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State Domestic Partnership Laws Present Unanswered Federal Tax Questions

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DEFINITION OF PROBLEM

While numerous tax provisions turn on individual and family relationships, state domestic relations law has outpaced federal tax law. In recent years, 11 states have established domestic partnerships or civil unions between individuals of the same gender,[1] while eight states,[2] as well as ten foreign countries,[3] have recognized marriage between individuals of the same gender. Generally, marriages are valid if recognized where celebrated,[4] but under the Defense of Marriage Act (DOMA), "marriage" for federal purposes does not encompass same-gender spouses.[5] DOMA does not disregard domestic partnerships, which may create parent-child relationships, property rights, and obligations under state law. Consequently, numerous federal tax questions arise for domestic partners, as well as same-gender spouses, whose marriages are disregarded under DOMA, but who nevertheless may have relationships, rights, and obligations under state law with ambiguous federal tax consequences. The IRS has not provided answers to these questions, requiring many taxpayers to file returns without knowing which rules apply and potentially subjecting them to audits and penalties, as well as costs for tax advice.

According to demographic research, the populations of individuals in same-gender marriages and domestic partnerships were 63,658 and 174,760, respectively, in 2008, when only three states authorized same-gender marriages and ten recognized domestic partnerships.[6] Nationwide, more than a million individuals are estimated to be living as same-gender

1 *See* Calif. Fam. Code § 297; Conn. Gen. Stat. § 46b-38aa *et seq.*; D.C. Code § 32-702; Haw. Rev. Stat. § 572C-1 *et seq.* (establishing reciprocal beneficiary relationships); Me. Rev. Stat. tit. 22, § 2710; Nev. Rev. Stat. § 122A.010 *et seq.*; N.H. Rev. Stat. § 457-A:1 *et seq.*; N.J. Stat. § 37:1-1 *et seq.*; Or. Rev. Stat. § 432.405; Vt. Stat. tit. 15, § 1201 *et seq.*; Wash. Rev. Code § 26.60.010 *et seq.*

2 *See Strauss v. Horton*, 46 Cal. 4th 384 (2009) (preserving marriages performed in 2008); *Kerrigan v. Comm'r* of Public Health, 289 Conn. 135, 957 A.2d 407 (2008); D.C. Code § 46-401; *Varnum v. Brien*, 763 N.W.2d 862 (Iowa 2009); *Goodridge v. Dep't of Public Health*, 440 Mass. 309, 798 N.E.2d 941 (2003); N.H. Rev. Stat. § 457:1-a; *Martinez v. County of Monroe*, 50 A.D.3d 189, 850 N.Y.S.2d 740 (4th Dep't 2008), *cert. den'd* 10 N.Y.3d 856, 889 N.E.2d 496 (2008) (recognizing same-gender marriage performed out-of-state); Vt. Stat. tit. 15, § 8.

3 Netherlands, Belgium, Canada, Spain, South Africa, Norway, Sweden, Iceland, Portugal, Argentina. *See* Dan Fastenberg, *International Gay Marriage*, Time, July 22, 2010.

4 *See* Restatement of Conflict of Laws § 121.

5 Pub. L. No. 104-199, 110 Stat. 2419 (1996).

6 The 2008 same-gender marriage states were California, Connecticut, and Massachusetts; domestic partnership states were California, Connecticut, District of Columbia, Hawaii, Maine, Massachusetts, New Jersey, Oregon, Vermont and Washington. *See* Gary J. Gates, *Same-Sex Spouses and Unmarried Partners in the American Community Survey, 2008*, Williams Institute, Univ. of Calif. at Los Angeles (Oct. 2009) Table 1 at 4, App. Table 2 (reporting 31,829 same-gender marriages and 87,380 other couples with non-marital legal recognition). Because these same-gender married and partnered couples cannot file jointly for federal tax purposes, the relevant number of individual taxpayers is twice the number of couples.

couples (whether or not registered), over 20 percent of which are raising children.[7] Consequently, hundreds of thousands of taxpayers need guidance.

ANALYSIS OF PROBLEM

Background

Certain States Recognize Domestic Partnerships and Same-Gender Marriages While the Federal Government Disregards the Latter

Domestic partnerships or civil unions between adults of the same gender continue to be established in California, Hawaii, Maine, Nevada, New Jersey, Oregon, and Washington. Additional states, even those that preclude performance of same-gender marriages, may offer more limited rights to domestic partners.[8] In some states, these couples are entitled to the benefits of marriage.[9] In other states, statutes set forth certain rights and obligations and may grant domestic partners the same rights and responsibilities as spouses, including attendant relationships, such as those of in-laws.[10] Some states permit certain persons of opposite gender to register as domestic partners.[11]

Connecticut, Iowa, Massachusetts, New Hampshire, Vermont, and the District of Columbia authorize same-gender marriages. During 2008, California issued licenses for approximately 18,000 such marriages, which still are valid.[12] Additionally, New York recognizes same-gender spouses whose marriages were performed out of state.[13] Five of these states allowed domestic partnerships (or civil unions) before recognizing same-gender marriages. In some states, same-gender spouses are constitutionally guaranteed the right to marry,[14] while other states legislatively grant marriage rights with attendant responsibilities.[15]

As enacted in 1996, DOMA states that in "determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person

7 *See* Gary J. Gates, *Same-Sex Spouses and Unmarried Partners in the American Community Survey, 2008*, Williams Institute, Univ. of Calif. at Los Angeles (Oct. 2009) App. Table 1.

8 *See, e.g.*, Md. Code, Tax-Prop. Art. § 12-101(e-2); Wis. Stat. § 770.001 *et seq*.

9 *See Lewis v. Harris*, 188 N.J. 451, 908 A.2d 196 (2006).

10 *See, e.g.*, Wash. Rev. Code § 26.60.015.

11 *See, e.g.*, Calif. Fam. Code § 297(b)(5)(B); Haw. Rev. Stat. § 572C-5; Wash. Rev. Code § 26.60.030(6).

12 *See Strauss v. Horton*, 46 Cal. 4th at 385 (upholding "the estimated 18,000 marriages of same-sex couples that were performed" between June 17 and November 4, 2008). In August 2010, a federal district court ruled California's Prop. 8, which had suspended performance of same-gender marriages, unconstitutional under the Equal Protection Clause of the 14th Amendment, holding that it denied a fundamental right without a legitimate reason. *See Perry v. Schwarzenegger*, 704 F. Supp. 2d 921 (N.D. Calif. 2010). The Ninth Circuit court has granted a stay pending appeal. *See* Order, No. 10-16696 (9th Cir. Aug. 16, 2010).

13 *See Martinez v. County of Monroe.*

14 *See Varnum v. Brien; Kerrigan v. Comm'r of Public Health; Goodridge v. Dep't of Public Health*.

15 *See* D.C. Code § 46-401; N.H. Rev. Stat. § 457:1-a; Vt. Stat. tit. 15, § 8.

of the opposite sex who is a husband or a wife."[16] In July 2010, the federal district court in Massachusetts declared DOMA unconstitutional under the Equal Protection Clause of the Fifth Amendment because the court could not discern a rational basis for denial of federal recognition to same-gender spouses.[17] Appeal to the First Circuit court is anticipated, with the federal government defending the constitutionality of DOMA even though the current Administration "does not support DOMA as a matter of policy, believes that it is discriminatory, and supports its repeal."[18]

At this point, same-gender spouses do not know whether they should continue to take certain tax positions as if DOMA applies and whether they will have to amend their returns if an appellate court reaches a contrary conclusion. The discussion below assumes that DOMA continues to apply.[19]

The Effect of State Laws on Federal Taxation Is Unclear

Generally, it has been well settled that "federal income tax liability follows ownership" which "state law controls,"[20] along with domestic relations.[21] However, DOMA calls the latter proposition into question, while previous IRS advice appears inconsistent with the general rule. In particular, domestic partners in California have community property.[22] In 2006, the IRS Chief Counsel nonetheless advised California domestic partners that they must report all earned income individually because of the inapplicability "of a state's community property law outside the context of a husband and wife."[23] Four years later, the Office of Chief Counsel effectively reversed this result, concluding that a California domestic partner now must report half of community income.[24] A retrospective rationale for the 2006 advice was that although earned income of a California partner was community property for state property law purposes, earned income had not been treated as community income for California income tax filing until 2007.[25] This pre-2007 treatment may have created symmetry with federal tax filing, but in any case, the 2006 advice appeared inconsistent with the principle that "Federal tax law generally respects state property law

16 1 U.S.C. § 7 (1996).

17 *See Gill v. Office of Personnel Management* (OPM), 699 F.Supp.2d 374 (D. Mass. 2010). In a companion case, the district court held that DOMA was unconstitutional under the Tenth Amendment (reserving unenumerated powers to the states) and the Spending Clause. *See Commonwealth of Mass. v. Dep't of Health & Human Services* (HHS), 698 F. Supp. 2d 234 (D. Mass. 2010).

18 *Gill v. OPM*, Memo. of Law in Support of Def.s' Mot. Dismiss 1.

19 Under IRC § 6013(a), same-gender spouses file singly for federal tax purposes. In the eight states that recognize same-gender marriage, same-gender spouses reformulate their tax returns as married for state purposes, a function that may require overriding commonly available software.

20 *See United States v. Mitchell*, 403 U.S. 190, 197 (1971).

21 *See Elk Grove United School District v. Newdow*, 542 U.S. 1 (2004).

22 As of 2005, registered "domestic partners shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, court rules, government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses." Calif. Family Code § 297.5.

23 CC Advisory 2006-08-038 (issued Feb. 24, 2006).

24 *See* CC Advisory 2010-21-050 (issued May 5, released May 28, 2010). Chief Counsel Advice memoranda are not precedential. IRC § 6110(k)(3).

25 *See id*. at n. 1. A companion piece that was silent on the state tax treatment of earned income in 2005-2006 but pertained to collection potential for purposes of IRC § 7122 (regarding offers in compromise) stated that "California state law provides that both domestic partners have an equal interest and liability in the community property." CC Advisory 2010-21-049 (issued May 6, released May 28, 2010).

characterizations and definitions."[26] Uncertainty surrounding the government's observance of fundamental principles, not to mention particular results, of federal taxation makes legal guidance necessary here.[27]

Uncertainty Leaves Taxpayers in an Untenable Position

Uncertainty concerning the federal taxation of same-gender spouses or domestic partners could put taxpayers and their return preparers in an untenable position. Generally, a taxpayer may take a filing position to which a penalty would not attach if there is substantial authority, such as a court case (not overruled by the U.S. Court of Appeals).[28] Thus, there may be substantial authority for same-gender spouses to take certain tax positions as married as long as the Massachusetts district court's opinion stands.[29] At the same time, DOMA itself may constitute substantial authority to continue to avoid numerous provisions that result in a marriage penalty.[30] Presumably, same-gender spouses and domestic partners need not file jointly, even if their underlying state law relationship is conjugal, under provisions requiring married couples to file jointly in order to claim a tax benefit.[31]

On the other hand, a return preparer faces a penalty unless a position would more likely than not be sustained on the merits.[32] Given the constitutional uncertainty of DOMA as well as the reversal of IRS advice between 2006 and 2010, it is unclear which position would be sustained. Meanwhile, hundreds of thousands of taxpayers need advice.[33]

Although the Office of Chief Counsel has issued a Private Letter Ruling (PLR) as well as the Chief Counsel advice on domestic partners discussed above, [34] it is unclear that this non-precedential type of guidance would be effective here. A PLR can cost hundreds or thousands of dollars, while many of the tax provisions at issue are targeted at low and moderate-income families who lack the resources to pay the fee.[35] Moreover, the relevant questions could be answered by the application of federal taxation to state law, rather

26 CC Advisory 2010-21-050.

27 *See* Dennis J. Ventry, Jr., *No Income Splitting for Domestic Partners: How the IRS Erred*, 110 Tax Notes 1221 (2006). Moreover, the National Taxpayer Advocate 2005 Annual Report to Congress at 407, observing inequities in taxation of family income, proposed legislation to repeal the rule of *Poe v. Seaborn*, 282 U.S. 101 (1930), that each spouse is taxed on half of community income. If enacted, this previous proposal would resolve this particular issue.

28 *See* Treas. Reg. § 1.6662-4(d)(3)(iii).

29 *See Gill v. OPM; Mass. v. HHS*.

30 *See* Theodore P. Seto, *The Assumption of Selfishness in the Internal Revenue Code: Reframing the Unintended Tax Advantages of Gay Marriage*, Loyola Legal Studies Paper No. 2005-33.

31 *See, e.g.*, IRC §§ 21(e)(2) (child-care credit), 32(d) (Earned Income Tax Credit), 25A(g)(6) (Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits), 221(f)(2) (student loan interest deduction), 135(d)(3) (U.S. savings bond interest exclusion for college expenses), 163(h)(4)(A)(ii) (home mortgage interest deduction), 36(c)(5) (First-Time Homebuyer Credit), 23(f)(1) (adoption credit), 137(e) (adoption exclusion), 22(e)(1) (elderly or disabled credit).

32 *See* IRC § 6694.

33 *See* Patricia A. Cain, *Taxing Families Fairly*, 48 Santa Clara L. Rev. 805, 848 (2008) (noting that lawyers have requested IRS guidance).

34 *See* PLR 2010-21-048 (issued May 5, released May 28, 2010); CC Advisory 2010-21-050.

35 *See* Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 67, App. A (including reduced user fee of $625 for individual with gross income of less than $250,000, or $2,000 for gross income between $250,000 and $1 million). A general "information letter" would be free but would relate only to "a well-established interpretation or principle of tax law." *See id*. at 7, 69.

than unique facts posed by taxpayers. Given the scope of the concerns, the Office of Chief Counsel should issue guidance of general applicability.

Taxation Affects Family Costs

Under substantive tax provisions, discussed below, the following questions arise for same-gender spouses or domestic partners:

- Does a parent-child relationship persist even if DOMA disregards the parent's marriage?
- Is a domestic partner or same-gender spouse in a community property state deemed to provide, for dependency purposes, the support that he or she earns?
- Is alimony under state domestic partnership or same-gender marriage law includible by the recipient and deductible by the payer?
- Is community property created upon marrying or partnering with an individual of the same gender a taxable gift?
- Do same-gender tenants by the entirety have a qualified joint interest for estate tax purposes?

Tax Law Contains Provisions for Children and Other Dependents

Federal tax law contains various provisions for costs of child care, health care, and education. Central to these provisions is the definition of "child," which figures in eligibility for head of household filing status and the dependency deduction,[36] as well as the child-care credit,[37] child tax credit (CTC),[38] and earned income tax credit (EITC).[39] These provisions have significant tax consequences, and taxpayers need guidance to determine their applicability.[40] In pertinent part, all of these provisions depend on whether the taxpayer has a child, which may include a stepson or stepdaughter.[41] A taxpayer who is a same-gender spouse may have a stepchild by virtue of marriage to the child's parent. The applicable definition of "child" does not refer to marriage, nor does DOMA define a child. Nevertheless, if

36 IRC § 2(b) head of household filing status generally provides favorable income tax rates under § 1(b) for an unmarried individual who maintains a home for a child. IRC §§ 151 and 152 allow a personal exemption deduction ($3,650 in 2010) for a child or other dependent.

37 The IRC § 21 child-care credit, which in conjunction with the § 129 exclusion of employer-provided child care historically has "represented the largest source of federal financial support for child care," generally allows a credit up to $2,100 in 2010 for household and dependent care services necessary for gainful employment of a taxpayer. Mary Louise Fellows, *Rocking the Code: A Case Study of Employment-Related Child-Care Expenditures*, 10 Yale J. L. & Feminism 307, 310 n. 11 (1998).

38 The IRC § 24 CTC allows a credit of $1,000 per child, a portion of which the IRS may refund to a low-income parent even in excess of any tax owed.

39 The IRC § 32 EITC, popularly recognized as "the nation's largest anti-poverty program," operates as a refundable wage supplement of up to $5,666 in 2010 to working parents (with reduced benefits to workers without children). Daniel P. Gitterman, Lucy S. Gorham & Jessica L. Dorrance, *Expand the EITC for Single Workers and Couples Without Children*, Pol'y Brief Prepared for the Ctr. on Poverty, Work & Opportunity, Univ. of N.C. at Chapel Hill 1 (Jan. 2007).

40 The child-care credit, the CTC, and the EITC provide tax benefits worth, nationwide, an estimated $3.75, $23.45, and $6.19 billion, respectively, in 2010. *See Budget of the United States Government* (USG) FY 2011, Analytical Perspectives, Ch. 16, Table 16-1, lines 122, 121 & 159, at 211-212 (noting significant additional outlay effects of $30.29 and $51.50 billion, respectively, for refundable portions of the CTC and EITC). Additionally, IRC § 129 excludes employer-provided child care, which results in an estimated $1.21 billion expenditure for 2010. *See USG Budget, loc. cit.*, line 116.

41 *See* IRC §152(f)(1)(A)(i).

DOMA has the effect of disregarding the marriage, the question arises whether the child is no longer a stepchild of this taxpayer for federal tax purposes.

In another section, the federal tax law defines "parent" by reason of "parental rights and duties in respect of the child."[42] Moreover, state law may stipulate that a parent-child relationship is not dependent on the persistence of either a marriage or a domestic partnership.[43] On the other hand, if a taxpayer has a stepchild by virtue of a domestic partnership with the parent under state law, DOMA, which applies only to marriage, presumably would not call this parent-child relationship into question. In any case, the fundamental issue of the parent-child relationship needs clarification before same-gender spouses can comply with significant provisions of federal tax law.

Another type of dependency deduction is the spousal exemption, for which a same-gender spouse or domestic partner is categorically ineligible.[44] Nonetheless, a dependent may be deductible as a qualifying relative in the household if, among other requirements, one same-gender spouse or domestic partner provides over half of the other's support for the year.[45] In a community property state, however, would half the support be deemed to belong to each same-gender spouse or domestic partner such that one could never be a dependent of the other? Clarification is necessary to allow these taxpayers to file correct returns.

Tax Law Contains Health and Education Provisions

The definition of "dependent" similarly has consequences for tax-favored health care and education provisions. With respect to medical care expenses of dependents, the tax law excludes from gross income certain employer reimbursements, allows a deduction, and provides for Flexible Spending Accounts, Archer Medical Savings Accounts, and Health Savings Accounts.[46] With respect to a dependent's college tuition, student loan interest, and related expenses, the tax law allows Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits, certain deductions and exclusions.[47] All of these are major federal programs for which eligibility should be clarified. While the policy of DOMA may be to discourage same-gender spouses, it is unclear how the law should affect health, education, and welfare provisions for domestic partners and children.

Taxation Pertains to Life Events such as Separation and Death

The federal tax law contains a number of provisions for the separation of individuals presumably attendant to divorce. For example, if married individuals in a community

42 IRC § 73(c).

43 *See, e.g.*, D.C. Code § 16-908.

44 *See* IRC § 151(b).

45 *See* IRC § 152(d)(1)(C).

46 *See* IRC §§ 105, 213, 125, 220, 223.

47 *See* IRC §§ 25A, 221, 222, 135.

property state live and file separately, their income is proportionately divided for federal tax purposes.[48] However, this provision does not apply to similarly situated same-gender spouses or domestic partners. Should they each report half of community income? Under a divorce or separation agreement, certain amounts paid and received are defined for federal tax purposes as alimony includible in gross income by the recipient and deductible by the payer.[49] Presumably, individuals not married for federal purposes cannot be divorced, but can they have "a written separation agreement"?[50] In another context, the U.S. Tax Court has held that individuals who never had been married could come within a provision that encompassed divorcees or individuals with "a written separation agreement" as well as parents living apart for the last half year.[51] On the other hand, before enactment of the alimony tax law, the U.S. Supreme Court held that alimony was neither includible nor deductible.[52] Similarly, federal tax law defines a Qualified Domestic Relations Order (QDRO) for division of employee plan benefits relating to child support, alimony, or otherwise.[53] Would a QDRO apply to same-gender spouses or domestic partners? Again, answers to these questions would enable taxpayers to comply with the law.

Under the federal transfer tax, a marital deduction does not apply to same-gender spouses or domestic partners,[54] but other provisions are ambiguous. For example, would the creation of community property as a consequence of marriage or partnership result in a federally taxable gift within same-gender couples? For married couples, courts have not viewed the creation of community property as a taxable transfer.[55]

In some cases, the federal estate tax deems half of spousal property to be included in the decedent's gross estate. [56] However, it is unclear if same-gender spouses or domestic partners who own property by the entirety in common law states have a "qualified joint interest" even though the federal tax law defines that term in part by reference to tenants by the entirety.[57] While federal tax law ordinarily designates the treatment of "interests or rights, so created" by state property law,[58] the statutory terms may have ambiguous consequences in this context.

48 *See* IRC § 66(a).

49 *See* IRC §§ 71, 215.

50 *See* IRC § 71(b)(2)(B).

51 *See King v. Comm'r*, 121 T.C. 245 (2003) (relating to IRC § 152(e)(1)(A)). The result was codified in Treas. Reg. § 1.152-4(b)(2)(i)(C). *See* 72 Fed. Reg. at 24,194 (May 2, 2007).

52 *See Gould v. Gould*, 245 U.S. 151 (1917).

53 *See* IRC § 414(p). The Dep't of Labor has regulatory authority under IRC § 414(p)(13).

54 *See* IRC §§ 2056, 2523.

55 *See Poe v. Seaborn*, 282 U.S. 101; *see also* PLR 2010-21-048 (ruling privately in a format not precedential under IRC § 6110(k)(3)).

56 *See* IRC § 2040(b)(2).

57 *See* IRC § 2040(b)(2)(A).

58 *Morgan v. Comm'r*, 309 U.S. 78, 80 (1940).

CONCLUSION

DOMA and various state laws regarding domestic partnerships and same-gender marriages give rise to a large number of unintended or unforeseen federal tax law ambiguities, making it possible for hundreds of thousands of taxpayers to take inconsistent positions in good faith. The National Taxpayer Advocate believes that it is a basic responsibility of government to provide taxpayers with sufficient guidance to enable them to comply with the law.

In conclusion, our preliminary recommendation is the IRS Office of Chief Counsel should publish a revenue ruling, establish adequate safe harbors, or issue other precedential guidance of general applicability.

IRS COMMENTS

As the National Taxpayer Advocate indicates in the report, states vary in the degree to which they recognize same-sex relationships. Some states recognize same-sex marriage, others provide for civil unions, and others permit couples to register as domestic partners. The IRC, on the other hand, generally categorizes individuals for federal income tax purposes either as unmarried individuals or as married individuals ("spouses"). The Defense of Marriage Act prohibits the IRS from publishing guidance that recognizes same-sex couples as "married" individuals or "spouses" for purposes of federal tax law.

The Office of Chief Counsel focuses its published guidance resources on resolving uncertain tax issues that affect a significant number of similarly-situated taxpayers. The existence of DOMA and the litigation over its validity, the wide variation among states in the extent of rights and obligations provided to same-sex couples, and the evolving nature of state laws make it unlikely that published guidance could provide a uniform set of rules that resolve the issues facing same-sex couples nationwide.

In the absence of legislation resolving these issues, the IRS and the Office of Chief Counsel intend to continue, where appropriate, to respond to taxpayer requests for advice tailored to their particular state's law. As the National Taxpayer Advocate's report recognizes, the Office of Chief Counsel provided advice in response to inquiries about California's domestic partner statute. In addition, the IRS and the Office of Chief Counsel will continue to monitor developments in state and federal law to ensure that federal tax laws are applied correctly to same-sex couples. The IRS and the Office of Chief Counsel will consider publishing guidance on discrete issues arising under a particular state's domestic relations laws if we determine that published guidance is necessary to ensure that federal tax laws are applied correctly to same-sex couples.