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COMMUNITY PROPERTY AND CONFLICT OF LAWS
PROBLEMS OF THE OIL AND GAS INVESTOR
AND OPERATOR

by

*Harold Marsh, Jr.**

INTRODUCTION

THE subject matter of this article concerns the area where the fields of oil and gas law, community property law and conflict of laws overlap. This area is of importance for two reasons. First, the community property system, while it is in force in only eight out of the forty-eight states of the Union, is the law in Texas, Louisiana and California, which are three of the largest oil-producing states. Therefore, an understanding of this system is of importance to every married owner of oil properties located in any one of these three states. Second, the tax advantages of investments in oil and gas properties for persons with large incomes have induced an increasing flow of capital into the oil and gas industries of these states from out-of-state investors. Whenever a married domiciliary of one state invests in oil and gas properties located in another state, the question is raised as to what law will govern the marital property rights of his spouse in such property, the law of the domicile or the law of the situs — i.e., a problem of conflict of laws.

This discussion will be confined to the laws of the three community property states which are of major significance so far as the oil and gas industry is concerned — Texas, Louisiana and California. Because of the wide divergencies between the community property laws of the eight states where that system has been adopted, it is impossible to discuss American “community property law” in general. There is no such thing. The discussion will also be confined to the problems arising when a married man domiciled in one of the non-community property states acquires

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oil and gas properties in one of these three community property states. Because of the divergencies mentioned between the community property laws of the various states, similar problems may also arise where a domiciliary of one community state — California, for example — acquires oil and gas properties in another community state such as Texas. However, it will not be possible to deal with these problems within the scope of this article.

In considering the various principles of law involved in this subject, it would be helpful to have before us a concrete situation illustrating the type of practical problems the answer to which may depend upon these principles.

Suppose that Mr. and Mrs. Smith are, at all pertinent times, domiciled in St. Louis, Missouri. Smith, a petroleum engineer, goes to East Texas at the time of the discovery of the East Texas oil field. He spends a majority of his time there for the next three years, although remaining domiciled in St. Louis. He acquires the following properties in Texas:

Tract A. Two of Smith's friends in St. Louis give him \$20,000 to invest in oil properties in Texas, and agree that in return for his services in scouting for the properties he is to receive a one-third interest in any property purchased. With this \$20,000 Smith acquires the leasehold interest in Tract A. This property is drilled under the supervision of Smith and a producing well results. Smith purchases a building in St. Louis in 1939 with \$250,000 received from his one-third working interest. The building now has a fair market value of \$1,000,000.

Tract B. Smith leases Tract B for a \$10,000 bonus payment, which he pays from funds acquired by him in Missouri. This property also is drilled under the supervision of Smith. The drilling costs are paid with a portion of Smith's share of the proceeds of oil runs on Tract A. This property also produces. With \$200,000 received from his working interest in this property, Smith purchases General Motors stock having a present market value of \$400,000.

Tract C. Smith purchases the mineral interest in Tract C for \$5,000, which he pays from his funds acquired in Missouri. He

leases this property to a major oil company for a bonus payment of \$50,000. The property is drilled and produces. With funds received as bonus and royalty payments from Tract C, Smith purchases over the years other Texas oil properties now having a fair market value of \$2,000,000.

In 1955 Mrs. Smith dies testate, and the son of Mr. and Mrs. Smith is the sole beneficiary under her will. After the death of Mrs. Smith, Mr. Smith sells the building in St. Louis for \$1,000,000 in cash, and he sells certain of his Texas oil holdings other than Tracts A, B and C for \$1,000,000 in cash.

In 1956 Smith dies testate before filing his income tax return for 1955. The son is the sole beneficiary and executor under Smith's will. He qualifies also as administrator *cum testamento annexo* in the estate of Mrs. Smith and files an estate tax return in her estate listing all of the above mentioned property as community property and showing one-half thereof taxable in her estate. He files an income tax return for Mr. Smith for 1955 showing the basis of the St. Louis building and the Texas oil properties as the fair market value at the date of Mrs. Smith's death and no tax due on either of the above mentioned sales. He files an estate tax return in the estate of Mr. Smith showing only one-half of the above property as taxable in his estate. The Commissioner assesses deficiencies on all of the tax returns. What result?

To attempt a solution of the problems raised by these facts, it is necessary to review a number of aspects of the law of oil and gas, community property, conflict of laws, and taxation.

COMMUNITY OR SEPARATE NATURE OF OIL AND GAS PROPERTIES ACQUIRED DURING MARRIAGE

The first question to be discussed is the community or separate nature under the laws of California, Louisiana and Texas of oil and gas properties acquired during marriage. The general rule in the community property states is that property acquired before marriage and that acquired by gift, devise or descent after marriage is separate property; all other property is community

property.¹ From this statement of the rule it would appear to be a relatively simple matter to determine whether a given property is separate or community. However, the rule is modified by another rule developed by the courts, namely, that separate property, so long as it can be clearly traced and identified, will remain separate property despite changes and mutations or exchanges of the original separate property for other property, real or personal.² Therefore, property acquired during marriage otherwise than by gift, devise or descent, although it is presumptively community property, may be shown to be in fact separate property by showing that the consideration for it was separate.

This doctrine of "tracing," as it is called, is applied in Texas and California to any property whether real or personal and whether acquired by the husband or by the wife. However, in Louisiana it is modified by the so-called "earmarking requirement." In Louisiana, if a husband purchases immovable property with his separate funds, the property becomes community unless the husband has inserted in the instrument of conveyance to him what is called a "double declaration."³ This "double declaration" consists of two recitals — that the property was purchased with the separate funds of the husband and that his intention was to purchase it for the benefit of his separate estate. One recital alone will not do; both must be made in order to preserve the separate character of the property acquired.⁴

The husband has a right of reimbursement against the community estate upon its dissolution for the amount of the purchase price where his separate funds thus go to acquire property for the benefit of the community estate. But since ownership of the property is in the community, any increase in value of the property purchased would accrue to the benefit of the community estate, and of course any income from the property would be community.

¹ CAL. CIV. CODE (1872), §162, 163, 164; TEX. REV. CIV. STAT. (1925), arts. 4613, 4614, 4619; *cf.* Art. 2402, LA. CIV. CODE of 1870. There are a number of exceptions to this general rule, and they vary from state to state.

² Huie, *The Community Property Law of Texas*, 13 VERNON'S ANN. TEX. CIV. STATS. ix-x (1951); McMurray, *Community Property*, 3, CAL. JUR. TEN-YEAR SUPP. 520-522 (1936).

³ *Coney v. Coney*, 220 La. 473, 56 So.2d 841 (1951); *Slaton v. King*, 214 La. 89, 36 So.2d 648 (1948); *Succession of Bell*, 194 La. 274, 193 So. 645 (1940).

⁴ See *Coney v. Coney*, 220 La. 473, 56 So.2d 841, 843 (1951).

This "earmarking requirement," according to the latest decisions of the Louisiana Supreme Court,⁵ does not apply to a purchase of *movable* property by the husband. Nor does it apply to an exchange of one immovable for another.⁶

The requirement does not apply at all to the wife, who is permitted to show by parol evidence that any property, movable or immovable, was purchased with her separate funds under her administration, and thus to preserve the separate character of the property acquired.⁷

The application of these principles to a case where a married person acquires a mineral or royalty interest during marriage does not ordinarily raise any special problems not arising with respect to other types of property. If such a mineral or royalty interest is acquired by gift, devise or descent it is separate property of the spouse acquiring it. It is also separate property if purchased with the separate funds of one spouse, with the exception that in Louisiana a mineral or royalty interest purchased by the husband with his separate funds is community property unless the required "double declaration" is inserted in the deed by which he acquires the interest. Such an interest otherwise acquired during marriage — for example, in return for the services of one of the spouses or by purchase with community funds — is community property.

In the case of a working interest acquired by one of the spouses during marriage there are some special considerations. If an oil and gas lease is acquired without any bonus payment, or with only a nominal bonus, the actual consideration for the lease is the implied or express covenants regarding the development and operation of the property. If a husband acquires such a lease during marriage, these obligations are obligations for which the community estate is liable. In addition, where the husband is in the oil business, he normally spends considerable time and effort

⁵ Succession of Hemenway, 228 La. 572, 83 So.2d 377 (1955); Bruyninckx v. Woodward, 217 La. 736, 47 So.2d 478 (1950); cf. Kittredge v. Grau, 158 La. 154, 103 So. 723 (1925). Earlier cases seem to be *contra*, and have not been specifically overruled: Hawthorne v. Hawthorne, 214 La. 905, 39 So.2d 338 (1949); Fleming v. Fleming, 211 La. 860, 30 So.2d 860 (1947).

⁶ See Slaton v. King, 214 La. 89, 36 So.2d 648, 650 (1948).

⁷ Guilbeau v. Guilbeau, 224 La. 837, 71 So.2d 129 (1954); American Surety Co. v. Noble & Salter, 196 La. 312, 199 So. 131 (1940); Miller v. Miller, 160 La. 936, 107 So. 702 (1926); Otis v. Texas Co., 153 La. 384, 96 So. 1 (1923).

in determining what properties to take under lease and in negotiating for and acquiring the particular properties which he does lease; in fact, his entire business may consist exclusively of such activities. Will a leasehold interest which he thus acquires be his separate property merely because a small bonus payment is made from his separate funds acquired before marriage? If so, the result may be that although the husband has accumulated a large estate during the course of a long married life, there will be no community property whatever in his estate.

These considerations would seem to justify a holding that a leasehold interest thus acquired by a husband is community property; and the Texas Supreme Court so held in the recent case of *Norris v. Vaughan*⁸ where only a nominal bonus was paid for the leasehold. The court based its holding on the personal effort expended by the husband in acquiring the leasehold, rather than the community obligations assumed in the lease. The court further held in that case that the character of the leasehold was fixed at the time of its acquisition, and therefore the fact that it was subsequently developed with separate funds would not change its character, although it would give the separate estate of the husband a claim for reimbursement against the community estate for the funds thus spent for its benefit.

Suppose, however, that a substantial bonus — say \$20,000 — is paid for the lease in these circumstances from the separate funds of the husband. Clearly, the bonus payment is at least *part* of the consideration for the lease, and under the Texas decisions, property acquired in part for a community consideration and in part for a separate consideration is owned in common by the two estates in the proportion in which they contributed the consideration. But how can it be determined what portion of the leasehold is attributable to the separate consideration and what portion to the efforts of the husband in acquiring it (and the development obligations assumed in the lease, if those are to be considered)? It would seem impossible to make such a determination on any rational basis. The sensible rule in these circumstances would seem to be the Louisiana rule in the absence of any earmarking, *i.e.*, to hold that the leasehold is community property and the

⁸ 152 Tex. 491, 260 S.W.2d 676 (1953).

husband's separate estate has a right of reimbursement for the amount of the bonus. However, in Texas such a solution seems precluded by the prior decisions, and the courts appear to be committed to making such an allocation.

The foregoing rule probably does not apply to a carried working interest which is purchased by the husband with his separate funds. The husband in such circumstances is in the position of an investor rather than one engaging in a "business," and it has always been recognized that the husband has a right to spend some portion of his time and effort in investing his separate funds without thereby making the resulting investments community property.

COMMUNITY OR SEPARATE NATURE OF INCOME RECEIVED DURING MARRIAGE FROM OIL AND GAS PROPERTIES

Assuming that the community or separate nature of the royalty or working interest has been determined, the next question is the nature of the income received therefrom during marriage. If the underlying property itself has been determined to be community property, then in all of the community states the income therefrom and any increase in the value thereof are also community property.

However, if the property has been determined to be separate property, the nature of the returns therefrom depends upon the jurisdiction involved. In California, income from separate property is also separate property, as well as any increase in the value thereof.⁹ In Texas and in Louisiana, on the other hand, income from separate property is community property. This rule applies, however, only to a periodic return from the property — sometimes called "rents and revenues"¹⁰ — and not to an increase in the value of the property itself. Such a profit in the nature of a capital gain from separate property is also held to be separate property even in Texas and Louisiana.

There is a further qualification in the Louisiana law concerning the income from the wife's separate property. If the wife has

⁹ CAL. CIV. CODE (1872), §§162, 163; *George v. Ransom*, 15 Cal. 322 (1860).

¹⁰ See the use of this phrase in TEX. REV. CIV. STAT. (1925), art. 4623; *cf.* LA. CIV. CODE of 1870, art. 2386.

recorded a notarized statement of her intention to reserve the fruits of her separate property and to administer it separately, the income from the wife's separate property perforce will also be her separate property.¹¹ This privilege is not given to the husband, and the income from his separate property falls into the community estate.¹²

How do these principles apply to the income from separately owned oil and gas properties? With respect to the income from mineral and royalty interests, it is clear that in California all such income is separate property, since any income from or increase in the value of separate property is itself separate. In Texas and in Louisiana, however, it is necessary to determine whether such income constitutes "rents and revenues," which are community, or is in the nature of a capital gain from the property, which is separate.

In Texas an ordinary oil and gas lease is considered to be a conveyance of a determinable fee in 7/8ths of the oil and gas in place, with the mineral owner retaining ownership of 1/8th of the oil and gas in place. Because of this theory, it has been held that bonuses¹³ and royalties¹⁴ from separately owned property are the consideration for the sale of a portion of the corpus of the land and are, therefore, in the nature of a capital gain; hence, they are held to be separate property. On the other hand, delay rentals, because they accrue merely by the lapse of time and do not exhaust the substance of the land, are considered to be like other rentals and are held to be community property, even when paid with respect to separate land.¹⁵

In Louisiana the same community property theory prevails,

¹¹ LA. CIV. CODE of 1870, art. 2386; *Matthews v. Hansberry*, 71 So.2d 232 (La. App. 1954).

¹² *Succession of Ratcliff*, 212 La. 563, 33 So.2d 114 (1947); *United States v. Burglass*, 172 F.2d 960 (5th Cir. 1949).

¹³ *Texas Co. v. Parks*, 247 S.W.2d 179 (Tex. Civ. App. 1952) *error ref. n.r.e.*; *Lessing v. Russek*, 234 S.W.2d 891 (Tex. Civ. App. 1950) *error ref. n.r.e.*; *Crabb v. Comm'r*, 119 F.2d 772 (5th Cir. 1941); *Comm'r v. Wilson*, 76 F.2d 766 (5th Cir. 1935); *Ferguson v. Comm'r*, 45 F.2d 573 (5th Cir. 1930).

¹⁴ *Bantuelle v. Bantuelle*, 195 S.W.2d 686 (Tex. Civ. App. 1946); *Stephens v. Stephens*, 292 S.W. 290 (Tex. Civ. App. 1927) *error disp.*; *McFaddin v. Comm'r*, 148 F.2d 570 (5th Cir. 1945); *Turbeville v. Comm'r*, 84 F.2d 307 (5th Cir. 1936); *Comm'r v. Wilson*, 76 F.2d 766 (5th Cir. 1935); *Ghesson v. Comm'r*, 57 F.2d 141 (5th Cir. 1932).

¹⁵ *McGarraugh v. McGarraugh*, 177 S.W.2d 296 (Tex. Civ. App. 1943) *error disp.*; *Bennett v. Scofield*, 170 F.2d 887 (5th Cir. 1948); *Comm'r v. Wilson*, 76 F.2d 766 (5th Cir. 1935).

but a different theory of oil and gas law. There the landowner is not considered to have any ownership of the oil and gas beneath his land prior to the "capture" thereof, and an oil and gas lease is held to be governed by the provisions of the Louisiana Civil Code relating to ordinary leases. Both bonuses and royalties are characterized as "rent" paid under the lease. This theory of oil and gas law has led the Louisiana Supreme Court to hold that all bonus and royalty payments, as well as delay rental payments, received from separate property are "rents and revenues," and therefore community property.¹⁶ The wife could, of course, preserve the separate character of all such payments with respect to *her* separate property by recording the notarized statement above mentioned.

What about the income from working interests separately owned by one of the spouses? In California and Louisiana the answer would seem to be fairly clear in view of the foregoing holdings. In California such income would be separate property, and in Louisiana it would be community property.¹⁷ In Louisiana the wife would have the same privilege of preserving the separate character of the income from her separately owned leaseholds.

In Texas the answer is not as clear. Since the lessee is considered to be the owner of 7/8ths of the oil and gas in place, and the corpus of that estate is depleted by the production and sale of a portion of the oil, it would seem that the income from a separately owned leasehold should be considered in the nature of a capital gain and therefore to be separate property. There is no doubt that this would be true in the case of a carried interest where the spouse owning the property expended no community funds or individual effort in the development or operation of the property. What about the cases, however, where (1) the leasehold is separately owned by the husband before marriage, but he spends community funds and individual effort in drilling and operating the property after marriage, or (2) the leasehold is separately owned by the husband and has already been drilled before marriage with separate funds, but the husband spends

¹⁶ *Milling v. Collector*, 220 La. 773, 57 So.2d 679 (1952). This case overruled two prior decisions in the Fifth Circuit: *United States v. Harang*, 165 F.2d 106 (5th Cir. 1948); *Comm'r v. Gray*, 159 F.2d 834 (5th Cir. 1947), *cert. denied*, 334 U.S. 811 (1948).

¹⁷ As to California, see *Kenney v. Kenney*, 128 Cal. App.2d 128, 274 P.2d 951 (1954).

community funds and individual effort in supervising the operation of the property after marriage.

To take the second question first, the Texas Supreme Court held in *Norris v. Vaughan*¹⁸ that the mere expenditure of community funds and efforts in the operation and maintenance of gas wells which were separately owned by the husband and were producing properties at the time of marriage did not convert the income from such properties into community property. However, the court qualified this holding by stating that in that particular case "there was not *such an expenditure* of community funds or effort as to impress community character on the gas produced . . ."¹⁹ (emphasis added). This suggests that when the community effort reaches a certain level on some judicial scale, the income from the separately owned leasehold is suddenly transformed into community property. But the Supreme Court in *Norris v. Vaughan* does not even give a hint as to what the nature of this scale may be or at what point on it this magical transformation takes place.

It may be conjectured, although the court does not expressly say so, that the court which decided *Norris v. Vaughan* would hold that if community funds and effort were used to *drill*, as well as operate a separately owned leasehold, the income therefrom would be community property. In 1934 the General Counsel of the Bureau of Internal Revenue so ruled with regard to Texas law.²⁰

Two ancient Texas authorities allegedly holding that bricks made from clay taken from separate land²¹ and finished lumber sawed from separate timber²² by community effort were community property have been cited to support this result.²³ The latter case is clearly not in point since it merely held that timber grown on the wife's separate land was community property, and of course the lumber sawed from the timber was also community property. There is no reported opinion in the former case, but merely a bald statement of the holding in Willson's digest of cases decided by the old Court of Appeals. The basis of the de-

¹⁸ 152 Tex. 491, 260 S.W.2d 676 (1953).

¹⁹ *Id.* at 498, 260 S.W.2d at 680.

²⁰ G.C.M. 13742, XIII-2 CUM. BULL. 181 (1934).

²¹ *Craxton, Wood & Co. v. Ryan*, 3 Willson, Civ. Cas. Ct. App. §367 (1888).

²² *White v. Hugh Lynch & Co.*, 26 Tex. 195 (1862).

²³ See *Norris v. Vaughan*, 152 Tex. 491, 498, 260 S.W.2d 676, 680 (1953); XIII-2 CUM. BULL. 181, 183 (1934).

cision may have been a feeling that the bricks were a different substance than the clay; that they were therefore new property acquired during marriage otherwise than by gift, devise or descent, and hence were community property. Whether or not we would be justified in so regarding the bricks, it seems clear that the oil or gas on top of the ground is exactly the same oil or gas that was beneath the ground, and that only its location has been changed by community effort. No one would imagine that a separately owned herd of cattle would become community property because they were shipped from one place to another and the freight bill paid with community funds.

Finally, in *Norris v. Vaughan* itself the Texas Supreme Court squarely held that where a community property leasehold was drilled with separate funds, this did not transform the gas produced therefrom into separate property, but the separate estate merely had a claim for reimbursement against the community estate for the cost of the drilling. Why should a different result obtain in the reverse situation?

COMMUNITY OR SEPARATE NATURE OF OIL AND GAS PROPERTIES ACQUIRED IN A COMMUNITY STATE BY A DOMICILIARY OF A COMMON LAW STATE

The next question to be investigated is the extent and manner in which the foregoing rules apply to a case where the oil and gas property in the community state is acquired by a domiciliary of a common law state. In other words, the problem involves the conflict of laws rules which have been applied by the courts in this area.

The American conflict of laws rules with respect to marital property are generally stated to be (1) that the law of the domicile of the husband and wife at the time of acquisition determines marital property interests in movables acquired during marriage,²⁴ and (2) that the law of the situs determines marital property interests in immovables acquired during marriage.²⁵ Therefore, we must inquire whether oil and gas interests are classified as movables or immovables for this purpose. In Texas

²⁴ RESTATEMENT, CONFLICT OF LAWS §290 (1934); *Shilkret v. Helvering*, 138 F.2d 925 (D.C.Cir. 1943).

²⁵ RESTATEMENT, CONFLICT OF LAWS §238 (1934).

unquestionably both a mineral or royalty interest²⁶ and a leasehold interest²⁷ would be classified as immovables for this purpose. No direct authority on this point in California or Louisiana is known to the author. However, in both of these states oil and gas interests, including mineral or royalty interests and working interests, are characterized as real property or immovable property for internal purposes.²⁸ Therefore, it is probably safe to assume that they would also be characterized as immovable property for the purpose of applying the marital property conflict of laws rules.

We noted above that the rule is stated to be that the marital property characteristics of an immovable acquired by husband or wife during marriage are determined by the law of the situs. In the community states property acquired during marriage otherwise than by gift, devise or descent is community property. One might assume, therefore, that if a husband domiciled in a common law state purchased, with funds earned during marriage, an immovable situated in a community state, the immovable would be community property. However, this is not true. The "tracing doctrine," which we have discussed before, is applied in this situation also and largely nullifies the conflict of laws rule as above stated. The courts in Texas and California have repeatedly held that where a domiciliary of a common law state purchases an immovable situated in a community state, the marital property characteristics of the immovable are determined by the marital property characteristics of the fund with which it was purchased, and not by the law of the situs.²⁹ Hence, if those funds

²⁶ *Huston v. Colonial Trust Co.*, 266 S.W.2d 231 (Tex. Civ. App. 1954) *error ref. n.r.e.*; *cf. Thompson v. Thompson*, 149 Tex. 632, 236 S.W.2d 779 (1951); *Veal v. Thomason*, 138 Tex. 341, 159 S.W.2d 472 (1942).

²⁷ *Trapp v. United States*, 177 F.2d 1 (10th Cir. 1949); *Hammonds v. Comm'r*, 106 F.2d 420 (10th Cir. 1939); *cf. Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 254 S.W. 290 (1923).

²⁸ *La Laguna Ranch Company v. Dodge*, 18 Cal.2d 132, 114 P.2d 351 (1941); *Dabney v. Edwards*, 5 Cal.2d 1, 53 P.2d 962 (1935); *Dabney-Johnston Oil Corp. v. Walden*, 4 Cal.2d 637, 52 P.2d 237 (1935); *Callahan v. Martin*, 3 Cal.2d 110, 43 P.2d 788 (1935); *LA. R. S.* (1950), §9:1105; *Continental Oil Co. v. Landry*, 215 La. 518, 41 So.2d 73 (1949); *Vincent v. Bullock*, 192 La. 1, 187 So. 35 (1939); *Serio v. Chadwick*, 66 So.2d 9 (La. App. 1953); *Hatch v. Morgan*, 12 So.2d 476 (La. App. 1942).

²⁹ *Montgomery v. Montgomery*, 101 Tex. 118, 105 S.W. 38 (1907); *Thayer v. Clarke*, 77 S.W. 1050 (Tex. Civ. App. 1903), *aff'd*, 98 Tex. 142, 81 S.W. 1274 (1904); *McDowell v. Harris*, 107 S.W.2d 647 (Tex. Civ. App. 1937) *error disp.*; *Grange v. Kayser*, 80 S.W.2d 1007 (Tex. Civ. App. 1935); *Cox v. McClave*, 22 S.W.2d 961 (Tex. Civ. App. 1929) *error disp.*; *Estate of Arms*, 186 Cal. 554, 199 Pac. 1053 (1921); *Estate of Warner*, 167 Cal. 686, 140 Pac. 583 (1914); *Melvin v. Carl*, 118 Cal. 249, 4 P.2d 954 (1931).

were the earnings of the husband during marriage in a common law state, and thus his separate property, the immovable purchased with these funds in the community state would likewise be separate property.

The same rule was followed by the Louisiana courts prior to 1852.⁸⁰ However, in that year the Louisiana Legislature enacted what is now Article 2400 of the Civil Code, providing that: "All property acquired in this state by non-resident married persons . . . shall be subject to the same provisions of law which regulate the community of acquets and gains between citizens of this State."⁸¹ Under this statute, a non-resident husband purchasing an immovable in Louisiana with his separate funds must have inserted in the deed the "double declaration" above discussed, or the immovable will be community property, since that is the rule applying to citizens of Louisiana.⁸² As we have seen, however, a wife is permitted to prove the separate nature of the purchase price for an immovable purchased by her, even though no reference thereto is made in the deed.

Let us consider briefly the effect of these rules upon the rights of a surviving spouse. In most of the common law states today there are forced heirship or non-barrable interest statutes for the benefit of a surviving spouse. Under such statutes, the surviving spouse may renounce the will of his or her deceased spouse and take some portion of the estate of the deceased spouse as against the devisees and legatees named in the will. For example, in New York a surviving spouse has a right to one-half of the estate in fee if there are no surviving children of the deceased, and one-third if there are, despite the contrary provisions of the will of the deceased spouse. Suppose, however, that a husband domiciled in New York invests funds in an immovable situated in Texas. The immovable is not community property as we have

⁸⁰ *Succession of Waterer*, 25 La. Ann. 210 (1873); *Leech v. Guild*, 15 La. Ann. 349 (1860); *Connor's Widow v. Administrators and Heirs of Connor*, 10 La. Ann. 440 (1855), *aff'd*, 59 U.S. (18 How.) 591 (1855); *Armorer v. Case*, 9 La. Ann. 288 (1854); *Wolfe v. Gilmer*, 7 La. Ann. 583 (1852); *Huff v. Borland*, 6 La. Ann. 436 (1851); *Succession of McGill*, 6 La. Ann. 327 (1851).

⁸¹ Art. 2400, LA. CIV. CODE of 1870.

⁸² *Succession of Chapman*, 225 La. 641, 73 So.2d 789 (1954); *Smith v. Cloyd*, 182 La. 770, 162 So. 617 (1935); *cf. Fleming v. Fleming*, 211 La. 860, 30 So.2d 860 (1947); *Rush v. Landers*, 107 La. 549, 32 So. 95 (1902). The specific purpose of the statute of 1852 was to overrule the holding of the cases cited in note 30, *supra*. See the discussion in *Succession of Dill*, 155 La. 47, 98 So. 752 (1924).

seen, and therefore his wife has none of the community property rights provided by Texas law. The non-barrable interest statute of New York, on the other hand, is considered a law of "succession" and the conflict of laws rule is that succession with respect to immovables is governed by the law of the situs. Therefore, the New York non-barrable interest statute is not applicable upon the death of the husband.⁸³ Texas, of course, has no such statute since the community property laws were designed to accomplish exactly the same objective with respect to residents of Texas. Hence, the wife has no interest in this Texas immovable which cannot be defeated by the testamentary disposition of the husband.⁸⁴

If a husband domiciled in a common law state with a \$10,000,000 estate wishes to leave all of his property to a third person upon his death, without his wife having any right to take any portion of it against his will, there is one simple and certain method to accomplish this objective: invest all of the property in Texas oil royalties. He can have all this and depletion too.

Thus far we have been considering a case where a husband or wife domiciled in a common law state *purchases* with separate funds oil and gas properties situated in a community state. Let us now consider the case where an oil and gas property is acquired in a community state by the personal effort of or in return for the services of a spouse domiciled in a common law state. If the so-called rule that the law of the situs governs the marital property characteristics of immovable property is to have any effect, then it must be applicable in such a situation. We have already seen that the rule does not apply to property purchased, and property acquired by gift, devise or descent is separate property under the law of the community states as well as under the law of the common law states.

The Court of Appeals for the Tenth Circuit has held in two cases⁸⁵ that the law of the situs does govern in this case and that immovable property acquired in a community state by a domiciliary of a common law state in return for services is community

⁸³ Estate of O'Connor, 218 Cal. 518, 23 P.2d 1031 (1933).

⁸⁴ Huston v. Colonial Trust Co., 266 S.W.2d 231 (Tex. Civ. App. 1954) *error ref. n.r.e.*; cases cited *supra* note 29.

⁸⁵ Hammonds v. Comm'r, 106 F.2d 420 (10th Cir. 1939); Trapp v. United States, 177 F.2d 1 (10th Cir. 1949).

property. One of the reasons the court gave for this holding was that unless the law of the situs were held to govern in this situation, the exceptions would have become coextensive with the rule.

One would, of course, wish to have decisions by more than one court before saying that the law is settled on this point. The decision of *Joiner v. Joiner*³⁶ by the Texas Supreme Court, although the point was not discussed and was perhaps not adequately considered, is a square holding to the contrary. That case involved one of the "folk heroes" of Texas — "Dad" Joiner, the discoverer of the East Texas oil field. Mr. Joiner and his wife were divorced, and subsequent to the divorce she sued to establish that all of the property acquired by him in Texas had been community property, and that therefore an undivided one-half thereof belonged to her after the divorce. The jury found as a fact that the parties had been domiciled at all times in Oklahoma. The court thus described the acquisition by Joiner of his oil interests in Texas:

About the year 1922 defendant acquired certain oil leases on lands in East Texas by means arising solely from his own efforts and ability. . . . The record clearly justifies the statement that but for the persistent, tireless, and almost heroic fortitude and efforts of defendant in the matter of making the discovery of oil, these leases would never have been of any substantial value to him.³⁷

But after reciting the jury finding that Joiner and his wife were domiciled at all times in Oklahoma, the court held that: "This takes out of the case all questions of title in plaintiff [the ex-Mrs. Joiner] by reason of the law of this state."³⁸

It seems fairly clear, under the facts as stated by the court, that the leases would have been community property by the rule of *Norris v. Vaughan* if acquired by a domiciliary of Texas, even if some small bonus were paid with separate funds of the husband. Therefore, the case seems to be squarely opposed to the holdings of the Tenth Circuit although that court attempted to distinguish it.

At the moment, however, the weight of the slight existing authority seems to favor the view that an oil and gas interest in a community state acquired by a domiciliary of a common law state by personal efforts or in return for services is community property.

³⁶ 131 Tex. 27, 112 S.W.2d 1049 (1938).

³⁷ *Id.* at 33, 112 S.W.2d at 1052.

³⁸ *Id.* at 30, 112 S.W.2d at 1050.

Before leaving this topic we should consider briefly what effect the acquisition of the oil and gas interest through the instrumentality of a corporation or a partnership will have. If a spouse domiciled in a common law state acquires stock in a corporation which in turn owns or acquires oil and gas properties in a community state, the corporate stock is of course movable property, and the marital property interests therein and also any rights of succession with respect thereto are governed by the law of the domicile.³⁹ The law of the community state has no application at all, regardless of how the stock is acquired.

As to what effect the intervention of a partnership may have, there seems to be almost no authority. It could be argued that the partnership should be considered an entity for this purpose, as it is considered for some purposes in the law; that it is the partnership entity which owns or acquires the immovablè in the community state; and that the spouse domiciled in the common law state acquires merely an interest in the partnership, which is a movable and governed in all cases with respect to marital property rights by the law of the domicile. No cases are known where this argument has been made. In one case⁴⁰ the Tax Court ignored the partnership entity, if there is such a thing, and considered the married partner domiciled in the common law state as owning an undivided interest in the immovable situated in the community state. However, the point was not argued or discussed, so that the case is scarcely an authority on the point.

COMMUNITY OR SEPARATE NATURE OF INCOME RECEIVED BY
A DOMICILIARY OF A COMMON LAW STATE FROM AN
IMMOVABLE SITUATED IN A COMMUNITY STATE

Assuming that the nature of the immovable property owned by a domiciliary of a common law state and situated in the community state has been determined as community or separate property, what will be the nature of the income from that property accrued during marriage? For example, in Texas and Louisiana the income from the separate property of one spouse during marriage is community property, as we have seen. Does that rule apply to the in-

³⁹ *Wells v. Hiskett*, 288 S.W.2d 257 (Tex. Civ. App. 1956) *error ref. n.r.e.*

⁴⁰ *Benjamin H. McElhinney, Jr.*, 17 T.C. 7 (1951).

come from an immovable situated in Texas or Louisiana and owned by a domiciliary of a common law state?

Two theoretical approaches might be suggested to this question. First, it might be said that the rents and revenues from the immovable property are themselves *movable* property acquired during marriage, and therefore under the general rule any marital property characteristics therein are governed by the law of the domicile. Second, it might be said that the nature of the rents and revenues as separate or community property is merely one of the *characteristics* of the ownership of the immovable. Since the ownership of the immovable, and the marital property characteristics therein, are governed by the law of the situs, the nature of the rents and revenues as community or separate is also governed by the law of the situs.

This question would be more important in Louisiana than in Texas, of course, since in the former state all income from separately owned oil and gas interests is considered to be in the nature of rent and is community under the local law. In Texas, on the other hand, bonuses and royalties from separately owned property are separate property, just as they would be under the law of the common law state of domicile.

In *Commissioner v. Skaggs*⁴¹ a husband domiciled in Texas owned separate realty in California. Under California law the rent from separate realty was separate, whereas under Texas law it was community. The Court of Appeals for the Fifth Circuit held in a 2 to 1 decision that the law of the situs governed the nature of the income. This decision has been followed by the Supreme Court of New Mexico with respect to income from immovable property situated in that state and owned by a domiciliary of Texas and by the Tax Court with respect to immovable property owned in Texas by a domiciliary of a common law state.⁴²

If the immovable in the community state is itself determined to be community property, then of course the common law state of

⁴¹ 122 F.2d 721 (5th Cir. 1941), *cert. denied*, 315 U.S. 811 (1941); *cf.* *Succession of Robinson*, 23 La. Ann. 174 (1871). Despite the statement in the headnote, this latter case is not a clear holding on the point.

⁴² *In re Clark's Will*, 59 N.M. 433, 285 P.2d 795 (1955); Benjamin H. McElhinney, Jr., 17 T.C. 7 (1951); W. D. Johnson, 1 T.C. 1041 (1943), *aff'd*, 153 F.2d 348 (5th Cir. 1946); *cf.* John O'Neil, 16 B.T.A. 614 (1929).

the domicile has no law with respect to the nature of income from community property. It would seem that the law of the situs must necessarily govern with respect to the income from community property. To hold that such income was the separate property of either spouse would probably be unconstitutional.

EFFECT OF TRANSPORTATION OF COMMUNITY PROPERTY INTO COMMON LAW STATE OF DOMICILE

The final problem to be considered concerns the effect of the transportation of community property from the community state, where it is acquired, to the common law state of the domicile. For example, a husband domiciled in a common law state acquires an immovable in a community state in return for services. We will assume that such immovable, as held by the Tenth Circuit, is community property. It, of course, cannot be transported back to the common law domiciliary state. Suppose, however, that income is received from this property or that the property is sold. The income or the sale price is also community property at the moment it is received in the community state. The husband, however, takes this movable property back to the domiciliary state and there invests it in movable or immovable property. What is the nature of the ownership of that property in the domiciliary state?

On principle, it would seem that there could be only one answer to this question. If the property was community property the moment before it was transported across the state line into the common law jurisdiction, it must still be community property after it crosses the line. However, the Oklahoma Supreme Court in *Edwards v. Edwards*⁴³ and the Missouri Supreme Court in *Depas v. Mayo*⁴⁴ have stated in dictum that property thus brought into a common law state would be owned as a tenancy in common between the husband and his wife, each owning an undivided one-half interest.

What the Oklahoma and Missouri courts apparently did not realize was that a tenancy in common between husband and wife is more unlike community property than is the husband's separate property in the common law states. Community property is in gen-

⁴³ 108 Okla. 93, 233 Pac. 477 (1924).

⁴⁴ 11 Mo. 314 (1848).

eral liable for the husband's debts, and not for those of the wife, whereas one-half of property held by such a tenancy in common is liable for the debts of each co-tenant. The husband can in general convey movable community property for value without the joinder of the wife, whereas each such tenant in common can transfer one-half, and only one-half, of the property owned in common. The husband is entitled to the management and control of community property, whereas each tenant in common has an equal right to the management of the property owned in common. It would be difficult to find any legal question arising *inter vivos* with respect to which the characteristics of community property and such a tenancy in common do not differ.

It might be suggested that the real reason for these statements by the common law courts is a feeling that community property is a sort of contagion which must be quarantined at the border long enough to be transformed into a species of property which the common law court can understand. However, this would not seem to be sufficient reason to transform the property into a type of ownership which it would not be under the operative facts by the law of any jurisdiction whatever.⁴⁵ A serious question would exist as to whether a decision to that effect might not violate the due process clause of the Fourteenth Amendment.

CONCLUSIONS: APPLICATION OF FOREGOING PRINCIPLES TO HYPOTHETICAL CASE

We are now in a position to consider the solution to the questions raised by the facts of the hypothetical case stated earlier.

⁴⁵ Compare *Succession of Packwood*, 9 Rob. 438, 12 Rob. 334 (La. 1845); *Succession of Popp*, 146 La. 464, 83 So. 765 (1919); *King v. Bruce*, 145 Tex. 647, 201 S.W.2d 803 (1947), *cert. denied*, 332 U.S. 769 (1947). The Supreme Courts of Virginia and Montana have held that community property transported into those states from California may be subjected to a gift tax or inheritance tax as though it were the husband's separate property. *Commonwealth v. Terjen*, 197 Va. 596, 90 S.E.2d 801 (1956); *In re Hunter's Estate*, 125 Mont. 315, 236 P.2d 94 (1951). These holdings are clearly inconsistent with any holding that such community property is transformed into a tenancy in common, and in fact go to the opposite extreme of holding that, for state tax purposes at least, it is transformed into the husband's separate property. However, these decisions are based on the holdings of the California courts that the wife does not have a "vested interest" in California community property, which the Virginia and Montana courts deny were overruled by the enactment of Section 161a of the CALIFORNIA CIVIL CODE in 1927. Therefore, these decisions, aside from being pretty clearly wrong, would not be applicable to community property originating in any state other than California. See *Stone v. Sample*, 216 Miss. 287, 62 So.2d 307, 63 So.2d 555 (1953), as to community property transported from Texas into Mississippi.

It will be recalled that Smith acquired a one-third working interest in Tract A as the consideration for the services performed by him for his two friends who advanced the funds for the acquisition of this interest. If the decisions of the Tenth Circuit are correct, this working interest was the community property of Mr. and Mrs. Smith. So also was the income received from the oil runs from that property. What about the building in St. Louis purchased with this income? If that building were community property, only one-half thereof would be includible as a part of the gross estate of each spouse for estate tax purposes, and in addition there would be a stepped-up basis on the entire building upon the death of Mrs. Smith in 1955 for income tax purposes. The Internal Revenue Code provides that there is a stepped-up basis upon the entire community property (not merely one-half thereof) upon the death of either spouse, if at least one-half of the whole thereof is includible in the gross estate of the deceased spouse.⁴⁶ In that event, there would be no income tax payable upon the sale of the building after the death of Mrs. Smith, since there would be no gain on the sale.

On the other hand, if the dicta of the Missouri and Oklahoma courts are correct and the property was transformed into a tenancy in common by being transported to the common law state, although only one-half of the value of the building would be includible in the gross estate of each spouse, since each would only own an undivided one-half, there would be a stepped-up basis only upon Mrs. Smith's undivided one-half upon her death and not upon the one-half belonging to Mr. Smith. Therefore, there would be a capital gains tax payable upon the sale with respect to one-half of the excess of the sales price over the original adjusted basis.

It would seem that the first result is clearly the correct one, but it cannot be asserted that the matter has been settled one way or the other by judicial authority.

With respect to the working interest in Tract B, it will be recalled that Mr. Smith acquired this property for a bonus payment of \$10,000 from his separate property acquired in Missouri. However, it is also true that he acquired it partly as the result of personal efforts and enterprise. That portion of the property attribut-

⁴⁶ INT. REV. CODE OF 1954, §1014 (b) (6).

able to the bonus payment was undoubtedly the separate property of Mr. Smith. Under the theory of *Norris v. Vaughan* that portion of the leasehold attributable to the personal efforts of Mr. Smith would be community property. How any such allocation can be made has not been explained by the Texas courts, but we may assume that the trial court will be permitted to make an arbitrary guess, unless the decision of *Norris v. Vaughan* is to be overruled. It will be recalled, however, that this leasehold was drilled with community funds (a portion of the income from Tract A) and through the personal efforts of Mr. Smith. Therefore, if one is to accept the ruling of the Bureau of Internal Revenue and the intimations in the opinion in *Norris v. Vaughan* as representing the Texas law, the income from even the portion of the leasehold which was Mr. Smith's separate property would be community property under the law of the situs. And if one accepts the decision of the majority in *Commissioner v. Skaggs*, the law of the situs would determine this question.

Therefore, an argument could be made that all of the income from Tract B as well as Tract A was community property. If that is true, then only one-half of the General Motors stock purchased with this income would be includible in the gross estate of each spouse. This would be so whether or not the ownership is considered to have been transformed into a tenancy in common by the transportation of the property to Missouri.

With respect to the mineral interest in Tract C purchased by Mr. Smith with his separate funds, it is clear that this was the separate property of Mr. Smith, unless the principle of *Norris v. Vaughan* is to be extended to a mineral or royalty interest as well as a working interest. Logically, there is no reason why it could not be so extended if the husband spent a substantial amount of time "scouting" for the royalty interest which he purchases with his separate funds. However, the court will probably find that it has created too many problems for itself in connection with working interests for it to open this Pandora's box with respect to royalty interests also.

If the mineral interest in Tract C was Mr. Smith's separate property, then so also under the Texas law were the bonuses and

royalty payments received with respect to that interest and the other oil properties purchased in Texas with those funds.

Hence, all of this property must be included in the gross estate of Mr. Smith, and none of it is includible in the gross estate of Mrs. Smith. With respect to the sale made by Mr. Smith after the death of Mrs. Smith, a capital gains tax would have to be paid with respect to the entire excess of the sales price over the adjusted basis of the property in the hands of Mr. Smith.

It should be noted that the facts of this hypothetical case have been unrealistically simplified in order to present more clearly the legal issues which are in themselves by no means simple. One would never expect to find a situation where the proceeds of these different properties would be so segregated as to be easily traceable into the different properties owned at death. Normally, these proceeds would be co-mingled with each other and with other property and would be largely unidentifiable.

In the case of a person dying domiciled in a community state, the rule applicable in such a case is that all of the property on hand at the death of either husband or wife is presumed to be community property unless clearly shown to be separate. Without this principle, the whole system might have collapsed long ago from its own complexities.

This presumption, however, is not applicable in the case of a person dying domiciled in a common law state. Hence, in that case an effort must be made to untie the Gordian knot.