ASSET PROTECTION PLANNING - - GETTING READY FOR MARRIAGE IN TEXAS

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I. INTRODUCTION

Going into a marriage, especially a subsequent one, an estate planning client may be more interested in protecting the client's "estate" from the significant other (and/or the significant other's creditors and successors) than planning for the benefit of the significant other. The client's perception of the "estate" is likely to include not only what the client brings into the marriage and that what is acquired during the marriage by "gift, devise or descent," but also that what those assets generate during the marriage (gains, rents, dividends, interest, etc.). The client may even consider the client's compensation during the marriage (whether in the form of salary, bonus, contributions to retirement plans and other fringe benefits) to be part of the "estate" in need of asset protection.

Changing laws and developing planning techniques have led to new and creative planning strategies to preserve the client's "estate."

Note: Asset protection planning for the client is not necessarily mutually exclusive with planning for the benefit of the client's spouse. "Separate property" estate planning is done in common law states every day. Texas couples have the additional advantage of later converting separate property to community property, if advisable later for estate planning purposes - - "step up in basis" at death. See VII, J, *infra*.

II. KEY MARITAL PROPERTY CONCEPTS

An understanding of the characterization/reimbursement rules, the management/liability rules and the termination/dissolution rules are essential to premarital planning. However, a detailed discussion of those rules is beyond the scope of this paper. See Featherston *Marital Property Characterization and Reimbursement and Fraud on the Community*, 2012 Advanced Estate Planning Strategies, State Bar of Texas. However, there are nine key concepts that should be in the "back of the planner's mind" and perhaps explained to the client during the premarital planning process.

A. The Community Presumption

According to the Texas Family Code, all assets of the spouses on hand during the marriage and upon its termination are presumed to be community property, thereby placing the burden of proof on the party (e.g., a spouse, or that spouse's personal representative, or the heirs/devisees of the spouse) asserting separate character to show by "clear and convincing evidence" that a particular asset is, in fact, separate. Tex. Fam. Code §§ 3.001, 3.003.

B. Community Claims for Reimbursement

Reimbursement between the marital estates usually arises when a spouse's pre-marriage debt is later paid with community funds or one spouse's separate property is improved through the expenditure of community funds. Reimbursement may also be applicable if separate funds are expended to benefit community property. In addition, the expenditure of community time, talent and labor in excess of what is necessary to reasonably manage one's separate property can give rise to a community claim for reimbursement to the extent that excess time, talent or labor is not compensated. *Jensen v. Jensen*, 685 S.W.2d 107 (1984). Another common reimbursement situation is where one spouse owns separately an insurance policy on that spouse's life and

uses community property to pay the premiums, and upon the insured spouse's death, the proceeds are payable to a third party. See Tex. Fam. Code §§ 3.401 – 3.410.

C. Special Community Property

The term "special community property" was originally defined by Texas courts as that portion of the community estate which was under the wife's exclusive control and not liable for the husband's debts following the landmark decision of *Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925), where the Texas Supreme Court held that the legislature could not define the rents and revenue from the wife's separate property as her separate property, but could exempt those assets, her "special community property," from his debts. *Moss v. Gibbs*, 370 S.W.2d 452 (Tex. 1963). Today, it is common practice to refer to the community assets subject to either spouse's "sole management, control and disposition" under Section 3.102(a) as his or her "special community property."

D. Fraud on the Community

In *Arnold v. Leonard*, *supra*, the Court explained ". . . that the statutes empowering the husband to manage the . . . community assets made the husband essentially a trustee, accountable as such to the . . . community." See also *Howard v. Commonwealth Building and Loan Assn.*, 94 S.W.2d 144 (Tex. 1936), where the court explained that, where title to a community asset is held in one spouse's name, that spouse has legal title and the other has equitable title, explaining: "That one in whose name the title is conveyed holds as trustee for the other. *Patty v. Middleton*, 82 Tex. 586, 17 S.W. 909 (Tex. 1891)." A breach of that fiduciary duty will likely result in a "fraud on the community" claim when the marriage terminates. Such a claim may follow a gift or nonprobate transfer of special community property to a child of a prior marriage.

E. Marital Liabilities

The Texas Family Code creates an "in rem" system of marital property liability. Tex. Fam. Code §§ 3.201 – 3.203. A spouse's separate property and special community property, as well as the joint community property, are liable for that spouse's debts during the marriage. If the liability is a tort debt incurred during the marriage, the other spouse's special community property is also liable for the debt (the other spouse's separate property is exempt).

If the debt is not a tort debt incurred during the marriage, the other spouse's separate property and special community property are exempt during the marriage from the debt unless the other spouse is personally liable under other rules of law (e.g., the "necessaries rule"). In which event, the other spouse's property (i.e., that spouse's special community and separate) is liable as well. See IX, *infra*.

Note: *The marriage relationship, in and to itself, does not make one spouse personally liable for the debts of the other spouse unless it is a debt for a "necessary." Tex. Fam. Code § 3.201.*

F. Death of a Spouse

When a married resident of Texas dies, the marriage terminates and community property ceases to exist. Nonprobate assets pass to the designated beneficiaries. Tex. Est. Code § 111.052 (formerly Tex. Prob. Code § 450). Death works a legal partition of the community

probate assets; the deceased spouse's undivided one-half interest passes to his heirs and/or devisees, and the surviving spouse retains her undivided one-half interest therein. Tex. Est. Code § 101.001 (formerly Tex. Prob. Code § 37). A spouse's testamentary power is generally limited to that spouse's separate property and undivided one-half interest in the community property. *Avery v. Johnson*, 108 Tex. 294, 192 S.W. 542 (1917). The surviving spouse's rights may be affected by the doctrine of election. See II, H., 2, *infra*.

G. Death of Claimant Spouse

Upon the death of the spouse who has a reimbursement claim or claim for fraud on the community against the surviving spouse, the claimant spouse's one-half interest in the claim passes to that spouse's heirs or devisees.

1. DUTY OF PERSONAL REPRESENTATIVE

If the heir or devisee is not the other spouse (or if the estate is insolvent), the personal representative has a duty to pursue the claim against the surviving spouse.

2. LIQUIDITY PROBLEMS

The existence of the claim may result in a much larger estate than had been anticipated. The deceased spouse's interest in the claim is included in the deceased spouse's gross estate for estate tax purposes and may cause an immediate liquidity problem.

3. CONFLICT OF INTERESTS

The existence of the claim may create a conflict of interest for both the personal representative and the attorney who are attempting to represent the entire family.

H. Claimant as the Surviving Spouse

Upon the death of the owner spouse, the asset which is the subject of the community claim for reimbursement will remain the owner's separate property and pass under the owner's will or by intestate succession; however, the claim of the surviving spouse continues to exist, as does any claim that the deceased spouse committed a fraud on the community.

1. CONFLICT OF INTERESTS

The death of the owner spouse or the claimant spouse can create a conflict of interest (i) between the surviving spouse and the decedent's heirs or devisees or (ii) between the heirs or devisees where the heirs or devisees of the separate property are not the same as the heirs or devisees of the community property. This potential conflict can be particularly troublesome for the personal representative or attorney who attempts to represent all members of the family.

2. ELECTION

The doctrine of election may force the surviving spouse to (i) assert the claim and waive any and all benefits under the will or (ii) accept the benefits conferred in the will and forego the claim. The doctrine of election is applied where any devisee receives a benefit and suffers a detriment in a will. Accordingly, the election concept might work against any party involved.

3. OTHER PROBLEMS

The existence of such a claim with an uncertain value is likely to delay the administration of the estate and create liquidity problems.

I. Closing the Estate

Upon the death of the first spouse and while record legal title still reflects that some community assets are held in the decedent's name, some are held in the survivor's name and others are held in both names, the surviving spouse and the heirs and/or devisees of the deceased spouse are, in effect, tenants in common as to each and every community probate asset, unless the surviving spouse is the sole distributee of some or all of the deceased spouse's one-half interest in such assets. When administration is completed, the survivor and the distributees are generally entitled to their respective undivided one-half interests in each and every remaining community probate asset. Tex. Est. Code § 101.001 (formerly Tex. Prob. Code § 37). The surviving spouse's rights may be affected by the doctrine of election. See II, H., 2, *supra*.

III. MARITAL PROPERTY ISSUES

Absent a pre-marital agreement, what effect is marriage going to have on the client's "estate." The first explanation may be that, absent effective planning, any property the client owned before the marriage can (not necessarily will) remain his or her separate property.

A. Existing Assets

Generally, as soon as the client marries, each and every item of property of either spouse will be presumed to be community property. Each traceable asset acquired prior to marriage, as well as any property acquired during the marriage as separate property (e.g., a gift or inheritance), can remain the client's separate property, if the community property presumption can be overcome by clear and convincing evidence. See II, A, *supra*.

B. Future Acquisitions

However, the spouses' respective salaries and other forms of compensation (i.e., employer contributions to retirement plans) will be community property. The income being generated by their respective separate properties will be community property. Any other assets acquired by either spouse during the marriage will be presumed community property unless proven to be separate property (e.g., traceable to clearly identifiable separate property). Tex. Fam. Code §§ 3.001 - 3.002.

C. Fraud on the Community

In addition, the client needs to understand that any unilateral gifts (inter vivos or nonprobate) of the client's special community property by the client to a child, a child by a prior marriage, or other third party may later be found by a probate or divorce court to have been a breach of a duty owing by the donor spouse to the other spouse and a "fraud on the community." See II, D, *supra.*

Note: *A unilateral attempt to transfer joint community property may be void as a matter of law as between the spouses and their successors. See Tex. Fam. Code § 3.102.*

D. Debts

While the marital relationship itself does not create vicarious liability, one

spouse acting as the agent of the other spouse can expose the entire marital estate to a debt incurred by the agent spouse. If the client's spouse acting individually incurs a tort debt during marriage, the creditor may be able to enforce any resulting judgment against any and all community property, even if the client does not have personal liability for the debt, and the creditor can take advantage of the community presumption. A breach of contract claim will expose the client's one-half interest in the joint community and the spouse's special community to liability as well. A debt, contract or tort, incurred before marriage by the spouse will expose the client's interest in any joint or the spouse's special community property to liability. See IX, *infra.*

E. The Necessaries Doctrine

A spouse who fails to discharge his or her duty of support is liable to third parties who provide necessaries to the other spouse. Tex. Fam. Code § 2.501(b). Accordingly, when third parties (e.g., doctors, hospitals, nursing homes – perhaps even lawyers) provide services deemed reasonably necessary for one spouse's support, both spouses become personally liable for the costs of such services. While the spouse who actually incurs the debt may be deemed to be "primarily liable," both spouses are "jointly and severally" liable to the third party under the necessaries doctrine. Tex. Fam. Code § 3.201(a)(2). A debt incurred for necessaries will expose the entire non-exempt marital estate to liability. Tex. Fam. Code § 3.202.

F. Divorce

In the event of a divorce, generally any community property will be subject to an equitable division by the divorce court and separate property will not. See Tex. Fam. Code § 7.001.

Note: *While contractual alimony can be incorporated into a divorce decree, absent such an agreement, the Texas divorce court cannot award alimony to a spouse. Alimony is contrary to Texas public policy. A limited form of alimony, "maintenance," is available in certain defined situations. See Tex. Fam. Code §§ 8.001 – 8.059.*

G. Reimbursement

Whether the marriage eventually terminates in death or divorce, its dissolution will be even more complicated due to the possibility of reimbursement issues accruing during the marriage and maturing upon its termination. See II, B, and II, D, *supra.*

H. Death of First Spouse

Upon the first spouse's death, the deceased spouse will only have testamentary power over the decedent's separate probate property and one-half of the community probate property. The surviving spouse can retain his or her own separate property and one-half of the community probate property after the deceased spouse's debts are paid. See II, F, *supra*. The surviving spouse may have homestead rights and/or rights to an "allowance" or to certain exempt personal property. The surviving spouse's rights may be affected by the doctrine of election. See II, H., 2, *supra*.

I. Portability

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 introduced the concept of "portability" to estate and gift taxation. Portability creates the possibility that the surviving spouse can take advantage of the

unused tax applicable exemption amount for estate and gift tax purposes from the estate of a pre-deceased spouse. For a complete discussion, see Marc Bekerman, *Portability of Estate and Gift Tax Exemptions Under TRA 2010*, Tax Management Estates, Gifts and Trusts Journal, May/June 2011. The American Taxpayer Relief Act of 2012 made portability "permanent."

"APPLICABLE EXCLUSION AMOUNT"

The "applicable exclusion amount" is the sum of a decedent's basic exclusion amount (currently $5 million *plus* and indexed for inflation) plus, in the case of a surviving spouse, the "deceased spousal unused exclusion amount" – the basic exclusion amount of the deceased spouse, less the amount exemption actually used at the deceased spouse's death (the "DSUE amount").

LIMITATIONS

The surviving spouse's estate is limited to the unused exclusion amount of his/her most recent deceased spouse. The surviving spouse's estate cannot take advantage of the deceased spouse's unused exclusion unless the deceased spouse's estate timely filed U.S. Estate Tax Return reflecting the amount of the unused exclusion amount.

EFFECT ON GIFT TAX AND GST TAX

While it appears that a surviving spouse will be able to utilize the deceased spouse's unused exclusion amount in making inter vivos gifts, there are a number of unanswered questions concerning its application, which are beyond the scope of this paper. Portability does not apply to the generation-skipping transfer tax. Any unused generation-skipping transfer tax exemption cannot be used to increase the surviving spouse's exemption.

1. OVERLOOKED RESOURCE

Going into a subsequent marriage, a surviving spouse should consider any DSUE amount from a deceased spouse as a separate and valuable resource to be utilized like any other separate property resource. In addition, if the value of the prospective spouse's estate is likely to be less than the basic exclusion amount, the potential benefit of the prospective spouse's DSUE amount should not be ignored in the event the client survives the prospective spouse.

J. To He_ _ (Double Hockey Sticks) With This!

In view of all of these complications, the client may wish to "opt out" of the Texas community property regime, a result that can be accomplished in a well-crafted pre-marital agreement. Through such an agreement, parties intending to marry can address these issues, perhaps even create a "community free" marriage where all property is the separate property of one spouse or both spouses and eliminate many of the complications described above. See V, VI, and VII, *infra*.

IV. UNILATERAL PLANNING

However, even in the absence of a premarital agreement, the client can take steps unilaterally prior to and during the marriage to minimize the complications of a subsequent marriage in order to maintain the separate character of the client's separate

property and avoid other issues that could otherwise arise during the marriage. At a minimum, the client's accountant should prepare a balance sheet, supported by documentation of the client's assets and liabilities, as the time of the marriage.

Note: *The creation and funding of a revocable trust prior to marriage can be an effective way to maintain the separate character of the settlor's assets. The trust's initial principal and its mutations can remain separate but any income generated during the marriage will be community property.*

A. The FLP

Prior to the marriage, the client may want to consider creating a family limited partnership, and exchange some portion of the client's estate for interests in the partnership. The partnership interest should remain the client's separate property; the assets of the partnership should be treated as partnership assets if the partnership is properly administered. Paying a reasonable salary for services rendered should avoid *Jensen* reimbursement claims. Not making community contributions to the entity during the marriage can avoid reimbursement and fraud on the community claims. For a more complete discussion, see X, *infra*.

B. Segregated Accounts

In any event, the client should be advised to "keep separate, separate" by maintaining existing assets in the client's name and opening bank and brokerage accounts in the client's individual name (perhaps with a designation "separate account") and only depositing into the accounts separate property. Contemporaneous business records showing the source of any and all separate deposits should be retained in the event proof of separate character of the account is later needed.

C. Avoid Inadvertent Commingling

Since income from separate property is generally community property, any interest (or other income generated by a separate investment) should be paid into a "special community account" in order to avoid a "commingling" of community and separate funds in the same account. If an account is "commingled," the account becomes community property.

D. 401(k) Plans

While Texas generally follows the "apportionment" approach to determine the marital property character of defined benefit and contribution retirement plans, the separate nature of a defined contribution plan brought into a marriage can easily be lost during the marriage through commingling. To maintain the separate character of the plan as it existed on the date of the marriage, the separate property interest will have to be traced using the same tracing rules that apply to non-retirement assets. See Tex. Fam. Code § 3.007(a). For employer-provided stock option plans and restricted stock plans, see Tex. Fam. Code § 3.007(d).

E. Earmark Future Acquisitions

Any future gift to or inheritance by the client, or property purchased with separate funds, should be held in the client's name only. When possible, if property is acquired on credit, the client and lender can agree that the lender will look only to the client's separate property for repayment in order for the property to be classified as separate property. Further, titled assets, especially real estate, should be conveyed to

the client "as separate property." Again, contemporaneous business records should be retained to serve as evidence of the nature of the transaction and the separate character of the assets.

F. Asset Protection Trusts

Any and all of future inter vivos or testamentary gifts to the client by others could be placed by the donor in an asset protection trust for the client's benefit. The spendthrift provisions will help not only insulate the interest from the claims of the client's creditors, but also any community property claims of the spouse, the spouse's successors or creditors. The inclusion of a statement in the trust agreement that it is the settlor's intent that any and all interests of the client, as well as any and all distributions of the trust, are the client's separate property may not be conclusive, but may prove to be persuasive in future litigation. Limiting distributions of income and/or principal to an ascertainable standard (health, education, maintenance, or support) is especially important if the client is going to be the trustee or is going to be given general power of appointment. If a third party is going to serve as trustee, income distributions to the client could be at the discretion of the trustee or pursuant to an ascertainable standard. Caution should be exercised in granting any other powers to the client over the trustee or the trust estate. Carefully planning, drafting and administering the trust could prove to be persuasive in maintaining the client's interests in the trust, as well as distributions from the trust, as separate property. For a more complete discussion, see XI, *infra*.

G. Family Entities

Later, during marriage, if the client is to become a partner in a family partnership, a member in a family-oriented limited liability company or a shareholder in a closely-held corporation, the client's interest should be given to the client as a gift (or purchased by the client with traceable separate property). Again contemporaneous business records of the nature of the transaction should be retained. See X, *infra*.

H. Closely Held Business Interests

Capital contributions during marriage to any existing or subsequently acquired separately owned closely held business interest should be funded with clearly documented separate funds or structured in the form of a loan out of community funds. See X, *infra*.

I. Jensen Claims

If the client expends any "time, talent or labor" in the management of a separately owned closely held entity during marriage, the payment of reasonable documented compensation for those services can hopefully avoid a later *Jensen* reimbursement claim by the client's spouse. See II, B, *supra*.

J. Fraud on the Community/ Reimbursement Issues

An understanding of the concepts of "wrongful transfers" and "reimbursement" can minimize the risks that such issues will become material issues when the marriage eventually terminates. For example, the client can avoid using community property (i) to make improvements to separate property, (ii) to make principal and interest payments on indebtedness secured by separate property, (iii) to pay the premiums on any separately owned life insurance policies, or (iv) to pay the capital gains tax on the sale of separate property. Gifts to children by a prior marriage and others

should be given from provable separate sources or with the documented approval of the spouse if community property is given. If the client created an intentionally defective grantor trust for the children of a prior marriage, any resulting income tax liability should be paid by the client with separate property.

K. Take Advantage of Portability

If the previous marriage ended in the prior spouse's death, portability allows for the DSUE amount from the deceased spouse's estate to be used during the lifetime of the surviving spouse or at the surviving spouse's death. Thus, portability is another reason gifts to or for the benefit of the client's descendents prior to and during the subsequent marriage should be considered.

L. Legal Fees

Any legal fees paid by the client during the marriage for this type of planning should be paid by the client with documented separate property to avoid any claim by the spouse that the client misused their community property to the spouse's detriment. The documentation should be retained.

V. PREMARITAL AGREEMENTS – FORMALITIES

If the couple is open to joint premarital planning, Texas law permits persons intending to marry to enter into property agreements that can convert into separate property what would otherwise be community property and therefore subject to the claims of certain creditors of both spouses, or subject to division by a divorce court, or partition by a probate court. A spouse's separate property is generally exempt from the creditors and claims of the other spouse in the event of divorce or death. The ability to accomplish this result depends initially on satisfying the formality requirements specified in the Texas Uniform Premarital Agreement Act.

Note: For these purposes "joint planning" does not suggest that one lawyer should represent both parties during the planning. See V, E., infra.

A. Uniform Premarital Agreement Act

The 1987 Legislature enacted the Texas version of the Uniform Premarital Agreement Act. This legislation attempted to define what parties intending to marry could accomplish in a premarital agreement. However, the power to contract in these matters is ultimately controlled by the Texas Constitution. *See* VI, *infra*. The Uniform Premarital Agreement Act defines the formal requirements and enforceability rules of premarital agreements.

B. Statutory Requirements

A premarital agreement must be in writing and signed by the parties. It need not be witnessed, acknowledged or sworn to. It is enforceable without consideration. Tex. Fam. Code § 4.002. It becomes effective on marriage. Tex. Fam. Code § 4.004. It can be amended by a written agreement of the parties. Tex. Fam. Code § 4.005.

C. Burden of Proof

Prior to the Act, the burden of proof was imposed on the party seeking to enforce the agreement to establish by clear and convincing evidence that the other party gave "informed consent" and that the agreement was not obtained by fraud, duress

or overreaching. Under the Act, the burden of proof is placed on the party asserting the agreement's invalidity. Tex. Fam. Code § 4.006.

D. The Opponent's Burden

The party opposing the agreement must now prove that (i) the agreement was not entered into voluntarily, or (ii) it was unconscionable when it was executed and the opponent was not provided with a fair and reasonable disclosure of the proponent's financial situation, or did not waive such disclosure and did not have adequate knowledge of such situation. In other words, there is a statutory presumption of validity.

1. INVOLUNTARINESS

The issue of involuntariness (i) relates to the issue of whether the opponent entered into the agreement "freely" and (ii) incorporates effectively the possible contractual defenses of competency, fraud, misrepresentation, duress and coercion as evidenced by the terms of the agreement or the surrounding facts and circumstances. Other relevant factors may be the opponent's understanding of the agreement at the time it was executed and whether the opponent had adequate time to consider the terms of the agreement prior to execution. See Fullenweider and Rainey, "Litigating Premarital Agreements," Advanced Family Law Course, State Bar of Texas (1988).

2. UNCONSCIONABILITY

Section 4.006(b) of the Texas Family Code provides that the issue of unconscionability is a question of law to be decided by the court, not the jury. The relevant factors for the court to consider may include the negotiating atmosphere, the relative bargaining abilities of the parties, and over-reaching by a party, as well as the legality of the contract and whether or not it violates public policy. Fullenweider and Rainey refer to the Uniform Premarital Agreement Act, 9(b) UCA 20, to include factors such as concealment of assets and sharp dealing not consistent with the obligation of marital partners to deal fairly with each other. See Fullenweider, *supra*. However, it is important to remember that, according to Sec. 4.006(b), even an unconscionable agreement can be enforced if it was entered into voluntarily by an opponent who was either provided fair and reasonable disclosure or who waived such disclosure or who did not already have adequate knowledge of the financial situation of the proponent.

3. WAIVER

Generally, in order to be valid, a waiver of a statutory right must be a voluntary and intentional release of the right. It must be clear, specific and unequivocal. The party signing the waiver must have full knowledge of its consequences.

4. TIMING OF WAIVER

Any waiver of financial information should be in a document separate from the agreement and executed prior to the pre-marital agreement.

5. FAIRNESS

Notwithstanding the discussion of involuntariness and unconscionability, it is important to remember that there is no

requirement that a premarital agreement be fair to be enforced. In *Chiles v. Chiles*, 779 S.W.2d 127 (Tex. App.–Houston [14th Dist.] 1989, writ denied), overruled on other grounds by *Twyman v. Twyman*, 855 S.W.2d 619 (Tex. 1993), the court held: "Parties should be free to execute agreements as they see fit and whether they are 'fair' is not material to validity." Accordingly, Texas law currently appears to require only that a premarital agreement be fairly entered into and not that it be fair in application to both parties.

6. COMMON LAW DEFENSES

In *Daniel v. Daniel*, 779 S.W.2d 110 (Tex. App.–Houston [1st Dist.] 1989, no writ), the court discussed whether old Sec. 5.46's comparable section for marital agreements, old Sec. 5.55, abolishes common law contract defenses (e.g. such as fraud, duress and competency), and concluded that it did not. However, the predecessor to Sec. 4.006 eliminated the common law defenses for agreements executed on or after September 1, 1993, but they still appear to be incorporated into the concepts of involuntariness or unconscionability.

7. CASE LAW

In *Sheshunoff v. Sheshunoff*, 172 S.W.3d 686 (Tex. App.–Austin 2005, pet. denied), the court discussed the premise that premarital agreements are presumptively enforceable, even if they are unconscionable, unless they were entered into unfairly. Other courts have followed this presumption that premarital agreements are enforceable. See *Larson v. Prigoff*, 2001 WL 13352 (Tex. App.—Dallas, Jan. 8, 2011).

8. RE-EXECUTION

Some practitioners follow the practice of recommending that the couple re-execute the pre-marital agreement following the wedding, a practice which is not necessary, in the author's opinion, if the original agreement is a properly drafted "partition and exchange agreement." Further, the Texas Family Code states that a pre-marital agreement actually becomes effective upon marriage. However, many practitioners recommend re-execution to support the enforceability of the agreement.

E. Disclosure/Assistance of Counsel

The law does not require that the parties be represented by separate legal counsel at the time of the agreement; however, the lack of independent counsel representing the party opposing the agreement's enforcement is likely to be an important factor in determining an agreement's enforceability. Failing to fully disclose the client's financial situation can be problematic even if a waiver of such information is obtained from the other party.

F. Statute of Limitations

The statute of limitations applicable to any breach of the agreement is tolled until the marriage is terminated. Equitable defenses, such as laches and estoppel, are, however, preserved. Tex. Fam. Code § 4.008.

VI. PREMARITAL AGREEMENTS – SUBSTANCE

Prior to 1987, the Texas Family Code granted blanket authority to parties to enter into such agreements as they desired, subject, of course, to the limitations of the Texas Constitution and other public policy concerns. While the Texas Uniform Premarital Agreement Act includes a laundry list of subjects that can be addressed in a premarital agreement, any agreement is still subject to the limitations of the Texas Constitution and other public policy concerns.

A. Mere Agreement Rule

In 1902 the Texas Supreme Court announced what became known as the mere agreement rule: "The question whether particular property is separate or community must depend upon the existence or nonexistence of the facts, which, by the rules of law, give character to it, and not merely upon the stipulations by the parties that it shall belong to one class or the other." *Kellet v. Trice*, 95 Tex. 160, 66 S.W. 51 (1902). The net effect of the mere agreement rule is that the constitutional definition of separate property limits the flexibility of spouses and those about to marry in their property agreements.

Note: *The mere agreement rule today can be summarized as follows: The provisions of an agreement which attempt to change the character of property in a manner not authorized by Art. XVI, Sec. 15, are void.*

B. Constitutional Amendments

The 1948 amendment to Art. XVI, Sec. 15, permitted spouses to partition and exchange presently existing community property. The 1980 amendment to Art. XVI, Sec. 15 authorized the creation of separate property in more ways:

1. PREMARITAL PARTITIONS

Persons intending to marry can partition and exchange community property not yet acquired. See also Tex. Fam. Code § 4.003.

2. SPOUSAL PARTITIONS

Spouses may now partition and exchange not only presently existing community property but also community property not yet in existence into the spouses' separate properties. See also Tex. Fam. Code § 4.102.

3. INCOME FROM SEPARATE PROPERTY

Spouses may also agree that income from one spouse's separate property will be that spouse's separate property. See also Tex. Fam. Code § 4.103.

4. SPOUSAL DONATIONS

A gift by one spouse to the other spouse will be presumed to include the income generated by the donated property so that both the gift and the future income from the gift are the donee spouse's separate property. See also Tex. Fam. Code § 3.005.

Note: The 1987 amendment authorized community property survivorship agreements and the 1999 amendment permitted spouses to convert by agreement separate property into community property beginning on January 1, 2000.

C. Sec. 4.003, Texas Family Code

Currently, parties to a premarital agreement are authorized by statute to contract with respect to:

1. The rights and obligations of each of the parties in any of the property of either or both of them whenever and wherever acquired or located.

2. The right to buy, sell, use, transfer, exchange, abandon, lease, consume, expend, assign, create a security interest in, mortgage, encumber, dispose of, or otherwise manage and control property.

3. The disposition of property on separation, marital dissolution, death, or the occurrence or nonoccurrence of any other event.

4. The modification or elimination of spousal support.

5. The making of a will, trust, or other arrangement to carry out the provisions of the agreement.

6. The ownership rights in and disposition of the death benefit from a life insurance policy.

7. The choice of law governing the construction of the agreement.

8. Any other matter, including their personal rights and obligations, not in violation of public policy or a statute imposing a criminal penalty.

D. Standard Provisions

It is common for premarital agreements to simply confirm the status of relevant Texas law. For example, the parties agree that certain itemized assets brought into the marriage and their mutations are to remain the owner's separate property. They may also confirm that anything acquired during marriage by gift, devise or descent will be separate property. They may even agree that such separate property will not be subject to a just and equitable division at divorce. *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977) and *Cameron v. Cameron*, 641 S.W.2d 210 (Tex. 1982).

E. Income from Separate Property

Parties may agree that income from separate property will be the owner's separate property. Since the Constitution expressly authorizes only spouses to make such agreements and not persons intending to marry, it is advisable to draft such an agreement as a partition and exchange, since both spouses and persons intending to marry can partition community property not yet in existence (i.e., future income from separate property). Accomplishing this result through a partition and exchange, however, may not be necessary since by statute a premarital agreement becomes effective on marriage; thus, spouses are really making the agreement. Tex. Fam. Code § 4.004. On the other hand, since the Constitution distinguishes between parties intending to marry and spouses, the "safe harbor" approach is to follow the constitutional mandate of a partition and exchange. See *Fanning v. Fanning*, 828 S.W.2d 135 (Tex. App.–Waco 1992), rev'd in part on other grounds, 847 S.W. 2d 225 (Tex. 1993); *Dokmanovic v. Schwarz*, 880 S.W.2d 272 (Tex. App.–Houston [14th Dist.] 1994, no writ).

F. Wages, Salaries, Personal Earnings

Following the passage of the 1980 amendment to Art. XVI, § 15, some commentators questioned whether the parties to a premarital agreement should be able to agree that wages and salaries and other personal earnings will be the acquiring spouse's separate property. For example, Professor Sampson noted:

> It remains to be seen whether revising the type of agreement entered into here to contemplate a present partition of future earnings will suffice to take the parties completely out of the community property system. Generally, I hope not, although I also tend to believe that folks ought to be able to do what they want with their property. On the other hand, an agreement such as this between a doctor and his to be housewife seems clearly abusive and overreaching. Editor's note, Family Law, State Bar Section Report, Vol. 87-6, Fall 1987, pp. 35-36.

Professor Sampson's comments followed a discussion of *Bradley v. Bradley*, 725 S.W.2d 503 (Tex. App.–Corpus Christi 1987, no writ), where the court held that a particular premarital agreement did not effectively partition the parties' future earnings. It should be noted that the Bradley agreement itself was not drafted to accomplish a direct partition of future earnings, but was an agreement to partition future earnings once the earnings came into existence.

G. Partition and Exchange

Notwithstanding Professor Sampson's initial concerns, Art. XVI, Sec. 15 of the Texas Constitution expressly authorizes the partition and exchange of any and all community property to be acquired during-marriage which would include personal earnings, retirement benefits, I.R.A.s, trust income, income from separate property, and property acquired on credit; so does the legislature. See Sec. 4.001(2) of the Texas Family Code. The cases of *Fanning v. Fanning*, *supra*, and *Winger v. Pianka*, 831 S.W.2d 853 (Tex. App.–Austin 1992, writ denied) have confirmed this viewpoint.

H. Community Free Marriage

It is, therefore, the "partition and exchange" agreement which can be effectively used to create the "community free marriage." By eliminating community property from the marriage, wrongful transfer issues, like "fraud on the community" are also eliminated. This type of agreement also allows the couple to address some otherwise troubling issues.

1. REIMBURSEMENT

If there still exists the possibility of a community claim for reimbursement, it would be advisable to address specifically any such potential claim in the premarital agreement. For example, perhaps the nonowner spouse could agree to waive the claim for reimbursement. *Stoker v. Stoker*, 2008 WL 4837084 (Tex. App.–Houston [1st Dist.] 2008), involved a premarital agreement that waived economic contribution claims by the nonowner spouse. The court held that this was permissible under Tex. Fam. Code § 3.410. However, it may be advisable for the couple to partition the claim in a manner which would at least limit the exposure the owner spouse would have by reason of the community claim for reimbursement.

Note: To avoid a separate claim for reimbursement, the expenditure of one spouse's separate property to benefit the other spouse's separate property should be structured and documented as a loan or a gift.

2. QUASI-COMMUNITY PROPERTY

Separate property acquired by a couple while residing in a common law state that would have been community had they been residing in Texas can be divided by a Texas divorce court on a just and right basis. Tex. Fam. Code § 7.002. The Family Code does not convert such asset into community property, but allows for it to be treated as such in a divorce proceeding. This concept is not available in probate. See *Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987). Since such property is merely quasi-community and not actually community property, can it be subject to a partition and exchange agreement as authorized by the constitution and the statutes? Is this a right that the nonowner spouse can waive in a premarital agreement? There does not appear to be a good answer to this question, but it is an issue that should be addressed specifically in this agreement, if relevant.

3. QUASI-SEPARATE PROPERTY

A 2003 amendment to Sec. 7.002 treats as separate property any community property that was acquired while the couple resided in another state that would have been separate, had they resided in Texas at the time of its acquisition. Presumably "quasi-separate" property would be treated as community property if the marriage terminates by reason of a spouse's death, if the reasoning of the *Hanau* case, *supra*, is followed. Since such property is merely quasi-separate and not actually separate property, this category of community property should be subject to a partition and exchange agreement.

4. PROFESSIONAL DEGREES, LICENSES

In view of the trend in some states to treat professional degrees and licenses as property and therefore capable of division by the divorce court and possible partition by the probate court, the possibility of such a result in Texas should be anticipated although the only case in Texas to date on point has held to the contrary. See *O'Brien v. O'Brien*, 489 N.E.2d 712 (N.Y. 1985) and *Frausto v. Frausto*, 611 S.W.2d 656 (Tex. Civ. App.–San Antonio 1980, writ dism'd w.o.j.). If professional degrees and licenses are eventually found to be property in Texas and consequently community property, if acquired during marriage, they should be treated as such in the agreement and could be subjected to a partition and exchange, if the parties so agree.

5. CERTAIN PERSONAL INJURY RECOVERIES

Personal injury recoveries for loss of earning capacity during marriage are defined as community property. Tex. Fam. Code § 3.001(a)(3). Notwithstanding this statutory provision and *Graham v. Franco, supra*, the author is of the opinion that actual "lost earnings" should be deemed to be community property, while "loss of

earning capacity" should be considered separate property. Lost earnings are properly characterized as community property since the community estate will be liable for payment of medical expenses and will suffer as a result of losing one spouse's community earnings. However, characterizing the recovery for lost earning capacity as community property requires a presumption that the couple will remain married indefinitely. In reality, should the spouses divorce following the injury, community recoveries will be divided on a just and right basis; or should the non-injured spouse die, the estate will be entitled to one-half of the entire recovery. Since the primary purpose of a personal injury recovery is to compensate the injured spouse, classifying lost earning capacity as community property and giving the non-injured spouse a one-half interest therein may leave the injured spouse with only a fraction of the amount awarded. The potential for such a situation clearly warrants a distinction between lost earnings and lost earning capacity which characterizes the former as community and the latter as separate. In view of current law possibly creating such an inequitable result, possible personal injury recoveries could be addressed in a partition and exchange agreement.

6. PERSONAL SERVICE CONTRACTS

Wages and salaries earned during the marriage are clearly community property, but the characterization of money earned during the marriage pursuant to a contract signed before marriage, or money received after the marriage pursuant to a deferred compensation agreement signed during the marriage, can be complicated. Even if wages and salaries generally are not going to be partitioned, these other issues could be addressed in the premarital agreement to avoid future confusion and litigation.

I. Division of Property Upon Divorce

The parties should be able to agree as to a certain division of any community and their respective separate properties in the event of divorce instead of awaiting an "equitable division" of the community by the divorce court. Of course, such an agreed to division cannot affect a parent's child support obligations. Such an agreement may also affect the determination of whether an agreement is unconscionable or not.

J. Contracts Concerning Succession

The parties to a premarital agreement may also agree that they will not assert inheritance rights upon the first spouse's death or that one spouse is to leave to the other spouse certain assets in the event the marriage terminates by reason of the obligor's death. Sec. 59A of the Texas Probate Code was amended in 2003 in order to confirm that a contract to make a will or devise can be established by either (i) provisions in a will stating that the contract exists and the material provisions of the contract, or (ii) the provisions of a written agreement that is binding and enforceable. Even without the addition of the latter provision, this author is of the opinion that Sec. 59A was never intended to apply to an agreement whereby a spouse is required to leave property to the other spouse pursuant to a premarital agreement. This situation is not one where there are reciprocal testamentary promises but one where there is current consideration in exchange for a

testamentary promise. See Tex. Est. Code § 254.004 (formerly Tex. Prob. Code § 59A).

K. Homestead, Exempt Personal Property and Allowances

In *Williams v. Williams*, 569 S.W.2d 867 (Tex. 1978), the Texas Supreme Court approved the provisions of a premarital agreement whereby one party waived his right following the first spouse's death to occupy the other party's separate property home, to utilize the exempt personal property and to claim a family allowance.

1. SELECTION AND ABANDONMENT

The premarital agreement presents the opportunity for a couple to agree which of their homes will be the homestead and what process should be followed to abandon and select a new one.

2. SALE OR ENCUMBRANCE

The *Williams* case involved the surviving spouse's rights following the owner's death. Sec. 5.001 of the Texas Family Code prohibits the owner of the homestead from selling or encumbering it during the marriage without the joinder of the non-owner spouse. Can this right of the non-owner be waived in a premarital agreement? Sec. 4.003(a)(2) appears to authorize it.

3. LIABILITY

So long as the owner is alive, the homestead and certain items of personal property continue to be exempt from the claims of certain creditors. Tex. Prop. Code §§ 41.001 and 42.002. However, if the non-owner has waived the right of occupancy and possession upon the death of the owner, will such property continue to be exempt from most creditors following the owner's death? Presumably yes, if the owner also was survived by a minor child. But if the only constituent family member surviving the owner is the spouse who previously waived these rights, the answer is not so clear.

L. Addressing Necessaries

Notwithstanding a spouse's duty of support and the necessaries doctrine, increasingly lawyers with clients considering marriage but concerned with the potential overwhelming costs of caring for an elderly spouse are focused on the Texas version of the Uniform Premarital Agreement Act, specifically Section 4.003(a)(4) of the Texas Family Code, which states that the parties to a premarital agreement may contract with respect to "the modification or elimination of *spousal support.*" Can a Texas couple by an agreement eliminate the spouses' mutual obligation of support and a third party's rights under the necessaries doctrine? See VIII, *infra.*

M. Preserving Portability

The parties should consider a provision in the agreement that requires that the first spouse to die is to direct the personal representative of his or her estate to elect to transfer to the surviving spouse the deceased spouse's DSUE amount by filing a United States Estate Return whether one is otherwise required to be filed or not. As consideration for the agreement, the surviving spouse may be required to reimburse the estate of the deceased spouse for any expenses that would not otherwise be incurred by the deceased spouse's

personal representative. See *Portability and Prenuptials: A Plethora of Preventative, Progressive and Precautionary Provisions,* George K. Karibjanian and Lester B. Law, *Probate & Property* (May/June 2013).

VII. EFFECTIVENESS OF THE PREMARITAL AGREEMENT

Assuming a valid, enforceable agreement has been executed in order to create a "community free marriage," have the goals of insulating each spouse's separate estate from the claims of the other spouse and the other spouse's creditors and successors been accomplished? The answer: "Maybe!"

A. Generally

Since everything is his or her separate property, each spouse is free generally to manage his or her property without interference from the other spouse. However, absent an effective waiver in the agreement, the homestead rules will still prohibit a transfer or encumbrance of the home without the joinder of the other spouse.

Further, the separate assets of one spouse are generally exempt from the creditors of the other spouse. In the event of divorce, there is no community property to divide on a just and right basis; and upon the death of a spouse, the decedent's estate passes to the decedent's heirs and devisees, and the surviving spouse retains his or her estate untainted by the claims of the decedent's heirs and devisees.

However, the situation may not be as perfect as it may appear.

B. Necessaries

Generally, each spouse still has the legal duty to support the other spouse and their children for so long as the children are minors and thereafter until they graduate from high school. Tex. Fam. Code §§ 2.501 and 154.001. Therefore, both spouses' separate properties are liable for such necessaries unless the mutual duty of support can be waived by the spouses in the agreement. *See* VIII, *infra*.

C. Child Support

As would be expected, an agreement between spouses to limit either's child support obligations would be against public policy. This concept has been codified in Sec. 4.003 of the Texas Family Code.

D. Tax Liability

For any tax year that the spouses file joint income tax returns, each spouse remains jointly and severally liable for any tax liability arising from that year's tax.

E. Spousal Torts Claims

Will public policy prevent the anticipatory waiver in premarital agreement of tort claim asserted by one spouse against the other? Should there be a different rule for negligence and intentional torts? In general, see "Releases: An Added Measure of Protection from Liability," 39 *Baylor L. Rev*. 487 (1987).

F. Agency

A spouse remains personally liable for the acts of the other spouse if the other spouse is an agent or otherwise innocent spouse. Tex. Fam. Code § 3.201. Although the marital relationship itself does not create

a principal/agency relationship among the married couple, their being engaged together in a business venture or other joint action can create vicarious liability and expose each spouse's separate property to any liability arising therefrom.

G. Preexisting Creditors

Section 4.106 of the Family Code says that a partition and exchange agreement during marriage is void with respect to the rights of preexisting creditors whose rights are intended to be defrauded therein. It should be noted that it is not clear whether this provision applies to premarital partition and exchange agreements. Such provision does not by its own terms apply to spousal income agreements under Sec. 4.102.

H. U.F.T.A. and the Bankruptcy Code

Creditors may avoid and recover fraudulent transfers. The trustee in bankruptcy can avoid transfers deemed fraudulent under the Texas version of the Uniform Fraudulent Transfer Act. This means that certain prepetition transfers of community property by a filing spouse to a nonfiling spouse, by way of gift or partition, can be avoided because the transfer acted to deprive creditors of property that would otherwise be available to creditors as part of the bankruptcy estate. Each type of transfer must be analyzed under the fraudulent transfer theory to determine if assets otherwise within the reach of a creditor have been pulled beyond the creditor's reach by virtue of the challenged transfer. For example, a spouse might impermissibly transfer his own interest in existing community property by way of a partition. Yet the same spouse could probably renounce, by way of a premarital partition, an interest in community property to be acquired in the future since the parties to the partition had no vested interest in the future community property absent the partition. Of course, these sections of the U.F.T.A. and the Bankruptcy Code also invalidate transfers involving actual or constructive fraud.

I. ERISA Plans

ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan…" 29 U.S.C.A. Sec. 1144. Further, ERISA requires for many qualified retirement plans that the participant's spouse receive a mandatory death benefit upon the death of the participant or a joint and survivor annuity upon the retirement of the participant, regardless of the marital property character of the participant's interest in the plan. Of course, the spouse may waive these statutory rights in a consent procedure described by statute. 29 U.S.C.A. Sec. 1055(c).

1. FEDERAL CASE LAW

Several cases have held that these ERISA granted rights of the participant's spouse cannot be waived in a premarital agreement. In *Manning v. Hayes*, 212 F.3d. 866 (5th Cir. (Tex.) 2000), cert. denied, 121 S.Ct. 1401 (2001), language in a premarital agreement was not sufficiently explicit to result in a waiver of an ex-wife's beneficiary status under an ERISA plan. In *Hurwitz v. Sher*, 789 F.Supp. 134 (S.D.N.Y. 1992), aff'd by 982 F.2d. 778 (2nd Cir. 1992), cert. denied 508 U.S. 912 (1995), the decedent and his spouse executed a premarital agreement waiving any rights with respect to the other's separate property and the court held that the wife had not waived her rights to the plan benefits to which she was entitled because only a spouse, not a fiancé, can

waive such rights under federal law. A similar result was reached in *Nellis v. Bowing Co*., 1992 WL 122773, 15 Employee Benefits Vas. 1651 (D. Kan. 1992); further, the court noted that language in the agreement stating that the agreement was to take effect upon marriage did not save the agreement. In *Zinn v. Donaldson Co*., 799 F.Supp. 69 (D. Minn. 1992), the court even held that a constructive trust could not be imposed on the surviving spouse to equitably enforce the premarital agreement. A similar result was affirmed by the Sixth Circuit in *Howard v. Branham & Baker Coal Co*., No. 91-5913, 968 F.2d 1214 (table), (6th Cir. 1992) (text in Westlaw).

2. TRAP FOR THE UNWAY

Accordingly, a properly prepared premarital agreement under Texas law may ensure that the employee's interest in the retirement plan is separate property, but such a result, in and of itself, does not negate whatever rights the spouse may have under ERISA at the time of the employee's retirement or death absent an effective ERISA waiver of those rights under federal law.

J. Future Estate Planning

To the extent property is held as community property, both halves receive a new income tax basis upon the death of the first spouse under Sec. 1014(b)(6) of the Internal Revenue Code. This potential tax advantage is lost if what would have been community property has been partitioned into separate property.

1. TRANSMUTATION

However, if advisable under the circumstances, all or part of the separate estate can later be converted into community property by way of a transmutation agreement. See Tex. Fam. Code § 4.202. Converting a separately held business interest into community property could even facilitate valuation planning.

2. TRADITIONAL PLANNING

Marital deduction planning techniques, like QTIP trust and bypass (credit shelter) trust coordination, can be used to provide for the surviving spouse whether the client's "estate" stays separate or is converted, in whole or part, into community property. Funding and maintaining an irrevocable life insurance trust for the benefit of the client's spouse with the client's separate property is simpler and more efficient than using community funds since it avoids the need to partition the community funds.

K. Future Legislative Changes

The potential impact of future state and federal legislation (e.g., amending ERISA or adopting the concepts of quasi-community property at death, or a statutory share system, or even permanent alimony) should be considered and addressed in the agreement. Of course, these potential rights could be expressly waived in the premarital agreement, but is the waiver of a right that is not yet in existence enforceable? Generally, to be enforceable, a waiver of statutory rights must be clear, specific and unequivocal, and given by a party who has full knowledge of its consequences. In any event, the issues should be addressed and identified as specifically as possible.

VIII. WAIVING SPOUSAL SUPPORT

As noted earlier, some commentators have suggested that a couple can, avoid joint and several liability for necessaries by waiving their mutual duty of support in a premarital agreement. The treatise *Texas Family Law: Practice and Procedure,* VI, 130, Waiver of Spousal Support During Marriage (Matthew Bender & Company 2012), states that the parties to a premarital agreement can modify or eliminate "the duty of spousal support." It further states that, in the premarital agreement, the parties ". . . may waive the right of *spousal support*, limit it to a certain amount, or provide that the *duty of support* arises only if one spouse becomes disables or unemployed." Similar language is found in Matthew Bender's *Texas Transaction Guide – Legal Forms,* § 93.230 (2012). Unfortunately, the only authority cited for the assertions is Tex. Fam. Code § 4.003(a)(4).

A. Texas Premarital Agreement Act

Section 4.003(a)(4) of the Texas Family Code states that the parties to a premarital agreement may modify or eliminate *spousal support*. It does not state that the parties can modify or eliminate the *duty of support*. In addition, a review of the annotations under Section 4.003 does not reveal any real authority to support the argument that such an agreement can eliminate or modify a spouse's *duty of support* of the other spouse during the marriage, or a third party's rights under the necessaries doctrine. Section 4.003's laundry list of matters which can be addressed in a premarital agreement suggests that the parties can contract with each other concerning their mutual rights and obligations, and the contract is enforceable among themselves and their successors in interest as long as the agreement does not violate public policy.

A matter which extends beyond the parties' mutual rights and obligations and which affects third parties should be subject to a more stringent public policy examination prior to being enforceable against a third party, especially a third party creditor that provided services deemed reasonably necessary for either spouse's support.

Note: *It is important to note that Subchapter B of Title 1, Chapter 4 of the Texas Family Code, which relates to agreements between spouses during the marriage, does not contain similar language. This omission suggests that, once married, spouses may not be able to enter into a contract that modifies or eliminates spousal support.*

B. The Community-Free Marriage

Texas public policy does allow the parties to the premarital agreement to create a "community-free marriage" – a marriage where all assets are either the separate property of one spouse, or the other, or both spouses. Art. XVI, § 15, Texas Constitution. Even existing spouses can create a community-free marriage. Tex. Fam. Code § 4.102. Such a marital agreement cannot prejudice the rights of pre-existing creditors. Tex. Fam. Code § 4.106. Subject to the provisions of Section 4.106, creating a community-free marriage is a valid means of affecting the rights of third parties, including the spouses' creditors, since generally one spouse's separate property is not liable for the contract debts or tort debts of the other spouse. Tex. Fam. Code § 3.202(a).

Even if the parties have a community-free marriage, each spouse is still personally liable for a debt of the other spouse if (i) the other spouse acted as the spouse's agent when incurring the debt or

(ii) the other spouse incurred a debt for necessaries. Accordingly, that spouse's separate property is reachable by the creditor of the other spouse that provided services that are deemed to have been reasonably necessary for the other spouse's support. Tex. Fam. Code § 3.201.

C. Effect of Support Waiver

If the terms of an otherwise valid, enforceable premarital agreement purport to eliminate or modify the spouses' mutual obligation of support, its effectiveness should be limited to the relative rights and obligations between the parties themselves and their successors. Public policy considerations suggest that the agreement should not affect the rights of a third party who provided uncompensated services deemed reasonably necessary for the other spouse's support. Those same public policy considerations suggest that a spouse's *duty of support* during the marriage still exists notwithstanding the agreement; consequently, the agreement should be able to only affect "reimbursement" claims among the spouses upon termination of the marriage. Tex. Fam. Code §§ 3.401-3.410.

D. Reimbursement Between Spouses

Absent such an agreement when the marriage terminates, a spouse is not entitled to reimbursement from the other spouse for expending separate funds during the marriage for the support of the other spouse because of the spouses' mutual duty of support. *Burney v. Burney*, 225 S.W.3d 208 (Tex. App.—El Paso 2006, no pet.); In re Marriage of Case, 28 S.W.3d 154 (Tex. App.—Texarkana 2000, no pet.). However, if a premarital agreement contains a "waiver of support," the spouse who is required to pay a third party under the necessaries doctrine should be able to seek reimbursement from the other spouse upon the termination of the marriage. Notwithstanding the terms of the agreement, the bottom line is each spouse still has a duty to support the other spouse during the marriage, even if they have agreed, in effect, that each spouse is primarily liable for his/her own necessities.

E. "Spousal Support"

Critics of this position will point out that both the Uniform Premarital Agreement Act and its Texas version specifically state that a premarital agreement can modify or eliminate *spousal support;* however, neither expressly states that the agreement can modify or eliminate the parties' mutual *duty of support* that attaches during their marriage. The *duty of support* is not the same concept as *spousal support.* The term "*spousal support*," as used in both the Uniform Premarital Agreement Act and the Texas version, was intended to refer to the more politically correct equivalence of "alimony" – *spousal support*. *Spousal support* is the generally accepted term used to describe payments required from one spouse to another after divorce. It is synonymous with the terms "alimony" and "maintenance."

F. But Texas Doesn't Have Alimony!

Accordingly, it is likely that a Texas court would interpret the term "*spousal support*" within the context of Section 4.003(a)(4) to be its generally accepted meaning – a legal obligation on a person to provide financial support to an ex-spouse after divorce. Critics of this interpretation will argue that Texas does not recognize alimony; thus, the Legislature must have retained that specific provision from the uniform act for a reason. The counter to that argument is that, while Texas

(then and now) maintains its policy prohibiting court-ordered permanent alimony, (i) the parties to the agreement may marry and then move to a state that has more traditional spousal support statutes or (ii) the Legislature may in the future adopt a more traditional spousal support statute. Accordingly, it is likely that the Legislature retained Section 4.003(a)(4) anticipating that the parties intending to marry in Texas may wish to address those situations in their premarital agreements.

G. Texas Maintenance

In 1997, a limited form of post-divorce spousal support was enacted. See Chapter 8, Court-Ordered Maintenance, Title 1, Subchapter C, of the Texas Family Code. However, the Texas Family Code does not expressly address whether court-ordered maintenance can be waived in a premarital or marital agreement although Sec. 4.003 does refer to the waiver of spousal support in premarital agreements. Since court-ordered maintenance was created as part of a welfare reform package, such a waiver may be against Texas public policy, notwithstanding the language to the contrary in the premarital agreement act.

H. UPAA Comments

The official comment of the uniform act states:

> Paragraph (4) of subsection (a) specifically authorizes the parties to deal with *spousal support* obligations. There is a split in authority among the states as to whether a premarital agreement may control the issue of *spousal support*. Some few states do not permit a premarital agreement to control this issue (see, e.g., *In re Marriage of Winegard*, 278 N.W.2d 505 (Iowa 1979); *Fricke v. Fricke*, 42 N.W.2d 500 (Wis. 1950)). However, the better view and growing trend is to permit a premarital agreement to govern this matter if the agreement and the circumstances of its execution satisfy certain standards (see, e.g., *Newman v. Newman*, 653 P.2d 728 (Colo. Sup. Ct. 1982); *Parniawski v. Parniawski*, 359 A.2d 719 (Conn. 1976); *Volid v. Volid*, 286 N.E.2d 42 (Ill. 1972); *Osborne v. Osborne*, 428 N.E.2d 810 (Mass. 1981); *Hudson v. Hudson*, 350 P.2d 596 (Okla. 1960); *Unander v. Unander*, 506 P.2d 719 (Ore. 1973)).

All of the cases mentioned in this official comment involve post-divorce alimony, maintenance or support. It seems obvious that the relevant section of the uniform act was not intended to address the spouses' mutual duty of support or third party rights under the necessaries doctrine.

I. Other States' Laws

Surprisingly, there is very little authority in other jurisdictions addressing whether a "waiver of support" can eliminate the necessaries doctrine. Most of the cases that have discussed the waiver of spousal support were references to it in the context of post-divorce alimony and not in terms of the spouses' *duty of support* during

marriage. In *Rathjen v. Rathjen*, No. 05-93-00846-CV, 1995 Tex. App. LEXIS 3759 (Tex. App.—Dallas May 30, 1995, no pet.), the Texas court, applying the law of Hawaii, refers to the Hawaiian Supreme Court decision of *Lewis v. Lewis/Reese v. Reese*, 60 Haw. 497, 748 P.2d 1362 (1988) and noted that other states have held that a premarital agreement is unenforceable if its application would result in public assistance. This rationale is sound public policy that should be followed absent clear statutory authority to the contrary.

J. UPAA – Texas Version

When the Legislature adopted the Uniform Premarital Agreement Act, deleted from the uniform act's "enforceability" provisions language stating that, even if the agreement eliminated or modified the *spousal support*, and if such a provision causes a spouse to be eligible for public assistance, a court, upon divorce, could still require the other spouse to provide support to the extent necessary to avoid that eligibility. In a comment, the author suggests that this change in the Texas statute suggests that a Texas court cannot change the terms of a premarital agreement just because it results in a souse's eligibility for public assistance. Amberlyn Curry, *The Uniform Premarital Agreement Act and Its Variations Throughout the State*, 23 J. Am. Acad. Matrimonial Law, 335 (2010). The more likely reason for the deletion was Texas' prohibition of post-divorce court-ordered permanent alimony.

IX. MARITAL PROPERTY LIABILITY

With or without a pre-marital agreement, once married, the extent to which one spouse is liable for debt incurred by the other spouse, and the extent to which the marital estate is liable for either spouse's debts, are dependent on the statutory rules found in the Texas Family Code. The misnomer of "community debt" has been recently debunked by the Texas Supreme Court. According to the Court, the term "community debt" means nothing more than some community property may be liable for its satisfaction. See *Tedder v. Gardner Aldrich LLP*, 2013 W.L. 2150081 (May 17, 2013). Thus, the rules of marital property liability are found in Sec. 3.202 and Sec. 3.203 of the Texas Family Code.

A. Statutory Rules

1. SEPARATE PROPERTY EXEMPTION

As a general rule, a spouse's separate property is not subject to the debts of the other spouse. Tex. Fam. Code § 3.202(a).

2. SPECIAL COMMUNITY EXEMPTION

As a general rule, a spouse's special community property is not subject to any debts incurred by the other spouse prior to the marriage or any nontortious debts of the other spouse incurred during the marriage. Tex. Fam. Code § 3.202(b).

3. OTHER RULES OF LAW

These two general rules apply unless both spouses are personally liable under "other rules of law." Tex. Fam. Code § 3.202(a) and (b).

4. EXEMPT PROPERTY

Of course, the family homestead and certain items of personal property are generally exempt from the debts of both

spouses, regardless of the marital character of the property. Tex. Prop. Code §§ 41.001 and 42.001. The Texas Property Code and Texas Insurance Code also create exemptions for retirement benefits and life insurance.

5. CREDITORS' RIGHTS

Accordingly, a spouse's nonexempt separate property and special community property are subject to any liabilities of that spouse incurred before or during the marriage. Nonexempt joint community is liable for the debts of either spouse. In addition, the nonexempt special community properties of both spouses are subject to the tortious liabilities of either spouse incurred during marriage. Tex. Fam. Code § 3.202 (c) and (d).

6. ORDER OF EXECUTION

A court may determine, as deemed just and equitable, the order in which particular separate or community property is subject to execution and sale to satisfy a judgment. In determining the order, the court is to consider the facts and circumstances surrounding the transaction or occurrence on which the debt is based. Tex. Fam. Code § 3.203.

B. Record Title

Whether a nonexempt asset is held in one spouse's name or in both spouses' names, it is presumptively community property, thereby placing the burden on a spouse claiming separate status to prove why it is separate property.

1. MANAGEMENT PRESUMPTION

If the community presumption is not rebutted, the fact that title is held in one spouse's name (or it's untitled, but in the sole possession of one spouse) creates a rebuttable presumption that the asset is the spouse's special community property and liable for that spouse's debts and the tort debts of the other spouse incurred during the marriage, but generally exempt from the other spouse's premarital debts and any non-tortious debts of the other spouse incurred during marriage.

2. REBUTTING THE RESUMPTION

If the facts indicate that a community asset is not property the "titled" spouse would have owned, if single (e.g., personal earnings, income from separate property, increases and expenses from special community property), Section 3.102(c) indicates it is joint community and, therefore, liable for all debts of both spouses.

3. MIXING SPECIAL COMMUNITY

If one spouse's special community is "mixed" with the other spouse's special community (or presumably their joint community), the "mixed" community is converted into joint community and subject to both spouses' debts. This result typically occurs when the spouses deposit their respective salaries into a joint account. If an asset is subsequently purchased with funds from the joint account and placed in one spouse's name (absent donative intent of the other spouse), the asset is presumptively subject to that spouse's sole management, but may be found to be joint community for liability purposes due to its traceable "joint" source.

4. THE "SOLE MANAGEMENT" JOINT ACCOUNT

If only one spouse deposits his or her special community funds into a joint account, the account is community property, and the account agreement will dictate who can write the checks or otherwise make withdrawals (typically, either spouse can write a check or make a withdrawal). However, if the other spouse's creditors attempt to subject it to the contractual debts of the non-depositing spouse, the depositing spouse has a good argument that the account is still the depositing spouse's special community property and exempt from other spouse's non-tort and any premarital creditors. A joint account belongs to the party who deposited the funds. Tex. Est. Code § 113.102 (formerly Tex. Prob. Code § 438(a)).

C. Other Factors

The general rules described in IV, A, *supra*, apply unless both spouses are personally liable under "other rules of law."

1. JOINT OBLIGATIONS

Of course, both spouses may sign a contract or commit a tort which would make them jointly and severally liable and thereby subjecting the entire nonexempt marital estate to liability. "Generally, both spouses are jointly and severally liable for the tax due on a joint return. Thus, a spouse may be liable for the entire tax liability, although the income was totally earned by the other spouse." *Kimsey v. Kimsey*, 915 S.W.2d 690, 695 (Tex. App.—El Paso 1998, pet denied).

2. PRINCIPAL-AGENT

The law also defines other situations where any person can be held personally liable for debts of another. These situations include the following relationships: respondent superior, principal/agency, partnership, joint venture, etc. These special relationships can exist between husband and wife and can impose vicarious liability on an otherwise innocent spouse. *See Lawrence v. Hardy*, 583 S.W.2d 795 (Tex. App.—San Antonio 1979, writ ref'd n.r.e.). The Texas Family Code has codified this concept. Tex. Fam. Code § 3.201(a)(1). However, the marriage relationship, in and to itself, is not sufficient to generate vicarious liability. Tex. Fam. Code § 3.201(c). *See* also *Wilkinson v. Stevision*, 514 S.W.2d 895 (Tex. 1974).

3. DUTY OF SUPPORT

In addition, each spouse has a duty to support the other spouse and a duty to support a child generally for so long as the child is a minor and thereafter until the child graduates from high school. Tex. Fam. Code Secs. 2.501 and 154.001. Accordingly, all nonexempt marital assets are liable for such "necessaries."

4. POINT OF CLARIFICATION

Except as provided in IX(C)(1), (2) and (3), *supra*, community property is not subject to a liability that arises from act of a spouse. Tex. Fam. Code §3.201(b).

5. CRIMINAL RESTITUTION

Retirement allowances, annuities, accumulated contributions, optional benefits and money in the various public retirement system accounts *which are one spouse's sole management community property* are generally not subject to a claim of a criminal restitution judgment against the other spouse. Tex. Fam. Code § 3.202(e).

D. Child Support

Prior to 2007 legislation, unless otherwise agreed in writing or ordered by a court, a parent's child support obligation ended when the parent died; now the Family Code provides that court-ordered child support obligations survive the obligor's death. Tex. Fam. Code § 154.006. Subsequent amendments to the Family Code also provide that the obligor's child support obligations can be accelerated upon the obligor's death and a liquidated amount will be determined using discount analysis and other means. Tex. Fam. Code § 154.015. An amendment to the probate code makes the liquidated amount a class 4 claim. Tex. Est. Code § 355.102 (formerly Tex. Prob. Code § 322). The court can also require that the child support obligation be secured by the purchase of a life insurance policy. Tex. Fam. Code § 154.016.

E. The Necessaries Doctrine

A spouse's duty of support extends beyond the marital relationship itself. A spouse who fails to discharge this duty is liable to others who provide necessaries to the other spouse. Tex. Fam. Code § 2.501(b). Accordingly, when third parties (e.g., doctors, hospitals, nursing homes – perhaps even lawyers) provide services deemed reasonably necessary for one spouse's support, both spouses are personally liable for the costs of such services. While the spouse who actually incurs the debt may be deemed to be "primarily liable," both spouses are "jointly and severally" liable to the third party under the necessaries doctrine. Tex. Fam. Code § 3.201(a)(2). A debt incurred for necessaries exposes the entire non-exempt marital estate to liability. Tex. Fam. Code § 3.202.

F. Spousal Necessaries Cases

1. *Approved Personnel Serv. v. Dallas*, 358 S.W.2d 150 (Tex. App.—Texarkana 1962, no writ) ("No case is cited holding a contract for services of the nature rendered here to be a necessary. There are numerous cases in which courts have, on the basis of facts of the particular case, held medical, dental and legal services to be necessaries. . . . The facts and circumstances of a case control and mold the meaning of the term as here used and the formulation of a comprehensive definition is difficult. Decision in this case must be made on the basis that the term encompasses such services as the husband is financially able to and should provide for the wife's benefit and that are suitable to the maintenance of the condition and station in life the family occupies").

2. *Finney v. State*, 308 S.W.2d 142 (Tex. Civ. App.—Austin 1957, writ ref'd n.r.e.) (court held deceased wife's estate liable for medical bills incurred by deceased husband while he was a patient at three state facilities).

3. *Fleming v. Oring*, Civil Action No. 3:04-CV-1303-B, 2005 U.S. Dist.

LEXIS 5062 (N.D. Tex. Mar. 29, 2005) (facts of case concern suit against husband for funds that caretakers spent in order to provide for basic needs of husband's wife; case was dismissed for lack of personal jurisdiction.)

4. *Jarvis v. Jenkins*, 417 S.W.2d 383 (Tex. Civ. App.—Waco 1967, no writ) (husband ordered to reimburse wife's attorney, who paid for her groceries and an airline ticket for her to travel to Virginia to visit family and seek medical treatment; items considered to be necessities).

5. *Turner v. Lubbock County Hospital District*, No. 07-96-0272-CV, 1998 Tex. App. LEXIS 53 (Tex. App.—Amarillo 1998, no pet.) (court found that as a matter of law, medical services are necessaries).

6. *White v. Lubbock Sanitarium Co.*, 54 S.W.2d 1058 (Tex. Civ. App.—Amarillo 1932, writ dism'd w.o.j.) (wife's medical expenses held to be necessaries; husband and wife found to be jointly liable for the medical debt).

Note: The author's research discovered statements from various sources suggesting that once one spouse has qualified for Medicaid nursing care the other spouse no longer has any personal liability for the nursing care. The author appreciates Clyde Farrell confirming this general understanding of this complex set of Medicaid rules. Clyde also explained that, while the community spouse is still generally liable for other "necessaries," when the other spouse is in the nursing home, Medicaid covers most of the needs of the other spouse. If the other spouse is receiving Medicaid home care, Medicaid does not pay for "necessaries" other than medical care (including personal attendant care). However, for the purpose of this paper, it will be assumed that neither spouse has qualified for Medicaid nursing care.

G. Summary- No Pre-Nup

Accordingly, absent a statutory exemption, a spouse's separate property and special community property, as well as the couple's joint community property, are liable for that spouse's debts during the marriage. If the liability is a tort debt incurred during the marriage, the other spouse's special community property is also liable for the debt (the other spouse's separate property may be exempt depending upon the circumstances).

If the debt is not a tort debt incurred during the marriage, the other spouse's separate property and special community property are exempt during the marriage from the debt unless the other spouse is personally liable under other rules of law. In which event, the other spouse's property (i.e., that spouse's special community and separate) is liable as well.

For example, if the debt was incurred as a reasonable expense for the support of either spouse, each spouse has personal liability, and the entire non-exempt marital estate (each spouse's separate property and their community property) is liable.

H. Summary – Pre-Nup

Maximizing a spouse's separate estate through an effective pre-marital agreement generally insulates the separate estate from the debts of the other spouse. The separate estate is exposed to (i) any debt incurred by the other spouse acting as the agent of the spouse or (i) any debt incurred for the reasonable support of the other

spouse. Any debt incurred by both spouses creates joint and several liability.

X. FAMILY BUSINESS PLANNING

The use of modern business entities, such as corporations, partnerships and limited liability companies, has become an integral part of family estate planning. One popular technique is for family members to contribute assets to a family limited partnership in exchange for interests in the partnership. A client intending to marry can also take advantage of this planning opportunity to preserve the assets contributed to the family limited partnership for the client and the children of a prior marriage. The client's partnership interest should remain the client's separate property during the marriage. In other words, the assets contributed to the partnership, as well as assets acquired by the partnership, should remain partnership assets and not become marital assets of the owner and the owner's spouse during the subsequent marriage.

Note: *In any separately-owned, closely-held business enterprise where a spouse is involved in the management, Jensen v. Jensen must be factored into the planning. See II, B, supra. The short answer is to pay reasonable compensation for services rendered by the owner during marriage and maintain contemporaneous business records of the reasonableness of the compensation paid.*

A. Entity Theory

The assets contributed to the partnership become the assets of the partnership, and the partners receive partnership interests. The marital character of a spouse's interest in a partnership created during marriage should depend on the separate or community nature of the assets contributed in exchange for the interest itself. If an interest in the partnership was acquired as a gift, the interest itself is, of course, the separate property of the donee spouse. The assets of the partnership, including undistributed income and profits, belong to the entity and do not take on a separate or community character under normal circumstances. See Sec. 152.056 of the Texas Business Organizations Code and see also *Harris v. Harris*, 765 S.W.2d 798 (Tex. App.–Houston [14th Dist.] 1989, writ denied). Caution should be taken in the day-to-day management of the partnership to avoid claims for reimbursement because of the expenditures of uncompensated time, talent or labor or contributions of community property to the separate property business. See II, B, *supra*.

B. Distributed Profits

When the partnership distributes its profits to its partners, the profits distributed to a married partner are community property, whether the partner's partnership interest is separate or community property. This result can work a conversion of what would ordinarily be the separate property into community property. For example, if a spouse contributes separately owned oil and gas royalty interests into a partnership, the royalties collected by the partnership and then distributed to the partners as partnership profits are community property. Had the spouse not contributed the royalty interest to the partnership, the royalties received would have been the owner's separate property. See *Marshall v. Marshall*, 735 S.W.3d 587 (Tex. App.—Dallas 1987, writ ref'd n.r.e.). The *Marshall* case has been cited for the proposition that all partnership distributions during marriage are community property. However, some commentators argue that a distribution in excess of current or retained earnings or

other distributions of capital should be separate property. See Jack Marr, *Business and Divorce*, 34th Annual Marriage Dissolution Institute (2011).

C. Comparison to Corporations

Partnerships, limited partnerships and limited liability companies are treated as entities under Texas law. The owners do not own the entity's assets; they own interests in the entity similar to shares of stock in a corporation. A divorce court cannot award specific partnership assets to the other spouse. *Gibson v. Gibson*, 190 S.W. 3d 821 (Tex. App.—Ft. Worth 2006, no pet.). Non-liquidating distributions by the entity to the owners generally take on a community character like ordinary cash dividends distributed by a corporation to its shareholders. But, do established corporate law concepts, like the alter ego/reverse veil piercing, *Dillingham v. Dillingham*, 434 S.W.2d 459 (Tex. Civ. App.—Ft. Worth 1968, writ dism'd w.o.j.) and reimbursement for the expenditure of community time, talent and labor like in *Jensen* apply to these new entities as well?

Reverse veil piercing has been held to be inapplicable to partnerships. See *Lifshutz v. Lifshutz*, 61 S.W. 3d 511 (Tex. App.—San Antonio, 2001, pet. denied) and *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners' Association*, 77 S.W. 3d 487 (Tex. App.—Texarkana, 2002, pet. denied). Marr notes that the same rule may apply to limited partnerships and limited liability partnerships. See Marr, *supra*. However, he notes that the concept has been applied to limited liability companies. See *McCarthy v. Wani Venture, A.S.*, 251 S.W. 3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied.

The concepts of fraud on the community and reimbursement would appear to apply to any entity situation.

D. Corporate Veil Piercing

Notwithstanding the "entity" rule, the assets of a separately owned corporation have been held by Texas courts to be part of the community estate and subject to a just and right division by the divorce court in some situations. See *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App.—Ft. Worth 1985, writ dism'd w.o.j.); *Spruill v. Spruill*, 624 S.W.2d 694 (Tex. App.—El Paso 1981, writ dism'd w.o.j.); *Dillingham v. Dillingham*, 434 S.W.2d 459 (Tex. Civ. App.—Ft. Worth 1968, writ dism'd w.o.j.).

While the cases are not numerous and the theories used to justify the result are not always consistent, reverse veil piercing is a reality. In its landmark case, *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986), the Texas Supreme Court explained the basic theories that can be used to disregard a corporate entity: alter ego, sham to perpetrate a fraud, or actual fraud. The court further explained that veil piercing is an equitable doctrine that can be used to prevent an unfair and unjust result.

In *Lifshutz v. Lifshutz*, 61 S.W.3d 511 (Tex. App.—San Antonio 2001, pet. denied), the court purported to explain the elements necessary to disregard the corporate entity. First, there must be a finding that the corporation is the alter ego of the shareholder (i.e., there is a unity between the corporation and the shareholder). Second, the shareholder's use of the corporation damaged the community estate beyond that which could be remedied by a claim of reimbursement. While some courts have required that the shareholder must be the sole shareholder, other courts have not. See *Zisblatt*, *supra*.

The *Lifshutz* court also suggested that the use of the corporation must also have had a negative impact on the community estate. In other words, even if the corporation is the shareholder's alter

ego, the corporation may not be disregarded unless community property was transferred to the corporation.

E. Convert Sole Proprietorships

Even if the client is not willing to share a business enterprise with other members of the family, a sole proprietorship could be converted into an entity, like a corporation, prior to the marriage. Proper management and record keeping can maintain the client's stock in the corporation as separate property and the assets of the corporation as corporate assets, not marital assets. Continuing to operate the "business" as a sole proprietorship during the marriage is likely to result in a commingling of separate and community assets so that over time the "business" becomes community property because of the client's inability to trace which of the business assets were owned prior to marriage or traceable to assets owned prior to marriage. Caution should be taken in the day-to-day management of the corporation to avoid claims for economic contribution and reimbursement.

F. Partnership Formation

Some divorce lawyers take the position that a general partnership interest acquired during marriage is always community property. See Marr, *supra*, citing one case decided over twenty-five years ago, *York v. York*, 678 S.W. 2d 110 (Tex. App.—El Paso 1984, writ ref'd n.r.e.). Marr's article does state that the regular rules of characterization do apply to shares of corporate stock, limited partnership interest, interests in limited liability partnerships and interest in limited liability companies. The better view is that the separate or community character of the partner's interest (like shares of stock) should depend on the character of the consideration used to acquire the interest (i.e., capitalize the entity), if any. If separate consideration, the investment should be separate.

For example, if a general partnership is created at the time of the partners' "handshake" rather than at the time the partnership agreement is signed, the individual partner's interest in the partnership becomes property at that time and is likely to be community property under the inception rule. It was not acquired by gift, devise or descent; and if the "idea" or "concept" was an intangible that did not have a separate or community charter, the partnership interest would appear not to be traceable back to any separate property of the partner.

On the other hand, if the general partnership is not created until the partnership agreement is signed, the partner's interest is more like a shareholder's stock in a corporation, and it should be the partner's separate property, if separate property was contributed by the partner to the partnership in exchange for the partner's interest.

XI. MARITAL PROPERTY RIGHTS IN IRREVOCABLE TRUSTS

The private express trust is a unique concept and one that is frequently misunderstood by members of the public and practitioners alike. The common law established that the trust is not an entity; it cannot own property; it cannot incur debt. Although it may be treated as if it were an entity for some purposes, it remains today a form of property ownership. *See* Tex. Trust Code § 111.004(4). Certain other common law principles remain relevant today. For example, a person serving as trustee is not a legal personality separate from such person in his or her individual capacity. A person

serving as trustee is not the agent of either the trust, the trust estate or the beneficiaries of the trust. Finally, the trust assets are not considered to be the property of the person serving as trustee; such assets belong in equity to the beneficiary. These principles can affect the marital property rights of the parties.

A. The Private Express Trust

One noted authority describes the private express trust as ". . . a device for making dispositions of property. And no other system of law has for this purpose so flexible a tool. It is this that makes the trust unique. . . . The purposes for which trusts can be created are as unlimited as the imagination of lawyers." III, IV, *Scott on Trusts* (3d. ed. 1967).

1. DEFINITION

A trust, when not qualified by the word "charitable," "resulting" or "constructive," is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of the intention to create the relationship. Restatement (Third) of Trust § 2. (2003)

2. CREATION

According to Section 112.002 of the Texas Trust Code, a trust may be created by: (i) a property owner's declaration that the owner holds the property as trustee for another person; (ii) a property owner's inter vivos transfer of the property to another person as trustee for the transferor or a third person; (iii) a property owner's testamentary transfer to another person as trustee for a third person; (iv) an appointment under a power of appointment to another person as trustee for the donee of the power or for a third person; or (v) a promise to another person whose rights under the promise are to be held in trust for a third person.

3. REVOCABLE OR IRREVOCABLE

Inter vivos trusts are further divided into two categories: revocable and irrevocable. A revocable trust is one that can be amended or terminated by the settlor. An irrevocable trust, in contrast, is one that cannot be amended or terminated by the settlor for at least some period of time. The presumption regarding the revocability of inter vivos trusts varies by jurisdiction. For example, in Texas all inter vivos trusts created since April 19, 1943, are revocable unless the trust document expressly states otherwise; while in some other states, trusts (including Texas trusts created prior to April 19, 1943) are deemed irrevocable unless the trust document states otherwise. Tex. Prop. Code Ann. § 112.051. *See* Restatement (Second) of Trusts, § 330; Bogert, *Law of Trusts and Trustees*, § 998 (1983).

Note: *If the trust is revocable, it is deemed "illusory" for marital property purposes and the trust "entity" is generally ignored (i.e., the "trust veil" is pierced). For example, the income the revocable trust assets generate during the settlor's marriage will be community property absent an effective premarital agreement. See Land v. Marshall, 426 SW.2d 841 (Tex. 1968).*

B. Beneficial Ownership

While record legal title to the assets of the trust is held by the trustee, equitable title — true ownership — belongs to the beneficiaries. For example, trust law generally exempts the assets of the trust from any personal debt of the trustee not related to the administration of the trust. This exemption even applies if the trust property is held by the trustee without identifying the trust or the beneficiaries. The rationale behind this exemption is the concept that the assets of the trust really belong to the beneficiaries. *See* Tex. Prop. Code § 101.002 and Tex. Trust Code § 114.0821. These principles confirm that trust assets belong to the beneficiaries and not the trustees. Accordingly, a trustee's spouse generally does not acquire any marital property interest in trust property, but spouses of the beneficiaries may, depending on the circumstances.

C. Interests of the Settlor's Spouse

The creation and funding of an inter vivos trust by a settlor may or may not remove the trust assets from the reach of the settlor's spouse. If (i) the trust is irrevocable and (ii) the settlor has not retained an equitable interest in the trust estate, the assets of the trust really belong to the beneficiaries and no longer have either a separate or community character insofar as the settlor's spouse is concerned. If the transfer of community assets in order to fund the trust is found to have been in fraud of the interests of the settlor's spouse, the spouse may be able to reach the assets of the trust like any other assets transferred to a third party, free of trust, but in fraud of the community interests of the wronged spouse. *See* VIII, *supra*.

D. Settlor's Retained Interest

If the settlor creates an irrevocable trust and retains a beneficial interest in the trust assets, the rights and remedies of the settlor's spouse would appear to be similar to the rights of the settlor's creditors. Creditors can generally reach the maximum amount that the trustee can pay or distribute to the settlor under the terms of the trust agreement, even if the initial transfer into the trust was not in fraud of creditors. For example, if the settlor retains an income interest in the trust assets for the rest of the settlor's life, creditors can reach the retained income interest, and if the settlor retains a general power of appointment over the entire trust estate, creditors can reach the entire trust estate. *See Bank of Dallas v. Republic Nat. Bank of Dallas*, 540 S.W.2d 499 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.). If the settlor retains an income interest for the remainder of the settlor's lifetime, the creditors can reach the income interest, but not the fixed remainder interest already given to the remaindermen. If the trustee has the discretion to invade the principal for the settlor, the extent of the settlor's retained interest will probably be the entire trust estate. *See Cullum v. Texas Commerce Bank Dallas, Nat. Ass'n.*, 05-91-01211-CV, 1992 WL 297338 (Tex. App.—Dallas Oct. 14, 1992) (not designated for publication). The inclusion of a spendthrift provision will not insulate the settlor's retained interest from the settlor's creditors. *See* Tex. Trust Code § 112.035 and *Glass v. Carpenter*, 330 S.W.2d 530 (Tex. Civ. App.—San Antonio 1959, writ ref'd n.r.e.).

1. MARITAL PROPERTY ISSUES

The application of these principles in the marital property context would suggest that any income generated by the trust estate would still be deemed

community property if the settlor retained an income interest in the trust which, for example, was funded with the settlor's separate property. However, in a recent case where the trust was funded with the settlor's separate property prior to marriage and the trustee was a third party who had discretion to make income distributions to the settlor, the trustee's discretion prevented the trust's income from taking on a community character until the trustee exercised its discretion and distributed income to the settlor. The wife in a divorce action had claimed that all of the trust assets were community property since the income generated during the marriage had been commingled with the trust corpus. *See Lemke v. Lemke*, 929 S.W.2d 662 (Tex. App.—Fort Worth 1996, writ denied) and *Matter of Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.—Texarkana 1978, writ dism'd w.o.j.). Some older cases support that same result. *See Shepflin v. Small*, 4 Tex. Civ. App. 493, 23 S.W.432 (1893, no writ) and *Monday v. Vance*, 32 S.W. 559 Tex. Civ. App. 1895 no writ).

2. OTHER FACTORS

Had the trust been funded with community property without the consent of the other spouse, the other spouse could challenge the funding of the trust as being in fraud of the community. Had the assets been subject to the spouses' joint control, the other spouse could argue that the transfer was void since the other spouse did not join in the transfer. Had the settlor retained a general power of appointment, the other spouse could argue that the transfer of community property into the trust was "illusory" as to her community interests therein. *See* VIII, I, *supra*. Accordingly, the only safe conclusion to reach is that the proper application of marital property principles should depend on the nature and extent of the retained interest and perhaps the timing of the creation of the trust.

E. Interests of the Non-Settlor Beneficiary

Because a beneficiary of a trust owns a property interest in the trust estate created by a settlor who is not the beneficiary, the ability of the spouse of the beneficiary to establish a community interest in certain assets of the trust should depend on the nature of the beneficiary's interest. Equitable interests in property, like legal interests, are generally "assignable" and "attachable," but voluntary and involuntary assignees cannot succeed to an interest more valuable than the one taken from the beneficiary.

1. COMPARISON TO CREDITORS' RIGHTS

Again, a review of the rights of creditors of the beneficiary appears relevant. For example, if the beneficiary owns a remainder interest, a creditor's attachment of the beneficiary's remainder interest cannot adversely affect the innocent life tenant's income interest. On the other hand, if the beneficiary is only entitled to distributions of income at the discretion of the trustee for the beneficiary's lifetime, a creditor of the beneficiary cannot attach the interest and require the trustee to distribute all the income. In fact, a creditor may not be able to force the trustee to distribute any income to the creditor since it would infringe on the ownership interests of the remaindermen.

2. PRINCIPAL

The original trust estate (and its mutations and income generated prior to marriage) clearly is the beneficiary's separate property as property acquired by gift, devise or descent, or property acquired prior to marriage. Distributions of principal are likewise the beneficiary's separate property. *See Hardin v. Hardin*, 681 S.W.2d 241 (Tex. App.—San Antonio 1984, no writ).

3. DISTRIBUTED INCOME

If the discretionary income beneficiary is married, it would logically follow that distributed income should be considered separate. The exercise of discretion by the trustee, in effect, completes the gift. The result may be different if the beneficiary is the trustee or can otherwise control the distributions. On the other hand, if the trustee is required to distribute the trust's income to the married beneficiary, the income could be considered community once it is distributed since it arguably could be considered income from the beneficiary's equitable separate property. *See Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.—Corpus Christi 1997, no pet.). However, there is recent case authority that holds that trust income required by the trust document to be distributed to the beneficiary is the beneficiary's separate property, at least where the trust was created prior to the marriage. *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. App.—Tyler 1996, no writ). *See also Matter of Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.—Texarkana 1976, no writ), and *Wilmington Trust Co. v. United States*, 753 F.2d 1055 (5th Cir. 1985).

4. UNDISTRIBUTED INCOME

Undistributed income is normally neither separate nor community property. *See Matter of Marriage of Burns, supra; Buckler v. Buckler*, 424 S.W.2d 514 (Tex. Civ. App.—Fort Worth 1967, writ dism'd w.o.j.), and *McClelland v. McClelland*, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd). However, if the beneficiary has the right to receive a distribution of income but does not take possession of the distribution, such retained income may create marital property rights in the beneficiary's spouse. *See Cleaver, supra*. Depending on the intent of the beneficiary in allowing the distribution to remain in the trust, such income (and income generated by the retained income) may be considered to have taken on a community character or may be considered to have been a transfer to the other beneficiaries of the trust and subject to possible fraudulent transfer on the community scrutiny.

F. Spendthrift Trust

Texas law permits the settlor of a trust to prohibit both the voluntary and involuntary transfer of an interest in trust by the beneficiary prior to its actual receipt by the beneficiary. In fact, the settlor may impose this disabling restraint on the beneficiary's interest by simply declaring that the trust is a "spendthrift trust." Such a restraint is not effective if the beneficiary has a mandatory right to a distribution, but simply has not yet accepted the interest. Further, such a restraint is not effective to insulate a settlor's retained interest from the settlor's creditors. *See* Tex. Trust Code § 112.035. This rationale suggests that the settlor's intent as to the nature of the

beneficiary's interest may be relevant in determining whether the beneficiary's spouse acquires a community interest in the trust estate, the undistributed income or any distributed income.

G. Powers of Appointment

If the beneficiary has the absolute authority under the trust agreement to withdraw trust assets or to appoint trust assets to the beneficiary or the beneficiary's creditors, the beneficiary is deemed to have the equivalence of ownership of the assets for certain purposes. For example, such beneficiary would appear to have such an interest that cannot be insulated from the beneficiary's creditors by either the non-exercise of the power or a spendthrift provision. An appointment in favor of a third party could be found to have been in fraud of creditors. *See Bank of Dallas, supra*. While inconsistent with the common law, which treated the assets over which a donee had a general power as belonging to others until the power was exercised, application of this modern view may treat the assets over which a married donee has a general power as the separate property of the donee, but any income generated by those assets may be community property.

1. SPECIAL POWERS

Many beneficiaries are given limited general powers (i.e., "Crummey" and the so-called "Five or Five" power, both of which permit the beneficiary to withdraw a certain amount from the trust estate at certain periods of time).

2. LAPSE OF POWERS

If the beneficiary allows the withdrawal power to lapse, can the creditors still go after that portion of the estate that could have been withdrawn or can the beneficiary's spouse claim either a possible community interest in the assets allowed to continue in trust, or the income thereafter generated? In other words, does the lapse of the power make the beneficiary "a settlor" of the trust? The Legislature has answered some of these questions. Section 112.035 of the Texas Trust Code was amended by the Legislature in 1997 to confirm that a beneficiary of a trust is not to be considered a settlor of a trust because of a lapse, waiver or release of the beneficiary's right to exercise a "Crummey right of withdrawal" or "Five or Five" power.

3. ASCERTAINABLE STANDARD

If the beneficiary's power of withdrawal is limited to an ascertainable standard (i.e., health, support, etc.), creditors who provided goods or services for such a purpose should be able to reach the trust estate, but not other creditors. Further, it follows that any income distributed for such purposes, but not so expended, may be community since such expenses are normally paid out of community funds. *See* VII, E, *supra*.

4. NON-GENERAL POWERS

A beneficiary's power to appoint only to persons other than the beneficiary, the beneficiary's creditors and the beneficiary's estate are generally deemed personal to the beneficiary and not attachable by the beneficiary's creditors. It would also follow that such a power would not give the spouse any interest in the trust estate. However, if the power is exercised to divert

community income from the beneficiary, could it be subject to possible fraud on the community scrutiny?

Note: *See Sharma v. Routh, 302 S.W.3d 355 (Tex. App.—Houston [14th Dist] 2009, no pet.), for an example of a divorce case where the court examines the nature of the spouse's interests in irrevocable trusts to determine their marital character.*