

planning for same-sex couples

Until *Obergefell*, the recognition of same-sex marriages was dependent on the laws of each particular state and the decisions of federal or state courts in that state or Federal Circuit. Federally, same-sex marriages were recognized for some, but not all, provisions of federal law.



OVERVIEW

On June 26, 2015 the U.S. Supreme Court, in *Obergefell v. Hodges*, ruled that same-sex couples are entitled to equal dignity under the law and have the right to marry under the U.S. Constitution. The court ruled that no state can ban same-sex marriages and that states must recognize same-sex marriages legally performed in out-of-state jurisdictions. Legally married same-sex couples are now treated as married for all federal purposes.

PLACE OF CEREMONY

On August 29, 2013, the IRS issued Revenue Ruling 2013-17, which applied the place of ceremony rule for married same-sex couples for federal income tax purposes retroactively for all open tax years. This means as long as the marriage was legal in the state where the marriage occurred, it will be considered a marriage regardless of the state in which the couple resides.

On October 21, 2015, the IRS reversed this policy and ruled that a couple in a same-sex marriage, regardless of which state they were married in, would be recognized as married for tax purposes. This puts the IRS in line with the U.S. Supreme Court's June 2015 ruling. This should not have significant impact at the federal level since the 2013 ruling treated legally married same-sex couples as married for federal tax purposes regardless of the state of residence. Couples who were residing in states which did not recognize these marriages may be able to benefit from these changes in the law by filing amended returns at the state level to reflect married filing jointly status.

Under current case law and IRS rulings, the term "marriage" does not apply to registered domestic partnerships, civil unions or "other similar formal relationships."

One of the most significant impacts of partial recognition of same-sex marriages for federal purposes was for Social Security purposes which determined marital status based on the law of the state of residence. This meant that a couple legally married in a state which recognized their marriage who retired in a non-recognition state were denied spousal benefits under Social Security.

TAX CONSEQUENCES OF SUPREME COURT AND IRS RULINGS

The right/requirement to file a joint federal tax return for residents of all 50 states

The state where the ceremony was performed is no longer a factor. Married filing separately is the only other filing status option.

A return using the single filing status is no longer an option for married same-sex couples.

Cost of health insurance premiums

An employee's premiums paid by the employer for coverage of a same-sex spouse can now be excluded from income. The spouse can pay health coverage premiums for the same-sex spouse on a pre-tax basis.

Continuation of health coverage for same-sex spouses can be obtained under COBRA if a qualifying event occurs.

Same-sex spouses now have the rights of married spouses in retirement plans

Surviving spouses can rollover inherited IRAs and delay taking distributions until they are age 70½. This can be particularly helpful if there are significant age differences between the spouses.

The beneficiary designation is presumed to be the spouse. A spousal consent is needed if there is a non-spouse beneficiary.

Please see the chapter on retirement plans for more information.

Social Security spousal benefits

One-earner couples can receive a benefit of an extra 50% of the working spouse's retirement benefit. For 2-earner couples, the lower earning spouse can receive his/her benefit plus a spousal benefit to bring the total benefit up to 50% of the higher earning spouse's total benefit.

TAX PLANNING FOR MARRIED SAME-SEX COUPLES

2015 and beyond

Married same-sex couples are required to file as married filing joint or married filing separately. The single filing status is no longer an option! This applies at the state as well as the federal level.

Because the combined income of both parties is considered, there can be significant tax consequences and opportunities for a couple who is now required to file a joint return (or married filing separately). The consequences are a result of the changes due to limitations, phase-outs and increased tax brackets that are based on the total taxable income. The following are a few examples of income tax provisions that should be considered when preparing to file a joint tax return:

- Filing status, tax rate schedules and brackets
- Dependent care credit, elderly and disabled credit, adoption expense credit
- Earned income credit
- AMT exemption and brackets
- Standard deduction
- Level at which itemized deductions begin to phase out
- Social Security inclusion
- Amounts received from health plans and contributions made to a health plan
- Exclusion of gain from sale of principal residence
- Dependent care programs
- Statutory fringe benefits
- Exclusion from certain savings bonds used for education
- Charitable contributions
- Medical expense deduction
- Deductions for contributions to an IRA
- Various provisions of retirement plans, including survivor annuities
- Definition of dependent
- Attribution of participation in connection with passive activities
- Limitation on capital losses
- Gains on sales of depreciable property to a related taxpayer
- Persons required to file income tax returns
- Failure to pay estimated tax

OPPORTUNITY TO CLAIM REFUNDS

There may be an opportunity to file amended returns claiming joint (or married filing separately) status for the any open tax years to receive refunds of taxes if married filing jointly would reduce the tax paid as single filers. Amended returns must be filed within 3 years after the original due date, or if extended, within 3 years after the date the return was filed for federal taxes. Each state has its own statute of limitations. Keep in mind that amendment of prior year returns by spouses now permitted to file jointly may result in a “marriage bonus” for some couples, but others may incur a “marriage penalty,” depending upon the couple’s specific situation.

If a couple decides to amend a tax return for a previous year, they can choose to amend 1 year, 2 years or all open years. They can cherry pick which returns they wish to amend.

GIFT TAX CONSIDERATIONS

Before the repeal of DOMA in 2013, the excludable amount was \$14,000 for 2014 and 2015. Any additional gifts to a same-sex spouse would utilize the transferor’s available lifetime exemption. Since the repeal of DOMA, same-sex married couples are entitled to the unlimited marital deduction. This means they can make tax-free transfers to their same-sex spouse without any gift tax consequences.

Transfers to non-U.S. citizen same-sex spouses do not qualify for the unlimited marital deduction. However, such transfers are eligible for an increased annual exclusion amount (\$147,000 for 2015 and \$148,000 for 2016).

GIFT SPLITTING

Gift splitting allows a married couple to split all gifts made by one spouse and treat the total as if the gift was made one-half by each spouse. Prior to the repeal of DOMA, same-sex couples could not split gifts to take advantage of the double annual exclusion (\$14,000 per person, per donee or \$28,000 per married couple, per donee for 2015 and 2016). The overturning of section 3 of DOMA meant that same-sex married couples could split a gift and treat as if half was made by each spouse.

There may be an opportunity to file amended gift tax returns for the prior years in order to increase the amount of life-time gift tax exemption available for future years. In order to file an amended gift tax return, Form 843 should be filed with the IRS. This should be considered for any open years where a gift tax return was filed and gifts between married parties were treated as taxable gifts.

ESTATE TAX CONSIDERATIONS

The estate tax exemption increased from \$5,430,000 for 2015 to \$5,450,000 for 2016.

An estate will not incur an estate tax for any assets passing outright or in trust for the benefit of a surviving spouse. This defers the payment of any estate tax on these assets until the death of the surviving spouse. The surviving spouse must be a U.S. citizen.

Under DOMA, the assets in excess of the estate tax exemption left to a same-sex spouse were includible in the first estate. This unfairly “double taxed” the assets, as they would be taxed again if the surviving spouse’s estate were in excess of the estate tax exemption.

This basically outlines the case of *United States v Windsor*, which addressed the “differential treatment compared to other similarly situated couples without justification.” The U.S. Supreme Court held that Section 3 of DOMA was unconstitutional in requiring this differential treatment and same-sex couples can now leave assets to their spouse without incurring a federal estate tax liability.

There is an opportunity to file refund claims and get back any excess estate taxes. The IRS has stated that amended estate tax returns can be filed using Form 843.

PORTABILITY

The American Taxpayer Relief Act of 2012 (ATRA) permanently extended the concept of portability for 2011 and beyond. This provision is now available to same-sex couples.

Portability allows a decedent who does not use all of his/her estate tax exemption (\$5,430,000 for 2015 and \$5,450,000 in 2016) at their death to transfer the unused portion of their estate tax exemption to the surviving spouse so that the unused exemption amount can be added to the second spouse’s estate tax exemption.

Portability applies to the unused exclusion amount of the LAST pre-deceased spouse only.

Example: *In 2015, a decedent has \$3.43 million of assets at his/her death. Since the estate tax exemption is \$5.43 million for 2015, there is \$2 million of unused estate tax exemption. This amount can be transferred to the spouse, leaving the survivor with \$7.43 million (\$2 million plus the surviving spouse’s own 2015 applicable exclusion of \$5.43 million).*

For more information on estate and gift tax planning techniques, please see the chapter on gift and estate tax overview.

CONCLUSION

There are many factors that should be considered by same-sex couples when deciding if amended returns are necessary. In addition, tax planning is very important for a newly married couple, as their tax liability could be significantly higher than prior years, when single returns were filed. Same-sex couples should have their income and estate tax plans reviewed as well as their overall financial situation so as to maximize savings.