

PLANNING WITH THE FAILED MARRIAGE IN MIND

OR

WHERE IS MY PROPERTY?

DALLAS ESTATE PLANNING COUNCIL

January 5, 2006

TRUST PLANNING

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- A. Overview. Our discussion of trusts addresses defending the trust and its assets and income if you represent the beneficiary or to attack it and search for a way to share its assets and income if you are the non-beneficiary. The case law is in a state of total disarray and confusion with cases and legal principles flying off in every direction like startled deer.
1. Nature of Trusts.
 - a. Private Express Trusts. The private express trust is a unique concept and one that is frequently misunderstood by members of the public and practitioners alike. The common law established that the trust is not an entity; it cannot own property; it cannot incur debt. Although it may be treated as if it were an entity for some purposes, it remains today a form of property ownership. *See* Tex. Trust Code § 111.004(4). Certain other common law principles remain relevant today. For example, a person serving as trustee is not a legal personality separate from such person in his or her individual capacity. A person serving as trustee is not the agent of either the trust, the trust estate or the beneficiaries of the trust. Finally, the trust assets are not considered to be the property of the person serving as trustee; such assets belong in equity to the beneficiary. These principles can affect the marital property rights of the parties.
 - b. Definitions. A trust, when not qualified by the word “charitable,” “resulting” or “constructive,” is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of the intention to create the relationship. Restatement Trust (Second) § 2 and Tex. Trust Code § 111.004(4).
 - c. Types of Trusts. The types and combinations of trusts can generally be described as follows:

- (1) Self-Settled Trusts - trusts established for a spouse by that spouse:
 - (a) before marriage
 - (b) during marriage
- (2) Third Party Settled Trusts - trusts established for a spouse by a third party (testamentary or *inter vivos*)
 - (a) before marriage
 - (b) during marriage
- (3) Income Distributions - distributions to spouse of income may be:
 - (a) mandatory
 - (b) discretionary
- (4) Principal Distributions - distributions to spouse of principal may be:
 - (a) mandatory
 - (b) discretionary
 - (c) certain
 - (d) uncertain
- (5) Revocation and Amendment - trust is:
 - (a) revocable
 - (b) amendable

B. Trust Property.

1. Trust Property As Marital Property. “Trust Property” may, in certain circumstances, be considered under Texas law to be marital property of the beneficiary and his spouse at the time of divorce, even though the property was never “owned” by the beneficiary (other than beneficially). It is possible that a beneficiary who is not nominally acknowledged as a trust grantor is in fact a grantor of the trust.

- a. Dynasty Trust. Dynasty trust receives assets transferred by a grandparent or parent to a trust for the benefit of a younger generation family beneficiary. Upon divorce of the beneficiary, what theories can the beneficiary's spouse use to argue the trust property constitutes a part of the marital estate?

The grantor will generally be a third party family member (parent or grandparent) of the beneficiary (or, perhaps, the beneficiary's deceased spouse). The important issue is not who is the *nominal* grantor of the trust, but rather who is the *actual* grantor of the trust; that is, who is the person responsible for the transfer of property to the trust. In what ways can it be argued the beneficiary actually or constructively transferred property to the trust for his benefit and thus convert the trust to a self-settled trust? If the beneficiary is deemed to transfer property to the trust, it can be argued the beneficiary has become a grantor of the trust. The beneficiary's spouse may then claim all or a part of the trust property has become community property and is part of the marital estate upon divorce.

- (1) Lapse of Withdrawal Right. The gift tax laws include an annual exclusion, allowing taxpayers to avoid gift tax on what would otherwise be a "taxable gift." Internal Revenue Code ("I.R.C.") § 2503. Beneficiaries are often given limited withdrawal powers (i.e. "Crummey" withdrawal right and the so-called "Five (\$5,000) or Five (5%)" power, both of which permit the beneficiary to withdraw a certain amount from the trust estate at certain periods of time). The trust may include a "Hanging Power" which permits the beneficiary to subsequently withdraw contributions that exceed \$5,000 or five percent of the trust estate. These withdrawal rights continue in suspension until the gifted property is "covered" by the Five or Five Power.

Most Crummey withdrawal rights "lapse"—that is, they expire without being exercised—and the trust assets that were subject to withdrawal by the beneficiary remain in the trust. A spouse may argue that, for marital purposes, the lapse of a withdrawal right constitutes a constructive transfer by the beneficiary to the trust of the assets that were available for withdrawal. This would render the trust self-settled by the beneficiary (i.e., the beneficiary becomes the grantor) to the extent of the property subject to the lapsed withdrawal right or the trust property that continues subject to the "Hanging Power" withdrawal right.

- (a) Gift and Estate Tax. In general, the lapse of a right to withdraw property from a trust is treated as a transfer of that property to the trust by the beneficiary for estate and gift tax purposes. I.R.C. §§ 2041(a)(2), 2514(b). This tax result is changed, statutorily, to the extent the value of the property subject to the withdrawal right does not exceed, in any calendar year, the greater of \$5,000 or 5% of the value of the trust property. I.R.C. §§ 2041(b)(2), 2514(b), (e). However, the “Five and Five” rule is only a statutory exception to the general rule that the lapse of a withdrawal right is equivalent to a transfer of the subject assets by the beneficiary, to the trust, for estate and gift tax purposes.
- (b) Income Tax. A trust beneficiary who allows a withdrawal right to lapse is generally treated as a grantor of the trust for federal income tax purposes. I.R.C. § 678. Generally, the trust beneficiary is taxable on the income attributable to the property subject to the lapsed withdrawal right and, thus, the beneficiary is treated as a grantor of the trust for federal income tax purposes.
- (c) Creditor Rights. Section 112.035(d) of the Texas Trust Code was amended by the Legislature in 1997 to confirm that a beneficiary of a trust is not to be considered a settlor of a trust because of a lapse, waiver or release of the beneficiary’s right to exercise a “Crummey right of withdrawal” or “Five or Five” power; provided, the amount that could have been withdrawn in any calendar year does not exceed the greater of (i) the “five and five” amount, or (ii) the gift tax annual exclusion under I.R.C. § 2503(b). Tex. Prop. Code Ann. § 112.035(e). The effective date of this provision is September 1, 1997. In *Watson v. Parker*, 325 B.R. 380 (Bank. S.D. Tex. 2005), the Bankruptcy Court held that when the trustee fails to give withdrawal notices to the beneficiaries as required under the trust agreement, contributions to the trust are subject to the claims of the beneficiaries’ creditors and the trust assets are not protected by the trust agreement’s spendthrift provisions.
- (d) Analogy. The Internal Revenue Code and Texas Trust Code provisions discussed above apply only to tax and creditors’ rights issues. There is no similar statutory provision that expressly applies in the marital property context that governs

whether, or to what extent, a lapse of a withdrawal right will make the beneficiary a grantor of the trust for purposes of determining the marital property character of trust income or trust property. The beneficiary's spouse may argue by analogy that the lapse of a Crummey withdrawal right constitutes a transfer to the trust for marital property purposes, just as it does in general for estate, gift and income tax purposes, but with no "five and five" exception such as that which applies in the estate, gift tax and creditor context. If successful, then the trust beneficiary who allows a Crummey withdrawal right to lapse may inadvertently become a grantor of the trust thus characterizing trust income attributable to that property as community property.

- (2) Lapse of "Five and Five" Withdrawal Right. A trust may grant its beneficiary the power to withdraw annually the greater of \$5,000 or 5% of the value of the trust property. The five and five power allows the beneficiary to withdraw part of the trust property and vest it in himself.

Federal estate and gift tax law specifically provides a beneficiary who allows a five and five power to lapse will not be treated as having transferred any property to the trust for estate and gift tax purposes. I.R.C. §§ 2041(b)(2), 2514(b), (3). Section 112.035(d) of the Texas Trust Code provides the lapse of such power will not render the beneficiary a grantor of the trust for purposes of determining the validity of a spendthrift clause insofar as it applies to the beneficiary's interest in the trust. Tex. Prop. Code Ann. § 112.035(e). The question remains whether a beneficiary who allows a five and five power to lapse will be treated as the grantor of a trust for marital property purposes. The beneficiary's status as a grantor deems the trust self-settled, which can cause the accumulated trust income attributable to the lapsed property to be community property.

- (3) Distribution Standards. The beneficiary/trustee may be allowed by the terms of the trust to distribute trust assets in an amount necessary to provide for the beneficiary's health, education, maintenance and support ("HEMS Standard"). Often, a HEMS standard is included in the trust agreement when the beneficiary is also the trustee of the trust and has the power to make distributions to himself. The failure of a trustee/beneficiary to withdraw trust assets to which the beneficiary is entitled under a HEMS power could be deemed a constructive transfer of those assets to the trust by the beneficiary. This argument

is enhanced where the trust agreement does not require that the beneficiary's other resources be taken into account in determining what the beneficiary needs from the trust for his health, education, maintenance and support. The argument is also enhanced if the trust agreement states that distributions "shall" be made to the beneficiary for HEMS rather than "may." The failure to exercise that right could be characterized as a constructive transfer of wealth to the trust and could make the beneficiary grantor of the trust.

- (4) Disclaimers. Federal and state law provides a vehicle through which the intended recipient of a gift or inheritance may "disclaim" the property he is entitled to receive. A disclaimer is a refusal to accept the gift or inheritance, with the result that the property passes to someone else. If a spouse of the donor or descendant claims property, the alternate taker may be a trust for that spouse. If the surviving spouse disclaims a devise of property, with the result that the property passes into a trust for the benefit of the surviving spouse, is the surviving spouse the grantor of the trust for marital property purposes, so that a second spouse may raise a community property claim to trust income?
- (5) Guarantees. If a trust borrows funds from a third party and the beneficiary/spouse guarantees the indebtedness and is not paid a commercial rate fee for the guarantee, is the lapsed fee an indirect contribution to the trust by the beneficiary, thus permitting the spouse to raise a community property claim to the trust for the lapsed fee which would have been community property?
- (6) Loans. Similarly, if the trustee/spouse loans funds to the trust and interest is under market, is the difference between market interest and interest charged a contribution to the trust by the beneficiary, thus making the beneficiary/lender an inadvertent grantor of the trust for marital property purposes?
- (7) Bargain Sale. The beneficiary may sell assets to the trust at a bargain price for less than full and adequate consideration. Does the beneficiary become grantor of the trust for marital property purposes to the extent of the bargain sale?
- (8) Waiver of Trustee Fees. If the beneficiary is a trustee of the trust, the trustee may be entitled to compensation from the trust for serving as trustee, either under the trust agreement or under the Texas Trust Code. Tex. Prop. Code Ann. § 114.061. If the beneficiary/trustee

declines the compensation for serving as trustee, the beneficiary may be deemed to have made a contribution of the fee to which he was entitled which would have been community property to the trust.

- b. General Power of Appointment. It has been argued that if a beneficiary has a general power of appointment, the trust is illusory since no one can enforce the terms of the trust, thus the argument that the trust should become part of the marital property. Consider carefully the use of a general power of appointment in a GST non-exempt trust for that reason. The Court in the *Bank of Dallas* case stated: “In order for a trust to be a trust, the trustee must have some duty to account to someone.” Does the general power of appointment negate accountability to all persons other than the beneficiary? If the beneficiary is trustee, does the beneficiary/trustee have a duty to any other person since the beneficiary trustee has the general power of appointment? Is the trust illusory? See *Bank of Dallas v. Republic National Bank of Dallas*, 540 S.W.2d 499 (Tex. Civ. App. - Waco, 1976), n.r.e.; and *Fewell v. Republic National Bank, CCA (Eastland)*, 513 S.W.2d 596 (Tex. Civ. App. - Eastland, 1974), n.r.e.
- c. Trust Income. If property is placed in trust for a beneficiary by a third person such as a parent or deceased former spouse, the characterization of that income as separate property can be very important to the beneficiary receiving same in the event of the termination of the beneficiary’s marriage through death or divorce.
- (1) Unsettled Question. Whether trust income is separate or community property remains an unsettled question in the Texas courts. In so determining, it is necessary to determine who established the trust; did a trust beneficiary have the right to withdrawal property from the trust and allow that right to lapse; does the trust beneficiary have an existing right to withdraw property from the trust; has trust income been accumulated; has trust income been distributed; is mandatory distribution of income required or is it discretionary; is there only one beneficiary or multiple beneficiaries of the trust; and do the trust terms manifest the intent of the settlor to classify trust income as separate property of the beneficiary?
- (2) Construction. The courts generally agree that a beneficiary's interest in undistributed income of an irrevocable trust created by a third party is neither separate nor community property but rather trust property. But there has been a diversification of opinion whether trust income, once distributed, should be considered the beneficiary's separate property or property of the community estate. The courts have used

one or more of three theoretical approaches to reach their decisions as to the classification of trust income. These three approaches can be labeled as (i) the power theory, (ii) the equitable acquisition theory, and (iii) the intent theory. The power theory centers on whether the beneficiary may command any trust distributions. The equitable acquisition theory applies to the inception of title doctrine to determine the character of trust income. The intent theory looks to the settlor's intent to decide questions of characterization.

- (3) Equitable Acquisition Theory. The equitable acquisition theory takes the position that the beneficiary of a trust has separate property interest in the trust corpus. Because income from separate property is community property, trust income must be community property. This theory grants that the beneficiary's separate property interest in the trust corpus is merely an equitable interest but concludes that the equitable rather than the legal nature of the property interest is immaterial to the conclusion that trust income is community property. The equitable acquisition cases arose in early tax cases.

2. Court Construction.

a. Community Property.

- (1) The Supreme Court held in *Arnold v. Leonard*, 114 Tex. 535, 275 S.W. 799 (Tex. 1925), that neither the legislature nor spouses can expand the constitutional definition of separate property. Since the constitution states that separate property is that received by gift, bequest, or inheritance, the court reasoned that all other property must be community property. After *Arnold*, it has been argued that income from separate property trust corpus is community property.
- (2) In *Mercantile Nat'l Bank at Dallas v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App. -- Dallas 1955, writ ref'd n.r.e.), the Dallas Court of Civil Appeals stated, in what appears to be dicta, that from the date of the beneficiary's marriage undistributed trust income is community property.
- (3) In *In Re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.—Texarkana 1976, no writ), a trust provided that the income was to be either distributed or accumulated at the discretion of the trustee until the beneficiary (husband) reached twenty-five, at which time fifty percent of the trust corpus was to be distributed to him. When the husband reached thirty, the balance of the trust was to be distributed

to him. When husband reached twenty-five, he "decided to leave his half interest in the trust." The court held that the income accumulated by the trustee prior to the time the husband reached twenty-five and income accumulated from that portion of the trust not available for distribution until husband reached thirty was his separate property. Only the income attributable to the property the husband left in the trust after he reached twenty-five was community property and therefore subject to distribution in the divorce proceeding.

The opinion is unclear as to whether husband's decision to allow the distributable one half of the trust to continue in trust was in fact a reconveyance in trust subject to the terms of the existing trust to be held as part of the corpus until husband reached age 30 or was merely a decision by husband to postpone acceptance of the distribution. Since the court had said that, except for the distribution portion of the trust, the corpus and accumulated income was separate property, it would seem either that the identity of the trust settlor was relevant to the classification, or that husband's reconveyance to trust was a fraudulent transfer. *See also, Kolpack v. Torres*, 829 S.W.2d 913 (Tex. App. – corpus Christi 1992, no writ).

b. Separate Property.

- (1) *McClelland v. McClelland*, 37 S.W. 350 (Tex. Civ. App. – 1896, writ ref'd) was apparently the first Texas case involving division of trust income in a divorce of a trust beneficiary and spouse. The wife alleged that her husband was the sole heir to a large estate held in trust and that the accrued income during marriage equaled \$120,000 at the commencement of the suit. She contended that the income was community property, notwithstanding the fact that the property had been devised in trust for the husband by the husband's father. The trustee, under the terms of the will, had the discretion to accumulate all of the income from the trust property, with the exception of a small support payment. The Court of Civil Appeals held that the wife was not entitled to any income actually distributed by the trustee to the husband "because these amounts were his separate property, devised to him by the will, in which the wife had no community interest." Further, the court held that since the husband could not demand distribution of the accumulated income, the wife could not assert a claim that the husband did not have.
- (2) *Currie v. Currie*, 518 S.W.2d 386 (Tex. Civ. App. – San Antonio 1974, writ dism'd), held that undistributed trust income was not

community property when the trust income was added to the corpus and all distributions were made according to the trustee's "uncontrolled discretion." *See also, Young v. Young*, 609 S.W.2D 758 (Tex. 1980).

- (3) *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App. – Texarkana 1978, writ dismissed), during divorce proceedings, the wife claimed that undistributed trust income held for her husband's benefit was community property. The husband was the beneficiary of six trusts, three of which had been established by his parents and grandparents. Husband had established the other three trusts. Five of the trusts came into existence prior to the marriage. Husband established the sixth trust with his separate property after the marriage. The three trusts established by husband's ancestors were spendthrift trusts. Five of the six trusts were discretionary pay trusts in which "the trustee or trustees could either withhold or distribute the income and/or corpus at their sole discretion." The sixth trust required that its income be accumulated until May 28, 1982, when the entire corpus and accumulated income was to be distributed to husband.

The court held that the undistributed trust income in each of the trusts was separate property. While correct in result, the explanation offered by the court may be questionable. The court relied on (then) § 5.01(b) of the Tex. Fam. Code, which provided that "community property consists of the property, other than separate property, acquired by either spouse during marriage."

The court concluded that husband had not "acquired" the trust income during marriage as required by the statute inasmuch as it had not been distributed and he did not "have a present or past right to require its distribution so as to compel a finding that there was a constructive acquisition." *Id.* at 557. The court, thus, seemed to ignore the questions whether the trust income was the subject matter of the gift, and, therefore, separate property. The court appears to be saying that had the income been distributed, it would have constituted community property. The opinion is internally inconsistent in one significant respect. The court did not seem to appreciate that the trust scheduled to terminate in 1982 was a mandatory pay trust. It called for the accumulation of income, but it also required a distribution of all of the accumulated income in 1982.

While husband did not have a right to reduce the accumulated income to possession during marriage, his right to such income was certainly “acquired” during marriage.

The decision in *Burns* appears clearly inconsistent with the Supreme Court’s announcements in *Herring v. Blakely*, 385 S.W.2d 843 (Tex. 1965), and *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976), both divorce actions, where the Supreme Court held that it makes no difference whether the property is reduced to possession by the marriage beneficiary.

- (4) In *Taylor v. Taylor*, 680 S.W.2d 645 (Tex. App. – Beaumont 1984, writ ref’d n.r.e.), wife’s parents created a trust for her benefit prior to wife’s marriage. During the marriage, wife, with the earnings distributed from the trust, purchased realty. Upon divorce, the trial court awarded wife the realty as her separate property.
- (5) Additional confusion results from Fifth Circuit tax cases which hold that Texas permits income from separate property to remain separate when the donor clearly indicates that the income is to be separate. Other cases hold that income from a trust is community property. See *Commissioner v. Wilson*, 76 F.2d 766 (5th Cir. 1935); *Commissioner v. Sims*, 148 F.2d 574 (5th Cir. 1935); *McFadden v. Commissioner*, 148 F.2d 570 (5th Cir. 1945); *Commissioner v. Porter*, 148 F.2d 566 (5th Cir. 1945).
- (6) In *Wilmington Trust Co. v. United States*, 4 Cl.Ct.6 (1983), *aff’d*, 573 F.2d 1055 (Fed. Cir. 1985), Mr. and Mrs. Asche were domiciled in Texas at the time of Mr. Asche’s death. Mrs. Asche was the beneficiary of seven trusts. All were created during her marriage. Each trust was established solely by gift, either inter vivos or testamentary, and all were irrevocable. Mrs. Asche’s parents were the grantors of the six trusts, and Mr. Asche was the grantor of the seventh trust. Mrs. Asche was not a grantor of any of the trusts. Under each of the seven trusts, Mrs. Asche was entitled to receive mandatory distributions of the net income, but she was not entitled to distributions of principal. Upon Mrs. Asche’s death, the corpus of each trust passed to, or for the benefit of, one or more of her issue.

The sole question to be decided in this case was whether the income from the seven trusts during the marriage constituted Mrs. Asche’s separate or community property. The Court held:

"It is concluded that, under the law of Texas, as developed and expounded by the Texas courts, the income derived during the marriage of Mr. and Mrs. Asche from the seven trusts that are involved in the present case constituted the separate property of Mrs. Asche, and was not community property of Mr. and Mrs. Asche. Mrs. Asche 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 Mrs. Asche's lifetime, and, upon Mrs. Asche's death, the corpus will pass to her issue. Accordingly, the corpus of each trust was not Mrs. Asche's separate property, and the trust income was not from Mrs. Asche's separate property."

"What Mrs. Asche '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 Mrs. Asche's benefit, the income necessarily constituted her separate property under Section 15 of Article XVI of the Texas Constitution."

See also, Musslewhite v. Musslewhite, 555 S.W.2d 894 (Tex. Civ. App. – Tyler 1977, writ dism'd w.o.j.).

3. Trust Language. Some courts have looked to the intent of the settlor as set forth in the trust document to confirm the separate property characteristic of trust income. If settlor desires trust income to constitute the separate property of the beneficiary, the trust should include a provision confirming settlor's intent.

Sample Language:

Distributions Are Separate Property. It is Settlor's intent that all distributions of both income and principal to any beneficiary be deemed gifts and constitute the sole and separate property of the beneficiary receiving the distribution.

C. Self-Settled Trusts.

1. Overview. Spouse transfers that spouse's separate property to a self-settled trust and is also a beneficiary of the trust. Trust may be revocable or irrevocable. A Texas court is likely to determine that trust income, whether distributed or accumulated in the trust, is community property. Texas law has recognized that trust assets, although not owned by a spouse (other than "beneficially," as trust beneficiary) may be

considered to be and be treated as marital property, for purposes of division of the marital estate upon divorce of the beneficiary. Of particular importance, accumulated trust income may be considered, in such circumstances, to be community property.

2. Land v. Marshall. In *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968), the Texas Supreme Court held that a revocable inter vivos trust created by a husband with community property and over which the husband retained significant control was “illusory.” Wife retained her community property interest in the trust property notwithstanding the husband’s conveyance of community property to the trust. Even though the trust, and not the husband, was the owner of the subject assets, they were community property.
3. Change of Marital Property Rights. Texas marital property law expressly provides a specific, formal way for a spouse to cause the income from his separate property to become separate property: by agreement between the spouses. Accordingly, commentators have stated a spouse should not be able to act unilaterally to change the fundamental Texas marital property rule that income from separate property is community property by use of a self-settled trust. For example, Thomas M. Featherston, Jr., *Marital Property Characterization of Interests in Trusts, Including Distributed and Undistributed Income*, State Bar of Texas Advanced Estate Planning and Probate Course (June 2, 1999), at G-10, stated: “Where the settlor retains an interest in the income of the trust (whether it is discretionary or mandatory . . . whether the settlor is the trustee or not), the income the trust assets generate (distributed or undistributed) should retain its community character. Texas law does not permit a spouse to unilaterally convert community property into that spouse’s separate property.”
4. Distributed Trust Income. There seems to be little controversy regarding the marital property character of income of a self-settled trust that is actually distributed to the grantor/beneficiary. It appears to be Texas law that if a spouse creates a trust for his own benefit and funds it with his separate property, the income distributed to him will be community property, just as it would have been if the trust had not been created.
5. Undistributed Trust Income. Texas cases are inconsistent regarding the status of income that is not distributed but that is accumulated in a self-settled trust.
 - a. Community Property.
 - (1) 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 by his parents before his marriage. The trust instrument required the trustee to distribute one half of the trust property to the

husband when he reached age 25. However, upon attaining that age, the husband allowed the trustee to retain that half of the property in trust and to continue to manage it. The court observed that the husband had a “present possessory interest” in the portion of the trust assets that were distributable to him. Even though nominally owned by the trust, those assets represented the husband’s separate property because of his present right to possession. The court concluded that, consistent with normal marital property principles, the income accumulated in the trust on those separate property assets, following the husband’s 25th birthday, was community property.

- (2) In *Mercantile National Bank v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App. – Dallas 1955, writ ref’d n.r.e.), a spouse was the grantor of a trust created before marriage. The spouse was the sole beneficiary during her lifetime, and trust income could be distributed to her or accumulated in trust at the discretion of a friendly trustee. The Court determined that the trust income earned and accumulated during marriage was community property of the beneficiary and her spouse.

b. Separate Property.

- (1) *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App. – Fort Worth 1978, writ dismissed), dealt with six trusts that named the husband as beneficiary. The husband’s parents created three of those trusts and the husband created the other three for his own benefit. Of the three created by the husband, two were created prior to marriage and one was created after marriage with the husband’s separate property. Five of the six trusts were discretionary trusts that authorized the trustees, in their sole discretion, either to distribute corpus and income to the husband or to withhold it from him. The sixth trust did not permit distributions during the trust term at all, but the opinion does not disclose whether this was one of the trusts created by the husband. The husband was not the trustee of any of the trusts. The court in *Burns* focused on the statutory definition of community property: “Community property consists of the property, other than separate property, acquired by either spouse during marriage.” The court held that accumulated trust income was not “acquired” by the spouses and, therefore, could not be community property under the statutory definition. Rather, undistributed trust income was acquired by the trusts and therefore remained trust property and not marital property.

- (2) In *Lemke v. Lemke*, 929 S.W. 2d 662 (Tex. Ct. App. – Fort Worth 1998, no pet. H.), the courts followed *Burns* and held that accumulated income of a self-settled trust could not be community property because it had not been “acquired” by the spouses during marriage.

D. Sources.

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