

NAWJ 36th Annual Conference
October 15-19, 2014
Panel Discussion, "Changing Families, Changing Times"
Tax and Retirement Issues Post-Windsor
Larry Conway, Esq.

I. Income Taxes

A. Application of *Windsor* decision

1. The IRS announced in Rev. Rul. 2013-17 that it would apply place of celebration rule regardless of domicile.
2. All same-sex marriages will file the same as for opposite sex marriages, at least with respect to their Federal returns.

B. Filing Status

1. Legally Married must be Married Filing Joint or Married Filing Separate
2. Registered Domestic Partners, Civil Union, or "Marriage Equivalent" must be Single or Head of Household

C. Community Property State of Domicile- Federal handling

1. Split most types of community income and deductions per IRS Pub. 555
2. Married or RDP the same, although the application of community property rules to RDPs was a fabrication to address the inequality before *Windsor* (How could there be community if there was no relationship?)
3. IRS rules for filing RDP returns in California, Nevada, and Washington are a vivid example of imagination at work

a) Example: Because the IRS concludes that compensation is community income, they conclude that the withholding that occurs must be split between the partners and reported on separate returns. However, regardless of whether estimated tax payments are made from a community bank account, they are not split and must be reported by whomever the estimate was associated with.

b) Example: The IRS dictates that self-employment income, and the associated tax, must be split and reported one-half on each partner's return. However, there exists no such authority in the Internal Revenue Code, and the policy contradicts Social Security Administration rules, which dictate that only an individual engaged in self-employment can be credited with self-employment contributions.

c) None of the creative violations of community property rules would be a problem for married same-sex spouses who typically would file joint tax returns.

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- D. Net operating losses, capital losses, rental real estate losses, miscellaneous
1. RDP's and Civil Unions will generally fare better with respect to a variety of limitations that are more generous when filing as two unrelated people than when filing a joint tax return.
 2. As an example, at smaller levels of income, an individual is allowed to deduct up to \$25,000 of rental losses that would otherwise need to be carried forward. A married couple has the same \$25,000 limitation, but a couple in an RDP or civil union would get \$25,000 each at the Federal level.
- E. Tax Aspects of Divorce
1. Prior to *Windsor*, there were significant problems when applying local law dissolution to couples who were not recognized as married for Federal purposes:
 - a) *No non-taxable divisions of property under IRC Sec. 1041*
 - b) *Alimony taxable but not deductible by the paying party*
 2. These problems will still exist for RDPs and marriage equivalents
 3. Note this problem does not exist when the couple is domiciled in a state that does not recognize the marriage because there would also be no dissolution of marriage
- F. Imputed Income for Married Same Sex Couple Health Care Benefits
1. Employer provided health care benefits are generally excluded under IRC Sec. 106 when provided to an employee, spouse, and dependants.
 2. Prior to *Windsor*, since "spouse" only included opposite sex spouses, any amounts voluntarily paid by an employer or paid under state law requirements were treated as income to the employee.
 3. Since *Windsor* invalidated the restrictive definition of spouse under DOMA amounts paid under such employer health care benefits are now excluded even when paid for a same-sex spouse.
 4. The IRS announced in Rev. Rul. 2013-17 that they would apply a "place of celebration" rule for determining whether individuals would be entitled to refunds of tax paid on the imputed income.
 5. Further guidance as to procedures for both employers and employees to claim refunds was furnished in IRS Notice 2013-61.

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II. Estate and Gift Tax

A. *Windsor* was all about the estate tax marital deduction.

1. DOMA did not recognize same-sex spouses, so even though a couple was married under state or extra-territorial laws, no marital deduction was available to the estate of a deceased spouse.
2. The marital deduction for estate and gift tax purposes is unlimited, so having a recognized marriage is significant for estate planning purposes when the estate is large.
3. The benefit of now being able to transfer a large estate to the surviving spouse with no estate or gift tax only accrues to married couples, not to RDPs or marriage equivalents.

B. In community property states, there is also a benefit that accrues to a same sex couple on the first step by virtue of the income tax basis rules under Internal Revenue Code Sec. 1014

1. Property that is acquired from a decedent automatically receives a basis adjustment to market value at the date of death.
 - a) *This would be applicable to all decedents regardless of marital status.*
 - b) *The adjustment is only to the portion of the property coming from the decedent, so for property owned with a partner or spouse, normally one-half would get the adjustment to market value.*
2. Community property receives an adjustment for 100% of the property, so having property recognized as community can be a huge benefit under Internal Revenue Code Sec. 1014 for community property spouses.
3. Because community property will generally exist only when a couple is domiciled in a community property state, this benefit will only arise when a same-sex couple was married in a state that recognized the ceremony and they are domiciled at death in a community property state.

III. Social Security

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A. As a general rule, even on a joint tax return each person is assessed their own contributions to the Social Security system and is credited with their own earnings, either through W-2 earnings or self-employment tax. Each person then collects Social Security benefits based on their own earnings.

B. Spousal benefits are an exception to the general rule.

1. A surviving spouse can collect all of the retirement benefit applicable to the deceased spouse in lieu of their own.
2. A spouse can also elect to receive one-half of their spouse's benefit after age 62 if it is greater than their own.
3. Medicare eligibility typically requires 40 quarters of earnings credit, but a spouse with insufficient work history can also qualify based on his or her spouse's work credits.

C. Social Security Administration is currently processing claims for same-sex spousal benefits when the applicant is domiciled in a state that recognizes the marriage, but holding the claim when the applicant is domiciled in a state that does not recognize the marriage, because of the way 42 U.S.C. 416 defines a marital relationship.

D. Recognition for Non-Marital Legal Relationships

1. Curiously, 42 U.S.C. 416 works against same-sex couples who married in a state or jurisdiction which recognize it but live in a non-recognition state at time of application, but broadens the ability to receive benefits in a state that does not allow marriage but recognizes other forms such as RDP, civil union, etc.
2. 42 U.S.C. 416(h)(1)(A)(ii) provides that an applicant for survivor benefits who is not recognized as married in the state of application would still be entitled to benefits based on a decedent's record if the applicant would have the same status as a spouse with respect to the inheritance of property of the decedent.
3. Since most states which have Registered Domestic Partnership, Civil Unions, or similar status to marriage provide these same rights to inherit, SSA will process such survivor claims in accordance with SSA GN 00210.004 and provide a table in that notice of such similar recognitions.

IV. Other Federal Retirement Benefits

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- A. FERS and its predecessor CSRS both allow survivor retirement benefits to same-sex spouses, and do not suffer from the same problem as social security which limits to recognition based on the rules of the state of domicile
- B. Thus, Office of Personnel Management began processing claims to provide survivor annuities for same-sex married couples (but not marriage equivalents) once the *Windsor* decision was issued.
- C. Note that under FERS (CSRS), the retired worker receives an annuity. If survivor benefits are elected, the annuity paid to the retired worker will be reduced based on actuarial calculations in order to have sufficient funds to pay the survivor after the retired worker's death.
- D. OPM at least in one case has made a claim for overpayment of benefits based on the original date of marriage even though such date preceded *Windsor*.
Example: Rhonda (RP) was married to her partner of 20 years during the 2008 marriage "window" in California. On July 1, 2009, Rhonda, a Federal employee retired and began collecting a FERS annuity. At that time, Rhonda had no choice but to consider herself unmarried, and collected benefits as a single retiree, a significantly higher amount than a similar married retiree electing benefits for retiree and surviving spouse.
- As a result of the *Windsor* decision, Rhonda applied for a change in benefits to continue to her spouse after Rhonda's death, and was approved. In addition to reducing Rhonda's current monthly benefits, OPM demanded \$30,000 based on the "overpayment" which had occurred since her retirement date. (The overpayment because her benefits since July 1, 2009 were based on the only option provided her under a law found unconstitutional in 2013.)
- Right or wrong decision? (As of July 15, 2014, the decision is under Administrative Appeal)

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V. Private Retirement Plans

A. The IRS announced that all retirement plans covered under Sec. 401(a) and 403(b) of the Internal Revenue Code must be amended to reflect the *Windsor* decision by December 31, 2014, and in operation must reflect the decision after June 26, 2013.

1. This effectively includes all plans other than IRA's, state and local government plans, and some plans of tax-exempt entities.

2. On Sept. 18, 2013, IRS issued Technical Release 2013-04, which indicated that for Federal tax purposes, same-sex couples married in a jurisdiction which recognized the marriage must be treated equally regardless of state of domicile.

3. On April 21, 2014, IRS Notice 2014-19 clarified a number of retirement plan matters, and reflected the due date for plan amendments above.

a) Essentially all plan activities which rely on spouses or marriage such as qualified joint and survivor annuities, spousal rollovers, qualified domestic relations orders, etc. must treat same-sex spouses equally when the state of domicile recognized the marriage after Windsor and prior to Sept. 18, 2013, and regardless of domicile recognition subsequent to Sept. 18, 2013.