

IRS GUIDANCE ANSWERS SAME-SEX MARRIAGE TAX QUESTIONS IN WAKE OF THE SUPREME COURT'S DOMA RULING

SEPTEMBER 2013



In the groundbreaking decision of *Windsor v. U.S.*, the Supreme Court struck down a key provision in the Defense of Marriage Act (DOMA) that defined marriage as solely between a man and woman for federal law purposes. The Supreme Court's ruling established that the federal government, including the IRS, must treat legally married same-sex couples the same as their heterosexual counterparts. However, it left open a number of significant questions, including the meaning of "legally married" and whether and to what extent the decision would apply retroactively.

The IRS has issued highly awaited follow-up guidance in which it adopted a "state of celebration" rule for determining whether a same-sex couple is legally married for Federal tax purposes. Under this rule, the IRS looks to whether the couple was married in a state that allows same-sex marriage, without taking into account the laws of the state(s) in which the couple currently resides. The guidance also clarified the IRS's policy for accepting amended returns based on tax changes stemming from its ruling and explained the consequences for employers and employees.

The IRS also explained the ruling's impact on couples in state-sanctioned "marriage equivalents," including those residing in community property states. This report provides an explanation of the new guidance, as well as an official list of which states recognize same-sex marriage and when they began doing so.



The IRS has issued much anticipated guidance explaining the Federal tax implications of the Supreme Court's landmark *Windsor* decision striking down section 3 of the Defense of Marriage Act (DOMA), which had required same-sex spouses to be treated as unmarried for purposes of federal law.

The Supreme Court stated in *Windsor* that its holding was confined to "lawful marriages," the meaning of which was one of the most significant uncertainties left to be resolved by the IRS for purposes of applying the Court's holding to tax law administration. The IRS now says that same-sex couples who were legally married in jurisdictions that recognize their marriages (i.e., "state of celebration") will be treated as married for federal tax purposes, regardless of whether their current state of residence recognizes same-sex marriage.

This article examines the impact of the new guidance on matters related to individual income tax filing, such as joint filing status and for what years amended returns can be filed. It also explains a number of important consequences that the ruling carries for employers and affected employees.

Background on DOMA

In 1996, Congress enacted, and President Clinton signed into law, DOMA. Section 3 of DOMA defines marriage for purposes of administering federal law as the "legal union between one man and one woman as husband and wife." It further defines "spouse" as "a person of the opposite sex who is a husband or wife."

Supreme Court opinion

In a majority opinion delivered by Justice Kennedy (joined by Justices Ginsberg, Breyer, Sotomayor, and Kagan), the Supreme Court held that DOMA §3 was an unconstitutional deprivation of equal protection. (*Windsor v. U.S.*, (Sup Ct 6/26/2013) 111 AFTR 2d 2013-2385)

Although the Supreme Court's decision resolved the constitutionality of DOMA §3, it left a number of issues unanswered, including the effective date of its holding and how to resolve conflicting state laws. The IRS issued a statement on June 27, 2013, the day after the Court's decision, that it was reviewing the decision and would provide guidance shortly.

The IRS adopts a "state of celebration" rule

The IRS now has ruled that a same-sex couple that was legally married in a domestic or foreign jurisdiction that recognized their marriage will be treated as married for federal tax purposes, regardless of where they currently live. (Rev Rul 2013-17, 2013-38 IRB) Treasury Secretary Jacob L. Lew described the ruling as assuring "legally married same-sex couples that they can move freely throughout the country knowing that their federal filing status will not change." The ruling covers same-sex marriages legally entered into in one of the 50 states, the District of Columbia, a U.S. territory, or a foreign country, and it applies prospectively as of September 16, 2013. (See the state-by-state list on page 4 for the operative dates on which same-sex marriage became legal.) This treatment applies for all federal tax purposes—including income, gift and estate taxes—and to all federal tax provisions where marriage is a factor. These include filing status, claiming personal and dependency exemptions, taking the standard deduction, employee benefits, contributing to an IRA, the availability of innocent spouse relief, and claiming the earned income tax credit or child tax credit.

The IRS stated that its position is consistent with its earlier guidance on State law variations in marital status. For instance, in Rev Rul 58-66, 1958-1 CB 60, it determined that a couple would be treated as married for purposes of Federal income tax filing status and personal exemptions if

the couple entered into a common-law marriage in a state that recognizes that relationship as a valid marriage, and that the couple's filing status wouldn't change if they moved to another state that didn't have common-law marriage. The IRS stated that in "our increasingly mobile society, it is important to have a uniform rule of recognition that can be applied with certainty by the Service and taxpayers alike for all Federal tax purposes." It also noted that adopting a state-of-domicile rule would present serious administrative concerns, for the IRS and employers alike. (Rev Rul 2013-17)

The IRS's position is also consistent with that announced by many other federal agencies. For instance, Janet Napolitano, Secretary of Homeland Security, issued a statement and two questions and answers (Q&As) following the *Windsor* decision. In it, she stated that U.S. Citizenship and Immigration Services (USCIS), in considering an immigrant visa petition for a same-sex spouse, "looks to the law of the place where the marriage took place when determining whether it is valid for immigration law purposes." A similar position was announced on Q&As posted on the Department of State, Bureau of Consular Affairs. The Social Security Administration, however, adopted a contrary position that also looks to the same-sex spouses' state of residence. For purposes of determining entitlement to Social Security benefits, claims can be paid only when the Number Holder (i) was married in a state that permits same-sex marriage, and (ii) is domiciled, at the time of application or while the claim is pending a final determination, in a state that recognizes same-sex marriage.

Married same-sex couples who filed separate federal returns due to DOMA should consider filing amended returns or protective refund claims where applicable; for instance, if they paid higher taxes as a result of not being able to file jointly, if one spouse had capital gains in a year that would have been effectively cancelled by the other spouse's capital losses, or if they were previously taxed on health benefits provided to a spouse. The general statute of limitations for refunds is three years from filing or two years from payment, whichever date falls later.

Filing status change mandatory going forward

Legally-married same-sex couples generally must file their 2013 federal income tax return using either "married filing jointly" or "married filing separately" status. This filing status change may either result in an increased liability ("marriage penalty") or a decreased liability ("marriage bonus"). The IRS also provided that for tax year 2012, same-sex spouses who



file an *original* tax return on or after September 16, 2013 (i.e., Rev Rul 2013-17's effective date) generally must file either as married filing jointly, or married filing separately.

Amended returns can be filed within limitations period

Individuals who were in same-sex marriages are permitted, but not required, to file original or amended returns choosing to be treated as married for federal tax purposes for one or more prior tax years still open under the statute of limitations on refunds (in general, three years from the date the return was filed or two years from the date the tax was paid, whichever is later). Thus, refund claims may generally be filed for the 2010, 2011, and 2012 tax years. Some taxpayers may be able to file refund claims for earlier years if certain special circumstances apply (e.g., an extension of the limitations period). The IRS also clarified that employees who purchased same-sex spouse health insurance coverage from their employers on an after-tax basis may treat the amounts paid for that coverage as pre-tax and excludable from income, and file refund claims based on this exclusion for years for which the limitations period remains open. (Rev Rul 2013-17)

Effect on terminology in the Code















In light of the *Windsor* decision, the IRS has concluded that gender-neutral terms in the Code that refer to marital status, such as “spouse” and “marriage,” include an individual lawfully married to a person of the same sex and a lawful same-sex marriage. In addition, the IRS also determined that the terms “husband” and “wife” (used separately or together) should be interpreted to include same-sex spouses.

(Rev Rul 2013-17)

In an accompanying set of frequently asked questions (FAQs), the IRS addressed some of the tax issues relating to the new filing status for same-sex married couples. Many of the FAQs simply apply established law concerning married couples to legally married same-sex couples, including that a taxpayer’s spouse cannot be a dependent of the taxpayer (FAQ No. 4); a taxpayer who is considered married cannot file using head of household filing status (FAQ No. 5); if spouses file as married filing separate and have a child, only one can claim the child as a dependent (FAQ No. 6); and no adoption credit may be claimed for adopting the child of a taxpayer’s spouse (FAQ No. 8).

Operative dates

The following list was provided by the Social Security Administration. It gives the starting dates (and ranges, as applicable) that various states began permitting same-sex marriage.

	CALIFORNIA —June 17, 2008 through November 4, 2008, and June 26, 2013 through the present.
	CONNECTICUT —November 12, 2008.
	DELAWARE —July 1, 2013.
	IOWA —April 20, 2009.
	MAINE —December 29, 2012.
	MARYLAND —January 1, 2013.
	MASSACHUSETTS —May 17, 2004.
	MINNESOTA —August 1, 2013.
	NEW HAMPSHIRE —January 1, 2010.
	NEW YORK —July 24, 2011.
	RHODE ISLAND —August 1, 2013.
	VERMONT —September 1, 2009.
	WASHINGTON —December 6, 2012 (effective date).
	DISTRICT OF COLUMBIA —March 9, 2010 (effective date).

CONSEQUENCES FOR EMPLOYERS AND AFFECTED EMPLOYEES

The *Windsor* decision and the IRS's subsequent guidance also have important consequences for employers and affected employees. The IRS explained a number of the issues stemming from its ruling in the FAQs, but also specified that others will be addressed in future guidance.

Employee refunds relating to employer-provided health insurance coverage

Where an employer provided health coverage for an employee's same-sex spouse and included the value of that coverage in the employee's gross income, the employee can, for all open years, file an amended Form 1040 reflecting the employee's status as a married individual to recover federal income tax paid on the value of the health coverage of the employee's spouse. This means affected taxpayers may file a claim for refund for three years from the date the return was filed or two years from the date the tax was paid, whichever is later. (FAQ No. 10)



ILLUSTRATION: Employer's group health plan covers eligible employees and their dependents and spouses (including same-sex spouses) and pays 50% of the cost of coverage. Beginning January 1, 2012, Employee A elected coverage for her same-sex Spouse B, and the value of B's coverage was \$250 per month, or \$3,000 for the year. Employee A's Form W-2 for 2012 included the \$3,000 in her Box 1 (wages, tips and other compensation) amount, and her Form 1040 for 2012 reflected that inclusion. Now, Employee A can file an amended Form 1040 for 2012 excluding the \$3,000 from gross income. (FAQ No. 10)

Employee refunds relating to employer-sponsored cafeteria plan coverage

If an employer-sponsored cafeteria plan allows an employee to elect to pay for health coverage on a pre-tax basis, and the employee bought plan coverage on an after-tax basis for a same-sex spouse, the employee may, for open years, claim a refund of income taxes paid on the premiums for the coverage of the employee's spouse. This claim for a refund generally would be made through the filing of an amended Form 1040. (FAQ No. 11)

Here, an affected taxpayer may treat the amounts that were paid for the coverage of the same-sex spouse on an after-tax basis as if they had been pre-tax salary reduction amounts. (Rev Rul 2013-17)



ILLUSTRATION: Employer sponsors a group health plan as part of a cafeteria plan with a calendar year plan year. Employees pay the full cost of spousal and dependent coverage. In the open enrollment period for the 2012 plan year, Employee C elected to buy self-only health coverage through salary reductions under the plan. On March 1, 2012, he was married to same-sex spouse D and bought health coverage for D through the group health plan beginning March 1, 2012. He paid a \$500 monthly premium for D's health coverage. Employee C's W-2 for 2012 included in Box 1 the \$5,000 (\$500 per month x 10 months) of premiums he paid for Spouse D's health coverage, and C's 2012 Form 1040 year reflected the Box 1 inclusion. Employee C's salary reduction election is treated as including the value of the same-sex spousal coverage he bought for Spouse D. Thus, C may file an amended Form 1040 for the 2012 tax year excluding from gross income the \$5,000 he paid for Spouse D's health coverage. (FAQ No. 11)



OBSERVATION: Under Rev Rul 2013-17, and the FAQs issued to date on the *Windsor* decision's impact on employers and employees, all 2013 employer-provided health coverage for an employee's same-sex spouse should be treated as excluded income, and all 2013 cafeteria plan salary reduction elections to cover same-sex spouses under a health plan should be treated as made on a pre-tax basis.



RECOMMENDATION: Affected employees should pay careful attention to their pay stubs and their 2013 W-2s to ensure that same-sex spouse health coverage has been properly treated.

Employer overpayments of social security and Medicare taxes

Where the limitations period for filing a refund claim is open, an employer may claim a refund of, or make an adjustment for, any excess Social Security taxes and Medicare taxes paid, relating to (1) employer provided health coverage for an employee's same-sex spouse, and/or (2) cafeteria plan salary reduction elections to cover same-sex spouses under a health plan. The requirements for filing a claim for refund, or for making an adjustment for an overpayment of the employer and employee portions of Social Security and Medicare taxes, can be found in the Instructions for Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund. (FAQ No. 12)

The IRS says it will in the near future issue a special administrative procedure for employers to file claims for refunds or make adjustments for excess social security taxes and Medicare taxes paid on same-sex spouse benefits.

Generally, under Reg § 31.6413(a)-1(a) and Reg § 31.6413(a)-2(b), before making an adjustment of an overpayment of FICA tax, an employer must repay or reimburse its employee in the amount of the overcollection before the expiration of the credit or refund limitations period, and, for FICA tax overcollected in a prior year, must also secure the employee's written statement confirming that the employee hasn't made any previous claims (or the claims were rejected) and will not make any future claims for refund or credit of the amount of the overcollected FICA tax.

FAQ No. 14 applies the above FICA overpayment rules to FICA payments that arise as a result of the Windsor decision. The IRS says that if the employer makes reasonable but ultimately unsuccessful attempts to locate an affected employee who made overpayments in prior, open years due to (1) employer provided health coverage for an employee's same-sex spouse being treated as taxable, and/or (2) cafeteria plan salary reduction elections to cover same-sex spouses under a health plan being treated as made on an after-tax basis, it may claim a refund of the employer portion of social security and Medicare taxes, but not the employee portion.

Also, if an affected employee is notified and given the opportunity to participate in the claim for refund of social security and Medicare taxes but declines in writing, the employer can claim a refund of the employer portion of the taxes, but not the employee portion. A special administrative procedure to file such claims will be carried in forthcoming guidance. (FAQ No. 14)

Other employer adjustments

Employers cannot claim a refund, or make an adjustment of income tax withholding, relating to (1) prior-year employer provided health coverage for an employee's same-sex spouse, and/or (2) prior-year cafeteria plan salary reduction elections to cover same-sex spouses under a health plan. Only the employee can obtain a refund of prior year income taxes by filing an amended return for open years.

However, an employer may make adjustments for overwithheld income tax in the current year if it has repaid or reimbursed the employee for the overwithheld income tax before the end of the calendar year. (FAQ No. 13)

Impact on retirement plans

As of September 16, 2013, a qualified retirement plan must:

- Treat a same-sex spouse as a spouse for purposes of satisfying plan-related federal tax law requirements;
- Recognize a same-sex marriage that was validly entered into in a jurisdiction whose laws authorized the marriage, even if the couple lives in a domestic or foreign jurisdiction that does not recognize the validity of same-sex marriages; but
- Treat someone who is in a registered domestic partnership or civil union as a spouse, regardless of whether that person's partner is of the opposite or same sex. (FAQ No. 16)



ILLUSTRATION: A qualified defined contribution plan provides that a participant's account must be paid to his or her spouse upon the participant's death unless the spouse consents to a different beneficiary. The plan does not provide for any annuity forms of distribution. Here, the plan must pay a death benefit to the same-sex surviving spouse of any deceased participant, but is not required to provide a death benefit to a surviving registered domestic partner of a deceased participant. However, the plan may make a participant's registered domestic partner the default beneficiary who will receive the death benefit unless the participant chooses a different beneficiary. (FAQ No. 17)

Although qualified plans must comply with its rules as of September 16, 2013, the IRS will provide additional guidance as to how qualified plans are to apply the *Windsor* holding for periods before that date. (Rev Rul 2013-17) Forthcoming

guidance will also address, among other things, plan amendments and any necessary corrections for periods before the guidance is issued. (FAQ No. 19)



OBSERVATION: Plan amendments and modified election forms may become necessary for a number of plan features. For example, election language may have to be changed relating to plan features such as: the spousal right to a qualified joint and survivor annuity from a pension plan; spousal consent necessary for qualified retirement plan payments to nonspouse beneficiaries; and spousal consent necessary for certain plan-related actions, such as certain plan loan transactions.

HOW INDIVIDUALS IN REGISTERED DOMESTIC PARTNERSHIPS AND CIVIL UNIONS ARE AFFECTED BY THE IRS'S RULING

In the FAQs, the IRS clarified that individuals who are in registered domestic partnerships, civil unions, or other similar formal relationships that aren't marriages under State law (for simplicity, these individuals are referred to throughout as "registered domestic partners") aren't considered married or spouses for federal tax purposes. This is true regardless of whether the registered domestic partners are in a same-sex or opposite-sex relationship.

Accordingly, registered domestic partners can't file federal tax returns using a married filing jointly or married filing separately status. (FAQ No. 1)

A registered domestic partner can itemize deductions or claim the standard deduction regardless of whether his or her partner itemizes or claims the standard deduction. Although Code Sec. 63(c)(6)(A) prohibits a taxpayer from itemizing deductions if the taxpayer's spouse claims the standard deduction, this rule doesn't apply to registered domestic partners because they aren't spouses for federal tax purposes. (FAQ No. 4)

Similarly, other provisions that only apply to married taxpayers, such as the married taxpayer provisions in Code Sec. 66 (dealing with the treatment of community income) and Code Sec. 469(i)(5) (dealing with the \$25,000 offset for passive activity losses for rental real estate activities) do not apply to registered domestic partners since they are not married for federal tax purposes. (FAQ No. 7)

Head of household status

A taxpayer can't use the head-of-household filing status if the taxpayer's only dependent is his or her registered domestic partner. That's because, even if the registered domestic partner is the taxpayer's dependent, a registered domestic partner isn't one of the specified related individuals in Code Sec. 152(c) or Code Sec. 152(d) that qualifies the taxpayer to file as head of household. (FAQ No. 1)

Dependency deduction

If a child is a qualifying child under Code Sec. 152(c) of both parents who are registered domestic partners, either parent, but not both, may claim a dependency deduction for the qualifying child. If both parents claim a dependency



deduction for the child on their income tax returns, the IRS will treat the child as the qualifying child of the parent with whom the child resides for the longer period of time during the tax year. If the child resides with each parent for the same amount of time during the tax year, the IRS will treat the child as the qualifying child of the parent with the higher adjusted gross income. (FAQ No. 3)

The IRS also notes that if a registered domestic partner is the stepparent of his or her partner's child under State law, then the registered domestic partner is also the stepparent of the child for federal income tax purposes. (FAQ No. 8)

Adoption credit

If registered domestic partners adopt a child together, each registered domestic partner can claim the adoption credit for the amount of the qualified adoption expenses paid for the adoption. However, they can't both claim a credit for the same qualified adoption expenses, and the sum of the credit taken by each can't exceed the total amount paid. The maximum adoption credit is limited to \$12,970 per child in 2013. Registered domestic partners may allocate this maximum between them in any way they agree, and the amount of credit claimed by one can exceed the adoption expenses paid by that person, as long as the total credit claimed by both registered domestic partners doesn't exceed the total amount paid by them. The same rules generally apply for special needs adoptions. (FAQ No. 5)

A taxpayer who adopts the child of his or her registered domestic partner as a second parent or co-parent (the adopting parent) can claim the adoption credit for the qualifying adoption expenses that he or she pays. Under Code Sec. 23, a taxpayer can't claim an adoption credit for the expenses of adopting the child of the taxpayer's spouse. However, this limitation doesn't apply to adoptions by registered domestic partners who aren't spouses for federal tax purposes. (FAQ No. 6)



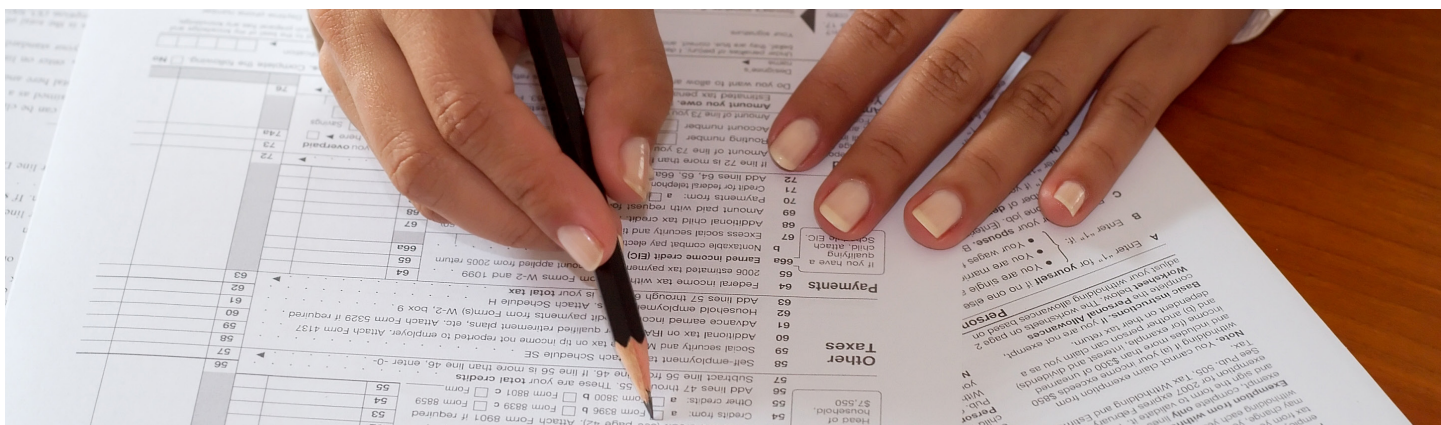
GUIDANCE FOR REGISTERED DOMESTIC PARTNERS IN COMMUNITY PROPERTY STATES

The FAQs also provided guidance for registered domestic partners residing in community property states (i.e., Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin).

In general, registered domestic partners must each report half the combined community income earned by the partners. A partner who has income that is not community income must also report that separate income. (FAQ No. 9) Registered domestic partners should report wages, other income items, and deductions according to the instructions to Form 1040, *U.S. Individual Income Tax Return*, and related schedules, and Form 8958, *Allocation of Tax Amounts between Certain Individuals in Community Property States*. Each partner must complete and attach Form 8958 to his or her Form 1040. (FAQ No. 13)

Half of the income, deductions, and net earnings of a business operated by a registered domestic partner must be reported by each registered domestic partner on a Schedule C, *Profit or Loss from Business* (or Schedule C-EZ). Each partner owes self-employment tax on half of the net earnings of the business. The IRS cautions that the self-employment tax rule under Code Sec. 1402(a)(5) that overrides community income treatment and attributes the income, deductions, and net earnings to the spouse who carries on the trade or business doesn't apply to registered domestic partners. (FAQ No. 15)

Generally, State law determines whether an item of income constitutes community income. Thus, if Social Security benefits are community income under State law, then they are also community income for federal income tax purposes. The converse is also true. (FAQ No. 14) Similarly, whether amounts a registered domestic partner receives for education expenses that cannot be excluded from the partner's gross income (includible education benefits) are community income depends on how they are treated under State law. (FAQ No. 20) But community property laws aren't taken into account in determining compensation for purposes of the Code Sec. 219(f)(2) IRA deduction, which is computed separately for each individual; each individual determines whether he or she is eligible for an IRA deduction by computing his or her individual compensation. (FAQ No. 24)



Head of household status

To qualify as a head-of-household under Code Sec. 2(b), a taxpayer must provide more than half the cost of maintaining his or her household during the tax year, and that household must be the principal place of abode of the taxpayer's dependent for more than half of the tax year. If registered domestic partners pay all of the costs of maintaining the household from community funds, each partner is considered to have incurred exactly half the cost, and, therefore, neither can qualify as head of household. Even if one of the partners pays more than half by contributing separate funds, that partner cannot file as head of household if the only dependent is his or her registered domestic partner because a registered domestic partner isn't one of the specified related individuals under Code Sec. 152(c) or Code Sec. 152(d) that qualifies the taxpayer to file as head of household, even if the partner is the taxpayer's dependent. (FAQ No. 10)

Dependency deduction

A registered domestic partner can be a dependent of his or her partner for purposes of the dependency deduction if the requirements of Code Sec. 151 and Code Sec. 152 are met. However, the IRS notes that it's unlikely that registered domestic partners will satisfy the Code Sec. 152(d)(1)(B) gross income requirement. To do so, the gross income of the individual claimed as a dependent must be less than the exemption amount (\$3,900 for 2013). Because registered domestic partners each report half the combined community income earned by both partners, it's unlikely that a registered domestic partner will have gross income that is less than the exemption amount.

The IRS notes that it's also unlikely that registered domestic partners will satisfy the Code Sec. 152(d)(1)(C) support requirement. To do so, more than half of an individual's

support for the year must be provided by the person seeking the dependency deduction. If Partner A's support comes entirely from community funds, then Partner A is considered to have provided half of his or her own support and cannot be claimed as a dependent by another. But, if Partner B pays more than half of the support of Partner A by contributing separate funds, Partner A may be a dependent of Partner B under Code Sec. 151, provided the other requirements under Code Sec. 151 and Code Sec. 152 are met. (FAQ No. 11)

A registered domestic partner can also be a dependent of his or her partner for purposes of the Code Sec. 105(b) exclusion for reimbursements of expenses for medical care if the Code Sec. 152(d)(1)(C) support requirement is met. Unlike the Code Sec. 152(d) requirements (dependency deduction for a qualifying relative), Code Sec. 105(b) doesn't require that a partner's gross income be less than the exemption amount in order to qualify as a dependent. (FAQ No. 12)

Tax credits

Community property laws are taken into account in determining adjusted gross income (AGI) or modified AGI for purposes of the Code Sec. 21(a) dependent care credit, the Code Sec. 24(b) child tax credit, the Code Sec. 32(a) earned income credit, and the pre-2011 Code Sec. 36A making work pay credit. (FAQ No. 19) However, community property laws aren't taken into account in determining earned income for purposes of the Code Sec. 21(d) dependent care credit, the Code Sec. 24(d) refundable portion of the child tax credit, the Code Sec. 32(a) earned income credit, and the pre-2011 Code Sec. 36A making work pay credit. (FAQ No. 18)

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