AN EXAMINATION OF FEDERAL TAX RULES IMPACTING MARRIED SAME-SEX COUPLES FROM THE U.S. SUPREME COURT RULING IN *U.S. v WINDSOR*

Ahroni, Scott
Queens College of the City University of New York

Silliman, Benjamin Rue
St. John's University

ABSTRACT

On June 26, 2013, in U.S. v. Windsor, 133 S. Ct. 2675 (2013), the U.S. Supreme Court, struck down Section 3 of the Defense of Marriage Act (DOMA), finding that the Act violated the Equal Protection Clause of the Fifth Amendment of the U.S. Constitution as applied to legally married same-sex couples who were legally married in states that permitted same-sex marriages. Such benefits include, but are not limited to, income tax benefits, estate and gift tax benefits, and employee tax benefits. Same-sex married couples must now confront certain negative tax ramifications which will be imposed on them following the Windsor decision. Couples previously denied joint return status must determine the effect of filing joint returns both for future tax years and for previously filed tax years still open within the statute of limitations on refund claims. Moreover, the benefits of filing a joint return may not be more advantageous than filing as single or as head of household. Couples with similar incomes often pay the "marriage penalty," with their tax liability as a couple being much higher than it would be if filing as single or head-of-household. Much of the guidance for same-sex married couples comes from Revenue Ruling 2013-38, IRB 201, which was issued on August 29, 2013. The purpose of this paper is to identify and examine the implications in the federal tax laws following the Windsor decision as well as those contained in Rev. Rul. 2013-38 in order to assist tax practitioners and same-sex married couples in complying with and planning under the federal tax laws.

INTRODUCTION

The United States Supreme Court recently struck down Section 3 of the Defense of Marriage Act (DOMA), in *U.S. v. Windsor*, 133 S. Ct. 2675 (2013), finding that the Act violated the equal protection clause of the Fifth Amendment of the U.S. Constitution as applied to legally married same-sex couples who were legally married in states that permitted same-sex marriages. The ruling is significant for married same-sex couples, who were denied federal tax benefits, previously only available to couples in heterosexual marriages. Such benefits include, but are not limited to, income tax benefits, estate and gift tax benefits, and employee tax benefits. For example, and as more fully explained below, prior to *Windsor*, same-sex married couples were not permitted the benefit of filing a joint tax return. Rather, individual same-sex spouses could only file as single, or if they had children, as a head-of-household. Further, if the same-sex couple had a qualifying child, only one of the taxpayers could claim the child as a dependent on their tax return and receive the benefit of the dependency exemption. In addition, tax benefits which flowed from jointly owned property, e.g., real estate taxes and/or the home mortgage

interest deduction, had to be allocated between same-sex couples and claimed on separate tax returns.

Same-sex couples must now also confront certain negative tax ramifications which will be imposed on them following the *Windsor* decision. Couples previously denied joint return status must determine the effect of filing joint returns both for future tax years and for previously filed tax years still open within the statute of limitations on refund claims. The benefits of filing a joint return may not always be greater than filing as single or as head of household. Couples with similar incomes often pay the "marriage penalty," with their tax liability as a couple being much higher than it would be if filing as single or head-of-household. Since same-sex couples are not obligated to file amended returns, and thus, same-sex couples and tax practitioners must fully consider how a change in filing status will affect their previously filed returns.

The purpose of this paper is to identify and examine the changes in the federal tax laws following the *Windsor* decision, in order to assist tax practitioners, as well as, same-sex couples in complying with and planning under federal tax laws.

PLACE OF CELEBRATION APPROACH

In response to the *Windsor* ruling, the Internal Revenue Service (IRS) recently issued Rev. Rul. 2013-17, that explains that the IRS will use a "place of celebration" approach, rather than a "place of domicile" approach, in determining whether same-sex couples are "*married"* for federal income tax purposes. Rev. Rul. 58-66, 1958-1 C.B. 60, previously applied the "place of celebration" approach for common law marriages. The place of celebration approach looks to whether same-sex couples were married in a jurisdiction that recognizes same-sex marriages. If the couple was married in a jurisdiction that recognizes same-sex marriages, the couple will be treated as married for federal income tax purposes, even if the state where they are domiciled does not recognize same-sex marriages.

STATES RECOGNIZING SAME-SEX MARRIAGE

Table 1 below lists the states that recognize same-sex marriages in chronological order of recognition:

Table 1: States Recognizing Same-Sex Marriage

Jurisdiction	***Date Marriages Went into Effect***
Massachusetts	May 17, 2004
Connecticut	November 12, 2008
Iowa	April 27, 2009
Vermont	September 1, 2009
New Hampshire	January 1, 2010
District of Columbia	March 9, 2010
New York	July 24, 2011
Washington	December 6, 2012
Maine	December 29, 2012
Maryland	January 1, 2013
California*	June 26, 2013
Delaware	July 1, 2013
Rhode Island	August 1, 2013
Minnesota	August 1, 2013
New Jersey	October 21, 2013
Hawaii	December 2, 2013
Illinois	June 1, 2014

*licenses issued between February 11, 2004 and March 11, 2004 are also valid.

Not reflected in Table 1 above, as of this writing, there are counties in New Mexico issuing marriage licenses to same-sex couples. Most recently, the New Jersey Supreme Court upheld a lower court ruling allowing same-sex marriage. The ruling will not be appealed by New Jersey Governor, Chris Christie. In addition, same-sex marriage is allowed in the State of Hawaii beginning December 2, 2013 and will be allowed in the State of Illinois beginning June 1, 2014.

Beginning on September 16, 2013 and for all tax years thereafter, same-sex couples filing original returns are required to file their federal income tax returns as *married filing jointly* or as *married filing separately*. This includes taxpayers on extension who have not filed their federal 2012 returns. Such taxpayers are required to file using a married status on or after September 16, 2013. The Internal Revenue Code (IRC) considers a person's marital status on December 31 of a particular tax year, in determining whether the person is considered married for that year. If the person is married on December 31 of a particular tax year, they are considered married for the *entire tax year*.

As for previously filed tax years, as summarized in Table 2 below, legally married same-sex couples who were considered married in 2010, 2011, or 2012, may elect to amend their previously filed income tax returns to claim a refund for taxes previously paid. A refund claim must be filed before the expiration of the statutory refund claim period, which is the later of three years from the time the return was filed or two years from the time the tax was paid (IRC §6511(a)). If the claim is filed within three years after the date the return was filed, the credit or

refund may not be more than the part of the tax paid within the three years, plus any extensions for filing, before the claim is filed. If the taxpayer did not file a return, a refund claim must be filed within two years after the tax was paid (IRC §6511(a)). A separate refund claim must be filed for each year and for each type of tax that a taxpayer seeks a refund. A refund claim for one year does not constitute a refund claim for a different year, even if the underlying legal and factual bases for the claims for the two years are the same (BCS Financial Corp. v US, CA-7, 97-2 USTC ¶50,514, 118 F3d 522; Sun Chemical Corp. v US, Ct Cls, 78-2 USTC ¶9790, 218 Ct Cls 702). In addition, a refund claim for income taxes does not protect a potential refund claim for gift taxes. Rather separate claims must be made. As discussed above, Rev. Rul. 2013-17 does not require same-sex married couples to amend their tax returns, it only provides the availability to file a refund claim if the couple was married in any of the three years prior to 2013.

Table 2 summarizes how legally married same-sex couples can handle prospectively and previously filed tax returns:

Table 2: Tax Returns Filed Prior to 2013

If a Same-Sex Married Couple was considered married in the following year(s):		
2013	Must file as either Married filing jointly or Married filing separately	
2012	When was the return filed?	
	Prior to 9/16/13: May choose to amend 2012 federal tax return and file as married filing jointly or separately*.	***On or after 9/16/13:*** Generally must file as Married filing jointly or Married filing separately.
2011	The same-sex married couple may (but is not required) file amended tax returns changing their filing status to married filing jointly or married filing separately; this amended return to claim a refund must be filed no later than three years from the date the return was originally filed or two years from the date the tax was paid, whichever is later*.	
2010	The same-sex married couple may (but is not required) file amended tax returns changing their filing status to married filing jointly or married filing separately; this amended return to claim a refund must be filed no later than three years from the date the return was originally filed or two years from the date the tax was paid, whichever is later*.	

*For more information, go to Tax Topic 308, Amended Returns, at: http://www.irs.gov/taxtopics/tc308.html.

THE OPTION OF AMENDING PREVIOUSLY FILED FEDERAL TAX RETURNS

Same-sex married taxpayers should consider amending a previously filed federal return, provided that they were legally married during a tax year that is still open by the statute of limitations (generally, 2010, 2011, and 2012) if they will realize a tax refund. However, taxpayers are not required to amend previously filed returns to change their filing status (Rev. Rul. 2013-17), thus they should only do so if the change would provide a tax benefit. Taxpayers should consult their tax advisors to determine if amending previously federal tax returns will generate any tax refunds.

Taxpayers affected by the *Windsor* decision may also want to consider filing a protective refund claim for taxes previously paid, pending further guidance from the IRS. For example, Rev. Rul. 2013-17 only briefly discusses the estate and gift tax ramifications from the *Windsor* decision, leaving uncertainty as to its application to same-sex married couples that previously filed estate and gift tax return. If a taxpayer believes that they would be entitled to a refund for gift taxes paid, or their deceased spouse would be entitled to a refund for estate taxes paid, they may want to file a protective claim to preserve their right to amend a previously filed gift/estate tax return.

A protective refund claim is filed for a taxpayer when there is current litigation that will not be resolved or expected changes in the tax law that will not occur, until the statute of limitations for filing an accurate amended return has expired (IRS Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, p. 14 (2008)). A protective claim can be submitted as either a formal written claim or as an amended return for credit or refund (IRS Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, p. 14 (2008)). In any situation where the limitations period is about to expire for a particular tax return, a married same-sex couple should consider filing a protective claim for a refund with the IRS in order to preserve the ability to obtain such a refund after the IRS has provided a means to amend the return. Tax advisors should discuss with their same-sex married clients whether to file protective tax refund claims with the IRS.

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." In general, the greater disparity of income between the spouses, the greater the benefit gained by filing jointly.

The following addresses both the advantages and disadvantages that same-sex couples should consider prior to filing amended returns.

MARRIAGE PENALTY POSSIBILITIES ON AMENDING FEDERAL TAX RETURNS

When same-sex married couples consider amending their previously filed returns, they should be aware that there are situations where filing separately as "single" taxpayers might avoid the marriage penalty. The marriage penalty refers to the imposition of higher taxes on certain married couples that file jointly as compared to two otherwise identical taxpayers filing single and reporting the same combined income. Tax practitioners need to determine if it is more advantageous for the same-sex married couple to leave the previously "single" return alone, or amend the return and file jointly. In general, the greater disparity of income between the spouses, the greater the benefit gained by filing jointly. For example, in 2012, an unmarried couple that each brings home taxable income of $80,000 will be subject to a maximum tax rate 25 percent. However, if the same couple was married and filing jointly or married filing separately, their combined taxable income of $160,000 would now be subject to a maximum tax rate of 28 percent. The marriage penalty is further discussed below.

EMPLOYER-PROVIDED HEALTH CARE COVERAGE

While married couples have to deal with the marriage penalty, they are also eligible for many tax breaks and benefits that may compensate for paying higher income tax. For example, if a spouse receives medical coverage through their employer, they can include their spouse on the coverage and such monthly premiums are not considered taxable income. Such monthly premiums would be taxable for unmarried domestic partners.

Prior to Rev. Rul. 2013-17, companies that provided health insurance plans which allowed employees to include their same-sex spouse to their health plan, had to impute income to the employee for federal income tax purposes equal to the fair market value of the health coverage provided to the same-sex spouse. In addition, employers who provided health care coverage to employees and their heterosexual spouses on a pre-tax basis were required to treat the same coverage to a same-sex couple's spouse on an "after-tax basis," meaning the employee was taxed on the value of the spouse's coverage. Rev. Rul. 2013-17 provides that any employee who purchased coverage on an after-tax basis for health care coverage for their same-sex spouse during the period(s) in which the statute of limitations is open, may file a claim for a refund of income taxes paid on the premiums for the health care coverage of the employee's same sex spouse (*See also*, FAQ, Q11). Please note: This would not apply to unmarried domestic partners for periods when same-sex couples were not married.

OFFSETTING GAINS AND LOSSES

Married same-sex taxpayers might examine to see if one taxpayer had capital losses that can be offset against the spouse's capital gains in a tax year that is still open to amend the returns.

ESTATE AND GIFT TAXES

As more fully detailed below, married same-sex taxpayers will now receive certain estate and gift tax benefits provided to married couples that they previously were not entitled to. However, the ability for same-sex married couples to amend previously filed estate and gift tax returns and retroactively take advantage of these benefits remains an unresolved issue. For example, the IRS has yet to issue guidance on how same-sex married couples can report and track previously reported gifts that are now eligible for the marital exclusion or the gift-splitting election. Amending these previously filed gift tax returns, will allow taxpayers to restore applicable unified credit amounts for previously made gifts. The ability to amend previously filed gift tax returns has an even greater collateral effect for estates of the first deceased spouse in same-sex married couples that exhausted their unified credit during their lifetime. Given the considerable amount of variables and uncertainly which surround these issues, it is best to err on the side of caution and file an amended return to protect your client's potential claim.

INFORMATION REQUIRED BY TAX PRACTITIONERS

Tax practitioners should make sure that when they mail out the tax return checklists to clients for the 2013 tax year, they incorporate language into the checklist that informs all clients in a same-sex marriage to update their filing status if they are changing their filing status from single or head-of-household (if a qualifying child) to married filing jointly or separately. Moreover, a checklist should require taxpayers to update dependency information if the married couple has any qualifying dependents. If the same-sex married couple is filing jointly, both spouses would need to submit tax information to the tax preparer as well as both sign the affidavit on the checklist that the information reported is accurate and complete.

INNOCENT SPOUSE RULES

Rev. Rul. 2013-17 requires that married same-sex couples file using one of the two married statuses. If the couple files as married filing jointly, both spouses will be required to sign the federal tax return. Moreover, both spouses will be jointly and severally responsible for the income tax determined on the return as well as interest or penalties that may result. While both married taxpayers should be aware of items reported on the federal tax return, Internal Revenue Code (IRC) Sec. 6015, innocent spouse rules, are available for any tax filer impacted by the fraudulent information reported as well as unreported income caused solely by the other spouse.

INCOME LIMTATIONS FOR 2013 IMPACTING MARRIED TAX FILERS

In general, beginning with the 2013 tax year, married tax filers will be subject to adjusted gross income (AGI) threshold limitations based on whether same-sex married couples file as joint filers or married filing separately. Table 3 below highlights some of the main tax provisions impacted by AGI limitations for 2013:

Table 3: AGI Thresholds for Married Taxpayers for Tax Provisions for 2013

Adjusted Gross Income (AGI) Threshold Issues with Deductions, Credits, and Exclusions for 2013:	**MAGI Phase-outs begin:**
Itemized Deduction Limitation	Deduction phases out for joint filers with AGI starting at $300,000; $150,000 for MFS.
IRA Deduction (only if taxpayer also participates in a qualified retirement plan)	Deduction phases out for joint filers with AGI starting at $95,000: partial deduction if MAGI below $10,000 for MFS.
Roth IRA	Allowability to fund for joint filers phases-out with AGI starting at $178,000; other limitations if MFS.
Student Loan Interest Deduction	Deduction phases out for joint filers with AGI starting at $100,000; Non-deductible if MFS.
American Opportunity Tax Credit	Credit phases out for joint filers with AGI starting at $160,000; MFS cannot claim a credit.
Lifetime Learning Tax Credit	Credit phases out for joint filers with AGI starting at $107,000; MFS cannot claim a credit.
Child Tax Credit	Credit phases out for joint filers with AGI starting at $110,000; MFS cannot claim a credit.

Note: **MAGI** = Modified AGI; **MFS** = Married filing separately

MARRIAGE PENALTY

As previously discussed above, same sex couples must now consider the effect of the marriage penalty, not only on previously filed returns, but for future tax years as well.

Consideration should be given to the following: (1) fiscal cliff legislation changes to federal tax rates on ordinary income; (2) fiscal cliff legislation changes to federal tax rates on capital gains and dividend income; and (3) the imposition of additional taxes created by the Patient Protection and Affordable Care Act.

ORDINARY INCOME

The American Taxpayer Relief Act of 2012 (ATRA) recently adjusted the federal tax rates for all filing statuses. In particular, the marriage penalty might impact tax filers who are close to the

39.6 percent tax bracket, which begins when joint filers have taxable income in excess of $450,000; married filing separate, the 39.6 bracket kicks in for taxable income in excess of $225,000.

CAPITAL GAINS/DIVIDENDS

The ATRA also raised the top rate for long-term capital gains and qualified dividends (a qualified dividend is a dividend received from a domestic corporation or a qualified foreign corporation, whereby the underlying stock is held for at least 61 days within a specified 121 day period) to 20 percent for taxpayers in the new 39.6 percent tax bracket only.

PATIENT PROTECTION AND AFFORDABLE CARE ACT

Starting in 2013, the Patient Protection and Affordable Care Act – otherwise known as Obamacare – will impose two additional taxes of note:

1. An additional 0.9% Medicare tax on wages and self-employment income in excess of the applicable threshold, and
2. An additional 3.8% tax on a taxpayer's net investment income when adjusted gross income exceeds certain thresholds.

The applicable threshold amounts is "modified adjusted gross income" of $200,000 for taxpayers filing as single, but only $250,000 for joint filers. To illustrate the inequity this causes for joint filers, consider the following example: In 2013, Tom and Bill, a legally married same-sex couple that resides in Massachusetts, each earn $300,000 of ordinary income respectively and $50,000 of dividend income. Had Tom and Bill remained single, they each would have paid ordinary income tax at maximum rate of 33%, and all of their dividend income would be taxed at 15%. If, however, Tom and Bill decide to file a joint return, the tax consequences would be significant. The joint return will reflect $600,000 of ordinary income and $100,000 of dividend income. As a result, $150,000 ($600,000-$450,000) of their ordinary income will now be taxed at a maximum of 39.6%, and the entire $100,000 of dividend income will be taxed at 20% rather than 15%. In addition, Tom and Bill must also pay the additional 0.9% Medicare tax on $350,000 of wages ($600,000 – $250,000) and an extra 3.8% on the net investment income of $100,000.

ESTATE AND GIFT TAX CONSIDERATIONS

Rev. Rul. 2013-17 only briefly addresses the estate and gift tax considerations from the *Windsor* decision, stating that taxpayers who wish to file a refund for gift and estate taxes should file Form 843, Claim for Refund and Request for Abatement. Further guidance in the estate and gift tax area including but not limited to, the marital deduction, gift-splitting and portability, is anticipated from the IRS. As discussed above, protective refund claims should be considered to protect potential refund claims for previously gift and estate tax returns which may be impacted by the *Windsor* decision.

MARITAL DEDUCTION

Prior to the *Windsor* decision, a gift or bequest to a same sex spouse was taxable as a transfer to a non-spouse individual. The value of the property transferred would reduce the transferor's applicable unified estate (IRC §2010) an *Windsor* d gift tax (IRC §2505(a)) exclusion amount ("Lifetime Exclusion Amount"), currently $5.25 million, adjusted annually for inflation. The top marginal transfer tax rate of 40% would be imposed on any transfers in excess of the Lifetime Exclusion Amount (IRC §2001(c)).

Following *Windsor*, married same-sex couples can now utilize the unlimited marital deduction from federal estate (IRC §2056) and gift taxes (IRC §2523(a)). The marital deduction provides an unlimited deduction for transfers between spouses (IRC §2056). This means that an individual in a same-sex marriage can now transfer, during his or her life or at death, property in any amount to their spouse, free of federal estate or gift tax.

GIFT SPLITTING

Same-sex married couples will now also get the benefit from gift splitting. In general, individual taxpayers are allowed to exclude the first $14,000 of gifts made to each donee, ("Annual Exclusion Amount"), during the calendar year. With gift splitting, the Annual Exclusion Amount is doubled, with each gift considered as made one-half by each spouse. If a split-gift election is made, each spouse can use its Annual Exclusion amount to reduce the potential gift tax liability (the gift-splitting election is made on Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return). By acting together, married couples can gift up to $28,000 to any one donee per year without using any portion of their either spouse's Lifetime Exclusion Amount. Once the annual gift tax exclusion amount for a given year is exhausted, the couple can still make combined gifts or bequests of up to $10.5 million over their lifetimes without incurring federal estate or gift tax.

PORTABILITY

Finally, same sex couples get the benefit of the portability election (*See*, IRC §*2010(c)(2) and (4), as amended by P.L. 112-240; Temp. Reg. §§20.2010-2T, 20.2010-3T*). The portability election which must be made on a timely filed estate tax return, including extensions actually granted, transfers a deceased spouse's unused Lifetime Exclusion Amount to the surviving spouse. The surviving same-sex spouse will now be able to use this extra exclusion amount to make additional tax-free gifts or reduce the tax liability of his or her own estate.

An issue relates to the portability election for the estate of the first deceased spouse in a same-sex marriage. In order for a decedent's estate to take advantage of the portability election, the executor of the predeceased spouse's estate must have timely filed an estate tax return on which the election is made (Internal Revenue Service Notice 2011-82, 2011-42 IRB 516). The due date of the estate return is nine months after date of death plus an additional extension of six months (IRC §6075(a)). Thus, it is likely that the time for making a portability election has expired for some previously filed estate tax returns of first deceased spouses in same-sex marriages. In addition, if an estate fell below the threshold for filing, or was not otherwise required to file, it is possible that no return was ever filed. Since estates are generally considered ineligible to claim portability on late-filed returns, guidance on the process for electing portability must be addressed by the IRS. Assuming a protective claim was not previously filed, such taxpayers may have lost their opportunity to file an amended estate return and make the portability election. Whether the IRS will grant estates of first deceased spouses in same-sex married couples additional time to make the election remains to be seen. The only option currently available to such estates is to apply for a private letter ruling, requesting permission to file a late portability election (Reg. §301.9100; Rev. Proc. 2013-1, 2013-1 IRB-1).

CONCLUSION

The *Windsor* ruling overturned federal law and allowed married same-sex couples to be considered legally married for tax and other purposes, in the states that recognize such marriages (Table 1). Rev. Rul. 2013-17 formally adopts the spirit and holding of *Windsor*, and is the first form of written tax guidance by the IRS which affirmatively states that same-sex married couples will be treated as married for federal income tax purposes, regardless of whether the State the

couple resides in recognizes such marriages. This paper summarizes and highlights some of the major federal tax implications that will impact married same-sex couples following the *Windsor* decision and provides guidance to tax advisors that are attempting to tackle the many unanswered questions that still remain.

REFERENCES

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