DISTRIBUTIONS FROM BUSINESS ENTITIES:
SIX POSSIBLE APPROACHES TO CHARACTERIZATION


Richard R. Orsinger
richard@ondafamilylaw.com
http://www.orsingerlaw.com

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

San Antonio Office:
26th Floor, Tower Life Building
San Antonio, Texas 78205
(210) 225-5567
http://www.orsingerlaw.com

and

Dallas Office:
5950 Sherry Lane, Suite 800
Dallas, Texas 75225
(214) 273-2400
http://www.ondafamilylaw.com

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I. INTRODUCTION. If a spouse has a separate property ownership interest in a business, issues can arise whether distributions from the business are community property or separate property. This paper explores six possible approaches to the issue: (i) distributions of profits are community property; (ii) tracing through the entity; (iii) the “liquidation approach”; (iv) the “exhaustion of earnings approach;” (v) the “return of capital approach;” and (vi) the “proportionality rule.”

II. SEPARATE PROPERTY PRINCIPLES. Separate property consists of (i) property owned or claimed prior to marriage; (ii) property acquired during marriage by gift, devise, or dissent; (iii) recovery for personal injuries sustained during marriage, except for loss of earning capacity during marriage; (iv) community property that is partitioned or exchanged into separate property; (v) income from separate property that the spouses agree is separate property; (vi) property acquired with separate property credit; and (vii) mutations of separate property. Tex. Const. art. XVI, § 15; Tex. Fam. Code §§ 3.001, 4.102, 4.103.

Community property is all property acquired by a spouse during marriage that is not separate property. Tex. Fam. Code § 3.002. Community property can also be created by agreement between spouses to convert separate property to community property. Tex. Fam. Code § 4.103.

All property possessed by a spouse during or on dissolution of marriage is presumed to be community property. Tex. Fam. Code § 3.003. To overcome this presumption, the party claiming separate property must prove that claim by clear and convincing evidence.

Tracing is the process of establishing the separate property character of property through evidence showing the time and means by which the spouse originally acquired the property. In re Marriage of Everse, 440 S.W.3d 749, 751 (Tex. App.–Amarillo 2013, no pet.). Tracing also involves following the separate property through its changes in form. Where distributions from business entities are received by a spouse, they are presumed to be community, and the party claiming separate property must fit the distributions into one of the categories of separate property.

A. OWNED OR CLAIMED PRIOR TO MARRIAGE. The concept of property “owned prior to marriage” is straightforward. Proof can include admission by the opposing spouse, supporting testimony, authenticated documents of title, photographs, proof of income received from the property prior to marriage, proof that the property was insured prior to marriage, etc. Oral testimony of separate property from a spouse that is not corroborated is often found to be insufficient to prove separate property. See e.g., Graves v. Tomlinson, 329 S.W.3d 128 (Tex. App.–Houston (14th Dist.) 2010,pet. denied).

The State Bar of Texas’ Pattern Jury Charges (Family & Probate 2014) PJC 202-2 gives the following instruction regarding property claimed before marriage:

Property is “claimed before marriage” if the right to acquire or own the property arises before marriage, even if title to the property is acquired during marriage.

B. ACQUIRED BY GIFT, DESCENT OR DEVISE. The State Bar of Texas’ Pattern Jury Charges (Family & Probate) PJC 202-3 gives the following definition of gift, devise and descent:
“Gift” means a voluntary and gratuitous transfer of property coupled with delivery, acceptance, and the intent to make a gift.

A third person may make a gift to one spouse or to both spouses. If the gift is made to one spouse, that spouse owns the gift as separate property. If the gift is made to both spouses, each spouse owns an equal undivided separate-property interest in the gift.

A spouse may make a gift to the other spouse, in which event the gift includes all the income and property that may arise from that gift unless the evidence establishes a different intent of the donor at the time of the gift.

“Devise” means acquisition of property by last will and testament.

“Descent” means acquisition of property by inheritance without a will.

Delivery can sometimes be a problem. See Marshall v. Marshall, 786 S.W.2d 493, 493 (Tex. App.--Texarkana 1990, no writ) (“[d]elivery requires that the property be placed within the control of the donee with the intention that a transfer of the title becomes currently operative”).

There is a presumption, with a gift of property from one spouse to the other, that the gift includes the future income and property that may arise from that property. Tex. Const. art. XVI, § 15, Tex. Fam. Code § 3.005.

Where a spouse transfers his or her separate property to the other spouse, there is a presumption of gift. Roberts v. Roberts, 999 S.W.2d 424, 432 (Tex. App.–El Paso 1999, no pet.).

C. PERSONAL INJURY RECOVERY. There is no likely instance in which a distribution from an entity would be part of a personal injury recovery.

D. PARTITION OR EXCHANGE. Persons about to marry and spouses can partition or exchange property on hand or to be acquired. Tex. Const. art. XVI, § 15; Tex. Fam. Code ch.4. Where a written premarital or marital partition of exchange agreement makes the distributions from a business the receiving spouse’s separate property, proving the agreement establishes the separate property nature of the distribution. Sometimes partnership agreements or organizational documents for corporations or limited liability companies contain a paragraph that constitutes a partition or exchange of distributions from the entity.

E. AGREEMENT THAT INCOME FROM SEPARATE PROPERTY IS SEPARATE. Spouses can agree that income or property arising from separate property will be separate property. Tex. Const. art. XVI, § 15; Tex. Fam. Code §§ 4.102 (partition or exchange agreement) and 4.103 (spousal agreement concerning income or property from separate property). Where a written agreement makes income or property arising from a business entity separate, proving the agreement establishes the separate property character of the distribution. Sometimes partnership agreements or organizational documents for corporations or limited liability companies contain a paragraph that constitutes an agreement between spouses that distributions from the entity will be separate property. Proof of the agreement proves the separate property claim.

F. ACQUIRED WITH SEPARATE PROPERTY CREDIT. Property acquired using a spouse’s separate property credit is his or her separate property. Cockerham v. Cockerham, 527 S.W.2d 162 (Tex. 1975). Proof that an interest in a business was acquired using separate property credit establishes that the interest in the business is separate property. However, proof that the interest in the business is separate property does not establish that distribution from the entity are separate property. It will require another rule of separate property to make distributions from the entity separate property.

G. MUTATIONS OF SEPARATE PROPERTY. The State Bar of Texas’ Pattern Jury Charges (Family & Probate 2014) PJC 202-4 gives the following instruction regarding mutations:

The character of separate property is not changed by the sale, exchange, or change in form of the separate property. If separate property can be definitely traced and identified, it remains separate property regardless of the fact that the
Distributions from Business Entities: Six Possible Approaches

Chapter 1

III. SEPARATE PROPERTY PRINCIPLES APPLIED TO BUSINESS ENTITIES.

A. WHEN THE INTEREST IS OWNED OR CLAIMED BEFORE MARRIAGE. When an ownership interest in a business is owned of claimed before marriage, it is separate property. Possible proof that an interest in a business was owned or claimed prior to marriage includes admission by the opposing spouse, testimony, executed contracts, stock certificates, stock transfer ledgers, partnership agreements, LLC company agreements, IRS Form 1040 Schedule A listings of dividends received, Schedule C listings of disregarded entities, Schedule E listings of partnerships and S corporations, K-1s, etc.

In Carter v. Carter, 736 S.W.2d 775 (Tex. App.--Houston [14th Dist.] 1987, no writ), the parties married on December 7, 1974. The husband testified that in 1970 he received 159 shares of stock in MPI, a family-owned business, as a gift from his father. He corroborated this testimony by showing dividends reflected on his 1974 tax returns, coupled with his testimony that MPI declared dividends at the end of the year and paid them in the following year. The reporting of dividends on the tax return was circumstantial evidence of ownership. Note that the tax return included 24 days of marriage, and tax returns don’t specify the date that dividends were received, so the tax returns alone were not conclusive of separate property. But the husband testified that the dividend was declared in 1973, a date prior to marriage. The appellate Opinion does not reflect whether this testimony was corroborated. Possible corroboration would be testimony from the company’s CPA, or another shareholder, or a bank record reflecting the deposit of dividends prior to the marriage date.

In the case of Harris v. Harris, 765 S.W.2d 798 (Tex. App.--Houston [14th Dist., 1989], writ denied), the lawyer-husband established that his partnership interest was acquired before marriage, and that the execution of two subsequent partnership agreements did not alter the fact that he maintained the same partnership interest throughout. Harris also involved the issue of whether an agreement signed by the husband during marriage, pertaining to the payment of a contingent fee earned by his law firm, was separate or community property. The jury found that the husband’s interest in the agreement was his separate property. The appellate court reasoned that the new agreement did not create the husband’s right to participate in the contingent fee, but rather clarified and defined each partner’s share of the earlier fee agreement and the manner of distributing the fee. Id. at 804. The right to receive the fee had been established prior to marriage.

A case reflecting some of the difficulties that can arise in proving ownership of a business before marriage is the case of Tucker v. Tucker, No. 13-11-00056-CV, 2013 WL 268937 (Tex. App.–Corpus Christi 2013, pet. denied) (memo. opinion). In that case, the husband said he purchased 500 shares in his father’s business prior to marriage, “as evidenced by a promissory note.” However, the stock transfer from the father to the son was not recorded until after the divorce was filed, when the stock transfer ledger was updated by the husband’s mother. Id. at *1. The husband admitted having met with a financial advisor and discussing how to hide money from his wife. Id. at *1. The corporate minutes showed an earlier transaction where the father bought out his partner, but not when the son supposedly purchased half of the company. Id. at *9. The company’s tax returns showed that the father owned 100% of the company up until 2005, which is when he died, and thereafter the returns show the son owned 100% of the company. Id. The marriage occurred in 1993. Notwithstanding all these proof problems, the trial court found the son’s ownership interest to be separate property and the court of appeals affirmed.

B. ACQUIRING AN OWNERSHIP INTEREST DURING MARRIAGE.

1. Acquired by Gift, Descent, or Devise. Business interests are sometimes acquired by gift or inheritance, in which event the interest is separate property.

Gift. Proof of gift requires proof of delivery, acceptance, and donative intent. Delivery and acceptance can be shown with evidence that the business interest was transferred by the donor, or by the business at the donor’s direction, and received by the donee. A transfer of an interest in a business interest can be reflected in an executed document of conveyance (a written assignment), or by a transfer of shares on the corporate books, or by the retiring of the donor’s shares and the issuance of new shares to the donee. Or organizational documents can be reflect the transfer, such as amending a partnership agreement to reflect the admission of the donee as a new partner or limited partner. Or the transfer can be
proved with circumstantial evidence, such as the donee’s tax return reflecting dividend income, or the reporting on Schedule E of income from a pass-through entity (i.e., a Subchapter S corporation, a partnership, or an LLC that elects to be taxed as a partnership), or the inclusion in the personal tax return of a Schedule C for an entity that is disregarded for Federal tax purposes. A frequent indicator of a transfer of ownership in a partnership is a Form K-1, issued by the partnership to each partner, because the K-1 shows the individual’s ownership interest in the partnership.

Note: if the gift of the interest in the business was from one spouse to the other spouse, there is a rebuttable presumption that the gift included future income (i.e., distributions) from the property. Tex. Const. art. XVI, § 15; Tex. Fam. Code § 3.005. Additionally, a claim of gift in the transfer of a business interest to a child is aided by a rebuttable presumption that a transfer from a parent to a child is a gift. See Bogart v. Somer, 762 S.W.2d 577 (Tex. 1988) (per curiam) (“a presumption of gift exists when a father- and mother-in-law place property in their son-in-law’s name, and the party seeking to disprove the presumption must prove lack of donative intent by clear and convincing evidence.”).

Descent. Inheritance by intestate succession seldom occurs in a family with an interest in a business, since most people with wealth have a last will and testament or at least a revocable trust. Where an ownership interest is acquired by intestate succession, there may be a probate court record if the estate was formally administered. If not, then the accepted means of proof is an affidavit of heirship sworn to by a disinterested party, filed in the deed record office. A form affidavit of heirship is set out in Texas Estates Code § 203.002, and is available from the Texas Comptroller’s Office’s website, at <http://comptroller.texas.gov/taxinfo/taxforms/53-111-a.pdf>. Once filed with the clerk, the affidavit can be authenticated through a certified copy. An affidavit of heirship was excepted from the hearsay rule under the former Texas Probate Code § 52, which was carried forward in Texas Estates Code § 203.001, which says that “[a] court shall receive in a proceeding to declare heirship or a suit involving title to property a statement of facts concerning the family history, genealogy, marital status, or the identity of heirs of a decedent as prima facie evidence contained in the statement is contained in an affidavit or other instrument legally executed and acknowledged of sworn to before, and certified by, an officer authorized to take acknowledgments or oaths, as applicable . . . .” One case says, however, that the declarant must be unavailable in order to be excepted from the hearsay rule under Tex. R. Evid. 804 (When the Declarant is Unavailable as a Witness). Compton v. WWV Enters., 679 S.W.2d 668, 671 (Tex. App.–Eastland 1984, no writ). The Opinion is questionable.

Devise. Proof that an interest in a business was acquired through devise (i.e., under a will) starts with proof of the Will. If the business interest is described as part of a specific bequest, the Will should suffice to prove devise. If the business interest passed under a global award, or residuary clause, or if the division of assets is left to the discretion of the executor, then the Will will not tell the full story and further evidence will be needed to show that the business interest passed under a particular provision of the Will. If a Federal Estate Tax return Form 706 was filed, it will usually specify in detail what property each heir received. If there is no Form 706, then a sworn inventory and appraisement and list of claims may have been filed with the probate clerk and may identify the business interest as belonging to the decedent. Often there will be an assignment from the executor to the heir mentioning the business interest. If not, there may be a letter from the executor informing the person that s/he is receiving the business interest as part of the settlement of the estate. Testimony from the executor, or the accountant for the estate, or from other heirs, or from the heir, can further support a claim of devise.

2. Acquired for Consideration. Where a spouse acquires an interest in an existing business using separate property cash or credit, the business interest is separate property. This is nothing more than the principle of mutation. Where the business is starting up, and the spouse acquires an interest at the start-up, the interest is separate property if separate property capital is contributed in exchange for the business interest. This is nothing more than the principle of mutation.

However, some business entities require not only an initial contribution, but also require that owners, partners, or members agree at the outset to meet "capital calls" to contribute capital to the entity in the future. Questions:

1. Where a person acquires an interest in an entity that requires not only "up front" capital but also a commitment to make future capital contributions, what effect does this commitment to make future capital contributions have on the character of the ownership interest in the business?

2. If the commitment to make future capital contribution occurs before marriage, and the owner later marries, is the commitment a separate property obligation? What if the capital calls are met during marriage using community funds? Does that affect ownership or create a claim for reimbursement? If reimbursement, is it
measured by the dollars contributed or the enhancement in value due to the contribution?

3. If the commitment is made during marriage, is it a community debt that imparts a community ownership interest? What happens at the time of divorce if the obligation to make capital calls extends out past the divorce? The business interest will become the separate property of the spouse who receives it in the divorce.

C. MUTATIONS OF AN EXISTING OWNERSHIP INTEREST. Shares of stock acquired through stock splits have the same character as the original stock. *Harris v. Harris*, 765 S.W.2d 798, 803 (Tex. App.--Houston [14th Dist.] 1989, writ denied); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism’d).

In *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism’d), the husband owned stock in a corporation prior to marriage. During marriage, that corporation merged with two other corporations to create yet another corporation. The court found that the new stock was husband’s separate property--this despite the fact that he and the other owners of the old corporation put $200,000 into the merger.

In *Carter v. Carter*, 736 S.W.2d 775 (Tex. App.--Houston [14th Dist.] 1987, no writ), the parties married on December 7, 1974. Husband testified that in 1970 he received 159 shares of stock in MPI, a family-owned business, as a gift from his father. He corroborated this testimony by showing dividends reflected on his 1974 tax returns, coupled with his testimony that MPI declared dividends at the end of the year and paid them in the following year. In 1976, MPI was acquired by Stauffer Chemical Company, and husband received 4,645 shares of Stauffer in exchange for his MPI stock. In 1979, Stauffer had a 2-for-1 split, raising husband’s shares to 9,290 in number. In 1981, husband sold 1,156 plus 1,000 shares of Stauffer, and expended the proceeds. Husband acquired 166 shares of Stauffer stock as a Christmas gift from his father in 1981 which he later sold, and participated in six short sales in 1982 and 1983. The trial and appellate courts held that the stock was proven to be husband’s separate property.

D. SELLING AN OWNERSHIP INTEREST.

1. **Character of Sales Proceeds.** The proceeds from selling an interest in a business have the same character as the ownership interest. This is an application of the law of mutations. *Marriage of McNelly*, No. 14-13-00281-CV, 2014 WL 2039855 (Tex. App.–Houston [14th Dist.] 2014, pet. denied) (memo. opinion) (where husband owned a partnership interest prior to marriage, proceeds from sale of that interest were his separate property).

2. **Delayed Payments From the Sale of a Business Before or During Marriage.** Where an interest in a business is sold before marriage but payments are received during marriage, or where an interest in a community property business is sold during marriage with payments to be received after divorce, characterization issues can arise in allocating the sales proceeds between community and separate. If the purchase price is fixed and paid over time, all payments would seem to have the character of the underlying business interest. Any interest payments accruing during marriage would be community property and those accruing after divorce would be separate property. What if the agreement provides for the seller to continue to receive profits from the business after the sale, say for a period of 3 years? Undoubtedly, the post-sale profit distributions would reduce the amount of money paid up front. Are those distributions of profits to be considered income earned later or proceeds from sale? Does it matter whether it is reported on the seller’s personal income tax return as income or capital gain?

3. **Post-Sale Employment and Consulting Agreements.** It is not uncommon, in the sale of a business, for the buyer and seller to agree for the seller to remain employed by the business for a period of time after the purchase/sale. This facilitates the transfer of goodwill, and makes for a smoother transition to new ownership with customers, suppliers, and employees. Sometimes the seller agrees to a consulting agreement as an alternative to an employment agreement. Because money paid to buy a business must be capitalized over time, whereas compensation paid to an employee or consultant is immediately deductible to the business as an expense, sellers have a tax motive to move part of the purchase price into a compensation agreement, even if future services to be rendered are nominal or non-existent. In any sale of a closely-held business, the terms of the sale and any related payments or agreements should be scrutinized to see if part of the purchase price is being disguised as compensation for future (i.e., post-divorce) employment. A reverse argument can arise when a separate property business is sold prior to marriage and payments are received during marriage.
4. **Covenants Not to Compete.** The right to compete after divorce is a separate property right. *See Ulmer v. Ulmer*, 717 S.W.2d 665, 667 (Tex. App.--Texarkana 1986, no writ), which held:

An individual’s ability to practice his profession does not qualify as property subject to division by decree of the court. *Nail v. Nail*, 486 S.W.2d 761 (Tex.1972). Thus, the trial court further erred in enjoining Rufus Ulmer from engaging in his chosen profession as part of the property division.

Where a community property business is sold during marriage and a covenant not to compete, or covenant not to solicit customers, is signed during marriage, the covenant is a contract right/obligation arising during marriage, and payments received under the agreement could for this reason be characterized as 100% community. On the other hand, an argument can be made that the payments represent compensation for foregone wages, and that foregone wages after divorce are separate property. But the spouse is free to work in other areas outside the scope of the covenant not to compete, and those wages could be deemed to fully compensate the separate estate for the value of post-divorce services.

Another potential issue can arise regarding a covenant not to compete signed during marriage with payments that extend past the date of divorce. A buyer’s covenant not to compete protects the buyer’s investment in the business, by keeping the seller from luring away suppliers, customers, or employees. Some have argued that the covenant not to compete represents the embodiment of the seller’s personal goodwill, and as such all payments attributable to the covenant not to compete are separate property under *Nail v. Nail*, whether received before or after divorce. A reciprocal argument can be made for payout received during marriage from a sale prior to marriage.

The contract for sale of a business can also impose other post-sale obligations on the seller, like a confidentiality agreement or a non-disparagement clause, that remain effective so long a post-sale payments are made. Are those portions of the payments allocable to the selling of a separate property business or to prohibited post-divorce activities, and what difference does it make?

**E. ASSETS OF THE ENTITY.** The assets of a corporation belong to the corporation and not the shareholders. So corporate assets are not marital property, and are neither separate nor community property. The same rule applied to partnerships. Tex. Bus. Code § 152.101 says:

> Sec. 152.101. NATURE OF PARTNERSHIP PROPERTY. Partnership property is not property of the partners. A partner or a partner’s spouse does not have an interest in partnership property.


See *McKnight v. McKnight*, 543 S.W.2d 863 (Tex. 1976) (trial court cannot award specific assets of a partnership to a spouse in a divorce). The same is true of LLCs, although no statute says so.

**F. CORPORATE DIVIDENDS.** The rules for characterizing corporate dividends are well-established, but they may need to be reexamined.

1. **Stock Dividends.** Stock dividends deriving from separate property stock are separate property. *See Duncan v. U.S.*, 247 F.2d 845, 855 (5th Cir. 1957). It follows that stock dividends deriving from community property stock are community. Stock dividends do not reduce the corporation’s net worth, and are seen as merely changing the structure of the corporation’s equity (i.e., ownership). *Tirado v. Tirado*, 357 S.W.2d 468, 473 (Tex. Civ. App.--Texarkana 1962, writ dism’d) (cash dividends are treated like income, while stock dividends are treated as a mutation of property and take the character of the stock from which they originated when they do not increase the value of the total stocks owned).

2. **Cash Dividends.** Cash dividends from corporate stock have been held to be community property. *See Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ); *Bakken v. Bakken*, 503 S.W.2d 315, 317 (Tex. Civ. App.--Dallas 1973, no writ). This view is probably based on the assumption that cash dividends paid by a corporation constitute a distribution of profits (i.e., income) and not a distribution of capital. There is more to this than you might think.
Bittker, Streng & Emory, *FEDERAL INCOME TAXATION OF CORPORATIONS & SHAREHOLDERS* (1995) says:

**Nondividend Distributions**

If a corporation has neither accumulated nor current E&P [“earnings and profits”], a distribution to its shareholders (as shareholders) will not be a “dividend” includable in their gross income under IRC § 61(a)(7). This assumes that the distribution itself (e.g., of appreciated property) will not trigger gain that will generate current E&P. As specified in IRC § 311(b), the distribution of appreciated property will cause gain recognition of that appreciation to the corporation, and that gain (after applicable income tax) is includable in E&P. This treatment results because of the repeal of the *General Utilities* doctrine in the Tax Reform Act of 1986. Of course, the risk of increasing E&P does not exist if cash (at least in the form of U.S., not foreign, money) is being distributed. Furthermore, if gain is realized on a property distribution, E&P may still not result if the gain would be absorbed by, and be less than the net operating loss accumulated for, that year.

Under IRC § 301(c)(2), a nondividend distribution is applied against, and reduces the adjusted basis of, the shareholder’s stock. If the distribution is greater than the adjusted basis of the stock, the excess is subject to IRC § 301(c)(3) and will be treated as gain from the sale or exchange of property (and, therefore, capital gain, assuming the stock is a capital asset).

Of course, to have nondividend treatment, the absence of E&P must be demonstrated by the recipient or the payor.

The IRS recognizes what it calls “nondividend distributions.” The IRS publication on the matter says: “A nondividend distribution is a distribution that is not paid out of the earnings and profits of a corporation or a mutual fund. You should receive a Form 1099-DIV or other statement showing the nondividend distribution. On Form 1099-DIV, a nondividend distribution will be shown in box 3. If you do not receive such a statement, you report the distribution as an ordinary dividend.” Another IRS publication says this:

A nondividend distribution is a distribution that is not paid out of the earnings and profits of a corporation or a mutual fund. You should receive a Form 1099-DIV or other statement showing the nondividend distribution. On Form 1099-DIV, a nondividend distribution will be shown in box 3. If you do not receive such a statement, you report the distribution as an ordinary dividend.

A nondividend distribution reduces the basis of your stock. It is not taxed until your basis in the stock is fully recovered. This nontaxable portion is also called a return of capital; it is a return of your investment in the stock of the company. If you buy stock in a corporation in different lots at different times, and you cannot definitely identify the shares subject to the nondividend distribution, reduce the basis of your earliest purchases first.

When the basis of your stock has been reduced to zero, report any additional nondividend distribution you receive as a capital gain. Whether you report it as a long-term or short-term capital gain depends on how long you have held the stock. See Holding Period in chapter 14.

You bought stock in 2001 for $100. In 2004, you received a nondividend distribution of $80. You did not include this amount in your income, but you reduced the basis of your stock to $20. You received a nondividend distribution of $30 in 2014. The first $20 of this amount reduced your basis to zero. You report the other $10 as a long-term capital gain for 2014. You must report as a long-term capital gain any nondividend distribution you receive on this stock in later years.1

This IRS approach suggests two things: a taxable dividend comes from earnings and profits; a non-taxable dividend is a return of capital. Tax law does not control state property law, but it is suggestive.

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On June 6, 2009, Time Warner Inc. spun off Time Warner Cable to shareholders and paid a $10.27 per share dividend in the process. Time Warner estimated that just 30% to 35% of the dividend was an actual dividend out of earnings and profits and the rest was a return of capital based on an adjustment to cost basis.

Mattel, Inc. currently (Sept. 2015) presents the following statement at its web site:

Why does Mattel expect a portion of its future dividend to be a non-dividend distribution?

The US federal income tax classification of dividends depends on the applicable “earnings and profits” of the entity paying the dividend. In general, dividends in excess of applicable “earnings and profits”, as determined under U.S federal income tax laws, are generally classified as non-dividend distribution. Although Mattel has significant retained earnings, these earnings do not constitute as “earnings and profits” as defined in U.S. federal tax rules. Going forward, assuming no changes in current business operations or current tax laws, Mattel expects more than 50% of future dividends to be designated a non-dividend distribution.2

So not all dividends are taxable as distributions of corporate earnings. A little refinement of the state marital property rule regarding dividends may be needed.

G. RULES FOR DISTRIBUTIONS FROM ENTITIES. As noted above, it has long been established that stock dividends retain the character of the underlying stock, and that cash dividends received by a spouse from a corporation are community property. Beyond that, the law become murky. The following explanation discusses six different approaches that could be taken for characterizing distributions from separate property business entities. The six approaches are: (i) distributions of profits are community property; (ii) tracing through the entity; (iii) the “liquidation approach”; (iv) the “exhaustion of earnings approach;” (v) the “return of capital approach;” and (vi) the “proportionality rule.”

1. Distributions of Profits are Community Property. Under the community property presumption, all property possessed by a spouse during or on dissolution of marriage is presumed to be community property, and the party claiming separate property has the burden of proof on clear and convincing evidence. Tex. Fam. Code § 3.003. One possible rule for distributions from entities would be that there is no path to proving that the distributions are separate property, so all such distributions fall into the community estate. Considering the three leading cases in the area of distributions from entities, this “all community property” approach was not suggested in Marshall v. Marshall, 735 S.W.2d 587 (Tex. App.–Dallas 1987, writ ref’d n.r.e.), nor was it suggested in Lifshutz v. Lifshutz, 199 S.W.2d 9 (Tex. App.–San Antonio 2006, no pet.) (“Lifshutz II”), and it was rejected in Legrand-Brock v. Brock, 246 S.W.3d 318 (Tex. App.–Beaumont 2008, pet. denied) (“Brock II”).

Marshall v. Marshall, 735 S.W.2d 587 (Tex. App.–Dallas 1987, writ ref’d n.r.e.), supports an argument that distributions of profits from a separate property entity are community property. In Marshall, the husband owned an interest in a partnership at the time of marriage. The partnership owned mineral interests that were acquired prior to husband’s marriage. The court of appeals held that the mineral interests were not separate property, because they belonged to the partnership and had no marital property character. The court rejected the idea that the husband retained an ownership interest in his capital contribution, or that partnership distributions were a mutation of his capital contribution. Id. at 594. The court also rejected the idea that the partnership’s production of oil and gas was subject to characterization as either separate or community property. Id. at 594-95. Under the partnership agreement, it was agreed that all distributions to the husband in excess of his salary “shall be charged against any such distributee’s share of the profits of the business.” Id. at 594. On its books, the partnership allocated husband’s draws that were in excess of the other partner’s draws to husband’s salary, and on the partnership tax returns the excess draws were reported as “guaranteed payments for partners.” Id. at 594. The husband reported the distributions as ordinary income on his personal tax return. Id. The court noted that “all monies disbursed by the partnership were made from current income.” Id. at 595. The court concluded:

The withdrawals nevertheless were distributions of partnership income or profits and, thus, community. We hold that all distributions by the partnership to Woody during the course of the second marriage were community

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Distributions from Business Entities: Six Possible Approaches

Chapter 1

property.

Id. at 595. Marshall clearly states that the husband’s distributions were community property because they were from the partnership’s income or profits. The significance of Marshall to a great degree depends on which statements in the Court’s Opinion you read as broad principles of law, or which statements you read to be as conclusions drawn from the facts in the particular case (such as the language of the partnership agreement that the distributions were charged against profits and the fact that all distributions were from current income and the fact that the husband reported the distributions as ordinary income (not capital gains) on his personal tax return).

Harris v. Harris, 765 S.W.2d 798, 802 (Tex. App.--Houston [14th Dist. 1989], writ denied), said:

Distributions of the partner’s share of profits and surplus (income) received during marriage are community property even if the partner’s interest in the partnership is separate property. TEX. FAM. CODE, § 5.01(b); Arnold v. Leonard, 114 Tex. 535, 273 S.W.2d 799 (1925); Marshall v. Marshall, 735 S.W.2d at 594.

In Lifshutz v. Lifshutz, 199 S.W.2d 9, 27 (Tex. App.–San Antonio 2006, no pet.) (“Lifshutz II”), a subsidiary corporation was transferred directly from a separate property family partnership to a separate property family corporation in a tax-free business recapitalization. Id. at 24-28. The trial court found this to be a “non-liquidating community distribution” from the partnership, and held the stock of the subsidiary to be community property of the husband. Id. at 24. After an extensive analysis of the facts and citation to Marshall, a 2-to-1 majority of the court of appeals wrote:

Accordingly, since partnership property does not retain a separate character, distributions from the partnership are considered community property, regardless of whether the distribution is of income or of an asset.

The court recognized that a Louisiana appellate court had “drawn a distinction between distributions of income and distributions of a capital asset,” but commented the Louisiana court did not analyze the effect of the entity theory of partnerships and further noted that in the present case, “the accumulated profits of [the partnership] exceeded the aggregate distributions, which included the [subsidiary] stock distribution.” Id. at 27 n. 4. This last comment suggests that the Majority applied the rule that distributions of profits are community property.

2. Tracing Through the Entity. The idea of tracing a separate property capital contribution into an entity and back out again was rejected in Marshall v. Marshall, 735 S.W.2d 587 (Tex. App.–Dallas 1987, writ ref’d n.r.e.). In Marshall, the husband owned an interest in a partnership at the time of marriage. The partnership owned mineral interests that were acquired prior to husband’s marriage. The Dallas Court of Appeals held that the mineral interests were not separate property, because they belonged to the partnership and had no marital property character. The Dallas Court rejected the idea that the husband had an ownership interest in his capital contribution, or that partnership distributions were a mutation of his capital contribution. Id. at 594. The Court also rejected the idea that the distributions were a mutation of the husband’s capital account. Id. at 594. The Court of Appeals said:

Woody apparently relies on the rule that mutations of separate property remain separate if properly traced. Norris, 260 S.W.2d at 679. However, a withdrawal from a partnership capital account is not a return of capital in the sense that it may be characterized as a mutation of a partner’s separate property contribution to the partnership and thereby remain separate. Such characterization is contrary to the UPA and implies that the partner retains an ownership interest in his capital contribution. He does not; the partnership entity becomes the owner, and the partner’s contribution becomes partnership property which cannot be characterized as either separate or community property of the individual partners. TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 8, 25, & 28–A(1) (Vernon 1970); Bromberg, 17 TEX. REV. CIV . STAT.ANN. at 300–01. Thus, there can be no mutation of a partner’s separate contribution; that rule is inapplicable in determining the characterization of a partnership distribution from a partner’s capital account.

Marshall, at 594. The Marshall court said that the separate property identity of separate property assets contributed to an business entity is lost because ownership by the entity destroys any marital property character. Following this logic to an extreme, tracing would not be allowed even if the entity were to distribute the same asset back out to the spouse that was separate property when it was contributed. Based on this analysis, it is sometimes said that you cannot trace inside an
entity. It should be noted, however, that the partnership agreement in *Marshall* specified that the distributions were to be charged against the husband’s share of profits. *Marshall*, at 595. Another partnership agreement might say something different that would change the outcome.

The court of appeals in *Harris v. Harris*, 765 S.W.2d 798, 802 (Tex. App.—Houston [14th Dist. 1989], writ denied), adopted *Marshall’s* view, saying:

> Under the entity theory of partnership, adopted by Texas in the Uniform Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon 1970), partnership property is owned by the partnership entity, not the individual partners. *Marshall v. Marshall*, 735 S.W.2d 587, 593–594 (Tex. App.—Dallas 1987, writ ref’d n.r.e.). A partner’s rights in specific partnership property are wholly subordinated to the rights of the partnership entity as owner of the property. He may possess the property only for partnership purposes. See TEX. REV. CIV. STAT. ANN. art. 6132b § 1; Bromberg, Source and Comments, (Vernon 1970). Partnership property is therefore neither separate nor community in character. *Marshall* at 594. The only partnership property right the partner has which is subject to a community or separate property characterization is his interest in the partnership, that is his right to receive his share of the partnership profits and surplus. *Marshall* at 594; *McKnight v. McKnight*, 543 S.W.2d 863, 867–868 (Tex.1976).

And the view was endorsed in *Lifshutz II*. There are still eleven courts of appeals yet to weigh in on the subject, and the Supreme Court has not addressed the notion of tracing into and out of an entity. Additionally, courts should recognize that a partnership agreement might establish that the distribution of a specific asset is a return of capital and not a distribution of profits.

3. **The “Liquidation Approach.”** Several cases support the view that proceeds received in liquidation of an ownership interest in a business have the same character as the interest itself. It is not clear whether it is necessary to surrender some or all of the ownership interest as part of the liquidation process, or whether a business with current or retained earnings can liquidate a capital asset and then preferentially distribute those proceeds to the owners and have the transaction treated as a distribution of capital. Nor is it clear whether such a liquidation must be a total liquidation of all assets, or whether instead be a sale of less than all of the assets can be treated as a partial liquidation.


> (6) (A) "Distribution" means a transfer of property, including cash, or issuance of debt, by a corporation to its shareholders in the form of:

- (i) a dividend on any class or series of its outstanding shares;
- (ii) a purchase or redemption, directly or indirectly, of any of its own shares; or
- (iii) a payment by the corporation in liquidation of all or a portion of its assets.

(B) The term does not include:

- (i) a split-up or division of the issued shares of a class of a corporation into a larger number of shares within the same class that does not increase the stated capital of the corporation; or
- (ii) a transfer of the corporation’s own shares or rights to acquire its own shares.

Note that dividends are listed in (i) while a liquidating distribution “of all or a portion of its assets” is listed in (ii).

An IRS publication says this about liquidating distributions:

> Liquidating distributions, sometimes called liquidating dividends, are distributions you receive during a partial or complete liquidation of a corporation. These distributions are, at least in part, one form of a return of capital. They may be paid in one or more installments. You will receive Form 1099-DIV from the corporation showing you the amount of the liquidating distribution in box 8 or 9.
Any liquidating distribution you receive is not taxable to you until you have recovered the basis of your stock. After the basis of your stock has been reduced to zero, you must report the liquidating distribution as a capital gain. Whether you report the gain as a long-term or short-term capital gain depends on how long you have held the stock. . . 3

a. Complete Liquidation. In Fuhrman v. Fuhrman, 302 S.W.2d 205, 212 (Tex. Civ. App.–El Paso 1957, writ dism’d), the court held that stock issued to a married shareholder upon dissolution of the holding corporation was received by the spouse as separate property. However, the character of distributions in complete liquidation of a corporation was questioned in Legrand-Brock v. Brock, 2005 WL 2578944, *2 (Tex. App.–Waco 2005, no pet.) (memorandum opinion) (“Brock I”), where a divided court suggested that payments in complete liquidation of a corporation might be community property to the extent that the distributions represent retained earnings 4 and profits. In his dissent, Chief Justice Grey cited three cases indicating that proceeds from the liquidation of an ownership interest in a business have the same character as the ownership interest. The view of the Waco majority was ignored on appeal after remand by the Beaumont Court of Appeals in Legrand-Brock v. Brock, 246 S.W.3d 318 (Tex. App.–Beaumont 2008, pet. denied) (“Brock II”), which held that all distributions by a corporation in exchange for surrender of all outstanding stock in a complete liquidation of separate property shares were received by the spouse as separate property.

b. Partial Liquidation. Given that distributions received in complete liquidation of an ownership interest have the same marital property character as the ownership interest itself, the question arises whether the rule applies to distributions that represent the proceeds from sale of only part of the company’s assets, rather than all of them. A follow-on question arises whether the concept of partial liquidation requires that part of the ownership interest be surrendered to the company in exchange for the distribution.

The case of Legrand-Brock v. Brock, 246 S.W.3d 318 (Tex. App.–Beaumont 2008, pet. denied) (“Brock II”), involved payments made pursuant to a plan of complete liquidation of a corporation’s assets. However, the court of appeals in Brock II mentioned “partial liquidations”:

A liquidating distribution includes a transfer of money by a corporation to its shareholders in liquidation of all or a portion of its assets. See BLACK LAW’S DICTIONARY 508 (8th ed. 2004) (A “liquidating distribution” is “[a] distribution of trade or business assets by a dissolving corporation or partnership.”); see also TEX. BUS. CORP. ACT. ANN. art. 1.02(A)(13)(c) (Vernon Supp. 2007) (“Distribution” means a transfer of money ... by a corporation to its shareholders ... in liquidation of all or a portion of its assets.”).

Brock II, at 323. The Brock II court also cited the U.S. Supreme Court in Hellmich v. Hellman, 276 U.S. 233, 235, 48 S.Ct. 244, 72 L.Ed. 544 (1928), a tax case:

A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock.

Brock II, 246 S.W.3d at 324. Note that the Supreme Court described two extremes: “Upon a surrender of his interest” on the one hand and on the other hand a dividend “out of current earnings or accumulated surplus . . . in the nature of a recurrent return upon the stock.” This statement of extremes does not help much with situation that falls between the two extremes, such as when there is no “surrender of interest” or when the distribution is not “out of current earnings or accumulated surplus” or when the transaction is not “recurrent.”

4. The “Exhaustion of Earnings” Approach. Several cases say that partnership profits distributed to a married partner are community property, regardless of whether the spouse’s partnership interest is separate or community property. Harris


4 Retained earnings consist of net income, less net losses, less dividends paid.
v. Harris, 765 S.W.2d 798, 804 (Tex. App.–Houston [14th Dist.] 1989, writ denied); Marshall v. Marshall, 735 S.W.2d 587, 594 (Tex. App.–Dallas 1987, writ ref'd n.r.e.). This is consistent with the fundamental community property principle in Texas that income earned on separate property is community property. What if a distribution occurs when there are no profits to distribute? If the underlying principle is that only distributed profits are community property, then evidence showing that there were no profits to distribute would rule out a community component to the distribution, and would by process of elimination establish that the distribution must be of capital.

The Barrington Case.

This exhaustion of earnings approach was used in Barrington v. Barrington, 290 S.W.2d 297 (Tex. Civ. App.–Texarkana 1956, no writ). The issue was the husband’s unincorporated business established prior to marriage. There being no entity, the issue was the characterization of cash and individual assets in the business. Using the community-out-first rule applied to bank accounts, the appellate court held that all of the assets were the husband’s separate property at the time of divorce. The husband commingled the proceeds from the sale of his date-of-marriage inventory and equipment with profits in one bank account, but he regularly withdrew more money from that account than he earned. The appellate court described the situation in this way:

Plaintiff had on hand $4,254.29 worth of new and used tires at the time of his marriage as his separate property and in his business he sold new and used tires and serviced tires. As he sold these tires and serviced tires in his business he deposited the proceeds in his one bank account and he would use the money he received in his business to buy new stock. His stock turned over about five times during his coverture with defendant. On February 28, 1955, a few days before the divorce suit, his stock of merchandise of new and used tires on hand was of the value of $2,700, which was a decrease of $1,554.29 from his original stock. He also sold some of his old equipment and bought new equipment which was necessary in his business of remolding and recapping tires—however, he kept accurate records of all of these transactions as hereinafter more fully shown. During the marriage he sold two re-tread molds (which was his original separate property) for $1,050 which money was placed in his business bank account. During the marriage he bought a new re-tread mold, paid $160 down on it from the bank deposit and paid a few (8 or 9) monthly payments of $68 per month from his business bank account and owed a balance on it at the time of the dissolution of the marriage. During the marriage he also bought a tire changer for $189, paying for same out of the business bank account check, also paid $75 out of said account on a cement spray machine, with an indebtedness still due against it at the time of the divorce, bought an air compressor on credit and made a few payments on it out of the business bank account as shown by the accountant’s statement, and with an indebtedness still due against it at the time of the divorce, and also paid $350 out of said business account for a matrice. Mr. Barrington caused to be kept a complete and correct set of books with reference to such business by T. C. Wilson, Tax Service and Accounting Office, certified public accountants in Jacksonville, Texas. This office prepared inventory of this business in March 1954, five days after the marriage and another inventory as of February 28, 1955, the closing month immediately preceding the trial of March 5, 1955. The accountants also prepared a profit and loss statement in detail covering from March 1, 1954, through *304 March 1, 1955, and also prepared a net worth statement of Elray Barrington during a like period of time. All of these inventories, profit and loss statement and net worth statement, were introduced in evidence. The operation of the business of the Barrington Tire Shop and the income and disbursement of its earnings was at no time invested, mixed or mingled with income or monies derived from any other source as only one bank account was maintained.

* * *

Unquestionably the real estate and the original tools, appliances, office furniture, and certain other original property of the Barrington Tire Shop owned by Mr. Barrington prior to his marriage and still on hand at the dissolution of the marriage had in no way changed their form and were and still remained the unquestioned separate property of Mr. Barrington.

It is our further view that the other remaining property of the Barrington Tire *305 Shop, consisting of the new re-tread mold, tire changer, cement spray machine, air compressor and matrice purchased out of the bank account of Barrington Tire Shop during the marriage (which was subject to various indebtedness as shown by the record) and
other property on hand in the Tire Shop including the $2,700 worth of stock of new and used tires on hand in Barrington Tire Shop at the dissolution of the marriage, under the undisputed facts in this case, and under the authorities cited in the Farrow and Sibley cases, supra, were in law the separate property of appellee, Elray Barrington.

Allocation of Corporation Distributions for Tax Purposes. From an accounting or financial standpoint, corporate distributions are treated as coming first out of current earnings, then out of retained earnings, and finally out of capital. Under Internal Revenue Code § 316 and Treasury Regulation 1.316-2, a corporate distribution is deemed to come from current earnings first, and then from accumulated earnings from prior years. Id. After current and retained earnings are exhausted, what is left, by process of elimination, must be a distribution of capital, and for this reason it reduces the tax basis in the corporate stock. This hierarchy is a model for how distributions from corporations or other entities could be distinguished for marital property characterization purposes. This “income-out-first” principle is an entity-related rule analogous to the community-out-first rule applied to bank accounts, or applied in the Barrington case.

Treas. Reg. § 1.316-2(a) provides:

§ 1.316-2 Sources of distribution in general.

(a) For the purpose of income taxation every distribution made by a corporation is made out of earnings and profits to the extent thereof and from the most recently accumulated earnings and profits. In determining the source of a distribution, consideration should be given first, to the earnings and profits of the taxable year; second, to the earnings and profits accumulated since February 28, 1913, only in the case where, and to the extent that, the distributions made during the taxable year are not regarded as out of the earnings and profits of that year; third, to the earnings and profits accumulated before March 1, 1913, only after all the earnings and profits of the taxable year and all the earnings and profits accumulated since February 28, 1913, have been distributed; and, fourth, to sources other than earnings and profits only after the earnings and profits have been distributed.

(b) If the earnings and profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings and profits at the time of the distribution) are sufficient in amount to cover all the distributions made during that year, then each distribution is a taxable dividend. See§ 1.316-1. If the distributions made during the taxable year consist only of money and exceed the earnings and profits of such year, then that proportion of each distribution which the total of the earnings and profits of the year bears to $60,000, the total distributions made during the year) shall be considered a taxable dividend to the extent of the earnings and profits accumulated since February 28, 1913, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings and profits accumulated since February 28, 1913, and the actual earnings and profits to the date of a distribution within any taxable year (whether beginning before January 1, 1936, or, in the case of an operating deficit, on or after that date) cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made.

(c) The provisions of the section may be illustrated by the following example:

Example.

At the beginning of the calendar year 1955, Corporation M had $12,000 in earnings and profits accumulated since February 28, 1913. Its earnings and profits for 1955 amounted to $30,000. During the year it made quarterly cash distributions of $15,000 each. Of each of the four distributions made, $7,500 (that portion of $15,000 which the amount of $30,000, the total earnings and profits of the taxable year, bears to $60,000, the total distributions made during the year) was paid out of the earnings and profits of the taxable year; and of the first and second distributions, $7,500 and $4,500, respectively, were paid out of the earnings and profits accumulated after February 28, 1913, and before the taxable year, as follows:
**Distributions from Business Entities: Six Possible Approaches**

**Chapter 1**

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Portion out of earnings and profits of the taxable year</th>
<th>Portion out of earnings accumulated since Feb. 28, 1913, and before the taxable year</th>
<th>Taxable amt. of each distribution</th>
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</thead>
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<tr>
<td>March 10</td>
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<td>$7,500</td>
<td>$7,500</td>
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<tr>
<td>June 10</td>
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<td>7,500</td>
<td>4,500</td>
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</tr>
<tr>
<td>December 10</td>
<td>15,000</td>
<td>7,500</td>
<td></td>
<td>7,500</td>
</tr>
</tbody>
</table>

Total amount taxable as dividends: $42,000

(d) * * *

(e) A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost or other basis of the property will not be considered as having been paid out of earnings and profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property as provided in section 301(c)(3)(A). A distribution from a depletion reserve based upon discovery value to the extent that such reserve represents the excess of the discovery value over the cost or other basis for determining gain or loss, is, when received by the shareholders, taxable as an ordinary dividend. The amount by which a corporation’s percentage depletion allowance for any year exceeds depletion sustained on cost or other basis, that is, determined without regard to discovery or percentage depletion allowances for the year of distribution or prior years, constitutes a part of the corporation’s “earnings and profits accumulated after February 28, 1913,” within the meaning of section 316, and, upon distribution to shareholders, is taxable to them as a dividend. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings and profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared. See section 301. No distribution, however, can be made from such a reserve until all the earnings and profits of the corporation have first been distributed.

A law review Comment published in 1962 described the operation of this tax rule:

**A. Tax Treatment of Corporate Distributions**

Historically the concept of earnings and profits first entered the tax statute to exempt the distribution of pre-1913 earnings from taxation; now it is the chief statutory basis for exempting return of contributed capital. Generally, a non-liquidating corporate distribution of cash is treated for tax purposes either as a dividend or a return of capital. Depending upon the source of the distribution, it may be treated as ordinary income, as a return of capital, as a gain from the sale or exchange of property, or as a distribution specially exempt from tax. Section 316 of the Code defines a dividend as "any distribution . . . by a corporation to its shareholders, (1) out of its earnings and profits accumulated after February 28, 1913, or (2) out of its earnings and profits of the taxable year...." If the source of the distribution is from either of the above, it is a dividend and is taxed as such to the recipient. The regulations recognize four basic possible sources

1. Earnings and profits of the taxable year;
2. Earnings and profits accumulated since February 28, 1913;
3. Earnings and profits accumulated before March 1, 1913;
4. Sources other than earnings and profits.

Each of these sources is chargeable only to the extent that a distribution exceeds the source mentioned in the preceding class or classes. Thus, if the corporation has current year’s earnings and profits (irrespective of a deficit in accumulated earnings and profits) or accumulated earnings and profits since February 28, 1913 (irrespective of a lack of earnings and profits in the current year), a distribution is taxable to the shareholder as a dividend.

The source of the distribution is determined by specific statutory rules not affected by statements or designations as to the source made by corporate directors or by entries upon the corporation’s books. A corporation cannot control the taxability of distributions by designating them to be from some specific fund such as accumulated earnings prior to February 28, 1913, or paid-in surplus. There is a conclusive presumption that all such distributions are made from the most recent earnings and profits.

A dividend declared by a corporation which does not have current earnings and profits or accumulated earnings and profits after February 28, 1913 will be treated as a return of capital and therefore tax exempt until it exceeds the stockholder’s tax basis for his stock. Any amount received in excess of the stockholder’s tax basis is given capital gain treatment. [Footnotes omitted.]

Comment, 46 MARQUETTE L. REV. 104, 104-05 (1962).

5. The “Return of Capital” Approach. Another possible approach would be to determine whether a distribution is a “return of capital” as that term is used in the Texas Business Organization Code.

The Texas Legislature believes that partial distributions from a limited partnership can be a return of capital, even outside the winding up of the business, because Section 153.208 of the Texas Business Organization Code specifically recognizes distributions that are a return of capital, and liquidation of the entity is not a required condition. The statute says:

§ 153.208. Sharing of Distributions

(a) A distribution of cash or another asset of a limited partnership shall be made to a partner in the manner provided by a written partnership agreement.

(b) If a written partnership agreement does not provide otherwise, a distribution that is a return of capital shall be made on the basis of the agreed value, as stated in the partnership records required to be maintained under Section 153.551(a), of the contribution made by each partner to the extent that the contribution has not been returned. A distribution that is not a return of capital shall be made in proportion to the allocation of profits as determined under Section 153.206.

(c) Unless otherwise defined by a written partnership agreement, in this section, “return of capital” means a distribution to a partner to the extent that the partner’s capital account, immediately after the distribution, is less than the amount of that partner’s contribution to the partnership as reduced by a prior distribution that was a return of capital.

Some analysis of Section 153.208 is in order. First off, Chapter 153 applies to limited partnerships, not corporations, general partnerships, or limited liability companies.

Second, Section (a) says that a written partnership agreement controls the manner in which a distribution of cash or other assets of a limited partnership are distributed. This would seem to include the allocation of a distribution to capital or to profits. This is an important point to remember: any bright line or even statutory rule on whether a limited partnership distribution is capital or profits must be subordinated to what the written partnership agreement provides.

Third, Section (b) provides a default rule for valuing limited partners’ capital contributions for purposes of making a distribution of capital, provided that the partnership agreement does not say otherwise. Section (b) says that the amount
of capital allocated to each partner “shall be made” on the basis of the agreed value of the contribution made by each partner, to the extent that capital has not already been returned. This statutory provision is potentially significant in cases where the default rule applies.

Fourth, Section (c) measures a return of capital based on (i) the agreed value of capital (ii) minus prior distributions that were a return of capital. No express mention is made of the partner’s share of profits and losses. However, for reasons external to Section 153.208(c), a partner’s capital account is increased by profits and reduced by losses. So, does the calculation of “return of capital” implicitly require that prior profits and losses be taken into account, or are profits and losses to be ignored? Note that a written partnership agreement can vary this rule.

6. The “Proportionality Rule.” The “proportionality rule” is taken from Tex. Bus. Org. Code § 153.208, Sharing of Distributions, which in Subsection (b) provides:

(b) . . . A distribution that is not a return of capital shall be made in proportion to the allocation of profits as determined under Section 153.206.

Since a distribution that is not a return of capital must be made in proportion to the allocation of profits, logic (i.e., the contrapositive) requires that a distribution that is not in proportion to the allocation of profits must be a return of capital, regardless of other considerations. On the other hand, it does not logically follow that a distribution made in proportion to the allocation of profits is necessarily a distribution of profits, because either a distribution of profits or a return of capital could be in proportion to the allocation of profits. Stated differently, a distribution made in proportion to the allocation of profits could be either a return of capital or a distribution of profits, but a distribution that is not in proportion to the allocation of profits cannot be a distribution of profits (and thus must be a distribution of capital).

QUESTION: What happens under this default rule when the liquidity event giving rise to the distribution is a borrowing, not income and not capital? Are the borrowed funds income or capital or something else?

IV. PARTNERSHIP ACCOUNTING. It is important to consider partnership accounting in the discussion about whether partnership distributions from a separate property partnership are separate or community property. The key concept is the partner’s “capital account.”

A. WHAT IS A PARTNER’S CAPITAL ACCOUNT?

There are many descriptions of a capital account available on the internet. This one, from www.accountingtools.com, is serviceable:

What is the partnership capital account?

The partnership capital account is an equity account in the accounting records of a partnership. It contains the following types of transactions:

• Initial and subsequent contributions by partners to the partnership, in the form of either cash or the market value of other types of assets

• Profits and losses earned by the business, and allocated to the partners based on the provisions of the partnership agreement

• Distributions to the partners

The ending balance in the account is the undistributed balance to the partners as of the current date.

For example, if Partner Smith originally contributed $50,000 to a partnership, was allocated $35,000 of its subsequent profits, and has previously received a distribution of $20,000, the ending balance in his account is $65,000, calculated as:
$50,000 initial contribution + $35,000 profit allocation - $20,000 distribution

A partnership can maintain a single partnership capital account for all partners, with a supporting schedule that breaks down the capital account for each partner. However, it is easier over the long term to instead maintain separate capital accounts within the accounting system for each partner; by doing so, it is easier to determine the amount to be distributed to each partner in the event of a liquidation of the business or the departure of a partner, which in turn reduces the amount of discussion over payments and liabilities amongst the partners.


The capital accounts of partners in a Texas general partnership are maintained in accordance with Section 152.202 of the Tex. Bus. Organizations Code, which provides:

Sec. 152.202. Credits of and Charges to Partner.
(a) Each partner is credited with an amount equal to:
(1) the cash and the value of property the partner contributes to a partnership; and
(2) the partner’s share of the partnership’s profits.
(b) Each partner is charged with an amount equal to:
(1) the cash and the value of other property distributed by the partnership to the partner; and
(2) the partner’s share of the partnership’s losses.
(c) Each partner is entitled to be credited with an equal share of the partnership’s profits and is chargeable with a share of the partnership’s capital or operating losses in proportion to the partner’s share of the profits.


Thus, a partner’s capital account, in a Texas general partnership, reflects four things:

(i) capital contributed by the partner, plus
(ii) the partner’s share of profits; less
(iii) distributions to the partner; less
(iv) the partner’s share of losses.

Tex. Bus. Organizations Code § 153.003 provides that the terms of Chapter 152, which apply to general partnerships, also apply to limited partnerships, except where it would violate the principle of limited liability of limited partners.

The capital accounts of partners in a Texas limited partnership are maintained in accordance with Section 153.206 of the Tex. Bus. Organizations Code, which sets out the rule for allocation of profits and losses in a Texas limited partnership:

Sec. 153.206. ALLOCATION OF PROFITS AND LOSSES.
(a) The profits and losses of a limited partnership shall be allocated among the partners in the manner provided by a written partnership agreement.
(b) If a written partnership agreement does not provide for the allocation of profits and losses, the profits and losses shall be allocated:

(1) in accordance with the current percentage or other interest in the partnership stated in partnership records of the kind described by Section 153.551(a); or
(2) if the allocation of profits and losses is not provided for in partnership records of the kind described
by Section 153.551(a), in proportion to capital accounts.

APPENDIX

1. No Preferential Return of Capital (Form).

The following form partnership agreement is taken from 19 TEX. PRAC., Business Organizations § 13:23 (3d ed.)

ARTICLE 8
DISTRIBUTIONS

8.1. Cash Distributions. Except as otherwise provided in this Article 8 and except as may be otherwise prohibited by any documentation or agreements between any third-party lender and the Partnership, Distributable Cash, if any, may be distributed by the General Partner, in its sole discretion, to all Partners based upon their Partnership Interests. No distributions in excess of Distributable Cash will be made without the approval of the General Partner and a Super Majority Interest. No General Partner or Limited Partner will be entitled to any priority or preference over any other Partner as to cash distributions. Any distribution made pursuant to the “good faith” direction set forth in Section 8.2 will be made pursuant to the authority and limitations of this Section 8.1 and will be considered a distribution pursuant to this Section 8.1 for purposes of this Agreement.

8.2. Distribution for Taxes. It is the intention of the General Partner to attempt in good faith to make cash distributions to the Partners each Fiscal Year in an aggregate amount equal to the estimated taxable income of the Partnership allocated pursuant to Article 7 for such Fiscal Year multiplied by the highest individual federal income tax rate in effect for such year; provided, however, that if for any Fiscal Year there is a special allocation of income (including allocations to a Partner pursuant to Section 704(c) of the Code), the General Partner will have the right to increase distributions to all the Partners such that the distributions are based on the highest amount of taxable income per one percent (1%) Partnership Interest allocated to a Partner. Such distribution is intended to be made on or before the filing date of such Partner’s income tax return (without extensions). Notwithstanding the foregoing, the General Partner will have no obligation to make any such distributions; and the Partners recognize that the General Partner may be prevented from making such distributions as a result of the General Partner’s determination, in its sole and absolute discretion, that such distribution would not be in the best interest of the Partnership.

8.3. Distribution in Kind. Distributions to be made pursuant to the provisions set forth in Section 8.1 may be satisfied by assets in kind instead of cash as determined by the General Partner. If any assets of the Partnership will be distributed in kind, the General Partner or the liquidator, as the case may be, will: (a) determine the value of such assets using appraisal techniques which are deemed to be appropriate by such Person, taking into account the nature of the assets; (b) immediately prior to any distribution of any property by the Partnership, adjust the Capital Accounts of all Partners to reflect the manner in which the unrealized income, gain, loss, and deduction inherent in such assets (that has not been reflected in the Capital Accounts previously) would be allocated among the Partners if there were a taxable conveyance of such assets for their fair market value on the date of distribution; and (c) except as otherwise agreed to by the General Partner and the receiving Partners, such assets will be distributed to the Partners entitled thereto.

8.4. Liquidating Distributions. Notwithstanding this Article 8, liquidating distributions upon termination of the Partnership will be governed by Article 17.

* * *

ARTICLE 17
WINDING UP, LIQUIDATION, AND TERMINATION


(a) Except as permitted by the Law, the Partnership must wind up the Business and affairs on the first to occur
of the following:

(i) The written consent of the General Partner and a Super Majority Interest;
(ii) An entry of a judicial decree requiring the winding up of the Partnership under applicable law;
(iii) The happening of an event requiring the winding up of the Partnership pursuant to the terms of this Agreement; or
(iv) The happening of any other event that under the Law requires the winding up of the Partnership and such requirement is not validly waived by this Agreement.

(b) If an event requiring a winding up occurs and is not cancelled or revoked pursuant to Section 17.2, the Partnership will wind up its affairs until the assets of the Partnership have been distributed as set forth in Section 17.3 below. Notwithstanding the winding up of the Partnership, the affairs of the Partners and the Business, as such, will continue to be governed by this Agreement.

17.2. Revocation or Cancellation of Winding Up Event. To the extent permitted by law, the Partnership may revoke or cancel, as applicable, the event requiring the winding up of the Partnership upon the approval of the General Partner and a Super Majority Interest. In the event of such revocation or cancellation, the Business and affairs of the Partnership will continue without any winding up of the Partnership.

17.3. Liquidation Upon Event Causing Winding Up. Upon the occurrence of an event requiring the winding up of the Partnership pursuant to Section 17.1 above, the General Partner will diligently proceed to wind up the affairs of the Partnership, liquidate the assets of the Partnership, or appoint one (1) or more Person(s) to liquidate the Partnership, and apply and distribute the proceeds thereof in the following order of priority:

(a) To the payment of obligations of the Partnership (including to Partners), including the expenses of liquidation;
(b) To the setting up of any reserves for contingencies which the General Partner may consider necessary; and
(c) To the Partners in the following order of priority:
   (i) To the Partners in accordance with the positive balances in their Capital Accounts; and
   (ii) Any remaining assets will be distributed to the Partners in the same proportion as the Partners have agreed to share Profits pursuant to Article 7 at the time of such distribution, any cash to be distributed immediately, and the accounts receivable as they are collected.

17.4. Cancellation of Certificate of Formation. On completion of the winding up process (including the distribution of Partnership assets as provided in Section 17.3), the General Partner must cause the cancellation of the Partnership’s Certificate by the filing of a Certificate of Termination with the Secretary of State of the State of Texas. Additionally, the General Partner will cause to be filed any and all documents necessary to terminate the Partnership as a foreign limited partnership where applicable.

17.5. Allocation of Gain or Loss Upon Winding Up. Any gain or loss on any transfer or conveyance of Partnership properties in the process of liquidation will be credited or charged to the Partners in the proportion of their interest in Profits or Losses, respectively, as determined under Article 7. Except as may be otherwise provided herein, any property distributed in kind in the liquidation will, to the extent practicable, be distributed in undivided fractional interests. Any property distributed in kind in liquidation will be valued and treated as though the property were sold and the cash proceeds were distributed. The provisions of this Section 17.5 will apply only to the accounting between the Partners on liquidation, and a distribution in kind pursuant to these provisions will not be treated as a sale for income tax purposes. The Partners (or their estates, as applicable) will continue to share Profits and Losses during the period of winding up in the same proportions as before winding up.

17.6. Discretion of General Partner Upon Winding Up. Notwithstanding the foregoing, in the event that the General Partner determines that an immediate sale of part or all of the Partnership assets would cause undue loss to the Partners, the General Partner, in order to avoid such loss, may after having given notification to all the Limited Partners, to the extent not then prohibited by the laws of any jurisdiction in which the Partnership is then formed or qualified and applicable in the circumstances, either defer liquidation of, and withhold from distribution for a reasonable time, any assets of the Partnership except those necessary to satisfy the Partnership’s debts and
obligations, or distribute the assets to the Partners in kind.

17.7. Recourse of Partner Upon Winding Up. Each Partner must look solely to the assets of the Partnership for all distributions with respect to the Partnership and his or her Capital Contribution thereto and share of cash, sale proceeds, and Profits or Losses thereof, and will have no recourse therefor (upon winding up or otherwise) against the General Partner or any Limited Partner, except as otherwise herein specifically provided.

17.8. Restoration of Deficit Capital Account. If, following the distribution of proceeds pursuant to Section 17.3 above, there is a deficit balance in the Capital Account of any General Partner (after giving effect to all contributions, distributions, and allocations for all taxable years, including the year during which such liquidation occurs), the amount of such deficit balance will be restored and repaid to the Partnership in compliance with Section 1.704-1(b)(2)(ii)(b)(3) of the Treasury Regulations, and such restoration or repayment will be distributed by the Partnership pursuant to Section 17.3 above.

17.9. Limited Partner’s Deficit Capital Account. If any Limited Partner who is not a General Partner has a deficit balance in his or her Capital Account (after giving effect to all contributions, distributions, and allocations for all taxable years, including the year during which such liquidation occurs), such Limited Partner will have no obligation to make any contribution to the capital of the Partnership with respect to such deficit, and such deficit will not be considered a debt owed to the Partnership or any other Person for any purpose whatsoever, as tenants-in-common in the same proportions in which such Partners would have been entitled to cash distributions. Provided, however, that no distributions may be made pursuant to the provisions of this Section 8.3 (without the express written consent of the contributing Partner and/or the receiving Partner, as applicable, who is to recognize such gain or loss) if such distributions would result in gain or loss to the contributing Partner and/or the receiving Partner pursuant to the provisions of Sections 704(c) and/or 737 of the Code.

2. Preferential Return of Distributions (Form). The following form language is taken from Terence Floyd Cuff, Some Observations on Drafting Distribution Provisions for Partnership Agreements, Loeb & Loeb, LLP, Los Angeles, California Copyright © 2009, Terence Floyd.

Sample 1 The following clause splits cash in a fixed percentage:

Clause 8. Section x.x. Distributions of Distributable Cash.

Distributable Cash shall be distributed 70% to Fred and 30% to Don.

Sample 2 The following clause provides for the partners to recover the capital contributions before profits are distributed:

Clause 12. Section x.x. Distributions of Distributable Cash.

Distributable Cash shall be distributed in this order:

(a) First, to Fred and Don (between them in accordance with the ratio of their Net Unrecovered Capital Contribution) until distributions of Distributable Cash have returned Fred and Don’s Net Unrecovered Capital Contribution, and then

(b) Second, the next seventy-five thousand dollars of Distributable Cash shall be distributed 70% to Fred and 30% to Don, and then

(c) Third, all remaining Distributable Cash shall be distributed 50% to Fred and 50% to Don.

The amounts distributable under each of the tiers of this Section x.x shall be measured cumulatively from the formation of the Company. Distributions of Distributable Cash shall be made annually, within
thirty (30) business days after the end of the immediately previous calendar year.

“Net Unrecovered Capital Contribution” of a Member means the excess of –
(a) All Capital Contributions by the Partner to the Partnership over
(b) All distributions of Distributable Cash to the Partner under Section x.x(a).

When it appears from the intrinsic nature of an agreement that the agreement is necessarily limited as to duration by the happening of any one of several contingencies, this ascertainable contingency determines the duration.

3 Cases that cite this headnote

Husband and wife sued each other for divorce. The 301st District Court, Dallas County, Bob O'Donnell, J., denied wife's claims for reimbursement for community funds used to pay husband's separate debt and for gifts of community funds to husband's daughter and grandson, held that community estate was not liable for unpaid debts of wife's business, divided household furnishings in kind, awarded damages for value of Mercedes automobile wrongfully taken from her possession by husband and denied claim of husband's partnership to ownership of household furnishings used by the spouses during marriage. Wife appealed, husband appealed on crosspoints and partnership appealed on crosspoint. The Court of Appeals, Stewart, J., held that: (1) wife was not entitled to reimbursement for gifts to husband's daughter and grandson; (2) wife was entitled to reimbursement to community for funds used to pay husband's separate income tax debt; (3) wife's business debts were community debts; (4) trial court erred in treating household furnishings as community property, necessitating remand; (5) wife had no usufructuary or other right to Mercedes automobile; (6) trial court mischaracterized husband's partnership distributions as separate property; and (7) in light of mischaracterizations, entire property and debt division, including attorney fee award, would be remanded for redivision.

Affirmed in part, reversed and rendered in part and reversed and remanded in part.

West Headnotes (28)

[1] Contracts
   ● Duration of Contract in General

[2] Divorce
   ● Resumption or offer of marital relations

First divorce of husband and wife was the ascertainable contingency which determined duration of their separate property agreement, executed less than two months after first marriage, and agreement therefore had no bearing on either the parties' second marriage or their second divorce, since it was unreasonable to assume that in executing the agreement they anticipated series of remarriages and divorces.

1 Cases that cite this headnote

[3] Divorce
   ● Businesses and associated assets in general

Husband did not retain an ownership interest in his separate contribution to capital of oil and gas partnership, in that the partnership entity itself became the owner, and there was no “mutation” of husband's separate contribution; rule of mutation was therefore inapplicable in determining characterization of partnership distribution to husband from partnership capital account, for purposes of divorce proceeding involving wife who was not a partner. Vern's Ann.Texas Civ.St. art. 6132b, §§ 8, 26, 28–A.

4 Cases that cite this headnote

   ● Rents, profits, and products of separate property
Partnership's receipt of proceeds from production of gas and oil was not subject to characterization as “separate” or “community” property for purposes of divorce proceeding involving husband's partnership interest, contrary to husband's claim that rule of mutation would render the proceeds “separate” in character if they were traceable from husband's separate property. Vernon's Ann.Texas Civ.St. art. 6132b, §§ 8, 26, 28–A.

Cases that cite this headnote

[5] Husband and Wife
Rents, profits, and products of separate property
Husband and Wife
Earnings of husband or wife

Partnership distributions from husband's interest in partnership, received by him during marriage, were either salary under partnership agreement or distribution of profits, for purposes of characterizing the property as separate or community, where all monies disbursed by partnership were from current income and partnership agreement provided that any and all distributions above named salary would be charged against partner's share of profits of the business. Vernon's Ann.Texas Civ.St. art. 6132b, §§ 8, 26, 28–A.

7 Cases that cite this headnote

[6] Divorce
Businesses and associated assets in general

Oil and gas partnership's bookkeeping device of allocating to salary partner's withdrawals in excess of copartners, did not alter provisions of partnership agreement, and the withdrawals were therefore distributions of partnership income or profits, for purposes of divorce proceeding. Vernon's Ann.Texas Civ.St. art. 6132b, §§ 8, 26, 28–A.

[7] Husband and Wife
Rents, profits, and products of separate property

Husband's withdrawals from partnership interest in oil and gas partnership during marriage were distributions of partnership income or profit and thus “community” in nature, notwithstanding that wife was not a partner and that husband had acquired his interest in partnership prior to the marriage. Vernon's Ann.Texas Civ.St. art. 6132b, §§ 8, 26, 28–A.

5 Cases that cite this headnote

[8] Divorce
Hearing
Evidence
Opinions of Witnesses in General
Husband and Wife
Particular property

Husband's testimony in divorce proceeding as to consumption of community distributions during marriage had no probative value because it was based on his lay conclusion concerning characterization of the property at issue, which was a question of law reserved for the court.

Cases that cite this headnote
Trial court's finding in divorce proceeding that spouses consumed all community distributions of husband's interest in partnership during marriage was error, since court's finding addressed only portion of income attributable to community labor and since husband's "consumption" contention addressed only $328,067 of total disbursement of $542,315.72.

Funds disbursed by husband's partnership to pay his separate tax debt during marriage was revenue acquired during marriage and consequently community property for purposes of divorce proceeding, thus subject to wife's claim for reimbursement for one half of money paid for husband's taxes. V.T.C.A. Family Code §§ 5.01(b), 5.02.

On a showing of constructive fraud, the burden is on the donor to prove that the gifts of his or her share of community property are fair; otherwise the gift will be set aside.

Primary factors considered in determining whether a wife's claim of constructive fraud exists in regard to gifts made from community property are the size of the gift in relation to the total size of the community estate, the adequacy of the estate remaining to support the wife in spite of the gift and the relationship of the donor to the donee.
Husband's gifts during marriage to his daughter and his grandson, from community funds, did not constitute constructive fraud, and wife was not entitled to reimbursement in divorce for the gifts, where gifts amounted to only 11.7% of amounts received during marriage as husband's special community property, remaining community funds were sufficient to support wife, gifts were made to natural objects of husband's bounty and there was no evidence of intent to deceive wife by making the gifts.

1 Cases that cite this headnote

[15] Courts  Other particular matters, rulings relating to

A provision in an agreed temporary order in divorce proceeding indicating which debts a spouse will be responsible for during pendency of case neither binds trial court in its division of property and debts after trial on the merits nor transforms community debts into separate debts of the spouse incurring them.

3 Cases that cite this headnote

[16] Divorce  Other particular and multiple debts

Trial court's temporary order in divorce proceeding that each party would be responsible for debts incurred on or after a specified date did not control court's subsequent division of property or change characterization of wife's business debts incurred during marriage, and such debts constituted "community" debt for purposes of final property division.

Cases that cite this headnote

[17] Divorce  Distribution in kind

Wife failed to show that divorce court abused its discretion by dividing in kind the household furnishings of the parties. V.T.C.A., Family Code § 3.63.

Cases that cite this headnote

[18] Husband and Wife  Property acquired by gift

When a third party attempts to make a gift to a community estate, the gift vests in each marital spouse, both taking a one-half undivided interest in the subject matter of the gift as his or her separate property.

Cases that cite this headnote

[19] Husband and Wife  Particular property

Evidence that husband's separate partnership owned spouses' household furnishings prior to marriage and that partnership continued to carry furnishings as an asset on its books and records after furnishings had been moved into spouses' home was sufficient to rebut presumption that furnishings were "community property" for purposes of divorce proceeding.

Cases that cite this headnote

[20] Divorce  Marital or separate property
Even though furnishings provided to marital home by husband's separate partnership were not community property, evidence was conflicting as to whether partnership lent or gave furnishings to husband and wife, necessitating remand in divorce proceeding for determination of whether furnishings were owned by partnership or, as an attempted gift to community estate, subject to one-half undivided interest of each marital spouse as his or her separate property.

Right to drive Mercedes automobile owned by husband's partnership was not a tangible profit and therefore not a “usufruct” to wife for purposes of divorce proceeding.

A “usufruct” is the right of using and enjoying and receiving the profits of property that belongs to another, and a “usufructuary” is a person who has the usufruct or right of enjoying anything in which he has no property interest.

Trial court's order directing husband to pay wife for wrongful termination of her usufructuary right in Mercedes owned by husband's partnership was error, and wife had no claim on Mercedes in divorce proceeding, since her right to drive the car was not a usufruct, and husband's retaking of possession did not constitute conversion.

There are three types of “usufructs”: natural profits produced by the subject of the usufruct, industrial profits produced by cultivation, and civil profits, which are rents, freights and revenues from annuities and from other effects or rights.

Entry of a final judgment inconsistent in its terms with an earlier temporary order operates to set aside the temporary order.

A trial court may award attorney's fees as part of the division of the community estate in a divorce proceeding.
Trial court was authorized to award attorney fees as part of division of community estate in divorce proceeding, and order that husband pay attorney fees to wife's attorneys, on finding that agreed temporary orders were inapplicable to fees of wife's attorneys but were applicable to fees of husband's attorney, was not error.

Evidence supported finding that fee award to wife's attorneys in divorce proceeding was reasonable and necessary, where wife's first attorney testified explicitly that services she performed for wife were reasonable and necessary, and wife's second attorney testified that his fees were reasonable and his services were necessary.

ARLENE'S REIMBURSEMENT CLAIMS

In her first point of error, Arlene argues that the trial court incorrectly characterized the disbursements by the partnership to Woody as his separate property and that, as a result, the trial court abused its discretion in denying her claim that Woody should be ordered to reimburse the community for (1) $125,375.50 of community funds used to pay Woody's 1982 taxes, a separate debt incurred before the marriage, and (2) $63,325.58 of community funds that Woody gave to his daughter during the marriage.
EXTENT OF COMMUNITY EARNINGS

To resolve Arlene's contentions, we must first determine the extent of the community earnings during the marriage. The partnership disbursed $542,315.72 to Woody during the marriage. The partnership records and Woody's tax returns reflect that some amounts were distributed as “salary” and other amounts were distributed as “distributions of profits.” Woody argues that only $22,400 of the amount disbursed was salary and that the rest was a return of capital and, therefore, his separate property. Arlene argues that all the disbursements were either salary or distributions of profits and, therefore, community.

Arlene first argues that all partnership disbursements to Woody during marriage were community property because they were acquired during the marriage, TEX. FAM. CODE ANN. § 5.01(b) (Vernon 1975), and, therefore, are presumed to have been community property. Id. § 5.02. She further contends that whatever is earned from the labor and effort of either spouse is community property. Givens v. Girard Life Insurance Co., 480 S.W.2d 421, 423 (Tex.Civ.App.—Dallas 1972, writ ref’d n.r.e.); thus, all the disbursements are community property because they are compensation for Woody's labor and effort on behalf of the partnership. Finally, she maintains that the partnership distributions are revenues and profits from Woody's separate property, thereby making them community property, Arnold v. Leonard, 114 Tex. 535, 273 S.W. 799 (1925); consequently, whether classified as “distributions of profits” or “salary,” all disbursements are community.

Woody brings three responses to justify the separate property characterization of the trial court. First, he argues that he and Arlene entered into a prior separate property agreement providing that all income arising from separate property owned or acquired by either spouse would be the separate property of said spouse. Second, he argues that the distributions from the partnership were distributions of capital and were, therefore, his separate property. Third, he contends that all community property distributions to him and to Arlene were first consumed by them.

SEPARATE PROPERTY AGREEMENT

We first consider whether the separate property agreement (the agreement) has any bearing on the present case. The parties were first married on April 26, 1982. On June 14, 1982, they executed a separate property agreement, which provides: “All income and/or property arising from the separate property now owned by [said spouse] or hereafter acquired by [said spouse], shall be the sole and separate property of [said spouse].” The October 15, 1982, judgment of divorce recited that the agreement was valid.

Approximately five months later the parties remarried, and it is from this marriage that the parties seek a divorce and a property division. Arlene's brief ignores the existence of the agreement; Woody's argues that the agreement is still in effect.

Woody relies primarily upon Sorrels v. Sorrels, 592 S.W.2d 692 (Tex.Civ.App.—Amarillo 1979, writ ref'd n.r.e.). In Sorrels, the property settlement incident to the parties' first divorce required Mr. Sorrels to pay alimony to Mrs. Sorrels after the divorce. It further provided that “should [Mrs. Sorrels] remarry, such remarriage shall have no effect upon obligations of [Mr. Sorrels] to make the aforesaid payments.” Mr. and Mrs. Sorrels subsequently remarried and divorced for a second time, and Mr. Sorrels argued that the second marriage invalidated the payment obligations. The court disagreed. The agreement had whatever legal force the law of contracts would give it. Id. at 696.

Sorrels is distinguishable. In Sorrels, the agreement specifically stipulated that a subsequent remarriage would have no bearing on the alimony payments. In the present case, no express provision provides for the termination or continuation of the agreement.

[1] When the duration of the contract is not expressly dictated by the agreement, courts will frequently presume that the parties intended that the agreement should continue for a reasonable time. Beckner v. Barrett, 81 S.W.2d 719 (Tex.Civ.App.—Dallas 1935, writ dism'd w.o.j.). When it appears, from the intrinsic nature of the agreement, that an agreement is necessarily limited as to duration by the happening of any one of several contingencies, this ascertainable contingency determines the duration. See Brittain v. General Telephone Co., 533 S.W.2d 886 (Tex.Civ.App.—Fort Worth 1976, writ dism'd w.o.j.); Kennedy v. McMullen, 39 S.W.2d 168 (Tex.Civ.App.—Beaumont 1931, writ ref'd).

[2] The agreement in this case was executed less than two months after the first marriage. The agreement recites:

WHEREAS, JOSEPH WOODROW MARSHALL and ARLENE O'BRIEN MARSHALL were married on April 26, 1982, and are now husband and wife;
WHEREAS, at the time of said marriage each owned separate property and each expects that each might hereafter acquire separate property; and

WHEREAS, both desire the income and/or property arising from all of the respective separate property now owned or which hereinafter might be acquired by each shall be the respective separate property of each, it is therefore agreed between them as follows:....

(Emphasis added.) We conclude from these provisions that the parties were contracting in relation to the existing marriage only. It is unreasonable to assume that they anticipated a series of remarriages and divorces. The first divorce is the ascertainable contingency that determined the duration of the agreement; consequently, the agreement has no bearing on either the second marriage or the second divorce. The agreement does not justify the trial court's separate characterization of the partnership distributions.

DISTRIBUTIONS FROM CAPITAL

Woody's second response is that the distributions from the partnership, other than the salary in the partnership agreement, were from his capital account and were, therefore, his separate property. We develop *593 Woody's argument and the reasons why we disagree with it below.

The partnership engaged in the business of exploring for, developing, and producing oil and gas. The partnership acquired all its oil and gas leases before the second marriage. The partnership agreement provides that it will pay Woody $700 in salary per month. For the duration of the marriage, the amount comes to $22,400. The partnership agreement also provides that all other distributions are from the distributee's share of the profits. The partnership disbursed $542,315.72 to Woody during the marriage. Woody maintains that only $22,400 was community property and that the rest was a return of capital.

The Texas Uniform Partnership Act (UPA) provides that unless the partners agree otherwise, no partner is entitled to remuneration for acting in the partnership business and that each partner is to share equally in the profits. TEX.REV.CIV.STAT.ANN. art. 6132b, § 18(1)(a) & (f) (Vernon 1970). Because the agreement is controlling, Woody concedes that the $22,400 is community.

Woody next points to Norris v. Vaughan, 152 Tex. 491, 260 S.W.2d 676 (1953). In Norris, the husband owned a separate determinable fee interest in the Pakan wells and an interest in a separate partnership that was in the sole business of acquiring gas wells, drilling under lease agreements, and selling the gas. The Texas Supreme Court held that the proceeds from the production and sale of oil and gas from the Pakan wells and from the three leases acquired by the partnership before the husband's marriage were the husband's separate property.

The supreme court applied the aggregate theory of partnership and treated the individual partners as owners of the partnership property. Thus, the court characterized partnership property as separate or community, depending upon whether the partnership acquired its property rights before or after the marriage of the partner/husband. Because the husband had acquired his interest in the partnership before the marriage, that interest was his separate property. Likewise, because the partnership had owned its interest in three producing gas wells prior to the husband's marriage, the court held that the husband's interest in the three wells was his separate property and the gas produced from them was "an invasion of the assets comprising [husband's] separate estate." Id. at 681. The court further held that the proceeds from the sale of oil and gas produced from separate property remains separate so long as the oil and gas can be definitely traced and identified. The court reasoned that, since oil and gas in place are part of the corpus of the land, when they are produced, they simply undergo a mutation. Similarly, when the oil and gas production is sold, the proceeds are derived from the piecemeal sale of a separate asset, the corpus of land, and remain separate property. Id. at 679–80.

Woodo contends that the Norris v. Vaughan analysis is applicable in this case because it is undisputed that his partnership interest is his separate property, that the primary business of the partnership is production of oil and gas, that all the partnership leases were acquired prior to marriage, and that the proceeds from the sale of oil and gas are simply mutations of the oil and gas in place, and, therefore, all partnership proceeds from these sales distributed during the marriage remain his separate property.

Arlene has two responses. First, she argues that the adoption of the Uniform Partnership Act in 1961 has amended Norris. Second, she contends that because Woody's tax returns and the partnership's own records reflect that Woody received...
$334,891 in salary for the years 1983 and 1984, Woody cannot now gainsay them. Arlene emphasizes that whether the distributions are for salary or from partnership profits makes no difference, since both salary and profits from separate property become community property. Trawick v. Trawick, 671 S.W.2d 105, 109 (Tex.App.—El Paso 1984, no writ).

With the passage of the Uniform Partnership Act in 1961, Texas discarded the aggregate theory and adopted the entity *594 theory of partnership. Under the UPA, partnership property is owned by the partnership itself and not by the individual partners. In the absence of fraud, such property is neither community nor separate property of the individual partners. A partner's partnership interest, the right to receive his share of the profits and surpluses from the business, is the only property right a partner has that is subject to a community or separate property characterization. TEX.REV.CIV.STAT.ANN. at 6132b §§ 8, 26, & 28–A; Note, Community Rights and the Business Partnership, 57 TEXAS L.REV. 1018, (1979); Bromberg, Commentary on the Texas Uniform Partnership Act, 17 TEX.REV.CIV.STAT.ANN. 300–01 & 321 (Vernon 1970). Further, if the partner receives his share of profits during marriage, those profits are community property, regardless of whether the partner's interest in the partnership is separate or community in nature. TEX.FAM.CODE ANN. § 5.01(b) (Vernon 1975); Arnold v. Leonard, 273 S.W. at 799; Note, 57 TEXAS L.REV. at 1032.

The supreme court recognized the changes in partnership law wrought by the adoption of the UPA in McKnight v. McKnight, 543 S.W.2d 863 (Tex.1976). There the court determined that the only partnership-related property a trial court can award upon dissolution of a partner's marriage is the partnership interest. Id. at 867–68; see Haney v. Fealey, Bate, Deaton & Porter, 618 S.W.2d 541, 542 (Tex.1981).

Initially, we note that according to the partnership records, Woody's distributions were a series of draws allocated to him, Arlene, and Debra (Woody's daughter), many of which were based on payments by the partnership to personal creditors on behalf of one of these three. The major “distribution” each year was the partnership's payment of Woody's individual income tax liability. It is true that a portion of the distributions was closed to Woody's capital account at the end of the year, but this was simply a bookkeeping entry after the fact.

The amount closed to the capital accounts of both partners, Woody and his ex-wife, Ruby, was based on the total of their draws for the year. In this manner the accountant determined their personal income and their income tax thereon; the accountant then had the partnership pay their personal income tax. These amounts are reflected on the partnership returns as “withdrawals and distributions” in the reconciliation of the partners' capital accounts. Woody's draws throughout each year at issue, and historically, always exceeded Ruby's. Consequently, Woody's excess draws were allocated to salary for Woody on the partnership books and reported as “guaranteed payments for partners” on the partnership tax returns. Woody reported all disbursements received from the partnership, either directly or indirectly, as ordinary income on the spouses' joint tax returns for 1983 and 1984.

[3] Woody apparently relies on the rule that mutations of separate property remain separate if properly traced. Norris, 260 S.W.2d at 679. However, a withdrawal from a partnership capital account is not a return of capital in the sense that it may be characterized as a mutation of a partner's separate property contribution to the partnership and thereby remain separate. Such characterization is contrary to the UPA and implies that the partner retains an ownership interest in his capital contribution. He does not; the partnership entity becomes the owner, and the partner's contribution becomes partnership property which cannot be characterized as either separate or community property of the individual partners. TEX.REV.CIV.STAT.ANN. art. 6132b, §§ 8, 25, & 28–A(1) (Vernon 1970); Bromberg, 17 TEX.REV.CIV.STAT.ANN. at 300–01. Thus, there can be no mutation of a partner's separate contribution; that rule is inapplicable in determining the characterization of a partnership distribution from a partner's capital account.

[4] [5] Further, the Norris v. Vaughan characterization of proceeds from the production of oil and gas is inapplicable to a partnership receipt of such proceeds, for they are simply partnership property and are not subject to characterization as separate *595 or community property. TEX.REV.CIV.STAT.ANN. art. 6132b, §§ 8, 25, & 28–A(1) (Vernon 1970); McKnight v. McKnight, 543 S.W.2d at 867; Bromberg, 17 TEX.REV.CIV.STAT.ANN. at 300–01. In this case, all monies disbursed by the partnership were made from current income. The partnership agreement provides that “any and all distributions ... of any kind or character over and above the salary here provided ... shall be charged against any such distributee's share of the profits of the business.” Under these facts, we hold that all of the partnership distributions that Woody received were either salary under the partnership agreement or distributions of profits of the partnership.

[6] [7] Although the partnership utilized the bookkeeping device of allocating to salary Woody's withdrawals that were
in excess of Ruby's, that device does not make such distributions “salary” contrary to the partnership agreement. The withdrawals nevertheless were distributions of partnership income or profits and, thus, community. We hold that all distributions by the partnership to Woody during the course of the second marriage were community property. Woody's second argument in support of the trial court's separate characterization of the partnership distributions is overruled.

CONSUMPTION OF COMMUNITY DISTRIBUTIONS DURING THE MARRIAGE

Finally, Woody argues that regardless of whether his partnership distributions during marriage were separate or community, the spouses consumed all income during the marriage. Therefore, argues Woody, any mischaracterization of these distributions was harmless error. Woody relies upon (1) the trial court's finding that “all income received by the community in exchange for community labor was consumed during the marriage,” (2) Arlene's reliance on his testimony that he and she “might have some community property in a house on Bonnard Street. That would be all I know of,” and (3) Woody's own analysis of the distributions, which results in a maximum total community income of $328,067.

We disagree with Woody; the evidence does not show that the spouses consumed all income during the marriage. First, the finding of the trial court addresses only the portion of the income attributable to community labor and fails to address other income received by the community. Second, Woody's testimony has no probative value on the issue because it is based on his lay conclusion concerning the characterization of the property at issue, which is a question of law reserved for the court to decide. Third, we held earlier that the partnership disbursed $542,315.72 to Woody, all of which was community income. Woody's analysis addresses only $328,067 of that amount, which still leaves $214,248.72 of community income unaccounted for. Consequently, we hold that the evidence does not show that the spouses consumed all income during the marriage and that the trial court's mischaracterization of the partnership distributions is not harmless error. Woody's argument that the spouses consumed all community income during the marriage is overruled.

WOODY'S 1982 TAX DEBTS

Having determined that all partnership distributions to Woody during the marriage were community property, we turn to Arlene's contention that the community should be reimbursed for the $125,375.50 that the partnership paid during the marriage for the balance due on Woody's 1982 taxes. It is undisputed that Woody's 1982 tax liability was his separate debt. This payment was charged to Woody's account by the partnership and became part of the total funds distributed to Woody during the marriage. Woody and Arlene reported this figure as part of their income on their joint 1983 tax return, and the community paid taxes on it. The trial court found that the source of the funds used by the partnership to pay Woody's 1982 taxes was the “proceeds of production which were earned prior to marriage.” It further found, “[T]he payment [of the taxes] by the partnership gives rise to no *596 claim to Arlene Marshall upon which relief can be granted.” It is evident from these findings that the trial court denied Arlene's claim for reimbursement regarding these funds because the trial court concluded that the funds could be characterized as separate or community depending upon when the partnership earned them. This finding is based on the Norris v. Vaughan rationale. The partnership funds used to pay Woody's 1982 taxes were neither separate nor community until the partnership disbursed the money for the taxes. At that point, the money became revenue acquired during marriage from Woody's separate partnership interest; consequently, the funds were community property. TEX.FAM.CODE ANN. §§ 5.01(b) & 5.02 (Vernon 1975); Arnold v. Leonard, 273 S.W. at 802. Accordingly, we remand Arlene's claim for reimbursement for one half of the money paid for Woody's 1982 taxes to the trial court for its redetermination in light of our holding that these funds were community property.

GIFTS TO WOODY'S DAUGHTER

Arlene also maintains that the community is entitled to reimbursement for funds that Woody gave to his daughter, Debra, and her son, Dustin, during the marriage. She asserts that the evidence reveals that Woody, or the partnership on his behalf, gave Debra and Dustin community funds totaling $103,235.44 during the marriage; that the community received benefits from exemptions and deductions on the parties' joint tax returns for 1983 and 1984 of $38,909.86; and that the balance of $64,325.88 was composed of gifts which were unfair and which constituted constructive fraud on the community.

Although the trial court made no specific finding regarding whether the gifts were made from separate or community funds, it found in relation to the gifts:

A. No dishonesty of purpose or intent to deceive Arlene Marshall;
B. That the transfers were not made with the primary purpose of depriving Arlene Marshall from having the use and enjoyment of the assets comprising the transfer;

D. No breach of a fiduciary relationship which resulted in injury. Based upon the above findings of fact, the court also finds no fraud either actual or constructive.

From these findings, we conclude that the trial court assumed that the gifts were made from community funds in ruling on Arlene's claim for reimbursement based on these gifts. Therefore, we need not remand this claim, as we have the claim for reimbursement for the 1982 tax payment, because of a mischaracterization of funds used.

Arlene argues that the trial court erred in placing the burden on her to prove constructive fraud because the law presumes constructive fraud when a spouse makes gifts to a stranger to the marriage. She further relies on the trial court's statement, "[T]here's already evidence in this trial that Mrs. Marshall did not actively consent to the giving of those gifts to the daughter." Finally, she maintains that there is insufficient evidence to support a finding that the gifts were fair.

We agree that when there is constructive fraud, the burden is on the donor to prove that the gifts of his or her share of the community property are fair; otherwise the gift will be set aside. Horlock v. Horlock, 533 S.W.2d 52, 55 (Tex.Civ.App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.). The courts consider three primary factors in determining whether the wife's claim of constructive fraud exists: the size of the gift in relation to the total size of the community estate, the adequacy of the estate remaining to support the wife in spite of the gift, and the relationship of the donor to the donee. Id.

We conclude that the evidence supports the trial court's finding of no constructive fraud, but only that none exists. Therefore, we sustain Arlene's second point of error.

II.

LTC DEBTS

In point of error two, Arlene contends that the trial court incorrectly ruled that the community estate is not liable for all unpaid debts of the business Leasing Telephone Concepts, Incorporated (LTC), including those incurred after June 25, 1984. Arlene began LTC in May of 1984. The trial court signed an agreed temporary order on August 17, 1984, that provided, "Each party shall be responsible for the debts incurred by him or her on or after June 25, 1984." Arlene terminated LTC in December 1984, at which time LTC was indebted in the amount of $60,000. The trial court ruled that the $60,000 debt of LTC was Arlene's responsibility by virtue of the August 17, 1984, temporary order.

In its finding, the trial court found that the August 17 order provided, "[E]ach party will be solely liable for any debt incurred by them subsequent to June 25, 1984." (Emphasis added.) This finding is a misstatement of the terms of the order. The trial court also found that this provision "controlled" these subsequent debts. In the judgment, the court characterized the debts incurred by Arlene after June 25, 1984, including those debts associated with LTC, as her separate debts and obligations. Arlene contends that this mischaracterization of the LTC debt as her separate debt resulted in the trial court's abusing its discretion in dividing the community debts and that this part of this case should be reversed and remanded.

We agree with Arlene that a provision in an agreed temporary order indicating which debts a spouse will be responsible for during the pendency of the case neither binds the trial court in its division of property and debts after a trial on the merits nor transforms community debts into the separate debts of the spouse incurring them. It is undisputed that the LTC debt was incurred during marriage and that, but for the agreed temporary order, it should be characterized as a community debt. Because we conclude the temporary order is not controlling, we hold that the LTC debt is a community debt. We sustain Arlene's second point of error.
III.

HOUSEHOLD FURNISHINGS

[17] In point of error three, Arlene contends that the trial court abused its discretion by dividing in kind the household furnishings located at the house on Bonnard Drive. Arlene argues that no evidence supports a division in kind, and, in any event, the division of the furnishings was neither just nor right, as required by section 3.63 of the Texas Family Code. The trial court's division of marital property will not be disturbed on appeal absent a showing of an abuse of discretion. Murff v. Murff, 615 S.W.2d 696, 698 (Tex.1981). This court must indulge every reasonable presumption in favor of a proper exercise of discretion by the trial court in dividing property. Van Dyke v. Van Dyke, 624 S.W.2d 800 (Tex.Civ.App.—Houston [14th Dist.] 1981, no writ). Arlene has failed to show that the trial court abused its discretion in dividing the household furnishings. Her third point of error is overruled.

In the partnership's cross-point one, it argues that the trial court erred in finding that the evidence failed to rebut the presumption that the furnishings belonged to the community and erred in awarding Arlene the furnishings listed in part II of exhibit A to the decree of divorce. The partnership attacks the trial court's findings *598 as erroneous in that the unrefuted evidence establishes that the furnishings belong to the partnership and, furthermore, as a matter of law one cannot make a gift of property to the community estate. For the reasons given below, we hold that the trial court erred in ruling that the evidence failed to rebut the community presumption.

[18] [19] Two possible scenarios exist. First, the partnership merely lent the furnishings. Second, the partnership made a gift of the furnishings. However, if the partnership intended a gift to the community, as Arlene contends, a gift to the community does not result; rather, when a third party attempts to make a gift to the community estate, the gift vests in each marital spouse, both taking a one-half undivided interest in the subject matter of the gift as his or her separate property. McLemore v. McLemore, 641 S.W.2d 395, 397 (Tex.Civ.App.—Tyler 1982, no writ); Ramsower v. Pieper, 114 S.W.2d 1188 (Tex.Civ.App.—Austin 1938, no writ)(applied to gift of personal property). Consequently, under either scenario, the furnishings do not become community property. The evidence is sufficient to rebut the presumption that the furnishings were community property. We sustain the partnership's cross-point one in this regard.

[20] However, the partnership contends that we should render judgment declaring that it owns the furnishings. We overrule this contention. Although we have determined that the furnishings do not belong to the community, the question remains whether the partnership lent or gave the furnishings to Arlene and Woody. As the evidence is conflicting, the trial court is the proper court to resolve this question of fact. We remand this issue to the trial court for its determination.

IV.

THE MERCEDES

In her fourth point, Arlene contends that there is no evidence to support the judgment of the trial court that only $5,500 represents the value of the Mercedes wrongfully taken by Woody from Arlene's possession. The partnership maintains that it owned the Mercedes prior to the parties' marriage and that Woody permitted Arlene merely to use the Mercedes. Woody denies giving Arlene the car. The trial court decided sua sponte that Woody gave Arlene a usufruct that was her sole and separate property and that Woody wrongfully terminated her usufruct. Woody brings a cross-point wherein he argues that the trial court erred in finding a usufruct. In the alternative, the partnership and Woody argue that if Arlene did have a usufructuary right that Woody wrongfully terminated, then the trial court correctly found that Woody should pay Arlene only $5,500 in damages for its wrongful termination.

[21] No usufruct is involved in the present case. A usufruct is the right of using and enjoying and receiving the profits of
property that belongs to another, and a usufructuary is a person who has the usufruct or right of enjoying anything in which he has no property interest. In re Adjudication of the Water Rights of the Upper Guadalupe Segment of the Guadalupe River Basin, 642 S.W.2d 438, 444 (Tex.1982) (Texas Supreme Court relies upon Sparks v. Spence, 40 Tex. 693 (1874), and Cartwright v. Cartwright, 18 Tex. 626 (1857)); Sparks, 40 Tex. at 700; *599 Kelly v. Lansford, 572 S.W.2d 369, 372 (Tex.Civ.App.—Fort Worth 1978, writ ref'd n.r.e.) (court relies upon C.J.S.); 91 C.J.S. Usufruct 550 (1955) (C.J.S. relies upon Sparks, 40 Tex. at 700, and Cartwright, 18 Tex. at 628).

Three types of usufructs exist. First, there are the natural profits produced by the subject of the usufruct. For example, the profits produced spontaneously by the earth or animals, such as timber, herbs, fruit, wool, milk, and the young of cattle are natural. Second, there are industrial profits, which are profits produced by cultivation, such as crops of grain. Third, there are civil profits, which are rents, freights, and revenues from annuities and from other effects or rights. Cartwright v. Cartwright, 18 Tex. 626, 628 (1857) (Texas Supreme Court relies upon Cartwright for another proposition in Kelly v. Kelley, 714 S.W.2d 303, 308 (Tex.1986)). A usufruct is a right to profits or something tangible originating from other property. The right to drive the partnership Mercedes is not a tangible profit; therefore, Arlene's right to drive the partnership Mercedes is not a usufruct.

Arlene argues simply that the unclaimed depreciation of the Mercedes was $10,833.33, not $5,500. She does not argue that the trial court erred in ruling that she received only a usufruct to the Mercedes and not the Mercedes itself. Because we hold that there is no usufruct and because Arlene does not complain of the trial court's implied finding that the partnership did not give the Mercedes itself to her, we hold that the Mercedes belongs to the partnership and that, therefore, when Woody retook possession of it, he did not commit conversion. Accordingly, we reverse the trial court's judgment ordering Woody to pay Arlene $5,500 for the wrongful termination of her usufructuary right in the Mercedes, and we render judgment that Arlene take nothing on her Mercedes claim.

V.

AWARD OF ATTORNEY'S FEES

In Woody's final cross-point, he contends that the trial court erred in finding the agreed August 17, 1984, temporary orders were inapplicable to the attorney's fees of Arlene's attorney, but were applicable to the attorney's fees of Woody's attorney. The trial court ordered Woody to pay $12,500 in attorney's fees to Arlene's attorney. Woody contends that under the terms of the temporary order and as a matter of law Arlene's attorney's fees are her sole responsibility. The entry of a final judgment inconsistent in its terms with an earlier temporary order operates to set aside the temporary order. Cf. Hill v. Robinson, 592 S.W.2d 376 (Tex.Civ.App.—Tyler 1979, writ ref'd n.r.e.) (final judgment and interlocutory judgment). The trial court may award attorney's fees as part of the division of the community estate. See Murff v. Murff, 615 S.W.2d at 699. Woody's cross-point is overruled.

In his final cross-point, Woody also argues that there was no evidence that the $2,500 fee to Arlene's first attorney was reasonable and necessary and that there was no evidence that the $10,000 fee to Arlene's second attorney was reasonable and necessary. When deciding a “no evidence” question, appellate courts are to consider only the evidence and the inferences tending to support the finding and to disregard all evidence and inferences to the contrary. Mitsubishi Aircraft International, Inc. v. Maurer, 675 S.W.2d 286 (Tex.App.—Dallas 1984, no writ). Arlene's first attorney testified explicitly that the services she performed for Arlene were reasonable and necessary. Arlene's second attorney testified that his fees were reasonable and his services were necessary. Woody's final cross-point is overruled.

Regarding Arlene's first point of error, which complains of the denial of her reimbursement claims, we affirm the trial court's denial of Arlene's claim for reimbursement for gifts to Woody's daughter and grandson. We reverse the trial court's denial of Arlene's claim for reimbursement to the community for $125,375.50 used to pay Woody's 1982 income tax and remand *600 this claim to the trial court for its reconsideration in the light of this opinion.

In point of error two, Arlene contends that the trial court improperly characterized the LTC debts, including those incurred after June 25, 1984, as her separate obligation. We reverse the trial court's determinations that the LTC debts were Arlene's separate debts.

CONCLUSION
Regarding the furnishings, the subject of Arlene's third point of error and the partnership's first cross-point, we reverse the trial court's treatment of the furnishings as community property. We remand the matter of the furnishings to the trial court for it to determine whether the partnership lent or gave the furnishings to Arlene and Woody.

Arlene's fourth point of error and Woody's first cross-point address the trial court's ruling that Woody wrongfully terminated Arlene's usufructuary right to the Mercedes. We reverse the trial court's judgment awarding Arlene $5,500 for the wrongful termination of her usufructuary right in the Mercedes, and we render judgment that Arlene take nothing on her Mercedes claim. We overrule Woody's second cross-point, which attacks the trial court's award of Arlene's attorney's fees.

Because the trial court mischaracterized Woody's partnership distributions as his separate property, the LTC debts as Arlene's separate liability, and the furnishings as community property, we reverse and remand the entire property and debt division, including the award of attorney's fees incident thereto, to the trial court for its redivision in light of this opinion. McKnight v. McKnight, 543 S.W.2d at 868.

All Citations

735 S.W.2d 587

Footnotes

1 Arlene does not complain of the trial court's finding of no actual fraud.

Wife appealed from final judgment of the 309th District Court, Harris County, John D. Montgomery, J., in divorce action, on ground that trial judge mischaracterized certain of her husband's assets as his separate property. The Court of Appeals, Draughn, J., held that: (1) definition of separate property in charge to jury did not warrant reversal; (2) evidence supported separate property characterization of distribution of husband's partnership interest in his former law firm and in firm's contingent fee arrangement for representation of heirs of large estate; and (3) any finding in response to special issue as to whether entity referred to was partnership was immaterial to judgment in case.

Affirmed.

West Headnotes (19)

[1] Trial Submission to jury for special findings

The only function of explanatory instruction or definition in charge is to aid and assist jury in answering issues submitted.

15 Cases that cite this headnote

[2] Trial Submission to jury for special findings

Trial court has considerably more discretion in submitting instructions and definitions than it has in submitting special issues.

33 Cases that cite this headnote

[3] Trial Submission to jury for special findings

Definitions shall be given in charge as necessary to enable jurors to understand legal words or phrases used so that they may properly answer special issues and render verdict in case; test of sufficiency of definition is its reasonable clarity in performing this function.

14 Cases that cite this headnote


Explanatory instruction is improper only if it misstates law as applicable to facts.

4 Cases that cite this headnote

[5] Divorce Instructions

Definition of separate property included in charge to jury in divorce action did not warrant reversal; definition given was correct legal definition of marital property, and it was highly possible that jury's understanding of concept of separate property would be aided by example included even though that inclusion was not mandated by the facts. Vernon's Ann.Texas Const. Art. 16, § 15; V.T.C.A., Family Code § 5.01.

Cases that cite this headnote
Party to divorce action claiming that property is separate has burden to overcome by clear and convincing evidence the presumption that property possessed by either spouse during or on dissolution of marriage is community property and must trace and clearly identify that property.

V.T.C.A., Family Code § 5.02.

5 Cases that cite this headnote

If separate property and community property have been so commingled as to defy resegregation and identification, the statutory presumption of community property status prevails; however, when separate property has not been commingled or its identity as such can be traced, statutory presumption is dispelled. V.T.C.A., Family Code § 5.02.

3 Cases that cite this headnote

Once determined, character of marital property is not altered by sale, exchange, or substitution; property established to be separate remains so regardless of fact that it undergoes mutations and changes in form.

2 Cases that cite this headnote

Under “entity theory” of partnership, partnership property is owned by partnership entity rather than by individual partners. Vernon's Ann.Texas Civ.St. art. 6132b, § 1 et seq.

2 Cases that cite this headnote

Only partnership property right that partner has which is subject to community or separate property characterization is partner's interest in partnership—i.e., partner's right to receive share of partnership profits and surplus. V.T.C.A., Family Code § 5.01(b).

1 Cases that cite this headnote

Presumption that property possessed by either spouse during or on dissolution of marriage is community property is not evidence, ceases to exist upon introduction of positive evidence to the contrary, and is not then to be weighed or treated as evidence. V.T.C.A., Family Code § 5.02.

3 Cases that cite this headnote

Time when character determined; continuance of character

Effect of change of form and commingling

12 Cases that cite this headnote
Distributions of partner's share of profits and surplus (income) received during marriage are community property even if partner's interest in partnership is separate property. V.T.C.A., Family Code § 5.01(b).

4 Cases that cite this headnote

  → Particular Property or Circumstances of Acquisition
  Husband and Wife
  → Particular property

Evidence supported jury's separate property characterization of payments to husband under buy out agreement entered into among partners of husband's former law partnership; any increase in sum due husband at buy out as result of change in system of valuation of his partnership interests during marriage by virtue of amendments to original partnership agreement would not presumptively be community property. V.T.C.A., Family Code §§ 5.01, 5.02.

Cases that cite this headnote

  → Notwithstanding Verdict
  Judgment
  → Where there is no evidence to sustain verdict

Trial court may on its own motion disregard jury finding on special issue which is immaterial and may, additionally, upon proper motion and notice, disregard any jury finding which has no support in the evidence. Vernon's Ann.Texas Rules Civ.Proc., Rule 301.

1 Cases that cite this headnote

[14] Husband and Wife
  → Particular property

Evidence supported separate property characterization of husband's interest in "Reserved Capital Agreement" of husband's former law partnership, the effect of which was to clarify and define each partner's proportionate share of contingent fee in large estate and manner of its distribution. V.T.C.A., Family Code §§ 5.01, 5.02.

Cases that cite this headnote

[16] Divorce
  → Businesses and associated assets in general
  Divorce
  → Money judgments and recoveries
  Divorce
  → Sufficiency and clarity

Any finding in response to special issue in divorce action to which former law partner was party, as to whether entity referred to was law partnership, was immaterial to judgment; contingent fee contract involved was, in any event, partnership property.

Cases that cite this headnote

[17] Divorce
  → Issues and questions in lower court

Party to divorce action waived recovery under theory that income from separate property was community property by failing to present evidence of community's share of income from opposing party's separate property interest. Vernon's Ann.Texas Rules Civ.Proc., Rule 278.

4 Cases that cite this headnote

[18] Husband and Wife
  → Improvements on separate property
While increase in value of separate property interest resulting from fortuitous circumstances and unrelated to expenditure of community effort will not entitle community estate to reimbursement, community is entitled to reimbursement for time, toil and talent spent by one spouse for benefit and enhancement of his or her separate property interest.

2 Cases that cite this headnote

[19] Husband and Wife
Evidence

Burden of pleading and proof at trial is on party asserting right to reimbursement of community for expenditure of community time.

Cases that cite this headnote

Attorneys and Law Firms

*800 Robert J. Piro, Pamela E. George, Houston, for appellant.

Donn C. Fullenweider, Houston, for appellee.

Before PAUL PRESSLER, DRAUGHN and ELLIS, JJ.

OPINION ON MOTION FOR REHEARING

DRAUGHN, Justice.

On Motion for Rehearing we withdraw our opinion of October 20, 1988, and substitute the following therefor.

Appellant Ann Harris and Appellee Paul Harris were twice married and twice divorced. Their first marriage was terminated in 1972; their last marriage began in 1979 and ended in a final judgment of divorce on May 28, 1987. Ann Harris now appeals this latter judgment on the ground that the trial judge mischaracterized certain of her husband's assets as his separate property.

Appellant's challenge is directed at the distributions of her husband's partnership interest in his former law firm and his interest in that firm's contingent fee arrangement for its representation of the heirs of the Howard Hughes estate. Based on the jury's answers to special issues, the trial judge ruled these assets were the husband's separate property. Appellant contends that there was insufficient evidence to support such a finding and that to divide the marital estate based on it was an abuse of discretion. She also asserts that the court erred in defining separate property in its charge to the jury. Further she contends that the court erred in disregarding the jury's answer to one special issue and its refusal to set aside the jury's answers to two others.

Specifically, in her first point of error, appellant contends that the trial court erred in defining separate property in the charge to the jury by including aspects of the definition which were not raised by the evidence and by excluding an instruction regarding the community property character of compensation for services under a separate property contract of employment. Appellant objected to the instruction on these grounds.

The definition of separate property included in the charge by the court was as follows:

Separate property means (1) all property a spouse owned or claimed before marriage and (2) all property the spouse acquired after marriage by gift, devise, or descent.

Property is “claimed before marriage” if the right to the property accrued before marriage even though the legal title or evidence of title might not be obtained until after marriage.

Property is “acquired before marriage” if the inception of the right, rather than the completion or ripening thereof, occurs before marriage.

If a contract to purchase is entered into before marriage, although the legal title is not finally perfected until after marriage, the property becomes the separate property of the purchaser-spouse. It is immaterial that part of the purchase price is thereafter paid from community funds.

Property acquired with separate-property moneys, property, or credit is separate property. The character of separate property will not be altered by the sale, exchange, or substitution of the property. As long as separate property can be definitely traced and identified from *801 clear and convincing evidence, it remains separate property regardless of the fact that the separate property may undergo any number of mutations and changes in form.

“Community property” consists of the property, other than separate property, acquired by either spouse during marriage. Property possessed by either spouse during or on dissolution of marriage is presumed to be community property, but this presumption may be rebutted by clear and convincing
evidence.

It is appellant's position that there was no evidence raising an issue of (1) acquisition of property after marriage by gift, devise or descent, (2) inception of title, (3) a contract to purchase prior to marriage, or (4) acquisition of property with separate monies or credit. Appellant therefore concludes that the inclusion of those parts of the definition referring to such issues was confusing to the jury and resulted in reversible error. We do not agree.

[1] [2] [3] [4] The only function of an explanatory instruction or definition in the charge is to aid and assist the jury in answering the issues submitted. First State Bank and Trust Co. v. George, 519 S.W.2d 198, 207 (Tex.Civ.App.—Corpus Christi 1975, writ ref'd n.r.e.). The trial court has considerably more discretion in submitting instructions and definitions than it has in submitting special issues. Id. at 207; Houston National Bank v. Biber, 613 S.W.2d 771, 775–776 (Tex.Civ.App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.). Definitions shall be given as necessary to enable jurors to understand legal words or phrases used so that they may properly answer the special issues and render a verdict in the case. Id. at 775. The test of the sufficiency of a definition is its reasonable clarity in performing this function. Id. at 776; Gulf Insurance Company v. Vela, 361 S.W.2d 904, 906 (Tex.Civ.App.—Austin 1962, writ ref'd n.r.e.). An explanatory instruction is improper only if it is a misstatement of the law as applicable to the facts. Wakefield v. Revly, 704 S.W.2d 339, 350 (Tex.App.—Corpus Christi 1985, no writ).

[5] The definition given by the court is the correct legal definition of marital property. Tex. Const. Art. XVI § 15; Tex.Fam.Code § 5.01. While appellant complains that the evidence did not raise issues involving the acquisition of property after marriage by gift, devise or descent, special issues number three and four inquire about an alleged oral gift of property from husband to wife. Furthermore, while inclusion of the example regarding a pre-marital contract to purchase was not mandated by the facts, there was testimony about separate real property as well as the pre-marriage acquisition of other property interests arising from contracts. (In this regard, see Allen v. Allen, 704 S.W.2d 600, 604 (Tex.App.—Fort Worth 1986, no writ) which applies the inception of title rule to the incorporation of a business.) The example also aids in an understanding of the distinction between property “claimed” or “acquired” before marriage. It is highly possible, therefore, that the jury's understanding of the concept of separate property would be aided by such an example and the neutral example used avoided a comment on the evidence. To show reversible error, appellant must demonstrate harm from the definition complained of. Wakefield, supra, 704 S.W.2d at 348. While appellant speculates as to confusion which may have been created by the examples submitted, there was no showing of such confusion as demonstrated by inconsistent or contradictory answers by the jury. Id. The court did not commit reversible error in giving the instruction. Appellant's first point of error is overruled.

In points of error two and three, appellant challenges the sufficiency of the evidence to support the jury's characterization of the previously mentioned financial assets as the separate property of appellee. The second point of error challenges the jury's separate property characterization of appellee's interest in the “Reserved Capital Agreement” of Andrews and Kurth, an agreement providing for the distribution of proceeds from the “AK/FRL Contingent Fee Agreement” between Andrews and Kurth and the maternal heirs of Howard #802 Hughes. Point of error three challenges the characterization of payments to appellee under a buy-out agreement (the A–K Interest Buy-out) entered into among the partners of appellee's former law partnership, Andrews and Kurth. It was alleged at trial that the A–K Interest Buy-out was worth approximately $500,000.00 while the value of appellee's interest in the AK/FRL fee was estimated to be several million dollars.

[6] [7] [8] [9] Property possessed by either spouse during or on dissolution of marriage is presumed to be community property. Section 5.02, Tex.Fam.Code. The party claiming property as separate has the burden to overcome this presumption by clear and convincing evidence. Id.; Horlock v. Horlock, 614 S.W.2d 478, 480 (Tex.Civ.App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.). To discharge this burden a spouse must trace and clearly identify the property claimed as separate. Cockerham v. Cockerham, 527 S.W.2d 162, 167 (Tex.1975); McKinley v. McKinley, 496 S.W.2d 540, 543 (Tex.1973). If separate property and community property have been so commingled as to defy resegregation and identification, the statutory presumption prevails. Tarver v. Tarver, 394 S.W.2d 780 (Tex.1965). However, when separate property has not been commingled or its identity as such can be traced, the statutory presumption is dispelled. Peaslee–Gaulbert Corp. v. Hill, 311 S.W.2d 461, 463 (Tex.Civ.App.—Dallas 1958, no writ). The presumption, which is not evidence, ceases to exist upon introduction of positive evidence to the contrary and is not then to be weighed or treated as evidence. Empire Gas and Fuel Co. v. Muegge, 135 Tex. 520, 143 S.W.2d 763, 767 (1940); Roach v. Roach, 672 S.W.2d 524, 530 (Tex.App.—Amarillo 1984, no writ); In re: Estate of Glover, 744 S.W.2d 197, 200 (Tex.App.—Amarillo 1987, writ denied). Once determined, the character of the property is not altered by the sale, exchange or substitution of the property. Norris v. Vaughn, 152 Tex. 491, 260 S.W.2d 676, 679 (1953); Horlock v. Horlock, 533 S.W.2d 52, 60 (Tex.Civ.App.—Houston [14th Dist.] 1975, writ dism.). Property established to be separate
remains separate property regardless of the fact that it may undergo any number of mutations and changes in form. *Id.* With these rules in mind, we first consider point of error three challenging the characterization of the A–K partnership buy-out payments.

[10] [11] [12] Under the entity theory of partnership, adopted by Texas in the Uniform Partnership Act, Tex.Rev.Civ.Stat.Ann. art. 6132b (Vernon 1970), partnership property is owned by the partnership entity, not the individual partners. *Marshall v. Marshall, 735 S.W.2d 587, 593–594 (Tex.App.—Dallas 1987, writ ref'd n.r.e.)*. A partner's rights in specific partnership property are wholly subordinated to the rights of the partnership entity as owner of the property. He may possess the property only for partnership purposes. See Tex.Rev.Civ.Stat.Ann. art. 6132b § 1; Bromberg, *Source and Comments,* (Vernon 1970). Partnership property is therefore neither separate nor community in character. *Marshall at 594.* The only partnership property right the partner has which is subject to a community or separate property characterization is his *interest* in the partnership, that is his right to receive his share of the partnership profits and surplus. *Marshall at 594; McKnight v. McKnight, 543 S.W.2d 863, 867–868 (Tex.1976).* Distributions of the partner's share of profits and surplus (income) received during marriage are community property even if the partner's interest in the partnership is separate property. *Tex.Fam.Code. § 5.01(b); Arnold v. Leonard, 114 Tex. 535, 273 S.W.2d 799 (1925); Marshall v. Marshall, 735 S.W.2d at 594.* In the trial court appellant made no claim regarding community property income from the partnership interest but focused instead on the characterization of the partnership interest itself.

[13] Appellant correctly asserts that appellee had the burden to show by clear and convincing evidence that his partnership interest in Andrews and Kurth was his separate property. It was undisputed at trial that this clearly identified partnership interest was awarded to him as his separate *803* property in a previous divorce and belonged to him long before his second marriage to appellant. See, *In re: Marriage of Higley, 575 S.W.2d 432, 434 (Tex.Civ.App.—Amarillo 1978, no writ).* During appellee's tenure as a partner at Andrews and Kurth, there were two partnership agreements executed. The second agreement, which was executed during their marriage, altered and controlled the terms of appellee's withdrawal from the firm. However, appellee's partner status in Andrews and Kurth was established when that association of attorneys, then known as Andrews, Kurth, Campbell and Jones, first executed their partnership agreement in 1972. He remained a partner at all relevant times thereafter. The partnership itself was never dissolved. Appellee's partnership interest upon his withdrawal from the firm was, therefore, the same partnership interest that he possessed in 1972 and which was adjudged his separate property in a prior divorce.

Under established principles requiring tracing and identification of separate property, the presumption of community property was rebutted. Once the presumption ceased to exist, it was incumbent upon appellant to go forward with evidence attacking appellee's successful identification of his partnership interest. There was no evidence presented to show that a "new" or "additional" interest had been acquired during the parties' marriage. Furthermore, while it may be possible in some cases to show that an increase in the value of a separate property asset was based on some community property factor, such was not shown by any evidence in this case. No such reimbursement theory was developed at trial.

Appellant's position instead is that the evidence appellee presented was insufficient to establish that the partnership interest owned by Paul Harris prior to the marriage as his separate property was the same as the interest for which he was receiving monthly payments under the buy-out agreement. Apparently, appellant believes that if the system of valuation of appellee's partnership interest changed during the marriage, by virtue of the amendments to the original partnership agreement, any increase in the sum due to him at buy-out would presumptively be community property. We do not agree with this reasoning.

While the value of appellee's separate property interest may have fluctuated from time to time, there was no evidence that any "additional" interest was acquired during the parties' marriage. As in the case of stock splits and increases, analogous to this situation involving "units" of a partnership, mutations and increases in separate property remain separate property. *Horlock v. Horlock, 533 S.W.2d 52, 60 (Tex.Civ.App.—Houston [14th Dist.] 1975, writ dism.).* There was sufficient evidence to support the jury's finding that the monthly payments of $8,833.00 as a buy-out of the value of his partnership interest were appellee's separate property. Appellant's third point of error is overruled.

[14] We now return to appellant's second point of error which attacks the sufficiency of the evidence to support the jury's separate property characterization of Paul Harris' interest in the "Reserved Capital Agreement of Andrews and Kurth."

It was undisputed that the AK/FRL contingent fee contract was entered into October 1, 1977, after the first marriage of appellant and appellee and before their second marriage, between the maternal heirs of Howard Hughes and the law partnership of Andrews and Kurth. It provided for recovery by Andrews and Kurth of thirty percent of all monies awarded to Hughes' maternal heirs as compensation for the firm's representation of the heirs in the complex legal battles which
ensued following Howard Hughes' death. Paul Harris is a party to that contract, and a beneficiary of it, only by virtue of his status as a partner in Andrews and Kurth.

Whether the contingent fee contract was the property of a separate partnership among the AK partners alleged to have been created specifically for the management of the Hughes case or not, the parties to the contract were the Hughes heirs and the Andrews and Kurth partnership. *804 There is no evidence in the record that the fee contract was owned by the several partners individually. Under the entity theory of partnership, the undivided interest owned by individual partners in specific partnership property is not community property. Tex.Rev.Civ.Stat.Ann. art. 6132b, § 28–A (Vernon 1970). Only the partner's interest in the partnership may be characterized as community property. Id. Therefore, as partnership property, the fee contract is not subject to classification as either community or separate in nature. Marshall v. Marshall, 735 S.W.2d at 594. However, that portion of the partnership profits and surplus (income) received by the partner during marriage is community property regardless of whether the interest in the fee contract itself can be characterized as community or separate. Tex.Fam.Code § 5.01(b); Marshall at 594; Arnold v. Leonard, supra, at 803. In re: Marriage of Higley, supra.

Although the Reserved Capital Agreement was executed during appellant's marriage to appellee, the effect of that agreement was not to create appellee's rights in the Hughes fee but only to clarify and define each partner's proportionate share of the fee and the manner of its distribution. Appellee testified that his rights to share in the fee accrued on October 1, 1977, the date of the execution of the contingent fee contract, by virtue of his separate property partnership interest. As further evidence of the accrual of those rights, a current Andrews and Kurth partnership tax return does not establish the status of a business entity as a partnership. However, while she believes that the jury's finding that AK/FRL was not a partnership, if allowed to stand, would confirm her right to recovery of a portion of appellee's interest in the AK/FRL fee, we do not agree.

Our analysis and holding under point of error number two also impacts our consideration of point of error number four in which appellant attacks the trial court's granting of appellee's motion to disregard the jury's answer to special issue five that AK/FRL was not a partnership.

Special issue number 5 inquired as follows:

Do you find from a preponderance of the evidence that the entity referred to as the “AK/FRL Partnership” is a partnership?

Answer: Choose a or b. Check one.

a. It is a partnership.

b. It is not a partnership. X

Answer: b

[15] A trial court on its own motion may disregard a jury finding on a special issue which is immaterial. Arch Construction, Inc. v. Tyburec, 730 S.W.2d 47, 51 (Tex.App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.); Clear Lake City Water Authority v. Winograd, 695 S.W.2d 632, 639 (Tex.App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.). An issue is immaterial when such finding is inapplicable to the case. Ridout v. Mobile Housing, Inc., 497 S.W.2d 66, 67 (Tex.Civ.App.—Austin 1973, writ ref'd n.r.e.); Dobbins v. Redden, 759 S.W.2d 477 (Tex.App.—San Antonio 1988, no writ). In addition, as provided by Rule 301 of the Texas Rules of Civil Procedure, the court may, upon proper motion and notice, disregard any jury finding which has no support in the evidence. Arch Construction, 730 S.W.2d at 51.

Both parties filed motions to disregard certain of the special issues. Appellee requested the court disregard issue number five on the grounds that, among other things, it was merely evidentiary and did not resolve an ultimate issue in the case. In other words, appellee alleged that the issue was immaterial. The court granted the motion to disregard issue number five and denied the remaining motions without specifying the grounds for its decision.

It was appellee's testimony, corroborated by the document itself and the testimony of a partner at Andrews and Kurth, that the firm of Andrews and Kurth was a partner with the maternal heirs of Hughes in the AK/FRL enterprise. The terms of that partnership allegedly were set out in the Contingent Fee Agreement together with the Reserved Capital Agreement of Andrews and Kurth which was made retroactive *805 to the date of the Contingent Fee Agreement.

Appellant claimed that appellee failed to establish that the entity satisfied several of the tests or overt manifestations of partnership. She correctly asserted that the mere filing of a partnership tax return does not establish the status of a business entity as a partnership. However, while she believes that the jury's finding that AK/FRL was not a partnership, if allowed to stand, would confirm her right to recovery of a portion of appellee's interest in the AK/FRL fee, we do not agree.

[16] Since we hold that the AK/FRL contingent fee contract was the property of the law partnership of Andrews and Kurth,
Harris v. Harris, 765 S.W.2d 798 (1989)

regardless of whether it could be classified as a separate partnership in and of itself, we must necessarily hold that any finding in response to special issue five was immaterial to the judgment in the case. The only interest appellee "owned" in AK/FRL arose from his partnership interest in the firm. That interest was established to be his separate property. Therefore, there was no error in the trial court's decision to disregard the jury's answer to the issue. Point of error number four is overruled.

[17] On the other hand, even though appellee's interest in AK/FRL was his separate property, any income from the AK/FRL enterprise paid to appellee during marriage would be community property since income from separate property is community property. Arnold v. Leonard, supra; Marshall v. Marshall, 735 S.W.2d at 594. While the community could not claim a portion of appellee's separate partnership interest in the fee, a claim to community income from that interest would have been viable. However, by failing to present evidence of the community's share of the income from appellee's separate property interest appellant waived recovery under this theory. Tex.R.Civ.P. 278.

[18] [19] In keeping with the principles applicable to stock splits, an increase in the value of a separate property interest resulting from fortuitous circumstances and unrelated to an expenditure of community effort will not entitle the community estate to reimbursement. Note, Community Property Rights and the Business Partnership, 57 Tex.L.Rev. 1018, 1035–1036. However, a significant line of decisions holds that the community is entitled to reimbursement for time, toil and talent spent by one spouse for the benefit and enhancement of his or her separate property interests. Jensen v. Jensen, 665 S.W.2d 107, 109 (Tex.1984); Vallone v. Vallone, 644 S.W.2d 455 (Tex.1982); In re: Marriage of York, 613 S.W.2d 764, 770 (Tex.Civ.App.—Amarillo 1981, no writ). While the law contemplates that a spouse may expend a reasonable amount of talent or labor in the management and preservation of his separate property without impressing a community character upon it, a showing that appellee's energy was spent in such a way that increased his future right to share in the separate fee without adequate compensation to the community, may have entitled the community to reimbursement for that expenditure of community time. Vallone at 459. The burden of pleading and proof at trial is on the party asserting a right to reimbursement. Id. In the instant case, the only evidence introduced relevant to this reimbursement issue was appellee's testimony that his income from the Hughes fee was unrelated to the amount or extent of his work on the case.

QUESTIONS BY MR. FULLENWEIDER:

Q. Now, Mr. Harris, did you work on this, part of the Hughes matter while you were a partner at Andrews, Kurth?

A. I certainly did.

Q. And did that have anything with reference to, as far as the work you did, did that have anything to do with the amount of income or fee that you would have from that matter?

A. The work itself?

Q. Yes.

A. On that particular matter?

Q. Yes.

A. No. It was an owned asset. It didn't matter how much work or how little work I did.

*806 Q. Is it true ... what about the other partners?

A. The same is true with them.

While several documents relevant to the payment and distribution of the fee suggest to us a correlation between time expended on the case and allocation of profit, no evidence that appellee's interest was tied to his performance on the case was introduced. Therefore, this unchallenged testimony precludes reimbursement to the community estate for the labor expended by appellee, if any, to increase the value of his separate property interest.

Since our holding in regard to points of error one through four is dispositive of the issues on appeal, we do not consider points five and six.

The judgment of the trial court is affirmed.

All Citations

765 S.W.2d 798

Synopsis

Background: In divorce action, wife sought to pierce corporate veil of companies in which husband owned an interest, and companies cross-claimed against husband and wife, alleging husband breached his fiduciary duties. Following a bench trial, the 225th Judicial District Court, Bexar County, Peter Michael Curry, J., pierced the corporate veil and found husband breached his fiduciary duties, but denied companies' claim for damages. Wife and companies appealed. The Court of Appeals, 61 S.W.3d 511, affirmed in part, reversed in part, and remanded for new trial on breach of fiduciary duty and division of community property. On remand, the 150th Judicial District Court, Bexar County, Richard Garcia and Michael P. Peden, JJ., divided community property and found the breach of fiduciary duty claim should be denied. Husband and companies appealed.

Holdings: The Court of Appeals, Alma L. López, C.J., held that:

[1] evidence established that husband breached his fiduciary duties by usurping corporate and partnership opportunities;

[2] law of the case doctrine, and limited scope of remand, precluded divorce court from relying on alter ego theory as basis for denying damages to corporations and partnerships for husband's breach of fiduciary duties; and

[3] evidence established that stock was distributed to husband during the marriage.

Affirmed in part, reversed in part, and remanded.

Sarah B. Duncan, J., filed an opinion concurring in the judgment only.

West Headnotes (52)

[1] Appeal and Error

Same effect as verdict

When a complete reporter's record is filed, the trial court's fact findings may be reviewed for legal and factual sufficiency under the same standards as jury verdicts.

Cases that cite this headnote

[2] Appeal and Error

Findings of fact and conclusions of law

The appellate court does not review a trial court's conclusions of law for factual sufficiency; rather, it evaluates the conclusions independently, determining whether the trial court correctly drew the legal conclusions from the facts.

Cases that cite this headnote


Rulings on questions of law

Incorrect conclusions of law will not require a reversal if the controlling findings of fact will support the judgment under a correct legal theory.

2 Cases that cite this headnote

   Findings of Court or Referee

When a party not bearing the burden of proof on an issue challenges the legal sufficiency of the evidence, the appellate court reviews the evidence in the light most favorable to the verdict, giving credit to favorable evidence if reasonable jurors could, and disregarding contrary evidence unless reasonable jurors could not.

Cases that cite this headnote

   Total failure of proof

Evidence is legally insufficient when the record discloses: (1) a complete absence of evidence of a vital fact; (2) the court is barred by rules of law from giving weight to the only evidence offered to prove a vital fact; (3) the evidence offered to prove a vital fact is no more than a mere scintilla; or (4) the evidence establishes conclusively the opposite of the vital fact.

2 Cases that cite this headnote

   Sufficiency of Evidence in Support

When a party attacks the legal sufficiency of an adverse finding on an issue on which it has the burden of proof, the party must demonstrate on appeal that the evidence establishes, as a matter of law, all vital facts in support of the issue.

2 Cases that cite this headnote

[7] Appeal and Error
   Findings of Court or Referee
   Appeal and Error
   Extent of Review
   Appeal and Error
   Total failure of proof

If a party attacks the legal sufficiency of an adverse finding on an issue on which it has the burden of proof, the reviewing court must first examine the record for evidence that supports the finding, while ignoring all evidence to the contrary, and if there is no evidence to support the finding, the reviewing court will then examine the entire record to determine if the contrary proposition is established as a matter of law, and the point of error should be sustained only if the contrary proposition is conclusively established.

Cases that cite this headnote

[8] Appeal and Error
   Manifest weight

When a party not bearing the burden of proof on an issue attacks the factual sufficiency of the evidence, the appellate court examines the entire record to determine whether there is some probative evidence to support the jury finding, after which it determines whether the evidence supporting the finding is so weak or so contrary to the overwhelming weight of the evidence as to be clearly wrong and manifestly unjust.

Cases that cite this headnote
When a party attacks the factual sufficiency of an adverse finding on an issue on which it has the burden of proof, the party must demonstrate on appeal that the adverse finding is against the great weight and preponderance of the evidence, and the court of appeals must consider and weigh all of the evidence, and can set aside a verdict only if the evidence is so weak or if the finding is so against the great weight and preponderance of the evidence that it is clearly wrong and unjust.

The test for whether the trial court abused its discretion is whether the trial court acted arbitrarily or unreasonably.

When a trial court, in a divorce action, mischaracterizes separate property as community property, the error requires reversal, because the subsequent division divests a spouse of his or her separate property.

Corporate officers owe fiduciary duties to the corporations they serve.

A corporate fiduciary is under an obligation not to usurp corporate opportunities for personal gain, and equity will hold him accountable to the corporation for his profits if he does so.
As a matter of common law, the relationship between partners is fiduciary in character, and imposes upon all partners the obligation of loyalty to the joint concern and the obligations of utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise.

Evidence established that shareholder/partner in corporations and partnerships breached his fiduciary duties by usurping corporate and partnership opportunities; entities were engaged in acquiring rental properties and promissory notes, two rental properties came to shareholder/partner's attention at offices he used in managing the entities, he acquired the properties for his and his wife's personal benefit without offering the properties to the entities, and he selected for purchase, for his and his wife's personal benefit, notes with highest rates of return or yields or with least risk of default.

As a fiduciary, a partner is under the same obligation as a corporate fiduciary not to usurp corporate opportunities.

Evidence established that shareholder/partner in corporations and partnerships breached his fiduciary duties by usurping corporate and partnership opportunities; entities were engaged in acquiring rental properties and promissory notes, two rental properties came to shareholder/partner's attention at offices he used in managing the entities, he acquired the properties for his and his wife's personal benefit without offering the properties to the entities, and he selected for purchase, for his and his wife's personal benefit, notes with highest rates of return or yields or with least risk of default.

On remand after appeal from divorce court's piercing of corporate veil of corporations in which husband had ownership interest, law of the case doctrine, relating to Court of Appeals' finding that evidence was legally insufficient to establish that corporations were alter ego of husband, and limited scope of remand, for new trial on corporations' breach of fiduciary duty claims against husband and for division of community property, precluded divorce court from relying on alter ego theory as basis for denying damages to corporations for husband's breach of fiduciary duty, relating to usurpation of corporate opportunities and improper payment of spouses' personal expenses with corporate funds.
The “law of the case” doctrine is defined as that principle under which questions of law decided on appeal to a court of last resort will govern the case throughout its subsequent stages.

A determination by an appellate court that the evidence is legally insufficient to support a finding involves a question of law and falls within the ambit of the law of the case doctrine.

5 Cases that cite this headnote

[21] Courts

By narrowing the issues in successive stages of the litigation, the law of the case doctrine is intended to achieve uniformity of decision as well as judicial economy and efficiency.

2 Cases that cite this headnote

[22] Courts

The law of the case doctrine is based on public policy and is aimed at putting an end to litigation.

Cases that cite this headnote

[23] Courts

The law of the case doctrine applies only to questions of law and does not apply to questions of fact.

5 Cases that cite this headnote

[24] Courts

[25] Appeal and Error

When an appellate court remands a case and limits a subsequent trial to a particular issue, the trial court is restricted to a determination of that particular issue, and thus, in a subsequent appeal, instructions given to a trial court in the former appeal will be adhered to and enforced.

3 Cases that cite this headnote

[26] Appeal and Error

In interpreting the mandate of an appellate court, the courts should look not only to the mandate itself, but also to the opinion of the court.

Cases that cite this headnote

[27] Corporations and Business Organizations

The law of the case doctrine applies only to questions of law and does not apply to questions of fact.
Transactions between corporate fiduciaries and their corporation are capable of ratification by the shareholders, by the board of directors through specific approval or acquiescence, through laches, or through acceptance of benefit.

Shareholder's use of corporate funds to pay his personal expenses was ratified by other shareholders, and thus, there was no breach of fiduciary duty; shareholders were on notice that the shareholder's personal expenses were being paid by the corporations, one of shareholder's brothers received similar benefits as a shareholder, and personal expenses of shareholder's father, who was also a shareholder, had been paid through the corporations for years.

Ratification, by the board of directors or shareholders, of transactions between corporate fiduciaries and their corporation is effective only when the fiduciary has fully disclosed all material facts of the transactions to the board of directors or shareholders.

Even assuming that shareholder's breach of fiduciary duty, in usurping corporate opportunities, could be ratified by other shareholders, no ratification occurred, where breaching shareholder did not fully disclose to other shareholders that he had diverted corporate opportunities.

Absence actual or apparent authority, an agent cannot bind a principal.
Both actual and apparent authority are created through conduct of the principal communicated either to the agent, i.e., actual authority, or to a third party, i.e., apparent authority.

Apparent authority is determined by looking to the acts of the principal and ascertaining whether those acts would lead a reasonably prudent person using diligence and discretion to suppose the agent had the authority to act on behalf of the principal.

"Actual authority" denotes that authority which the principal intentionally confers upon the agent, or intentionally allows the agent to believe he has, or by want of ordinary care allows the agent to believe himself to possess.

Apparent authority arises through acts of participation, knowledge, or acquiescence by the principal that clothe the agent with the indicia of apparent authority.

Apparent authority is determined by looking to the acts of the principal and ascertaining whether those acts would lead a reasonably prudent person using diligence and discretion to suppose the agent had the authority to act on behalf of the principal.

For apparent authority to exist, the principal must either have affirmatively held the agent out as possessing the authority or the principal must have knowingly and voluntarily permitted the agent to act in an unauthorized manner.

A party dealing with an agent must ascertain both the fact and the scope of the agent's authority, and if the party deals with the agent without having made such a determination, she does so at her own risk.
Shareholder/partner did not have actual authority to usurp business opportunities of corporations and partnerships; the entities did not intentionally confer on shareholder/partner the authority to usurp business opportunities, nor did they take any action that would enable shareholder/partner to believe he had authority to usurp business opportunities, nor did they fail to exercise ordinary care and thereby allow shareholder/partner to believe he had authority.

Conduct of shareholder/partner, in usurping business opportunities of corporations and partnerships, did not involve shareholder/partner acting on behalf of corporations and partnerships, and thus, the concept of apparent authority was inapplicable.

Evidence established that stock held by partnership, of which husband was a partner, was distributed to husband during his marriage and then was contributed to second corporation owned by husband, and thus, the stock became community property based on the distribution to husband during the marriage, for purposes of division of property in husband's divorce proceeding; partnership's tax return showed distribution of stock to partners, financial statement and tax return for second corporation, as well as husband's individual tax return, contained entries inconsistent with direct transfer from partnership to second corporation, and while stock book for transferor corporation reflected a direct transfer from partnership to second corporation, there was evidence the transaction reflected in the stock book had been back-dated.

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Since partnership property does not retain a separate character for purposes of community property principles, distributions from the partnership are considered community property, regardless of whether the distribution is of income or of an asset.

Wife, as the party seeking reimbursement to community estate, in divorce action, for reasonable value of time and effort that husband contributed to increase in value of stock that was his separate property, had the burden to prove that the community estate was entitled to reimbursement.

2 Cases that cite this headnote

[47] Divorce
Stocks, bonds, and other investments

Application of minority discount, when valuing stock that was community property because partnership distributed the stock to husband during his marriage, was not appropriate, for purposes of division of property in husband's divorce action; after distribution of stock to husband, the stock was contributed to second corporation owned by husband, and the interval between distribution of the stock and contribution to second corporation was nearly instantaneous.

Cases that cite this headnote

[48] Husband and Wife
Improvements on separate property

Spouse seeking reimbursement to community estate, in divorce action, for reasonable value of time and effort that other spouse contributed to increase in value of stock that was other spouse's separate property must establish that value of time and effort expended to enhance such separate property exceeds both: (1) time and effort reasonably necessary to manage and preserve other spouse's separate estate, and (2) remuneration received from corporation as compensation for that time and effort.

1 Cases that cite this headnote

[49] Husband and Wife
Actions for dissolution or partition

In order to establish that efforts of first spouse did more than was required to maintain first spouse's separate estate, as element of second spouse's claim seeking reimbursement to community estate, in divorce action, for reasonable value of time and effort that first spouse contributed to increase in value of stock that was first spouse's separate property, evidence must be introduced to show the amount of time that was reasonably necessary for first spouse to spend managing and preserving the separate estate.

Cases that cite this headnote
Great latitude must be afforded the trial court in its application of equitable principles to value a claim by a spouse for reimbursement to community estate, in divorce action, for reasonable value of time and effort that other spouse contributed to increase in value of stock that was other spouse's separate property.

Cases that cite this headnote

*15 From the 150th Judicial District Court, Bexar County, Texas, Trial Court No. 97–CI–13199; Michael Peden, Judge Presiding.

Attorneys and Law Firms


Sam C. Bashara, Law Offices of Sam C. Bashara, San Antonio, for appellee.

Sitting: ALMA L. LÓPEZ, Chief Justice, SARAH B. DUNCAN, Justice, REBECCA SIMMONS, Justice.

OPINION

Opinion by ALMA L. LÓPEZ, Chief Justice.

This is the second appeal relating to the divorce between James Lifshutz and Kymberly Benson Lifshutz. See Lifshutz v. Lifshutz, 61 S.W.3d 511 (Tex.App.-San Antonio 2001, pet. denied). In this appeal, James presents five issues asserting: (1) the trial court punished James when it reconsidered the property division on remand; (2) the trial court erred in finding that the stock of Berlee Lumber Company, *16 Inc. was distributed to James and his brothers before being contributed to Liberty Financial Corporation; (3) the evidence is insufficient to support the trial court's finding that the community estate was entitled to a Jensen reimbursement; (4) the trial court abused its discretion in awarding Kymberly attorneys' fees; and (5) the property division is not just and right. Liberty Financial Corporation, Liberty Properties Partnership, Texas Home Improvements, Inc., and Berlee Lumber Company, Inc. (the "Entities") are entities owned directly or indirectly by James and his brothers. The Entities filed a separate appeal contesting: (1) the evidence is legally and factually insufficient to support the trial court's finding that James did not breach his fiduciary duty; (2) the trial court violated the law of the case and the scope of the remand by making a finding of alter ego on remand, the evidence is legally insufficient to support the alter ego finding, and alter ego is not a defense to the breach of fiduciary duty claim; (3) the evidence is legally and factually insufficient to support the trial court's findings of ratification and actual and apparent authority. We overrule James's issues relating to both the trial court's punishing him on remand and the distribution of the Berlee stock. We sustain James's issue relating to the Jensen reimbursement claim. We sustain the Entities' issues and reverse the trial court's judgment as to the Entities' breach of fiduciary duty claim. Because liability as to the breach of fiduciary duty claim was contested and damages are unliquidated, we remand the breach of fiduciary duty claim to the trial court for further proceedings consistent with this opinion. “Any change in the trial court's judgment on liability or damages for breach of fiduciary duty could potentially result in a loss of property from both the community estate and Kymberly's separate estate. Because of this possibility, the property division must be remanded, including the award of attorney's fees.” Lifshutz I, 61 S.W.3d at 518. Accordingly, we need not address James's fourth and fifth issues.

Background

James and Kymberly were married in 1990 and separated in 1997. During the marriage, James managed the business of each of the Entities. The Entities paid various personal expenses for James and Kymberly, including a $95,000 addition to their home. The Entities were primarily involved in real estate, including the purchase and collection of notes and rental real estate. During the marriage, James purchased notes and rental real estate for the personal benefit of James and Kymberly.

During the divorce proceedings, Kymberly sought to pierce the corporate veil of the Entities so that James's interest in the Entities would be included as a community property asset. The Entities filed a breach of fiduciary duty claim against James...
seeking damages for the personal expenses the Entities paid on his behalf and a constructive trust or damages for the business opportunities James usurped for the personal benefit of James and Kymberly. Following a bench trial, the trial court found James had breached his fiduciary duty but denied the Entities' claim for damages or a constructive trust based on the trial court's alter ego finding. Because the trial court found alter ego, it increased the community estate by the amount of James's interest in the Entities.

In the first appeal, we held that “the trial court improperly pierced the corporate entities” because the evidence was *17 legally insufficient to support a finding of alter ego in a divorce case. *Lifshutz*, 61 S.W.3d at 518. We further held that the trial court improperly pierced Liberty Properties Partnership because it was a partnership. *Id.* Because the trial court denied damages for the Entities' breach of fiduciary duty claim based on its alter ego finding, we “reverse[d] and remand[ed] for [a] new trial on breach of fiduciary duty and the division of community property.” *Id.* at 519. In the opinion, we noted, “If the evidence supports a finding that James was undercompensated for his time and talent spent increasing the value of his separate interests, Kymberly may have a claim for reimbursement to the community.” *Id.* at 518 n. 5.

On remand, the trial court reviewed the evidence developed at the original trial along with bank statements regarding the funds received from the sale of James's carried interest in Hotel Partners. The trial court found that one-third of the stock in Berlee was distributed to James by Liberty Properties Partnership and then recontributed to Liberty Financial Corporation, making the stock a community property asset. The trial court further found that James was undercompensated and that the community estate was entitled to reimbursement. Finally, the trial court found that the breach of fiduciary duty claim should be denied because: (1) the claim is not just; (2) James is the alter ego of the Entities; (3) any diversion of corporate opportunities was ratified through agreement, consent, or acquiescence or James had actual or apparent authority to divert the opportunities.

Standard of Review

[1] [2] [3] When a complete reporter's record is filed, the trial court's fact findings may be reviewed for legal and factual sufficiency under the same standards as jury verdicts. *David L. Smith & Assocs., L.L.P.*, 169 S.W.3d at 819. Rather, we evaluate the conclusions independently, determining whether the trial court correctly drew the legal conclusions from the facts. *Id.* Incorrect conclusions of law will not require a reversal if the controlling findings of fact will support the judgment under a correct legal theory. *Id.*

[4] [5] When a party not bearing the burden of proof on an issue challenges the legal sufficiency of the evidence, we review the evidence in the light most favorable to the verdict giving “credit [to] favorable evidence if reasonable jurors could, and disregard[ing] contrary evidence unless reasonable jurors could not.” *City of Keller v. Wilson*, 168 S.W.3d 802, 827–28 (Tex.2005). Evidence is legally insufficient when the record discloses: (1) a complete absence of evidence of a vital fact; (2) the court is barred by rules of law from giving weight to the only evidence offered to prove a vital fact; (3) the evidence offered to prove a vital fact is no more than a mere scintilla; or (4) the evidence establishes conclusively the opposite of the vital fact. *Id.* at 810.

[6] [7] When a party attacks the legal sufficiency of an adverse finding on an issue on which it has the burden of proof, the party must demonstrate on appeal that the evidence establishes, as a matter of law, all vital facts in support of the issue. *Dow Chem. Co. v. Francis*, 46 S.W.3d 237, 241 (Tex.2001). In reviewing a “matter of law” challenge, the reviewing court must first examine the record for evidence that supports the finding, while ignoring all *18 evidence to the contrary. *Id.* If there is no evidence to support the finding, the reviewing court will then examine the entire record to determine if the contrary proposition is established as a matter of law. *Id.* The point of error should be sustained only if the contrary proposition is conclusively established. *Id.*

[8] [9] [10] When a party not bearing the burden of proof on an issue attacks the factual sufficiency of the evidence, we examine the entire record to determine whether there is some probative evidence to support the jury finding, after which we determine whether the evidence supporting the finding is so weak or so contrary to the overwhelming weight of the evidence as to be clearly wrong and manifestly unjust. *Potter v. GMP, L.L.C.*, 141 S.W.3d 698, 702 (Tex.App.--San Antonio 2004, pet. dism'd). When a party attacks the factual sufficiency of an adverse finding on an issue on which it has the burden of proof, the party must demonstrate on appeal that the adverse finding is against the great weight and preponderance of the evidence. *Id.* at 242. The court of appeals must consider and weigh all of the evidence, and can set aside a verdict only if
the evidence is so weak or if the finding is so against the great weight and preponderance of the evidence that it is clearly wrong and unjust. *Id.* In doing so, the court of appeals must “detail the evidence relevant to the issue” and “state in what regard the contrary evidence greatly outweighs the evidence in support of the verdict.” *Id.*


**Entities’ Appeal**

A. Establishment of Breach of Fiduciary Duty

In their first issue, the Entities contend that they conclusively established their entitlement to relief on their claim for breach of fiduciary duty or, in the alternative, denial of relief was against the great weight and preponderance of the evidence. In addressing this issue, the Entities initially focus on the evidence supporting their claim and separately address the possible defenses. Kymberly's brief, on the other hand, focuses on the evidence supporting the defenses to recovery rather than challenging whether the evidence was sufficient to support a finding that James did not breach his fiduciary duty.

[14] [15] [16] [17] Corporate officers owe fiduciary duties to the corporations they serve. *Grinnell v. Munson*, 137 S.W.3d 706, 718 (Tex.App.-San Antonio 2004, no pet.). A corporate fiduciary is under an obligation not to usurp corporate opportunities for personal gain, and equity will hold him accountable to the corporation for his profits if he does so. *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex.1963). The Texas Supreme Court has long recognized “as a matter of common law that ‘[c]onflict of interest is fiduciary in character, and imposes a constructive trust as a remedy for breach of fiduciary duty, the second requirement for piercing the corporate veil. Accordingly, Kymberly believes that the trial court was not precluded from entering an alter ego finding on demand and relying on that finding in denying the breach of fiduciary duty claims. Kymberly further argues that if this court were to impose a constructive trust as a remedy for breach of fiduciary duty, the second requirement for piercing the corporate veil would be established because the community estate would be damaged. Finally, Kymberly contends that the trial court properly denied the breach of fiduciary duty claim because no true adversity existed between the Entities and James;
therefore, the claim was a sham.

In *Lifshutz I*, this court asserted, “The doctrine of alter ego, in a traditional business context, allows the trial court to set aside the corporate structure of a company, or ‘pierce the corporate veil,’ to hold individual shareholders liable for corporate *20 debt.” 61 S.W.3d at 516. This court then distinguished between the application of the principles of alter ego and piercing the corporate veil in the traditional business context and the divorce context. *Id.* at 516–17. This court noted that in exceptional circumstances, the principles of alter ego and piercing the corporate veil have been applied in divorce cases in what could be termed “reverse piercing.” *Id.* at 516. “Piercing the corporate veil in a divorce case allows the divorce court to characterize as community property corporate assets that would otherwise be the separate property of one spouse .... [and] allows the trial court to move assets out of the corporation and divide them between spouses as part of the shareholder’s community estate.” *Id.* This court then concluded:

At the least, a finding of alter ego sufficient to justify piercing in the divorce context requires the trial court to find: (1) unity between the separate property corporation and the spouse such that the separateness of the corporation has ceased to exist; and (2) the spouse's improper use of the corporation damaged the community estate beyond that which might be remedied by a claim for reimbursement. *Id.* at 517.

Kymberly argues that the first requirement relates only to a finding of alter ego, and the second requirement relates only to a finding that the corporate veil should be pierced. Since this court deferred to the trial court's implied finding on the first requirement in *Lifshutz I*, Kymberly asserts that *Lifshutz I* actually “embraces” the trial court's finding of alter ego on remand.

We agree with the Entities' argument that reliance on the alter ego finding on remand was precluded by the law of the case and the scope of the remand. “The ‘law of the case’ doctrine is defined as that principle under which questions of law decided on appeal to a court of last resort will govern the case throughout its subsequent stages.” *Hudson v. Wakefield*, 711 S.W.2d 628, 630 (Tex.1986). “By narrowing the issues in successive stages of the litigation, the law of the case doctrine is intended to achieve uniformity of decision as well as judicial economy and efficiency.” *Id.* “The doctrine is based on public policy and is aimed at putting an end to litigation.” *Id.* “The doctrine of the law of the case only applies to questions of law and does not apply to questions of fact.” *Id.* A determination by an appellate court that the evidence is legally insufficient to support a finding involves a question of law and falls within the ambit of the “law of the case” doctrine. *Lee v. Lee*, 44 S.W.3d 151, 153 n. 5 (Tex.App.-Houston [1st Dist.] 2001, pet. denied).

[25] [26] “When [an appellate court] remands a case and limits a subsequent trial to a particular issue, the trial court is restricted to a determination of that particular issue.” *Hudson*, 711 S.W.2d at 630. “Thus, in a subsequent appeal, instructions given to a trial court in the former appeal will be adhered to and enforced.” *Id.* “In interpreting the mandate of an appellate court, however, the courts should look not only to the mandate itself, but also to the opinion of the court.” *Id.*

In *Lifshutz I*, we sustained the Entities' issues regarding alter ego and piercing.” 61 S.W.3d at 518. In addressing the breach of fiduciary duty claim, we noted that the trial court did not award damages “based on its holding that the [Entities] were the alter ego of James.” *Id.* at 519. Because we reversed the alter ego finding, we concluded that the finding was an improper basis for the trial court to deny damages. *Id.* We noted, however, that other grounds were pled on which the *21 damages could have been denied. *Id.* Since those grounds were not considered by the trial court, we concluded that the trial court would need to reconsider whether to award damages. *Id.* Since the damages were unliquidated and liability was contested, we remanded the entire issue relating to the breach of fiduciary duty claim to the trial court. *Id.*

The law of the case and the limited scope of the remand in this case precluded the trial court from relying on the theory of alter ego as a basis to deny damages for the breach of fiduciary duty claim. Accordingly, each of the following findings by the trial court as a reason for denying the Entities' breach
of fiduciary duty claim was improper:

The Court finds the claims by Third–Party Defendants against JAMES G. LIFSHUTZ and KYMBERLY BENSON LIFSHUTZ are not just and should be denied.

The Court finds that the Third–Party corporate Defendants are the alter ego of JAMES G. LIFSHUTZ.

The Court finds that if judgment were granted to the Third–Party corporate Defendants as requested, part of the conduct which established the alter ego finding, i.e., the usurpation of corporate opportunities to the community and the use of corporate assets to pay for community expenses, would result in harm to the community and KYMBERLY BENSON LIFSHUTZ'S separate property estate, which would require piercing the corporate veil in order to avoid an inequitable result.

The Court finds that there is no true adversity between any of the Third–Party Defendants and JAMES G. LIFSHUTZ.

The Court finds that the Third–Party Defendants' claims against JAMES G. LIFSHUTZ and KYMBERLY BENSON LIFSHUTZ are invalid since they are merely alter ego of JAMES G. LIFSHUTZ.

The court finds that the Third–Party Defendants are all controlled by JAMES G. LIFSHUTZ, who sought to use the Third-party entities to advance as real an illusory and sham claim.

C. Ratification
The trial court found that the Entities ratified both the diversion of corporate opportunities and the improper payment of personal expenses through agreement, consent, or acquiescence.

If we assume that a breach of fiduciary duty can be ratified, there is no evidence of full disclosure to the other shareholders. Indeed, the evidence establishes that no disclosure was made. Accordingly, the trial court erred in finding that the Entities ratified James's breach based on the usurpation of business opportunities.

With regard to the payment of personal expenses, however, the evidence establishes that the shareholders were on notice that these expenses were being paid by the Entities. In fact, one of James's brothers received similar benefits, and the father's personal expenses had been paid through the Entities for years. Accordingly, the evidence supports the trial court's finding that James's actions with regard to the payment of personal expenses had been ratified.

D. Actual and Apparent Authority
The trial court found “that JAMES G. LIFSHUTZ
had actual and apparent authority to use corporate and partnership assets as his own.”

The Entities contend that the evidence is insufficient to establish that James had actual or apparent authority. The Entities assert, “There is no evidence that any entity intentionally authorized the misuse of its assets, either by word or conduct. There is no evidence of a resolution by any corporate board of directors, or any agreement of the shareholders or partners.” The Entities further assert that apparent authority extends only to conduct that is apparently for the purpose of carrying out the entity's business.


[34] [35] [36] [37] [38] [39] [40] Both actual and apparent authority are created through conduct of the principal communicated either to the agent (actual authority) or to a third party (apparent authority). Suarez, 35 S.W.3d at 272; Disney Enterprises, Inc., 981 S.W.2d at 30. Actual authority denotes that authority which the principal intentionally confers upon the agent, or intentionally allows the agent to believe he has, or by want of ordinary care allows the agent to believe himself to possess. Id.; Disney Enterprises, Inc., 981 S.W.2d at 30. Apparent authority arises through acts of participation, knowledge, or acquiescence by the principal that clothe the agent with the indicia of apparent authority. Insurance Co. of North America v. Morris, 981 S.W.2d 667, 672 (Tex.1998). Certain limitations apply in determining whether apparent authority exists. Suarez, 35 S.W.3d at 272. First, apparent authority is determined by looking to the acts of the principal and ascertaining whether those acts would lead a reasonably prudent person using diligence and discretion to suppose the agent had the authority to act on behalf of the principal. Suarez, 35 S.W.3d at 272; Disney Enterprises, Inc., 981 S.W.2d at 30. Only the conduct of the principal may be considered; representations made by the agent of his authority

*23 have no effect. Suarez, 35 S.W.3d at 272; Disney Enterprises, Inc., 981 S.W.2d at 30. Second, the principal must either have affirmatively held the agent out as possessing the authority or the principal must have knowingly and voluntarily permitted the agent to act in an unauthorized manner. Suarez, 35 S.W.3d at 272. Finally, a party dealing with an agent must ascertain both the fact and the scope of the agent's authority, and if the party deals with the agent without having made such a determination, she does so at her own risk. Suarez, 35 S.W.3d at 272; Disney Enterprises, Inc., 981 S.W.2d at 30.

[41] [42] There is no evidence in the record that the Entities intentionally conferred on James the authority to usurp business opportunities, took any action that would enable James to believe he had the authority to usurp business opportunities, or failed to exercise ordinary care thereby allowing James to believe he had authority. With regard to apparent authority, apparent authority exists “where the principal's conduct would lead a reasonably prudent person to believe that the agent possessed the authority to act on behalf of the principal.” Disney Enterprises, Inc., 981 S.W.2d at 30. This concept does not apply in this context where clearly James was not acting on behalf of the Entities. Accordingly, the trial court erred in finding that James had actual or apparent authority to use corporate and partnership assets as his own.

E. Conclusion as to Entities' Appeal

The evidence conclusively established that James breached his fiduciary duty in usurping the business opportunities of the Entities. The trial court erred in ignoring the law of the case and the scope of the remand in denying relief on the basis of alter ego, no true adversity, and sham. The evidence is insufficient to support the trial court's findings that the Entities ratified James's actions or that he had actual or apparent authority to engage in the wrongful acts. Because liability as to the breach of fiduciary duty claim was contested and damages are unliquidated, we remand the breach of fiduciary duty claim to the trial court for further proceedings consistent with this opinion. See Tex.R.App. P. 44.1(b).

James's Appeal

A. Award of Greater Percentage of Property to Kymberly

[43] In his first issue, James contends that the trial
court “improperly disregarded” our opinion in *Lifshutz I* and “punished James by awarding even more property to Kymberly than it awarded under the first, erroneous judgment.” James appears to contend that because we rejected Kymberly's complaints regarding the nature of the property division in *Lifshutz I*, the trial court erred in changing its division on remand. In *Lifshutz I*, however, we expressly remanded the division of community property to the trial court for reconsideration. See *Lifshutz I*, 61 S.W.3d at 519. James cites a criminal case to support the contention that because no new evidence was presented, the trial court could not “punish” him on remand by changing the property division. Because this court remanded the cause to the trial court to reconsider the property division, the trial court did not ignore the *Lifshutz I* decision or violate any legal principal in following this court's instructions on remand to reconsider the property division. See *Hudson*, 711 S.W.2d at 630 (noting instructions given in former appeal will be adhered to and enforced).

B. Distribution of Berlee Lumber Company Stock

In his second issue, James challenges the finding by the trial court “that *24 1/3 of the stock of Berlee Lumber Company was distributed by Liberty Partnership to JAMES G. LIFSHUTZ as a non liquidating community distribution and then recontributed by JAMES G. LIFSHUTZ to Liberty Financial during the reorganization and reimbursement was therefore due the community estate.” In the final divorce decree, the trial court further found, “that the distribution of Berlee stock should be and is hereby characterized as community property and when contributed by JAMES G. LIFSHUTZ to his separate corporate entities, JAMES G. LIFSHUTZ' separate estate was enhanced between $1,100,000.00–$1,780,630.00.”

The evidence presented on this issue is conflicting. In 1990, Liberty Properties Partnership appeared to have acquired the stock of Berlee Lumber Company from Barnard Lifshutz, James's father. Although there is conflicting evidence with regard to the recording of this transfer in the stock book, the remainder of the evidence appears to support a finding that the stock was transferred to Liberty Properties Partnership. In 1996, the Berlee stock was transferred from Liberty Properties Partnership to Liberty Financial Corporation. The trial court found that this transfer resulted in a distribution from the partnership to James, causing it to become a community property asset before it was then recontributed to Liberty Financial Corporation.

Kymberly called several experts in both legal and accounting or tax fields who testified that the transfer caused a distribution to James. James called several experts who testified to the contrary.

Janet E. Stigent–Burns, a certified public accountant, stated she reviewed the 1996 tax return, including the K1, financial statements, general ledgers, work paper entries, and various items in the minute book, corporate records, and partnership records. The 1996 partnership return showed a distribution to the partners consisting of the Berlee stock, a note receivable from Texas Home Improvement, and various cash distributions. Burns characterized the distribution as community property. Burns testified that the value of the distribution of Berlee stock was $1,108,348.00. On cross-examination, Burns stated that she was unaware of another way the transaction could be documented for tax purposes if the transfer was direct from Liberty Properties Partnership to Liberty Financial Corporation. Burns stated that the direct transfer could not be accomplished without a deemed or constructive distribution to James and his brothers. Burns also testified that the financial statement and tax return for Liberty Financial Corporation documenting the contribution of the Berlee stock and James's individual tax return contained entries that were inconsistent with a direct transfer.

Norman Seeman, a certified public accountant, prepared the tax returns for James and the Entities. Although Seeman agreed that the tax returns showed the Berlee stock as being distributed, Seeman stated that the “amount wasn't distributed. This amount was transferred to another corporation.” Seeman later insisted that the Berlee stock was not distributed, stating:

Don't use the word “distributed.” You keep coming back—it wasn't distributed. This was part of a recapitalization. It was transferred from one company to the other. You keep saying distributed, and it wasn't distributed.

Seeman testified that he did not intend the entries to reflect a distribution but a direct transfer of the Berlee stock from the partnership to the corporation.

Peter Wolverton, a tax attorney with a masters in taxation, reviewed the tax returns *25 of Liberty
Properties Partnership and Liberty Financial Corporation. Wolverton stated that the partnership reported the transaction as a distribution of Berlee stock to James and his brothers. Wolverton further testified that Liberty Financial treated the transaction as a contribution to capital by James and his brothers to Liberty Financial. Wolverton stated that if Berlee had transferred the stock to Liberty Financial directly and thereby became a shareholder, the transaction would have resulted in a $3,000,000 taxable gain. If the stock was transferred directly and Berlee did not become a shareholder as part of a tax reorganization, the Berlee stock would have a zero basis, and Liberty Financial would not be able to deduct any losses with regard to that asset. Wolverton stated that the fair market value of Berlee at the time of transfer was $3,400,000.00.

Stanley Blend, a tax attorney, testified that in planning the reorganization, the Berlee stock was to be transferred from the partnership to the corporation. Blend agreed that for federal income tax purposes, the transfer of the stock was shown as a distribution to the partners; however, Blend asserted that it could have been shown as a direct investment. Blend stated that the stock certificates reflected that the ownership was transferred from the partnership to the corporation under Texas substantive law.

William Bradley, a certified public accountant, testified that the tax returns contained one acceptable way in which the direct transfer of the stock could be reported; however, other methods could also have been used. Bradley agreed that the direct transfer would “possibly” require the Berlee stock to be reflected on Liberty Financial's books with a zero basis.

James relies on Thomas v. Thomas, 738 S.W.2d 342 (Tex.App.-Houston [1st Dist.] 1987, writ denied), to support his position. In Thomas, a spouse was claiming that retained earnings in a Subchapter S corporation should be considered marital property because the income of Subchapter S corporations is treated as the personal income of the shareholders for tax purposes. 738 S.W.2d at 343–44. The court noted that Subchapter S status does not determine who owns the corporation's earnings but merely provided an alternative method to tax the corporation's income. Id. at 344. “A Subchapter S corporation may distribute its income, but, like any other corporation, it is not required to do so. Corporate distributions, regardless of form, are controlled by state law.” Id. The court agreed with the unanimous holding of the courts in community property states that “corporate earnings remained corporate property until distributed and, therefore, were not divisible on divorce.” Id. at 344.

Thomas would be more on point if Liberty Properties Partnership had retained its interest in the Berlee stock. In that case, the Berlee stock would be a retained partnership asset and would not be a part of the community property estate. The distinction in this case is that the Berlee stock was undisputedly transferred, and the question is whether it resulted in a distribution to James.

Kymberly relies on Marshall v. Marshall, 735 S.W.2d 587 (Tex.App.-Dallas 1987, writ ref'd n.r.e.), to support her position. In Marshall, the husband owned a separate property interest in a partnership. The partnership engaged in oil and gas exploration and production. Id. at 594. The partnership acquired all of its oil and gas leases before the marriage. Id. The partnership disbursed $542,315.72 to the husband during the marriage. Id. The husband maintained that only the $22,400.00 paid as salary was community *26 property. Id. The court rejected the husband's argument and held that the distributions of partnership income or profits were community property. Id. at 595.

In view of Marshall, James argues that the distribution in this case was an asset distribution and not a profit distribution; therefore, James contends that Marshall is not controlling. In Marshall, the court noted:

[A] withdrawal from a partnership capital account is not a return of capital in the sense that it may be characterized as a mutation of a partner's separate property contribution to the partnership and thereby remain separate. Such characterization is contrary to the UPA and implies that the partner retains an ownership interest in his capital contribution. He does not; the partnership entity becomes the owner, and the partner's contribution becomes partnership property which cannot be characterized as either separate or community property of the individual partners. Thus, there can be no mutation of a partner's separate contribution; that rule is inapplicable in determining the characterization of a partnership distribution from a partner's capital account.
Whether the distribution was of an asset or cash, the distribution was from the capital account to which Marshall states that the “mutation of a partner's separate contribution” does not apply. As one commentator has explained:

As with trusts, a partnership can be an effective means of preserving the separate property character of assets contributed to the partnership and the undistributed income thereon. The partner's spouse does not have an interest in the assets of the partnership until the assets and profits are actually distributed to the partner either in the form of partnership income or return of capital. To the extent that income distributions are made from the partnership, the distributions will be characterized as community property. Further, to the extent that distributions from the partnership include a return of the partner's separate capital contribution, the distribution will be characterized as community income because the partnership entity becomes the owner of the capital contribution. Thus, no mutation of the partner's separate property contribution occurs. Essentially, the rule of mutation of separate property is inapplicable in characterizing a partnership distribution from a partner's capital account.


Even if we accept that the manner in which a transaction is documented for tax purposes is not controlling, it still must be considered as some evidence. Furthermore, although traditionally the stock book of a corporation might be decisive with regard to the manner in which stock ownership was transferred, evidence was presented in this case that could cause the trial court to question whether the validity of the stock book accurately reflect the conveyance of the corporate stock. There was evidence that when the stock book was reviewed in 1993, it did not reflect the conveyance of the Berlee stock to Liberty Properties Partnership in 1990 although a subsequent review of the stock book revealed certificates dated in 1990. The trial court could have found that in light of that evidence, the stock book was not credible evidence of the manner in which the Berlee stock was conveyed because the stock certificates could be created at any time and back dated. Accordingly, the evidence *27 is sufficient to support the trial court's finding that a distribution occurred.

Texas has adhered to the entity theory of partnership since the Texas Uniform Partnership Act was enacted in 1961. See *Haney v. Fenley, Bate, Deaton & Porter*, 618 S.W.2d 541, 542 (Tex.1981); *Burnap v. Linnartz*, 914 S.W.2d 142, 150 (Tex.App.-San Antonio 1995, writ denied). Under the entity theory, all property brought into the partnership is partnership property and, as partnership property, does not retain either a community or separate property nature. See *Harris v. Harris*, 765 S.W.2d 798, 804 (Tex.App.-Houston [14th Dist.] 1989, writ denied). “This is an area in which the community property principles and the Texas version of the Uniform Partnership Act conflict.” 38 Aloysius A. Leopold, *Texas Practice: Marital Property and Homesteads* § 7.10 (1993). “[W]hen an individual partner contributes property into a partnership, the partner loses individual interest in the property and, since the partnership itself is the new owner, the property can no longer be classified as separate or community.” *Id.* at § 4.10. Accordingly, since partnership property does not retain a separate character, distributions from the partnership are considered community property, regardless of whether the distribution is of income or of an asset.* Marshall*, 735 S.W.2d at 594.

James further contends that if the trial court did not err in finding that a distribution had occurred, it erred in failing to apply a minority discount in valuing James's 1/3 interest. Again, the evidence is conflicting on whether a minority discount should apply. James's expert testified that no minority discount would apply because:

The time when the Burlee [sic] Lumber Company stock was a minority interest was instantaneous, at best, and according to Mr. Pearl [Berlee's attorney], it never happened because it went—immediately became part of the capital of Liberty Finance [sic]. Under those circumstances, the number of cases which indicate whether you look at the entire transaction, there would never be a minority or marketability discount because 100% of the stock of the company was together and is still together.

Because it is within the trial court's province to weigh the credibility of the witnesses and the weight
to be given their testimony, the evidence is legally and factually sufficient to support the trial court's finding that a minority discount was not applicable.

C. Reimbursement for Undercompensation
In his third issue, James challenges the trial court's finding that "JAMES G. LIFSHUTZ was undercompensated and that the Jensen Claim of KYMBERLY BENSON LIFSHUTZ should be granted." In the final divorce decree, the trial court ordered "that KYMBERLY BENSON LIFSHUTZ' Jensen reimbursement claim be and it is hereby granted in the total amount of $492,835.00."

Texas has adopted the reimbursement theory with regard to the manner in which to treat, upon divorce, increases in the value of corporate stock during the marriage where the corporate stock is the separate property of one spouse. Jensen v. Jensen, 665 S.W.2d 107, 109 (Tex.1984). The reimbursement theory provides that the stock, as it appreciates, remains the separate property of the owner spouse. Id. Under this theory, the community is entitled to reimbursement for the reasonable value of the time and effort of both or either of the spouses which contributed to the increase in the value of the community stock. Id. Accordingly, the community is required to be reimbursed for the value of time and effort expended by either or both spouses to enhance the separate estate of either, other than that reasonably necessary to manage and preserve the separate estate, less the remuneration received for that time and effort in the form of salary, bonus, dividends and other fringe benefits, those items being community property when received. Id. (emphasis added). In Lifshutz I, we noted that "[i]f the evidence supports a finding that James was undercompensated for his time and talent spent increasing the value of his separate interests, Kymberly may have a claim for reimbursement to the community." 61 S.W.3d at 518 n. 5.

As the party seeking reimbursement, Kymberly had the burden to prove the community estate was entitled to it. Jensen, 665 S.W.2d at 110; Gutierrez v. Gutierrez, 791 S.W.2d 659, 665 (Tex.App.-San Antonio 1990, no writ). While mathematical certainty is not required, there must be some proof of the value by which the time, toil and effort exceeded that necessary to manage and preserve the separate estate. Gutierrez, 791 S.W.2d at 665. The party seeking reimbursement must establish that the value of the time and effort expended to enhance separate property exceeds both: (1) the time and effort reasonably necessary to manage and preserve his separate estate; and (2) the remuneration received from the corporation as compensation for that time and effort. In re Marriage of Cassel, No. 07–96–0268–CV, 1997 WL 260099, at *3 (Tex.App.-Amarillo May 19, 1997, no pet.). In order to establish that the efforts did more than was required to maintain the separate estate, evidence must be introduced to show the amount of time that was reasonably necessary for the party to spend managing and preserving the separate estate. Gutierrez, 791 S.W.2d at 665; Thomas, 738 S.W.2d at 345–46 (Dunn, J., concurring and dissenting).

In this case, Kymberly presented no evidence of the amount of time that was reasonably necessary for James to spend managing and preserving the Entities. In fact, Wolverton, one of the experts called to testify regarding the Jensen reimbursement, expressly declined to provide evidence regarding this element, responding to questions about this element, responding to questions about this element as follows:

Q. What was the value of the time or effort reasonably necessary for him to manage his separate property interest in Liberty Properties?

A. I do not have an opinion about that.

Q. What was the value of the time or effort reasonably necessary for him to manage his one-third ownership in Liberty Financial?

A. I do not have an opinion on that.

Although Wolverton's testimony may have been sufficient to establish that James was undercompensated and that the value of the Entities increased as a result of James's efforts, Kymberly is not entitled to the enhanced value of the separate property, but only to the value of time, toil, and labor utilized to benefit the Entities beyond that which was reasonably necessary for James to spend managing and preserving the Entities. Gutierrez, 791 S.W.2d at 665.
and preserve the separate property from the evidence that was presented. “We acknowledge that great latitude must be afforded the trial court in its application of equitable principles to value a claim for reimbursement.” In re Marriage of Cassel, 1997 WL 260099, at *3. “Yet, the court's proper exercise of its discretion obtains only when its action is neither arbitrary or unreasonable, but is taken with reference to guiding rules and principles.” Id. In this case, Wolverton could not give an opinion on the value of James's time or effort reasonably necessary for him to manage his separate property. James Park, the other expert who testified regarding the Jensen reimbursement claim, testified that the increased value or enhancement of the Entities was not attributable to the time and effort expended by James. Although “mathematical certainty” is not required, some evidence was required to be presented regarding the value of the time reasonably necessary to manage and preserve the separate property. Gutierrez, 791 S.W.2d at 665; In re Marriage of Cassel, 1997 WL 260099, at *3 (reversing trial court's finding regarding value of corporation based on figures provided by expert where expert testified that he did not have sufficient information to give an opinion on value). Because Kymberly did not meet her burden to present that evidence, the evidence was legally insufficient to support the trial court's award of the Jensen reimbursement.

Conclusion
The evidence is sufficient to support the trial court's finding with regard to the distribution of the Berlee stock. The evidence is insufficient to support the Jensen reimbursement award. The trial court's judgment as to the Entities' breach of fiduciary duty claim is reversed. Because liability as to the breach of fiduciary duty claim was contested and damages are unliquidated, we remand the breach of fiduciary duty claim to the trial court for further proceedings consistent with this opinion. “Any change in the trial court's judgment on liability or damages for breach of fiduciary duty could potentially result in a loss of property from both the community estate and Kymberly's separate estates. Because of this possibility, the property division must be remanded, including the award of attorney's fees.” Lifshutz I, 61 S.W.3d at 518.

Concurring opinion by SARAH B. DUNCAN, Justice.

SARAH B. DUNCAN, Justice, concurring.
Footnotes

1. Associate Judge Richard Garcia presided over the underlying proceedings and entered the judgment and the findings of fact and conclusions of law. The Honorable Michael Peden adopted Judge Garcia's recommendations.


3. We note that the trial court impliedly found that James breached his fiduciary duty in expressly finding that “if judgment were granted to the Third–Party corporate Defendants as requested, part of the conduct which established the alter ego finding, i.e., the usurpation of corporate opportunities to the community and the use of corporate assets to pay for community expenses, would result in harm to the community...”

4. We recognize that a Louisiana appellate court has drawn a distinction between distributions of income and distributions of a capital asset. Guilott v. Guilott, 361 So.2d 1271, 1276–77 (La.Ct.App.1978, writ denied). In Guilott, however, the court did not analyze the effect of the entity theory of partnerships in concluding that a distribution of the capital assets of the partnership, as distinguished from fruits or earnings, was the wife's separate property. We further note that Wolverton testified that the accumulated profits in Liberty Properties exceeded the aggregate distributions, which included the Berlee stock distribution.