All Same-Sex Marriages Valid for Federal Tax Purposes

08.30.2013

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Same-sex marriages that are valid where celebrated are valid for all Federal tax purposes, according to a U.S. Department of the Treasury and Internal Revenue Service ruling issued on August 29, 2013. Revenue Ruling 2013-17 implements the U.S. Supreme Court decision in *United States v. Windsor* which struck down a key provision of the Defense of Marriage Act (DOMA). The Revenue Ruling contains three key holdings.

Marriage Includes Marriage Between Individuals of Same Sex

First, the Revenue Ruling provides that, for Federal tax purposes, the terms "spouse," "husband and wife," "husband," and "wife" include an individual married to a person of the same-sex if the individuals are lawfully married under state law, and the term "marriage" includes such a marriage between individuals of the same-sex.

Place of Marriage Celebration Determines Validity of Marriage

Second, for Federal tax purposes, the IRS adopts a general rule recognizing a marriage between same-sex individuals that was validly entered into in a state whose laws authorize the marriage of two individuals of the same-sex even if the married couple is domiciled in a state that does not recognize the validity of same-sex marriages. Therefore, same-sex couples who travel out of state to be married and return to their domicile (which does not recognize same-sex marriage) will, nevertheless, be treated as being married for Federal tax purposes.

The "place of celebration" concept is consistent with the IRS's long standing position, found in Revenue Ruling 58-66. That Revenue Ruling provides that a couple will 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. The Service further concluded in Revenue Ruling 58-66 that its position with respect to a common-law marriage also applies to a couple who entered into a common-law marriage in a state that recognized such relationships and who later moved to a state in which a ceremony is required to establish the marital relationship.

Civil Unions and Domestic Partnerships Are Not Recognized

Finally, the Revenue Ruling concludes that, for Federal tax purposes, the terms "spouse," "husband and wife," "husband," and "wife" do ***not*** include individuals (whether of the opposite sex or the same-sex)

who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state, and the term “marriage” does not include such formal relationships.

Effective Date and Retroactive Application

The Revenue Ruling is effective, prospectively, as of September 16, 2013. Legally married same-sex couples generally must file their 2013 Federal income tax return using either the married filing jointly or married filing separately filing status.

Individuals who were in same-sex marriages may, but are 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. Generally, the statute of limitations for filing a refund claim is three years from the date the return was filed or two years from the date the tax was paid, whichever is later. As a result, refund claims can still be filed for tax years 2010, 2011 and 2012. Some taxpayers may have special circumstances, such as signing an agreement with the IRS to keep the statute of limitations open, that permit them to file refund claims for tax years 2009 and earlier. Taxpayers seeking a refund of income taxes should file Form 1040X, while taxpayers seeking a refund of estate or gift taxes should file Form 843.

Broad Implications and Planning Considerations

Revenue Ruling 2013-17 has sweeping implications. The following paragraphs highlight some of the considerations in the areas of income taxation, employee benefits, and estate and gift taxation.

Income Tax Implications

Under the Ruling, same-sex spouses will no longer be treated as unmarried individuals for Federal income tax purposes and will be ***required*** to file their 2013 Federal income tax return using either the married filing jointly or married filing separately filing status. Same-sex spouses may wish to talk with their advisors about the potential merits of amending previously filed Federal income tax returns, which may also involve statute of limitations concerns as discussed above. In addition, same-sex spouses should consider state income tax implications of the Revenue Ruling.

Many states, like Virginia, follow a rule of “Federal conformity” and adopt the Federal rules as their own; however, this issue remains open and may require further clarification by the applicable state taxing authorities.

Of course, there are some less favorable implications to being married from a Federal income tax perspective. Same-sex spouses with two incomes will now be subject to the “marriage penalty,” which requires some married couples to pay a higher effective tax rate than if the two spouses had filed as separate individuals.

Employee Benefits Implications

Employee benefit plan sponsors in every state, regardless of whether the state recognizes same-sex marriage, must review plan documents and update plan administration procedures to recognize the rights of same-sex spouses.

Tax Qualified Retirement Plans

Qualified retirement plans, such as 401(k) plans and defined benefit pension plans, are required to provide certain benefit, notice, and consent rights to participants’ spouses. Under Revenue Ruling 2013-

17, qualified retirement plans are required to treat a same-sex spouse as a spouse if the participant and spouse were married in a state that allows same-sex marriage. Accordingly, the Revenue Ruling will affect the following areas of qualified plan administration:

- Defined benefit pension plans and money purchase pension plans must offer a qualified joint and survivor annuity and qualified preretirement survivor annuity to same-sex spouses.
- Same-sex spouses have the right to consent to distributions, to non-spouse beneficiary designations, and to plan loans.
- Required minimum distributions must be determined by treating same-sex spouses as spouses.
- Same-sex spouses will be entitled to spousal rollovers.
- The benefit of a divorced participant who was in a same-sex marriage will be subject to division through a qualified domestic relations order.

Health Plans

Although Federal tax law does not require group health plans to provide coverage to spouses, Revenue Ruling 2013-17 will have an impact on plans that currently offer coverage to spouses. For example, coverage for same-sex spouses may be purchased on a pre-tax basis through a cafeteria plan. Health flexible spending arrangements may reimburse same-sex spouse medical benefits. Same-sex spouses also have special enrollment rights upon marriage or the birth of a child. In addition, same-sex spouses covered by health plans are entitled to COBRA continuation coverage if a qualifying event, such as divorce or the participant's termination of employment, occurs.

Revenue Ruling 2013-17 also provides that employees who file amended returns reflecting the employees' status as married can claim a refund for taxes paid in prior years on the value of health insurance paid by the employer, on the payment of premiums paid by the employee on an after-tax basis and on social security and Medicare taxes paid on such amounts. An employer can also claim a refund for the employer's share of social security and Medicare taxes.

Employers sponsoring employee benefit plans should review plan documents, summary plan descriptions, and forms to confirm compliance. Employers also need to identify employees in same-sex marriages in order to extend spousal benefit rights required by law. For example, non-spouse beneficiary designations made without same-sex spouse consent are invalid until consent is obtained. Cafeteria plan contributions to purchase same-sex spouse health coverage must be converted from after-tax to pre-tax. Plan administrators also need to know if a participant has a same-sex spouse who may be entitled to COBRA rights. Accordingly, employers should consider sending a notice to employees informing them of same-sex spouse benefit rights and encouraging employees in same-sex marriages to notify human resources.

Revenue Ruling 2013-17 applies to employee benefit plans as of September 16, 2013, but does not address the application of *Windsor* to prior periods. Future IRS guidance will address the retroactive application of the Supreme Court's ruling in *Windsor* to employee benefit plans as well as plan amendment requirements and corrections to plan operations.

Estate and Gift Tax Implications

In the wealth transfer tax arena, Revenue Ruling 2013-17 has significant implications and makes a number of tax benefits available to same-sex couples.

Marital Deduction

One of the most significant benefits now available to same-sex spouses is the availability of the

unlimited Federal estate and gift tax marital deduction. This permits one spouse to transfer assets to the other spouse (during life or after death) free from estate and gift tax. The deduction applies to both outright gifts and certain trusts, such as "qualified terminable interest property" (or "QTIP") trusts. Executors of estates of deceased same-sex spouses and same-sex spouses who previously paid estate or gift taxes on transfers may want to file amended returns and seek refunds for previously paid taxes. In addition, estate plans for same-sex spouses should be reviewed to ensure that dispositive provisions satisfy the requirements for the estate tax marital deduction.

Portability

Same-sex spouses will be able to take advantage of the new "portability" rules that

were made permanent earlier this year under the American Taxpayer Relief Act. The unused portion of a first spouse's $5.25 million (as indexed for inflation) estate tax exemption can be "ported" to the surviving spouse. In this case, the surviving spouse may elect to use the deceased spouse's remaining unused exemption in addition to the spouse's own exemption.

Gift-Splitting

Same-sex spouses will be able to "split gifts," whereby one spouse makes a gift and both spouses elect to treat the gift as if it came one-half from each of them. For example, John makes a $28,000 gift to his sister, Mary. John's spouse, Steve, can elect to treat one-half of the gift, or $14,000, as being made by him.

Other Issues

There are numerous other wealth transfer tax planning issues that should be considered. They include the conversion of trusts to grantor trust status for trusts created by one spouse with a same-sex spouse as a beneficiary, the application of the spousal interest rule for qualified disclaimers, implications for charitable remainder trusts with a same-sex spouse as a beneficiary, and the generation assignment rules for spouses in connection with the generation skipping transfer tax.

Conclusion

Revenue Ruling 2013-17 finally resolves significant questions regarding the Federal tax treatment afforded to same-sex couples after the *Windsor* case. The Revenue Ruling, however, raises a whole new set of issues and questions to consider whether previously filed returns should be amended, whether amendment is barred (because of the statute of limitations) and whether any retroactive relief will be granted. Existing documents, whether retirement plans or estate plans, will need to be revisited to ensure conformity with existing law and optimization under the new planning paradigms.

Please feel free to contact any member of the Williams Mullen Tax, Employee Benefits, or Private Client and Fiduciary Services Groups with questions regarding this important Revenue Ruling.

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