MARITAL PROPERTY RIGHTS IN CORPORATE BENEFITS FOR HIGH-LEVEL EMPLOYEES

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State Bar of Texas
IN HOUSE COUNSEL COURSE 2002
June 27-28, 2002
San Antonio, Texas
CHAPTER 7

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Member, Supreme Court Advisory Comm. on Rules of Civil Procedure (1994-2002); Chair, Subcommittee on Rules 16-165a
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Characterization of Marital Property, 39 BAY. L. REV. 909 (1988) (co-authored)

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Marital Property Rights in Corporate Benefits for High-Level Employees©

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I. INTRODUCTION.

This article discusses marital property issues surrounding highly-compensated employees. After laying some groundwork on the Texas rules of marital property, the article discusses employee benefits, the valuation of business interests, divorce taxation, and how to increase the chances that the employee will end up with the employee benefits, despite a divorce. The article finishes up with marital property reimbursement, and the new 2001 Family Code claim for economic contribution.

II. BASIC MARITAL PROPERTY RULES.

To understand marital property claims to employee benefits it is necessary to note some fundamental rules governing marital property in Texas.

A. Rule 1 - Separate and Community Property.

Property owned by a spouse is marital property. Marital property is either separate[1] property or community property,[2] or a mixture[3] of the two. Property not owned by a spouse is not marital property, and is neither separate nor community property. *See Gutierrez v. Gutierrez*, 791 S.W.2d 659, 664 (Tex. App.--San Antonio 1990, no writ) (portion of rental payments belonging to husband's brother were not community property). Thus, assets of a corporation or partnership, or assets held by a trustee for the benefit of a spouse, are not marital property (absent some unusual theory like piercing the corporate veil, constructive receipt of property, etc.) See Section II.P (regarding corporate assets); Section II.R (regarding trust holdings).

Rule 1 assumes that Texas marital property law applies to the property in question. Texas marital property law applies to property acquired by spouses while domiciled in Texas, regardless of where they married. TEX. FAM. CODE ANN. § 1.103. For non-domiciliaries, conflict of law rules will apply. *See Ossorio v. Leon*, 705 S.W.2d 219, 223 (Tex. App.--San Antonio 1985, no writ). In a Texas divorce or annulment, property is treated as if Texas marital property law controls, even where it doesn't under ordinary conflict of law principles. TEX. FAM. CODE ANN. § 7.002. In some instance, federal law preempts Texas marital property law. See Section II.S.

B. Rule 2 - Property Acquired Before Marriage.

Property owned at the time of marriage is separate property. TEX. CONST. art. XVI, § 15; *Parnell v. Parnell*, 811 S.W.2d 267, 269 (Tex. App.--Houston [14th Dist.] 1991, no writ) (real estate owned by husband prior to marriage was his separate property); *Gutierrez v. Gutierrez*, 791 S.W.2d 659, 665 (Tex. App.--San Antonio 1990, no writ) (car purchased by husband prior to marriage was his separate property). Even if a premarital purchase money debt on property is paid during marriage using community property funds, the property is nonetheless separate property. *See Colden v. Alexander* , 171 S.W.2d 320, 333 (Tex. 1943); *Smith v. Buss*, 144 S.W.2d 529, 532 (Tex. 1940). The fact that land owned prior to marriage is improved using community funds or community credit does not affect its separate property character. *Dakan v. Dakan*, 83 S.W.2d 620, 627 (Tex. 1935); *Leighton v. Leighton*, 921 S.W.2d 365,367 (Tex. App. –

Houston [1st Dist.] 1996, no writ). Payment of premarital debt, or improving premarital property using community property funds or credit, can give rise to a claim for marital property reimbursement or a claim for economic contribution. See Sections VII and XIII below.

C. Rule 3 - Inception of Title.

The character of marital property as separate or community or mixed is determined at the time of "inception of title." Inception of title occurs when a party first has a right of claim to the property by virtue of which title is finally vested. *Welder v. Lambert*, 91 Tex. 510, 22 S.W. 281, 284-86 (1898); *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 430 (Tex. 1970); *Saldana v. Saldana*, 791 S.W.2d 316, 319 (Tex. App.--Corpus Christi 1990, no writ), citing *Strong v. Garrett*, 148 Tex. 265, 224 S.W.2d 471 (1949). If inception of title to property occurs prior to marriage, the property is separate even if title is acquired during marriage. For example, if a man puts a house under an earnest money contract prior to marriage, then marries, then closes on the house, the house is his separate property even if he signed a promissory note during the marriage, and even if his wife signs the promissory note. *Carter v. Carter*, 736 S.W.2d 775, 778 (Tex. App.–Houston [14th Dist.] 1987, no writ). Property that has its inception of title during marriage is community property, even if title is acquired after divorce. *Allen v. Allen*, 751 S.W.2d 567, 572 (Tex. App.--Houston [14th Dist.] 1988, writ denied) (mineral interest received by former husband after divorce was community property because his inception of title to the interest arose during marriage).

D. Rule 4 - Property Acquired During Marriage.

Property acquired during marriage is community property unless it is acquired in the following manner, in which event it is the separate property of the acquiring spouse:

(1) by gift;[4]
(2) by devise or descent;[5]
(3) by partition or exchange;[6]
(4) as income from separate property made separate by a spousal separate property agreement;[7]
(5) by survivorship;[8]
(6) in exchange for other separate property;[9]
(7) as recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.[10]

Family Code Section 3.002 provides that "[c]ommunity property consists of the property, other than separate property, acquired by either spouse during marriage." Consistent with this rule, salary received during marriage is community property.

E. Rule 5 - Property Acquired after Dissolution of Marriage.

Property that is acquired after the marriage has ended is not community property. *Burgess v. Easley*, 893 S.W.2d 87, 90-91 (Tex. App.--Dallas 1994, no writ) (although deed was executed by husband's father during marriage, it was not delivered to husband until after divorce; since a conveyance is not effective until delivery, the property was not community property); *Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--El Paso 1981, no writ) (dividend declared after death of husband belonged to his heirs, not the community estate); *Echols v. Austron, Inc.* 529 S.W.2d 840 (Tex. Civ. App. – 1975, writ ref'd n.r.e.) (bonus paid to husband after granting of divorce was separate property); *see Berry v. Berry*, 647 S.W.2d 945, 948 (Tex. 1983) (increase in retirement benefits resulting from post-divorce employment was separate property). However, property acquired after dissolution of marriage, but that had its inception of title during marriage, is community property. *Allen v. Allen*, 751 S.W.2d 567, 572 (Tex. App.–Houston [14th Dist.] 1988, writ denied).

F. Rule 6 - Community Presumption; Degree

of Proof Necessary to Prove Separate.

Property *possessed* by either spouse during or on dissolution of marriage is presumed to be community property, and the separate character of property must be proved by clear and convincing evidence. TEX. FAM. CODE ANN. § 3.003; *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965) (all property possessed at the time of dissolution of marriage is presumed to be community property). The uncorroborated testimony of a spouse is sufficient to support a finding of separate property, but is not binding on the fact finder. *Hilliard v. Hilliard*, 725 S.W.2d 722 (Tex. App.--Dallas 1985, no writ) ("Husband's uncorroborated testimony . . . is not conclusive as to whether the house was separate or community").

G. Rule 7 - Commingling.

When separate and community property have become so commingled as to defy resegregation and identification, the burden of persuasion to overcome the presumption of community is not discharged, and the assets in question are treated as community property. *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Jackson v. Jackson*, 524 S.W.2d 308, 311 (Tex. Civ. App.--Austin 1975, no writ). *See Martin v. Martin*, 759 S.W.2d 463, 466 (Tex. App.--Houston [1st Dist.] 1988, no writ) (of three lots, two were separate and one community; the lots were sold for a unified price; absent proof of the sales price for each lot, all proceeds were deemed to be community property; tracing failed).

H. Rule 8 - Tracing.

The character of separate property is not changed by the sale, exchange, or change in form of the separate property. If separate property can be definitely traced and identified, it remains separate property regardless of the fact that the separate property undergoes mutations or changes in form. State Bar of Texas Pattern Jury Charges PJC 202.4 (2002). As stated in *Celso v. Celso*, 864 S.W.2d 652, 654 (Tex. App.--Tyler 1993, no wri): "Separate property will retain its character through a series of exchanges so long as the party asserting separate ownership can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character." To overcome the presumption of community, the party asserting separate property must trace and clearly identify the property which (s)he claims to be separate. *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965). The court in *Faram v. Gervitz-Faram*, 895 S.W.2d 839 (Tex. App.--Fort Worth 1995, no writ) described tracing in the following way:

> [T]he party claiming separate property must trace and identify the property claimed as separate property by clear and convincing evidence. 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. Hilliard v. Hilliard, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ). Separate property will retain its character through a series of exchanges so long as the party asserting separate ownership can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character. Cockerham v. Cockerham, 527 S.W.2d 162, 167 (Tex. 1975).

I. Rule 9 - Credit Obtained During Marriage.

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); *Anderson v. Royce*, 624 S.W.2d 621, 623 (Tex. Civ. App.--Houston [14th Dist.] 1981, writ ref'd n.r.e.). Property acquired with community credit is community property, and property acquired with separate credit is separate property. *Glover v. Henry*, 749

S.W.2d 502, 503 (Tex. App.--Eastland 1988, no writ). Credit during marriage is presumptively community, and the burden is on the proponent to prove separate credit. *Cockerham v. Cockerham*, 527 S.W.2d 162, 171 (Tex. 1975). Even property acquired with community credit can become separate property by interspousal gift, partition, etc.

J. Rule 10 - Presumption Arising from Deed Records.

When a real estate deed recites that separate property was paid for the property, or that the property is taken as the receiving spouse's separate estate, a rebuttable presumption of separate property arises. *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900); *Kyles v. Kyles*, 832 S.W.2d 194, 196 (Tex. App.--Beaumont 1992, no writ). Where the other spouse is grantor or otherwise chargeable with causing or acquiescing in the recital, the presumption become irrebuttable, absent fraud. *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900); *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 431 (Tex. 1970).

K. Rule 11 - Presumption Arising from Interspousal Conveyance.

Where one spouse conveys property to the other spouse, there is a rebuttable presumption of gift, even absent a recital in the instrument of conveyance. *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900).

L. Rule 12 - Presumption Arising from Including the Other Spouse's Name in Title.

Where one spouse uses separate property to acquire property during marriage and takes title to that property in the names of both spouses, a rebuttable presumption arises that the purchasing spouse intended to make a gift of a one-half separate property interest to the other spouse. *In re Marriage of Morris*, 12 S.W.3d 877, 881 (Tex. App. – Texarkana 2000, no pet.); *In re Marriage of Thurmond*, 888 S.W.2d 269, 273 (Tex. App.--Amarillo 1994, no writ), citing *Cockerham v. Cockerham*, 527 S.W.2d 162, 168 (Tex. 1975); *see Graham v. Graham*, 836 S.W.2d 308, 310 (Tex. App.--Tyler 1992, no writ) (recognizing rule but holding it was not applicable); *Peterson v. Peterson*, 595 S.W.2d 889, 892-93 (Tex. Civ. App.--Austin 1980, writ dism'd) (presumption overcome by husband's testimony that no gift was intended). In *Whorrall v. Whorrall*, 691 S.W.2d 32, 35 (Tex. App.--Austin 1985, writ dism'd), wife's testimony that she did not intend a gift was sufficient to support the trial court's finding of separate property.

M. Rule 13 - Presumption Regarding Income from Interspousal Gift.

When one spouse makes a gift of property to the other spouse, that gift is presumed to include all the income or property which might arise from the property given. TEX. CONST. art XVI, § 15, TEX. FAM. CODE ANN. § 3.005.

N. Rule 14 - Presumption Regarding Withdrawal of Commingled Funds.

Where an account contains both community and separate moneys, it is presumed that community moneys are withdrawn first. *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1976, writ dism'd). *Accord*, *Harris v. Ventura*, 582 S.W.2d 853, 855-56 (Tex. Civ. App.--Beaumont 1979, no writ). See the discussion in Section III of this article.

O. Rule 15 - Putting Separate Property Money in Joint Account.

The act of placing separate property funds into an account under the control of both spouses does not make the funds community property. *Celso v. Celso*, 864 S.W.2d 652, 655 (Tex. App.--Tyler 1993, no writ) ("The mere fact that the proceeds of the sale were placed in a joint account does not change the characterization of the separate property assets. The spouse that makes a deposit to a joint bank account of his or her separate property does not make a gift to the other spouse." *See Higgins v. Higgins*, 458 S.W.2d 498, 500 (Tex. Civ. App.--Eastland 1970, no writ).

P. Rule 16 - Corporate Assets.

Since a shareholder owns shares in the corporation and not the assets of the corporation, corporate assets are neither separate nor community property. See *Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--El Paso 1981, no writ) ("Prior to the actual declaration of a dividend, all the accumulation of surplus in the corporation merely enhanced the value of the shares held by the husband as his separate property and the community had no claim thereto"). This rule does not apply where court pierces the corporate veil. *Parker v. Parker*, 997S.W.2d 833, (Tex. App. – Ft. Worth 1995, pet. denied)(where corporations found to be alter ego of husband, corporate assets could become part of community estate; assets owned by corporation at time of marriage were husband's separate property, but assets acquired by the corporation during marriage were community property, absent tracing). The increase during marriage in value of a separate property corporation belongs to the separate estate. *Jensen v. Jensen*, 665 S.W.2d 107, 109 (Tex. 1984).

Q. Rule 17 - Partnership Rights of a Spouse.

Under the Texas Revised Partnership Act, there are two property rights of a partner. One of these cannot be community property (to-wit: the right to participate in the management of the partnership). TEX. REV. CIV. STAT. ANN. art. 6132b § 4.01(e). One can be community property (to-wit: the partner's interest in the partnership). TEX. REV. CIV. STAT. ANN. art. 6132b § 5.02 (a).

R. Rule 18 - Trust Holdings and Distributions.

Property held by a trustee for the benefit of a spouse is not owned by a spouse, and cannot be marital property. *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd) (undistributed income in several trusts was not community property because it had been neither received nor constructively received by the husband during marriage). However, where the spouse/beneficiary has an unconditional right to have the property free of trust, then the property is treated as if it is owned by the spouse, even though still in the hands of the trustee. *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ) (once the husband's right to receive half of the trust corpus matured, the income on such half began to belong to the community estate). Most estate planners agree that where the spouse is both settlor and beneficiary of the trust, the income of the trust property is likely community income. Where the trust is established by gift or will, case law is conflicting as to whether trust distributions are separate or community property. *Glover v. Henry*, 749 S.W.2d 502,503 (Tex. App.–Eastland 1988, no writ).

S. Rule 19 - Preemption of Texas Marital Property Law.

Federal law sometimes preempts Texas marital property law.[11] In those circumstances, the federal law must be consulted to determine the rights of spouses in the property in question. For example, the federal ERISA statute preempts the ability of persons about to marry to sign premarital agreements under state law that waive a spouse's survivorship rights under an ERISA plan. *Hurwitz v. Sher*, 982 F.2d 778, 781 (2d Cir.1992), *cert. denied*, 508 U.S. 912 (1993) (premarital agreement did not designate a beneficiary and did not acknowledge the effect of the waiver as required by ERISA; Second Circuit reserved judgment on whether the fact the parties were not married when the agreement was signed was alone sufficient to void the waiver, given that ERISA says only a spouse can waive survivorship rights). Treasury Regulation § 1.401(a)-20 (1991) specifically address premarital agreements. It says:

> Q-28 Does consent contained in an antenuptial agreement or similar contract entered into prior to marriage satisfy the consent requirements of sections 401(a)(11) and 417 [of The Internal Revenue Code]?

> A-28 No. An agreement entered into prior to marriage does not satisfy the applicable consent requirements, even if the agreement is executed within the applicable election period.

III. MARITAL PROPERTY RIGHTS IN EMPLOYEE BENEFITS.

A. Retirement Benefits and Dissolution of Marriage.

Private corporate retirement, annuity, and pension benefits earned by either spouse during marriage are part of the community estate and are subject to division on dissolution of the marriage. *See Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976). How this seemingly simple rule is applied to defined benefit retirement plans and defined contribution retirement plans has been the subject of much controversy.

1. Retirement Benefits Which Are Fully Vested at Divorce.

In 1965, the Texas Supreme Court declared that deferred compensation which is both acquired and vested during marriage is community property that is divisible on divorce. *Herring v. Blakely*, 385 S.W.2d 843 (Tex. 1965) (fully-vested profit sharing plan and annuity benefits earned by spouse during marriage are community property subject to division on divorce). Five years later, the rule was extended to military disability retirement which was acquired and fully-vested during marriage. *Busby v. Busby*, 457 S.W.2d 551 (Tex. 1970).

2. Retirement Benefits Which Are Not Vested At Divorce.

The benefits considered in *Herring v. Blakely* and *Busby v. Busby* were both acquired and 100% vested during marriage. In 1976, the Texas Supreme Court considered the divisibility of retirement benefits that partially resulted from employment during marriage but that were zero percent vested at the time of divorce. Following California case law, the Texas Supreme Court ruled that deferred compensation that had not yet vested by the time of divorce was partially community property, but only to the extent it was earned during marriage. *Cearley v. Cearley*, 544 S.W.2d 661, 665-66 (Tex. 1976). However, *Cearley* did not indicate how non-vested benefits should be pro-rated between separate and community portions.

3. *Taggart* Time-Allocation Formula.

In 1977, the Texas Supreme Court addressed the question of how to allocate between the separate and community estates defined benefit retirement benefits that were zero percent vested at the time of divorce. The Court said to use a time-related formula to determine the community property interest, with the numerator being the number of months of employment during marriage, and the denominator being the number of months of employment required to entitle the employee to retirement benefits. The community estate owned that fraction of the total retirement. *Taggart v. Taggart*, 552 S.W.2d 422, 424 (Tex. 1977).

The case of *Matter of the Marriage of Joiner*, 755 S.W.2d 496, 499 (Tex. App.--Amarillo 1988, no writ), presents a somewhat different view of how to handle a profit sharing plan that vested in stages. The terms of the plan are set out below.[12] In reversing the trial court's characterization of the plan based upon a *Taggart* time-based formula, the Court said:

> Unlike a military retirement or pension plan under which benefits are earned by reason of years of service, Cearley v. Cearley, 544 S.W.2d 661, 662 (Tex.1976), Anderson, Clayton & Co.'s employee's profit sharing stock plan manifests that benefits are not earned during the five-year period of employment required for participation in the plan; instead, the employee first acquires a vested interest in the benefits of the plan at the end of the sixth fiscal year of employment. Thus, the initial five-year employment period only generates a mere expectancy which, by not fixing any benefit in any sums at any future date, is not a property interest to which

> property laws apply. Hughes, Community-Property Aspects of Profit-Sharing Plans in Texas, 44 Tex. L. Rev. 860, 869 (1966). It follows that since the character of property as separate or community is fixed at the very time of acquisition, Colden v. Alexander, 141 Tex. 134, 171 S.W.2d 328, 334 (1943), the crucial time for determining the character of interests in and benefits of the plan is the time when the vested interests are acquired. Hughes, supra, at 871. Accord, Busby v. Busby, 457 S.W.2d 551, 553 (Tex.1970).
>
> By the application of these principles to the provisions of the plan, a 20% interest in the benefits of the plan was acquired and vested on 30 June 1973 and a similar 20% interest was acquired and vested on each June 30 thereafter through 30 June 1977, at which time the plan account was fully vested. The initial 20% interest was acquired and vested while Verne was a single man, and it is his separate property, Colden v. Alexander, supra; the remaining 80% was acquired and vested during the marriage, and it is community property. Herring v. Blakeley, supra, 385 S.W.2d at 845 -46. Therefore, the extent of the community interest in the plan account is 80%; however, since the amount of the account was not payable at the time of the divorce, the benefits to be apportioned to the parties are 80% of the value of the account on the date of divorce. Berry v. Berry, 647 S.W.2d 945, 947 (Tex. 1983).

4. *Taggart* Formula Applied To Value On Date Of Divorce.

It was not until six years after *Taggart*, in 1983, that the Texas Supreme Court realized that the *Taggart* formula applied to deferred compensation arrangements for spouses who continued working after divorce inadvertently deprived the working spouse of his or her separate property rights attributable to post-divorce retirement. In *Berry v. Berry*, 647 S.W.2d 945 (Tex. 1983), the Texas Supreme Court recognized that a straight time-related allocation of defined benefit retirement benefits improperly invades the separate estate of the spouse who continues to work after divorce. After *Berry*, Texas courts recognized that the increase in value of pension benefits accruing as compensation for services rendered after a divorce is not part of the community estate subject to division on divorce. See *Bloomer v. Bloomer*, 927 S.W.2d 118, 121 (Tex. App.--Houston [1st Dist.] 1996, writ denied) ("Pension benefits accruing as compensation for services rendered after a divorce are not part of the parties' community estate subject to a just-and--right division");*Phillips v. Parrish*, 814 S.W.2d 501, 505 (Tex. App.--Houston [1st Dist.] 1991, writ denied) (since none of the post- divorce increases granted to the wife were attributable to the husband's continued employment, *Berry* was not violated); *Humble v. Humble*, 805 S.W.2d 558, 561 (Tex. App.-- Beaumont 1991, writ denied) (rejecting the so-called "accrued benefit method" where one would determine the extent of the community interest by subtracting the date of marriage benefit from the date of divorce benefit); *Head v. Head*, 739 S.W.2d 635, 636 (Tex. App.--Beaumont 1987, writ denied) (employee's interest in retirement plans is community property only up to the date of divorce, and the non-employee spouse is entitled only to a share of the value of the retirement benefits as of the date of divorce). Stated differently, when a spouse continues to work after divorce, the spouse's interest in his or her deferred compensation is community property only up to the date of divorce, and all rights or increased value attributable to post-divorce employment are the working spouse's separate property. *Head*, 739 S.W.2d at 636. Post-divorce increases in the value of retirement benefits attributable to raises, promotion, services rendered, and contributions resulting from the employee spouse's continued employment after divorce are his separate property.

To avoid an unconstitutional divestiture of the increased value of retirement benefits attributable to employment after divorce, the Texas Supreme

Court ruled that the community estate's interest in on-going retirement benefits is to be calculated *based on the value* of the community's interest *at the time of divorce*. *Berry*, 647 S.W.2d at 946. The concept was applied to military retirement benefits in *Grier v. Grier*, 731 S.W.2d 931, 932 (Tex.1987) ("We hold that in apportioning military retirement benefits upon the dissolution of a marriage, the valuation of the community's interest in such benefits is to be based on the retirement pay which corresponds to the rank actually held by the service spouse on the date of the divorce"); *see Rankin v. Bateman*, 686 S.W.2d 707, 710 (Tex.App.-- San Antonio 1985, writ ref'd n.r.e.) (division must be based on the rank held by the prospective retiree at the time of divorce rather than upon the rank attained subsequent to divorce). The concept was applied to private retirement benefits in *Dunn v. Dunn*, 703 S.W.2d 317 (Tex. App.--San Antonio 1985, writ ref'd n.r.e.), where the court said:

> Penelope should receive out of any benefits Henry receives one-half of the amount produced when the "Taggart fraction" is multiplied by the benefit payment--based on a GS-12 Step 5 pay schedule for a civil servant with 31 years of service (Henry's "rank" at divorce). Since Henry is still working, such a division will occur if, as and when he collects retirement benefits. We reject Penelope's claim that cost of living increases and inflation should be included in her community share of Henry's retirement, pursuant to Berry.

5. Defined Contribution Retirement Benefits.

Texas courts have not applied the time-allocation rule of *Taggart* to defined contribution plans that were earned partly before and partly during marriage. Instead, they have taken the date of divorce value, subtracted the value on the date of marriage, and held the difference to be community property. *See Baw v. Baw*, 949 S.W.2d 764, 768 (Tex. App.--Dallas 1997, no writ), *Pelzig v. Berkebile*, 931 S.W.2d 398, 402 (Tex. App.--Corpus Christi 1996, no writ); *Hatteberg v. Hatteberg*, 933 S.W.2d 522, 531 (Tex. App.- -Houston [1st Dist.] 1994, no writ); *Iglinsky v. Iglinsky*, 735 S.W.2d 536, 538 (Tex. App.--Tyler 1987, no writ). As explained in *Pelzig v. Berkebile*, 931 S.W.2d 398, 402 (Tex. App.--Corpus Christi 1996, no writ):

> In this case, Berkebile's benefits were not controlled by the employee's length of service, but by the amount of money Berkebile put into the retirement plans. In contrast to a "defined benefit" plan, Berkebile had a "defined contribution plan." Two appellate courts that have considered defined contribution plans have held the Berry formula inapplicable. Hatteberg v. Hatteberg, 933 S.W.2d 522, 531-532 (Tex.App.--Houston [1st Dist.] no writ); see Iglinsky v. Iglinsky, 735 S.W.2d 536, 538 (Tex.App.-- Tyler 1987, no writ). In both of those cases, the appellate courts simply subtracted the pre-marriage sum from the sum at divorce to determine the portion that was added during marriage and therefore is community property. In this case, the portion of community funds can be determined by taking the figure the trial court found to be the value of the funds at the time of divorce, $356,072.45, and subtracting the amount already in place at the time of marriage, $31,912. The $ 31,912 is the only amount that represents separate property.

No Texas appellate court has ruled on an effort to trace growth of date-of-marriage assets inside a defined contribution plan.

6. Non-Qualified Retirement Plans.

Non-qualified plans like IRAs are typically treated like savings accounts, despite the fact they are held in trust for the owner-spouse. Since there is no developed appellate case law on 401(k) plans, the employed spouse typically attempts to trace the growth of date-of-marriage assets inside

the 401(k) plan in order to segregate it from deferred wages contributed to the plan and from earnings (interest and dividends) earned on assets held in the 401(k) plan. The other spouse attempts to treat the 401(k) like a defined contribution plan. Special circumstances occurred in *Lipsey v. Lipsey*, 983 S.W.2d 345 (Tex. App.--Fort Worth 1998, no pet.), that require that case to be examined. In *Lipsey*, the husband went to work and then retired from American Airlines before his marriage to his second wife. When the husband retired, and before his second marriage, he "rolled-over" his pension plan into the American Airlines 401(k) Capital Accumulation Plan and deferred receipt of any distributions or benefits until he reached age 70 ½ . The Plan was held and managed as a trust, with NationsBank serving as the trustee, and complied with the Employee Retirement Income Security Act ("ERISA"). The husband made no withdrawals or distributions from the trust since its creation. Upon divorce, the trial court held that all increase in the Plan's value during marriage was community property. The appellate court reversed, finding that trust case law and not retirement benefit case law was applicable. The appellate court noted that the husband had created the Plan with his separate property prior to marrying his second wife, and that he received no distributions from the Plan at any time during his second marriage. Further, during the marriage the husband had no right to compel such a distribution; therefore, he had not "acquired" the property during marriage. Since the husband did not actually acquire the undistributed Plan income during the marriage, such income, though earned during the marriage, remained a part of the trust estate and was not community property, and was not subject to division by the trial court. The appellate court commented:

> Absent fraud, a spouse may create a trust from separate property, and so long as the income remains undistributed during marriage and there is no right to compel distribution, the income is not acquired during marriage and remains separate trust property.

7. Where the Employee Benefit is a Gift From the Employer.

In *Hardin v. Hardin*, 681 S.W.2d 241, 242 (Tex. App.--San Antonio, 1984, no writ), the San Antonio Court of Appeals considered the character of the husband's beneficial interest in a trust created by the Texas Dental Association for his benefit. The trust document indicated that the trust was a gift to the husband for his past services. The court held that the benefits from the trust were a gift to the husband and were therefore his separate property. This case stands for the proposition that an interest in a trust received during marriage, although presumed to be community, can be shown to be separate property by proving it was acquired by gift, devise, or descent, even though it was incident to employment.

B. Disability Benefits.

Disability insurance purchased during marriage with community funds is community property, even when paid after divorce. *Andrle v. Andrle*, 751 S.W.2d 955, 955 (Tex. App.--Eastland 1988, writ den'd) (disability insurance carried by husband at the time of divorce was a property right that belonged to the community estate.). Similarly, disability benefits provided by an employer are community property even though they may be paid after dissolution of the marriage. *Simmons v. Simmons*, 568 S.W. 2d 169, 170 (Tex. Civ. App.-- Dallas 1978, writ dism'd) (where the right to receive disability benefits arises incident to employment during marriage, that right, and any benefits actually received are community property.). *Accord*, *Newsom v. Petrilli*, 919 S.W.2d 481 (Tex. App.--Austin 1996, no writ).

C. Life Insurance Incident to Employment.

Life insurance paid by an employer is deemed to be purchased out of earnings and is, therefore, presumed to be community property. *See Estate of Korzekwa v. Prudential Insurance Company*

of America, 669 S.W.2d 775, 777 (Tex. App.--San Antonio 1984, writ dism'd).

D. Employee Stock Options.

The Texas Supreme Court has not yet ruled on the divisibility of employee stock options on divorce, so Texas case law on employee stock options is still developing among the courts of appeals. Texas courts first confronted employee stock options in divorce in the case of *Myklebust v. Myklebust*, 605 S.W.2d 397 (Tex. Civ. App.–Houston [14th Dist.] 1980), *rev'd on other grounds*, 615 S.W.2d 187 (Tex. 1981). That case held simply that employee stock options earned during marriage are community property.

The next case was *Demler v. Demler*, 836 S.W.2d 696 (Tex. App.--Dallas 1992, no writ), where the husband received employee stock options during the marriage. The appellate court considered them to be community property. There was no discussion about whether the options were fully-vested by the time of divorce.In *Bodin v. Bodin*, 955 S.W.2d 380, 381 (Tex. App.--San Antonio 1997, no pet.), the husband contended that employee stock options granted during marriage were his separate property because the options were not vested by the time of divorce. The appellate court rejected this position, saying that the fact that the options had not vested by the time of divorce did not make the options entirely separate property. The court analogized the options to non-vested military retirement benefits as in *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976). The husband did not argue that a pro-rata allocation should apply. Therefore *Bodin*–like *Cearley*–does not address pro-rata allocation. Certain language in *Bodin* was criticized by the Superior Court of Pennsylvania, which said that "[i]ncluding as marital property all stock options granted during the marriage would erroneously include compensation for services to be performed after separation, which would not be a product of the marriage." *Macaleer v. Macaleer*, 725 A.2d 829 (Super. Ct. of Penn. 1999).

The case of *Farish v. Farish*, 982 S.W.2d 623, 625-28 (Tex. App.--Houston [1st Dist.] 1998, no pet.), addressed stock options granted as an incentive for future employment. *Farish* cites cases holding that options granted for work done outside of marriage requires an allocation between compensation for past work and incentives for future service. Unfortunately, this important part of the *Farish* opinion is unaccountably designated "not for publication" and therefore cannot be cited as precedent.

The Court in *Charriere v. Charriere*, 7 S.W.3d 217 (Tex. App.--Dallas 1999, no pet.), rejected an argument that employee stock options were governed by a time-allocation rule. There the employee stock options were both received and had become exercisable during the parties' marriage, so they were deemed to be community property divisible upon divorce.

Kline v. Kline, 17 S.W.3d 445 (Tex. App.--Houston [1st Dist.] 2000, pet. denied), dealt with non-vested stock options. The husband argued that if the options were awarded for past services, they would be community property. If they were awarded to induce future employment after the divorce, they should be entirely his separate property. The options themselves recited that they were granted for services during marriage, so the appellate court rejected the husband's contention, citing among its supporting authorities the retirement benefits case of *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976). The husband did not argue a pro-rata allocation, so the argument was not ruled on by the appellate court.

Boyd v. Boyd, 67 S.W.3d 398, 408 (Tex.App.--Fort Worth 2002, no pet.), involved employee stock options. The husband argued that the earlier stock option cases did not involve a claim that a *Taggart* time-apportionment method should be used to characterize options received during marriage that had not fully vested as of the time of divorce. The appellate court rejected this argument, saying that the husband had been given the opportunity to purchase the stock options because of his management position with his company, and he had purchased all of the stock options during marriage, and that none of the stock options were awarded for work done outside of

the parties' marriage. Because the husband acquired the stock options during marriage, they were not something that would be awarded in the future for continued employment after the divorce. Thus, acquisition of the options, and not the vesting of the options, determined their character as community property.

A number of courts in other states have recognized that employee stock options are related in some manner to the employee's employment status and could be compensation for either past, present, or future services. To the extent options are attributable to future services after the divorce, they are not divisible on divorce. *See Hug v. Hug*, 154 Cal.App. 3d 780, 786, 201 Cal.Rptr. 676 (Cal. Ct. App. 1984) (underlying purposes of employee stock options differ, so court should consider the facts of the case in determining separate and community property interests in options); *In re Marriage of Miller*, 915 P.2d 1314, 1318-1320 (Colo. 1996) (employee's stock option granted in consideration of past services is marital property because the employee has earned the compensation represented by that portion of the option and may enforce the option agreement to that extent; however, stock option granted in consideration of future services does not constitute marital property until the employee has performed those future services); *Davidson v. Davidson*, 578 N.W.2d 848, 855 (Neb. 1998) (portion of stock options that represents compensation earned for past or future services should not be included in marital estate); *Garcia v. Mayer*, 920 P.2d 522, 525 (N.M.Ct. App.1996) (court must determine whether option rights were, in whole or in part, compensation for effort prior to date of option, or whether option rights were granted solely as an incentive for future employment and effort); *In re Marriage of Powell*, 147 Or. App. 17, 934 P.2d 612 (1997) (marital interest in unvested options determined by dividing the number of months between date of grant and date of divorce by the number of months between date of grant and date of vesting); *In re Marriage of Short*, 125 Wash.2d 865, 890 P.2d 12, 16 (Wash. 1995) (trial court must ascertain whether stock options were granted to compensate employee for past, present, or future employment services).

E. Other Types of Stock-related Benefits.

A number of other stock-related benefits have not been litigated in Texas appellate courts, but general principles can be applied to determine the likely characterization in the event of divorce.

"Founder's stock" typically is fully vested when granted, but is subject to a duty to resell to the company if the founder leaves before a certain date. If acquired during marriage, this benefit is likely to be community property.

A case worth examining is *Acosta v. Acosta*, 836 S.W.2d 652, 654 (Tex.App.-El Paso 1992, no writ), which held that a stock plan, to which employer and employee spouse both made contributions and whose value was dependent on length of employee spouse's employment, was a deferred compensation retirement plan. The case did not reach the question of how to divide these rights upon divorce, but the language implies that ordinary retirement benefit case law would have been applied to the stock in the plan.

Stock Appreciation Rights Plans distribute to employees based upon the increase in share value between the date of award and date of distribution. It seems likely that the approach used for employee stock options would apply here, and the date of the award of rights under the plan is the date character of the property is fixed.

A "phantom stock plan" is a contractual arrangement for compensation. In the case of *In re Marriage of Leisner*, 579 N.E. 1091 (Ill. Ct. App. 1991), a phantom stock plan contracted for during marriage was deemed to be divisible upon divorce.

IV. EXCLUSION OF VALUE OF PERSONAL GOODWILL.

The Texas Supreme Court handed down a seminal decision in *Nail v. Nail*, 486 S.W.2d 761, 763-64 (Tex.1972), where the Court held that the goodwill that attaches to a professional practice of a medical doctor is not an asset of the community

estate that can be divided at divorce. The Court said that the accrued goodwill of Dr. Nail in his medical practice did not constitute an asset separate and apart from his person, or from his individual ability to practice his profession, and that it would be extinguished by death, retirement, or disablement. The later case of *Geesbreght v. Geesbreght*, 570 S.W.2d 427, 434-36 (Tex. App.--Fort Worth 1978, writ dism'd), examined the medical practice of a doctor who ran an emergency medical group, and concluded that goodwill of the business could exist separately from the doctor's personal goodwill, and that business goodwill was divisible upon divorce. The State Bar of Texas Pattern Jury Charges–Family Law (2002) provides the following instruction on valuing a business upon divorce:

> PJC 203.2
>
> "Personal goodwill" is the goodwill that is attributable to an individual's skills, abilities, and reputation.
>
> In determining the value of *PARTY A*'s *medical practice*, you are not to include the value of personal goodwill or the value of time and labor to be expended after the divorce. However, you may consider the commercial goodwill, if any, of the *practice* that is separate and apart from personal goodwill.

V. EFFECT OF BUY-SELL RESTRICTIONS.

In Texas there are two conflicting cases regarding the effect of buy-sell restrictions on the value of a community property interest in a business in divorce. The case of *Finn v. Finn*, 658 S.W.2d 735, 741-42 (Tex. App.--Dallas 1983, writ ref'd n.r.e.), held that "the community estate is not entitled to a greater interest than that to which the husband is entitled in the firm's goodwill." The court ruled that the value of the community estate's interest in the husband's law firm was limited by the terms of the partnership agreement, which excluded the value of goodwill to a departing or retiring partner. The case of *Keith v. Keith*, 763 S.W.2d 950 (Tex. App.--Fort Worth 1989, no writ), holds to the contrary, permitting the trial court to find fair market value independently of buy-sell provisions in a partnership agreement.

VI. DIVORCE TAXATION.

A. Non-recognition of Capital Gain upon Divorce.

Internal Revenue Code §1041 provides that neither the transferor nor the transferee are to recognize gain or loss on a transfer of property to a spouse or, if the transfer is incident to a divorce, to a former spouse. If the transfer meets the §1041 test, it will be treated as a gift, and the transferee spouse will receive a carryover basis in the transferred property (equal to the transferor's adjusted basis). To be under §1041, a transfer must either (1) occur within one year after the marriage ceases, or (2) be "related to the cessation of the marriage."

B. Redemption of Spouse's Stock.

When the divorce settlement involves a redemption by a corporation owned by the couple, complications can result. One issue is whether the selling spouse must recognize a capital gain. The other issue is whether the spouse who continues with the business will be taxed for a constructive dividend.

1. Non-Recognition of Gain Upon Redemption.

Non-recognition of gain upon redemption of stock is covered by Treas. Reg. § 1.1041-1T, which provides in part:

> Q-9 May transfers of property to third parties on behalf of a spouse (or former spouse) qualify under section 1041?
>
> A-9 Yes. There are three situations in which a transfer of property to a third party on behalf of a spouse (or former

spouse) will qualify under section 1041, provided all other requirements of the section are satisfied. The first situation is where the transfer to the third party is required by a divorce or separation instrument. The second situation is where the transfer to the third party is pursuant to the written request of the other spouse (or former spouse). The third situation is where the transferor receives from the other spouse (or former spouse) a written consent or ratification of the transfer to the third party. Such consent or ratification must state that the parties intend the transfer to be treated as a transfer to the nontransferring spouse (or former spouse) subject to the rules of section 1041 and must be received by the transferor prior to the date of filing of the transferor's first return of tax for the taxable year in which the transfer was made. In the three situations described above, the transfer of property will be treated as made directly to the nontransferring spouse (or former spouse) and the nontransferring spouse will be treated as immediately transferring the property to the third party. The deemed transfer from the nontransferring spouse (or former spouse) to the third party is not a transaction that qualifies for nonrecognition of gain under section 1041.

2. Constructive Dividend Upon Redemption.

"A constructive dividend is paid when a corporation confers an economic benefit on a stockholder without expectation of repayment." *Wortham Machinery Company v. U. S.*, 521 F.2d 160, 164 (10th Cir. 1975).

The application of the constructive dividend rule to corporate redemptions is governed by Rev. Rul. 69-608 (1969-2 C.B. 43), which provides that the non-redeeming shareholder receives a constructive dividend only if the redemption is in satisfaction of the remaining shareholder's primary and unconditional obligation to purchase the stock. The issue of when a transaction incident to divorce will be considered to be a constructive divided is further explored in an Internal Revenue Service Field Service Advisory (July 7, 1998) [1998 WL 1984227 (IRS FSA)].

C. Cases Applying These Doctrines.

The Arnes cases involved a divorce in which the spouses' McDonald's franchise redeemed the wife's shares. The obligation to purchase the wife's shares belonged to the corporation, and was guaranteed by the husband. In *Arnes v. U.S.*, 981 F. 2d 456 (9th Cir. 1992) [Arnes I], the Ninth Circuit Court of Appeals affirmed that IRC § 1041 applied to the wife so that she recognized no capital gain when her stock was redeemed by the corporation. In *Arnes v. Comm.*, 102 T.C. 522, 1994 [Arnes II], the Tax Court held that the husband received no constructive dividend as a result of the redemption because he did not have a primary and unconditional obligation to purchase his wife's stock.

Blatt v. Commissioner, 102 T.C. 77, 1994 WL 26306 (1994), was another divorce where both spouses were shareholders of a corporation. The divorce decree provided for the corporation to redeem the wife's shares for cash. Husband had no obligation to buy the stock, nor was he a guarantor of the corporation's obligation to buy the stock. The court ruled that §1041 did not apply to the redemption of the wife's stock because the transfer was not on her husband's behalf. As a result, wife suffered a capital gain during the year of the redemption.

In *Craven v. U.S.*,215 F.3d 1201 (11th Cir. 2000), the appellate court held that the redemption of a former wife's stock in a closely-held corporation pursuant to the divorce settlement was a transfer on behalf of her former husband incident to divorce and therefore qualified for nonrecognition under §1041.

In *Hayes v. Comm.*, 101 T.C. 593 (1993), the spouses owned a corporation that operated a McDonald's franchise. In the divorce settlement, the husband agreed to buy the wife's stock in the corporation. But instead of husband buying wife's

stock directly, he had the corporation redeem her stock. After the redemption, the parties amended their divorce agreement to provide for redemption of the wife's stock. The Tax Court held that husband had a primary and unconditional obligation to buy the stock, so that the transaction resulted in a constructive dividend to him.

In *Dolese v. US*, 605 F2d 1146 (10th Cir. 1979), *cert. denied*, 445 US 961 (1980), the court held that payment of the costs of shareholder's divorce litigation was partly personal, and hence a dividend.

VII. TAX CONSEQUENCES FOR THE AWARD OF STOCK OPTIONS UPON DIVORCE.

In 1999, the IRS issued a Field Service Advice, telling its agents in the field to apply the assignment of income doctrine to employee stock options that are awarded to the non-employee spouse in a divorce. The assignment of income doctrine, announced in *Lucas v. Earl*, 281 U.S. 111 (1930), holds that a taxpayer who has a current or future right to receive income cannot shift the tax on that income by transferring the right to receive the income to another taxpayer. Since employee stock options are a form of income, albeit deferred income, in FSA 200005006 (November 1, 1999), the IRS said that the assigning of the options causes the otherwise deferred income to be realized as income to the employee transferring the options, at the time of divorce.

The IRS recently changed its position as to non-qualified options, with the issuance of Revenue Ruling 2002-22, a copy of which is attached as an appendix to this article. In RR 2002-22, published May 13, 2002, the IRS determined that the assignment of income doctrine does not apply to the transfer of nonstatutory stock options and nonqualified deferred compensation by one spouse to the other incident to a divorce, and that under IRC 1041 no tax results from the transfer. The IRS has also issued a notice of proposed Revenue Ruling 2002 WL 906778 (IRS NOT) to the effect that the transfer of interests in nonstatutory stock options and nonqualified deferred compensation from the employee spouse to the nonemployee spouse incident to divorce does not result in a payment of wages for FICA and FUTA tax purposes, or trigger withholding until exercised by the transferee spouse.

VIII. DESIGNING EMPLOYEE BENEFITS THAT GO TO THE EMPLOYED SPOUSE AFTER A DIVORCE.

Given the popularity of employee compensation arrangements that operate as "golden handcuffs" to keep highly-valued employees committed to the company, and given further the state of Texas' marital property law on employee benefits in divorce, an employer is presented with a problem of how to keep valuable employees working for the company after they divorce. If a valuable employee's inducement to remain with the company is tied to future benefits that have been awarded one-half to a former spouse to be divided "if, as, and when received," then the employee has a financial incentive to leave the company (where s/he gets only ½ of the benefits) and to go to work for a company whose benefits will be entirely post-divorce property and will therefore belong entirely to the employee.

Here are some suggestions on how compensation might be structured to accomplish this purpose:

* Avoid employee acquisition of title to an asset during marriage (i.e., don't award an asset on the front end)
* Avoid employee inception of title during marriage (i.e., don't create a contract right to a future acquisition of an asset)
* Tie the benefit to future employment (i.e., make it a renewing employment agreement rather than a deferred compensation plan)
* Award the benefit in time-based increments (i.e., x benefits for first 12 months, y benefits for second 12 months, etc.)
* Avoid front-end loaded signing bonuses

As noted above, the case of *Charriere v. Charriere*, 7 S.W.3d 217 (Tex. App.--Dallas 1999, no pet.), rejected an argument that employee stock options were governed by a time-allocation rule. Footnote 4 to *Charriere,* shows what the employed spouse argued in that case:

> 4. Valerie's point of error breaks down into two basic categories–complaints about the trial court's fact findings and complaints about its legal conclusions. The first category complains that the evidence is factually and legally insufficient to support the findings that (1) all of Valerie's rights under the options accrued during marriage, (2) Valerie's options to purchase all 80,000 shares were earned entirely during marriage, (3) the options were granted in consideration of Valerie's past and present services, and (4) the options were granted to compensate Valerie for not having been offered options or shares of CBI in the past. As part of her sufficiency argument, Valerie also contends that the court's *failure to find* that Valerie's future services were considered in granting the stock options was either (1) erroneous as a matter of law, or (2) against the great weight and preponderance of the evidence. The second category of complaints involves the trial court's conclusions that (1) all 80,000 shares were community property, and (2) the options were not "divested" of their status as community property by the fact that Valerie's rights in the options were subject to "forfeiture" upon termination.

These contentions were rejected, suggesting that options that are both granted and exercisable during marriage are community property, even when they are subject to forfeiture if employment is terminated after divorce.

IX. The Family Code and Reimbursement.

The foregoing analysis of separate and community property is not the full story on marital property issues affecting highly-compensated employees. There is also the issue of marital property reimbursement. Marital property reimbursement is a court-created equitable remedy, and until 1999 the Texas Family Code did not mention it. In 1999, the Texas Legislature enacted a statue that approximated marital property reimbursement in some respects. Then in the 2001 amendments to the Family Code, the Legislature wiped out many of the 1999 provisions, enumerated types of claims for reimbursement (Tex. Fam. Code § 3.408), and listed certain types of expenditures that are not reimbursable (Tex. Fam. Code § 3.409).

X. REIMBURSEMENT CLAIMS BETWEEN MARITAL ESTATES.

A. Overview of Reimbursement.

The two principal issues involving traditional common law marital property reimbursement are: (1) when is reimbursement available; and (2) how is it measured? Secondary questions involve the role of offsetting benefits, and who has the burden of pleading, producing evidence, and persuasion. Overlaying the whole area is the idea that the decision to award reimbursement is addressed to the sound discretion of the trial court, and that error regarding reimbursement is reversible only if it renders the overall property division an abuse of discretion. *See* TEX. FAM. CODE § 7.007(b) (trial court in divorce must apply equitable principles to determine whether to recognize reimbursement claims "after taking into account all the relative circumstances of the parties," and must order a division of reimbursement claims in a manner that is just and right). The principle of reimbursement applies from community to separate, from separate to community, and from separate to separate, estates. *Dakan v. Dakan,* 125 Tex. 375, 83 S.W.2d 620, 627 (1935). Such claims can be asserted not only upon divorce, but also by heirs of a spouse, when the community estate is dissolved by death. *See Anderson v. Gilliland*, 684 S.W.2d 673 (Tex. 1985).

In *Vallone v. Vallone*, 644 S.W.2d 455, 458-59

(Tex. 1983), the Supreme Court defined marital property reimbursement in quite broad terms:

> The rule of reimbursement is purely an equitable one. Colden v. Alexander, 141 Tex. 134, 171 S.W.2d 328 (1943). It obtains when the community estate in some way improves the separate estate of one of the spouses (or vice versa). The right of reimbursement is not an interest in property or an enforceable debt, per se, but an equitable right which arises upon dissolution of the marriage through death, divorce or annulment. Burton v. Bell, 380 S.W.2d 561 (Tex.1964); Dakan v. Dakan, 125 Tex. 305, 83 S.W.2d 620 (1935).

Notice the description "in some way improves." That is not a tightly-drawn description – it is broad and expansive.

The Supreme Court of Texas said of reimbursement in *Penick v. Penick*, 783 S.W.2d 194, 197 (Tex. 1988):

> Admittedly it is difficult to announce a single formula which will balance the equities between each marital estate in every situation and for every kind of property and contribution.

B. The Pattern Jury Charge Instruction on Reimbursement.

STATE BAR OF TEXAS PATTERN JURY CHARGES (FAMILY) PJC 204.2A (2002 ed.) describes marital property reimbursement in the following terms:

> 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.

In addition to the foregoing situations, Texas cases have also recognized reimbursement where a spouse loses separate property through commingling with community property. It has been recognized where a separate property corporation made distributions to a spouse in excess of corporate profits and those distributions were used to buy community assets. It has been recognized where a spouse has unfairly dissipated community assets. These different types of reimbursement are discussed below. While the reimbursement award is usually in the form of money or a money judgment, the trial court can award specific community property in satisfaction of a separate property reimbursement claim. *Hilton v. Hilton*, 678 S.W.2d 645, 649 (Tex. App.--Houston [14th Dist.] 1984, no writ) (okay to award community shares of stock to husband to satisfy reimbursement claim in favor of husband's separate estate).

Many cases talk about a "right" of reimbursement. This suggests something that is guaranteed; something that a party is entitled to receive. However, the decision to grant or deny reimbursement is addressed to the trial court's sound discretion. Appellate courts speak of a "right" of reimbursement when they are speaking in generalities, and that they speak of the broad equity powers of the trial court in deciding reimbursement when they are affirming a trial court's decision on reimbursement. *See Gutierrez v. Gutierrez*, 791 S.W.2d 659, 663 (Tex.App.--San Antonio 1990, no writ) (discussing "right" versus "claim").

Texas Family Code Section 3.409 eliminates marital property 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.

C. Reimbursement for Enhancement Due to Community Time, Toil, Talent or Effort.

The community estate has a claim for reimbursement for uncompensated or undercompensated time, toil and talent expended by a spouse for the benefit and enhancement of his or her separate property interests, beyond that necessary to maintain the separate asset. *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984). The 2001 amendments to the Texas Family Code confirmed the availability of this reimbursement claim. TEX. FAM. CODE ANN. § 3.408(b)(2) (recognizing a reimbursement claim for "inadequate compensation for the time, toil, talent and effort of a spouse by a business entity under the control and direction of that spouse"). An increase in the value of a separate property business "resulting from fortuitous circumstances and unrelated to an expenditure of community effort will not entitle the community estate to reimbursement." *Harris v. Harris*, 765 S.W.2d 798, 805 (Tex. App.--Houston [14th Dist.] 1989, writ denied).

1. The Pattern Jury Charge.

STATE BAR OF TEXAS PATTERN JURY CHARGES (FAMILY) PJC 204.2 (2002 ed.) gives the following instruction regarding reimbursement arising from the community estate's providing the time, toil, talent or effort of a spouse, beyond that necessary to maintain the working spouse's separate estate:

> 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*. [*Italics* represents replaceable terms.]

The instruction is drawn from *Jensen*. In *Gutierrez v. Gutierrez*, 791 S.W.2d 659, 665 (Tex. App.--San Antonio 1990, no writ), a wife's reimbursement claim for services rendered in maintaining husband's separate property herd of cattle was reversed where wife provided no evidence as to the value of her services. Additionally, the fact that the growth of the herd through births was community property meant that some of wife's labors bore fruit for the community estate, and to that extent would not support a reimbursement claim against the husband's separate estate.

2. Form of Business.

There seems to be no reason to treat partnerships any differently from corporations, when it comes to a *Jensen*-like reimbursement claim. A *Jensen* reimbursement claim against a husband's interest in a law partnership was rejected in *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.--Houston [14th Dist.] 1989, writ denied), based on the husband's uncontradicted testimony that the enhancement in issue was not attributable to his labors.

3. Must Secure Finding.

In *Holloway v. Holloway*, 671 S.W.2d 51, 58 (Tex. App.--Dallas 1983, writ dism'd), although it was established that the value of husband's separate property corporations rose from $ 1,000 to $ 30 million, and $ 3,000 to $ 60 million, as a result of his labors during marriage, the wife waived her reimbursement claim by failing to secure a jury finding regarding the value of his time contributed to the businesses.

4. Back Wages.

Care should be given to distinguish reimbursement for undercompensation from a

claim for back wages. A claim for back wages is a claim against the corporation, not a claim against the owning spouse's separate estate. *Halamka v. Halamka*, 799 S.W.2d 351, 354-55 (Tex. App.--Texarkana 1990, no writ).

5. What Benefits are Considered?

In *Jensen*, the Supreme Court said that in determining whether the owning spouse was undercompensated, you must determine the value of the time, toil and talent expended by the owner-spouse, and subtract from that compensation paid to him/her for such time, toil and talent, in the form of salary, bonuses, dividends and other fringe benefits. *Jensen v. Jensen*, 665 S.W.2d 107, 110 (Tex. 1984). One wonders why dividends would be considered compensation for time, toil and talent, when dividends are distributions of profits to owners, even those owners who contribute no effort to the profits. The Supreme Court was wrong to include dividends as a form of compensation for services rendered, although dividends arguably are an offsetting benefit received by the community estate. But then that raises the question of whether something the community is otherwise entitled to receive (to-wit: income from separate property) is a proper offset to a reimbursement claim. In determining undercompensation, the *Trawick* court said to exclude rental income received from the business for use of the husband's separate property real estate, since the community owned that rental income separate and apart from husband's labors. The court also said that money paid to wife should not be considered, unless her employment was a sham and she performed no labor. The court also said to exclude expense account reimbursements to husband, except to the extent they exceeded his true out-of-pocket expenses.

6. Is Amount of Enhancement a Cap?

The court in *Trawick v. Trawick*, 671 S.W.2d 105, 108-9 (Tex. App.--El Paso 1984, no writ) (an estate case), indicated that the amount of enhancement in the separate property business is a cap on the amount of reimbursement that can be recovered for undercompensation of the spouse's labors.

D. For Separate Property Lost to Commingling.

Where separate property has been commingled and cannot be traced, courts have sometimes offered relief to the spouse who lost such assets by granting reimbursement for the separate property lost to commingling. In *Schmidt v. Huppman* 73 Tex. 112, 11 S.W. 175 (1889), a spouse owning a mercantile business at the time of marriage lost the separate identity of his date-of-marriage inventory to commingling. The trial court awarded the spouse monetary reimbursement for the amount of the inventory on that date, thus leaving only the growth in inventory (representing profit) as a community asset. In *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd), the husband lost separate property to commingling, and was awarded reimbursement to compensate. The appellate court affirmed, saying:

> The appellee commingled the proceeds of the sale of his separate property with the community property of the parties. The appellee admitted at trial and admits in his brief that the proceeds of the sale of his separate property have become completely commingled with the community estate. Appellee made no attempt at trial to trace the use of the proceeds of the sale of his separate property into any other transactions. The trial court determined in its conclusions of law that the appellee was entitled to reimbursement by reason of using his separate funds to enhance, improve and increase the value of the community estate. The trial court did not determine the amount of such reimbursement; however, the court did find as a fact that during the marriage specific properties owned by the appellee prior to the marriage were sold for a total sum in excess of $ 900,000, which was placed in the investment account at First City National Bank of Houston and

> thereafter used for the enhancement of the community estate.
>
> * * *
>
> Under these cases [cited in the Opinion], the trial court was justified in awarding the husband a separate estate reimbursement. The husband's separate estate served as a strong foundation upon which the community's wealth was built. Throughout the marriage the husband utilized that foundation to provide for the appellant and to establish the $3,000,000 to $4,000,000 estate. Equity is well served by reimbursing him for that initial investment.

Id. at 58.

E. Where Distributions from Closely-held Corporation Exceed Profits.

In *Brooks v. Brooks*, 612 S.W.2d 233 (Tex. Civ. App.--Waco 1981, no writ), the trial court awarded and the appellate court affirmed reimbursement from the community estate to husband's separate estate upon a showing that distributions from the husband's closely-held separate property corporation exceeded profits, and that community assets were acquired with those excess distributions.

XI. WHERE MARITAL PROPERTY REIMBURSEMENT IS NOT AVAILABLE.

A. For Payment of Child Support or Alimony.

TEX. FAM. CODE § 3.409(1), effective 9-1-2001, rules out reimbursement for payment of child support, alimony, or spousal maintenance.

B. For Paying Family Living Expenses.

TEX. FAM. CODE § 3.409(2), effective September 1, 2001, rules out reimbursement for the living expenses of a spouse or child of a spouse. A distinction was made in order to permit reimbursement where living expenses were incurred with community credit that was later paid using separate property funds–an exception that may swallow the rule. *Hilton v. Hilton*, 678 S.W.2d 645, 648 (Tex. App.--Houston [14th Dist.] 1984, no writ) (reimbursement is available for the use of separate property funds to pay community debts, even if these debts were incurred to pay community living expenses). *Accord, Oliver v. Oliver*, 741 S.W.2d 225, 228 (Tex.App.--Fort Worth 1987, no writ).

C. Contribution of Property of Nominal Value.

TEX. FAM. CODE § 3.409(3) prohibits reimbursement for contributions of property of nominal value.

D. Payment of a Liability of Nominal Value.

TEX. FAM. CODE § 3.409(4) prohibits reimbursement for paying liabilities of nominal value.

E. For Cost of College Degree or Student Loan.

TEX. FAM. CODE ANN. § 3.409(5) effective September 1, 2001,rules out reimbursement for paying a student loan of a spouse.

XII. WHERE MARITAL PROPERTY REIMBURSEMENT MIGHT BE AVAILABLE.

A. For Investing Funds in Business.

In *Halamka v. Halamka*, 799 S.W.2d 351, 354-55 (Tex. App.--Texarkana 1990, no writ), where there was inadequate evidence of the amount of community funds invested in husband's separate property business, the trial court awarded wife 60% of the community estate, in lieu of a specific reimbursement award. The decision was upheld on appeal.

B. Where Community Credit Is Used to Guarantee Corporate Debt.

In *Thomas v. Thomas*, 738 S.W.2d 342 (Tex. App.--Houston [1st Dist.] 1987, writ denied), an issue arose as to whether the community estate had a reimbursement claim where community credit is used to refinance a spouse's separate

property debt. In *Thomas*, a debt of husband's separate property corporation was refinanced with husband's personal guarantee, which subjected the community estate to liability and therefore was a community debt. Justice Dunn, in her concurring and dissenting Opinion, stated:

> Neither the parties' research nor ours has revealed a Texas case deciding the question of whether the community has a right to reimbursement for the use of its credit to secure a loan to refinance the husband's separate property debts. However, I am not willing to state, at this time, that this new reimbursement theory is without merit. I would analogize this situation to cases where separate debts are discharged with community funds. See Villarreal v. Villarreal, 618 S.W.2d 99 (Tex. Civ. App.--Corpus Christi 1981, no writ); Hawkins v. Hawkins, 612 S.W.2d 683 (Tex. Civ. App.--El Paso 1981, no writ). However, there is an important difference between the case before us and cases involving the discharge of a separate debt with community funds. When a debt is discharged, the cost to the community is obvious, but when a separate property debt is refinanced with the community acting as a guarantor, the cost to the community is not so readily ascertainable. In the latter situation, expert testimony would be required on the percentage risk undertaken by the community, and a dollar value would have to be assigned to that risk.
>
> In the case before us, there is no testimony concerning the cost to the community resulting from the use of their credit to guarantee the refinancing of the separate property debt. Further, there is evidence in the record that even though the guarantee was for $2,200,000, and the net community assets were approximately $660,000, the appellant was nevertheless able to negotiate a loan from the River Oaks Bank & Trust Co. subsequent to the guarantee. The appellee has, therefore, failed to meet her burden of establishing the community's right to reimbursement for the use of the community credit.

Id. at 346.

C. Subchapter S Corporation.

In *Thomas v. Thomas*, 738 S.W.2d 342 (Tex. App.--Houston [1st Dist.] 1987, writ denied), the court held that retained earnings of husband's separate property Subchapter S corporation were neither separate property nor community property, since they were assets of a corporation and not assets of a spouse. This was true despite the fact that the corporation's earnings were reported on the spouses' federal income tax return and community funds were used to pay the income tax liability. In this situation, where the community estate paid income tax on earnings that remained inside husband's separate property corporation, and significantly enhanced the value of that corporation, arguably the community estate would have a claim for reimbursement to the extent of the federal income taxes paid on behalf of the husband's separate estate.

XIII. LIENS TO SECURE REIMBURSEMENT AWARDS.

It appears that, where reimbursement is awarded as a money judgment to be paid after divorce, the trial court can impress a lien on the property as to which the reimbursement is awarded. However, it appears that a lien cannot be imposed in one separate property asset to secure a reimbursement judgment relating to another separate property asset. It is firmly established that the court cannot impose a lien on separate real estate to secure a money judgment which is used to balance the property division. *Rusk v. Rusk*, 5 S.W.3d 299, 308 (Tex. App.–Houston [14th Dist.] 1999, pet. denied) (citing to equitable lien cases in overturning a receivership imposed on separate property to secure an award of a money judgment as

"owelty"); *Parker v. Parker*, 997 S.W.2d 833 (Tex. App.--Fort Worth 1995, pet. denied). In *Heggen v. Pemelton*, 836 S.W.2d 145, 146 (Tex. 1992), the Supreme Court said:

> When dividing marital property on divorce, trial courts may impose equitable liens on one spouse's separate real property to secure the other spouse's right of reimbursement for community improvements to that property. *See, e.g., Dakan v. Dakan*, 125 Tex. 305, 83 S.W.2d 620, 627 (1935); *Smith v. Smith*, 715 S.W.2d 154, 160 (Tex. App.--Texarkana 1986, no writ); *Eggemeyer v. Eggemeyer*, 623 S.W.2d 462, 466 (Tex. App.--Waco 1981, writ dism'd) *on remand from*, 554 S.W.2d 137 (Tex. 1977). Although courts may impress equitable liens on separate real property to secure reimbursement rights, they may not impress such liens, absent any compensable reimbursement interest, simply to ensure a just and right division. *Compare Mullins v. Mullins*, 785 S.W.2d 5, 11 (Tex. App.--Fort Worth 1990, no writ) *and Smith*, 715 S.W. 2d at 157 *with Eggemeyer*, 554 S.W.2d at 141 *and Johnson v. Johnson*, 804 S.W.2d 296, 299-300 (Tex. App.--Houston [1st Dist.] 1991, no writ). In the case before us, the trial court granted Mr. Pemelton an equitable lien on separate real property to secure a judgment imposed by the court simply to ensure a just and right division. Thus, the trial court erred because it allowed this lien against Ms. Heggen's separate real property for reasons other than to secure Mr. Pemelton's reimbursement interest.

There is a puzzling statement in *Jensen v. Jensen*, 665 S.W.2d 107, 110 (Tex. 1984), which suggests that a lien to secure a reimbursement award cannot be imposed upon separate property corporate stock.

> Upon retrial of this case the burden of proving a charge upon the shares of RLJ owned by Mr. Jensen will be upon the claimant, Mrs. Jensen. . . . The right to reimbursement is only for the value of the time, toil and effort expended to enhance the separate estate other than that reasonably necessary to manage and preserve the separate estate, for which the community did not receive adequate compensation. . . . *However, if the right to reimbursement is proved, a lien shall not attach to Mr. Jensen's separate property shares. Rather a money judgment may be awarded.* [Emphasis added.]

Some courts of appeals have called this language in *Jensen* "confusing," and have had some difficulty in dealing with it. In *Smith v. Smith*, 715 S.W.2d 154, 160 (Tex. App.--Texarkana 1986, no writ), the court of appeals essentially ignored the plain meaning of the *Jensen* language saying: "We do not believe the Supreme Court of Texas by their opinion in *Jensen* intended to change the longstanding rule of permitting divorce courts to attach a lien to secure an award of reimbursement for improvements." The Tyler court of appeals agreed in *Kamel v. Kamel*, 760 S.W.2d 677, 680 (Tex. App.--Tyler 1988, writ denied), as to affixing equitable liens in real estate to secure reimbursement awards *for improvements made to the property*. The *Kamel* case did not extend the principle to reimbursement claims regarding payment of debt, insurance and taxes. The matter was also considered in *Gutierrez v. Gutierrez*, 791 S.W.2d 659, 666 (Tex. App.--San Antonio 1990, no writ), where the court noted the confusion and then left the question to be resolved by the trial court on remand.

You might think that *Heggen v. Pemelton* would remove doubt about imposing liens in separate property to secure judgments for reimbursement. However, the holding in *Heggen* had to do with imposing a lien in a spouse's separate property *homestead* to secure a judgment to ensure a just and right division of the community estate. Under Texas law, a homestead is immune from all but four types of liens, and the lien in *Heggen* did not fit within

those four possibilities. There is some general language in the majority Opinion that says a lien can be imposed in separate real property to secure a reimbursement award for community "improvements" to that property. *Id*. at 146. Does that extend to reimbursement for paying debts, taxes or insurance for that property? *Falor v. Falor*, 840 S.W.2d 683, 686-87 (Tex. App.--San Antonio 1992, no writ), says that a lien can be imposed upon separate property *homestead* only to secure the other spouse's right or reimbursement for paying taxes, improvements or purchase money indebtedness of the land. Does anything in the *Heggen* Opinion apply to reimbursement claims against separate property corporations, where the issue is a lien in shares and not in real estate? And a concurring Opinion was written in *Heggen*, by Justice Cornyn, stating his concern that the language in the majority Opinion regarding homestead protection might cloud the power of a divorce court to freely deal with a community property homestead upon divorce.

It should be noted that establishing that a parcel is homestead requires perhaps pleadings but for sure some evidence of that fact. *See Magill v. Magill*, 816 S.W.2d 530, 535-36 (Tex. App.--Houston [1st Dist.] 1991, writ denied). In *Falor*, 840 S.W.2d at 686, the appellate court remanded a case to the trial court to determine to what extent the rural separate property realty in question was homestead, since that affected the validity of the lien imposed on the land by the divorce court.

TEX. FAM. CODE § 3.406 requires the Court in a divorce to impose a lien to secure a claim for economic contribution. If the claim relates to the property in which the lien is imposed, the lien would be consistent with case law. If not, then such a lien may run afoul of the foregoing case law.

XIV. TRIAL COURT HAS BROAD DISCRETION.

Although many cases speak of a "right" of reimbursement, reimbursement is not a right. Reimbursement is an equitable claim that is addressed to the trial court's discretion. TEX. FAM. CODE ANN. §3.408(c) ("The Court shall resolve a claim for reimbursement by using equitable principles...") Therefore, it is difficult to reverse a trial court for a decision relating to reimbursement. *See Golias v. Golias*, 861 S.W.2d 401, 403 (Tex. App.--Beaumont 1993, no writ). An error regarding reimbursement is reversible only where it is of sufficient magnitude that it makes the overall property division an abuse of discretion. Reimbursement is part and parcel of the property division.

Baccus v. Baccus, 808 S.W.2d 694, 700 (Tex. App.--Beaumont 1991, no writ), lists reimbursement as one of the factors the court can consider in dividing the estate of the parties.

> [T]he Supreme Court has held that circumstances of each marriage dictate what factors the trial court will consider in dividing the community property. *See Young v. Young*, 609 S.W.2d 758 (Tex. 1980). We are well aware of the many factors which the trial court considers daily in making "just and right" divisions. These factors include future needs for support; fault in the breakup of the marriage; disparity of incomes or of earning capacities; spouses' capacities and abilities; benefits the innocent spouse would have derived from the continuation of the marriage; business opportunities; education and training; relative physical conditions; relative financial conditions and obligations; disparity of ages; size of community estate; size of separate estate; expected inheritance of the spouses; nature of property; attorneys' fees; custody of children; *reimbursement*; gifts to a spouse during marriage; excessive community property gifts to others; wasting community assets; out-of-state property; tax consequences; and credit for temporary alimony paid. *See LeBlanc v. LeBlanc*, 761 S.W.2d 450, 452 (Tex. App.-- Corpus Christi 1988,

writ denied). [Emphasis added.]

According to *Penick v. Penick*, 783 S.W.2d 194, 198 (Tex. 1988), reimbursement is an equitable right, not an absolute right, and the trial court's discretion in evaluating a claim for reimbursement is as broad as that discretion exercised by making a "just and right" division of the community property.

In contrast to marital property reimbursement, the trial court is required to award an economic contribution claim and secure it by a lien. TEX. FAM. CODE § 3.406.

XV. WAIVER OF REIMBURSEMENT CLAIMS.

Some lawyers like to eliminate the prospect of reimbursement claims when writing premarital or post-marital agreements. Reimbursement is not a property right, and therefore may not be impacted by clauses in an agreement relating solely to property rights. To eliminate reimbursement, either the money used to benefit a separate estate should be partitioned as that party's separate estate, or there should be a waiver of reimbursement claims. *See Pearce v. Pearce*, 824 S.W.2d 195, 200 (Tex. App.--El Paso 1991, writ denied) (agreement providing that income from separate property would be separate did not waive reimbursement claims). Where the spouses have partitioned or exchanged their future wages and the fruits of their labors, arguably no *Jensen*-type reimbursement claim can arise, since any undercompensation of the owning spouse's labors would be the separate property of the owning spouse. If money made separate by a premarital or marital agreement is used to improve or pay expenses of a separate asset, there would be no reimbursement claim in favor of the community for the use of the funds in that manner.

The Texas Family Law Practice Manual [Vol. 5, Chapter 48, p. 61-62] suggests the following waiver language to be used in such agreements:

> No Reimbursement Claims
>
> [Name of party A] waives and releases all rights of reimbursement of any kind or nature (including time, toil, talent, and labor) that he might have in the future or claim on behalf of his separate estate or the community estate against the separate estate of [name of party B]. [Name of party B] waives and releases all rights of reimbursement of any kind or nature (including time, toil, talent, and labor) that she might have in the future or claim on behalf of her separate estate or the community estate against the separate estate of [name of party A]. Additionally, no reimbursement claims shall be allowed resulting from contributions made by a party from his or her separate estate for the living expenses of the parties, for the ordinary and customary maintenance of the separate property of the other party, or for any sums expended on or for the benefit of the other party. No reimbursement claims shall be allowed as a result of any contribution made by a party from his or her separate estate for the purchase of, improvement of, or discharge of any lien or encumbrance on the separate property of the other party.

The Texas Family Law Practice Manual [Vol. 5, Chapter 48] also contains suggested language relating to the waiver of equitable interests.

XVI. CLAIMS FOR ECONOMIC CONTRIBUTION.

In 2001, the Legislature amended the Family Code by adding new Sections 3.401 through 3.410, eliminating the concept of "equitable interests" and creating in their stead a "claim for economic contribution" against a spouse's estate. The Legislature also added Family Code § 7.007, which requires the court in a divorce to determine claims for economic contribution, and then to divide community property claims in a manner that is just and right, and order a claim for economic contribution in favor of a separate estate to be awarded to the owner of that estate. It would be unconstitutional under *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977), for the Legislature to

purport to empower a trial court to take separate property of one spouse and give it to the other upon divorce. The economic contribution statute attempts to circumvent this prohibition by reaffirming the inception of title rule on the one hand while on the other hand making inroads in the rule by creating a claim for economic contribution that is tantamount to an ownership interest in the property which the trial court must award, *Eggemeyer* notwithstanding. Whether the distinction between a legal "taking" and an "equitable" taking has sufficient substance to withstand constitutional attack remains to be seen.

The scheme of economic contribution claims replaces the cost or enhancement model of equitable reimbursement, and instead substitutes a monetary claim, to be secured by a lien upon dissolution of marriage, for what amounts to prorata "ownership" of the benefitted asset. This new approach is radical departure from marital property reimbursement concepts, and it requires close attention.

Some of the highlights of the new statutory provisions relating to claims for economic contribution are as follows.

1. Economic contribution claims exist only as to debts secured by liens in property of another marital estate, not unsecured debts of another estate. TFC § 3.402. Economic contribution claims also apply to property receiving capital improvements paid by another marital estate. *Id.*

2. The economic contribution claim is calculated as fraction of the equity in the property on the date of divorce, or date of disposition. Thus, the economic contribution concept makes the contributing estate a sort of "partner" in ownership of the property. TFC § 3.403(b)(1).

3. Economic contribution claims for paying debt includes only reduction in principal and not payment of interest. Economic contribution claims also do not include payment of property taxes or insurance. TFC § 3.402(b).

4. Making "capital improvements" can give rise to a claim for economic contribution, but the term "capital improvements" is not defined. TFC § 3.402(a)(6). Also, the measure of the economic contribution claim for making capital improvements is based on the cost of the improvements, and not any enhancement resulting from the improvements. TFC § 3.402(a)(6). If capital improvements are financed during marriage by a loan secured by lien in the property, only the reduction in principal of the improvement loan is included in the claim for economic contribution. TFC § 3.402(3). There appears to be a "gap" for capital improvements made to property by incurring debt that is not secured by lien in the property being improved. Those capital improvements do not fall under either TFC § 3.402(3) or (6). Presumably a traditional reimbursement claim could be made, based on enhancement.

5. "Use and enjoyment" of property is not an offsetting benefit to a claim for economic contribution. TFC § 3.403(e).

6. If the property giving rise to a claim for economic contribution is disposed of during marriage, the amount of the claim for economic contribution is fixed at the time the property is disposed of. TFC § 3.403(b)(1).

7. A divorce court is required to impose a lien on property of the benefitted estate to secure a claim for economic contribution. This is not discretionary with the court. TFC § 3.406(a). The lien is not restricted to the specific property benefitted, but can instead be placed on any other property of the benefitted estate, subject only to homestead protection of such assets. TFC § 3.406(c). This suggests that other exemption statutes in the Texas Property Code will not protect exempt property from such a lien.

8. The trial court must offset claims for economic contribution running between estates. TFC § 3.407.

9. Marital property reimbursement principles still apply to payment of unsecured debt, and whenever someone fails to prove up an economic contribution claim. TFC § 3.408(a). Economic contribution claims also do not apply to *Jensen* claims for undercompensation from a separate property corporation. TFC § 3.408(b)(2). *See* TFC § 3.402(b)(2) (economic contribution does not include time, toil, talent or effort).

10. The statute does not say who must plead and prove offsetting benefits.

XVII. APPENDIX.

Here is IRS Revenue Ruling 2002-22, published May 13, 2002 [2002 WL 881644 (IRS RRU)],relating to the tax effect of transferring employee stock options to the non-employed spouse incident to a divorce.

Rev. Rul. 2002-22; 2002-19 IRB 1
Part I
Part Section 61.--Gross Income Defined
Part 26 CFR 1.61-1: Gross income.
Part (Also: 83, 1041; 1.83-7, 1.1041-1T.)

Part ISSUES

(1) Is a taxpayer who transfers interests in nonstatutory stock options and nonqualified deferred compensation to the taxpayer's former spouse incident to divorce required to include an amount in gross income upon the transfer?

(2) Is the taxpayer or the former spouse required to include an amount in gross income when the former spouse exercises the stock options or when the deferred compensation is paid or made available to the former spouse?

FACTS

[1] Prior to their divorce in 2002, A and B were married individuals residing in State X who used the cash receipts and disbursements method of accounting.

[2] A is employed by Corporation Y. Prior to the divorce, Y issued nonstatutory stock options to A as part of A's compensation. The nonstatutory stock options did not have a readily ascertainable fair market value within the meaning of 1.83-7(b) of the Income Tax Regulations at the time granted to A, and thus no amount was included in A's gross income with respect to those options at the time of grant.

[3] Y maintains two unfunded, nonqualified deferred compensation plans under which A earns the right to receive post-employment payments from Y. Under one of the deferred compensation plans, participants are entitled to payments based on the balance of individual accounts of the kind described in 31.3121(v)(2)-1(c)(1)(ii) of the Employment Tax Regulations. By the time of A's divorce from B, A had an account balance of $100x under that plan. Under the second deferred compensation plan maintained by Y, participants are entitled to receive single sum or periodic payments following separation from service based on a formula reflecting their years of service and compensation history with Y. By the time of A's divorce from B, A had accrued the right to receive a single sum payment of $50x under that plan following A's termination of employment with Y. A's contractual rights to the deferred compensation benefits under these plans were not contingent on A's performance of future services for Y.

[4] Under the law of State X, stock options and unfunded deferred compensation rights earned by a spouse during the period of marriage are marital property subject to equitable division between the spouses in the event of divorce. Pursuant to the property settlement incorporated into their

judgment of divorce, A transferred to B (1) one-third of the nonstatutory stock options issued to A by Y, (2) the right to receive deferred compensation payments from Y under the account balance plan based on $75x of A's account balance under that plan at the time of the divorce, and (3) the right to receive a single sum payment of $25x from Y under the other deferred compensation plan upon A's termination of employment with Y.

[5] In 2006, B exercises all of the stock options and receives Y stock with a fair market value in excess of the exercise price of the options. In 2011, A terminates employment with Y, and B receives a single sum payment of $150x from the account balance plan and a single sum payment of $25x from the other deferred compensation plan.

LAW AND ANALYSIS

Section 1041 and the assignment of income doctrine

[6] Section 1041(a) provides that no gain or loss is recognized on a transfer of property from an individual to or for the benefit of a spouse or, if the transfer is incident to divorce, a former spouse. Section 1041(b) provides that the property transferred is generally treated as acquired by the transferee by gift and that the transferee's basis in the property is the adjusted basis of the transferor.

[7] Section 1041 was enacted in part to reverse the effect of the Supreme Court's decision in United States v. Davis, 370 U.S. 65 (1962), which held that the transfer of appreciated property to a spouse (or former spouse) in exchange for the release of marital claims was a taxable event resulting in the recognition of gain or loss to the transferor. See H.R. Rep. No. 432, 98th Cong., 2d Sess. 1491 (1984). Section 1041 was intended to "make the tax laws as unintrusive as possible with respect to relations between spouses" and to provide "uniform Federal income tax consequences" for transfers of property between spouses incident to divorce, "notwithstanding that the property may be subject to differing state property laws." Id. at 1492. Congress thus intended that 1041 would eliminate differing federal tax treatment of property transfers and divisions between divorcing taxpayers who reside in community property states and those who reside in non-community property states.

[8] The term "property" is not defined in 1041. However, there is no indication that Congress intended "property" to have a restricted meaning under 1041. To the contrary, Congress indicated that 1041 should apply broadly to transfers of many types of property, including those that involve a right to receive ordinary income that has accrued in an economic sense (such as interests in trusts and annuities). Id. at 1491. Accordingly, stock options and unfunded deferred compensation rights may constitute property within the meaning of 1041. See also Balding v. Commissioner, 98 T.C. 368 (1992) (marital rights to military pension treated as property under 1041).

[9] Although 1041 provides nonrecognition treatment to transfers between spouses and former spouses, whether income derived from the transferred property and paid to the transferee is taxed to the transferor or the transferee depends upon the applicability of the assignment of income doctrine. As first enunciated in Lucas v. Earl, 281 U.S. 111 (1930), the assignment of income doctrine provides that income is ordinarily taxed to the person who earns it, and that the incidence of income taxation may not be shifted by anticipatory assignments. However, the courts and the Service have long recognized that the assignment of income doctrine does not apply to every transfer of future income rights. See, e.g., Rubin v. Commissioner, 429 F.2d 650 (2d Cir. 1970); Hempt Bros., Inc. v. United States, 490 F.2d 1172 (3d Cir. 1974), cert. denied, 419 U.S. 826 (1974); Rev. Rul. 80-198, 1980-2 C.B. 113. Moreover, in cases arising before the effective date of 1041, a number of courts had concluded that transfers of

income rights between divorcing spouses were not voluntary assignments within the scope of the assignment of income doctrine. See Meisner v. United States, 133 F.3d 654 (8th Cir. 1998); Kenfield v. United States, 783 F.2d 966 (10th Cir. 1986); Schulze v. Commissioner, T.C.M. 1983-263; Cofield v. Koehler, 207 F. Supp. 73 (D. Kan. 1962).

[10] In Hempt Bros., Inc. v. United States, the court concluded that the assignment of income doctrine should not apply to the transfer of accounts receivable by a cash basis partnership to a controlled corporation in a transaction described in 351(a), where there was a valid business purpose for the transfer of the accounts receivable together with the other assets and liabilities of the partnership to effect the incorporation of an ongoing business. The court reasoned that application of the assignment of income doctrine to tax the transferor in such circumstances would frustrate the Congressional intent reflected in the nonrecognition rule of 351(a). Accordingly, the transferee, not the transferor, was taxed as it received payment of the receivables. In Rev. Rul. 80-198, the Service adopted the court's position in Hempt Bros., but ruled that the assignment of income doctrine would nonetheless apply to transfers to controlled corporations where there was a tax avoidance purpose.

[11] Similarly, applying the assignment of income doctrine in divorce cases to tax the transferor spouse when the transferee spouse ultimately receives income from the property transferred in the divorce would frustrate the purpose of 1041 with respect to divorcing spouses. That tax treatment would impose substantial burdens on marital property settlements involving such property and thwart the purpose of allowing divorcing spouses to sever their ownership interests in property with as little tax intrusion as possible. Further, there is no indication that Congress intended 1041 to alter the principle established in the pre-1041 cases such as Meisner that the application of the assignment of income doctrine generally is inappropriate in the context of divorce. Specific provisions governing nonstatutory stock options

[12] Section 83(a) provides, in general, that if property is transferred to any person in connection with the performance of services, the excess of the fair market value of the property over the amount, if any, paid for the property is included in the gross income of the person performing the services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. In the case of nonstatutory stock options that do not have a readily ascertainable fair market value at the date of grant, 83 does not apply to the grant of the option, but applies to property received upon exercise of the option or to any money or other property received in an arm's length disposition of the option. See 83(e) and 1.83-7(a).

[13] Although a transfer of nonstatutory stock options in connection with a marital property settlement may, as a factual matter, involve an arm's length exchange for money, property, or other valuable consideration, it would contravene the gift treatment prescribed by 1041 to include the value of the consideration in the transferor's income under 83. Accordingly, the transfer of nonstatutory stock options between divorcing spouses is entitled to nonrecognition treatment under 1041.

[14] When the transferee exercises the stock options, the transferee rather than the transferor realizes gross income to the extent determined by 83(a). Since 1041 was intended to eliminate differing federal tax treatment for property transferred or divided between spouses in connection with divorce in community property states and in non-community property states, 83(a) is properly applied in the same manner in both contexts. Where compensation rights are earned through the performance of services by

one spouse in a community property state, the portion of the compensation treated as owned by the non-earning spouse under state law is treated as the gross income of the non-earning spouse for federal income tax purposes. Poe v. Seaborn, 282 U.S. 101 (1930). Thus, even though the non-employee spouse in a non-community property state may not have state law ownership rights in nonstatutory stock options at the time of grant, 1041 requires that the ownership rights acquired by such a spouse in a marital property settlement be given the same federal income tax effect as the ownership rights of a non-employee spouse in a community property state. Accordingly, upon the subsequent exercise of the nonstatutory stock options, the property transferred to the non-employee spouse has the same character and is includible in the gross income of the non-employee spouse under 83(a) to the same extent as if the non-employee spouse were the person who actually performed the services.

[15] The same conclusion would apply in a case in which an employee transfers a statutory stock option (such as those governed by 422 or 423(b)) contrary to its terms to a spouse or former spouse in connection with divorce. The option would be disqualified as a statutory stock option, see 422(b)(5) and 423(b)(9), and treated in the same manner as other nonstatutory stock options. Section 424(c)(4), which provides that a 1041(a) transfer of stock acquired on the exercise of a statutory stock option is not a disqualifying disposition, does not apply to a transfer of the stock option. See H.R. Rep. No. 795, 100th Cong., 2d Sess. 378 (1988) (noting that the purpose of the amendment made to 424(c) is to "clarif[y] that the transfer of stock acquired pursuant to the exercise of an incentive stock option between spouses or incident to divorce is tax free").

CONCLUSION

[16] Under the present facts, the interests in nonstatutory stock options and nonqualified deferred compensation that A transfers to B are property within the meaning of 1041. Section 1041 confers nonrecognition treatment on any gain that A might otherwise realize when A transfers these interests to B in 2002. Further, the assignment of income doctrine does not apply to these transfers. Therefore, A is not required to include in gross income any income resulting from B's exercise of the stock options in 2006 or the payment of deferred compensation to B in 2011. When B exercises the stock options in 2006, B must include in income an amount determined under 83(a) as if B were the person who performed the services. In addition, B must include the amount realized from payments of deferred compensation in income in the year such payments are paid or made available to B. The same conclusions would apply if A and B resided in a community property state and all or some of these income rights constituted community property that was divided between A and B as part of their divorce.

[17] This ruling does not apply to transfers of property between spouses other than in connection with divorce. This ruling also does not apply to transfers of nonstatutory stock options, unfunded deferred compensation rights, or other future income rights to the extent such options or rights are unvested at the time of transfer or to the extent that the transferor's rights to such income are subject to substantial contingencies at the time of the transfer. See Kochansky v. Commissioner, 92 F.3d 957 (9th Cir. 1996). Transfers of certain types of property incident to divorce, the tax consequences of which are governed by a specific provision of the Code or regulations (for example, 402, 408, 414, 424, or 453B) are not affected by this ruling.

HOLDINGS

(1) A taxpayer who transfers interests in nonstatutory stock options and nonqualified deferred compensation to the taxpayer's former spouse incident to divorce is not required to include an amount in gross income upon the

transfer.

(2) The former spouse, and not the taxpayer, is required to include an amount in gross income when the former spouse exercises the stock options or when the deferred compensation is paid or made available to the former spouse.

PROSPECTIVE APPLICATION

[18] The Service will apply 7805(b) and assignment of income principles to treat income as gross income of the transferor and not of the transferee if --

(i) The income is attributable to an interest in nonstatutory stock options, unfunded deferred compensation rights, or other similar intangible property rights;

(ii) The options or rights were transferred from one party to a divorce to the other party to the divorce;

(iii) The transfer was required by a provision of an agreement or court order;

(iv) The provision was contained in the agreement or order before November 9, 2002; and

(v) (a) The agreement or court order specifically provides that the transferor must report gross income attributable to the transferred interest, or

(b) It can be established to the satisfaction of the Service that the transferor has reported the gross income for federal income tax purposes.

EFFECT ON OTHER DOCUMENTS

[19] Rev. Rul. 87-112, 1987-2 C.B. 207, which deals with the treatment of transfers of United States savings bonds between spouses or former spouses, is clarified by eliminating references to assignment of income principles. As so clarified, the ruling is reaffirmed respecting the application of 454 and the regulations thereunder to the transfer and the determination of the transferee's basis.

FURTHER INFORMATION

[20] For further information or questions regarding 61 or 1041, contact Edward Schwartz of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 622-4960. For further information or questions regarding 83, 402, 408, 414, 422, 423, 424, or 453B, contact Erinn Madden of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622-6030. These are not toll-free calls.

The controlling definition of separate property is contained in the Texas Constitution, art. 15, § 15, which reads as follows:

> Sec. 15. Separate and community property of husband and wife
>
> Sec. 15. All property, both real and personal, of a spouse owned or claimed before marriage, and that acquired afterward by gift, devise or descent, shall be the separate property of that spouse; and laws shall be passed more clearly defining the rights of the spouses, in relation to separate and community property; provided that persons about to marry and spouses, without the intention to defraud pre-existing creditors, may by written instrument from time to time partition between themselves all or part of their property, then existing or to be acquired, or exchange between themselves the community interest of one spouse or future spouse in any property for the community interest of the other spouse or future spouse in other community property then existing or to be acquired, whereupon the portion or interest set aside to each spouse shall be and constitute a part of the separate property and estate of such spouse or future spouse; spouses also may from time to time, by written instrument, agree between themselves that the income or property from all or part of the separate property then owned or which thereafter might be acquired by only one of them, shall be the separate property of that spouse; if one spouse makes a gift of property to the other that gift is presumed to include all the income or property which might arise from that gift of property; and spouses may agree in writing that all or part of their community property becomes the property of the surviving spouse on the death of a spouse.

The Family Code definition of separate property comports with the constitutional definition, except that Section 3.001(3) says that "the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage" is separate property. TEX. FAM. CODE ANN. § 3.001(3). This personal-injury related category of separate property, which is not in the Constitution, was validated in *Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972). Section 4.102 provides that "[p]roperty or a property interest transferred to a spouse by a partition or exchange agreement becomes his or her separate property." TEX. FAM. CODE ANN. § 4.102 (Vernon 1993).

[2] Community property consists of the property, other than separate property, acquired by either spouse during marriage. TEX. FAM. CODE ANN. § 3.002.

[3] Property may be partly separate and partly community property, in proportion to the portion of the purchase price paid with separate and community property. *Gleich v. Bongio*, 99 S.W.2d 881, 883 (Tex. 1937). See State Bar of Texas Pattern Jury Charges PJC 202.06 (1989). In the case of *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-73 (Tex. App.--Amarillo 1994, writ denied), the court reviewed various descriptions of "mixed" ownership as being "pro tanto ownership," "equitable title," and "separate interest." The court felt that the most viable characterization of the interest of the spouse's separate estate in a mixed asset is one of "equitable title." *Id.* at 273.*See* TEX. FAM. CODE § 3.006 (Proportional Ownership of Property by Marital Estates.)

[4] TEX. CONST. art. XVI, § 15; TEX. FAM. CODE ANN. § 3.001. One consequence of this rule is that there can be no gift to the community estate. *Tittle v. Tittle*, 148 Tex. 102, 220 S.W.2d 637, 642 (1949); *Celso v. Celso*, 864 S.W.2d 652, 655 (Tex. App.--Tyler 1993, no writ). Note that when one spouse gives property to the other spouse a presumption arises that the gift includes all income or property arising from the property transferred. TEX. CONST. art. XVI, § 15; TEX. FAM. CODE ANN. § 3.005. "Gift" means

a voluntary and gratuitous transfer of property coupled with delivery, acceptance, and the intent to make a gift." State Bar of Texas Pattern Jury Charges PJC 202.3 (2002). *See Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565, 569 (1961) ("When an inter vivos transfer is made to either or both of the spouses during marriage, the separate or community character of the property is determined by looking to the consideration given in exchange for it. Any right, title or interest acquired for a valuable consideration paid out of the community necessarily becomes community property . . . .").

[5] TEX. CONST. art. XVI, § 15; Tex. Fam. Code Ann. § 3.001(2). "Devise" means acquisition of property by last will and testament. State Bar of Texas Pattern Jury Charges PJC 202.03 (1992). "Descent" means acquisition of property by inheritance without a will. State Bar of Texas Pattern Jury Charges PJC 202.03 (1992).

[6] TEX. CONST. art. XVI, § 15. Family Code § 4.102 provides that "[p]roperty or a property interest transferred to a spouse by a partition or exchange agreement becomes his or her separate property." TEX. FAM. CODE § 4.102.

[7] TEX. CONST. art. XVI, § 15. *See* TEX. FAM. CODE ANN. § 4.103.

[8] TEX. CONST. art. XVI, § 15; TEX. PROB. CODE ANN. § 451 (Vernon Supp. 1995). *See Banks v. Browning*, 873 S.W.2d 763 (Tex. App.--Fort Worth 1994, writ denied) (signature card indicating survivorship by "X" in a box was sufficient to establish survivorship agreement as to community property); *Haynes v. Stripling*, 812 S.W.2d 397 (Tex. App.--Austin 1991, no writ) (constitutional amendment retroactively validated survivorship agreement, signed prior to effective date, that was invalid under prior law).

[9] *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965).

[10] "[T]he recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage" is separate property. TEX. FAM. CODE ANN. § 3.001(3). *See Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972). However, in *Graham v. Franco* 488 S.W.2d 390, 396 (Tex. 1972), the Supreme Court said that a recovery for medical and related expenses incurred during marriage belongs to the community, since the community is responsible for these expenses.

[11] For a good discussion of preemption, see *Ex parte Hovermale*, 636 S.W.2d 828, 837 (Tex. App.--San Antonio 1982, orig. proceeding) (Cadena, C.J., dissenting). *See also Ridgway v. Ridgway*, 454 U.S. 46, 102 S.Ct. 49, 70 L.Ed.2d 39 (1981) (provisions of the Servicemen's Group Life Insurance Act of 1965, giving an insured service member the right to freely designate and alter the beneficiaries named under the contract, prevail over and displace a constructive trust for the benefit of the service member's children imposed upon the policy proceeds by a state-court divorce decree); *McCarty v. McCarty*, 453 U.S. 210, 101 S.Ct. 2728, 69 L.Ed.2d 589 (1981) (federal law preempted power of state court to divide military retirement benefits in a divorce); *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 99 S.Ct. 802, 59 L.Ed.2d 1 (1979) (federal law preempted power of state court to divide railroad retirement benefits on divorce); *Yiatchos v. Yiatchos*, 376 U.S. 306, 84 S.Ct. 742, 11 L.Ed.2d 724 (1964); *Free v. Bland*, 369 U.S. 663, 82 S.Ct. 1089, 8 L.Ed.2d 180 (1962) (savings bond survivorship provisions in treasury regulations preempted inconsistent Texas community property law); *Wissner v. Wissner*, 338 U.S. 655, 70 S.Ct. 398, 94 L.Ed. 424 (1950) (National Service Life Policy benefits are the sole property of the beneficiary, and are not community property); *McCune v. Essig*, 199 U.S. 382, 26 S.Ct. 78, 50 L.Ed. 237 (1905) (veteran's right, under federal statute, to designate beneficiary of life insurance could not be controlled by state court); *Ex parte Burson*, 615 S.W.2d 192 (Tex. 1981) (Veterans Administration disability payments are not property and cannot be divided upon divorce); *Eichelberger v. Eichelberger*, 582 S.W.2d 395 (Tex. 1979) (railroad retirement preempted); *Perez v. Perez*, 587 S.W.2d 671 (Tex. 1979) (military readjustment benefits held to be separate property due to gratuitous nature under federal statute); *United States v. Stelter*, 567 S.W.2d 797 (Tex. 1978) (ex-wife could not garnish ex-husband's retired pay, under federal statute); *Valdez v. Ramirez*, 574 S.W.2d 748 (Tex. 1978) (joint survivor annuity permitted by Civil Service Retirement Act preempted contrary state law); *Ex parte Johnson*, 591 S.W.2d 453 (Tex. 1979) (federal statute precluded division of V.A. disability benefits upon divorce); *Arrambide v. Arrambide*, 601 S.W.2d 197 (Tex. Civ. App.--El Paso 1980, no writ) (federal law prohibits division of VA disability payments upon divorce).

[12] "Anderson, Clayton & Co. maintains a profit sharing stock plan, which embraces its employees and those of its subsidiaries and affiliated companies who for five fiscal years have been salaried employees. The company and its subsidiaries and affiliates make annual contributions to the plan, based on a percentage of the net profits for that fiscal year, at the end of the company's fiscal year

on June 30. The contributions are paid to trustees who, crediting the employee-participants with their proportions of the contributions determined by the amount of the company's profits and the employees' compensation paid for that year, then invest the contributions in the stock of the company. The employee-participants do not make any contributions to the plan. The allocated shares of stock and credits to an employee-participant are paid upon severance of employment by death, disability, or retirement to the employee or to his or her heirs. Upon severance of employment for any other reason, the employee receives the portion of his or her account that has vested, and the portion not vested, if any, is redistributed among active participants in the plan in the same way as company contributions. By the terms of the plan, a 20% interest in the employee's account vests after six years of service, i.e., after the first fiscal year of participation in the plan, and a 20% interest vests each year thereafter until the tenth year of service, i.e., the fifth fiscal year of participation in the plan, when the account becomes 100% vested." *Matter of the Marriage of Joiner*, 755 S.W.2d 496, 496 (Tex. App.--Amarillo 1988, no writ).