallas 1983, writ dismissed) (upholding jury's finding of separate property): "We know of no authority holding that a witness is incompetent to testify concerning the source of funds in a bank account without producing bank records of the deposits."

- *Huval v. Huval*, 2007 WL 1793771 (Tex. App.--Beaumont 2007, no pet.) (affirming trial court's finding of separate property):

Generally, documents such as bank records are used to corroborate a spouse's testimony that property is the spouse's separate property. See *Osorno v. Osorno*, 76 S.W.3d 509, 512 (Tex.App.-Houston [14th Dist.] 2002, no pet.); *Purser v. Purser*, 604 S.W.2d 411, 413 (Tex.Civ.App.-Texarkana 1980, no writ). Here, the real estate sales documents corroborated Betty's testimony as to the amount of the sale proceeds she received from selling the property. She apparently also consulted bank records during her testimony, although the trial court did not admit the records into evidence. . . . In addition to Betty's testimony and the records referenced, the trial court heard testimony from the Huvals' daughter. A reasonable conclusion from Betty's testimony, corroborated by the sales documents before the trial court and Linda Dubose's testimony, is that the Huvals used Betty's separate property to purchase certificates of deposit, and Betty's separate property remained in the certificates of deposit when the marriage was dissolved, with the exception of the proceeds from the first sale. . . . On this record,

the trial court could reasonably form a firm belief or conviction that \$215,467 of Betty's separate property remained when the marriage was dissolved.

- *Newland v. Newland*, 529 S.W.2d 105, 107-08 (Tex. Civ. App.--Fort Worth 1975, no writ) (affirming trial court's finding of separate property):

While most of Mr. Newland's testimony was corroborated by bank records, etc., some was not so supported. Mrs. Newland contends that where there is not corroboration there is lacking the requirement of evidence that it be 'clear and convincing'. She cites *Duncan v. Duncan*, 374 S.W.2d 800 (Eastland, Tex.Civ.App., 1964, no writ history) and *West v. Austin National Bank*, 427 S.W.2d 906 (San Antonio, Tex.Civ.App., 1968, writ ref., n.r.e.). We do *108 not believe either case supports the contention. In a suit of this nature between a husband and wife the parties are each able to testify upon material agreements, express or implied, but rarely would any third persons be able to corroborate either. The same applies to action of one with no participation of the other. To adopt the rule for which Mrs. Newland contends would be to deny justice in a great number of cases, indeed in nearly all where the facts are within the knowledge of only one spouse. Of course the fact finder would be entitled to disbelieve and refuse to find for the spouse having knowledge and testifying, but in instances where he is believed and the finding made for him a judgment based thereupon should not be disturbed because of a lack of corroboration of his testimony.

- *Peterson v. Peterson*, 595 S.W.2d 889, 892 (Tex. Civ. App.--Austin 1980, writ ref'd n.r.e.) (affirming the trial court's finding of separate property):

Our courts have varied between a strict and lenient application of the tracing rules. In *McKinley v. McKinley*, 496 S.W.2d 540 (Tex.1973), the Supreme Court applied the principles of tracing to a savings account. In that case Mr. McKinley had on deposit \$9,500 of his separate funds in a savings account, earning interest, until the account balance was \$10,453.81. Mr. McKinley

thereafter withdrew \$10,400 to purchase a savings certificate. The Supreme Court held that the \$9,500 was clearly identified as separate property. This case has been described as the “most liberal tracing case that we have seen.” *Latham v. Allison*, 560 S.W.2d 481 (Tex.Civ.App. Fort Worth 1977, writ ref'd n. r. e.).

In the case at bar Mr. Peterson testified that he sold inherited property and deposited funds in excess of \$35,000 into his personal bank account. He subsequently paid the balance of the purchase price from that same account. Appellant argues that no evidence was introduced to establish the beginning balance of that account on the date of marriage or to establish what deposits or withdrawals were made between the date of the marriage and the date of closing.

In reviewing appellant's “no evidence” point, after examining only that evidence in favor of the trial court's finding, we find probative evidence to support the trial court's finding that the community property presumption was overcome by tracing the entire purchase price to appellee's separate funds. In viewing the evidence in its entirety, we also find sufficient evidence to support the trial court's finding, and that the finding is not against the great weight and preponderance of the evidence. Mr. and Mrs. Peterson were married less than one month when Mr. Peterson made the payment from his personal account. Although Mrs. Peterson testified that she desired an interest in the house, under cross-examination she admitted that her only financial interest would be in maintaining the home landscaping, furniture, etc.

Relying upon *McKinley v. McKinley*, supra, we hold that appellee has traced the \$32,973.64 to his separate property.

- *Welder v. Welder*, 794 S.W.2d 420, 424-25 (Tex. App.--Corpus Christi 1990, no writ) (upholding jury's finding of separate property):

[O]ur courts have found no difficulty in following separate funds through bank accounts. *Sibley v. Sibley*, 286 S.W.2d 657,

659 (Tex. Civ. App.--Dallas 1955, writ dismissed). A showing that community and separate funds were deposited in the same account does not divest the separate funds of their identity and establish the entire amount as community when the separate funds may be traced and the trial court is able to determine accurately the interest of each party. *Holloway v. Holloway*, 671 S.W.2d 51, 60 (Tex. App.--Dallas 1983, writ dismissed); *Harris v. Ventura*, 582 S.W.2d 853, 855 (Tex. Civ. App.--Beaumont 1979, no writ). One dollar has the same value as another and under the law there can be no commingling by the mixing of dollars when the number owned by each claimant is known. *Trawick v. Trawick*, 671 S.W.2d 105, 110 (Tex. App.--El Paso 1984, no writ); *Farrow v. Farrow*, 238 S.W.2d 255, 257 (Tex. Civ. App.--Austin 1951, no writ).

In addition, when separate funds can be traced through a joint account to specific property purchased with those funds, without surmise or speculation about funds withdrawn from the account in the interim, then the property purchased is also separate. See *McKinley v. McKinley*, 496 S.W.2d 540, 543-44 (Tex. 1973); *DePuy v. DePuy*, 483 S.W.2d 883, 887-88 (Tex. Civ. App.--Corpus Christi 1972, no writ).

- *Zagorski v. Zagorski*, 116 S.W.3d 309, 316-17 (Tex. App.--Houston [14 Dist.] 2003, pet. denied) (upholding trial court's finding of separate property):

The evidence shows that before he married Lori, Tony placed substantial amounts of his personal money with an Australian business associate, John Rundell, to collateralize and/or guarantee overseas business ventures. These funds were initially deposited into an Australian account and subsequently transferred into an account in the name of Darwin Ltd. at the Hong Kong Bank. Tony testified this money was a loan to facilitate Rilco Manufacturing Company (“Rilco”), a separate property business, and its subsidiaries to bid successfully for lucrative contracts. Tony and John Rundell testified the Account was established in 1988. The Account money originated from the repayment of the loan Tony made to Rilco Western Australia

Pty. Ltd (Rilco W.A.). Specifically, the record reveals that the funds in the Account originated when Tony personally loaned money to Rilco W.A., which in turn loaned the money to its subsidiary, Rilco Process Heat Pty. Ltd., in order to fund guarantees to perform a contract in Australia. Thereafter, the funds were returned to Rilco W.A. which in turn deposited the funds into the Account through Gordon Fisher, a Hong Kong solicitor. John Rundell, the manager of the Australian projects, and signatory on the Account, testified Tony could, and did, request repayment of the funds. Tony introduced a series of letters written by Tony to Rundell requesting telegraphic transfers of money from the Account dated from July 21, 1993, to May 25, 1997. He also introduced a series of letters written by Rundell to Tony reporting annual reconciliations of the Account dated from January 29, 1993, to February 12, 1997. Lori contends Tony's evidence regarding the original source of the funds in the Account is simply not credible. While it is true the evidence does not include documents such as a trust agreement for the Account, a Rilco W.A. loan agreement or copies of original wire transfers sending the money overseas, it is not our role to question the absence of such documents. Three witnesses corroborated Tony's testimony regarding the existence of the foreign bank account prior to the marriage and the source of the funds in it. Their testimony was bolstered by documentation, the series of letters written by Tony to Rundell requesting telegraphic transfers of money from the Account dated from July 21, 1993 to May 25, 1997, and the series of letters written by Rundell to Tony reporting annual reconciliations of the Account dated from January 29, 1993, to February 12, 1997. Moreover, there was documentary evidence of the foreign transactions requiring funding guaranties. Tony's testimony was corroborated, and even in the absence of more specific documentary evidence of inception of title, it is clear and convincing evidence that the Account was separate property prior to the marriage. Cf. *Robles v. Robles*, 965 S.W.2d 605, 616 (Tex. App.-Houston [1st Dist.] 1998, writ denied) (uncorroborated testimony of interested party does not con-

clusively establish a fact even when uncontradicted).

C. COMMUNITY-OUT-FIRST APPROACH. The community-out-first approach is the predominant approach used in tracing efforts to allocate withdrawals from financial accounts containing both separate property and community property funds. The tracer preferentially allocates withdrawals to community funds until the community funds are gone, after which the withdrawal(s) are charged against separate funds in the account.

1. Community-Out-First: The Minimum Balance Approach. The minimum balance approach to tracing occurs when there has been a commingling of separate and community funds in an account, and it can be established that the account balance never dipped below a certain level. It doesn't matter what other transactions have occurred in the account; the court presumes that separate property funds "sink to the bottom" of the account, and remain in the account.

In *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.--Dallas 1955, writ dismissed) (per curiam), the husband mixed community funds in a bank account with \$3,566.68 of wife's separate funds. There were a number of deposits and withdrawals to the account. However, the account never dropped below \$3,566.68. Seeing the husband as a trustee of the wife's separate property funds that were in his care, the appellate court invoked a rule of trust law, that where a trustee mixes his own funds with trust funds the trustee is presumed to have withdrawn his own money first, leaving the beneficiary's on hand. Since the husband owned none of wife' separate funds, and half of the community funds, it was presumed that the community moneys in the bank account were withdrawn first, before the wife's separate moneys were withdrawn. When the account had a balance of \$4,009.46, the sum of \$1,929.08 was withdrawn to buy a farm. The appellate court held that all \$442.78 in community property came out, and the rest of the withdrawal was separate property, making the farm 11% community property and 89% wife's separate property. The court said:

The community moneys in joint bank account of the parties are therefore presumed to have been drawn out first, before the separate moneys are withdrawn.

Id. at 659.

The community-out-first rule was described in *Mock v. Mock*, 216 S.W.3d 370, 373 (Tex. App.--Eastland 2006, pet. denied): “Under this rule, courts presume that separate funds in a commingled account sink to the bottom of the account and that community funds are withdrawn first.”

A variation of the minimum balance approach is reflected in *Barrington v. Barrington*, 290 S.W.2d 297, 304-05 (Tex. Civ. App.--Texarkana 1956, no writ), where *Sibley* was cited for the proposition that community funds in a joint bank account are as a matter of law presumed to have been drawn out before separate moneys are withdrawn. The Court said:

The profit and loss statement with respect to the Barrington Tire Shop, introduced in evidence, covering from March 31, 1954, to March 1, 1955, shows that the earnings of the business for that period was \$3,620.92, and that the withdrawals therefrom during that period was the sum of \$4,637.22. The trial court found in his findings of fact that these withdrawals were made for the support, maintenance, pleasure, etc., of the parties, which clearly show that these withdrawals were withdrawals of community funds for community purposes and under the case of *Sibley v. Sibley*, supra, community funds in a joint bank account are as a matter of law presumed to have been drawn out first before the separate monies are withdrawn. The trial court also specifically found that at no period during the marriage of the parties did the earnings of the Barrington Tire Shop equal or exceed said regular withdrawals therefrom, and also that said withdrawals during the marriage of the parties were \$1,140.41 in excess of the earnings of such business during the marriage of the parties. Appellant has not attacked these specific findings of the trial court. The evidence is amply sufficient to sustain such findings-in fact the evidence supporting these specific findings is undisputed in the record.

Unquestionably the real estate and the original tools, appliances, office furniture, and certain other original property of the Barrington Tire Shop owned by Mr. Barrington prior to his marriage and still on hand at the dissolution of the marriage had

in no way changed their form and were and still remained the unquestioned separate property of Mr. Barrington.

It is our further view that the other remaining property of the Barrington Tire Shop, consisting of the new re-tread mold, tire changer, cement spray machine, air compressor and matrice purchased out of the bank account of Barrington Tire Shop during the marriage (which was subject to various indebtedness as shown by the record) and other property on hand in the Tire Shop including the \$2,700 worth of stock of new and used tires on hand in Barrington Tire Shop at the dissolution of the marriage, under the undisputed facts in this case, and under the authorities cited in the *Farrow* and *Sibley* cases, supra, were in law the separate property of appellee, Elray Barrington.

The case of *Hill v. Hill*, 971 S.W.2d 153, 159 (Tex. App.--Amarillo 1998, no pet.), was an instance where the court used the “sink to the bottom” approach to tracing:

Michael testified that prior to his marriage he had a savings account at Norwest Bank, which was later converted into the Account. Into it, he made two deposits of funds which he said were his separate property. One deposit, for \$10,000, represented a portion of a gift from his father. Another, for \$14,678, represented the proceeds from the sale of a house that he owned before his marriage to Lucia. See Tex. Fam. Code Ann. § 3.001(1) (Vernon Pamph.1998) (stating that property owned by a spouse prior to marriage is the spouse's separate property). Receipts manifesting that both of these deposits were made were then admitted into evidence. This constitutes some probative evidence that the \$24,678 sum deposited was Michael's separate property.

Also admitted was a summary of the transactions in the Account. According to that exhibit, the balance in the account at the time of marriage was \$7,551.99. This sum was separate property given that it was Michael's before the marriage. The lowest this balance sank before the first separate property deposit was made was \$4,901.99.

Thus, when the \$10,000 separate property deposit was made on May 27, 1993, the total amount of separate property in the account was \$14,901.99. Between this deposit and the next separate property deposit, the lowest account balance was \$7,935.87. When the next, and last, separate property deposit of \$14,678.20 was made on July 22, 1993, the amount of separate property in the account rose to \$22,614.07.

Throughout the life of the account many other deposits and withdrawals were made. Whether they involved separate or community funds is not revealed in the record. Nevertheless, we assume that the withdrawals consumed first the community and then the separate funds. *Welder v. Welder*, supra; *Sibley v. Sibley*, supra. Next, as the withdrawals of community funds were being made, they encroached on the \$22,614.07 balance referred to above. According to the account summary, the balance of the separate property in the Account stood at \$17,310.39 as of the date of divorce. And, that sum was the maximum amount which the court could have “confirmed” as Michael's separate property in the Account. Thus, the record is replete with evidence supporting the determination that the Account contained separate funds. Moreover, the contradictory evidence, such as it was, was not of such quantum so as to render the decision wrong.

Nevertheless, according to Michael's amended inventory and appraisal, the total balance in the Account immediately before the final divorce hearing was \$18,200.49. As can be seen, the latter sum exceeded the monies subject to being traced as his separate property by \$890.10. And, to the extent that the trial court awarded him the \$890.10, it did so without any evidentiary support. So, we agree with Lucia's contention that the court's decision to award Michael the Account in toto lacked legally sufficient evidentiary support, but our agreement is limited to the \$890.10 sum.

In *McElwee v. McElwee*, 911 S.W.2d 182, 188 (Tex. App.--Houston [1st Dist.] 1995, writ denied), a claim of separate property failed because the proponent did not

demonstrate that all community funds in a commingled account had been withdrawn at the time a check was written to buy a house:

When an account contains intermingled separate and community funds, it is presumed that the funds first spent are community funds. See *Hill v. Hill*, 971 S.W.2d 153, 158 (Tex.App.-Amarillo 1998, no pet.); *Welder v. Welder*, 794 S.W.2d 420, 433 (Tex.App.-Corpus Christi 1990, no writ). This presumption exists until all community funds have been exhausted from the account. See id. Absent a showing that all community funds had been exhausted before Bobby and Pauline purchased the residence, any funds spent are presumed to be community funds. See id.

In *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973), a savings account containing \$ 9,500.00 of separate property earned \$ 472.03 in interest at year end. On January 2, \$472.03 was withdrawn. The Supreme Court held that the interest had been withdrawn, leaving the separate property balance of \$9,500.00.

In *Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--Dallas 1981, no writ), the Court said:

On the date of the marriage, the balance in the account was \$27,642.45. Upon dissolution of the community by the husband's death, the balance was \$35,809.80. The account grew by interest from time to time, as well as by new deposits, and was reduced by withdrawals from time to time. The witness Wofford testified that an additional deposit of \$10,000.00 of separate funds of the husband was made after the marriage and that the remaining deposits, as well as withdrawals, were made by the community. The passbook for this account was introduced into evidence and supports the separate character and balance of the account on the date of marriage. Between the marriage on October 3, 1972, and October 20, 1972, no interest was earned and no deposits were made, but withdrawals reduced the balance to \$19,642.45. Between October 20, 1972, and April 23, 1973, there were entries of

earned interest, deposits of unknown character, and withdrawals, but the balance was never below \$19,642.45. On April 23, 1973, a separate property deposit of \$10,000.00 was made and the identifiable separate property interest in the account became \$19,642.45 plus \$10,000.00 or \$29,642.45. Subsequent interest earned, deposits, and withdrawals to the date of the husband's death never reduced the account balance to or below \$29,642.45. We hold that this record traces and identifies the husband's separate interest in the Mercantile savings account to the extent of \$29,642.45 with the remainder of the account being deemed community for want of tracing or identity.

To reiterate, the "sink to the bottom" approach does not involve maintaining running balances of separate and community property, inside an account. It involves only establishing the minimum balance in an account over a period of time.

2. Uses for the Community-Out-First Rule Other Than Minimum Balance. The community-out-first rule is also used in situations where the account has "gone to zero" so that no minimum balance can be established, or where the question is the character of assets bought using funds from the account and not the character of the balance remaining in the account. The tracer recreates and maintains running balances of separate and community property, by characterizing, each deposit as separate or community and characterizing each withdrawal using the rule that community property funds are withdrawn until the community balance is exhausted, after which separate property funds are withdrawn. If an account is overdrawn, the negative balance is typically treated as a loan using community credit. The following cases embrace the community-out-first rule.

In *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1976, writ dismissed), the court cited *Sibley* for the rule that "where a bank account contains both community and separate moneys, it is presumed that community moneys are drawn out first."

The court in *Harris v. Ventura*, 582 S.W.2d 853, 855-56 (Tex. Civ. App.--Beaumont 1979, no writ), said that "where the checking account contains both community and separate funds, it is presumed that community

funds are drawn out first." The court cited *Horlock and Sibley*. The Court went on to say:

The testimony with reference to this account is clearly outlined, step by step, beginning with the amount in the account on April 12, 1974, and traced each deposit and withdrawal. Such facts appear in the record and have not been challenged in any manner by appellee. Therefore, they are accepted as being correct. Tex.R.Civ.P. 419. On April 12, 1974, the account balance was \$460.15. It is presumed that this sum was community property. The next deposit was in the sum of \$7,825.79 on April 16. This deposit was admitted to have been the proceeds of the sale of real property owned by George Ventura prior to his marriage to appellee. The next deposit was \$1,174.62 on July 2. This included the sum of \$878.63 which was admittedly inherited by deceased. Other deposits made between April 12, 1974, and January 1, 1975, were deposits of interest and that the total of the interest deposits and the beginning balance was \$1,339.63; that all other money placed in the account was George Ventura's separate property. This testimony given as to the deposits in the account was not disputed or contradicted. There was a total amount of withdrawals during this same period in the amount of \$5,046.54.

There was no attempt made to contradict any of the above facts. Appellants have clearly traced and identified the funds in this checking account in the sum of \$3,657.88 as deceased's separate property. Thus, appellants met the burden of tracing their father's separate property as it was received and retained in the account. . . .

However, where the checking account contains both community and separate funds, it is presumed that community funds are drawn out first. See *Horlock v. Horlock*, 533 S.W.2d 52, 58 (Tex.Civ.App. Houston (14th Dist.) 1975, writ dismissed); *Sibley v. Sibley*, 286 S.W.2d 657 (Tex.Civ.App. Dallas 1955, writ dismissed). Applying this rule, the \$460.15 beginning balance was withdrawn after the first withdrawal, thereby establishing the sum of \$4,118.03 as the separate funds of

deceased, and appellee's community interest in the balance of the checking account would be \$439.74 instead of \$2,498.76 found by the trial court.

In *Smith v. Smith*, 22 S.W.3d 140, (Tex. App.--Houston [14th District] 2000, no pet.), the court said: "We assume without deciding that the community-out-first presumption is a rebuttable one.FN5" The Court went on to say: "FN5. We also note that a blind application of the community-out-first presumption does not uphold the policy reason for the presumption's original application."

In *Cesar v. Cesar*, 2000 WL 639892 (Tex. App.--Beaumont 2000, no pet.), the appellate court said this about the community-out-first rule:

The husband employed the community-out-first theory to trace the community estate's interest in the brokerage account. This theory has been criticized. See Stewart W. Gagnon & Christina H. Patierno, Reimbursement and Tracing: The Bread and Butter to a Gourmet Family Law Property Case, 49 Baylor L. Rev. 323, 383 (1997); Oliver S. Heard, Jr., Richard A. Strieber, & Richard R. Orsinger, Characterization of Marital Property, 39 Baylor L.Rev. 909, 924 (1987). But it is accepted by this court, see *Harris v. Ventura*, 582 S.W.2d 853, 855-56 (Tex. App.--Beaumont 1979, no writ), and it has received recent acceptance by other courts. See *Scott v. Estate of Scott*, 973 S.W.2d 694, 696 (Tex.App.-El Paso 1998, no writ). Accordingly, we hold it is **an acceptable method of tracing** the community estate interest in the brokerage account. [Emphasis added]

3. Beyond the Community-Out-First Rule. There are instances in which the community-out-first approach will not work, or its application is uncertain.

In *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973), the Supreme Court recounted its own tracing of funds in bank account as follows. The husband had \$9,500.00 of separate property money on deposit in a savings and loan account. By year end, it had earned

\$472.03 in interest. On January 5, the husband withdrew \$472.03. The Supreme Court said that "the \$9,500.00 originally deposited remained in the account and continued to earn interest, until on December 31 of the following year [1967], the account balance was \$10,453.81. There were no withdrawals after the one mentioned above. All deposits were deposits of interest. On January 2 of 1968, \$10,400.00 was withdrawn and used to purchase a CD. The Supreme Court concluded that the \$9,500.00 originally on deposit had been "traced in its entirety" into the CD. Thus, \$9,500.00 of the \$10,400.00 CD was separate property. The community-out-first rule cannot explain this analysis. This is no small matter, since this was the Texas Supreme Court conducting its own tracing. Adherents who would elevate the community-out-first approach to a binding rule will have some difficulty in reconciling their view to *McKinley*.

Here is another example. Imagine an account that contains only separate property funds of husband and separate property funds of wife. A withdrawal is made that is less than the entire balance in the account. Whose funds are deemed withdrawn first? The community-out-first rule cannot provide the answer.

Imagine a brokerage account containing 1,500 shares of GM stock, 1,000 of which are husband's separate property and 500 of which are community property. Assume 250 shares are sold. Should the tracer deem that all 250 shares sold were community property, or should the sale be allocated pro rata one-third to community property and two-thirds to separate property? Or should the oldest shares be deemed sold first, or instead the shares most recently purchased? No Texas appellate case says. This problem is discussed later in this article.

4. Tax Treatment as Indication of Character. In tracing, reference is sometimes made to the tax treatment applied to various transactions. The Waco Court of Appeals recently said:

Federal or state tax treatment does not control the character of marital property in Texas. See Tex. Const. art. XVI, § 15; *Thomas v. Thomas*, 738 S.W.2d 342, 345 (Tex.App.-Houston [1st Dist.] 1987, writ denied).

Legrand-Brock v. Brock, 2005 WL 2578944 (Tex. App.--Waco 2005, no pet.).

IV. REIMBURSEMENT VS. ECONOMIC CONTRIBUTION (EC) CLAIMS.

A. REIMBURSEMENT. In the context of brokerage accounts, the primary reimbursement claim would relate to the payment of separate debt using community assets, or the payment of community debt using separate assets. In each instance, the contributing marital estate has a dollar-for-dollar reimbursement claim for paying the debt of the benefitted estate. *See Colden v. Alexander*, 171 S.W.2d 328, 334 (Tex. 1943). The rules of law and factual questions relating to this kind of reimbursement are reflected in PJC 204.9A, included in Appendix A to this article.

However, the economic contribution statute imposed a degree of complexity on the foregoing scenario, as explained in the next section.

B. ECONOMIC CONTRIBUTION CLAIMS. An economic contribution claim arises when, among other situations, a debt of one marital estate used to buy or make capital improvements to property, that is secured by a lien in property, is paid down using assets of another marital estate. An economic contribution claim also arises when assets of one marital estate are used or to make capital improvements to property belonging to another marital estate.

Such an economic contribution claim is measured by a formula that allocates the equity in the property on the date of disposition (or divorce) based on the economic contribution made to the property by each marital estate.

It is important to note that the award of a reimbursement claim is discretionary with the court, while an economic contribution claim if proven, must be granted by the court. In terms of the outcome, the essential difference between a reimbursement claim and an economic contribution claim is as follows: reimbursement for payment of debt is measured by the dollars expended to pay down the debt, plus interest paid. Reimbursement for making capital improvements is measured by the enhancement in value to the improved property. An economic contribution claim is measured as a percentage claim to the equity in the benefitted property on the date of disposition of the property, except that if the benefitted property is owned at the time of divorce, the percentage applies to the equity in the property on the day of divorce.

The case of *Boyd v. Boyd*, 131 S.W.3d 605, 613 (Tex.

App.--Fort Worth 2004, no pet.) said: "When a separate estate is the claimant, the spouse seeking economic contribution has the burden to prove, by clear and convincing evidence, that the funds expended to reduce the community debt were separate funds. Id. § 3.003(b). Moreover, a spouse seeking economic contribution must bring forth sufficient evidence for the fact finder to determine the enhancement value to the benefitted estate."

V. BROKERAGE ACCOUNT TRANSACTIONS.

This Section of the article considers brokerage account transactions, without regard to the marital property implications. The marital property consequences of these transactions are covered in Section VI.

A. MECHANICAL ISSUES. There are a number of mechanical issues connected with brokerage accounts, and the way they operate differently from the bank accounts that have been considered in most Texas appellate tracing decisions.

1. Trade Date vs. Settlement Date. In most markets, several business days will elapse between the trading date and the settlement date in a securities transaction. When a security is bought or sold, or borrowed, the trade date is the date that the order was executed. This is the date used for tax reporting purposes. The settlement date is the date when the cash or securities from the transaction are posted to the investor's account, or the margin loan balance is debited or credited. The settlement date for marketable stocks is usually three business days after the trade was executed and for listed options and government securities it is usually one day.

When a buy or sell order is placed with a broker, it is probably executed within an hour, but the brokerage statement usually reflects the transaction as being consummated 2 or 3 days later. Significant sums of separate or community money can, on occasion, flow into or out of the brokerage account between the trade date and the settlement date. In tracing, should the tracer use the actual trade date, or the settlement date, for tracing purposes? When tracing commingled funds in bank accounts, tracers typically follow the check clearing date and not the check written date. The usual rationale is that someone can write a check and date it, but hold it until a later time, or can mail a check that is deposited sooner or later, which subjects the tracing analysis to hypothetical consequences that are not matched to actualities. But trade dates are immediate and can be objectively verified. So does the dubious reliability of the date on checks equate to the trade

dates in brokerage transactions? If the settlement date is to prevail, can the trade date be considered on the issue of intent, such as the intent to sell one stock and invest the proceeds into another stock? If the sale and purchase transactions are nearly simultaneous based on trade dates but not settlement dates, would the trade date support treatment of the events as a matching transaction despite the actualities of the brokerage account statements?

Between the trade and the time of settlement, the rights and obligations of the purchaser, or the seller, are contractual. Thus, in a sense all purchases of securities are preceded by a short window of time where the purchaser has a contractual obligation to pay the purchase price. This could be a complicating factor if someone tries to argue that inception of title occurred when the trade was executed, and that the security was acquired in exchange for a community property contractual liability, even if upon settlement, the purchase price was paid with separate property funds. Ultimately, this position would lead to a conclusion that all securities acquired during marriage are invariably community property, even if paid for on settlement using separate property funds. Under this literal approach, tracing would be impossible.

2. Mixed Character Blocks of Securities. It sometimes happens that securities in one company, held in a brokerage account, will have been acquired at different times. And yet brokerage firms typically consolidate all securities in one company into one line item in the statement. These separate blocks of identical securities can cause difficulties when there is a sale of part of the block. There can be an allocation issue if some securities would qualify for long term capital gain treatment while others only short term (held for 1 year or less) treatment. An issue can similarly arise when some securities in the block have a higher tax basis than others, and the question is whether it was high tax basis or low tax basis securities that were sold first. And if some of the securities in a block were purchased as separate property while other shares in the block were purchased as community property, with a partial liquidation an issue can arise as to whether separate property shares were sold, or community property shares were sold, first.

In tracing commingled funds, the community-out-first rule has gained prevalence. Can the community-out-first approach be adapted to the partial liquidation of mixed character blocks of securities? In other words, if two blocks of stock in the same company were pur-

chased at different times and had different character, and were sold in partial lots, does the tracer deem that the community shares were sold before the separate shares were sold?

For example, assume that 2,000 shares in a company were purchased in two 1,000-share blocks, Block A and Block B. Block A is 51% separate and 49% community, and Block B is 49% separate and 51% community. That means that, overall, there are 2,000 shares of stock, half of which are separate property and half of which are community property. If 1,000 shares are sold, would the tracer deem that Block B was sold before Block A because Block B has slightly more community property shares, or would the tracer deem that 1,000 shares of community property stock were sold and no separate property shares were sold? Or would the tracer pro-rate the allocation and deem that 500 shares of separate were sold and 500 shares of community were sold?

An analogy can be drawn to generally accepted accounting methods for dealing with inventories. Tax reporting and financial accounting principles recognize several different methods for reporting the disposition of identical assets acquired at different times, typically to determine the cost of inventory items for calculating cost of goods sold and to determine the value of year-end inventory: FIFO, LIFO, Average Cost, Lower of Cost and Market, and other methods. FIFO treats the first items disposed of as having come from the first items purchased. LIFO treats the first items disposed of as having come from the most recent items purchased. *See* FIFO and LIFO in the Glossary at the end of this paper. The Average Cost Method takes the weighted average of all units available for use during the accounting period and then uses that average cost to determine the cost of goods sold and the value of ending inventory. To explore other methods, it is recommended that you invite an accountant out for drinks, and buy two bottles of wine.

For capital gain tax purposes, Treas. Reg. § 1.1012-1(c)(1) requires taxpayers to use the first-in, first-out (FIFO) method for determining which shares are sold (and the tax basis and holding periods of the shares sold) unless the stock sold can be “adequately identified” under rules set forth in the regulation. The IRS has specifically ruled that shareholders cannot use an average basis computed by blending different blocks of stock for determining gain or loss on shares sold. Rev. Rul. 61-97, 1961-1 CB 394. So, with the IRS it’s either FIFO or specific identification (if the shareholder

can adequately identify the shares sold).
<https://business.cch.com/capchanges/featuredProduct/cccn_02-04_rev.pdf>.

Each brokerage firm has its own protocol to determine which shares of a block of identical securities are sold. Brokerage firms typically report their choice of which shares were sold in the brokerage statement. Often this is based on a FIFO allocation. Sometimes no designation is made on the brokerage statement. What if the spouse “adequately identified” the shares to be sold, but the brokerage house reports the sales on a FIFO basis? Whether the brokerage firm’s treatment is to be given controlling effect is subject to debate.

At the end of a tax year in which securities are sold, the taxpayer must report on Schedule D of his/her Form 1040 the acquisition date and acquisition cost of securities sold during the year. Taxpayers may prefer to have sold higher tax basis shares before selling lower tax basis shares, since this would reduce capital gain tax. However, if the taxpayer has capital loss carry forwards or loss position the taxpayer may prefer to sell lower basis securities. Whether the listing of shares sold in the tax return should be given controlling effect in the event of a conflict with the brokerage statement, is subject to debate.

In fact, the whole question of whether to follow the tax return, the brokerage statement, community-out-first, FIFO, or some other method of allocation, in tracing separate and community property securities in brokerage accounts has not been authoritatively resolved.

Remember also that brokerage accounts contain cash and that cash is removed from the account, to buy more securities, to pay margin debt, or to cover checks written on the brokerage account. An argument can be made that tracing commingled cash in a brokerage account is no different than tracing commingled funds in a bank account.

3. Credits to Margin Debt. In margin accounts, strange things can happen to cash balances and debt balances.

For instance, one major brokerage firm reflects a margin loan for the period of time between the trade date and the settlement date, even on securities that are paid for with cash on settlement day. According to the statements, the securities were purchased on credit, but in the mind of the investor they weren’t.

Some brokerage accounts are set up to sweep earnings at the end of every month into a cash account that is separate from the securities account. Accumulated dividends and interest are thus routinely removed from the account. If the account has a margin debt, however, a close look at the brokerage statements sometimes reflects that the brokerage house actually used the dividend and interest income to temporarily pay down the margin debt, then loaned it back again at the time the cash was swept out of the account. At the most literal level, the cash swept into the other account is loan proceeds, not income. In most cases, both the income and margin loan proceeds would be community property, so the distinction has no practical effect. But if a pre- or post-marital agreement makes income from separate property separate, the brokerage firm’s procedure could have the effect of converting separate property income into community property loan proceeds, if the brokerage firm’s actions are taken literally.

A variation of this problem involves proceeds from sale of separate property securities, with the proceeds deposited into a margin account. Assume that a spouse sells Stock A, which is separate property, with the intent to buy Stock B with the proceeds. The proceeds from Stock A are settled on a Friday. Stock B is bought the following Monday. A close look at the brokerage statement reflects that the proceeds from sale of Stock A actually reduced the margin debt for 72 hours, and that when Stock B was purchased, it was purchased with new margin debt. Do we have separate property tracing, or do we have the payment of a community margin debt using separate funds, and then the purchase of new shares using margin debt?

4. Depositing Separate Property Into a Brokerage Account in Both Spouses’ Names. Texas Probate Code § 438, “Ownership During Lifetime,” subsection (a) provides that:

- (a) A joint account belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent.

The term “account” is defined as follows:

- (1) "Account" means a contract of deposit of funds between a depositor and a financial institution, and includes a checking account, savings account, certificate of deposit, share account, and other like arrangement.

Tex. Prob. Code §436(1). The statute defines "Financial institution" to mean "an organization authorized to do business under state or federal laws relating to financial institutions, including, without limitation, banks and trust companies, savings banks, building and loan associations, savings and loan companies or associations, credit unions, and brokerage firms that deal in the sales and purchases of stocks, bonds, and other types of securities." Tex. Prob. Code § 436(3). Thus, putting the other spouse's name on a brokerage account containing a spouse's separate property does not give rise to a presumption of gift.

5. "Sweeping the Account." As noted above, sometimes an account holder will arrange for the brokerage firm to sweep income out of an investment account. The income is transferred to another account at the brokerage firm. The sweeps are usually done periodically, like monthly or quarterly, and not daily. In tracing, do we look at daily balances, or do we adopt a broad view and look at the account as a whole, monthly, quarterly, or whatever?

B. BUYING SECURITIES "LONG." Buying securities "long" means paying for the securities when you buy them and owning them unconditionally. The investor is thus a shareholder, or bond holder, or limited partner, etc. If the value of the security goes up, and the investor sells, s/he makes a profit. If the value goes down, and s/he sells, the investor loses money. Income from the investment, whether dividends from stock, interest from bonds, or distributions from partnership interests, comes to the investor. A long position can be paid for with cash, or with borrowed funds (i.e., margin debt).

C. MARGIN ACCOUNTS. In July 2007, margin debt owed on stocks listed on the New York Stock Exchange surpassed \$350 billion.

A margin account is a brokerage account through which the brokerage firm lends the customer money, usually to purchase securities. Unlike a cash account, a margin account allows an investor to buy securities with money that he/she does not have, by borrowing the money from the broker. The Federal Reserve limits margin borrowing to at most 50% of the value of the collateral securing the margin loan. Some brokerages have even stricter requirements, especially for volatile stocks. People usually open margin accounts with a desire to leverage their investment, and not because they don't have the money to make the full purchase. Brokerage firms charge a relatively low interest rate on margin

loans in order to entice investors into buying on margin.

Sometimes a margin account is used as a source of funds to buy assets that are not left in the margin account, like when the investor writes a check on the margin account to buy a car, or make a down payment on a house. Sometimes money is withdrawn from a margin account to pay down credit card balances or to pay for living expenses. Used in this manner, the margin account is a convenient line of credit, collateralized by the money and securities on deposit with the brokerage firm.

A margin account is always established by the investor signing a margin loan agreement. Each brokerage firm has its own version of the margin agreement, but the fundamentals seldom vary. The account holder is personally liable for the margin debt. All cash and assets in the margin account are collateral for the margin debt. But the margin debt is further secured by all other cash and assets the investor has at the brokerage firm.

Margin Debt and Collateral is Undifferentiated. Under nearly all margin agreements, margin debt is secured by not only the securities purchased on margin, but also by all other cash and securities in the margin account, as well as all other cash and securities that the investor has on deposit in any other account at the brokerage firm. The brokerage firm does not maintain any correlation of margin debt to particular securities. All margin debt is secured by all collateral, and any funds the investor has on deposit in any account with the brokerage firm are subject to the overall margin debt. The brokerage firm does not attempt to apply proceeds from the liquidation of a particular security to the margin debt specifically used to purchase that security. The margin debt and its collateral are not differentiated by the brokerage firm.

Long Positions on Margin. Taking a long position using margin is nothing more than buying a security with the brokerage firm advancing the cost while adding it to the margin loan balance. The investor owns the security, and at the same times owes a debt for the purchase price. The security purchased, and the debt incurred, netted against each other, could fluctuate around the zero point depending on how the value of the security moves. But even if the net of asset value and debt is zero, the true situation is that the asset and the debt exist separately.

Short Sales on Margin. A short sale is a margin transaction in which the investor borrows a security from the

brokerage firm and immediately sells it. The proceeds from the sale are deposited into the brokerage account. The brokerage statements typically reflect the loan of the security to the investor as a monetary obligation owed to the brokerage firm, expressed in a dollar figure which is based on the market price of the borrowed security. The amount of the margin debt fluctuates with the market price of the securities. When an investor short sells a security that the investor already owns, it is called a "short sale against the box."

When an investor sells a security short, sometime later the seller must either purchase similar securities and deliver them to the lender, or deliver to the lender securities that the investor already held but did not wish to surrender at an earlier date. This act of repayment is called "closing the position" or "covering the short sale." For income tax purposes, there is no gain or loss on a short sale until the short sale is covered.

Selling short is the opposite of taking a long position. A short seller makes money if the stock goes down in price and the investor covers at a price lower than his purchase price plus commissions paid. An investor in a long position makes money when the stock goes up and the investor sells for more than his purchase price plus commissions paid. In a long purchase, the profit that the investor receives is equal to the net proceeds from sale of the shares less the cost of purchasing them, plus commissions. In a short sale, the profit that the investor receives is equal to the net proceeds from sale of the borrowed shares less the cost of repurchasing the borrowed shares. Losses are the reverse.

Example: suppose an investor sells 1,000 shares short, at a cost/sales price of \$20 per share. The sum of \$20,000 (less commission) is then put into the investor's account, and the account is credited with a margin debt equal to the acquisition cost. Assume that the shares fall to \$15 and the investor closes out the position by purchasing 1,000 shares at \$15 each (\$15,000). Those shares are deposited into the margin account, thus extinguishing the investor's short sale obligation to the brokerage firm. The investor's profit is measured by the difference between the cost of the borrowed shares and the cost of repaying the borrowed shares, ($\$20,000 - \$15,000 = \$5,000$), less commissions and interest that accrued on the margin debt in the interim.

D. OPTIONS.

1. Types of Options. There are two basic kinds of options: "calls," which give an investor the right to buy

a certain amount of stock at an agreed-upon price, and "puts," which give the investor the ability to force a sale of the security to another person at the contracted price. All options have an "exercise" price, also called the "strike" price, which is the level at which an investor can use his or her right to buy or force a sale of the security. Another feature of options is that they usually expire if not exercised within a certain time period. Puts and calls are generally written for one, two, three, or six months, although any period over 21 days is accepted by the New York Stock Exchange.

A **Call** is a contract that gives the holder the right to purchase a given stock at a specific price within a specified period of time. It is the opposite of a **Put**, which is a contract that allows the holder to force a sale of the given stock at a specific price within a designated period of time.

To buy a Call, the investor pays a fee to the potential buyer or seller of the stock (the **maker**), who, in turn, pays a commission to the broker who brought the two parties together. Calls are generally purchased by investors who want to profit from a rise in stock prices but, at the same time, want to avoid sharp losses. Thus, an investor holding a Call chooses one of two options. If the market advances he can buy the designated security at the lower price quoted in the Call, and then sell the stock at a profit. If the market declines, he can simply choose not to exercise his option to buy the stock, thereby avoiding a major loss, the only expense being the cost paid for the option. An investor buys a Put in order to profit from a fall in stock prices. For example, an investor holding a Put for a stock that declines in price is able to force someone to buy the stock at the higher price quoted in the Put, thereby profiting by the amount the stock declines from the Put price; if the stock price rises and the Put is not exercised, the investor can lose only the money used to purchase the Put option.

Long Call – Buying a Call is the simplest option position there is. It's a strategy that's used if you think a stock's price will rise and can be seen as a substitute for buying stock. Buying a Call offers leverage and limited risk. It usually costs less to buy an option than it does to buy the underlying stock, and is generally considered less risky than holding a long position in stock. But you have to be confident that the stock price will rise sufficiently before the expiration date of the option. Options expire, stock does not. You can "sit" on a stock and hope that eventually it will rise in price. You can't do that with a Call option. If the stock price

doesn't rise enough by a certain date, the Call option will expire worthless or with a lower price than you originally paid.

A **covered Call** exists when an investor holds a long position in an asset and writes (sells) call options on that same asset in an attempt to generate increased income from the asset by virtue of the premium received from sale of the Call. This is often employed when an investor has a short-term neutral view on the asset and for this reason holds the asset long and simultaneously has a short position via the option to generate income from the option premium. This is also known as a "buy-write".

Investors can also sell a Call or a Put. For example, let's say that you own shares of Company A and like its long-term prospects as well as its share price but feel in the shorter term the stock will likely trade relatively flat, perhaps within a few dollars of its current price of, say, \$25. If you sell a covered Call option on Company A for \$26.00, you earn the premium from the option sale but you cap your upside because if the stock price goes above \$26.00 the holder of the Call will force you to sell the stock at \$26.00. With a covered Call, one of three scenarios is going to play out:

a) Company A's shares trade flat (below the \$26 strike price) - the option will expire worthless and you keep the premium from the option. In this case, by using the buy-write strategy you have successfully outperformed the stock.

b) Company A's shares fall - the option expires worthless, you keep the premium, and again you outperform the stock.

c) Company A's shares rise above \$26 - the option is exercised, and your upside is capped at \$26, plus the option premium you received from selling the Call. In this case, if the stock price goes higher than \$26, plus the premium, your buy-write strategy has underperformed the Company A's shares.

When an investor sells a Call, and receives a premium, the premium is property acquired during marriage, and is presumptively community property. But what if the Call is a covered Call and the underlying security for the covered Call is separate property? Since the investor is selling an interest in the underlying separate property security, is the premium really the separate property proceeds from selling a "right" in the separate property security?

2. Why do investors buy puts and calls, or sell puts and calls?

Buying a Call is a speculation that the price of the stock will rise above the strike price.

Selling a Call short is the mirror image of buying a Call. It's a speculation that the price of the stock will fall, stay the same, or rise only very little. You have to consider the same things as when buying a Call, except in reverse. It's a zero-sum game: where a long Call loses money, a short Call makes money. However, a short Call has limited profit potential in exchange for unlimited risk if the stock decides to skyrocket.

Buying Puts is a strategy that profits from a drop in a stock's price. The only practical difference between buying Puts and buying Calls is that you want the stock price to go down if you buy a Put, and up if you buy a Call.

Buying a Put is an effective alternative to selling stock short. Short stock can have high margin requirements, and some brokers restrict their customers from shorting stock. Unlike short stock, buying Puts has limited risk, but like short stock it has unlimited profit potential. Strictly speaking, the potential profit on a long Put is the dollar value of the strike price of the Put minus the premium of the Put – it is not infinite.

Selling a Put short is the mirror image of buying a Put. Like a short Call, a short Put requires you to assume unlimited risk. Like the potential profit on a long Put, the risk of a short Put is the dollar value of the strike price of the Put minus the premium of the Put. Because a stock can never have a value less than zero, the potential loss on a short Put can be very, very large, but it is not infinite.

All things being equal, a long Call makes money if the stock price goes up, and a long Put makes money if the stock price goes down.

3. Value of Options. Option values depend on the price of the stock, the strike price, the implied volatility of the stock price, the time to expiration, interest rates, and any dividends payable before the expiration of the option.

An option's value is continuously whittled down by the passage of time. There is a constant battle between the erosion of the option's value with the passage of time, while waiting for a favorable move in the stock price or

an increase in implied volatility that will push the value of the option back up.

4. Equivalencies.

The basic equivalents are:

Long Stock	=	Long Call and Short Put
Short Stock	=	Short Call and Long Put
Long Call	=	Long Stock and Long Put
Short Call	=	Short Stock and Short Put
Long Put	=	Short Stock and Long Call
Short Put	=	Long Stock and Short Call

5. Naked Options. The term “naked option” refers to the selling a Call or a Put without owning or shorting the stock. The term 'naked' is used because these are uncovered positions. In both cases, the object of the strategy is to collect the option premium without ever having to buy the underlying stock. An investor will sell an out-of-the-money (OTM) Call or Put against a security. The investor wants the option to remain OTM so it expires worthless and the investor will keep the premium. Naked Calls are a Bearish strategy; Naked Puts are a Bullish strategy.

Selling Puts is the more common of the two approaches. First, Puts are written when the market is expected to go up, and the market tends to go up historically more than decline. Calls are written when the market is expected to decline. Secondly, writing a Put is sometimes used as a means of acquiring the underlying stock for less money. When an investor sells (shorts) a Put they are obligating themselves to have the stock Put to them at that strike price if the stock is trading below the strike at expiration. Generally, the stocks selected for selling Puts should be fundamentally sound and poised for growth. A Put seller should have the equivalent of the strike price in reserve, if it should be needed for stock purchase. All of the above discussion is without consideration of margin. Each brokerage firm may have different requirements on the cash needed for security. However, the use of margin just increases the risk/reward and is not considered in this discussion.

Summary of Naked Put Strategy

1. Write Puts only when you are bullish on the stock, index, or market in general.
2. Select candidates whose underlying stock is in an up-trend or has a recent BUY signal.
3. Select candidates whose fundamental outlook is positive and getting better.

4. Generally, the time to maturity should be no more than 2 to 3 months.

5. Diversify your Portfolio with 4 or more different stocks.

6. Out of the money options are most often selected since "in the money" options increase the probability of being exercised, even in a flat market.

6. What To Do At Expiration of an Option? Eventually, you reach expiration day. What do you do then?

If the option is still out of the money it is likely that it will just expire worthless and not be exercised. In this case, you need do nothing. If you still want to hold the position, you could "roll out" and write another option against your stock further out in time. Although there is the possibility that an out of the money option will be exercised, this is extremely rare.

If the option is in the money, you can expect the option to be exercised. Depending on your brokerage firm, it is very possible that you don't need to worry about this; everything will be automatic when the stock is called away. What you do need to be aware of, however, is what, if any, fees will be charged in this situation. You will need to be aware of this so that you can plan appropriately when determining whether writing a given covered call will be profitable.

Example: Suppose that you buy 100 shares of XYZ at \$38 and sell calls for \$1/share. In this case, you would receive \$100 in premium for the option you sold. This would make your cost basis on the stock \$37 (\$38 paid per share - \$1 for the premium from the option). If the expiration date arrives and the stock is trading at or below \$40 per share, it is very likely that the option will simply expire worthless and you will keep the premium (in cash). You can then continue to hold the stock and write another option if you choose.

If, however, the stock is trading at \$41, you can expect the stock to be called away. You will be selling it at \$40 - the option's strike price. But remember, you brought in \$1 in premium for the option, so your profit on the trade will be \$3 (bought the stock for \$38, received \$1 for the option, stock called away at \$40). Likewise, if you had bought the stock and not sold the option, your profit in this example would be the same \$3 (bought at \$38, sold at \$41). If the stock was higher than \$41, the trader that held the stock and did not write the Call would be gaining more, whereas for the trader who wrote the covered Call the profits would be capped.

E. SHORT SALES. A “short sale” is the sale of a security that the seller borrows for purpose of the sale. This speculative practice is done in the expectation that the price of a stock is going to fall and the seller will then be able to cover the sale by buying the security back and repaying the “stock loan” at a lower price. The profit would be the difference between the initial selling price and the subsequent purchase price. It is illegal for a seller not to declare a short sale at the time of placing the order.

There are margin rule requirements for a short sale in which 150% of the value of the shares shorted needs to be initially held in the account. Therefore, if the value is \$25,000, the initial margin requirement is \$37,500 (which includes the \$25,000 of proceeds from the short sale). This prevents the proceeds from the sale from being used to purchase other shares before the borrowed shares are returned.

Sometimes people will sell short a stock they already own in order to protect a paper profit. This is know as *selling short against the box*.

VI. TRACING, REIMBURSEMENT AND ECONOMIC CONTRIBUTION IN BROKERAGE ACCOUNTS.

A. TRACING.

Example A-1: Husband has a brokerage account containing only 2,000 shares of GM stock, registered in street name at Brokerage House and no other assets or cash. He tells Broker to sell all GM stock and buy Ford stock. Broker executes the sale and purchase with a few dollars left over. The settlement date on the sale of GM stock & purchase of the Ford stock is the same. What is the character of the Ford stock?

Example A-2: Same as Example A-1, except that on the trade date there were \$1,000 of community property dividends in the brokerage account, but that community property money was withdrawn from the account before the settlement date. What is the character of the Ford stock?

Example A-3: Same as Example A-2, except that \$1,000 of community property dividends were deposited into the brokerage account after the trade date but before the settlement date, and they were still in the account at the time of settlement. What happened to the \$1,000?

Example A-4: During marriage, Husband acquires 23 shares of stock under a dividend reinvestment plan. The underlying stock is separate property. What is the character of the 23 shares?

Example A-5: Husband has separate property securities in a brokerage account, and the brokerage firm sweeps all earnings from the securities account into a cash management account on the last business day of every month. Husband sells separate property stock A on the 3rd day of the month, and the proceeds are credited on the 6th day of the month. In the next two weeks, \$3,000 of dividends are deposited into the securities account. On the 25th day of the month, Husband buys stock B for \$6,000, using money in the securities account. On the 30th day of the month, \$3,000 is “swept” from the securities account into the cash management account. What is the character of stock B? What is the character of the \$3,000 swept into the cash management account?

Example A-6: Husband buys 1,000 shares of stock using funds that are half separate property and half community property. Are 500 shares separate and 500 share community, or is each share half separate and half community?

Example A-7: Husband has a brokerage account containing 2,000 shares of separate property GM stock, and \$5,000 of dividends earned during marriage. Husband sells 500 shares of GM stock for \$15,000, and the proceeds are deposited into the account. Husband tells Broker to buy \$10,000 worth of Ford stock. After the transaction is executed, what is the character of the Ford stock?

Example A-8: Husband buys 1,000 shares of GM stock using his separate property. A week later, he buys another 1,000 shares of GM stock using community property funds. There are no other shares in the account when Husband tells Broker to sell 500 share of GM stock. The trade is executed. The brokerage statement does not allocate which shares were sold. What is the character of the proceeds from sale of the GM stock?

Example A-9: Husband has a brokerage account containing only 2,000 shares of separate property GM stock. The account is a margin account. Husband instructs Broker to buy 1,000 shares of Ford stock, on margin. The trade is executed. What is the character of the Ford stock?

Example A-10: Husband has a brokerage account

containing only separate property shares in a number of different companies. During marriage, Husband's stock broker buys shares in a new company on margin, then pays that margin debt by selling all of Husband's separate property shares. What is the character of the new shares?

Example A-11: Husband has a margin account containing only 2,000 shares of separate property GM stock. Husband tells Broker to sell 500 shares of GM stock "short." The trade is executed and the brokerage statements reflects a deposit of \$32,000 proceeds from the short sale. What is the character of the proceeds from the short sale?

Example A-12: Husband has a brokerage account containing only 2,000 shares of separate property GM stock. The account is a margin account with no margin debt outstanding. Husband tells Broker to sell GM and buy Ford stock. It so happens that the Ford purchase settles the day before the GM stock settles. The brokerage statement show he had a margin balance for 24 hours. What is the character of the Ford stock?

Example A-13: Husband sells a covered Call on his separate property GM stock. Is the obligation on the Call a community property liability or a separate property liability? Does that change if Husband sells his GM stock before the Call expires? If the Call is exercised and Husband transfers his separate property GM stock to the holder of the Call, what claim does Husband's separate property estate have? How is it measured?

Example A-14: Husband sells a naked Call for stock he doesn't own (a naked Call). Is the obligation on the Call a community liability or a separate liability? What if the Call is covered by separate property stock? What if the Call is covered by separate property stock, but the Husband sells the underlying cover before the option expires?

Example A-15: Husband has a margin account containing only 2,000 shares of separate property GM stock. Husband tells Broker to sell a Call for 1,000 shares of Ford stock that he doesn't own. After the transaction is executed, a premium of \$2,000 is credited to Husband's account. What is the character of the premium from selling the Call? Does the result change if the Call is a covered Call on Husband's separate property GM stock?

Example A-16: Husband has a margin account and

instructs Broker to sell a naked Put. What is the character of the premium received from sale of the Put?

Example A-17: Husband owns a separate property zero coupon bond that will mature in 2.5 years. This is a 5-year bond, which husband has held from the date of issuance. Husband instructs Broker to sell the bond. The proceeds from the sale are deposited into the brokerage account. Are any of the proceeds community property? What if Husband holds the bond to maturity and receives the face amount of the bond, are any of the proceeds community property?

Example A-18: On the date of marriage, Husband owns 2,000 shares of GM stock. One day after the wedding, Husband receives a dividend from this stock that is deposited into his brokerage account. Is the dividend separate or community property? What is the result if the dividend is both declared and received during marriage.

Example A-19: Husband's separate property assets in his 401(k) are deposited in a brokerage account. Is tracing any different for that brokerage account than a brokerage account held in his individual name?

Example A-20: On the date of marriage, Husband has a brokerage account. One month after marriage, he adds Wife's name to the account. Is the character of the securities inside the account changed because he added Wife's name?

Example A-21: Husband owns 3,000 shares of GM stock, bought at different times. 1,000 shares were owned prior to marriage. 1,000 shares were purchased during marriage using funds that were half separate and half community property. 1,000 shares were purchased on margin during marriage. The brokerage house reports all the share on one line item of 3,000 shares. Husband sells 500 shares. The brokerage statement does not indicate the date on which the shares sold were originally acquired. What is the character of the 500 shares sold?

Example A-22: Same as Example A-21, only Husband specified in an email at the time that he wanted the broker to sell the stock he most recently acquired. What was the character of the 500 shares sold?

Example A-23: Same as Example A-21, only Husband's accountant reported in the parties' Form 1040 for the year that the stock with highest tax basis was sold. This happens to be the shares acquired on margin.

What was the character of the 500 shares sold?

Example A-24: Same as Example, A-21, except that Husband does not specify at the time which shares are to be sold, and the tax return for the year of sale has not yet been prepared. Upon divorce, Husband says he intended to sell the 100% community property shares. What then is the character of the shares sold?

B. REIMBURSEMENT.

Example B-1: On the date of marriage, Husband has an existing margin loan of \$50,000, all of which was incurred to pay his living expenses and not to acquire property or make capital improvements to property. During marriage he receives dividends from separate property stock that are deposited into the margin account. The brokerage statement reflects that the margin debt was reduced by the amount of dividends received. Is there a community property reimbursement claim? If the margin debt was used to acquire property prior to marriage instead of paying living expenses, does the community estate have an EC claim?

Example B-2: During marriage Husband withdraws \$50,000 in margin funds to pay community living expenses. Husband then pays that margin debt with proceeds from the sale of separate property securities. Does Husband's separate estate have a claim for reimbursement against the community estate?

C. ECONOMIC CONTRIBUTION CLAIM.

Example C-1: On the date of marriage, Husband has a margin loan of \$50,000, all of which was used to acquire securities held in the account. During marriage, Husband receives dividends from separate property stock that are deposited into the margin account. The brokerage statement reflects that the margin debt was reduced by the amount of dividends received. Is there an EC claim?

Example C-2: On the date of marriage, Husband has a margin loan of \$50,000, all of which was used to make the down payment on a house husband bought prior to marriage. During marriage, Husband receives dividends from separate property stock that are deposited into the margin account. The brokerage statement reflects that the margin debt was reduced by the amount of dividends received. Is there an EC claim? In calculating the claim do you consider the equity in the house on the day of first economic contribution or the equity in the securities in the margin account on the day

of first economic contribution?

Example C-3: Husband has a margin brokerage account containing only 2,000 shares of separate property GM stock. Husband buys 500 shares of Ford stock on margin at a cost of \$20,000. Then he buys 500 shares of Proctor & Gamble on margin at a cost of \$15,000. None of the margin debt is paid until Husband sells his 2,000 shares of GM stock for \$60,000, and the margin debt for both margin purchases is then fully discharged. On the date the separate property sales proceeds were credited to Husband's brokerage account, the equity in the Ford stock was \$1,500, and but the Proctor & Gamble stock was trading \$1,000 below its purchase price. Is there an EC claim, and if so, for how much? Is there a reimbursement claim arising from these events? If so, for how much?

Example C-4: During marriage, Husband has a margin account containing only 1,000 share of separate property Ford stock. Using that account, Husband sells 500 shares of Ford stock short. This obligation is his only margin obligation. The short sale is covered by Husband's separate property Ford stock. The price of Ford stock ticks upward, and Husband closes the short sale by selling 500 shares of Ford stock and paying the brokerage firm the proceeds. Is there an EC claim? If so, then what was the net equity in the property on the day of first economic contribution? And what was the equity in the benefitted property on the day of disposition?

Example C-5: During marriage, Husband sells a Call on 500 shares of Ford stock. The Call is covered by separate property Ford stock owned by Husband. The price of Ford stock ticks upward, and the Call is exercised. Husband transfers his Ford stock to the holder of the Call. Is there an EC claim? How is it calculated?

Example C-6: Husband has many shares of separate property stock on deposit in a brokerage account. He uses margin to buy 100 IBM stock at \$100 per share, then sells the IBM stock and pays off that margin debt with the proceeds, with money left over. Is there an EC claim?

Example C-7: Same as Example C-6, except that Husband pays the \$10,000 margin debt on the IBM stock using proceeds from sale of his separate property GM stock. Assume the IBM stock was trading at \$110/share on the date the margin debt was paid off. Is there an EC claim? How is it calculated?

Example C-8: Same as Example C-6, except that the day after the IBM stock was acquired on margin, Husband deposited \$2,000 of his separate property cash into the margin account. The brokerage statement shows that the IBM margin debt was reduced by \$2,000. On that day IBM was trading at \$98/share. Husband later sells separate property GM stock and the proceeds pay the \$8,000 balance of the margin debt. How do you calculate Husband's EC claim against the community estate? Husband's separate property proceeds also paid interest on the margin debt. What claim does Husband's separate estate have for paying the interest?

Example C-8: Husband has the following separate property shares: 1,000 shares of Company A, 1,000 shares of Company B, and 1,000 shares of Company C. During marriage, Husband's stock broker buys 3,000 shares in Company D on margin for \$40,000. It is the only margin debt in the account. Some time later, Husband pays that margin debt, plus accrued interest, by selling all of his separate property shares in Companies A, B & C. At the time the margin debt was paid off, the 3,000 shares in Company D had climbed to \$50,000 value. The shares are still owned at the time of divorce, only they are now worth \$60,000. Is there an EC claim? For how much?

Example C-9: Husband owned 1,000 shares in Companies A, B and C, as his separate property. He buys 3,000 shares in Company D on margin for \$40,000. Three days after the margin purchase, Husband sells 100 shares of Company A stock for \$3,000. The proceeds pay down the margin debt to \$37,000. The stock in Company D was still worth \$40,000 at that time. A month later Husband sells the rest of his shares in Company A for \$27,000, and the proceeds pay down the margin debt to \$10,000. A month after that, Husband sells all of his shares in Companies B and C, and the proceeds extinguish the margin debt. What is the date of first economic contribution? What was the net equity in the benefitted property as of the day of the first economic contribution? What is the fraction in the EC calculation?

Example C-10: During marriage, Husband made several hundred margin purchases and also has withdrawn margin funds from his margin account to pay living expenses. There have been multiple instances where the margin debt has been paid down using the proceeds from sale of Husband's separate property securities. Does it matter that some of the margin debt was used to acquire securities and some was used to

pay living expenses? How do we determine which margin debt was used to acquire property, and which was used to pay living expenses?

Example C-11: Husband buys a Call on Stock X, using margin debt to pay the premium. Husband pays margin debt equal to the premium on the Call using separate property funds. Is there an EC claim? How do you determine the net equity on the day of first economic contribution? What happens to the EC claim if the Call expires without being exercised?

Example C-12: Husband withdraws \$40,000 on margin to make capital improvement to his separate property house. He pays off that margin debt with proceeds from sale of separate property securities. Does the community estate have an EC claim? Does Husband's separate estate have an EC claim? Do the claims offset exactly?

VII. APPENDIX.

A. PJC REIMBURSEMENT. State Bar of Texas Pattern Jury Charges PJC 204-9A sets out instructions to the jury on marital property reimbursement.

PJC 204-9A

Texas law recognizes three marital estates: the community property owned by the spouses together and referred to as the community estate; the separate property owned individually by the husband and referred to as a separate estate; and the separate property owned individually by the wife, also referred to as a separate estate.

A claim for reimbursement for funds expended by an estate to pay debts, taxes, interest, or insurance for the property of another estate is measured by the amount paid. An offset against a claim for reimbursement for funds expended by an estate to pay debts, taxes, interest, or insurance for the property of another estate is measured by the value of any related benefit received by the paying estate, such as the fair value of the use of the property by the paying estate, income received by the paying estate from the property, and any reduction in the amount of any income tax obligation of the paying estate by virtue of the paying estate's claiming tax-deductible items relating to the property, such as depreciation, interest, taxes, maintenance, and other deductible payments.

A claim for reimbursement of funds expended by

an estate for improvements to real property of another estate is measured by the enhancement in value to the receiving estate resulting from such expenditures. An offset against a claim for reimbursement for improvements to real property of another estate is measured by the value of any related benefit received by the paying estate, such as the fair value of the use of the property by the paying estate, income received by the paying estate from the property, and any reduction in the amount of any income tax obligation of the paying estate by virtue of the paying estate's claiming tax-deductible items relating to the property, such as depreciation, interest, taxes, maintenance, and other deductible payments.

A claim for reimbursement to the community estate for the spouses' time, toil, talent, or effort expended to enhance a spouse's separate estate is measured by the value of such community time, toil, talent, and effort other than that reasonably necessary to manage and preserve the separate estate, and for which the community did not receive adequate compensation. An offset against a claim for reimbursement for the spouses' time, toil, talent, or effort expended to enhance a spouse's separate estate is measured by the compensation paid to the community in the form of salary, bonuses, dividends, and other fringe benefits.

Texas law does not recognize a marital estate's claim for reimbursement for the payment of child support, alimony, or spousal maintenance; for living expenses of a spouse or child of a spouse; for contributions of property of nominal value; for the payment of a liability of a nominal amount; or for a student loan owed by a spouse.

A spouse seeking reimbursement has the burden of proving each element of the claim by a preponderance of the evidence. However, a spouse seeking reimbursement to a separate estate must prove by clear and convincing evidence that the funds expended were separate property. "Clear and convincing evidence" is that measure or degree of proof that produces a firm belief or conviction that the allegations sought to be established are true. The amount of the claim is measured as of the time of trial.

A spouse seeking an offset against a claim for reimbursement has the burden of proving each element of the claim by a preponderance of the evidence. The amount of the offset is measured as of the time of trial.

B. ECONOMIC CONTRIBUTION/REIMBURSE-

MENT STATUTE.

TFC § 3.401. Definitions

In this subchapter:

- (1) "Claim for economic contribution" means a claim made under this subchapter.
- (2) "Economic contribution" means the contribution to a marital estate described by Section 3.402.
- (3) "Equity" means, with respect to specific property owned by one or more marital estates, the amount computed by subtracting from the fair market value of the property as of a specific date the amount of a lawful lien specific to the property on that same date.
- (4) "Marital estate" means one of three estates:
 - (A) the community property owned by the spouses together and referred to as the community marital estate;
 - (B) the separate property owned individually by the husband and referred to as a separate marital estate; or
 - (C) the separate property owned individually by the wife, also referred to as a separate marital estate.
- (5) "Spouse" means a husband, who is a man, or a wife, who is a woman. A member of a civil union or similar relationship entered into in another state between persons of the same sex is not a spouse.

TFC § 3.402. Economic Contribution

(a) For purposes of this subchapter, "economic contribution" is the dollar amount of:

- (1) the reduction of the principal amount of a debt secured by a lien on property owned before marriage, to the extent the debt existed at the time of marriage;
- (2) the reduction of the principal amount of a debt secured by a lien on property received by a spouse by gift, devise, or descent during a marriage, to the extent the debt existed at the time the property was received;
- (3) the reduction of the principal amount of that part of a debt, including a home equity loan:
 - (A) incurred during a marriage;
 - (B) secured by a lien on property; and

- (C) incurred for the acquisition of, or for capital improvements to, property;
- (4) the reduction of the principal amount of that part of a debt:
 - (A) incurred during a marriage;
 - (B) secured by a lien on property owned by a spouse;
 - (C) for which the creditor agreed to look for repayment solely to the separate marital estate of the spouse on whose property the lien attached; and
 - (D) incurred for the acquisition of, or for capital improvements to, property;
- (5) the refinancing of the principal amount described by Subdivisions (1)-(4), to the extent the refinancing reduces that principal amount in a manner described by the appropriate subdivision; and
- (6) capital improvements to property other than by incurring debt.

(b) "Economic contribution" does not include the dollar amount of:

- (1) expenditures for ordinary maintenance and repair or for taxes, interest, or insurance; or
- (2) the contribution by a spouse of time, toil, talent, or effort during the marriage.

TFC § 3.403. Claim Based on Economic Contribution

(a) A marital estate that makes an economic contribution to property owned by another marital estate has a claim for economic contribution with respect to the benefitted estate.

(b) The amount of the claim under this section is equal to the product of:

- (1) the equity in the benefitted property on the date of dissolution of the marriage, the death of a spouse, or disposition of the property; multiplied by
- (2) a fraction of which:
 - (A) the numerator is the economic contribution to the property owned by the benefitted marital estate by the contributing marital estate; and
 - (B) the denominator is an amount equal to the sum of:
 - (i) the economic contribution to the

property owned by the benefitted marital estate by the contributing marital estate; and

(ii) the contribution by the benefitted estate to the equity in the property owned by the benefitted estate.

(b-1) The amount of the contribution by the benefitted marital estate under Subsection (b)(2)(B)(ii) is measured by determining:

- (1) if the benefitted estate is the community property estate:
 - (A) the net equity of the community property estate in the property owned by the community property estate as of the date of the first economic contribution to that property by the contributing separate property estate; and
 - (B) any additional economic contribution to the equity in the property owned by the community property estate made by the benefitted community property estate after the date described by Subdivision (A); or
- (2) if the benefitted estate is the separate property estate of a spouse:
 - (A) the net equity of the separate property estate in the property owned by the separate property estate as of the date of the first economic contribution to that property by the contributing community property estate or the separate property estate of the other spouse; and
 - (B) any additional contribution to the equity in the property owned by the separate property estate made by the benefitted separate property estate after the date described by Subdivision (A).

(c) The amount of a claim under this section may be less than the total of the economic contributions made by the contributing estate, but may not cause the contributing estate to owe funds to the benefitted estate.

(d) The amount of a claim under this section may not exceed the equity in the property on the date of dissolution of the marriage, the death of a spouse, or disposition of the property.

(e) The use and enjoyment of property during a mar-

riage for which a claim for economic contribution to the property exists does not create a claim of an offsetting benefit against the claim.

TFC § 3.404. Application of Inception of Title Rule; Ownership Interest Not Created

(a) This subchapter does not affect the rule of inception of title under which the character of property is determined at the time the right to own or claim the property arises.

(b) The claim for economic contribution created under this subchapter does not create an ownership interest in property, but does create a claim against the property of the benefitted estate by the contributing estate. The claim matures on dissolution of the marriage or the death of either spouse.

TFC § 3.405. Management Rights

This subchapter does not affect the right to manage, control, or dispose of marital property as provided by this chapter.

TFC § 3.406. Equitable Lien

(a) On dissolution of a marriage, the court shall impose an equitable lien on property of a marital estate to secure a claim for economic contribution in that property by another marital estate.

(b) On the death of a spouse, a court shall, on application for a claim of economic contribution brought by the surviving spouse, the personal representative of the estate of the deceased spouse, or any other person interested in the estate, as defined by Section 3, Texas Probate Code, impose an equitable lien on the property of a benefitted marital estate to secure a claim for economic contribution by a contributing marital estate.

(c) Subject to homestead restrictions, an equitable lien under this section may be imposed on the entirety of a spouse's property in the marital estate and is not limited to the item of property that benefitted from an economic contribution.

TFC § 3.407. Offsetting Claims

The court shall offset a claim for one marital estate's economic contribution in a specific asset of a second marital estate against the second marital estate's claim for economic contribution in a specific asset of the first

marital estate.

TFC § 3.408. Claim for Reimbursement

(a) A claim for economic contribution does not abrogate another claim for reimbursement in a factual circumstance not covered by this subchapter. In the case of a conflict between a claim for economic contribution under this subchapter and a claim for reimbursement, the claim for economic contribution, if proven, prevails.

(b) A claim for reimbursement includes:

- (1) payment by one marital estate of the unsecured liabilities of another marital estate; and
- (2) inadequate compensation for the time, toil, talent, and effort of a spouse by a business entity under the control and direction of that spouse.

(c) The court shall resolve a claim for reimbursement by using equitable principles, including the principle that claims for reimbursement may be offset against each other if the court determines it to be appropriate.

(d) Benefits for the use and enjoyment of property may be offset against a claim for reimbursement for expenditures to benefit a marital estate on property that does not involve a claim for economic contribution to the property.

TFC § 3.409. Nonreimbursable Claims

The court may not recognize a marital estate's claim for reimbursement for:

- (1) the payment of child support, alimony, or spousal maintenance;
- (2) the living expenses of a spouse or child of a spouse;
- (3) contributions of property of a nominal value;
- (4) the payment of a liability of a nominal amount; or
- (5) a student loan owed by a spouse.

TFC § 3.410. Effect of Marital Property Agreements

A premarital or marital property agreement, whether executed before, on, or after September 1, 1999, that satisfies the requirements of Chapter 4 is effective to

waive, release, assign, or partition a claim for economic contribution under this subchapter to the same extent the agreement would have been effective to waive, release, assign, or partition a claim for reimbursement under the law as it existed immediately before September 1, 1999, unless the agreement provides otherwise.

C. PJC ON ECONOMIC CONTRIBUTION CLAIMS. PJC 204 addresses economic contribution claims.

PJC 204-1 Economic Contribution—Instructions

Texas law recognizes three marital estates: the community property owned by the spouses together, the separate property owned individually by the husband, and the separate property owned individually by the wife.

A spouse must prove by clear and convincing evidence that funds expended were the separate property of that spouse. "Clear and convincing evidence" is that measure or degree of proof that produces a firm belief or conviction that the allegations sought to be established are true.

"Fair market value" means the amount that would be paid in cash by a willing buyer who desires to buy, but is not required to buy, to a willing seller who desires to sell, but is under no necessity of selling.

In answering Questions 3 through 10, do not consider expenditures for ordinary maintenance and repair, expenditures for taxes, interest, or insurance, or the contribution by a spouse of time, toil, talent, or effort during the marriage.

The principal amount of a debt referred to in Questions 3, 4, 6, and 9 may be reduced by payment on the principal of the debt and by refinancing, to the extent the refinancing reduces the principal amount in the manner described in the question.

PJC 204-2 Economic Contribution—Equity at Date of Dissolution of Marriage or Disposition of Property

QUESTION 1

With respect to PROPERTY ITEM OF PARTY A, state in dollars the amount of each of

the following on CURRENT DATE OR DATE OF PROPERTY DISPOSITION:

1. the fair market value

Answer: \$ _____

2. the principal amount of LIENS

Answer: \$ _____

If in answer to Question 1 you have found that the fair market value is less than or equal to the principal amount of debt, do not answer the following questions. Otherwise, answer the following questions.

PJC 204-3 Economic Contribution—Equity at Date of First Economic Contribution by Contributing Estate

QUESTION 2

With respect to PROPERTY ITEM OF PARTY A, state in dollars the amount of each of the following on DATE OF FIRST ECONOMIC CONTRIBUTION BY THE COMMUNITY ESTATE:

1. the fair market value

Answer: \$ _____

2. the principal amount of LIENS

Answer: \$ _____

PJC 204-4 Economic Contribution—Reduction of Debt Secured by Property Owned before Marriage

QUESTION 3

With respect to PROPERTY ITEM OF PARTY A, state in dollars the amount, if any, of the reduction of the principal amount of DEBT W, to the extent the debt existed at the time of marriage-

1. by the community estate

Answer: \$ _____

2. after DATE OF FIRST ECONOMIC CONTRIBUTION BY THE COMMUNITY ESTATE by PARTY A's separate estate, as proved by clear and convincing evidence

Answer: \$ _____

PJC 204-5 Economic Contribution—Reduction of Debt Secured by Property Received by Spouse after Marriage by Gift, Devise, or Descent

QUESTION 4

With respect to PROPERTY ITEM OF PARTY A, state in dollars the amount, if any, of the reduction of the principal amount of DEBT X, to the extent the debt existed at the time PARTY A received the property-

1. by the community estate

Answer: \$ _____

2. after DATE OF FIRST ECONOMIC CONTRIBUTION BY THE COMMUNITY ESTATE by PARTY A's separate estate, as proved by clear and convincing evidence

Answer: \$ _____

PJC 204-6 Economic Contribution—Reduction of Debt Incurred during Marriage to Acquire or Improve Property

QUESTION 5

Was DEBT Y incurred during the marriage for capital improvements to PROPERTY ITEM OF PARTY A?

Answer "Yes" or "No."

Answer:

If you have answered Question 5 "Yes," then answer Question 6. Otherwise, do not answer Question 6.

QUESTION 6

State in dollars the amount, if any, of the reduction of the principal amount of DEBT Y-

1. by the community estate

Answer: \$ _____

2. after DATE OF FIRST ECONOMIC CONTRIBUTION BY THE COMMUNITY ESTATE by PARTY A's separate estate, as proved by clear and convincing evidence

Answer: \$ _____

PJC 204-7 Economic Contribution—Reduction of Debt Incurred during Marriage to Acquire or Improve Separate Property—Separate-Estate Debt

QUESTION 7

Did CREDITOR FOR DEBT Z agree to look for repayment solely to the separate estate of PARTY A?

Answer "Yes" or "No."

Answer:

If you have answered Question 7 "Yes," then answer Question 8. Otherwise, do not answer Question 8.

QUESTION 8

Was DEBT Z incurred during the marriage to acquire PROPERTY ITEM OF PARTY A?

Answer "Yes" or "No."

Answer:

If you have answered Question 8 "Yes," then answer Question 9. Otherwise, do not answer Question 9.

QUESTION 9

State in dollars the amount, if any, of the reduction of the principal amount of DEBT Z-

1. by the community estate

Answer: \$ _____

2. after DATE OF FIRST ECONOMIC CONTRIBUTION BY THE COMMUNITY ESTATE by PARTY A's separate estate, as proved by

clear and convincing evidence

Answer: \$ _____

PJC 204-8 Economic Contribution—Capital Improvements—Other Than by Incurring Debt

QUESTION 10

State in dollars the amount, if any, expended for capital improvements to PROPERTY ITEM OF PARTY A other than by incurring debt-

1. by the community estate

Answer: \$ _____

2. after DATE OF FIRST ECONOMIC CONTRIBUTION BY THE COMMUNITY ESTATE by PARTY A's separate estate, as proved by clear and convincing evidence

Answer: \$ _____

D. GLOSSARY FOR TRANSACTIONS INVOLVING SECURITIES. This glossary was assembled from a number of financial sites on the World Wide Web. No attribution is made to sources, and no assurance is given about accuracy.

Auction market – The system of trading securities through brokers or agents on an exchange such as the New York Stock Exchange. Buyers compete with other buyers while sellers compete with other sellers for the most advantageous price.

Bid and Asked – Often referred to as a quotation or quote. The bid is the highest price anyone wants to pay for a security at a given time, the asked is the lowest price anyone will take at the same time. (See: Quote)

Blue chip – A company known nationally for the quality and wide acceptance of its products or services, and for its ability to make money and pay dividends.

Bond – Basically an IOU or promissory note of a government entity or private or public corporation, usually issued in multiples of \$1,000 or \$5,000, although \$100 and \$500 denominations are not unknown. A bond is evidence of a debt on which the issuing entity usually promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. In every case a bond represents debt - its holder is a creditor of the

bond issuer and not a part owner, as is a shareholder. Types of bonds include US government bonds, federal agency securities, municipal securities, asset backed securities, corporate bonds, zero coupon bonds, index linked bonds, and convertible bonds.

Broker – An agent who handles the public's orders to buy and sell securities, commodities or other property. A commission is charged for this service.

Brokerage account – A customer's account at a brokerage firm. There are three kinds of brokerage accounts. The most basic kind is a *cash-management account*, into which investors place money in order to make trades. There must be enough money in the account to cover the trade at the time of its execution (including both the price of the security and the commission), or the investor must be able to pay for the trade within three days (which is called the settlement date). Some brokerage firms accept credit cards to fund cash accounts, but the most require cash or a personal check. Such an account is often a good substitute for a bank account. A second, more sophisticated kind of brokerage account is a *margin account*, which allows an investor to buy securities with money borrowed from the broker. The Federal Reserve limits margin borrowing to at most 50% of the amount invested, but some brokerage firms have even stricter requirements, especially for volatile stocks. Brokerage firms charge a relatively low interest rate on margin loans in order to encourage investors to buy on margin. A third kind of brokerage account is a *discretionary account*, which permits the broker to buy and sell shares for the investor without first contacting the investor for approval. A discretionary account is an effective source of complicated EC claims.

Broker's Call Rate – Interest rate that brokers pay to borrow from banks to cover the positions of their customers who buy on margin.

Brokers' loans – Money borrowed by brokers from banks or other brokers for a variety of uses. It may be used by specialists to help finance inventories of stock they deal in; by brokerage firms to finance the underwriting of new issues of corporate and municipal securities; to help finance a firm's own investments; and to help finance the purchase of securities for customers who prefer to use the broker's credit when they buy securities. (See: Margin)

Buy and write -- A strategy in which the investor buys the underlying security and writes covered calls on the

securities held to cover them. In other words, investors collect the premium for selling the call and receive any dividends earned on the securities. However, the investor gives up potential upside because they will be required to sell the security should the call buyer exercise their right to buy at the strike price. This is a conservative options strategy because the investor owns the underlying security and is therefore protected should the option buyer exercise their right to buy the security at the strike price.

Capital gain or capital loss – Profit or loss from the sale of a capital asset.

Capital stock – All shares representing ownership of a business, including preferred and common.

Cash sale – A transaction on the floor of the stock exchange that calls for delivery of the securities the same day. In "regular way" trade, the seller is to deliver on the third business day, except for bonds, which are the next day.

Certificate fees – The fee the broker charges for sending share certificates. Once certificates are received, the shares are in your sole possession.

Collateral – Securities or other property pledged by a borrower to secure repayment of a loan.

Commercial paper – Debt instruments issued by companies to meet short-term financing needs.

Commission – The broker's basic fee for purchasing or selling securities or property as an agent.

Commission broker – An agent who executes the public's orders for the purchase or sale of securities or commodities.

Commodities – Investments made in bulk goods such as grains, metals, and foods. For the most part, the price of the commodity is determined by supply of the commodity and the risk factors that may effect supply. Commodity risk is unique to the product being sold. For example, drought would have a bigger impact on grain prices than on copper. All commodity prices can be subject to acts of nature: fire, wind, drought, flood disease, and insect. They can also be affected by unpredictable governmental legislation, like import-export quotas, embargoes, subsidies, and foreign exchange re-valuations.

Common stock – Securities that represent an ownership interest in a corporation. If the company has also issued preferred stock, both common and preferred have ownership rights. Common stockholders assume the greater risk, but generally exercise the greater control and may gain the greater award in the form of dividends and capital appreciation. The terms common stock and capital stock are often used interchangeably when the company has no preferred stock.

Convertible – A bond, debenture or preferred share that may be exchanged by the owner for common stock or another security, usually of the same company, in accordance with the terms of the issue.

Coupon bond – Bond with interest coupons attached. The coupons are clipped as they come due and presented by the holder for payment of interest.

Cumulative preferred – A stock having a provision that if one or more dividends are omitted, the omitted dividends must be paid before dividends may be paid on the company's common stock.

Day order – An order to buy or sell that, if not executed, expires at the end of trading day on which it was entered.

Dealer – An individual or firm in the securities business who buys and sells stocks and bonds as a principal rather than as an agent. The dealer's profit or loss is the difference between the price paid and the price received for the same security. The dealer's confirmation must disclose to the customer that the principal has been acted upon. The same individual or firm may function, at different times, either as a broker or dealer.

Debenture – A promissory note backed by the general credit of a company and usually not secured by a mortgage or lien on any specific property.

Debit balance – In a customer's margin account, that portion of the purchase price of stock, bonds or commodities that is covered by credit extended by the broker to the margin customer.

Depository Trust Company (DTC) – A central securities certificate depository through which members effect security deliveries between each other via computerized bookkeeping entries thereby reducing the physical movement of stock certificates.

Derivative – In finance, a security whose price is

dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage. Futures contracts, forward contracts, options and swaps are the most common types of derivatives. Because derivatives are just contracts, just about anything can be used as an underlying asset. There are even derivatives based on weather data, such as the amount of rain or the number of sunny days in a particular region.

Derivatives are generally used to hedge risk, but can also be used for speculative purposes. For example, a European investor purchasing shares of an American company off of an American exchange (using American dollars to do so) would be exposed to exchange-rate risk while holding that stock. To hedge this risk, the investor could purchase currency futures to lock in a specified exchange rate for the future stock sale and currency conversion.

Discretionary account – An account in which the customer gives the broker or someone else discretion to buy and sell securities or commodities, including selection, timing, amount, and price to be paid or received.

Diversification – Spreading investments among different types of securities and various companies in different fields.

Dividend – The payment designated by the board of directors to be distributed pro rata among the shares outstanding. On preferred shares, it is generally a fixed amount. On common shares, the dividend varies with the fortunes of the company and the amount of cash on hand, and may be omitted if business is poor or the directors determine to withhold earnings to invest in plant and equipment. Sometimes a company will pay a dividend out of past earnings even if it is not currently operating at a profit.

Dividend Reinvestment Plans – Some companies will automatically reinvest dividends in additional shares for you for no charge.

Dollar-cost-averaging – A system of buying securities at regular intervals with a fixed dollar amount. Under this system investors buy by the dollars' worth rather than by the number of shares. If each investment is of

the same number of dollars, payments buy more shares when the price is low and fewer when it rises. Thus temporary downswings in price benefit investors if they continue periodic purchases in both good and bad times, and the price at which the shares are sold is more than their average cost. Dollar-cost-averaging does not assure a profit and does not protect against loss in declining markets. Since dollar-cost-averaging involves continuous investment in securities regardless of fluctuating price levels of such securities, investors should consider their financial ability to continue purchases through periods of low price levels.

Equity – The ownership interest of common and preferred stockholders in a company. Also refers to excess of value of securities over the debit balance in a margin account.

Equity collar – Where an investor simultaneously sells an out-of-the money call option and purchases an out-of-the money put option on the underlying position. The strike price on the call option is set so that the premium earned by selling the call option exactly offsets the premium owed from purchasing the put option, creating a zero-premium collar. By selling the call option, the investor “sells away” the ability to benefit from any price appreciation above the level of the call strike price. The strike price of the put provides a level of downside protection. By constructing a zero-premium collar, the investor, for no up-front cost, has effectively defined a “range” for the net value of the underlying equity position at the maturity of the hedge. Once the shares have been “collared,” they are very secure as collateral, and the financial institution that underwrote the collar will lend the investor money against the protected position at a comparatively attractive interest rate. Because the put option ensures a minimum value for the shares at maturity, the investor should never face a margin call on this borrowing. Only equities registered under the Securities Act of 1933 may be “collared.”

Exchange Fund – An exchange fund (sometimes referred to as a swap fund) is a limited partnership in which all partners share a single problem: they each have a concentrated position in a highly-appreciated stock. By contributing shares of their highly-appreciated securities in exchange for interests in a partnership comprised of investors in similar situations, they can diversify their holdings without incurring immediate capital gains taxes. And, because contributing stock to an exchange fund is likely to keep the stock from being sold in the public markets for several years,

corporate counsel and financial officers generally view these transactions favorably. In most cases, holders of restricted stock can invest in exchange funds, subject to approval by his or her corporate counsel. Some exchange funds accept cash investors or may require a portion of each investment to be made in cash. A cash investment in an exchange fund may satisfy a particular investment objective and/or wealth transfer need.

Ex-dividend – A synonym for "without dividend." The buyer of a stock selling ex-dividend does not receive the recently declared dividend. When stocks go ex-dividend, the stock tables include the symbol "x" following the name.

Face value – The value of a bond that appears on the face of the bond, unless the value is otherwise specified by the issuing company. Face value is ordinarily the amount the issuing company promises to pay at maturity. Face value is not an indication of market value. Sometimes referred to as par value.

FIFO – A method of measuring cost of goods sold or valuing remaining inventory, where the business assumes that the first unit making its way into inventory is the first sold. For example, let's say that a business buys 2,000 widgets at a cost of \$1 each, and 2,000 more at cost of \$1.25 each, and uses 900 widgets to produce units of finished product that are sold to customers during a tax year. FIFO assumes that all 900 widgets contributing to the cost of goods sold were acquired at \$1.00 apiece, rather than \$1.25 apiece. FIFO results in a lower cost of goods sold, which improves profitability. However, with higher profitability comes higher taxes which must be paid out of cash, reducing net after tax cash flow. So under FIFO the business declares more profits, and pays more taxes, and therefore has less cash left after tax, than if the more expensive widgets had been treated as part of cost of goods sold, which would have reduced profits, and therefore taxes, and resulted in there being more net after tax cash flow. FIFO gives a better indication of the value of ending inventory (on the balance sheet), but it also reduces net after tax cash flow.

Flat income bond – This term means that the price at which a bond is traded includes consideration for all unpaid accruals of interest. Bonds that are in default of interest or principal are traded flat. Income bonds that pay interest only to the extent earned are usually traded flat. All other bonds are usually dealt in "and interest," which means that the buyer pays to the seller the market price plus interest accrued since the last payment date.

Floor – The huge trading area - about the size of a football field - where stocks, bonds and options are bought and sold on the New York Stock Exchange.

Floor broker – A member of the stock exchange who executes orders on the floor of the Exchange to buy or sell any listed securities.

Formula investing – An investment technique. One formula calls for the shifting of funds from common shares to preferred shares or bonds as a selected market indicator rises above a certain predetermined point - and the return of funds to common share investments as the market average declines.

Forward Contract – A cash market transaction in which delivery of the commodity is deferred until after the contract has been made. Although the delivery is made in the future, the price is determined on the initial trade date. Most forward contracts don't have standards and aren't traded on exchanges. A farmer would use a forward contract to "lock-in" a price for his grain for the upcoming fall harvest.

Free and open market – A market in which supply and demand are freely expressed in terms of price. Contrasts with a controlled market in which supply, demand and price may all be regulated.

Futures – Contracts that must be exercised at a future date. There is no premium charged to enter a futures contract, and money only changes hands at the time of expiration. Unlike options, which give the holder a right to transact, futures obligate the parties to transact.

General mortgage bond – A bond that is secured by a blanket mortgage on the company's property but may be outranked by one or more other mortgages.

Gilt-edged – High-grade bond issued by a company that has demonstrated its ability to earn a comfortable profit over a period of years and pay its bondholders their interest without interruption.

Good delivery – Certain basic qualifications must be met before a security sold on the Exchange may be delivered. The security must be in proper form to comply with the contract of sale and to transfer title to the purchaser.

Good 'til canceled (GTC) or open order - An order to buy or sell that remains in effect until it is either executed or canceled.

Government bonds – Obligations of the U.S. Government, regarded as the highest grade securities issues.

Growth stock – Stock of a company with a record of growth in earnings at a relatively rapid rate.

Hedge fund – Investment funds which use derivatives to either maximize growth or minimize losses. They are generally considered to be higher risk due to the complexity of their strategies and the high turnover of investments within these funds.

Hedging – A strategy used to offset risk. For example, a cereal manufacturer might fear that their ingredient costs will rise, so they will "hedge" their risk by purchasing a futures contract on grain. In this case, they use the futures contract to lock in a price for grain today so that they are not stuck paying the higher prices later.

Hybrid Security – A security that combines two or more different financial instruments. Hybrid securities generally combine both debt and equity characteristics. The most common example is a convertible bond that has features of an ordinary bond, but is heavily influenced by the price movements of the stock into which it is convertible.

Hypothecation – The pledging of securities as collateral - for example, to secure the debit balance in a margin account.

Inactivity Fees – The fee the broker charges when you have not made a buy/sell during a specified period of time.

"In the money" option -- the opposite of an "out of the money" option. With an "in the money" call, the exercise price is below the market price so the buyer can exercise their right to buy the security at a price below what they'd find in the open market. An "in the money" put is one where the exercise price is significantly above the market price for the underlying security.

Income bond – Generally income bonds promise to repay principal but to pay interest only when earned. In some cases unpaid interest on an income bond may accumulate as a claim against the corporation when the bond becomes due. An income bond may also be issued in lieu of preferred stock.

Indenture – A written agreement under which bonds

and debentures are issued, setting forth maturity date, interest rate and other terms.

Independent broker – Member on the floor of the NYSE who executes orders for other brokers having more business at that time than they can handle themselves, or for firms who do not have their exchange member on the floor.

Index – A statistical yardstick expressed in terms of percentages of a base year or years. For instance, the NYSE Composite Index of all NYSE common stocks is based on 1965 as 50. An index is not an average.

Initial margin – Amount of cash or eligible securities required by the Federal Reserve Board and one's brokerage to be deposited with one's brokerage before buying on margin. Also called original margin.

Institutional investor – An organization whose primary purpose is to invest its own assets or those held in trust by it for others. Includes pension funds, investment companies, insurance companies, universities and banks.

Interest – Payments borrowers pay lenders for the use of their money. A corporation pays interest on its bonds to its bondholders.

Investment – The use of money for the purpose of making more money, to gain income, increase capital, or both.

Investment company – A company or trust that uses its capital to invest in other companies. There are two principal types: the closed-end and the open-end, or mutual fund. Shares in closed-end investment companies, some of which are listed on the New York Stock Exchange, are readily transferable in the open market and are bought and sold like other shares. Capitalization of these companies remains the same unless action is taken to change, which is seldom. Open-end funds sell their own shares to investors, stand ready to buy back their old shares, and are not listed. Open-end funds are so called because their capitalization is not fixed; they issue more shares as people want them.

IRA – Individual retirement account. A pension plan with tax advantages. IRAs permit investment through intermediaries like mutual funds, insurance companies and banks, or directly in stocks and bonds through stockbrokers.

IRA Custodian fees – The fee the broker charges for maintaining an IRA. May also be called an IRA maintenance fee. Brokers may also charge an initial IRA setup fee. Many brokers charge no fees for maintaining an IRA.

LIFO – An accounting term reflecting one of several different approaches to figuring the cost of goods sold and valuing remaining inventory. The LIFO, or Last In-First Out, method of inventory costing assumes that the company is using the most recently-acquired items out of its inventory first. The recently-acquired items were usually more expensive than items previously purchased, due to inflation and other factors. A trend has existed, since the early 1970s, toward the increased use of LIFO. This has been attributed to a realization by businessmen that, in an inflationary economy where inventory replacement items cost more each year, a method other than LIFO tends to convert inflation into apparent profits, which increases taxable income and therefore increases taxes, while leaving actual cash income the same, resulting in overall reduced cash flow. The LIFO costing method contrasts with the first in, first out (FIFO) inventory method, which assumes that the cost of items sold in a period reflects the oldest cost in inventory just before sale. *See* FIFO in this Glossary.

Limit, limited order, or limited price order – An order to buy or sell a stated amount of a security at a specified price, or at a better price, if obtainable after the order is represented in the trading crowd.

Limit order – When an investor wishes to buy/sell shares at some predetermined price. For example, if you wished to purchase Microsoft at no more than \$90 per share and it is selling at \$95 now, you can place a limit order on Microsoft at \$90. Some brokers charge a higher commission for limit orders than for market orders.

Liquidation – The process of converting securities or other property into cash. The dissolution of a company, with cash remaining after sale of its assets and payment of all indebtedness being distributed to the shareholders.

Listed stock – The stock of a company that is traded on a securities exchange.

Locked in – Investors are said to be locked in when they have profit on a security they own but do not sell because their profit would immediately become subject

to the capital gains tax.

Long – Signifies ownership of securities. "I am long 100 U.S. steel" means the speaker owns 100 shares.

Margin – The amount paid by the customer when using a broker's credit to buy or sell a security. Under Federal Reserve regulations, the initial margin requirement since 1945 has ranged from the current rate of 50% of the purchase price up to 100%. Borrowing money from a broker using the portfolio as collateral. Margin is usually used to purchase additional securities. In many divorces, however, borrowed funds are removed from the margin account to buy other investments like real estate, or consumer items like cars, or to pay living expenses.

Margin account – A brokerage account in which the brokerage firm lends the customer cash with which to purchase securities.

Margin call – A demand upon a customer to put up money or securities with the broker. The call is made when a purchase is made; also if a customer's account declines below a minimum standard set by the exchange or by the firm.

Margin loan – A loan from a broker to a client that essentially functions as a margin account. The funds may be used for any purpose, and the loan is secured with securities owned by the client.

Margin rate – Brokers will typically charge their margin customers an interest rate above the brokers call rate, depending on their account balance. This is called the margin rate.

Market order – An order to buy or sell a stated amount of a security at the most advantageous price obtainable after the order is represented in the trading crowd. When an investor buys/sells shares at current market price.

Market price – The last reported price at which the stock or bond sold, or the current quote.

Maturity – The date on which a loan or bond comes due and is to be paid off.

Money market fund – A mutual fund whose investments are in high-yield money market instruments such as federal securities, CDs and commercial paper. Its intent is to make such instruments, normally purchased

in large denominations by institutions, available indirectly to individuals.

Mortgage bond – A bond secured by a mortgage on a property. The value of the property may or may not equal the value of the bonds issued against it.

Municipal bond – A bond issued by a state or a political subdivision, such as county, city, town or village. The term also designates bonds issued by state agencies and authorities. In general, interest paid on municipal bonds is exempt from federal income taxes and state and local taxes within the state of issue. However, interest may be subject to the alternative minimum tax (AMT).

Naked options – "naked" refers to strategies in which the underlying stock is not owned and options are written against this phantom stock position.

Naked shorting – The illegal practice of short selling shares that have not been affirmatively determined to exist. Ordinarily, traders must borrow a stock, or determine that it can be borrowed, before they sell it short. However, some professional investors and hedge funds take advantage of loopholes in the rules to sell shares without making any attempt to borrow the stock.

NASDAQ – An automated information network that provides brokers and dealers with price quotations on securities traded over-the-counter. NASDAQ is an acronym for National Association of Securities Dealers Automated Quotations.

Negotiable – Refers to a security, the title to which is transferable by delivery.

Net capital ratio – SEC requirement that all broker/dealers maintain a ratio of no more than 15:1 between indebtedness and liquid assets. Indebtedness includes money owed to the firm, margin loans, and commitments to purchase securities. Liquid assets include cash and assets which are easily converted to cash. The purpose of this rule is to make sure that the broker/dealer will be able to maintain its operations and not adversely affect the capital markets even if it suffers a large amount of bad debt. Called net capital rule.

Net change – The change in the price of a security from the closing price on one day to the closing price the next day on which the stock is traded. The net change is ordinarily the last figure in the newspaper stock price list. The mark +1 1/8 means up \$1.125 a

share from the last sale on the previous day the stock traded.

New issue – A stock or bond sold by a corporation for the first time. Proceeds may be used to retire outstanding securities of the company, for new plant or equipment, for additional working capital, or to acquire a public ownership interest in the company for private owners.

New York Futures Exchange (NYFE) – A subsidiary of the New York Stock Exchange devoted to the trading of futures products.

New York Stock Exchange (NYSE) – The largest organized securities market in the United States, founded in 1792. The Exchange itself does not buy, sell, own or set the prices of securities traded there. The prices are determined by public supply and demand. The Exchange is a non-profit corporation of 1,366 individual members, governed by a board of directors consisting of 10 public representatives, 10 Exchange members or allied members and a full-time chairman, executive vice chairman and president.

NYSE Composite Index – The composite index covering price movements of all common stocks listed on the New York Stock Exchange. It is based on the close of the market December 31, 1965, as 50 and is weighted according to the number of shares listed for each issue. The index is computed continuously and printed on the ticker tape. Point changes in the index are converted to dollars and cents so as to provide a meaningful measure of changes in the average price of listed stocks. The composite index is supplemented by separate indexes for four industry groups: industrial, transportation, utility and finance.

Odd lot – An amount of stock less than the established 100-share unit.

Off-board – This term may refer to transactions over-the-counter in unlisted securities or to transactions of listed shares that are not executed on a national securities exchange.

Offer – The price at which a person is ready to sell. Opposed to bid, the price at which one is ready to buy.

Online commission – Amount the broker charges an investor for placing a trade online.

Option – A contract allowing the owner the right to

buy or sell a specified number of securities at a pre-determined price (the exercise price or strike price) within a specific time period (the expiration date). This right is tradeable, but does not have to be exercised if market conditions make it unprofitable to do so. Investors pay a premium for the right to hold an option, and one option contract represents 100 shares of stock. Options are not issued by the underlying company. Options expire on the third Friday of each month.

"Out of the money" option – an option for which it would be unprofitable to exercise the right to buy or sell the underlying security given current stock prices. In the case of a call option, this means that the exercise price is greater than the current market price. In that situation, it would be unprofitable for the option holder to exercise their right to buy the underlying security.

Over-the-counter – A market for securities made up of securities dealers who may or may not be members of a securities exchange. The over-the-counter market is conducted over the telephone and deals mainly with stocks of companies without sufficient shares, stockholders or earnings to warrant listing on an exchange. Over-the-counter dealers may act either as principals or as brokers for customers. The over-the-counter market is the principal market for bonds of all types.

Paper profit (loss) – An unrealized profit or loss on a security still held. Paper profits and losses become realized only when the security is sold.

Penny stocks – Low-priced issues, often highly speculative, selling at less than \$1 a share. Frequently used as a term of disparagement, although some penny stocks have developed into investment-caliber issues.

Portfolio – Holdings of securities by an individual or institution. A portfolio may contain bonds, preferred stocks, common stocks and other securities.

Preferred stock – A class of stock with a claim on the company's earnings before payment may be made on the common stock and usually entitled to priority over common stock if the company liquidates. Usually entitled to dividends at a specified rate - when declared by the board of directors and before payment of a dividend on the common stock - depending upon the terms of the issue.

Premium – The amount by which a bond or preferred stock may sell above its par value. May refer, also, to redemption price of a bond or preferred stock if it is

higher than face value. Can also refer to the price at which an option sells.

Prime rate – The lowest interest rate charged by commercial banks to their most credit-worthy customers; other interest rates, such as personal, automobile, commercial and financing loans are often pegged to the prime.

Principal – The person for whom a broker executes an order, or dealers buying or selling for their own accounts. The term "principal" may also refer to a person's capital or to the face amount of a bond.

Profit-taking – Selling stock that has appreciated in value since purchase, in order to realize the profit. The term is often used to explain a downturn in the market following a period of rising prices.

Quote – The highest bid to buy and the lowest offer to sell a security in a given market at a given time. If you ask your financial advisor for a "quote" on a stock, he or she may come back with something like "45 1/4 to 45 1/2." This means that \$45.25 is the highest price any buyer wanted to pay at the time the quote was given on the floor of the exchange and that \$45.50 was the lowest price that any seller would take at the same time.

Real Estate Investment Trust (REIT) – An organization similar to an investment company in some respects but concentrating its holdings in real estate investments. The yield is generally liberal since REITs are required to distribute as much as 90% of their income.

Record date – The date on which you must be registered as a shareholder of a company in order to receive a declared dividend or, among other things, to vote on company affairs.

Redemption price – The price at which a bond may be redeemed before maturity, at the option of the issuing company. Redemption value also applies to the price the company must pay to call in certain types of preferred stock.

Registered bond – A bond that is registered on the books of the issuing company in the name of the owner. It can be transferred only when endorsed by the registered owner.

Registered competitive market maker – Members of the New York Stock Exchange who trade on the floor for their own or their firm's account and who have an

obligation, when called upon by an exchange official, to narrow a quote or improve the depth of an existing quote by their own bid or offer.

Registered representative – The man or woman who serves the investor customers of a broker/dealer. In a New York Stock Exchange-member organization, a registered representative must meet the requirements of the exchange as to background and knowledge of the securities business. Also known as a financial advisor or customer's broker.

Registrar – Usually a trust company or bank charged with the responsibility of keeping record of the owners of a corporation's securities and preventing the issuance of more than the authorized amount.

Regular way delivery – Unless otherwise specified, securities sold on the New York Stock Exchange are to be delivered to the buying broker by the selling broker and payment made to the selling broker by the buying broker on the third business day after the transaction. Regular way delivery for bonds is the following business day.

Regulation T – The federal regulation governing the amount of credit that may be advanced by brokers and dealers to customers for the purchase of securities. A Federal Reserve Board regulation that governs customer cash accounts and the extension of credit by broker/dealers to customers to purchase and carry securities.

Regulation U – The federal regulation governing the amount of credit that may be advanced by banks to customers for the purchase of listed stocks.

Return of capital -- For tax purposes, a distribution that may occur if a fund distributes amounts that are not out of earnings and profits. If an investor received a return of capital, it will be reported on Form 1099-DIV. A return of capital is not taxed as ordinary dividends, but is treated as a return of the original investment. As such, it will reduce the cost basis of the shares in the fund by the amount you receive. Since the tax basis cannot be reduced below zero, if a return of capital exceeds the adjusted tax basis of your shares, the excess amount must be reported as a capital gain.

Round lot – A unit of trading or a multiple thereof. On the NYSE, the unit of trading is generally 100 shares in stocks and \$1,000 or \$5,000 par value in the case of bonds. In some inactive stocks, the unit of trading is 10

shares.

Scale order – An order to buy (or sell) a security, that specifies the total amount to be bought (or sold) at specified price variations.

SEC – The Securities and Exchange Commission, established by Congress to help protect investors. The SEC administers the Securities Act of 1933, the Securities Exchange Act of 1934, the Securities Act Amendments of 1975, the Trust Indenture Act, the Investment Company Act, the Investment Advisers Act and the Public Utility Holding Company Act.

Securities Industry Automation Corporation (SIAC) – An independent organization established by the New York and American Stock Exchanges as a jointly owned subsidiary to provide automation, data processing, clearing and communications services.

Securities Investor Protection Corporation (SIPC) – Provides funds for use, if necessary, to protect customers' cash and securities that may be on deposit with a SIPC member firm in the event the firm fails and is liquidated under the provisions of the SIPC Act. SIPC is not a government agency. It is a non-profit membership corporation created, however, by an act of Congress. Nonprofit corporation that insures the cash and securities in the accounts of brokerages up to \$500,000 in the event of a firm failure. All brokers and dealers registered with the Securities and Exchange Commission (SEC) must be SIPC members.

Seller's option – A special transaction on the NYSE that gives the seller the right to deliver the stock or bond at any time within a specified period, ranging from not less than two business days to not more than 60 days.

Sell side – The portion of the securities business in which orders are transacted. The sell side includes retail brokers, institutional brokers and traders, and research departments. If an institutional portfolio manager changes jobs and becomes a registered representative, he or she has moved from the buy side to the sell side.

Settlement – Conclusion of a securities transaction when a customer pays a broker/dealer for securities purchased or delivers securities sold and receives from the broker the proceeds of a sale.

Settlement date – The date by which an executed securities transaction must be settled, by paying for a

purchase or by delivering a sold asset; usually three business days after the trade was executed (T+3); or one day for listed options and government securities.

Short against the box – A transaction whereby an investor who owns stock borrows equivalent stock and sells it (a short sale) while using the owned stock as collateral for the loan (against the box). The “box” is a figurative reference to the proverbial lock box where securities were safeguarded, in olden days. Once used to liquidate a long position without triggering a capital gain, under current tax law it is deemed to be a constructive sale which triggers a capital gain.

Short covering – Buying stock to return stock previously borrowed to make delivery on a short sale. The act of purchasing securities in order to close an open short position. This is done by buying the same type and number of securities that were sold short. Most often, traders cover their shorts whenever they speculate that the securities will rise. In order to make a profit, a short seller must cover the shorts by purchasing the security below the original selling price. Also referred to as “buy to cover” or “buy back.”

Short sale – A market transaction in which an investor sells borrowed securities in anticipation of a price decline and is required to return an equal amount of shares at some point in the future.

Specialist – A member of the New York Stock Exchange who has two primary functions: first, to maintain an orderly market in the securities registered to the specialist. In order to maintain an orderly market, the exchange expects specialists to buy or sell for their own account, to a reasonable degree, when there is a temporary disparity between supply and demand. Second, the specialist acts as a broker's broker. When commission brokers on the exchange floor receive a limit order, say, to buy at \$50 a stock then selling at \$60 - they cannot wait at the post where the stock is traded to see if the price reaches the specified level. They leave the order with a specialist, who will try to execute it in the market if and when the stock declines to the specified price. At all times the specialists must put their customers' interests above their own.

Speculator – One who is willing to assume a relatively large risk in the hope of gain.

Stock exchange – An organized marketplace for securities featured by the centralization of supply and demand for the transaction of orders by member bro-

kers for institutional and individual investors.

Stock dividend – A dividend paid in securities rather than in cash. The dividend may be additional shares of the issuing company, or in shares of another company (usually a subsidiary) held by the company.

Stockholder of record – A stockholder whose name is registered on the books of the issuing corporation.

Stock index futures – Futures contracts based on market indexes, e.g. NYSE Composite Index Futures Contracts.

Stock option – An option to purchase or sell a stock at a specified price, and by a specific date. Also called equity option. Options on stocks are offered by brokerages, just as any other investment vehicle. Instead of buying the stock of a company, an investor may buy options of various kinds. The simplest kind is a "call option," in which investors buy the right to purchase shares at a certain price.

Stock Split – The division of the outstanding shares of a corporation into a larger number of shares. A 3-for-1 split by a company with 1 million shares outstanding results in 3 million shares outstanding. Each holder of 100 shares before the 3-for-1 split would have 300 shares, although the proportionate equity in the company would remain the same; 100 parts of 1 million are the equivalent of 300 parts of 3 million. Ordinarily, splits must be voted by directors and approved by shareholders.

Stop order – An order to buy at a price above or sell at a price below the current market. Stop buy orders are generally used to limit loss or protect unrealized profits on a short sale. Stop sell orders are generally used to protect unrealized profits or limit loss on a holding. A stop order becomes a market order when the stock sells at or beyond the specified price and, thus, may not necessarily be executed at that price.

Straddle -- A strategy in which the investor buys an equal number of put and call options, all with the same underlying stock, stock index, or commodity future, and all at the same strike price and maturity date. Each option may be exercised separately, but the combination of options is normally bought and sold as a group. The buyer of a straddle is anticipating the stock moves in either direction and will benefit from any move in the stock. The opposite is true for an investor who sells a straddle.

Street name – Securities held in the name of a broker instead of a customer's name are said to be carried in "street name." This occurs when the securities have been bought on margin or when the customer wishes the security to be held by the broker.

Swapping – Selling one security and buying a similar one almost at the same time to take a loss, usually for tax purposes.

Trader – Individuals who buy and sell for their own accounts for short-term profit. Also, an employee of a broker/dealer or financial institution who specializes in handling purchases and sales of securities for the firm and/or its clients.

Transfer – This term may refer to two different operations. For one, the delivery of a stock certificate from the seller's broker to the buyer's broker and legal change of ownership, normally accomplished within a few days. For another, to record the change of ownership on the books of the corporation by the transfer agent. When the purchaser's name is recorded, dividends, notices of meetings, proxies, financial reports and all pertinent literature sent by the issuer to its securities holders are mailed directly to the new owner.

Transfer agent – A transfer agent keeps a record of the name of each registered shareowner, his or her address, the number of shares owned, and sees that certificates presented for transfer are properly canceled and new certificates issued in the name of the new owner.

Transfer of Accounts – Amount the broker charges you for transferring existing funds into and out of your account.

Treasury stock – Stock issued by a company but later reacquired. It may be held in the company's treasury indefinitely, reissued to the public or retired. Treasury stock receives no dividends and has no vote while held by the company.

Unlisted stock – A security not listed on a stock exchange.

Variable Prepaid Forward Contracts – where the investor agrees to deliver some or all of the underlying shares at a future date in exchange for an up-front cash advance today. In a variable prepaid forward contract transaction, a client, with substantially-appreciated stock enters into a contract that economically resembles a combination of a sold call and purchased put, in order

to obtain money for the value of the security without triggering a capital gain tax. One example of such a transaction is discussed in Revenue Ruling 2003-7 [2003-5 IRB 1 (January 16, 2003)]. There the shareholder entered into a variable prepaid forward transaction with an investment bank, wherein the shareholder agreed to deliver to the investment bank upon expiration of the contract (exchange date) a variable number of shares of such stock (determined by a formula) in exchange for an upfront cash payment upon execution of the agreement. The term of the transaction was three years. Under the formula, if the market price of a share of the common stock was less than \$20 on the exchange date, the shareholder would have to deliver 100 shares of the common stock to the investment bank. If the market price of a share of stock was between \$20 and \$25 on the exchange date, the shareholder would have to deliver a number of shares having a total market value equal to \$2,000. If the market price of a share exceeded \$25 on the exchange date, the shareholder would be required to deliver 80 shares of common stock. This is the equivalent of an embedded collar band equal to 100–125% of the fair market value of the shares upon execution of the transaction. In order to secure the obligation under the variable prepaid forward, the shareholder pledged to the investment bank on the execution date the maximum number of shares that would be required under the agreement (i.e., 100). This pledge was effected by transferring the shares in a trust to an unrelated third-party trustee. The shareholder retained the right to vote the pledged shares and to receive dividends from the stock. Under the terms of the variable prepaid forward, the shareholder had the unrestricted legal right to, upon settlement, deliver the pledged shares, cash, or shares other than the pledged shares to satisfy its obligation under the agreement. The Revenue Ruling indicates that at the time the parties entered into the variable prepaid forward, the shareholder intended to deliver the pledged shares to the investment bank on the exchange date in order to satisfy his obligations under the variable prepaid forward. The shareholder, however, was not otherwise economically compelled to deliver the pledged shares and could have, in fact, delivered either cash or different shares. The IRS concluded that the transaction was not a sale that triggered a capital gains tax. See < <http://www.nyss-cpa.org/cpajournal/2003/1203/dept/d125503.htm>> [The CPA Journal, Dec. 2003] More recently, the IRS has claimed that the transaction is a constructive sale.

Warrants – Certificates giving the holder the right to purchase securities at a stipulated price within a speci-

fied time limit or perpetually. Sometimes a warrant is offered with securities as an inducement to buy. Warrants are a derivative security because their value is "derived," or based on, the value of the underlying security.. Despite their similarities, warrants are different from calls because they are issued directly by the corporation whose stock they are based on, rather than by an independent option writer. Also, the terms governing a warrant are specified in detail in a legal contract called a "warrant agreement." This agreement stipulates the details surrounding when and how the warrant can be exercised.

When issued – A short form of "when, as and if issued." The term indicates a conditional transaction in a security authorized for issuance but not as yet actually issued. All "when issued" transactions are on an "if" basis, to be settled if and when the actual security is issued and the exchange or National Association of Securities Dealers rules the transactions are to be settled.

Wire transfer fees – Amount the broker charges you for wiring transfers into and out of your account.

Yield – Also known as return. The dividends or interest paid by a company expressed as a percentage of the current price. A stock with a current market value of \$40 a share paying dividends at the rate of \$3.20 is said to return 8% ($\$3.20 \div \40.00). The current yield on a bond is figured the same way.

Yield to maturity – The yield of a bond to maturity takes into account the price discount from or premium over the face amount. It is greater than the current yield when the bond is selling at a discount and less than the current yield when the bond is selling at a premium.

Zero coupon bond – A bond that pays no interest until maturity but is priced, at issue, at a discount from its redemption price.