



STATE OF CALIFORNIA  
**FRANCHISE TAX BOARD**  
**Legal Branch**  
PO Box 1720  
Rancho Cordova, CA 95741-1720  
(916) 845-6254 Fax (916) 843-0146

STEVE WESTLY  
Chair

CAROLE MIGDEN  
Member

STEVE PEACE  
Member

February 25, 2003

Information Letter No. 20030009

\*\*\*\*\*

Dear \*\*\*\*\*:

Your request for information regarding the application of California Revenue and Taxation Code section 18662, paragraph (e)(1), to inter-spousal transfers incident to divorce, dated \*\*\*\*\* , has been referred to me for response.

## ISSUE

Does the withholding requirement on the transfer of real property under California Revenue and Taxation Code section 18662, paragraph (e)(1), apply to inter-spousal transfers of property incident to divorce under California Revenue and Taxation Code section 18031<sup>1</sup> (See Internal Revenue Code (IRC) section 1041).

## FACTS

Situation 1: H and W are California residents. Pursuant to a divorce settlement, H receives all of the parties' interest in a business and, in exchange, W receives all of the parties' interest in a rental property or vacation home located in California.

Situation 2: H and W are California residents and own two rental properties (property A and B) of equal value located in California. Pursuant to a divorce settlement, H receives W's one-half interest in property A and W receives H's one-half interest in property B.

Situation 3: H and W are California residents. Pursuant to a divorce settlement, H receives cash from W in exchange for H's one-half interest in a secondary home located in California.

---

<sup>1</sup> Unless otherwise stated, all further section references are references to the California Revenue and Taxation Code.

## LAW AND ANALYSIS

AB 2065 (Stats. 2002, Ch. 488) amended section 18662, applicable to dispositions of real property occurring on or after January 1, 2003. Section 18662, paragraph (e)(1), provides that in the case of any disposition of California real property by an individual (including both residents and non-residents), the transferee is required to withhold three and one-third percent (3 1/3%) of the total sales price at escrow unless the seller qualifies for an exemption.

Section 18662 provides exemptions for certain transactions. The exemptions for individuals generally include the following:

- Property sold for a total sales price of \$100,000 or less (subparagraph (e)(2)(A));
- Property that is the transferor's principal residence within the meaning of IRC section 121 (subparagraph (e)(2)(D));
- Property sold as part of a like-kind exchange pursuant to IRC section 1031 (clauses (e)(2)(E)(i)-(iii));
- Property sold due to an involuntary conversion pursuant to IRC section 1033 (subparagraph (e)(2)(F)); and
- Property sold at a loss for California income tax purposes (subparagraph (e)(2)(G)).

Section 18662 defines "sales price" as the sum of all of the following:

- The cash paid or to be paid, excluding stated or unstated interest or original issue discount (as determined under IRC sections 1271 through 1275) (subparagraph (e)(8)(A));
- The fair market value of other property transferred, or to be transferred (subparagraph (e)(8)(B)); and
- The outstanding amount of any liability assumed by the transferee or to which the California real property interest is subject immediately before or after the transaction (subparagraph (e)(8)(C)).

IRC section 1041, subsection (a), provides that no gain or loss shall be recognized on a transfer of property from an individual to (or in trust for benefit of) a spouse, or former spouse, where the transfer occurs incident to divorce. Subsection (b) provides that the transfer be treated as a gift, which has a carry-over basis.

In *Commissioner v. Duberstein* (1960) 363 U.S. 278, the United States Supreme Court held that a voluntary executed transfer of property by one to another for no consideration or compensation in exchange is a common-law gift.

\*\*\*\*\*

February 25, 2003

Page 3

Thus, since an inter-spousal transfer of property incident to divorce is specifically deemed a "gift" under IRC section 1041, there is no consideration or compensation transferred from one party to the other. Accordingly, the "sales price" of the property would be zero. Since the total sales price of the property is zero, the transaction is exempt from the withholding requirements under section 18662, paragraph (e)(1) because subparagraph (e)(2)(A) states that no withholding is required where the total sales price of the property is less than \$100,000.00.

### **CONCLUSION**

Transfers of real property incident to divorce that are treated as gifts under IRC section 1041 are not subject to the withholding requirements in section 18662, paragraph (e)(1).

Therefore, in the above three factual situations, the transferee of real property would not be required to withhold three and one-third percent (3 1/3%) under section 18662, paragraph (e)(1), because the transfer would be considered a gift under IRC section 1041, and the total sales price would be zero, making the transaction an exempt sale of property under section 18662, subparagraph (e)(2)(A).

Very truly yours,

Margalo A. Weissman  
Tax Counsel