

IRS GUIDANCE ON SAME-SEX MARRIAGE

September 3, 2013

Special Report

HIGHLIGHTS

- Place Of Celebration Of Marriage Controls
- Guidance For 2013 Tax Returns
- Amended Returns May Be Filed For Open Years
- Treatment Of Domestic Partners
- Approaches Of Other Federal Agencies
- More Guidance Expected

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IRS Recognizes All Same-Sex Marriages Nationwide

All legally married same-sex couples will be treated as married for federal tax purposes whether or not the couple lives in a jurisdiction that recognizes same-sex marriage, the IRS announced on August 29. The ruling, issued two months after the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA) in *E.S. Windsor* (2013-2 USTC ¶50,400, June 26, 2013), affects all federal taxes, including income taxes, estate and gift taxes, payroll taxes associated with employee spousal benefits, and more.

In an effort to simplify and streamline tax administration as much as possible, the IRS, like many other federal agencies, took a “place of celebration” approach rather than using a couple’s “place of domicile” to determine their tax status.

IMPACT. Legally-married same sex couples must file as married filing jointly or married filing separately for the entire 2013 tax year. For earlier tax years still open by the statute of limitations (generally 2010, 2011 and 2012 returns), these couples have the option to file an amended return to reflect their married status. In an unusual twist based on the effective date of the guidance, legally-married same-sex couples who have not yet filed their 2012 returns have a limited time to file as unmarried taxpayers. If they file on or after September 16, 2013, they must file as married. In addition, employers, employees and plan administrators will need to sort out withholding, pre- and after-tax benefits, retroactive benefits, and refund opportunities.

CAUTION. The ruling applies to any same-sex marriage that is legally entered

into in one of the 50 states, the District of Columbia, a U.S. territory, or a foreign country, the Treasury Department explained at an August 29 news conference in Washington, D.C. However, the ruling does not apply to registered domestic partnerships, civil unions, or similar formal relationships recognized under state law.

IMPACT. The IRS rules create complexities for legally married same-sex couples who reside in jurisdictions that do not recognize same-sex marriage. Most of these couples will need guidance on how to prepare their state income tax returns. As of September 3, 2013, there are 13 states and the District of Columbia that recognize same-sex marriage. Several counties in New Mexico are issuing marriage licenses to same-sex couples, as is one county in Pennsylvania.

COMMENT. Although the Windsor case involved the estate tax, the IRS did not address any estate or gift tax rules other than briefly mentioning that taxpayers who wish to file a refund for gift and estate taxes should file Form 843. Further guidance in the estate and gift area, involving the split-gift election, marital claims against an estate, and other matters, is anticipated from the IRS.

BACKGROUND

After Congress passed DOMA in 1996, the IRS announced that it would not recognize same-sex marriages as marriages for federal tax purposes because Section 3 of DOMA defined the word “marriage” as a legal union

between one man and one woman as husband and wife, and the word “spouse” as a person of the opposite sex who is a husband or a wife.

Edith Windsor, the surviving spouse in a state-recognized same-sex marriage, filed for a refund of federal estate taxes. Because of DOMA, Windsor did not qualify for the unlimited marital deduction under the Internal Revenue Code. A federal district court and the Court of Appeals for the Second Circuit found that Section 3 of DOMA was unconstitutional. The Supreme Court agreed in a decision handed down on June 26, 2013.

Writing for the five-justice majority, Justice Anthony Kennedy said that, “DOMA’s principal effect is to identify a subset of state-sanctioned marriages and make them unequal. The principal purpose is to impose inequality, not for other reasons like governmental efficiency.” Kennedy concluded that “by creating two contradictory marriage regimes within the same State, DOMA forces same-sex couples to live as married for the purpose of state law but unmarried for the purpose of federal law.”

COMMENT. *The Supreme Court did not address Section 2 of DOMA which provides that no state is required to recognize a same-sex marriage recognized by another state.*

MARRIAGE

A taxpayer’s filing status for an entire year is determined as of the close of that tax year and depends mainly on marital status. A taxpayer’s filing status may be single, surviving spouse, head of household, married filing joint returns, or married filing separate returns. Married couples generally must file as married filing jointly or married filing separately.

Common-Law Spouses

Some states recognize common law marriage; others do not. In Rev. Rul. 58-66

(1958-1 CB 60), the IRS determined that a couple would be treated as married for purposes of federal income tax filing status and personal exemptions if the couple had entered into a common-law marriage in a state that recognized their relationship as a valid marriage. The couple would also be treated as married for federal tax purposes if they later moved to a state that did not recognize common-law marriage.

“Like many other federal agencies, the IRS took a place of celebration approach to same-sex marriage....”

COMMENT. *In its ruling on same-sex marriage, the IRS noted that it has applied Rev. Rul. 58-66 for more than 50 years despite the fact that many states do not recognize common-law marriage.*

Same-Sex Married Couples

In Rev. Rul. 2013-17 (August 29, 2013), the IRS explained that in light of the Supreme Court’s decision in *Windsor*, Rev. Rul. 58-66, and the need for effective tax administration, it will interpret the Internal Revenue Code as incorporating a general rule that recognizes any same-sex marriage that is legally valid in the state where it was entered into, regardless of the married couple’s place of domicile.

IMPACT. *The IRS guidance officially opens the door for legally-married same-sex couples to enjoy many federal tax-related benefits previously available only to opposite-sex married couples. These include income tax benefits, estate and gift tax benefits, tax advantages for employee benefits, health-care law credits, and more.*

EXAMPLE. *Adam and Josh were legally married in Maine, a state that recognizes same-sex marriage, on July*

1, 2013. On September 1, 2013, they sell their home in Maine and move to Virginia, a state that does not currently recognize same-sex marriage. Adam and Josh are recognized as married for federal tax purposes even though they have moved from a state that recognizes same-sex marriage (Maine) to a state that does not (Virginia).

IMPACT. *Taking the opposite approach (state of domicile of the married same-sex couple) would create serious administrative concerns, the IRS cautioned in laying out the legal justification for its position. “Given our increasingly mobile society, it is important to have a uniform rule of recognition that can be applied with certainty by the IRS and taxpayers alike for all federal tax purposes,” the agency explained.*

COMMENT. *When referring to the “state” in which the same-sex couple’s marriage was entered, the IRS presumably means to encompass other U.S. jurisdictions, such as the District of Columbia, and foreign jurisdictions that recognize same-sex marriage. The IRS indicated that additional guidance on this subject will be issued.*

In Rev. Rul. 2013-17, the IRS reports that “there are more than two hundred Code provisions and Treasury regulations relating to the internal revenue laws that include the terms “spouse,” “marriage” (and derivatives thereof, such as “marries” and “married), “husband and wife,” “husband,” and “wife.””

FILING STATUS

For the 2013 tax year and all future tax years, legally-married same-sex spouses must generally file their federal returns as married filing jointly or married filing separately, the IRS explained in frequently asked questions (FAQs) posted on its website. For all prior open tax years, same-sex spouses who file an *original* return on or after September 16, 2013 (the effective date of Rev. Rul. 2013-17) must also generally file as married filing jointly or married

filing separately. For 2012 returns filed before September 16, 2013, and for all prior tax years that are still open under the statute of limitations, legally-married same-sex couples may choose to amend their federal income tax returns to claim married filing jointly or married filing separately status, but they are not required to do so.

Limitations Period. The statute of limitations for amending a return is generally three years from the filing date or two years from the date taxes are paid, whichever is later. The limitations period on open tax years may be extended by agreement or through a protective refund claim.

COMMENT. *Leading up to the Supreme Court's decision, many same-sex couples filed protective income tax refund claims using married filing jointly status to keep the statute of limitations open on 2009 or earlier years. The IRS must now act on these protective claims.*

IMPACT. *The IRS did not specifically address situations involving divorce or separation in connection with the option to be considered married. Presumably, if a spouse elects to file an amended return as married filing separately for a year in which the couple was legally married and not separated, the other spouse must also amend his or her return from single unmarried to married filing separately, regardless of whether the change benefits both spouses.*

PROS AND CONS OF MARRIED STATUS

Rev. Rul. 2013-17 provides that if same-sex spouses amend their returns to reflect their married status, “all items required to be reported on the return or claim that are affected by the marital status of the taxpayer must be adjusted to be consistent with the marital status reported on the return or claim.”

Marriage Penalty

Same-sex couples must now also deal with quirks in the tax law that may create a so-called “marriage penalty.” Employers

must also prepare for extensive changes in the treatment of same-sex couples. Individuals claiming tax credits and other benefits under the Patient Protection and Affordable Care Act may also be impacted by the ruling.

IMPACT. *Although married-filing-jointly status is usually preferable to married-filing-separately status, the benefits of filing a joint return are not always greater than filing separately as unmarried individuals. A Treasury official on August 29, 2013, told the press that data indicated that approximately half of married same-sex couples would benefit from filing as married, and half would not. Generally, however, the greater the disparity of income between the spouses, the greater the benefit gained by filing jointly.*

Both differences in tax rate bracket amounts and a variety of income floors and thresholds used to determine the right to certain tax breaks come into play in determining whether a particular couple is better off filing as married for federal tax purposes.

Married Filing Separately

If legally-married same-sex couples want to keep their finances (and liabilities) separate by filing separate returns, they usually—but not always—pay more federal income tax than if they filed joint returns. The rate brackets for “married filing separately” are higher than for “unmarried,” “surviving spouse” or “head of household.” Several credits and deductions are also reduced or eliminated.

Innocent Spouse Status

Married taxpayers who file joint returns are jointly and severally responsible for the tax and any interest or penalty due on the joint return. In some cases, “innocent spouse” relief under Code Sec. 6015 is available. However, married individuals cannot turn a blind eye to any item that is listed on a joint return. In deciding whether to file amended returns for prior years under the new IRS guidance, a same-sex couple should consider the joint and several liability that would be triggered. Separate returns eliminate the possibility of joint liability entirely (though community property laws can make one spouse liable for tax on income reported on the other spouse’s separate return).

Filing Status, AGI Floors and Threshold Amounts

The amounts of income and deductions reported on a return are used by the IRS in determining whether certain threshold levels and floors are reached. Those amounts, in turn, determine access to a variety of tax benefits. Some of these floors or threshold amounts are applied to all filing statuses uniformly; others vary depending upon filing status.

IMPACT. *Depending upon adjusted gross income (AGI), and other data reported on a return, combining the income and deductions of each same-sex partner on a single joint return may or may not work to the advantage of the couple as a unit, in contrast to filing as unmarried or as married filing separately.*

SELECTED COMPARISON OF MARRIED SAME-SEX COUPLES AND DOMESTIC PARTNERS

	Married Same-Sex Couples	Domestic Partners
File joint returns	Yes	No
Itemize deductions	Yes*	Yes
Claim credits as married	Yes	No

*No, if filing separate returns and the other spouse claims the standard deduction

Floors. Several tax benefits depend on floor levels of adjusted gross income (AGI) or modified AGI (MAGI), including:

- Medical expense deduction floor (10 percent of AGI (temporarily 7.5 percent for taxpayers age 65 and older));
- Casualty loss deduction floor (10 percent of AGI); and
- Miscellaneous itemized deductions floor (two percent of AGI).

COMMENT. *In the case of married individuals who file separate returns, if one spouse itemizes deductions on his or her return, the other spouse must also do so, regardless of whether his or her standard deduction would be larger. This rule does not apply to unmarried couples who file separate returns.*

Ceilings. Use of excess capital losses to offset ordinary income is generally limited to \$3,000 per return, whether on a joint return or an unmarried single return. Taxpayers who are married filing separately, however, are allowed only a \$1,500 maximum capital loss deduction; the balance in all cases may be carried forward into the next tax year.

Thresholds. For some taxpayers, AGI above designated thresholds reduces certain tax

benefits. Reduction in itemized deductions and personal exemptions are most common among higher-income individuals. Thresholds are also commonly used to restrict deductions, credits and other benefits based upon AGI and filing status.

IMPACT. *In dealing with threshold amounts, a benefits/drawbacks analysis generally depends upon the extent to which that portion of any tax benefit below a threshold amount would otherwise go unused by one of the partners if filing separately. With certain deductions, credits or contribution levels, however, electing “married filing separately” status may eliminate the benefit for both spouses. For example, a married taxpayer who files a separate return cannot claim education credits (lifetime learning and Hope scholarship / American Opportunity) or the student loan interest deduction.*

SPECIAL WARNINGS IN FAQs FROM IRS

Within the FAQs released on August 29, the IRS specifically reminded same-sex legally-married spouses that the same, sometimes unfavorable, rules under the Tax Code applicable to one spouse filing separately that have applied

to opposite-sex married couples now apply with equal force to same-sex legally-married couples:

Spouse as Dependent

A taxpayer’s spouse cannot be the taxpayer’s dependent. The IRS also clarified the limitations on registered domestic partners and individuals in civil unions as dependents.

Standard Deduction

A taxpayer who files separately cannot itemize deductions if his or her spouse elects to take the standard deduction.

Head of Household Status

Generally, a married taxpayer cannot file as a head of household. However, a legally married taxpayer is not considered “married” for tax purposes if the taxpayer lives apart from his or her spouse for the last six months of the tax year and provides more than half the cost of maintaining a household that is the principal place of abode of the taxpayer’s dependent child for more than half of the year.

Dual Claims to Dependency Deduction

Absent an agreement between parents who file separate returns as to who may claim a dependent child, the IRS gives the dependency deduction to the parent with whom the child resided for the longer period of time during the year; and in the case of a tie, to the parent with the higher adjusted gross income.

Adoption Credit

Code Sec. 23 provides a credit to qualified taxpayers for qualified expenses incurred in connection with the adoption of an eligible child. Married taxpayers generally must file jointly to claim the credit. In addition, the credit does not apply to expenses that a taxpayer incurs in adopting the child of his or her spouse.

Passive Activity Loss

An individual may offset up to \$25,000 of passive activity loss from all rental real estate

2013 AGI (MAGI) PHASEOUT THRESHOLD START POINTS

	Joint Return	Single	Married Filing Separately
Itemized Deductions:	\$300,000	\$250,000	\$150,000
Personal Exemptions:	\$300,000	\$250,000	\$150,000
Maximum Net Capital Gains:	\$450,000	\$400,000	\$225,000
Net Investment Income Surtax:	\$250,000	\$200,000	\$125,000
Additional Medicare Tax:	\$250,000	\$200,000	\$125,000
Child Tax Credit:	\$110,000	\$75,000	\$55,000
American Opportunity Credit:	\$160,000	\$80,000	\$0
Lifetime Learning Credit:	\$107,000	\$53,000	\$0
IRA Deduction (plan participants):	\$95,000	\$59,000	*
Roth IRA Eligibility:	\$178,000	\$112,000	**

* Deduction determined under single status if not living with spouse at anytime during tax year; otherwise partial deduction if MAGI is less than \$10,000 and no deduction if MAGI is \$10,000 or more
 * \$10,000 if lived with spouse at anytime during tax year; \$112,000 if did not live with spouse at anytime during tax year

activities in which the taxpayer actively participates against nonpassive income. For married taxpayers filing separately, Code Sec. 469(i)(5)(A) essentially cuts the \$25,000 amount in half.

IMPACT. *Same-sex legally-married couples may find that they can avoid the force of many of these rules if they opt not to file amended returns for 2012 and prior open years but retain their status as unmarried filing separately or head of household.*

EMPLOYEE BENEFITS/ RETIREMENT

Perhaps in no area outside of income taxes is the impact of the Supreme Court's decision to strike down Section 3 of DOMA more expansive than on employee benefits. In Rev. Rul. 2013-17 and FAQs, the IRS provided limited guidance for employers and taxpayers.

COMMENT. *The IRS announced that it intends to issue further guidance on the application of Windsor to employee benefits and employee benefit plans and arrangements.*

Employee Benefits

Many employers offer health care benefits to unmarried domestic partners. Under DOMA, domestic partners were not treated as spouses for federal income tax purposes. As a result, an employee paid taxes on the fair market value of the coverage for the employee's domestic partner (whether the domestic partner was a same-sex partner or an opposite-sex partner). However, domestic partner benefits would be tax-free if the employee's partner qualifies as a dependent under Code Sec. 152.

COMMENT. *Some employers have attempted to equalize the treatment between opposite-sex couples and same-sex couples by providing so-called gross-ups to cover the additional taxes that same-sex couples pay on health benefits.*

Employees. In its FAQs, the IRS explained that if an employer provided health coverage for an employee's same-sex legally-married spouse and included the value of that coverage in the

employee's gross income, the employee can file an amended return for open tax years reflecting his or her status as a married individual to recover federal income tax paid on the value of health coverage of the employee's spouse.

IMPACT. *At a press conference immediately following the release of guidance, a Treasury official stated that entitlement to employee benefits must be consistent with filing status; that is, a switch in spousal coverage from after-tax to pre-tax treatment also requires the employee to file an amended return as married. The IRS in its FAQs, however, is silent on this requirement. In many cases, the pre-tax savings will not outweigh the additional tax that may be due on an amended return claiming married status.*

Employers. If the limitations period for filing a refund claim is open, the employer may claim a refund of, or make an adjustment for, any excess Social Security and Medicare taxes paid on the benefits to a same-sex legally-married partner, the IRS explained in its FAQs. The IRS reported that it will issue a special administrative procedure for employers to file claims for refunds or make adjustments.

IMPACT. *Employers cannot file claims for refunds of overwithheld income tax for prior years. Employers may make adjustments for income tax withholding that was overwithheld from an employee in the current year provided the employer has repaid or reimbursed the employee for the overwithheld income tax before the end of the calendar year, the IRS explained in its FAQs.*

Cafeteria Plans

Employer contributions to a cafeteria plan are usually made under a salary reduction agreement between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and

FUTA. Among the forms of cafeteria plans that provide health benefits to employees and their spouses are:

Health Flexible Spending Accounts. A health flexible spending arrangement (FSA) is a form of cafeteria plan benefit, funded by salary reduction, which reimburses employees for qualified medical expenses. Post-Windsor, legally married same-sex couples should be able to take advantage of FSAs to the same extent as legally married opposite-sex couples. The IRS is expected to issue more guidance.

Health Savings Accounts. A health savings account (HSA) is a vehicle that eligible taxpayers can use to pay qualified medical expenses, including those incurred by the taxpayer's spouse. Post-Windsor, legally married same-sex couples should be able to take advantage of HSAs to the same extent as legally married opposite-sex couples. The IRS is expected to issue more guidance.

Qualified Retirement Plans

Under Rev. Rul. 2013-17, a qualified retirement plan must treat legally married same-sex spouses as married for purposes of applying the federal tax laws that govern qualified retirement plans, the IRS explained in its FAQs. A qualified plan must recognize a same-sex marriage that was entered into in a jurisdiction whose laws authorize the marriage, even if the married couple lives in a domestic or foreign jurisdiction that does not recognize the validity of same-sex marriages.

IMPACT. *Qualified retirement plans must comply with these rules as of September 16, 2013. The IRS indicated that it will provide additional guidance on the application of Windsor to qualified retirement plans, including guidance on plan amendments, retroactive application of Windsor, and spousal benefit waivers.*

COMMENT. *A person who is in a registered domestic partnership or civil union is not considered to be a spouse for purposes of applying the federal tax law requirements for qualified retirement plans (domestic partnerships are discussed in more detail below).*

DOMESTIC PARTNERS

Domestic partner laws vary significantly among U.S. states and territories. Some states allow registered domestic partners to file state income returns jointly. In Rev. Rul. 2013-17 and FAQs, the IRS explained that individuals of the same sex and the opposite sex who are in registered domestic partnerships, civil unions or other similar formal relationships that are not marriages under state law are not considered as married or as spouses for federal tax purposes.

IMPACT. *The treatment of same-sex domestic couples (and opposite-sex domestic couples) is essentially unchanged by Windsor. Depending on their state of residence, domestic couples may be able to file state tax returns jointly, but they cannot file joint federal returns.*

Among the provisions affecting registered domestic partners described by the IRS in its FAQs are:

Filing Status

Registered domestic partners may not file federal returns as married filing jointly or married filing separately because the individuals are not married or spouses for federal tax purposes.

Itemized Deductions

A registered domestic partner may itemize or claim the standard deduction regardless of whether his or her partner itemizes or claims the standard deduction because the individuals are not married or spouses for federal tax purposes.

Children

If a child is a qualifying dependent of parents who are registered domestic partners, either parent, but not both, may claim the dependency deduction.

Among other topics in its FAQs for domestic partners, the IRS also addresses:

- Head of household status
- Adoption

- Community property
- Dependency deductions
- Various tax credits and deductions

GUIDANCE FROM OTHER FEDERAL AGENCIES

Guidance released recently by other federal agencies on the treatment of same-sex marriage has not been uniform. The U.S. Departments of Defense (DOD), Health and Human Services (HHS), Homeland Security (DHS), Labor (DOL), and Veterans Affairs (VA), as well as the Social Security Administration (SSA) and the federal Office of Personnel Management (OPM), have taken various positions on when same-sex marriage is recognized for the benefits and rules that they administer.

Civilian Employees. Effective June 26, 2013, the date of the Supreme Court decision, benefits coverage is now available to a federal employee's or annuitant's same-sex spouse, and to the children of the employee's same-sex marriage. Similar to the IRS, OPM is recognizing same-sex marriages based on the place of celebration, regardless of the state of residence. Affected federal benefits include health, life, vision, dental, long-term care insurance, and flexible spending accounts (both health and dependent care). The guidance notes that there is no change to the status of same-sex couples in a civil union or other form of domestic partnership other than a marriage; thus, these couples will remain ineligible for most federal benefits.

Active Military. DOD announced on August 14, 2013 its plan to extend spousal and family benefits to legally-married same-sex spouses of uniformed service members. Benefits including health care, housing allowances, and family separation allowances will be provided retroactively to June 26, 2013 (the date of the *Windsor* decision). No benefits will be granted for any period before that date. The Pentagon will also grant "non-chargeable marriage leave" to allow Service member in a same-sex relationship to travel to a jurisdiction that allows same-sex couples to get married.

Veterans. Certain provisions of Title 38 of the U.S. Code define "spouse" and

"surviving spouse" as a person of the opposite sex. Because the Supreme Court did not address these provisions, the Department of Veterans Affairs has not decided whether it can extend veterans' benefits to a same-sex spouse.

COMMENT. *A federal district court in California declared these provisions unconstitutional (Cooper-Harris, et al v. U.S., August 29, 2013). Legislation has also been introduced in Congress to remove the statutory requirement that a veteran's spouse be of the opposite sex.*

Medicare. HHS is requiring that all beneficiaries in Medicare Advantage plans must have access to equal coverage provided by a nursing home where the spouse lives, regardless of sexual orientation. This requirement applies based on the state of celebration, regardless of the law in the state of residency.

SSA. The SSA, effective August 9, 2013, will approve the payment of claims involving same-sex marriage, provided that at the time of application or while a claim is pending the couple lived in a state that recognizes same-sex marriage. This differs from the place-of-celebration approach that most federal agencies are using to determine the effects of a same-sex marriage.

FMLA. The Family and Medical Leave Act (FMLA) entitles certain employees to take extended leave to care for a spouse or child with a serious health condition. DOL issued a fact sheet in August 2013 providing that "spouse" means a husband or wife recognized in the state where the employee resides, including same-sex marriage.

Immigration. DHS has explained that: (1) a U.S. citizen or lawful permanent resident can sponsor a same-sex spouse who is a foreign national for a family-based immigrant visa; and (2) it will generally recognize a same-sex marriage as valid based on the place of celebration, not on the law in the state of residency, thus allowing the U.S. citizen or permanent resident can file an immigrant visa petition for the same-sex spouse.