TRUSTS IN TEXAS FAMILY LAW:

WHAT ARE THE COMMUNITY RIGHTS IN SEPARATELY CREATED TRUSTS?

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RICHARD R. ORSINGER

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TRUSTS AND FAMILY LAW

by

Richard R. Orsinger[1]

Things have changed in the past ten years in family law.

In 1975: Until September 1, there was no long arm statute for the exercise of jurisdiction over a non-resident in a Texas family law proceeding; retirement benefits were divisible only if vested by the time of divorce; military retirement benefits were divisible on divorce; separate personalty was divisible on divorce; no one knew whether the measure for reimbursement between marital estates was cost, enhancement or the lesser of the two; no one knew the statute of limitations for past-due child support; the trial court could enforce its judgment by contempt during appeal. Many other issues in Texas family law were uncertain. The benefits which accrued to the specialist with intimate knowledge of family law were great. A case could be found for or against most any proposition of family law; but only the experts had these cases in inventory. It was a great time for the family law specialist.

Things are different now. The Family Law Legislative Council has prompted the Legislature to resolve most of the difficult questions of family law jurisdiction, venue and procedure. The Texas Supreme Court has answered many questions that were highly debatable ten years ago. Now, 900+ people annually attend the State Bar of Texas' Advanced Family Law Course, and several hundred more attend the Marriage Dissolution Course, and still others attend family law courses conducted by S.M.U. and St. Mary's University Law Schools, and the South Texas School of Law and the University of Texas Law School. At these courses, everyone is told what's what in family law. And there are many, many family law specialists. In today's marketplace, just being a family law specialist is no big deal.

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1 The assistance and inspiration of Dan Price is gratefully acknowledged. The author also wishes to thank Michael Diehl for the opportunity to preview his article, entitled "The Trust in Marital Law: Divisibility of a Beneficiary Spouse's Interests on Divorce," soon to be published in the Texas Law Review.

<u>Trusts: A Forgotten Jewel</u>

There is one area of family law, however, that has remained unretouched by the Legislature, and the Texas Supreme Court--that is the area of trusts in family law. There are some Texas Supreme Court cases, but they are <u>muy</u> <u>ancien</u>. There is a motley assortment of Texas Civil Appeals cases which seem never to have arrived at a unified view. There are some Fifth Circuit tax cases that open a bonanza of unanswered questions on the topic. And there is a recent Court of Appeals case that appears to espouse a rule of law which eluded the authors of the older appellate opinions. In short, there is money, and confusion, and therefore opportunity, in the area of trusts and family law.

SECTION ONE

GENERAL PRINCIPLES

In Texas, there are express trusts, resulting trusts and constructive trusts. The main focus of this article is on express trusts. While resulting trusts can occur within express trusts, and constructive trusts can occur in connection with express trusts, this Article concentrates on the creation of express trusts, possible methods to penetrate or overcome the express trust as an entity, and marital property issues relating to principal and income of express trusts.

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I. **THREE CATEGORIES OF TRUSTS.** The Supreme Court of Texas has recognized three categories of trusts: express trusts, resulting trusts, and constructive trusts. Mills v. Gray, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948). These terms are defined below.

A. **THE EXPRESS TRUST.** An express trust comes into existence by the execution of an intention to create it by one having legal and equitable dominion over the property made subject to the trust. Mills v. Gray, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948). Many aspects of express trusts are addressed by the Texas Trust Code. TEX. PROP. CODE ANN. chs. 111-115 (Vernon 1984), which applies to trusts created on or after January 1, 1984, and all transactions occurring on or after January 1, 1984, but relating to trusts created before January 1, 1984. The Trust Act, TEX. REV. CIV. STAT. ANN. art. 7425a et seq. (Vernon 1960) still controls the validity of trusts created between its effective date in 1943 and December 31, 1983, and actions taken in connection with such trusts prior to January 1, 1984.

B. **THE RESULTING TRUST.** A resulting trust arises by operation of law when title is conveyed to one party while consideration is paid by another, Cohrs v. Scott, 338 S.W.2d 127, 130 (Tex. 1960). A resulting trust must arise at the time when title passes, Id., at 130. A resulting trust also arises when a conveyance is made to a trustee pursuant to an express trust, which fails for any reason. Nolana Development Ass'n v. Corsi, 682 S.W.2d 246, 250 (Tex. 1984). The proponent of a resulting trust has the burden of overcoming the presumption of ownership arising from title by "clear, satisfactory and convincing" proof of the facts giving rise to the resulting trust, Stone v. Parker, 446 S.W.2d 734, 736 (Tex. Civ. App.--Houston [14th Dist.] 1969, writ ref'd n.r.e.).

C. THE CONSTRUCTIVE TRUST. A "constructive trust" is not really a trust; it is an equitable remedy. Oak Cliff Bank & Trust Co. v. Steenberger, 497 S.W.2d 489 (Tex. Civ. App.--1973, writ ref'd n.r.e.). The court imposes a "constructive trust" when an equitable title or interest ought to be, as a matter of equity, recognized in someone other than the taker or holder of legal title. Mills v. Gray, 14~~1~~7 Tex. 33, 210 S.W.2d 985, (1948). The Texas Supreme Court said: "A transaction may, depending on the circumstances, provide the basis for a constructive trust where one party to that transaction holds funds which in equity and good conscience should be possessed by another." Meadows v. Bierschwale, 516 S.W.2d 125, 131 (Tex. 1974). Thus, a constructive trust arises, not by agreement of persons on some prior occasion, but by fiat of the court, as a vehicle to undo an unjust enrichment.

1. "Resulting Trust" vs. "Constructive Trust." In Mills v. Gray, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948), the Texas Supreme Court drew the following distinction between a resulting trust and a constructive trust:

> Resulting and constructive trusts are distinguishable, but there is some confusion between them. From a practical viewpoint, a resulting trust involves primarily the operation of the equitable doctrine of consideration - the doctrine that valuable consideration and not legal title determines the equitable title or interest resulting from a transaction - whereas a constructive trust generally involves primarily a presence of fraud, in view of which equitable title or interest should be recognized in some person other than the taker or holder of the legal title. [Citing 54 AM. JR. 22, § 5]

II. CHALLENGES TO VALIDITY OF EXPRESS TRUSTS. A trust may appear to be a trust, but may in reality be vulnerable to challenge. Several possible attacks on trusts are outlined below.

A. FAILURE IN MECHANICS OF CREATION. The Texas Trust Code has certain requirements for express trusts that must be observed. When these conditions are not met, an express trust might not be recognized in a court proceeding.

1. Must be in Writing. The Texas Trust Code provides that an express trust containing real or personal property is unenforceable unless it is created by a written instrument, signed by the settlor, containing the terms of the trust. TEX. PROP. CODE ANN. § 112.004 (Vernon 1984). The mere designation of a party as "trustee" on an instrument does not alone create a trust. Nolana Development Ass'n v. Corsi, 682 S.W.2d 246, 249 (Tex. 1985).

a. Exception for Personalty. There are two exceptions for trusts involving only personalty.

(1) Personalty Transferred to Another With Intent Expressed. Where the trust includes only personalty, the trust is enforceable if the personalty is transferred to a trustee who is not a beneficiary or settlor, and the settlor expresses the intention to create a trust, either before or at the time of the transfer. TEX. PROP. CODE ANN. § 112.004 (Vernon 1984).

(2) Personalty Retained by Settlor With Writing Reflecting Trust. A trust of personalty is also enforceable where an owner of personalty states in writing that certain personalty is held by that person as trustee for another, as beneficiary, or for himself and another, as beneficiaries. TEX. PROP. CODE ANN. § 112.004 (Vernon 1984).

2. A Transfer is Necessary. There must be a present transfer of legal title of property from the settlor to the trustee for the trust to be valid. Cutrer v. Cutrer, 334 S.W.2d 599, 605 (Tex. Civ. App.--San Antonio 1960), aff'd, 162 Tex. 166, 345 S.W.2d 513 (1961). However, the settlor may "transfer" legal title to the property to himself as trustee as long as his words or acts clearly reflect his intent to relinquish individual ownership in favor of holding the property merely as trustee for the beneficiary. Westerfeld v. Huckaby, 474 S.W.2d 189 (Tex. 1972). Accord, TEX. PROP. CODE ANN. § 112.004(2) (Vernon 1984). The settlor may retain rights in the property, or may be the initial trustee, and may retain the right to revoke the trust, without violating this rule. Westerfield, supra at 193.

B. ILLUSORY TRUST. A trust can be challenged on the grounds that it is an "illusory trust." The leading Texas case on illusory trusts is Land v. Marshall, 426 S.W.2d 841 (Tex. 1968). In Land v. Marshall, the husband had created an inter vivos trust using almost all of the community property. He retained, however, the power to revoke the trust, the right to consume the principal, to control the trustee and other beneficial interests during his lifetime. Upon his death, the trust passed title in the community property to the parties' daughter. In a challenge brought by the wife after the husband died, the trust was held by the Supreme Court to be invalid. The test announced by the Supreme Court was: "Did the decedent, by his conveyance in his lifetime, retain such a large interest in the property that, at least as to his wife, his inter vivos trust was illusory?" Id. at 848. If so, then the trust was "illusory," and failed as to the wife's one-half community property interest. See generally Annot., 39 A.L.R.3d 1 (1971); Husband as Manager of the Community Estate: Illusory Trusts, 10 S. TEX. L.J. 301 (1968); The Illusory Trust and Community Property, 22 SW. L.J. 447 (1968). See also Bell, Jr., Community Property Trusts--Challenges by the Non-Participating Spouse, 22 BAY. L. REV. 311 (1970).

1. Is It Only Upon Death? The "illusory trust" doctrine was developed in common law jurisdictions to defeat attempts by the husband, by means of a lifetime conveyance, to circumvent the wife's survivor-interest in his property. Land v. Marshall, 426 S.W.2d at 847. The doctrine was transplanted to Texas in Land v. Marshall, when the husband sought to deprive his wife of her community interest in property by conveying the property into an inter vivos trust. Texas law already prohibited the husband from bequeathing all of the community property to his daughter. The question in Land v. Marshall was whether the husband could do by inter vivos trust what he could not do by will. Id. at 846. The Texas Supreme Court concluded that, where the conveyance into trust was illusory, the trust failed as to the wife's one-half community interest. The case was seen by the Court to involve "a problem created by our community property protection of the wife's distribution share." Id. at 848.

2. **Only When Non-Consenting Spouse's Property is Used to Fund a Trust.** The "illusory trust doctrine of Land v. Marshall "is limited to instances in which a non-consenting spouse's property is used to fund a trust." Westerfeld v. Huckaby, 474 S.W.2d 189 (Tex. 1971). Consequently, it is available only to the extent that the complaining spouse's separate property, or share of the community property, is used. As explained in Westerfeld, the trust in Land v. Marshall failed as an illusory trust only as to the wife's property. Westerfeld, 74 S.W.2d at 191. The trust then

failed as to the husband's property because the loss of half of the trust corpus was deemed to defeat the husband's plan of distribution. Id.

3. **Excessive Control Not Basis of "Illusory Trust" Attack.** As explained by a majority of the Supreme Court in Westerfeld v. Huckaby, 474 S.W.2d 189, 191 (Tex. 1972), the trust in Land v. Marshall did not fail because the husband reserved too much control over his own property.

> Land v. Marshall dealt with a problem created by our community property protection of the wife's distributive share. We therefore could not look solely to the husband's reservation of powers over his own property but had to bring additional policy considerations to bear.

Id. at 191. In Westerfeld, the administratrix of a decedent sought to set aside inter vivos trusts made by the decedent, on the grounds that the decedent had retained too much control and the trusts were "illusory." Her attack was rejected by a majority of the Supreme Court which felt that the decedent could create valid trusts even though she reserved in herself broad beneficial rights, as well as the right to revoke the trusts and the right to control or manage the trustees. Id. at 192.

C. **COLORABLE TRUST.** The "colorable trust" doctrine may be an available tool to dismantle a trust. In Land v. Marshall, 426 S.W.2d 841, 846 (Tex. 1968), the Texas Supreme Court said the following about a colorable trust:

> ". . . The term "colorable" as used herein, indicates a transfer which may be absolute on its face, but which, actually, is not a transfer at all because, through some secret or tacit understanding, the parties intend that ownership is to be retained by the donor. . . ." Edward A. Smith, 44 Mich.L.Rev. 151, 153; Martin v. Martin, 282 Ky. 411, 138 S.W.2d 509 (1940).

The "colorable trust" doctrine was discussed in a law review article by John L. Bell, Jr., 22 BAY. L. REV. 311, 319 (1970). Mr. Bell quotes different authorities on the meaning of the term "colorable," as used in this context. He concludes:

> The heirs of the settlor who would be deprived of the assets if the testamentary provisions of the purported trust instrument were given effect, may seek a judicial declaration of the invalidity of the colorable transfer on the grounds that the transaction is fraudulent. This is purely a fraud doctrine and is not affected by community property considerations.

Bell, 22 BAY. L. REV. 311, 319 (1970). Whether the doctrine, if available at all in Texas, applies only upon the trustee's death is an open question.

D. ALTER EGO. Family lawyers know that the independence or separateness of a corporation or other business entity can be attacked under the "alter ego" doctrine. The doctrine should just as readily be available to "pierce the veil" of a trust. The Court of Civil Appeals, in In re Marriage of Burns, 573 S.W.2d 555, 557 (Tex. Civ. App.--Texarkana 1978, writ dism'd) acknowledged this potential attack, when it pointedly observed that the wife in that case had not challenged the husband's trust as being the alter ego of the husband. The necessary legal standards to establish a trust as alter ego can be adapted from cases where a spouse has sought to pierce the corporate veil. See Spruill v. Spruill, 624 S.W.2d 694 (Tex. Civ. App.--El Paso 1981, writ dism'd); Duke v. Duke, 605 S.W.2d 408 (Tex. Civ. App.--El Paso 1980, writ dism'd); Humphrey v. Humphrey, 593 S.W.2d 824 (Tex. Civ. App.--Houston [14th Dist.] 1980, writ dism'd); Goetz v. Goetz, 567 S.W.2d 892 (Tex. Civ. App.--Dallas 1978, no writ).

E. DRY TRUST. The Texas Supreme Court has said that "[w]hen a trustee has no duties to perform, the purposes of the trust having been accomplished, it becomes a simple, passive or dry trust, as it is termed in the law, and the cestui que trust is entitled to have the full legal title and control of the property, because no other person has an interest in the property." Lanius v. Fletcher, 100 Tex. 550, 101 S.W.2d 1076, 1078 (1907). Under these circumstances, the beneficiary is entitled to possession of the contents of the trust. Hall v. Rawls, 188 S.W.2d 807, 815 (Tex. Civ. App.--Beaumont 1945, writ ref'd). Similarly, if the trustee is not given affirmative powers and duties in the trust instrument, the trust is passive or dry, and legal title is vested in the beneficiaries, not the trustee. Nolana Development Ass'n v. Corsi, 682 S.W.2d 246, 249 (Tex. 1984).

F. **FRAUD, DURESS, MISTAKE, ETC.** Conveyances into trust, like every other transaction, are subject to rescission on the venerable old grounds of fraud, duress, overreaching, mistake, etc. See 57 TEX. JUR.2d Trusts § 36 (1964).

G. **CONSTRUCTIVE FRAUD.** There are a number of Texas cases asserting that constructive fraud can arise when a spouse gives community property to a third party. Most of these cases have involved direct gifts to third parties. However, the conveyance of community property into an inter vivos or testamentary trust should just as easily support a constructive fraud case. As much was admitted by the Supreme Court in Land v. Marshall, 426 S.W.2d 841 (Tex. 1968). The following cases, among others, have addressed the issue of constructive fraud of a spouse in conveyances to third parties: Carnes v. Meador, 533 S.W.2d 365 (Tex. Civ. App.--Dallas 1976, writ ref'd n.r.e.); Horlock v. Horlock, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd); Logan v. Barge, 568 S.W.2d 863 (Tex. Civ. App.--Beaumont 1978, writ ref'd n.r.e.). The authorities agree that the court will rescind a transaction where one spouse unfairly disposes of the other spouse's one-half interest in community property. The doctrine of constructive fraud is one tool the practitioner can use to undo one spouse's conveyance of the other spouse's share of community property into a trust. See Stephens County Museum, Inc. v. Swenson, 517 S.W.2d 257 (Tex. 1975) (case remanded to trial court for determination of constructive fraud issue regarding transfer into trust).

H. **MERGER.** The essence of an express trust is the separation of legal title from equitable title. Thus, when the beneficiaries of an express trust convey equitable title to the trustee, so that legal title and equitable title are merged in the trustee, the trust is terminated and the trustee has an unrestricted right to the property. See Becknal v. Atwood, 518 S.W.2d 593 (Tex. Civ. App.--Amarillo 1975, no writ). Thus, in Becknal, where the father conveyed real property to his wife as trustee for their children, and the children later conveyed their remainder interest back to their mother, for her use and enjoyment during her lifetime, and then to the trustor/father, for his use during his lifetime, legal and equitable title merged and the property in question dropped from trust. Other trust property not involved in the re-conveyance continued to remain in trust. The doctrine of merger is expressly set out in section 112.034 of the Texas Trust Code. The Code provides:

> . . . if a settlor transfers both the legal title and all equitable interests in property to the same person or retains both the legal title and all equitable interests in property in himself as both the sole trustee and the sole beneficiary, a trust is not created and the transferee holds the property as his own . . . . Except as provided by subsection (c) of this section, a trust terminates if the legal title to the trust property and all equitable interests in the trust become united in one person.

TEX. PROP. CODE ANN. § 112.034 (Vernon 1984). The Code further provides that merger cannot occur for the beneficiary (other than the settlor) of a spendthrift trust, and that if such occurs, the court must appoint a new trustee or co-trustee to administer the trust. Whenever the settlor is a beneficiary as well as a trustee, the possibility of merger arises. Id.

I. **INTERNAL REVENUE CODE STANDARDS.** The Internal Revenue Code addresses an issue analagous to the "illusory trust" and alter ego doctrines in connection of taxation of trust income. The Internal Revenue Code recognizes a trust as a separate taxable entity only when there is a genuine relinquishment of the settlor's control over his wealth. If the settlor retains too much control over the trust, the income of the trust will be taxed to the settlor.[2] While recognition of a trust as a taxable entity under the Internal Revenue Code is different from recognition of a trust under local property law, in most instances the Code standards relate to the true "separateness" of the trust from the trustor. Also, the failure to meet Code requirements makes the trust's income taxable to its grantor, creating a liability for the community estate, and perhaps bolstering the claim that if income is taxable to the community, then the conveyance into

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2 The Code also taxes trust income to the settlor if the income is used to make payments which the settlor is obligated to make, such as child support.

trust should be declared to be ineffective.[3] For a discussion of the specific questions addressed by the Internal Revenue Code on the subject, see 33 AM. JUR.2d Federal Taxation § 1845 (1985).[4]

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III. **TEXAS TRUST CODE.** The Texas Trust Code is now set forth in Chapters 111-115 of the Texas Property Code. TEX. PROP. CODE ANN. § 111 et seq. (Vernon 1985). A helpful review of the significant features of the Code is set out in Reid, Wills and Trusts, 39 SW. L.J. 301, 310-313 (1985).

A. **APPLIES TO EXPRESS TRUSTS ONLY.** The Texas Trust Code applies to express trusts created on or after January 1, 1984, and to all transactions relating to such trusts, TEX. PROP. CODE ANN. § 111.006 (Vernon 1984), but not to resulting trusts or constructive trusts. TEX. PROP. CODE ANN. § 111.003 (Vernon 1984). Transactions occurring on or after January 1, 1984, involving trusts created under the Texas Trust Act, repealed in 1984, are governed by the Code. TEX. PROP. CODE ANN. § 111.006; Nolana Development Ass'n v. Corsi, 682 S.W.2d 246, 249 (Tex. 1984).

B. **IMPORTANT DEFINITIONS.** The Texas Trust Code contains important definitions regarding express trusts. Definitions relevant to this Article are set out below.

1. **Settlor.** Under the Texas Trust Code, a "settlor" is a person who creates a trust. TEX. PROP. CODE ANN. § 111.004(14) (Vernon 1984). A settlor is sometimes called a "grantor" or "trustor." The terms all mean the same thing. Id. Where the trust is a testamentary trust, the settlor is sometimes called the "testator."

2. **Beneficiary.** The "beneficiary" of a trust is the person for whose benefit property is held in

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3 If the trust is nonetheless valid under property law, then perhaps a right of reimbursement arises for community property used to pay taxes on the income of the trust.

4 There are also Internal Revenue Code standards which require the inclusion of the trust property in the settlor's estate if the settlor retains too much control over the trust. See 34 AM. JUR. 2d Federal Taxation § 43.501 (1985).

trust, regardless of the nature of the interest. TEX. PROP. CODE ANN. § 111.004(2) (Vernon 1984).

3. __Trustee.__ "Trustee" means the person holding property in trust. TEX. PROP. CODE ANN. § 111.04(18) (Vernon 1984).

4. __Trust Property.__ "Trust property" means property placed in trust by one of the recognized methods of creating a trust,[5] as well as property otherwise transferred to, or acquired or retained by, the trustee for the trust.

5. __Express Trust.__ "Express trust" is defined to mean a fiduciary relationship with respect to property "which arises as a relationship and which subjects the person holding title to the property to equitable duties to deal with the property for the benefit of another." TEX. PROP. CODE ANN. § 111.004(4) (Vernon 1984).

6. __Terms of a Trust.__ "Terms of a trust" means "the manifestation of intention to the settlor with respect to the trust expressed in a manner that admits of its proof in judicial proceedings." TEX. PROP. CODE ANN. § 111.004(15) (Vernon 1984).

IV. __PRINCIPAL AND INCOME IN EXPRESS TRUSTS.__ Under the now superceded Texas Trust Act, the settlor could direct, in the trust instrument, the allocation of trust receipts to income or principal. TEX. REV. CIV. STAT. ANN. art. 7425b-27 (Vernon 1960). The same is true under the Texas Trust Code. Reid, __Wills and Trusts__, 39 SW. L.J. 301, 312 (1985). TEX. PROP. CODE ANN. § 113.101(a)(1) (Vernon 1984). In the absence of instructions from the settlor, the Texas Trust Act (old) and the Texas Trust Code (new) has a set of rules which govern. TEX. PROP. CODE ANN. § 113.102 (Vernon 1984).

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A. __TRUST PRINCIPAL.__ The "principal" of a trust is described in the Texas Trust Code by way of a listing, rather than by a definition. The list of items treated as principal are as follows.

1. __Property Received in Exchange.__ Principal includes the consideration received by the trustee upon the sale or transfer of principal, or repayment of the

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5 The recognized methods of creating an express trust are set out in section 112.001 of the Texas Property Code.

principal of a loan, or a refund, or replacement, or change in the form of principal. TEX. PROP. CODE ANN. § 113.102(b)(1) (Vernon 1984).

2. __On Condemnation.__ Principal includes the proceeds of property taken by eminent domain. __Id.__ TEX. PROP. CODE ANN. § 113.102(b)(2) (Vernon 1984).

3. __Insurance Proceeds.__ Principal includes insurance proceeds on property forming part of the principal, except for proceeds on a separate interest of an income beneficiary. TEX. PROP. CODE ANN. § 113.102(b)(3) (Vernon 1984).

4. __Corporate Distributions.__ Principal includes stock dividends, receipt upon liquidation of a corporation, and other distributions from a corporation,[6] as provided in section 113.104 of the Act. TEX. PROP. CODE ANN. § 113.104 (Vernon 1984).

5. __Stock Proceeds.__ Principal includes receipts from the disposition of corporate securities (including stocks, bonds, etc.), as provided in section 113.104 of the Act. TEX. PROP. CODE ANN. § 113.102(b)(4) (Vernon 1984).

6. __Royalties.__ Principal includes royalties and other receipts from the disposition of natural resources, or timber, as provided in sections 113.107 and 113.108 of the Act. TEX. PROP. CODE ANN. § 113.102(b)(6) (Vernon 1984).

7. __Depleting Assets.__ Principal includes receipts from principal subject to depletion, as provided in section 113.109 of the Act. TEX. PROP. CODE ANN. § 113.102(b)(7) (Vernon 1984).

8. __Change of Form.__ Principal includes profits resulting a change in form of principal. TEX. PROP. CODE ANN. § 113.110 (Vernon 1984).[7]

9. __Underproductive Property.__ Principal includes receipts from the disposition of underproductive property, as provided in section 13.110 of the Act. TEX. PROP. CODE ANN. § 113.102(b)(9) (Vernon 1984).

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6 It is unfortunate that the Legislature did not speak to distributions from a partnership.

7 There is an exception for underproductive property.

10. __Depreciation Allowance.__ Principal includes allowances made for depreciation. TEX. PROP. CODE ANN. §§ 113.106 & 113.110 (Vernon 1984).

B. __TRUST INCOME.__ As stated above, the settlor may provide for the allocation of trust receipts to income or principal. Absent that, the provisions of the Texas Trust Act or Code will control. According to the Texas Trust Code, the "income" of a trust is the return derived from the use of the principal, including the following items.

1. __Rent.__ Trust income includes rent on real or personal property. TEX. PROP. CODE ANN. § 113.102(a)(1) (Vernon 1984).

2. __Interest.__ Trust income includes interest on money lent, excluding bond premiums and discounts, as provided in section 113.105 of the Act. TEX. PROP. CODE ANN. § 113.102(a)(2) (Vernon 1984).

3. __Corporate Distributions.__ Trust income includes all distributions from corporations, except those described in section 113.104(b) and (c) of the Act. TEX. PROP. CODE ANN. § 113.104 (Vernon 1984).

4. __Increments on Discounted Bonds.__ Trust income includes accrued increments on bonds or other obligations issued at a discount. TEX. PROP. CODE ANN. § 113.105 (Vernon 1984).

5. __Business and Farming Profits.__ Trust income includes receipts from business and farming operations. TEX. PROP. CODE ANN. § 113.106 (Vernon 1984).

6. __Natural Resources.__ Trust income includes a portion of the receipts from the disposition of natural resources, excluding timber, allocated pursuant to section 113.107 of the Act. TEX. PROP. CODE ANN. § 113.102(6) (Vernon 1984). Timber is controlled by section 113.108 of the Act.

7. __Depleting Assets.__ Trust income includes receipts from other principal subject to depletion. TEX. PROP. CODE ANN. § 113.109 (Vernon 1984).

8. __Underproductive Property.__ Trust income includes certain receipts from underproductive property,

as provided in section 113.110 of the Act. TEX. PROP. CODE ANN. § 113.102(a)(8) (Vernon 1984).

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V. SPENDTHRIFT TRUSTS. Under the Texas Trust Code, a settlor may provide that the interest of a beneficiary in income or principal, or both, may not be voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee. TEX. PROP. CODE ANN. § 112.035 (Vernon 1984). The settlor may create a spendthrift trust by merely indicating with the words "spendthrift trust." Id. The Trust Code provides, however, that if the settlor is a beneficiary of the trust, spendthrift provisions do not prevent his creditors from satisfying claims from his interest in the trust estate. Id. This was also true for trusts created under the Texas Trust Act, as a result of case law. See First Bank & Trust v. Goss, 533 S.W.2d 93, 95 (Tex. Civ. App.--Houston [1st Dist.] 1976, no writ). Thus, it has been said that when a settlor creates a spendthrift trust and makes himself a beneficiary, the spendthrift clause is void as far as then existing or future creditors are concerned, and they can reach his interest under the trust by garnishment. Bank of Dallas v. Republic Nat. Bank of Dallas, 540 S.W.2d 499, 501 (Tex. Civ. App.--Waco 1976, writ ref'd n.r.e.).

Hisquierdo = AA
McCarty = No-AA

A. CAN ORDER PAYMENT OF CHILD SUPPORT. Under section 14.05(c) of the Texas Family Code, the court in a suit affecting the parent-child relationship may order the trustees of a trust, including a spendthrift trust, to make disbursements for the support of the child to the extent that the trustees are required to make payments to a beneficiary who is, in turn, required to make support payments for a child under section 14.05. If disbursement of the trust assets is discretionary with the trustee, the court can order payments for the benefit of the child from the trust income, but not from the principal of the trust. TEX. FAM. CODE ANN. § 14.05(c) (Vernon 1975). See In re Marriage of Long, 542 S.W.2d 712, 715 (Tex. Civ. App.--Texarkana 1976, no writ).

mandatory dist.

discretionary dist

VI. TRUSTS AND MARITAL PROPERTY LAW. The interface between trusts and family law is a confusing area. Some commentators attribute this to the fact that trusts are a creature of the common law, where the wife's identity merged into the husband, upon marriage. Special rules regarding trusts developed in the context of the common law. When transplanted to Texas, these rules did not mix well with the joint ownership concept of the community property system. The law is so confused in the area that a commentator can scarcely digest the law more effectively than to advocate his or her predispositions. To minimize this problem, this Article takes significant trust and marital property law cases, one-by-one, summarizing their holdings and, occasionally, making editorial comments.

The remaining sections of this Article set forth the views of various commentators on the subject of trusts and marital property law, and a digest of important trust-related family law cases, followed by sample documents and exhibits relating to the trial and appeal of trust-related family law issues. Due to this format, the remainder of the Article may not flow as easily as ordinary text. However, the ingredients are assembled for the reader to synthesize into a suitable dish to serve to the court or jury.

CONCLUSION

There is a tremendous opportunity for strong advocacy to prevail in the area of trusts in family law. The concepts are confusing, the case law is conflicting, and no really satisfactory "how to" article or treatise has been written to guide the family law trial or appellate lawyer in assailing or defending trusts in family law cases. It is hoped that this Article, especially combined with the companion seminar discussions, will develop the possibilities which the clever lawyer can use to win.

SECTION TWO

OPINIONS OF WRITERS

SKIP

Brink, Marital Property: Characterization and Reimbursement Concerns in Estate Planning and Administration, SOUTH TEXAS COLLEGE OF LAW ADVANCED ESTATE PLANNING AND PROBATE SHORT COURSE D-21 (1985).

[EXCERPT]

D. TRUSTS. Transferring separate property assets into an inter vivos management trust is a more sophisticated means by which assets can be protected from commingling and readily identified since the title to the assets is actually held by the trustee. The trust might even provide for disposition of the property upon the grantor's death. In establishing such a trust, the question arises as to the character of the income from the trust. Unless otherwise agreed by the spouses, the general rules applicable to income from separate property should make the trust income community property. This is probably true for any distributed income. See discussion in Wilmington Trust & Co. v. U.S., 83-2 USTC [para.] 13,547 (1983), a federal tax case holding income from a trust distributed to a spouse during marriage to be separate property. Although a similar conclusion has been reached in the Texas courts, the facts are distinguishable when the trust is created by a third party, not a grantor-spouse. Wilmington, supra, should not be relied on without careful review of all Texas authority cited therein.

Rather, in a situation where there is no agreement between the spouses that the trust's income will be separate, it is advisable to keep the trust's books as accurately as possible to identify income vs. principal or else to mandate that all income be distributed currently. A simplified example of a trust which might be used for this purpose is attached as Appendix C.

If the non-owner spouse joins in or consents to creation of the trust, the trust agreement assumes some of the same characteristics of a property agreement discussed below in Paragraph E and should probably be executed with the same formalities and protections. This is not needed if all income is distributed out currently or payable to the owner's estate at death (where it is subject to the non-owner spouse's claims). Perhaps the most comprehensive plan involves a trust used in connection with a property agreement which addresses income and reimbursement rights. In a trust executed by both spouses, the final disposition of assets may be assured. Unlike a testamentary dispositive plan which can be changed at will by either spouse's execution of a new will, a trust can be used in connection with a marital property agreement to insure desired disposition of assets despite their classification.

Campfield, Characterization of Income from Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE (1984).

[EXCERPT]

Overview

1. Trust income whether distributed or undistributed is clearly the separate property of the trust beneficiaries.

a. Exception. A trust should not be used as a vehicle through which to launder property to change its character. Accordingly, a person cannot create a trust for his own benefit and, thereby cause the income produced by the trust property to be his or her separate property if the income would have been community had it not been laundered through the trust.

(1) Exception to an exception. In the case of discretionary pay trusts for the benefit of the settlor -- where all distributions are at the discretion of the trustee -- trust income, both distributed and undistributed, would be the separate property of the settlor in those cases where there was no collusion between the settlor and the trustee with respect to trust distributions.

2. Income distributed from an estate is the community property of the distributee if the distributee was married at the time the income was earned by the estate.

a. However, income in respect of a decedent is probably property classified as separate property.

* * * *

Conclusion

It is appropriate to note that the Texas cases which have considered this question have uniformly held that trust income is the separate property of the trust beneficiary to whom the income has been given.

a. While this statement may appear inconsistent with the conventional wisdom often expressed in the cloakrooms, the statement is, in fact, correct.

b. In no way does the much celebrated case of Arnold v. Leonard (or its progeny), contradict it.

c. This line of reasoning follows from the common law notion that the income interest in a trust -- as well as the trust corpus -- can be the subject matter of a gift. A donor can create a trust giving one beneficiary the right to enjoy trust income while giving another beneficiary the ultimate right to enjoy the trust corpus. Thus, "income" is only a formula or shorthand expression to describe the gift that the donor wants the trust beneficiary to have at regular intervals. To reach any other result would frustrate a fundamental Constitutional principle, namely that persons should be free to dispose of their property in whatever manner choose.

2. While the foregoing generalizations are accurate, it is appropriate to suggest that, notwithstanding Wilmington Trust, policy considerations dictate that a settlor should not be able to launder property through a trust and, thereby, purge it of its community character.

Counts, Trust Income--Separate or Community Property? 30 TEX. B.J. 851 (1967).

[EXCERPT]

My primary points will be that the holdings of the court in Arnold v. Leonard and Herring v. Blakely are not in point on the question of whether a receipt attributable to a principal fund held in trust (whether or not distributed) is separate or community, that general principles of trust law and contract law are and ought to be controlling, and that the Texas cases of Martin Brown Co. v. Perrill, et al, McCelland v. McCelland and Sullivan v. Skinner (and other similar cases) are the controlling Texas authorities.

* * * *

It is one thing to convey the full legal title to property to A but to undertake to direct that all income derived by A from the property shall be separate; it is quite a different thing to convey full legal title to property, not to A at all but to B as Trustee, with specific directions to B concerning the holding, management, use of, and ultimate disposition and distribution of the property, which directions are binding on the Trustee, Trustor and Beneficiary and enforceable by the Trustor and Beneficiary.

* * * *

[Mr. Davis] might also . . . have cited Judge Ocie Speer, Speer's Marital Rights in Texas, 4th edition, Sec. 420, the author reaching the same conclusions and citing many of the same Texas authorities on the particular points:

> "It must be conceded that if an estate were conveyed by any other than the husband to a trustee, in trust that the issues, rents, increase, profits, and the like, be by such trustee delivered to the wife, in her separate right, the gift, bequest, or devise, as the case may be, would be specifically of such issues, rents, increase, or profits, and would

> hence be within the letter and spirit of the statute making them the separate property of the wife. For surely one entitled to convey the greater, may convey the lesser, estate. In such case it is not the fee nor the corpus of the property granted, but only its use, rents, profits, and increase."

Certainly, the general concept of trust law is that one holding title to property with full rights of disposition upon such terms as he may choose may in lieu of disposing of it outright transfer it by inter vivos or testamentary transfer to a trustee with directions to the trustee binding on the trustee and all others as to the handling of the property and as to the disposition to be made of it by the trustee, both of original principal and of income, and as long as the directions of the settlor are not unenforceable because of some public policy consideration, the manifested intention of the trustor will be recognized and given effect.

* * * *

As to the truly discretionary trust, by the very terms of the instrument itself, the beneficiary has no indefeasible interest or claim to the item until it is distributed, certainly no such interest as would require it to be regarded as "acquired" by the beneficiary, in the sense of the constitutional provision and thus, hardly can it be said that the community would have some kind of interest when the beneficiary of the trust has acquired no interest, and at best has some nature of expectancy, or some contractual remedy depending upon the particular trust involved (e.g. perhaps founded on abuse of discretion by the trustee). Moreover, after distribution, and receipt by the trust beneficiary even if it is a distribution of current income it is acquired by way of gift or devise by the beneficiary. In the first place, it was the income item itself which the trustor gave. In the second place, the trustee in exercising his discretionary authority to make the distribution qualifies as a donor for the purpose of a decision that the beneficiary receives the item as a gift within the meaning of the constitutional provision. Thirdly, it is quite realistic to treat the trustee as completing the gift from the trustor which remained incomplete until the distribution was made. If the distribution is of an item which was originally income to the trustee but by virtue of the terms of the trust had been added to the principal of the trust by the trustee, then the further contention may be made that the distribution to the beneficiary of the item is legally the same as a distribution of that which came into trustees hands intitially as principal.

* * * *

In the case of a trust with distribution of the income on a current basis as mandatory, the discussion assumes that by the terms of the trust the treatment of the distributed item as community property would be contrary to the stated desires of the trustor. In the first place, there certainly does not seem to present itself any valid reason why the stated intention of the trustor should be frustrated on the grounds of public policy, or illegality, and the trust property having been transferred upon the express trust condition that the sole beneficiary of the trust should be the beneficiary designated by the trustor, not his or her spouse, or a "Community estate" such conditions should control. Indeed, the trustor never parted with the property except subject to this condition. The rights of the beneficiary's spouse are certainly in no manner violated. If analysis is to be required in relation to the constitutional provision, it can be said (1) that it was the income itself which was given by the trustor, (2) that there is no completed gift until the distribution is made by the trustee and (3) there is no completed gift except subject to the prescribed preexisting condition which the trustee attached to the distribution.

* * * *

In summary, these conclusions seem to be sound:

(1) Cases holding that the characteristic of a receipt as community or separate may

not be altered by contractual stipulation in advance do not answer the question of whether or not a particular receipt is or is not community income.

(2) That the decision as to whether or not a receipt attributable to property held in trust is or is not community may be a different one depending on the terms of the trust.

(3) The answer to the question as to whether a receipt is or is not community income may be different depending on whether the question is posed as to an item which has been distributed to a beneficiary or as to an item still in the trustee's hands.

(4) The Texas cases support the proposition that a settlor may create a trust for the sole and exclusive use of a designated beneficiary and that the trust income, even if subject to a mandatory direction to distribute currently, will be received by the beneficiary as a part of his separate estate.

(5) The gift of the income of the trust where there is an active trust with a true separation of the legal and beneficial interest is either from the trustee to the beneficiary or from the donor to the beneficiary through the instrumentality of the trustee and thus is literally received by gift or devise and there is no completed gift prior to distribution.

(6) The income from the trust asset although received by the trustee as income attributable to the corpus or principal held in trust when distributed is a gift to the beneficiary and is not income from separate property or income to the beneficiary at all.

(7) Where the trustor imposes the condition of the gift that it be distributed and received for the sole and separate use of the designated beneficiary any distribution to the beneficiary vests in title subject to this condition and thus, the gift is only completed from the original donor to the beneficiary subject to such condition precedent.

(8) To treat the income of the trust as community income is to constitute the spouse of the benficiary a co-beneficiary contrary to the stated intention of the trustor and violates the terms of the trust and for such to be done requires a holding that the evidenced intention of the trustor is contrary to public policy, which it is not and should not be.

(9) In the case of many trusts (trust to specific use) the holding that the income item, whether or not distributed, is community would violate the use for which the trustor designated the income should be restricted or limited and there is nothing in the constitutional provisions defining the community and separate estates of a husband and wife requiring this result.

(10) Certainly until distribution no property is "acquired" by a beneficiary within the meaning of the constitutional provisions involved. [footnotes omitted.]

Davis, Income Arising From Trusts During Marriage is Community Property, 29 TEX. B.J. 901 (1966).

[EXCERPT]

The article entitled "Income Distributions from Trusts--Separate or Community Property?", Vol. 29 Texas Bar Journal, p. 449 (June 1966) considers the question of whether income distributions during marriage from trusts created with separate property is separate or community property. The conclusion is made in that article that such distributed income is the separate property of the married beneficiary. Analysis of the controlling principles laid down by Texas and Federal cases indicates that this conclusion is incorrect. These controlling principles indicate that the Texas law is that income arising from such trusts and distributed to the married beneficiary is community property. The principles also indicate that undistributed income from such trusts is also community property.

All of the Texas cases but one relied upon in the prior article to support the view that such income is separate property were decided before 1900. The one exception is Sullivan v. Skinner, 66 S.W. 680 (Tex. Civ. App. writ refused) decided in 1902. To the extent that any of these old cases hold that such distributed income is separate property of the married beneficiary who owns the equitable estate in the trust corpus, such cases have been in effect overruled by the Texas Supreme Court in the 1925 case of Arnold v. Leonard, 114 Tex. 535, 273 S.W. 799, and by a number of later Texas Supreme Court and Federal cases which fortify the principles laid down in Arnold v. Leonard.

* * * *

Applying the principles laid down in Arnold v. Leonard, it is seen that the method of acquiring income arising from the corpus of trust property during marriage is different than by "gift, devise or descent." Such income is acquired by earnings of the trust corpus, Lesage v. Gateley, 287 S.W.2d 193 (Tex. Civ. App. 1956 error dism.). Therefore such income does not, by definition, fall within the class of separate property, as fixed by the Constitution. There can be no title to income nor any acquisition of income until the income comes into existence. If income comes into existence during marriagee its property status as community property is thus fixed.

* * * *

The Supreme Court of the United States has clearly recognized the nature and extent of the wife's vested interest in community property at the moment it is created during marriage. Poe v. Seaborn, 282 U.S. 101 (1930), and the following companion cases decided at the same time, Goodell v. Koch, 282 U.S. 118 (1930), Hopkins v. Bacon, 282 U.S. 122 (1930), Bender v. Plaff 282 U.S. 127 (1930), and U.S. v. Malcolm, 282 U.S. 792 (1930).

The Texas Supreme Court has held that the nature of community property cannot be changed by contract provisions of insurance policies such as giving the insured husband the right to change beneficiary at his absolute discretion. Brown v. Lee, 371 S.W.2d 694 (Tex. S. Ct. 1963). The Texas Supreme Court has also held that contracts setting up profit-sharing trusts or pension trust plans cannot change the nature of community property by spendthrift provisions, by provisions prohibiting possession or control of the property and provisions permitting the husband-employee to name parties other than the wife as the beneficiary. Herring v. Blakeley, 385 S.W.2d 843 (Tex. S. Ct. 1965).

All these cases clearly demonstrate that the community property system of Texas forms a pattern whereby constitutionally the property rights of the spouses are definitely fixed, and cannot be enlarged or diminished by legislative, judicial or contractual processes, even though the contractual process is attempted by means of a spendthrift discretionary trust.

* * * *

The principles laid down in the above cases support the conclusion that undisturbed income arising from such trusts during marriage is community property. The nature of community property is determined by its method of creation, whether it is income, rents or profits arising during marriage. The nature of property is not determined by its distribution or its possession. The Supreme Court in Blakeley v. Herring, supra, pointed out that community rights may exist in property interests that cannot be reduced to possession by the husband and wife at the time of divorce.

* * * *

So it is seen that a married spouse may receive a vested equitable title to the trust corpus as a gift, either before or during marriage. This trust corpus is separate property. During marriage, income arises from the trust corpus. This income is community property upon the moment of its creation because it is not property acquired by gift, devise or descent. It makes no difference that the income is not then distributed or is not reduced to possession or cannot be reduced to possession by the married beneficiary. It is and remains community property nonetheless.

* * * *

A spendthrift trust in Texas will prevent a creditor of the beneficiary of trust funds from reaching the funds, but the wife is not in the position of a creditor; she is in a position of being the vested owner of the community property income that arises from the corpus of the trust funds in the form of rents, revenues and profits. Therefore, the spendthrift trust provisions have no effect upon her property interest in the funds.

* * * *

Although there are no recent Texas cases squarely in point, all of the pertinent and controlling principles laid down by the cases since Arnold v. Leonard indicate that the

Texas law is that distributed and undistributed income arising during marriage from trusts is community property.

Huie, Commentary on the Community Property Law of Texas, 13 VERNON'S ANNOTATED REVISED CIVIL STATUTES OF THE STATE OF TEXAS (1960).

[EXCERPT]

Property Interests of Limited Duration.--If a father makes a gift to his married daughter of income to accrue from certain land for a period of five years, but does not give her any further interest in the land, the income received during the five-year period would not be classified as ordinary income which goes into the community. It could be said that the property itself is not given to the wife, but only the income. Such an analysis, treating the income as the subject matter of the gift, might lead the court to hold that all of the income as it is received is separate. On the other hand, if the wife immediately sells the right to receive the future income for cash and invests the proceeds of the sale, the income from the investment would be community. There is a logical basis, therefore, for apportionment of the income as it is received between the separate and the community estates. There is authority that the entire income as received is separate, but no cases have been found where it was contended that an apportionment should be made.

If a gift of the right to receive future income from property for a limited period of time is to be treated as a gift of income which makes the money when received entirely separate, how far will the principle be carried? A father puts property in trust with directions to the trustee to pay the net income to his married daughter during her life and at her death to divide the principal among her children. Is this income as she received it to be classed as entirely separate, entirely community, or is it to be apportioned between the separate and community estates? Again the problem is one that has not been settled. Some support can be found in earlier cases for letting the donor determine whether the income is to be separate or community, but it would be hard to reconcile such a conclusion with the reasoning in Kellett v. Trice and later cases that the separate or community character of the property is fixed by law. Without passing upon whether the donor could effectively provide otherwise, the Court of Appeals for the Fifth Circuit has held that at least in the absence of a contrary expression of intention, the income received by the life beneficiary during marriage belongs to the community. The result reached conforms to the principle of the Texas community property system that the ancestral wealth shall constitute an endowment for the marriage, with the revenue going into the community. The owner of property is permitted to control to some extent its transmission from one generation to the next for a period of time limited by the rule against perpetuities, and the present tax structure encourages the exercise of that control, but the fact that an ancestor has exercised his power by giving limited interests to successive beneficiaries should not be allowed to weaken the community property tie; revenue received by a son or daughter during the marriage, whether a fee is owned or just a life estate, should be community property. [footnotes omitted.]

McKnight, Family Law: Husband and Wife, 31 SW. L.J. 105, 112-13 (1977).

[EXCERPT]

The subject matter of a gift in trust has long perplexed the courts. For example, if a spouse is the beneficiary of a trust, is the subject of the gift merely the equitable estate held in trust or does it also include the income by which that beneficial interest is valued? There is no other means of measuring the beneficiary's interest in corpus than by its production of income. Hence, it is asserted that the right to receive income is really the subject matter of the gift. On three occasions the Supreme Court of Texas has stated that the settlor of a trust or the donor of other inter vivos gifts may provide that income from the property shall be the separate property of the donee.[74] Several old federal court tax cases have reached the conclusion that in the absence of such directions trust income is community property.[75] But the courts have consistently held that income of a discretionary trust which is not paid the beneficiary is not community property.[76] Hence, if the settlor directs that such income be added to the trust corpus, it follows, as the Texarkana court held in In re Marriage of Long,[77] that such additions constitute separate property of the beneficiary who, as a distinct and separate right, may also be the donee of the corpus.

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74. Strickland v. Webster, 131 Tex. 23, 112 S.W.2d 1047 (1983) (dictum in case involving non-trust gift by husband to wife); Cauble v. Beaver-Electra Ref. Co., 115 Tex. 1, 274 S.W. 120 (1925) (dictum in case not involving gifts between husband and wife); Hutchison v. Mitchell, 39 Tex. 488 (1873) (gift in trust by husband for wife providing that income should be her separate property). Lower court decisions have reached the same conclusion. Sullivan v. Skinner, 66 S.W. 680 (Tex. Civ. App. 1902, writ ref'd); McClelland v. McClelland, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd); Monday v. Vance, 32 S.W. 559 (Tex. Civ. App. 1895, no writ); Shepflin v. Small, 23 S.W. 432 (Tex. Civ. App. 1893, no writ).

75. _See_, _e.g._, Commissioner v. Porter, 148 F.2d 566 (5th Cir. 1945); Commissioner v. Terry, 69 F.2d 969 (5th Cir. 1934).

76. Currie v. Currie, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd); Buckler v. Buckler, 424 S.W.2d 514 (Tex. Civ. App.--Fort Worth 1967, writ dism'd), _discussed in_ McKnight, _Matrimonial Property, Annual Survey of Texas Law_, 23 SW. L.J. 44, 47 (1969).

77. 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ). The case follows Currie v. Currie, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd), _discussed in_ McKnight, _Family Law, Annual Survey of Texas Law_, 29 SW. L.J. 67, 76 (1975).

Reppy, The Uniform Marital Property Act: Some Suggested Revisions For a Basically Sound Act, 21 HOU. L.REV. 679, 698-99 (1984).

[EXCERPT]

IV. CLASSIFYING PROPERTY

A. Determining What Is Appreciation, What Is Profit

The UMPA properly adopts the civil law rule[94] that rents and profits of separate property are community property if they accrue during marriage.[95] Community property includes dividends, interest income from trusts[96] and net rents, and other net returns attributable to investment, rental, licensing, or other use of property, unless attributable to a return of capital or appreciation.[97] Section 4 of the UMPA specifically makes all such income marital (community) property if "earned or accrued" during marriage.

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* * * *

96. UMPA should be revised so that the reference is to "interest income from trusts, whether or not the payee has any ownership in corpus." This is necessary to qualify the impact of UMPA § 4(g)(1), which provides that a gift is separate property. A great debate rages among the states adhering to the civil-law rule regarding whether all trust income is community or whether a donee or legatee of an income interest alone takes it as separate property because the income is the sole item that has been given. See Reynolds v. Reynolds, 388 So.2d 1135 (La. 1980); Commissioner v. Porter, 148 F.2d 566 (5th Cir. 1945) (Texas law); Wilmington Trust Co. v. United States, 4 Cl. Ct. 6 (1983) (Texas law); O. SPEER & L. SIMPKINS, TEXAS FAMILY LAW § 15.42 (5th ed. 1976); W. REPPY & C. SAMUEL, supra note 1, at 158-64; Counts, Trusts Income -- Separate or Community Property, 30 TEX. B.J. 851, 914-17 (1967); David, Income Arising From Trusts During Marriage Is Community Property, 29 TEX. B.J. 901, 901 (1966).

A statute or official comment should also note that it matters not whether the instrument of gift or bequest declares an intention that the income gift be separate property. Cf. Commissioner v. Porter, 148 F.2d 566, 567-69 (5th Cir. 1945) (stating that such intention is determinative). A community property characterization is equally compelled if the trust is spendthrift or if the trustee has discretion over how much income is paid to the donee spouse. Id. Contra Buckler v. Buckler, 424 S.W.2d 514, 515-16 (Tex. Civ. App.--Fort Worth 1967, writ dism'd). Because the policy of the UMPA is that of the broadest possible marital property sharing, short of a general community, each of the various splits of authority should be resolved in the statute itself or in its official commentary in favor of a community characterization.

Smith, <u>Characterization of Property</u>, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

[EXCERPT]

The character of income arising from a trust during marriage is uncertain. As the discussion below indicates, case law has been less than definitive, and the commentators are in disagreement.

The weight of authority of older Texas cases was that the income of separate property trust was the separate property of the beneficiary.

* * * *

The cases decided subsequent to <u>Arnold</u> appear to be consistent in holding that distributed trust income earned during the marriage is community property while undistributed income to which the beneficiary does not have a present possessory interest is separate property. In light of the fact that the Texas Supreme Court has not addressed this issue subsequent to its decision in <u>Arnold</u>, however, it may still be argued under <u>Arnold</u> that all trust income is community property. On the other hand, it may be argued that all trust income is acquired by gift, devise, or descent and thus is separate property. [footnotes omitted]

Stewart & Patterson, Theories of Recovery: Partnerships & Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-20-ff (1983).

[EXCERPT]

In a divorce case, the problems of handling assets held in trusts are similar to those problems created by partnership assets: (1) Is the interest of a spouse in trust assets held in the trust entity at the time of divorce divisible by the divorce court? (2) If the spouse's interest in the trust is divisible, what portion of his interest in the trust is community property and what portion is separate property? (3) Is a distribution from the trust entity to the individual spouse during marriage to be characterized as separate property or community property?

If Texas law appeared confusing and uncertain with regard to division of partnership interest upon divorce, it is even more confusing and uncertain with regard to characterizing distributions from trusts. There is no definitive Texas Supreme Court opinion. Law review articles and case law appears to be evenly split on a very basic issue: If the trustee in a discretionary pay irrevocable trust accumulates income inside the trust entity during marriage of the parties, will a distribution of trust assets to a spouse create community property, or must such a distribution be characterized as separate property because it is a gift? There is also an unexamined question that the cases do not presently address, but which might be addressed in the future due to the Texas Supreme Court opinions in the Cearley v. Cearley, 544 S.W.2d 661 (Tex. 1976), and Jensen v. Jensen, 26 Tex. Sup. Ct. J. 480 (July 6, 1983): Will a spouse's contingent interest in trust assets (not yet matured) be considered a divisible item of property in which the community might have a partial interest at the time of future distribution?

There are law review articles on both sides of the fence on whether trust income can be community property or not. One of the best reviews of the old cases, the federal cases, and the recent state divorce cases is found in "Interspousal Transfers," by Regis W. Campfield, 32 SW. L.J. 1091 at 1134-1161 (1979) (concluding that all distributions from trusts are separate property). Another excellent Law Review is "Community Property and the Law of Trusts," by Branscomb & Miller, 20 SW. L.J. 699 (1966) (reviewing federal cases holding that distributions of income accumulated in trusts during marriage can be community property.)

* * * *

Despite these cases, the very real possibility has arisen that contingent property or expectancy interests may some day be considered "divisible" property upon divorce. Specifically, in the retirement benefits--divorce case of Cearley v. Cearley, 544 S.W.2d 661 (Tex. 1976), the Texas Supreme Court held that retirement benefits which were not yet vested constituted community property, even though they were only a contingent "expectancy" interest. The Court ruled that it made no difference that the retirement benefits had not vested at the time of divorce, because contingent earnings, "prior to accrual and maturity, constitute a contingent interest in property and a community asset, subject to consideration, along with other property in the division of the estate of the parties under Section 3.63, of the Texas Family Code." 544 S.W.2d at 665-666. The Texas Supreme Court affirmed its position in Taggert v. Taggert, 552 S.W.2d 422 (Tex. 1977), where it held that the community had an interest in a percentage of the benefits "if, as, and when the benefits are received by the retiring spouse." How is it possible to distinguish the "expectancy" or contingent property which was held to be divisible upon divorce in Cearley from the expectancy or contingent property which a spouse may be legally entitled to under the provisions of a trust instrument? Both types of property interest may be subject to defeasance if the spouse/beneficiary fails to live to the appointed date. Neither interest can be reduced to immediate possession at the time of divorce. In both cases, by proper accounting, the percentage interest owned by the community can be determined.

The issue of dividing future, contingent, distributions has now been addressed by the Texas Supreme Court in divorce cases involving division of ownership interest in closely held corporations. Jensen v. Jensen, 26 Tex. Sup. Ct. J. 480 (July 8, 1983), required the Court to consider the community interest in the enhancement of value of the stock during marriage due to the spouse's labor, even though a present distribution of funds from the corporation cannot be legally forced. The same is true concerning the "reimbursement theory" in Vallone v. Vallone, 644 S.W.2d 455 (Tex. 1982), where the Texas Supreme Court recognized that, upon proper pleadings and proof, the wife may be entitled to a dollar sum for the community interest in a closely held corporation arising from community labor during marriage, even though a spouse could not force the corporation to distribute the reimburseable amount to the wife or husband.

The Texas Supreme Court has never handed down a decision stating one way or another whether the spouse's expectancy or contingent property interest in a trust could be divided upon divorce. It is submitted that when such an issue reaches the Texas Supreme Court, that Court will be hard pressed to handle the community's interest in such contingent property in a different manner from that involving the contingent property interest in retirement benefits and closely held corporations.

23 TEX. JUR. Husband and Wife § 55 (1932).

> **§ 55. Rents and Profits from Trust Estates. --** To the general rule that rents, profits and the like belong to the community, there is the well-defined exception that where the estate itself consists in the specific right ot take the rents, revenues and profits, such items constitute the corpus of the estate itself and may be the separate estate which we are here discussing.[17] Thus where a devise or trust instrument grants the rents, increase, revenues, profits and the like, those things come within the letter and spirit of our statute defining the separate estates. Surely, o ne entitled to convey the greater estate may grant the lesser estate at will. In such a case it is not the fee nor the corpus of the property granted, but only its use, rents, revenues, profits and the like.[18] Either husband or wife may thus, in his or her separate right, enjoy to the fullest extent the rents, revenues, income and profits of trust property.
>
> From what has been said it follows that either husband or wife may convey in trust for the beneficial use of the other in such a way as to convert into separate property those things which otherwise would belong to the community estate.[19] This is the rationale of the doctrine allowing gifts between the spouses. Indeed, in view of the undisputed right of either husband or wife to give or grant his or her separate property, nothing appears to prevent either from conveying the same in trust with an appropriation of the rents, revenues and profits therefrom to his or her own separate use or any other legitimate purpose. This would, of course, be a withdrawal of those rents and profits from the community and a transfer of the same to the separate estate, but after all, it is an indisputable incident to ownership. One owning property before marriage may thus convey the same in trust upon an annuity, rentals or otherwise, and the fruits thereof would never become community in their nature.[20]

17. Sullivan v. Skinner, (Civ. App.) 66 S.W. 680, writ refused.

18. McClelland v. McClelland, (Civ. App.) 37 S.W. 350, writ refused; Gamble v. Dabney, 20 Tex. 69.

19. Scottish-American Mort. Co. v. Massie, 94 Tex. 339, 60 S.W. 544; Monday v. Vance, 11 Civ. App. 374, 32 S.W. 559, Schepflin v. Small, 4 Civ. App. 493, 23 S.W. 432.

20. Krohn v. Krohn, 5 Civ. App. 125, 23 S.W. 848.

SECTION THREE

DIGEST OF CASES

The following cases relating to trusts and family law are summarized in the following pages:

Case Name **Page**

Const. Fraud
Merger (p.9)

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1. **Becknal v. Atwood**, 518 S.W.2d 593 (Tex. Civ.-App.--Amarillo 1975, no writ). In Becknal, the Court of Civil Appeals reversed the trial court's finding that community property was conveyed into trust in constructive fraud upon the wife's interest in the community. The wife was named as trustee of the trust created by her husband, for the benefit of the parties' children. There was no evidence of deceit, violation of confidence or injury to public interest. As a consequence, the husband's conveyance passed title to the trust of all the community interest in the property conveyed.

The trust was a spendthrift trust. Although beneficiaries of a spendthrift trust may not alienate or encumber the trust estate, or their interest in the trust property, a spendthrift trust may be modified or terminated by the consent of all the parties to it. Id. at 598. In this case, the children conveyed a life interest in the land to their mother and their father. This did not terminate the trust, in total, because other realty remained in the trust. However, the real estate made the basis of the conveyance back to the parents, through the transaction became free of trust.

Secondary Authorities

No secondary authorities could be found discussing the the Becknal case.

RECAP

While the beneficiaries of the spendthrift trust may not alienate or encumber the trust estate or their interests in the trust can be modified or terminated by consent of all parties to it. A conveyance of real estate from the beneficiaries to the trustor and trustee removes the property from trust. The trust continued, however, as to other assets. Where there was no evidence of constructive fraud, and especially where the wife participated to the extent of being trustee, the trial court's finding of constructive fraud was reversed and rendered.

2. Buckler v. Buckler, 424 S.W.2d 514 (Tex. Civ. App.--Fort Worth 1967, writ dism'd). In Buckler the question was whether the wife, in a divorce, was entitled to have the undistributed income accumulated in the husband's "spendthrift trust" considered as community property. According to findings set forth in the judgment, the trial court excluded the undistributed income from the trust on the theory that it constituted no part of the community estate. Id. at 515.

The terms of the trust are not quoted in the Court of Civil Appeals' opinion. However, the Court did state that "the terms and provisions of the trusts created in behalf of appellee Buckler so restricted and defined his rights and interests as to exclude his entitlement to undistributed income which the trustees had not seen fit to deliver to him." Id. at 516. The wife, in her brief, characterized the trust as a "discretionary trust." The Fort Worth Court of Appeals felt constrained to follow McClelland v. McClelland, 37 S.W. 350, (Tex. Civ. App. 1896, writ ref'd), which held that undistributed trust income is not community property where the trustee has the right under the trust instrument to withhold it from the trust beneficiary. Id. at 515.

Secondary Authorities

a. Campfield. Professor Regis W. Campfield made the following comments about the Buckler case:

> . . . In [Buckler], the court held that undistributed income from a spendthrift trust created for the benefit of the husband was not community property. . . . By the trust terms the husband was not entitled to the undistributed income. . . . The court relied on McClelland v. McClelland in rendering its decision, rejecting the argument that [McClelland] had been directly overruled by Arnold v. Leonard.

Campfield, Characterization of Income from Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-17 (1984).

b. McKnight. Professor Joseph W. McKnight made the following comment about Buckler: "Undistributed income subject to a discretionary trust for the benefit of one spouse is another factor that may not be considered." McKnight, Division of Texas Marital Property on Divorce, 8 ST. MARY'S L.J. 413, 430-31 (1976).

c. <u>Smith</u>. Donald R. Smith said: "In <u>Buckler v. Buckler</u>, the court, following the older case of <u>McClelland v. McClelland</u>, held that undistributed income from a spendthrift trust was separate property. The court suggested, however, that distributed trust income was community property under the holding of <u>Arnold</u>." Smith, <u>Characterization of Property</u>, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

d. <u>Stewart</u>. James D. Stewart and Kirk Patterson made the following comments regarding <u>Buckler</u>:

> There is dicta in several of the modern cases, indicating that, upon distribution, income accumulated in a trust during marriage of the beneficiary would be received as community property. [<u>Buckler</u>] held that undistributed income in a trust is not divisible upon divorce; but, in dicta, the Court appeared to agree that <u>Arnold v. Leonard</u>, did overrule the <u>McClelland</u> case, as argued by the wife, which means that distributed income from a trust which is not the result of "gift, devise, or descent," would have the character of community property.

Stewart & Patterson, <u>Theories of Recovery: Partnerships and Trusts</u>, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-28 (1983).

RECAP

Undistributed income in a discretionary distribution trust is not part of the community estate. <u>Arnold v. Leonard</u> overruled <u>McClelland</u> as to distributed trust income.

3. <u>In re Marriage of Burns</u>, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd). The <u>Burns</u> case stands for the proposition that, where a spouse is a beneficiary of a trust, but the spouse does not actually or constructively acquire income of the trust, the undistributed income remains part of the trust and is not subject to division by the court on divorce. Such income is not community property, says the court. The same rule applies where a spouse is beneficiary of an estate.

<u>The Trusts Involved</u>

The <u>Burns</u> case involved six trusts existing at the time of divorce, plus two testamentary trusts which had not yet been funded. The undistributed income in the estates of the husband's parents were also in issue.

Mr. Burns' parents and grandparents were settlors of three of the trusts. Mr. Burns was settlor of the other three. Five of the trusts came into existence prior to the marriage. The sixth was established and funded by Mr. Burns with his separate property funds, three months after the marriage. Mr. Burns was not trustee of any of the trusts. Three of the trusts were "spendthrift trusts." Five of the trusts were "discretionary trusts," in that the trustees could withhold or distribute the income and/or corpus at their sole discretion. The other trust provided that the income would be accumulated, with the corpus and accumulated income to be distributed to Mr. Burns on May 28, 1982, some five years after the divorce.

Mr. Burns was the beneficiary of testamentary trusts established under the wills of each of his parents, who died during the marriage. These testamentary trusts had not been funded at the time of the divorce. The wills had, however, been probated. The testamentary trusts were both "spendthrift trusts" and "discretionary trusts." Mr. Burns was not a trustee of either testamentary trust.

<u>No Allegation of Fraud or Alter Ego</u>

The Court of Civil Appeals noted that "Mrs. Burns does not suggest that any of the trusts or estates were created, funded or operated in fraud of her rights nor does she suggest that such entities are the alter ego of Mr. Burns for any reason such as his having constructive control over their assets by virtue of his relationship with the trustees." <u>Id.</u> at 557.

Buckler and Currie Explained

The Texarkana Court of Civil Appeals cited the Buckler case and the Currie case. The Court characterized Buckler as holding "that undistributed trust income was not community property where the trustee had the right to withhold it from the trust beneficiary." Id. at 557. The Court characterized Currie as holding "that undistributed income in a trust estate is not community property where the beneficiary does not have a claim to such income other than an expectancy interest in the corpus." Id. at 557. The Texarkana court agreed with each of the decisions.

Buckler and Currie were distinguished as follows:

> It was discretionary with the trustee in the Currie case, supra, whether to pay certain expenses out of either the income or the corpus of the trust and for that reason it was uncertain therein whether any income would be available for the beneficiary. Such a situation does not here exist. The trust in the Buckler case, supra, was a "spendthrift trust" while three of the trusts in question do not contain provisions which prohibit alienation, assignment or attachment of the assets by either Mr. Burns or his creditors. Neither case considered whether income earned by the estate of a decedent was community property.

Id. at 557.

Was the Property Acquired During Marriage?

The Court of Civil Appeals acknowledged that "the property in question is income and thereby would normally be characterized as community property; however, the issue presented for our determination is whether the property was acquired by either spouse during the marriage." Id. at 557. The appellate court stated:

> By definition, the undistributed trust and estate income have not been distributed to Mr. Burns nor did he have a present or past right to require its distribution so as to compel a finding that there was a constructive acquisition. The income was actually acquired by the trusts and estates and not by either Mr. or Mrs. Burns. As stated, there

> was no constructive acquisition. Since neither spouse actually or constructively acquired the undistributed trust and estate income during the marriage, such income, though earned during the marriage, remained a part of the respective trust or estate and was not subject to division by the court. Such income was not community property.

Id. at 557-58.

Secondary Authorities

This is what the secondary authorities say about In re Marriage of Burns.

a. Campfield. Professor Regis W. Campfield says the following about the Burns case.

> [In Burns,] the court held that undistributed trust income was not community property. . . . Mr. Burns was the beneficiary of eight trusts, five established by his ancestors and three established by him from his separate property. . . . The court concluded that undistributed income was not community but made the off-hand observation, by way of obiter dicta, that the income would have been community property had it been distributed. Id. at 557. . . . There was no reason for the court to elaborate on its decisions in Burns. However, the facts in Burns provide the occasion for making an important distinction that seemed to escape the court. That distinction is this. Trusts created by the beneficiary of a trust need to be treated differently from trusts created by ancestors of the beneficiary.
>
> (a) Conceptually speaking, trust distributions -- whether made from income or principal -- from a trust established by the ancestor of the beneficiary are separate property because the distributions themselves constitute the gift from the ancestor. Distributions of trust income from such a trust are not "income from separate property" because the trust corpus is not the beneficiary's separate property. Accordingly, such distributions are not community property.

(b) On the other hand, when the beneficiary is also the settlor of the trust, to say, as the court did in Burns, that undistributed trust income is not community property, means that a spouse can launder his income from his separate property through the trust and avoid having the income from the separate property be characterized as community property. Such a result obviously smacks of fraud, for if the spouse had retained the trust property, free of trust, there would be no doubt that the income from the property would be community property.

Perhaps the best explanation for what was said by the court in Burns is that the court intended to confine its remarks to the three trusts that Mr. Burns had established with his separate property . . . . Distributions from these trusts would be community property . . . . But as to the distributions from the trusts established by Mr. Burns' ancestors, those distributions would be separate property because the income was not "income from Mr. Burn's separate property!"

Campfield, Characterization of Income from Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-19--21 (1984).

b. McKnight. Professor Joseph W. McKnight made the following comments on the Burns case:

In Burns v. Burns it was alleged that the undistributed income of discretionary trusts of which a spouse was beneficiary was community property. But whether the undistributed trust income was separate or community depended on whether the property was "acquired" within the context of section 5.01 of the Family Code. Having found that the income was acquired by the trust and not by the spouse actually or constructively, the court stated that the property remained a part of the trust and was subject to division on divorce. [footnotes omitted]

McKnight, Family Law: Husband and Wife, 33 SW. L.J. 99, 112 (1979).

c. Simpkins. The editors of Professor Simpkins' treatise said the following about Burns:

> Where a spouse does not have a present or past right to require distribution of undistributed trust and estate income, such has not been constructively acquired. Such income is actually acquired by the trusts and estate and not by either of the spouses and as such was not community property subject to division on divorce.

Simpkins, SPEER'S TEXAS FAMILY LAW § 15:42 n. 20 (Supp. 1985).

d. Smith. Donald R. Smith said this about the Burns case:

> In [Burns], it was held that undistributed trust income was not community property when the beneficiary did not have a past or present right to compel distribution. The court based its decision on Family Code Section 5.01(b), which provides that property is not community property unless it is acquired during marriage. The court stated that the trust income was income and would be community property except for the fact that it was not acquired when the beneficiary did not have a past or present right to require its distribution.

Smith, Characterization of Property, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

e. Stewart. James D. Stewart and Kirk Patterson had this to say about Burns:

> [In Burns] the husband was the beneficiary of both "spendthrift" trusts and "discretionary" trusts. Although the Court recognized that the property in question is income and therefore would normally be characterized as community property, the Court was explicit in stating the rule that the property was nondivisible in divorce proceedings.

Stewart & Patterson, Theories of Recovery: Partnerships and Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-22 (1983). They went on to say:

> See also: [Burns], where one of the eight trusts in question provided that corpus and accumulated income would be distributed to the

> husband on May 28, 1982, which would be five years after the granting of the divorce. Without discussing the issue, the Court of Civil Appeals affirmed the trial court decision, holding that the wife had no community property interest in the undistributed income of all the trusts established for the husband's benefit in that case.

Id. at M-24.

RECAP

In Burns, the Texarkana Court apparently recognized "fraud" and "alter ego" as grounds for attacking or penetrating a trust. Buckler was said to hold that undistributed income in a discretionary distribution spendthrift trust is not community property. Currie was said to hold that undistributed income in a trust in which a spouse has only an expectancy interest in the corpus is not community property. According to Burns, undistributed trust income is not property "acquired by either spouse during marriage," and cannot be community property, where the beneficiary does not have a present or past right to require distribution. Having, such a right to require distribution constitutes "constructive" acquisition. The same concepts apply to undistributed income of an estate.

Trustor's intent

4. <u>Commissioner of Internal Revenue v. Estate of Hinds</u>, 180 F.2d 930 (5th Cir. 1950). The <u>Hinds</u> case is an estate tax case addressing the question of whether community property, irrevocably transferred into trust by a man for the use and benefit of his wife and children, was includable in the man's gross estate because he had "retained the possession and enjoyment of, or right to the income from, the property during his life." <u>Id.</u> at 931. The Tax Court held that under Texas law the income of the trust was community property. The Fifth Circuit ruled that, regardless of whether the income from the trust was treated as the wife's separate property or as community income from her separate estate, the decedent did not retain possession or enjoyment sufficient to bring the conveyance back into his estate. <u>Id.</u> at 932. The Fifth Circuit did not say whether the trust income was separate or community.

In a concurring opinion, Judge Waller addressed the issue of the character of the trust income. He suggested that the income received by the wife from the trust estate would, during the existence of the community, have been community income "unless there was a clear, definite, and distinct intention expressed in the trust indenture to make such income her separate, rather than community, property." <u>Id.</u> at 932. Judge Waller then examined Texas authority regarding gifts between spouses, and cited 23 TEX. JUR. § 55 (1932) to the effect that a spouse could convey property into trust for the benefit of the other spouse in such a way that the "use, rents, revenues, profits and the like" were the subject of the gift and were therefore separate property. Judge Waller concluded that the court should "hold that the Texas law, in instances where it is made clearly to appear, permits that to be done which General Hinds clearly undertook to do in the trust instrument here, viz., to make the income from the property conveyed to the trustee the separate property of the wife." <u>Id.</u> at 934.

<u>Secondary Authorities</u>

a. <u>Campfield.</u> Professor Campfield had the following to say about <u>Hinds</u>:

> In <u>Hinds</u>, the decedent, <u>H</u>, and his spouse, <u>W</u>, had transferred certain community property to an irrevocable trust with income from the trust to be paid to <u>W</u> for life and then to their children. The Tax Court found that under Texas law the income of the trust was

the community property of the spouses as long as the community existed. From this finding, the Tax Court concluded that, under the predecessor of section 2036, one-half of the value of the property that the decedent transferred to the trust -- one-quarter of the whole -- was includable in his gross estate because under Texas law he had retained the right to one-half of the income from the transferred property. In reaching the question of includability, the Tax Court specifically noted that it made no difference, because of the community property law in Texas, whether the decedent, H, affirmatively retained the income right or whether it arose under operation of law.

* * *

The Court of Appeals for the Fifth Circuit agreed with the taxpayer and affirmed the Tax Court's decision without approving it and denied the petition for review stating:

> We do this upon the authority of the settled law of Texas, that whether the income be regarded as separate property of the wife or as community income from the wife's separate property, the taxpayer retained neither "the possession or enjoyment of, or the right to the income from," the property so as to make applicable [section 2036(a)(1)], invoked by the commissioner and in part applied by the Tax Court.

[footnotes omitted]

Campfield, Interspousal Transfers, 32 SW. L.J. 1091, 1099-1100 (1979).

b. McKnight. Nothing published by Professor McKnight could be found on Hinds.

c. Smith. Nothing by Don Smith could be found on Hinds.

d. Stewart. James D. Stewart and Kirk Patterson said this about Hinds:

> In the federal tax case of Commissioner v. Estate of Hinds, 180 F.2d 930 (Fifth Cir. 1950), the Court stated that the settlor clearly undertook in the trust instrument "to

> make the income from the property conveyed to the trustee the separate property of the wife." Accordingly, following settlor's intent, the income did become separate property.

Stewart & Patterson, <u>Theories of Recovery: Partnerships and Trusts</u>, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-28 (1983).

RECAP

Judge Waller, at least, believed that the intent of the trustor should control whether or not the income distributed by a trust to a married beneficiary is received by that beneficiary as separate or community property.

Dist Income is CP
Character is controlled by domicile of recipient

5. __Commissioner of Internal Revenue v. Porter__, 148 F.2d 566 (5th Cir. 1945). __Porter__ is a tax case involving the character of dividends and interest distributed to two married women living in Texas, from a trust established by their father, a citizen of New York, and administered in New York. The taxpayers cited __Arnold v. Leonard__, 114 Tex. 535, 273 S.W. 799 (1925), for the proposition that income from separate property falls into the community estate. The Internal Revenue Service, citing __McClelland v. McClelland__, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), argued that the spendthrift provisions of the trust had the effect of making the income from the trust separate property.

The taxpayers urged the Fifth Circuit to rule that under Texas law a trust could not validly be created so as to make the income distributed from the trust the separate property of a spouse. However, the Court did not reach that question, because the trust instrument itself did not express the intent that the distributed income be received by the beneficiaries as separate property. Since the trustor did not express the intent to do so, the Court did not need to resolve the question of whether this intent could be given effect under Texas law. The dividends and interest, when distributed, were deemed to be community property.

The Court also went on to state:

> As long as the income was in the hands of the trustees and undistributed, it was protected, but as soon as it was paid over, it passed to the daughters as their property, freely and completely alienable, and as fully subject as any other unrestricted property of theirs to the ordinary impact of the law. Here what is in question is not undistributed income in the hands of the trustees as in McClelland's case, but income distributed to the daughters, no longer fettered but their own, and our only concern is to determine in what character it became their own. . . . We think it entirely plain that when they received the income it fell into the community.

__Id.__ at 568-69.

The Internal Revenue Service alternatively argued that, although the beneficiaries were domiciled in Texas, the trusts, which had been created and were managed in New York, should be construed under New York law, which had no community property system. The

Service cited Commissioner of Internal Revenue v. Skaggs, 122 F.2d 721 (5th Cir. 1941), cert. denied, 315 U.S. 811 (1942), where the Fifth Circuit had held that California law controlled the character of income on realty located in California, even though the income was received by a married resident of Texas. In Porter, Skaggs was distinguished on the grounds that real property was involved in that case, and that the law of the locus therefore controlled the characters of the rentals. In contrast, the income received by the taxpayers from the New York trust was a movable, the character of which is determined by the law of domicile at the time the movable is acquired. Id. at 569.

Secondary Authorities

a. Campfield. Professor Regis W. Campbell said the following about Porter:

> In [Porter, the court] relied on Irwin v. Gavit and Commissioner v. Terry . . . . Porter held that distributed trust income was community for federal tax purposes . . . . In doing so, the court rejected the Commissioner's contention that McClelland v. McClelland should control . . . . The court distinguished McClelland apparently on the ground that McClelland involved undistributed trust income whereas the trust income in Porter had been distributed . . . . Contrary to the conclusion in Porter, a reading of McClelland, indicated that the trust in McClelland had involved both distributed and undistributed trust income and had held that both were separate.
>
> Furthermore, in Porter, the court would not go so far as to say that a trust could not be validly created upon terms giving income to a spouse for life as his or her separate property. Instead, the court concluded that, to make such a gift, the trust instrument would have to "in the most precise and definite way, and by the use of language of unmistakable intent, make that desire and intention clear." 148 F.2d at 568 . . . . Apparently, the Court did not think this language was not [sic] present in the Porter trust instrument.

b. McKnight. No comment by Professor McKnight could be found.

c. <u>Reppy.</u> Professor William A. Reppy, Jr., characterized <u>Porter</u> as saying that "whether the instrument of gift or bequest declares an intention that the income gift be separate property" is determinative. Reppy, <u>The Uniform Marital Property Act: Some Suggested Revisions for a Basically Sound Act</u>, 21 HOUS. L.REV. 679, 693 n. 96 (1984).

d. <u>Simpkins.</u> Professory Simpkins said the following about <u>Porter</u>:

> "In [<u>Porter</u>], the court seemed to be of the opinion that generally income from separate property is community but that it might be possible for a trust instrument, by the use of precise and definite language and the expression of an unmistakable intent, to make the income from the trust separate property. This is doubtful, however, as a husband and wife have no power to convert, by mere agreement, community property yet to come into existence into the wife's separate property. [Footnotes omitted.]

Simpkins, SPEER'S TEXAS FAMILY LAW _ 15:43 (1976). The last sentence of the quotation would have to be modified to conform to the amendment to art. XVI, sec. 15 of the Texas Constitution.

e. <u>Smith.</u> Donald R. Smith said the following about <u>Porter</u>:

> In <u>Commissioner of Internal Revenue v. Porter</u>, it was held under Texas law that income which was distributed from spendthrift trust was community property. The court stated, however, that undistributed income remained protected from community property law. In addition, the court stated that income distributed from a trust would be the separate property of the beneficiary if the trust instrument clearly indicated this intention. [footnote omitted]

Smith, <u>Characterization of Property</u>, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE 11.50 (1985).

f. <u>Stewart.</u> James D. Stewart and Kirk Patterson said that, "in [<u>Porter</u>], the Court stated that the trust instrument could make a "gift" of the income interest to be separate property of the beneficiary, but that such intent must be clear, precise, definite and unmistakable."

RECAP

Dividend and interest income distributed from a trust to a married beneficiary is community property under Texas law. The Court did not ask the question of whether a trustor can alter that rule by express language in the trust. Undistributed income in the hands of the trustee was "protected" [presumably from a community claim by a spouse]. Also, the character of cash trust distributions from a New York trust is controlled by the law of the domicile of the beneficiaries, not the law where the trust was created, or administered.

(BAG)

6. **Commissioner of Internal Revenue v. Wilson**, 76 F.2d 766 (5th Cir. 1955). In Wilson, the Fifth Circuit addressed the question of whether married men residing in Texas received distributions from a certain trust as separate or community property. The two men, together with 25 other beneficiaries, did not get a "fixed annuity or annual money gifts." Rather they got "the residual income of the trust property each year and the proceeds of any property that is sold." Id. at 768.

The Internal Revenue Service argued that the incomes were separate property, or alternatively, that at least the distributed bonus and royalty payments from oil and gas properties were separate. The Court held that the taxpayers' interests in the corpus of the trust were separate property, although acquired during marriage, because the interests were acquired by gift. Id. at 769. The Court went on to say:

> It is argued that the result should be otherwise because the husbands do not get the revenue directly from the property but through the hands of the trustee and subject to the expenditures which he is authorized to make. But the trustee is bound to act always for the benefit of the beneficiaries and to divide the net results among them. All net income and corpus ultimately go to them. The beneficiaries receive the income as income. The corpus is theirs in equity, the legal title being conveyed to the trustee expressly for their benefit. In Irwin v. Gavit, 268 U.S. 161, 45 U. Ct. 475, 69 L. Ed. 897, where the trust instrument did not expressly give the corpus to the beneficiary but only the income, it was held that the payments were taxable income from a corpus impliedly given. Income accruing from the separate equitable estates of the husbands during the marriage though collected and paid over by a trustee belongs to their respective communities.

Id. at 769.

The oil and gas income required special treatment. "Delay rentals" on oil and gas leases were treated as rent which fell into the community. Id. at 769. However, royalties and bonuses were treated as separate property. The Court ruled that whatever portion of the trust income as could be shown to be derived from royalties is the separate property of the taxpayers. The Court then observed that "[i]n the accounting, outlays by the trustee specially connected with [royalties] are to be considered, and also a fair proportion of the general expenses of the trust, so as to ascertain what part of the net payment to the beneficiaries really came from royalties." Id. at 770. Proceeds from sales of trust property were not involved, and were therefore not addressed by the Court.

Secondary Authorities

a. Campfield. Professor Regis W. Campfield said the following about the Wilson case:

> Commissioner v. Wilson includes a trust that required annual distribution of all trust income. In holding the distributed income to be community property, the Fifth Circuit rejected the Commissioner's argument that the property lost its character as separate or community as the result of the interposition of the trust . . . . Thus, the Fifth Circuit totally disregarded the trust entity on the basis of the alleged holding in Irwin v. Gavitt that the gift was of the trust corpus and not of the right to income. Turning to oil royalty income, however, the court felt compelled to follow state law and accordingly held that "so much of the trust income of respondents as can be shown to be derived from royalties is their separate property." (footnotes omitted]

Campfield, Interspousal Transfers, 32 SW. L.J. 1091, 1153 (1979).

Nothing by Professor McKnight, Don Smith or Jim Stewart and Kirk Patterson could be found on Wilson.

RECAP

Under Texas law, the income distributed from a trust falls into the community estate of the married beneficiary. This includes delay rentals on separate property mineral interests. However, royalties and bonuses are not income, but have the character of the mineral interest giving rise to them. Hence, a separate property mineral interest held in a trust gives rise to separate property income when distributed from the trust. Where a trust is created by gift, the beneficiary's interest in the trust is his separate property.

7. Currie v. Currie, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd). The Currie case involved the wife's complaint that the Trial Court abused its discretion in awarding the husband his undivided one-third interest in trusts created by the wills of his great-grandfather and grandfather, of the value estimated to be $1,300,000.00.

The Great-Grandfather's Will

The husband's great-grandfather was John Nance Garner. A trust was created in Mr. Garner's will. Under the will, the net income from his estate was to become part of the corpus of a trust. When the oldest child of Mr. Garner's granddaughter [i.e., the husband] turned 21, the corpus, together with any accumulated income, was to be divided into separate trusts for each such great-grandchild. As each great-grandchild became 21, the trustee was to pay $25,000.00 in cash or its equivalent to such child. Thereafter, the trustee "could from time to time make such additional distributions when in the trustee's 'uncontrolled discretion' such child beneficiary attained sound discretion and good business judgment." Id. at 388-89. The will further provided that if any great-grandchild died before receiving all of its distribution, the trustee was to set up a trust fund for that child's issue, or if none existed, then to distribute the corpus of the great-grandchild to other great-grandchildren. The trustee had full discretion to determine what constituted net income, and to determine the amount to be reserved to preserve, repair or otherwise protect the principal. The trustee also had full power to allocate the receipts and disbursements become income in principal. Id. at 389.

The husband, as the oldest of three great-grandchildren, received his $25,000.00 distribution, as well as additional sums, most of which were lost in the stock market. The trustee testified to his practice of distributing the income that was available after payment of an annual installment due to the IRS for estate tax, and after payment of expenditures necessary to maintain the property and pay property taxes. The trustee anticipated making full distribution to the beneficiaries if all three are still surviving when the IRS is paid in full in 1979.

Mrs. Currie argued that one-third of the income earned during the parties' marriage by the John Nance Garner trust was community property and that she should have received half. Unfortunately, there was little undistributed income in the trust. She therefore asserted a claim for reimbursement for the use of undistributed community income to pay estate taxes due on separate property corpus. Id. at 389.

The Court of Civil Appeals construed the will to authorize the trustee to pay estate taxes from income earned by the trust estate. Since the husband had no claim to income other than his "expectancy interest in the corpus," the community estate did not acquire any interest in the income. The court said that "[t]he Trial Court properly refused to consider income earned by the John Nance Garner trust during appellant and appellee's marriage as being part of their community estate." Id. at 389.

The Grandfather's Will

The husband's grandfather was Tully C. Garner, who died five years after the parties' marriage. Under his will, a trust was created with all net income to be paid to the husband's mother during her lifetime. On her death, the trust corpus was to be divided into separate trusts for her surviving children, to be used for her support and maintenance until each child reached 21 years of age, when the corpus would be distributed free of trust.

The husband's mother was alive at the time of trial. Mrs. Currie argued that accumulated income which had not been spent for the husband's mother as of the time of trial should be considered community earnings of the spouses. The appellate court rejected this argument on the grounds that the husband was not entitled to receive any income or corpus unless and until he survived his mother. Since she was still alive, the husband had received nothing. The community estate was not entitled to any part of the income owned by the trust estate of the husband's grandfather. Id. at 390.

The Court of Civil Appeals also rejected the wife's complaint that the trial judge did not assess cost of her appraiser, accountant and actuary against the husband, since no statutory authority exists by which a party may recover witness fees unless incident to attorney's fees.

Lastly, the wife's argument that the Trial Court erred in severing the trustee and other trust beneficiaries in the case was rejected for her failure to show harm.

<u>Secondary Authorities</u>

a. <u>Campfield.</u> Professor Regis W. Campfield gave the following description of <u>Currie</u>:

> [T]he San Antonio Court of Civil Appeals held in <u>Currie v. Currie</u> 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd), that undistributed income earned by the two trusts during the marriage did not become part of the community estate . . . . The income from the first trust was held not to be community because the husband had no claim to the income . . . . The income from the second trust was held not to be community because it was necessary for the husband to survive the life beneficiary before receiving any of the income.

Campfield, <u>Characterization of Income from Estate and Trusts</u>, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-17--18 (1984).

b. <u>McKnight.</u> Professor Joseph W. McKnight made the following observations regarding the <u>Currie</u> case:

> <u>Currie v. Currie</u> dealt with the character of income from two trusts of which a spouse was beneficiary. In one the net income of the trust was to become part of the corpus subject to the full discretion of the trustee to determine what constituted the net income. The trustee was also empowered to pay estate taxes on the estate of the settlor from the income and corpus of the trust, as well as current expenses of the trust. The trustee had done so, and the principal argument advanced by the beneficiary's spouse was that their community estate was entitled to reimbursement for those funds expended. The court held that those payments were made before any interest would accrue to the beneficiary and, hence, there was no community interest in them. In the other trust the spouse was beneficiary of one-third of the corpus of the trust to be distributed on the death of the spouse's mother, to whom the net income of the trust was to be paid in the trustee's discretion during her lifetime. Any undistributed net income was to be added to the corpus. The court held that accumulated

> net income was not community property of the "contingent" remainderman. But as a general rule, the right of this beneficiary would be said to be vested subject to divestiture for failure to survive the life tenant.

McKnight, Family Law, 29 SW. L.J. 67, 76-77 (1975). In a later article, Professor McKnight made the following observations:

> In Currie v. Currie undistributed income of a trust was accumulated and added to the corpus in which the spouse would share on the death of the life tenant. The court defined this interest as "contingent" in applying the test of vested interests then regarded as subject to division.[98]

> [Footnote] 98. Id. at 390. For a criticism of this conclusion see McKnight, Family Law, Annual Survey of Texas Law, 29 SW. L.J. 67, 76-77 (1975). In Currie, the settlor of another trust directed that net income of the trust become part of the corpus of the trust for the benefit of one of the spouses. The trustee had full discretion to determine what constituted net income. The settlor also empowered the trustee to pay estate taxes on the estate of the settlor, as well as expenses of trust administration, from the income of the trust. The beneficiary's spouse asserted that the community was entitled to reimbursement for income so expended by the trustee. This contention was rejected on the ground that the trustee's expenditures were made before any interest accrued to the beneficiary and, hence, that there was no community interest in the funds expended. Currie v. Currie, 518 S.W.2d 386, 390 (Tex. Civ. App.--San Antonio 1984, writ dism'd).

c. Smith. Donald R. Smith had the following to say about Currie:

> In Currie v. Currie, it was held that the community estate had no claim to undistributed trust earnings, at least in the instance in which the beneficiary had only an expectancy interest in distributions under the trust instruments. [footnote omitted]

Smith, Characterization of Property, KAZEN; TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

d. **Stewart.** James D. Stewart and Kirk Patterson made the following analysis of Currie:

> The case of Currie v. Currie, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd), involved two trusts: The great-grandfather's trust required the trustee to pay $25,000.00 in cash when the beneficiary became 21 years of age, with additional distributions to be made in the uncontrolled discretion of the trustee thereafter. The second trust required all net income to be paid to the husband's mother during her lifetime, and upon her death, the corpus was to be distributed when her children reached 21 years of age (the mother was still living at the time of divorce). The ruling of the Court was that the wife had no interest in the accumulated net income of the trust because the husband was not entitled to receive any income or corpus until he survived the life beneficiary.

Stewart & Patterson, Theories of Recovery: Partnerships and Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-28 (1983).

RECAP

Where the husband has only an expectancy interest in whatever portion of the trust corpus the trustee chooses to distribute to him after paying estate taxes, the community estate has no interest in the trust income. Also, when the husband has only a remainder interest in a trust, and the life beneficiary is still alive, the community estate has not part of the income of the trust. No harm was shown from severing the trustees and trust beneficiaries from the divorce.

Disc Alloc of Income

8. <u>De Amodio v. Commissioner of Internal Revenue</u>, 299 F.2d 623 (3rd Cir. 1962). In <u>De Amodio</u>, the issue was whether a brother or sister could be taxed for the capital gains of a trust which they created, and of which they are sole beneficiaries. Under the trust agreement, the trustee had the power to determine whether property acquired by the trust would be treated as corpus or income. One-half of the trust's net income was payable monthly to each taxpayer for life. The trust would be amended or terminated by joint action of the beneficiaries.

The tax court determined that the grantors/beneficiaries were taxable on long term capital gains of the trust. The Third Circuit affirmed on the different ground that under the Internal Revenue Code a grantor is taxable on the income of trust which may in the discretion on a non-adverse party be distributable to the grantor.

The trust was a Texas trust, and under Texas law a trustee could distribute the capital gains to the beneficiary. The court cited <u>St. Mark's Episcopal Church, Mt. Pleasant, Texas v. Lowry</u>, 271 S.W.2d 681 (Tex. Civ. App.--1954, writ ref'd n.r.e.).

The Court of Appeals agreed with the tax court's assessment that the trust income was taxable to the grantors because there existed the power, for each grantor alone or in conjunction with a non-adverse party, to reinvest in the grantor title to any part of the corpus of the trust. The taxpayer's argument that there interests were adverse to each other was rejected. Both grantors/beneficiaries shared equally in the income. Amendments or termination of the trust could be accomplished by joint action of beneficiaries. The court could not see how the brother and sister had adverse interests, so far as the trust was concerned.

<u>Secondary Authorities</u>

No comments by secondary authorities could be found on <u>De Amodio</u>.

RECAP

Under Texas law, where the trust agreement allows the trustee to determine whether money or property coming into his possession should be treated as corpus or income, capital gains can be distributed to the beneficiaries as income. Under federal tax law as it then existed, a grantor is taxable on the income of a trust which may in the discretion of a non-adverse party be distributed to him, regardless of whether the income is actually distributed. A brother and sister, each of whom are income beneficiaries under the trust, are not adverse parties for tax purposes.

9. <u>Hardin v. Hardin</u>, 681 S.W.2d 241 (Tex. App.--San Antonio 1984, no writ). The <u>Hardin</u> case involved the husband's beneficial interest in a Texas Dental Association Trust created for the husband by the Dental Association. The husband, a lawyer, had acted as legal consultant to the Dental Association for 33 years. At the same time, he was employed by the Texas Board of Dental Examiners. When a question arose concerning a possible conflict of interest between his two jobs, the husband resigned as legal consultant to the Dental Association.

After the husband's resignation, the Board of Directors of the Dental Association created the trust. The preamble "contains a reference to [the husband's] past services and an expression of the Dental Association's appreciation." The trial court determined "that the benefits from the trust were a gift to [the husband] by the Dental Association." <u>Id.</u> at 242. The San Antonio Court of Appeals agreed that the "[husband's] interest in the trust was properly characterized as his separate property." <u>Id.</u> at 242.

The Court of Appeals' explanation as to why the interest was a gift concerns more the issue of retirement benefits than the issue of trusts. However, <u>Hardin</u> is authority that an interest in a trust received during marriage, although presumed to be community, can be shown to be separate property by proving that it was acquired by gift, devise or descent.

<u>Secondary Authorities</u>

a. <u>McKnight.</u> Professor Joseph W. McKnight made the following comments about the <u>Hardin</u> case:

> In <u>Hardin vs. Hardin</u>, the husband had been made a participant of a retirement trust of a professional association by which he had been employed for over 30 years. Upon divorce the trial court characterized his interest as separate property and awarded it to him. The Court of Appeals affirmed, holding that the trust fund interest was received as a gift. The court stressed the fact that the ex-husband did not expect the trust benefit as compensation for his employment. The interest was thus distinguished from an interest in a retirement pension plan, which is an earned property right. The employer received no benefit by providing the trust fund. Thus the

husband's interest was much like a legacy for faithful service when no wages are due.

McKnight, <u>Family Law: Husband and Wife</u>, 39 SW. L.J. 1, 8 (1985).

No comments by Professor Campfield, Mr. Smith, or Messrs. Stewart & Patterson were found on <u>Hardin</u>.

RECAP

Where a trust is created on behalf of a spouse as a gift, the trust interest is that spouse's separate property.

10. Hutchison v. Mitchell, 39 Tex. 488 (1873). The Hutchison case was a suit by a creditor to execute upon property of a debtor's wife. The property levied upon grew out of the corpus of property deeded by the husband to a third party "for the sole and separate use of [the wife]." Id. at 491. The Supreme Court said:

> We can find nothing in any of the Constitutions or laws of the state or republic which would prevent a married man from declaring an express trust in favor of his wife, and giving her the exclusive use and enjoyment of all the rents, issues and profits of the trust estate, provided there is no fraud in the transaction against creditors. . . . The language of the trust is full and explicit. It is, "For the separate use, occupation and enjoyment of the said Elizabeth H. Mitchell, free from the intervention or control of all other persons whomsoever."
>
> Had Mrs. Mitchell held this property in her own name and right, there can be no doubt but that its accumulations would have belong to the community estate of herself and husband, and might have been subject to the execution levied upon it.

Id. at 492.

Wife's Equitable Separate Estate

The terms of the trust which give the wife "the exclusive use of the rent, issues and profits of the trust estate," had special meaning in the last century. Under the doctrine of a married woman's equitable separate estate, when property was set apart for the "sole and separate use" of a married woman, a trust arose that was recognized by courts of equity, and the wife was emancipated from the disability of coverture insofar as the trust property was concerned. 41 AM. JUR.2d Husband and Wife § 34 (1968). The wife had the power to manage the property without the concurrence of her husband. Id. Under the equitable separate estate doctrine, the rents, profits and increase of the equitable separate estate were for the wife's "sole and separate use." Id. [Author's comment:] the extent to which this old common law doctrine, uniquely for the protection of the wife suffering the disabilities of coverture, is carried forward in our contemporary community property system, with equal rights between husband and wife, is a debatable point.

Secondary Authorities

a. Campfield. Professor Regis W. Campbell said the following about Hutchinson v. Mitchell.

> Hutchison v. Mitchell, . . . was the first case in Texas which examined whether trust income was community or separate. . . . In Hutchinson, the Texas Supreme Court held that a husband can create an express trust for his wife under which the rents and profits of the trust estate would be her separate property and not subject to the debts incurred by the husband after the trust was created . . . . The court made it clear that if the wife had owned the property in her own name the rents and profits would have been community . . . . But, applying common law rules, the court found that, as the property was in trust for her, the rents and profits were her separate property. "Her separate property was not the land but its produce." Id. at 490-91 . . . . Hence, Hutchinson clearly held that trust income is separate, concluding that the gift was of the income generated by the principal of the trust, not the principal itself.

Campfield, Characterization of Income from Estate and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-6 (1984).

Nothing by Professor McKnight, Don Smith or Jim Stewart and Kirk Patterson could be found on Hutchison v. Mitchell.

RECAP

Under old Texas law, a conveyance into trust for the "sole and separate use" of the wife made the rent, issues and profits of the trust estate free from the control and claims of the husband. [Author's comment:] Is Hutchison an expression of the common law doctrine of "the wife's equitable separate estate," or is it an expression of marital property trust law?

11. <u>Land v. Marshall</u>, 426 S.W.2d 841 (Tex. 1968). <u>Land v. Marshall</u> introduced the doctrine of "illusory trusts" to Texas. In that case, the husband, without his wife's knowledge, conveyed into a trust shares of stock constituting the bulk of the community estate.

Under the trust, the trust proceeds were, upon the death of the husband and wife, to be paid over to their grandchild. The husband retained virtually full control over the property, with all income of the trust to be paid to him during his lifetime, and then to his wife for the balance of her life. The husband also retained the following powers: to control the trustee's decision as to holding, voting, selling and encumbering the stock; to require liquidation of the stock and payment of the proceeds to the husband; to require the distribution of the trust corpus to the husband whenever, in his sole judgment, he and his wife were in need. The trustee was to invade the trust corpus to support the husband or wife if either became incompetent. The husband also retained the right to amend the trust, which he later did, by changing the remainder beneficiary from his granddaughter to his daughter.

The Supreme Court said:

> The Marshall trust was invalid. The trustor transferred the legal title of the corpus to a trustee, but he retained complete control over the trustee. Marshall had and could exercise every power over the corpus of the trust after the creation of the trust that he possessed before its creation. As expressed by respondent, Marshall created the trust, but nothing happened. . . . [T]he transfer took back all that it conveyed except legal title.

<u>Id.</u> at 847.

<u>Case Involves Death, not Divorce</u>

<u>Land v. Marshall</u> is a death-related case. At issue were public policies that operate upon the death of a spouse. These policies are not necessarily applicable in a divorce situation.

Texas law at the time gave the husband management powers over the wife's community interest, as well as his own. These powers did not, however, extend past his death. The husband could not dispose of the wife's community interest in property by will. If he did so, the wife was entitled to elect to take under the will, or else to take her community one-half share. The question in Land v. Marshall was whether the husband could do by inter vivos trust what he could not do by will. The Supreme Court resolved the problem in Land v. Marshall by invoking the doctrine of "illusory trusts":

> Under the doctrine, the husband has the power to create an inter vivos trust as a part of his managerial powers over the wife's share; but when her community share is involved, the wife can require the trust to be real rather than illusory, genuine rather than colorable.[4]

Id. at 846. In footnote 4, the Court said that "[t]he term 'colorable,' as used herein, indicates a transfer which may be absolute on its face, but which, actually, is not a transfer at all because, through some secret or tacit understanding, the parties intended that ownership is to be retained by the donor." Id. at 846 n. 4. The Court went on to say:

> In the present case, we deal with a problem created by our community property protection of the wife's distributive share, a factor not present in the cases defendants rely upon.

Id. at 849. The Court therefore ruled that the wife was entitled to recover an undivided one-half interest in the stock, as well as one-half of the dividends received since the husband's death.

Illusory Only as to Wife's One-Half Share

Having released the wife's one-half interest in the stock, as well as dividends earned since the husband's death, from the strictures of the trust because of the "illusory trust" doctrine, the Court reevaluated the husband's over-all estate plan. Concluding that the plan had been disrupted, the court also invalidated the conveyance of the husband's one-half community property interest into trust, causing that property to fall back into his estate. Note that the "illusory trust" doctrine did not, of itself, invalidate the trust as to the husband's property. Furthermore, the "illusory trust" doctrine gave back to the wife only dividends earned by the trust since the time of the husband's death, not undistributed dividends (if any) received prior to his death. Whether there were none, or whether they were not asked for, or whether the doctrine did not apply, is not revealed in the opinion. It could be argued, however, that the "illusory trust" doctrine did not take effect until the husband's death.

Secondary Authorities

The published reviews of Land v. Marshall have dealt with the death-related issues of the case. The following articles shed some light on the case: Bell, Community Property Trusts--Challenges by the Non-Participating Spouse, 22 BAY. L. REV. 311 (1970); Comment, The Illusory Trust and Community Property: a new Twist to an old Tale, 22 SW. L.J. 447 (1968); Note, 10 S. TEX. LAW. J. 301 (1968). Also, Land v. Marshall was the subject of an ALR annotation, Annot., Inter Vivos Trust--Impairing Spouse's Right, 39 A.L.R.3d 1 (1971).

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Crenshaw v. Swenson

12. **Landry v. Williamson**, 335 S.W.2d 400 (Tex. Civ. App.--Houston 1960, writ ref'd n.r.e.), involved the burden of proving the commingling of trust with non-trust funds. A stepson sued his stepfather asserting ownership in certain real property by virtue of his inheriting his mother's one-half community interest in same. The court said:

> Appellant also contends that he was entitled to an interest in the property because he showed there was community property and the burden was on appellee to show it was not used to pay the indebtedness against the property assumed by appellee. He cited Logan v. Logan, 138 Tex. 40, 156 S.W.2d 507, Hand v. Errington, supra, and Boettcher v. Means, Tex. Civ. App., 201 S.W.2d 255, no writ hist. These cases are not applicable. They are all cases where the trustee had commingled funds belonging to the trust estate with his personal funds and had then so invested both of them in property that the cestui was unable to prove what part of the invested funds was trust funds and what was personal funds of the trustee. In such case the burden is on the trustee to segregate the funds or else the whole will be held to be trust property. However, we think the burden is on the cestui to show as a fact the commingling of the funds and to show that the commingled funds were invested in the property on which he seeks to impress a trust.
>
> * * *
>
> In this case there was absolutely no showing that there was any commingling of funds nor that any community property went into the 15 acres . . . .

Id. at 404-05.

Secondary Authorities

No comments by secondary authorities were found on the Landry case.

RECAP

Once a party shows that a trustee has acquired property with commingled trust and non-trust funds, the burden shifts to the trustee to segregate the funds or else the whole will be held to be trust property. The burden is on the beneficiary, however, to first show the commingling.

13. <u>In re Marriage of Long</u>, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ). This divorce case involves: a discretionary income distribution trust, part of which expired during marriage, with the beneficiary leaving the proceeds in the hands of the trustee; "loans" from the trust to the beneficiary-spouse, occurring after the parties separated; and the proper way to order a trust to pay child support to a minor child of the trust's beneficiary.

The trust in question was created by the husband's parents in 1954, for the benefit of their four children. During the term of the trust, the trustees had sole discretion to distribute to the beneficiaries whatever portion of the net income the trustee thought proper for support. When each child reached age 25, he was entitled to half of his share of the corpus, free of trust. When each child reached age 30, he was entitled to the balance of his share of the corpus, free of trust.

The trust contained oil and gas producing property. When the husband married in 1969, his share of the accumulated net income of the trust was approximately $25,000.00. When the husband attained 25 years, in 1974, he announced his intention to allow the trustees to continue to manage the one-half share he owned free of trust.

The wife argued on appeal that the trial court erred in failing to find that one-half of the interest, dividends, equipment rentals and cattle sales earned by the trust and subject to mandatory distribution was community property.

<u>Effect of Partial Termination of the Trust</u>

The opinion by the Court of Civil Appeals made the following comments:

> Charles E. Long had a present possessory interest in the trust at the time of trial. The trust had terminated as to one-half of the corpus of the trust. Charles was entitled to that one-half of the corpus and the income that had accumulated on that portion of the corpus following his having reached age twenty-five. The one-half of the corpus was his separate property but was appropriate for consideration by the trial court in dividing the estate of the parties. The accumulated income from his one-half of the corpus after reaching age twenty-five was community

property and was also subject to division by the court.

* * *

Income received by a married beneficiary on the trust corpus to which the beneficiary is entitled has been held to be community property. <u>Mercantile Bank at Dallas v. Wilson</u>, 279 S.W.2d 650, 654 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.), and has been taxed accordingly. <u>McFaddin v. Commissioner of Internal Revenue</u>, 148 F.2d 570 (5th Cir. 1945).

Trust income which a married beneficiary does not receive, and to which he has no claim other than an expectancy interest in the corpus, has been held not to be community property. <u>Currie v. Currie</u>, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd).

* * *

By the terms of the trust, the income was to be accumulated until the beneficiary (appellee) reached age twenty-one. At that time, income was distributable solely at the discretion of the trustees. When the beneficiary reached age twenty-five the trust dictates that the trustees deliver and distribute unto the beneficiary one-half of the assets and property comprising the corpus of the trust. At age thirty, the beneficiary is to receive the remaining one-half. The appellee reached age twenty-five at a time after separation but before suit for divorcee had been filed. The appellee decided to leave his half interest in the trust though he was entitled to withdraw approximately $85,000.00 in liquid assets exclusive of interests in real property.

Appellant does not claim a community interest in the entire $85,000.00, nor does she deny that such portion of this sum attributable to the corpus acquired by gift is separate property of the appellee. Kathy does contend that some $10,853.83 is attributable not to the corpus but to the income from the corpus. Outlined in appellant's brief is the income from interest, dividends, equipment rental and cattle sales which shows that from August 15, 1974, to July 31, 1975, there was accumulated $4,973.21. This is the only sum that we view to partially be community property from the

> sources named since the $4,973,21 represented income on the total Charles E. Long Trust. Only one-half of the $4,973.21 was subject to distribution to Charles since the other one-half of such sum still belonged to the trust. It thus appears that $2,486.60 could be classified as community income to Charles and Kathy.
>
> Unlike the situation in Currie, supra, the beneficiary in the case before us was entitled to a present possessory interest in one-half of the trust corpus and the income from than one-half. In the Mercantile Bank case, supra, undistributed income was in the hands of the trustees but the beneficiary had a present possessory interest in the funds. As in the Mercantile Bank case, we conclude that the income on the trust corpus should have been labeled community property.

Id. at 716-18.

Discretionary Distribution of Income

According to the Court, since distribution of the net income of the Trust was discretionary, the undistributed net income truly held in trust was not community property. The appellate court recognized a community interest in only the income on the one-half of the corpus to which the husband had a present possessory right, beginning with the date that possessory right arose. Id. at 718.

So-Called "Loans" from the Trust

At trial, the husband and the Trustee (the Trust was a party) claimed that the husband owed the Trust $35,704.42, as a community debt, reflected in promissory notes signed after the parties separated. Id. at 716. Some of this money was spent to pay income taxes, and some to pay living expenses. The balance was spent for the support of the family. All of the notes were signed after the husband attained 21 years, and became entitled to one-half of the corpus, free from trust. The appellate court instructed the trial court to decide upon retrial whether these notes represented community debts, or whether the sums were advancements on property to which the husband was otherwise entitled. Id. at 717.

Order for Trustees to Pay Child Support

The husband appealed from the order of the court that did not require him, but did require the trustee, to pay $200.00 per month child support for the parties' minor child. The Court looked to section 14.05(c) of the Family Code, which provides:

> (c) The court may order the trustees of a spend-thrift or other trust to make disbursements for the support of the child to the extent the trustees are required to make payments to a beneficiary who is required to make support payments under this section. If disbursement of the assets of the trust is discretionary in the trustees, the court may order payment for the benefit of the child from the income of the trust, but not from the principal.

TEX. FAM. CODE ANN. § 14.05(c) (Vernon 1975). The appellate court reversed this portion of the judgment, saying that the trial court must first order the beneficiary of the trust to pay child support, and then order the trustees to make the disbursements. Id. at 719.

Secondary Authorities

This is what the secondary authorities say about In re Marriage of Long.

a. Campfield. Professor Regis W. Campfield says the following about the Long case.

> . . . The court held that [t]he income accumulated by the trustee on the half interest in the trust the husband could have withdrawn at age 25 (but did not) was community property. However, the court concluded that the income accumulated on this half interest before the husband reached 25 and was not community property. [T]he income accumulated by the trustee on the other half interest was not community property. . . . The court's holding in Marriage of Long is perfectly consistent with Texas precedent.
>
> The husband was in constructive receipt of half of the trust when he reached 25; therefore, the income produced by this one-half of the trust was community property . . . . He did not have any part of the other half of the trust (or any portion of the trust before he was 25) and, therefore, no part of the income

> accumulated on the other half of the trust (or any income accumulated before he attained 25) was community property . . . . Why? Because in the latter two cases, the alleged fruit was, in fact the tree. The income -- the fruit -- was the subject of the gift and therefore the Texas Constitution dictates that the income be his separate property.

Campfield, Characterization of Income From Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEX FAMILY LAW AND COMMUNITY PROPERTY COURSE C-18--19 (1984).

b. McKnight. Professor Joseph W. McKnight cited Long for the following proposition: "It may also be said that income is but part of the subject matter of the gift of the settlor of the trust and, therefore, is separate property. If by the terms of the trust, income not subject to distribution is added to and becomes a part of the corpus, it is corpus when received by the beneficiary and, therefore, his separate property." McKnight, Division of Marital Property on Divorce, 8 ST. MARY'S L.J. 413, 430 (1976).

c. Smith. Donald R. Smith said this about the Long case:

> In Matter of Marriage of Long, it was held that undistributed trust income is community property when the beneficiary has a present possessory interest in the corpus and the interest from the corpus. The court stated additionally that undistributed trust income

> was community property while undistributed income to which the beneficiary had no claim other than an expectancy is not community property.

Smith, Characterization of Property, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

d. Stewart. James D. Stewart and Kirk Patterson had this to say about the Long case:

> The terms of the trust in [Long], required a full distribution of trust corpus when the husband beneficiary reached age 30, which was to be four years after the divorce was granted. This certainly created an "expectancy" interest in the corpus, and there was trust income accumulated during marriage and held in the trust which could be held to create a partial community interest in that expectancy. Nonetheless, the Court of Appeals ruled that trust income which a married beneficiary does not receive and to which he has no claim "other than an expectancy interest in the corpus" was not community property, citing Currie v. Currie, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd).

Stewart & Patterson, Theories of Recovery: Partnerships and Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-24 (1983). Later in the same article, they said:

> Interestingly, in the Long case, while the Court was treating the trust assets subject to present distribution at the will of the husband as marital property, it was only the income accumulated on such property after the distribution could have been acquired by husband that became community property. The income that accumulated in the trust during marriage prior to such date was not viewed by the wife as community property and therefore the Court did not allocate that portion to the community.

Id. at M-29. The authors went on to say that:

> As previously indicated, [Long] is the only Texas divorce case involving assets held in trust to which the spouse had a present legal right to possession. The Court characterized part of the trust fund as community and part

> as separate, allocating to community only the income received during marriage after the spouse obtained his present possessory interest.

Id. at M-29.

RECAP

Long says that where the husband has a present possessory interest in part of the contents of the trust, the income accruing on that portion falls into the community, regardless of whether or not it is distributed. The corpus itself was separate, because it was initially received by gift. The community estate had no claim to undistributed income which was subject to distribution to the husband only at the trustee's discretion. The trial court was cautioned to consider whether so-called "loans" from the trust to the husband were to be repaid, or whether they really constituted advancements of the sums to which he was entitled. As to ordering the trustee to pay child support, the appellate court held that the parent/beneficiary must first be ordered to pay child support before the trustee of his trust can be required to make the distributions to fund that payment.

14. McClelland v. McClelland, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), was a divorce case in which the wife, Dora, asserted an interest in undistributed income held in a testamentary trust created by her father-in-law for the benefit of her husband, Peter. The trustee was joined as a party. A jury verdict and judgment for $42,000.00 was given to the wife and against the trustee.

The trust was a spendthrift trust. Id. at 358. Under Peter's father's will, the property in question was to be held in trust for Peter for 25 years after his father's death, and then distributed to Peter free of trust. By codicil, the father extended the trust for Peter's life, and upon Peter's death, the trust property was to be distributed to the father's heirs.

The trustee was required to provide Peter with a monthly allowance of $100.00, or $150.00 if Peter married, as well as a "suitable house for him to live in." Under the codicil, if in the trustee's judgment Peter was "provident and careful," the trustee could make such additional advances from the estate as the trustee thought "right and proper." Id. at 356. At no time did Peter take possession of any of the property held in trust, except as provided in the will and codicil.

The Court of Civil Appeals said that "the real question in the case . . . is the one of construction and interpretation of the will and codicil." Id. at 358. The court must "ascertain the purpose and intention of the testator, and this is to be gathered from all the terms of the will when considered as a whole." Id. The Court of Civil Appeals concluded that "the purpose and intention of the testator was to devise to his son . . . a life estate only, to be held in trust by the executors for the term of his life, with remainder over to the heirs of the testator. . . ." Id. The Court went on to say:

> If the income arising from the estate was not available to [the husband], and could not be reached by him, the right of his wife would be no greater than his, and she would not be allowed to work out and enjoy a right in his estate that was denied him. It is not the purpose and object of the statutes that create the community interest of husband and wife in property to prevent a testator from making a disposition of his property to either upon conditions and trusts which will limit the right of the beneficiary, or restrict his

> interest to a limited extent, and define what its character shall be. This is the right of the testator. The law did not impose upon him the duty of devising and bequeathing his property to his son, and when he elected to do so he had the authority to determine what interest in his estate the son should enjoy; and, having defined this interest, the wife, by force of the community statutes, could not exceed and extend it.

The Court concluded that the wife "had no interest in the property conveyed by the will that she could reach, and that the will passed the property to [the trustee], charged with the trusts therein mentioned." Id. at 359. As a consequence, the judgment for the wife and against the trustee was reversed and rendered.

The Court also addressed the monthly payments from the trust, saying that "the wife is not entitled to any interest in the amounts received by [Peter] from the executors, because these amounts were his separate property, devised to him by the will, in which the wife had no community interest." Id.

Secondary Authorities

a. Campfield. Professor Regis W. Campfield had this to say about McClelland.

> McClelland was a divorce case in which the wife alleged that the income which had accrued during the marriage on property devised by the husband's father in trust for the husband was community property . . . . The trustee had the discretion to accumulate the income of the trust, except for small support payments . . . . The court rejected the wife's argument in holding that: . . . [t]he wife was not entitled to any of the trust income distributed to the husband "because these amounts were his separate property, devised to him by the will, in which the wife had no community interest." Id. at 359 . . . . The court also held that . . . [t]he wife had no greater interest than the husband in the accumulated income; and . . . [t]he deference should be given to the testator's intention . . . .
>
> Although the . . . language [quoted above] was in reference to undistributed trust income, it is applicable to any case involving a trust

> because it demonstrates that the Texas courts give clear deference to the settlor or testator's intentions in determining whether trust income is separate or community.

Campfield, Characterization of Income From Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEX FAMILY LAW AND COMMUNITY PROPERTY COURSE C-8--9 (1984).

b. McKnight. Nothing by Professor McKnight could be found on McClelland.

c. Simpkins. Professor Loy M. Simpkins said the following about McClelland:

> One early decision stated that the income, and not the corpus, was the thing bequeathed to a married woman, and therefore the income from the trust was within the statutory definition of separate property.

SIMPKINS, SPEER'S TEXAS FAMILY LAW § 15.42 (1976).

d. Smith. Donald R. Smith made the following comments about McClelland:

> In McClelland v. McClelland, the income earned under a testamentary spendthrift trust was declared to be separate property. As to accrued but undistributed income which was payable at the discretion of the trustee, the court stated that the rights of the beneficiary's spouse could hardly be greater than those of the beneficiary who could not compel payment under the trust. As to income of the trust which was distributed, the court stated that this was property devised by will and thus the separate property of the beneficiary. [footnote omitted]

Smith, Characterization of Property, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

e. Stewart. James D. Stewart and Kirk Patterson said the following about McClelland.

> If the trust instrument creates an irrevocable trust where the trustee has absolute discretion to distribute or not distribute funds, the beneficiary spouse has no legal right to demand payment from the trustee and the Courts have uniformly held that at the time of divorce the wife also has

no right to demand any payments from the trustee. The old case of McClelland v. McClelland, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), contains a classic statement of this rule. In this divorce case, the husband's father had created a trust under his Will, in which the trustee had discretion to accumulate all the income from trust property with the exception of certain fixed support payments. If the husband had no legal right to demand distribution of accumulated income in the trust, then neither could the Wife assert such rights in a divorce proceeding: "The law did not impose upon (the testator) the duty of devising and bequeathing his property to his son, and when he elected to do so he had the authority to determine what interest in his estate the son should enjoy and, having defined this interest, the wife, by force of the community statutes could not exceed and extend it." 37 S.W. at 358.

Stewart & Patterson, Theories of Recovery: Partnerships and Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-21--22 (1983).

RECAP

The McClelland case holds that a person married to a trust beneficiary has no greater claim on the trust than the beneficiary does. Here the husband had only a right to a monthly stipend for life, together with such other sums as the trustee saw fit to give him, plus the right to use a house to be provided by the trustee. The trust was a spendthrift trust, with the trustee having full power of investment, payment of expenses, etc. The wife had no claim to the undistributed income of the trust. Additionally, the Court of Civil Appeals "took the occasion" to state in dicta that the wife had no interest in sums received by the husband from the executors, because they were property devised to him by will, and were therefore the husband's separate property. [Author's comment:] McClelland did not say that income from a separate property trust is separate property. It said that a bequest of regular payments from a testamentary trust is received by a life-time beneficiary as an inheritance, and not as community income.

15. McFaddin v. Commissioner, 148 F.2d 570 (5th Cir. 1945). McFaddin is a tax case involving the question of whether certain income of a trust was separate or community property.

The trust was created by the mother and father of the McFaddin children. The parents conveyed two large cattle ranches into trust, subject to the debts secured by the properties and further subject to an annual payment to the mother of $30,000 per year, payable from income or, if insufficient, from the corpus. The Fifth Circuit held that the property conveyed was a gift. Id. at 572. Therefore, the oil royalties, bonuses and profits from the sale of the land "came to" the McFaddin children as separate property, taxable as separate income.

The Fifth Circuit did, however, accept the McFaddin children's argument that property acquired by the trust was community by virtue of a commingling of separate funds with community funds. The Court stated:

> The theory of the Tax Court that none of the commingled property with which the after-acquired property was purchased was community property because, under the terms of the trust instrument, gross income was treated as corpus, the rights of the beneficiaries did not attach to gross income but only to the distributable net income, and the gross income used by the trustees was, therefore, not community property, will not at all do. The taxpayers were the beneficial owners of the trust properties, and every part and parcel of them, including income from them, belonged beneficially to them, either as separate or as community property, in the same way that it would have belonged to them had the property been deeded to the taxpayers and operated by themselves. The greater part of the normal income from the property during the years preceding the tax years in question was community income. When it was commingled in a common bank account with other funds of the trust so that the constituents had lost their identity, the whole fund became community; and when it was used by the trustees to purchase additional properties, those properties, taking the character of the funds which bought them, were community property. [footnotes omitted]

Id. at 573.

The Fifth Circuit Court of Appeals also rejected the Commissioner of Internal Revenue's argument that because the trusts were spendthrift trusts, they were in effect conveyances of income to the separate use of the beneficiaries. Id. at 574.

In sum, the McFaddin case stands for proposition that income received by a trust is community or separate by the same rules as would apply had the income been received outside of trust.

This rule was applied to the gross income of the trust, not just to the distributable net income. Id. at 573. Since the gross income was commingled in trust bank accounts with separate property receipts, the whole fund became community property, and the subsequently-acquired property was community in nature, and the oil income therefrom was similarly community.

The Fifth Circuit Court of Appeals also rejected the Commissioner of Internal Revenue's argument that because the trusts were spendthrift trusts, they were in effect "conveyances of income to the separate use of the beneficiaries." Id. at 573.

Secondary Authorities

a. Campfield. Professor Regis W. Campfield had the following to say about McFaddin.

> It reflects the Fifth Circuit's insistence upon disregarding the trust entity in order to find the trust income as community for income tax purposes. While finding the property originally placed in trust by the settlors became the beneficiaries' separate property, it noted that the trust income consisted of both oil royalties, which are separate property under Texas law, and other income that if received directly by the beneficiaries would be community property under Texas law. It then concluded that the community property portion of the trust income was commingled with the separate property income to such an extent that the two were unidentifiable, and thus, the income from the whole became community. The trustees had used the separate property income of the trust to purchase other property for the trust. The Fifth Circuit rejected the Tax Court conclusion that such after-acquired property was separate property

and that, therefore, the income from that property was separate.

Campfield, Interspousal Transfers, 32 SW. L.J. 1091, (1979). See also Campfield, Characterization of Income from Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-14 (1984).

b. McKnight. No published comments of Professor McKnight could be found on McFaddin.

c. Smith. No published comments by Don Smith could be found on McFaddin.

d. Stewart. James D. Stewart and Kirk Patterson made the following comments regarding McFaddin:

> The case of McFaddin v. Commissioner, supra, was significant in that it applied Texas commingling doctrine to mix the separate and community assets held by the trust in such a way that to extent that two were unidentifiable. All income from the trust became community. The property originally placed in trust included both oil royalties which were separate property and other income which, if received directly by the beneficiaries, would be community property. The trustees had used the mixtures to acquire new properties, and to the extent the distributions could not be identified as coming from separate or community, the distributions were community property, even though gross income was treated as corpus under the trust instrument.

Stewart & Patterson Theories of Recovery: Partnership and Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-27--28 (1983).

RECAP

In the Tax Court

In McFaddin, the Tax Court ruled that children who are beneficiaries of a trust, created by gift of their parents, hold that interest as separate property. The Tax Court further found that the rights of the beneficiaries did not attach to the gross income, but rather to the distributable net income, of the trust, and that the gross income of the trust used by the trustees to purchase additional property could not be community income of the beneficiaries. Furthermore, the fact that the property was conveyed into trust subject to debts and liens did not convert what was otherwise a gift into a transfer for onerous consideration. Oil royalties and bonuses from the corpus remained the beneficiaries' separate property.

In the Fifth Circuit

In the Fifth Circuit, the fact that the trust instrument treated gross income as corpus, and gave the beneficiaries only an interest in the distributable net income and not the gross income, did not affect the character of the gross income. The same rules of characterization apply to the income of the trust as if the property were owned by the beneficiaries free of trust. Income from separate property held in trust fell into the community estate.Where community gross income of the trust was commingled with separate property funds, the whole fund in trust became community. When those commingled funds were used to acquire additional property, this property was community in character. The fact that the trust contained a spendthrift clause did not make the transaction a conveyance of income "to the separate use of the beneficiaries."

16. <u>Mercantile National Bank at Dallas v. Wilson</u>, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.). In the <u>Mercantile Bank</u> case, the Dallas Court of Civil Appeals concluded that the undistributed profits or income from a trust created by a wife before marriage, for her own benefit, is community property.

The case was a suit by a creditor against the widow of a deceased debtor. The creditor argued that income of the widow's trust estate, which accrued during her marriage to the deceased, constituted community property, and that assets purchased with that income constituted community property. <u>Id.</u> at 651. The creditor argued: that the original corpus of the trust had become so commingled with trust income that a large portion of the trust res became community property; that the burden was on the wife to trace the property acquired during the marriage back to the original corpus of the trust, or mutations thereof; and that, even if the foregoing arguments were wrong, the income distributed from the trust during marriage was community property, as community income derived from separate property during marriage. <u>Id.</u> at 652-53.

The Court made the following comments:

> [T]he trustees under such instrument were bound to first pay out or expend the income from the trust before paying out or expending the corpus of the trust, and in our opinion there is as presumption that the trustee and substitute trustee did, as was his duty, first pay out or expend such income before paying out or expending the corpus of the trust. The beneficiary had no control over the trust funds and should not be prejudiced by the trustee or substitute trustee placing the income in the same account as that in which he kept the corpus of the estate.
>
> * * *
>
> [T]he trustee and substitute trustee, as said above, were bound to reinvest the income from the trust corpus or deliver same to Mrs. Wilson, or to expend the same for her use and benefit. It follows that they were therefore required to pay out income first, and even if such income was commingled with corpus funds, it will be presumed that the first moneys paid out, until all income was exhausted, was in fact income; and Mrs. Wilson as beneficiary could not be prejudiced by the trustee or substitute trustee having deposited both the corpus and the income in

the same bank account, since both items, corpus and income, could be definitely ascertained as to amounts and disbursement by the trustee and substitute trustee in such manner as that each item of corpus or income could be properly ascertained and disbursed to those entitled to it.

Id. at 659-60.

Secondary Authorities

a. Campfield. Professor Regis W. Campfield said the following about the Mercantile Bank case:

> In Mercantile National Bank v. Wilson . . . the Dallas Court of Civil Appeals held that a creditor could not reach trust income in satisfaction of a community debt incurred by the deceaed husband . . . . The trust had been established prior to the marriage by the wife for her own benefit.
>
> Mercantile is significant because the court, in a clearly stated dictum, said that the undistributed trust income was community . . . . After reaching this conclusion, the court still denied the creditor recovery . . . . The court reasoned that the trust income was the special community of the wife, and, therefore, was not reachable in satisfaction of the husband's community debt . . . . Trust was not subject to creditors because art. 4616 exempted rents, interest, dividends, etc. on a wife's separate property from payment of debts contracted by her husband. 279 S.W.2d at 654.
>
> The irrelevancy of the court's conclusion with respectd to the character of the undistributed trust income is apparent when one considers that the result would have been the same if the court had concluded that the trust income was the wife's separate property.
>
> Consistent with this notion is the fact that an application for writ of error was filed in Mercantile but the Texas Supreme Court refused it on the grounds that "no reversible error" was present. Perhaps, the Supreme Court realized that the income was not community but, recognizing that the case was corectly decided, found no occasion to speak to the

character question. But the income was community, because the wife was entitled to the corpus, her separate property!

Campfield, Characterization of Income from Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-16--17 (1984).

b. McKnight. Nothing by Professor McKnight could be found on the Mercantile case.

c. Smith. Donald R. Smith said the following about the Mercantile Bank case:

> In Mercantile National Bank at Dallas v. Wilson, the court stated that undistributed trust income earned during marriage is community property. [footnote omitted]

Smith, Characterization of Property, KAZEN, TEXAS FAMILY LAW: PRACTICE AND PROCEDURE § 11.50 (1985).

d. Stewart. James D. Stewart and Kirk Patterson said the following about the Mercantile Bank case.

> A similar case is Mercantile National Bank at Dallas v. Wilson, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955), writ ref'd., n.r.e.), which is a creditor's case, not a divorce case. The husband's creditor was seeking a share of accumulated income in the wife's trust. Certain bonds were gifted to the wife by her father. Then, the wife created a trust, naming her father as trustee to keep the bonds or her and collect the interest thereon and reinvest the revenue derived therefrom. The trust was made irrevocable. After the trust became effective, there were numerous changes in the assets of the trust through sales of securities, purchase of other securities, and certain payments from the trust to the wife. The Court concluded that income on the trust corpus was community property fromt he date of marriage, but that it was special community, not subject to payment of debts contracted by the husband. After the husband had died, the trust was distributed to the wife in full. Sepcifically, the Court held that a traceable portion of these assets distributed was community property, but not subject to the husband's debts because it was income derived from her separate property.

Stewart & Patterson Theories of Recovery: Partnership and Trusts, STATE BAR OF TEXAS ADVANCED FAMILY LAW COURSE M-23 (1983).

RECAP

Mercantile National Bank at Dallas v. Wilson held that the undistributed income of a trust created by a woman before marriage, for her own benefit, was community property beginning with the date of her marriage and ending with the date the husband died. This result was not affected by the Court's opinion that the trust was a spendthrift trust. The trust reverted to the wife after her father (the trustee) and her mother (the substitute trustee) died, all of which occurred after the death of her husband. The Court traced the purchase of a number of separate property assets by the trust, using a presumption that, where the trust instrument provided that the income either be reinvested, distributed to the wife, or spent for her benefit, the first moneys paid out of the trust were income, until all income was exhausted.

17. **Musslewhite v. Musslewhite,** 555 S.W.2d 894 (Tex. Civ. App.--Tyler 1977, writ dism'd). This divorce case could have been a very important case on trusts and family law. Unfortunately, there were no findings of fact or conclusions of law. Additionally, the trial court recited in the decree that, despite the dispute over the character of the property, "the Court finds that whether such property be deemed community or separate, in the exercise of the Court's discretion, it should be divided in the following equitable manner." Id. at 897. Consequently, the appellate court concluded that the trial court had not made a determination of the community or separate nature of trust income, and did not reach the issue. Id. at 897. However, the appellate court did make some interesting comments regarding the character of income from trusts. Some background is required.

In Musslewhite, there were two trusts, No. 129 and No. 395, both of which were created by the husband's parents.

Trust No. 129

Trust No. 129 was created 3-1/2 years before the marriage, by a written trust agreement, wherein the husband's parents conveyed an undivided 1/8th interest in the Baker Tank Company partnership to a Bank and the husband, as co-trustees, to be held in trust for the sole benefit of the husband. The trust agreement directed the Bank and the husband to enter into a partnership agreement with the other partners of the Baker Tank Company. The trust agreement authorized the husband to actively participate in the management of the partnership as ordinarily required of a partner. The partnership tax returns showed that the husband spent 100% of his time on partnership business. The Trust terminated by its own terms when the husband reached 30 years of age. This occurred during the marriage, about 3 years before the parties separated. However, the husband did not at that time receive the Trust's assets; rather, he allowed the Bank to continue to manage the properties.

During the Trust's existence, partnership distributions were received by the Trust and managed by the Bank. Distributions from the Trust were periodically made to the husband. When the Trust terminated, the value of the Trust was $125,939.27, plus 1/8th of the undistributed profits of the partnership. During the marriage, but after the parties had separated, the Baker Tank Company was sold. The 1/8th interest held by the Bank generated $328,151.11, which was placed into a special escrow account, pursuant to letter agreement between the husband, the wife, and the Bank. In the divorce, the wife was awarded some $160,000.00 from this escrow account.

Trust No. 395

Trust No. 395 was created by the husband's parents some 6 years into the marriage. They transferred a 1/32nd interest in the Baker Tank Company partnership to the same Bank and the husband, as co-trustees. The trust agreement was similar to Trust No. 129, except that the Trust was to remain in effect until the husband's death. The husband had a lifetime power of appointment over the income from Trust No. 395. In the divorce, the husband was awarded Trust No. 395.

Appellate Court's Comments

The Court of Civil Appeals made the following comments:

> Had the court made a determination of the community or separate nature of the trust income, of particular importance would be the fact that appellant's time, toil and talent were devoted to his management position with the Baker Tank Company. The evidence is also conclusive that appellant had a present possessory right to the income of both trusts. Appellant exercised an option to continue Trust No. 129 on his own accord on August 1, 1962 (prior to his marriage).[1] As to Trust No. 395, appellant had a lifetime power of appointment over the income of said trust. The record also indicates that much of the other property was purchased with distribution from the trusts.

Id. at 897. Unfortunately, the appellate court did not tell us the significance of the recited facts. It would appear, however, that these factors would have inclined the appellate court toward a finding that the income of the trusts was community property subject to division on divorce.

Secondary Authorities

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1 What the Court meant here is not evident from the opinion. The trust was created on January 1, 1961. The parties married on July 11, 1964. The trust expired on July 27, 1971. Nowhere else in the opinion are events on August 1, 1962, described.

No reference to Musslewhite could be found among the secondary authorities.

RECAP

Musslewhite would have been a very good exercise in applying the law in this area. Unfortunately, the trial and appellate court side-stepped the issue of character of property. The appellate court did mention factors it considered important, without saying in what way. For example, the portion of the distributed trust income representing distributions on a partnership on which the husband spend 100% of his time, toil and talent, appeared to raise a question as to whether that income was community. The appellate court also noted that the husband had "a present possessory right" to the income of the trust which he allowed to continue past maturity, as well as of the trust in which the husband had a lifetime power of appointment over the income. Musslewhite represents a great opportunity lost. High marks go to the appellee's lawyer for manipulating the findings of fact in a way to avoid reversal on the characterization issue.

18. San Antonio Loan & Trust Co. v. Hamilton, 283 S.W.2d 19 (Tex. 1955). The San Antonio Loan & Trust Co. case involved the question of whether the heirs of a life tenant or remaindermen under a trust owned a beneficial interest in property acquired by the trustee using funds of both the life estate and the remainder estate. The Supreme Court ruled that the life tenant and remaindermen became equitable owners of the new property in the same proportion as they owned the consideration given for the property. This is the so-called "doctrine of apportionment between income and principal." Id. at 23. Where the property acquired is sold for a gain, the gain is owned proportionately. Where it is sold for a loss, the loss is borne proportionately. Id. at 22.

Tracing was involved. At the outset, a promissory note for $1,300.00, secured by lien in real estate, was conveyed into the trust. The note went into default. The trustee obtained a judgment for $1,300.00 principal, and $1,257.83 in interest. The lien was foreclosed. At foreclosure sale, the property was purchased by the trust for $1,500.00. The trustee subsequently signed two oil and gas leases, receiving $9,770.00 in bonus payments. Since under Texas law a bonus payment is considered part of the corpus and not income, the bonus did not go totally to the income beneficiary. Rather the bonus belonged to the income beneficiary and the remaindermen in the same proportion as interest and principal bore to the original judgment: income owned 49% and principal owned 51% of the bonus payments. The Supreme Court concluded that a resulting trust in the property existed, and that when the trustee took the land in its name, it did so for the benefit of the income beneficiary to the extent of her proportionate interest in the judgment. Thus judgment was rendered requiring the trustee to convey a 49% interest in the land to the heirs of the income beneficiary, together with 49% of the bonus payments, which had been reinvested in U.S. Savings Bonds.

Secondary Authorities

No comments by secondary authorities could be found.

RECAP

The doctrine of apportionment as between income and principal applies within a trust. That is, if property is acquired by a trustee, partly with income and partly with corpus, the property acquired is owned in the same proportion by the income beneficiary and the remainderman. As long as the property can be traced, this apportionment will apply. Both gains and losses will be apportioned on the same basis. Bonuses on oil and gas leases are considered part of the corpus, and not trust income.

19. Shepflin v. Small, 23 S.W. 432 (Tex. Civ. App.--El Paso 1893, no writ). In this case, a husband and wife joined in a conveyance of the wife's separate property to a trustee, who was to collect the rents and used them for the support of the wife and the parties' children. In a suit by a creditor to reach this income, the court held that the conveyance of the property into trust withdrew the income from the community estate.

Secondary Authorities

a. Campfield. Professor Campfield said the following about Shepflin v. Small:

> There a debtor and his wife conveyed her separate property to a trustee, who was to collect the rents and appropriate the same for the support of the wife and children. . . . The court held that by creating the trust the couple had withdrawn the rents from the community estate and that therefore the husband's creditor could not garnish the rents. . . . The decision in Shepflin is incorrect and should be decided differently by a modern court. . . . Shepflin should be decided differently because its policy considerations should preclude a spouse from using a trust [as] a vehicle to change the character of property for the benefit of the spouse.

Campfield, Characterization of Income From Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-7 (1984).

b. Simpkins. Professor Simpkins said the following about Shepflin:

> In one case a husband and wife conveyed the wife's separate property in trust to collect the income and pay the same for the support of the wife and children. A creditor of the husband attempted to reach the income, but the court denied him the right to do so. The court held that the conveyance in trust had the effect of withdrawing the income from the community estate.

Simpkins, SPEER'S TEXAS FAMILY LAW _ 15:42 (1976).

Nothing by Professor McKnight, Don Smith or Jim Stewart and Kirk Patterson could be found on Shepflin.

(rents + profits)

20. Sullivan v. Skinner, 66 S.W. 680 (Tex. Civ. App. 1902 writ ref'd). In Sullivan, the wife received under her father's will a life estate in a piece of real estate located in San Antonio, Texas. The father's will gave her a life estate in the property "[f]or the term of her natural life, with full power to receive, for her sole and separate use and no other, the rents and profits of the same, and on her death the same to belong to any [of her] child or children . . . ." The Court of Civil Appeals made the following observations:

> . . . [T]he rents and profits issuing from the property during her life was all she could get out of it, unless she should sell her life estate therein. These "rents and profits" she was empowered by the will "to receive for her sole and separate use and no other." This use excluded the right of her husband to any interest in the rents and profits, and made them her separate property. The fact that the statute gives to the husband the control and management of his wife's separate property gives him no interest in it.

Id. at 681.

The Court of Civil Appeals concluded that creditors of the husband had no claim against the rents and profits derived from the real estate. Id. at 682.

Wife's Equitable Separate Estate

The terms of the wife's father's will, that the rents and profits were for her "sole and separate use and no other," had special significance at the time. See the discussion under Hutchison v. Mitchell, above.

Secondary Authorities

a. Simpkins. Professor Simpkins said the following about the Sullivan case:

> Where a wife is willed property "[f]or the term of her natural life, with full power to receive for her sole and separate use, and no other, the rents and profits of the same, and on her death the same to belong to any child or children" of the wife, the rents and profits become her separate property.

Simpkins, SPEER'S TEXAS FAMILY LAW _ 15:42 (1976). No opinions about Sullivan by other secondary authorities were found.

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Where a wife was given the rents and profits issuing from property during her life "to receive for her sole and separate use and no other," the rents and profits from the property were her separate property. [Author's comment:] Arguably this rule involved the old doctrine of the wife's equitable separate estate, which has passed out of fashion, if not out of the law, in the hundred years since its heyday. In Sullivan, the wife's interest was a life estate, not an express trust.

21. __Taylor v. Taylor__, 680 S.W.2d 645 (Tex. App.--Beaumont 1984, no writ), involved the character of funds distributed by a trust to a wife was a beneficiary. The Court of Appeals explained its decision without citing any authorities on trust and marital property law. __Taylor__ represents an interesting addition to the confusing library of authorities on the subject of the character of income distributed from a spouse's trust during marriage.

In __Taylor__, certain realty was purchased with income distributions to the wife from a trust created by her parents. The husband argued that the distributions were community property, as income generated by or from a spouse's separate property. The Court of Appeals agreed that income from separate property is community, but denied that the rule applied to the case.

The Trust was created by the wife's parents ten years before she married. The Trust was established for the "use and benefit of the respective children of the Trustors, and their lineal descendants. . . ." __Id.__ at 648. At its inception, the sole asset of the Trust was an unidivided interest in a clothing store. The wife was, under the trust agreement, beneficiary of a 20% interest in the business. At the time of wife's marriage, the Trust had $62,850.68 in retained earnings. During the marriage, the Trust distributed $161,050.70 "of income or retained earnings" to or for the wife.

The trust agreement provided that the Trustee have "a 40% undivided interest in the retail business herein described as SCHMIDT'S . . . ." __Id.__ at 649. The Trustee's interest was subject to payment of a salary to management, a buy-sell agreement, rental obligation, and necessary reserves and proper additions to capital from earnings, all of which would come out before any earnings were distributed. The Trustee was given the "right to distribute the net income at such times and in such amounts as the Trustee i[n] its sole discretion may elect." __Id.__ at 649. The trust agreement further provided that "any undistributed income be likewise invested and reinvested, [in] such investments and re-investments as our said Trustee may select . . . ." __Id.__ at 649.

The Court of Appeals concluded that "the income and profits derived from the operation of the dress shop were a part of the corpus of the trust estate." __Id.__ at 649. The Court said:

> The intention of the trustors clearly show that the income and profits were as

> much a part of the corpus of the trust as the individual items of personal property used in the operation of the retail business. The mere operation of a dress shop by the trustee, without receiving income or profits, would be of not benefit or value to the beneficiary of the trust. We hold that the income and profits from the operation of the dress shop were not only a part of the corpus of the trust estate, but were the principal assets of the trust.

Id. at 649. Unfortunately for the husband, counsel for both sides had stipulated that the corpus of the trust was the separate property of the wife. Consequently, the distributions from the trust were distributions of corpus, and were therefore the wife's separate property. The realty acquired with these distributions was likewise her separate property.

Secondary Authorities

Taylor is newer than the published articles on this subject. For this reason, no comments by other authors are brought forward in this Article.

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In Taylor, the Court found that the trustors intended for the income and profits derived from the business interest placed into trust to be part of the corpus of the trust. Since all distributions during marriage were distributions of corpus, and since both parties had stipulated that the corpus of the trust was the wife's separate property, the distributions were also her separate property. The distributions were not income generated by or from a spouse's separate property. [Author's comment:] The Beaumont Court of Appeals did not say that the wife's parents intended a gift of the trust's income to the wife; rather, the Court said that the income from the business held by the trust was part of the separate property corpus of the trust. However, the Court's conclusion that the distributions from the trust were distributions of corpus, conflicts with the language in the trust that the trustee's power to distribute related to distribution of "the net income." The trust therefore operated to convert what arguably would have been community property (i.e., income earned from a business) into separate property (i.e., "distributions of corpus").

One lesson learned is that you'd better define "corpus" before you agree it is separate property.

22. **Wilmington Trust Co. v. United States**, 83-2 USTC (1983). In Wilmington Trust Co., the U.S. Claims Court addressed the question of whether income from a spouse's trusts was received by her as separate or community property.

The wife was beneficiary of seven trusts, six created by her parents, and one created by her husband. She was not the grantor of any of the trusts. Under each of the trusts, the wife was entitled to receive mandatory distributions of net income, but not of principal. On her death, the corpus of the trusts passed to her heirs. All but one of the trusts contained a spendthrift provision.

The Court of Claims reviewed Texas law. First, the Court mentioned the general rule in Texas that income from separate property is community. Colden v. Alexander, 171 S.W.2d 328, 334 (Tex. 1943). The Court next cited Hutchison v. Mitchell, 39 Tex. 487 (1873), for the proposition that a married man could declare an express trust for his wife which gave her the "exclusive use and enjoyment" of all the rents, issues and profits of the trust. Next the court considered Martin Brown Company v. Perrill, 13 S.W. 975 (Tex. 1890), where property inherited by the wife but given over to her husband to hold as trustee on her behalf, generated income that was considered by the Supreme Court not to be community property. Next was Shepflin v. Small, 23 S.W. 432 (Tex. Civ. App. 1893), in which the court held that the rents from the wife's realty were community property up to the time she conveyed the property to trust, but that, thereafter, the rents were her separate property. A contrary conclusion was acknowledged in the case of Mercantile National Bank at Dallas v. Wilson, 279 S.W.2d 650 (Tex. Civ. App. 1955, writ ref'd n.r.e.), but was attributed to the fact that the trust in that case had been established by the grantor for her own benefit and because the trust would terminate upon the death of the grantor's father and mother, so that the grantor had an expectation of recapturing the corpus during her lifetime. McClelland v. McCelland, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), was cited for the conclusion that the income from the trust property, rather than the trust property itself, was the basis of the gift. Buckler v. Buckler, 424 S.W.2d 514 (Tex. Civ. App.--Fort Worth 1968, writ dism'd), was cited as holding that undistributed income of a spendthrift trust is not community property. In re Marriage of Long, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ), was cited for the proposition that where the beneficiary has no right to take over the corpus of a trust created on his behalf by gift, the undistributed income thereon is not community property. Where the beneficiary has the right to the corpus, however, then the income is community property.

The Claims Court criticized the Fifth Circuit's opinions in Wilson and Porter saying that "[i]t appears that the Fifth Circuit in the two decisions previously mentioned, failed to analyze properly the community property law of Texas, as it has been developed by the Texas courts . . . . [B]oth cases seemingly overlook the circumstance that the income involved in each case was from a trust corpus, and the trust corpus was not the 'separate property' of the beneficiaries of the trust." Id.

The Court went on to say:

> It is concluded that, under the law of Texas, as developed and expounded by the Texas courts, the income derived during the marriage of [the spouses] from the seven trusts that are involved in the present case constituted the separate property of [the wife], and was not community property of [the spouses]. [The wife] never "acquired"--and she will never acquire--the corpus of any of these trusts. The corpus of each trust is to be held and controlled by the trustee or trustees during [the wife's] lifetime, and, upon [the wife's] death, the corpus will pass to her issue. Accordingly, the corpus of each trust was not [the wife's] separate property, and the trust income was not from [the wife's] separate property.
>
> What [the wife] "acquired"--and what she used to purchase the stocks and establish the bank accounts that are involved in the litigation--was the income from the trust property. As the income resulted from the gifts made to trustees for [the wife's] benefit, the income necessarily constituted her separate property under section 15 of article XVI of the Texas Constitution.

Id.

Secondary Authorities

a. Campfield. Professor Regis W. Campfield said the following about Wilmington Trust Co.:

> The most recent case following the view that trust income is separate property is Wilmington Trust Company v. U.S., a recent estate tax case arising in Texas but decided by the U.S. Claims Court. No. 371-82T (Cl.Ct. November 21, 1983) . . . . After copiously analyzing the historic trend of Texas cases, the court concluded that when the corpus of a trust established by inter vivos or testamentary gift is held and controlled by a trustee, then the corpus is not the separate property of the beneficiary spouse. Accordingly, the income is not from separate property, but constitutes separate property, whether or not it is distributed.
>
> . . . Does the [case] suggest that if the trust corpus was to be ultimately distributed to Mrs. Asche -- perhaps at some attained age -- the trust income would be community property?
>
> On the other hand, one of the trusts was created by Mr. Asche. Does that mean that a settlor can establish a trust for the benefit of his spouse and, by laundering property through that trust, purge the income from the property of its community character so as to defeat creditors? . . . Surely, based on Wilmington Trust, trust income can be purged of its community character for federal estate tax purposes by use of a trust.

Campfield, Characterization of Income from Estates and Trusts, S.M.U. SCHOOL OF LAW 8TH BIENNIAL TEXAS FAMILY LAW AND COMMUNITY PROPERTY COURSE C-22--23 (1984).

b. McKnight. Professor Joseph W. Knight made the following comments about the Wilmington Trust case:

> In Wilmington Trust Co. v. United States, seven trusts were created for the benefit of a wife during her marriage. Her parents created six of the trusts and her husband created the seventh. Under each trust the wife was entitled to all the income for life, and on her death the corpus of each trust was to pass to others. With but one exception, the wife's interest in all the trusts was not subject to anticipation by her and was immune from her creditors' claims. The trustee held significant undistributed income when the husband

> died, and the Internal Revenue Service took the position that the undistributed income and the wife's investments with distributed income should be treated as community property for purposes of taxing the husband's estate. The United States Court of Claims analyzed the Texas and the Fifth Circuit cases on the subject. The court concluded that the Texas cases treated the income from trusts as the separate property of the beneficiary and that the Fifth Circuit cases had miscontrued Texas law in concluding that trust income is community property. Hence the court reasoned that neither undistributed income held by the trustees on the death of the husband nor investments made by the wife with trust income received should be included in the husband's estate for estate tax purposes. Thus the income from the trust was the true subject matter of the gifts in trust from the settlors to the wife. [footnotes omitted]

McKnight, Family Law: Husband and Wife, 39 SW. L. J. 131, 137 (1984).

Nothing could be found by Don Smith or Stewart & Patterson regarding Wilmington Trust.

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After a review of Texas law, the Claims Court concluded that the income derived by a beneficiary from a trust created by gift from another party is separate property, not community property. The income is not income from a spouse's separate property, because the spouse does not own the corpus. The income of the trust is itself the gift. According to the Claims Court, the Fifth Circuit is simply wrong on the point.