

## Tax Bulletin

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### After DOMA: Impacts on Tax and Benefits Planning

***What Federal benefits should be afforded to same-sex spouses as a result of the Supreme Court's decision?***

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The Supreme Court's rulings yesterday in *United States v. Windsor* and *Hollingsworth v. Perry* will have far-reaching legal implications for same-sex couples in the United States.

In delivering the opinion of the Court in *Windsor*, Justice Kennedy stated:

"DOMA undermines both the public and private significance of state-sanctioned same-sex marriages; for it tells those couples, and all the world, that their otherwise valid marriages are unworthy of federal recognition. This places same-sex couples in an unstable position of being in a second-tier marriage. The differentiation demeans the couple, whose moral and sexual choices the Constitution protects, ... and whose relationship the State has sought to dignify. And it humiliates tens of thousands of children now being raised by same-sex couples. The law in question makes it even more difficult for the children to understand the integrity and closeness of their own family and its concord with other families in their community and in their daily lives.

The federal statute is invalid, for no legitimate purpose overcomes the purpose and effect to disparage and to injure those whom the State, by its marriage laws, sought to protect in personhood and dignity. By seeking to displace this protection and treating those persons as living in marriages less respected than others, the federal statute is in violation of the Fifth Amendment."

These words struck down Section 3 of the Defense of Marriage Act ("DOMA"), which defined the word "marriage" at the Federal level to mean only "a legal union between one man and one woman as husband and wife", and the word "spouse" as only "a person of the opposite sex who is a husband or a wife." *Windsor* did not address Section 2 of DOMA, which allows states to refuse to recognize a same-sex marriage legally entered into in another state.

The Court dismissed *Hollingsworth v. Perry* on procedural grounds, stating that the proponents of California's Proposition 8 did not have standing to appeal the lower courts' rulings declaring the proposition unconstitutional. As a result, the United States District Court's ruling stands, and clears the way for same-sex marriage in California (more below). If the Court had found that the supporters of Proposition 8 had standing, it would have had an opportunity to rule on the constitutionality of same-sex marriage bans across the country.

The combined holdings mean that those couples who were legally married in California (before Proposition 8 and after *Hollingsworth v. Perry*), Connecticut, the District of Columbia, Iowa, Maine, Maryland, Massachusetts, New Hampshire, New York, Vermont or Washington (or who will be married in Delaware on or after July 1, or Minnesota or Rhode Island on or after August 1) and reside in one of those states will now be treated as spouses for purposes of over 1,000 Federal laws.

Where a same-sex couple was legally married in one state but now resides in a state that does not recognize same-sex marriage, the couple will not be afforded the benefits of married couples in their state of residence; moreover, as noted by Justice Scalia in his dissent, uncertainty remains as to whether such couple will be considered married for Federal purposes. It is speculated that action by the executive branch may resolve this uncertainty by applying a uniform, Federal agency-wide definition of "marriage" as being determined by the state of celebration, and not the state of residence.

#### Implications for Same-Sex Spouses

Here are some of the Federal benefits that should be afforded to same-sex spouses as a result of the Supreme Court's decision in *Windsor*:

- The ability to pass wealth from one spouse to the other at death without the payment of Federal

estate taxes, thanks to the marital deduction, and the ability to inherit the first deceased spouse's unused estate and gift tax exemption. These changes will have a substantial and favorable impact on the ability to do estate planning for same-sex spouses.

- Deferral of income recognition when a surviving spouse inherits a deceased spouse's IRA or other qualified retirement plan, as the surviving spouse can "roll over" the account to his or her own retirement account, potentially deferring the required dates for distribution.
- The ability for a wealthier spouse to support a less wealthy spouse without the concern of making taxable gifts, as the marital deduction also applies to gifts between spouses.
- Splitting gifts to treat a gift made by one spouse to a third party as having been made one-half by each spouse.
- Simpler Federal income tax returns. Same-sex spouses may file joint Federal income tax returns, with the resulting "marriage penalty" for spouses who both work and have comparable earnings, and resulting benefits for spouses who have disparate earnings or where one spouse is a homemaker.
- Social Security retirement and death benefits, with the greatest benefit going to those couples where only one spouse has been employed.
- A U.S. citizen spouse should be able to sponsor a non-citizen spouse for legal permanent resident status.
- Military same-sex spouses will be eligible for benefits such as health coverage and housing allowances, as well as the right to be buried together at Arlington National Cemetery.

Because the *Windsor* ruling holds that DOMA has been unconstitutional since its inception, same-sex spouses should re-examine their past income, gift and estate tax returns where the statute of limitations has not expired. If filing joint Federal income tax returns would reduce the income tax liability, taxpayers may amend the returns and request a refund. Like the plaintiff in *Windsor*, estate tax refunds may be claimed as well. The flip side is that those same-sex spouses who engaged in sophisticated estate planning to take advantage of the fact that they were not considered spouses at the Federal level (by creating common-law grantor retained income trusts and the like) should immediately revisit their estate plans.

Clients with children or grandchildren who have entered into same-sex marriages should also re-examine their estate plans, as it may be necessary to modify the definitions of "spouse" and "children" or "issue" to ensure the intended beneficiaries will inherit regardless of whether the documents are interpreted in a state that permits same-sex marriage or a state that does not recognize it.

### **Employee Benefits Implications**

The *Windsor* holding will also have a significant impact on the administration of employee benefit plans for same-sex married couples. Eligibility for employee benefit plans has historically been the purview of plan sponsors. However, such plans are generally governed by Federal law, and thus have been prohibited in certain ways from treating same-sex married couples the same as opposite-sex married couples.

With respect to health benefits, this has meant that, although employers may have provided coverage to the same-sex spouses of their employees, such coverage was often not eligible to be paid for on a pre-tax basis. With the reversal of DOMA, employees with same-sex spouses will now be eligible for the Federal tax advantages applicable to spouses. Similarly, same-sex spouses will now be afforded rights under COBRA when their coverage under an employer plan terminates.

The decision will also have an impact on retirement plans. Many legal provisions relating to such plans are tied to the employee's marital status, including notice and distribution rules. Such plans should now have to recognize any same-sex marriage that is valid under state law for these purposes.

### **Implications for California Couples**

It should be noted that, even though it appears likely that same-sex couples will shortly be able to marry in California, the issue remains complicated. California Attorney General Kamala Harris has said that every California county must now recognize the right of same-sex couples to legally marry, and that such marriages will resume as soon as the U.S. Ninth Circuit Court of Appeals lifts its stay on the District Court ruling that declares Proposition 8 unconstitutional in California and requires the state to permit same-sex marriage. The Ninth Circuit has said that it would wait at least 25 days to put the District Court ruling into effect; consequently, Governor Brown has stated that he expects same-sex

marriages to resume in California in about 30 days. However, proponents of Proposition 8 have indicated that they believe the decision in *Hollingsworth* is only applicable to the two same-sex marriages at issue in that case, and they will continue to seek legal enforcement of Proposition 8.

Many practical questions exist as to how the changes mandated by the Supreme Court's far-reaching decision will be implemented. Accordingly, we encourage those same-sex couples, employers and others who may be impacted by the *Windsor* decision to reach out to a member of Venable's **Tax and Wealth Planning** and **Employee Benefits Groups** to determine how to move forward given this significant change in the legal landscape.