

## TEXAS MARITAL PROPERTY LAW

Marital property law in Texas is based upon the community property system. Although some Texans regard the community property system as an unfathomable mystery, actually its rules are fairly easy to understand. They are also flexible because spouses who do not like the application of the rules to their situation can change the rules by written agreement either before marriage (called a *premarital property agreement*) or during the marriage (called a *marital property agreement* or *community property partition agreement*).

It is perhaps easiest to understand this system by imagining a hypothetical entity, known as “the community,” that owns the community assets of the husband and wife. The husband and wife each have an undivided one-half (1/2) interest in the community. In addition to community property, Texas also recognizes the status of some property as separate property. The characterization of property as separate property or community property is significant in dividing property upon termination of the marriage by divorce or death.

### Characterization of Property

Separate property includes property that is owned by either spouse before the marriage, property that is acquired during the marriage by gift, will, or inheritance, and property that is purchased with separate property funds. Also, separate property can be created by the spouses with a written agreement partitioning or exchanging community property.

Community property is defined by exclusion as all property other than separate property. The most common types of community property include salary, wages, and income generated from both community property and separate property. Some are surprised to learn that dividends and income earned on separate property investments are not separate property, but instead are community property.

### Separate Property vs. Community

Separate Property	Community Property
Owned by spouse before marriage. Acquired during marriage by gift, will, or inheritance. Purchased during marriage with separate funds. Community property partitioned or exchanged by written agreement.	Salary and wages. Income from separate and community property. Assets acquired during marriage.* Assets acquired on credit during marriage.* Assets on hand at dissolution of marriage.*  *Presumptively community property.

There is a presumption in Texas that all assets owned by a husband and wife are community property. All assets acquired during the marriage presumptively belong to the community. All assets on hand during the marriage, and on dissolution of the marriage by death or divorce, are presumptively community assets. Separate property must be proven to be separate by the spouse

asserting that it is separate by clear and convincing evidence.

*Planning Idea: Persons about to be married with substantial property to be brought to the marriage may want to consider a Premarital Property Agreement so the separate property is recognized by both parties.*

### **Inception of Title**

In those cases where classifying the assets is required, Texas applies the inception of title rule. Under this rule, the character of the asset as separate or community property is determined at the time the asset is acquired. Subsequent events, such as the payment of a mortgage, do not change the character of the asset. Consider the following example:

*Example 1: A single man acquires a residence and agrees to pay a mortgage. Shortly thereafter, he marries and the mortgage payments are thereafter made from community property funds. The home will be the separate property of the husband. Upon death or divorce, the wife may have a claim for the expenditure of community funds to pay the principal portion of the mortgage, but that does not affect the separate property ownership by the husband. There is no claim by the community for the interest portion of the mortgage, because the community received the use of the residence.*

The effect of the inception of title rule on the characterization of assets becomes important for those who move to Texas from a common law state.<sup>1</sup> In common law states, each spouse's salary is that spouse's separate property and title to property determines ownership. If property was one spouse's separate property in another state, it remains that spouse's separate property when it is brought to Texas. The rationale behind this rule is to assure that people do not lose rights in property by moving to Texas. Consider the following example:

*Example 2: A husband and wife live in Atlanta, Georgia. Title to their investment securities is in the husband's name. They sell the securities and move to Texas. They use the \$30,000 in proceeds from the sale of the securities to make a down payment on a house in Texas and finance the balance of \$70,000. Because the securities were the husband's separate property, the \$30,000 in proceeds remained the husband's separate property when they moved to Texas. As a result, the Texas house is 30% husband's separate property and 70% community property.*

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<sup>1</sup> Common law states are all states other than the community property states of Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Alaska permits voluntarily opting into its community property trusts even for persons who are not Alaska residents.

Under the inception of title doctrine, how title is held in Texas does not determine ownership. Thus, regardless of whose name appears on the title, the inception of title rule looks to the time and circumstance of the acquisition to determine whether the asset is a community asset or a separate asset. Consider the following example:

*Example 3: Husband buys a fancy sports car in his own name. Because it was acquired during the marriage, it is presumptively community property, even though only one name is on the car title.*

However, where one spouse uses separate funds to purchase an asset but takes title solely in the other spouse's name, a presumption arises that a gift was made to the other spouse. In this situation, the asset is the donee spouse's separate property.

The inception of title doctrine also applies to life insurance policies and employee retirement benefits. The character of a life insurance policy is based upon the marital status and the domicile of the policy owner when the first premium payment is made. Therefore, if the first premium payment was made while the policy *owner* resided in a common law state or while the policy owner was unmarried, the life insurance policy would be that spouse's separate property. Likewise, employee benefits accumulated before marriage are the separate property of the spouse while those accumulated during marriage are community property. Regardless of this state law characterization, federal law may give benefits to the non-employee spouse that are even greater than community property rights.

### **Credit Purchases**

All assets bought on credit during the marriage are presumptively purchased on community credit and, therefore, are community assets. However, there are ways to overcome this community credit presumption. One spouse could show that a creditor agreed to look solely to the separate credit of the borrowing spouse. Also, one spouse could show that the spouses agreed that it was to be separate credit of the borrowing spouse.

*Planning Idea: Even without the agreement of the other spouse, one spouse can purchase on credit an asset as separate property by getting the lender's agreement to look solely at the separate property of the borrowing spouse.*

### **Commingled Bank Accounts**

Commingling separate property and community property in a single bank account can create characterization problems. When the funds are commingled, it is presumed that community funds are withdrawn first before separate funds. If at some point all of the community funds are withdrawn, further withdrawals represent the expenditure of separate funds. Later deposits do not restore the amount of separate funds but inure solely to the benefit of the community. Thus, the amount of separate funds in a commingled account is determined based upon the lowest intermediate balance of the account. Consider the following example:

*Example 4. Wife inherits \$20,000 and opens a savings account. Husband's salary is then deposited in the account until the balance reaches \$30,000. During a family emergency, the balance is drawn down to \$10,000. Later, upon the termination of the marriage by death or divorce, the balance stands at \$35,000. Regardless of the fact that the account has been replenished, the wife's separate property is limited to \$10,000, the lowest intermediate balance.*

### **Income From Separate Property**

One of the more unique features of the Texas community property system is that the income derived from separate property is community property. There are two exceptions to this rule. First, the spouses can agree in writing, either before marriage or during the marriage, that the income from separate property will remain separate property. Second, if there is a gift from one spouse to another, income from the gifted property is presumptively the donee spouse's separate property.

As a result of this rule, interest and dividends earned on separate funds are community property. If interest and dividends in a separate property portfolio are reinvested and over a period of many years the account records are lost or destroyed, then the commingling of funds may prevent the spouse claiming the account as separate from proving its separate property character by clear and convincing evidence.

*Planning Idea: A person with a large stock portfolio and about to be married may want a premarital property agreement so the dividends from the stock remain separate property rather than community property.*

If one spouse owns a mineral interest as separate property, the delay rentals are community property. Bonus payments and royalty payments remain separate property. If one spouse owns corporate stock as separate property, cash dividends from that stock are community property. Stock dividends, stock splits, and capital gains from the sale of that stock remain separate property. For some assets, it may be difficult to separate the community income from the appreciation in the underlying asset.

*Planning Idea: A business owner about to be married may want a premarital property agreement to explicitly provide that his or her business interest is separate property, regardless of whether the increase in value was due to capital appreciation or reinvested income.*

### **Premarital Property Agreements**

Because of the presumption that property on hand at death or divorce is community property, many people with substantial assets enter into premarital property agreements to clarify the nature of their assets or to change the rules applicable to division of their property. These

agreements must be in writing. The agreement can provide that income from separate property will remain separate property. The agreement can govern the disposition of property on separation, divorce, or death. Furthermore, the agreement can waive any homestead allowance, personal property set aside, and family allowance to which a spouse may be entitled.<sup>2</sup> Although the agreement can cover other matters as well, the agreement cannot limit any obligation one spouse may have to provide child support. Although it is clear that a premarital property agreement may characterize one spouse's salary and wages as separate property, some enter into such agreements and then ratify them after the marriage with a marital property agreement. A ratification after marriage is required where the premarital property agreement attempts to waive spousal rights in a qualified pension plan.

*Planning Idea: A person who already has high earning potential before marriage may want a premarital property agreement that provides that income he or she earns remains separate property.*

The terms of a premarital property agreement are subject to negotiation and preparation of a premarital property agreement should begin months before the planned marriage.

### **Marital Property and Community Property Partition**

Another agreement frequently entered into between spouses is an agreement to partition or exchange community property. One article of community property may be partitioned by written agreement so that each spouse owns a fraction of that property as their own separate property. The partition does not have to be into equal shares. Furthermore, spouses may exchange community property interests in different assets in order to make one of the assets the separate property of one spouse and another asset the separate property of the other spouse. If any real property is the subject of either of these types of agreements, the new ownership status must be recorded in the deed records in the county in which the property is located.

### **Community Property by Agreement**

Under Texas law, a married couple can agree in writing that the separate property of one of the spouses will be community property. Community property is different than a co-tenancy of separate property. In a co-tenancy each spouse has a fifty percent separate property interest. Under federal tax law, upon the death of one spouse there is a change in basis (either a step-up or a step-down) on the deceased spouse's separate property and both spouses' community property (including the surviving spouse's one-half interest), but not in the surviving spouse's separate property.

### **Management Powers**

The classification of an asset as community property or separate property is also important in the

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<sup>2</sup> These are certain allowances to which a surviving spouse may be entitled. They are fully paid to the surviving spouse from the estate before any other distributions are made.

determination of what types of powers each spouse has to manage that property. Community property can be classified as either sole management community or joint management community property. Salary, wages, and income from separate property, although community property, are the sole management community property of the spouse who earns the money or owns the property. Other types of community property are joint management community property.

A commingling of sole management community property of one spouse with either the sole management community property of the other spouse or with joint management community property transforms the sole management community property into joint management community property. Property that is in one spouse's name or possession (if the asset has no document evidencing ownership) is presumptively that spouse's sole management community property.

**Responsibility to Creditors**

The importance of this characterization is that a judgment creditor in a non-tortious claim, such as a contract claim, against one spouse can only reach the guilty spouse's separate property and the community property over which the guilty spouse has management power. However, in a claim for a tortious liability, such as a negligence claim, a judgment creditor can reach the sole management community property of the innocent spouse as well but only for claims that arose during marriage and excluding claims that the guilty spouse incurred prior to marriage.

**Property Exposed to Judgment Creditors**

Claim Based in Tort-(Negligence) Liability	Claim Based in Non-Tortious (Contract) Liability
Guilty spouse's separate property. Guilty spouse's sole management community property. Joint management community property. Innocent spouse's sole management community property.	Guilty spouse's separate property. Guilty spouse's sole management community property. Joint management community property.

From another perspective, the innocent spouse's sole management community property and separate property are exempt for non-tortious claims made against the other spouse while only the innocent spouse's separate property is exempt from tort claims.

### Property Not Exposed to Judgment Creditors

Claim Based in Tort-(Negligence) Liability	Claim Based in Non-Tortious (Contract) Liability
Innocent spouse's separate property.	Innocent spouse's separate property. Innocent spouse's sole management community property.

*Planning Idea: Spouses may allocate the responsibility for debts and negligence claims between themselves by either a premarital property agreement or a marital property agreement.*

One of the more frequent uses of partition and exchange agreements is to protect assets when one of the spouses is potentially exposed to negligence (*i.e.* malpractice) claims. Since the residence of an individual is exempt from these claims, most partitions involve causing the residence to become the separate property of the at risk spouse and causing the nonexempt assets to become the separate property of the other spouse. Consider the following example:

*Example 5: Wife is a physician. To protect the couple's assets from potential malpractice claims, husband and wife enter into a partition or exchange agreement. Since the couple's residence is exempt from the claims of judgment creditors, husband could transfer his community interest in the residence to wife. In exchange, the wife could transfer her community interest in other, vulnerable assets to husband. In this way, wife would own the residence as her separate property and husband would own the other assets as his separate property. As a result, any claimant against the wife would not be able to reach any of the couple's personal assets.*

#### **Division Upon Divorce**

The primary significance of the characterization of an asset as community or separate property arises in the event of death or divorce. Upon divorce, each spouse is entitled to his or her own separate property. The court has no power to divert one spouse's separate property to the other spouse. The only power that a court has over the separate property of one spouse is to set it aside for the support of minor children.

The court's power to make a just and right equitable division of property in a divorce applies to community property. Although each spouse has a one-half interest in the community, a court is not required to split the community assets equally. Courts may take into consideration factors such as the age and physical condition of the parties, the relative ability and earning power of the parties, the relative needs for future support, the overall size of the estate, the benefits one spouse would have received from a continuation of the marriage, and fault in breaking up the marriage.

Some characterizations as separate property change in the case of a divorce. For purposes of a divorce, property acquired in another state that would have been community property if acquired in Texas is known as quasi community property. Unlike separate property, but like regular community property, quasi community property is subject to a just and right equitable division by a court upon divorce.

*Premarital Planning Idea: Before entering into the marriage, the parties may want to provide that the community property will be divided equally and neither spouse will invoke the just and right division powers of a court.*

### **Division Upon Death**

The distinction between separate and community property is also important upon death. For persons dying without a will, the method of intestate succession is different for separate and community assets. For those who die with wills, each spouse is free to dispose of his or her separate property as desired. This freedom is limited only by interests that the surviving spouse may have in the homestead, certain exempt personal property and a court authorized family allowance to pay living expenses while the will is probated. These interests are paid to the surviving spouse off the top of the estate before any other distributions are made.

*Premarital Planning Idea: A person about to marry and bringing a residence to the marriage may want a premarital agreement waiving the other spouse's homestead rights.*

There are no statutory requirements, such as a dower, curtesy, or statutory forced share, in Texas forcing one spouse to provide for the other. This lack of statutory protection is based on the assumption that the surviving spouse will be provided for by that spouse's one-half interest in the community and the interests in the homestead, personal property and family allowance described above.

By will, a spouse has no power to dispose of the other spouse's separate property or the other spouse's one-half interest in the community. The will may only dispose of the testator's one half interest in community property and the testator's own separate property. In rare circumstances, wills provide for the disposition of the entire community and/or the surviving spouse's separate property. In such a circumstance, the surviving spouse is usually provided for elsewhere. Nevertheless, the surviving spouse may elect either to take under the will or to reject the will and take his or her one-half interest in the community as well as his or her separate property.

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