

Recent IRS Ruling That All Legal Marriages Are Equal For Federal Tax Purposes Impacts Same-Sex Couples And Employers

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The June 2013 United States Supreme Court decision in United States v. Windsor invalidated the portion of the Defense of Marriage Act ("DOMA") that defined "marriage" for federal purposes as the union between a man and a woman. Prior to the Supreme Court's ruling, the Internal Revenue Service ("IRS") took the position that DOMA prohibited it from recognizing same-sex marriages for federal tax purposes. After Windsor, it was clear that same-sex marriages would be recognized for federal tax purposes in jurisdictions that legally recognize them. However, it was not clear how Windsor would impact same-sex spouses living or working in jurisdictions that did not legally recognize same-sex married couples. Therefore, the IRS provided important guidance on this issue in Revenue Ruling 2013-17.

Revenue Ruling 2013-17

In light of the Windsor decision, the IRS concluded in Revenue Ruling 2013-17 ("Ruling") that same-sex couples who were legally married in any jurisdiction that recognizes same-sex marriages will be treated as married for federal tax purposes (including income, gift, and estate taxes) even if they live in a jurisdiction that does not recognize the validity of same-sex marriages.

Thus, even though North Carolina does not recognize same-sex marriages, the Ruling applies to a same-sex couple legally married in another state, such as New York or California, but living in North Carolina.

The Ruling does not apply to registered domestic partnerships, civil unions, or other similar arrangements that may be recognized in a jurisdiction.

Same-sex couples can now enjoy the same federal tax benefits as traditional married couples and may be able to amend previously-filed federal tax returns to claim a refund for tax years that are still open for recalculation under the applicable statute of limitations. The Ruling applies to all federal tax provisions using marriage as a factor including provisions related to filing status and employee benefits. For example, the Ruling applies to the ability to file a joint tax return, which can result in lower taxes for a married couple, and the ability to obtain tax-free employer-provided health insurance to a spouse, which is a major tax benefit.

Impact On Employers

Employers will be impacted even if they only operate in a state such as North Carolina that does not recognize same-sex marriages. Under DOMA, employers withheld and paid employment taxes on certain employee benefits such as health insurance that were provided to an employee's same-sex spouse. These benefits are now excludable from the employee's income and, therefore, not subject to employment tax or withholding. IRS Notice 2013-61 provides special administrative procedures for employers to use to make claims for refunds and payroll adjustments for certain benefits provided to same-sex spouses.

Another example of change will involve employer benefits provided in a qualified plan such as a Section

401(k) plan. Similar to the IRS guidance, the U.S. Department of Labor has announced that it will also recognize legally-married same-sex couples (regardless of their domicile) for ERISA purposes. An employer must now treat a participant who is legally married to a same-sex spouse as married for purposes of the qualified plan (and plan language may need to be revised as a result).

Impact At The State Level

The Ruling raises complicated issues in states such as North Carolina that do not legally recognize same-sex marriages. As previously mentioned, as long as a same-sex couple has a valid marriage certificate from any state, the couple may file a joint federal tax return. The problem is that a taxpayer's state tax return is generally linked to the taxpayer's federal tax return. For example, the North Carolina individual income tax return starts with the taxpayer's federal adjusted gross income to calculate state taxable income. To make the issue even more complex and potentially controversial, the North Carolina Constitution currently provides that "marriage between one man and one woman is the only domestic legal union that shall be valid or recognized in this State," but statutory law often makes reference to the federal tax code and that code now considers same-sex marriages valid. For example, Section 105-153.3 of the North Carolina General Statutes defines a "married individual" as an individual who is married and is considered married as provided in Section 7703 of the Internal Revenue Code.

On October 18, 2013, the North Carolina Department of Revenue ("DOR") released a directive to address the filing status issue. Same-sex couples cannot file a North Carolina income tax return using the filing status of married-filing-jointly or married-filing-separately. Instead, each spouse must file a separate state tax return using the filing status of single, head of household, or qualifying widow(er). In addition, if the couple filed a federal tax return using the filing status of married-filing-jointly or married-filing-separately, the couple must prepare a separate "substitute" federal tax return to use for purposes of preparing the state tax return. The "substitute" federal tax return must reflect a filing status of single, head of household, or qualifying widow(er) and must be filed with the North Carolina tax return. Although the DOR has released guidance addressing filing status, there are other issues that remain unclear. For example, employers may have questions on how to treat benefits coverage for the employee's spouse for state tax purposes.

Conclusion

The IRS has expanded its application of the Windsor decision for federal tax purposes to cover jurisdictions that do not recognize same-sex marriages such as North Carolina. The federal and North Carolina taxing authorities will need to provide additional guidance to address certain unanswered questions. We will continue to monitor rulings and interpretations regarding the taxing of same-sex spouses and provide future updates.

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