

Changes for Lesbians and Gays as a result of Windsor Supreme Court Case



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A recent U.S. Supreme Court decision has changed the rules regarding tax and estate planning for gays and lesbians who have married in the various states and countries that permit same-sex marriages. On June 26, 2013, the Supreme Court issued its decision in the Windsor case, recognizing same-sex marriages in a case that centered on the federal estate tax.

In this case, Edie Windsor and her wife, Thea Spyer, married many years ago in Canada, while both of them were residents of New York. At the time they married, New York recognized marriages performed in other jurisdictions but did not permit same-sex marriages to be performed in New York. Subsequent to their marriage, and before Spyer died, New York decided to allow same-sex marriages to be performed in New York State.

After her wife's death, Windsor filed a federal estate tax return on behalf of the estate. Although the spousal estate tax rate is zero percent, Windsor paid \$363,000 in federal estate taxes, as the federal government did not recognize the marriage.

The federal Defense of Marriage Act, enacted in 1996, defined marriage as being between a man and a woman, and therefore prohibited the recognition of same-sex marriages for federal purposes, even if the marriage had been performed in a jurisdiction that allowed same-sex marriages. Therefore Windsor was required to pay federal estate taxes on the assets she inherited from her wife.

Windsor filed suit, requesting a refund of the \$363,000 tax that she had paid and challenging the constitutionality of a particular section of DOMA. The case eventually reached the U.S. Supreme Court which ruled in June that part of DOMA was unconstitutional, and there was no compelling reason for the U.S. government to discriminate against lesbians and gays who had been married in states and countries where same-sex marriages were being validly performed. Therefore, the court held that Windsor was entitled to a refund of her \$363,000. As a result, the Internal Revenue Service announced it would recognize same-sex marriages for federal estate tax and federal income tax purposes.

New IRS Rules Enacted in Response to the Windsor Case

In the short time since this case was decided, it has been used as the basis for many changes in the benefits being offered through employers as well as tax-law benefits.

- Same-sex spouses of federal employees who had married in a state where those marriages were being validly performed are eligible for the

spousal survivorship benefits on the employee's government pension, heretofore limited to heterosexual married couples. Spouses are eligible for coverage under the employee's health insurance, and could also choose to be covered by life insurance and long term care insurance at the same rates as other spouses. These IRS changes affect not just federal employees but all taxpayers who are in same-sex marriages.

- A same-sex married employee will not be taxed when covering their spouse on their health insurance, and employers should ensure that they do not report this as taxable income on 2013 W-2s.
- Couples who were married in states where same-sex marriages are validly performed will be required to file federal income tax returns as married persons for 2013 and future years, using what is being referred to as a "place of celebration" rule. This means that the same-sex married couple can choose to file a joint federal income tax return or file using the "Married Filing Separately" filing status. In most cases where both individuals have any appreciable income, the couple will pay more federal income taxes compared to the amount they would have paid as single taxpayers, and this is generally true if they are filing jointly or separately.
- The IRS does not require same-sex married taxpayers to amend prior year returns, but the couple can decide to amend all open tax years (generally 2010, 2011 and 2012) if they would benefit. Like other married couples,

same-sex married couples will be able to exclude from income \$500,000 of taxable gain from the sale of a primary residence instead of \$250,000, and this will be especially helpful where the house was owned by only one member of the couple.

- Couples will be able to utilize spousal rollover rules when they inherit pension or retirement funds from their deceased spouse, rolling over the funds into their own name and deferring taxation until the survivor begins taking distributions.
- Windsor's suit also helped change estate planning for same-sex couples, making the process much more straightforward, allowing all married couples to benefit from a zero percent federal estate tax rate for assets inherited from a spouse.

This also means that married same-sex couples will be able to take advantage of the same federal gifting rules that apply to married couples, which permit the gifting limits (currently \$14,000) to be doubled to \$28,000 before being deducted from the \$5.34 million amount of assets that can be owned at the time of death without being subject to any federal estate tax. In addition, same-sex married couples will now be able to take advantage of the "portability" rules, meaning that any portion of the \$5.25 million amount that was not used at the death of the first spouse can be applied at the time of the death of the second spouse if a federal estate tax return is timely filed when the first spouse dies.

The U.S. government has also issued advisories that same-sex marriages will be recognized for both active duty military personnel, as well as veterans, with regard to benefits issues.

A few exceptions

Windsor's suit has not changed the treatment for all federal benefits with regard to same-sex married individuals, and some of these issues are still being evaluated.

Family and Medical Leave Act (FMLA) is still not available to same-sex married couples unless they reside in a state that recognizes same-sex marriages, although some believe this could be challenged in some circumstances. The Social Security Administration has announced that they do not currently recognize "place of celebration" but instead will use state of residency in determining the applicability of social security benefits that could be available to same-sex married couples. This could be problematic if the couple moves or if children are involved.

What does this mean for Pennsylvania residents?

At the time this article was written, 17 states and the District of Columbia as well as various countries permit same-sex marriages and that number is expected to increase. However, Pennsylvania does not currently permit same-sex marriages, having enacted its own version of the Defense of Marriage Act (DOMA), nor does it recognize marriages performed in other states. This means that same-sex married individuals who are Pennsylvania residents will still be subject to a 15 percent inheritance tax rate on any assets inherited at the death of the first spouse. Also, real estate transfer taxes will still apply to any transfer of real property between them. For Pennsylvania income tax purposes, the impact is minimal as the Commonwealth does not treat married returns as "joint" returns, but rather simply allows married taxpayers to file

on one form. Same-sex married taxpayers will be required to continue to file separate returns at the present time.

Several lawsuits have recently been filed in both the federal and Pennsylvania courts challenging the constitutionality of the Pennsylvania DOMA law, and it is possible that the decisions in these cases will overturn Pennsylvania DOMA. If Pennsylvania DOMA is ruled unconstitutional, it is likely that the Commonwealth would be required to recognize marriages performed in other jurisdictions and also grant divorces to same-sex married couples. In some cases, same-sex married couples are unable to get divorced if they are Pennsylvania residents, unless the state or jurisdiction where they were married has enacted special legislation that would permit a non-resident to be divorced under the laws of that "place of celebration" state. These rules are somewhat complicated and impose burdens that are not applicable to different-sex married couples. In some cases, divorce isn't even possible for Pennsylvania residents if the couple's "place of celebration" state does not allow non-residents to divorce in that state. Division of property is also an issue, even in states that permit divorce, as their courts may not have jurisdiction over property disputes, but rather only the divorce itself.

It is difficult to predict how this landscape will change both in Pennsylvania and nationally, and how fast these changes will occur. If you are personally affected by these laws, or if you have family or friends who may be affected, it is essential you begin discussing these important issues as part of managing your legal and tax decisions.