

July 1, 2010 | Posted By

[IRS Changes Tax Treatment of Community Property for Registered Domestic Partners](#)

The Chief Counsel of the IRS recently made statements that result in a change in the federal tax treatment of domestic partners registered pursuant to California state law. In two recent pronouncements, the Chief Counsel concluded that registered domestic partners must each report one-half of community income on their federal returns.

Changes in California law that took effect January 1, 2007 treated the earned income of a registered domestic partnership as community property for state income tax purposes. Previously, such income was treated as community property only for state property law purposes, and the IRS had taken the position that a registered domestic partner was required to report all of his or her income from personal services, despite the fact that it was treated as community property under California state law. This created a disparity in the way registered domestic partners were obligated to report their income for federal and state income tax purposes.

The IRS has now reversed their position, viewing the California state law changes as extending full community property treatment to registered domestic partners for federal income tax purposes as well. As a result, registered domestic partners in California must each report one-half of the community property income on their separate federal income tax returns (although they must still file joint returns for such income in California). Among other things, this eliminates the concern that the creation of community property under state law triggers taxable gifts from one partner to the other. But it also means that the IRS can consider the assets of a taxpayer's registered domestic partner when determining the reasonable collection potential of a taxpayer's offer in compromise, since California law provides both partners have an equal interest and liability in the community property.

“Applying the principle that federal law respects state law property characterizations, the federal tax treatment of community property should apply to California registered domestic partners,” the IRS Chief Counsel stated. “Consequently, for tax years beginning after December 31, 2006, a California registered domestic partner must report one-half of the community income, whether received in the form of compensation for personal services or income from property, on his or her federal income tax return.”

The IRS Chief Counsel noted that taxpayers may have filed returns in accordance with prior IRS pronouncements, which based based on prior California law concluded that a registered domestic partner

must report all of his or her income earned from the performance of personal services. Therefore, for tax years beginning before June 1, 2010, registered domestic partners may, but are not required to, amend their returns to report income in accordance with the new guidance.

Although not addressed by the IRS Chief Counsel, the same reasoning should apply to same-sex couples that are legally married in California.

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