

Economic Contribution and Community Reimbursement

1. **A BRIEF HISTORY.** In 1999, Rep. Toby Goodman added a late amendment to his Family Harmony Bill (allowing the conversion to community property from separate property by agreement of the spouses), which dealt with the creation of an equitable interest in funds advanced by the community estate for the benefit of the separate estate of one of the spouses. The amendment, creating a new Subchapter E of Chapter 3 of the Texas Family Code, was hastily crafted, and although improved upon by comments from the Real Estate, Probate and Trust Law Section of the State Bar, proved so difficult (and unpopular enough among family lawyers) that Rep. Goodman assembled a committee headed by professor Jack Sampson of the University of Texas School of Law composed primarily of family lawyers, but with two probate lawyers, the Jones Boys -- Barney of Houston and Jerry Frank of Austin, invited to sit in. The result of this committee's work is the statute discussed below, which represents a vast improvement on existing law.

1. **Charge of the Committee.** The committee was charged with implementing the idea that if funds are advanced by one marital estate (as defined in the statute) for the benefit of another for the payment of debts or the improvement of property, an absolute right of recovery exists from the benefitted estate. Defining that right, and then measuring it are the purposes of the statute. The official Bill Analysis sets forth Rep. Goodman's (and Professor Sampson's) belief that, "The statute was aimed at reducing the unfairness of a classic rule known as the Inception of Title." None of the members of the Committee were willing to go as far as Professor Sampson and attempt to repeal this long standing rule which holds that the character of property as community or separate is determined at the time the property is acquired. In fact, the statute specifically now provides that the inception of title rule is not affected by this statute. ' 3.404(a).¹

2. **The Major Changes.** The 1999 statute spoke in terms of an equitable interest, which was specifically defined in Texas Family Code ' 3.006(b) as not "creat[ing] an ownership interest in a spouse's separate property," but rather as creating "a claim against the spouse who owns the property that matures² on termination of the marriage."

1. **Change of Terminology.** The one difference that the family lawyers and the probate lawyers on the committee could not resolve centered around what to call this right. The family lawyers wanted to keep the term "equitable interest," but the probate lawyers felt that this term was confusing because it implied an ownership interest and then was specifically defined as not being an ownership interest. The result was that two different bills were submitted to Rep. Goodman, one with the old formulation and one with the term "claim for economic contribution." Rep. Goodman chose the latter term which does not implicitly create any sort of ownership interest.

¹All section references are to the Texas Family Code (after enactment of this Bill) unless otherwise indicated.

²"That matures" undoubtedly refers to the claim and not the claim against the spouse.

2. Even Handed Application. The new statute applies not only to the right of reimbursement by the community, but also applies to instances in which separate funds are used to benefit the community estate. The statute creates three Amarital estates³ -- community estate, the husband=s separate estate, and the wife=s separate estate. ' 3.401(4).³

3. Measurement of Benefit. While it was very difficult to apply the formula in the 1999 statute, this formula is very clear. (Although divining the numbers to be plugged into the formula may create some interesting problems.) The new statute does change the application of *Anderson v. Gilliland*, 684 S.W.2d 673 (Tex. 1985), which measured the right of reimbursement by the enhancement in value when the benefit was the making of improvements. This new section values the economic contribution the same whether it accrues because of improvement or because of the payment of a debt.

2. **ANALYSIS OF THE DETERMINATION AND EFFECT OF ECONOMIC CONTRIBUTION.** The statute first defines economic contribution, and then allows recovery from the benefitted estate at the dissolution of the marriage or at death of a spouse, to the extent that one marital estate makes an economic contribution to another marital estate. ' 3.403. It requires that the Court impose an equitable lien to enforce the right. ' 3.406.

1. **Sources of the Claim.** Texas Family Code ' 3.402 will define an economic contribution as the dollar amount of:

1. Reduction of Principal of a Debt (1) existing at the time of the marriage, secured by a lien on specific property owned before marriage⁴; (2) existing at the time of the acquisition of property gift, devise during marriage and secured by such property; (3) incurred during marriage (including a home equity loan) for the acquisition of or making capital improvement to the property securing such lien; or (4) incurred during marriage for the acquisition of or making capital improvements to property where the creditor agreed to look for repayment solely to the separate marital estate of the spouse on whose property the lien attached. (1), (2) and (4) apply to a reimbursement which will be due the community estate and (3) applies to a reimbursement which will be to the separate property estate of the contributing spouse.

³Note that the numbering throughout the statute is not consistent in that some initial subsections are numerals in parentheses while others are lower case letters in parentheses. This, however, is true throughout all the Codes.

⁴This section, as drafted, refers to the reduction of principal of a secured debt to the extent that the *lien* existed at the time of marriage. All other sections refer to the *debt* existing at time of marriage.

2. Refinancing of the principal amount of a debt described in (1) through (4), above, to the extent refinancing reduces that principal amount in a manner described by the appropriate subdivision. ' 3.402(a)(5). This subdivision is somewhat obtuse. What it probably applies to is the situation in which the debt of one marital estate is refinanced so that it becomes the obligation of the other marital estate. For example, if there was a separate debt, and such debt was refinanced during marriage so that it became the obligation of the community estate, the amount of the debt refinanced would be an economic contribution. This codifies a somewhat doubtful proposition that a refinancing is equivalent to a payment.⁵ (I suppose that an offsetting economic claim is created if separate funds are used to make payments on the refinanced debt.) It would seem that the debt could be more easily dealt with a just and right division of property in the marriage dissolution proceeding and allocation of debt between the soon to be ex-spouses.. Handling the refinancing at death could prove a little trickier, and an economic claim might work better in that context.

3. Capital Improvements to property other than by incurring debt. ' 3.402(a)(6).

4. Economic Contribution does not include expenditures for ordinary maintenance and repair, or for taxes, interest and insurance. Nor does the community efforts doctrine create an economic contribution. Except for the refinancing, any Economic Contribution requires a cash payment. ' 3.402(b).

2. **Calculation of Amount of Contribution.** The statute prescribes the development of a fraction to determine the amount of the claim for economic contribution. ' 3.403(b).

1. Numerator is the value of the economic contribution by the contributing estate.

2. Denominator is an amount equal to the sum of:

1. the economic contribution to the property by the contributing estate;

⁵See *Thomas v. Thomas*, 738 S.W.2d 342 (Tex. App. -- Houston [1st Dist.] 1987, writ denied), in which the argument was made that a refinancing of a separate debt created a right of reimbursement to the community for the value of the use of community credit, not for the amount of the refinancing. The wife failed to establish the cost to the community estate of the use of its credit.

2. the equity⁶ in the property as of the date of the marriage or, if later, the date of the first economic contribution by the contributing estate⁷; and
3. the economic contribution to the property by the benefitted estate during the marriage.

3. The fraction is then multiplied by the equity in the property as of the date of death, dissolution of the marriage or the sale of the property. This resulting product quantifies the economic contribution which gives rise to the claim.

4. Use and enjoyment of property is not an offset against the amount of the claim for economic contribution, unlike in an equitable claim for reimbursement (discussed below).

3. **Limitations on Amount.** The statute limits the right of the recovery so that it may be less than the amount of economic contribution, but cannot result in the benefitted estate owing funds to the benefitted estate. ' 3.402(c). It is hard to see how the fraction described above could ever produce this result. Additionally, the amount of the claim cannot exceed the equity in the property at the dissolution of the marriage, the death of a spouse or the sale of the property, whichever is the applicable time.

4. **Enforcement.** The claim for economic contribution is enforced by an equitable lien. ' 3.406. This lien attaches at the dissolution of the marriage or its termination at the death of a spouse. Note that this lien is not limited to the property as to which an economic benefit was conferred, but, subject to the homestead restrictions, is a lien on the entire benefitted estate. ' 3.406(c). Even though it arises if the benefitted property is sold during the marriage, the claim does not Amature® until the dissolution of the marriage or the death of a spouse. ' 3.404(b). Thus, the statute of limitations apparently begins to run at that point.

1. On dissolution of the marriage the court is commanded to attach an equitable lien to the property of the benefitted marital estate.

⁶Equity is defined as "the amount computed by subtracting from the *present* fair market value of the property the amount of a lawful lien specific to the property *on the date of dissolution of the marriage, death of a spouse, or disposition of the property.*" ' 3.401(3), emphasis added. It is unclear as to what *Apresent*® means and the amount of the lien should be consistent with the date of valuation. I would redraft that section to define equity as: "the amount computed by subtracting from the fair market value of the property on the date of dissolution of the marriage, death of a spouse, or disposition of the property the *principal* amount of a lawful lien specific to the property on such date."® The insertion of *Aprincipal*® is required because the section does not make clear whether equity is reduced by the principal amount only or by principal plus accrued interest. Since economic contribution does not include interest payments, it would be logical to assume that fair market value is reduced solely by principal in determining equity.

⁷It is difficult to see why the date of the original contribution would not always be after the date of marriage, and the better wording would probably have been *Athe date of the first economic contribution on or after the date of marriage.*® But, as written, it works, I think.

2. On the death of a spouse the court is commanded again to attach an equitable lien on the application of the surviving spouse, the personal representative of a deceased spouse, or any person interested in the estate as defined in ' 3 of the Texas Probate Code.

5. **Offsetting Claims.** If there are claims for economic contribution held by more than one marital estate, the court is directed to offset the claims.

6. **Management Rights Not Affected.** The statute does not affect the right to manage, control, or dispose of marital property as provided by Chapter 3 of the Family Code. ' 3.405.

3. **CLAIM FOR REIMBURSEMENT.** For the first time, ' 3.408 codifies the right to a claim for reimbursement based upon equitable principles. Thus, it is clear that the enactment of a statute creating a claim at law does not abrogate a claim in equity. However, if the claim for economic contribution is proven, then it prevails over the equitable claim. The payment of an unsecured liability of one estate can give rise to an equitable claim for reimbursement. ' 3.408(b)(1). Also, inadequate compensation for the time, toil and effort of a spouse by a business entity under the control and direction of that spouse. ' 3.408(b)(1).

1. **Court to Apply Equitable Principles.** The court is to apply equitable principles, including the offset of one claim for reimbursement against another. Presumably, then, an equitable claim for reimbursement could not be offset against a statutory claim for economic contribution. Likewise, use and enjoyment of property may be considered in determining the amount of the right of reimbursement. (See discussion of use and enjoyment below.)

2. **Problems with Section ' 3.408.** Aside from the fact that the codification of an equitable right of reimbursement appears unnecessary, other than the provision that this statute does not abrogate those rights except when a claim for economic contribution is proven, there are other problems raised by the language of ' 3.408.

1. Codification of *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1983) was apparently the purpose of ' 3.408(b)(2). However, it requires that the undercompensated spouse be in control of the entity, whereas there may be situations in which related parties (*e.g.*, siblings), none of whom are in control, conspire to take less than adequate compensation. These kinds of actions could be solved by a court under existing law.

2. Exclusivity may be inadvertently created by the statute, causing some court to find that the legislature has limited the court's plenary equitable powers to redress situations which are not on the list.

3. Use and Enjoyment of the Property is a term with different meanings to different specialties. For example, to a family lawyer this means the right of occupancy, whereas to a probate lawyer, enjoyment would also include the receipt of rentals from the property.

4. **NONREIMBURSABLE CLAIMS.** ' 3.409 specifically makes certain claims

nonreimbursable. This section does not distinguish between claims for economic reimbursement and equitable claims, so it also would appear to circumscribe the court's general equitable powers, especially since ' 3.409 includes unsecured claims. There are five classes of nonreimbursable claims: (1) payment of child support, alimony, or spousal maintenance; (2) living expenses of a spouse or a child of the spouse; (3) contributions of property of a nominal value; (4) the payment of a liability of a nominal amount; and (5) a student loan owed by a spouse.

5. **EFFECT OF MARITAL PROPERTY AGREEMENTS.** A Marital Property Agreement which is valid under Chapter 4 of the Family Code is effective to waive, release, assign, or partition a claim for economic contribution to the same extent such agreement would have been effective under the law as it existed on September 1, 2001, the effective date of this statute. (See discussion of effective date below).

6. **CONFORMING AMENDMENTS.** The following amendments have been made to other sections.

1. **Deletion of Equitable Interest.** The new statute retains the rule that if property is owned by two marital estates, then the ownership of each marital estate is determined under the inception of title doctrine. ' 3.006. The conforming amendment simply eliminates language referring to an equitable interest, a term created by the 1999 statute, but no longer relevant. It further eliminates the term economic interest from ' 7.002.

2. **In Decree of Divorce.** New ' 7.007 is added to the Code directing the Court as to what to do in decrees of divorce or annulment with respect to both claims for economic contributions and rights of reimbursement.

7. **EFFECTIVE DATE AND TRANSITION RULES.** The effective date of the Act is September 1, 2001.

1. **Pending Suits.** The law applies to suits pending on or filed after the effective date.

2. **Effect on Marital Property Agreements.** ' 3.410 applies to marital property agreements (whether premarital or post marital) before, on or after the effective date.

8. **APPLICATION OF THE STATUTE.**

1. **Practical Problems.** The application of the statute presents some practical problems.

1. The calculation of the fraction presents the practical problem of determining the value of the property at the date of the first economic contribution after marriage and will undoubtedly be resolved by appraisals long after such date since it is unlikely in most cases that any appraisal will exist at that time. Valuations at death or divorce will be undertaken in any event at the time of death or divorce, and the valuation is fixed upon an arms-length sale of the property.

2. Sales during marriage at less than fair market value raise the issue as to how to calculate the fraction. Gifts of the property by the benefitted estate to someone other than the spouse also raise interesting problems. Suppose however, that a property is sold during marriage at less than full fair market value, or is given away. For example, let's assume no game playing, but we have a second marriage with children from both marriages. Community funds are used to pay the mortgage on the ranch that has been in W's family for years. She makes a gift of the ranch to her children, and then H dies, leaving the residue of his estate to his children. What are their rights with respect to the claim for economic contribution to H's estate?

3. In a probate context, what is the effect of the failure to assert a claim? Is this something that personal representatives are going to have to affirmatively seek out? Assume W has substantial separate real estate which was mortgaged at the date of the marriage. H and W both use the property during their thirty year marriage. Either income from the property and/or H's earnings are used to pay the debts. If W dies and leaves some or all of that property to the children of her marriage to H, and H fails to assert a claim, has he made a gift to his children at that point. Moreover, if the debts had been paid within the first five years of marriage, how will anyone remember?

2. **Example:** Assume that H owned separate encumbered real estate at the time of his marriage. After he has been married one year, he uses community property to pay \$1,000 principal. At that time, the equity in the property is \$10,000. In the second year of the marriage, he pays \$2,000 of principal from separate funds, and in the third year he pays the \$2,000 balance of the mortgage with community funds. At the time of termination of the marriage at H's death, the property is debt free and is valued at \$70,000.

The numerator of the fraction is the value of the contribution of the contributing estate; *i.e.*, the community estate. That amount is \$3,000.

The denominator of the fraction is \$3,000 (the contribution of the contributing estate) + \$10,000 (the equity in the property at the date of the first contribution by the contributing estate) + \$2,000 (the contribution by the benefitted estate during marriage) = \$15,000.

The fraction, then, is $\$3,000/\$15,000$ (20%) multiplied by $\$70,000 = \$14,000$. That is the reimbursement due to the community estate. The result, of course, is that the community estate, by paying off 60% of the mortgage existing at the date of marriage, has acquired the right to receive 20% of the value of the property at dissolution of the marriage or the death of a spouse. (Remember, also, that where the community is the benefitted estate, the spouse owning the separate property benefits from half of the settlement of the economic claim.)

If, in the above example, the property had only appreciated to \$12,000, then the contributing estate would have received only \$2,400 of reimbursement.

9. **CONCLUSION.** While the 2001 statute is a vast improvement in many ways over the 1999 statute, as with every other piece of complex legislation, there are still some unanswered questions. However, there is no doubt that we have vastly improved our situation, especially since the issue as to whether this is good policy was predetermined.