Daily Journal

Do you calend California state
Miscalendaring jeopardizes your cases,
Learn how to avoid these problems in thi

This is the property of the Daily Journal Corporation and fully protected by copyright. It is made available only to Daily Journal subscribers for personal or collaborative purposes and may not be distributed, reproduced, modified, stored or transferred without written permission. Please click "Reprint" to order presentation-ready copies to distribute to clients or use in commercial marketing materials or for permission to post on a website.

Overlooked implications of same-sex marriage decision

Bruce Givner *is a partner at Givner & Kaye in Los Angeles. He can be reached at bruce@givnerkaye.com.*

Owen Kaye *is a partner at Givner & Kaye in Los Angeles. He can be reached at owen@givnerkaye.com.*

Since the U.S. Supreme Court's June 26 epochal decision in *United States v. Windsor*, hundreds of articles have been written about its income tax, estate tax, health care, family law and other implications. Those implications are far-reaching and still evolving. However, there are at least two tax implications relating to real estate that have been little noted.

The first little-noted *Windsor* impact relates to the most common capital gain transaction facing the average citizen: the sale of the personal residence. Internal Revenue Code Section 121 is titled "Exclusion of gain from sale of principal residence." Subsection (a) provides that "Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more." The amount excluded cannot exceed $250,000. However, "In the case of a husband and wife who make a joint return for the taxable year of the sale or exchange of the property" the exclusion can be $500,000 if only one spouse meets the ownership requirement. This exclusion of an additional $250,000 for a married same-sex couple can be worth as much as $82,500 in California (approximately 33.3 percent of $250,000 - 20 percent federal capital gains rate + 13.3 percent state capital gains rate).

Example 1: Carol and Alice are married in 2005. That same year Carol buys a home in Westwood for $300,000 for the two of them to live in. Five years later Carol sells the home for $800,000. Even though they are married, because it pre-dates *Windsor*, Carol is only able to exclude $250,000 of the $500,000 capital gain from her taxable income.

Example 2: Claudia and Ann are married in 2010. That same year Claudia buys a home in Santa Monica for $600,000 for the two of them to live in. Five years later Claudia sells the home for $1,100,000. Because they are married and it is after *Windsor*, Claudia is able to exclude the entire $500,000 capital gain from her taxable income.

There is another important principal residence exclusion benefit now available to same-sex couples that was not available before *Windsor*. Internal Revenue Code Section 121(b)(4) provides that if one of the spouses dies, the surviving spouse can still benefit from the $500,000 exclusion if the sale occurs within two years of the first spouse's death.

There are at least two tax implications relating to real estate that have been little noted.

Example 3: Joe and Bob are married in 2000. That same year Joe buys a home in Encino for $300,000 for the two of them to live in. Unfortunately, Bob dies in 2005. Joe sells the home in 2007 for $800,000. Since this is before *Windsor*, Joe is only able to exclude from his taxable income $250,000 of the $500,000 capital gain.

Example 4: James and Ben are married in 2010. That same year James buys a home in Tarzana for $600,000 for the two of them to live in. Unfortunately, Ben dies in 2015. James sells the home in 2017 for $1,100,000. Since this is after *Windsor*, James is able to exclude the entire $500,000 capital gain from his taxable income.

Yet another common real estate transaction is the sale of investment real estate. One way to not be forced to recognize all of the taxable gain in the year of the sale is to enter into a tax-deferred exchange under Internal Revenue Code Section 1031. However, that means that the "seller" is still going to be invested in real estate. What if the seller wants to be out of the real estate business? Another way not to be forced to recognize all of the taxable gain in the year of the sale is to enter into an installment agreement with the buyer. IRC Section 453. For example, on each $5,000,000 of promissory note received by the buyer, a California taxpayer might defer $1,667,000 of tax. However, the seller now must rely on the buyer's credit worthiness, and that may be a risk the seller is not interested in taking, even if it is secured by the property.

There is a post-*Windsor* disadvantage. Before *Windsor*, Joe could sell his investment property to his spouse Bob and take back Bob's promissory note. Bob would hold the property long enough to have a capital gain basis. Then Bob could sell the property to an outside cash buyer and receive the cash without recognizing any gain since Bob's basis was equal to the note. After *Windsor*, in the same transaction, since Bob is a related person for income tax purposes, Bob's basis is the same as Joe's basis. IRC Sections 453(e)(1), (f)(1), and 318(a)(1)(A)(i). However, that can be overcome if Bob holds the property for more than two years before he sells to the outside cash buyer. Section 453(e)(2)(A).

One related item is a potential post-*Windsor* same-sex marriage benefit. The holder of a note must pay interest to the Internal Revenue Service and California Franchise Tax Board on the deferred tax if the note exceeds $5,000,000. IRC Section 453A(a)(1); Rev. & Tax. Code Section 17551(a). The rate - which is what the IRS charges for underpayments - is currently 3 percent. However, for community property, the limit is $10,000,000. So if Joe owns the property, he can gain the $10,000,000 limit by declaring it to be community property with his spouse Bob.

As we continue to live with this happy new post-*Windsor* world, more interesting tax consequences, with real estate and other important areas of commerce, will continue to unfold.

Bruce Givner *is a partner at Givner & Kaye in Los Angeles. He can be reached at bruce@givnerkaye.com*.

Owen Kaye *is a partner at Givner & Kaye in Los Angeles. He can be reached at owen@givnerkaye.com*.