

**THE BASICS OF TRACING**  
**The Ultimate Property Division Seminar 2011**  
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**What is Tracing and When Is it Necessary?**

Tracing involves proving that an asset owned at the time of divorce is separate property because the property is traced back to an asset that was clearly separate property at the time it was first obtained.

*To prove by clear and convincing evidence that a certain asset is the separate property of one spouse, it is generally necessary to trace the origin of the asset. Value tracing is commonly accepted as the means by which cash assets are traced, while item tracing is required of other assets. This requirement for tracing to the origin not only necessitates a showing of how one spouse obtained the property but also requires evidence which clearly establishes the origin of the asset. Mortenson v. Trammell, 604 S.W.2d 269, 274 (Tex. Civ. App.—Corpus Christi 1980, writ ref'd n.r.e.).*

Tracing is necessary in situations where the item now owned is different than what was originally separate property (e.g. your client inherited a piano from his aunt but sold it and used that money to buy a drum set) or in situations where separate property money is in a financial or retirement account and is mixed with community funds.

An expert witness is not always needed for tracing. If the documentary evidence is obtained in admissible form (e.g. probate records and bank records) and summarized on a spreadsheet that the client can testify to the accuracy of and then explain, you may not need to hire an accountant to do basically the same thing.

**Basic Rules**

- Inception of title rule
- Burden of proof: it is all community property unless clear and convincing evidence proves it is separate.
- Income from separate property (other than income from gifts and royalties from separate property mineral interest) is community property, including interest and dividends.
- If separate property increases in value during the marriage, the entire value is still separate

**Item Tracing**

Start at the point of origin and prove the item owned before marriage (or received as a gift or inherited) was transferred for the current item owned during marriage.

- Example:
1. Bill of sale dated March 2003 for painting “Black Swans” by Sara Pinson showing ownership before marriage.
  2. Marriage on December 10, 2006.
  3. Testimony from art gallery owner that in summer 2010, Mr. Smith traded “Black Swans” for the painting “Moonscape” along with notes in gallery owner’s inventory ledger showing the trade.
  4. Conclusion: the painting “Moonscape” is Mr. Smith’s separate property.
- Example:
1. On the date of marriage there were 200 shares of Texaco stock in the husband’s

- brokerage account.
2. The Texaco stock was sold for \$5,755.00 and on the same date 200 shares of City Investing stock were purchased for \$5,634.00.
  3. The City Investing stock was sold for \$6,021.00 and on the same date 200 shares of TransWorld stock were bought for \$6,170.00.
  4. Conclusion: the TransWorld stock is separate property.

*Estate of Hanau v. Hanau*, 730 S.W.2d 663, 667 (Tex. 1987)(since these transactions occurred in a brokerage account, many cite this case as an example of the Clearinghouse method of tracing discussed below).

## Value Tracing

Value tracing is used for cash assets. At least three of the following four methods of value tracing have been used and approved by Texas courts:

### 1. Clearinghouse Method and Identical-Sum Inference Method

The clearing house method of tracing is used when separate property funds are deposited and then withdrawn from an account. This method is based on the assumption that if separate property is deposited and then a withdrawal is made shortly thereafter, it is presumed that it was the separate funds that were withdrawn.

The identical sum inference method is basically the same but only involves one deposit and one withdrawal.

Example: *“In late 1964, Royal McKinley had \$9,500 on deposit in a First Federal Savings & Loan savings account. It is uncontroverted that this \$9,500 was Royal's separate property. By December 31, 1965, the interest earned by this account was \$472.03, and on January 5, 1966, \$472.03 was withdrawn. The \$9,500 originally deposited remained in the account and continued to earn interest until, on December 31, 1967, the account balance was \$10,453.81. From January 5, 1966, to December 31, 1967, no withdrawals were made from this account and all deposits are shown on the account statement to have been 'dividends.' On January 2, 1968, \$10,400 was withdrawn from the savings account and, on the same date, was used to purchase First Federal Savings & Loan savings certificate No. 101046 in the amount of \$10,400. The First Federal certificate remained on account and untouched until Royal's death on October 15, 1970. ...In applying these principles to the \$10,400 savings certificate, it seems clear that the \$9,500 originally on deposit with the First Federal Savings & Loan was traced in its entirety into savings certificate No. 101046, and that \$9,500 of that certificate was clearly identified as separate property. We therefore hold that \$9,500 of savings certificate No. 101046 in the face amount of \$10,400 is separate property.”*

*McKinley v. McKinley*, 496 S.W.2d 540, 542 (Tex. 1973).

- Example:
1. Wife receives her inheritance check from the executor of her father's estate in the amount of \$44,000 (evidence: copy of check and letter from executor)
  2. Wife deposits \$44,000 into the joint Chase Bank checking account on March 4 (evidence: bank statement, deposit slip)
  3. On April 10, Wife withdraws \$38,452.00 in the form of a cashier's check from the Chase Bank checking account and that same day buys her BMW (evidence: bank statement, copy of cashier's check, purchase order for BMW).
  4. Conclusion: BMW is Wife's separate property.

2. Community-Out-First Method and Minimum Sum Balance Method (they are basically the same)

When separate and community funds are mixed in one account, it is presumed that the first money withdrawn is community.

*“Generally, when separate property and community property are commingled in a single bank account, we presume that the community funds are drawn out first, before separate funds are withdrawn, and where there are sufficient funds at all times to cover the separate property balance in the account at the time of divorce, we presume that the balance remains separate property. The only requirement for tracing and the application of the community-out-first presumption is that the party attempting to overcome the community presumption produce clear evidence of the transactions affecting the commingled account.”*

*Smith v. Smith*, 22 S.W.3d 140, 146 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

- Example:
1. Community savings account has \$12,000 balance when \$10,000 of Husband's inheritance is deposited in February.
  2. Over the next four months, interest of \$80 is deposited in April and two withdrawals totaling \$8,300 are made in April and June.

Month	Starting Balance	Deposits	Withdrawals	Ending Balance	Community Portion	Separate Portion
January	\$12,000.00	\$0.00	\$0.00	\$12,000.00	\$12,000.00	\$0.00
February	\$12,000.00	\$10,000.00	\$0.00	\$22,000.00	\$12,000.00	\$10,000.00
March	\$22,000.00	\$0.00	\$0.00	\$22,000.00	\$12,000.00	\$10,000.00
April	\$22,000.00	\$80.00	\$2,300.00	\$19,780.00	\$9,780.00	\$10,000.00
May	\$19,780.00	\$0.00	\$0.00	\$19,780.00	\$9,780.00	\$10,000.00
June	\$19,780.00	\$0.00	\$6,000.00	\$13,780.00	\$3,780.00	\$10,000.00

3. Conclusion: \$10,000 in the account at the end of June is separate property because the balance never went below the amount of separate funds deposited.
4. Pro Rata Method - this method is not really used and is contrary to the above methods, so forget it!