

**FAMILY LAW SECTION**  
**June 29, 2005, Noon**

**CROSS OVER ISSUES: FAMILY AND PROBATE LAW and ESTATE (GIFT) TAXES**

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**Child Support Obligations**

1. Ventura County Dept. of Child Support Services vs. Brown 117 Cal. App. 4<sup>th</sup> 144 (2004).

**Facts:** 6 kids, 8-15, 3 mothers, \$140,000 child support judgments - 15 years.

- 1990 ILIT - beneficiary and bio
- 2002 died
- Benef. \$535,000 - 3<sup>rd</sup> Party Trustee - as result of legal proceedings by guardian ad litem
- Beneficiary had no ability to compel distributions.

**Critical Issue:** Whether Court could order satisfaction of judgment from Trust assets if Trustee refused to make any distributions.

**Ruling:** If a Trustee of a discretionary Trust is making discretionary distributions in good faith, claim must be satisfied out of such distributions; limitation will not apply when Trustee refuses to make distributions in bad faith.

**Public Policy:** In favor of payment of child support Per PC § 15305: Even if Trust has spendthrift clause applicable to claims for child support - it is against public policy to give effect to provision. Outweighs public policy that owner of property may dispose of his assets as he/she pleases and may impose spendthrift restraints.

**Parent-Child Relationship**

1. Estate of Ford 96 Cal. App. 4<sup>th</sup> 386 (2002). CA Supreme Court has affirmed: Estate of Ford 96 Cal. App. 4<sup>th</sup> 386 (2002).

**Facts:** Petitioner was placed in Deceased and Deceased's wife's home as a foster child - lived there 20 years, including 2 years after Wife died. After Deceased died, Petitioner filed a statement of interest claiming entitlement to Deceased's estate under PC 6454 and 6455 (equitable adoption sections).

- 6455: No evidence Deceased ever told Petitioner or anyone else that he wanted to adopt Petitioner nor held Petitioner out as his son.

**Ruling:** • In CA equitable adoption cannot be established by merely showing a mutually affectionate relationship - **Must have clear and convincing evidence of intent to adopt** or promise to adopt or held out to world as natural or adopted son or represented to Petitioner that he was their son.

2. Estate of Jones 122 CA 4<sup>th</sup> 326, 18 CR 3<sup>rd</sup> 637 (2004).

**Facts:** Deceased created a will leaving all to Wife and if she predeceased, to two "stepdaughters," Paula and Kathy. The parties divorced. Eight years later Deceased died. PC 6122 revokes devises to former spouse and property passes as if spouse predeceased. However, the statute does not revoke devises to relatives of a former spouse. Deceased's next of kin argued "stepdaughters" created a class which ceased to exist on dissolution. The Court agreed, relying on Estate of Hermon: gift to ex-spouses children was class gift - children ceased to be members of the class on dissolution.

**Ruling:** The Court of Appeal affirmed: The question of whether or not the gift is a class gift is primarily resolved on the basis of what Deceased would have wanted at the time of his death. The Court said it could have gone differently with sufficient evidence to show an ongoing relationship between stepdaughters and Deceased subsequent to the dissolution.

3. Gillett-Netting v. Barnhart (9<sup>th</sup> Cir. 2004) 371 Fed 3d 593.

**Facts:** Husband and wife were trying to conceive when Husband was diagnosed with cancer. Husband deposited semen before beginning his cancer treatment. Husband died soon thereafter. Ten months later Wife conceived twins.

- After birth, Wife applied for social security child's benefit Insurance - SSA denied arguing:

1. Children could not satisfy "legitimate child" requirement
2. Could not show they were dependent on Husband at his death

**Ruling:**• **District Court:** Not Husband's child under the Act and not dependent on Husband at the time of death

- **9<sup>th</sup> Circuit reversed:** Children were Husband's legitimate children under AZ law therefore automatically considered dependent under the Act - Act's provision for determining status of dependency of child only applies when parentage is disputed. Posthumously conceived children are entitled to Social Security benefits.

4. Ehrenclou vs. MacDonald 117 Cal. App. 4<sup>th</sup> 364 (2004). 4<sup>th</sup> District Court of Appeal affirmed Trial Court ruling that adults adopted under CO's adult adoption and did **not** qualify as "issue" of the person adopting them.

- On Deceased's death, Trustee divided assets of Trust between Deceased's adopted daughter and each of her two then living children.
- Trust to be construed by California law
- In Trust, discretionary distributions: principal at 30, 35 and 40. Thirty-two

- years later daughter, residing in CO, adopted two adults.
- Daughter exercised her POA over Deceased's 1937 Trust appointing half of trust estate to two adopted if they were not entitled to share in 1954 trust.
- On daughter's death her two natural children petitioned the Court to exclude adopted children from 1954 Trust.
- Adult adoption in CA confers status of parent/child. Severs parent/child relationship with natural parents.
- Adult adoption in CO confers status of heir at law only as to adopting parent -adopted does not equal issue-does not sever parent/child relationship with natural parents
- Under CA law state where adoption took place determines the status of the parties.
- Read from Justice Sill's concurring opinion

5. **Recent Rulings:** On September 1, 2004, the California Supreme Court granted review in 3 cases raising the issue of whether a child might have two parents of the same sex: K.M. v. E.G. ( S125643, superceded 118 Cal. App. 4<sup>th</sup> 477, 13 Cal. Rptr. 3d 136); Elisa B. v. Superior Court (S125912, superceded 118 Cal. App. 4<sup>th</sup> 966, 13 Cal. Rptr. 3<sup>rd</sup> 494); and Kristine H. v. Lisa R. (S126945, superceded 120 Cal. App. 4<sup>th</sup> 143, 16 Cal. Rptr. 3<sup>rd</sup> 123).

#### KM vs EG.

**Facts:** Woman donated egg used to impregnate partner by in-vitro fertilization. When separated court rejected egg donor's claim for custody and visitation.

- Court applied Johnson vs Calvert "intention" test, used to decide between genetic mother and surrogate birth mother
- Ignored possibility donor partner could be child's other parent.
- 1/1/2005 Family Code 7540: Child of woman cohabiting with Registered Domestic Partner will be conclusively presumed to be child of domestic partnership, child considered natural child of partner for purposes of intestate succession (PC 6453) because a presumed parent under FC 7540 is considered a natural parent under Uniform Parentage Act (FC 7611)

6. **New Probate Code Sections 249.5-24-249.8, 6453** These sections provide conditions for being "deemed" born during a parent's life. The Decedent must specify in writing that his or her genetic material will be used for posthumous conception of a child of the Decedent. Conception must occur within two years of Decedent's death. Assuming the requirements are met, distribution of assets that might pass to a child or children posthumously conceived must be delayed for the two year period.

7. New Family Code 7540: The child of woman cohabiting with Registered Domestic Partner will be conclusively presumed to be child of domestic partnership, child considered natural child of partner for purposes of intestate succession (PC 6453) because a presumed parent under FC 7540 is considered a natural parent under Uniform Parentage Act (FC 7611)

### **Domestic Partnership**

Family Code Section 297.5(a)-(c) provides to registered domestic partners, former partners, and surviving domestic partners the same rights and responsibilities under California law as those of spouses, former spouses, and surviving spouses. This means property acquired by registered domestic partners is community property if the property is acquired under circumstances which would make it community property if acquired by heterosexual spouses.

New Family Code Section 297.5(m)(1) provides that vis a vis these laws, any reference to "the date of marriage" shall be deemed to refer to the date of registration of the domestic partnership.

Because the property ownership implications of the statute may take some registered domestic partners by surprise, new Family Code Section 297.5(m)(2) permits partners registered prior to January 1, 2005 to enter into an agreement akin to a postnuptial agreement, provided the agreement is fully executed on or before June 30, 2005.

### **Power of Attorney (POA):**

1. Kaneko vs. Yager 120 Cal. App. 4<sup>th</sup> 970 (2004).

**Facts:** Ex-wife appointed Ex-husband her attorney in fact on special power of appointment. She alleged that the power of appointment was executed for him to sell the residence.

- Special POA was not notarized or witnessed
- Instead of selling property, Ex-husband borrowed \$50,000. Lenders released \$20,000 on the special POA, but required Ex-husband to produce properly notarized or witnessed POA to release remaining \$30,000
- Ex-husband then obtained new POA and got \$30,000
- Ex-husband later sold residence and reported \$50,000 in order to close escrow
- Ex-wife sued

#### **Ruling:**

- Lenders are not protected by 4303 re: first \$20,000, but was protected (in unpublished portion) by law of agency because (1) POA expressly authorized encumbrance and (2) Ex-husband had unrestricted access to residence
- Read comments regarding unanswered question of interplay of POA/agency especially in not properly executed POA

## Property Rights

1. Estate of Miramontes-Najera 118 Cal. App. 4<sup>th</sup> 750 (2004). Charlie Bird, Mary Gillick and Jennifer McGibbons of Luce Forward in San Diego represented petitioner and appellant widow.

- Facts:**
- In 1956, H and W entered into an Express CP marriage in Mexico and remained married until H's death in October of 2000.
  - 42 years later, H, without W's consent transferred +/- \$803,000 in CP funds into nine POD accounts payable to persons other than W.
  - W received +/- 1.3 million in a like manner less ½ CP
  - W petitioned under PC 5021 for an order setting aside transfer of ½ funds in each POD account
  - 5021(a) provides: absent spouse's consent, "the Court shall" set aside non-probate transfers of CP effective on death. The statute also provides, "subject to terms and conditions or other remedies that appear equitable under the circumstances...taking into account rights of all interested persons."
  - TRIAL COURT (Judge Thomas Mitchell and Judge Kronberger) read the "other equitable remedies" language to mean there was no need to set aside transfers because W had received more than one-half of the CP.
- Ruling:**
- Justice McConnell said the Trial Court was wrong: to give the statute that effect would be to give no meaning to the previous words - the Court "shall" set aside the transfer because W had not consented to the transfer.

2. Marriage of Starkman 129 Cal. App. 4<sup>th</sup> 659 (2005).

**Facts:** Family Code Section 852(2): Transmutation of separate property of either spouse to community property is not valid unless it is made by an express declaration in writing, made, joined in, and consented to, or accepted by, the spouse whose interest in the property is adversely affected.

A provision in Husband and Wife's family Trust that "Settlers agree that any property transferred by either of them to the Trust is the community property of both of them," did **not** establish a transmutation of Husband's separate property.

The Court reasoned that the Trust's purposes were to avoid probate and provide for orderly administration of estate. Nowhere was there the required express declaration that Husband was unambiguously effecting a change of ownership in his separate property.

3. Regents v. UC. (2005) 128 Cal.App.4th 867.

Anti-alienation provisions in UC pension plans prohibit a non-employee spouse who predeceases the working spouse from bequeathing his or her community property interest in the plans. The executor of decedent's estate and decedent's children

claimed that Family Code Section 2610 prohibits termination of decedent's interests in the plans on her death and takes precedence over contrary regulations adopted by the Regents.

The Court held that Section 2610 is inapplicable when the non-employee spouse dies before the property has been divided in a divorce or legal separation, and the regulations do not conflict with any other state statutes.

4. Estate of Coleman (2005) 129 Cal.App.4th 380. Decedent's ex-wife could not inherit decedent's property under will prepared while the couple was still married, nor could ex wife act as the Trustee under the terms of the Trust incorporated by the default clause of the will. The couple's Marital Settlement Agreement had transferred their property out of the Trust, causing the Will's transfer of property to the Trust to lapse by virtue of Probate Code Section 6300, which provides that a revocation or termination of a Trust before the death of the testator causes the devise to lapse.

The Court held that under the provisions of Section 6122, Jean Coleman may not inherit the decedent's property under the Will or act as Trustee under the terms of the Trust incorporated by the default clause of the will, and that she must be treated pursuant to Probate Code Section 6122 as having predeceased the decedent.

5. Reimbursement of Separate Property Used to Acquire Separate Property  
New Family Code Section 2640(c) provides for purposes of division of property on dissolution of marriage, a party who contributed his or her separate property (i.e., an inheritance) to the acquisition of separate property (presumably for the other spouse) shall be entitled to reimbursement. Reimbursement for separate property contributions to the acquisition of community property was already codified at Family Code Section 2640(b).

## Taxes

### 1. Gift Tax / Estate Tax

Recall that we have a unified gift and estate tax system.

#### 1. Introduction

A transfer between spouses incident to a divorce within the scope of IRC § 1041 is treated as a "gift" for income tax purposes. But, a gift for income tax purposes is not necessarily characterized as a "gift" for purposes of § 2501(a)(1), which imposes a tax on transfers of property by gift ("gift tax").<sup>1</sup>

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<sup>1</sup> **Note:** Section 2502(c) provides that the gift tax is paid by the donor. However, under the gift tax rules, a donor will not actually owe a gift tax until his aggregate cumulative gifts for all taxable gifts made in all years exceeds the applicable exclusion

Donative intent is not an essential element in determining whether a gift has been made for purposes of § 2501(a)(1). Instead, the definition of "gift" for gift tax purposes is purely objective. Section 2512(b) defines a "gift" as any transfer for "less than an adequate and full consideration in money or money's worth" (hereafter referred to as "adequate consideration"). The transfer constitutes a gift to the extent that the value of the property given up exceeds the value of the consideration received.

Transfers of property and payments of cash incident to divorce occur for various reasons - property division, satisfaction of support obligations, exchanges in release of marital rights, even payments to facilitate a quick divorce. Section 2512(b), could encompass many of these divorce-related transfers as the transferor often receives no measurable consideration for the transfer. However, the IRS and the Courts recognize various exceptions to the gift tax which are applicable to divorce-related transfers. They fall into the following categories:

- transfers fully or partly offset by annual exclusion;
- transfers subject to the unlimited marital deduction;
- direct payments of educational and medical payments;
- transfers under divorce settlement agreements; (IRC § 2516 including to a Trust)
- payments in satisfaction of support obligations (Rev. Ruling 68-379, 1968-2 CB 414); and
- court ordered transfers. (Harris v. Commr. (1950) 340 US 106)

A payment of cash or transfer of property may be subject to one or more of these exceptions.

a. Direct Payment of Tuition and Medical Expenses

IRC § 2503(b) is an important provision in the divorce area. It exempts from gift tax certain payments of college and other expenses made on behalf of adult children. See Section 2503(e). Obligations to pay college costs are a frequent feature of divorce settlements.

**Note:** Section 2503(e) excludes from the definition of "gift" tuition paid **directly** to a qualified educational institution and payments for an individual's medical care (including insurance premiums) paid directly to a medical care provider. <sup>2</sup>

**Note:** The exclusion under § 2503(e) is applied **before** taking into account the annual exclusion (under § 2503(b)).

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amount (\$1,000,000 for gifts made in 2002 through 2009). See § 2505(a) and reference to § 2010(c).

<sup>2</sup> **Note:** Payments for other school or medical related costs, such as books, room and board or reimbursements for tuition or medical expenses paid by others do not escape the gift tax under § 2503(e).

Example: In 1998, H and W enter into a separation agreement under which H is to pay C's college tuition, room and board, and transportation. In 2002, H and W divorce. Their divorce decree does not incorporate the separation agreement. In 2004, when C is age 23, H pays C's \$12,000 tuition directly to the university. H also gives C \$15,000 for living expenses. The \$12,000 payment is not a gift because it is an amount paid as tuition to a qualifying educational organization. The \$15,000 payment is a gift. (But up to \$11,000 of it may be offset by H's annual exclusion under § 2503(b)).

b. Unlimited Gift Tax Marital Deduction

Section 2523(a) creates a gift tax marital deduction. The transferor and transferee **must be married** at the time of the transfer to obtain a deduction for qualifying intra-spousal transfers. Section 2523(b) limits this rule, however, by excluding transfers of life estates and other terminable interests unless the donee spouse receives a QTIP (i.e., income for life with property value included in donee's estate tax return.)

While not a divorce tax provision, § 2523(a) is arguably the most useful tax loophole for divorcing spouses. In many divorces, the parties reach a settlement of marital issues and complete all or almost all property transfers incident to the settlement during the separation period. Usually, these are outright transfers. In such cases, spouses need not worry whether the transfers are gifts, and, if so, whether they fall into one of the other gift tax exceptions.

2. Alimony

If the requirements of IRC § 71 are satisfied, cash payments regardless of the purpose of the payment (e.g., support, consideration for other property received, payments in release of marital rights or purely donative transfers) and regardless of amount, will be treated as alimony. Alimony is income to the payee and deductible by the payor. Thus, apparently, the situation could arise where a transfer is technically both a gift under § 2501 and a deductible expense under § 215. And, there is a split of authority as to whether payments by an Estate to satisfy a spousal support obligation are "alimony" and deductible. Kitch v. Commr. 103 F3d 104 (10<sup>th</sup> Cir. 1996). (Payments for arrearages are deductible) vs. Burkle v. Commr. TC Memo 1996-394. Decedent's estate not entitled to deduct payments as IRC § 215 provides for deduction "to individual" (not "Estate").

**Note:** Payments which are made under any agreement which provides for support payments after the payee's (supported Spouse) death are NOT alimony. Regulation 1.71-ITA-14. Exception: life insurance payments may not fall within this Regulation, but final Regulations have not yet been issued.

Section 2516 requirements: Section 2516 applies if:

- The spouses enter into a written agreement relating to their marital and property rights; *and*
- Divorce occurs within the three-year period beginning on the date one year before such agreement was entered into. (IRC § 2516)

Timing: Under IRC §2516, the agreement need not be approved by the family law court adjudicating the marriage dissolution. The transfer called for by the agreement can be made at any time so long as divorce occurs within the period of one year before and two years after the agreement is executed (IRC § 2516).

**Note:** IRC § 2516 would be *inapplicable* if the marriage is not dissolved or if either spouse dies before entry of the judgment of dissolution. (*Estate of Hundley v. Commr.* (1969) 52 TC 495, *aff'd* (4<sup>TH</sup> Cir. 1971) 435 F2d 1311).

Filing steps when transfer occurs before dissolution judgment: In the event the spouses enter into the written agreement described in IRC § 2516, and the final dissolution judgment has not yet been entered before the due date for filing a gift tax return for the year in which the transfer is made, the parties should file a gift tax return disclosing the transfer, with a copy of the agreement.

No gift tax needs to be paid with the return.. The spouses should file a certified copy of the final judgment with the appropriate Internal Revenue officer within 60 days after entry of the judgment. (Regulations § 25.6019-3(b))

### 3. Estate Tax

#### 1. Introduction

An estate tax is imposed on a decedent's taxable estate passing at death and on taxable gifts transferred during the decedent's life. When a separated or divorced spouse dies, there are two principal divorce-related issues having estate tax implications: (i) whether and to what extent the value of property transferred by the decedent as a result of the divorce or separation will be included within the tax base (either as part of the decedent's taxable estate or as adjusted taxable gifts) subject to estate tax; and (ii) whether and to what extent divorce-related obligations continuing beyond the death of the decedent will be deductible from the decedent's gross estate as a claim against the estate.

As a general rule, if a decedent makes a lifetime transfer deemed to be a completed taxable gift (after taking into account the annual exclusion, medical and tuition exclusion, and the marital and charitable deductions) during his or her life, the value of the property transferred is included in the decedent's estate tax base as an adjusted taxable gift at date of gift values. If the decedent makes a lifetime transfer deemed to be an incomplete gift (e.g., after the transfer, the transferor continues to have or obtains an interest in or power over the property transferred), the value of the property transferred is subject to estate tax imposed on the decedent's taxable estate at date of death values. If, however, a transferor makes a lifetime transfer for adequate consideration, the transfer is not considered a gift at all and the value of the property transferred is excluded from the estate tax base. Thus, in determining whether a divorce-related transfer is subject to estate tax, either as an adjusted taxable gift or as part of the decedent's taxable estate at death, the IRS and courts will look at whether the transfer was made for adequate (or deemed adequate) consideration.

## Handling Existing Revocable and Irrevocable Trusts in Divorce

Revocable Trust - What to do in the event of divorce.

- create two new trusts
- assign interests held in trust to new trusts
- convey after judgment

Irrevocable Trust - What to do in the event of divorce.

- consider requesting the resignation of Trustee
- have an agreement signed by beneficiaries to modify or terminate
- obtain approval from Court. Probate Code §§ 15402, 15403 et seq. and 1509
- do not terminate an irrevocable trust without talking to a tax advisor.