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Defense of Marriage Act: What Should Same-Sex Couples Do?

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The Defense of Marriage Act, which denies recognition of same-sex marriages for purposes of administering federal law, has recently been in the headlines. Two new cases, one in Massachusetts and the other in New York, have been filed challenging the constitutionality of Section 3 of the Act. In those jurisdictions, no precedent exists as to whether the issue of sexual-orientation classifications is subject to a rational basis of review or must satisfy some form of heightened scrutiny. In response to those cases, on February 23, 2011, the Attorney General announced that the Justice Department will no longer defend the constitutionality of the Act. The President and the Attorney General concluded that the classification must satisfy heightened scrutiny and therefore as applied to same-sex couples legally married under state law, Section 3 of the Act was unconstitutional. Recently, the law firm that was hired by the Republicans in the House to defend the constitutionality of the Act withdrew. (*Editor Note*: *Tax Insider* readers should note that while the firm withdrew, the actual lawyer quit the firm, but did not withdraw and Congress will continue to defend the Act's constitutionality.) What does this mean with respect to the administration of the tax laws and who does this affect?

Section 3 of the Act

Enacted by Congress in 1996, the Act provides in Section 3 provides 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 of the opposite sex who is a husband or a wife."

Act Binds IRS and Taxpayers

Despite the announcement by the Department of Justice and the White House, the Internal Revenue Service (IRS) still is bound by the Act and will be until Congress repeals the Act or the Supreme Court declares it unconstitutional. As a result, same-sex couples who are legally married in a state providing for same-sex marriages will be unable to file joint federal-income tax returns that result in a lower combined tax:

- To get tax-free employer health coverage for the same-sex spouse;
- To obtain more easily a dependency exemption for the same-sex spouse;
- To utilize the marital deduction by either same-sex spouse to transfer unlimited amounts during life to the other same-sex spouse free of gift taxes;
- To get a marital deduction for the estate of the first same-sex spouse to die for amounts transferred to the surviving same-sex spouse;
- To transfer the deceased same-sex spouse's unused exclusion amount to the surviving same sex spouse; and
- For a surviving same-sex spouse to stretch out distributions from a qualified retirement plan or individual retirement account (IRA) after the death of the first same-sex spouse under more favorable rules that apply for non-spousal beneficiaries (which same-sex spouses presently must use).

How Many Taxpayers Are Affected

It is difficult to quantify how many taxpayers are affected by the Act and the IRS's compliance with it. Today there are six states, as well as 10 foreign countries, that issue marriage licenses to same-sex couples, including Connecticut, Iowa, Massachusetts, New Hampshire, Vermont, and the District of Columbia. California issued licenses for same gender marriages between June 17, 2008 and November 4, 2008, when California's Proposition 8 (Prop. 8)

suspended performance of same-sex marriages. Prop. 8 has been held unconstitutional and a stay has been granted while the Ninth Circuit is considering the case. New York, Rhode Island and Maryland recognize same-sex marriages performed in other states that permit same-sex marriages. Other states such as Hawaii, Illinois, Maine, Nevada, New Jersey, Oregon, Washington and Wisconsin granting similar or the same rights as opposite sex marriages provided domestic partnerships or civil unions are established between same-sex individuals. There were estimated to be approximately 64,000 individuals in same-sex marriages and approximately 175,000 individuals in domestic partnerships or civil unions in 2008 when only three states authorized same-sex marriages and 10 states recognized domestic partnerships. Today, it is estimated that there are more than a million individuals living as same-sex couples.

Current Cases Challenging the Act

There are eleven cases challenging the constitutionality of the Act currently in the federal courts. The following cases including the two mentioned in the Department of Justice's notice are challenging the Act with respect to federal tax laws:

- *Commonwealth of Massachusetts v. U.S. Department of Health and Human Services* (D. Mass.), in which the Commonwealth of Massachusetts is challenging the Act because IRS rules require the inclusion of healthcare-benefit values of same-sex spouses in an employee's income, resulting in the Commonwealth paying additional Medicare taxes;
- *Dragovich v. Department of the Treasury* (N.D. Cal.) in which same-sex couples married in California before Proposition 8, are challenging the Act because long-term-care program excludes coverage of same-sex spouses;
- *Gill v. Office of Personnel Management* (D. Mass) in which same-sex couples are challenging the IRS's denial of their federal income tax returns as amended, to claim joint filing status;
- *Pedersen v. Office of Personnel Management* (D. Conn.) in which legally married same-sex couples from Connecticut are challenging the IRS's denial of their federal tax returns as amended to claim married filing jointly; and
- *Windsor v. United States* (S.D.N.Y.) in which the surviving spouse of a same-sex couple whose marriage was legally recognized in New York is challenging the denial of the marital deduction to the decedent spouse's estate.

What Should Same Sex Couples Do?

As reported by institutional author Amy S. Elliott, married same-sex couples who would benefit from joint filing are being advised to file original returns as "single" or "head of household" and then file amended tax returns as "married, filing jointly" seeking a refund. This will allow the married same-sex couple to take their case to court if the refund is denied or possibly to speed up a refund if in the interim Section 3 of the Act is held unconstitutional. In the interim, the IRS will continue to abide by Section 3 of the Act. Meanwhile the IRS has issued two legal memoranda and a private letter ruling concerning the treatment of community property held by California domestic partners. In that advice, the IRS ruled that:

- Domestic partners should treat their earned income as community property for state law purposes but should report half of their community income on their federal tax returns;
- A domestic partner's assets may be factored into the IRS's calculation of reasonable collection potential in an offer in compromise case; and
- A registered domestic partner must report half the combined income earned by the domestic partners and that the transfer of half of the community property income by one domestic partner to the other does not qualify as a transfer under Section 2501 of the gift tax.

Conclusion

Until Congress steps in or the Supreme Court holds the Act unconstitutional, married same-sex couples will be forced to file separate individual returns, rather than a joint return and file an amended joint income-tax return to preserve their rights. At the same time the IRS will be forced to abide by the Act and to treat married same-sex couples as not married, for purposes of administering and enforcing the federal tax laws.

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