Community Property - Life Insurance - Application of the Inception of Title Doctrine

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this veracious assertation has been echoed forcefully in recent years by Judge Morrison[27] of the present Court of Criminal Appeals. In order to facilitate the process of criminal justice and to eliminate an unneeded, harrassing technicality, the Legislature of Texas should abrogate this distinction between parties to crime. A new enactment should embrace as principals all who under our present statutes would be considered either principals or accomplices, thereby once and for all ending the turmoil and confusion in this sphere of criminal law in Texas.[28]

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Plaintiff's husband, prior to marriage, obtained two insurance policies on his life and made his estate the beneficiary of the policies. Two-thirds of the total premiums paid on the policies was furnished by the husband's separate funds before marriage; the remaining one-third was paid from community funds.[1] After the death of husband-insured, his executor included the entire proceeds from the policies in the husband's separate estate. The widow appealed from an adverse judgment of the district court in a suit to determine title to the proceeds from the policies. *Held*: The separate estate of the husband-insured, as designated beneficiary, is entitled to the entire proceeds from life insurance policies initially purchased with separate funds (in this case the policy was purchased by decedent before marriage), but the community estate has a right of reimbursement for the amount of premiums paid with community funds. *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App. 1963) *error ref.*

There are two alternative theories[2] that could be used to determine

[27] Morrison & Blackburn, *supra* note 4.

[28] An example of such a statute is Iowa Code Ann. § 688.1 (1950): "The distinction between an accessory before the fact and a principal is abrogated, and all persons concerned in the commission of a public offense, whether they directly commit the act constituting the offense, or aid and abet its commission, though not present, must hereafter be indicted, tried, and punished as principals."

[1] Premiums totaling $1094.66 were paid by the husband-insured out of separate funds prior to marriage; premiums totaling $657.60 were paid from community funds. McCurdy v. McCurdy, 372 S.W.2d 381 (Tex. Civ. App. 1963) *error ref.*

[2] A third possible method has been suggested for the disposition of life insurance policies after a change of marital status of the spouses. This method would recognize the proceeds as the product only of the community funds used to maintain the insurance policy after

ownership of proceeds from a life insurance policy acquired in part with community property and in part with the separate funds of the insured—the *tracing principle*[3] and the *inception of title doctrine*.[4] Under the tracing principle, the separate or community ownership of the *proceeds* is apportioned according to the separate or community character of the funds used to pay the premiums.[5] Under the inception of title doctrine, the entire proceeds are separate or community depending upon the character of the funds used in the initial acquisition[6] of the life insurance policy.[7] Thus, under this latter doctrine the separate property character of a policy acquired with separate funds would not be altered by the subsequent use of community funds for payment of most or even virtually all of the premiums on the policy.[8]

The question presented in the instant case is one of first impression in Texas; viz., whether the entire proceeds of life insurance policies acquired with separate property are to be allocated between

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marriage, the insurance premiums paid with separate funds having been consumed before marriage. Under this principle, the proceeds would be impressed with the character of the funds used to pay the *last* premium before the death of the insured. Huie, *Community Property and Life Insurance—Substantive Aspects—Developments in Texas*, 2 Texas Institutes 118, 128 (1957). See Sherman v. Roe, 153 Tex. 1, 262 S.W.2d 393 (1953), (in which the Texas Supreme Court seemed to apply this method).

However, this method fails to consider that premiums paid for life insurance are a single cumulative asset and not a series of distinct individual investments, each of which is consumed during its respective premium period. See, *e.g.*, Stapf v. U.S., 189 F. Supp. 830 (N.D. Tex. 1960), *modified on other grounds*, 309 F.2d 592 (5th Cir. 1962), *rev'd on other grounds*, 375 U.S. 118 (1963).

[3] The tracing principle is applied in California and Washington. First applied to realty in California, the tracing principle has been extended to life insurance in that jurisdiction. Forbes v. Forbes, 118 Cal. App. 324, 257 P.2d 721 (Dist. Ct. App. 1953); Modern Woodmen of America v. Gray, 113 Cal. App. 729, 299 Pac. 754 (Dist. Ct. App. 1931). The Washington courts adopted the tracing principle as the more equitable means of dividing proceeds of life insurance policies in fact situations similar to that of the instant case. Metropolitan Life Ins. Co. v. Skov, 51 F. Supp. 470 (D. Ore. 1943) (applying Washington law); Coffey's Estate v. Coffey, 195 Wash. 379, 81 P.2d 283 (1938).

[4] Arizona, Louisiana, and New Mexico have applied the inception of title doctrine to life insurance situations. Arizona: Jackson v. Griffin, 39 Ariz. 183, 4 P.2d 900 (1931). Louisiana: Toussant v. National Life & Acc. Ins. Co., 147 La. 977, 86 So. 415 (1920); Succession of Verneville, 120 La. 605, 45 So. 520 (1908); Succession of Buddig, 108 La. 406, 32 So. 361 (1902). New Mexico: *In re* Miller's Estate, 44 N.M. 214, 100 P.2d 908 (1940); *In re* White's Estate, 41 N.M. 631, 73 P.2d 316 (1937). The doctrine originated in Louisiana. See *In re* Moseman's Estate, 38 La. Ann. 219 (1886).

[5] Cases cited note 3 *supra*. See Huie, *supra* note 2, at 126.

[6] The time at which the right to the proceeds from a life insurance policy is acquired is a question that has not been settled. But since life insurance policies almost invariably stipulate that the liability of the insurer will not attach until the payment of the first premium, the acquisition date is usually the date of the first premium payment. American Ins. Union v. Lowry, 62 F.2d 209 (5th Cir. 1933), *cert denied*, 289 U.S. 745 (1933). See Rio Grande Nat'l Life Ins. Co. v. Faulkner, 241 S.W.2d 468 (Tex. Civ. App. 1951) *error ref. n.r.e.*; Minnesota Mut. Life Ins. Co. v. McIntosh, 126 S.W.2d 1031 (Tex. Civ. App. 1939) *error dism.* See Tex. Ins. Code Ann. art. 3.44 (1963).

[7] Cases cited note 4 *supra*.

[8] See Ray, *Life Insurance, Community Property and Death Taxes in Texas*, 26 Tex. B.J. 835, 894 (1963).

the separate and community estates in proportion to the amount of premiums paid by each estate, or belong entirely to the separate estate, with the community being allowed only reimbursement for the actual amount of premiums paid with community funds.[9]

Conflicting claims to life insurance proceeds have been made by the separate and community estates in previous Texas cases in which the community was dissolved by the death of one of the spouses. In these decisions, however, the principal question was whether the proceeds themselves were property,[10] a question that until recently was not resolved authoritatively.[11] The 1957 legislative amendment of the definition of "property" to include life insurance,[12] and the supreme court's decision in *Brown v. Lee*[13] finally established that the right to the proceeds from life insurance policies is property. This classification of life insurance proceeds as "property" raised the issue of whether the tracing principle or the inception of title doctrine would be employed to determine ownership.[14]

The problem of acquisition of title to forms of property other than life insurance previously has been considered in Texas. In resolving separate and community claims to the ownership of *realty*, Texas courts almost uniformly apply the inception of title doctrine,

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[9] The court in the instant case did not explain or analyze the allowance of a right of reimbursement to the community with the application of the inception of title doctrine in favor of the separate estate. Apparently it assumed that a right of reimbursement exists in situations involving property for which funds of a different character are used to discharge the purchase-money debt after legal title has vested. There is authority to this effect. Wehring v. Schumann, 83 S.W.2d 1112 (Tex. Civ. App. 1935); Miller v. Odom, 152 S.W. 1185 (Tex. Civ. App. 1912) *error ref.*; Huie, *Community Property Laws as Applied to Life Insurance*, 17 Texas L. Rev. 121, 147 (1939).

[10] Prior to Brown v. Lee, ___ Tex. ___, 371 S.W.2d 694 (1963), noted in 18 Sw. L.J. 133 (1964), there existed a curious dichotomy among authoritative decisions as to whether the right to the proceeds from a life insurance policy prior to maturity constituted property. Decisions holding that proceeds rights are property: Blackmon v. Hansen, 140 Tex. 536, 169 S.W.2d 962 (1943); Lee v. Lee, 112 Tex. 392, 247 S.W. 828 (1923); Martin v. Moran, 11 Tex. Civ. App. 509, 32 S.W. 904 (1895). *Contra:* Warthan v. Haynes, 155 Tex. 413, 288 S.W.2d 481 (1956); Volunteer State Life Ins. Co. v. Hardin, 145 Tex. 245, 197 S.W.2d 105 (1946); Martin v. McAllister, 94 Tex. 567, 63 S.W. 624 (1901).

[11] Brown v. Lee, *supra* note 10.

[12] "'Property' includes real and personal property, and life insurance and the effects thereof." Tex. Ref. Civ. State. Ann art. 23(1) (1959).

[13] ___ Tex. ___, 371 S.W.2d 694 (1963).

[14] One previous case involving conflicting claims to the *cash surrender value* of life insurance policies upon the dissolution of the community by divorce is related somewhat to the problem raised in the instant case. In Berdoll v. Berdoll, 145 S.W.2d 227 (Tex. Civ. App. 1940) *error dism.*, a policy on the life of a spouse was obtained before marriage, and part of the premiums were paid from separate and part from community funds. In that case the tracing principle was applied to apportion the cash surrender value of the policy as of the time of divorce.

under which the character of the funds used in the acquisition[15] of the realty controls ownership.[16] This well-established rule was adopted in *Welder v. Lambert*,[17] an early supreme court case, in which the court relied on a Louisiana case which applied the inception of title doctrine to life insurance.[18] *Welder v. Lambert*[19] has been followed consistently in subsequent decisions.[20] The Texas Supreme Court has stated the rule applicable to realty as follows: "The character of title to property as separate or community depends upon the existence or non-existence of the marriage at the time of the incipiency of the right in virtue of which the title is finally extended, and that the title when extended relates back to that time."[21]

The determination of the ownership of personalty is not as well settled as that of title to realty. However, substantial importance is placed upon the character of the funds used in the disposition of claims to personalty upon the dissolution of the community; apparently, personalty acquired with separate funds will be allocated to the separate estate if it is not commingled with community property beyond identification.[22]

In applying the inception of title doctrine to the proceeds of life insurance policies in the *McCurdy* case, the court effectuated its conception of the legislative intent in amending the statutory definition of property to include life insurance; *i.e.*, "to fit life insurance pro-

[15] Title to realty is acquired fully upon the execution and delivery of the deed. Hall v. Edwards, 222 S.W. 167 (Tex. Comm. App. 1920). However, when title finally is acquired the time of acquisition dates back to the time of the incipiency of the right out of which the title finally is extended. Creamer v. Briscoe, 101 Tex. 490, 109 S.W. 911 (1908).

[16] Strong v. Garret, 148 Tex. 265, 224 S.W.2d 471 (1949); Colden v. Alexander, 141 Tex. 134, 171 S.W.2d 328 (1943); Creamer v. Briscoe, 101 Tex. 490, 109 S.W. 911 (1908); Welder v. Lambert, 91 Tex. 510, 44 S.W. 281 (1898); Price v. McAnelly, 287 S.W. 77 (Tex. Civ. App. 1926) *error dism. But see* Johnson v. Smith, 115 Tex. 192, 280 S.W. 158 (1926); Sparks v. Taylor, 99 Tex. 411, 90 S.W. 485 (1906).

[17] 91 Tex. 510, 44 S.W. 281 (1898).

[18] *In re* Moseman's Estate, 38 La. Ann. 219 (1886).

[19] 91 Tex. 510, 44 S.W. 281 (1898).

[20] Cases cited note 16 *supra*.

[21] Creamer v. Briscoe, 101 Tex. 490, 109 S.W. 911, 912 (1908). The quoted language is used in many Texas cases. It is misleading in that it is possible to have title incept in a spouse's separate estate, even if purchased after marriage, if separate property is used in the initial acquisition. Property purchased with separate property is separate. Love v. Robertson, 7 Tex. 6 (1851).

[22] Schmidt v. Huppman, 73 Tex. 112, 11 S.W. 175 (1889); Rauch v. Rauch, 237 S.W. 334 (Tex. Civ. App. 1922); Holloway v. Schuttles, 51 S.W. 293 (Tex. Civ. App. 1899). "Tracing" is used in connection with situations involving personalty wholly owned by a spouse in his or her separate right. In these instances the separate property is "traced" through various transactions during marriage to maintain its separate identity from the community. The title is wholly in the separate estate and *there is no question of proportionate ownership resulting from the use of community and separate funds for purchase payments*. But this use of "tracing" is to be distinguished from the tracing principle relevant to the present case which involves *the determination of ownership of an asset* acquired in part with separate funds and in part with community funds. See cases cited note 3 *supra* and text accompanying note 5 *supra*.

ceeds . . . to the pattern of Texas community property law as applied to other types of property."[23] The court noted the general application of the inception of title doctrine to other forms of property. If its interpretation of the legislative intent were correct, there would have been no need to proceed any further; the court would have performed its judicial function by determining the meaning of the 1957 amendment[24] and then applying the statute as interpreted to the facts of the instant case. In further support of its decision, however, the court briefly discussed the uniformity and simplicity that would follow from the adoption of the inception of title doctrine, as opposed to the tracing principle. The court stated clearly that the inception of title doctrine was adopted instead of the tracing principle not because of any superior qualities of the former or of any inherent defects in the latter, but rather solely in the overriding interest of uniformity and simplicity. The application of the inception of title doctrine to life insurance, the court concluded, would promote the uniform determination of ownership of all forms of property in instances involving a change of marital status. The court further determined that the inception of title doctrine would simplify the disposition of the proceeds of life insurance policies upon the dissolution of the community by the death of one of the spouses; the only knowledge necessary for the application of this doctrine to determine ownership is the character of the funds with which title was acquired.[25]

If the legislature merely sought to resolve the judicial dilemma as to whether or not life insurance is property, then the 1957 amendment, instead of solving the tracing-inception of title problem (as the court in *McCurdy* seemed to think), created it. If the legislature merely intended to declare life insurance policies property and to rely upon the judiciary to apply the rules of property law which would provide the most equitable results in particular life insurance situations, then in the instant case it would have been necessary for the court to base its acceptance of the inception of title doctrine upon thorough analysis of the two available methods.

The court concluded correctly in *McCurdy* that the application of the inception of title doctrine will promote uniformity and simplicity in community property law. However, beyond these two attributes the inception of title doctrine has shortcomings. In fact

[23] McCurdy v. McCurdy, 372 S.W.2d 381, 383 (Tex. Civ. App. 1963) *error ref.*

[24] Tex. Rev. Civ. Stat. Ann. art. 23(1) (1959).

[25] That is, once the character of the funds is known, the question of ownership is closed. With ownership determined, the burden of showing a right of reimbursement is upon the party claiming such right.

situations similar to that in the present case in which the community is entitled only to reimbursement for its funds used in paying premiums, the separate estate will receive an interest-free loan thereof from the community. It follows that the community will be deprived of the use of its funds for investment or other purposes beneficial to it. In addition, if an overwhelming percentage of the total premiums were paid with community funds, the application of the inception of title doctrine could operate as a constructive fraud on the rights of the other spouse.[26] The situation would be analogous to one in which a husband, as manager of the community, makes an inequitable gift of community property to a third person, thereby defeating his wife's rights. It is established that constructive fraud may exist in such situations.[27] No actual intent to defraud is necessary;[28] the fraudulent intent will be implied from the inequitable results of the transaction.[29]

The tracing principle, on the other hand, could not produce such inequities. The application of this principle recognizes that the proceeds are the product of the premiums,[30] and under this principle they will be so apportioned. The adoption of the tracing principle in life insurance-community property situations would produce a disunity in Texas community property law because of the well-established application of the inception of title doctrine to realty.[31] The tracing principle, however, has been used in Texas;[32] in fact, it was applied

[26] See Martin v. Moran, 11 Tex. Civ. App. 509, 32 S.W. 904 (1895).

[27] This result is derived from the defrauded-creditor situations. If a transfer of property by a debtor produces an infringement upon the rights of the creditor, the debtor is held as a matter of law to have intended to defraud the creditor. See Guaranty State Bank & Trust Co. v. Maxwell, 15 S.W.2d 659 (Tex. Civ. App. 1929). The courts have extended this doctrine to gifts by the husband of community property to third persons, regardless of his intent in doing so. Kemp v. Metropolitan Life Ins. Co., 205 F.2d 857 (5th Cir. 1953), *on second appeal,* 220 F.2d 952 (5th Cir. 1955); Biccochi v. Casey-Swasey Co., 91 Tex. 259, 42 S.W. 963 (1897); Watson v. Harris, 61 Tex. Civ. App. 263, 130 S.W. 237 (1910). See Huie, *Community Property Laws as Applied to Life Insurance,* 18 Texas L. Rev. 121, 130-37 (1940).

[28] Constructive fraud is to be distinguished from actual fraud in which a definite intent to perpetrate a fraud must be shown. Generally, actual fraud consists of six necessary elements: (1) A material misrepresentation (2) that is false, (3) with the speaker having knowledge of the falsity of the statement or having made it without reasonably attempting to ascertain the truth of it. (4) The statement must have been made with the intention that it would be relied upon. (5) It actually must have been relied upon. (6) The person so relying must have suffered some harm or injury thereby. Watson v. Brazelton, 176 S.W.2d 216 (Tex. Civ. App. 1943). See Martin v. McAllister, 94 Tex. 567, 63 S.W. 624 (1901); Jones v. Jones, 146 S.W. 265 (Tex. Civ. App. 1912); Rowlett v. Mitchell, 52 Tex. Civ. App. 589, 114 S.W. 846 (1908).

[29] Kemp v. Metropolitan Life Ins. Co., 205 F.2d 857 (5th Cir. 1953), *on second appeal,* 220 F.2d 952 (5th Cir. 1955).

[30] Huie, *supra* note 2, at 129.

[31] Cases cited note 16 *supra.*

[32] Johnson v. Smith, 115 Tex. 192, 280 S.W. 158 (1926); Sparks v. Taylor, 99 Tex. 411, 90 S.W. 485 (1906); Berdoll v. Berdoll, 145 S.W.2d 227 (Tex. Civ. App. 1940)

in a divorce situation otherwise very similar to that of the instant case.[33]

The instant decision cannot be questioned if the court construed correctly the legislative intent that the rules of law presently applicable to other forms of property should be extended to life insurance. If, however, the legislative intent was restricted to defining life insurance as property, as it most likely was, then the virtues of uniformity and simplicity are not sufficient to overcome the unjust results that the inception of title doctrine may produce in certain life insurance situations. This purely mechanical doctrine will not provide for the equitable, reasoned determination of conflicting claims by the community and separate estates to life insurance proceeds. In contrast, the rejected tracing principle effectuates by equitable apportionment the realistic notion that the proceeds from a life insurance policy are a product of, or a return on, the funds invested as premiums. Although the supreme court has evidenced its approval of the instant decision by refusing a writ of error,[34] it is hoped that the results which will flow from the application of the inception of title doctrine to life insurance will cause this decision to be reconsidered.

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error dism.; Warthan v. Haynes, 272 S.W.2d 140 (Tex. Civ. App. 1954) (This case was decided by the supreme court on the basis that the proceeds were not property before maturity; the court did not rule on the method of disposition of the proceeds.)

[33] Berdoll v. Berdoll, *supra* note 32.

[34] 7 Tex. Sup. Ct. J. 246 (Feb. 29, 1964).