



TAX CONSIDERATIONS FOR SAME-SEX COUPLES

The pursuit of marriage equality for same-sex couples brings much-needed focus to the everyday needs of gay and lesbian couples. Without full legal recognition and protections, same-sex couples confront a variety of complicated legal and financial issues—not surprisingly tax questions prominent among them. Lambda Legal, with assistance from Merrill Lynch and Numerical LLC, has assembled this general information to assist same-sex couples to obtain professional legal and tax advice specific to their situation. Unless specifically stated, the following information applies only to federal taxation.

***THIS INFORMATION IS NOT LEGAL OR TAX ADVICE. CONSULT A PROFESSIONAL REGARDING YOUR SPECIFIC TAX AND LEGAL OBLIGATIONS.¹**

MARRIAGE:

Federal Income Tax Filings:

The Federal Defense of Marriage Act (“DOMA”) defines marriage for federal purposes as a legal union between one man and one woman. Therefore, the federal government will not respect, for purposes of federal income tax filings, the marital status of a same-sex couple married in Canada, Belgium, the Netherlands, Spain, Massachusetts, or anywhere else in the world. A taxpayer may also face legal liability from filing a tax return that the taxpayer knows to be false or misleading. Same-sex married couples thus face a potential dilemma in filing their federal tax returns. Some tax professionals advise that each member of a married same-sex couple file their tax return singly, but seriously consider disclosing in some way that they are married.² The taxpayer could check the “single” filing status box on the tax form, but place an asterisk next to the box and note on the form or in a cover letter that the taxpayer is married to a same-sex partner and is filing as single in light of DOMA. We have attached a sample disclosure statement for federal tax filings. This approach may help prevent others from using the designation of “single” on a tax return to claim that a person is not legally married if the issue arises in non-tax contexts, such as in connection with applying for a joint mortgage or spousal insurance benefits.

¹ To ensure compliance with Treasury Department regulations, we advise you that information contained in this bulletin was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein. Further, please note that this information pertains to 2006 personal income tax filings and may not apply to future tax filings.

² Marriage to a same-sex spouse may create special legal pitfalls for members of the armed forces and immigrants in the United States. These individuals should seek legal advice from counsel with special expertise in the area, such as Servicemembers Legal Defense Network (www.sldn.org) at (202) 328-3244 or Immigration Equality (www.lgirtf.org) at (212) 714-2904.

State Income Tax Filings:

State tax treatment for same-sex married couples varies by state. Married same-sex couples should consult with local tax practitioners to evaluate their options under state law.

SHARING A FINANCIAL LIFE:

Sharing a financial life means that same-sex partners own most of their assets together, such as a home, bank accounts, investments, etc. Almost any asset may be legally owned jointly by any two U.S. citizens, except retirement accounts. Income or expenses from jointly held assets may be allocated all or in part to either owner's tax return. Income (i.e. interest, dividends, capital gains, etc.) could be shifted to the partner with the lower income, while deductions (i.e. mortgage interest, real estate taxes, capital losses, etc.) might be claimed by the partner in the higher income tax bracket.

Same-sex couples with joint checking and investment accounts need to be careful they don't become subject to Federal Gift Tax. Gift Tax may be applicable if one partner is deemed to give more than \$12,000 per year to the other partner. Consult your tax advisor and financial planner about how to structure your joint accounts.

CHILDREN:

If a same-sex couple has a child, and each member of the couple is a legal parent (biological or adoptive), either may claim the child as a dependent on their federal income tax return. In addition, the presence of a dependent child may entitle the parent to claim HEAD OF HOUSEHOLD STATUS, which is generally more advantageous than filing SINGLE STATUS. The HEAD OF HOUSEHOLD parent must provide more than 50% of the child's support. If a same-sex couple has two children, each partner may be able to claim HEAD OF HOUSEHOLD status by each claiming one child as a dependent. Consult your tax professional on what qualifies as support and eligibility to claim a dependent.

ADOPTION CREDIT:

Taxpayers may claim a federal Adoption Credit of up to \$10,630 for Qualified Adoption Expenses for each eligible child. The credit is phased out for taxpayers with adjusted gross income in excess of \$164,410. The phase-out limitation will disqualify more couples filing joint returns than same-sex couples filing separately with SINGLE STATUS.

CHILD TAX CREDIT:

The federal Child Tax Credit is available to taxpayers with a dependent child. This \$1,000 per child credit phases out when a SINGLE or HEAD OF HOUSEHOLD STATUS taxpayer's adjusted gross income exceeds \$75,000. For JOINT STATUS filers, the credit phases out when adjusted gross income exceeds \$110,000.

HEALTH INSURANCE:

Health insurance benefits to employees, their spouses, and children are considered fringe benefits exempted from federal income tax. Domestic Partner benefits are fringe benefits, but are not expressly exempt in the Internal Revenue Code. For federal tax purposes, but not all states (e.g. California), employers who provide Domestic Partner Benefits are required to report the value of the benefit as taxable income.

PROPERTY

To safeguard shared interest in real property, such as a house, between same-sex partners, titling is vital. If a couple titles the house in a single name only (e.g., one partner owns it outright), upon that partner's death, the house ownership passes as designated in the will of the deceased (assuming the partner had one) and will go through probate. The survivor's right to inherit the house may be subject to contest by other family members.³ Some couples attempt to safeguard against those concerns by sharing title to the house as Joint Tenants with Rights of Survivorship ("JTWROS"). If the house is titled JTWROS, and one partner dies, the other should automatically receive ownership of the house regardless of the will or contestations of outside parties.

However, JTWROS has several negatives for tax treatment that should be taken into account. First, the entire house's value will be considered in the [federal] estate tax calculation. The burden is on the surviving partner to prove contribution to the asset up to 50% of the fair market value of the house. If the survivor cannot prove that having made such a contribution, the entire value will be included in the estate tax calculation and could trigger estate taxes. Second, if the house was not originally titled JTWROS, and the partner with sole title re-titles it to JTWROS, the other partner will have to provide proof of contribution to the asset, or the IRS will look upon the re-titling as a "gift" of half the value of the house, which could trigger gift tax liability.

RETIREMENT ASSETS

In almost all cases regarding retirement income and assets, domestic partners are considered "non-spouse" beneficiaries. This can have serious implications that can impact a couple's retirement plans. The most important of the assets affected are:

1. Social Security benefits – Domestic Partners do not qualify as a "spouse" and thus will not receive a spousal continuation of social security benefits at the death of the first partner.
2. 401k plans – As a non-spouse beneficiary, in most cases, a surviving domestic partner will be required to accept a "lump-sum distribution" of 401k assets from a company plan. This means that the assets are distributed to the surviving partner, in cash, net of all income and estate taxes. This can significantly reduce the value of the assets passed between domestic partners.
3. IRA Distributions – As a non-spouse beneficiary, a domestic partner cannot take advantage of certain distribution options available only to spouses, such as rolling over inherited IRA assets into his or her own IRA.
4. Beneficiary designations – Retirement assets such as IRAs, 401k plans, 403(b) plans etc., provide the owner the ability to select a beneficiary for the assets after death. If the owner does not select a beneficiary, or the selected beneficiary is deceased, the assets will revert to the owner's estate, and be distributed through probate accordingly. If the

³ If the partner should die without a will, depending on state law, the surviving partner may have no rights to inherit the house.

owner does not have the proper documents, the owner's assets may not pass to his/her partner or intended beneficiaries.

SEEK COUNSEL FROM YOUR OWN PROFESSIONAL ADVISORS WHEN MAKING TAX, ESTATE AND/OR FINANCIAL PLANNING DECISIONS.

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Sample Attachment to Federal Tax Return

This form accompanies the federal income tax return for taxpayer _____

The above named taxpayer married a person of his/her same sex in [place] in [year]. (A copy of the marriage certificate is attached.) The taxpayer has not filed as "married" on the federal income tax return and/or filed a joint federal tax return solely because, pursuant to the Defense of Marriage Act, the federal government defines marriage as a legal union between a man and a woman. By filing as "single," the taxpayer is in no way disavowing his/her marriage.

Signature: _____

Date: _____

Social Security #: _____