# GIFTS AND TRUSTS, AND HOW TO ATTACK THEM

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Chapter 3

# GIFTS AND TRUSTS, AND HOW TO ATTACK THEM

by

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**I. INTRODUCTION.** This Article discusses the requirements for making a gift and for creating an express trust, under Texas law. The Article distinguishes between express, resulting and constructive trusts. The Article also analyzes possible ways to undo gifts and express trusts. The Article ends with a discussion of marital property issues relating to express trusts.

**II. GIFT.** A gift is a transfer of property made voluntarily and gratuitously. *Hilley v. Hilley*, 342 S.W.2d 565, 568 (Tex. 1961). A gift requires: 1) an intent to make a gift; 2) delivery of the property; and 3) acceptance of the property. *See* State Bar of Texas Pattern Jury Charges PJS 202.3 (Family & Probate 2018). *See Grimsley v. Grimsley*, 632 S.W.2d 174, 177 (Tex. App.--Corpus Christi 1982, no writ). The burden of proving a gift is on the party claiming the gift. *Woodworth v. Cortez*, 660 S.W.2d 561, 564 (Tex. App.--San Antonio 1983, writ ref'd n.r.e.). If the claim of gift is by a spouse, the burden of proving the gift is clear and convincing evidence. Tex. Fam. Code § 3.03(b).

**A. LACK OF CONSIDERATION.** Lack of consideration is an essential characteristic of a gift; an exchange of consideration precludes gift. *Pemelton v. Pemelton*, 809 S.W.2d 642, 647 (Tex. App.--Corpus Christi 1991), *rev'd on other grounds sub nom. Heggen v. Pemelton*, 836 S.W.2d 145 (Tex. 1992); *Kunkel v. Kunkel*, 515 S.W.2d 941 (Tex. Civ. App.--Amarillo 1974, writ ref'd n.r.e.). "Gift" and "onerous consideration" are exact antitheses and a recital of onerous consideration "negatives the idea of a gift." *Pemelton*, 809 S.W.2d at 647; *Ellebracht v. Ellebracht*, 735 S.W.2d 658, 659 (Tex. App.--Austin 1987, no writ); *Kitchens v. Kitchens*, 372 S.W.2d 249, 255 (Tex. Civ. App.--Waco 1963, writ dism'd). An exchange of consideration precludes a gift. *Williams v. McKnight*, 402 S.W.2d 505, 508 (Tex. 1966). *See Saldana v. Saldana*, 791 S.W.2d 316, 319 (Tex. App.--Corpus Christi 1990, no writ) (wife's testimony that she paid $ 10.00 to husband's mother in exchange for real estate was sufficient to support the trial court's finding that the property was community property and not gift).

**B. DONATIVE INTENT.** An essential factor in establishing a gift is the donative intent of the grantor at the time of the conveyance. *Ellebracht*, 735 S.W.2d at 659. In *Scott v. Scott*, 805 S.W.2d 835, 839-40 (Tex. App.--Waco 1991, writ denied), the jury found that the wife did not make a gift of money to the husband, even though she put a $ 100,000 certificate of deposit in his name alone. A gift cannot occur without the intent to make a gift. *Campbell v. Campbell*, 587 S.W.2d 513, 514 (Tex. Civ. App.--Dallas 1979, no writ). In *Scott*, the wife testified she had no donative intent, the jury believed her, and the appellate court affirmed. *See Haile v. Holtzclaw*, 414 S.W.2d 916, 927 (Tex. 1967) (proper to find gift based on circumstances, despite transferor's testimony of no donative intent.)

**C. TRANSFER FROM PARENT TO CHILD PRESUMPTIVELY GIFT.** A conveyance of property from parent to child is presumed to be a gift, but the presumption is rebuttable by evidence showing the facts and circumstances surrounding the deed's execution in addition to the deed's recitations. *Woodworth v. Cortez,* 660 S.W.2d 561, 564 (Tex. App.--San Antonio 1983, writ ref'd n.r.e.). The burden of proof to overcome the presumption of gift is clear and convincing evidence *Bogart v. Somer,* 762 S.W.2d 577 (Tex. 1988) (involving transfer to son-in-law).

**D. GIFT TO BOTH SPOUSES.** A gift made by a third party to both spouses leaves the spouses owning the gifted asset in equal undivided one-half separate property interests. *Roosth v. Roosth*, 889 S.W.2d 445, 457 (Tex. App.--Houston [14th Dist.] 1994, writ denied) (engagement gifts and wedding gifts to both spouses were one-half the separate property of each); *Kamel v. Kamel*, 721 S.W.2d 450, 452 (Tex. App.--Tyler 1986, no writ) (where husband's father made payments on a liability owed by both spouses, the payments were a gift one-half to each spouse).

**E. GIFT BETWEEN SPOUSES.** A spouse can make a gift of community property to the other spouse. *See Pankhurst v. Weitinger & Tucker,* 850 S.W.2d 726, 730 (Tex. App.--Corpus Christi 1993, writ denied) (husband gave one-half of his community property interest in a cause of action to wife, to hold as her separate property). When one spouse makes a gift of property to the other spouse, the gift is presumed to include all the income or property which might arise from the property given. TEX. CONST. art XVI, § 15; TEX. FAM. CODE § 3.005.

**F. GIFT OF ENCUMBERED PROPERTY.** A grantor may make a gift of encumbered property even if the grantee assumes an obligation to extinguish the encumbrance. *Taylor v. Sanford*, 108 Tex. 340, 193 S.W. 661, 662 (1917); *Kiel v. Brinkman*, 668 S.W.2d 926, 929 (Tex. App.--Houston [14th Dist.] 1984, no writ) (no showing that parents transferred land to son *in exchange* for his extinguishing the debt); *Van v. Webb*, 237 S.W.2d 827, 832 (Tex. Civ. App.--Amarillo 1951, writ ref'd n.r.e.). The gift extends to the equity in the property. To the extent the debt is assumed by the grantee, the transaction is a purchase. If the grantee is married, the credit is community credit.

**III. DEVISE AND DESCENT.** Property acquired during marriage by devise or descent is separate property. Tex. Const. art. XVI, § 15, and TEX. FAM. CODE § 3.001(2). PJC 202.03 defines "devise" as "acquisition of property by last will and testament. PJC 202.03 defines "descent" as "acquisition of property by inheritance without a will."

Under Texas law, legal title vests in estate beneficiaries immediately upon the death of the donor. TEX. ESTATES CODE § 101.001(a)(1); *Dyer v. Eckols*, 808 S.W.2d 531, 533 (Tex. App.--Houston [14th Dist.] 1991, writ dism'd by agr.). An argument can therefore be made that income of an estate is community property of the married heirs or devisees, even though the assets are titled in the decedent and the income arising from the assets may still be in the hands of the executor.

**IV. SURVIVORSHIP AGREEMENTS.** TEX. ESTATES CODE § 111.001, permits persons to hold property with a right to survivorship. Article XVI, Section 15, of the Texas Constitution permits spouses to "agree in writing to hold community property with right to survivorship." The Estates Code says that an agreement between spouses creating a right of survivorship in community property "must be in writing and signed by both spouses." TEX. ESTATES CODE § 112.052. Upon death, the transfer to the survivor occurs as a result of the agreement, and the transfer is "non-testamentary" and the property is not considered to be a non-probate asset. Ch. 111 & § 111.054.

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

**A. Express Trust.** An express trust comes into existence by the execution of an intention to create it by one having legal and equitable dominion over the property made subject to the trust. *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948).

Express trusts were controlled by the common law in Texas, until April 19, 1943. On that date, the Texas Trust Act went into effect. *See* TEX. REV. CIV. STAT. art. 7425a *et seq.*; *Land v. Marshall*, 426 S.W.2d 841, 845 (Tex. 1968). The Texas Trust Act controlled express trusts until its repeal, effective December 31, 1983. On January 1, 1984, the Texas Trust Code went into effect. *See* TEX. PROP. CODE chs. 101, 111-115. The old Texas Trust Act still controls the validity of trusts created while the Act was in effect, and actions taken relating to express trusts while the Act was in effect. The newer Texas Trust Code applies to trusts created on or after January 1, 1984, and to transactions relating to prior trusts, but which occur on or after January 1, 1984.

**B. Resulting Trust.** A resulting trust arises by operation of law when title is conveyed to one party while consideration is provided by another. *Cohrs v. Scott*, 338 S.W.2d 127, 130 (Tex. 1960). Generally, a resulting trust can arise only when title passes, not at a later time. *Id*. at 130. This rule, often stated in the case law, does not apply in certain instances between spouses. If before marriage a person acquires a right to later acquire title to property, and then marries and actually acquires title during marriage, the property is separate property under the inception of title rule, because the right to acquire the property had its inception prior to marriage. The rule of consideration underlying resulting trust does not apply in that instance, even if community property consideration is provided in connection with taking title to the property. A resulting trust also arises when a conveyance is made to a trustee pursuant to an express trust, which fails for any reason. *Nolana Development Ass'n v. Corsi*, 682 S.W.2d 246, 250 (Tex. 1984). Ordinarily, the proponent of a resulting trust has the burden of overcoming the presumption of ownership arising from title by "clear, satisfactory and convincing" proof of the facts giving rise to the resulting trust, *Stone v. Parker*, 446 S.W.2d 734, 736 (Tex. Civ. App.--Houston [14th Dist.] 1969, writ ref'd n.r.e.). However, when marital property is in issue, the presumption of community prevails over the presumption of ownership arising from title, so proof that property is possessed by a spouse during marriage is sufficient to establish, prima facie, community property even where title is held in the name of one spouse alone. *See* TEX. FAM. CODE § 3.003(a). Resulting trusts are excluded from coverage in the Texas Trust Code. TEX. PROP. CODE § 111.003(2).

**C. Constructive Trust.** A "constructive trust" is not really a trust; it is an equitable remedy. The court imposes a "constructive trust" when an equitable title or interest ought to be, as a matter of equity, recognized in someone other than the taker or holder of legal title. The Supreme Court described the doctrine as follows:

> A constructive trust does not, like an express trust, arise because of a manifestation of intention to create it. It is imposed by law because the person holding the title to property would profit by a wrong or would be unjustly enriched if he were permitted to keep the property.

*Omohundro v. Matthews*, 341 S.W.2d 401, 405 (Tex. 1960), *accord*, *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, (1948). Constructive trusts are excluded from coverage in the Texas Trust Code. Tex. Prop. Code § 111.003(2).

**VI. "RESULTING TRUST" VS. "CONSTRUCTIVE TRUST."** In *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948), the Texas Supreme Court drew the following distinction between a resulting trust and a constructive trust:

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

**VII. EXPRESS TRUSTS.** Property held by a trustee for the benefit of a beneficiary is not owned by the beneficiary. Instead, the trustee owns legal title and the beneficiary has a beneficial interest in the trust property. *Bradley v. Shaffer*, 535 S.W.3d 242, 248 (Tex. App.--Eastland 2017, no pet.). However, where the beneficiary has an unconditional right to have the property free of trust, then the property is treated as if it is owned by the beneficiary, even if legal title is in the hands of the trustee.

**A. Different Kinds of Express Trusts.**

**1. What is an "Express Trust"?** An express trust is defined in the Texas Trust Code as a fiduciary relationship with respect to property "which arises as a relationship and which subjects the person holding title to the property to equitable duties to deal with the property for the benefit of another." TEX. PROP. CODE § 111.004. Under Texas law, a trust is not an entity, like a corporation. It is a *relationship*, between the trustee, and certain property, and the beneficiary for whose benefit the trustee holds the property. Thus, it is not really accurate to talk about "property in a trust," we should instead say "property held in trust."

**2. "Trust" Accounts.** In Texas, "trust accounts" were once governed by case law but are now governed by statute. Under the case law, the mere act of depositing funds in an account designated as a "trust account" for another person did not establish an express trust for the other person's benefit. Case law required that the beneficiary/claimant demonstrate the intent to create a trust "by a larger number of acts than in the case of an ordinary trust." *Frost Nat. Bank of San Antonio v. Stool*, 575 S.W.2d 321, 322 (Tex. Civ. App.--Beaumont 1978, writ ref'd n.r.e.). If a trust was found to have been intended, it was a revocable trust, which matured only upon the death of the settlor/trustee, at which times the proceeds are payable to the beneficiary. *See Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654, 657 (Tex. Civ. App.--Eastland 1978, writ ref'd n.r.e.) (involving certificate of deposit held "in trust"). Recitals on the bank signature card that the funds were held "in trust" for another were considered to be evidentiary only, and did not give rise to a presumption that a trust was intended. *Fleck v. Baldwin*, 141 Tex. 340, 172 S.W.2d 975, 978 (1943).

The Legislature adopted a statutory framework for multiple-party accounts, including trust accounts, in 1979. Tex. Probate Code §§ 436-449. That statutory framework was replaced in 2015 by the Texas Estates Code, which governs accounts created on or after September 1, 2015. (Prior law continues to govern accounts formed previously). The current statutory framework is conceptually similar to the previous statutory framework. Under the Estates Code, a "trust account" is one form of a multi-party account governed by Chapter 113 of the Texas Estates Code. Tex. Estates Code § 113.004(3). The Code defines a "trust account" as an account in the name of one or more parties as trustee for one or more beneficiaries. Tex. Estates Code § 113.004(5).

The trust relationship is established by the form of the account and deposit agreement with the financial institution. *Id.* There can be no subject of the trust other than the sums on deposit in the account. *Id.* The deposit agreement does not have to address payment to the beneficiary. The term "trust account" does not include a "regular trust account" under a testamentary trust or trust agreement that is separate from the trust account. Tex. Estates Code § 113.004(5)(A). The term also does not include a "fiduciary account" arising from a fiduciary relationship, such as the attorney-client relationship. Tex. Estates Code § 113.004(5)(B).

Texas Estates Code Section 113.104 provides that the funds in a trust account, during the trustee's lifetime, belong beneficially to the trustee, unless the terms of the account or deposit agreement "manifest a contrary intent," or other clear and convincing evidence exists of "an irrevocable trust." Where there two or more trustees of such a trust account, their rights in the funds are governed by Section 113.102, meaning that the funds belong to the person who contributed them to the account. When the trust account is an irrevocable trust, the beneficial interest belongs to the beneficiary. Tex. Estates Code § 113.104(c). This statute bears further analysis. First, if the "trust" is revocable, the statute makes the trustee the true beneficiary during the trustee's lifetime. If the "trust" is irrevocable, the statute makes the account beneficiary the true beneficiary during the trustee's lifetime. Second, the "terms of the account or the deposit agreement" prevail over the statutory allocation of beneficial rights. Third, the statute creates a rebuttable presumption that the "trust" is revocable, unless the terms of account or deposit agreement indicate irreversablity, "other clear and convincing evidence of an irrevocable trust exists." This suggests that the presumption of revocable trust does not vanish in the face of evidence of contrary intent, but instead carries through to the fact-finders' decision. Fourth, where there are multiple trustees, the rule of ownership in proportion to net contributes applies.

A succinct summary of the law of trust accounts is set out in the statutory form prescribed for setting up a trust account. It says:

> The parties named as trustees to the account own the account in proportion to the parties' net contributions to the account. A trustee may withdraw funds from the account. A beneficiary may not withdraw funds from the account before all trustees are deceased. On the death of the last surviving trustee, the ownership of the account passes to the beneficiary. The trust account is not a part of a trustee's estate and does not pass under the trustee's will or by intestacy, unless the trustee survives all of the beneficiaries and all other trustees.

There are two blanks in the form to enter the names of the trustees, and two blanks to enter the name(s) of the beneficiaries, and two blanks to enter the name(s) of the convenience signer(s). Tex. Estates Code § 113.052(7).

To sum up, if a person puts funds in an account in her name, but the account indicates that she is "trustee" for someone, the trustee/depositor continues to own the funds and is free to withdraw the funds. The account is essentially a revocable trust. The beneficiary's right to the funds does not mature until all named trustees die. Tex. Estates Code § 113.104. However, this can be altered if the terms of the account or deposit agreement manifest a contrary intent, or if other clear and convincing evidence exists of an irrevocable trust. Tex. Estates Code § 113.104(1) & (2). This statute establishes a presumption that depositing funds into "trust account" is not a conveyance of an interest (including a beneficial interest) to a third party, and that no fiduciary obligations are owed to the beneficiary during the trustee's lifetime. That presumption can be overcome, and an irrevocable trust established, but only if the terms of account or deposit agreement say so, or there is other clear and convincing evidence.

When a "trust account" becomes an issue in a divorce, because the arrangement is presumed to be a revocable trust, there is no special theory of recovery that must be asserted to establish the settlor-trustee's ownership of those funds. Under the law, the funds on deposit belong to the trustee and not the beneficiary. If the trustee is getting divorced, the court may award the funds on deposit according to the normal rules of property division. If the beneficiary is getting divorced, the funds on deposit are neither separate nor community property of the beneficiary. However, it is possible for a party to claim that the trust is irrevocable, and if the terms of account or deposit agreement make the trust irrevocable or if they can prove that on clear and convincing evidence, then the funds on deposit do not belong to either the trustee or the beneficiary, but are instead property held in trust.

**3. Securities Held "as Trustee."** The question arises whether the rules discussed above for funds on deposit "in trust" for another also apply to securities held "in trust" for another. In *Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654 (Tex. Civ. App.--Eastland 1978, writ ref'd n.r.e.), the issue was whether the settlor/trustee intended to create a trust when she acquired a certificate of deposit in her own name, "as Trustee for" another person. The jury found, and judgment was rendered, that the settlor/trustee intended to establish a *revocable* trust for the benefit of the third person. The Court of Civil Appeals affirmed the judgment, finding that such an inter vivos revocable trust is permissible under Texas law, and that it becomes irrevocable and payable upon the death of the settlor/trustee. The Court also extended the rule to stock certificates held in the name of the purchaser in trust for another, where the purchaser so intends. As stated by the Court:

> The ultimate and controlling question is the intent of the purchaser. The recitals on the certificate that such is held "in trust" for another are evidentiary only, and do not give rise to a presumption that a trust was intended.

*Id.* at 658. The Texas Estates Code says that the rules applying to multiple-party accounts apply to "accounts" at a "financial institution." The terms "accounts" includes checking, savings, CD, share account, or "other similar arrangement," at a financial institution. Tex. Estates Code § 113.001(1). "Financial institution" is defined to include a bank, savings bank, building and loan association, credit union, and securities brokerage firm. Tex. Estates Code § 113.001(3). However, in describing trust accounts Texas Estates Code Section 113.004(5) refers to "sums on deposit," so it appears that securities (stock and bonds) are excluded from the statutory scheme. *But see In re Estate of Dillard*, 98 S.W.3d 386 (Tex. App.-- Amarillo 2003, writ denied), which applied the multiple-party account provisions in the Probate Code to a Merrill Lynch account containing "more than a million dollars of property." *Id.* at 398 n. 4.

## VIII. ESTATE PLANNING TRUSTS.

The most popular estate planning trusts are: GST (generation-skipping dynasty trust; QPRT (qualified personal residence trust); CRT (charitable remainder trust); GRAT (grantor retained annuity trust) and GRUT (grantor retained unitrusts). *If you run into one of these trusts in a divorce, consult with an estate planning lawyer.*

**A. (GST) GENERATION-SKIPPING DYNASTY TRUST.** A GST is created by the older generation for the benefit of children, grandchildren and even great grandchildren. The trust corpus remains in the trust for as many generations as possible, sometimes capped by the Rule Against Perpetuities.

**1. The Rule Against Perpetuities.** The Texas Constitution provides that "[p]erpetuities ... are contrary to the genius of free government, and shall never be allowed." Tex. Const. art. I, § 26. Texas courts have enforced this provision by applying the rule against perpetuities. *Trustees of Casa View Assem. of God Ch. v. Williams*, 414 S.W.2d 697, 702 (Tex. Civ. App.--Austin 1967, no writ). Under the Rule, no interest is valid unless it must vest, if at all, within twenty-one years after the death of some life or lives in being at the time of the creation of the interest. *Peveto v. Starkey*, 645 S.W.2d at 772; *Foshee v. Republic Nat'l Bank of Dallas*, 617 S.W.2d 675, 677 (Tex. 1981).

The Rule Against Perpetuities relates only to the vesting of estates or interests, not vesting of possession, and is not applicable to present interests, or future interests which vest at their creation. *Kelly v. Womack*, 153 Tex. 371, 268 S.W.2d 903 (1954). You must therefore, examine the challenged conveyance as of the date the instrument was executed, and the conveyance is void if, by any possible contingency, the interest could vest outside the perpetuities period. *Peveto v. Starkey*, 645 S.W.2d at 772; *Brooker v. Brooker*, 130 Tex. 27, 106 S.W.2d 247, 254 (1937).

**2. Irrevocable, Spendthrift Trust.** A GST is ordinarily an irrevocable, spendthrift trust with multiple beneficiaries in successive generations who become beneficiaries when the older generations die off. The "spend thrift" provision prohibits the beneficiary or her creditors from obtaining the trust assets *Bradley v. Shaffer*, 535 S.W.3d 242, 248 (Tex. App.--Eastland 2017, no pet.). Because the trust property is owned by the trustee and not the beneficiaries, the trust assets are not included in the taxable estate of each generation to die. The trustee has the "power to invade" meaning to distribute not only income but also trust principal, to beneficiaries. However, the settlor can specify mandatory distribution of trust principal or income. If the distributions exceed what is needed for the beneficiary's "best interest," the trust principal may be included by the IRS in the beneficiary's estate. If the beneficiary is also trustee with the power to invade, the invasion must be done only as required for the beneficiaries' health, education, maintenance, and support (a "HEMS" standard) or else the trust assets on date of death will be included in the beneficiary's estate. Sometimes the beneficiaries will have limited powers of appointment that permit them to control how the assets flow to the next generation.

**B. QPRT (QUALIFIED PERSONAL RESIDENCE TRUST).** A QPRT is an irrevocable trust created by homeowners, into which they convey their principal residence or vacation home, retaining the right to live there rent-free, for a specified term of years. The plan is to outlive this rent-free period. The grantors usually can direct the trustee to sell one home and buy another. If the house is sold and a new house is not purchased, the proceeds are usually invested in an annuity paid to the grantors. At the end of the specified trust term, the residence goes to the remaindermen (usually the grantors' children, or a trust for the children). If the grantors are still alive, they can rent from the children.

Sometimes the house is partitioned before it is conveyed into trust, and sometimes a community property house is conveyed into trust. The conveyance into trust will be reflected by a deed which is recorded. This arrangement reduces the value of the gift into trust to the extent of the free tenancy retained by the grantors. The value of the remainder interest is usually very small.

**C. CRT (CHARITABLE REMAINDER TRUST).** A CRT is an irrevocable trust that provides for a specified annual payment to the grantors or other non-charitable beneficiaries for life or a term of years, and with the remainder to a charity. Some CRTs generate an income tax charitable deduction and some generate a gift tax charitable deduction. Under a CRT, the wealth leaves the family upon the death of the income beneficiaries or end of the term certain.

**D. GRAT (GRANTOR RETAINED ANNUITY TRUST) AND GRUT (GRANTOR RETAINED UNITRUSTS).** GRATs are trusts that reserve to the grantor an annual payment of a fixed sum, determined by a percentage of the value of the trust assets at the time of initial funding. GRATs can be funded only once, at the beginning. GRUTs reserve to the grantor an annual payment of a fixed percentage of the value of trust assets, determined annually. GRUTs can receive additional contributions over time. For both GRATs and GRUTs, the remaindermen are usually the grantors' children.

GRATs and GRUTs remove assets from the estate at a fixed value, with later appreciation accruing to the GRAT, while retaining a finite stream of payments for the grantor. There is no gift except to the extent that the remainder interest exceeds the value of the annuity payments. Appreciation on the corpus during the life of the trust passes to the remaindermen without gift tax.

**E. "DEFECTIVE" TRUST.** If the settlor retains the power to substitute assets in the trust, the trust is "defective" and the trust income is taxed to the settlor.

**IX. CHALLENGES TO VALIDITY OF EXPRESS TRUSTS.** What appears to be an express trust may in fact not be a trust, or it may be vulnerable to attacks which would defeat the trust. Several possible methods to defeat or penetrate express trusts are discussed below.

**A. CHALLENGING INTENT TO CREATE THE TRUST.** Before there can be a trust, the settlor must intend the creation of the trust. *See* TEX. PROP. CODE § 112.002 ("A trust is created only if the settlor manifests an intention to create a trust"); *Gonzalez v. Gonzalez*, 457 S.W.2d 440 (Tex. Civ. App.--Corpus Christi 1970, writ ref'd n.r.e.); *Tolle v. Sawtelle*, 246 S.W.2d 916, 918 (Tex. Civ. App.--Eastland 1952, writ ref'd).

Some trust arrangements, such as funds deposited in a financial account with a depositor's agreement or signature card reading "in trust," or securities held "as trustee" for another, or land taken "in trust" for an unspecified beneficiary, are so vague that a clear intention to create a trust is not readily ascertainable from the documentation. Texas case law has traditionally treated such "trust" designations as no more than weak evidence of intent or no more than a revocable trust. Special statutory rules for "trust" financial accounts are discussed in Section VII.A.2 above.

The issue of intent can arise even in connection with formal trust documents. For example, in the case of *In re Estate of Daniels*, 665 P.2d 594 (Colo. 1983), the decedent executed a formal trust agreement, but never funded it. She never advised the co-trustee of the trust's creation, and the co-trustee never signed the trust agreement. The decedent's attorney testified to giving the decedent legal advice that the trust agreement would have no effect until it was signed by the co-trustee and funded. The trial court concluded that, notwithstanding the settlor's signing the agreement, she never intended the trust agreement to take effect. That judgment was affirmed by the Colorado Supreme Court.

Thus, intent of the settlor to create the trust is the first thing to check when considering an assault on an express trust.

**1. Extrinsic Evidence of Intent, Generally.** The Parol Evidence Rule normally prohibits the use of extrinsic evidence to add to or vary the terms of a written document, absent allegations of ambiguity, fraud, duress, or mistake. *Guardian Trust Co. v. Bavereisen*, 132 Tex. 396, 121 S.W.2d 579, 583 (1938).

However, the court may consider parol evidence as to the circumstances surrounding the creation of the document, for the purpose of applying the document to the subject with which it deals, and for the purpose of ascertaining the real intention of the parties. *Id*. at 583. *See* McClung, *A Primer on the Admissibility of Extrinsic Evidence of Contract Meaning*, 49 TEX. BAR. J. 703 (1986).

On the other hand, some courts have taken a more restrictive approach to parol evidence. In the case of *Otto v. Klement*, 656 S.W.2d 678 (Tex. App.--Amarillo 1983, writ ref'd n.r.e.), the court refused to consider parol evidence on intent where the proof was offered to vary a survivorship provision contained on a bank signature card. In *Isbell v. Williams*, 705 S.W.2d 252 (Tex. App.--Texarkana 1986, writ ref'd n.r.e.), parol evidence was admitted only because a conflict between printed language and writing on a financial account signature card created an ambiguity.

**2. Intent to Create a Trust.** There is specific authority that parol evidence may be considered in determining whether a person intended to create a trust in a particular circumstance. As stated by the Texas Commission of Appeals in connection with funds deposited in an account "in trust" for another:

> The ultimate controlling fact to be determined is the intention of the donor. Such a transaction does or does not create a trust according as the donor intended. Since in this case no one but Mrs. Baldwin knew or could have known what were her real intentions in these transactions, that fact must be arrived at by a consideration of her relevant acts and declarations, prior to, at the time of, and subsequent to the various transactions. As stated in the application for writ of error:
>
> "The intention referred to is to be ascertained, not by the application of barren concepts to a single fact, but 'by rational deductions' based upon all the facts."

*Fleck v. Baldwin*, 141 Tex. 340, 172 S.W.2d 975, 978-79 (1943).

Other states have held that evidence of the settlor's words and conduct is admissible on the issue of the settlor's intent to create a trust. *See Porreca v. Gaglione*, 358 Mass. 365, 265 N.E.2d 348, 350 (1970) (parol evidence admissible where parties were not attempting to vary or contradict terms of trust agreement, but rather were challenging the very existence of the trust); RESTATEMENT (SECOND) OF TRUSTS §§ 23 & 24 (1959).

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

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

There are exceptions to this rule.

**a. No exception to the requirement of a writing exists for realty.** Where one person holds title to real estate as "trustee," and no written trust agreement exists, the relationship is not an express trust. It may, however, be a resulting trust, not because of the title document but because of the consideration paid.

**b. Personalty Transferred to Another With Intent Expressed.** Where the trust includes only personalty, the trust is enforceable if the personalty is transferred to a trustee who is not a beneficiary or settlor, and the settlor expresses the intention to create a trust, either before or at the time of the transfer. TEX. PROP. CODE § 112.004. In such a situation, written evidence of the trust is not required.

**c. Personalty Retained by Settlor With Writing Reflecting Trust.** A trust of personalty is also enforceable where an owner of personalty states *in writing* that certain personalty is held by that person as trustee for another, as beneficiary, or for himself and another, as beneficiaries. Tex. Prop. Code § 112.004. Under the case law, this exception would apply to funds which the party has deposited in a financial institution, where the account reflects the party as "trustee" for another. *See Jameson v. Bain*, 693 S.W.2d 676 (Tex. App.--San Antonio 1985, no writ). But under the statutory framework in the Estates Code, the recital of "in trust" or "trustee" on a financial account creates a revocable trust. Under the case law, the exception would apply to stocks and bonds, carried in the name of the party "as trustee" for another, since they are not covered by Chapter 113 of the Estates Code. *See Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654, 658 (Tex. Civ. App.--Eastland 1979, writ ref'd n.r.e.).

**d. Resulting and Constructive Trusts Are Outside of Rule.** The Texas Trust Code, by its very terms, does not apply to resulting or constructive trusts. Tex. Prop.Code § 111.003. Cases also hold that the requirement of a writing, contained in the old Trust Act, and in the statute of frauds provisions of the Trust Code, do not apply to resulting and constructive trusts. *Rankin v. Naftalis*, 557 S.W.2d 940, 944 (Tex. 1977); *Rowe v. Palmer*, 277 S.W.2d 781, 783 (Tex. Civ. App.--Texarkana 1955, no writ).

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

**C. DRY TRUST.** The Texas Supreme Court has said that "[w]hen a trustee has no duties to perform, the purposes of the trust having been accomplished, it becomes a simple, passive or dry trust, as it is termed in the law, and the cestui que trust is entitled to have the full legal title and control of the property, because no other person has an interest in the property." *Lanius v. Fletcher*, 101 S.W.2d 1076, 1078 (1907). Under these circumstances, the beneficiary is entitled to possession of the contents of the trust. *Hall v. Rawls*, 188 S.W.2d 807, 815 (Tex. Civ. App.--Beaumont 1945, writ ref'd). Similarly, if the trustee is not given affirmative powers and duties in the trust instrument, the trust is passive or dry, and legal title is vested in the beneficiaries, not the trustee. *Nolana Development Ass'n v. Corsi*, 682 S.W.2d 246, 249 (Tex. 1984). Consider, however, the effect of Section 112.004 of the Texas Trust Code, which recognizes the enforceability of a trust of personalty in certain situations, even though the terms of the trust are not specified.

The doctrine of "dry trust" was explored in the case of *Zahn v. National Bank of Commerce*, 328 S.W.2d 783 (Tex. Civ. App.--Dallas 1959, writ ref'd n.r.e.). The settlor's will provided that land was to be held for two years after her death and if at that time, oil or minerals were not found, the land was to be sold and the oil and mineral rights reserved and placed in trust for the benefit of five cousins. The trustee asked for a construction of the will to determine if this trust was valid. The Court of Civil Appeals determined that it was permissible for the trust to remain "dry" or unfunded for the two-year period. If the oil or mineral rights were found within that period, the beneficiaries would receive title in fee simple. If not, the trust would be funded (with the oil and mineral rights as the *res*) for administration on behalf of the beneficiaries.

**1. Cases From Other States.** The doctrine of dry trusts has been adjudicated in other states.

**a. Pennsylvania.** The Supreme Court of Pennsylvania addressed the doctrine of dry trust in connection with a fraudulent conveyance. In *Eaves v. Snyder*, 368 Pa. 459, 84 A.2d 195 (1951), Snyder, Sr., conveyed certain real estate to his son, Snyder, Jr., and his son's wife. At the same time, the grantees signed a "deed of trust" back to Snyder, Sr. The deed to Snyder, Jr., and wife was recorded, but the deed of trust was not. Shortly thereafter, Snyder, Sr., filed for bankruptcy. Some years after the bankruptcy was closed, and shortly before Snyder, Jr., and his wife were divorced, the deed of trust was filed of record. Ten years later, the ex-wife sued Snyder, Jr., for her half of the land, arguing that although a fraudulent conveyance is void as against creditors, it is valid as against the fraudulent grantor. The Court rejected the argument, saying it applied only where there is a mere agreement to reconvey, or where the grantor seeks to establish a resulting or constructive trust. In this case, the deed and the deed of trust must be construed together, with the result that the transaction created a dry trust in the hands of Snyder, Jr., and wife, who held legal title merely for conveyance back to Snyder, Sr. Both the legal and equitable estates in the land vested immediately in Snyder, Sr., who was the beneficiary of the dry trust.

**D. ILLUSORY TRUST.** An express trust can be challenged on the ground that it is an "illusory trust." The leading Texas case on illusory trusts is *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968). In *Land v. Marshall*, the husband had created an inter vivos trust using almost all of the community property. He retained, however, the power to revoke the trust, the right to consume the principal, to control the trustee, and other beneficial interests during his lifetime. Upon his death, the trust passed title in the community property to the parties' daughter. In a challenge brought by the wife after the husband's death, the entire trust was held by the Supreme Court to be invalid. The test announced by the Supreme Court for an "illusory trust" was:

> Did the decedent, by his conveyance in his lifetime, retain such a large interest in the property that, at least as to his wife, his inter vivos trust was illusory?

*Id.* at 848. If so, then the trust was "illusory," and failed as to the wife's one-half community property interest. This happened in *Land v. Marshall*. However, in *Land v. Marshall*, the Court also nullified the trust as to the husband's one-half of the property, because the removal of the wife's one-half interest in the property was seen as defeating the husband's testamentary intent. *Id*. at 849.

*See generally* Simpkins, TEXAS FAMILY LAW § 21:24 (5th ed. 1976); *Husband as Manager of the Community Estate: Illusory Trusts*, 10 S. TEX. L.J. 301 (1968); *The Illusory Trust and Community Property*, 22 SW. L.J. 447 (1968) Annot., 39 A.L.R.3d 14 (1971). *See also* Bell, *Community Property Trusts--Challenges by the Non-Participating Spouse,* 22 BAY. L. REV. 311 (1970). A similar concept was described in *Hunter v. Clark*, 687 S.W.2d 811, 814 (Tex. App.--San Antonio 1985, no writ), that a spouse could not defeat the other spouse's survivor's homestead right by conveying the homestead during lifetime.

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

One may ask whether the illusory trust doctrine can be used during the settlor's lifetime, to nullify a conveyance into trust. There is no statement in Texas cases that the illusory trust argument can only be raised after the settlor's death.

**2. Only When Non-Consenting Spouse's Property is Used to Fund a Trust.** The illusory trust doctrine "is limited to instances in which a non-consenting spouse's property is used to fund a trust." *Westerfeld v. Huckaby*, 474 S.W.2d 189 (Tex. 1971). Consequently, the remedy is available only to the extent that the complaining spouse's separate property, or share of the community property, is used without her consent. As explained in *Westerfeld*, the trust in *Land v. Marshall* was an illusory trust only as to the wife's interest in the property. *Westerfeld*, 74 S.W.2d at 191. However, the entire trust failed, even as to the husband's interest in the property, because the loss of half of the trust corpus was deemed to defeat the husband's plan of distribution. *Id.* at 849.

**3. Excessive Control Not Sole Basis of "Illusory Trust" Attack.** In *Land v. Marshall*, the Supreme Court determined that the inter vivos trust was invalid. The Court said:

> The Marshall trust was invalid. The trustor transferred the legal title of the corpus to a trustee, but he retained complete control over the trustee. Marshall had and could exercise every power over the corpus of the trust after the creation of the trust that he possessed before its creation. As expressed by respondent, Marshall created a trust, but nothing happened. Mr. Justice Holmes in *Leonard v. Leonard*, 181 Mass 458, 63 N.E. 1068 (1902) expressed the same idea when he said that the transfer took back all that it conveyed except legal title.

*Id.*, at 846-47. However, as explained by a majority of the Supreme Court in *Westerfeld v. Huckaby*, 474 S.W.2d 189, 191 (Tex. 1972), the trust in *Land v. Marshall* did not fail simply because the husband reserved too much control over his own property. In *Westerfeld* the Court said:

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

*Id.* at 191.

In *Westerfeld*, the administratrix of a decedent sought to set aside inter vivos trusts created by the decedent, on the grounds that the decedent had retained too much control and the trusts were "illusory." The administratrix's attack was rejected by a majority of the

Supreme Court which felt that the decedent could create valid trusts even though she reserved in herself broad beneficial rights, as well as the right to revoke the trusts and the right to control or manage the trustees. *Id.* at 192. [There was no problem of community property in *Westerfeld,* because the decedent was a single woman (feme sole).]

**4. Spouse's Participation Forecloses Attack.** In one case the court held that an illusory trust attack cannot be raised by a spouse who participated in the original conveyance into trust. *United States v. Gordon,* 406 F.2d 332, 343 (5th Cir. 1969). One would expect a claim of fraudulent inducement or mistake in such a situation.

**5. Law From Other Jurisdictions.** The illusory trust doctrine has been litigated in a number of other jurisdictions.

**a. Massachusetts.** The high court of Massachusetts considered the illusory trust doctrine, in the case of *Sullivan v. Burkin,* 390 Mass. 864, 460 N.W.2d 572 (1984). Reversing precedent, the Court announced that the estate of the decedent would, for purposes of the surviving spouse's heirship rights, include "the value of assets held in an inter vivos trust created by the deceased spouse as to which the deceased spouse alone retained the power during his or her life to direct the disposition of those trust assets for his or her benefit, as, for example, by the exercise of a power of appointment or by revocation of the trust." *Id.* at 574-75. The rule was to be applied prospectively only. The Court preferred its definite standard to the "rather unsatisfactory process of determining whether the inter vivos trust was, on some standard, 'colorable,' 'fraudulent,' or 'illusory.'" *Id.* at 577. The Court also saw itself as bringing the heirship law into line with the equitable distribution law applicable to divorce proceedings in Massachusetts. The Court observed:

> The interests of one spouse in the property of the other have been substantially increased upon the dissolution of a marriage by divorce. . . . It is neither equitable nor logical to extend to a divorced spouse greater rights in the assets of an inter vivos trust created and controlled by the other spouse than are extended to a spouse who remains married until the death of his or her spouse.

*Id.* at 577.

The rule announced in *Sullivan* accomplishes much the same effect as the illusory trust doctrine in Texas and some other states. However, the rule in Massachusetts is probably a matter of law for the court, whereas the illusory trust doctrine in Texas may involve fact issues. Note that the illusory trust doctrine of *Land v. Marshall* was applied to community property. There is reason to question whether the doctrine of illusory trust applies in a death case where the property belonged to only one spouse under the law of the state where the parties were domiciled at the time of acquisition. *Compare Cameron v. Cameron* 641 S.W.2d 210 (Tex. 1982) *to Estate of Hanau v. Hanau*, 730 S.W. 2d 663 (Tex. 1987).

**b. New York.** One of the leading cases on illusory trusts is *Newman v. Dore*, 275 N.Y. 371, 9 N.E.2d 966 (1937), a case cited in *Land v. Marshall*. In *Newman*, the husband by will created a trust for the benefit of his wife, to contain one-third of his property, and to pay her the income for life. Under New York law, this provision in his will eliminated the wife's right to elect to partake of the husband's estate, as if he died intestate. Three days before his death, the husband conveyed all of his property into a trust. If the trust was valid, his widow would get none of his estate, since the provision in the will eliminated her widow's election, and there was no property on hand to fund her testamentary trust. The trial judge invalidated the inter vivos trust, finding that the husband's motive was to evade the laws of the state. The high court, however, concluded that "[m]otive or intent is an unsatisfactory test of the validity of a transfer of property." *Id.* at 968. "The fact that the [person] desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you intentionally may go as close to it as you can if you do not pass it." *Id.* at 967 (quoting *Bullen v. Wisconsin*, 240 U.S. 625 (1916)). The Court adopted the "illusory trust" doctrine, saying:

> The test has been formulated in different ways, but in most jurisdictions the test applied is essentially the test of whether the husband has in good faith divested himself of ownership of his property or has made an illusory transfer. "The 'good faith' required of the donor or settlor in making a valid disposition of his property during life does not refer to the purpose to affect his wife but to the intent to divest himself of the ownership of the property. It is, therefore, apparent that the fraudulent intent which will defeat a gift inter vivos cannot be predicated on the husband's intent to deprive the wife of her distributive . . . share as a widow." *Benkart v. Commonwealth Trust Co., of Pittsburgh*, 269 Pa. 257, 259, 112 A. 62, 63.

*Id.* at 969. In *Newman*, the husband retained the income for life, and the power to revoke the trust, and also the right to control the trustees. Thus, "[j]udged by the substance, not by the form, the testator's conveyance [was] illusory, intended only as a mask for the effective retention by the settlor of the property which in form he had conveyed." *Id.* at 969. Although the judgment is not stated in the opinion, it appears that the property was included in the husband's estate, and therefore passed into the testamentary trust, for the benefit of the widow.

*Newman* was followed in *President & Directors of Manhattan Co. v. Janowitz*, 172 Misc. 290, 14 N.Y.S.2d 375 (1939), which said that the test was whether the settlor in good faith divested himself of ownership, or instead made an illusory transfer to hide the effective retention of the property. An illusory trust was found because the settlor reserved the right to revoke the trust, reserved income from the trust for life, and reserved substantial control over the trust during his lifetime.

An illusory trust was also found in *Burns v. Turnbull*, 266 App. Div. 779, 41 N.Y.S.2d 448 (1943), where the settlor was one of two trustees, and reserved the authority to replace the other trustee, and retained exclusive control over the corpus, and reserved the right to amend or revoke the trust.

**c. Oklahoma.** Oklahoma has case law applying the illusory trust doctrine. In *Thomas v. Bank of Oklahoma*, 684 P.2d 553 (Okl. 1984), the Supreme Court of Oklahoma determined that a forced heir election under Oklahoma statutes could not be defeated by placing assets in a revocable inter vivos trust. The Court acknowledged that, under Oklahoma law, a spouse could freely give away his or her separate property, in that neither the spouse nor the children had a claim to the separate property, except insofar as the donor is liable for their support. *Id.* at 554. However, the gift must be bona fide and complete. "A gift is not a gift if the donor retains right of complete control and dominion, and especially the right to take back the "gift" at any time." *Id.* at 554. The Court relied upon Oklahoma cases holding that a gift, in which the donor retains during lifetime complete control of the property and acts as if he still owns it, creates a resulting trust only, and beneficial interest remains with the donor. The Court also cited New York and Kansas cases involving the illusory trust doctrine. The trustee argued that the Uniform Testamentary Addition to Trust Act, which declared that "pour-over" provisions in a will were valid even though the inter vivos trust to be funded upon death was revocable, established the validity of the trust. The Court rejected this argument, saying:

> We also distinguish between the general revocability of a trust, the legality of which there is not doubt, and the effect of revocability on a forced heir's right under [Oklahoma law]. Such revocable power cannot be allowed to defeat a survivor's rights to the estate.

*Id.* at 556. The retention by the settlor, in *Thomas*, of the right to revoke the inter vivos trust, subjected the trust assets to forced heirship.

The *Thomas* case demonstrates three important points: (i) the Court acknowledged the illusory trust doctrine; (ii) in Oklahoma, a gift to a third party creates merely a resulting trust, where the donor retains control over the property, and especially where the gift is revocable; thus, although legal title may pass, beneficial title remains with the donor, and is subject to forced heirship; (iii) the law permitting trusts to be revocable does not insulate revocable trusts from forced heirship.

**d. West Virginia.** The illusory trust doctrine was examined by the Supreme Court of West Virginia in *Davis v. KB & T Co.*, 309 S.E.2d 45 (W. Va. 1983). There the husband conveyed his non-tangible personalty into a trust, retaining the right to the income for life, and if his wife survived him, then to her for her life, with a remainder interest to certain named beneficiaries. The widow sued asserting a dower interest in the property conveyed by the husband into trust. The Court said:

> The question of the validity of an inter vivos trust which impairs the statutory right of the surviving spouse to share in the settlor's estate is an issue which has been addressed in numerous jurisdictions. . . . Generally, in resolving the issue, courts have taken one of two approaches. The first approach involves a determination of whether the transfer of property is real and bona fide, or whether the settlor has reserved such powers of ownership and control over the trust property as to make the transfer illusory or testamentary in character. . . . The second approach involves examination of the question whether the transfer of property in trust constituted a fraud upon the rights of the spouse.

*Id.* at 49. The West Virginia Court applied both tests to the case.

In *Davis*, the primary basis for the illusory trust attack was that the husband reserved the right to amend or revoke the trust during lifetime. The Court said that "[i]t is well established, however, that the retention by the settlor of the power to revoke or modify a trust is insufficient, standing alone, to render the trust illusory or testamentary." *Id.* at 49 (citing I.A. Scott, THE LAW OF TRUSTS § 57.1 (3d ed. 1967). The Court also quoted RESTATEMENT (SECOND) OF TRUSTS § 57 (1959) in support of the rule. The illusory trust attack was rejected.

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

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

Footnote 4 provides:

> 4. ". . . The term "colorable" as used herein, indicates a transfer which may be absolute on its face, but which, actually,

> is not a transfer at all because, through some secret or tacit understanding, the parties intend that ownership is to be retained by the donor . . . ." Edward A. Smith, 44 MICH. L. REV. 151, 153; *Martin v. Martin*, 282 Ky. 411, 138 S.W.2d 509 (1940).

*Id.*, at 846 n. 4.

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

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

Bell, *Community Property Trusts--Challenges by the Non-Participating Spouse*, 22 BAY. L. REV. 311, 319 (1970). Although the doctrine was discussed in a death-related case, there is no reason why it should be limited to death.

**F. ALTER EGO.** Family lawyers know that the independence or separateness of a corporation or other business entity can be attacked under the "alter ego" doctrine, or more broadly, on several grounds for disregarding the separate identity of an entity. The doctrine could be used to contest whether certain property is truly "held in trust." The Court of Civil Appeals, in *In re Marriage of Burns*, 573 S.W.2d 555, 557 (Tex. Civ. App.--Texarkana 1978, writ dism'd), acknowledged this potential attack, when it noted that the wife in that case had not challenged the husband's trust as being the alter ego of the husband.

The necessary legal standards to establish a trust as an alter ego can be adapted from cases where a spouse has sought to pierce the corporate veil. *See Spruill v. Spruill*, 624 S.W.2d 694 (Tex. Civ. App.--El Paso 1981, writ dism'd); *Duke v. Duke*, 605 S.W.2d 408 (Tex. Civ. App.--El Paso 1980, writ dism'd); *Humphrey v. Humphrey*, 593 S.W.2d 824 (Tex. Civ. App.--Houston [14th Dist.] 1980, writ dism'd); *Goetz v. Goetz*, 567 S.W.2d 892 (Tex. Civ. App.--Dallas 1978, no writ). *Martin v. Martin*, 628 S.W.2d 534 (Tex. App.--Fort Worth 1982, no writ). *See generally* TEX. PROP. CODE §112.008(c) (settlor and beneficiary may be trustee, except where merger would occur). It should be noted that a trust may be operated as an alter ego of the settlor, or of the beneficiary, or of the trustee.

However, alter ego is just one of several grounds to disregard the separate identity of an entity, a discussed below.

**1. Castleberry v. Branscum.** The Supreme Court examined the contours of piercing the corporate veil in *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986). There the Court discussed seven recognized grounds for disregarding the corporate fiction: (i) alter ego; (ii) because "the corporate form has been used as part of a basically unfair device to achieve an inequitable result; (iii) fraudulent conveyance; (iv) the trust fund doctrine; (v) breach of fiduciary duties; (vi) the denuding theory; and (vii) inadequate capitalization. *Id.* at 271-73. As to the alter ego theory the Court said:

> Alter ego applies when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice. *First Nat. Bank in Canyon v. Gamble*, 132 S.W.2d 100, 103 (Tex. 1939). It is shown from the total dealings of the corporation and the individual, including the degree to which corporate formalities have been

> followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes. [Citations omitted.] Alter ego's rationale is: "if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors."

*Id.* at 272.

The policy reasons which support disregarding the corporate fiction may well also apply to situations where an ostensible trust relationship in property is conducted in a manner that meets the conditions for disregarding the separate identity of an entity. If the facts warrant it, plead the cause of action, and if the trial judge will not allow it, take it up on appeal.

**2. Colorable Trust vs. Alter Ego.** One can draw some distinctions between a "colorable" trust and a trust relationship which should be disregarded on recognized grounds. To prove that a trust is colorable, the proponent must show an agreement between the settlor and the trustee such that the settlor retains the benefit of the principal and income of the trust, notwithstanding the apparently completed conveyance to the trustee. To establish that a trust is being operated as an alter ego, the proponent would show that the settlor, or trustee, or beneficiary, as the case may be, dealt with the trust property as if it was not subject to the fiduciary obligations deriving from the trust instrument. Thus, even if the attempt to prove an *agreement* between the trustee and the settlor is unsuccessful, and the colorable trust attack fails, the trust relationship may be disregarded on other grounds.

Where the beneficiary is also the trustee, (and especially also the settlor), the situation becomes very problematic. Past behavior may demonstrate that the trust structure is a pretense, driven by estate tax motives but not real in the actual operation.

**G. TRUST AS INSTRUMENT OF FRAUD.** No published Texas appellate case has disregarded the separateness of a trust on the ground that it was used to perpetrate a fraud. However, this cause of action exists in some other jurisdictions. In this subsection, an analogy is drawn to Texas precedent disregarding the corporate fiction, and some case law from other states is examined.

**1. Comparison to Cases Disregarding the Corporate Entity.** In the case of *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986), the Supreme Court discussed disregarding the corporate fiction where the corporate entity is used to perpetrate a fraud. The Court indicated that the corporate veil could be pierced upon a showing that the corporate form had been used in such a way as to amount to constructive fraud. The Court said:

> Because disregarding the corporate fiction is an equitable doctrine, Texas takes a flexible fact-specific approach focusing on equity.

*Id.* at 273. There are a number of Texas cases discussing constructive fraud-on-the-spouse, in situations involving the conveyance of community property by a spouse to a third party. However, these cases would address only the conveyance by a spouse of property into trust. One can imagine other instances of constructive fraud in connection with a trust, apart from a spouse's conveyance of community property into trust. Take, for example, the man who, shortly prior to marriage, conveys all of his income-producing property into trust, and then, either as trustee or through control over the trustee, uses undistributed trust income to acquire assets such as the car which he drives, the house in which he lives, etc.--items which would have been community property had the income been received by him free of trust. This activity would not constitute a constructively fraudulent conveyance of community property, but might constitute use of an express trust in a constructively fraudulent manner. If the principles that apply to use of a corporation to perpetrate a fraud can be adapted to express trusts, equity would allow the court in a divorce to disregard the trust "fiction."

**H. RESCISSION, CANCELLATION AND REFORMATION FOR FRAUD, DURESS, MISTAKE, ETC.** Conveyances into trust, like every other transaction, are subject to rescission, cancellation or reformation on the grounds of fraud, accident, mistake, undue influence, duress, failure of consideration, etc. *See* 72 TEX. JUR.3d *Trusts* § 154 (1990).

**1. Fraud in the Inducement as Basis for Rescission.** In order to rescind a conveyance for fraud in the inducement, it must be shown that: (1) a false representation was made by the victim; (2) the victim detrimentally relied upon the false representation; and (3) the victim suffered resultant injury. *Citizens Standard Life Ins Co. v. Muncy*, 518 S.W.2d 391, 194 (Tex. Civ. App.--Amarillo 1974, no writ). The misrepresentation must relate to a material fact. *Runfield v. Runfield*, 324 S.W.2d 304, 406 (Tex. Civ. App.--Amarillo 1959, writ ref'd n.r.e.). The speaker need not know the falsity of the representation. *Citizens Standard Life Ins. Co. v. Muncy*, 518 S.W.2d 391, 195 (Tex. Civ. App.--Amarillo 1974, no writ). The failure to disclose a material fact will not support rescission, unless the wrongdoer had a duty to disclose arising from the nature of the relationship between the wrongdoer and the victim. *Anderson v. Anderson*, 620 S.W.2d 815, 819 (Tex. Civ. App.--Tyler 1981, no writ). A promise regarding future behavior will not support rescission unless the wrongdoer had no intent to carry out the promise at the time it was made. *Bassett v. Bassett*, 590 S.W.2d 531, 533 (Tex. Civ. App.--Houston [1st Dist.] 1979, writ dism'd).Where the victim had knowledge of the falsity, rescission will not lie. *Shaw Equipment Co. v. Hoople Jordan Const. Co.*, 428 S.W.2d 835, 839 (Tex. Civ. App.--Dallas 1968, no writ).

In the context of an express trust, it can be imagined that the settlor, or someone claiming through him, might assert fraud in the inducement as a ground to rescind the conveyance into trust. Consider the following scenario. Assume that the wife is induced by her husband to join in a conveyance of their community property into trust, with the income from the trust to be paid in equal portions to husband and wife, for their lives, and then to the survivor, for life, and with the remainder to go to the spouses' children. Shortly after the conveyance, the husband files for divorce, and moves in with his girl-friend. The wife's lawyer wants to rescind the conveyance into trust. Given the fiduciary relationship which exists between spouses, and the husband's failure to disclose the existence of a girlfriend or his intent to seek a divorce, rescission of the conveyance into trust would be appropriate, based on fraud in the inducement and breach of fiduciary duty. Proof of actual fraud eliminates the need to show a fiduciary relationship. *Meadows v. Bierschwale*, 516 S.W.2d 125 (Tex. 1974).

The reader should differentiate fraudulent inducement from actual fraud and constructive fraud/breach of fiduciary duty. Fraudulent inducement requires only a false inducement, not a knowingly false inducement. Actual fraud involves scienter. Constructive fraud involves only unfairness to the victim to whom a fiduciary or special duty is owed.

**2. Accident.** The Texas Supreme Court discussed what constitutes an accident sufficient to rescind or cancel a transaction, in *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 432 (Tex. 1970). The Court described such an accident as:

> an unforeseen and unexpected event, occurring externally to the party affected by it, *and of which his own agency is not the proximate cause*, whereby, contrary to his own intention and wish, he loses some legal right or becomes subject to some legal liability and another acquires a corresponding legal right, which it would be a violation of good conscience for the latter person, under the circumstances, to retain . . . . If the party's own agent is the proximate cause of the event, it is mistake rather than an accident.

*See Lott v. Kaiser*, 61 Tex. 665, 668-69 (Tex. 1884).

**3. Mistake.** Equity recognizes "mistake" as a ground for reformation, rescission or cancellation of a transaction. It should be noted that if rescission or cancellation is not available, the settlor could alternatively reform the trust agreement to make it revocable, and then later exercise his power to revoke the trust.

**a. Mistake as Basis for Rescission and Cancellation.** To rescind or cancel an agreement for mistake, the mistake in most instances must be mutual. *Hanover Ins. Co. v. Hoch*, 469 S.W.2d 717, 722 (Tex. Civ. App.--Corpus Christi 1971, writ ref'd n.r.e.). The mistake must relate to a material and essential issue, not an incidental one. *Simpson v. Simpson*, 387 S.W.2d 717, 719 (Tex. Civ. App.--Eastland 1965, no writ). The mistake cannot have resulted from the negligence of the party seeking to negate the transaction. *Plains Cotton Cooperative Assn. v. Wolf*, 553 S.W.2d 800, 803 (Tex. Civ. App.--Amarillo 1977, writ ref'd n.r.e.). Ordinarily, an error in predicting the future will not support rescission or cancellation. *City of Austin v. Cotten*, 509 S.W.2d 554, 557 (Tex. 1974). A mistake as to a party's existing legal rights can support rescission. *Plains Cotton Cooperative Assn. v. Wolf*, 553 S.W.2d 800, 803 (Tex. Civ. App.--Amarillo 1977, writ ref'd n.r.e.).

Unilateral mistake, that is not known to or induced by the other party, will not support rescission or cancellation of an agreement. *Johnson v. Snell*, 504 S.W.2d 397, 399 (Tex. 1973). However, unilateral mistake can support rescission where the mistake is of such a magnitude that to enforce the contract would be unconscionable; the mistake involves a material feature of the agreement; the mistake was made despite the exercise of ordinary care; and the parties can be returned to the status quo ante after rescission. *Taylor v. Arlington Ind. School Dist.*, 335 S.W.2d 371, 373 (Tex. 1960).

**b. Mistake as Basis for Reformation.** Reformation is an equitable proceeding in which a document which is erroneously written is caused to conform to the true agreement between the parties. *Continental Oil Co. v. Doornbos*, 402 S.W.2d 879, 883 (Tex. 1966). Ordinarily, the mistake in the document must be mutual, and not unilateral, in order to support reformation. To warrant reformation, the proponent must prove the true agreement of the parties, and that the written memorandum deviates from the true agreement as a result of mutual mistake. *Brown v. Havard*, 593 S.W.2d 939, 942 (Tex. 1980). However, unilateral mistake by one party will support reformation where it is accompanied by fraud or inequitable conduct by the other party. *Ace Drug Marts, Inc. v. Sterling*, 502 S.W.2d 935, 939 (Tex. Civ. App.--Corpus Christi 1974, writ ref'd n.r.e.). For example, where the other party knows of the mistake but fails to mention it, inequitable conduct exists to support reformation based upon unilateral mistake. *Cambridge Companies, Inc. v. Williams*, 602 S.W.2d 306, 308 (Tex. Civ. App.--Texarkana 1980), *aff'd*, 615 S.W.2d 172 (Tex. 1981).

**c. Cancellation of Trust Agreements.** American Law Reports, Second Edition, contains an annotation on the subject of when an irrevocable inter vivos trust can be cancelled on the ground of mistake or misunderstanding. Annot., 59 A.L.R.2d 1229 (1958).

One federal judge concluded that, under Texas law, a settlor may reform a trust agreement to insert a power of revocation where that power was omitted from the trust agreement by mistake. *See DuPont v. Southern Nat. Bank of Houston, Texas*, 575 F. Supp. 849, 859 (S.D. Tex. 1983), *aff'd in part, rev'd part on other grounds*, 771 F.2d 874 (5th Cir. 1985). The Court also dealt with rescission of a trust on the grounds of mistake as to tax consequences, and suggested that Texas law would require the following showing before rescinding the trust: (1) that the trust was created solely for tax considerations; (2) that these tax considerations had been definitely changed or frustrated by an actual assessment of tax liability or by a change in law that would lead an expert to conclude that a transfer tax liability would more likely than not accrue on the transaction; (3) that the changed tax circumstance amounts to a material mistake; (4) that the settlor proves that but for the mistake he would not have entered into the transaction; and (5) that when plaintiff knew or should have known of the mistake he acted immediately to remedy the situation. *Id.* at 861.

**d. Undue Influence.** Undue influence can support rescission or cancellation of a transaction. It is a form of legal fraud. *Bounds v. Bounds*, 382 S.W.2d 947, 951 (Tex. Civ. App.--Amarillo 1964, writ ref'd n.r.e.). In the area of will contests, where undue influence usually arises, the term is defined as such an influence as would subvert or overpower the mind at the time of the transfer in question, and without which influence the transfer would not have been made. *Bohn v. Bohn*, 455 S.W.2d 401, 409 (Tex. Civ. App.--Houston [1st Dist.] 1970, writ dism'd). *See In Re Estate of Willenbrock*, 603 S.W.2d 348, 350 (Tex. Civ. App.--Eastland 1980, writ ref'd n.r.e.). The same definition was applied to a suit to rescind a real estate conveyance, in *Edwards v. Edwards*, 291 S.W.2d 783, 786 (Tex. Civ. App.--Eastland 1956, no writ), where a daughter sought to rescind a conveyance of real estate by her mother to her half-brother. Where the conveyance is made in the context of a confidential or fiduciary relationship, and the fiduciary thereby profits, a presumption of fraud may arise and a different burden of proof (i.e., fairness) may apply. *Mason v. Mason*, 366 S.W.2d 552 (Tex. 1963), is an example of a testamentary trust that was invalidated when the will creating it was held invalid for undue influence.

**e. Duress.** Duress may be used as a basis to cancel instruments. Duress exists when: (1) there is a threat to do some act which the party threatening has no legal right to do; (2) there is some illegal exaction or fraud or deception; and (3) the restraint is imminent and such as to destroy free agency without present means of protection. *Housing Authority of City of Dallas v. Hubbell*, 325 S.W.2d 880 (Tex. Civ. App.--Dallas 1959, writ ref'd, n.r.e.); *Hailey v. Fenner & Beane*, 246 S.W. 412, 412 (Tex. Civ. App.--Dallas 1923, no writ).

**4. Fraudulent Conveyances.** A conveyance into trust can be set aside if it violates one of the fraudulent transfer statutes. The general features of these doctrines are discussed below.

Chapter 24 of the Texas Business and Commerce Code sets out the Uniform Fraudulent Transfer Act. By using this Act, a spouse can perhaps undo a conveyance into trust.

The provisions of Chapter 24 apply to "transfers," including every mode of or parting with an interest in an asset. TEX. BUS & COM. CODE § 24.002(12) [UFTA]. A spouse is a "creditor" who can invoke the provisions of the statute. UFTA § 24.002(4).

**a. Transfers Made with Intent to Defraud.** Section 24.005(a)(1) of UFTA voids transfers made with the intent to hinder, delay or defraud creditors. Transferred property cannot be recovered from a "bfp" who gave a reasonably equivalent value for the transfer. UFTA § 24.009(a). Cases involving spouses under earlier law include: *Lott v. Kaiser*, 61 Tex. 665 (1884) (for transfer made during divorce in which wife sought alimony); *Goodwin v. Goodwin*, 451 S.W.2d 532 (Tex. Civ. App.--Amarillo), *rev'd on other grounds*, 456 S.W.2d 885 (Tex. 1970) (regarding transfer by husband occurring between date of rendition and date of signing of decree of divorce awarding wife judgment against husband); *Spence v. Spence*, 455 S.W.2d 365 (Tex. Civ. App.--Houston [14th Dist.] 1970, writ ref'd n.r.e.) (regarding transfer by husband between the date the decree of divorce was signed and the date it became final, where wife received an unsecured money judgment against husband); *Rilling v. Schultze*, 95 Tex. 352, 67 S.W.2d 401 (1902) (regarding transfer by ex-husband after entry of divorce decree ordering him to pay child support to ex-wife. *See generally White v. White*, 519 S.W.2d 689 (Tex. Civ. App.--San Antonio 1975, no writ), in which the husband was held not to be a creditor of the wife where the spouses had partitioned their property and exchanged deeds dividing their community estate.

**b. Debtor's Transfer Not for Value.** Section 24.005 of the Texas Business and Commerce Code states that a transfer made by a debtor without receiving a reasonably equivalent value is void with respect to an existing creditor if: (1) the debtor was about to engage in a transaction for which his/her assets were unreasonably small; (2) the debtor believed that he/she would incur debts beyond the debtor's ability to pay as they come due. TEX. BUS. & COM. CODE § 24.005(a)(2). Intent by the debtor to defraud a creditor or interested person is not an issue under this provision. *See First State Bank of Mobeetie v. Goodner*, 168 S.W.2d 941, 944 (Tex. Civ. App.-- Amarillo 1943, no writ). The burden of proving insolvency is on the creditor. *Wester v. Strickland*, 87 S.W.2d 765, 767 (Tex. Civ. App.--Amarillo 1935), *aff'd* 112 S.W.2d 1047 (Tex. 1938).

**5. Conveyances During Divorce.** Section 6.707 of the Texas Family Code provides that a transfer of community property, or the incurring of community debt, by a spouse while a divorce is pending is void as against the other spouse, if done with the intent to injure the rights of the other spouse. TEX. FAM. CODE § 6.707. The statute further provides, however, that the transfer or debt is not void as to the transferee or lender who had no notice of the intent to injure. The complaining spouse has the burden to prove such notice. While the mere pendency of the divorce is not constructive notice to third parties of fraudulent intent, *First Southern Properties, Inc. v. Gregory*, 538 S.W.2d 454, 458 (Tex. Civ. App.--Houston [1st Dist.] 1976, no writ), it would seem that courts might be more inclined to negate gratuitous transfers into trust made during the pendency of a divorce, where the transferee would suffer no loss of consideration paid, etc. were the transfer into trust rescinded.

**6. Fraud-on-the-Spouse Doctrine.** There are many Texas cases asserting that actual or constructive fraud can arise when a spouse gives community property to a third party. In such a situation, the court will reconstitute the community estate based on the injury to the community estate. *See* Tex. Fam. Code § 7.009. Most actual and constructive fraud-on-the-spouse cases have involved either outright gifts to third parties or the designation of a third party as beneficiary of a community property life insurance policy. However, the conveyance of community property into an inter vivos or testamentary trust can just as easily support a fraud-on-the-spouse case. This was recognized by the Texas Supreme Court, in dicta, in *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968).

**7. Actual Fraud.** Bogert's TRUSTS AND TRUSTEES, Section 211, says:

> A trust, like any other transfer, conveyance, or contract, may be invalid because it is intended to accomplish an illegal purpose. Trusts for which the settlor's primary purpose was to defraud private persons or corporations of their common law or statutory rights, or defraud the government, or encourage crime or other highly unsocial conduct, will not be carried out by the courts and will be set aside on application of interested and innocent parties.

No Texas cases were found where a conveyance into trust was attacked as constituting actual fraud upon a spouse. However, the issue was examined in *Martin v. Martin*, 282 Ky. 411, 138 S.W.2d 509 (1940). In that case, the issue was whether a man who was about to marry could transfer his property to a third party with the intent to deprive his intended spouse of a distributive share of his estate, upon his death. The high court of Kentucky made the following statement of the law:

> [A] man may not make a voluntary transfer of either his real or personal estate with the intent to prevent his wife, *or intended wife*, from sharing in such property at his death and that the wife, on the husband's death, may assert her marital rights in such property in the hands of the donee. [Emphasis added.]

*Id.* at 515. The TEXAS PATTERN JURY CHARGES (FAMILY & PROBATE) (2018) PJC 206.2A gives the following instruction regarding actual fraud of a spouse's interest in community property:

> A spouse commits fraud if *that spouse transfers community property or expends community funds for the primary purpose of depriving the other spouse of the use and enjoyment of the assets involved in the transaction*. Such fraud involves dishonesty of purpose or intent to deceive. [Italicized language is subject to substitution of different language, depending on facts of case]

**I. CONSTRUCTIVE FRAUD.** Many authorities agree that, even without proof of actual intent to defraud the spouse, the court will rescind or otherwise compensate for a transaction whereby one spouse unfairly transfers community property. The doctrine of constructive fraud is one tool the practitioner can use to undo one spouse's conveyance of community property into a trust. *See Stephens County Museum, Inc. v. Swenson*, 517 S.W.2d 257 (Tex. 1975) (a non-marital case remanded to trial court for determination of constructive fraud issue regarding transfer into trust).

The TEXAS PATTERN JURY CHARGES (FAMILY & PROBATE) (2018) PJC 206.4A gives the following instruction regarding constructive fraud as to a spouse's interest in community property:

> *A spouse may make moderate gifts, transfers, or expenditures of community property for just causes to a third party. However, a gift, transfer, or expenditure of community property that is capricious, excessive, or arbitrary is unfair to the other spouse. Factors to be considered in determining the fairness of a gift, transfer, or expenditure are—*
>
> 1. *the relationship between the spouse making the gift, transfer, or expenditure and the recipient*;
>
> 2. *whether there were any special circumstances tending to justify the gift, transfer, or expenditure; and*
>
> 3. *whether the community funds used for the gift, transfer, or expenditure were reasonable in proportion to the community estate remaining*. [Italicized language is subject to substitution of

different language, depending on facts of case]

**a. In Conveyances During Lifetime.** The following cases, among others, have addressed the issue of constructive fraud-on-a-spouse in inter vivos conveyances to third parties: *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd) (wife sought to recover from husband in divorce proceeding for gifts of community property he made to his children from a prior marriage); *Carnes v. Meador*, 533 S.W.2d 365 (Tex. Civ. App.--Dallas 1976, writ ref'd n.r.e.) (widow sued to negate gifts of community property from deceased husband to his children from prior marriage); *Logan v. Barge*, 568 S.W.2d 863 (Tex. Civ. App.--Beaumont 1978, writ ref'd n.r.e.) (widow sued step-children to recover one-half of gifts of community property made to them by her deceased husband); *In re Estate of Vackar*, 345 S.W.3d 588 (Tex. App.--San Antonio 2011, no pet.) (husband leaving $100,000 in insurance proceeds to his sister was set aside as unfair).

**b. In Conveyances Effective Upon Death.** The following cases have addressed the issue of constructive fraud-on-a-spouse in conveyances taking effect upon death: *Barnett v. Barnett*, 67 S.W.3d 107 (Tex. 2001) (deceased husband designated his estate as beneficiary of community property life insurance, with his mother and not his wife receiving the insurance proceeds; wife's fraud claim was preempted by ERISA); *Givens v. Girard Life Ins. Co. of America*, 480 S.W.2d 4211 (Tex. Civ. App.--Dallas 1972, writ ref'd n.r.e.) (widow sued deceased husband's girlfriend to recover proceeds from community property life insurance policy on life of deceased husband); *Murphy v. Metropolitan Life Ins. Co.*, 498 S.W.2d 278 (Tex. Civ. App.--Houston [14th Dist.] 1973, writ ref'd n.r.e.) (decedent's mother sued insurance company and decedent's wife for proceeds of community property life insurance policy on decedent's life);

**J. MERGER.** The essence of an express trust is the separation of the legal title from the equitable title in property, with the trustee holding legal title and the beneficiary holding equitable title. *Jameson v. Bain*, 693 S.W.2d 676, 680 (Tex. App.--San Antonio 1985, no writ). Whenever legal title and equitable title to trust property are joined in the same person, the two interests merge, and the property is no longer in trust.

The doctrine of merger is expressly set out in Section 112.034 of the Texas Trust Code. The Code provides:

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

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

Merger can occur at the outset of the trust, or as a result of a design defect in the trust instrument, or it can result from a subsequent act of the beneficiary. For example, when the beneficiary of an express trust conveys equitable title to the trustee, so that legal title and equitable title are merged in the trustee, the trust is terminated and the trustee has an unrestricted right to the property. *See Becknal v. Atwood*, 518 S.W.2d 593 (Tex. Civ. App.---Amarillo 1975, no writ). In *Becknal*, where the father conveyed real property to his wife as trustee for their children, and the children later conveyed their remainder interest back to their mother, for her use and enjoyment during her lifetime, and then to the trustor-father, for his use during his lifetime, legal and equitable title merged and the property in question exited the trust. However, other trust property not involved in the re-conveyance continued to remain in trust.

Note that the merger provision of the Texas Trust Code speaks of merger of legal and equitable title in *one* person. Note the Code's use of the words "sole trustee" and "sole beneficiary." There is a general view that, where there are multiple trustees and multiple beneficiaries, a unification of legal and equitable title in just one of the trustees and beneficiaries does not constitute merger. *See* Annot., 7 A.L.R.4th 621 (1981). However, this argument did not avoid merger in the *Becknal* case, discussed above, where there were two trustees.

In sum, whenever the legal and equitable titles to property held in trust are combined, the possibility of merger arises.

**K. STANDARDS IN THE INTERNAL REVENUE CODE.**The Internal Revenue Code addresses issues analogous to the "illusory trust," "colorable trust," and alter ego doctrines in connection with taxation of trust income and the inclusion of trust property in the estate of a decedent. While there is a distinction between the validity of a transaction under state property law and the validity of the transaction for tax purposes, the parallels cannot be avoided. The similarity was touched upon in *Sullivan v. Burkin*, 390 Mass. 864, 460 N.E.2d 572, 575 (1984).

**1. Income Tax Considerations.** The Internal Revenue Code recognizes a trust as a separate taxable entity only when there is a genuine relinquishment of the settlor's control over his wealth. If the settlor retains too much control over the trust, the income of the trust will be taxed to the settlor. The Code also taxes trust income to the settlor if the income is used to make payments which the settlor is obligated to make, such as child support. I.R.C. 674(b)(1), 677(b); Regs. §§ 1.674; 1.677. While recognition of a trust as a taxable entity under the Internal Revenue Code is different from recognition of a trust under local property law, in most instances the Code standards relate to the true "separateness" of the trust from the settlor. Also, the failure to meet Code requirements makes the trust's income taxable to its grantor, creating a liability for his community estate, and perhaps bolstering the claim that if income is taxable to the community, then the conveyance into trust should be declared to be ineffective. [If the trust is nonetheless valid under property law, then perhaps a right of reimbursement arises for community property used to pay taxes on the income of the trust.] For a discussion of the specific questions addressed by the Internal Revenue Code on the subject, see 33 AM. JUR.2d *Federal Taxation* § 3000-3038 (1996).

**2. Estate Tax Considerations.** The Internal Revenue Code also contains provisions which cause property conveyed into a trust to be included in the decedent's estate, for estate tax purposes. The rules are similar to those discussed above in connection with income taxation. See 34A AM. JUR.2d *Federal Taxation* § 143,179 (1996).

**L. BREAKING CHARITABLE TRUSTS.** If someone wants to break up or break into a charitable trust, there are special problems relating to the Attorney General set out in Chapter 123 of the Texas Property Code.

**1. Attorney General's Participation.** The Texas Property Code gives the Texas Attorney General the right to participate in litigation relating to charitable trusts. The relevant section provides:

§ 123.002. Attorney General's Participation

For and on behalf of the interest of the general public of this state in charitable trusts, the attorney general is a proper party and may intervene in a proceeding involving a charitable trust. The attorney general may join and enter into a compromise, settlement agreement, contract, or judgment relating to a proceeding involving a charitable trust.

TEX. PROP. CODE § 123.002.

**2. Notice to the Attorney General.** The Texas Property Code requires that the Texas Attorney General be given notice of litigation relating to charitable trusts. The relevant section provides:

§ 123.003. Notice

(a) Any party initiating a proceeding involving a charitable trust shall give notice of the proceeding to the attorney general by sending to the attorney general, by registered or certified mail, a true copy of the petition or other instrument initiating the proceeding involving a charitable trust within 30 days of the filing of such petition or other instrument, but no less than 25 days prior to a hearing in such a proceeding. This subsection does not apply to a proceeding that is initiated by an application that exclusively seeks the admission of a will to probate, regardless of whether the application seeks the appointment of a personal representative, if the application:

(1) is uncontested; and

(2) is not subject to Subchapter C, Chapter 256, Estates Code.

(b) Notice shall be given to the attorney general of any pleading which adds new causes of action or additional parties to a proceeding involving a charitable trust in which the attorney general has previously waived participation or in which the attorney general has otherwise failed to intervene. Notice shall be given by sending to the attorney general by registered or certified mail a true copy of the pleading within 30 days of the filing of the pleading, but no less than 25 days prior to a hearing in the proceeding.

(c) The party or the party's attorney shall execute and file in the proceeding an affidavit stating the facts of the notice and shall attach to the affidavit the customary postal receipts signed by the attorney general or an assistant attorney general.

TEX. PROP. CODE § 123.003.

**3. Voidable Judgment or Agreement.** The Texas Property Code makes a judgment involving a charitable trust voidable if the Texas Attorney General was not notified of the proceeding. The relevant section provides:

§ 123.004. Voidable Judgment or Agreement

(a) A judgment in a proceeding involving a charitable trust is voidable if the attorney general is not given notice of the proceeding as required by this chapter. On motion of the attorney general after the judgment is rendered, the judgment shall be set aside.

(b) A compromise, settlement agreement, contract, or judgment relating to a proceeding involving a charitable trust is voidable on motion of the attorney general if the attorney general is not given notice as required by this chapter unless the attorney general has:

(1) declined in writing to be a party to the proceeding; or

(2) approved and joined in the compromise, settlement agreement, contract, or judgment.

TEX. PROP. CODE § 123.004.

**M. JOINDER OF BENEFICIARIES.** As a general rule, both the trustees and the beneficiaries should be made parties to suits involving trust property. *Starcrest Trust v. Berry*, 926 S.W.2d 343, 355 (Tex. App.--Austin 1996, no writ). However, beneficiaries need not be joined in the action if the dispute does not involve a conflict between the trustee and beneficiaries, or between the beneficiaries themselves. *Id*. at 355. Also, the beneficiaries need not be joined if the trust instrument places the power to litigate exclusively on the trustee. *Hedley Feedlot, Inc. v. Weatherly Trust*, 855 S.W.2d 826, 833 (Tex. App.--Amarillo 1993, writ denied). The terms of the trust instrument and the purpose of this suit must be examined to determine whether a suit may be prosecuted with the trustee without joining the beneficiaries. *Id.* at 833.

**N. TRUSTEE'S ATTORNEY-CLIENT PRIVILEGE.** In *Huie v. DeShazo*, 922 S.W.2d 925 (Tex. 1996), the Supreme Court held that the attorney-client privilege applies to communications between a trustee and the lawyer hired by the trustee, even as against beneficiaries of the trust. There is a crime-fraud exception to the attorney-client privilege. Tex. R. Evid. 503(d)(1).

**X. MARITAL PROPERTY ISSUES.** There is much disagreement about the intersection between trust law and marital property law. That discussion is for another day. An article on the subject that discussed Texas cases is Steve D. Baker *The Texas Mess: Marital Property Characterization of Trust Income*, 5 Est. Plan. & Community Property L.J. 217 (Summer 2013).

**A. BENEFICIAL INTEREST**. The beneficial interest would be separate property for a trust established prior to marriage or a testamentary trust. Where a trust is created as a gift, the beneficial interest in the trust is separate property. *Hardin v. Hardin*, 681 S.W.2d 241, 243 (Tex. Civ. App.--San Antonio 1984, no writ).

**B. UNDISTRIBUTED ASSETS HELD IN TRUST.** According to the following cases, property held in trust for a spouse was not marital property: *Buckler v. Buckler*, 424 S.W.2d 514 (Tex. Civ. App.--Fort Worth 1967, writ dism'd) (undistributed income in a spendthrift trust not part of the estate of the parties, where distribution of such income was discretionary with the trustee); *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd) (undistributed income inside discretionary distribution trust not "acquired" by the spouse during marriage, and was therefore not part of the community estate); *Currie v. Currie*, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd) (property inside of discretionary distribution trust was not community property of the husband; property inside another trust, as to which husband was remainder beneficiary, was not "acquired" by the spouse, and was therefore not part of the community estate). This is not so, however, when assets are no longer held in trust but are voluntarily left with the trustee. *See In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ) (where one half of the corpus (principal) of the trust had passed to the husband free of trust, the income on that half of the corpus belonged to the community, despite the fact that the husband left that half in the hands of the trustee).

In *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ), the husband was the beneficiary of a trust created prior to marriage by his parents. Prior to the divorce, the husband's right to receive half of the corpus free of trust had matured, but the husband left that half in the hands of the trustee. The Court held that once the husband's right to receive half of the corpus matured, the income on such half began to belong to the community. However, the half of the corpus which emerged from trust was itself the husband's separate property, and the income on the other half of the corpus, which remained in trust, did not belong to the community since it still "belonged to the trust." It appears to have been important to that last determination that the distribution of income was discretionary with the trustee. *Id.* at 718. *Long* can be read as tacitly agreeing that distributed income from a trust can be community property.

**C. INCOME FROM SELF-SETTLED TRUST.** A "self-settled" trust is a trust in which the settlor is also the beneficiary. In *Mercantile National Bank at Dallas v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.), the Court held that the undistributed income of a trust created by wife for her own benefit, prior to marriage, is community property. *See In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd) (income on separate property corpus of trust created by spouse for his own benefit was community property to the extent it was received by husband). In *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.--Corpus Christi 1997, no writ), the appellate court says that the income a spouse receives from a trust is community property. The court also said that if the spouse does not receive income from the trust and has no more than an expectancy interest in the corpus, the income remains separate property. *Id.* at 148. In *Ridgell* some of the trusts were funded by gift or devise and one was funded by the spouse prior to marriage. Also in *Ridgell*, the court recognized that separate property principal distributed out of the self-settled trust was received by the spouse as separate property. *Id.* at 150.

The question is impacted by Texas Property Code § 112.035 regarding self-settled spendthrift trusts. Section 112.035(d) says:

> (d) If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of the settlor's beneficial interest does not prevent the settlor's creditors from satisfying claims from the settlor's interest in the trust estate. A settlor is not considered a beneficiary of a trust solely because:
>
> (1) a trustee who is not the settlor is authorized under the trust instrument to pay or reimburse the settlor for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by the settlor under the law imposing the tax; or
>
> (2) the settlor's interest in the trust was created by the exercise of a power of appointment by a third party.

In *Lemke v. Lemke*, 929 S.W.2d 662, 664 (Tex. App.--Fort Worth 1996, writ denied), the court of appeals considered a self-settled spendthrift trust created by a husband before marriage, to hold damages he recovered in a medical malpractice case for a brain injury he suffered. The self-settled trust had husband as sole beneficiary, and an independent trustee with sole discretion to distribute principal or income to husband for his health, education, maintenance and welfare. The remainder beneficiaries were husband's parents, brother, and their descendants. The trustee made distributions during marriage for trust expenses and for the spouses' living expenses. Citing *In re Marriage of Burns*, the Fort Worth Court of Appeals held that the income still in trust was not marital property because the it had not been distributed and husband had no right to require distribution. The Fort Worth Court of Appeals rejected the wife's claim that the self-settled trust exception to the spendthrift trust rule in Texas Property Code Section 112.0359(d), applied, without any explanation other than referring to *Burns*.

The Fort Worth Court of Appeals the same position in *Lipsey v. Lipsey*, 983 S.W.2d 345 (Tex. App.-Ft. Worth 1998, no pet.), where before marriage the husband rolled over a pension into a 401(k) "Capital Accumulation Plan." The plan manager was a trustee, and under the plan husband deferred receipt of any distributions until he attained age 70-1/2. The trial court found the increase on the Capital Accumulation Plan during marriage to be community property. The Fort Worth Court of Appeals noted that the Plan was a trust created prior to marriage, and that no trust assets had been distributed during marriage, and husband had no right to compel distributions during marriage. Therefore he had not acquired the income, and it was not community property. *Id*. at 350-51. No import was given to the fact that the trust was self-settled.

**D. TRUST CREATED OR FUNDED BY GIFT OR DEVISE.** Where a trust is created as a gift, the beneficial interest in the trust is separate property. *Hardin v. Hardin*, 681 S.W.2d 241, 243 (Tex. Civ. App.--San Antonio 1984, no writ).There are a number of cases which say that income from a trust which was created in a separate property manner (i.e., by will or by gift) is received by the spouse/beneficiary as separate property. These cases do not address the question of whether a trust created by a spouse for his own benefit, using separate property, gives rise to separate or community income.

*McClelland v. McClelland*, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), is probably the most often quoted of these older cases. *McClelland*, which involved a testamentary trust created for the husband by his father, presented the issue as being a contest between the intent of the testator and community property claims of the wife. In *McClelland*, the intent of the testator won out. Thus, a monthly allowance paid by the trustee to the husband, pursuant to a provision in the will, as well as other discretionary distributions made by the trustee under the will, were held to be the husband's separate property. *See Sullivan v. Skinner*, 66 S.W. 680 (Tex. Civ. App. 1902, writ ref'd) (where wife received a life estate in land under her father's will, which provided that she was to receive the income for her sole and separate use, the rentals from the land were wife's separate property).

Several other old cases, involving a conveyance by one spouse into trust for the benefit of the other spouse, held that income from the property held in trust was also separate property. *See Hutchinson v. Mitchell*, 39 Tex. 488 (1873) ("We can find nothing in any of the Constitutions or laws of the state or republic which would prevent a man from declaring an express trust in favor of his wife, and giving her the exclusive use and enjoyment of all the rents, revenues and profits of the trust estate, provided there is no fraud in the transaction against creditors . . ."); *Shepflin v. Small*, 23 S.W. 432 (Tex. Civ. App.--El Paso 1893, no writ) (where husband and wife joined in conveyance of wife's separate property to trustee, to collect the income and use it to support the wife and children, the income was withdrawn from the community estate). In 1980, the Texas Constitution, art. XVI, § 15, was amended to provide that if one spouse makes a gift of property to the other that gift is presumed to include all the income or property which might arise from that gift of property. The Constitution thus recognized a gift between spouses of future income.

In the case of *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-75 (Tex. App.--Amarillo 1994, no writ), the court of appeals without explanation treated a trust distribution from a testamentary trust as entirely separate property, even though the distribution included interest earned by the trust.

A Federal Court of Claims case has reviewed the broad panorama of Texas cases on marital property law and trusts, and concluded that, where a trust is established by gift, the correct view is that distributions from the trust to a married beneficiary are the beneficiary's separate property, notwithstanding some authorities to the contrary. *Wilmington Trust Co. v. United States*, 4 Ct. Cl.6 (1983), *aff'd*, 753 F.2d 1055 (Fed. Cir. 1985). The Court stated:

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

*Id.* *See also Taylor v. Taylor*, 680 S.W.2d 645, 649 (Tex. App.--Beaumont 1984, writ ref'd n.r.e.) (trust distributions held to be separate property where trust instrument said that income of trust became part of the corpus and the parties had stipulated that corpus was separate property).

*Ridgell v. Ridgell*, 960 S.W.2d 144, 149 (Tex. App.--Corpus Christi 1997, no writ), contains language that suggests that the court might have found trust distributions to be separate property if the settlors had included language in the trust instruments indicating a desire for the trust income not be treated as community property in the event the beneficiary married. The court cited *Commissioner v. Porter*, 148 F.2d 455, 568 (5th Cir. 1945) for the proposition that trust distribution might be separate property if the trust instrument indicates that desire "in a precise and definite way, with language of 'unmistakable intent'."

On the other hand, there are several cases suggesting that income on property held in trust is community property, even where the trust is established by gift or devise.

*In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd), the Court determined that undistributed income in several trusts was not community property because it had been neither received nor constructively received by the husband during marriage. This rule was applied not only to several trusts established for the husband by his parents and grandparents, but also to a trust established by the husband for himself, three months after marriage, using husband's separate property. The opinion suggests, albeit somewhat obliquely, that if the income from the trusts had been received by the husband, either actually or constructively, that the income would have been community property.

In *Commissioner of Internal Revenue v. Porter*, 148 F.2d 566 (5th Cir. 1945), the Fifth Circuit Court of Appeals concluded that income distributed from a trust established by the spouse's father was received by the spouse/beneficiary as community property. The Court said that while the income remained in the hands of the trustee, it was "protected," but once it was distributed it became subject to the "ordinary impact of the law."

In *Commissioner of Internal Revenue v. Wilson*, 76 F.2d 766 (5th Cir. 1955), the Fifth Circuit held that income from property held in trust for a married man was received by him as community property, although the corpus was not community property. However, some of the distributed trust income derived from royalties and bonuses on "separate property" corpus. Also, delay rentals were received by the trustee. According to the Fifth Circuit, the delay rentals would be community property, while the royalties and bonuses would not; therefore, whatever portion of the trust income could be shown to be derived from royalties and bonuses would be separate property when received by the beneficiary. This analysis required tracing of the distributions to income received by the trust. In this regard, the Court said:

> In the accounting, outlays by the trustee specially connected with [royalties] are to be considered, and also a fair proportion of the general expenses of the trust, so as to ascertain what part of the net payment to the beneficiaries really came from royalties.

*Id.* at 770. Proceeds from sale of trust assets was not an issue in the case.

**E. FIFTH CIRCUIT *McFADDIN* CASE.** 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.

## F. TRUST DISTRIBUTIONS.

**1. Trust Principal.** *In re Marriage of Long*, 542 S.W.2d at 718, supports the view that a distribution of principal from trust to a married beneficiary is received as separate property if the principal was conveyed into trust by gift or devise or was funded prior to marriage. It would seem that, where a spouse conveys separate property into trust and then recovers it back as a trust distribution during marriage, it would be received by the beneficiary spouse as separate property. *Ridgell v. Ridgell* 960 S.W.2d 144, 150 (Tex. App.--Corpus Christi 1997, no writ). However, an argument can be made that conveying the separate property into trust destroys the identity of the asset as separate property, so that the property has no marital property character while held in trust, and that the character of the distributed principle will be determined without tracing principles. *See Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.--Dallas 1987, writ ref'd n.r.e.) (tracing not allowed when separate property is contributed to partnership and is then distributed out); *see Lifshutz v. Lifshutz*, 199 S.W.3d 9 (Tex. App.--San Antonio 2006, pet.denied) (distribution from partnership was community property even though the asset distributed was not cash but was a business entity owned by the partnership before marriage). Whether the inception of title rule comes into play is yet to be determined.

**2. Trust Income (*Sharma v. Routh*).** The case of *Sharma v. Routh*, No. 14-06-00717-CV (Tex. App.--Houston [14th Dist.] 2009) (opinion withdrawn), *opinion on rehearing*, 302 S.W.2d 355 (Tex. App.--Houston [14th Dist.] 2009, no pet), has had an impact on the question of the character of distributions from trust to a married beneficiary. Because the case is more recent than many, and perhaps because the issues were more sharply drawn, more ably briefed, and more comprehensively analyzed by the appellate court, *Sharma v. Routh*, has been given significant weight by practitioners and forensic experts. The case was actually a close call, and it would be beneficial to examine the Court of Appeals' activity in some detail.

**a. Four Opinions: Two Rulings.** In *Sharma v. Routh*, the Fourteenth Court of Appeals initially held that trust distributions received by a husband (Sharma) during marriage were community property. The initial Majority Opinion was written by Chief Justice Adele Hedges, joined by Justice Eva Guzman; the Dissenting Opinion was written by Justice Kem Frost. [This opinion, later withdrawn, has been officially destroyed; however, the copy retained on www.leagle.com is Appendix A.] After this initial decision, University of Texas School of Law Professor Stanley M. Johanson wrote a letter to the Court, disagreeing with the Court's analysis and explaining why. [A copy of this letter brief is attached as Appendix B.] On rehearing, Justice Guzman changed her vote. Justice Frost, who dissented first time around, wrote the new Majority Opinion, joined by Justice Guzman. Chief Justice Hedges changed her vote as well, but she issued a Concurring Opinion. The Court's final Majority Opinion determined that the trust distributions received by the husband during marriage were his separate property. Justice Guzman, who switched her vote on rehearing, now sits on the Texas Supreme Court.

**b. The Facts.** In *Sharma v. Routh*, the husband's previous wife established in her last will and testament two trusts, the "Marital Trust" and the "Family Trust." The husband was both trustee and beneficiary of the Marital Trust. The Marital Trust agreement required mandatory distribution of trust income to the husband. The Marital Trust agreement also gave the trustee (i.e., the husband) the discretion to distribute trust principal for his own health, support and maintenance, "in accordance with the standard of living to which [he] is accustomed." As to the Family Trust, husband was named as both trustee and beneficiary, and husband as trustee had the discretion to distribute trust principal and income as necessary for his own health, support and maintenance, in order to maintain himself at the standard of living to which he had become accustomed. A charitable foundation was the remainder beneficiary of both trusts. Husband, acting as trustee of both trusts, sold the real estate held in both trusts, taking in exchange promissory notes with payments of principal and interest.

After his previous wife died, husband remarried and then a short time later got divorced from his second wife. The evidence showed that the husband had deposited principal and interest payments received by both trusts into his personal account for approximately 4 years, including 1 year during his second marriage. The Marital Trust had mandatory distribution of income, which amounted to $2,272,063 during marriage. The interest on the Family Trust note during marriage was $32,955. The husband reported the interest payments as his personal income on his tax returns and on a loan application. The trial court found that the interest on the promissory notes held in trust that accrued during marriage was community property, and divided it 50-50.

**c. The Husband's Arguments.** The husband attacked the characterization finding on three grounds:

(1) The trust income was not community property because husband had no remainder interest in the trust corpus (principal);
(2) Husband did not own the trust income; and
(3) The trust income was husband's separate property, received by gift or devise.

**d. The Initial Majority Opinion.** The Majority Opinion, written by Chief Justice Adele Hedges, said that the distributions of trust income during marriage were community property because the husband had an interest in the trust corpus.

Chief Justice Hedges explained:

> Courts have articulated the following rule: if a married beneficiary has an interest in trust principal and receives income from the principal, the income is characterized as community property. *Ridgell v. Ridgell*, 960 S.W.2d 144, 148 (Tex. App.--Corpus Christi 1997, no pet.) (holding that trust income is community property where the spouse beneficiary maintains an interest in trust corpus); *In re Marriage of Long*, 542 S.W.2d 712, 718 (Tex. Civ. App.--Tex-arkana 1976, no writ) (concluding that income received

> on trust corpus is community property if married beneficiary is entitled to corpus); *Mercantile Nat'l Bank at Dallas v. Wilson*, 279 S.W.2d 650, 654 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.) (holding that income on trust corpus during the marriage is community property where spouse has interest in corpus); *c.f. Cleaver v. Cleaver*, 935 S.W.2d 491, 493-94 (Tex. App.--Tyler 1996, no pet.) (holding that trust income is separate property only where trust prohibits distributions from corpus). Thus, if the record reveals that Sharma (1) has an interest in the corpus and (2) received trust income, the interest is community property.[7] *See Ridgell*, 960 S.W.2d at 148; *Long*, 542 S.W.2d at 718; *Wilson*, 279 S.W.2d at 654. [Endnote omitted.]

Chief Justice Hedges went on to say that the husband's interest in the trust corpus was undisputed. All principal payments made on the notes were transferred into the husband's personal account for a period of sixteen months, thus "invading the corpus." The Marital Trust provided that the trust principal should be used to pay any estate tax resulting from the inclusion of Marital Trust principal in his taxable estate. Additionally, husband reported the payments made on the notes held in the Marital Trust as income on his personal tax return and on a bank loan application. Chief Justice Hedges wrote:

> A spouse beneficiary, in the context of a discretionary trust, becomes entitled to trust corpus when a distribution from the principal is made to the spouse beneficiary. Because Sharma invaded the corpus, possessed the corpus in his personal account, and later donated the corpus to his charity, we conclude that Sharma has an interest in the corpus of the Marital and Family trusts. [Endnotes omitted.]

Chief Justice Hedges also noted that husband received distributions of income from the two trusts, and she wrote:

> Because Sharma has interest in the corpus and made distributions from the corpus to himself, the income that rose from the corpus is community property.

Chief Justice Hedges rejected the husband's assertion of gift or inheritance, writing:

> Courts have further interpreted income from trust corpus, identical to the disputed property in the instant case, to be community property. *See Ridgell*, 960 S.W.2d at 148; *Long*, 542 S.W.2d at 718; *Wilson*, 279 S.W.2d at 654.
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> * * *
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> There is not "clear and convincing" evidence that Sharma acquired the interest payments prior to marriage or during marriage by gift, devise, or descent. Because we cannot expand the definition of separate property beyond what the Texas Constitution provides and courts have interpreted income from trust corpus as community property, the disputed property in this case cannot be characterized as separate property. Sharma has failed to rebut the statutory presumption that the interest payments, received during marriage, are community property. *See* Tex. Fam. Code § 3.003(b); *Stavinoha*, 126 S.W.3d at 607; *see also Ridgell*, 960 S.W.2d at 148; *Long*, 542 S.W.2d at 718.

**e. The Initial Dissenting Opinion.** Justice Kem Thompson Frost wrote a Dissenting Opinion. Justice Frost stated her review in these terms:

> In the context of a spouse who receives distributions of trust income under an irrevocable trust during marriage, case law indicates that the income distributions are community property if the receiving spouse owns the trust

corpus but that the distributions are separate property if the receiving spouse does not own the trust corpus.

Justice Frost saw the Majority as saying that the distributed income was community if the spouse had an interest in the corpus. Justice Frost wanted the distributed income to be community property only if the recipient has a "present possory right to part of the corpus." Because the husband had no present possessory right to the corpus of either trust, Justice Frost thought that the distributions of corpus and income were the husband's separate property.

Justice Frost also believed that the income distributed from the mandatory-distribution-of-income Marital Trust was received by the husband by devise from his former wife.

Justice Frost then goes on to posit four possible rules for charactering trust distributions to a married beneficiary.

- Rule A - the beneficiary is effectively an owner of the trust corpus so all distributed income is community property.
- Rule B - all distributions of income are community property if the beneficiary has some potential right to the corpus even if not yet reduced to possession, because the beneficiary is effectively an owner of the trust corpus.
- Rule C - distributions of trust income are community property because the recipient has a present possessory right to the corpus, even if the recipient has chosen not to exercise that right and is therefore effectively an owner of the corpus.
- Rule D - distributions of trust income are community property only if the beneficiary has exercised a possessory right to the corpus because the recipient is effectively the owner of the corpus.

Justice Frost cited cases she said supported Rule C, and she adopted Rule C, rejecting the other rules. Justice Frost gave no weight to the fact that the husband was trustee as well as beneficiary, saying that as trustee he held bare legal title to the trust property.

**f. Professor Johanson's Amicus Curiae Letter.** After the Fourteenth Court of Appeals issued its original decision, University of Texas School of Law Professor Stanley Johanson filed a nine-page amicus curiae letter brief with the Court. [A copy of the letter brief is attached to this Article as Appendix B.] Professor Johanson opened the brief with a quotation of his commentary from his own Johanson's Probate Code Annotated, § 116.002, p. 992 (2008). The quotation is Professor Johanson's opinion that, where a trust provides that "the trustee shall pay all trust income to my daughter for life," the "gift is of the income interest itself (and not the underlying assets that generate the income) ...." Professor Johanson wrote that under such a trust arrangement the income distributed by the trust was acquired by the married beneficiary by gift or devise and was therefore separate property. He cited as authority "*Wilmington Trust Co. v. United States*, 4 Ct. Cl. 6 (1983), *aff'd*, 753 F.2d 1055 (Fed. Cir. 1985) (extended discussion of Texas cases); *but see Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App--Corpus Christi 1997, no writ)." [Note that Professor Johanson sided with the opinion of the Court of Claims and against a Texas court of appeals' opinion on point. Note also that his assertion applies only to mandatory-distribution-of-income trusts.]

Professor Johanson argued that the husband did not have an interest in the trust principal because his power to "invade" and distribute principal to himself was "limited by an ascertainable standard relating to the health, support, or maintenance" as described in Internal Revenue Code Sections 2041(b) and 2514. The Professor called this a "HEMS" standard. With regard to both trusts, Professor Johanson says that husband as trustee did not have the power to distribute trust principal to himself "for his 'benefit'."

Professor Johanson called the court's attention to recently-enacted legislation in Texas (which he says he prompted), creating a HEMS standard by default if no standard was specified for making discretionary distributions to a beneficiary. [The law applies only to trusts created or becoming irrevocable after September 1, 2009, so it did not apply to the *Sharma v. Routh* case.]

Professor Johanson called the Court's attention to the "Spendthrift" provision in Texas Trust Code § 112.005. Under that statute, if a trustee can distribute trust principal to "herself" as beneficiary, spendthrift protection is lost unless the power of the trustee to distribute to herself is limited by a HEMS standard.

Professor Johanson also contrasted a HEMS standard exercisable "without regard to other resources available for such person" (quotation in original text), under which "very generous distributions could be made, most likely up to 65% of the beneficiary's gross income in the year of his former wife's death. With the two trusts in *Sharma v. Routh*, however, distribution could be made to the husband only when 'necessary', after taking into account "other funds reasonably available...from all other sources known to by Trustee." Professor Johanson suggested that, with husband receiving $1 million per year in interest income that was mandatorily distributed to him, husband could not justify making distributions of principal "without committing a breach of trust" with respect to the remainder beneficiary. Professor Johanson attributed the distribution of all principal payment from the Marital Trust to a mistake, subjecting husband to a suit to return it to the trust.

Professor Johanson noted that "sole discretion" is not absolute but is subject to court oversight measured by a reasonableness and good faith standard.

Professor Johanson disagreed with the Majority's conclusion that husband's interest in the trust principal was evidenced by the fact that the Marital Trust provided that any estate tax, levied on husband's estate due to the Marital Trust, would be paid out of the principal of the Marital Trust. Professor Johanson wrote that the estate tax was due based on the former wife's estate, but payment was deferred under the Internal Revenue Code, until husband's death.

Professor Johanson distinguished two cases cited in the Majority Opinion, *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ), and *Mercantile Nat.'l Bank v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.).

In *Long*, the beneficiary's right to part of the trust corpus had matured, and he was entitled to receive that part of the corpus. That did not exist in the *Sharma* case. In *Wilson*, the wife's trust was self-settled. Professor Johanson said "not surprisingly, you can't defeat the 'income from separate property is community property' rule by putting your separate property in a trust."

**g. The Final Majority Opinion.** Justice Frost's final Majority Opinion restated her original Dissenting opinion. She stated the controlling rule of law: "We hold that, when a spouse receives distributions of trust income under an irrevocable trust during marriage, the income distributions are community property only if the recipient has a present possessory right to part of the corpus" 302 S.W.3d at 357. Justice Frost restated the four possible rules listed in her previous Dissenting Opinion, and said: "We adopt Rule C." *Id*. at 364.

**h. The Final Concurring Opinion.** Chief Justice Hedges issued a Concurring Opinion. Perhaps reflecting the influence of Professor Johanson's amicus curiae letter brief, she treated the distributions of trust principal during marriage as improper handling of trust property, because no evidence suggested that the husband as trustee complied with the trust requirements that trust principal could be distributed only when needed for husband's health, support, or maintenance. Chief Justice Hedges continued to adhere to her rule that distributions of trust income are community property only if the recipient has an interest in the trust corpus. Chief Justice Hedges, thus, applying her own test, changed her mind and agreed that the income distributions were separate property.

**i. Take-Away from the Case.**

- Justice Frost (joined by Justice Guzman) adopted a narrow test that distributions of income from a testimentary trust are community property only if the beneficiary has a *present possessory right* to part of the corpus. Chief Justice Hedges adopted a broader rule that the distributed income is community property if the beneficiary has *an interest in* trust corpus.

- Justice Frost believed that the husband did not receive distributions of corpus. Chief Justice Hedges believe that principal payments on the trust notes were deposited into the husband's person accounts, but improperly, so that they were not truly distributions.

- Professor Johanson's argument that the HEMS standard was violated appears to have won over Chief Justice Hedges, even absent evidence on the point.

- Both final Opinions noted that husband was not the remainder beneficiary of either trust. That probably would not have mattered under Justice Frost's "present possessory right to part of the corpus" test, but it may have mattered under Chief Justice Hedges' "interest in the trust corpus" test.

- Justice Frost's view was dictated by the unambiguous language of the two trust instuments. Chief Justice Hedges' view was influenced by the facts, particularly (initially) that the husband deposited both principal and interest payments on the promissory notes in his personal account, reported the income on his personal tax return, and listed trust property on his personal financial statement. In the end however, the absence of evidence that the HEMS standard had been respected was treated by Chief Justice Hedges as an indication that the HEMS standard had been violated. This is an interesting assumption; one could argue that the presumption of community would have put the burden on the husband to prove that he had violated his duties as trustee owed to the remainder beneficiaries.

- Justice Frost accepted the view that income on trust corpus held pursuant to a testamentary trust, when distributed, is received by the beneficiary as a gift or inheritance.

- Justice Frost's discernment of previous trust cases as a unified body of law tends to minimize differences in the factual circumstances of prior cases. The wide variety of facts in trust cases makes it difficult to derive a consistent rule to apply in all future cases.

**j. Agreement from San Antonio.** The San Antonio Court of Appeals agreed with the *Sharma* rule that distributions from a testamentary or inter vivos trust to a married beneficiary are community property only if the recipient has a present possessory right to part of the corpus. *Benavides v. Mathis*, 433 S.W.3d 59, 63 (Tex. App.--San Antonio 2014, pet. denied).

**G. REVOCABLE TRUSTS.** While no Texas appellate opinions address the subject, there are reasons to consider the income on property held in a spouse's revocable trust to be community property. The settlor of a revocable trust has an interest in the property held in trust, in that s/he can reacquire the property at will. *Moon v. Lesikar* 230 S.W.3d 800, 804 (Tex. App.--Houston [14th District] 2007, pet. denied), held that a remainder beneficiary under a revocable trust has no standing to sue over the settlor's management of the revocable trust, since the beneficiary had no pecuniary interest in the revocable trust, but Justice Guzman concurred, arguing that standing existed but no claim existed. The El Paso Court of Appeals followed Justice Guzman's concurrence, in *Mayfield v. Peck*, 546 S.W.3d 253, 262 (Tex. App.--El Paso 2017, no pet.).

**H. REMAINDER INTERESTS.** Some trusts, like GSTs, go on for generations. Most Texas trust-related divorce appellate opinions to date deal with distributions made to a primary or life beneficiary, as opposed to a remainder beneficiary. What happens when the trust terminates while the beneficiary is married, and trust principal and accumulated undistributed income are conveyed to the beneficiary free of trust? *Currie v. Currie*, 518 S.W.2d 386, 389 (Tex. Civ. App.--San Antonio 1974, writ dismissed), held that a contingent beneficiary, who acceded to benefits upon the death of a life beneficiary, had no right to income or principal prior to accession. In *Dickinson v. Dickinson*, 324 S.W.3d 653, 658-59 (Tex. App.--Fort Worth 2010, no pet.), where the husband was a remainder beneficiary who would receive benefits after the death of his father and another person, the court held that the husband's remainder interest was received by devise and was his separate property.

# SHARMA v. ROUTH

No. 14-06-00717-CV.



*TIMOTHY L. SHARMA, Appellant, v. LISA C. ROUTH, Appellee.*

Court of Appeals of Texas, Fourteenth District, Houston.

Majority and Dissenting Opinions filed December 31, 2008.

## MAJORITY OPINION

ADELE HEDGES, Chief.

Appellant, Timothy L. Sharma, appeals the final decree of divorce entered by the trial court. In seven issues, Sharma challenges the trial court's characterization of income from two testamentary trusts created by Sharma's first wife, the division of the marital estate, the reliability of expert testimony, and the trial court's refusal to file additional findings of fact and conclusions of law. We affirm the trial court's judgment.

## I. FACTUAL BACKGROUND

Sharma and Routh were married on August 29, 2004. The couple separated months later, and their marriage was dissolved on January 26, 2006. In the final decree of divorce, the trial court characterized certain trust income as community property. The trust at issue was created by Sharma's first wife, Alice Hinniker Sharma ("Alice"). In her last will and testament, Alice created two trusts, the Marital Deduction Trust ("Marital Trust") and the Family Trust.

### A. The Marital Trust

Under the Marital Trust, Sharma is the trustee and beneficiary; Upward Reach Foundation, a charity created by Alice and Sharma, is named as the remainder beneficiary.[1] The Marital Trust provides for mandatory distributions of trust income to the beneficiary. The trust also provides for distributions from "trust principal . . . as are necessary . . . to provide for [Sharma's] health, support, and maintenance in order to maintain him . . . in accordance with the standard of living to which [he] is accustomed . . . ." At the time of Alice's death in July 2001, the Marital Trust owned two buildings that were psychiatric hospitals in Houston. The hospitals' services and other assets were owned by Cambridge International, Inc. and North Houston Enterprises, Inc. (companies owned by Alice and Sharma). In 2002, additional corpus was transferred into the Marital Trust. Specifically, the following pieces of corpus were added: (1) 6798 shares of common stock in Cambridge International; (2) an 86.25% interest in real estate located on Lake Houston (the "Lake Houston Property"); and (3) an 83.08% interest in real estate located on Earle Street in the Houston area (the "Earle Street Property").

### B. The Family Trust

The Family Trust also names Sharma as the trustee and beneficiary; the remainder beneficiary is again Upward Reach Foundation. The Family Trust provides for distributions from trust income and principal as necessary "to provide for [Sharma's] health, support and maintenance in order to maintain him . . . in accordance with the standard of living to which [he] is accustomed . . . ." The Family Trust's corpus initially consisted of 1272 shares of common stock in Cambridge International.

### C. Sale of Corpus in the Marital Trust

In early 2003, Sharma and his financial advisors created a plan to convert the two psychiatric hospitals into tax exempt hospitals, requiring that the hospitals be sold to a tax exempt entity. The two psychiatric hospitals were renamed Intracare and Intracare North. Sharma then created the Cambridge Health Foundation, the 501(c)(3) corporation that would acquire the two hospitals. [2] Sharma is on the board of trustees for Cambridge Health Foundation.

In December 2003, Sharma, acting as trustee to the Marital Trust, conveyed Intracare and Intracare North to Cambridge Health Foundation. The sale was financed by five promissory notes: one note was made payable to the Marital Trust, another to North Houston Enterprises, and three notes to Cambridge International. The first note was made payable to the Marital Trust for the real property on which the buildings were located (referred to hereinafter as the "MT building note"). The MT building note was in the amount of $30,115,000.00 and became corpus to the Marital Trust.

The second note was made payable to North Houston Enterprises in the amount of $1,127,494.00 for its ownership interest in Intracare North (the "Houston Enterprises note"). [3] The three remaining notes, totaling $5,814,475.00, were made to Cambridge International and were divided between the three co-owners of Cambridge International. A note in the amount of $3,952,680.10 was transferred to the Marital Trust (the "MT asset note"), which owned 6798 shares of Cambridge International common stock. A note in the amount of $1,122,193.68 was made payable to Cambridge International but was not transferred to the Marital Trust; instead, this note was subsequently transferred to Sharma for his ownership interest in Cambridge International. A note in the amount of $739,601.22 was transferred to the Family Trust (the "FT note"), which owned 1272 shares of common stock in Cambridge International. Subsequently, the principal and accrued interest on these notes were generally transferred to Sharma's personal account. [4]

### D. Divorce Proceedings

Shortly after the parties' separation in 2004, Sharma filed an original petition for dissolution of marriage. He initially obtained a default judgment against Routh. Routh, then, successfully moved for a new trial, and the trial court set aside the first decree. A trial on the merits commenced on October 10, 2005 and continued thereafter for 13 days. One of the primary issues at trial was the proper characterization and division of the interest accrued during the marriage on the Marital and Family trusts. At the time, the Marital Trust owned the MT building and MT asset notes. [5] The Family Trust owned the FT note. Both parties admitted and relied on expert testimony regarding the proper characterization of the trust interest income from the Marital and Family trusts.

On May 24, 2006, the trial court signed the final decree of divorce, dissolving the marriage. The trial court also characterized the accrued interest on the MT building, MT asset, and FT notes as community property. In its findings of fact and conclusions of law, the trial court specified the amount of interest accrued on the notes during the marriage. The MT building note had $2,096,067.00 in accrued interest, while the MT asset note had $175,996.00. The Houston Enterprises note accrued $50,146.00 in interest during the marriage, and the FT note had $32,955.00 in accrued interest. The trial court found the interest accrued during the marriage to be community property and awarded Routh 50% thereof.

### E. Issues on Appeal

Sharma raises seven issues on appeal. In issues one through four, Sharma challenges the trial court's characterization of the trust income as community property. [6] First, he contends that the trust income is his separate property because he is not a named remainder beneficiary, and therefore he is not entitled to receive trust principal. Second, Sharma argues that the "income from separate property is community property" rule is not controlling in this case because he did not own the property giving rise to the income. Third, Sharma claims that the interest is his separate property because he acquired it by gift or devise. Fourth, Sharma argues that the trial court's mischaracterization of the trust income constitutes reversible error. In his fifth issue, Sharma claims that the trial court erred by including the trust income as part of the marital estate absent a favorable finding on Routh's claims for reimbursement or fraud. In his sixth issue, Sharma contends that the testimony of Routh's expert, Jeannie McClure, was not reliable with respect to the proper characterization of the trust income. Lastly, Sharma alleges that the trial court erred in refusing to file additional findings of fact and conclusions of law after it made its initial findings.

## II. STANDARD OF REVIEW

We review the trial court's characterization of property under an abuse of discretion standard. *Murff v. Murff,* 615 S.W.2d 696, 698-99 (Tex. 1981); *Stavinoha v. Stavinoha,* 126 S.W.3d 604, 607-08 (Tex. App.-Houston [14th Dist.] 2004, no pet.). The issue of whether property is separate or community is determined by the facts that, according to rules of law, give character to the property. *Raymond v. Raymond,* 190 S.W.3d 77, 80 (Tex. App.-Houston [1st Dist.] 2005, no pet.). We may reverse the trial court only if, after reviewing the record, it is clear that the trial court's decision is an abuse of discretion or is manifestly unjust and unfair. *Stavinoha,* 126 S.W.3d at 607-08; *see also Sutton v. Eddy,* 828 S.W.2d 56, 58 (Tex. App.-San Antonio 1991, no writ) (stating that the record must affirmatively show that the trial court's decision is arbitrary and unreasonable).

Under this abuse of discretion standard, the legal and factual sufficiency of the evidence are not independent grounds for error, but are merely relevant factors in assessing whether an abuse of discretion has occurred. *Stavinoha,* 126 S.W.3d at 608. When a court mischaracterizes separate property as community property, the error requires reversal because the subsequent division divests a spouse of his or her separate property. *Smith v. Smith,* 22 S.W.3d 140, 147 (Tex. App.-Houston [14th Dist.] 2000, no pet.);*McElwee v. McElwee,* 911 S.W.2d 182, 189 (Tex. App.-Houston [1st Dist.] 1995, writ denied).

## III. CHARACTERIZATION OF TRUST INCOME

In Sharma's first four issues, he contends that the trial court abused its discretion by improperly characterizing the trust income as community property. According to Sharma, the trust income is his separate property because he has no interest in the trust corpus, and he acquired the interest by gift or devise.

### A. Definition of Separate and Community Property

In Texas, all marital property is either separate or community property. *Hilley v. Hilley,* 342 S.W.2d 565, 567 (Tex. 1961). Separate property is defined by the Texas Constitution as property acquired before marriage or during marriage by gift, devise, or descent. Tex. Const. art. XVI, § 15. Community property consists of property, other than separate property, acquired by either spouse during marriage. Tex. Fam. Code § 3.002; *Barnett v. Barnett,* 67 S.W.3d 107, 111 (Tex. 2001). There is a statutory presumption that all property possessed by either spouse during or on dissolution of marriage is community property. Tex. Fam. Code § 3.003(a); *Barnett,* 67 S.W.3d at 111. To overcome this statutory presumption, a spouse claiming assets as separate property is required to establish their separate character by clear and convincing evidence. Tex. Fam. Code § 3.003(b); *Stavinoha,* 126 S.W.3d at 607. "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; *In re J.F.C.,* 96 S.W.3d 256, 264 (Tex. 2002).

### B. Characterization of Trust Income

The property in question is trust income in the form of interest payments from the MT building, MT asset, and FT notes. Courts have articulated the following rule: if a married beneficiary has an interest in trust principal and receives income from the principal, the income is characterized as community property. *Ridgell v. Ridgell,* 960 S.W.2d 144, 148 (Tex. App.-Corpus Christi 1997, no pet.) (holding that trust income is community property where the spouse beneficiary maintains an interest in trust corpus); *In re Marriage of Long,* 542 S.W.2d 712, 718 (Tex. Civ. App.-Texarkana 1976, no writ) (concluding that income received on trust corpus is community property if married beneficiary is entitled to corpus); *Mercantile Nat'l Bank at Dallas v. Wilson,* 279 S.W.2d 650, 654 (Tex. Civ. App.-Dallas 1955, writ ref'd n.r.e.) (holding that income on trust corpus during the marriage is community property where spouse has interest in corpus); *c.f. Cleaver v. Cleaver,* 935 S.W.2d 491, 493-94 (Tex. App.-Tyler 1996, no pet.) (holding that trust income is separate property only where trust prohibits distributions from corpus). Thus, if the record reveals that Sharma (1) has an interest in the corpus and (2) received trust income, the interest is community property. [7] *See Ridgell,* 960 S.W.2d at 148; *Long,* 542 S.W.2d at 718; *Wilson,* 279 S.W.2d at 654.

### 1. Sharma Has an Interest in the Trust Corpus

There is undisputed evidence that Sharma has an interest in the trust corpus. Sharma's former CPA, Elizabeth Bunk, and bookkeeper, Valinda Allen, testified that all principal payments made to the Marital and Family trusts were directly transferred to Sharma's personal account until April 2005. Invading the corpus and depositing the principal payments into his personal account gave Sharma an interest in the corpus. [8] *See Ridgell,* 960 S.W.2d at 147 (stating that under a discretionary trust, a beneficiary is entitled to or has an interest in trust corpus when a distribution from the trust principal is made to the beneficiary); *see also Long,* 542 S.W.2d at 718 (reasoning that a spouse retains an interest in trust corpus if he physically or constructively receives a portion of the trust corpus). Alice's will created the two trusts for the benefit of Sharma with all income, and potentially all corpus, to be utilized for his benefit as determined to be appropriate exclusively by Sharma. By acquiring portions of the trust corpus, Sharma affected the relative interest of the remainder beneficiary. Although Upward Reach Foundation is named as a remainder beneficiary of the corpus remaining in the trust, if any, upon Sharma's death, the trust was created for the benefit of Sharma and contemplated that the entire trust, both income and principal, could be expended for Sharma's benefit, at his sole discretion.

The Marital Trust also requires that the trust pay from *principal* "the difference between all taxes which must be paid by reason of [Sharma's] death and those taxes which would be payable by reason of [Sharma's] death had such principal not been includ[ed] in his gross estate for the purpose of calculating such taxes." By its terms, the trust contemplated that the principal would be considered as part of Sharma's personal estate and required a mandatory distribution from trust principal for payment of Sharma's death taxes. Additionally, Sharma reported the principal payments as his personal income on his tax returns and on a financial report for a loan application. An interest in corpus arises when the spouse beneficiary is or becomes entitled to the corpus. *Ridgell,* 960 S.W.2d at 148. A spouse beneficiary, in the context of a discretionary trust, becomes entitled to trust corpus when a distribution from the principal is made to the spouse beneficiary. *Id.* at 147. Because Sharma invaded the corpus, possessed the corpus in his personal account, and later donated the corpus to his charity, we conclude that Sharma has an interest in the corpus of the Marital and Family trusts. [9]

### 2. Sharma Received Trust Income

There is also undisputed evidence that Sharma received income distributions from the trusts. The Marital Trust required mandatory distributions of trust income to Sharma. Because the interest payments were trust income, the interest had to be distributed to Sharma. The mandatory distribution provision limited all income distributions to Sharma, and thus the only manner in which the interest could have reached Cambridge Foundation was if Sharma donated the funds after the interest was mandatorily distributed to him. Likewise, the Family Trust provided that, during Sharma's lifetime, trust income could only be discretionarily distributed to Sharma. Based on the discretionary provision of the Family Trust, the interest could have only been distributed to Sharma. The only manner in which Cambridge Foundation could have received the interest from the Family Trust was if a discretionary distribution had been made first to Sharma. Pursuant to the terms of the two trusts, the only manner in which the interest could have reached Cambridge Foundation was through mandatory and discretionary distributions to Sharma.

The dissent sharply disputes the fact that distributions from trust corpus were made to Sharma because there was no explicit declaration of a distribution by Sharma. We cannot imagine what an "explicit declaration" could add to the evidence of distribution. Based on the undisputed facts supported by the record, the Cambridge donations can only be the result of a prior distribution from corpus to Sharma. The following facts are undisputed: (a) the only way the principal could be retrieved from the trusts was by way of a distribution; (b) Sharma was the only beneficiary allowed to receive a distribution from trust corpus during the relevant time period; and (c) Sharma donated trust corpus to Cambridge. To go from undisputed fact Ab" to undisputed fact Ac," Sharma had to make a distribution to himself. A distribution from trust principal could not be made directly to Cambridge. On these three undisputed facts, it is illogical to conclude that no distribution from corpus was made to Sharma.*See McDonald v. New York Cent. Mut. Fire Ins. Co.,* 380 S.W.2d 545, 547 (Tex. 1964) (an appellate court may logically infer facts from the evidence in the record);*Texas Dep't of Pub. Safety v. Segrest,* No. 03-02-00671-CV, 2003 WL 22348841, at *3 (Tex. App.-Austin Oct. 16, 2003, no pet.) (mem op.) (same); *Derouen v. State,* Nos. 14-98-

00632-CR, 14-98-00633-CR, 2000 WL 767757, at *3 (Tex. App.-Houston [14th Dist.] June 15, 2000, pet. ref'd) (not designated for publication) (reasoning that an appellate court may infer the existence of one fact from the proof of other related facts). Sharma also reported the interest payments as his personal income on his tax returns and on a financial report for a loan application. This evidence sufficiently shows that Sharma personally received the interest payments. Because Sharma has an interest in the corpus and made distributions from the corpus to himself, the income that rose from the corpus is community property. *See Ridgell,* 960 S.W.2d at 148; *Long,* 542 S.W.2d at 718; *Wilson,* 279 S.W.2d at 654. Accordingly, the trial court did not abuse its discretion in characterizing the interest payments as community property. We overrule Sharma's first, second, and fourth issues.

### C. Sharma Did Not A Constructively Receive" the Income

We find Sharma's "constructive receipt" argument, effectually adopted by the dissent, unpersuasive. Sharma contends that the interest was earmarked for subsequent charitable donation and that his receipt of the funds was a mere "constructive distribution." However, the fact that Sharma may have intended to receive the funds and subsequently donate them to a third party does not change the character of the property. *See Long,* 542 S.W.2d at 718 (holding that a spouse's physical or constructive receipt of distribution on trust corpus is community property). Sharma and the dissent cite no authority allowing for an intended charitable commitment to redefine community property as separate property. Once the distributions were made to Sharma individually and as the beneficiary, the funds became community property.*See id.*

Although the dissent denies advocating Sharma's constructive receipt argument, it effectually adopts the argument in its reasoning. Our dissenting colleague argues that Sharma's accounting team made clerical errors in depositing the trust distributions into Sharma's account for over a year. The dissent's "clerical error proposition" allows a spouse's reinvestment or donation of community property to be recharacterized as separate property. The dissent cites to no authority to support this theory. We also not persuaded by this "clerical error proposition" because Allen testified that Sharma made sure that all principal payments were deposited into his personal account. The record reflects that there was no clerical error by the accounting team; they were acting exclusively at the direction of Sharma.

### D. The Interest Payments Were Not Acquired by Gift or Devise

Sharma also argues that he acquired the interest by gift or devise, rendering it his separate property. The Texas Constitution clearly defines separate property as property acquired before marriage or during marriage by gift, devise, or descent. Tex. Const. art. XVI, § 15; *see also Arnold v. Leonard,* 114 Tex. 535, 542, 273 S.W. 799, 803 (1925) (enunciating the general definition of separate property: property acquired before marriage or during marriage by gift, devise, or descent). However, if property does not fit within this definition of separate property, the property is characterized as community property. *See* Tex. Fam. Code § 3.002. Courts have interpreted property that does not necessarily fit within the definition of separate property as community property. *See Smith v. Lanier,* 998 S.W.2d 324, 332 (Tex. App.-Austin 1999, pet. denied) (cash dividends on separately held stock are community property); *McElwee,* 911 S.W.2d at 188-89 (rental payments, crops, and timber arising from separate property are community property); *Gutierrez v. Gutierrez,* 791 S.W.2d 659, 664-65 (Tex. App.-San Antonio 1990, no writ) (offspring born from separate property cattle during marriage is community property); *Harris v. Harris,* 765 S.W.2d 798, 802 (Tex. App.-Houston [14th Dist.] 1989, writ denied) (profit-sharing distributions on separate property are community property). Courts have further interpreted income from trust corpus, identical to the disputed property in the instant case, to be community property. *See Ridgell,* 960 S.W.2d at 148; *Long,* 542 S.W.2d at 718; *Wilson,* 279 S.W.2d at 654.

There is not "clear and convincing" evidence that Sharma acquired the interest payments prior to marriage or during marriage by gift, devise, or descent. Because we cannot expand the definition of separate property beyond what the Texas Constitution provides and courts have interpreted income from trust corpus as community property, the disputed property in this case cannot be characterized as separate property. Sharma has failed to rebut the statutory presumption that the interest payments, received during marriage, are community property. *See* Tex. Fam. Code § 3.003(b); *Stavinoha,* 126 S.W.3d at 607; *see also Ridgell,* 960 S.W.2d at 148; *Long,* 542 S.W.2d at 718.

## IV. REIMBURSEMENT

In Sharma's fifth issue, he contends that the trial court erred by including the trust income in the overall value of the community estate. Specifically, Sharma argues that while the trial court denied all reimbursement claims, it implicitly reimbursed the community estate with the trust income. Sharma argues that the only manner in which the interest could have been awarded to Routh was reimbursement because the interest was "nonexistent" at the time of trial. According to Sharma, the trial court's reimbursement resulted in an improper division of the marital estate. We disagree.

A trial court has wide discretion in awarding a spouse his or her share of community property, including reimbursement and economic contribution. *See Zieba v. Martin,* 928 S.W.2d 782, 789-90 (Tex. App.-Houston [14th Dist.] 1996, no writ) (op. on reh'g); *see generally Jensen v. Jensen,* 665 S.W.2d 107 (Tex. 1984). A money judgment is a distinct remedy, exclusive of reimbursement, that may be used by the trial court for the wronged spouse to recoup the value of his or her share of community property. *See Schlueter v. Schlueter,* 975 S.W.2d 584, 588-89 (Tex. 1998); *see also Murff,* 615 S.W.2d at 699 (allowing money judgment against husband in division of community property where he had substantial sums in savings before separation that had disappeared by the time of trial). Contrary to Sharma's assertions, the trial court in this case did not reimburse the community estate with the value of the trust income. Instead, the trial court awarded Routh a money judgment that directly refers to the specific amount of lost community property, i.e., her community share of the trust income.

As discussed above, the trial court properly characterized the trust income as community property. Thereafter, the trial court was entitled to award Routh, by way of a money judgment, her share of the trust income that was wrongfully depleted by Sharma. [10] Accordingly, we conclude that the trial court did not abuse its discretion in awarding a money judgment to Routh for the value of her share of the trust income.*See Schlueter*, 975 S.W.2d at 588-89. We overrule Sharma's fifth issue.

## V. RELIABILITY OF EXPERT TESTIMONY

In his sixth issue, Sharma argues that the expert testimony of Jeannie McClure is not reliable. Jeannie McClure, a licensed CPA and expert witness for Routh, testified that the trust income was community property. On appeal, Sharma challenges the admissibility of and the weight to be given to McClure's expert testimony.

Sharma's admissibility challenge essentially attacks the factual sufficiency of the evidence with respect to the proper characterization of the trust income. As discussed above, there is sufficient evidence that the trust income was properly characterized as community property. Furthermore, Sharma has waived his admissibility challenge because he stipulated to the admissibility of McClure's expert testimony. To preserve error for appellate review, the complaining party generally must object to the complained-of evidence. *See* Tex. R. App. P. 33.1(a) (providing that as a prerequisite for presenting a complaint for appellate review, a party must have raised the complaint in the trial court by a timely and sufficiently specific request, objection, or motion). The record reflects that Sharma lodged no admissibility objections to McClure's expert testimony on assessing the value of the estates, characterizing community assets and separate property, and assessing the reimbursement claims. We find that Sharma has not preserved his admissibility complaint for our review. *See id.*

As to Sharma's challenge on the weight to be given to McClure's testimony, we, as an appellate court, are prohibited from making credibility determinations. *See Ulmer v. Ulmer,* 130 S.W.3d 294, 300 (Tex. App.-Houston [14th Dist.] 2004, no pet.). The trier of fact is the sole judge of witnesses' credibility and the weight to be given their testimony. *See id.* We decline Sharma's invitation to re-weigh McClure's expert testimony.

We overrule Sharma's sixth issue.

## VI. REQUEST FOR ADDITIONAL

## FINDINGS OF FACT AND CONCLUSIONS OF LAW

In issue seven, Sharma argues that the trial court erred when it failed to issue additional findings of fact and conclusions of law. On July 3, 2005, the trial court issued findings of fact and conclusions of law. In these original findings, the trial court found that the interest and earnings were community property and granted each party a 50% interest in the community estate. The trial court also denied all reimbursement claims. Thereafter, Sharma filed a request for additional findings of fact and conclusions of law, but the trial court never granted his request. In the request for additional findings, Sharma asked the trial court to add facts surrounding the formation of the Marital and Family trusts, to add the terms of the two trusts in its findings, and to specify whether Sharma acquired the trust income by constructive or actual receipt. Sharma further requested that certain findings of fact be converted to conclusions of law.

A trial court is required to file findings of fact and conclusions of law within twenty days after a timely request is made. Tex. R. Civ. P. 297. Upon a party's timely request for additional findings, the trial court "shall file any additional or amended findings and conclusions that are appropriate." Tex. R. Civ. P. 298. Additional findings are not required if the original findings and conclusions "properly and succinctly relate the ultimate findings of fact and law necessary to apprise [the party] of adequate information for the preparation of [the party's] appeal." *In re R.D.Y.,* 51 S.W.3d 314, 322 (Tex. App.-Houston [1st Dist.] 2001, pet. denied). An ultimate fact is one that would have a direct effect on the judgment. *Jamestown Partners, L.P. v. City of Fort Worth,* 83 S.W.3d 376, 386 (Tex. App.-Fort Worth 2002, pet. denied). Thus, Sharma must show that the trial court's refusal to file the requested additional findings caused the rendition of an improper judgment. *See Johnston v. McKinney Am., Inc.,* 9 S.W.3d 271, 277 (Tex. App.-Houston [14th Dist.] 1999, pet. denied). If the refusal to file additional findings did not prevent Sharma from adequately presenting his argument on appeal, there is no reversible error. *See In re R.D.Y.,* 51 S.W.3d at 322.

We find that Sharma was able to adequately brief his appeal to this court without the issuance of additional findings. The original findings were sufficient for Sharma to adequately present his case on appeal to this court. The findings of fact and conclusions of law are comprised of his factual and legal arguments which the trial court rejected. The requested additional findings would not cause the rendition of a different judgment. Because Sharma has not established that the trial court's refusal to make the requested additional findings and conclusions prevented him from adequately presenting his case on appeal, we overrule his seventh issue.

## CONCLUSION

We hold that the trial court properly characterized the trust income as community property. Further, the trial court did not abuse its discretion in awarding Routh a money judgment for her share of the trust income. We affirm the trial court's judgment.

## DISSENTING OPINION

KEM THOMPSON FROST, Justice.

This is an appeal from a divorce decree in which the husband, appellant Timothy L. Sharma, asserts that the trial court reversibly erred by characterizing distributions from two testamentary trusts as community property and awarding half of those distributions to his wife, appellee Lisa C. Routh, rather than awarding all of the distributions to him as his separate property. In the context of a spouse who receives distributions of trust income under an irrevocable trust during marriage, case law indicates that the income distributions are community property if the receiving spouse owns the trust corpus but that the distributions are separate property if the receiving spouse does not own the trust corpus. Neither the Texas Supreme Court nor this court has decided what the legal standard should be for determining whether the receiving spouse owns the trust corpus. Today this court holds that the receiving spouse need only have "an interest in the corpus" and then holds that the husband who received the distributions has such an interest under the facts of this case. Rather than adopting this vague "interest in the corpus" legal standard, this court instead should hold that such income distributions are community property only if the recipient has a present possessory right to part of the corpus. Under either legal standard, however, this court should hold that the trial court reversibly erred by characterizing the trust income as community property. The trial evidence conclusively proved that the distributions in question are separate property because the husband acquired title to them by devise or gift during marriage. Therefore, after affirming the trial court's grant of divorce and dissolution of the marriage, this court should sever the remainder of the decree, and reverse and remand.

## THE LEGAL STANDARD

In the context of a spouse who receives a distribution of trust income under an irrevocable trust during marriage, case law indicates that the income distribution is community property if the receiving spouse owns the trust corpus but is separate property if the receiving spouse does not own the trust corpus. No case from the Texas Supreme Court or this court identifies the legal standard for determining whether the receiving spouse "owns" the trust corpus. The majority holds that the receiving spouse need only have "an interest in the corpus." [1] The cases upon which the majority relies do not support the majority's legal standard. [2]

The majority relies on *Ridgell v. Ridgell,* a case in which the Corpus Christi Court of Appeals held that mandatory distributions of income from two testamentary trusts to the wife were community property. *See* 960 S.W.2d 144, 147-50 (Tex. App.-Corpus Christi 1997, no pet.). However, the *Ridgell* court did not hold that the legal standard is whether the receiving spouse has an interest in the corpus; rather, the *Ridgell* court focused on whether the receiving spouse "is entitled, or becomes entitled" to distributions of trust corpus during the marriage. *Id.* at 148. In *Ridgell,* the testamentary trusts mandated that the trustee make annual distributions of trust corpus to the receiving spouse throughout the time period during which she was married and receiving distributions of trust income. *See id.* at 146-50. In the instant case, the trust instruments give Timothy no present possessory right to receive distributions of trust corpus. Under the *Ridgell* legal standard, Timothy is not entitled to any trust corpus and therefore, the income distributions are separate property. *See id.* For this reason, the *Ridgell* case does not support either the majority's adopted legal standard or the result reached in the majority opinion.

Likewise, the Texarkana Court of Appeals in *Long* did not hold that the legal standard is whether the receiving spouse has an interest in the corpus; rather, the *Long* court focused on whether the receiving spouse "is entitled" to distributions of trust corpus during the marriage and whether the spouse has "a present possessory interest" in part of the trust corpus. *See In re Marriage of Long,* 542 S.W.2d 712, 717-18 (Tex. Civ. App.-Texarkana 1976, no writ). Because the receiving spouse in*Long* had a present possessory right to half of the trust corpus under the mandatory language of the trust, the *Long* court held that half of the corpus would be treated as the husband's separate property and the accrued income on that half of the corpus would be treated as community property, even though the husband had told the trustee to leave that half of the corpus in the trust. *See id.* Under the *Long* legal standard, Timothy is not entitled to any trust corpus and therefore, the income distributions are separate property. *See id.* The *Long* case does not support either the majority's legal standard or the result reached in the majority opinion. [3]

As explained more fully below, this court should hold that, when a spouse receives distributions of trust income under an irrevocable trust during marriage, the income distributions are community property only if the recipient has a present possessory right to part of the trust corpus.

### *The rationale for this court's holding is not clear.*

The majority does not explain what is necessary for the receiving spouse to have "an interest in the corpus." In part of its opinion, the majority states that it is sufficient if the receiving spouse, who is also the trustee, for more than one year deposits payments that were part of the trust corpus into his personal bank account. [4] In other parts of the opinion, the majority indicates that the trustee also must have made distributions from the corpus to himself in his capacity as a trust beneficiary. [5] If the latter is required, then, as discussed below, there is no evidence that Timothy declared and made a distribution of trust corpus to himself as beneficiary. If the former is all that is necessary, then the majority concludes that Timothy, who also was the trustee, has an interest in the trust corpus because for more than one year payments that were part of the trust corpus were deposited into his personal bank account. In the majority opinion, the court holds that this action gives Timothy "an interest in the corpus" even though

> • Timothy had no interest in the remainder of the trust;
>
> • Timothy was entitled to exercise control over the trust corpus in his capacity as trustee;
>
> • No evidence demonstrates that Timothy, as trustee, declared a distribution of trust corpus;
>
> • No evidence reflects that Timothy determined that the condition precedent mandated by the trust instruments for such a distribution had been satisfied;
>
> • Evidence indicates that the depositing of trust corpus into Timothy's personal bank account was done by Timothy's staff in error;6 and
>
> • The depositing of these payments into Timothy's personal account ceased and Timothy then had a reconciliation performed, after which he returned the trust corpus to separate accounts for both of the trusts.

Even under the majority's adopted legal standard (whether Timothy had an "interest in the corpus" during the marriage), the plain meaning of the trust instruments and the trial evidence prove as a matter of law that Timothy had no such interest. A trustee's depositing of trust corpus into his personal bank account, even if imprudent or wrongful, does not in and of itself withdraw the property from the corpus and constitute a distribution of corpus to any trust beneficiary, including the trustee in his personal capacity. The depositing of trust corpus into Timothy's personal account did not confer upon him an interest in the corpus. Therefore, even applying the standard the court adopts today, the trial court erred in characterizing the trust income and the majority errs in analyzing the issue. A better approach is outlined below following an overview of the relevant facts. [7]

## OVERVIEW OF FACTS RELEVANT TO CHARACTERIZATION OF THE TRUST INCOME

Timothy and Lisa were married in August 2004. A few months later, Timothy filed for divorce. Soon thereafter, the couple separated and ceased living together as husband and wife. After a lengthy bench trial, in January 2006, the trial court signed a decree ending the parties' brief marriage.

### *Husband's Prior Marriage and Rights to Trust Property*

Before his marriage to Lisa, Timothy was married to Alice Hiniker Sharma from 1982 until Alice's death in 2001. Under Alice's will, two trusts were created: the Alice Hiniker Sharma Marital Trust (hereinafter "Marital Trust") and the Alice Hiniker Sharma Family Trust (hereinafter "Family Trust"). Timothy is the trustee of both the Marital Trust and the Family Trust. Alice's will requires that the net income of the Marital Trust be distributed to Timothy at least quarterly. Likewise, under certain circumstances and to a specified extent, the trustee of the Family Trust is required to distribute income or principal to Timothy from the Family Trust.

While married to Alice, Timothy, who is a psychiatrist, built up and developed psychiatric hospitals in the Houston area. In 2002, the Marital Trust was initially funded with two psychiatric hospitals, realty, and shares of common stock in Cambridge International, Inc. ("International"), with a total stated value of more than $39 million. The Family Trust was initially funded only with shares of International common stock.

In 2003, Timothy, as trustee of the Martial Trust, sold the realty and improvements for the two hospitals to a nonprofit organization now known as the Cambridge Health Foundation [8] (hereinafter "Cambridge Foundation") in exchange for a promissory note in the original principal amount of $30,115,000 (hereinafter "Building Note"). As a result of its ownership of International stock, the Marital Trust also received a promissory note in the original principal amount of $3,952,680.10; the maker of the note is Intracare Hospital (hereinafter "Intracare Note"). As a result of its ownership of International stock, the Family Trust received a promissory note in the original principal amount of $739,601.22; the maker of the note is Intracare Hospital (hereinafter "Family Trust Note"). [9] Following a complex set of transactions in December 2003, two nonprofit organizations, Intracare Hospital and Intracare Hospital North, began operating the two psychiatric hospitals. The Cambridge Foundation owns the land and buildings for these two hospitals.

The Building Note, the Intracare Note, and the Family Trust Note (hereinafter collectively the "Notes") all provide for periodic payments of principal and interest. The interest portion of the payments on the Building Note and the Intracare Note is income to the Marital Trust, which, under Alice's will, must be distributed to Timothy. The record reflects that Timothy also received distributions of income from the Family Trust. However, at all material times since the execution of the Notes on December 31, 2003, Timothy has donated the income distributions (not principal or trust corpus, as stated by the majority [10] ) from both trusts to the Cambridge Foundation without taking actual receipt of any money. [11] Timothy reported these distributions as income on his personal income tax return and claimed a charitable deduction for his donation of these distributions. [12] The record contains no evidence that Timothy received distributions of trust corpus from the Marital Trust or the Family Trust. [13]

## *Trial Court Proceedings*

After a lengthy bench trial involving extensive testimony and trial exhibits, the trial judge signed an order on January 26, 2006. In this order, the trial court granted the parties a divorce and, among other things, made the following determinations:

> • The corpus of the Marital Trust is Timothy's separate property.
>
> • Because interest received on separate property is community property, the interest on the corpus of the Marital Trust is community property.
>
> • Lisa is entitled to fifty percent of the interest that accrued on the Building Note and the Intracare Note during the marriageCfrom August 29, 2004 through January 26, 2006.

In the order, the trial court did not specifically mention the Family Trust, but it indicated that it also was awarding Lisa half of the interest that accrued on the Family Trust Note during the marriage. This order did not contain all the necessary information for a property division and a final decree; therefore, further proceedings in the trial court were required. Following these proceedings, Timothy and Lisa agreed that, from the date of their marriage (August 29, 2004) through the date of their divorce (January 26, 2006), $2,096,067 in interest accrued on the Building Note and $175,996 in interest accrued on the Intracare Note. The sum of these two amounts is $2,272,063 (hereinafter collectively "Marital Trust Income"). The parties also agreed that, during the same period, $32,955 in interest accrued on the Family Trust Note (hereinafter "Family Trust Income"). The trial court signed a final decree and issued findings of fact and conclusions of law. The trial court found that a just and right division of the community estate having due regard for each party's rights would be to award each party fifty percent of the community estate. The trial court determined that the total community estate, including the Marital Trust Income and the Family Trust Income, had a value of $3,872,924.23. The trial court awarded Lisa one-half of this amount to equalize the division of the estate. The trial court rendered judgment in favor of Lisa and against Timothy in the amount of $1,936,462.12, plus interest. The trial court denied all parties' claims for reimbursement or economic contribution. [14]

## *Analysis of Appellate Issues*

Timothy challenges the trial court's division of property, asserting, inter alia, that the trial court erred by characterizing the Marital Trust Income and the Family Trust Income as community property rather than as Timothy's separate property. Timothy asserts that this income is his separate property because he acquired it by devise or gift, and that the trial court erred by awarding half of this income to Lisa.

In a divorce decree, the trial court "shall order a division of the estate of the parties in a manner that the court deems just and right, having due regard for the rights of each party and any children of the marriage." TEX. FAM. CODE ANN. § 7.001 (Vernon 2006). To convince this court to disturb the trial court's division of property, Timothy must show the trial court clearly abused its discretion by a division or an order that is manifestly unjust and unfair. *See Stavinoha v. Stavinoha,* 126 S.W.3d 604, 607 (Tex. App.-Houston [14th Dist.] 2004, no pet.). Under this standard, the legal and factual sufficiency of the evidence are not independent grounds of error, but they are relevant factors in assessing whether the trial court abused its discretion. *Id.* at 608. If the trial court mischaracterizes a spouse's separate property as community property and awards some of it to the other spouse, then the trial court abuses its discretion and reversibly errs. [15]

All property possessed by either spouse during or on dissolution of marriage is presumed to be community property. TEX. FAM. CODE ANN. § 3.003(a) (Vernon 2006). The burden of overcoming the presumption of community property is on the party asserting otherwise by clear and convincing evidence. *Id.* § 3.003(b). "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. *In re J.F.C.,* 96 S.W.3d 256, 264 (Tex. 2002). Whether property is separate or community is determined by its character at the inception of the party's title. *Barnett v. Barnett,* 67 S.W.3d 107, 111 (Tex. 2001). Inception of title occurs when a party first has a claim of right to the property by virtue of when title is ultimately vested. *Smith v. Smith,* 22 S.W.3d 140, 145 (Tex. App.-Houston [14th Dist.] 2000, no pet.).

In the Texas Constitution, the people of Texas have proclaimed:

> All property, both real and personal, of a spouse owned or claimed before marriage, and that acquired afterward by gift, devise or descent, shall be the separate property of that spouse; and laws shall be passed more clearly defining the rights of the spouses, in relation to separate and community property . . . .

TEX. CONST. art. XVI, § 15. In the Texas Family Code, the legislature restates this definition of "separate property" from the Texas Constitution, and it then states that "community property consists of the property, other than separate property, acquired by either spouse during marriage." Tex. Fam. Code Ann. § 3.002 (Vernon 2006). In interpreting the Texas Constitution, Texas courts rely heavily on the literal text and must give effect to its plain language. *Republican Party of Texas v. Dietz,* 940 S.W.2d 86, 89 (Tex. 1997); *Arnold v. Leonard,* 273 S.W. 799, 801-03 (Tex. 1925) (stating that a court's duty is to give effect to the will of the people of Texas, as expressed by the plain meaning of the Texas Constitution). Basing its analysis on the plain meaning of the constitutional text, the Supreme Court of Texas has reasoned that, as to property a spouse acquires during marriage, if the spouse acquires the property by gift, devise, or descent, then the property belongs to the spouse's separate estate, but if the property is acquired in any other manner, then the property belongs to the community estate. *See Arnold,* 273 S.W. at 801-03. Decades ago in *Arnold,* our high court concluded that rents and revenues acquired during marriage based on a spouse's ownership of separate realty were not acquired by gift, devise, or descent and therefore were community property. *See id.* The *Arnold* court held unconstitutional a statute in which the legislature attempted to make such property part of the spouse's separate estate. *See id.* at 803-05. The high court indicated that rents and revenues were acquired at the time they came into existence rather than when a spouse received the property that generated the rents and revenues. *See id.* The *Arnold* case did not involve trust income or a devise or gift of income. *See id.*

### *The evidence proves, as a matter of law, that the husband acquired the marital trust income by devise or gift so that this income is his separate property.*

Under the unambiguous language of Alice's will, Alice required the trustee of the Marital Trust to distribute the Marital Trust Income to Timothy. [16] A devise is "the act of giving property by will." Black'S LAW DICTIONARY 483 (8th ed. 2004). Timothy acquired the Marital Trust Income because in Alice's will she required that this income be distributed to him. Under the unambiguous meaning of "acquired . . . by . . . devise" and under the unambiguous language of Alice's will, Timothy acquired the Marital Trust Income by devise.

Courts have held that distributions from testamentary or *inter vivos* trusts to married recipients who have no right to the trust corpus are the separate property of the recipient because these distributions are received by gift or devise. [17] *See Cleaver v. Cleaver,* 935 S.W.2d 491, 492-94 (Tex. App.-Tyler 1996, no pet.); *Wilmington Trust Co. v. United States,* 4 Cl. Ct. 6, 14 (1983) (applying Texas law), *aff'd,* 753 F.2d 1055 (Fed. Cir. 1985). However, though the *Arnold* case did not involve trust income or a devise or gift of income, the *Arnold* court suggested that, if a spouse owns the property that generates income during the marriage, then the income results from the ownership of the property rather than any gift or devise that may have bestowed the income-generating property on the spouse in the past. *See Arnold,* 273 S.W. at 803-05. Consequently, for the Marital Trust Income to constitute separate property, it appears that Timothy must not have owned the property that generated the income. *See id.* In the context of a distribution of trust income under an irrevocable trust during marriage, there are at least four possible rules that could be adopted:

> (a) Income distributions are always community property, even if the recipient has no right to the corpus of the trust, because the recipient's right to receive the income means that the recipient is a trust beneficiary and effectively an owner of the trust corpus (hereinafter Rule A).
>
> (b) Income distributions are community property only if the recipient has some potential right to the corpus, even if the right has not yet become a possessory right, because the recipient's potential right to access the corpus means that the recipient is effectively an owner of the trust corpus (hereinafter Rule B).
>
> (c) Income distributions are community property only if the recipient has a present possessory right to part of the corpus, even if the recipient has chosen not to exercise that right, because the recipient's possessory right to access the corpus means that the recipient is effectively an owner of the trust corpus (hereinafter Rule C).
>
> (d) Income distributions are community property only if the recipient has exercised a possessory right to part of the corpus, because the recipient's exercise of this possessory right means that the recipient is effectively an owner of the trust corpus (hereinafter Rule D).

Because there are no decisions by the Texas Supreme Court or this court that specifically address this issue, this court must determine which rule to apply. [18]

Texas courts have addressed similar issues using a variety of approaches. In *Ridgell v. Ridgell,* the court held that mandatory distributions of income from two trusts to the wife were community property, using an analysis that supports Rule C. [19] In *Ridgell,* as to both of these trusts, the wife either had received or had a present possessory right to receive mandatory distributions of corpus beginning in the year in which she was married. [20]

In *McClelland v. McClelland,* the husband was a beneficiary under his father's testamentary trust. 37 S.W. 350, 354-56 (Tex. Civ. App. 1896, writ ref'd). Upon the husband's death, the trust would end and the assets would be distributed to the father's heirs at law. Though he had no interest in the remainder of the trust, the husband was entitled to a mandatory monthly distribution of $100 while he was unmarried and $150 while he was married. *See id.* In addition, if the trustee determined that the husband was "provident and careful," then the trustee had discretion to make additional distributions to the husband. *See id.* at 356. The trustee did not make any discretionary distributions to the husband, but the trustee did make the monthly distributions of $150 during marriage. *See id.* at 357. In *McClelland,* the trial court granted the wife a divorce from the husband and ruled as a matter of law that all trust income that had accrued during marriage was community property. *See id.* at 358. The court of appeals concluded that (1) this income was separate property as a matter of law, and (2) except as to the monthly distributions, husband had no possessory right to access the income on the trust corpus and therefore, the husband had not acquired this property during marriage. *See id.* at 358-59. As to the monthly distributions that the husband acquired during marriage, the court of appeals concluded that these distributions were the husband's separate property because he acquired them by devise. [21] *See id.* The holding in the *McClelland* case supports Rule C and is contrary to Rule A and Rule B. [22]

Various other courts of appeals have indicated disapproval of Rule D and have concluded that, if a spouse has a present possessory right to trust income or corpus but the spouse elects not to receive it, then that spouse should be treated as having acquired title to the corpus or income as separate property to the extent they are entitled to receive it. *See Cleaver,* 935 S.W.2d at 492-94; *In re Marriage of Long,* 542 S.W.2d at 717-18. This reasoning is sound. For this reason, Rule D should be rejected.

In adopting a legal standard, it is important to select a rule that not only honors the text and spirit of the Texas Constitution and the principles emphasized by the Texas Supreme Court but also makes it easy to clearly distinguish community property from separate property. By adopting precise standards, the courts promote consistency, uniformity, fairness, and predictability in our jurisprudence. [23] Given the plain meaning of article XVI, section 15 of the Texas Constitution ("Section 15") and the applicable sections of the Family Code, as well as the cases discussed above, this court should adopt Rule C. In the context of a distribution of trust income under an irrevocable trust during marriage, income distributions should be characterized as community property only if the recipient has a present possessory right to part of the corpus, even if the recipient has chosen not to exercise that right, because the recipient's possessory right to access the corpus means that the recipient is effectively an owner of the trust corpus. [24]

The unambiguous language of Alice's will and the trial evidence prove the following as a matter of law:

> • The Marital Trust is an irrevocable, testamentary trust.
>
> • The trustee of the Marital Trust must distribute the income on the corpus of the Marital Trust to Timothy, at least quarterly.
>
> • Under Alice's will, Timothy has no interest in the remainder of the Marital Trust, which expires upon his death.25
>
> • The only potential right that Timothy has to access the corpus of the Marital Trust is the will's requirement that the trustee of the Marital Trust distribute such amounts of trust principal to [Timothy] as are necessary, when added to the funds reasonably available to [Timothy] from all other sources known to my Trustee (excluding the Article VI trust property), to provide for [Timothy's] health, support and maintenance in order to maintain him, to the extent reasonably possible, in accordance with the standard of living to which [Timothy] is accustomed at the time of [Alice's] death (hereinafter Support Provision).
>
> • At the time the trial court granted divorce on January 26, 2006, Timothy had not received any distributions of any part of the corpus of the Marital Trust.26
>
> • At no time during his marriage to Lisa did Timothy have a present possessory right to any part of the corpus of the Marital Trust.27

Under the unambiguous meaning of Section 15 and of Alice's will, Timothy acquired the Marital Trust Income by devise. [28] *See Arnold,* 273 S.W. at 801-03; *McClelland,* 37 S.W. at 358-59; BLACK'S LAW DICTIONARY 483 (8th ed. 2004). Because Timothy had no present, possessory right to any part of the Marital Trust corpus, the court should hold that Timothy was not effectively an owner of the trust corpus during his marriage to Lisa, and the Marital Trust Income, as a matter of law, is not community property. [29] *See McClelland,* 37 S.W. at 358-59.

Lisa argues that, if an income beneficiary is also the trustee, then, because the trustee holds legal title and right to control the trust corpus, the trustee/beneficiary must be deemed the owner of the trust corpus for purposes of characterizing the trust income. Lisa cites language from the *Wilmington Trust Co.* case, in which the court states that the income beneficiary was not the trustee and therefore lacked the right to possess and control the trust corpus. *See* 4 Cl. Ct. at 14. The *Wilmington Trust Co.* court noted that the income beneficiary was not the trustee; however, the court, in concluding that the income distributions were separate property, also noted and strongly emphasized that the income beneficiary had no right to access the trust corpus. *See id.* at 8-14. The *Wilmington Trust Co.* court did not need to decide whether an income beneficiary's service as trustee would be a controlling factor in the marital-property characterization of the trust income. [30]

In her trial court pleadings, Lisa did not allege, and Lisa does not assert on appeal, that the trusts were created, funded, or operated in fraud of her rights, nor has she pleaded that the trusts should be disregarded or that the trusts are Timothy's alter egos. [31] *See Lemke v. Lemke,* 929 S.W.2d 662, 664 (Tex. App.-Fort Worth 1996, writ denied). Timothy may serve as trustee even though he is one of the beneficiaries under the trusts. *See* Tex. Prop. Code Ann. § 112.008(b) (Vernon 2006). However, Timothy, as trustee of the trusts, holds bare legal title and the right to possession of trust assets. *Burns v. Miller, Hiersche, Martens & Hayward, P.C.,* 948 S.W.2d 317, 322 (Tex. App.-Dallas 1997, writ denied). Therefore, the fact that an income beneficiary also holds legal title to the corpus in his capacity as trustee should not be a controlling factor in the marital-property characterization of the trust income. [32]

For the foregoing reasons, this court should hold that the trial court reversibly erred in characterizing the Marital Trust Income as community property rather than Timothy's separate property and by awarding part of this property to Lisa. [33]

### *The evidence proves, as a matter of law, that the husband acquired the Family Trust Income by devise or gift so that this income is his separate property.*

The trial evidence shows that Timothy also received distributions of income from the Family Trust. These distributions were significantly smaller than the income distributions from the Marital Trust. The record contains no evidence that trust corpus has been distributed. The trial court concluded that $32,955 in community property was attributable to income from the Family Trust Note. Timothy asserts that the trial court erred as matter of law and should have characterized this income as his separate property. The unambiguous language of Alice's will and the trial evidence prove the following as a matter of law:

> • The Family Trust is an irrevocable, testamentary trust.
>
> • Under Alice's will, Timothy has no interest in the remainder of the Family Trust, which expires upon his death.34
>
> • The only potential right that Timothy has to access the corpus of the Family Trust is the will's requirement that the trustee of the Family Trust distribute such amounts of income and principal as shall be necessary for Timothy's support and maintenance as determined by a standard substantially similar to the Support Provision of the Marital Trust.35
>
> • At the time the trial court granted Timothy and Lisa a divorce on January 26, 2006, Timothy had not received any distributions of any part of the corpus of the Family Trust.
>
> • At no time during his marriage to Lisa did Timothy have a present possessory right to any part of the corpus of the Family Trust.

Under the unambiguous meaning of Section 15 and of Alice's will, Timothy acquired the Family Trust Income by devise or gift. [36] In addition, because Timothy had no present, possessory right to any part of the Family Trust corpus, Timothy was not effectively an owner of the trust corpus during his marriage to Lisa, and the Family Trust Income, as a matter of law, was not community property. [37]

Therefore, the trial court reversibly erred in characterizing the Family Trust Income as community property rather than Timothy's separate property and by awarding any part of this property to Lisa. [38] This error requires a reversal and remand to the trial court. [39]

## CONCLUSION

The flaws in the majority's analysis are twofold. The majority misses the mark both in its adoption of the governing legal standard and in its determination that this newly adopted standard was satisfied under the facts of this case.

The majority's "interest in the corpus" legal standard lacks precision and is too vague to provide a meaningful touchstone by which Texas courts and practitioners can assess ownership of income distributions under an irrevocable trust during marriage. The nebulous measure the court adopts today holds little promise for uniformity or ease in application. A more precise and concrete criterion not only would provide clear guidance to courts and practitioners but also would enhance the prospects for consistency, fairness, and predictability in the law governing the characterization of distributions from trusts during marriage. For these reasons, our jurisprudence would be better served by a clearer, more workable legal standard.

This court should hold that, under the plain meaning of Section 15 and of the applicable sections of the Family Code, in the context of income distributions under an irrevocable trust during marriage, these distributions are community property only if the recipient has a present possessory right to part of the corpus, even if the recipient has chosen not to exercise that right. Under these circumstances, the recipient's possessory right to access the corpus means that the recipient is effectively an owner of the trust corpus. Under this standard, the trial court erred in characterizing the Marital Trust Income and the Family Trust Income as community property because Timothy acquired this property by devise or gift rather than by the receipt of income on property he owned. Thus, under either legal standard, this court should hold that the trial court reversibly erred in characterizing the trust income as community property rather than as Timothy's separate property.

## FootNotes

1. Routh disputes whether the Marital Trust has a remainder beneficiary. On voir dire, Deo Shanker, Sharma's nephew and financial advisor, testified that Sharma was the sole beneficiary of the Marital Trust. Additionally, at the time of trial, Upward Reach Foundation had ceased to exist and was renamed the Timothy and Alice Foundation.

2. The 501(c)(3) corporation was originally named the Alice and Timothy Sharma Foundation and was thereafter changed to Cambridge Health Foundation. The former Alice and Timothy Sharma Foundation is a separate entity from the Timothy and Alice Sharma Foundation, which is the newly-named remainder beneficiary.

3. Sharma contends that because he individually owned North Houston Enterprises, this note was not subsequently transferred to either trust.

4. The dissent disputes whether there is evidence that the interest was transferred to Sharma's personal account. Valinda Allen, Sharma's bookkeeper, testified that all money received from the Marital Trust, including principal, was deposited into Sharma's personal account. Additionally, the terms of Alice's trust required that the trust income, i.e., the interest from the notes, be distributed to Sharma.

5. Prior to trial, Sharma sold the Lake Houston Property and most of the Earle Street Property, which was part of the corpus in the Marital Trust. The proceeds from the sales were deposited into Sharma's personal account.

6. On review, Sharma only disputes the characterization of the interest accrued during the marriage on the MT building, MT assets, and FT notes totaling $2,305,018.00.

7. The dissent rejects this rule and insists that we expand the definition of community property by further defining "an interest in corpus" with a distinction between expectancy right and present possessory right. As explained further below, we cannot add to or take from the constitutional definition of community property. *See Arnold v. Leonard,* 114 Tex. 535, 542, 273 S.W. 799, 803 (1925). Furthermore, there is no need for us to make this novel distinction because the record reveals that under either rule, Sharma is deemed to have an interest in trust corpus or, as articulated by our dissenting colleague, a present possessory right to the corpus, because he distributed trust corpus to himself.

8. Sharma also sold the Lake Houston Property and most of the Earle Street Property, which were parts of the corpus in the Marital Trust. The proceeds from the sales were deposited into Sharma's personal account.

9. The dissent's conclusion that Sharma did not receive any distributions from any part of the corpus from the Marital or Family trusts is not supported by the record. Ms. Bunk's and Ms. Allen's uncontroverted testimony contradicts the dissent's factual conclusion. The dissent concedes that Sharma donated the disputed principal to his charity. As explained in more detail below, the only manner in which the principal could have reached and could have been donated to the charity is by a distribution first to Sharma.

10. We note that Sharma cites to no authority prohibiting a trial court from simultaneously denying a reimbursement claim and awarding a money judgment for a wronged spouse's share of community property.

1. The majority indicates that another requirement of the legal standard is that the receiving spouse has received distributions of trust income; however, this element is more appropriately considered part of the context for this legal standard rather than part of the legal standard.

2. *See ante* at pp. 7-8.

3. The majority also relies on *Mercantile National Bank at Dallas v. Wilson. See* 279 S.W.2d 650, 651-54 (Tex. Civ. App.-Dallas 1955, writ ref'd n.r.e.). However, in that case, the court does not articulate the legal standard the majority adopts today. *See id.* Moreover, the *Wilson* case is not on point. Because the trust in *Wilson* was an *inter vivos* trust, there was no possibility of a devise. *See id.* Because the wife was the sole settlor and sole beneficiary of the trust, there was no possibility that she could receive a gift, because she could not make a gift to herself. In addition, the majority incorrectly describes *Cleaver v. Cleaver.* 935 S.W.2d 491, 492-94 (Tex. App.-Tyler 1996, no pet.). *See ante* at pp.7-8. The *Cleaver* court did not hold that trust income is separate *only* in cases in which the receiving spouse has no right to receive distributions from the corpus. *See id.*

4. *See ante* at p. 8.

5. *See ante* at p. 8, n.7; p. 9 & n.9; p. 10.

6. The majority states that Valinda Allen testified that Timothy made sure all principal payments were deposited into his personal bank account. *See ante* at p. 11. Allen did not so testify. Rather, Allen testified that she received instructions about where to deposit the principal payments on the Notes but that these instructions did not come from Timothy. Allen testified that Elizabeth Bunk previously had told her that trust income could go straight to Timothy and that she applied this instruction to the principal on the Notes and erroneously deposited them into Timothy's personal bank account. Allen testified that she was getting direction from Bunk and the relevant documents and that Timothy gave her no direction as to how to handle the trusts. Allen testified repeatedly that the payments of principal on the Notes were placed in Timothy's personal account in error, and she testified she was not acting at the direction of Timothy.

7. The record in this case is voluminous and contains evidence regarding many matters. This opinion focuses on the facts relevant to the analysis and disposition of this appeal.

8. At the time of the sale, the foundation was known as the Alice and Timothy Sharma Foundation.

9. The majority states that the Marital Trust's sale of the two hospitals was financed by means of the Building Note, the Intracare Note, the Family Trust Note, a note payable to North Houston Enterprises, Inc. ("Houston Enterprises Note"), and one other note. However, of these instruments, only the Building Note could be considered the means of financing this sale. The other notes were generated by the sale of the assets of International and North Houston Enterprises, Inc. ("Houston Enterprises"). The Houston Enterprises Note was generated when Houston Enterprises, an entity not owned by any trust, sold its assets to Intracare Hospital North. Lisa does not assert that the Houston Enterprises Note was ever held by a trust, and, in any event, Timothy has not challenged the trial court's characterization of the interest on this note. Therefore, the Houston Enterprises Note is not relevant to this appeal.

10. The majority states that this dissent concedes that Timothy donated trust corpus or principal on the Notes to the Cambridge Foundation. *See ante* at p.9, n.9 & p.10. This opinion contains no such concession. The majority also states that the record shows that it is undisputed that Timothy donated trust corpus to the Cambridge Foundation. This, too, is incorrect. There is no evidence in the record that Timothy donated trust *corpus* or *principal* on the Notes to the Cambridge Foundation. There is evidence that Timothy donated *income distributions* from both trusts to the Cambridge Foundation. The majority also states that the record shows an "undisputed fact" that "the only way the principal could be retrieved from the trusts was by way of a distribution." *See ante* at p. 10. Thus, the majority reasons that because Timothy donated trust corpus to the Cambridge Foundation, he must have first distributed trust corpus to himself. *See ante* at p. 10. However, there is no evidence that the only way the principal could be retrieved from the trusts was by way of a distribution. Even if there were such evidence, the proposition is a matter of law, not of fact. A trustee who is also a potential beneficiary of trust principal under certain conditions, might be entitled to receive a distribution of principal as a beneficiary of the trusts. However, the trustee also could receive trust principal in his capacity as trustee, even if that capacity were not clearly indicated. In addition, a trustee can also receive trust principal by appropriating it in his individual capacity even though he has no right to do so, which would amount to conversion but would not be a distribution. *See Ames v. Ames,* 776 S.W.2d 154, 157 (Tex. 1989) (discussing trustee's distribution of funds to certain beneficiaries and his conversion of other funds).

11. Timothy testified that he donated the income from the trusts to the Cambridge Foundation, and the record contains no evidence that trust income was deposited in any of Timothy's bank accounts. The majority states that the accrued interest on the Notes was "generally transferred to [Timothy's] personal account." *See ante* at p. 4. Initially, whether distributions of income from the trusts were deposited into Timothy's personal bank account is irrelevant to the marital-property analysis under the legal standard stated in the majority opinion and this dissenting opinion. In any event, the trial court made no finding in this regard, and the record contains no trial evidence that such a transfer ever occurred. The majority claims that there is such evidence based on Valinda Allen's testimony that all money received from the Marital Trust prior to April 2005 was deposited into Timothy's personal account and that the Marital Trust required that trust income be distributed to Timothy. *See ante* at p.4, n.4. However, no reasonable factfinder could find that any trust income distribution derived from interest on the Notes was deposited into Timothy's personal account based on this evidence. Allen did not testify that any of the money received from the Marital Trust was derived from interest on the Notes. In addition, the Marital Trust's requirement that trust income be periodically distributed to Timothy does not require that Timothy actually receive funds and does not preclude Timothy from donating this income back to the maker, the Cambridge Foundation, so that he never actually received money from the Marital Trust. Because Timothy donated the trust income distribution from the interest back to the Cambridge Foundation, there was no actual transfer of funds involved in the income distributions. For this reason, the trial court did not make any findings that any interest was paid on the Notes; rather, the trial court made findings as to the amount of interest that accrued.

12. The record contains no evidence that Timothy paid income tax on any amount of principal under the Notes or on distributions of trust corpus, as asserted by the majority. *See ante* at p.9. There is no evidence that Timothy donated trust corpus to any charity, as asserted by the majority. *See id.* at pp. 9, 10.

13. Evidence at trial, however, showed that, during the twenty months following the funding of the Marital Trust and the Family Trust, neither of these trusts had its own bank account. During this period the principal portions of payments on the Notes were deposited into one of Timothy's community-

property bank accounts by staff hired to assist him. There was testimony that this was done in error because Timothy and his advisors lacked experience in operating trusts, given that Timothy had never been a trustee before. Eventually, a reconciliation was performed by professional staff, and separate accounts were established for both of the trusts. There is no evidence that Timothy, as trustee, ever declared or determined that he was entitled to receive or had received distributions of corpus from the Marital Trust or the Family Trust. The trial court did not find that the depositing of this principal into Timothy's personal bank account constituted distributions of corpus to Timothy. Based in part on the depositing of part of the trust corpus into Timothy's personal bank account, Lisa sought leave to file a trial amendment asserting that the Marital Trust and the Family Trust should be disregarded because Timothy allegedly had engaged in a pattern of dealing with the trust property as if he owned the property, such that the trusts are Timothy's alter egos. The trial court denied Lisa leave to file this trial amendment. Lisa has not challenged this ruling on appeal.

14. Timothy's Brief Contains No Argument, Analysis, or Citations to the Record and Legal Authorities Regarding Any Assertion That the Trial Court Erred in Dividing the Trust Income in Question Because it Was No Longer Part of the Parties' Estate, Given That Timothy Had Donated this Income Back to the Maker of the Notes. *See* Tex. R. App. P. 38.1(h); *San Saba Energy, L.P. v. Crawford,* 171 S.W.3d 323, 337 (Tex. App.-Houston [14th Dist.] 2005, no pet.).

15. *See Eggemeyer v. Eggemeyer,* 554 S.W.2d 137, 142 (Tex. 1977); *Gana v. Gana,* No. 14-05-0060-CV, 2007 WL 1191904, at *4 (Tex. App.-Houston [14th Dist.] Apr. 24, 2007, no pet.) (mem. op.).

16. Lisa agrees that this action is required under Alice's will.

17. Courts also have held that, if a potential beneficiary under a trust has no right to acquire corpus or accrued trust income, then that income or corpus cannot possibly be the community property of the potential beneficiary's spouse. *See Lemke v. Lemke,* 929 S.W.2d 662, 663B64 (Tex. App.-Fort Worth 1996, writ denied); *In re Marriage of Burns,* 573 S.W.2d 555, 556-67 (Tex. Civ. App.-Texarkana 1978, writ dism'd); *Currie v. Currie,* 518 S.W.2d 386, 389-90 (Tex. Civ. App.-San Antonio 1974, writ dism'd). Conversely, if a spouse has a present possessory right to trust income or corpus but the spouse elects not to receive it, then courts have treated the spouse as having acquired title to the corpus or income as separate property, with any future income from that property during marriage being community property. *See Cleaver,* 935 S.W.2d at 492-94 (holding that, because wife had present possessory right to undistributed income from trust, she would be treated as having acquired that income as her separate property and income on the undistributed income was community property); *In re Long,* 542 S.W.2d at 717-18 (holding that, because husband had present possessory right to half of trust corpus, that half of the corpus would be treated as the husband's separate property and the accrued income on that half of the corpus would be treated as community property, even though husband had decided to leave that half of the corpus in the trust).

18. The *Arnold* case does not address this issue. *See Arnold,* 273 S.W. at 801-05. Timothy cites *Hutchison v. Mitchell,* 39 Tex. 487 (1873) (holding that income from trust received by wife was her separate property in situation in which wife was income beneficiary). The *Hutchison* case was decided by the so-called "Semicolon Court" that sat from 1870-73, during the end of the Reconstruction Era. James R. Norvell, *Oran M. Roberts and the Semicolon Court,* 377 Tex. L. Rev. 279, 279-87 (1959). Lisa asserts that cases from this court have no precedential value, citing *Peck v. City of San Antonio,* 51 Tex. 490, 1879 WL 7699 (1879). However, the *Peck* court held that decisions from the so-called "Military Court" (the Texas Supreme Court from 1867 to 1869, which was appointed without constitutional basis by military authorities under Congressional Reconstruction) have no precedential value, while decisions from the Semicolon Court do have precedential value because that court had authority under the Texas Constitution of 1869. *See Peck,* 51 Tex. at 492-93, 1879 WL 7699, at *1-2; *see also* Norvell, 377 TEX. L. REV. at 287-96. In any event, though the *Hutchison* case is inconsistent with Rule A, it does not affirmatively address which rule applies. Therefore, the *Hutchison* case does not aid this court in determining the legal rule in this case.

19. *See* 960 S.W.2d 144, 147-50 (Tex. App.-Corpus Christi 1997, no pet.).

20. *See Ridgell,* 960 S.W.2d at 147-50.

21. Lisa cites *Buckler v. Buckler* for the proposition that the Texas Supreme Court overruled this part of the *McClelland* holding in the *Arnold* case. *See* 424 S.W.2d 514, 516 (Tex. Civ. App.-Fort Worth 1967, writ dism'd). Though the *Buckler* court quoted the *Buckler* appellant's argument that *Arnold* overruled this part of *McClelland,* the *Buckler* court held that *Arnold* did not overrule this part of *McClelland. See id.* In any event, a review of the *Arnold* case shows that the *Arnold* court did not overrule any part of *McClelland* relevant to the analysis in the case at hand. *See Arnold,* 273 S.W. at 801-05.

22. The court of appeals in *Shepflin v. Small* concluded that trust income was a spouse's separate property; however, in the opinion the court did not detail the rights of the spouse, if any, to access the corpus of the trust, so that case is not helpful to the inquiry at hand. 23 S.W. 432, 432-33 (Tex. Civ. App. 1893, no writ).

23. *See* J. Thomas Oldham, *Tracing, Commingling, and Transmutation,* 23 FAM. L.Q. 219, 250 (1989) (noting that legal rules clearly distinguishing community property from separate property increase predictability and uniformity).

24. Lisa cites obiter dicta from a case involving the characterization of income generated by patents. *See Alsenz v. Alsenz,* 101 S.W.3d 648, 653 (Tex. App.-Houston [1st Dist.] 2003, pet. denied). The general obiter dicta statements in *Alsenz* are not on point in answering the issues in this appeal. *See id.*

25. According to the majority, Lisa disputes that the Marital Trust named a remainder beneficiary. *See ante* at p.2, n.1. This statement is incorrect. Lisa does not argue that Alice's will fails to name a remainder beneficiary for the Marital Trust. Under the unambiguous language of Alice's will, the remainder of the Marital Trust must be distributed to the Timothy and Alice Sharma Foundation f/k/a The Upward Reach Foundation. Instead, Lisa asserts that there is disputed evidence as to whether this foundation or Timothy is entitled to the remainder of the Marital Trust, in light of an unaudited statement of Timothy's financial condition and testimony of Deo Shanker, who prepared the statement. However, as a matter of law, this parol evidence cannot be used to create an ambiguity or vary the terms of Alice's unambiguous will. *See Universal C.I.T. Credit Corp v. Daniel,* 243 S.W.2d 154, 157 (Tex. 1951) (holding that Texas courts must enforce an unambiguous written instrument as written and parol evidence will not be received for the purpose of creating an ambiguity or varying the meaning of the instrument); *Fein v. R.P.H., Inc.,* 68 S.W.3d 260, 265-66 (Tex. App.-Houston [14th Dist.] 2002, pet. denied) (same); *see also Appling v. Jay,* 390 S.W.2d 799, 803 (Tex. Civ. App.-Texarkana 1965, writ ref'd n.r.e.) (rejecting effort by one party interested in a trust to modify a term of the trust by unilateral interpretation of the trust instrument that clashes with its specific language). Therefore, any conflict or dispute created by this parol evidence is of no moment, and, under the unambiguous language of the will, the Timothy and

Alice Sharma Foundation is the sole remainder beneficiary of the Marital Trust.

26. In addition to mistakenly concluding that Timothy as trustee made distributions of trust corpus to himself, the majority also relies on a provision of the Marital Trust that is not triggered until after Timothy dies. *See ante* at p. 9. Because Timothy is still alive and did not die while married to Lisa, this provision could not have given Timothy any present, possessory right to any part of the Marital Trust corpus. The majority further suggests that, because a provision in the Marital Trust appears to anticipate that the corpus of the trust will be included in Timothy's gross estate for the purpose of calculating estate taxes, Timothy must have a right to the trust corpus for marital-property purposes. The majority does not cite any case for the proposition that a hypothetical calculation of estate taxes that would be due upon Timothy's death should be employed to determine whether Timothy has a right to the trust corpus or in characterizing the trust income at issue in this case. The obvious difference between the two contexts counsels against using estate-tax principles in a marital-property analysis.

27. Based on the unambiguous language of Alice's will, Timothy would have a present possessory right to receive distributions of corpus only if he, as trustee of the Marital Trust, determined that such distributions were necessary for his maintenance under the Support Provision. The record contains no evidence that Timothy ever made such a determination or that he ever was entitled to receive distributions of trust corpus from the Marital Trust.

28. Lisa asserts that Timothy could not possibly have acquired the trust income by devise because Timothy acquired it during marriage and after Alice's death. Lisa cites no case in this regard; however, all devises occur after the death of the person making the devise. In addition, the passage of time following Alice's death does not change the fact that the only reason that trust income was distributed to Timothy was because of the commands of Alice in her will. *See McClelland,* 37 S.W. at 358-59 (stating that monthly income distribution was acquired by devise). In any event, Timothy's acquisition of the Marital Trust Income also satisfies the essential elements of a gift. *See Hilley v. Hilley,* 342 S.W.2d 565, 569 (Tex. 1961) (stating a gift is a transfer of property made voluntarily and gratuitously); *Cleaver,* 935 S.W.2d at 493 (concluding that wife's acquisition of income from testamentary trust was either by gift or devise). This court should hold that Timothy acquired the income in question by devise or gift during marriage. Such a holding would be based on the plain meaning of the definition of separate property in the Texas Constitution and would not enlarge or go beyond the definition of separate property in the Texas Constitution.

29. Lisa cites an obiter dictum from the *Ridgell* case that the beneficiaries of a valid trust are the owners of the equitable title to the trust property and are considered the "real owners." *See Ridgell,* 960 S.W.2d at 147. Though the court, in making this general statement, does correctly contrast the bare legal title held by the trustee with the equitable title of beneficiaries, it does not distinguish between remainder beneficiaries and income beneficiaries who do not have a present possessory interest in the trust corpus. This distinction is significant in the marital-property characterization under Section 15 and the *Arnold* case.

30. Lisa also relies on *Wilson,* 279 S.W.2d at 651-54. However, that case is not on point. Because the trust in *Wilson* was an*inter vivos* trust, there was no possibility of a devise. *See Wilson,* 279 S.W.2d at 651-54. Likewise, because the wife was the sole settlor and sole beneficiary of the trust, there was no possibility that she could receive a gift, given that she could not make a gift to herself.

31. As noted above, Lisa requested leave to file a trial amendment containing a pleading of alter ego, but the trial court denied leave. Lisa has not challenged the trial court's ruling in this appeal. Thus, there are no pleadings to support any alter ego theory. Despite the trial court's refusal to allow Lisa to assert that Timothy's actions as trustee of the trusts should be considered the same as his actions on behalf of himself in his individual capacity, the majority concludes that evidence that Timothy received principal payments on the Notes as trustee and deposited these payments in his personal bank account is evidence that Timothy received distributions from the trust corpus. A trustee's depositing of trust corpus into his personal bank account, even if imprudent or wrongful, does not in and of itself withdraw the property from the corpus and constitute a distribution of corpus to any trust beneficiary, including the trustee in his personal capacity. The record contains trial testimony that this depositing of trust corpus into Timothy's personal bank account was done in error by staff. Eventually, Timothy arranged for a professional to perform a reconciliation; the trust corpus was returned to separate accounts for both of the trusts. The record contains no evidence that Timothy, as trustee, ever declared or determined that he was entitled to receive or had received distributions of corpus from the Marital Trust or the Family Trust. Moreover, the trial court did not find that, by depositing this trust corpus into his personal bank account, TimothyCas trusteeCdistributed trust corpus to Timothy in his individual capacity.

32. Lisa asserts that Timothy's trial counsel agreed in his opening statement that the trust corpus is Timothy's separate property. However, in the cited passage, Timothy's counsel first stated that there would be evidence that Timothy's permanent possessory interest in the trust is only in the interest income, not in the corpus. Counsel then stated that the trust itself owns the corpus and that Lisa is trying to obtain "monies that were generated from that trust, which is [Timothy's] separate property." In context, it is apparent that the latter clause modifies "monies" rather than "trust" and that Timothy's counsel was saying that the trust income was Timothy's separate property. Timothy's counsel had just asserted that Timothy did not have a possessory interest in the trust corpus. In addition, in a subsequent discussion between trial counsel and the trial court regarding Timothy's alleged failure to produce documents in response to Lisa's discovery requests, Timothy's counsel first asserted that the trust owned the trust corpus such that the corpus was not Timothy's separate property. Lisa's counsel then stated that Timothy claimed the Marital Trust Income was his separate property. Timothy's counsel then made a statement indicating that the Marital Trust Income is community property. In any event, the statements of Timothy's trial counsel in these two instances certainly were not a clear, deliberate, and unequivocal statement that the trust corpus is Timothy's separate property or the trust income is community property. Therefore, these statements of counsel do not constitute judicial admissions. *See Regency Advantage Ltd. P'ship v. Bingo Idea-Watauga, Inc.,* 936 S.W.2d 275, 278 (Tex. 1996).

33. *See Eggemeyer,* 554 S.W.2d at 142; *Gana,* 2007 WL 1191904126, at *4. Though Timothy raises numerous issues and arguments on appeal, including the "constructive receipt" argument, he also asserts that the Marital Trust Income and the Family Trust Income are his separate property because he acquired them by devise or gift. Timothy conditions his "constructive receipt" argument on this court's determining that the trial court correctly characterized the Marital Trust Income and the Family Trust Income as community property. Because the trial court did not correctly characterize the income, this court need not and should not address Timothy's "constructive receipt" argument. Timothy's "constructive receipt" argument has nothing to do with the depositing of trust corpus into Timothy's personal bank account by Timothy's staff in error. Rather, in the "constructive receipt" argument, Timothy asserts that, because he donated distributions of trust income to the Cambridge Foundation without taking actual receipt of any money, Timothy never acquired this income and therefore this income is not separate or community property. The majority incorrectly states that this dissent adopts Timothy's "constructive receipt" argument. *See ante* at p. 11. This dissent takes no position on that argument.

34. Lisa suggests that the evidence is unclear as to whether there are beneficiaries of the Family Trust other than Timothy based on an unaudited statement of Timothy's financial condition stating that Timothy is the sole beneficiary of the Family Trust. Lisa also cites testimony from a witness who stated that Timothy is the sole beneficiary of the Family Trust and that there is no remainder beneficiary under "that will." However, as previously noted, a financial statement prepared at Timothy's request and the legal opinion of a nonlawyer witness, as a matter of law, cannot change the terms of Alice's will. *See Appling,* 390 S.W.2d at 803.

35. This court need not address whether, under the Support Provision of the Family Trust, it, in fact, was necessary to distribute the Family Trust Income to Timothy.

36. *See Hilley,* 342 S.W.2d at 569 (stating a gift is a transfer of property made voluntarily and gratuitously);*Arnold*, 273 S.W. at 801-03; *Cleaver,* 935 S.W.2d at 493 (concluding that wife's acquisition of income from testamentary trust was either by gift or devise); *McClelland,* 37 S.W. at 358-59; BLACK'S LAW DICTIONARY 483 (8th ed. 2004).

37. *See McClelland,* 37 S.W. at 358-59.

38. The total amount of Marital Trust Income and Family Trust Income during the marriage is $2,305,018.

39. *See Eggemeyer,* 554 S.W.2d at 142; *Gana,* 2007 WL 1191904, at *4.

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CAUSE NO. 04-06-717-CV

IN THE COURT OF APPEALS
FOURTEENTH JUDICIAL DISTRICT
HOUSTON, TEXAS

TIMOTHY L. SHARMA, APPELLANT

VS.

LISA C. ROUTH, APPELLEE

**On Appeal from Cause No. 2004-61264**
**Pending in the 246th Family District Court**
**Of Harris County, Texas**

BRIEF OF AMICUS CURIAE, PROFESSOR STANLEY JOHANSON,
UNIVERSITY OF TEXAS SCHOOL OF LAW,
IN SUPPORT OF APPELLANT'S REQUEST FOR REHEARING

"In Texas, the income from separate property is community property. How does this rule apply to income received by one spouse from a trust created by (*e.g.,)* a parent? If the trust provides that 'the trustee shall pay all trust income to my daughter for life,' the gift is of the income interest itself (and not the underlying assets that generate the income), and the trust income falls under the rule that property acquired by gift or devise is separate property. *Wilmington Trust Co. v. United States*, 4 Ct. Cl. 6 (1983), aff'd, 753 F.2d 1055 (Fed. Cir. 1985) (extended discussion of Texas cases); but see *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.—Corpus Christi 1997, no writ)."

The above quotation is taken from the 2008 edition of my book, Johanson's Probate Code Annotated (see Commentary under § 116.002 of the Trust Code, at p. 992). Needless to say, I believe that my Commentary correctly states Texas law. This court held otherwise in *Sharma v. Routh*, 2008 WL 5443213 (Tex.App.—Houston [14th Dist.] 2008). Fortunately, the court's opinion has not been released for publication—a good thing because, regardless of how the court ultimately decides the case, the opinion makes two misstatements of Texas (and federal) law. Left uncorrected, the opinion would create problems for estate planning attorneys and their clients.

Here are the facts, as taken from the court's opinion: The case involved a divorce action that dissolved a 21-month marriage. Sharma's first wife died in 2001, leaving a will that created a Marital Trust and a Family Trust. The Marital Trust contained the usual terms for a QTIPable trust (*i.e.*, a trust for which a marital deduction is taken by reason of the executor's election): income to Sharma at least annually for life and an "ascertainable standard" invasion power over trust principal. The Family Trust gave Sharma as trustee a discretionary power to distribute income and principal to himself, also limited by an ascertainable standard. Sharma was named trustee of both trusts, and the remainder interest in both trusts was to pass to a foundation. Because the federal estate tax exemption equivalent was $675,000 in 2001, the bulk of the wife's very substantial estate passed to the Marital Trust, which owned two psychiatric hospitals in the Houston area, stock in a health services corporation, and real property interests.

After his first wife's death, Sharma and his financial advisers created a plan to convert the two hospitals into tax exempt hospitals, requiring that the hospitals be sold to a tax exempt entity. As a result of the sale, the Marital Trust held notes valued at over $34,000,000, and the Family Trust held a note valued at $740,000. From the date of the parties' marriage on August 29, 2004, to the entry of the final decree of divorce on May 24, 2006, accrued interest on the Marital Trust notes totaled $2.2 million, and accrued interest on the Family Trust note totaled $33,000.

The trial court found that the accrued interest on the notes was community property and ordered a 50-50 division. In affirming, this court announced the following rule: "[I]f a married beneficiary has an interest in trust principal and receives income from the principal, the income is characterized as community property [citing several cases, to be discussed below]." The opinion then concludes that because "the record reveals that Sharma had an interest in the corpus and (2) received trust income, the interest is community property."

And what was Sharma's interest in trust corpus that caused the income from the Marital Trust to be community property? The opinion relies on two elements. Foremost was Sharma's distribution power over trust principal. Sharma as trustee was given the power to "distribute such amounts of trust principal to [Sharma] as are necessary, when added to the funds reasonably available to [Sharma] from all other sources known to my Trustee (excluding the [Family Trust] property), to provide for [Sharma's] health, support and maintenance in order to maintain him, to the extent reasonably possible, in accordance with the standard of living to which [Sharma] is accustomed at the time of [first wife's] death." And how does the court characterize this power? Although a charity had been "named as a remainder beneficiary of the corpus remaining in the trust, if any, upon Sharma's death, the trust was created for the benefit of Sharma and contemplated that ***the entire trust***, both income and principal, ***could be expended for Sharma's <u>benefit</u>, at his sole discretion***." [Emphasis added.]

The highlighted statement is, quite simply, wrong. Sharma's distribution power over principal was "limited by an ascertainable standard relating to the health, education, support, or maintenance" within the meaning of Int. Rev. Code of 1986, §§ 2041(b) and 2514, which means that Sharma did not hold a taxable general power of appointment for estate tax purposes. [In my writing and teaching, I (along with other commentators) reverse the order of the words in statute from "health, education, *support, or maintenance*" to "health, education, *maintenance, or support*," as this leads to a better acronym: it is commonly referred to as the HEMS standard—the invasion power "HEMS him in."]

While it is true that the corpus of the Marital Trust will be includible in Sharma's gross estate for estate tax purposes by reason of the QTIP election, the will drafter wisely drafted the trust (as most good estate planning attorneys would do) by limiting the distribution power to the HEMS standard because (for example) the wife's executor might have made only a partial QTIP election (or Sharma might have made a partial disclaimer of the Marital Trust for some tax or other reason). It would be important that that portion of the trust not be includible in Sharma's estate (to the extent of the partial election or disclaimer).

In contrast, limiting Sharma's distribution power over the Family Trust to the HEMS standard was absolutely necessary. Otherwise, that trust would not be a "bypass trust," and it would be subject to estate tax in Sharma's estate.

The central point, though, is that Sharma as trustee most certainly ***did not have a power to distribute trust principal to himself for his "benefit."*** As all estate planning attorneys know (and my students certainly learn in my Wills & Estates and Estate Planning courses), the term "benefit," along with "comfort," "welfare" and "well-being," are "bad words" because the beneficiary who holds this power—whether a distribution power as trustee or a withdrawal power as beneficiary—would hold a taxable general power of appointment not limited by the "good words" of the HEMS ascertainable standard.

The significance of the ascertainable standard invasion power is reflected by Trust Code §113.029, captioned "Discretionary Powers: Tax Savings," which was enacted at the recently-ended legislative session. (I can take some pride of authorship here. It was based on my recommendation that the Council of the Real Estate, Probate and Trust Law Section of the State Bar made the proposed statute a part of its legislative package.) Here is the Commentary that will appear in the 2009 edition of <u>Johanson's Texas Probate Code Annotated</u>: "This statute, which applies to trusts that are created or become irrevocable on or after September 1, 2009, protects beneficiary-trustees from inept drafting that would cause a beneficiary to hold a taxable general power of appointment. Under the statute, if a trust gives the trustee a power to make discretionary distributions to herself and the power is not limited to an ascertainable standard as defined in Int. Rev. Code of 1986 §§ 2041 and 2514 (*e.g.*, if the trustee is given the power to make distributions to herself for her 'comfort,' or 'welfare') the trustee can exercise the power only in accordance with an ascertainable standard relating to the trustee-beneficiary's health, education, support or maintenance. If there are co-trustees, the broader distribution power may be exercised by a majority of the remaining trustees. If there are no co-trustees, the court may appoint a special fiduciary with authority to exercise the power."

The significance of the ascertainable standard invasion power is also reflected by Trust Code §112.035, captioned "Spendthrift Clauses." Here is my Commentary on a 2005 amendment, set out at <u>Johanson's Texas Probate Code Annotated</u> (2008), p 920: "The Restatement (Third) of Trusts, published in 2003, suggested that if a trustee has a power to distribute trust principal to herself as beneficiary, the trustee-beneficiary could lose spendthrift protection even if the distribution power was limited by an ascertainable standard. This raised a concern, because the Texas courts have sometimes looked to the Restatement for guidance. (See Commentary under § 58.) Subsection (f), added in 2005, makes it clear that spendthrift protection is not lost if a beneficiary has a power, either as beneficiary or as trustee, to reach trust principal, as long as the invasion or distribution power is limited by an ascertainable standard relating to health, education, support or maintenance. Also, spendthrift protection is not lost if the beneficiary is given an inter vivos or testamentary power of appointment." In short: If a trustee has a power to distribute to himself for his "benefit" or "comfort," spendthrift protection against creditors' claims is lost. If, however the power is limited by an ascertainable standard, spendthrift protection continues.

It also merits emphasis that the HEMS power in this case was within a restrictive class of such powers. There are two ways in which such a distribution power can be drafted. The power might be exercisable "without regard to other resources available for such purposes"—under which very generous distributions could be made, most likely up to about 65% of the beneficiary's gross income as reported on his Form 1040 in the year of his wife's death. Here, however, Sharma's distribution power could be exercised only when "necessary," and then only after Sharma had taken into account other "funds reasonably available ... from all other sources known to my Trustee." I have no knowledge of either Sharma's other resources or the standard of living to which he was accustomed (although I suspect that both are on the high side). But with the Marital Trust turning out over $1 million each year—in interest income alone—it strikes me as that (unless he had made major investments with Bernie Madoff) it is inconceivable that Sharma could *ever* justify making any distribution of principal to himself without committing a breach of trust with respect to his fiduciary duties to the remainder beneficiary.

The quoted portion of the opinion that I have highlighted on page 2 makes reference to Sharma's "sole discretion." That language does not appear in the portion of the trust quoted in the opinion—but even that phrase did appear in the trust, it wouldn't matter. Exercise of the power would not be unfettered; it would nonetheless be subject to a reasonableness and good faith standard. This point was made by the Supreme Court in *First Nat'l Bank of Beaumont v. Howard*, 229 S.W.2d 781 (Tex. 1950), where the trustee was given a power to distribute trust principal "as the trustee in its sole and uncontrolled discretion determines is necessary and advisable for the beneficiary's support." Furthermore, the trustee's decision was to be "final and conclusive." It doesn't matter, said the court; the trustee's discretion was not in fact absolute and was subject to review. The beneficiary could compel a distribution upon a showing that it was needed for support. While the case involved an altogether different issue, the bottom line is the same: "Sole discretion" does *not* mean unfettered discretion that is not subject to challenge.

If Sharma did make a distribution of trust principal to himself in violation of the HEMS standard (when taking into account his other resources), he would have committed a breach of trust. The remainderman would have a cause of action to recover the improper distribution "their" property. And most assuredly, Sharma could *not* properly distribute the "entire trust" to himself. As the remainderman was a charity, the Attorney General could step in and bring an action on the charity's behalf. While I know of no Texas case involving excess distributions of principal, other courts have so held. In *Mahoney v. Mahoney*, 370 N.E.2d 1011 (Mass. App. 1777), for example, a trust gave testator's wife the income for life and authorized the wife as trustee to distribute principal to herself "for the necessity of providing for [the wife's] comfort and happiness"—hardly within an ascertainable standard. The court ruled that this language "does not enable [the wife] to call down the principal at will." See generally the discussion at Scott & Ascher on Trusts (5th ed. 2007) at §§ 13.2.3, 13.2.4 and 13.2.7.

Bottom line: if Sharma did make a distribution of principal to himself without satisfying the restrictive HEMS ascertainable standard, he would have committed a breach of trust. In addition to his removal as trustee, as in *Mahoney v. Mahoney*, the remainderman could sue to have the property restored. It is for this reason that Sharma's explanation, that the distributions of principal before the trust had been formally established, is so plausible. After the sale of the two hospitals on a (very large) note, the obligor sent note payment checks that consisted of both interest income and principal. The opinion says this: "There is undisputed evidence that Sharma has an interest in the trust corpus. Sharma's former CPA, Elizabeth Bunk, and bookkeeper, Valinda Allen, testified that all principal payments made to the Marital and Family trusts were directly transferred to Sharma's personal account until April 2005. *Invading the corpus and depositing the principal payments into his personal account gave Sharma an interest in the corpus.*" [Emphasis added.]

No it didn't! This could not properly be considered an invasion of corpus, or at least could not be considered a *proper* invasion of corpus, without a good faith determination of necessity for Sharma's health, support and maintenance, taking into account his other resources. If the entire note payment checks were deposited in Sharma's personal account for a time, whether intentionally or (as here) accidentally by someone acting on his behalf, the proper remedy would be to return the excess distribution to the trust principal account—which is precisely what happened here.

The second element relied on in the court's opinion is this: "The Marital Trust also requires that the trust pay from *principal* 'the difference between all taxes which must be paid by reason of [Sharma's] death and those taxes which would be payable by reason of [Sharma's] death had such principal not been includ[ed] in his gross estate for the purpose of calculating such taxes.' By its terms, the trust contemplated that the principal would be considered as part of Sharma's personal estate and required a mandatory distribution from trust principal for payment of Sharma's death taxes." [Court's emphasis.]

The proper response to this statement is "Oops!" The above statement is simply wrong. That provision in the wife's will assuredly did *not* give Sharma an interest in trust principal. It merely restated what the Internal Revenue Code mandates when a decedent's executor makes a QTIP election pursuant to Int. Rev. Code §2056(b)(7).

Let me explain. Prior to 1981, the estate tax marital deduction was limited to roughly one-half of a decedent's estate. Under the former law, the price one had to pay to secure a marital deduction was to give the surviving spouse the unfettered power of disposition over the assets on his or her subsequent death. To qualify for the deduction, property had to be left either outright to the spouse or to a trust that gave the spouse a general power appointment. When the marital deduction was limited to one-half of the estate, given the advantages of tax deferral this was considered an acceptable price to pay.

When the unlimited marital deduction was enacted in 1981—meaning that estate taxes could be deferred even in a $5 million estate—Congress was concerned about this requirement, and used as its example a second marriage with each spouse having children by a first marriage. Suppose Wife, with a $5,000,000 estate (and an exemption of $175,625 in 1982), wanted to secure the marital deduction so that no taxes would be paid on her death. If the only way to secure the marital deduction (and defer taxes) would be to leave property outright to Husband or create a trust that gave him a general power of appointment, on his subsequent death Husband would likely benefit his children, not her children.

Enter the QTIP trust and the QTIP election. As long as the trust gives income to Husband for life, Wife can name anyone she wants as remainderman—in particular, she can name her own children as remainder beneficiaries. Wife's executor can then make a QTIP election, deferring taxes to Husband's death. On Husband's death, the trust property is includible in his gross estate under §2044. Congress recognized, however, that it wouldn't be right to have any resulting tax come out of Husband's estate. Instead, the tax is charged against the QTIP trust itself, so that (in essence) Wife's children and not Husband's children pay the tax. Section 2207A of the Code provides that, unless Husband in his will provides otherwise, "[i]f any part of the gross estate consists of property the value of which is includible in the gross estate by reason of section 2044 (relating to certain property for which marital deduction was previously allowed), the decedent's estate shall be entitled to recover from the person receiving the property" the amount of tax attributable to inclusion of the QTIP property in the decedent's gross estate.

In sum, Mrs. Sharma's will merely paraphrased what the Internal Revenue Code expressly states to be the law. The trust did not "contemplate that the principal would be considered as part of Sharma's personal estate." Quite the opposite! The purpose of this provision was to make sure that although taxes would be generated at

Sharma's death by reason of the QTIP election, the trust property was *not* to be considered as part of Sharma's estate!

The opinion cites several cases in support of its decision. Except for *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.—Corpus Christi 1997, no writ), the cited cases are distinguishable. In *Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.—Texarkana 1976, no writ), Long's parents had set up a trust under which Long would be entitled to one-half of the corpus when he reached age 25, and the remaining one-half when he reached age 30. When Long attained age 25, he told the trustees that hedidn't want to withdraw that one-half of the trust (quite possibly because of marital difficulties—the divorce came a year later). The court held, quite properly, that the income from that one-half was community property. Had Long withdrawn that one-half from the trust, the income from that share assuredly would have been community property under the "income from SP is CP" rule. He couldn't defeat that rule by leaving the property with the trustee. The court held that "Charles was entitled to that one-half of the corpus and the income that had accumulated on that portion of the corpus following his having reached age twenty-five." No comparable provision appears in the trust before the court.

In *Mercantile Nat'l Bank v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App.—Dallas 1955, writ ref'd n.r.e.), Wilson created the trust with her separate property prior to her marriage—it was what is called in the practice a "self-settled trust." The court held, not surprisingly, that you can't defeat the "income from SP is CP" rule by putting your separate property in a trust. Thus, creditors of the community estate could reach the trust's income. If the income from her separate property was community property before creating the trust, she couldn't alter that rule by putting the property in a trust in which she retained an income interest.

The only case that doesn't follow that pattern is *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.—Corpus Christi 1997, no writ). I begin by noting that the case has no writ history. I go on to note that, with deference to the Corpus Christi Court of Appeals, the court's decision is, at best, dubious. In that case, trusts created by Nona's parents provided income to Nona for life. The trusts further provided that beginning on Nona's 40th birthday and ending on her 50$^{th}$ birthday, the trustee was to distribute to Nona from the principal of each trust the lesser of $25,000 or 3% of the trust's value. Interpolating from the facts of the case, Nona was born in 1938 (the facts tell us that she reached age 21 in 1959). Thus, Nona was to receive (and presumably received) the first distribution of principal in 1978 and the last distribution of principal in 1988, when she reached age 50. The parties separated in 1989, and the divorce action was filed in 1991. The court concluded that "because Nona received the income from Trusts #2 and #4 and ***has*** expectancy interests in the trust corpuses, we hold that the trial court erred in concluding that the income distributions from Trusts #2 and #4 were Nona's separate property; the incomes are community property." [Emphasis added.]

Well, what's wrong with that? The problem is that at the time of the divorce, "has" was not the appropriate word to employ. The proper word to use was the past tense "had." The distributions of principal that were to have been made were history; at the time of the divorce action, Nona had no interest, expectancy or otherwise, in the trust principal. The fact that she once had such an interest—and even between age 40 and 50 she had an interest in the lesser of $25,000 or 3% of the trusts' value, not the entire trust—by my analysis the court reached a most dubious result.

I also want to discuss the problems raised by the court's current opinion on estate planning attorneys and their clients. Back when I began teaching (and consulting) in the 1960s, it was quite typical for parents to provide, in their wills, that on the death of the surviving spouse, property would be distributed outright to the children (if they were adults). If the wills created trusts for the children, the trusts would almost invariably provide that (as in *Marriage of Long*) at some age the trust principal would be distributed to the children—for example, one-third at age 30, one-half of the balance at age 35, and the entire trust at age 40.

In today's world, we often draft parents' wills and such trusts quite differently. To use Mrs. Johanson and myself as an example, on the death of the survivor of us, any remaining property will pass—not outright to our children, but to trusts under which each child is trustee of his or her trust. There are a lot of advantages to trusts rather than outright dispositions. A trust can (i) include a spendthrift clause that gives the child protection against creditors' claims, (ii) give estate tax protection as a "bypass trust," and (iii) avoid a guardianship administration if (later in life) the beneficiary has capacity problems.

And finally, a trust can give ***divorce protection*** in addition to the above advantages. If Daughter inherits $500,000, the inheritance her separate property, not subject to division on divorce. Well, that's what the law says, but it may not work out that way in reality. What if the marital difficulties arise ten years later? Will Daughter have records that will enable her establish separate ownership by the clear and convincing evidence needed to overcome the community presumption?

As I have told my students and CLE audiences over the past several decades, leaving the child's share in a trust gives divorce protection. Because of the trustee's duty to segregate trust assets from personal assets, and her duty to "earmark" the assets in the name of the trustee, the resulting bookkeeping will make it easy to establish the child's separate ownership of the trust assets. Also, the income from the trust also will be the child's separate property, off the table in that divorce action—or at least that's what we all thought was the law.

It is this latter point that is undercut by the court's opinion. In drafting trusts for a client's spouse or children, it is a common and desirable practice to give the beneficiary (whether a child or a spouse), not just an income interest, but also access to trust principal by way of a HEMS ascertainable standard invasion power. We are in an era in which banks proudly (!) advertise certificates of deposit that pay interest at 2.5 percent. If a trust funded with $1,000,000 invests in CDs, the income would be $25,000, just barely above the poverty level. Investing in stocks would not likely be much better, given that many investment-grade corporations do not pay dividends. But the court's opinion in its current form says that if the beneficiary is given a distribution power as trustee, or an invasion power as beneficiary, even if the power is limited by an ascertainable standard the trust's income interest will be community property, subject to division on divorce.

It is for these reasons that I urge the court to revise its opinion. I also urge the court to rule that Sharma's access to principal by way of an ascertainable standard invasion power did not give him an interest in corpus such that Sharma's income interest was and is community property.

In writing and filing this amicus brief, be advised that I have no professional or other relationship with either party (nor have I met any of them). I also have no professional or other relationship with any of the attorneys involved in this case. No one asked me to file this amicus brief, nor have I received or will receive any compensation for doing so. My only concern is the proper status of Texas law. I have attached my curriculum vitae as an appendix.

Respectfully submitted,

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