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Married, Filing Jointly? Same-Sex Marriages and New York Taxes

By: *Joseph Lipari and Debra Silverman Herman*

Although New York does not yet permit same-sex marriages,¹ it does recognize same-sex marriages entered into outside New York, in connection with certain legal rights (i.e. divorce, adoption and child custody matters).² With respect to New York taxes, however, same-sex married couples are not treated equivalently to opposite-sex married couples. Most notably, same sex-married couples are unable to file a joint personal income tax return, and as a result, may have a higher burden of tax than their opposite-sex counterparts.

As explained in a recent Advisory Opinion issued by the New York State Department of Taxation and Finance (the "Tax Department"), the primary reason for this disparate treatment is that New York's tax laws are based primarily on federal tax laws, and for federal tax law purposes, same sex marriages are not recognized.³ Unless and until federal legislation is enacted that eliminates the nonrecognition of same-sex marriages for federal tax purposes, a state law change is necessary. Although draft legislation⁴ is currently pending before the New York Legislature that addresses the unequal tax treatment of same-sex and opposite-sex married couples for New York

personal income tax and estate tax purposes, it is unclear when and if such legislation will be enacted. Simply put, the proposed legislation is part of the Executive Budget Bill,⁵ and there is currently no civil union among New York's political bodies that will allow for the passage of a budget.

Federal Defense of Marriage Act

In 1996, Congress enacted the "Defense of Marriage Act" ("DOMA").⁶ DOMA allows the states to deny full faith and credit to marriages of same-sex couples entered into under other states laws.⁷ DOMA also denies marital benefits under federal statutes to same-sex couples, stating:

In determining any 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.⁸

As a result of DOMA, same-sex married couples are not recognized as married under the federal tax laws and are treated as two unmarried individuals. Accordingly, same-sex married couples are not eligible to file a joint⁹ federal income tax return and receive the

same tax advantages (or disadvantages, see below) as opposite-sex married couples.

In September 2009, New York Congressman Jerrold Nadler introduced a bill that would repeal DOMA, the "Respect for Marriage Act of 2009."¹⁰ The legislation was referred to the Subcommittee on the Constitution, Civil Rights, and Civil Liberties.

DOMA And Its Impact on Calculating Federal Taxable Income

On a joint return, married couples compute their tax on a combined basis by adding together their net income and gains and expenses and deductions. As such, the net income of one partner can be netted against the losses and deductions of the other partner.

If a married couple files a joint income tax return, the couple may receive the benefit of certain credits and deductions, which would not be available to single filers. Internal Revenue Service Publication 501,¹¹ explains the consequences when married couples file on a separate basis, stating in part:

Because of . . . special rules, you will usually pay more tax on a separate return than if you used another filing status that you qualify for.

1. Your tax rate generally will be higher than it would be on a joint return.
2. Your exemption amount for figuring the alternative minimum

Joseph Lipari and Debra Silverman Herman are partners in the law firm of Roberts & Holland LLP.

tax will be half that allowed to a joint return filer.

3. You cannot take the credit for child and dependent care expenses in most cases, and the amount that you can exclude from income under an employer's dependent care assistance program is limited to \$2,500 (instead of \$5,000 if you filed a joint return).
4. You cannot take the earned income credit.
5. You cannot take the exclusion or credit for adoption expenses in most cases.
- ...
9. The following credits and deductions are reduced at income levels that are half of those for a joint return: (a) the child tax credit, (b) the retirement savings contributions credit, (c) itemized deductions, and (d) the deduction for personal exemptions.
10. Your capital loss deduction limit is \$1,500 (instead of \$3,000 if you filed a joint return).

In contrast, in certain instances, the federal tax provisions are more favorable for single filers, in particular with respect to provisions that "phase out" above certain income levels. For example, the phase out for itemized deductions is the same whether the return is filed on a joint or single basis.¹² Further, as The New York State Bar Association, Tax Section, highlights in a Report on Tax Issues Relating to Same-Sex Unions (the "NYSBA Report"), "under the phenomenon commonly referred to as the 'marriage penalty, joint filing status has tended to produce a federal benefit when one member of a couple earns significantly more than the other; but to produce a federal detriment (i.e., a higher tax bill) when members of a couple earn substantially equivalent amounts."¹³ (Note that Congress has made efforts to eliminate the marriage penalty, with certain provisions being phased out beginning after 2010). In light of the above, as emphasized in the

NYSBA Report, it is not always advantageous for couples to file on a joint basis. Nevertheless, opposite-sex married couples are provided an option to determine which filing status to use, an option currently unavailable to same-sex married couples.

New York Tax Department Ruling on Same-Sex Married Couples

On May 14, 2008, Governor David Paterson, issued a directive to state agencies instructing them to recognize same-sex marriages legally performed in other states (the "Directive").¹⁴ In particular, the Directive directed state agencies to review and revise their internal policies and regulations to afford "comity and full faith and credit" to marriages of same-sex couples.

On September 21, 2009, a taxpayer petitioned the Tax Department for an Advisory Opinion as to whether marriage to a same sex partner will be recognized for New York personal income tax purposes as a result of the Directive. The Tax Department recently concluded that "since marriage to a same-sex partner is not a marriage for federal income tax purposes, it is not a marriage for New York State personal income tax purposes."¹⁵

The Advisory Opinion explains that under the statutory provisions of the personal income tax law, terms generally have the same meaning as they have for federal income tax purposes, unless a different meaning is clearly required or a specific exception or modification prescribes otherwise.¹⁶ The Advisory Opinion further states that the statutory provision that defines marital status, expressly provides that an individual's marital tax filing status is the same as that individual's marital status for federal income tax purposes (with minor exceptions, such as where one spouse is a nonresident or part year resident of New York, and the other spouse is a resident of New York).¹⁷ Accordingly, as a result of DOMA, the Advisory Opinion concludes that "a marriage to a same-sex partner will not be recognized for purposes of New York personal income tax."

New York Personal Income Tax Treatment of Same-Sex Married Couples

As made clear by the Advisory Opinion, same-sex married couples residing in the state of New York are required to file as single individuals. Since this is the method prescribed by federal law, the preparation of returns on a single basis are easy to prepare—they follow the federal return. In New York, a resident individual computes his New York taxable income starting with federal taxable income and then makes certain New York specific modifications (i.e. additions to and subtractions from federal taxable income) to determine the correct amount of tax.

As at the federal level, one of the major consequences of not being able to file a joint return is the ability to combine each partners income and deductions. However, as noted above, it is incorrect to assume that netting always produces a smaller tax burden. Also, as the NYSBA Report highlights, joint return filers are sometimes in a better position under New York's itemized deduction rules, and sometimes in a worse position—"generalizations are impossible, as the results under the New York formula are heavily fact sensitive."¹⁸

Proposed New York State Legislation

Part R of the Executive Budget Bill (and similar provisions in the Senate Resolution Bill and Assembly Bill) would amend the Tax Law (and City Administrative Code), to provide that marriages recognized in New York, but not recognized by the federal government, would receive the same treatment as other marriages under the Tax Law. The amendments would be effective for tax years beginning on or after January 1, 2010.

Specifically, the legislation would add new sections to the State (and City) Tax Law, that incorporate the concept of a "state recognized marriage" for all taxes imposed under the Tax Law.¹⁹ A "state recognized marriage" means "a marriage recognized by New York state law, including a marriage outside the state recognized under principles of comity."²⁰ More significantly, however,

the law would make clear that the tax liability under the New York State and City income tax, the Estate Tax and Generation Skipping Transfer Tax, must be computed for any state recognized marriage in the same way liability would be computed for any other marriage recognized under federal and state law.²¹ This provision, in effect “decouples” New York’s Tax Law provisions, from the federal provisions, and eliminates the effect of DOMA. Furthermore, the personal income tax provision, discussed above, defining marital status, would be amended to clarify that state recognized same-sex marriages would be recognized under the personal income tax law, notwithstanding the federal tax treatment of such marriages. Specifically, the law, if enacted, would provide as follows:

Individuals in any state recognized marriage shall be treated as married and as ‘husband,’ ‘wife,’ spouse,’ ‘widow’ or other similar term used in this article to indicate marital status to the same extent and in the same way as are individuals in any other legally performed marriage. In applying relevant provisions of the laws of the United States to this article, the terms ‘married,’ ‘wife,’ ‘spouse,’ ‘widow’ or other similar term indicating marital status as used in this article shall include any state recognized marriage, notwithstanding the treatment afforded such individuals under the laws of the United States.

In sum, the effect of these amendments would be to achieve parity between same-sex married couples and opposite sex married couples for New York personal income tax and Estate Tax purposes, including the ability to file a return and compute tax on a joint basis.²² As discussed above, parity may not translate into a lower New York tax bill. The Memorandum in Support of the legislation indicates that “the married filing [joint] income tax filing status would lead to higher tax liabilities.”²³ However, “these higher liabilities would be offset by revenue losses associated with the income tax exclusion for family coverage under employer health plans, and the estate tax marital deduction.”

Recent IRS Memorandum on Community Property

A recent legal memorandum (the “ILM”) issued by the Internal Revenue Service, underscores another significant issue affecting taxpayers in community property states that recognize same-sex marriages.²⁴ In the ILM, the Office of Associate Chief Counsel (Income and Accounting) concluded that a California registered domestic partner, notwithstanding the individual’s inability to file a joint income tax return with his partner as a result of DOMA, must report half of the individual partner’s earned income earned during the domestic partnership since state law con-

siders such income community property, and federal law respects the state law property characterization.

The ILM raises issues for other states that do or do not recognize same-sex marriage. For example, a member of a California registered domestic partnership may own, in his own name, income producing property in New York (or an interest in an LLC that owns such property). Under California and federal law, one-half of the income from the property or LLC must be reported by each of the two registered domestic partners. But what about New York? Does this mean that both of the domestic partners must now file New York nonresident returns or can the domestic partner who does not own the interest in the New York property claim that New York has no nexus to tax him?²⁵ Can New York tax the domestic partner who owns the interest in the property on 100 percent of the income even though such amount is different from the individual’s federal taxable income on which New York’s personal income tax is based? Is the answer different if the state where the property is located is not New York but is instead a state that does not recognize same-sex marriage?

Over time we can expect that a variety of questions will arise that require new thinking.

¹ For purposes of this Article, the term “same-sex marriage” is being used broadly to refer to same sex couples who legally formalize their relationship under state law, whether that legal status is defined as marriage, union, partnership or by some other term.

² See *Martinez v. Monroe County*, 850 N.Y.S.2d 740 (N.Y. App. Div. 4th Dep’t 2008)(ruling in an employee benefit matter that the marriages of same sex couples entered into in other jurisdictions are “entitled to recognition in New York State”); *Beth R v. Donna M.*, 853 N.Y.S.2d 884 (N.Y. Sup. Ct. N.Y. County 2008) (allowing a divorce action to proceed among same-sex spouses). A report issued by The New York State Bar Association, Special Committee on LGBT People and the Law, provides a comprehensive overview of the current treatment of same-sex couples under New York law and recommendations for the type of reform necessary under New York law to ensure that same-sex couples are provided with rights equal to those enjoyed by their opposite-sex counterparts. N.Y.S. Bar Ass’n, Special Comm. on LGBT People and the Law, *Report and Recommendations on Marriage Rights for Same Sex Couples*, May 4, 2009.

³ N.Y.S. Dep’t of Taxation & Fin., Office of Counsel, Advisory Opinion Unit. TSB-A-10(2)I, May 12, 2010 [hereinafter the “Advisory Opinion”].

⁴ S.6610/A.9710-A (the “Budget Bill”).

⁵ *Id.*

⁶ Pub. L. No. 144-199, 110 Stat. 2419 (1996), codified at 1 U.S.C. § 7 and 28 U.S.C. § 1738C.

⁷ Pub. L. No. 144-199, section 2(a).

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- ⁸ Pub. L. No. 144-199, section 3(a).
- ⁹ There are five federal income tax filing statuses: Single, Married Filing Jointly, Married Filing Separately, Head of Household and Qualifying Widow(er) with Dependent Child. To qualify for head of household status, the individual cannot be married.
- ¹⁰ H.R. 3567, 111th Cong. (2009).
- ¹¹ Internal Revenue Service, Publication 501, *Exemptions, Standard Deduction, and Filing Information (For use in preparing 2009 Returns)*, Dec. 18, 2009, available at <http://www.irs.gov/pub/irs-pdf/p501.pdf> (last visited June 9, 2010).
- ¹² See Internal Revenue Code of 1986, as amended, section 68(f).
- ¹³ New York State Bar Association, Tax Section, Report on New York State Tax Issues Relating to Same-Sex Unions, Report No. 1090, June 23, 2005 [hereinafter NYSBA Report].
- ¹⁴ Directive of Governor David Paterson, Memorandum from David Nocenti to All Agency Counsel re: Decision on Same-Sex Marriages, May 14, 2008.
- ¹⁵ Advisory Opinion, *supra* note 3.
- ¹⁶ N.Y. Tax Law 607(a).
- ¹⁷ N.Y. Tax Law 607(b); see also N.Y. Tax Law 611(b).
- ¹⁸ NYSBA Report, *supra* note 13.
- ¹⁹ Budget Bill, *supra* note 4, Part R, section 1.
- ²⁰ *Id.* section 2.
- ²¹ *Id.* section 3.
- ²² To avoid any doubt with respect to the ability to file joint returns, Section 651 of the Tax Law would also be amended to provide that “notwithstanding any other provision of this section, an individual in a state recognized marriage not recognized by federal law shall file a state return using the same filing status that would have been available had such marriage been recognized by federal law.” Budget Bill, Part R, section 4.
- ²³ Memorandum in Support, 2010-2011 New York State Executive Budget Revenue Article VII Legislation, Part R.
- ²⁴ Internal Revenue Service, Office of Associate Chief Counsel (Income Tax & Accounting), ILM 201021050, *California Registered Domestic Partners*, May 5, 2010.
- ²⁵ In the case of California residents, both domestic partners would likely get a full state tax credit in California for payments to New York but other community property states will have lower tax rates or no personal income tax in which case the non property owning domestic partner will have an incentive not to pay tax to the state where the property is located.

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