NEW FRONTIERS IN TRACING SEPARATE PROPERTY

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by

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I. INTRODUCTION. Texas courts have entertained a variety of approaches to proving separate property. Other jurisdictions, as well, have published appellate cases about how to trace property upon divorce. Tracing is not limited to marital property disputes. Tracing is also needed to sort out proceeds from the sale of exempt assets that were mixed with non-exempt cash, or to allocate funds when monies embezzled from different people have been mixed. This article discusses various approaches to tracing used by Texas courts, along with tracing approaches used in other jurisdictions.

II. TRACING; MUTATIONS. "[T]he question whether particular property is separate or community must depend upon the existence or nonexistence of the facts, which, by the rules of law, give character to it . . . ." *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565, 568 (Tex. 1961). "Tracing involves establishing the separate origin of the property through evidence showing the time and means by which the spouse originally obtained possession of the property." *Boyd v. Boyd*, 131 S.W.3d 605, 612 (Tex. App.--Fort Worth 2004, no pet.). As noted in *Pace v. Pace*, 160 S.W.3d 706, 711 (Tex. App.--Dallas 2005, pet. denied): "Where an asset is purchased during marriage with monies traceable to a spouse's separate estate, the asset may appropriately be characterized as separate property."

The Supreme Court said, in *Rose v. Houston*, 11 Tex. 324, 1854 WL 4287, *2 (Tex. 1854):

> It has been decided, not only that property received in exchange for the separate property of one of the parties to the nuptial contract remains separate property, but that property purchased with money which was obtained upon the sale of the separate property of either husband or wife, also remains separate property. (*Love v. Robinson*, 7 Tex. R., 6; *McIntyre v. Chappell*, 4 *Id*.) The consequence is, that to maintain the character of separate property, it is not necessary that the property of either husband or wife should be preserved in specie, or in kind. It may undergo mutations and changes, and still remain separate property; and so long as it can be clearly and indisputably traced and identified, its distinctive character will remain.

In *Smith v. Bailey*, 66 Tex. 553, 1 S.W. 627, 628 (Tex. 1886), the Supreme Court said: "Another principle, equally well settled, is that the wife's separate property may undergo mutations and changes, yet retain its separate character; but the proof to trace and identify it in its changed condition must be clear and satisfactory." Again in *Norris v. Vaughan*, 152 Tex. 491, 496-97, 260 S.W.2d 676, 679 (1953), the Supreme Court said: "so long as separate property can be definitely traced and identified it remains separate property regardless of the fact that the separate property may undergo 'mutations and changes.'"

In *Celso v. Celso*, 864 S.W.2d 652, 654 (Tex. App.--Tyler 1993, no writ), the court said: "Separate property will retain its character through a series of exchanges so long as the party asserting separate ownership can overcome the presumption of community property by tracing the assets on hand during the marriage back to property that, because of its time and manner of acquisition, is separate in character."

The court in *Faram v. Gervitz-Faram*, 895 S.W.2d 839, 842 (Tex. App.--Fort Worth 1995, no writ), described tracing in the following way:

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

In *Legrand-Brock v. Brock*, 246 S.W.3d 318, 321(Tex. App.--Beaumont 2008, pet. denied), the court said:

> Generally, when a spouse owns separate-property stock in a dissolving corporation and receives distributions of liquidated assets, the distributions remain the stockholder's separate property. . . . The character of property is not altered by the sale, substitution, or exchange of the property; separate property that merely undergoes mutations or changes in form remains separate property.

Despite the current popularity of tracing separate property through commingled funds using line-item-tracing based on the community-out-first "rule," there is no case saying that this is the preferred or only way to trace separate property through commingled financial accounts. As noted in *Gibson v. Gibson*, 614 S.W.2d 487, 489 (Tex. Civ. App.--Tyler 1981, no writ):

> Courts dealing with the tracing of separate property commingled with community funds have required varying degrees of particularity in identifying separate property. See 6 St. Mary's L. J. 234 (1974). Many Texas cases have been strict in demanding a "dollar for dollar" accounting of separate funds used to purchase an asset, the ownership of which is in dispute.

> *e.g., Schmeltz v. Gary*, 49 Tex. 49 (1878); *Latham v. Allison*, *supra*; *West v. Austin National Bank*, 427 S.W.2d 906 (Tex. Civ. App.-San Antonio 1968, writ ref'd n.r.e.); *Stanley v. Stanley*, 294 S.W.2d 132 (Tex. Civ. App.-Amarillo 1956, writ ref'd n. r. e., *cert. den'd,* 354 U.S. 910, 77 S.Ct. 1296, 1 L.Ed.2d 1428).
>
> Certain other courts have been more lenient in their treatment of the tracing problem. The philosophy prompting these decisions was expressed in *Farrow v. Farrow*, 238 S.W.2d 255, 257 (Tex. Civ. App.-Austin 1951, no writ): "One dollar has the same value as another and under the law there can be no commingling by the mixing of dollars when the number owned by the claimant is known." In *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.-Dallas 1955, writ dism'd), the court allowed appellee to trace her separate property through a series of transactions, including the deposit of the proceeds from a sale of her separate realty into a joint account containing a substantial amount of community funds and separate funds belonging to the other spouse. According to *Sibley*, community funds will be presumed to have been drawn out before separate funds from a joint bank account.
>
> In still other cases, spouses have been permitted to distinguish their separate funds commingled in a bank account with community money by proving that community withdrawals, e. g. for living expenses, equaled or exceeded community deposits. For example, in *Coggin v. Coggin*, 204 S.W.2d 47, 52 (Tex. Civ. App.--Amarillo 1947, no writ), evidence was presented to show that income from the wife's property totaled approximately $1,000 per year, while family living expenses were $200-$500 monthly. The court found that such community funds could not have been used to pay for the property in question since they had already been depleted in paying for the living expenses. *See DePuy v. DePuy*, 483 S.W.2d 883, 888 (Tex. Civ. App.--Corpus Christi 1972, no writ).

A close analysis of Texas case law demonstrates that Texas courts have recognized a variety of approaches to proving a claim of separate property.

The court in *Coggin v. Coggin*, 204 S.W.2d 47, 55 (Tex. Civ. App.--Amarillo 1947, no writ), commented:

> [W]here the terms community property and separate property have been adequately defined, it is not necessary to point out specifically in special requested charges the various fact situations whereby separate property may become community property.

Coggin supports an argument that it is not the role of the court to detail to the fact-finder specific tracing methods that can and cannot be used. This suggests that whether a tracing approach is clear and convincing is a question for the fact-finder to decide.

In keeping with general rules of litigation, unless separate property identity is proven conclusively (i.e., as a matter of law), or unless there is not more than a scintilla of evidence to support a separate property claim (i.e., legally insufficient evidence), the character of property is a fact issue to be determined by the finder of fact based upon a clear and convincing evidence standard.

A tracing case can involve disputes over both the facts and what law should be applied to those facts. However, some aspects of tracing methodologies are not mentioned in case law, and their use is a matter of accounting practices, tracing conventions, logic, or opinion, not law.

III. PRESUMPTIONS AND BURDEN OF PROOF. In many tracing cases, the fight over the law has to do with the use of presumptions proposed by a party to support his/her position. The role of presumptions in trying and appealing cases is a complicated and poorly understood area of the law.

A. THE COMMUNITY PRESUMPTION. The starting point law to apply to a tracing case in Texas is the presumption of community property. In *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965), the Supreme Court wrote:

> The plain wording of the statute [Art. 4619] creates a rebuttable presumption that all property possessed by a husband and wife when their marriage is dissolved is their community property and imposes the burden upon one asserting otherwise to prove the contrary by satisfactory evidence. . . . The general rule is that to discharge the burden imposed by the statute, a spouse, or one claiming through a spouse, must trace and clearly identify property claimed as separate property . . . .
>
> Thus, in a divorce the spouse claiming a separate property interest must "trace and clearly identify the property in question."

All property possessed by a spouse during and on dissolution of marriage is presumed to be community property. TEX. FAM. CODE § 3.003(a). However, this presumption is rebuttable, and can be overcome by evidence to the contrary. The community property presumption can be said to cast upon the adverse party the burden of producing contradictory evidence.

B. THE BURDEN OF PERSUASION. The burden of proof (also called the "burden of persuasion") to be applied by the fact finder in determining separate property is "clear and convincing evidence." TEX. FAM. CODE § 2.002(b). Courts in marital property cases sometimes borrow the definition of "clear and convincing evidence" set out in Title 5 of the Family Code relating to parent-child suits: "'Clear and convincing evidence' means the measure or degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established." TEX. FAM. CODE § 101.007. *See Huval v. Huval*, 2007 WL 1793771 (Tex. App.–Beaumont 2007, no pet.) (memo. op.) (citing Section 101.007 in a tracing case).

C. COUNTER-PRESUMPTIONS. Even the role of assigning the burden of proof can be taken from the community presumption in some situations. The introduction into evidence of certain facts can give rise to a presumption that replaces the presumption of community property, with regard to a particular issue. For example, *Kahn v. Kahn*, 94 Tex. 114, 58 S.W. 825, 826 (1900), indicated that a deed from a third party to a spouse, which recites separate property, creates a presumption that the property is the separate property of that spouse. In *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 431 (Tex. 1970), the Supreme Court said:

> Before Miller offered evidence to show that the property was acquired during coverture, which would give rise to the presumption that this was community property, the Sheriff introduced into evidence the deed to Nancy Shoaf containing the recitals to the effect that the land was conveyed to her as her sole and separate estate, and that the consideration was paid and to be paid out of her separate estate. As a result of the recitals in the deed, no presumption of community property existed. By the introduction of the deed containing these recitals into evidence, the Sheriff established a prima facie defense that the Amanda Street property was the separate property of the wife, Nancy Shoaf, and Not subject to execution; Article 4616.

Another example is the presumption that a transfer from a parent to a child is a gift. *Blair v. Blair*, 1999 WL 649082, at *4 (Tex. App.--Houston [14 Dist.] 1999, no pet.) ("When property is deeded from a parent to a child it is presumed that a gift was intended"). In *Somer v. Bogert*, 762 S.W.2d 577 (Tex.1988) (per curiam), the Supreme Court said:

> [T]he court of appeals . . . held that 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. . . . We approve the holding of the court of appeals that the burden of proof in refuting the presumption of gift is by clear and convincing evidence.

Other countervailing presumptions were set out in *Dessommes v. Dessommes*, 505 S.W.2d 673, 679 (Tex. App.--Dallas 1973, writ ref'd n.r.e.):

> The burden of proof is not necessarily determined by which party happens to be in the position of plaintiff. It may rest on broad considerations of fairness, convenience and policy, 9 J. Wigmore, Evidence § 2486 at 275 (3d ed. 1940); 1 C. McCormick & R. Ray, Texas Law of Evidence § 43 at 40 (2d ed. 1956). One of the recognized principles in determining the burden is to place it on the party having peculiar knowledge of the facts to be proved. *W. A. Ryan & Co. v. M.K. & T. Ry.*, 65 Tex. 13 (1885); *Beaumont, S.L. & W. Ry. v. Myrick*, 208 S.W. 935(Tex.Civ.App.-Beaumont 1919, writ dism'd); *Rowe v. Colorado & S.R.*, 205 S.W. 731 (Tex.Civ.App.-Amarillo 1918, writ ref'd); 9 J. Wigmore, Supra at 275; 1 C. McCormick & R. Ray, Supra at 39. This principle is consistent with authorities holding that one who has innocently commingled another's goods or funds with his own does not gain anything by the commingling, but has the burden of establishing what portion is his. *Wright v. Ellwood Ivins*

> *Tube Co.*, 128 F. 462 (C.C.E .D.Pa.1904); *Claflin v. Continental Jersey Works*, 85 Ga. 27, 11 S.E. 721 (1890); *In re Thompson*, 164 Iowa 20, 145 N.W. 76 (1914). A fair general rule deducible from the above authorities is that if the parties are shown to have been the equal owners of a fund at a certain time, and one of them is shown to have made additions to that fund in an undetermined amount, the party who made the additions should have the burden to show the amount of the additions.

Another countervailing presumption was set out in *Giesler v. Giesler*, 309 S.W.2d 949, 950 (Tex. Civ. App.–San Antonio 1958, no writ):

> We think, in view of the fact that appellant managed the community estate and in that capacity personally was guilty of commingling said community funds into his wife's separate bank account, that it would be inequitable to permit him to profit by such action by applying the strict doctrine of commingling.

The Texas Family Law Practice Manual form premarital agreement (Form 63-3) undertakes to replace the community presumption in some instances. See Section III.D below.

D. ALTERING THE BURDEN OF PROOF BY AGREEMENT. Premarital and post-marital agreements can alter the marital property character of assets despite the normal rules of characterization. The parties can make community property separate, separate property community, and at least in premarital agreements can waive reimbursement claims.

The Texas Family Law Practice Manual premarital agreement form (Form 63-3) purports to alter presumptions and methods of proving separate property.

Paragraph 17.3 says that property held in a spouse's individual name is presumed to be that spouse's separate property:

> *17.3 Presumption of Separate Property*
>
> Any property held in [**name of party A**]'s individual name is presumed to be the separate property of [**name of party A**]. Any property held in [**name of party B**]'s individual name is presumed to be the separate property of [**name of party B**]. Any property or liability inadvertently omitted from the schedules attached to this agreement is the separate property or liability of the party to whom it belongs or by whom it was incurred.

Paragraph 3.3 negates any presumptive ownership resulting from commingling:

> *3.3 No Commingling Intended*

> Neither party intends to commingle his or her separate property with the separate property of the other party, except when intentionally done in a joint financial account, and neither party may claim an interest in any separate property of the other party as a result of such commingling, except as provided in this agreement.

Paragraph 3.4 lists facts that cannot be considered evidence of intent to create community (why not preclude the items as "evidence of community property"?):

> *3.4 Certain Events Not Evidence of Community Property*
>
> The following events may not, under any circumstances, be considered evidence of any intention to create community property:
>
> 1. the filing of joint tax returns;
> 2. the taking of title to property, whether real or personal, in joint tenancy or in any other joint or common form;
> 3. the designation of one party by the other party as a beneficiary of his or her estate or as trustee or any other form of fiduciary;
> 4. the combining or mixing by one party of his or her separate funds or property with the separate funds or property of the other party, including the pledging of joint or separate credit for the benefit of the other party's separate estate;
> 5. any oral statement by either party;
> 6. any written statement by either party, other than a written agreement signed by both parties to convert separate property to community property pursuant to the Texas Family Code;
> 7. the payment from the funds of either party for any obligations, including but not limited to the payment of mortgages, interest, real property taxes, repairs, or improvements on a separately or jointly held residence; and
> 8. the joint occupation of a separately owned residence, even though designated as a homestead.
>
> The provisions of this section 3.9 are not comprehensive.

Paragraph 9.1 says that jointly-held property "may not be deemed to be community property," and that absent records of each party's contribution (that is, oral testimony has no probative weight), ownership is conclusively presumed to be 50-50.

The form premarital agreement, para. 14.1, provides terms on how you can and cannot prove a gift.

> *14.1 Gifts*
>
> * * *

> To remove any uncertainty about the issue of interspousal gifts, the parties agree that:
>
> 1. Gifts of wearing apparel, jewelry, and athletic equipment may be established by parol testimony if the item or property is customarily used and enjoyed exclusively by the party claiming it as a gift to him or her;
>
> 2. Gifts of other items of personal property not covered by item 1. above, such as furnishings, artwork, cash, and collections, must be established by clear and convincing evidence; and
>
> 3. Any property that is held by title, as in a deed, in a certificate, or by account name, may not be effectively transferred to the party claiming it as a gift unless, in fact, the deed, certificate, or account is transferred by name to the party claiming the gift.

The author could find no case in America where an appellate court ruled on a contractually-altered burden of proof. The few law review articles on point support the right to contract.

IV. MANAGEMENT RIGHTS. An issue that has not been adequately explored in the context of marital property tracing cases is a spouse's management rights.

TEX. FAM. CODE § 3.101 provides:

> Each spouse has the sole management, control, and disposition of that spouse's separate property.

TEX. FAM. CODE § 3.102(a) provides:

> (a) During marriage, each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single, including:
>
> (1) personal earnings;
> (2) revenue from separate property;
> (3) recoveries for personal injuries; and
> (4) the increase and mutations of, and the revenue from, all property subject to the spouse's sole management, control, and disposition.

Does a spouse have the right, in the exercise of his/her management powers, to decide to expend separate property for some purposes and community property for other purposes? Or do tracing rules, mechanically applied after the fact, negate that right? To be effective, does the management intent need to exist at the time of the transaction, as opposed to the time of divorce?

V. THE MUTATION PRINCIPLE. A concept at the core of the tracing process is the concept of mutation, and the tenet that separate property does not lose its character because it changes in form. Most of the issues regarding tracing techniques have to do with the way you follow the wealth as it changes form. People sometimes talk about tracing under the assumption that you must precisely follow the flow of wealth as it mutates in form, and if you lose track of that precise flow then the separate wealth become community property. Texas courts have, in cases stretching over many years, reflected a different view: if they know the separate property is "in there somewhere," they have allowed different methods of showing where that wealth is, or how much that wealth is.

A. ASSET EXCHANGE. In a sense, nearly all acquisitions (other than gift or inheritance) are asset-exchange transactions, where one thing is swapped for another, or something is paid to purchase another thing, or where someone promises to pay something in the future in connection with buying something. The same applies when your perspective is the asset sold. "Trading in" an automobile in connection with buying a new one is an asset exchange. But then so is a corporation transferring some or all of its assets to another entity in exchange for an ownership interest in the other entity. A distribution in redemption or liquidation of corporate stock is likewise a mutation.

B. ENTITY CHANGE. Texas law now permits corporations to convert into partnerships, and partnerships to convert into corporations, and different entities to convert into limited liability companies, etc. This procedure replaced a more cumbersome process where a corporation was converted into a partnership by creating a new entity and merging the two, or by creating the new entity and then conveying all assets of the corporation to the partnership, with shareholders becoming partners in the partnership. It is valid to ask whether the character of a new business formed from an old business should depend upon the exact manner of converting the business from one form to another, or whether the concept of mutation should apply, regardless of the details.

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 the husband's separate property, despite the fact that he and the other owners of the old corporation put $200,000 into the merger.

One case affirmed a trial court's finding that, in a business reorganization, the transfer of an asset from a partnership to a corporation was a constructive distribution to the married partner. *See Lifshutz v. Lifshutz*, 199 S.W.2d 9, 27 (Tex. App.–San Antonio 2006, no pet.) ("*Lifshutz II*"). The trial court found this to be a "non-liquidating community distribution" from the partnership, and held the asset to be community property distributed to the husband. *Id*. at 24. After an extensive analysis of the facts and citation to *Marshall v. Marshall*, 735 S.W. 2d 587, 594 (Tex. App.–Dallas 1987, writ ref'd n.r.e.), 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.

VI. SEPARATE CREDIT. Under Texas law, "debts contracted during marriage are presumed to be on the credit of the community and thus are joint community obligations, unless it is shown the creditor agreed to look solely to the separate estate of the contracting spouse for satisfaction." *Cockerham v. Cockerham,* 527 S.W.2d 162, 171 (Tex. 1975) (footnote omitted). The mere intent of the spouses does not control whether the credit is community or separate. *Gleich v. Bongio,* 128 Tex. 606, 99 S.W.2d 881 (1937). Some courts of appeals have taken a liberal view of what constitutes proof of an agreement by the creditor to look solely to the borrowing spouse's separate estate for repayment. For example, in *Brazosport: Bank of Texas v. Robertson,* 616 S.W.2d 363, 366 (Tex. Civ. App.--Houston [14th Dist.] 1981, no writ), the court held that the bank's loaning money to the wife over the husband's objection, where the note was signed by the wife alone and the title to the automobile was taken in the wife's name alone, constituted an agreement by the lender to look to the wife alone for satisfaction of the debt. In *Holloway v. Holloway, 671* S.W.2d 51, 57 (Tex. App.--Dallas 1983, writ dism'd), an implied agreement on the part of a creditor to look solely to the husband's separate estate was inferred from the fact that the loan proceeds were deposited into an account designated as the husband's separate property account, and the fact that the husband alone signed the loan papers "Pat S. Holloway, Separate Property," and the fact that only the husband's separate property was used a collateral.

The case of *Edsall v. Edsall,* 240 S.W.2d 424, 428 (Tex. Civ. App.--Eastland 1951, no writ), involved an acquisition where part of the purchase price was paid in two installments, separated over time. One spouse claimed that separate property was used for both installments. The other spouse claimed that the second installment was a instance of community credit. The appellate court said:

> It is to be noted that such 80 acre tract was acquired by appellee about one year after his marriage. It is undisputed that at the time it was acquired he delivered to his son the 11 head of cattle valued at $660.00 and that these cows were his separate property. It is likewise undisputed that the 8 cows delivered two months after the date of the deed were also appellee's separate property. This constituted a total of $1,100.00 of the consideration for such tract which came from appellee's separate estate. This evidence, in our opinion, raised a question of fact as to whether the parties intended at the time of the conveyance that such portion of the total consideration as was later satisfied by the 8 cows should be paid from appellee's separate estate. If such was the intention, the same proportion of the tract

> purchased thereby become separate property. It is undisputed that such portion was so paid from the separate estate. In our opinion the court was justified under these facts in holding that such 80 acre tract was 11/16ths appellee's separate property and 5/16ths community property.

VII. COMMINGLING. Commingling is the mixing of separate and community property assets, often money. In *Smith v. Bailey*, 66 Tex. 553, 554-55, 1 S.W. 627, 628 (Tex. 1886), the Supreme Court said:

> Mr. and Mrs. Bailey were married in 1877 or 1878. The goods in her store at that time were her separate property. She did business with them from that time on, selling them in the usual course of trade, and with the proceeds of the goods replenished her stock. From the date of her marriage down to the time when the witness Meeks took charge of the store, a period of about three years, we have not one particle of testimony to show how much of the profits of the business entered into the purchase of goods to keep up the stock. The stock must have gone through many mutations before passing into Meeks' charge. Separate property and profits had been mingled at various times and in varied proportions in the purchase of this and preceding stocks. The presumed community character of this stock was not disproved, and, under the evidence, was subject to the husband's debts.

The Supreme Court of Texas said this about commingling, in *Tarver v. Tarver*, 394 S.W.2d 780, 783 (Tex. 1965):

> The plain wording of the statute [Art. 4619] creates a rebuttable presumption that all property possessed by a husband and wife when their marriage is dissolved is their community property and imposes the burden upon one asserting otherwise to prove the contrary by satisfactory evidence. . . . The general rule is that to discharge the burden imposed by the statute, a spouse, or one claiming through a spouse, must trace and clearly identify property claimed as separate property, *Schmeltz v. Garey*, 49 Tex. 49, 61 (1878); *Chapman v. Allen*, 15 Tex. 278, 283 (1855); . . . and that when the evidence shows that separate and community property have been so commingled as to defy resegregation and identification, the burden is not discharged and the statutory presumption that the entire mass is community controls its disposition. *Hodge v. Ellis*, 154 Tex. 341, 277 S.W.2d 900, 907 (1955). . . .

The Supreme Court reiterated in *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973), that "when the evidence shows that separate and community property have been so commingled as to defy resegregation and identification, the burden is not discharged and the statutory presumption prevails."

In *Martin v. Martin*, 759 S.W.2d 463, 466 (Tex. App.--Houston [1st Dist.] 1988, no writ), three lots were sold, two that were separate property and one that was community property. The lots were sold for a combined price. The appellate court held that, absent proof of the sales price for each lot, all proceeds were deemed to be community property.

In *Munoz v. Munoz*, 2003 WL 22977487, *5 (Tex. App.--El Paso 2003, no pet.) (unpublished), the appellate court considered a "commingled" personal injury recovery. The court said:

> [A]fter reviewing the record, we find a lack of clear and convincing evidence to rebut the presumption that some portion of the settlement funds were attributable to Appellee's lost earnings and lost earning capacity which are community estate assets. Since Appellee did not prove what amount of the settlement proceeds were separate or community property, a reasonable trier of fact could not have formed a firm belief or conviction that the net recovery from the settlement was entirely Appellee's separate property. . . . When some portion of a settlement may be for lost wages or lost earning capacity, the spouse receiving the settlement has the burden to show that none of the funds constitute payment for lost wages or lost earning capacity during marriage. . . . In the absence of such evidence, the entire settlement proceeds are properly characterized as community property. . . . Therefore, the trial court erred in its characterization of the settlement fund as Appellee's separate property. [Citations omitted]

Schneider v. Schneider, 2004 WL 254247, *2 (Tex. App.--Fort Worth 2004, pet. struck) (unpublished), is an odd case where spouses were fighting over a dog ("Lucky") purchased prior to marriage. The court said:

> Neither party presented any evidence to clarify the source of funds used to purchase Lucky. However, it is undisputed that appellee purchased Lucky prior to the marriage. Under the family code, a spouse's separate property consists of the property owned or claimed by the spouse before marriage. . . . However, in this case the parties lived together prior to marriage, and commingled their funds in a joint bank account. Both appellant and appellee testified that the funds used to purchase Lucky were the commingled funds from the joint bank account. Therefore, because neither of the parties established by clear and convincing evidence that Lucky was purchased with the separate property funds of either appellant or appellee, the most the evidence shows is that they own Lucky as tenants in common. . . . Thus, the trial court erred in confirming Lucky as appellee's separate property. [Citations and footnote omitted]

VIII. METHODS OF PROOF.

A. TESTIMONY OF A SPOUSE. Different appellate courts have said different things about the importance of a spouse's testimony of separate property. The cases as a whole usually (but not always) support the view that the uncorroborated testimony of a spouse (i) is more than a scintilla of evidence to support a finding of separate property, but (ii) is not so overwhelming as to cause the appellate court to overturn a negative finding on separate property.

Some of the tracing cases commenting on the weight to be given to a spouse's testimony involve purely conclusory statements by a spouse regarding character of property. Some of the cases involve the spouse's testimony alone without corroborating evidence. Some of the cases involve testimony by a spouse that is corroborated by other information. This makes it hard to discern a uniform principle regarding a spouse's testimony regarding separate property. It does appear that some of the appellate cases that reverse trial court findings of separate property have not scrupulously observed the dictates of appellate review of the sufficiency of the evidence. And some may have been inattentive to the proper disposition of the appeal (i.e. reverse and remand) when sustaining a factual sufficiency point.

The Supreme Court has said that the testimony of an interested witness can establish a fact *as a matter of law* (a higher standard than by clear and convincing evidence):

> It is the general rule that the testimony of an interested witness, such as a party to the suit, though not contradicted, does no more than raise a fact issue to be determined by the jury. But there is an exception to this rule, which is that where the testimony of an interested witness is not contradicted by any other witness, or attendant circumstances, and the same is clear, direct and positive, and free from contradiction, inaccuracies, and circumstances tending to cast suspicion thereon, it is taken as true, as a matter of law.

Ragsdale v. Progressive Voters League, 801 S.W.2d 880, 882 (Tex. 1990). The court went on to say:

> [W]e do not mean to imply that in every case when uncontradicted testimony is offered it mandates an award of the amount claimed. For example, even though the evidence might be uncontradicted, if it is unreasonable, incredible, or its belief is questionable, then such evidence would only raise a fact issue to be determined by the trier of fact.

Id. at 882.

The standard set out by the Supreme Court for testimony of an interested witness in civil cases generally precludes a rule that the uncorroborated testimony of a spouse is legally insufficient to support a finding of separate property. *See Sheikh v. Sheikh*, 2007 WL 3227683, *7 (Tex. App.--Houston [1st Dist.] 2007, no pet.) ("Wasim's position--that an interested witness's uncorroborated and contradicted testimony is no evidence, rather than its being just some evidence that raises a fact issue--runs afoul of decades of case law that is consistently to the contrary"); *Kirtley v. Kirtley*, 417 S.W.2d 847, 853 (Tex. Civ. App.--Texarkana 1967, writ dism'd w.o.j.) (a divorce property division case, where the court said: "[g]enerally the testimony of an interested party, when not corroborated, does not conclusively establish a fact even when uncontradicted, but only raises an issue of fact for a jury").

The following cases upheld tracing of separate property assets through various accounts even though, in some instances some account statements were missing, and in other instances no account statements at all were offered into evidence: *Estate of Hanau v. Hanau*, 730 S.W.2d 664, 666-67 (Tex. 1987); *Carter v. Carter*, 736 S.W.2d 775, 777-80 (Tex. App.–Houston [14th Dist.] 1987, no writ); *Holloway v. Holloway*, 671 S.W.2d 51 (Tex. App.–Dallas 1983, writ dism'd); *Huval v. Huval*, 2007 WL 1793771 (Tex. App.–Beaumont 2007, no pet.); *Newland v. Newland*, 529 S.W.2d 105, 107-08 (Tex. Civ. App.--Fort Worth 1975, no writ); *Peterson v. Peterson*, 595 S.W.2d 889, 892 (Tex. Civ. App.--Austin 1980, writ ref'd n.r.e.); *Welder v. Welder*, 794 S.W.2d 420, 424-25 (Tex. App.--Corpus Christi 1990, no writ); and *Zagorski v. Zagorski*, 116 S.W.3d 309, 316-17 (Tex. App.--Houston [14 Dist.] 2003, pet. denied). In *Holloway*, the court said: "We know of no authority holding that a witness is incompetent to testify concerning the source of funds in a bank account without producing bank records of the deposits."

In *Celso v. Celso*, 864 S.W.2d 652, 654-55 (Tex. App.--Tyler 1993, no writ), the appellate court reversed a trial court's refusal to find separate property, as follows:

> The relatively short record shows that Brian testified to the following facts. Before the marriage, Brian purchased from his father Celso's Dry Cleaners. After Brian and Kimberly were married, the business was sold for $16,000. The couple then moved to Springfield, Missouri, where they purchased a house with the proceeds from the sale of the dry cleaner business and approximately $13,000 from a CD purchased by Bryan prior to the marriage from a New York bank. The couple then sold their house and moved to Tyler, Texas, where the proceeds of the sale were placed into a CD with First National Bank of Winnsboro. The Tyler CD was worth approximately $25,000, half of which was withdrawn by Kimberly immediately prior to Brian's filing for divorce. The Springfield house was deeded to Brian and Kimberly Celso and the proceeds from the sale were paid via check to Brian and Kimberly.
>
> Kimberly did not dispute any of Brian's testimony. She added, however, that the Tyler CD was purchased in both their names and both spouses had the authority to withdraw funds from the CD.
>
> The court concluded that the house purchased by the parties in Springfield, Missouri during their marriage was the community property of the parties. Brian testified that the house was purchased with the funds acquired before the marriage: the proceeds from the sale of the dry cleaners and from the New York CD. Kimberly testified that the purchase price of the house was approximately $24,000. Significantly, Kimberly affirmed that only Brian's separate property assets were used to buy the Springfield house, as evidenced by the following exchange:
>
> Q: Do you know approximately how much money he paid for the house?
>
> A: About twenty-four thousand, I think.
>
> Q: Did any of that money come from any property that you owned?

> A: No.
>
> Q: In regards to the house, all the money was obtained from Brian?
>
> A: Mm-hmm.
>
> The evidence is uncontroverted that the sole source of purchase money to buy the Springfield house was from Brian's separate property assets. Had Brian intended a gift to Kimberly of the house, then her interest would have been her separate property, not community property as the court found. . . . Nevertheless, we note that there was no evidence that Brian intended a gift of his separate property assets to Kimberly when the house was purchased or sold. Furthermore, when separate property is conveyed and both spouses join in the instrument granting the property, the conveyance, without more, is insufficient to change the character of the property or the proceeds. . . . The evidence was clear and convincing that the funds used to purchase the Springfield house were traced to Brian's separate assets. The trial court, therefore, erred in concluding that the Springfield, Missouri house was the couple's community property. The evidence does not support the court's conclusion that the Springfield house was the couple's community property.
>
> The evidence is likewise uncontroverted that the proceeds of the sale of the Springfield house were deposited into a Tyler certificate of deposit in the names of Brian and Kimberly Celso. Kimberly's testimony affirms that the proceeds, in the form of a check payable to Brian and Kimberly Celso, were directly deposited into the First National Bank of Winnsboro without any commingling with community funds. Again, there was no evidence that Brian made a gift to Kimberly of his separate assets. The mere fact that the proceeds of the sale were placed in a joint account does not change the characterization of the separate property assets. The spouse that makes a deposit to a joint bank account of his or her separate property does not make a gift to the other spouse. . . . We conclude that the Appellant proved by clear and convincing evidence that the funds in the First National Bank of Winnsboro certificate of deposit were traced to his separate property. Consequently, the trial court abused its discretion in characterizing the CD as community property, subject to the court's just and right equitable division. [Citations omitted.]

In *Rojas v. Rojas*, 2004 WL 43227, *3 (Tex. App.--Corpus Christi 2004, no pet.), the appellate court affirmed a finding of separate property even where the spouse's testimony that he used separate property cash was not corroborated by records. The court said:

> The trial court found that appellee purchased the home before the marriage and he did so with monies owned by him before marriage. Evidence supporting these findings begins with the earnest money contract which was entered into in August 1989, some weeks before the couple's September 2, 1989 wedding. Although appellant is correct that the earnest contract is undated, the receipt for the same five hundred dollar earnest money, introduced into

> evidence without objection, is dated August 18, 1989. The title policy was issued in appellee's name alone. Appellee testified that the ten thousand dollars used to pay off the house in January 1990 came from his savings. Appellee further testified he worked forty-three years and saved the money he earned. "I had money in the bank that I had saved up. I made good money." A cashier's check from MBank in the same amount bore appellee's name and that of the seller. The only tax records introduced into the record showed the property taxed to appellee.

In *Pace v. Pace*, 160 S.W.3d 706 (Tex. App.--Dallas 2005, pet. denied), the appellate court affirmed a trial court's finding of separate property, as follows:

> Thomas testified at trial that the earnest money check was paid from her separate funds and Pace offered no evidence to the contrary. Evidence in the trial court included an excerpt of Pace's deposition in which he admitted the Harvest Hill house was purchased completely with Thomas's separate property. This is some evidence that the earnest money check was drawn on Thomas's separate property account. Because the evidence is uncontroverted, it is also clear and convincing evidence that the funds used to purchase the Harvest Hill house were traced to Thomas's separate assets. . . . [FN2]
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> FN2. In fact, although not evidence, Pace's attorney even admitted during trial that the Harvest Hill house was purchased solely with Thomas's separate property.
>
> We conclude the evidence was sufficient to support the trial court's finding that the Harvest Hill house was Thomas's separate property.

In *Hilliard v. Hilliard*, 725 S.W.2d 722 (Tex. App.--Dallas 1985, no writ), the appellate court upheld a trial court's implied finding that a house acquired by the husband during marriage was community property. The husband claimed that the house was distributed out of a separate property corporation during marriage and that, under the principle of mutation, it was his separate property. The appellate court said:

> It is evident that the corporate stock was separate property, since it was acquired before coverture. However, we do not know if there are any community charges against this asset. Furthermore, we know that dividends are community income as distinguished from a mutation resulting from an exchange of corporate stock for cash or other assets. Because husband did not provide the trial court with sufficient evidence that the house was a mutation, through the introduction of corporate minutes, a deed, or other evidence, the trial court could readily have found that the presumption of community property was not rebutted and the house was community property.

Id. at 723. The appellate court also said that "Husband's uncorroborated testimony . . . is not conclusive as to whether the house was separate or community." *Id.*

In *Hinton v. Burns*, 433 S.W.3d 189, 197 (Tex. App.--Dallas 2014, no pet.), the husband had copies of checks representing an inheritance but no bank statements showing the deposit of those funds in a particular account. The checks, coupled with the husband's testimony, was sufficient to support a reimbursement claim for contributing the separate property inheritance to the community estate.

In *Miller v. Miller*, 2002 WL 31410965 (Tex. App.--Dallas 2002, pet. denied), the appellate court overturned a trial court's finding of separate property saying:

> A witness may testify concerning the source of funds in a bank account without producing bank records of the deposits. *Holloway v. Holloway*, 671 S.W.2d 51, 56 (Tex. App.--Dallas 1983, writ dism'd). Mere testimony that property was purchased with separate property funds, without any tracing of the funds, is generally insufficient to rebut the presumption. *Bahr*, 980 S.W.2d at 728; *McElwee v. McElwee*, 911 S.W.2d 182,188 (Tex. App.--Houston [1st Dist.] 1995, writ denied).

In *Miller*, despite rejecting the trial court's finding of separate property, due to the "magic finding" (that even if the asset was community property the court would still award it to the husband as part of a just and right division) the appellate court found that the error did not cause the overall property division to be an abuse of discretion, so that the characterization error was deemed to be harmless.

In *Faram v. Gervits-Faram*, 895 S.W.2d 839, 843 (Tex. App.--Fort Worth 1995, no writ), the testimony of wife, that investment accounts and T-bills were either gifts from her father or proceeds from sale of separate real estate was, standing uncontradicted, sufficient evidence to support a finding of separate property.

In *Peterson v. Peterson*, 595 S.W.2d 889, 892 (Tex. Civ. App.--Austin 1980, writ ref'd n.r.e.), the husband's testimony that realty was purchased with his separate property cash supported a finding of separate property, even without evidence of activity in the account, where the transaction occurred less than one month after marriage.

In *Gana v. Gana*, 2007 WL 1191904, *5 (Tex. App.--Houston [14th Dist.] 2007, no pet.) (memorandum opinion), the appellate court reversed the trial court's failure to find separate property, saying:

> [A]t the divorce hearing, Bradley submitted a proposed property division reflecting the Rampart Street property as his separate property. He also testified that he purchased the property before he married Susan. We conclude that this evidence, coupled with Susan's admission that Bradley owned the property before they were married, is sufficient to overcome the community property presumption and to demonstrate Bradley's separate ownership by clear and convincing evidence.

In *Klein v. Klein*, 370 S.W.2d 769 (Tex. Civ. App.--Eastland 1963, no writ), the wife testified that she made a $3,000.00 separate property cash payment for a house acquired during marriage. She said that she got the money from a safety deposit box in an unnamed bank. The trial court found that the house was community property. The appellate court affirmed, saying that the wife's testimony was not binding on the trial court. *Id.* at 773.

In *Bahr v. Kohr*, 980 S.W.2d 723, 728-29 (Tex. App.--San Antonio 1998, no pet.) a creditor's rights case, the appellate court reversed the trial court's finding of separate property, saying that wife's testimony was factually insufficient to establish certain property as her separate property because the documentary evidence offered to support claim that property was purchased with monies from a separate property account did not show the date the account was opened, the running balance of the account, or identify the party receiving the wire transfer for the alleged purchase of property at issue. The case was remanded for a new trial.

In *Boyd v. Boyd*, 131 S.W.3d 605 (Tex. App.–Fort Worth 2004, no pet.), the appellate court held the evidence factually insufficient to support the trial court's finding of separate property. The appellate court said:

> When tracing separate property, it is not enough to show that separate funds could have been the source of a subsequent deposit of funds. . . . Moreover, as a general rule, mere testimony that property was purchased with separate funds, without any tracing of the funds, is insufficient to rebut the community presumption. . . . . Any doubt as to the character of property should be resolved in favor of the community estate. [Citations omitted.]

Id. at 612. (The court of appeals misstated the standard of appellate review of the sufficiency of the evidence. On appeal, the standard of review of the evidence favors the trial court's findings, not the community estate. Even at the trial court level, the fact finder is not required to resolve any doubt in favor of the community estate. That would be tantamount to proof beyond a reasonable doubt.) The court went on to say:

> David did not present specific tracing testimony or corroborating testimony or evidence, similar to evidence presented in cases where courts have determined that the separate nature of the property was established by clear and convincing evidence. . . . As a result, the trial court was left to surmise or speculate, based on David's testimony alone, that the proceeds from the sale of David's separate property were the source of funds that created his claim for economic contribution.

Id. at 616. The court remanded the case for a new property division. *Id.* at 618. (The court should have made it clear that it was remanding for a new trial on the characterization issue, not just a new division based upon a finding of community property, since it sustained a factual sufficiency point).

In *Brehm v. Brehm*, 2000 WL 330076 *3 (Tex. App.--Houston [14th Dist.] 2000, no pet.) (unpublished), the appellate court affirmed the trial court's finding of community property, saying:

> Here, the only testimony presented by Ralf that this CD was his separate property was his own testimony that it was purchased with proceeds from the sale of property he inherited from his uncle. Ralf testified that he inherited the property, sold it, deposited the proceeds into the joint account he shared with Angela, and purchased the CD four months later. Ralf introduced no bank records which would clearly trace the money used to buy the CD to the proceeds from his inheritance, nor did he introduce any other evidence which would show deposits and withdrawals from the account over the four month period. . . . Because Ralf failed to provide clear and convincing evidence that the CD was his separate property, we find the trial court did not abuse its discretion in dividing it with the community estate.

In *Ganesan v. Vallabhaneni*, 96 S.W.3d 345, 354 (Tex. App.--Austin 2002, pet. denied), the appellate court affirmed the trial court's denial of a separate property claim, holding that husband's testimony failed to establish that certain brokerage accounts were separate property because neither his testimony nor the exhibits offered "provid[ed] account numbers, statements of accounts, dates of transfers, amounts transferred in or out, sources of funds or any semblance of asset tracing."

In *Garza v. Garza*, 217 S.W.3d 538, 548 (Tex. App.--San Antonio 2006, no pet.), the appellate court reversed the trial court because the evidence was factually insufficient to support the trial court's finding of separate property. The appellate court said: "As a general rule, testimony that funds are separate property without any tracing of the funds is insufficient to rebut the community presumption." The court remanded the case for a new property division "based upon the correct characterization of the property." *Id.* at 551. It is not clear whether a new trial on character was contemplated, or just a new property division. The former would be the correct disposition.

In *Granger v. Granger*, 236 S.W.3d 852, 856 (Tex. App.--Tyler 2007, pet. denied), the court said: "As a general rule, mere testimony that property was purchased with separate funds, without any tracing of the funds, is insufficient to rebut the community property presumption." (The appellate court actually articulated the burden of persuasion in the trial court. The test on appeal was whether the trial court's failure to find separate property was against the great weight and preponderance of the evidence.)

In *Holcemback v. Holcemback*, 580 S.W.2d 877, 879 (Tex.Civ.App.--Eastland 1979, no writ), the appellate court affirmed the trial court's finding of community property, saying:

> [T]here is evidence that community funds came into the possession of the husband prior to the conveyance. This is some evidence to support the finding of the trial court that the thirty acre tract was purchased with community funds. The testimony of the husband, an interested witness, that he purchased the property with cash, kept in a dresser drawer, that he owned prior to the marriage was not conclusive.

In *Klein v. Klein*, 370 S.W.2d 769 (Tex. Civ. App.--Eastland 1963, no writ), the appellate court affirmed the trial court's finding of community property, where the wife testified that she made a $3,000.00 separate property cash payment for a house acquired during marriage. She said that she got the money from a safety deposit box in an unnamed bank. The appellate court said that the wife's testimony was not binding. *Id.* at 773.

In *Levesque v. Levesque*, 2006 WL 47044, *1 (Tex. App.--San Antonio 2006, no pet.) (memo. op.), the court affirmed a trial court's finding of community property, saying: "Mere testimony that property was purchased with separate property funds, without any tracing of the funds, is generally insufficient to rebut the presumption."

In *In re Malekzadeh*, 2007 WL 1892233 (Tex. App.--Houston [14th Dist.] 2006, pet. denied), the appellate court upheld a trial court's determination that furniture was community property despite husband's claim that the furniture was his separate property. The court said that "[m]ere testimony that property was purchased with separate property funds, without any tracing of funds, is generally insufficient to rebut the community presumption."

In *Micklethwait v. Micklethwait*, 2007 WL 1852609, *6 (Tex. App.--Austin 2007, pet. denied) (memo. op.), the court said:

> Jonathan testified that he was employed as an assistant manager at a Mr. Gatti's Restaurant. At the time of trial, he had been working at the restaurant for four years and had a 401(K) plan with $10,800 in it. From April 2002, when he started working at Mr. Gatti's, until March 2004, when he married, any contribution would be considered separate property. But when asked when he began contributing to the retirement plan, he responded, "I would say maybe four or five months after starting with them." Our review of the record does not show any other evidence concerning the retirement plan, and Jonathan does not cite us to any relevant record references.
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> * * *
>
> Based upon the evidence before it, the trial court concluded that Jonathan failed to carry his burden to establish that any portion of the retirement account was separate property. Given the paucity of testimony and Jonathan's failure to present clear and convincing evidence showing any portion of the retirement account to be his separate property, the trial court's allocation is supported by the evidence.

In *Mock v. Mock*, 216 S.W.3d 370, 373 (Tex. App.--Eastland 2006, pet. denied), the appellate court affirmed the trial court's finding of community property, saying:

> Appellant did not produce any records tracing the deposits to the account or the withdrawals from the account. As a general rule, testimony that funds are separate property without any tracing of the funds is insufficient to rebut the community presumption. *Boyd*, 131 S.W.3d at 612. Appellant failed to trace the assets in the account with any documentary evidence. In

> the absence of such evidence, appellant did not meet her burden of establishing by clear and convincing evidence that the balance in the savings account was her separate property.

In *Osorno v. Osorno*, 76 S.W.3d 509, 512 (Tex. App.--Houston [14th Dist.] 2002, no pet.), the appellate court affirmed the trial court's finding of community property, saying:

> Henry argues that accounts listed in the decree totaling almost $100,000 were designated his separate property in the parties' premarital agreement. But the only evidence as to the source of funds placed in those accounts was Henry's testimony; no deposit slips or bank records were offered tracing the money to support Henry's claim. Without tracing, Henry's testimony cannot overcome the community property presumption.

In *Prevallet v. Prevallet*, No. 02–12–00260–CV, 2014 WL 92793 (Tex. App.–Fort Worth Jan. 9, 2014, no pet.), the appellate court affirmed a finding of community property when the only evidence of separate property was the testimony of the husband and his father, uncorroborated by bank records.

In *Robles v. Robles*, 965 S.W.2d 605, 616 (Tex. App.--Houston [1st Dist.] 1998, pet. denied), the court said:

> Gus testified he purchased the lot at 2319 Freeman for $27,000 with money he received as a gift from Thomas while she was alive. Irene again stated she listed the 2319 Freeman property as community property because Gus told her it was community property. Richard Sedgeley stated that, in his opinion, the 2319 Freeman lot was Gus's separate property because Gus purchased the property with money he inherited from Thomas's estate. The deed for this property does not appear to be included in the record before this Court. No documentary evidence was presented to trace the money used to purchase this property.
>
> Generally, the testimony of an interested party, when not corroborated, does not conclusively establish a fact even when uncontradicted. . . . Uncorroborated evidence coming from one party is not conclusive. . . .
>
> The trial court found Gus did not present clear and convincing evidence to rebut the presumption that the 2319 Freeman property was community property. The evidence presented concerning the nature of this property was, at best, conflicting. Accordingly, we conclude Gus did not present sufficient evidence to rebut the community property presumption, and the trial court did not abuse its discretion in characterizing the 2319 Freeman lot as community property.

In *In re Marriage of Santopadre*, No. 05-07-00027-CV, 2008 WL 3844517 (Tex. App.--Dallas August 19, 2008, no pet.) (memo. op.), the court said:

> Wife contends there is no evidence or insufficient evidence to prove the following assets are the separate property of Husband: Texas Instrument employee pension plan, Texas Instruments retirement benefits, Texas Instruments stock, certain real property in Ruidoso, New Mexico, certain real property in Nashua, New Hampshire, Charles Schwab account PJ7785-9979, USAA IRA # 001277495, USAA Account # 65118968, E-Trade Account # 4575-0831, E-Trade Account # 4842-3269.
>
> After reviewing the record in this case, we agree with Wife's contentions.
>
> Because Husband claimed these assets to be his separate property, he bore the burden at trial of establishing by clear and convincing evidence the separate origin of each asset. To do so, he was required to show the time and means by which he originally obtained possession of each asset. Although Husband testified at trial these assets were his separate property, he presented no documentary evidence to establish that any asset was his separate property. Specifically, he did not produce deeds, closing statements, property tax statements, financial records, or other evidence to establish when any of these assets was acquired or set up on his behalf.FN1 Rather, he relied on his testimony at trial that he owned each property or asset before his September 1996 marriage to Wife. This is "insufficient to constitute clear and convincing evidence rebutting the community presumption and establishing characterization of property as separate."

In *In re Marriage of Smith*, No. 07–02–0509–CV, 2003 WL 22715581, *3-4 (Tex. App.--Amarillo Nov. 17, 2003, pet. denied) (memo. op.):

> Considering that Matthew maintained complete control of the separate and community property of the parties, that he had duties as a fiduciary, that separate character cannot be established by his testimony without tracing and documentary support, and the absence or inadequacy of the documents to demonstrate the date and source of the acquisition of the funds which were commingled into the two accounts, we conclude the evidence was factually insufficient to establish that $15,111 and $26,623 of the two accounts were the separate funds of Matthew by clear and convincing evidence.
>
> *   *   *
>
> Although Matthew acknowledged that community funds had been deposited into the account, in his brief, he bases his support of the findings of the trial court on *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.--Dallas 1955, writ dism'd), which held that where an account contains community and separate funds, it is presumed the community funds are drawn first so that the balance in the account is presumed to be separate property. **Although *Sibley* was a divorce case, it is not controlling here because it involved a "joint account," which is not presented here.** Accordingly, because Matthew's testimony standing alone is insufficient to trace the separate nature of the funds, *McElwee*, 911 S.W.2d at 188, the documentation does not show the origin or source of the funds, the referenced real estate transactions were not independently documented and community funds were admittedly deposited into the

> account, the evidence is insufficient to overcome the community property presumption by clear and convincing evidence. [Emphasis added.]

In *Warriner v. Warriner*, 394 S.W.3d 240, 248 (Tex. App.–El Paso 2012, no pet.), a claim that bank accounts were separate property was rejected at trial and on appeal because “there was no evidence offered indicating the source of funds, dates of transfers, statements of accounts, or of any asset tracing by Appellant in relation to any of those accounts.”

In *Wells v. Wells*, 251 S.W.3d 834, 840 (Tex. App.--Eastland 2008, no pet.), the appellate court affirmed the trial court’s finding of separate property, saying:

> Jacqueline’s mother testified that, when her husband retired, he gave part of his farming equipment to Jacqueline and part to a son and sold part to Jacqueline and Richard. She testified that the gift was not to Jacqueline and Richard but to Jacqueline alone. She identified the twelve items of equipment in dispute as the equipment that her husband had given to Jacqueline. Richard argues that this testimony is insufficient to rebut the community property presumption, citing the general rule that mere testimony that property is separate without any tracing of the property is insufficient.FN3
>
> FN3. See *Boyd*, 131 S.W.3d at 612.
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> The general rule is inapplicable because there was no need to trace assets. There was no dispute about what items of equipment were gifted, and there was no claim that any of this equipment had been sold, traded, or otherwise converted into any other asset.

B. SWORN INVENTORIES. A number of cases involve the use of sworn inventories as proof of the character of property.

1. The Inventory as a Judicial Admission. As is so often the case for marital property issues, the best place to look for an understanding of the role of a sworn inventory as a judicial admission in a tracing case is an appellate Opinion written by Chief Justice Ann McClure, in this instance *Rivera v. Hernandez*, 441 S.W.3d 413 (Tex. App.--El Paso 2014, no pet.). The wife claimed on appeal that the husband’s sworn inventory was a judicial admission that the property in question was community property. *Id*. at *6. “A judicial admission establishes the issue in dispute as a matter of law in behalf of the adversary of the one making such admission.” *Id*. at *6. Justice McClure analyzes a list of cases. The case of *Roosevelt v. Roosevelt*, 699 S.W.2d 372, 374 (Tex. App.--El Paso 1985, writ dism’d), held a party bound by his sworn inventory, which operated as a judicial admission that certain property was community property. However, no evidence was offered to prove separate property. In *Myers v. Myers*, No. 05-93-00906-CV, 1994 WL 137244, *6 (Tex. App.--Dallas, April 15, 1994, no writ) (unpublished), the appellate court rejected a claim that a sworn inventory was a judicial admission, because the inventory had been amended prior to trial. The appellate court in *Tschirhart v. Tschirhart*, 876 S.W.2d 507, 508 (Tex. App.--Austin 1994, no writ), cited *Roosevelt* for the proposition that a sworn inventory could operate as a judicial admission. The appellate court in *Dutton v. Dutton*, 18 S.W.3d 849, 856 (Tex. App.--Eastland 2000, pet. denied), held that a sworn inventory was a judicial admission in that the appellate court could take judicial notice of it. The court in *Taylor v. Taylor*, No. 2-05-435-CV, 2007 WL 2460359 (Tex. App.--Fort Worth, August 31, 2007, pet. denied) (memo. op.), held that a sworn inventory could operate as a judicial admission. The court in *Magness v. Magness*, 241 S.W.3d 910, 913 (Tex. App.--Dallas 2007, pet. denied), held that the wife's claim, that the husband's sworn inventory was judicial estoppel, was waived because it was not raised in the trial court. The court in *Graves v. Tomlinson*, 329 S.W.3d 128, 140 (Tex. App.--Houston [14th Dist.] 2010, pet. denied), held that husband's sworn inventory, listing farm equipment as community property, undercut his unsubstantiated oral testimony that the equipment was his separate property. Justice McClure analyzes these cases, and says: "'Fair notice' has always been the underpinning of Texas rules and procedures. Judicial admissions are utilized to prevent trial by ambush." *Id*. at *9.

2. The Inventory as Evidence. A number of cases hold that a sworn inventory is a form of evidence. *Richardson v. Richardson*, 424 S.W.3d 691, 699 (Tex. App.--El Paso 2014, no pet.); *Warriner v. Warriner*, 394 S.W.3d 240, 248 (Tex. App.--El Paso 2012, no pet.) ("A sworn inventory is simply another form of testimony"); *Viera v. Viera*, 331 S.W.3d 195, 207 (Tex. App.--El Paso 2011, no pet.). In *Johnson v. Johnson*, 948 S.W.2d 835, 837 (Tex. App.--San Antonio 1997, writ denied), the appellate court held that listing an asset as separate property in a sworn inventory, without supporting testimony or documentary evidence, is not clear and convincing evidence of separate property.

C. ACCOUNT RECORDS. Account records can (and where available should) be used to support a claim of separate property.

In *In re Marriage of Everse*, 2013 WL 3362054, (Tex. App.–Amarillo 2013, no pet.), a ten-year gap in account records was fatal to a separate property claim:

> In Johannes' first issue, he contends the trial court mischaracterized as community property part of the assets held in a Prudential Discovery Select Annuity account. The record shows a balance of $53,257.80 in the account at the time divorce proceedings were initiated. In its findings of fact, the trial court found $13,551.21 of the amount to be Johannes' separate property, but treated the remaining $39,706.59 as community property. It is this characterization Johannes challenges.
>
> There is no dispute that Johannes traced the $13,551.21 to an Aetna account which contained that amount at the time of the marriage. He contends he traced the remaining $39,706.59 to accrued retirement benefits he received in 1994 from the University of California, where he worked from 1969 to 1976.

> When tracing separate property, it is not enough to show that separate funds could have been the source of a subsequent deposit. *Boyd*, 131 S.W.3d at 612. Lea points to gaps in Johannes' tracing evidence, including a gap of over ten years between a November 1999 statement in evidence and a statement for September 2010. We conclude the trial court did not err by finding Johannes' tracing evidence as to the $39,706.59 to be less than the clear and convincing evidence required. Johannes' first issue is overruled.
>
> American State Bank Account # 6061
>
> References In his second issue, Johannes similarly contends the trial court mischaracterized funds in American State Bank account # 6061 as community property because he established their separate property character. At issue here again is the evidence Johannes set forth at trial to show the savings balance of $23,773.84 in account # 6061 was his separate property.
>
> Johannes testified he placed his Social Security payments for 2010 in that account. The record also indicates a document pertaining to the balances of the accounts at American State Bank was present in the courtroom, and was discussed by the parties. The document was not offered into evidence, however, and we cannot conclude the trial court erred by finding Johannes' testimony insufficient to establish the separate character of the funds, particularly given his testimony that he transferred funds from account to account.

In *Padon v. Padon*, 670 S.W.2d 354 (Tex. App.--San Antonio 1984, no writ), the husband successfully traced separate property funds into the parties' home. The parties agreed that husband received $160,000.00 by way of inheritance, which he deposited into an account in the name of husband and wife. The parties further agreed that they acquired a home in "early 1977," for $89,900.00. The March bank statement showed an initial deposit of $160,490.00, on February 25, 1977. The statement reflected no further deposits into the account until March 4, 1977. However, the statement reflects that a check for $89,900.00 cleared the account on March 1, 1977. The appellate court held that the husband had established that the house was his separate property, as a matter of law. *Id*. at 357.

In *Newland v. Newland*, 529 S.W.2d 105, 107-09 (Tex. Civ. App.–Fort Worth 1975, writ dism'd), the husband's testimony, corroborated by bank records and other records, was sufficient to support a finding of separate property.

D. TAX RETURNS. Tax returns can provide evidence to support a separate property claim. Schedule B of the Form 1040 should reflect dividend and interest income earned during the year. Thus, ownership of corporate stock during a tax year can be shown by dividends reported on Schedule B of that year (unless the stock was acquired after the last quarterly dividend). For most widely-held corporations, information is available on the internet regarding a company's historical dividend rates and dividend dates. By dividing the dividend rate into the dividend income, you can determine the number of shares held at the time the dividend was declared. Interest income on

Schedule B can reflect ownership of bonds, or money on deposit in accounts at various institutions. Calculating exact balances of cash in savings from the amount of interest income reported on Schedule B is usually difficult because balances vary during the year and the interest rate is hard if not impossible to reconstruct from publicly-available information. However, the exact face amount of bonds can usually be reconstructed from the amount of interest paid because the interest rate on bonds can usually be determined from public information.

Schedule D of the Form 1040 may also permit you to reconstruct the purchase date of securities, since the taxpayer must report the date and acquisition price of the security on Schedule D in the year in which the security is sold. The taxpayer must also report the tax basis of the security, which gives you the purchase price which can help to fix the date of acquisition by comparing the tax basis to historical data on stock prices. In the event that a closely-held entity has changed forms, the tax basis will sometimes reflect whether there was a carryforward of the tax basis of a preceding entity.

Sometimes work papers supporting a Schedule C for a sole proprietorship business will contain a depreciation schedule that can be used to establish the date when equipment was acquired.

Tax returns of an entity reflect the date the entity was established. The taxpayer id. no. on a tax return can also be used as indication of whether an entity is a continuation of a prior entity or is instead a new entity.

E. CORRESPONDENCE; MEMORANDA. In *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App.–Houston [14th Dist.] 2003, pet. denied), two series of letters were sufficient to support a finding of separate property in a bank account, even absent the account agreement, copies of wire transfers, and more basic documents relating to the account. The evidence showed that approximately $115,000 in interest was deposited into the account during marriage, while $360,000 was withdrawn for marital living expenses. Using the community-out-first presumption, withdrawals were deemed to have depleted the community funds in the account, so that the account remained separate property.

Zagorski underscores the fact that old records, old correspondence, etc. can be the basis for an opinion of separate property even if the items are strictly-speaking hearsay. Old letters and memoranda are ordinarily not conclusive evidence. However, the job of a forensic expert or fact finder is to use available evidence to recreate past events and conditions, so that such evidence is important to consider. If the memoranda are admissions of a party opponent or are business records, or meet some other exception to the hearsay rule, they are admissible in evidence. Even if not admissible as such, they may still be used, at least by experts, in arriving at their opinions. *See* TEX. R. EVID. 703 ("The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by, reviewed by, or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence.")

F. PUBLIC INFORMATION. Public information can be used to establish facts relevant to the character of property. Deed records can establish when title to land was acquired, and sometimes the consideration paid. *See Rivera v. Hernandez*, 2014 WL130748, *11 (Tex. App.–El Paso 2014, no pet.) (the trial court's finding that realty was community property was reversed because the promissory note, deed, and release of lien established as a matter of law that the property was owned prior to marriage). Records from the secretary of state, or state comptroller, can show the date an entity came into existence. Historical financial data available on the internet can establish the ex dividend date, and amounts of dividends, for widely-held companies.

In *Moore v. Moore*, No. 01–13–00182–CV. June 5, 2014 WL 2538555 (Tex. App.--Houston [1st Dist.] 2014, no pet.) (memo. op.), the trial court found certain land to be community property. The appellate court reversed and held that the land was the husband's separate property. The Court wrote:

> The trial court determined that the property located at 846 W. Austin, Giddings, Texas, was community property, valued the property interest held by the community to be $11,620, and awarded it to Curtis in the property division.
>
> In her Second Amended Inventory and Appraisement, Veronica listed 846 W. Austin as a community asset. In his initial Inventory and Appraisement, Curtis lists 846 W. Austin only as separate property. Curtis's First Amended Inventory lists 846 W. Austin as both community and separate property. Curtis's Third Amended Inventory lists 846 W. Austin as both separate and community. Finally, Curtis's Fourth Amended Inventory, which was also admitted as an exhibit at trial, identified 846 W. Austin as both separate and community.
>
> At trial, Curtis testified that he and his brothers, Victor and Michael Moore, obtained the property at 846 W. Austin in 1985. The record also contains a deed showing that Curtis, Victor, and Robert Moore purchased the property from Martin and Norma Halick on July 22, 1985. The record also contains information in the documents that Veronica's expert provided showing the deed history of the property, with the last transfer occurring in 1990.
>
> Finally, Veronica testified at trial as follows:
>
> Q. Page 2 of Petitioner's 18, Item 1, what property is identified there, ma'am?
> A. 86-846 West Austin, Giddings, Texas.
> Q. Okay. And it's true, is it not that Mr. Moore owned that property prior to the marriage?
> A. Yes.
>
> Again, while the trial court had some evidence to support its classification of the 846 W. Austin property as community, i.e., Veronica's Second Amended Inventory and Curtis's conflicting inventories, we again note that Veronica's assessment of the property as community is not supported by any documentary evidence.

> Indeed, we hold that the great weight and preponderance of the evidence supports the conclusion that Curtis established that the property was separate. Both Curtis and Veronica testified at trial that Curtis owned the property before they were married. More importantly, all of the documentary evidence relating the property, including a real property deed, shows that Curtis and his brothers acquired the property in 1985. Because there is factually insufficient evidence to support the trial court's characterization of the 692 Boundary Street property as community property, the trial court erred by including it in the community property division.

Id. at *4. Similar treatment was given to another piece of real estate.

IX. METHODS OF TRACING COMMINGLED FUNDS. There are a number of approaches that have been used to trace commingled funds, in Texas as well as Federal courts, and the courts of other states, and nations that adhere to the Common Law. While the Federal court system, England, Canada, and Australia may seem like far-flung places to look for ideas on tracing commingled funds, in fact the tracing techniques recognized in much of the United States, have roots going back to the English Common Law.

A. THE MINIMUM BALANCE APPROACH (LIBR). Texas courts have recognized a "minimum balance approach" to tracing commingled funds. This is a special application of the tracing rule used in other jurisdictions called the "lowest intermediate balance rule" (LIBR). The minimum balance approach is not used to characterize funds *withdrawn* from an account. Rather it is used to characterize funds that *remain* in an account. In the community property context, it can be envisioned by a rule that separate property funds "sink to the bottom" of an account, and all withdrawals are taken "off the top" from the community funds until they are exhausted. If separate property funds are later deposited into the account, they "sink to the bottom"; if community property funds are later deposited into the account, they "rise to the top," where they remain until they are withdrawn, etc.

The court in *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.–Dallas 1955, writ denied), applied a variation of the minimum balance approach to an account where the wife's separate property had been commingled with community property funds in an account under the husband's control. The court characterized the husband as being a trustee of the wife's separate property funds, and borrowed a rule from trust law that when a trustee commingles his funds with trust funds and then makes withdrawals, it is presumed that the trustee withdrew his own money first, leaving the trust funds behind. Applied to the facts of the case, the presumption resulted in the wife's separate property "sinking to the bottom," resulting in what was in effect the minimum balance approach tracing. Interestingly, once this trustee's-money-out-first rule was used to establish the character of the funds in the account, and then the check was written to buy a piece of land, the trial court did not apply a trustee's-money-out-first rule to the check. Instead, it applied a pro rata rule, taking separate and community funds from the account in the same ratio as the funds on deposit. The appellate court affirmed. Nonetheless, the *Sibley* case is famously remembered for its statement that in a mixed fund, community funds are withdrawn first before separate funds are withdrawn. (The trust relationship also recognized in *Trevino v. Trevino,* 555 S.W.2d 792, 798 (Tex. Civ. App.–Corpus Christi 1977, no writ) ("Dr. Trevino managed the parties' community estate during the marriage ... and, as such, a trust relationship existed between the Doctor and his wife"), although it was not a tracing case.)

The case of *Hill v. Hill*, 971 S.W.2d 153, 159 (Tex. App.--Amarillo 1998, no pet.), was an instance where the court used the minimum balance "sink to the bottom" approach to tracing:

> Michael testified that prior to his marriage he had a savings account at Norwest Bank, which was later converted into the Account. Into it, he made two deposits of funds which he said were his separate property. One deposit, for $10,000, represented a portion of a gift from his father. Another, for $14,678, represented the proceeds from the sale of a house that he owned before his marriage to Lucia. See Tex. Fam. Code Ann. § 3.001(1) (Vernon Pamph.1998) (stating that property owned by a spouse prior to marriage is the spouse's separate property). Receipts manifesting that both of these deposits were made were then admitted into evidence. This constitutes some probative evidence that the $24,678 sum deposited was Michael's separate property.
>
> Also admitted was a summary of the transactions in the Account. According to that exhibit, the balance in the account at the time of marriage was $7,551.99. This sum was separate property given that it was Michael's before the marriage. The lowest this balance sank before the first separate property deposit was made was $4,901.99. Thus, when the $10,000 separate property deposit was made on May 27, 1993, the total amount of separate property in the account was $14,901.99. Between this deposit and the next separate property deposit, the lowest account balance was $7,935.87. When the next, and last, separate property deposit of $14,678.20 was made on July 22, 1993, the amount of separate property in the account rose to $22,614.07.
>
> Throughout the life of the account many other deposits and withdrawals were made. Whether they involved separate or community funds is not revealed in the record. Nevertheless, we assume that the withdrawals consumed first the community and then the separate funds. *Welder v. Welder*, supra; *Sibley v. Sibley*, supra. Next, as the withdrawals of community funds were being made, they encroached on the $22,614.07 balance referred to above. According to the account summary, the balance of the separate property in the Account stood at $17,310.39 as of the date of divorce. And, that sum was the maximum amount which the court could have "confirmed" as Michael's separate property in the Account. Thus, the record is replete with evidence supporting the determination that the Account contained separate funds. Moreover, the contradictory evidence, such as it was, was not of such quantum so as to render the decision wrong.
>
> Nevertheless, according to Michael's amended inventory and appraisement, the total balance in the Account immediately before the final divorce hearing was $18,200.49. As can be seen,

> the latter sum exceeded the monies subject to being traced as his separate property by $890.10. And, to the extent that the trial court awarded him the $890.10, it did so without any evidentiary support. So, we agree with Lucia's contention that the court's decision to award Michael the Account in toto lacked legally sufficient evidentiary support, but our agreement is limited to the $890.10 sum.

In *Snider v. Snider*, 613 S.W.2d 8, 11 (Tex. Civ. App.--Dallas 1981, no writ), the Court said:

> On the date of the marriage, the balance in the account was $27,642.45. Upon dissolution of the community by the husband's death, the balance was $35,809.80. The account grew by interest from time to time, as well as by new deposits, and was reduced by withdrawals from time to time. The witness Wofford testified that an additional deposit of $10,000.00 of separate funds of the husband was made after the marriage and that the remaining deposits, as well as withdrawals, were made by the community. The passbook for this account was introduced into evidence and supports the separate character and balance of the account on the date of marriage. Between the marriage on October 3, 1972, and October 20, 1972, no interest was earned and no deposits were made, but withdrawals reduced the balance to $19,642.45. Between October 20, 1972, and April 23, 1973, there were entries of earned interest, deposits of unknown character, and withdrawals, but the balance was never below $19,642.45. On April 23, 1973, a separate property deposit of $10,000.00 was made and the identifiable separate property interest in the account became $19,642.45 plus $10,000.00 or $29,642.45. Subsequent interest earned, deposits, and withdrawals to the date of the husband's death never reduced the account balance to or below $29,642.45. We hold that this record traces and identifies the husband's separate interest in the Mercantile savings account to the extent of $29,642.45 with the remainder of the account being deemed community for want of tracing or identity.

In *Mock v. Mock*, 216 S.W.3d 370, 373 (Tex. App.--Dallas 2006 pet. denied), the Court said:

> Appellant asserts that the gift checks from her father were her separate property. She acknowledges that the gifts were commingled in the account with community property--$150 a month from her paycheck. Appellant contends that she deposited gifts into the account in excess of the account balance of $39,654. Therefore, she asserts that the balance of $39,654 is her separate property under the community-out-first rule. Under this rule, courts presume that separate funds in a commingled account sink to the bottom of the account and that community funds are withdrawn first. *See Hill v. Hill*, 971 S.W.2d 153, 158 (Tex. App.--Amarillo 1998, no pet.).... Appellant failed to trace the assets in the account with any documentary evidence. In the absence of such evidence, appellant did not meet her burden of establishing by clear and convincing evidence that the balance in the savings account was her separate property.

Like the minimum balance approach, the LIBR refers to the allocation of funds in a commingled fund. "Intermediate" in this context means between the moment of commingling and the time of trial. Under certain circumstances, if a claimant's funds are traced into an account, the claimant continues to have a claim to those funds. If the funds are expended, however, the claimant loses his claim to the money withdrawn.

American courts have used the LIBR in different contexts: segregating exempt from non-exempt funds; segregating funds that are and are not subject to a security interest; segregating funds that are and are not part of a bankrupt debtor's estate; segregating illegally-obtained funds subject to forfeiture from funds that are not subject to forfeiture; allocating funds among victims of a Ponzi scheme; and segregating separate from community property.

Schuyler v. Littlefield, 232 U.S. 707, 710-11 (1914) ("The case involves an application of the rule that where one has deposited trust funds in his individual bank account, and the mingled fund is at any time wholly depleted, the trust fund is thereby dissipated, and cannot be treated as reappearing in sums subsequently deposited to the credit of the same account. [Citing] *Knatchbull v. Hallett* ...").

In re United Cigar Stores Co., 70 F.2d 313, 316 (2d Cir.1934) ("If a trustee mingles the trust funds with the mass of his other funds, as long as there remains on hand a sufficient sum to cover the amount of the trust fund, the cestui que trust may follow the trust fund and reclaim it.... There can be no recovery, however, where all that can be shown is enrichment of the trustee. It must be clearly traced and identified in specific property.... It is insufficient to show that trust property went into the general estate and increased the amount and the value thereof.... In the instant case the appellants have failed to show more than a general enrichment of the bankrupt's estate. The bankrupt's accounts appear to have been active. There might have been a reduction of each of these accounts in turn to practically nothing, and yet the aggregate be above the alleged trust fund amount at all times. To recover, the funds must be traced into the estate and there now be found.... There is no evidence that the trust fund has remained intact during the period of the trustee's possession.).

Universal C. I. T. Credit Corp. v. Farmers Bank of Portageville, 358 F. Supp. 317, 325 (E.D. Mo. 1973) ("As indicated above, *Perry v. Perry*... stated the general rule that in tracing commingled funds it is presumed that any payments made were from other than the funds in which another had a legally recognized interest. This is commonly referred to as the "lowest intermediate balance" rule. Restatement of Trusts, Second, § 202, Comment *j* provides in pertinent part [quotation omitted]. The situation in the instant case differs from Comment *j* and the Illustration in one respect. We have not one, but six, separate deposits of funds of a "trust character" spanning a period of nearly a month, during which time a substantial number of withdrawals and deposits of other funds were made in the account. Comment *m* to the Restatement of Trusts, Second, § 202 at 453 provides [quotation omitted]. Thus, individual funds subsequently deposited to a trust account by the trustee are presumed to be by way of restitution. *Perry v. Perry*....).

Connecticut Gen. Life Ins. Co. v. Universal Ins. Co., 838 F.2d 612, 619-20 (1st Cir. 1988) ("Here, there is no dispute that the lowest intermediate balance in the account into which the insurance proceeds were deposited is zero. CG attempts to overcome the obvious conclusion that it is thus entitled to take nothing by arguing, in essence, that the hotel corporation had not twelve separate bank accounts, but one general "cash-in-banks" account. CG bases this fictional combined bank account on the hotel's financial statements, which list "cash" as a single item. The fact that multiple accounts are consolidated for accounting purposes on a single line of the financial statement does not, of course, mean that they are effectively one account. Nor does it obviate the need for tracing the assets in any particular account. The point of tracing is to follow the particular entrusted assets, not simply to identify some assets.").

In re Columbia Gas Systems Inc., 997 F.2d 1039, 1054 (3d Cir. 1993), *cert. denied*, 510 U.S. 1110 (1994) ("Because the commingling precluded specifically tracing the trust funds, however, the bankruptcy court endorsed the lowest intermediate balance test. This principle assumes that money held in trust is withdrawn last from a commingled account. Once trust money is withdrawn, however, it is not replenished by subsequent deposits. Therefore, a beneficiary is entitled only to the lowest intermediate cash balance in a commingled account.").

City of Farrell v. Sharon Steel Corp., 41 F.3d 92, 102-03 (3d Cir. 1994) ("we recognize that the LIBT may constitute a "reasonable assumption [ ] under which the Internal Revenue Service, and other taxing authorities, can demonstrate that amounts of withheld taxes are still in the possession of the debtor at the commencement of the case ...").

Creative Merch. Sys., Inc. v. Famous Fixtures, No. 05-95-01129-CV, 1997 WL 181523, at *6 (Tex. App. Apr. 16, 1997), writ denied) (Hankinson, J.) (unpublished) ("The trial court was entitled to give more credence to King's testimony than to Schreimann's testimony. Schriemann had never testified about the lowest intermediate balance rule before; he did not learn about the lowest intermediate balance rule in college; and he could not recall if the lowest intermediate balance rule was tested on the CPA exam or if either generally accepted accounting or auditing procedures referred to the lowest intermediate balance rule. Lacking firsthand knowledge and experience in applying this tracing rule, Schreimann relied solely on the explanation of the lowest intermediate balance rule found in *Universal CIT Credit Corp. v. Farmers Bank*, 358 F.Supp. 317 (E.D.Mo.1973), to gain understanding of its application. In contrast, King testified he spent much of his time doing forensic accounting and tracing cash. Based on Schreimanns' lack of personal experience with the lowest intermediate balance test and King's broader experience in forensic accounting, the trial court could rationally have chosen to believe King's testimony over Schreimann's and concluded that Schreimann relied on erroneous assumptions while applying the lowest intermediate balance rule to trace Stevens's proceeds interest in the operating account.

In re Foster, 275 F.3d 924, 927 (10th Cir. 2001) ("The lowest intermediate balance rule is an equitable fiction that should not be employed where equity does not warrant the result. ... Courts refuse to employ the lowest intermediate balance fiction where the commingled account is comprised largely of funds acquired from other fraud victims.").

In re Martin Wright Electric Company (Rodriguez v. Consolidated Electrical Distributors, * 17 (U.S. Bankr. Ct. W.D. Texas Jan. 9, 2008) ("when tracing trust funds in a commingled account, the accepted method employed by most courts is the 'lowest intermediate balance'").

In re Erickson Ret. Communities, LLC, 497 B.R. 504, 511 (Bankr. N.D. Tex. 2013) [footnotes omitted] ("Under the lowest intermediate balance test, if the amount on deposit in commingled funds (which has occurred in this case) has at all times equaled or exceeded the amount of the trust, the trust's funds will be returned in their full amount. In other words, the lowest intermediate balance test creates a legal fiction that, when funds are withdrawn from a trust account, non-trust funds are withdrawn first. Under this test, if the balance of cash on hand on any interim day was less than the amount of the trust fund claims, then the trust fund claims are limited to that "lowest intermediate balance." Moreover, the "lowest intermediate balance test" is applied to all of the debtor's accounts taken together.) .

The LIBR is mentioned in Article 9.315 of the Texas Business and Commerce Code (UCC) comment 3:

> 3. **Secured Party's Right to Identifiable Proceeds.** Under subsection (a)(2), which derives from former Section 9-306(2), a security interest attaches to any identifiable "proceeds," as defined in Section 9-102. See also Section 9-203(f). Subsection (b) is new. It indicates when proceeds commingled with other property are identifiable proceeds and permits the use of whatever methods of tracing other law permits with respect to the type of property involved. Among the "equitable principles" whose use other law may permit is the "lowest intermediate balance rule." See Restatement (2d), Trusts § 202.

The RESTATEMENT (SECOND) OF TRUSTS § 202, *Following Trust Property into Its Product* (1959), comment j, says:

> *j. Effect of withdrawals and subsequent additions.* Where the trustee deposits in a single account in a bank trust funds and his individual funds, and makes withdrawals from the deposit and dissipates the money so withdrawn, and subsequently makes additional deposits of his individual funds in the account, the beneficiary cannot ordinarily enforce an equitable lien upon the deposit for a sum greater than the lowest intermediate balance of the deposit. If the amount on deposit at all times after the deposit of the trust funds equaled or exceeded the amount of trust funds deposited, the beneficiary is entitled to a lien upon the deposit for the full amount of the trust funds deposited in the account. If after the deposit of trust funds in the account the deposit was wholly exhausted by withdrawals before subsequent deposits of the trustee's

> individual funds were made, the beneficiary's lien upon the deposit is extinguished, and if he is unable to trace the money withdrawn, he is relegated to a mere personal claim against the trustee, and is entitled to no priority over other creditors of the trustee.
>
> Illustrations:
>
> 20. A is trustee for B of $1000. He deposits this money together with $1000 of his own in a bank. He draws out $1500 and dissipates it. He later deposits $1000 of his own in the account. B is entitled to a lien on the account for $500, the lowest intermediate balance.
>
> 21. A is trustee for B of $1000. He deposits this money together with $1000 of his own in a bank. He draws out the whole $2000 and dissipates it. He later deposits $500 of his own. B is not entitled to a lien on the account.
>
> 22. A is trustee for B of $1000. He deposits this money together with $1000 of his own in a bank. He draws out various amounts and makes further deposits of money of his own. The amount on deposit in the account is at no time less than $1000. B is entitled to a lien on the account for $1000.

Section 202, comment m says:

> *m. Subsequent additions by way of restitution.* Where the trustee deposits trust funds in his individual account in a bank, and makes withdrawals from the deposit and dissipates the money so withdrawn, and subsequently makes additional deposits of his individual funds in the account, manifesting an intention to make restitution of the trust funds withdrawn, the beneficiary's lien upon the deposit is not limited to the lowest intermediate balance.

Section 202, comment n says:

> *n. Mingling funds of two or more trusts.* Where a trustee wrongfully mingles property held by him as trustee under different trusts and exchanges the mingled mass for other property, the beneficiaries of the trusts are entitled to enforce a constructive trust on the property so acquired and are entitled to share the property proportionately.... Where the trustee deposits in a single account funds held by him as trustee under different trusts, and subsequently wrongfully withdraws and dissipates a part of the deposit, the beneficiaries of the trusts are entitled to share the balance of the deposit proportionately, regardless of the order in which the deposits were made.

> Where the deposit of trust funds and of his individual funds was in an account in the name of the trustee as such, and not in his individual account, and he withdraws more than the amount of his individual funds, and subsequently deposits his individual funds in the account, the beneficiary's lien upon the deposit is not limited to the lowest intermediate balance since the new deposit will be treated as made by way of restitution of the trust funds previously withdrawn.

While Section 212 is expressed in terms of imposing a lien and not imposing a constructive trust or tracing the marital property character of funds, the concept is the same.

The LIBR is easy to apply when a fiduciary misapplies the funds of only one claimant, and there are complete account records. If there are multiple claimants account records are missing, or if then calculating the lowest intermediate balance can be complicated, and if there are many victims, like in a Ponzi scheme, it can be impossible. For this reason, in multiple victim cases courts have used some other allocation approach, such at FIFO, LIFO, or (the modern rule) pro rata allocation.

The LIBR originally emerged in equity courts in the early 1800s in England in connection with imposing a constructive trust (i.e., declaring an ownership interest) in property misappropriated by a fiduciary. Under the rules of the equity courts, two things were required to impose a constructive trust on property held by the defalcating fiduciary: (i) the beneficiary must trace his property into the hands of the fiduciary, and (ii) the beneficiary's property must remain in the hands of the fiduciary at the time of trial. If the misappropriated property had been conveyed away by the fiduciary before the trial, a constructive trust could not be imposed. Situations arose where a fiduciary misappropriated trust funds and deposited them into an account containing the fiduciary's funds. The equity court presumed that, if withdrawals occurred, the fiduciary's money was withdrawn first, leaving the beneficiary's funds behind. If the withdrawals exceeded the amount of the fiduciary's money in the account, then the beneficiary's money was by necessity withdrawn. In British Common Law, it didn't matter if the fiduciary later deposited more of his own funds in the account; a constructive trust could be imposed only on the amount of the beneficiary's original funds that remained in the account.

The rule that a constructive trust could be imposed only on the beneficiary's original funds still in the hands of the fiduciary at the time of trial. This requirement did not result from an assessment that it was the best method to achieve justice between wrongdoer and victim. Instead, it is an artifact of the British legal system, with its strict separation between legal and equitable remedies, and the residual limitations on remedies that were a holdover from the old English Forms of Action. In recent times, British courts have allowed the tracing of funds into assets purchased by the fiduciary, and into the hands of transferees who are not BFPs bona fide purchases for value without notice. In one instance, the Judicial Board of the high court of the British Island of Jersey ruled that the fiduciary's later deposit of his own funds into the account can be considered a replenishment of beneficiary's funds–so called "backward tracing." The Judicial Board also noted the arbitrariness of the LIBR when an account balance is reduced and then replenished due to the coincidental timing of deposits and withdrawals by financial intermediaries. In *The Federal Republic of Brazil and another (Respondents) v. Durant International Corporation and another (Appellants)* (Jersey) [2015] UKPC 35, the Judicial Board of Jersey's Privy Council wrote that a fund would not be treated as diminished if there was a "clear link" between later deposits and earlier withdrawals. The report of the case says:

> The other limb of the appellants' argument is that the Chanani account was a mixed account; and that where a claimant's money is mixed with other money, and drawings are made on the account which reduce the balance at any time to less than the amount which can be said to represent the claimant's money, the amount which the claimant can thereafter recover is limited to the maximum that can be regarded as representing his money ("the lowest intermediate balance rule").
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> The Royal Court (HWB Page QC, Commissioner and Jurats Kerley and Marett-Crosby) rejected the appellants' arguments. After a thoughtful and thorough review of the authorities and academic writings, the court concluded that the law was uncertain, that at a conceptual level the subject seemed incapable of wholly satisfactory solution and that at the level of policy it was unlikely to be settled in English Law below the Supreme Court. Its own view was that Jersey law should not set its face against accepting that "backward tracing" may be legitimate. It said that, at least where the account remained in credit during the relevant period, so there was no question of possible insolvency and prejudice to unsecured creditors, and where there was no suggestion of an intervening bona fide purchaser for value, the question should be whether there was sufficient evidence to establish a clear link between credits and debits to an account.

The case report is interesting to read in its entirety, not only because of the insight it gives into the British law of tracing but also because it reflects one of those fairly rare moments in British legal history where a court changes (i.e., circumvents or overturns) long-standing precedent. The case report is available at:

<https://www.jcpc.uk/cases/docs/jcpc-2013-0069-judgment.pdf>.

A similar approach is reflected in *Federal Trade Commission v. American Precious Metals, LLC*, Civil Action No. 11-61072-Civ-Scola April 10, 2017 (U.S. Dist. Ct. Southern Dist. Florida). There a federal judge imposed an equitable lien on funds obtained through fraud, applying the Florida law of tracing. The federal judge analyzed forensic tracing done by a forensic accountant, Melissa Davis. The court wrote, at p. 3:

> Although Goldman commingled the fraudulently obtained funds with legitimately obtained funds, the commingling of funds does not defeat a claim for an equitable lien. *In re Hecker*, 316 B.R. 375, 387 (Bankr. S.D. Fla. 2004) (Friedman, J.), affirmed, 264 Fed. App'x. 786 (11th Cir. 2008); *In re Mazon*, 387 B.R. 641, 646 (M.D. Fla. 2008). However, Florida courts have created certain presumptions for tracing commingled funds.

> *In re Hecker*, 316 F.3d at 387. First, courts apply the "lowest intermediate balance rule," which presumes that the person who controls the commingled funds will first dissipate his own funds, rather than those that were fraudulently obtained. *Id*. (citations omitted). Second, courts apply the replenishment rule, which presumes that when funds are replenished in a commingled account, the person who controls the commingled funds will first replenish any fraudulently obtained funds. *Id*. at 387-88.

The expert witness in the Florida case, Melissa Davis, wrote an article for the American Bankruptcy Institute on *Tracing Commingled Funds in Fraud Cases*--

<http://www.kapilamukamal.com/wp-content/uploads/2017/07/tracing_commingled_funds_in_fraud_cases_ABI.pdf>.

What the Federal judge and Melissa Davis described as "replenishment" is part of what the Judicial Branch of the Jersey Privy Council described as "backward tracing." Carried over to our Texas practice, one could argue that, where separate and community funds are commingled and a withdrawal of separate funds is made to pay a community expense, and community funds are later deposited into the account, the separate funds are replenished, and vice versa. Replenishment could also apply when a withdrawal causes the account to go into overdraft, and the overdraft is covered by a later deposit. Instead of treating the overdraft as community credit, replenishment or backward tracing would charge the original withdrawal to the marital estate whose funds covered the overdraft.

Replenishment or backward tracing is supported by RESTATEMENT (SECOND) OF TRUSTS § 202, comment m (1959):

> *m. Subsequent additions by way of restitution.* Where the trustee deposits trust funds in his individual account in a bank, and makes withdrawals from the deposit and dissipates the money so withdrawn, and subsequently makes additional deposits of his individual funds in the account, manifesting an intention to make restitution of the trust funds withdrawn, the beneficiary's lien upon the deposit is not limited to the lowest intermediate balance.
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> Where the deposit of trust funds and of his individual funds was in an account in the name of the trustee as such, and not in his individual account, and he withdraws more than the amount of his individual funds, and subsequently deposits his individual funds in the account, the beneficiary's lien upon the deposit is not limited to the lowest intermediate balance since the new deposit will be treated as made by way of restitution of the trust funds previously withdrawn.

Edsall v. Edsall, 240 S.W.2d 424, 428 (Tex. Civ. App.--Eastland 1951, no writ), is a Texas case that appears to allow "backward tracing." There a husband purchased land from his son. He delivered 11 cows to his son at the time of purchase, and 8 cows two months later. All cows were husband's separate property. The appellate court held that a fact issue was presented as to whether the parties intended at the time of sale for the delayed payment to come from the husband's separate property cows, and affirmed the trial court's finding of separate property.

One Texas case has already endorsed a "replenishment" approach to tracing commingled funds, although not in a LIBR context. In *Newland v. Newland*, 529 S.W.2d 105 (Tex. Civ. App.--Fort Worth 1975, no writ), the husband's contemporaneous historical accounting entries reflected "loans" from community to separate and from separate to community, repaid, reloaned, repaid, etc. The appellate court recognized the husband's approach as a valid form of tracing.

To recap, what appears in Texas tracing cases as the minimum balance approach to tracing separate property is an application of the lowest intermediate balance rule recognized in Common Law countries and in state and Federal courts around America. While at least one British court has allowed "replenishment" or "backward tracing," American jurisdictions using the rule have not recognized this British modernization of the LIBR. The LIBR has the following problems:

1. the LIBR cannot be applied without sufficient account records;
2. the LIBR can be too difficult to use if there are multiple claimants to the same fund;
3. the LIBR does not work if the claimant's funds are deposited into an account in overdraft;
4. the LIBR does not address temporary reductions attributable to banking practices;
5. the LIBR does not consider funds later deposited into the account when it could and should;
6. the LIBR does not address assets purchased with funds from the commingled account.

B. LINE-ITEM TRACING. In the last 20 years or so, line-item-tracing has gained wide popularity in Texas. The term "line-item tracing" is taken to mean the re-creation of hypothetical running balances of funds in a bank account or securities in a brokerage account, or balances due on an open account, line-of-credit, or margin account. In the modern era this is done using electronic spreadsheets like Excel. No case, to date, has mandated line-item tracing as the only permissible form of tracing. Many times line-item tracing is not possible, due to lack or records or gaps in records. In some cases line-item tracing is too expensive for the litigants to afford. In other cases there is uncertainty on how to handle transactions such as margin purchases of securities, short sales of securities, the buying and selling of option contracts, day-trading in a brokerage account, etc., that may require a party to present alternate tracings, which is expensive and potentially confusing to the fact finder. There are even some suspicions and criticisms of the universality of the most popular basis for line-item tracing, which is the "community-out-first" approach.

Line-item tracing is based on reconstructing hypothetical running balances of the separate and community property funds in an account after each transaction, be that a deposit or a withdrawal. Deposits are characterized according to the standard definitions of separate and community property. Under the community property presumption, the balance in an account on an particular date (the start date of the tracing) is treated as community property. Deposits are treated as community property unless a separate property source can be established. So far, so good. When there is a *withdrawal* from an account, it becomes necessary to allocate that withdrawal. Different approaches have been recognized for allocating withdrawals to separate or community property funds in a commingled account.

The line-item tracing approach was put to the test in a complicated tracing case in *Richard v. Towery*, No. 01-11-00132-CV, 2013 WL 1694861 (Tex. App.--Houston [1st Dist.] April 18, 2013, no pet.) (memo. op.) Appellant's Brief reflects multiple focused attacks on the steps husband used in tracing his separate property. The Court of Appeals' Opinion follows much of this detail. However, the appellate court repeatedly said that it must give substantial deference to the trial court's determination of the weight of the evidence and credibility of the witnesses. The court also said:

> We note that the percentages calculated by trial court need not be perfect--minor variances in the math, if any, do not amount to reversible error as long as they are not material in light of the community estate as whole.

Id. at *11.

C. COMMUNITY-OUT-FIRST APPROACH. The most popular line-item tracing approach at this time is the community-out-first approach. An historical sketch of the invention and rise of the approach is available at–

<http://www.orsinger.com/PDFFiles/Texas-Bar-Journal-extracted-RRO-publication.pdf>

The approach derives from *Sibley v. Sibley*, 286 S.W.2d 657 (Tex. Civ. App.--Dallas 1955, writ dism'd) (per curiam). In *Sibley*, the husband mixed community funds in a bank account with $3,566.68 of wife's separate funds. There were a number of deposits and withdrawals to the account. However, the account never dropped below $3,566.68. Seeing the husband as a trustee of the wife's separate property funds that were in his care (at a time when the disabilities of coverture existed in Texas), the appellate court invoked a rule of trust law that, where a trustee mixes his own funds with trust funds, the trustee is presumed to have withdrawn his own money first, leaving the beneficiary's money on hand. Since the husband owned none of wife's separate funds, and half of the community funds, it was presumed that the husband withdrew community moneys in the bank account first, before he withdrew the wife's separate moneys. The court said:

> The community moneys in joint bank account of the parties are therefore presumed to have been drawn out first, before the separate moneys are withdrawn.

Id. at 659.

It is unfortunate that the court of civil appeals used language suggesting a fundamental rule of law, instead of using language that suggested a presumption applied to the facts of the case. Be that as it may, the *Sibley* case is said to have used the so-called "community-out-first" approach, even though the court really applied the presumption that a fiduciary withdraws his own funds first leaving the trust funds behind.

The Beaumont Court of Appeals called community-out-first a "theory," and said it was "an acceptable method of tracing." The Houston Fourteenth District Court of Appeals called it a "rebuttable presumption." No court has held that the "community-out-first" approach is the *only* valid tracing approach, or that it *must* be used, or that failing to use the "community-out-first" approach is *improper* or results in a *failure* in tracing. The late Professor Joseph W. McKnight, a law professor at SMU School of Law for over 50 years and a noted authority on Texas marital property law, has criticized the cases which take *Sibley* as establishing a community-property-out-first rule, calling them "inequitable bastard-descendants of *Sibley*." Joseph W. McKnight, *Family Law: Husband and Wife*, 55 SMU L. REV. 1035, 1048 n. 87 (2002). Professor McKnight said:

> Other issues in *Beard* involved claims for reimbursement when the wife's separate estate was commingled with community property. Insofar as the husband made withdrawals from the commingled accounts, they should have been presumed to be community property under the actual holding in *Sibley v. Sibley* [FN87] because the husband is subject to a fiduciary duty to preserve the wife's separate property and to withdraw the community property in which he has a one-half interest. [FN88] With respect to withdrawals by the wife from an account containing her separate property and community property, the court relied on the inequitable bastard-descendants of *Sibley* [FN89] for the proposition that the wife's withdrawal should also be presumed to have been community property. But surely if her separate funds and community funds were subject to her care, she should be deemed first to withdraw the funds which were wholly hers rather than those in which her husband had a one-half interest. The court's conclusion that community funds were withdrawn first and were, as a result, depleted, leaving only her own separate funds, therefore, seems erroneous for tracing purposes. However, it should be noted that, if both spouses act in concert to make a withdrawal of funds from a commingled community account and a separate property fund of one (or both) of them, a presumption of withdrawal of community funds seems reasonable. In *Beard* [FN90] the court reached this conclusion, but for the wrong reasons, i.e. simplistic reliance on the bastard line of cases, which are contrary to all principles of equity. [FN91] If one spouse expends the other spouse's property and stands in a fiduciary position in doing so, reimbursement is due to the other spouse on fiduciary principles. [FN92] But if a spouse expends his or her own property, or the community property, for an alleged reimbursable purpose, recovery should depend on the nature of the purpose.

Id. at 1048-49.

In *Ceasar v. Ceasar*, No. 09-99-138 CV, 2000 WL 639892 (Tex. App.–Beaumont May 18, 2000, no pet.) (unpublished), the appellate court said this about the community-out-first approach:

> The husband employed the community-out-first theory to trace the community estate's interest in the brokerage account. This theory has been criticized. See Stewart W. Gagnon & Christina H. Patierno, *Reimbursement and Tracing: The Bread and Butter to a Gourmet Family Law Property Case*, 49 Baylor L. Rev. 323, 383 (1997); Oliver S. Heard, Jr., Richard A. Strieber, & Richard R. Orsinger, *Characterization of Marital Property*, 39 Baylor L.Rev. 909, 924 (1987). But it is accepted by this court, *see Harris v. Ventura*, 582 S.W.2d 853, 855-56 (Tex. App.--Beaumont 1979, no writ), and it has received recent acceptance by other courts. *See Scott v. Estate of Scott*, 973 S.W.2d 694, 696 (Tex. App.--El Paso 1998, no writ). Accordingly, we hold it is **an acceptable method of tracing** the community estate interest in the brokerage account. [Emphasis added]

In *Smith v. Smith*, 22 S.W.3d 140, (Tex. App.--Houston [14th District] 2000, no pet.), the court said:

> We assume without deciding that the community-out-first presumption is a rebuttable one.FN5
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> > FN5. We also note that a blind application of the community-out-first presumption does not uphold the policy reason for the presumption's original application.

One reason that the community-out-first approach has become so popular is its mechanical nature. In other words, in allocating withdrawals it is not necessary for a forensic accountant to interview anyone, or look for and examine old records. Instead, a formula can be created in an electronic spreadsheet to allocate a withdrawal to community property until community property is exhausted and then to allocate to separate property. Periodically, however, this automatic allocation rule may go against common sense or the party's intent at the time of the transaction. Additionally, sometimes it is the separate property funds of both spouse that are commingled, in which event the community-out-first rule does not apply. So there are reasons to vary from a community-out-first approach, and it is important to recognize what the approach is not–it is *not* the *only* way to trace commingled funds.

D. USE DETERMINES CHARACTER. In an after-the-fact allocation of withdrawals from a commingled fund, one could allocate community expenses to community funds and allocate funds expended on separate property to separate funds. Common sense supports this approach, as it is likely that a person with knowledge of Texas law would choose to spend separate property dollars on separate property expenses rather than use community dollars, thereby creating a claim for reimbursement. Assuming that separate funds pays separate property expenses and community funds pay community property expenses is fair and it also avoids the complexity of sorting through marital property reimbursement claims and offsets at the time of divorce.

In *Rolater v. Rolater*, 198 S.W. 391-92 (Tex. Civ. App.--Dallas 1917, no writ), the appellate court said this about a presumption that separate property funds were used for separate property expenditures:

> Appellant and appellee were married in the year 1903, appellee owning at the time a 66-acre farm, against which there was a principal indebtedness of $1,200, which the evidence shows without dispute was paid during the years 1906, 1907, 1909, 1910, 1911, and while the marriage relation existed. The total amount of principal and interest paid on the note during marriage of the parties was $1,879. The jury found that the community funds contributed for that purpose $973, appellee's separate funds $810, and appellant's separate funds $96, and no complaint is made concerning the sufficiency of the evidence to support the finding that $973 of community funds and $96 of appellant's separate funds were applied for the purpose stated. The only proof which sustains the finding of the jury that $810 was paid out of appellee's separate funds is his statement that he sold two mules and two cows, his separate property, from which he realized $265, which amount he says at one point he applied on his note, and at another he used in payment of household expenses. Such sum falls $545 short of the amount found by the jury to have been paid out of appellee's separate estate. Likewise there is in the record no proof that said sum was paid from the community funds. Such being the facts disclosed by the record, counsel for appellant contends, in effect, that the presumption arises as matter of law that the sum not accounted for was paid from the community funds. No such presumption, we believe, may be indulged under the authorities. Suits for divorce and an accounting are not unlike all other judicial proceedings, in that proof must be adduced in support of every material issue asserted, and when such issue fails of any proof at all it cannot be established by presumption. The finding of the jury that the $810 was paid out of the separate funds of the appellee, we agree as stated, is not supported in full by the evidence. At the same time there is nothing whatever in the record that will support a finding of fact that it was paid out of the community funds. The finding of the jury that only $973 was so paid tends to deny the presumption that the $810 was paid from the community funds. It is true that the entire indebtedness was paid by appellee during the years 1906 to 1911, both inclusive, and while the marital relation existed, but the jury found, with all the facts before them, that only $973 was contributed by the community. We have found no case exactly in point as to the facts, but it has been held that payments made shortly after marriage by one of the spouses upon separate indebtedness will not be presumed to have been made out of community funds in the absence of proof in that respect. *Medlenka v. Downing*, 59 Tex. 32; *McDougal v. Bradford*, 80 Tex. 558, 16 S. W. 619; *Richmond v. Sims*, 144 S. W. 1142. It is, we believe, correct to say that, in the absence of all proof on such issue, the presumption does not arise that the money so paid was not contributed by the separate estate of the spouse bound to pay. As much is said in the *Medlenka* Case.

The appellate court in *Jenkins v. Robinson*, 169 S.W.2d 250, 251 (Tex. Civ. App.--Austin 1943, no writ) said this, in a case involving a claim for reimbursement to the community estate:

> This conclusion as to the burden of proof is clearly erroneous. The real estate was and is conceded by appellees to have been the separate property of Cecil Jenkins. The only right or interest asserted by appellees in the proceeds of the sale of the real estate was that the community estate should be reimbursed for its funds used in paying in part the notes

> representing a part of the purchase price of the real estate, and which payments completed title thereto in Cecil Jenkins. Having so alleged the burden was on appellees to prove that the notes were paid in part with community funds. *Welder v. Lambert*, 91 Tex. 510, 44 S.W. 281; *Gameson v. Gameson*, Tex.Civ.App., 162 S.W. 1169; *Rolater v. Rolater*, Tex.Civ.App., 198 S.W. 391; *Price v. McAnelly*, Tex.Civ.App., 287 S.W. 77; *Gillespie v. Gillespie*, Tex. Civ. App., 110 S.W.2d 89. This burden is not met by merely showing that the indebtedness was paid during the time the marital relationship existed; but it must be established by a preponderance of the evidence as in any civil case not otherwise controlled by statute or law. This burden of proof is not aided by the statutory presumption that all property acquired during marriage is presumed to be community property; because this presumption would defeat the rule that the burden of proof is on appellees to show that the community property acquired under that presumption was actually used to pay off the indebtedness on the real estate.

See generally Welder v. Lambert, 91 Tex. 510, 44 S.W. 281, 287 (1898) ("The lands in controversy appearing to be of the separate estate of Power, we are of opinion that, in order for the heirs of the first wife to establish a charge upon them for a reimbursement of community funds expended in their acquisition, the burden was upon them to prove that the funds had been so expended"); *Price v. McAnelly*, 287 S.W. 77 (Tex. Civ. App.–San Antonio 1926, writ dism'd) (burden is on the party seeking reimbursement to show that community and not separate funds were expended to pay separate debt); *contra*, *Horlock v. Horlock*, 533 S.W.2d 52, 60 (Tex. Civ. App.–Houston [14 th Dist.] 1975, writ dism'd w.o.j.) ("It is the appellant's burden to establish the right of equitable reimbursement of the community estate from the separate estate of the appellee. The appellant is aided in meeting her burden by the presumption that assets purchased and money spent during marriage are community rather than separate property."), citing *Hartman v. Hartman*, 253 S.W.2d 480 (Tex. Civ. App.–Austin 1952, no writ).

It certainly makes some sense, in an after-the-fact reconstruction of events, to apply separate funds to separate purposes and community funds to community purposes, rather than to require an inflexible rule of allocation that disregards what spouses probably would have intended if they had thought about it at the time and tends to replace ownership rights with equitable claims for reimbursement.

However, such a rule does not alone tell us how to allocate *purchases* from a commingled fund. Actual intent (a subjective standard) may play a part. What a reasonable person would have done under the circumstance(an objective standard) may play a part. Pro rata allocation would give all marital estates a proportionate share of gains and losses of the investments made. Or a mechanical rule like community-out-first or FIFO or LIFO could be applied.

E. MATCHING TRANSACTIONS. A recognized rule of tracing allows the proponent to match transactions that are related, without regard to other rules that might be applied. In some articles this is called the “clearing-house method” or the “identical sum inference,” but its use is not limited to transactions that are nearly simultaneous, nor does it require that the sums be identical.

An example of tracing by showing a matching transaction occurred in *Higgins v. Higgins*, 458 S.W.2d 498 (Tex. Civ. App.--Eastland 1970, no writ), where the jury found that, when the husband deposited $71,200.00 of separate funds in a joint bank account and shortly thereafter drew out $ 70,000.00 to purchase a ranch, the ranch was the husband’s separate property. That finding was affirmed by the appellate court. Whether there were community funds in the account at the time the check was issued to buy the ranch was not determinative. No community-out-first analysis was used.

Another example of a matching transaction is *In re Marriage of Tandy*, 532 S.W.2d 714, 717 (Tex. Civ. App.--Amarillo 1976, no writ), where the evidence showed that the husband mixed community property proceeds from grain sales in an account with $25,000 in proceeds from the sale of land which was half-owned by the husband as separate property. After the $25,000 was received, the husband paid $6,250 to each of his sons for their ownership interests in the land, and then paid $12,500 on the husband’s separate property debt. The appellate court held that this evidence traced the separate property. *Id*. at 718-19.

An entirely different form of matching transactions is reflected in *Newland v. Newland*, 529 S.W.2d 105 (Tex. Civ. App.--Fort Worth 1975, no writ). In *Newland*, the husband maintained distinct bank accounts, the “general account” being for community deposits and expenditures, and the “separate account” being for business transactions relating to his separate estate. On occasion the balance of one account would run low, and Mr. Newland would “borrow” from the other account, for “short terms.” The husband treated such transactions as loans, and repaid the borrowed funds “so that the two accounts were restored to the condition which would have obtained had there not been necessity for any transfer.” *Id*. at 109. There was documentary proof of this type of activity for most of the 20-year plus period involved. The trial court, and the appellate court, found that the husband’s methods avoided commingling of the funds, since “there was always ability to compute correct balances for purposes of resegregation.” *Id*. at 109.

And yet another form of matching transaction is reflected in *Beeler v. Beeler*, 363 S.W.2d 305 (Tex. Civ. App.--Beaumont 1962, writ dism’d). In *Beeler*, the spouses purchased real property, partly with a separate property down payment made by the husband, and partly with a community loan. The collateral for the loan was a separate property promissory note of the husband. Payments on the community loan were made to coincide with payments received by the husband on the separate property note, in time and amount. During the marriage, the husband deposited his separate property note payments into a joint account, then wrote checks to make the payments on the community note. Husband sought reimbursement for his separate funds used to pay a community debt. Wife opposed the reimbursement claim, saying that the payments from the separate property note were commingled when they were deposited into the bank account. The trial court found, however, that the parties had agreed to pay the new note with the proceeds from the old note, and that “it was not the intention of the parties to commingle such funds with the community funds of the parties.” The appellate court found that the momentary deposit of such funds into a joint bank account did not convert "the $2,500.00, plus interest" into community funds. "Such sum, in each instance, was, in effect, earmarked a trust fund, in equity already belonging to the bank from the moment collected by appellee . . . . This being so, the installments paid upon the bank note were paid from the separate funds of appellee and his separate estate is therefore entitled to reimbursement therefor." *Id*. at 308. The case was driven by the husband's likely intent.

Other matching transactions are easy to imagine. Imagine that a married woman has set up an automatic payment from her bank account to pay a car loan borrowed prior to her current marriage. The car payment is automatically debited on the third day of the month. Normally the car payment is made from a payment in the same amount that the wife receives from her previous husband on the first day of every month, pursuant to their divorce settlement. In one instance, however, the ex-husband's payment was delayed, so that under the community-out-first approach the car payment was actually paid from the married woman's community funds. If you don't match the transactions, these circumstances will created a reimbursement claim for using community funds to pay separate debt, while the separate property payment, received late from the ex-husband, just mixes with other funds and will be used for some other expenditure.

As another example, a matching could be made between a check that causes an overdraft which the spouse covers by the transfer of separate property funds into the account. Some would argue that an overdraft is community credit, and if repaid with a later separate property deposit then a reimbursement claim would arise for paying community debt with separate property funds. Or you could match the transactions, giving the overdrafting check the same character as the funds used to cover the overdraft. The problem could be addressed by "backward tracing" discussed in Section IX.A above.

Matching transactions can also occur in stock brokerage accounts, such as with day trading, call options, and short sales. In day trading, the investor may buy and sell the same stock several times in the same day, or on successive days. In selling a call option, in exchange for a fee the seller sells to a third part the right to force the seller to sell on demand shares in a certain company. The fee can be matched to the call obligation. If the seller owns the shares subject to the call option at the time s/he sells the call option, then the call option is "covered." If the call option is exercised, the seller must sell the shares to the holder of the call option, and the proceeds from sale can be matched to the call option as well as to the shares sold. In a short sale, an investor borrows a security (not dollars but shares) from his/her broker and immediately sells them. When the short sale is closed, the investor must either sell shares s/he owns, or the investor must purchase the security in order to repay the short sale loan. Closing the covered short position can be matched to the loan, or to the security sold when the short sale is closed.

To a great degree, the matching transaction approach is nothing more than using circumstantial evidence to discern a spouse's intent at the time of the transaction. See Section XII regarding intent.

F. SUPREME COURT TRACING.

The Texas Supreme Court considered specific tracing in the following cases:

1. ***McKinley v. McKinley*****.** In *McKinley v. McKinley*, 496 S.W.2d 540, 542-43 (Tex. 1973), the Supreme Court conducted its own tracing of funds in bank account as follows. The Supreme Court said:

> In late 1964, Royal McKinley had $9,500 on deposit in a First Federal Savings & Loan savings account. It is uncontroverted that this $9,500 was Royal's separate property. By December 31, 1965, the interest earned by this account was $472.03, and on January 5, 1966, $472.03 was withdrawn. The $9,500 originally deposited remained in the account and continued to earn interest until, on December 31, 1967, the account balance was $10,453.81. From January 5, 1966, to December 31, 1967, no withdrawals were made from this account, and all deposits are shown and the account statement to have been 'dividends.' On January 2, 1968, $10,400 was withdrawn from the savings account and, on the same date, was used to purchase First Federal Savings & Loan savings certificate No. 101046 in the amount of $10,400. The First Federal certificate remained on account and untouched until Royal's death on October 15, 1970.
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> [Omitted discussion of *Tarver v. Tarver*, 394 S.W.2d 780 (Tex. 1965).]
>
> In applying these principles to the $10,400 savings certificate, it seems clear that the $9,500 originally on deposit with the First Federal Savings & Loan was traced in its entirety into savings certificate No. 101046, and that $9,500 of that certificate was clearly identified as separate property. We therefore hold that $9,500 of savings certificate No. 101046 in the face amount of $10,400 is separate property.

The Supreme Court's tracing in *McKinley* cannot be squared with a community-out-first approach.

2. ***Estate of Hanau v. Hanau.*** In the case of *Estate of Hanau v. Hanau*, 730 S.W.2d 663, 666-67 (Tex. 1987), the Supreme Court ruled that tracing was successful, *as a matter of law*, when it overturned the court of appeals which had reversed the trial court's summary judgment that stock was separate property:

> [W]e must address whether the court of appeals erred in holding that the 200 shares of TransWorld stock were not properly traced.
>
> The stipulations of the parties provided the following:
>
>> (1) Both parties owned considerable amounts of property before entering the marriage.

> (2) After the marriage, both Robert and Dorris continued to keep their respective stock, bond and mutual funds accounts in their own names.
>
> (3) During all times pertinent to this lawsuit, all transactions in Robert's account were from his income, and all transactions in Dorris' account were from her income.
>
> (4) That the following transactions took place in the stock brokerage account of Robert:
>
> A) On the date of marriage, there were 200 shares of Texaco stock in the account.
>
> B) That while married and living in Illinois, the Texaco stock was sold for $5,755.00 and on the same date 200 shares of City Investing stock were purchased for $5,634.00.
>
> C) After moving to Texas, the City Investing stock was sold for $6,021.00 and on the same date 200 shares of TransWorld stock were bought for $6,170.00.

> The court of appeals held that the above stipulations did not constitute sufficient evidence to overcome the community property presumption. The court held that it is not sufficient "to show that the separate funds *could have been* the source of a subsequent deposit of funds," citing *Lantham v. Allison*, 560 S.W.2d 481, 485 (Tex. Civ. App.--Fort Worth 1978, writ ref'd n.r.e.) (emphasis in original).
>
> The account here has not been commingled, as it was stipulated that the decedent had always kept the property in his own name and that his wife had no power over the account. It certainly does not appear that the property has so radically changed as to "defy resegregation and identification" as said by this court in *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex.1973) . . . . Because the court of appeals' holding that the TransWorld stock was not properly traced was erroneous, we reverse the judgment of the court of appeals and render judgment that the TransWorld stock be transferred to Steven Hanau.

In *Hanau*, there were no account statements or share certificates admitted into evidence. There was no testimony as to whether there was community property cash in the account at the time when TransWorld Stock was purchased. The TransWorld stock purchase required more cash than the proceeds from sale of the Texaco stock could provide. The Court of Appeals said that the husband had only shown that separate property "could have been the source" for the purchase of the TransWorld stock. The Supreme Court disagreed, noting that the husband had kept the property in his own name, and that the wife had no power over the account. The Supreme Court held that the original separate property stock had not "so radically changed as to 'defy resegregation and identification.'"

3. *Pearson v. Fillingim.* In *Pearson v. Fillingim*, 332 S.W.3d 361 (Tex. 2011), the Supreme Court considered a post-divorce suit to divide mineral interests that had been conveyed to the husband by his parents during marriage, but which were not mentioned in the divorce decree. The court in the post-divorce law suit received into evidence four mineral deeds and the testimony of the ex-spouses, then found that the ex-husband's parents had transferred the mineral interests to the ex-husband as a gift. The trial court found the mineral interests to be separate property and the court of appeals affirmed. *Id*. at 362. The Supreme Court reversed, saying that the husband had not appeared at the trial of the original divorce, and thus offered no evidence that the mineral interests were his separate property. The community presumption thus prevailed, and the mineral interests were deemed to be community property, regardless of what proof was offered in the post-divorce proceeding.

G. OVERDRAFTS. One must be careful, in considering overdrafts in checking accounts, whether the overdraft exists just in the check register or exists on the bank statement. The former is not really an overdraft. Phantom overdrafts can also be created when checks and deposits clear the bank on the same day, and it is assumed for tracing purposes that withdrawals are credited before deposits. There is no Texas appellate case telling us how to treat overdrafts in a line-item-tracing effort. Logic and general principles suggest that an overdraft is a loan, which would presumptively be community credit. One can imagine, however, someone making a deposit in an account and writing checks in reliance on the deposit, but a check clears before the deposit clears. The community credit rule would seem not to apply there. One can imagine matching transactions in which an overdraft check is written with the express intent to cover the overdraft with a transfer of separate property funds from another account or with a separate property deposit to be made afterwards. Another way to get to the same place is "backward tracing" discussed in Section IX.A.

H. LINES-OF-CREDIT. It can occur that a person will marry with a line-of-credit in place. Obviously that credit obligation cannot be community credit, because there was no community estate at the time of the extension of credit. If the transaction were a promissory note, signed before marriage, but which is funded during marriage, the credit and the borrowed funds would seem to be separate property, under the inception of title doctrine.

A line-of-credit existing at the time of marriage is likewise established by papers signed before marriage. Remember also that both the premarital and the post-marital debt can be collected out of the borrowing spouse's sole management community property and joint management community property. If a spouse draws on the line-of-credit during marriage, is the credit drawn during marriage separate or community credit? This question, which is not directly answered by case law, could affect the character of investments purchased using that line-of-credit.

I. MARGIN ACCOUNTS. Margin account credit presents a legal issue similar to the line-of-credit, when the margin account agreement was signed prior to marriage. Does the borrowing on margin during marriage somehow relate back to the premarital execution of the margin account agreement, or are sums borrowed during marriage, on a pre-marital line-of-credit, community funds arising from community credit?

J. THE "NET CONTRIBUTIONS APPROACH." This Article proposes another tracing approach that has support in the law and may prove to be more cost-effective other approaches in use today while still achieving an equitable outcome. The name offered is the "net contributions approach." This tracing approach is based on Texas Estates Code Section113.102, which provides a rule to determine the ownership of funds in a joint account during the parties' lifetimes.

Family lawyers may not be familiar with this, but the Texas Legislature has implemented a comprehensive statutory framework governing the handling of joint financial accounts in Chapter 113 of the Texas Estates Code. The framework is covered in detail in Orsinger, *Probate & Family Law - What a Family Lawyer Can Learn from the Texas Estates Code*, State Bar of Texas Advanced Family Law Course ch. 35, pp. 10-14 (2015) available at–

<http://www.orsinger.com/PDFFiles/the-Texas-Estates-Code.pdf>.

For purposes of the present discussion, it is sufficient to focus on Section 113.102, "Ownership of Joint Account During Parties' Lifetimes," and Section 113.003, "Definition of Net Contribution."

> Texas Estates Code §113.102, Ownership of Joint Account During Parties' Lifetimes
>
> During the lifetime of all parties to a joint account, the account belongs to the parties in proportion to the net contributions by each party to the sums on deposit unless there is clear and convincing evidence of a different intent.
>
> Texas Estates Code § 113.003, Definition of Net Contribution
>
> (a) In this chapter, "net contribution" of a party to a joint account at any given time is the sum of all deposits made to that account by or for the party, less all withdrawals made by or for the party that have not been paid to or applied to the use of any other party, plus a pro rata share of any interest or dividends included in the current balance of the account. The term also includes any deposit life insurance proceeds added to the account by reason of the death of the party whose net contribution is in question.
>
> (b) * * *

According to this statute, if the spouses in a divorce have a joint account, their ownership rights are determined by their "net contributions." If separate and community property funds are commingled in a joint account, this statute indicates that the net contributions approach must be used to determine ownership. This of course deviates from the accepted norms in current divorce practice. If not mandatory, at the very least the net contributions approach exists as an alternative form of tracing.

It should be noted that the net contributions approach, like the minimum balance method, is a way to determine ownership of funds that remain in an account, not a rule for allocating withdrawals from a commingled fund.

The question arises as to how to allocate withdrawals from a joint account in calculating "net contributions." The statute says "less all withdrawals made by or for the party that have not been paid to or applied to the use of any other party." This allocation rule would require the tracer to determine which party made each withdrawal, and the use to which the withdrawal was put. If the funds were used to pay community living expenses, it would be allocated to the community funds in the account. In cases involving many transactions over time, the tracing effort could more difficult and more expensive than a mechanical rule like community-out-first, which does not require an assessment of who made the withdrawals and what they were used for.

K. FIFO/LIFO. First in-First-Out and Last in-First-Out are rules used in the accounting profession to allocate the cost of inventory items used in manufacturing. When identical inventory items are purchased at different prices, it is necessary to determine whether the less expensive inventory items or the more expensive inventory items were used. LIFO and FIFO are arbitrary rules used to make this allocation. Using LIFO and FIFO in tracing was discussed in *Note: Tracing Case Proceeds in Insolvency Proceedings Under Revised Article 9*, AM. BANKR. INST. L. REV. 385, 412 (2001):

> The "first-in, first-out" ("FIFO") and "last-in, last out" ("LIFO") rules are inventory valuation methods used mostly in accounting. FIFO is a method which assumes that the first goods purchased or produced are the first to be sold. LIFO, on the other hand, assumes that the last goods purchased or produced are the first to be sold. These methods can be employed to come to a conclusion as to the traceability of cash proceeds. For example, FIFO would assume that the first funds deposited in a commingled account would also be the first funds withdrawn or paid out of that account. In *In re California Trade Technical Schools, Inc.*, [923 F.2d 641, 649-50 (9th Cir. 1991)], the Ninth Circuit utilized FIFO in order to determine whether an account contained funds from another account which contained funds deposited in violation of the preferential transfer rule. The court looked at the Bankruptcy Code provisions which prevent preferential transfers and fraudulent conveyances and found their intent was to discourage last minute transfers from debtors. Based on that intent, the court determined that a FIFO rule would best serve that purpose. FIFO presumes that funds wrongfully transferred to an account at the eleventh hour remain there until all of the funds previously in the account have been expended. The rule thereby makes it more difficult for a debtor to dissipate funds owed to his creditors by commingling those funds with other money. [Footnotes omitted.]

One of the early rules for tracing commingled funds dates back to *Devaynes v Noble* (1816) 35 ER 781, and has come to be called "the rule in Clayton's case." It was decided that, when a debtor makes a payment to a creditor holding debts of different dates, without specifying the debt to be paid, it would be presumed that the parties intended to pay the oldest debt first. Since funds on deposit with a bank create a debtor-creditor relationship, when the rule in Clayton's case was applied to commingled funds it translated into a rule that payments to depositors out of a commingled fund would be allocated to the earliest deposits first, which is tantamount to a FIFO rule.

The U.S. Supreme Court, in a case involving the infamous Carlo Ponzi, applied the FIFO approach to the commingled funds. *Cunningham v. Brown*, 265 U.S. 1, 12-13 (1924). The Court cited as justification Clayton's Case [1816] Ch. 1 Merivale, 572:

> Lord Chancellor Eldon, in Clayton's Case, [1816] Ch. 1 Merivale, 572, held that, in a fund in which were mingled the moneys of several defrauded claimants insufficient to satisfy them all, the first withdrawals were to be charged against the first deposits, and the claimants were entitled to be paid in the inverse order in which their moneys went into the account.

This resulted in early investors being made whole, while later investors received nothing–not an equitable sharing of losses. In the case of *In re Christensen*, 122 Nev. 1309, 1324-26, 149 P.3d 40, 50-51 (2006), the Nevada Supreme Court reviewed its options for adopting a tracing rule in an exemption case and selected FIFO. The court's reasoning is interesting:

> The debtors urge us to take a case-by-case approach rather than adopting one particular method of tracing. Such an approach, however, would lead to greater litigation between debtors and trustees over the appropriate tracing method to be utilized. In the interest of judicial economy, we therefore conclude that it is appropriate to adopt one method of tracing.
>
> As NRS 21.090(1)(g) is silent on the appropriate method of tracing, we must turn to common-law principles. Other jurisdictions generally apply one of the following four methods borrowed from trust and accounting law to trace funds: the lowest intermediate balance rule (LIBR) approach; the pro-rata approach; the last-in, first-out (LIFO) approach; and the first-in, first-out (FIFO) approach.
>
> LIBR is a tracing method derived from the law of trusts. Under this approach, "the exempt fund may not exceed the lowest balance occurring at any time between the deposit of the exempt amount of money and the time of levy." New deposits do not replenish the original exempt fund, although the new deposits may themselves be exempt. Courts, however, use LIBR most often when tracing with respect to conversion actions, and thus, this method is not particularly useful within the context of the wage exemption statute.

> Under the pro-rata approach, withdrawals from an account containing exempt and nonexempt funds are to be attributed to the several funds in proportion to their respective sizes at the time of the withdrawals. Thus, if a debtor's bank account contains $100 of exempt funds and $500 of nonexempt funds, and the debtor proceeds to make a withdrawal, one-sixth of the withdrawal is assumed to have come from the exempt funds and five-sixths of the withdrawal is assumed to come from the nonexempt funds.
>
> FIFO assumes that the first funds deposited in a commingled account are also the first funds withdrawn or paid out of that account. By way of example, assume a debtor deposits $100 of earnings and several days later deposits $500 from a nonexempt source. The debtor then withdraws $150. Using the FIFO method, the debtor exhausts $100 of the funds from earnings, and only $50 of the funds from the nonexempt source. In contexts similar to situations presented by the debtors in these cases, several courts have used FIFO to trace exempt funds in a commingled account. LIFO, in contrast, assumes that the last funds deposited in a commingled account are the first funds withdrawn or paid out of that account. Using the LIFO accounting method, the $150 withdrawal is assumed to come entirely from the nonexempt $500.
>
> We conclude that LIBR and LIFO are less workable approaches and inconsistent with expeditious and simple enforcement. While the pro-rata approach seems to be the most simple, it does very little to preserve the rights of creditors to execute against nonexempt funds. Accordingly, we conclude that FIFO best serves the dual interests of NRS 21.090(1)(g) of assuring that the debtors have the necessities of life while doing as little harm to the creditors as possible. Thus, in answer to certified question no. 5, we adopt FIFO as the approved method for tracing exempt funds from private debtor accounts.
>
> CONCLUSION
>
> Based on the foregoing analysis, we conclude that NRS 21.090(1)(g), in both its original and amended form, exempts the proceeds of any and all deposits of earnings in a debtor's bank account. Once exempt, the proceeds of exempt earnings retain the exemption even if commingled with nonexempt funds unless tracing is not possible or the proceeds take on the form of an investment. Finally, we adopt FIFO as the appropriate method to trace exempt proceeds. [Footnotes omitted.]

L. SHOULD EQUITY BE SERVED? Perhaps instead of elevating one tracing approach above others, perhaps we should be more flexible about what is permissible and leave it to the fact-finder to be convinced or not. This sentiment was shared in *In re Lantz*, 451 B.R. 843, 847-49 (Bankr. N.D. Ill. 2011):

Methods of tracing commingled funds are "an equitable substitute for the impossibility of specific identification" and therefore a court must "exercise case-specific judgment to select the method best suited to achieve a fair and equitable result on the facts before them." *United States v. Henshaw*, 388 F.3d 738, 741 (10th Cir.2004). Thus in *Winfield,* even while choosing to apply the "first-in first-out" method in that case, the court stressed that "we have no thought to suggest that this or any other formula ... is of such inflexible validity as to admit of no exceptions" and noted that the "rule will not be applied where it produces an unjust result." 212 N.E.2d at 13 (quoting *Carson v. Fed. Reserve Bank of New York*, 254 N.Y. 218, 172 N.E. 475 (1930)). Similarly, the "lowest intermediate balance rule is an equitable fiction that should not be employed where equity does not warrant the result." *Lichtenberger*, 337 B.R. at 324 (quoting *In re Foster*, 275 F.3d 924, 927 (10th Cir.2001)). As Judge Perkins has noted:

> There is little, if any, significance to be placed upon the "commingling" of the exempt funds with nonexempt funds, or upon the inability to trace the repaid funds to the previously withdrawn funds, dollar for dollar. Account debits and credits are intangible representations of money, in the form of the drawee's promise to pay. In circumstances such as those before the Court, the focus should be on the debtor's intent, not on the physical or metaphysical path traveled by the asset in question.

Barber v. Dunbar (*In re Dunbar*), 313 B.R. 430, 438 n. 8 (Bankr.C.D.Ill.2004). Therefore, in selecting a method of tracing, a court should consider the intent of the parties, the policy underlying the exemption, and the general rule that exemption statutes are to be construed in favor of debtors. In *Lichtenberger*, Judge Gorman ultimately concluded that the first-in first-out principle was the most appropriate method for determining whether funds in a commingled account were traceable to exempt social security benefits. *Lichtenberger*, 337 B.R. at 326. In so concluding, she relied heavily on the principle under Illinois law that "personal property exemption statutes are to be construed liberally to protect debtors" and that if "it is possible to construe an exemption statute in ways that are both favorable and unfavorable to a debtor, then the favorable method should be chosen." *Id.* at 324 (citing *In re Barker*, 768 F.2d 191, 196 (7th Cir.1985). However, the exemption at issue in *Lichtenberger* was the exemption for social security benefits, not the exemption for homestead proceeds. Moreover, here, it is the application of the lowest intermediate balance rule that would benefit the Debtors, not the first-in first-out method. While the various exemption statutes in Illinois law have similar policies, they are not identical, nor are the expectations as to how the exempt property will be used the same. The purpose for most of the personal property exemptions, including the exemption for social security and other public assistance benefits, is to ensure that debtors and their families have sufficient means to support themselves through difficult times without "becoming a public charge." *See*, e.g., *In re Marriage of Logston*, 103 Ill.2d 266, 279, 82 Ill.Dec. 633, 469 N.E.2d 167, 168 (Ill.1984).

There is therefore an expectation that the benefits will be used to pay ongoing daily expenses, which is consistent with the assumptions underlying the first-in first-out method. As the 7th Circuit Court of Appeals has stated with respect to the exemption for public benefits, the exemption "has nothing to do with funds on deposit long after their receipt and commingling with the debtor's other assets." *In re Schoonover*, 331 F.3d 575 (7th Cir.2003). In contrast, the homestead exemption is somewhat more narrow, with the focus on maintaining a homestead. The "purpose of the homestead exemption is to provide the debtor with the necessary shelter or the means to acquire shelter required for his welfare during difficult economic circumstances." *Bank of Illmo v. Simmons*, 142 Ill.App.3d 741, 745, 97 Ill.Dec. 4, 492 N.E.2d 207, 211 (Ill. App. Ct. 1986) (citing *State Bank of Antioch v. Nelson*, 132 Ill.App.3d 120, 123, 87 Ill.Dec. 476, 477 N.E.2d 77, 79 (Ill. App. Ct. 1985)). It is true that I noted in my prior opinion in this case that I believe that the reference to "means to acquire shelter in *Illmo*, together with the relatively long one-year period for protecting proceeds, means that the proceeds exemption is also intended to protect a debtor's ability to acquire temporary shelter for up to a year in temporary housing while searching for a permanent homestead. However, the emphasis is still on obtaining a long-term homestead, and therefore it would be more consistent with the policy behind the exemption to presume that any money from a commingled account spent on things other than acquiring a new homestead (or at least spent on rent for temporary housing) came from sources other than the homestead proceeds. The tracing method most consistent with that policy would be the lowest intermediate balance rule. I recognize that this causes some tension with the holding of *Lichtenberger* because of the fact that *Lichtenberger* also involved some non-exempt homestead proceeds. The debtor in *Lichtenberger* filed his bankruptcy 4 months too late to claim an exemption in the homestead proceeds. He therefore wanted to use the first-in first-out rule of tracing to assume that he was using the non-exempt homestead proceeds for his daily living expenses rather than his monthly social security benefits. However, despite any tension in theoretical assumptions, ultimately the statute is to be construed in favor of the debtor on the issue at hand and it is the Trustee's burden to demonstrate that the exemption is improperly asserted. The Debtors argue that it was their intent to segregate the homestead proceeds and not use them for daily expenses unless they had to, and they did in fact move funds to a segregated account within a month of receiving the initial proceeds. Where the statute and case law do not require the funds to be segregated, the Debtors should not be punished simply because money happened to come into and go out of the 1st Account before they were able to set up the 2nd Account, at least unless the intermediate balance rule demonstrates that funds could not have constituted proceeds from the initial sale. Therefore, since the Debtors claim an exemption of $9,000 in the 3rd Account and the Trustee has not demonstrated that the balance in the 1st Account, 2nd Account or 3rd Account ever fell below $9,000 while funds attributable to the homestead proceeds were on deposit, the Trustee's objection to the claim of exemption in those funds will be denied. [Footnotes omitted.]

X. EXHAUSTION OF COMMUNITY APPROACH. There are several tracing approaches that consider an overall view of money in and money out as a way of tracing.

A. COMMUNITY LIVING EXPENSE PRESUMPTION. Texas courts have recognized tracing using the presumption that family expenses were paid with community money, known also as the "family expense method" in California and elsewhere. This tracing approach is described in an article in the Journal of the American Academy of Matrimonial Lawyers:

> The concept of the family expense method is to adopt the rule that in a commingled account, family ("marital" or "community") money will be used to pay family expenses before separate money will be used for family expenses. Therefore, it is not necessary to document every deposit and every expenditure as it occurred; no running balance is required. All of the family money that went into the account, up to the date in question, is calculated. Then, all of the family expenses that were paid out of the "account in the same time period are computed. If the family expenses are equal to, or greater than, the family income, what is left is separate. Hence, the remainder of the account at that date or the asset purchased on that date with the "leftover" separate money is separate property."

Kessler, Joan F., Koritzinsky, Allan R., Meyers, Marta T., *Tracing to Avoid Transmutation*, 17 J. AMER. ACAD. MATRIMONIAL LAWYERS (Sept. 2002), <http://www.aaml.org/i4a/pages/index.cfm?pageid=3392>.

The presumption that community funds were used to pay family expenses is exemplified in *Zagorski v. Zagorski*, 116 S.W.3d 309 (Tex. App.–Houston [14th Dist.] 2003, pet. denied), where the husband "introduced an exhibit showing less than $115,000 in interest was earned during the marriage. Another exhibit shows approximately $366,000 was withdrawn for marital living expenses." *Id*. at 320. The appellate court concluded that, "[b]ecause the withdrawals for community expenses depleted the community funds in the Account, the Account remained [the husband's] separate account." *Id.* The court said: "Tony's tracing of the community funds into and out of the Account rebutted the statutory presumption the Account was a community asset. . . . Here, the evidence demonstrates community funds in the Account were depleted." This was an aggregate-level (not line-item) tracing, accomplished by showing the total interest income and the total withdrawals for living expenses, and the court presumed that the interest income was used up in paying for the living expenses.

The case of *DePuy v. DePuy*, 483 S.W.2d 883, 887-88 (Tex. Civ. App.–Corpus Christi 1972, no writ), noted the following evidence regarding community income versus community expenses:

> There was also evidence of the income as well as living expenses of the parties during their marriage. It is apparent that the parties had net earnings which approximated their living expenses with only small amounts, if any, left over. The combined take-home pay of the parties for most of the period involved was about $750.00 per month. Mr. DePuy did not work for short periods of time. The earnings of Mrs. DePuy tended to increase, particularly after the parties moved to Corpus Christi, Texas in the summer of 1969.

Id. at 888. In finding that tracing had been successful the court cited both *Barrington v. Barrington*, 290 S.W.2d 297 (Tex. Civ. App.-- Texarkana,1956 no writ); and *Coggin v. Coggin*, 204 S.W.2d 47 (Tex. Civ. App.--Amarillo 1947, no writ), which are community expense presumption cases.

In *Coggin v. Coggin*, 204 S.W.2d 47, 52 (Tex. Civ. App.–Amarillo 1947 no writ), the wife commingled agricultural rentals with separate property in various bank accounts over a period of four years, out of which she purchased a home and several tracts of land. *Id*. at 52. However, the rental income was $1,000 per year, while living expenses ranged from $200 to $500 per month. The jury found, and the appellate court agreed, that none of the community money deposited into the accounts was used to buy the real property. *Id*. at 52.

The Family Expense Method of tracing was recognized by the Supreme Court of California in the case of *In re Marriage of Mix*, 536 P.2d 479, 484 (Cal. 1975), which expressly recognized "a presumption that family expenses are paid from community funds." *Id*. at 484. The presumption was previously recognized in *Beam v. Bank of America*, 490 P.2d 257, 263 (Cal. 1971), as the "family expense presumption," established by a long line of cases, and "universally invoked," that "it is presumed that the expenses of the family are paid from community rather than separate funds [citations] [and] thus, in the absence of any evidence showing a different practice, the community earnings are chargeable with those expenses." *Accord*, *Estate of Murphy v. Murphy*, 544 P.2d 956, 918 (Cal. 1976); *See v. See*, 415 P. 2d 776, 783 (Cal. 1966); *Estate of Neilson v. Neilson*, 371 P.2d 745, 742 (Cal. 1962); *In re Marriage of Braud*, 53 Cal. Rptr. 2d 179, 195 (Cal. App. 1996); *Frick v. Frick*, 181 Cal. App. 3d 997, 1013 (Cal. App. 1986); *Thomasset v. Thomasset*, 264 P.2d 626, 632 (Cal. App. 1953). In *See v. See*, 64 Cal. 2d 778, 783, 415 P.2d 776, 780 (1966), the Court seemed to limit the tracing approach to situations where account records are not available through no fault of the contestant. The Court wrote:

> He may trace the source of the property to his separate funds and overcome the presumption with evidence that community expenses exceeded community income at the time of acquisition. If he proves that at that time all community income was exhausted by family expenses, he establishes that the property was purchased with separate funds.... Only when, through no fault of the husband, it is not possible to ascertain the balance of income and expenditures at the time property was acquired, can recapitulation of the total community expenses and income throughout the marriage be used to establish the character of the property.
>
> * * *
>
> A husband who commingles the property of the community with his separate property, but fails to keep adequate records cannot invoke the burden of record keeping as a justification for a recapitulation of income and expenses at the termination of the marriage that disregards any acquisitions that may have been made during the marriage with community funds. If funds used for acquisitions during marriage cannot otherwise be traced to their source and the husband who has commingled property is unable to establish that there was a deficit in the community

> accounts when the assets were purchased, the presumption controls that property acquired by purchase during marriage is community property. The husband may protect his separate property by not commingling community and separate assets and income. Once he commingles, he assumes the burden of keeping records adequate to establish the balance of community income and expenditures at the time an asset is acquired with commingled property.

B. DISTRIBUTIONS FROM PROFITS FROM BUSINESSES. In *Barrington v. Barrington*, 290 S.W.2d 297 (Tex. Civ. App.--Texarkana 1956, no writ), the husband conducted throughout the marriage a sole proprietorship tire company which existed at the time he married. The trial court found that, during marriage, the husband had withdrawn more money from the business than the business earned. *Id*. at 300. The profit and loss statement reflected that withdrawals for the support, maintenance, pleasure, etc. of the parties exceeded the business's earnings. *Id*. at 304. The trial and appellate courts found that the withdrawals had depleted the community earnings and that the funds and assets remaining in the tire company were the husband's separate property. *Id.* The courts did not concern themselves with the timing of deposits and withdrawals.

In *Blumer v. Kallison*, 297 S.W.2d 898, 900-01 (Tex. Civ. App.--San Antonio 1956, writ ref'd n.r.e.), the appellate court upheld a finding that the wife's share of assets in a business were her separate property. The court said:

> It appears that the books of the Kallison Enterprises accurately disclosed the profits derived therefrom and the part thereof set aside and apportioned to the interest of Pauline Kallison, and that during the existence of her marriage with appellant she drew from the Kallison accounts an amount in excess of that apportioned to her as profits. The evidence discloses that an attempt was made to keep the books so that at all times the principal investment of Pauline Kallison (separate property) could be identified and calculated separately from the profits or earnings thereon (community property). No objection to the bookkeeping methods employed to accomplish this purpose was ever raised by appellant.

Id. at 901.

> Under these circumstances, the trial judge was correct in regarding the interest of Pauline Kallison in the Kallison Enterprises at the time of her marriage as an interest in a business and in a stock of merchandise, and further concluding that under the business practices and bookkeeping methods employed, there was no commingling of properties or funds that would prevent the identification of the separate property of Pauline Kallison.

Id. at 903.

XI. INTENT. Some tracing cases consider testimony from spouses about what they intended in a transaction as some evidence to support a tracing claim. Many have been discussed above.

Obviously, corroboration of this testimony with historical memoranda or communications, or other direct or circumstantial evidence (like matching transactions), could be judged to be more credible than statements made at the time of divorce, unsubstantiated by historical evidence.

As in other areas of the law, we can use either a subjective approach to intent or an objective approach. "Subjective intent" would be the intent that existed in the mind of the actor at the time of the act. "Objective intent" would be the intent of a reasonable person under the same or similar circumstances. Either approach has virtues compared to a mechanical rule that considers neither what was intended nor what is reasonable. The only advantage of the mechanical rule is that it removes the mind and the heart from the tracing practices so that a machine can tell you how to resolve the dispute.

XII. MAXIMUM COMMUNITY AVAILABLE APPROACH. The case of *Duncan v. U.S.*, 247 F.2d 845 (5th Cir. 1957), reflects what might be called the "maximum community available" approach. The court said:

> The Estate's case was simply made. And, with a candid forthrightness, it insists that to the extent the record does not, or cannot, indicate the facts as to the origin of the money which produced Items I, II and III, the presumption operates to make it all community even though, without contradiction and established as an absolute fact, community income during the three years (1947, 1948, 1949) of this short three-year marriage available FN3 for investment was only $16,737.19. The result would be that, with neither showing nor purpose of showing circumstances from which gifts of the husband's separate property to the community could be inferred, the application of the presumption not only turns the sow's ear into a silk purse, but by alchemist's wizardry, fills it with gold by making the maximum of all community funds $16,737.19 turn into $81,688.84. [Footnote omitted.]

Id. at 848-49. The court continued:

> For the short year 1946, disregarding altogether gains from the sale of his premarriage property, the net income for dividends, interest, professional income was $3,588.62. After deducting contributions, state and federal income taxes actually paid totaling $2,394.88, only $1,193.74 was available. The presumptions would neither permit nor require a holding that all was earned in the last two months during marriage. The Government's estimate of 1/6 ($598.10) for this purpose is conservative, although later on, for apportionment, we include the whole ($1,193.74).The maximum total available was:

1946	$ 598.10
1947	4,137.32
1948	6,024.26
1949	5,977.51
	$16,737.19

> This assumes that all of the income available for spending was used to accumulate Items I, II and III since the amount of living and household expenses disbursed by the wife from funds drawn out of the State National Bank account (Item III) were not established in amount.

Id. at 849. The court went on to say:

> When facts demonstrate positively and conclusively that on the assumption that every cent of community funds was invested, it was but a fraction of the cost of the property thus acquired, the presumption no longer has any basis in fact, and indeed, flying in the face of facts, it is overcome.

Id. at 851-52.

XIII. PRO RATA APPROACH. Professor Joseph W. McKnight endorsed the pro rata method in a law review article he published in 1999, Joseph W. McKnight, *Family Law: Husband and Wife*, 52 SMU L. Rev. 1155-56 (1999):

> In *Sibley* the husband as custodian for his wife of her separate property deposited her funds in a community bank account. On divorce, the wife sought return of her property. After the wife's funds had been deposited in her husband's account, many payments had been made from the account, but the account balance had never dipped below the amount of the wife's funds deposited there. The appellate court held that the husband-fiduciary was deemed to have paid out community funds before exhausting any of the wife's funds. This holding based on fiduciary principles has been often cited in support of the proposition that in any situation of commingling of separate property with community funds, the community funds will be deemed to be paid out first. [FN83] Such citation is a gross misstatement of the holding in *Sibley*. But by treating each withdrawal as a transaction, the conclusion may still be defended as an application of the community presumption. Even so, each withdrawal is more properly characterized as being of the same character as the fund from which it was taken. That is, if the fund at the time of withdrawal is forty percent separate and sixty percent community, the withdrawal should reflect the same mix. [FN84]

Professor McKnight's suggestion is a form of mutation approach: if the fund has a certain mix, what is bought out of the fund should have the same mix.

The pro rata approach was in fact used in the *Sibley* case, when a withdrawal was taken from a commingled account to make a down payment on property. The *Sibley* case used the minimum balance method of tracing up to the date of the withdrawal, and then applied a pro rata allocation to the funds in the account at the time of the withdrawal in question. In *Bombardier Capital v. Key Bank of Maine*, 639 A.2d 1065 (Me. 1994), the appellate court considered a case where a wrongdoer mixed the funds of two innocent victims, then drew the account down to a lower balance. The court ruled that the remaining funds would be prorated between the two claimants.

XIV. TRACING AND EXPRESS TRUSTS. In *McFaddin v. Commissioner*, 148 F.2d 570 (5th Cir. 1945), a tax case, a trust was created by the mother and father of the McFaddin children. The parents conveyed two large cattle ranches into trust, subject to the debts secured by the properties and further subject to an annual payment to the mother of $30,000 per year, payable from income or, if insufficient, from the corpus.

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

The Fifth Circuit agreed that the res of the trust was a gift, and thus separate property. *Id*. at 572. Therefore, the oil royalties, bonuses and profits from the sale of the land "came to" the McFaddin children as separate property, taxable as separate income. Nonetheless, the Court held that property acquired by the trust during the beneficiaries' marriages was community because separate and community funds had been commingled within the trust. The Court stated:

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

Id. at 573.

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

In sum, the *McFaddin* case stands for proposition that income received by a trust is community or separate by the same rules as would apply had the income been received outside of trust. And if those funds are commingled, then the separate corpus of the trust can be lost to the community, upon subsequent distributions to the beneficiaries.

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

Several subsequent Texas cases have suggested that assets held in an ancestor-created spendthrift trust are not marital property, unless the beneficiary is entitled to present possession the trust principal. If this view of the law is applied to a situation where the beneficiary has become entitled to some or all of the principal, then the income on that portion of the principal is community property. In this way community property can be commingled with trust property, creating a tracing issue.

If called upon to trace inside a trust, the question arises as to what methods apply. Line-item tracing, such as we often use for commingled bank accounts, contravenes normal trust accounting. Trustees are required to allocate between principal and income only on an annual basis, and they do so based on "net income" not a dollar-by-dollar tracing. TEX. PROP. CODE ch. 116. Consequently, a tracing method for community property commingled inside a trust may be more like the exhaustion method used in *Zagorski* or *Barrington* or *Blumer v. Kallison*.

The maximum community available approach could also be used, in that the income on trust property (ranging from 1 to 6% per year) should not be enough to swallow the trust principal.

When distributions are made to a beneficiary-spouse, from a trust with some matured principal, some method of allocation must be used to determine when community property is being distributed, and when separate property is being distributed. The settlor's intent is paramount in trust law, so expressions of intent in the trust instrument may be determinative. The law prescribes how a trustee must allocate receipts to principal and income absent a directive in the trust instrument. See the Texas Uniform Principal and Income Act contained in Chapter 116 of the Texas Property Code. The trustee likely has some discretion to allocate receipts between principal and interest, and complete discretion to allocate distributions as well, in which event the trustee's intent may be a consideration. Absent those indicators, one can imagine a hierarchy where distributions are allocated to community property income first, then community principal free of trust, then separate property income, then separate property principal now free of trust, then trust income, and finally trust principal.

XV. THE REIMBURSEMENT ALTERNATIVE. In *Schmidt v. Huppman*, 73 Tex. 112, 11 S.W. 175 (1889), a spouse owning a mercantile business at the time of marriage lost the separate identity of his date-of-marriage inventory due to commingling. The trial court awarded the spouse monetary reimbursement for the amount of the inventory on that date, thus leaving only the growth in inventory (representing profit) as a community asset. The Supreme Court affirmed. Although the trial court in *Schmidt* awarded reimbursement, the case could be viewed as a mutation case. The Supreme Court said:

> But can it be said that in this case there was any actual mutation in this separate property of the husband? The business was carried on for a period of about 13 years, goods bought and added to the stock, and sold out from day to day, during these years. While the specific articles that made up the original stock had been sold, and their places supplied by others from time to time as the exigencies of the business required, the property was in fact the same, a stock of merchandise, and we think there was not such change in the property as would divest it of its separate character, to the extent of the goods owned by appellant at the time of the marriage.

Id. at 175-76. In a sense, *Schmidt* is a tracing case, involving the principle that mutations in form do not change the separate property character of property. The assets that mutated were the inventory and equipment in the business on the day of marriage which, although changed in form, are still somewhere in the business. In this light, *Barrington* and *Blumer v. Kallison* can be viewed as similar instances, only in those cases the profits of the business were distributed, leaving behind the separate property beginning inventory and equipment that were changed in form but were nonetheless separate property assets that had mutated but not lost their character.

In *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd), the husband lost separate property to commingling, and was awarded reimbursement to compensate. The appellate court affirmed, saying:

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

> upon which the community's wealth was built. Throughout the marriage the husband utilized that foundation to provide for the appellant and to establish the $3,000,000 to $4,000,000 estate. Equity is well served by reimbursing him for that initial investment.

Id. at 58.

Thus, even if tracing fails, a spouse may be able to recover his/her original separate property stake through reimbursement even though s/he cannot definitively show the specific assets that contain that separate property wealth.

XVI. ESTIMATING GROWTH OF CAPITAL. If you have a case where a known amount of separate property wealth was invested stocks, but cannot do line-item tracing due to lack or records or lack of funds to pay for the tracing effort, one way to achieve "rough justice" would be to allocate to the separate estate a reasonable growth rate of invested capital. There is no Texas case law approving this approach, but it could be worth trying. A reasonable growth rate could be approximated by comparison to a stock market index like the Standard & Poor's 500 or the Russell 2000. All other increase in the investment portfolio would be attributed to the community estate.

Most divorce cases are settled in mediation, and some are settled in collaborative law. If the parties can reach a compromise based on estimating the growth of capital, they could in some circumstances reach a fairly accurate result without the cost of tracing the brokerage accounts.

XVII. THE 10,000 FOOT VIEW. Tracing methods around America, used mostly in the debt collection or commercial context, developed from the rigid framework of the British system of law and equity, and they maintain much of that rigidity. Texas developed its approaches to tracing independently from the influence of British law, mostly in divorce cases. Line-item tracing based on the community-out-first rule seems to dominate the field today, perhaps because it is a mechanical process that requires few or no judgment calls, and does not depend on the credibility of the client. However, Texas courts have recognized a number of different approaches to tracing separate property, and those approaches should be considered to be tools in the tool box. And, if tracing fails, do not forget that the Supreme Court has approved the award of reimbursement to make up for forfeiture of separate property due to commingling.

XVIII. HYPOTHETICALS.

1. Schedule B. Wife owns 375 shares of IBM. Wife's stock brokerage records from early in the marriage have been lost. Schedule B on each of her tax returns shows dividends from IBM stock dating back to before marriage. Historical financial information on the internet shows a dividend rate that consistently matches the reported dividend income each year to 375 shares of IBM stock. Schedule D of W's tax returns shows that no shares of IBM were sold during marriage. Is this clear and convincing evidence that the shares are Wife's separate property? Would you grant Wife a summary judgment on this proof? If the trial court found community property, and you were on the court of appeals, would you vote to reverse and remand? Reverse and render?

2. Schedule D. Husband's stock brokerage records from early in the marriage have been lost. However, Schedule D of his tax return from the year in question shows that he sold 1,000 shares of Microsoft stock, and reflects an acquisition date prior to marriage. Is this clear and convincing evidence that the Microsoft stock was separate property? Would you grant Husband a summary judgment? If not, is this clear and convincing evidence? If the trial court found community property, would you reverse and remand? Reverse and render?

3. Sale of Partial Block 1. Husband owned 500 shares of Ford Motor Co. stock prior to marriage. During marriage he buys 500 more shares of Ford stock, using community funds. Later he sells 500 shares of Ford Stock. What is the character of the remaining shares, using the following methods: (i) community-out-first; (ii) FIFO; (iii) LIFO; (iv) pro rata; (v) W's testimony of intent; (vi) contemporaneous memo reflecting W's intent to sell CP shares; (vii) assuming that higher tax basis stock was sold?

4. Sale of Partial Block 2. Same as #3, except Schedule D in the year of sale reflects that the shares sold had an acquisition date during marriage. What is the character of the shares sold? Would you grant Husband a summary judgment that the shares sold were community property? If not, is this clear and convincing evidence? If the trial court found community property, would you reverse and remand? Reverse and render?

5. Sale of Partial Block 3. Same as #3, except the tax return from the year of sale is lost. The current brokerage account statement reflects an unrealized capital gain on the unsold shares suggesting a share purchase price this is lower than any price achieved during marriage. In other words, the brokerage statement reflects that the shares with a higher tax basis were liquidated. Would you grant Husband a summary judgment that the remaining shares are separate property? Would you find SP by clear and convincing evidence? Would you reverse and remand a finding of CP? Reverse and render?

6. Business Reorganization. H owned a car dealership before marriage, held in an SP corporation. The corporation was converted to an LP before marriage. During marriage, the dealership was transferred from the LP to a newly-created corporation. The corporation's unanimous consent of directors reflects that H is to receive 100% of the shares in exchange for $1,000 paid in capital. Is the stock in the new corporation SP or CP? What if no record can be found of a $1,000 check? What if a $1,000 check was written but there is no account statement and thus no tracing of SP funds? What if there are account statements and they show that the check was $750 CP and $250 SP?

7. Family Limited Partnership. An estate planning lawyer convinces H & W to put their investments into an FLP, each spouse owning a 49.5% limited partner interest and each owning half of the LLC 1% general partner. Some investments were H's SP and some were W's SP and some were CP. What is the character of the ownership interests? Can the FLP be set aside? What if the children were given small partnership interests prior to divorce?

8. Minimum Balance. Account records reflect that W deposited a $75,000 inheritance in a joint savings account containing CP funds. More CP funds were added and numerous withdrawals were made. The account balance fluctuated over time, but never dropped below $50,000. At the time of divorce, the account balance was $60,000. What portion is W's separate property?

9. Line-Item Tracing. In a 10-year marriage, the first five years' bank records are lost; but later records are available. What is the character of the starting balance of a line-item tracing? What happens if one monthly bank statement is missing from the last five years? What if one year of statements are missing? What if there are no bank records, but a Quickbooks ledger exists?

10. Commingled Separate. The spouses commingled their separate property funds in one account. What rule can be used to allocate withdrawals between the separate funds of each spouse?

11. Intent. A bank account contains H's SP and CP funds. H purchases an investment using funds from that account. H tells his forensic CPA that he intended to invest his SP funds. Does that override a community-out-first allocation? Is H's testimony on intent clear and convincing evidence? What if there is a contemporaneous memo indicating intent to invest SP? What if there is no memo, but there is a pattern of spending CP on living expenses and making investments with SP?

12. Investing SP. A bank account contains $20,000 of CP. One day W deposits $20,000 of her SP funds into the account. The next day W writes a check to purchase an investment for $20,000. What is the character of the investment under: (i) the community-out-first approach; (ii) the clearinghouse approach; (iii) the identical-sum-inference approach; (iv) *McKinley v. McKinley*; (v) W's testimony of intent to invest SP; (v) a contemporaneous letter stating W's intent to invest SP? Would you give W a SJ that the investment is her SP? Would you find clear and convincing evidence? Would you reverse a finding of CP, and remand or render? What if the purchase was made 3 days after the deposit of SP funds? One week later? One month later? One year later? What if the deposit was for $15,000?

13. Tracing Backwards. A bank account contains 100% CP. W writes a check to purchase an investment for $20,000. The next day she deposits $20,000 of her SP funds into the account. Is it SP under the "clearinghouse method" or "identical sum inference"? What if the deposit was made 3 days later? One week later? One month later? One year later? What if the deposit was for $15,000?

14. Overdraft. A bank account contains only SP funds. In a line-item tracing, an investment is purchased by a check that puts the account in overdraft. The overdraft is covered the next day by a deposit of SP funds. Did the overdraft constitute CP credit, making the investment CP, or did covering the overdraft with SP funds make the investment SP? Can you use the matching transaction method? Can you trace "backwards"?

15. Living Expenses. W had substantial SP at the time of marriage; H had none. In years one and two of marriage, records reflect that family living expenses matched net after-tax community income. In year three several lucrative investments were made, but the records from year three were lost. Can you assume that CP income was used to pay living expenses, leaving only SP to make the investments? Or, are the investments CP because there are no records to allow conventional tracing?

16. Maximum Community Available for Investment. During the first five years of marriage, tax returns establish net after-tax CP income. No account records or ledgers are available to do a line-item tracing. Money invested during those five years exceeds the total CP income net of tax. SP was available to make the investments. Can the CP ownership of investments be limited to the total CP net income during those five years? Should any adjustment be made for community living expenses?

17. FIFO/LIFO. The task is to prepare a line-item tracing using the FIFO or LIFO approach. There are multiple deposits and withdrawals. How can an electronic spreadsheet be constructed to allocate based on FIFO or LIFO? Is FIFO/LIFO only practical for inactive accounts, or sales of mixed character securities?

18. Tracing Based on Use of Funds. How difficult would it be to construct a line-item tracing based on the use of funds? If a check is written to pay an AmEx bill, should the payment be allocated based on what the charges were for? What if credit card charges are not paid in full every month? What if credit card statements cannot be obtained?

19. Missing Records. When the parties separated, W moved out of the house. She says she left all the parties' financial records in the home. W needs those records to trace some separate property transactions. H says there are no financial records at the house. W claims spoliation. Is a spoliation sanction appropriate? If so, what would it be?

20. Direct Tracing. H has an investment account containing SP and CP securities and cash. One day H tells his broker to sell his SP shares of IBM and buy APL shares. The APL shares are acquired before the proceeds from the sale of IBM shares are deposited to the account. Are the APL shares SP or CP? Do you apply community-out-first to the cash in the account when the APL shares are credited to the cash balance?

21. Margin. H has a margin investment account containing SP and CP securities and cash. He buys APL shares on margin, and the next days pays the margin debt by liquidating SP shares of IBM. Are the APL shares SP or CP? What if the sale occurs 3 days later? One week later? One month later? One year later?

22. Margin Before Marriage. H had a margin investment account prior to marriage. The margin debt was $50,000 on DOM. One month into marriage, H buys stock on margin. H later sells SP shares in the same amount. Did the sale proceeds pay down the SP debt or the CP debt? Why?

23. Short Sale. H borrows 500 shares of Exxon stock in a short sale, and sells it immediately for $35,000. It is a "covered" short sale because H already owns 500 Exxon shares as his SP. Ten days later H liquidates his short position by surrendering 475 shares, leaving him with 25 SP shares of Exxon stock. What is the character of the proceeds from sale of the borrowed shares? Does H have a reimbursement claim for using SP stock to pay the CP loan? Or do we match the transactions and treat the proceeds from the short sale as H's SP? Does it matter if the short sale is not "covered." What if H loses money on the short-sale?

24. Calls. H sells a "call" option in his SP Exxon stock, for $2,000. The option expires unexercised. Is the $2,000 SP or CP? What if the option is exercised and H must sell his SP stock for less than market price? Does that make the $2,000 SP? Does H have a reimbursement claim of some kind?

25. Oil and gas interests in a limited partnership. H owns separate property oil and gas interests. He contributes those interests to a limited partnership. The LP agreement states the consideration to be exchanged for his LP interest is $1,000 of agreed value. There is no record of $1,000 being contributed. What is the character of the limited partnership? The oil and gas interests pay the LP royalties which are distributed to husband. What is the character of the distributions? What would the character be had the interests not been contributed to a partnership?

26. Distributions from an entity. W has a 50% separate property corporation that owns 5 buildings and nothing more. One building is sold and the corporation distributed half of the proceeds to wife. The corporation remains active. What is the character of the distribution? What if there are some undistributed current-year earnings and some undistributed retained earnings from prior years? What if it was a partnership instead of a corporation?

27. Trust property and distributions. W is trustee and beneficiary of a testamentary spendthrift trust. There are other remainder beneficiaries. The trust allows wife to distribute income and principal to herself subject to a HEMS clause. Wife takes income distributions, but never principal distributions. What is the character of the distributed income? What is the character of the undistributed income? What effect if the trust agreement says that undistributed income is added to trust principal? What if the trust instrument says that the distribution of all income is mandatory on a yearly basis?

28. Tracing Inside of Trust. By gift from his grandmother, H is beneficiary of a discretionary distribution spendthrift trust, with other remainder beneficiaries. Fifty percent of the trust principal matured three years ago but was left in the hands of the trustee who retained all income on the property. Is CP mixed in with trust property? Does the presumption of community arise? Who has what burden of proof about the ownership of property held by the trustee? If distributions were made, how are they to be allocated? Does the trustees intent matter?