

Reimbursement Is Required for Separate Property Improvement

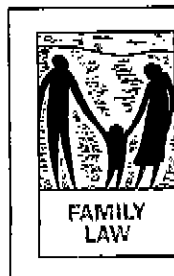
By Mitchell A. Jacobs and
David L. Marcus

In two recent and very similar cases, the courts appear to have changed the law with respect to certain reimbursement issues. In *In re Marriage of Wolfe*, 91 Cal.App.4th 962 (3rd Dist. 2001), and *In re Marriage of Allen*, 116 Cal.Rptr. 887 (2nd Dist. 2002), the courts held that the community should be reimbursed for capital improvements to a spouse's separate property.

In *Wolfe*, the court ordered reimbursement in the amount of the improvement. In *Allen*, the court left open the issue of the measure of reimbursement.

In *Allen*, the parties were married in 1981. They had three children, the first born in 1983. Prior to the marriage, the husband purchased a residence subject to a life estate in the prior owner. During the marriage, the parties cared for the prior owner. After the birth of the parties' first child, the wife stopped working as a dental hygienist and devoted her time to raising the children, remodeling the

house and caring for the life tenant. The parties devoted a considerable amount of time toward restoring and renovating the house. At the life tenant's death, the husband's mortgage was forgiven as a testamentary bequest.



The party seeking reimbursement should determine whether community property was spent for improvements to the separate property.

house and caring for the life tenant. The parties devoted a considerable amount of time toward restoring and renovating the house. At the life tenant's death, the husband's mortgage was forgiven as a testamentary bequest.

The trial court found that during the marriage, the husband transmuted the house to community property. The court held that the community was not entitled to reimbursement for capital improvements made prior to the transmutation. The trial court reasoned that a rule of reimbursement, known as the *Moore/Marsden* rule (named after the two cases that established it), allowed the community a proportional interest in the appreciation of a separate property residence based on payments made with community property to reduce the principal portion of the mortgage.

The trial court held that no opinion had expanded this rule to include capital improvements made with community property. In light of the absence of such authority, the trial court applied cases that predated *Moore/Marsden* and held

Mitchell A. Jacobs, a certified family law specialist in Los Angeles, limits his practice to marital dissolution and other family law matters. David L. Marcus, an attorney with the Law Offices of Mitchell A. Jacobs, also practices exclusively in the area of family law.

that the community is presumed to have made a gift of capital expenditures to a spouse's separate-property residence. For several reasons, the Court of Appeal reversed. First, a spouse who consents to using community funds to improve a separate-property residence would not expect to be making a gift and likely would expect reimbursement upon divorce. Also, the rationale of the *Moore/Marsden* rule applies equally to the reduction of principal from community-property payments and to capital improvements, because both increase the equity of the property.

Further, the rationales of the older cases that do not allow reimbursement have been superseded by changes in the law. Those older cases rested on the former law that the husband had control of the community finances. If the husband applied community property to improve the wife's separate property, then a gift was presumed. Since both spouses now control the community, there is no reason to presume a gift.

Additional reasons relied upon by the

stood doctrine and miscited cases."

The opinion traces more than 100 years of cases to show how the California gift presumption arose and then was misapplied to prevent reimbursement. The trial court's decision to allow reimbursement for the improvements demonstrates that trial courts probably have been allowing such reimbursement, even though prior to *Allen* and *Wolfe*, the "correct" trial court decision probably would be not to allow reimbursement.

However, the trial court in *Wolfe* was reversed when it ordered reimbursement for community-property payments of property taxes on separate property. The Court of Appeal held that payments for property taxes are not reimbursable because they do not increase the equity of the property.

The *Wolfe* case presents no real guidance as to the measure of the reimbursement because the court did not address that issue. Although the wife was reimbursed one-half of the cost of the improvement, there was no claim for a proportional interest, and the equity increase to the property resulting from the improvement was not disputed.

In what appears to be dicta, the *Wolfe* court suggested that a spouse could be reimbursed for the increase in value to nonbusiness property due to the labor of the spouse during the marriage.

These two cases spawn several new issues that need to be addressed by a combination of expert testimony and legal analysis. The attorney for the party seeking reimbursement should review the financial records during the marriage to determine whether community property was spent for improvements to the separate property. If community property was spent to improve separate property, the party needs to decide whether to seek reimbursement in the amount of the improvement, in the amount of the increase to the equity or in a proportional interest in the property.

To address this issue, expert opinion is needed to determine the extent to which the capital improvement increased the equity in the property. Expert real estate appraisers are the obvious choice for this work. Experienced real estate agents also could offer evidence on which improvements increase equity and which do not.

Another consideration is that an improvement to property may have only a limited lifetime. For example, even if new carpeting or paint increases the equity in the property, the effect of the increase may last only for a few years until new carpet is needed. Income-tax depreciation tables may provide guidance on that issue.

After an attorney obtains this information, a prudent approach would be to determine which measure of reimbursement benefits the client. Persuading the court to use one particular method over another is an area that requires creative legal analysis. A strong argument in favor of a proportional interest is that capital improvements should be treated the same as reductions in the principal portion of the mortgage. The *Wolfe* case provides contrary authority.

This reimbursement issue is likely to generate further appellate opinions on the issue of the proper measure of reimbursement.

court are that the California Supreme Court has never adopted the gift presumption and that acquisitions during the marriage are presumed to be community. Finally, Family Code Section 852 requires a writing to transmute the character of property.

The Court of Appeal did not decide the amount of the community claim, which could be either the cost of the improvements, the increase in the equity resulting from the improvements or a proportional interest in the separate-property residence. The reason was because the trial court did not allow any evidence of whether community funds were spent to improve the residence or of the amount of community funds, if any, spent to improve the residence. The trial court also did not allow evidence of any increase in value of the residence resulting from the improvements. Thus, the appellate court stated that it did not want to decide this "difficult and complex issue" in a vacuum.

In *Wolfe*, the couple spent community property to improve the husband's vineyard by installing an irrigation system. The trial court ordered reimbursement to the community, and the Court of Appeal upheld that order.

The court in *Allen* cited *Wolfe* with approval. The reasoning in both cases was similar. *Wolfe* described the cases that presumed that the community made a gift of capital improvements to separate property as "a California invention, though not one in which we should take pride, cobbled together from misunder-