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Community Property—Characterization of the Inflationary Increase in the Value of Separate Property Improved by Community Funds—In re Marriage of Elam, 97 Wn. 2d 811, 650 P.2d 213 (1982)

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COMMUNITY PROPERTY—CHARACTERIZATION OF THE INFLATIONARY INCREASE IN THE VALUE OF SEPARATE PROPERTY IMPROVED BY COMMUNITY FUNDS—*In re Marriage of Elam*, 97 Wn. 2d 811, 650 P.2d 213 (1982).

Stanley and Norma Elam were married in April 1972. Mrs. Elam brought into the marriage, as part of her separate property, a home purchased prior to the marriage.[1] At the time of marriage, its estimated value was $15,000.[2] In October 1979, at dissolution of the marriage, it was worth $34,000.[3]

During the marriage, $5,500 of community funds and labor[4] was contributed to improve the home. In addition, the home's value increased $13,500 due to inflation.[5] The trial court characterized the home as Mrs. Elam's separate property and, erroneously valuing the community contribution at $9,000, awarded Mr. Elam $5,000 as his interest in the community contribution.[6] He was not given a share of the inflationary increase in the value of the property.

Mr. Elam appealed this award, arguing that the entire increase in the value of the house was community property absent evidence tracing the increase entirely to inflation, or to contributions from Mrs. Elam's separate estate.[7] The Washington Court of Appeals certified to the Washington Supreme Court the issue of whether there is any community interest in the inflationary increase in the value of separate property when community funds and labor have been used to improve it.[8]

The Washington Supreme Court held that: (1) the increase in value of separate property is presumptively separate, unless the community claimant rebuts the presumption by direct and positive proof that community contributions caused the increase,[9] and (2) the community is entitled to a

1. *In re* Marriage of Elam, 97 Wn. 2d 811, 812, 650 P.2d 213, 214 (1982).
2. *Id.* at 817, 650 P.2d at 216. The house cost Mrs. Elam $7,500 in 1967. *Id.* at 812, 650 P.2d at 214. Prenuptial contributions of $3,500 were made by Mr. Elam. *Id.* at 813, 650 P.2d at 214. Mr. Elam testified at trial that these contributions effectively doubled the value of the house. *Id.* at 817, 650 P.2d at 216.
3. *Id.* at 812, 650 P.2d at 214.
4. *Id.* at 813, 650 P.2d at 214. The trial court erroneously valued the postnuptial contributions at $9,000. Of this amount, $3,500 had been contributed by Mr. Elam prior to marriage, making the amount of community contributions $5,500. *Id.*
5. *See id.* at 817, 650 P.2d at 216.
6. *Id.* at 812, 650 P.2d at 214.
7. *Id.* at 813, 650 P.2d at 214.
8. *Id.* at 812, 650 P.2d at 214.
9. *Id.* at 816–17, 650 P.2d at 216.

share of the inflationary increase in the value of the separate property proportionate to the community contributions.[10]

The *Elam* court's first holding, that the increase in value of separate property is presumptively separate, is in accord with prior Washington law. However, the court's second holding, that the community is entitled to a share of the inflationary increase in the value of the separate property, is not. Under relevant Washington case law the community has not been entitled to any of the inflationary increase in the value of separate property. Such inflationary increase attaches to the separate property itself. The court's holding changes Washington law, threatens the continuity of the reimbursement theory,[11] and makes future characterization of inflationary increases uncertain.[12]

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10. *Id.* at 817, 650 P.2d at 216. On the basis of these holdings, the court recalculated the amount of Mr. Elam's award as $4,559. *Id.* The court used a two-step process—$2750 was calculated as Mr. Elam's share in the community contribution, and the remaining $1809 was his pro rata share in the inflationary increase in the value of the property:

a. Community contribution	5,500	
Mr. Elam's share (50%)	x.50	2,750
b. Value of house at marriage	15,000	
Community contributions	5,500	
Value of house at dissolution without inflation	20,500	
Mr. Elam's share (2,750) = 13.4% of 20,500.		
Total value of house at dissolution	34,000	
Less value without inflation	20,500	
Inflationary increase	13,500	
Mr. Elam's share (13.4%)	x.134	1,809
Mr. Elam's entire share		4,559

The supreme court found that the trial court's award of $5,000 was fair and equitable, and that there was sufficient evidence before the trial court for it to have reached that result within the principles articulated by the supreme court. Consequently, the court affirmed the $5,000 award and granted Mr. Elam an equitable lien on Mrs. Elam's house for that amount. *Id.*

11. "Reimbursement theory," as used in this Note, refers to the method by which Washington courts reimburse the separate and community estates at the dissolution of a marriage for contributions made by these estates to each other during the marriage. Under Washington reimbursement theory, when assets of one estate are contributed to improve the property of another marital estate, the contributing estate does not acquire any ownership interest in the improved property, but rather has an equitable right to be reimbursed for the contribution. *See infra* Parts IA & IB.

12. This Note is limited in scope to the situation where one spouse uses community funds to improve the other's separate property. It does not consider those situations in which community funds are used by one spouse to improve his or her own property, separate funds are used to improve community property, or separate funds of one spouse are used to improve the separate property of the other.

I. LEGAL BACKGROUND

A. *The Right to Reimbursement*

Under Washington community property law, the character of property becomes fixed at the date of its acquisition.[13] Property acquired by a spouse prior to marriage, or acquired during marriage by "gift, bequest, devise, or descent," is the separate property of the acquiring spouse.[14] The "rents, issues and profits" of separate property are also separate.[15] All property acquired otherwise during marriage is community property.[16] Thus, there are three types of property that may be owned during marriage: the wife's separate property, the husband's separate property, and community property.

Once the status of property is fixed, it will retain its character unless it is changed by agreement of the parties, by deed, by estoppel, or by due process of law.[17] Separate property is presumed to continue as separate property through its changes and value fluctuations until it can no longer be traced, or until the presumption is overcome by evidence to the contrary.[18] Thus, if assets of a different character are used to improve the property, the character of the property will remain unchanged and title to the improvement will follow title to the improved asset.[19] The contributing estate does not have an ownership interest in the improved property.[20] Rather, the improvement may give rise to a right of reimbursement on behalf of the contributing estate, secured by an equitable lien on the improved asset.[21]

13. Baker v. Baker, 80 Wn. 2d 736, 745, 498 P.2d 315, 320 (1972); *In re* Witte's Estate, 21 Wn. 2d 112, 124, 150 P.2d 595, 601 (1944); Conley v. Moe, 7 Wn. 2d 355, 360, 110 P.2d 172, 174 (1941); *In re* Marriage of Harshman, 18 Wn. App. 116, 122, 567 P.2d 667, 671 (1977).

14. WASH. REV. CODE §§ 26.16.010, .020 (1983).

15. *Id.*

16. *Id.* § 26.16.030 (1983). There is a presumption that all property acquired by purchase during a marriage is community property. *In re* Witte's Estate, 21 Wn. 2d 112, 125, 150 P.2d 595, 601 (1944); Yesler v. Hochstettler, 4 Wash. 349, 353, 30 P. 398, 399 (1892).

17. *In re* Witte's Estate, 21 Wn. 2d 112, 125, 150 P.2d 595, 601 (1944); Conley v. Moe, 7 Wn. 2d 355, 360, 110 P.2d 172, 174 (1941).

18. State *ex rel.* Van Moss v. Sailors, 180 Wash. 269, 274, 39 P.2d 397, 399 (1934); *see also In re* Witte's Estate, 21 Wn. 2d 112, 125, 150 P.2d 595, 601 (1944); Guye v. Guye, 63 Wash. 340, 352, 115 P. 731, 735 (1911).

19. Leroux v. Knoll, 28 Wn. 2d 964, 968, 184 P.2d 564, 566 (1947); Conley v. Moe, 7 Wn. 2d 355, 362, 110 P.2d 172, 175 (1941); Merrit v. Newkirk, 155 Wash. 517, 522, 285 P. 442, 444 (1930). This rule is termed the "fixtures doctrine." W. REPPY & C. SAMUEL, COMMUNITY PROPERTY IN THE UNITED STATES 106 (2d ed. 1982). Under the doctrine, the contributing estate has a right to reimbursement, but the improved estate has title to the improvement.

20. Merrit v. Newkirk, 155 Wash. 517, 522, 285 P. 442, 444 (1930).

21. Conley v. Moe, 7 Wn. 2d 355, 362, 110 P.2d 172, 175 (1941). Professor Bartke characterizes the lien as a "true equitable lien which attaches pro tanto as the improvements are made." Bartke, *Yours, Mine and Ours—Separate Title and Community Funds*, 44 WASH. L. REV. 379, 398

Because the right to reimbursement is an equitable right, it will not arise in every situation.[22] The contribution may have been intended as a gift to the benefited estate, creating no need for reimbursement.[23] The right also may be offset if the contributing estate derives a comparable benefit from using the enhanced property.[24] Additionally, no right to reimbursement will arise if the evidence is insufficient to ascertain the extent of a community contribution.[25]

B. Measure of Recovery

Washington courts have not clearly defined the proper measure of the right to reimbursement. In some cases the right to reimbursement has

(1969). Professor Cross, on the other hand, concludes that there is the traditional right to reimbursement protected by an equitable lien to assure payment of the debt. Cross, *The Community Property Law in Washington*, 49 WASH. L. REV. 729, 776 (1974). A right to reimbursement was first recognized on behalf of a marital community in Legg v. Legg, 34 Wash. 132, 140, 75 P. 130, 132–33 (1904). Such a right was secured by an equitable lien in Conley v. Moe, 7 Wn. 2d 355, 110 P.2d 172 (1941). In *Conley*, community funds had been used to build a home on the husband's separate property, "greatly enhanc[ing] the value of the property." *Id.* at 362, 110 P.2d at 175. The court held that the community had acquired an interest in the separate property in the form of an equitable lien against it. The court allowed the marital community's trustee in bankruptcy to enforce the lien on behalf of the community's creditors. *Id.*

A right to reimbursement has similarly been recognized on behalf of a separate estate, where the separate property of one spouse was used to improve the property of the other. *In re* Estate of Trierweiler, 5 Wn. App. 17, 486 P.2d 314 (1971). It has been noted that "the lien should arise whenever property of one of the three characters (separate property of the husband, separate property of the wife, or community property) is used to improve property of either of the two other sorts." *Id.* at 22, 486 P.2d at 318. *See also* Cross, *supra*, at 777.

The same reimbursement situation may also arise with respect to payment on a mortgage obligation, Merkel v. Merkel, 39 Wn. 2d 102, 114, 234 P.2d 857, 863 (1951), or on an installment purchase contract, Farrow v. Ostrom, 16 Wn. 2d 547, 555–56, 133 P.2d 974, 977–78 (1943), made with assets of a different character than the encumbered property. The contributing estate gains no ownership interest. At most it has been entitled to reimbursement secured by an equitable lien on the enhanced asset. *Merkel*, 39 Wn. 2d at 114, 234 P.2d at 863.

22. "The right to reimbursement is undoubtedly predicated upon equitable considerations. Thus the facts surrounding the contributions must be evaluated to determine where the equities lie and whether the right to reimbursement will arise." Cross, *supra* note 21, at 776–77.

23. According to Professor Cross, if community funds are used by a spouse to improve his or her own separate property, a gift will not be found, and the right to reimbursement will arise to protect the community. If, however, a spouse uses community funds to improve the other spouse's property, or separate funds to improve the community property, the possibility that the contribution was intended as a gift arises. The circumstances surrounding the contribution must be examined to determine if a gift was intended. Cross, *supra* note 21, at 777–79. *See also, e.g., In re* Hart's Estate, 149 Wash. 600, 271 P. 886 (1928); *In re* Carmack's Estate, 133 Wash. 374, 233 P. 942 (1925).

24. Merkel v. Merkel, 39 Wn. 2d 102, 234 P.2d 857 (1951). In *Merkel*, community earnings were used to make mortgage payments on the husband's separately owned farmland. The community had a right to reimbursement only to the extent that community funds were used to pay the mortgage principal. The court reasoned "that interest, tax and upkeep payments made by the community represent no more than reasonable rental for the use of the land." *Id.* at 116, 234 P.2d at 864.

25. Pekola v. Strand, 25 Wn. 2d 98, 101–02, 168 P.2d 407, 409 (1946).

been measured as the actual amount contributed to the improved estate.[26] This contributed amount is characterized as a loan or advancement to the improved estate.[27] Interest on this amount may be included at the court's discretion.[28]

The amount of reimbursement has also been measured as the increase in property value directly attributable to the improvement.[29] This measurement is useful, for example, in situations where it is difficult to determine the actual amount contributed to the improved estate, such as when labor rather than money has been contributed. Such a measurement is not analogous to a loan or advancement because it bears no necessary relation to the actual amount contributed.[30] It has not been clearly indicated, however, whether this measurement is to be made at the time of the contribution or at the settling of the estates.[31]

Regardless of the measurement used, the right to reimbursement tradi-

26. *Id.* The *Pekola* court stated that "implicit in our decision is the rule that an equitable lien may be claimed by the community for improvements upon the separate property of a spouse to the extent only that *community funds are invested.*" *Id.* at 102, 168 P.2d at 409. *See also In re* Marriage of Johnson, 28 Wn. App. 574, 625 P.2d 720 (1981); *In re* Estate of Trierweiler, 5 Wn. App. 17, 486 P.2d 314 (1971). In a mortgage situation, the value of the right to reimbursement is the amount of the expenditure used to discharge the mortgage principal. Merkel v. Merkel, 39 Wn. 2d 102, 116, 234 P.2d 857, 864 (1951); *In re* Marriage of Harshman, 18 Wn. App. 116, 123, 567 P.2d 667, 671–72 (1977).

27. Cross, *supra* note 21, at 776.

28. Conley v. Moe, 7 Wn. 2d 355, 110 P.2d 172 (1941). The court in *Conley,* discussing Legg v. Legg, 34 Wash. 132, 75 P. 130 (1904), suggested that when the equities of the case demand it, the lien should equal the value of the improvements "together with interest on the amount thus ascertained by the court." *Conley,* 7 Wn. 2d at 361, 110 P.2d at 174.

Because the profits from separate property are separate property in Washington, it has been suggested that allowing the contributing community an interest factor on the "loan" would compensate the community for a "lost investment." W. REPPY & C. SAMUEL, *supra* note 19, at 107–08. Professor Cross reasons, however, that, while an interest factor is conceivable, equitably it would often be unnecessary, as the contributing estate generally will derive some offsetting benefit from the improved property. Cross, *supra* note 21, at 780.

29. Baker v. Baker, 80 Wn. 2d 736, 498 P.2d 315 (1972).

30. Such a valuation scheme is not a certain means of reimbursement, however. It is conceivable that some expenditures may not enhance the property value to the extent of funds used, while others may greatly enhance the value. Valuing the right to reimbursement at the enhanced property value consequently entitles some contributing estates to a substantial return on their contribution, while denying others full reimbursement. Results may be more consistent when the right is valued at the amount expended, with a possible interest factor when equity demands.

31. In Baker v. Baker, 80 Wn. 2d 736, 745, 498 P.2d 315, 320–21 (1972), the right to reimbursement was measured as the increase in property value attributable to the improvement at the settling of the estates. The court did not indicate why it chose to measure the increase at that time rather than at the time of contribution. The court cited Burch v. Rice, 37 Wn. 2d 185, 222 P.2d 847 (1950), for authority. The *Burch* case had stated that when the community makes improvements on the separate property that enhances the value of the separate property, it is entitled to a lien on the separate property to the extent of the improvement. The court did not, however, indicate whether the measurement was to be made at the time the improvement was made, or when the estates were settled. Thus, there is no clear indication of the time at which measurement is to be made.

tionally has not included a proportional share in the inflationary increase in the value of the improved asset.[32] The inflationary increase in the value of an asset is a part of the asset itself.[33] As the contributing estate traditionally does not acquire an ownership interest in the asset, it likewise does not acquire a share of the inflationary increase. Thus, the inflationary increase in the value of separate property has been likened to "issues" of such property and belongs to the separate estate.[34] The inflationary increase in the value of community property similarly belongs to the community.[35]

C. *The Court of Appeals Controversy*

Disagreement between three recent Washington Court of Appeals decisions, representing all three divisions of the court, provides the immediate legal background for the *Elam* decision.[36] The controversy stemmed from a misinterpretation of dicta in *Hamlin v. Merlino*[37] in which the court stated:

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32. Conley v. Moe, 7 Wn. 2d 355, 363, 110 P.2d 172, 175 (1941); Guye v. Guye, 63 Wash. 340, 348, 115 P. 731, 734 (1911).

33. *In re* Marriage of Johnson, 28 Wn. App. 574, 576, 625 P.2d 720, 720–21 (1981).

34. Guye v. Guye, 63 Wash. 340, 115 P. 731 (1911). The *Guye* court stated: "Since by the statute the spouse owning separate property is entitled to the rents, issues and profits thereof, so such owner must be entitled to the natural increase in value, as such increase is as much the issue of such property as would be the rents derived therefrom." *Id.* at 348, 115 P. at 734. This reasoning was reiterated in Conley v. Moe, 7 Wn. 2d 355, 110 P.2d 172 (1941). The *Conley* court recognized that although the community had a lien on the separate property for improvements built with community funds, it had no similar interest in the natural enhancement, all of which attached to the separate property. *Id.* at 363, 110 P.2d at 175.

This result has been criticized as denying the contributing estate a fair return on its contribution. *See* Bartke, *supra* note 21, at 400. Professor Bartke reasoned that valuing the reimbursement right as the amount of the expenditure would be unfair to the contributing estate if the value of the property increased, and unfair to the improved estate if the value of the property decreased. He suggested:

> If the court would treat such expenditures as an equity investment of community funds, rather than a loan, the community would share in the fluctuations of the market, taking both the gains and the losses. In view of the inflationary forces at work in the economy at present, tying the recovery to the amount of the expenditure in each case seems grossly unfair to the community.

Id. See also McCoy v. Ware, 25 Wn. App. 648, 651, 608 P.2d 1268, 1269–70 (1980) (Roe, J., concurring).

35. The inflationary increase of community property attaches to the community property itself. As this increase is not the separate property of either spouse, it is properly characterized as property acquired during marriage that is community property pursuant to WASH. REV CODE § 26.16.030 (1983).

36. *In re* Marriage of Johnson, 28 Wn. App. 574, 625 P.2d 720 (1981) (Division Two); McCoy v. Ware, 25 Wn. App. 648, 608 P.2d 1268 (1980) (Division Three); *In re* Marriage of Harshman, 18 Wn. App. 116, 567 P.2d 667 (1977) (Division One). The several divisions of the court differed as to the proper characterization of the increase in value of separate property during marriage and the proper valuation of the right to reimbursment.

37. 44 Wn. 2d 851, 272 P.2d 125 (1954).

> [W]here the separate property in question is *real estate or an unincorporated business* with which personal services ostensibly belonging to the community have been combined, the rule is that all the income or increase will be considered as community property *in the absence of a contemporaneous segregation of the income between the community and the separate estates*.[38]

Relying on this statement, the court in *In re Marriage of Harshman*[39] held that when the value of separate property increases during marriage, there is a presumption that the increase is community property. The owner of the separate property can overcome this presumption by clear and convincing evidence tracing the increase to the separate property, or by evidence of contemporaneous segregation of the increase as it arises.[40]

The *Harshman* community presumption was accepted in *McCoy v. Ware*.[41] The *McCoy* court stated that when separate real estate is improved by community services or funds, any increase in value is presumptively community property "to the extent that the community has a lien against the property to secure reimbursement for the increased value."[42] Thus, the *McCoy* court required that the party asserting that the increase is separate property assume the burden of proving that the increased value of the separate property was due to a cause other than the community contribution.[43] The court stated that evidence that the increase is due to inflation can rebut the community property presumption.

The court in *In re Marriage of Johnson*[44] questioned the *Harshman-McCoy* community presumption.[45] The *Johnson* court found that the *Harshman* rule had developed from a misapplication of the *Hamlin v. Merlino* contemporaneous segregation rule[46] and that the *Harshman* rule

38. *Id.* at 858, 272 P.2d at 129.

39. 18 Wn. App. 116, 567 P.2d 667 (1977). In *Harshman*, community funds were expended on the husband's separate property. The value of the property increased $23,000 during the marriage.

40. *Id.* at 125–26, 567 P.2d at 673. The *Elam* court disagreed with this result. *See infra* notes 51–54 and accompanying text.

41. 25 Wn. App. 648, 608 P.2d 1268 (1980). In *McCoy*, community funds were used to maintain and improve the wife's home and to retire the mortgage on the home. The trial court had allowed reimbursement to the community for the mortgage payments but had denied the request for a community lien for the increased value of the home because the community had not established that the increase in value was due to improvements by the community rather than to inflation. *Id.* at 649–50, 608 P.2d at 1269.

42. *Id.* at 650, 608 P.2d at 1269. The *Elam* court disagreed with this result. *See infra* notes 51–54 and accompanying text.

43. 25 Wn. App. at 650, 608 P.2d at 1269.

44. 28 Wn. App. 574, 625 P.2d 720 (1981).

45. The *Johnson* case involved a separately owned home with a $400 community improvement. The house had increased in value during the marriage by over $10,000. *Id.* at 575, 625 P.2d at 720. The trial court characterized the entire inflationary increase in value as community property, relying on the *Harshman* presumption. *Id.* at 577, 625 P.2d at 721. The *Johnson* court reversed.

46. *Id.* at 577–78, 625 P.2d at 721–22. The *Hamlin v. Merlino* rule of contemporaneous segrega-

was contrary to Washington precedent.[47] The court indicated that the inflationary increase in the value of separate property is properly characterized as separate.

Thus, the immediate background for the *Elam* case was a direct split in the divisions of the court of appeals over whether the increase in the value of separate property during marriage is presumptively separate property or community property, and which estate has the burden of proof.

II. THE *ELAM* COURT'S REASONING

The issue certified to the *Elam* court was "[t]o what extent, if any, is there a community interest in the increase in value of separate property due to inflation, where community funds and labor were used to improve the property?"[48] The court commented that, had there been no community contributions, the inflationary increase in the value of the separate property would be entirely separate.[49] The court held, however, that when community contributions are made, "the community should be entitled to a share of the increase in value due to inflation in proportion to the value of community contributions to the property."[50]

The court reviewed the *Harshman, McCoy,* and *Johnson* decisions and found that both the *Harshman* and *McCoy* courts erred in holding that any

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tion dealt with the commingling of separate property income with income from community labor. The resulting income cannot be characterized absent proof of its source. Segregating the income proportionately to its sources as it arises is a means of establishing its character. The rule stated that absent segregation the income is presumed to be community property. Hamlin v. Merlino, 44 Wn. 2d 851, 858, 272 P.2d 125, 129 (1954).

The *Hamlin* rule stated only that when community labor and separate property income have been commingled such that any increase from them cannot be traced, that increase is presumptively community property absent contemporaneous segregation of the income to its source as it arises. The *Harshman* and *McCoy* courts misapplied the *Hamlin* decision, as commingling was not an issue in those cases. The *Harshman* and *McCoy* courts also misread *Hamlin* by applying the community presumption to any increase in the value of separate property, regardless of its source. *See infra* text accompanying notes 51–54.

47. The *Johnson* court stated:

> The *Harshman-McCoy* rule, which places the burden of proof on the separate property-owning spouse to disprove that an investment of community funds or labor produced the increase in value, appears to run counter to established precedent in this state. The principle is well established that one seeking a community interest in separate property must overcome the presumption to the contrary.

In re Marriage of Johnson, 28 Wn. App. 574, 578–79, 625 P.2d 720, 722 (1981) (citations omitted).

48. *In re* Marriage of Elam, 97 Wn. 2d 811, 812, 650 P.2d 213, 214 (1982).

49. *Id.* at 813, 650 P.2d at 214.

50. *Id.* at 817, 650 P.2d at 216. The court supported this result only by citing Judge Roe's concurring opinion in McCoy v. Ware, 25 Wn. App. 648, 651, 608 P.2d 1268, 1269–70 (1980). Judge Roe urged the adoption of a stance that would allow the contributing estate to share in the present value of the improved property. Such a stance would require that the contributing estate purchase an ownership share in the improved property. *See infra* note 58.

increase in the value of separate property during marriage is presumptively community property.[51] According to the *Elam* court, the *Harshman* and *McCoy* courts misread the contemporaneous segregation dicta of *Hamlin v. Merlino*,[52] incorrectly applying the community property presumption to any increase in the value of separate property, regardless of its source.[53] Like the *Johnson* court, the *Elam* court concluded that such a presumption is inconsistent with prior case law.[54]

The *Elam* court instead held that any increase in the value of separate property is presumptively separate. The party asserting that it is community property can rebut this presumption with evidence attributing the increase to community contributions of labor or funds. The separate property-owning spouse is entitled to all of the increased value of the separate property "except to the extent to which the other spouse can show that the increase was attributable to community contributions."[55]

III. ANALYSIS

It is well established in Washington law that once property is shown to be separate, it is presumed to retain that character until it can no longer be traced or until the presumption is overcome by rebutting evidence.[56] Therefore, the *Elam* court properly held that each spouse is entitled to the increase in value of his or her separate property, except to the extent to which the other spouse can prove the increase was due to community contributions.[57]

The court did not, however, explain why the community was entitled to a share of the inflationary increase in the value of the separate property. By granting the community a share of the inflationary increase, the court

51. *In re* Marriage of Elam, 97 Wn. 2d 811, 816, 650 P.2d 213, 216 (1982).

52. 44 Wn. 2d 851, 272 P.2d 125 (1954). The court held in *Hamlin* that when separate property and community labor are commingled to increase the value of the separate property or to create profits, the increase is presumed to be community property absent contemporaneous segregation of the income according to its source. *See supra* note 46.

53. *In re* Marriage of Elam, 97 Wn. 2d 811, 816, 650 P.2d 213, 216 (1982).

54. *Id.*

55. *Id.* The disagreement in the court of appeals divisions was only over this presumption question—the divisions did not reach the question of whether the community should share in the inflationary increase in the value of separate property. Yet the *Elam* court gave no indication how this separate property presumption could lead it to summarily characterize a portion of the inflated value of the separate property as belonging to the community.

56. *See supra* note 18 and accompanying text.

57. The *Elam* court valued the community's right to reimbursement as the increase in value of the separate property directly attributable to the improvement. 97 Wn. 2d 811, 816, 650 P.2d 213, 216 (1982). This is consistent with the rule of valuation used in Baker v. Baker, 80 Wn. 2d 736, 498 P.2d 315 (1972). Arguably a more consistent measure of the value of the right is the actual amount of the expenditure. *See supra* note 30 and accompanying text.

appears to have ignored established case law and shifted from a theory of reimbursement to a share-of-ownership theory.[58] But it is not clear that an ownership theory was actually adopted by the court; it is probable that the reimbursement theory has been retained. This raises questions about the proper application of the *Elam* decision to future cases.[59]

A. *Conflict with Prior Law*

By granting the community estate a share of the inflationary increase, the *Elam* decision conflicts with the theory of reimbursement established in prior case law. In *Guye v. Guye*,[60] the Washington Supreme Court held that the inflationary increase in the value of separate property is separate property.[61] According to the *Elam* court, however, the rule is different if funds or services of the community have been contributed.[62]

Under the analysis prior to *Elam*, the inflationary increase in the value of separate property inures to the separate property regardless of whether community funds have been contributed.[63] Inflationary or deflationary fluctuations in the property value are simply incidents of ownership. Thus, the contributing estate has been entitled to a share of the inflationary increase only if it purchased an ownership share of the property.

58. An ownership theory treats the contributing estate as having "bought in" to a share of the present market value of the property. Any inflationary increase in the property attaches proportionately to the ownership interests, giving the contributing estate a beneficial return on its "investment." Implicit in this theory is the corresponding loss which will attach proportionately to the ownership interests due to deflationary decreases in the property value. Thus, while a reimbursement theory entitles the contributing estate to reimbursement for its contribution regardless of the changes in property value, an ownership theory makes any return to the contributing estate dependent upon market fluctuations.

59. There is a second problem in the court's reasoning as well. The *Elam* decision does not clearly indicate how the right to reimbursement is to be measured. While the court stated that the community is entitled to reimbursement to the extent that the contribution increased the value of the improved estate, the court then assumed that this increased value equaled the amount of the contribution. In so doing the court confused two distinct approaches to reimbursement measurement.

Both approaches to reimbursement measurement have been used in prior Washington cases. In some cases, courts have treated the contribution as a loan to the improved estate and fixed reimbursement as the amount expended. *See supra* notes 26–27 and accompanying text. In other cases, courts have fixed reimbursement as the value added to the improved property. *See supra* note 39 and accompanying text. In few cases would these amounts be equal. The cost of an improvement generally is distinct from the effect the improvement has on the value of improved property.

Because the *Elam* court equated the cost of contribution with the consequences of contribution there is no indication which approach to reimbursement is preferable. The *Elam* decision provides no guidance.

60. 63 Wash. 340, 115 P. 731 (1911).

61. The *Elam* court agreed that if no community funds or services have been contributed to the separate property, the inflationary increase in the value of the property is entirely separate. *In re* Marriage of Elam, 97 Wn. 2d 811, 813, 650 P.2d 213, 214 (1982).

62. *Id.*

63. *See supra* notes 32–34 and accompanying text.

Under Washington law, however, the contributing estate acquires no ownership interest in the improved property. It can only claim reimbursement.[64] By holding that the community is entitled to a share of the inflationary increase, the *Elam* court appears to have shifted to a share-of-ownership result without expressly adopting a share-of-ownership theory.

The court did not explain how it reached this result. The only clue to the court's reasoning is its citation of Judge Roe's concurring opinion in *McCoy v. Ware*.[65] Judge Roe stated that mere reimbursement does not provide a realistic return of the purchasing power of the money invested when inflation is high. He suggested that the community should proportionately share in the present value of the property, whether it is inflated or deflated.[66] This result is consistent with a share-of-ownership theory.[67] The question thus arises whether the *Elam* court was adopting a share-of-ownership theory or merely Judge Roe's result.

Two aspects of the case indicate that the *Elam* court adopted only Judge Roe's result and that the reimbursement theory still prevails. First, though the court's result is inconsistent with well-established case law, the court did not overrule this prior law. Second, the court cited several cases which characterize the community's interest as a right to reimbursement rather than an ownership interest.[68] Having never discussed this aspect of these cases, the court impliedly accepted a right to reimbursement as the correct characterization of the community's interest. Moreover, Mr. Elam's award, which included a refund for contributions to his wife's separate property and which was protected by an equitable lien on his wife's house,[69] is consistent with the court's implied acceptance of a reimbursement theory. Thus, the court has apparently retained the reimbursement theory, but has reached a share-of-ownership result.

B. Problems of Application

The future application of the *Elam* result is complicated by the absence of any detailed explanation of the nature of property interests in inflationary increases. Under the reimbursement theory, there is no theoretical

64. *See supra* notes 19–21 and accompanying text.

65. 25 Wn. App. 645, 651, 608 P.2d 1268, 1269 (1980).

66. *Id.* at 651, 608 P.2d at 1270.

67. *See supra* note 58.

68. *In re* Marriage of Elam, 97 Wn. 2d 811, 815, 650 P.2d 213, 215 (1982). The *Elam* court cited *In re* Marriage of Harshman, 18 Wn. App. 116, 126, 567 P.2d 667, 673 (1977), which states that "the community would be entitled to an equitable lien or right of reimbursement as to the increased value," and McCoy v. Ware, 25 Wn. App. 648, 650, 608 P.2d 1268, 1269 (1980), which states that "the community has a lien against the property to secure reimbursement for the increased value."

69. *In re* Marriage of Elam, 97 Wn. 2d 811, 817, 650 P.2d 213, 216 (1982).

basis for the existence of an inflationary share. Since the court did not indicate how such a share arose, there are no guidelines for the application of the *Elam* result to other cases.

For example, since the right to reimbursement is an equitable right, it does not arise in all cases. Likewise, in some cases it may be diminished if the contributing estate derives some benefit from the improved asset.[70] Whether the inflationary share will also be subject to such equitable adjustments is uncertain. If the inflationary "entitlement" attaches to the right to reimbursement, it will exist only when, and to the extent that, the right exists. On the other hand, if it attaches to the contribution itself, it should be available even if the equitable right to reimbursement is not. The *Elam* decision does not offer sufficient analysis to enable a court to calculate the inflationary share in such a case.

Additionally, the *Elam* holding provides no guidelines for the calculation of the share in a deflationary situation. Under a share-of-ownership theory the contributing estate not only enjoys the benefit of inflation, but must also bear the cost of deflation. Under a reimbursement theory, however, the contributing estate is entitled to reimbursement for its contribution regardless of whether the value of the improved property is inflated or deflated.[71] In *Elam,* the court used a two-step formula for the calculation of the contributing estate's interest.[72] The court first calculated Mr. Elam's right to reimbursement and then calculated an additional share of the inflationary increase. Presumably in a deflationary situation the court would also first calculate the right to reimbursement. The court gave no indication, however, that it would be willing to subtract the cost of deflation from this reimbursement share. Thus, there is no indication whether the court will reach a share-of-ownership result or a reimbursement result in a deflationary situation.

Finally, there is no indication whether *Elam* will apply to mortgage repayment situations as well as to improvement situations and, if so, to what extent. Will the inflationary share be proportional to the contributing estate's contribution to the entire mortgage payment, or only to the extent that the contribution goes to pay the mortgage principal?

These situations arise frequently and must be considered in order for the *Elam* result to be generally applicable.

C. *A More Flexible Approach*

The *Elam* result is an attractive one. Considerable sums can be contrib-

70. *See supra* notes 22–25 and accompanying text.

71. The measure of reimbursement is of course subject to equitable adjustment. *See id.*

72. *See supra* note 10.

uted over a long period of time by one estate to another during a marriage. Granting the contributing estate a share of the inflationary increase of the improved property is, during times of high inflation, a more realistic return in terms of the purchasing power of the money invested than is a simple "repayment" of a loan. In reaching this equitable result, however, the court did not clearly indicate the proper measure of the right to reimbursement. The court also shifted to a share-of-ownership result with no comparable shift in the underlying theory. This result is theoretically unsound and is therefore of no value for predicting results in factual situations that differ from that in *Elam*.

The *Elam* court, however, could have reached a comparable result consistent with the reimbursement theory. The measure of reimbursement may be fixed as (1) the amount of the contribution, (2) the amount by which the improvement has increased the value of the asset at the time of the contribution, or (3) the amount by which the improvement has increased the value of the asset at the time of the controversy.[73] Under all three of these approaches the equitable result sought by the *Elam* court may be obtained. Equally important, each approach is consistent with Washington case law.

If the right to reimbursement is measured as the cost of the contribution, it is analogous to a loan or advancement to the improved estate. As with ordinary loans, interest on this contribution should be available to the "lending" estate.[74] Adding a high interest factor may not yield a monetary result equivalent to the *Elam* two-step calculation.[75] However, this approach is predictable, easily administered, and consistent with Washington case law.

Likewise, an equitable adjustment can be added if the right to reimbursement is measured as the increase in value of the improved property attributable to the contribution at the time of the contribution. Though this measure of the right to reimbursement is not analogous to a loan,[76] some adjustment is proper to compensate the contributing estate for the lost use of capital contributed to the improved estate. Such an adjustment would also be comparable to the result reached by the *Elam* court.

Both of these approaches are more certain than that adopted by the *Elam* court because neither approach violates existing theory, and neither poses the difficult application problems inherent in the *Elam* approach. In either an interest or adjustment approach, the entitlement to interest is

73. *See supra* notes 26–31 and accompanying text.

74. The availability of interest when equity demands was first suggested in Conley v. Moe, 7 Wn. 2d 355, 110 P.2d 172 (1941).

75. *See supra* note 30 and accompanying text.

76. *See supra* note 27–28 and accompanying text.

equitable as is the right to reimbursement and thus can be allowed or disallowed as equity demands. For example, an interest factor would often be equitably unnecessary as the contributing estate usually derives an offsetting benefit from the use of the improved property.[77] In such a case, the interest factor need not arise as it is an equitable right only, not an unalterable entitlement.

In improvement situations, the easiest and most flexible means of reaching the *Elam* result may be to measure the right to reimbursement under the third approach—as the amount by which the improvement has increased the value of the asset at the time of the controversy. Under this approach inflation need not be treated as a separate "entitlement" as it was in *Elam*. Rather, the inflation is included in the increased value of the improved asset and is thus simply part of the measurement of the right to reimbursement. This approach is consistent with Washington case law[78] and is the most flexible and equitable.

Such an approach is analogous to the contributing estate's ownership of the improvement.[79] The contributing estate would benefit from inflationary increases in the value of the improvement. It would likewise bear the loss of deflationary decreases in its value, and possible loss of the improvement itself. The measurement of the right to reimbursement would thus be self-adjusting as the market fluctuates, and equitable adjustments would not be necessary.

77. Cross, *supra* note 21, at 780.

78. *See, e.g.*, Baker v. Baker, 80 Wn. 2d 736, 498 P.2d 315 (1972); Burch v. Rice, 37 Wn. 2d 185, 222 P.2d 847 (1950).

79. Under this approach, fluctuations in value attendant upon inflation and deflation attach to the contribution itself, not to the total value of the improved property. This approach is therefore different than a share-of-ownership approach.

Assume, for example, that at the time of marriage one spouse owned 100 acres of farmland worth $500 per acre, or $50,000. After marriage, the community constructed a building on the land worth $10,000, making the total value of the property $60,000. During the marriage, the building increased in value five times due to inflation, and at dissolution was worth $50,000. The land, however, increased in value 20 times, and at dissolution was worth $10,000 per acre, or $1 million.

Under a share-of-ownership approach, the community would have purchased a one-sixth share of the improved property at the time of its contribution. At dissolution, the community would thus own one-sixth of the total value of the improved property, or $175,000. Under a reimbursement approach, however, the community would be entitled only to reimbursement for its contribution. If reimbursement is measured as the amount by which the improvement has increased the value of the asset at the time of dissolution, the community would be entitled to $50,000.

The reimbursement and share-of-ownership approaches are different for other reasons as well. Under the reimbursement theory, the contributing estate does not acquire an ownership interest in the improved property; thus the separate estate retains all the rights of ownership incident to the property. For example, the separate estate can dispose of or encumber the property without joinder of the contributing estate. The separate estate also owns all the rents, issues, and profits of the property. Under an ownership approach, however, the separate estate must share these incidents of ownership proportionately with the contributing estate.

Thus, under all three methods of measuring the right to reimbursement, an equitable result comparable to the *Elam* result can be reached which is consistent with the Washington theory of reimbursement. All three methods are more flexible than the *Elam* approach. Under the interest and adjustment approaches the equitable adjustments to the measurement can be made on a case-by-case basis, as is necessary to adequately compensate the contributing estate. Under the "ownership of the improvement" approach the measurement would be self-adjusting.

IV. CONCLUSION

The *Elam* decision provides no guidance for future cases involving the settling of community and separate estates when contributions have been made by one estate to improve the other during marriage. The *Elam* court granted the community estate a proportionate share in the inflationary increase of the separate property, a result inconsistent with prior Washington case law and reimbursement theory. While the court's result is equitable and desirable in times of high inflation, the court's decision will be difficult to apply in future cases due to the court's failure to justify the existence of an inflationary share within the principles of the reimbursement theory.[80]

The first step necessary to resolve this problem is to indicate precisely which measurement approach is to be used in measuring the right to reimbursement: (1) the amount of contribution, (2) the amount by which the improvement has increased the value of the asset, measured at the time of the contribution, or (3) the amount by which the improvement has increased the value of the asset, measured at the time of the settling of the estates. Under each approach, inflation, or an adjustment comparable to inflation, is available. Each approach is consistent with the Washington reimbursement theory. Thus, the equitable result sought in the *Elam* case can be obtained within existing Washington law, without the problems of application inherent in the *Elam* approach.

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80. Actually the decision poses two problems in its application to future cases. The first is its inclusion of a share of inflationary increase. The second is its failure to indicate the proper way to measure the right to reimbursement—whether it is to be measured as the cost of contribution or as the increased value of the improved asset due to the improvement. *See supra* note 59. This is a basic problem that must be resolved to give guidance to other courts in properly measuring the right to reimbursement.