

***EXEMPT PROPERTY AND  
PROBATE ALLOWANCES UNDER  
THE TEXAS STATUTES.***

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### **ARTICLE 1 INTRODUCTION**

This article was originally prepared as a probate administration article, because I have had the pleasure of administering several very large “insolvent” estates. How large can an insolvent estate be, you might wonder. Well, if an estate has assets worth \$100 million, and debts of \$101 million, it can be both quite large and very insolvent. Fortunately, this type of situation is not as common as it was in the 80s when declining oil prices and bank failures were an everyday occurrence, but the 80s taught me a thing or two about creditor claims, even though I am much more of a probate lawyer than a bankruptcy lawyer. I have partners who are bankruptcy lawyers, though.

State law has traditionally governed what property is exempt from execution by creditors, including a trustee in bankruptcy. Recently, a concerted effort was made to limit the application of state exempt property laws in the case of bankruptcy. However, that effort largely failed, and so, for now, a debtor in bankruptcy can still rely on state statutes declaring certain types of property to be exempt, unless the federal exemptions are elected.

### **ARTICLE 2 HOMESTEAD.**

#### **2.1 TEXAS HAS ONE OF THE MOST GENEROUS HOMESTEAD EXEMPTIONS ON EARTH.**

Texas has one of the most “generous” homestead exemptions in the country, perhaps in the world. If you can fit the Taj Mahal on ten acres of land in downtown Houston, and it is your principal residence, it may fit the definition of homestead and be unreachable by your creditors. (Is the reader old enough to remember Billy Sol Estes?) Of course, if you are broke, you may have trouble paying the upkeep, much less the property taxes on the Taj Mahal, so a homestead in it may not be a realistic solution. Your Taj Mahal can be foreclosed upon to pay property taxes, a mortgage, or a mechanics and materialman’s lien. But it cannot be foreclosed upon to pay an unhappy patient, client or other ordinary claimant.

#### **2.2 WHAT IS THE HOMESTEAD.**

I have a penchant for letting a statute speak for itself whenever possible. In Texas, the homestead exemption is found in our Constitution.

##### **2.2(a) Art. §51 Of The Constitution**

Art. §51 of The Constitution defines the homestead:

“§51. Amount and value of homestead; uses

“Sec. 51. The homestead, **not** in a town or city, shall consist of not more than **two hundred acres** of land, which may be in one or more parcels, with the improvements thereon; the homestead **in a city**, town or village, shall consist of lot or contiguous lots amounting to not more than **10 acres** of land, together with any improvements on the land; **provided, that the homestead in a city, town or village shall be used for the purposes of a home**, or as both an urban home and a place to exercise a calling or business, of the homestead claimant, whether a single adult person, or the head of a family; provided also, that any temporary renting of the homestead shall not change the character of the same, when no other homestead has been acquired; provided further that a release or refinance of an existing lien against a homestead as to a part of the homestead does not create an additional burden on the part of the homestead property that is unreleased or subject to the refinance, and a new lien is not invalid only for that reason. [Emphasis added.]

Amended Nov. 2, 1999.

**2.2(b) No Restriction On Value Of Urban Homestead.**

Note that there is no longer a \$10,000 restriction on the value of an urban homestead lot. This dollar limitation was removed in 1983.

**2.2(c) During Life, A Claimant Is Entitled To A Business As Well As A Residential Homestead.**

The Constitution recognizes the existence of a business homestead as well as a residential homestead. The two are not mutually exclusive, and it should be possible to claim both.

An urban homestead need not consist of contiguous lots, and both residential and business properties are entitled to the exemption.<sup>1</sup> There are some very interesting possibilities in connection with the business homestead exemption, which are sometimes overlooked.

**2.2(d) Leasehold Homestead.**

It is possible to claim a leasehold interest as a homestead.<sup>2</sup>

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<sup>1</sup>*Miller v. Menke*, 56 Tex. 539 (1882); *Ford v. Aetna Insurance Co.*, 424 S.W.2d 612 (Tex. 1968), rehearing denied; *O'Neil v. Mack Trucks, Inc.*, 542 S.W.2d 112, 114 (Tex. 1976).

<sup>2</sup>*Davis v. Lund*, 41 S.W.2d 57 (Tex. Comm. App. 1931, holding approved. *Sullivan v. Barnett*, 471 S.W.2d 39 (Tex. 1971).

### **2.3 THE PROBATE HOMESTEAD.**

I told you that my experience with creditor claims came from counseling large insolvent estates. That is why, from my perspective, I consider the probate homestead exemption to be as important as the lifetime exemption. Much of the discussion that follows is concerned with the probate homestead, so if you are alive, you may wish to skip the next few sections as being someone else's problem your problem —for instance, your family's.

### **2.4 DISTINGUISH THE RIGHT OF OCCUPANCY AND THE RIGHT TO RECEIVE THE HOMESTEAD FREE OF DEBT.**

There are two discrete characteristics of a Texas homestead that are present at death. On the one hand, there is the right of the surviving spouse (and in some cases the guardian of the minor children) to use and occupy the homestead. On the other hand, there is the right to receive the homestead free of debts. These two rights should not be confused.

### **2.5 THE RIGHT TO USE AND OCCUPY THE HOMESTEAD.**

The surviving spouse of a deceased homestead owner has the right to use and occupy the homestead for life. This comes up often in a probate estate, and is not related to whether the estate is solvent or not. The estate can be perfectly solvent, but the decedent did not leave the home to the spouse. In that case, the spouse can assert homestead rights, and continue to live in the home for life. The persons who inherited the house (usually step-children) will just have to wait for their step-parent to die or to abandon the home.

#### **2.5(a) Art. 16, §52 Of The Constitution.**

§52. Descent and distribution of homestead; restrictions on partition

Sec. 52. On the death of the husband or wife, or both, the homestead shall descend and vest in like manner as other real property of the deceased, and shall be governed by the same laws of descent and distribution, but it shall not be partitioned among the heirs of the deceased during the lifetime of the surviving husband or wife, or so long as the survivor may elect to use or occupy the same as a homestead, or so long as the guardian of the minor children of the deceased may be permitted, under the order of the proper court having the jurisdiction, to use and occupy the same.

#### **2.5(b) Prob. Code §284.**

§284. When Homestead Not Partitioned.

The homestead shall not be partitioned among the heirs of the deceased during the lifetime of the surviving spouse, or so long as the survivor elects to use or occupy the same as a homestead, or so long as the guardian of the minor children of the deceased is permitted, under the order of the proper court having jurisdiction, to use and occupy the same.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 37, ch. 24, §13, eff. Aug. 27, 1979.

**2.5(c) Who Has Homestead Rights Following the Death of the Homestead Owner?**

The surviving spouse automatically has the right to use and occupy the homestead. This is true regardless of whether the homestead was the separate property of the decedent.<sup>3</sup> Note further, the court can order that the guardian of the decedent's minor children may use and occupy the homestead.<sup>4</sup> However, the homestead cannot be claimed by the children if there is a surviving spouse asserting the right.<sup>5</sup>

An unmarried child has no right to use and occupy the homestead following the death of the parents,<sup>6</sup> even though the existence of such a child may allow the homestead to pass free and clear of creditor claims.<sup>7</sup> This issue is discussed in more detail below.

**2.5(d) Surviving Spouse Has No Right to a Substitute Probate Homestead if the Decedent Spouse's Home is No Longer Suitable.**

The problem with the homestead is that there is no power of substitution. This means that if the surviving spouse desires to establish a homestead elsewhere, perhaps in a smaller home or in a more suitable location, the probate homestead may have to be abandoned. This often works a great inconvenience. This is one of the reasons that an estate does not get a marital deduction in Texas for the homestead interest passing to the surviving spouse.

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<sup>3</sup>Prob. Code §282.

<sup>4</sup>Prob. Code §284. Tex. Const. Art. 16, §52.

<sup>5</sup>*Shambaugh v. Scofield*, 132 F.2d 345 (5th Cir. 1942); *Ellis v Patrick*, 93 S.W. 1201 (Tex. Civ. App.- 1936, no writ); *Williams v. Jones*, 106 S.W. 755 (Tex. Civ. App.- 1908); *Garrison v. Ferguson's Estate*, 54 S.W. 247 (Tex. Civ. App.- 1899, writ ref'd); *Salmons v. Thomas*, 62 S.W. 102 (Tex. Civ. App. 1901, no writ).

<sup>6</sup>*Thompson v. Kay*, 124 Tex. 252, 77 S.W. 2d 201 (1934) at pages 209 & 214; *Quintana v. Giraud*, 209 W.W.770 (Tex. Civ App. -1919, no writ). *Hayworth v. Williams*, 102 Tex. 308, 313, 116 S.W. 43, 45, cited in *Thompson v. Kay*, *id.* at p. 209.

<sup>7</sup>*Ward v. Hinkle*, 117 Tex. 566, 8 S.W.2d 641 (1928); *First Coleman National Bank v. Vaughan*, 139 S.W.2d 870 (Tex. Civ. App. - 1940, writ dis'm'd).

## **2.5(e) Problems With The Mortgage And Other Expenses Associated With The Probate Homestead.**

Expenses in connection with the homestead may arise during its use and occupancy, and questions may arise as to who should be liable for these expenses: the homestead claimant or the estate and the remaindermen. The Texas Supreme Court has held that a homestead is akin to a life estate.<sup>8</sup> Therefore, expenses will generally be apportioned on the same basis as if the homestead claimant were the owner of a legal life estate, with the heirs being the remaindermen.

### **2.5(e)(1) Mortgage Payments.**

If the homestead is so burdened with debt as to be essentially worthless, the survivor may elect to receive an allowance in lieu of homestead. See below. Often however, the survivor chooses to assert his homestead rights despite the debt on the property. The question then becomes whether the decedent's estate should pay any portion of the debt, and if so how much. A life tenant is generally responsible for the portion of the mortgage payment representing interest; therefore, the surviving spouse as homestead claimant will usually bear this expense and the estate will be liable for its share of the principal payments. However, the will must be examined to determine if the executor intended otherwise. If the decedent directed that all debts be paid, and did not expressly authorize the executor to extend or continue existing indebtedness, an argument might be made that prepayment was required under the terms of the will.

### **2.5(e)(2) Upkeep.**

The homestead claimant, like a life tenant, is responsible for the expenses of care and maintenance, such as cost of repairs.<sup>9</sup>

### **2.5(e)(3) Taxes.**

The life tenant (and therefore, the homestead claimant) is responsible for ordinary taxes.<sup>10</sup>

### **2.5(e)(4) Insurance.**

The life tenant is **not** under a duty to insure the remainder.<sup>11</sup>

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<sup>8</sup>*Trimble v. Farmer*, 157 Tex. 533, 305 S.W.2d 157 (1957) and *Sargeant v. Sargeant*, 118 Tex. 343, 15 S.W.2d 589 (1929).

<sup>9</sup>*Murphy v. Slaton*, 154 Tex. 35, 273 S.W.2d 588 (1954).

<sup>10</sup>*Roberts v. Roberts*, 136 Tex. 255, 150 S.W.2d 236 (1941); *Trimble v. Farmer* 157 Tex. 533, 305 S.W.2d 157 (1957).

<sup>11</sup>*Richardson v. McCloskey*, 276 S.W. 820 (1925 Tex. Comm. Ap.); *Hill v. Hill*, 623 S.W.2d 779 (Tex. App.-Amarillo 1981, writ ref'd n.r.e.).

**2.5(f) The Election Issue.**

If the spouse's homestead claim is inconsistent with a gift to the spouse under the will, the spouse may be deemed to have been put to an election between the two. Although it is said that for an election to be required, the will must be open to no other construction,<sup>12</sup> the courts are occasionally quick to find that an election is implied.<sup>13</sup> It will usually be sufficient if the testator purports to dispose of both halves of the community property under the will.<sup>14</sup>

There appears, however, to be a decided trend in the more recent cases to require more in the way of affirmative evidence of an intent to force an election, on the theory that it is presumed the testatrix only intended to dispose of her own property.<sup>15</sup> For example, in *Noble v. Noble*<sup>16</sup> the court, citing *Lieber v. Mercantile Nat'l Bank*,<sup>17</sup> found no election to be implied where the will was simply silent on the subject:

In this case, the will of decedent contains no hint of an intention on testator's part that appellee's acceptance of benefits under the will shall preclude her from claiming the statutory allowance in favor of a surviving spouse.<sup>18</sup>

**2.5(g) Distinction Between Right Of Occupancy And Title.**

The right of occupancy is said to be entirely distinct from the title to the land, which may be in someone other than the homestead claimant.<sup>19</sup>

§283. Homestead Rights of Surviving Spouse

On the death of the husband or wife, leaving a spouse surviving, the homestead shall descend and vest in like manner as other real property of the deceased and shall be governed by the same laws of descent and distribution.

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<sup>12</sup>*Wright v. Wright*, 154 Tex. 138, 274 S.W.2d 670 (1955).

<sup>13</sup>*Little v. Birdwell*, 27 Tex 688 (1864); *Lindsley v. Lindsley*, 139 Tex. 512, 163 S.W.2d 633 (1942); *Miller v. Miller*, 149 Tex. 543, 235 S.W.2d 624 (1951).

<sup>14</sup>*Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968).

<sup>15</sup>*Smith v. Smith*, 657 S.W.2d 457 (Tex. App.-San Antonio 1984, writ ref'd, n.r.e.). *Noble v. Noble*, 636 S.W.2d 551 (Tex. App.—San Antonio 1982, no writ). *Churchill v. Churchill*, 780 S.W.2d 913 (Tex. App.—Fort Worth 1989, no writ).

<sup>16</sup>*Noble v. Noble*, 636 S.W.2d 551 (Tex. App.—San Antonio 1982, no writ).

<sup>17</sup>*Lieber v. Mercantile Nat'l Bank*, 331 S.W.2d 463, 465 (Tex. Civ. App.—Dallas 1960, writ ref'd n.r.e.).

<sup>18</sup>*Noble v. Noble*, 636 S.W.2d 551, 552 (Tex. App.—San Antonio 1982, no writ).

<sup>19</sup>*Woodward and Smith, Probate and Decedents' Estates*, Vol. 18, §862, TEXAS PRACTICE (1971). *Zwernemann v. Von Rosenberg*, 13 S.W. 285 (Tex. 1890).

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts. 1979, 66th Leg., p. 37, ch. 24, § 12, eff. Aug. 27, 1979.

## **2.6 ALLOWANCE IN LIEU OF PROBATE HOMESTEAD-PROB. CODE §273.**

If there is no homestead, the Probate Code provides for an allowance in lieu thereof, not to exceed \$15,000. Whoopee!

### **2.6(a) Probate Code §273.**

§273. Allowance in Lieu of Exempt Property

In case there should not be among the effects of the deceased all or any of the specific articles exempted from execution or forced sale by the Constitution and laws of this state, the court shall make a reasonable allowance in lieu thereof, to be paid to such surviving spouse and children, or such of them as there are, as hereinafter provided. The allowance in lieu of a homestead shall in no case exceed **\$15000** and the allowance for other exempted property shall in no case exceed **\$5000**, exclusive of the allowance for the support of the surviving spouse and minor children which is hereinafter provided for.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1977, 65th Leg., p. 351, ch. 172, § 1, eff. Aug. 29, 1977; Acts 1979, 66th Leg., p. 36, ch. 24, § 4, eff. Aug. 27, 1979; Acts 1993, 73rd Leg., ch. 846, §19, eff. Sept 1, 1993. (Emphasis added.)

### **2.6(b) Allowance Where Homestead Is “Incomplete” By Reason Of Large Encumbrance.**

The widow is entitled to an allowance in lieu of homestead if property is so heavily encumbered as to be useless.<sup>20</sup>

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<sup>20</sup>*Copplin v. Ewald*, 70 S.W.2d 608 (Tex. Civ. App.-San Antonio 1934, no writ) and *George v. First National Bank*, 67 S.W.2d 324 (Tex. Civ. App.-Amarillo 1933, writ ref'd). *Ward v. Braun*, 417 S.W.2d 888 (Tex. Civ. App.-Corpus Christi 1967, no writ).

**2.6(c) Apportionment Of Allowance In Lieu Of Homestead-Prob. Code §275.**

Allowances in lieu of exempt property are paid solely to the surviving spouse, unless there are children by another parent.<sup>21</sup> If there are children of the deceased who are not the children of the surviving spouse, the surviving spouse receives half of the whole, plus the shares of the children of whom the survivor is the parent, and the remaining shares are paid to the children (or their guardian) of whom the survivor is not the parent.<sup>22</sup> For this purpose, there does not appear to be any distinction in the Probate Code between the allowance in lieu of exempt personal property and the allowance in lieu of homestead, both of which are treated as different species of “allowances in lieu of exempt property.” This is interesting since children do not have homestead rights if there is a surviving spouse.<sup>23</sup>

The “children” referred to are minor children and unmarried children living at home, though the statute does not say so explicitly.

Is the allowance in lieu of homestead a community debt, like the family allowance?

**2.7 THE LIABILITY OF THE HOMESTEAD FOR DEBTS.**

**2.7(a) Art. 16, §50 Of The Constitution.**

Article 16, §50 of The Texas Constitution generally exempts the Texas homestead from forced sale, except in the case of a purchase money mortgage:

“§50. Homestead; protection from forced sale; mortgages, trust deeds and liens

“Sec. 50. The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for the purchase money thereof, or a part of such purchase money, the taxes due thereon, or for work and material used on constructing improvements thereon, and in this last case only when the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sale and conveyance of the homestead; nor may the owner or claimant of the property claimed as homestead, if married, sell or abandon the homestead without the consent of the other spouse, given in such manner as may be prescribed by law. No mortgage, trust deed, or other lien on the homestead shall ever be valid, except for the purchase money

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<sup>21</sup>Tex. Prob. Code §275.

<sup>22</sup>Tex. Prob. Code §275(c).

<sup>23</sup>*Shambaugh v. Scofield*, 132 F.2d 345 (5th Cir. 1942); *Ellis v Patrick*, 93 S.W. 1201 (Tex. Civ. App.- 1936, no writ); *Williams v. Jones*, 106 S.W. 755 (Tex. Civ. App.- 1908); *Garrison v. Ferguson's Estate*, 54 S.W. 247 (Tex. Civ. App.- 1899, writ ref'd); *Salmons v. Thomas*, 62 S.W. 102 (Tex. Civ. App. 1901, no writ).

therefor, or improvements made thereon, as hereinbefore provided, whether such mortgage, or trust deed, or other lien, shall have been created by the owner alone, or together with his or her spouse, in case the owner is married. All pretended sales of the homestead involving any condition of defeasance shall be void. This amendment shall become effective upon its adoption.

“Amended Nov. 6, 1973.”

**2.7(b) §270 Of The Probate Code.**

§270 of the Probate Code provides

“§270. Liability of Homestead for Debts:

“The homestead shall not be liable for the payment of any of the debts of the estate, except for the purchase money thereof, the taxes due thereon, or work and material used in constructing improvements thereon; and in this last case only when the work and material are contracted for in writing, with the consent of both spouses given in the same manner as required in making a sale and conveyance of the homestead.

“Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 35, ch. 24, § 1, eff. Aug. 27, 1979.”

But §270 does not tell us what the “homestead” is, or under what conditions the home will be a homestead following the death of the owner. Here, we have to look to case law and §271, discussed below.

**2.7(c) The Basic Rule.**

The basic rule is that the homestead and other exempt property passes free and clear of the claims of creditors, other than the creditors specifically listed in §270 (purchase money, improvements and taxes), if the decedent is survived by a family member described in Probate Code §271.<sup>24</sup>

**2.7(d) Who Are The Constituent Family Members That Can Cause The Homestead To Survive?**

The family members described in Probate Code §271 are the surviving spouse, minor children, and unmarried adult children remaining with the family, sometimes referred to in the literature as the *constituent* family members.

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<sup>24</sup>*Zwernemann v. Von Rosenberg*, 13 S.W. 285 (Tex. 1890); *Hoefling v. Hoefling*, 167 S.W. 210 (Tex. 1914); *Chisholm v. Mills*, 250 S.W.2d 268 (Tex. Civ. App.-Waco 1952, writ ref'd); *Kay v. Thompson*, 40 S.W.2d 884 (Tex. App.-Waco 1931, *affd*, *Thompson v. Kay*, 124 Tex. 252, 77 S.W.2d 201).

**2.7(e) Once The Homestead Passes Free And Clear Of Debt, It Matters Not That It Ceases To Be Used As A Homestead**In *George v. Taylor*, 296 S.W.2d 620 (Tex. Civ. App.-Fort Worth 1956, writ ref'd n.r.e.), the homestead was not liable for the decedent's debts, following the death of his widow. Anyone who inherits the property, receives it free from debts.<sup>25</sup>

**2.7(f) A Constituent Family Member Need Not Be A Beneficiary Of The Decedent's Estate In Order For The Homestead To Pass Free Of Debts**

Moreover, the homestead passes free of debt if the decedent is survived by a constituent family member, whether or not such family member inherits the homestead! In other words, the property can pass to a *nonconstituent* family member, free and clear of debt, if the decedent was survived by a constituent family member.<sup>26</sup>

Consider that if only an unmarried adult daughter or son was living at home at the date of the decedent's death, the homestead could be partitioned under Probate Code §285<sup>27</sup>; nevertheless an unmarried adult daughter or son living at home is within the class of constituent family members which cause the homestead to pass free and clear of debts, so, presumably, the property would pass free and clear in that event even if the decedent left the property to an unrelated third party who immediately took possession following administration.<sup>28</sup>

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<sup>25</sup>Woodward and Smith, *Probate and Decedents' Estates*, Vol. 18, §859, TEXAS PRACTICE (1971).

<sup>26</sup>*Chisholm v. Mills*, 250 S.W.2d 268 (Tex. Civ. App.-Waco 1952, writ ref'd); *Galloway v. Galloway*, 236 S.W.2d 832 (Tex. Civ. App.-Dallas 1951, no writ); Woodward and Smith, *Probate and Decedents' Estates*, Vol. 18, §856 & 857, p. 188-190, TEXAS PRACTICE (1971). *Dorman v. Grace*, 122 S.W. 401 (Tex. Civ. App.- 1909, writ ref'd); §52 of the Texas Constitution.

<sup>27</sup>*Thompson v. Kay*, 124 Tex. 252, 77 S.W. 2d 201 (1934) at pages 209 & 214; *Quintana v. Giraud*, 209 W.W.770 (Tex. Civ App. -1919, no writ). *Hayworth v. Williams*, 102 Tex. 308, 313, 116 S.W. 43, 45, cited in *Thompson v. Kay*, *id.* at p. 209.

<sup>28</sup>*Ward v. Hinkle*, 117 Tex. 566, 8 S.W.2d 641 (1928); *First Coleman National Bank v. Vaughan*, 139 S.W.2d 870 (Tex. Civ. App. - 1940, writ dism'd).

## **ARTICLE 3**

### **EXEMPT PERSONAL PROPERTY-PROBATE ASSETS.**

#### **3.1 ART. 16, §49 OF THE TEXAS CONSTITUTION.**

Article 16, §49, of the Texas Constitution provides:

§49. Protection of personal property from forced sale

Sec. 49. The Legislature shall have power, and it shall be its duty, to protect by law from forced sale a certain portion of the personal property of all heads of families, and also of unmarried adults, male and female.

#### **3.2 §42.001 AND §42.002 OF THE TEXAS PROPERTY CODE.**

Pursuant to Article 16, §49, of the Texas Constitution, the Legislature has enacted Texas Property Code §42.001 and §42.002, which read as follows:

##### **§42.001 Personal Property Exemption**

(a) Personal property, as described in Section 42.002, is exempt from garnishment, attachment, execution, or other seizure if:

(1) the property is provided for a family and has an aggregate fair market value of not more than \$60,000, exclusive of the amount of any liens, security interests, or other charges encumbering the property; or

(2) the property is owned by a single adult, who is not a member of a family, and has an aggregate fair market value of not more than \$30,000, exclusive of the amount of any liens, security interests, or other charges encumbering the property.

(b) The following personal property is exempt from seizure and is not included in the aggregate limitations prescribed by Subsection (a):

(1) current wages for personal services, except for the enforcement of court-ordered child support payments;

(2) professionally prescribed health aids of a debtor or a dependent of a debtor.

(c) This section does not prevent seizure by a secured creditor with a contractual landlord's lien or other security in the property to be seized.

(d) Unpaid commissions for personal services not to exceed 25 percent of the aggregate limitations prescribed by Subsection (a) are exempt from seizure and are included in the aggregate.

[Acts 1983, 68th Leg., p. 3522, ch. 576, § 1, eff. Jan. 1, 1984. Amended by Acts 1991, 72nd Leg., ch. 175, § 1, eff. May 24, 1991.]

Section 2 of the 1991 amendatory act provides:

The changes in law made by this Act do not apply to property that is, as of the effective date of this Act, subject to a voluntary bankruptcy proceeding or to valid

claims of a holder of final judgment who has, by levy, garnishment, or other legal process, obtained rights superior to those that otherwise would be held by a trustee in bankruptcy if a bankruptcy petition were then pending against the debtor. That property is subject to the law as it existed immediately before the effective date of this Act, and the prior law is continued in effect for that purpose.]

#### **§42.002 Personal Property**

- (a) The following personal property is exempt under Section 42.001(a):
- (1) home furnishings, including family heirlooms;
  - (2) provisions for consumption;
  - (3) farming or ranching vehicles and implements;
  - (4) tools, equipment, books, and apparatus, including boats and motor vehicles used in a trade or profession;
  - (5) wearing apparel;
  - (6) jewelry not to exceed 25 percent of the aggregate limitations prescribed by Section 42.001(a);
  - (7) two firearms;
  - (8) athletic and sporting equipment, including bicycles;
  - (9) a two-wheeled, three-wheeled, or four-wheeled motor vehicle for each member of a family or single adult who holds a driver's license or who does not hold a driver's license but who relies on another person to operate the vehicle for the benefit of the nonlicensed person;
  - (10) the following animals and forage on hand for their consumption;
    - (A) **two horses, mules, or donkeys and a saddle, blanket, and bridle for each;**
    - (B) 12 head of cattle;
    - (C) 60 head of other types of livestock; and
    - (D) 120 fowl;
  - (11) household pets; and
  - (12) the present value of any life insurance policy to the extent that a member of the family of the insured or a dependent of a single insured adult claiming the exemption is a beneficiary of the policy.
- (b) Personal property, unless precluded from being encumbered by other law, may be encumbered by a security interest under Section 9.203, Business & Commerce Code, or Sections 41 and 42, Certificate of Title Act (Article 6687-1, Vernon's Texas Civil Statutes), or by a lien fixed by other law.

[Acts 1983, 68th Leg., P. 3522, ch. 576, § 1, eff. Jan. 1, 1984. Amended by Acts

1991, 72nd Leg., ch. 175, § 1, eff. May 24, 1991. For applicability provision of the 1991 amendatory act, see note following § 42.001.]

### **3.3 EXEMPT PROBATE PROPERTY**

#### **3.3(a) Exempt Probate Property To Be Set Apart-Prob. Code §271.**

All property that is exempt from execution by creditors is required to be set aside for the family immediately after the approval of the inventory, or sooner, if an affidavit of need.

#### **3.3(b) Exempt Probate Property To Vests In Heirs If Estate Solvent And In Family If Estate Is Insolvent-Prob. Code §§278 and 279.**

If, upon final settlement, the estate shall “appear” to be solvent, “the exempted property, except the homestead or any allowance in lieu thereof, shall be subject to partition and distribution among the heirs and distributees of such estate in like manner as the other property of the estate.”<sup>29</sup>

However, if the estate should “prove” to be insolvent, “the title of the surviving spouse and children to all the property and allowances set apart or paid to them under the provisions of this Code shall be absolute, and shall not be taken for any of the debts of the estate except as hereinafter provided.”<sup>30</sup>

#### **3.3(c) Exempt Probate Property May Be Liable For Certain Debts-Prob. Code §281.**

§281 of the Probate Code provides:

##### §281. Exempt Property Liable for Certain Debts

The exempt property, other than the homestead or any allowance made in lieu thereof, shall be liable for the payment of Class 1 claims [i.e., ‘funeral expenses and expenses of last sickness in a reasonable amount not to exceed \$15,000, with any excess to be classified as an unsecured claim’], but such property shall not be liable for any other debts of the estate.<sup>31</sup>

#### **3.3(d) Allowance In Lieu Of Exempt Probate Personal Property-Prob. Code §273.**

As indicated above, Probate Code §273 grants a surviving spouse and children an allowance in lieu of exempt property, not to exceed \$5000, “In case there should not be among the effects of the deceased all or any of the specific articles exempted from execution or forced sale by the Constitution and laws of this state.”

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<sup>29</sup>Prob. Code §278.

<sup>30</sup>Prob. Code §279.

<sup>31</sup>Prob. Code §281.

The case law appears to make the allowance in lieu of exempt property all but automatic, whether the estate is solvent or not, and whether or not the spouse demonstrates a need for the allowance,<sup>32</sup> in the absence of an election.<sup>33</sup> Thus, the only issue is whether or not \$5000 worth of exempt property is missing from the estate, which will usually be the case, for it is hard to imagine a decedent that owned all of the items of personal property enumerated above in Property Code 42.002.<sup>34</sup>

Recall that although exempt property is to be set aside for the family, if the estate is solvent the exempt property, **“except the homestead or any allowance in lieu thereof,”** is subject to partition and distribution.<sup>35</sup> However, if the estate is insolvent, “the title of the surviving spouse and children to all the property and **[all] allowances** shall be absolute, and shall not be taken for any of the debts of the estate.”<sup>36</sup> Note that it is only the allowance in lieu of homestead that is specifically mentioned as not being subject to partition in a solvent estate, but that all allowances are specified as being exempt and remaining titled in the family, if the estate is insolvent. Does this imply that if the estate is solvent, the allowance in lieu of homestead may be retained, but the allowance in lieu of other exempt property must be returned? There are no cases that make this distinction, and although the Woodward and Smith treatise discusses the allowance in lieu of exempt property at length —emphasizing the categorical nature of the right— the authors do not even hint at the existence of an obligation to return the allowance if the estate proves solvent.<sup>37</sup>

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<sup>32</sup>Woodward and Smith, *Probate and Decedents' Estates*, 18 TEXAS PRACTICE (1971), §874. *Mabry v. Ward*, 50 Tex. 404 (1878). *First National Bank v. MacFarlane*, 160 S.W.2d 969 (Tex. Civ. App.— xxx 1942, writ ref'd w.o.m.). *In Re Mays Estate*, 43 S.W.2d 306 (Tex. Civ. App.— Beaumont 1931, writ ref'd). *Hickman v. Hickman*, 149 Tex. 439, 234 S.W.2d 410 (1950).

<sup>33</sup>*Cooper v. Cooper*, 168 S.W.2d 686 (Tex. Civ. App.-Galveston 1943, no writ).

<sup>34</sup>For example, if the estate were missing a breeding age bull or a few guineas.

<sup>35</sup>Prob. Code §278.

<sup>36</sup>Prob. Code §279.

<sup>37</sup>Woodward and Smith, *Probate and Decedents' Estates*, 18 TEXAS PRACTICE (1971), §869-882.

### **3.4 APPORTIONMENT OF ALLOWANCES BETWEEN SURVIVING SPOUSE AND MINOR CHILDREN IN PROBATE PROCEEDINGS-PROB. CODE §275.**

Allowances in lieu of exempt property are paid solely to the surviving spouse, unless there are children by another parent.<sup>38</sup> If there are children of the deceased who are not the children of the surviving spouse, the surviving spouse receives half of the whole, plus the shares of the children of whom the survivor is the parent, and the remaining shares are paid to the children (or their guardian) of whom the survivor is not the parent.<sup>39</sup> For this purpose, there does not appear to be any distinction in the Probate Code between the allowance in lieu of exempt personal property and the allowance in lieu of homestead, both of which are treated as different species of “allowances in lieu of exempt property.”

Is the allowance in lieu of exempt property a community debt, like the family allowance?

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<sup>38</sup>Tex. Prob. Code §275.

<sup>39</sup>Tex. Prob. Code §275(c).

## **ARTICLE 4**

### **THE PROBATE FAMILY ALLOWANCE**

#### **4.1 THE STATUTES.**

The surviving spouse and minor children are entitled to an allowance for support sufficient for maintenance for one year from the time of the death of the decedent.<sup>40</sup>

**§286. Family Allowance to Surviving Spouses and Minors.** Immediately after the inventory, appraisal, and list of claims have been approved, the court shall fix a family allowance for the support of the surviving spouse and minor children of the deceased.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 38, ch. 24, § 15, eff. Aug. 27, 1979.

**§287. Amount of Family Allowance.** Such allowance shall be of an amount sufficient for the maintenance of such surviving spouse and minor children for one year from the time of the death of the testator or intestate. The allowance shall be fixed with regard to the facts or circumstances then existing and those anticipated to exist during the first year after such death. The allowance may be paid either in a lump sum or in installments, as the court shall order.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 38, ch. 24, §16, eff. Aug. 27, 1979.

**§288. When Family Allowance Not Made.** No such allowance shall be made for the surviving spouse when the survivor has separate property adequate to the survivor's maintenance; nor shall such allowance be made for the minor children when they have property in their own right adequate to their maintenance.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. I, 1956. Amended by Acts 1979, 66th Leg., p. 38, ch. 24, § 17, eff. Aug. 27, 1979.

**§289. Order Fixing Family Allowance.** When an allowance has been fixed, an order shall be entered stating the amount thereof, providing how the same shall be payable, and directing the executor or administrator to pay the same in accordance with law.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956.

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<sup>40</sup>Tex. Prob. Code §§286-287.

**§290. Family Allowance Preferred.** The family allowance made for the support of the surviving spouse and minor children of the deceased shall be paid in preference to all other debts or charges against the estate, except expenses of the funeral and last sickness of the deceased.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 38, ch. 24, § 18, eff. Aug. 27, 1979.

**§291. To Whom Family Allowance Paid.** The executor or administrator shall apportion and pay the family allowance:

(a) To the surviving spouse, if there be one, for the use of the survivor and the minor children, if such children be the survivors.

(b) If the surviving spouse is not the parent of such minor children, or of some of them, the portion of such allowance necessary for the support of such minor child or children of which the survivor is not the parent shall be paid to the guardian or guardians of such child or children.

(c) If there be no surviving spouse, the allowance to the minor child or children shall be paid to the guardian or guardians of such minor child or children.

(d) If there be a surviving spouse and no minor child or children, the entire allowance shall be paid to the surviving spouse.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 38, ch. 24, § 19, eff. Aug. 27, 1979.

**§292. May Take Property for Family Allowance.** The surviving spouse, or the guardian of the minor children, as the case may be, shall have the right to take in payment of such allowance, or any part thereof, any of the personal property of the estate at its appraised value as shown by the appraisal; provided, however, that property specifically devised or bequeathed to another may be so taken, or may be sold to raise funds for the allowance as hereinafter provided, only if the other available property shall be insufficient to provide the allowance.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 39, ch. 24, § 20, eff. Aug. 27, 1979.

**§293. Sale to Raise Funds for Family Allowance.** If there be no personal property of the deceased that the surviving spouse or guardian is willing to take for such allowance, or not a sufficiency of them, and if there be no funds or not sufficient funds in the hands of such executor or administrator to pay such allowance, or any part thereof, then the court, as soon as the inventory, appraisalment, and list of claims are returned and approved, shall order a sale of so much of the estate for cash as will be sufficient to raise the amount of such allowance, or a part thereof, as the case requires.

Acts 1955, 54th Leg., p. 88, ch. 55, eff. Jan. 1, 1956. Amended by Acts 1979, 66th Leg., p. 39, ch. 24, § 21, eff. Aug. 27, 1979.

#### **4.2 AMOUNT OF THE ALLOWANCE.**

The allowance is to be in an amount sufficient for the maintenance of the surviving spouse and minor children for one year after the decedent's death. The allowance is to be fixed with regard to the facts or circumstances then existing and those anticipated to exist during the first year after death.<sup>41</sup>

#### **4.3 TO WHOM IS THE ALLOWANCE PAID?**

The allowance is paid to the surviving spouse for the use of the survivor and the minor children, if the children are the survivor's.<sup>42</sup> If the surviving spouse is not the parent of all of the minor children, the portion of the allowance necessary for the support of the children of which the survivor is not the parent is paid to the guardian of those children.<sup>43</sup>

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<sup>41</sup>Tex. Prob. Code §287.

<sup>42</sup>Tex. Prob. Code §291(a).

<sup>43</sup>Tex. Prob. Code §291(b).

#### **4.4 HOW IS THE ALLOWANCE CHARGED?**

The family allowance is a debt against the estate<sup>44</sup> in the nature of a support obligation.<sup>45</sup> Therefore the obligation is charged against both halves of the community estate first (not just the survivor's half).<sup>46</sup> Because the allowance is a community obligation, the estate is probably only liable for half of the allowance.<sup>47</sup> The decedent's separate property is liable to the extent that the community estate is insufficient.<sup>48</sup> Is the survivor's half of the community charged for the portion of the allowance payable to the minor children of which the survivor is not the parent?

#### **4.5 CONSIDERATION OF THE SURVIVING SPOUSE'S (AND MINOR CHILDREN'S) OTHER ASSETS.**

No allowance is to be made if the surviving spouse (and minor children) have separate property sufficient for their maintenance.<sup>49</sup> Because of this requirement, it has been held that, in establishing the allowance, neither community property nor property inherited under the will shall be considered.<sup>50</sup> In all other respects the court has discretion to consider all of the surrounding facts and circumstances.<sup>51</sup> Of particular importance is the survivor's condition in life and accustomed manner of living.<sup>52</sup>

What if the survivor has separate property but the minor children do not? Apparently, an allowance is to be made for the children and not the spouse, and it would be paid to the survivor to be used solely for the children's benefit.<sup>53</sup>

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<sup>44</sup>*Ward v. Braun*, 417 S.W.2d 888, at 894, (Tex. Civ. App.-Corpus Christi 1967, no writ). *Pace v. Eoff*, 48 S.W.2d 956 (Tex. Comm'n App. 1932, jdgmt adopted).

<sup>45</sup>*Cf. Hutchings v. Bates*, 393 S.W.2d 338 (Tex. Civ. App. —xxx 1965, *aff'd* 406 S.W.2d 410 (Tex. 1966)).

<sup>46</sup>*Miller v. Miller*, 235 S.W.2d 624 (Tex. 1951). See also *Miller v. Miller*, 230 S.W.2d 237 (Tex. Civ. App.—Beaumont 1950, rev'd on other grounds, 235 S.W.2d 624).

<sup>47</sup>*Pace v. Eoff*, 48 S.W.2d 956, at 959-960 (Tex. Comm'n App. 1932, jdgmt adopted). *Ward v. Braun*, 417 S.W.2d 888 (Tex. Civ. App.-Corpus Christi 1967, no writ). *Miller v. Miller*, 235 S.W.2d 624, 628-29 (Tex. 1951).

<sup>48</sup>*Ward v. Braun*, 417 S.W.2d 888, at 894 (Tex. Civ. App.-Corpus Christi 1967, no writ).

<sup>49</sup>Tex. Prob. Code §288.

<sup>50</sup>*Pace v. Eoff*, 48 S.W.2d 956 (Tex. Comm'n App. 1932, jdgmt adopted) and *Ward v. Braun*, 417 S.W.2d 888 (Tex. Civ. App.-Corpus Christi 1967, no writ).

<sup>51</sup>*Gonzalez v. Gonzalez*, 541 S.W.2d 865 (Tex. Civ. App.-Waco 1976, no writ).

<sup>52</sup>*Kennedy v. Draper*, 575 S.W.2d 627 (Tex. Civ. App.-Waco 1978, no writ).

<sup>53</sup>*Cooper v. Pierce*, 74 Tex. 526, 12 S.W. 211 (1889). Tex. Prob. Code §291(a).

#### **4.6 WHEN IS THE ALLOWANCE DUE.**

The family allowance is ordinarily to be paid immediately after the inventory, appraisal, and list of claims have been approved by the court.<sup>54</sup> However, a recent amendment to the Probate Code provides:

Before the approval of the inventory, appraisal, and list of claims, a surviving spouse or any person who is authorized to act on behalf of minor children of the deceased may apply to the court to have the court fix the family allowance by filing an application and a verified affidavit describing the amount necessary for the maintenance of the surviving spouse and minor children for one year after the date of the death of the decedent and describing the spouse's separate property and any property that the minor children have in their own right. The applicant bears the burden of proof by a preponderance of the evidence at any hearing on the application. The court shall fix a family allowance for the support of the surviving spouse and minor children of the deceased.<sup>55</sup>

#### **4.7 APPLICATION TO INDEPENDENT ADMINISTRATIONS.**

Although the statute says that "the court shall fix a family allowance,"<sup>56</sup> the family allowance is a claim against the estate, and as such, is to be set, at least initially, by the independent executor,<sup>57</sup> free from court control, in those cases where an independent administration is pending:

An independent executor, in his administration of an estate, although free from the control of the court, shall nevertheless, independently of and without application to, or any action in or by the court . . . set aside and deliver to those entitled thereto exempt property and allowances for support, and in lieu of homestead, as prescribed in this Code, to the same extent and result as if his actions had been accomplished in and under orders of, the court.<sup>58</sup>

Presumably, Probate Code §146 operates in cases where §286(b) otherwise allows the spouse to "apply to the court to have the court fix the family allowance" prior to the approval of the inventory. If so, the application by the spouse should be made to the independent executor rather than the court.

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<sup>54</sup>Tex. Prob. Code §286(a).

<sup>55</sup>Tex. Prob. Code §286(b).

<sup>56</sup>Tex. Prob. Code §286(a).

<sup>57</sup>Woodward and Smith, *Probate and Decedents' Estates*, 17 TEXAS PRACTICE (1971), §504. *Runnels v. Runnels*, 27 Tex. 515 (1864).

<sup>58</sup>Tex. Prob. Code §146. *Cf. Runnels v. Runnels*, 27 Tex. 515 (1864).

If the independent executor refuses to set the allowance, or if the surviving spouse is dissatisfied with the size of the allowance set, then the spouse may prosecute a claim against the estate in the manner of any other dissatisfied creditor.<sup>59</sup>

#### **4.8 THE ELECTION ISSUE.**

The election issue is ubiquitous. It exists with respect to all of the various statutory rights that to which the survivor is otherwise entitled. As was the case with the homestead, if the widower claims allowances that are inconsistent with a gift under the Will, he will be put to an election.<sup>60</sup> However, the more recent decisions are cautious in applying this doctrine and will not infer an election requirement unless the will is very explicit.<sup>61</sup>

#### **4.9 PAYMENT, CLASSIFICATION AND PRIORITY.**

The family allowance is to be paid in preference to all other debts or charges against the estate, except expenses of the funeral and last sickness of the deceased.<sup>62</sup> However, it may be inferior to claims by the federal government. In general, claims of the United States are given superior priority over all other “debts”.<sup>63</sup> The family allowance is not, strictly speaking, a “debt”, and the 1977 8th Circuit decision of *Schwartz v. Commissioner*,<sup>64</sup> indicates that such allowances are not subject to the superior priority of United States claims. This issue has yet to be squarely determined and there is contrary authority.<sup>65</sup>

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<sup>59</sup>*Kopplin v. Ewald*, 70 S.W.2d 608 (Tex. Civ. App.— San Antonio 1934, no writ).

<sup>60</sup>*Little v. Birdwell*, 27 Tex 688 (1864); *Lindsley v. Lindsley*, 139 Tex. 512, 163 S.W.2d 633 (1942); *Miller v. Miller*, 149 Tex. 543, 235 S.W.2d 624 (1951).

<sup>61</sup>*Noble v. Noble*, 636 S.W.2d 551 (Tex. App.-San Antonio 1982, no writ).

<sup>62</sup>Tex. Prob. Code §286.

<sup>63</sup>31 U.S.C.A. §3713.

<sup>64</sup>*Schwartz v. Commissioner*, 560 F.2d 311 (8th Cir. 1977).

<sup>65</sup>*Federal Reserve Bank of Dallas v. Smylie*, 134 S.W.2d 838 (Tex. Civ. App.-Amarillo 1939, no writ).

## **ARTICLE 5**

### **EXEMPT PROPERTY—NONPROBATE ASSETS.**

#### **5.1 CAN A DECEDENT'S CREDITORS REACH NONPROBATE ASSETS?**

An interesting question is the extent to which creditors can reach non-probate assets. Just because an asset is a non-probate asset does not mean that it is automatically exempt from the decedent's debts, but in many instances this may be the result. Recall that there is at least one significant species of property that is a probate asset in the sense that it is subject to testamentary disposition, and yet is not subject to administration without the consent of the surviving spouse, *viz.*, the decedent's interest in the surviving spouse's special community estate.

In this context it is important to remember that with respect to certain community debts, the survivor may be jointly liable with the decedent.

#### **5.2 LIFE INSURANCE.**

##### **5.2(a) General Creditors Under The Common Law Exemption.**

Death benefit proceeds under a life insurance policy have historically been held to be beyond the reach of the decedent's creditors unless paid to the estate, or unless there was an intent to defraud creditors (whatever that means).<sup>66</sup> The theory was that when the beneficiary is designated, the decedent has made a revocable gift which becomes irrevocable at death. Whether or not the transfer is in fraud on creditors was, therefore, generally to be made at the time the beneficiary is designated. If the decedent was insolvent at the time of the beneficiary designation, the fraudulent transfer rules were likely to operate to prevent the exemption.

##### **5.2(b) Estate Taxes.**

Unless the decedent directs otherwise in his will, the executor is entitled to recover from the beneficiary of life insurance proceeds, the pro rata share of Federal estate taxes attributable to such proceeds. Internal Revenue Code §2206. A similar rule applies under Internal Revenue Code §2207 with respect to property over which the decedent had a power of appointment under §2041. (Interestingly, there is no corresponding provision for property includable in the decedent's Federal gross estate (for Federal estate tax purposes) by virtue of a retained power under §2036.)

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<sup>66</sup>*Parker Square State Bank v. Huttash*, 484 S.W.2d 429 (Tex. Civ. App.-Ft. Worth 1972, writ ref'd); *Pope Photo Records, Inc. v. Malone*, 539 S.W.2d 224 (Tex. Civ. App.-Amarillo 1976, no writ); *Oden v. McAdams*, 108 S.W.2d 920 (Tex. Civ. App.-Waco 1937, no writ); *San Jacinto Building, Inc. v. Brown*, 79 S.W.2d 164 (Tex. Civ. App.-Beaumont 1935, writ ref'd); and *Lane v. Kuehn*, 141 S.W.2d 363 (Tex. Civ. App.-Texarkana 1911 aff'd, 167 S.W. 804). See also Art. 21.22 of the Texas Insurance Code.

Texas now has an apportionment statute (Prob. Code §322A), which may serve as enabling legislation giving the executor the power under State law to enforce Internal Revenue Code §§2206 and 2207.

**5.2(c) Article 21.22 Of The Texas Insurance Code.**

This exemption described above has been incorporated in a much expanded form into the insurance code. The first broad exemption was added in 1987, but the courts limited its application. In 1991 the statute was amended again. The statute was further amended in 1993 to include individual annuities. The 1993 amendments are indicated in italics below. The pertinent provisions of the statute are set forth verbatim below:

Art. 21.22. *Unlimited Exemption of Insurance Benefits and Certain Annuity Proceeds From Seizure Under Process*

Sec. 1 Notwithstanding any provision of this code other than this article, all money or benefits of any kind, **including policy proceeds and cash values**, to be paid or rendered to the **insured** or any **beneficiary** under any policy of insurance *or annuity contract* issued by a life, health or accident insurance company, **including** mutual and fraternal insurance, **or** under any plan or program of **annuities** and benefits in use by any **employer or individual**, shall:

- (1) inure exclusively to the benefit of **the person for whose use and benefit the insurance or annuity is designated in the policy or contract**;
- (2) **be fully exempt from execution**, attachment, garnishment or other process;
- (3) be fully exempt from being seized, taken or appropriated or applied by any legal or equitable process or operation of law to pay any debt or liability **of the insured or of any beneficiary**, either before or after said money or benefits is or are paid or rendered, and
- (4) be fully exempt from all demands in any bankruptcy proceeding of the insured or beneficiary.

Sec. 2 The exemptions provided by Section 1 of this article apply without regard to whether:

- (1) the power to change the beneficiary is reserved to the **insured**; or
- (2) the insured or the insured's estate is a contingent beneficiary.

Sec. 3 The exemptions provided by Section 1 of this article do not apply to:

- (1) premium payments made in fraud of creditors subject to the applicable statute of limitations for the recovery of the premium payments; or
- (2) a debt of the insured or beneficiary secured by a pledge of the policy or its proceeds.

Sec. 4 This article does not prevent the proper assignment of any money or benefits to be paid or rendered under an insurance policy or annuity contract to which this article applies, or any rights under the policy or contract, by the insured, owner, or annuitant in accordance with the terms of the policy or contract.

Sec. 5 Wherever any policy of insurance, annuity contract, or plan or program of annuities and benefits mentioned in Section 1 of this article shall contain a provision against assignment or commutation by any beneficiary thereunder of the money or benefits to be paid or rendered thereunder, or any rights therein, any assignment or commutation or any attempted assignment or commutation by such beneficiary of such money or benefits or rights in violation of such provision shall be wholly void. [Emphasis added.]

*Sec. 6 For purposes of regulation under this code, an annuity contract issued by a life, health, or accident insurance company, including a mutual company or fraternal company, or under any plan or program of annuities or benefits in use by an employer or individual, shall be considered a policy or contract of insurance. [Emphasis added.]*

**5.2(d) Limitations on Application of Statute.**

It seems clear that the legislature intended by the amendment for the exemption to extend to the cash value of life insurance without a dollar limitation, in response to a case that had held that the prior version of the statute was limited by the overall exemption dollar limitation for personal property found in Property Code §42.001(a)(1). However, this question is still not free from doubt.

Article 21.22 was amended in 1991. When Section 1 was added in 1987 there was doubt as to whether it would be literally construed. At least one bankruptcy case held that Section 1 of Article 21.22 was limited by Property Code §42.001 which limits the exemption for personal property to \$60,000 in the case of a family and \$30,000 in the case of a single individual.<sup>67</sup> The 1991 amendment added the phrase “Notwithstanding any provision of this **code** other than this article” to the first sentence of section 1. My interpretation of this article is that it should not be read literally without limitation; however, in the context where the statute is found, the “code” is the Insurance Code and not the Property Code. Therefore, it is possible that contrary to the apparent intent of the legislature, a court may once again seek to limit the application of the statute.

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<sup>67</sup>*In re Brothers*, Bkrcty. N.D. Tex., 1988, 94 B.R. 82.

The Texas Attorney General considered this issue in Opinion No. DM-125, and concluded that “the total exemption provided for the cash value of a life insurance policy in article 21.22, section 1 of the Insurance Code to prevail over the limited exemption provided in sections 42.001 and 42.002 of the Property Code. Life insurance proceeds and cash values thus are wholly exempt from seizure under process.”

A 1993 bankruptcy case recognized that there is no limitation on the amount of life insurance exempted under 21.22, but held that **any exemption claimed under 21.22 will reduce the amount available under the personal property exemption found in the Property Code**, which is limited to \$60,000.<sup>68</sup>

**Note further that this exemption arguably does not apply to the owner as such, unless the owner is also the insured or a beneficiary.** The exemption applies to “policy proceeds and cash values, to be paid or rendered to the *insured* or any *beneficiary*.” Cf. *In re Gould* (*Gould v. Phillips*, 457 F.2d 393 (5th Cir. 1972); *Bartholow v. Garner*, 43 Bankr. 463 (N.D. Tex. 1984).

Private annuities were made exempt under the statute in 1993. The exemption for annuities was recognized by the 5th Circuit in a 1994 decision *Walden v. McGinnes* (5th Cir. 1994) Case No. 93-8207.

Query: What is an annuity? Traditionally an annuity was thought of as the opposite of a life insurance contract. Under the terms of a true, traditional life contingency only annuity, the annuitant received annuity payments at regular fixed intervals and in fixed amounts. On the death of the annuitant the annuity payments ceased. If the annuitant outlives his life expectancy, the annuitant wins; if the annuitant does not outlive his life expectancy, the annuity company wins: the opposite of life insurance. A common variation on the traditional theme is to put a term certain feature in the contract, thereby limiting the risk of premature death to the annuitant. There is a price for this—the periodic payments will be reduced somewhat to reflect this additional obligation of the annuity company. An annuity contract for the life of the participant or for ten years, whichever is longer, is a common annuity feature.

Modern annuity contracts, like life insurance contracts, are beginning to look more and more like investment contracts, little different from an investment in a mutual fund, in the case of certain variable contracts. The IRS has struggled with this issue for years, and periodically Congress responds with legislation such as that we have seen in recent years under TEFRA and TRA '86 where restrictions have been placed on single premium deferred contracts, modified endowment contracts and the like.

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<sup>68</sup>In Re Bowes, Case No. 293-20135, Bkrtcy. N.D. Tex. (10/29/93).

The question posed here is when is a contract that is defined as an “annuity” or “life insurance” under the contract what it purports to be under Art. 21.22. Perhaps the question could favorably be resolved by asking whether the contract is subject to regulation under the Insurance Code, which it probably is, in which case it ought to benefit from the exemption described by the Code.

### **5.3 MULTIPLE PARTY ACCOUNTS IN PROBATE.**

The creditor can reach non-probate assets owned by the decedent in a multiple party account only if other probate assets are insufficient to pay the decedent's debts.<sup>69</sup>

### **5.4 PROBATE CREDITORS CLAIMING ASSETS HELD IN JOINT TENANCY WITH RIGHT OF SURVIVORSHIP.**

It may be the case that upon the death of one joint tenant, the other joint tenant takes the property free and clear of the claims of the deceased joint tenant. The argument would be that there is no fraudulent transfer. (And even if there were, do the fraudulent transfer statutes apply at death?) The property passes to the surviving joint tenant by operation of law. That being the case, on what basis can a creditor of the deceased joint tenant levy on property owned by someone else. Since the joint tenancy is reciprocal, it is even arguable that the surviving joint tenant paid fair and adequate consideration for the survivorship interest.

### **5.5 IRAS.**

Prior to the passage of Tex. Prop. Code §42.0021, effective September 1, 1987, a general creditor probably could reach assets held in an IRA, both during the decedent's lifetime and after death. The prohibition on alienation found in ERISA §206(d) and its IRC counterpart, §401(a)(13), does not apply to IRAs. However, at death, the analogy to life insurance would seem to have been apt.

Effective September 1, 1987, an IRA account was added to the list of items constituting property exempt from execution from creditors under State law.<sup>70</sup>

For a Texas case holding that IRA proceeds are not probate assets and do not belong to the estate beneficiaries in the absence of fraud, see *Ashmore v. Carter*, 716 S.W.2d 171 (Tex. App.-Beaumont 1986, no writ). Of course the problem in Texas continues to be what happens to the nonparticipant spouse's community property interest in the IRA when it is the nonparticipant spouse that dies first. If this interest passes under the nonparticipant spouse's will as a probate asset, it is somewhat ironic that if the participant had died it would have been a nonprobate asset. Perhaps, however, the irony is no different than when the noninsured spouse dies owning a community property interest in a life insurance policy standing in the name of the survivor.

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<sup>69</sup>Tex. Prob. Code §442.

<sup>70</sup>Tex. Prop. Code §42.0021.

## **5.6 QUALIFIED PLAN ASSETS.**

ERISA §206(d) and Internal Revenue Code §401(a)(13) require that a qualified plan, as a condition of qualification, contain a prohibition against alienation. With the exception of bankruptcy, the courts have generally held qualified plan assets to be generally exempt from execution by creditors.<sup>71</sup>

Bankruptcy was thought for a while to be an exception to the rule, unless the trust would constitute a *spendthrift* trust under local law.<sup>72</sup> However, the United States Supreme Court has settled this issue in favor of the debtor.

In *Patterson v. Shumate* the Court held that the antialienation provision of ERISA is applicable nonbankruptcy law under §541(c)(2) of the Bankruptcy Code, and therefore, assets in a qualified plan are exempt even in bankruptcy.<sup>73</sup> The decision affects Texas plan participants, because even though Texas residents have the benefit of a state exemption for qualified plan benefits,<sup>74</sup> it had been argued (so far unsuccessfully) that this exemption was preempted under ERISA §514(a) because it “relates” to an employee benefit plan.<sup>75</sup>

However, this issue may have been mostly irrelevant to a decedent’s estate (unless the decedent was in bankruptcy at the date of his death) because an estate is not subject to the Bankruptcy laws!<sup>76</sup>

## **5.7 EMPLOYEE DEATH BENEFITS.**

Property Code §§121.051 and 121.055 exempts certain employer sponsored death benefits, including nonqualified salary continuation arrangements, from execution by creditors.

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<sup>71</sup>*Tenneco, Inc. v. First Virginia Bank (Tidewater)*, 698 F.2d 688 (4th Cir. 1983); *Ellis National Bank v. Irving Trust Co.*, 786 F.2d 466 (2d Cir. 1986).

<sup>72</sup>*McLean v. Central States, Southeast and Southwest Areas Pension Fund*, 762 F.2d 1204 (4th Cir. 1985); *Goff v. Taylor*, 706 F.2d 574 (5th Cir. 1983); *Samore v. Graham*, 726 F.2d 1268 (8th Cir. 1984); *In re Lichstrahl*, 750 F.2d 1488 (11th Cir. 1985); and *In re Daniel*, 771 F.2d 1352 (9th Cir. 1985). *In the matter of Brooks*, 844 F.2d 258 (5th Cir. 1988).

<sup>73</sup>*Patterson v. Shumate* is 112 S. Ct. 2242 (S. Ct. 1992); CCH PPG ¶23,853W.

<sup>74</sup>Tex. Prop. Code §42.0021.

<sup>75</sup>*In re Volpe*, \_\_\_ F.2d \_\_\_ (5th Cir. 1991); *In Re Dyke*, \_\_\_ F.2d \_\_\_ (5th Cir. 1991).

<sup>76</sup>Bankruptcy Code §109.