Community Property:
Who Owns What in Washington State

The Community Property Basics

A Washington State community property primer

When you get married, no matter what state you live in, it's usually about love, family, and commitment—not who owns what property. But as you're planning for and living your life together, it's very important to understand how the state views what legally belongs to whom. Community property laws are one of the many things we take into account as we develop in-depth financial plans for our clients and their families.

In this e-booklet, we'll provide an overview on community property laws in Washington State and what you need to know in case of separation/divorce, the death of a spouse, creditor disputes and taxes. We'll also discuss the four types of property recognized by Washington State law: community property, separate property, quasi-community property, and community-like property. We'll focus mostly on the first two, since they are the most common.

Why Community Property?

Washington is one of just nine US states that recognize community property. (The others are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Wisconsin.) Alaska sees community property as an elective choice made by the couple.

Washington State has been a community property state since establishment in 1889. Why? The explanation goes way back to the culture of Visigoth tribes of medieval Europe who saw men and women as equal. This was the basis for the development of civil laws in Spain that granted women property rights. A few hundred years later, the Spanish colonizers of Mexico brought those customs here when settling what is now California.

Since Californians made up a large part of Washington's settlers and they were accustomed to community property, they carried the familiar rules with them to the new state of Washington. Also, as you may know if you've seen "Seven Brides for Seven Brothers," Washington State needed women to help populate the region. Washington may have adopted California's property rules for the same reason they worked in California: to attract women to the frontier by offering them equal share in property acquired during marriage.

Community Property in Washington State: The Ground Rules

Let's talk about how you own property in Washington State. All property acquired during a valid marriage or state registered domestic partnership (partnership) is **presumed to be community property**. (That's in the Revised Code of Washington, RCW 26.16.030, if you'd like to look it up). This applies to property you acquire while living in Washington, *even if you were married in a non-community property state.* The exceptions to this definition are property that is:

- Acquired by gift or inheritance and its income
- Personal injury awards for pain and suffering
- *Very* intimate personal items, e.g. clothing and jewelry
- Gifts from one spouse to another

All these exceptions are considered **separate property**. In addition to the exceptions above that may be acquired *during* marriage, separate property includes all property that was owned by each spouse (or partner) *prior* to the marriage (or partnership) – as well as the income from that and any appreciation in value. A couple might choose to convert any separate property into community property by making a written agreement. It's up to you.

Beyond agreeing that it's community property, what determines how property is characterized in Washington? First, the time it was acquired. As we noted above, all property acquired during a valid marriage or partnership is presumed to be community property. How that property was acquired and what funds were used can determine how it is characterized. For instance, property purchased with funds that are separate property is also separate. One thing that does not make property separate is the name on an account.

When the characterization of any property is unclear, such as when money has been co-mingled in accounts, *Washington State will presume that it is community property*. To establish its separateness, you must overcome this presumption with proofs like original source of funds and the intent of the parties involved in the property's acquisition (which may also have to be proven by acts or documents). Also important is how clearly you can trace the property or money back to a separate source belonging solely to you.

Who Owns What: Community vs. Separate Property

Community Property	Separate Property
▸ Salaries and Wages ▸ Windfalls ▸ Other compensation (stock options, RSAs, RSUs, etc.) – Directors Fees – Trustee Fees ▸ Personal injury awards for lost wages and medical expenses Pension and retirement benefits earned during marriage* ▸ Property purchased with community funds – Furniture and appliances – Vehicles ▸ Gains on community property assets ▸ Employee Stock rights ▸ Income from community assets – Rents – Interest – Dividends	▸ Gifts ▸ Inheritances ▸ Property owned before marriage ▸ Personal injury awards for pain and suffering ▸ Wedding rings ▸ Clothing ▸ Income from separate assets (such as rents, interest, and dividends) ▸ Gains on separate property assets

*Except for employer-sponsored retirement plans subject to ERISA.

Now that we've established *what* community property is, let's take a look at *how* it is treated under Washington State law. Under state law, **each spouse owns an undivided one-half of the community property**. That doesn't mean that one of you owns the right side of the BMW. "Undivided" means each spouse or partner owns one-half interest in the value of the whole property. So either spouse acting alone can manage and control the whole piece of property, except in the following cases:

- **In a will**, each spouse can bequeath only one-half of the community property.
- **As a gift**, neither spouse can give away community property without consent of the other.
- **Real estate community property** can only be purchased or sold with both spouses' written executionof a deed.

The Exception To The Rule: Mixed Property

There are circumstances where community property and separate property get intermingled and become another type - **Mixed Property**. Mixed property can be created when property or funds of different types are used to purchase new property. For instance, if a couple purchases new property using both community and separate property funds, then ownership of the improved or new property is proportional to the amounts paid from the different types of funds. So if two-thirds of the purchase was funded with community property, then two-thirds of the new property is community property.

What about when both partners/spouses contribute to improving a property, say a business, that started out as separate property? Or when both partners/spouses pay the mortgage on a house that is separate property? As you might expect in these murkier situations, the characterization question is much more complex. Generally speaking, there can be a lien placed against the separate property for the amount of the community funds used. However, other considerations such as use of the residence rent-free can impact the determination. Sometimes, when joint funding or joint efforts are used to improve separate property, each partner/spouse (the "community") gets a share of the value created by the improvement.

- **Household items** (including appliances and mobile homes) that are community property cannot be sold or encumbered by one spouse without consent of the other.
- **Business community property**. If both spouses/partners participate in managing the business, assets can only be purchased or sold with the consent of both spouses.

Debt as Community Property

Debt is also addressed under community property law in Washington State. Any debt incurred during marriage is *presumed* to be community debt, regardless of whose name is on the debt. Both spouses owe the money due, even if just one spouse or partner signed for the debt. As a result, community property *and both spouse's separate property may be taken to satisfy family expenses*. If the debt was for non-family purposes and was incurred by just one spouse or partner, all community property is still fair game for collection, but only the signing partner's separate property can be used to repay.

In case where one spouse is sued for injuries caused to someone else (lawyers call this a tort), creditors cannot access the separate property of the other spouse to satisfy judgments that compensate for those injuries. This is true unless both spouses are responsible for the injury (even if they weren't married) or the injury somehow benefits both spouses, such as an act of fraud whose proceeds benefitted both.

When Does Community Property Stop Being Community Property?

Washington State law says a couple continues to accrue community property until they divorce, or the marriage becomes defunct. The term "defunct" may seem odd, but it has a specific meaning. Basically, it means the couple is separated and *has no intention* of getting back together. If that happens, community property rules change. Once that "defunct" status has been reached, income and acquisitions of new property are not community and spouses are not liable for the debts of the other incurred after the separation. There is an important exception: debts on accounts that are in both their names, such as the husband using the wife's credit card or a joint card after separation.

A Couple of Common Questions

Who Owns Our Insurance Policies?

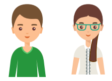
Individual insurance policies have value for that person. But what if community funds pay for the premiums? For whole life policies, it's treated similarly to Mixed Property above, where the value of the proceeds are allocated between community and separate based on which kinds of funds were used to pay all premiums—including mixtures of funds. Same with Term ife insurance policies, only in this case the allocation of funds is based on which types of funds paid for the most recent term. Interestingly, a disability insurance policy's property type is based on the property or funds it is intended to replace—often that would be an individual's income, so community property.

Are Mortgages and Installment Loans Community Property?

Mortgages follow similar logic to mixed property (and often result in mixed property). How the mortgaged property is characterized depends on both the characterization of the funds used for the down payment and the credit pledged.

Community Property Scenarios

Jack and Jill's Home Appreciation.

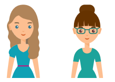


Jack and Jill, a married couple, buy a house for $300,000. 1/3 from Jack's separate property, 1/3 Jill's, and 1/3 community property. Then over the years, the house appreciates to $750,000.

What's the new division?

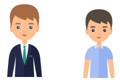
- Jack's separate property: $250,000
- Jill's separate property: $250,000
- Community property: $250,000

It's Pam and Paula's Home. But Whose House?



Pam owns a house that is worth $250,000 when she marries Paula. There is a $100,000 mortgage balance at that time. The balance of the mortgage is repaid by Pam using her wages. The community does not acquire an interest in the home because the community is also living in the home rent-free. So the house remains Pam's.

Marvin and Martin and The New Bathroom.



Marvin and Martin are married when they purchase a home together as a community asset bought with community funds. Then Marvin uses $15,000 of his separate property to pay for a second bathroom. Martin, being handy, does all the work. The improvement increases the value of their home by $50,000. As a result, Marvin gets his $15,000 separate property interest in the house, while the community (both of them) has increased its interest by the other $35,000, the value of Martin's labor. Fair? It is under community property law.

Other Types of Property

Community-Like Property

When a couple is not married but is in a long-term, committed relationship that ends either by death or breakup, property acquired during the committed relationship **may** be treated

similarly to community property. Usually community-like property is identified either when one former partner sues the other, or the property goes into probate for inheritance. To establish the characterization of the property in these situations, a probate or other court may consider:

- How long the couple has lived together.
- The length of the relationship.
- Purpose of the relationship. Was it romantic? Financial? Convenient?
- How the couple pooled resources for projects.
- The intent of the partners to “act” like a married couple.

Quasi-Community Property

In Washington, property is only determined to be quasi-community after a spouse has died. If the deceased spouse acquired property while not living in Washington State that *would* have been considered community property of the decedent and the surviving spouse had that person lived here, then that property can be treated as quasi-community property. This also applies if the property is located within Washington State and includes property acquired with funds or other property that meet the definition of quasi-community property.

On the death of one spouse, half of the quasi-community property belongs to the surviving spouse, the other half can be passed on through the deceased’s will. If there’s no will, then the rules for community property inheritance through intestate succession will apply (which we’ll explain below). Quasi-community property is fully subject to the decedent’s creditors.

The surviving spouse can also recover half of any transfers of quasi-community property made within three years of the death—such as transfers into a trust, or establishing co-ownership or ownership with joint rights of survivorship with third parties — as long as the deceased still had control over the property at death.

What Happens When…

A Spouse Dies

Washington law allows spouses to dispose of one-half of the community property and all of their separate property by will or other designation. If a spouse dies without a will, the surviving spouse receives 100% of the community property. For separate property when the decedent has no will, trust, or beneficiary designation, the law gives the surviving spouse the following:

- 100% of separate property if the deceased had no family
- 50% of separate property if the deceased had issue (children or grandchildren)
- 75% of separate property if the deceased is survived by parents, siblings, or siblings’ children

Some costs of estate administration are considered community expenses (remember, debts can also be community property) such as funeral expenses, the costs of notices to creditors and other announcements, as well as a portion of professional fees. Keep in mind that 100% of community property goes through probate court to determine succession, unless it is transferred through a trust or via beneficiary designation (retirement accounts, etc.).

One final note on community property and death: Under US federal law, which applies to all states including Washington, 100% of community property gets a tax-basis adjustment upon death. That's a tax basis step-up (or step-down) to current market value, not only for the decedent's half of the property, but for the survivor's interest as well. What this means is that if a married couple had bought a house for $200,000 that is now worth $2 million, the surviving spouse will inherit that house at the recent market value of $2 million (a mark-up from the original cost basis of $200,000). This can be very beneficial to the surviving spouse, including limiting taxable capital gains upon sale of the property. Ask your tax professional about community property and Internal Revenue Code IRC §1014(b)(6).

You Get Divorced

In Washington State, divorce is referred to as "Dissolution of Marriage" and is made official by a Decree of Dissolution of Marriage. Settlements, including the property settlement, are approved by the judge as part of the dissolution process. In a property settlement agreement, all of a couple's property and debts are identified as community or separate and their values assessed. There is no fixed method for determining the division between spouses. Generally, though, each spouse get one-half of all community property and debts as well as their own separate property and debts. Ideally, the spouses mutually agree on a property settlement. If they do not, a judge will decide the division. Washington is an equitable division state, which means judges can award more or less than 50% of community property — and in some circumstances even separate property to one or the other spouse. These judgments are made based on the length of the marriage, the financial positions of the spouses, and the nature of the property itself. If there are creditors, they are not bound by any divisions made: they can still come after either party to collect any formerly community property debt.

You Pay Income Tax

Generally, the federal government respects state property rights, including community property, when it comes to taxation. If you're married and filing separately, each spouse should report one-half of wages and withholding of both spouses. This method always works. When reporting estimated income tax, spouses can report one-half of the estimate paid under the other spouse's Social Security Number. Talk with your tax professional about this approach to ensure it applies.

You Have a Pension or Retirement Plan

The Employee Retirement Income Security Act (ERISA), is a federal law passed in 1974 to govern pension plans. Unlike a lot of what we've been talking about, ERISA rules override Washington State law when it comes to retirement plans, and this can have a significant impact on estate planning. ERISA allows *only* the employee-spouse to direct what happens to her/his employer-sponsored retirement account at death — even though that account may be characterized as community property under Washington State law. A complication to this is that ERISA also mandates that after one year of marriage, spouses acquire rights to each other's employer-sponsored retirement plan. After that first year, to designate someone other than your spouse as your retirement account beneficiary, you must get a signed waiver from your spouse. And this also applies if you wish to make withdrawals upon retirement other than as a joint and survivor annuity. In case of divorce, retirement plan benefits can be divided tax-free through a "qualified domestic relations" court order.

Other Federal Overrides

Social Security benefits are not community property and cannot be divided by agreement of the spouses. Instead, federal law grants spouses and former spouses rights to benefits that are based on, but not subtracted from, the working spouse's benefit.

Income taxes may be a community liability or perhaps a combination of community and separate, but the tax code provides that if spouses file a joint tax return, they are both liable for up to 100% of the tax and the IRS can collect the entire tax from either spouse.

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