BETWEEN THE SHEETS OR SPLITTING THE SHEETS

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I. BACKGROUND

AB 205, as amended by AB 2580, the Domestic Partner Rights and Responsibilities Act ("Act"), was a complicated but landmark piece of legislation. This California state law, which took effect on January 1, 2005, expanded domestic partner rights to include most, but not all, rights of opposite sex married couples. The legislation provided rights but also imposed responsibilities. Family Code Section 297.5(a) gives community property rights to domestic partners. It states: "Registered domestic partners ("RDPs") shall have the same rights, protections and benefits and shall be subject to the same responsibilities, obligations and duties under law . . . as are granted to and imposed upon spouses."

A "registered domestic partner" is defined as two adults who have chosen to share one another's lives in an intimate and committed relationship of mutual caring. To be recognized as an RDP in California, one must file a Declaration of Domestic Partnership with the Secretary of State (See Exhibit A) and meet the following criteria: (1) 18 years of age or older; (2) share a common residence; (3) be members of the same sex if over 18 or over 62 for opposite sex couples who also meet the requirements of the Social Security Act; (4) cannot be married or a member of another domestic partnership; (5) cannot be related by blood in a manner that would prohibit marriage; (6) have the mental capacity to consent; and (7) both partners must agree to be jointly responsible for basic living expenses of the partnership.

One issue that arises with RDPs is termination. RDPs often believe that no requirements are necessary to terminate the registered domestic partnership. After January 1, 2005, this is entirely untrue, and for most RDPs, dissolution of the domestic partnership will require proceedings identical to that of a marital dissolution. California Superior Court has jurisdiction over all proceedings governing dissolutions of RDPs. All cases are assigned to a family law department and must go through procedures equivalent to filing divorce in a marriage unless exceptions apply.

No court determination is necessary only in the cases where the following applies: (1) the domestic partnership lasts for less than five years; (2) there were no children during the term of registration; (3) there are minimal assets and debts and no real property; (4) both RDPs mutually agree; (5) no support is being sought; and (6) a property settlement agreement has been signed.

The Act unfortunately raises legal uncertainty, however, on the interplay between state community property rights and state and federal income, gift and estate tax laws. It also caused many other tax issues to rise to the surface. To clarify community property issues with RDPs, SB 1827, signed by the Governor on September 30, 2006, revised two provisions in the law. Under Family Code Section 297.5(g), California law

now permits RDPs to file joint returns and actually requires them to file as married filing separately if they do not file jointly. It also removed the provision of prior law that earned income would not be treated as community income. Now, it is crystal clear under California law that all income, whether earned or unearned, is treated as community income, split equally between the RDPs, absent a written agreement executed by both RDPs overriding the treatment.

On May 15, 2008, in a 4/3 decision, the California Supreme Court justices ruled that people have a fundamental "right to marry" a person of their choice and that gender restrictions violate the state constitution's equal protection guaranty. The California Supreme Court struck down the state's ban on same sex marriage in a broadly-worded decision that invalidates virtually any law that discriminates on the basis of sexual orientation. (See, *Lockyer v. City and County of San Francisco* and *Lewis v. Alfaro*, 43 Cal.4th 757 (Cal. Sup. Ct. 2008).) Although the Supreme Court invalidated portions of the Family Code that prevented same sex couples from getting married and allowed same sex couples to marry beginning at 5:00 p.m. on Monday, June 16, 2008, same sex couples, whether married or RDPs, will have similar issues regarding federal tax treatment and tax return obligations.

The Franchise Tax Board ("FTB") treats same sex married persons similarly to same sex RDPs. The FTB issued Notice 2008-5 ("Notice") on June 20, 2008, clarifying income tax issues in California. The Notice makes clear that for purposes of the Revenue and Taxation Code and those provisions of the Internal Revenue Code that are applicable for California income tax purposes, the term "spouse" includes every individual married to another individual in a legal relationship recognized as a marriage under California law, including individuals married to another individual of the same sex. In general, taxpayers that are required to file an income tax return who are married as of the last day of the taxable year may file either a joint return or a married, filing separate return. For California income tax purposes, taxpayers married to another individual of the same sex are required to file either a joint return or a married, filing separate return for a taxable year if they are married as of the last day of that taxable year, just like RDPs.

Taxpayers are required to use their adjusted gross income ("AGI") for various income tax purposes, including computing their allowable itemized deductions and the deductibility of contributions to an individual retirement account. Where California has conformed to these federal rules, California taxpayers are required to use their federal AGI. However, since same sex married couples and RDPs are not allowed to file a joint federal income tax return, when filing their California income tax returns, same sex married couples and RDPs are required to instead use an amount equal to what their federal AGI would have been if they were treated as married under federal law and filed a federal income tax return using the same filing status they used to file their California income tax return. In many cases, this amount is equal to the sum of the AGI of each of the same sex spouses as reflected on their separate federal income tax returns for the same taxable year.

The FTB in its Notice warns taxpayers that, since taxpayers are required to either pay estimated taxes or have income taxes withheld from wages and certain other payments during a taxable year, newly married couples need to carefully review their income tax withholding and estimated tax payments to avoid a penalty. One exception to the imposition of the penalty for underpayment of estimated tax is based on the amount of taxes paid for the prior year. For taxpayers who filed a single, head-of-household, or married filing separate

returns for a prior taxable year and file a joint return for the current taxable year, to determine whether the prior year's exception to the penalty for underpayment of estimated tax will apply, the tax paid by each spouse is added to determine the amount of tax paid for the prior year.

II. PROPERTY RIGHTS AND INCOME

Under prior state law, effective for tax years 2005 and 2006, in filing California state income tax returns, RDPs had to use the same status used in filing federal income tax returns. Federal law does not consider domestic partners to be married due to the Defense of Marriage Act, 1 U.S.C. 7, which provides:

> In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word `marriage' means only a legal union between one man and one woman as husband and wife, and the word `spouse' refers only to a person of the opposite sex who is a husband or a wife.

Thus, for 2005 and 2006, domestic partners had to file individual federal and state income tax returns. For 2007 and later years, they will continue to file individual federal returns even though they will file either a joint state return or married filing separate return in California. Same sex married couples will have the same filing status as discussed above.

Same sex spouses are granted the same property rights as opposite sex spouses. Under California Family Code Section 297.5(a), RDPs are granted the same property rights as spouses, including community property rights. Although community income is deemed community property for all state law purposes, its character for federal income tax purposes is unclear for RDPs and same sex married couples.

In 1930, the United States Supreme Court decided the case of *Poe v. Seaborn*, 282 U.S. 101. This case held that in Washington State community income is equally earned by each spouse so that one-half of the community income should be reported on each spouse's separate income tax return (joint income tax returns were not possible prior to 1942). The principles of *Seaborn* were extended to California community property the next year in *United States v. Malcolm*, 282 U.S. 792 (1931). The Treasury Department and the Internal Revenue Service were asked to apply the principles of *Seaborn* and *Malcolm* to RDPs. The first request, in November 2004, was for a public ruling. The second request, in April 2005, was for a private ruling.

For 15 months the federal government was silent on this issue. Then on February 24, 2006, an internal memo to the Service Centers was issued as Chief Counsel Advice, No. 200608038 ("Memo"). This Memo concludes that an individual who is an RDP in California must report all of his or her income earned from the performance of his or her personal services on his or her own individual return. The Memo quoted in its factual statement former Family Code Section 297.5(g), which states as follows: "Notwithstanding this section, in filing state income tax returns, RDPs should use the same filing status as is used on their federal income tax returns, or that would have been used had they filed federal income tax returns. Earned income may not be treated as community property for state income tax purposes." The Service, however, states that it did not rely on that provision in its analysis.

The Memo relied heavily on *Lucas v. Earl*, 281 U.S. 111 (1930) which states a taxpayer may not shift the tax burden of his or her earned income to another by contractually assigning all or a portion of it to someone else. In *Lucas* the Supreme Court held that all of the husband's earnings are to be taxed to husband even though husband and wife had previously entered into an agreement under which all earnings of husband and wife "shall be treated and considered and hereby is declared to be received, held, taken, and owned by us as joint tenants, and not otherwise, with the right of survivorship."

The Memo concluded that *Seaborn*, decided the same year as Lucas, did not apply to California RDPs. The Memo states that the case law relating to income splitting in community property states has always arisen solely in the context of spouses. The Memo further states that the IRS does not believe that *Seaborn* and its progeny apply to the application of a state's community property law outside the context of a married husband and wife. In its view, the rights afforded domestic partners under the Act are not "made an incident of marriage by the inveterate policy of the state." Therefore, they do not extend *Seaborn* to RDPs. The Memo concludes that an individual who is an RDP in California must report all of his or her income earned from the performance of his or her personal services, notwithstanding the enactment of California law.

It is unclear how this ruling will affect same sex marriages. The ruling does state that the rights afforded RDPs under the Act are not "made an incident of marriage by the inveterate policy of the state" further stating that the California Act is not "marriage under California law". But, California is now a state that allows marriage by its inveterate policy. On the other hand, the internal memo also has a statement that a state's community property law does not apply outside the context of a married husband and wife, implying that a marriage must be of the opposite sex. Further, they have the Defense of Marriage Act to further bolster their position. It is also unclear whether RDPs should follow the Memo or split their income under California community property principles on separate federal returns.

Regardless of the nuances, this Memo and the lack of guidance causes a dilemma here for tax practitioners, including accountants, other return preparers and tax lawyers. While the IRS and Treasury acknowledge that spouses, and RDPs and same sex spouses have the same community property rights, they are taxing same sex spouses and domestic partners differently from opposite sex spouses. This in essence causes a dichotomy between state property laws and federal income tax laws when dealing with RDPs and same sex spouses.

Staff at the Treasury Department and the IRS in Washington D.C. working on this issue, indicate that the revisions of the Family Code and Revenue and Taxation Code by SB 1827 and the California Supreme Court decision on same sex marriage will not affect their Memo. One must bear in mind that the Memo is only an internal memo and none of these issues have yet been brought before a court, as they are virtually certain to be. As to RDPs, SB 1827 will likely strengthen, not weaken, an RDPs argument that earned and unearned income should be treated as community property for federal income tax purposes as well, and be allocated 50/50 to each partner's return. The legislation of same sex marriages will bolster this argument for these persons.

One of the movements in Washington is to legislatively override Seaborn. This legislation would in effect prevent, even spouses in community property states, from splitting income. It would mandate that the spouse who controls the income reports that income on his or her separate return. While this may be seen as a solution, it raises concerns from a liability perspective. IRS expects the non-reporting RDP and same sex spouse to maintain liability under community property principles, thus he or she would be obligated to pay any tax deficiency. This is inconsistent, since, if community property principles are not applied, the nonreporting partner should bear no liability.

There remains uncertainty as to how IRS will deal with the consequences of the Memo. For example, is the Service taking the position that community income is earned equally by both partners and same sex spouses, and taxed, by the Memo's special rule, to only one? This could be a problem under *Hoeper v. Tax Commission*, 284 U.S. 206, 52 S.Ct. 120, 76 L.Ed. 248 (1931) which suggests it is unconstitutional to tax one person's income to another.

Or is the Service taking the position that the salary paid to an RDP and same sex spouse, initially, is that the partner's/spouse's income and then one-half of it is transferred to the other partner/spouse? If so, is this a reportable gift? Or, is it IRC section 61 income to the receiving partner/spouse? And, if both partners/spouses work, are the transfers netted, or is each transfer viewed separately as a gift or income?

Currently, many RDPs split income and report income 50/50 on each RDP's return since this is what California law provides. Similarly, many same sex spouses will treat income the same. Additionally, the Memo issued by the Service specifically states that it cannot be relied on. Unfortunately, until legislation on the issues raised herein exists, no clarity will exist.

III. TERMINATING RELATIONSHIPS AND DIVISION OF PROPERTY

Internal Revenue Code Section 1041 prohibits recognizing any gain on property transfers between spouses either during or after marriage if the transfer was incident to divorce. Since that provision only applies to a "spouse" or "former spouse," the federal government's position is that it currently does not apply to RDPs or same sex spouses. This could result in a taxable transaction if the community property is not divided equally or when separate property is used in dividing community property. This is particularly problematic when living in a non-community property state or when dealing with non-community property or quasi-community property in equalizing a division.

If Section 1041 is not applicable, then one will have to utilize Davis and its progeny. (*United States v. Davis* (1962) 370 U.S. 65) Taxation will then turn on the state property rights in the state of residency and the characterization of the property rights of the property being divided. In a community property state, if there is an equal division of community property, no gain will result. Thus, in California the tax consequences will be minimized. However, in many other states or if dividing non-community property (even in California), then gain could likely result.

In *United States v. Davis* (1962) 370 U.S. 65, Mr. Davis transferred appreciated property to his former wife pursuant to a property settlement agreement executed prior to divorce in a non-community property state. The Supreme Court held that a transfer of appreciated property to a spouse or former spouse in satisfaction of the transferee spouse's support rights or other marital claims and property rights results in the recognition of gain to the transferor spouse. Under Section 1001(a), the transferor spouse recognizes gain or loss on the difference between fair market value and his or her adjusted basis. The spouse receiving the property receives the basis in the asset transfer equal to its fair market value on the date of transfer and realizes no gain. (Rev. Ruling 67-221, 1967-2 C.B. 63) The nature of the property in the hands of the transferor determines whether the gain or loss was ordinary or capital. The rationale of Davis was that the transferee spouse exchanged inchoate marital rights under state law, the value of which was deemed to be equal to the value of the property transferred by the transferor spouse.

The biggest problem with the Davis decision was that the tax result in property settlements differed among the various jurisdictions as it hinged on the particular state's classification of property rights. (See *Lenz v. Lenz* (1982) 117 Misc. 2d 78, 457 N.Y.S. 2d 401, mod., remanded, 103 App. Div. 2d 822, 478 N.Y.S. 2d 56 (1984).) States which were non-community property states followed the Davis result. In community property states where there is an equal division of property, or a partition of jointly-held property, the Davis result did not apply. (Revenue Ruling 74-347, 1947-2 C.B. 26) This is because in a community property state, a husband and wife have equal interests in community property and there is no realization when the community property is equally divided between them. Additionally, in a community property state, each asset does not have to be split in half, as the assets can be distributed non prorata so that each party ends up with approximately one-half of the community property. (*Waltz v. Com'r*. (1939) 32 B.T.A. 718 and Rev. Ruling 76-83, 1967-1 C.B. 218)

If non-community property is used in a division of community property, however, the division is partly taxable to the person who receives the non-community property, even in a community property state. (*Carrieres v. Com'r*. (1975) 64 P.C. 959, affirmed 552 F.2d 1350 9th Cir. 1977) Likewise, if the division is unequal, gain will also result in a community property state. (*Siewert v. Com'r*. (1979) 72 P.C. 326) In essence, if non-community property is used in a community property state to equalize division, then in that instance gain is recognized up to the non-community property amount. To calculate this amount one looks at, for instance, husband's assets received. If a portion of the property exchanged is separate property, one must calculate the separate property portion compared to the entire amount received to arrive at a fraction. Once that fraction is obtained, it is multiplied by unrealized gain on the property transferred to the wife. Hence, gain will result in this case even in a community property state.

Additionally, there can be further disparity between the non-community property states depending on their classification of property rights. In equitable distribution states, the law has been all over the board. In effect, courts have tried to interpret the way in which the state law characterized the party's interests. The states which found co-ownership, avoided the Davis result. Yet, if the party's interests were not so classified, the *Davis* result applied. (See *Imei v. U.S.*, 375 F.Supp. 1102 (D Colo 1974)., aff'd. 523 F.2d 853 (10th Cir. 1975); *Cook v. Com'r.*, 80 T.C. 513 (1983); and *Siewert v. Com'r*. ,72 T.C. 336 (1979).

In essence, the inapplicability of Section 1041 to RDPs and same sex spouses, will cause disparate treatment between various states. This treatment will hinge on whether the parties reside in a community property or non-community property state. It will further hinge on whether the property rights in the non-community states are more similar to a community property state or other. In effect, one will have to analyze division based on the Davis line of case law. Section 1041 will apply to RDPs and same sex spouses with respect to their state income tax liabilities.

The legislative branch of the government previously believed, the disparate treatment on division of property between spouses, between states, was problematic. Thus, Section 1041 was enacted to provide uniformity in a property division regardless of the state where the parties resided or property was located. In fact, it is virtually impossible except under extremely limited circumstances to cause gain recognition in such a division between spouses. In California, division is not as problematic as taxation will only occur when noncommunity property or quasi-community property is utilized to equalize the division. In other states, however, depending on the characterization of state property rights, taxation will occur. Thus, when property is divided between RDPs/same sex spouses, disparate tax treatment will exist, depending on the state in which the RDPs/same sex spouses reside and the property jurisdiction.[1] Unfortunately, until legislation is enacted, such inequities will continue to exist.

IV. ESTATE PLANNING ISSUES AND TECHNIQUES

A Potential Conflict of Interest.

1. RDPs. Practitioners should recognize that while the interests of the two RDPs may not be adverse, the RDPs may have issues as to whether property is separate property or community property and may choose to make different beneficial designations, before and after the death of the surviving RDP. Therefore, lawyers must advise their clients of potential conflicts and should recommend individual representation of each RDP. If the RDPs choose to retain one lawyer, the lawyer should obtain written acknowledgement from the RDPs that they have been advised of the potential conflict issues and that they consent to joint representation. Accountants need to be aware of these conflicts as well.

2. Same Sex Spouses. A conflict letter needs to be executed if a lawyer is being retained to represent both spouses. Accountants need to be aware of conflicts as well.

[1] Utilizing the Service's analysis in its memo, which does not recognize community property rights between RDPs/same sex spouses, do they agree that Davis avoids imposition of tax on division of community property co-owned by RDPs/same sex spouses in a community property state? For example, a home is purchased with community earnings, the source of which is from one RDP/same sex spouse. On divorce, if that house is divided 50/50, does Davis apply for federal tax purposes, since IRS may treat those earnings and the source of purchase as belonging solely to the earning RDP/spouse?

B. Property Agreement.

1. RDPs. AB 2580 made the date of state registration the effective date for determination that all property acquired by RDPs is to be considered community property of the registered domestic partnership. The parties had until June 30, 2006, to enter into an agreement stating the characteristics of their property, if their intent was not to consider all property community.

Couples that did not enter into a written agreement prior to June 30, 2006, may still enter into an agreement similar to a post-nuptial agreement establishing their intent as to title and ownership to property, payment of living expenses, division of property on termination, right to support during relationship and upon termination, and child support and visitation by a non-parent partner.

2. Same Sex Spouses. All the provisions of the Family Code apply and pre-marital agreements should be considered to outline property rights prior to entering into the marriage. There must be full disclosure of assets and separate counsel for each spouse. Post-marital agreements can also be used. Additionally, under California law, there are now timing requirements as to execution of pre-marital agreements.

C. Basic Estate Planning Tools.

1. Revocable Living Trust-- may be two individual trusts or one trust for both RDPs/same sex spouses. The decision whether to use one or two trusts should be driven by the specific facts and circumstances of the RDPs/same sex spouses. Among other things, consideration should be given to the net worth of each RDP/same sex spouse, whether or not there are children, what the ultimate disposition will be and ease of administering two trusts.

2. Wills--RDPs have the same intestacy rights as spouses (P.C. Section 6401). Same sex spouses have the same intestacy rights as opposite sex spouses. When there are children, guardianship provisions should be addressed in the Wills.

3. Durable Powers of Attorney—which designates the RDP/same sex spouse or any other party to act on behalf of the incapacitated RDP/same sex spouse.

4. Advance Health Care Directive and HIPAA Designation—allows the designated agent (RDP, same sex spouse or other party) to make medical decisions on behalf of the incapacitated RDP/same sex spouse.

D. Holding Title to Property.

1. Community Property. Without agreement to the contrary, property owned or acquired as of the date of registration is currently considered community property under California law.

2. Joint Tenancy. There are potential gift issues if both RDPs/same sex spouses did not equally contribute to the property. On death of the first RDP/same sex spouse, 100% of property will be included in the estate of the deceased RDP/same sex spouse unless there is proof that both RDPs/same sex spouses owned the property or the surviving RDP/same sex spouse acquired their interest for full and adequate consideration.

3. Payment on Death Accounts and Totten Trusts. To pass to title to bank accounts, stock, automobiles and other assets without administration. Once again, the transfer between RDPs/same sex spouses is taxable for estate tax purposes.

E. Advanced Estate Planning Techniques.

1. Irrevocable Trusts.

a. Charitable Remainder Trusts (CRT), can provide income for the surviving RDP/same sex spouse and give the decedent RDP/same sex spouse a charitable gift and estate tax savings.

b. Grantor Retained Income Trust (GRIT), the grantor retains the income interest for a specified term then the property passes to the remainder beneficiary. There are limitations for the benefit of the grantor's family, however, Treasury Regulation § 25.2702-2(a)(1) does not recognize a RDP as a family member, and therefore cannot be a qualified remainder beneficiary. The gift will be valued based upon actuarial tables and the term of the grantor retained interest.

c. Qualified Personal Residence Trust (QPRT), for transferring title of the grantor's residence to the other RDP/same sex spouse by gifting the residence to the QPRT, with the grantor retaining an interest for a specified term of years.

d. Life Insurance Trusts can be used to replace lost income of decedent RDP/same sex spouse as well as to provide liquidity for the payment of estate taxes, debts and expenses of administration.

e. Creation of LLC or other formed entities to hold title to real property or for the management and operation of a business. Specific facts and circumstances must be considered before creating any entity to hold property.

f. Other advanced planning techniques should be explored as well. These include the use of family entities so that liability protection, gifting, and discounts may be available. Fractional interest gifts of real property may also be utilized to obtain fractional interest discounts.

V. ESTATE AND GIFT TAX ISSUES

There are a myriad of gift and estate tax provisions that come into play between RDPs and same sex spouses. This is primarily due to the fact that no marital deduction is available to RDPs/same sex spouses, as once again, under the Defense of Marriage Act cited above, neither will be treated as married for purposes of spousal provisions throughout the Internal Revenue Code. The various provisions that will come into play in the transfer tax arena are described below.

Under Internal Revenue code Section 2523, gifts between opposite sex spouses are not subject to gift tax. This does not apply to RDPs/same sex spouses. Gifts would also include transmutation of separate property to community property between RDPs/same sex spouses. Thus, gift tax would be triggered on the amount of the transfer, less the annual $12,000 gift exclusion (increasing to $13,000 in 2009) and lifetime gift exclusion of $1,000,000 allowed per individual. While the treatment may be appropriate, this could happen accidentally as, traditionally, RDPs often transfer property back and forth, unknowingly, or change the character of property from separate to community, potentially triggering transfer tax, and, presumably, same sex spouses, will do the same. While many RDPs/same sex spouses are aware of the transfer tax implications on death, they are unaware of the implication of life time transfers, particularly recharacterizations.

On death, RDPs/same sex spouses are ineligible for the unlimited marital deduction for transfers to a surviving RDP/same sex spouse. They are also ineligible for the step-up in basis for the survivor's share of community property (Section 1014). One RDP/same sex spouse may transfer up to the unified credit amount to his or her RDP/same sex spouse upon death, which is currently $2,000,000 (reduced by use of the lifetime exclusion of $1,000,000). As federal law does not recognize community property between RDPs/same sex spouses, transfers between RDPs/same sex spouses either during life or upon death may be deemed gifts of separate property even if the surviving RDP/same sex spouse owns a community property interest.

With joint tenancy transfers, there are similar problems. Once again, RDPs/same sex spouses are ineligible for the unlimited marital deduction for the transfer to the surviving RDP/same sex spouse. Therefore, under the Internal Revenue Code, the IRS may attempt to argue that the joint tenancy property was owned one-hundred percent (100%) by the first joint tenant to die. This puts the burden on the surviving joint tenant to trace books and records to prove contribution. This is because the Internal Revenue Code requires joint tenancy property to be taxed in proportion to contribution. Once again, RDPs/same sex spouses are unaware that such records need to be kept.

Generation-skipping transfer ("GST") tax laws may also come into play. If the surviving RDP/same sex spouse is less than 37-1/2 years younger than the deceased RDP/same sex spouse, GST tax will arise on any such property transferred over the exclusion amount, which currently is equal to the unified credit amount of $2,000,000. Gifts to an RDPs'/same sex spouse's children or grandchildren may trigger GST tax as well. Thus, taxpayers and practitioners need to be aware of the interplay of these rules.

Because of complications with the gift and estate tax laws, it is important for RDPs/same sex spouses to be aware of what is available. RDPs/same sex spouse can utilize a $12,000 per year (increasing to $13,000

per year in 2009) annual gift tax exclusion under IRC Section 2503(b)(1). Additionally, medical and educational expenses of a RDP/same sex spouse are exempt if they are paid directly to the provider such as directly to a university or hospital under IRC Section 2503(b). Transfers on death up to $2,000,000 in 2006, increasing to $3,500,000 in 2009, unlimited in 2010 and back down to $1,000,000 in 2011 can be utilized. Gifts are excluded only up to $1,000,000, however.

Because of the unavailability of the marital deduction, bypass trusts can be utilized so that any property passing to the RDP/same sex spouse is taxed at the first death but then excluded from the surviving RDP's same sex spouse's estate on the survivor's death. These trusts are obviously irrevocable and must contain the ascertainable standard, allowing the survivor to access principal on health, education, support or maintenance or, alternatively, they can allow unlimited access to principal if an independent trustee is appointed. The survivor can be given a limited power of appointment if the deceased RDP/same sex spouse wants to permit the RDP/same sex spouse to change the beneficiaries.

VI. MISCELLANEOUS ISSUES

Spousal support paid to an RDP/same sex spouse also raises transfer tax issues. Spousal support paid by one former RDP/same sex spouse to another is currently not deductible. Is the nondeductible support taxable to the recipient for income tax purposes? Because of the 1917 Supreme Court case of *Gould v. Gould*, 245 U.S. 151 (1917) which suggests that support is not taxable to the recipient (a result changed by IRC Section 71), such payments may be gifts. Alternatively, since the definition of income has broadened since Gould, this support may simply be income to the recipient and not a gift at all.

One further very serious income tax problem that will begin to surface deals with ERISA retirement plans. This issue will be faced by any company that offers such a plan and by all of the participants. The issue begins when a judge in a family law court divides an ERISA retirement plan. Typically with a husband and wife of opposite sex, a Qualified Domestic Relations Order ("QDRO") is obtained under Section 414(p) of the Internal Revenue Code. This allows the plan to be divided pursuant to the marital settlement agreement so that no income tax is triggered on division, assuming both spouses leave the money in a plan or roll proceeds to an IRA. More importantly, this QDRO prevents the plan from being tainted, i.e., disqualified under the ERISA rules that prior to QDROs did not allow a plan to be distributed to a nonparticipant spouse. This would be disastrous for all the employees of the company and the company itself when a judge divides a plan between two RDPs/same sex spouses. Many people practicing in the ERISA/employee benefits arena believe that on a company's receipt of any such order, dividing a plan between two RDPs/same sex spouses, employers will ignore the order so as not to cause plan disqualification. This will cause a huge problem as there is no way to prevent or persuade a family law judge not to divide a plan between RDPs/same sex spouses as state law mandates that family law courts cannot take tax consequences into account.

There are a myriad of other issues not outlined herein. They include but are not limited to the following: (1) head of household; (2) innocent spouse provisions; (3) withholding; (4) joint liabilities; (5) rental real estate and passive distributions; (6) IRC Section 121 exclusion; (7) self-employed health insurance; (8) capital losses; (9) mortgage interest deduction; (10) estimated payments; and (11) social security income.

VII. PROPERTY TAXES

Prior to January 1, 2006, transfers of real property between RDPs were not eligible for the interspousal property tax exclusion. Additionally, RDPs who terminated their partnership were not eligible for the interspousal exclusion on transfers of real property. Revenue & Tax Code Section 62 was revised to incorporate any transfers occurring on or after January 1, 2006, between RDPs and are excluded from the definition of "change in ownership."

Similarly R&T § 63.1 is a parent to child exclusion on certain transfers of real property. Under AB 205, any relationship between parents and children established by an RDP is accorded the same treatment as if established by marriage. For transfers before January 1, 2005, the property must be transferred by the birth parent or by a parent who legally adopted the child. On or after January 1, 2005, the parent to child exclusion applies to transfers from either RDP to a child born to one of the RDPs during the registered domestic partnership. Finally, in the case of a transfer arising due to the death of an RDP, transfers that occurred on or after July 1, 2003, are excluded from reassessment. Since same sex marriages are recognized, same sex marriages will receive all the same property tax exclusions that spouses have with property tax and reassessment exclusions.

VIII. CONCLUSION

While California law gives many rights to RDPs/same sex spouses, it has created havoc on taxpayers attempting to comply with federal tax law, due to the classification of property rights in California versus the federal government's treatment of those property rights. Additionally, other tax provisions cause problems as well. While the tax issues are too numerous to discuss, the issues raised clearly indicate that until clarity is received at the national level through case law or legislation, these tax issues will continue to remain problematic.