WRMarketplace

An AALU Washington Report

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Thursday, 27 October 2016 **WRM #16-43**

TOPIC: Definitions of Husband, Wife, Spouse, and Marriage – IRS Issues Final Regulations.

MARKET TREND: As gender neutrality grows, the IRS follows suit. Recently-issued final regulations now provide gender-neutral meanings for "husband," "wife," and "spouse" and clarify the definition of "marriage" for income, transfer, and employment tax purposes.

SYNOPSIS: Recently-issued final regulations provide gender-neutral definitions for terms related to marital status. The regulations generally treat same-sex and opposite-sex married couples similarly for federal income, employment, and transfer tax purposes. A marriage (same-sex or opposite-sex) will be recognized for federal tax purposes if it is recognized by the state in which the individuals are married, regardless of where the couple is domiciled. Common law marriages also are recognized for federal tax purposes when entered into in a state that permits such marriages.

TAKE-AWAYS: While it is impossible to change specific provisions throughout the Internal Revenue Code ("Code") and Treasury Regulations to be gender neutral, the final regulations have assigned gender-neutral definitions to the terms "spouse," "husband," "wife," and "husband and wife" to achieve the same result. Note that, while the recognition of same-sex marriage is a significant social change, not all couples aspire to be legally married for tax or other reasons. Any couple in a domestic partnership, civil union, or other relationship that is considering marriage should understand that, from a federal law perspective, marriage can result in the application of the marriage penalty, the reduction of certain deductions, or the potential loss of Social Security benefits from a prior marriage.

PRIOR REPORTS: 14-18; 13-29; 13-28; 13-26.

MAJOR REFERENCES: TD 9785, August 19, 2016; Regs. §301-7701-18 (published and effective September 2, 2016).

Same-sex couples have long struggled for the right to marry and have such marriages recognized under federal and state law. The 2013 Supreme Court decision in United States v. Windsor[1] required the federal government to recognize that same-sex couples legally married under state law are also married for federal law purposes. Then, in 2015, the Supreme Court decision in Obergefell V. Hodges[2] required that all states legalize same-sex marriage. The wide-reaching ramifications of the Windsor and Obergefell decisions include changes to the taxation of same-sex married couples.

To implement the Windsor and Obergefell decisions, the Treasury Department and IRS recently issued final regulations adopting gender-neutral definitions of terms relating to marital status and the meaning of marriage for purposes of income, employment, and transfer taxes.[3] With only a few changes, the final regulations generally mirror the proposed regulations issued in 2015[4] and reflect the holdings in Windsor and Obergefell that same-sex married couples are to be treated the same as opposite-sex married couples for federal tax purposes.

DEFINITIONS OF SPOUSE, HUSBAND, AND WIFE

The final regulations provide for gender-neutral interpretations of the terms "spouse," "husband," and "wife", which are used throughout the Code and Treasury Regulations. Under the regulations, these terms mean an individual who is lawfully married to another individual. Similarly, the term "husband and wife" means two individuals lawfully married to each other.[5]

DEFINTION OF LAWFUL MARRIAGE

For federal tax purposes, the regulations recognize a marriage if that marriage is recognized by the state (or possession or territory of the United States, collectively referred to as a "state") in which the individuals married, regardless of the state of the couple's domicile.[6]

> Example: X and Y, a couple domiciled in Tennessee, are married in Hawaii in a ceremony that is recognized by Hawaii. Their marriage will be recognized for federal tax purposes.

The proposed regulations originally recognized a marriage that was valid in any state, not necessarily the state in which it was entered, which could have produced unintended consequences. For example, an unmarried couple living in a state that did not authorize common-law marriage could have been deemed married for federal tax purposes if any other state recognized their living situation as a common-law marriage. Similar unintended tax consequences could have occurred if any state deemed a couple's registered domestic partnership or civil union to be a marriage.

To avoid these issues, the final regulations modified the proposed definition of marriage to require that it must be valid in the state in which it was entered. The change also gives meaning to the intent of couples who choose not to marry and instead enter into a domestic partnership or civil union.

Foreign Marriages. The final regulations contain a separate rule for marriages entered into in a foreign jurisdiction. Such marriages will be recognized for federal tax purposes if the marriage would be recognized in at least one state, regardless of the couple's domicile.[7]

> Example: T and S, a couple domiciled in Virginia, are married in Canada in a ceremony that is recognized as valid by Canada and California. Their marriage will be recognized for federal tax purposes.

Common Law Marriages. All states have statutes that define the requirements for a valid "civil" marriage in that state – generally, a marriage license recorded in the state and a service performed by an authorized official (such as a minister, justice of the peace, or judge). Several states also authorize so-called "common-law" marriages.[8] While states' laws differ slightly, common-law marriage doctrine generally provides that a couple is considered legally married if they (1) are of age, (2) agree to be married, (3) cohabitate, and (4) hold themselves out to be married to each other. Many states that do not authorize common-law marriage will recognize its validity if entered into in another state.

The preamble to the final regulations makes clear that common-law marriages (whether of same-sex or opposite-sex couples) will be recognized as lawful marriages for federal tax purposes if the requirements for a common-law marriage are satisfied, even if the couple has not obtained a marriage license or fulfilled other statutory requirements.[9]

REGISTERED DOMESTIC PARTNERS AND CIVIL UNIONS

Registered domestic partnerships, civil unions, and similar relationships that are not given the status of marriage under the law of the state where entered are specifically excluded from the definition of marriage in the final regulations. Further, an individual who enters into this type of arrangement is not a spouse, husband, or wife for federal tax purposes.[10]

In the preamble to the final regulations, the Treasury Department and IRS acknowledge that individuals may intentionally enter into non-marital arrangements to preserve certain benefits, such as single taxpayer status for income tax filing purposes, Social Security benefits associated with a prior spouse, and other tax and non-tax reasons. Such individuals have an expectation that their relationship will not be deemed a marriage for federal tax or any other purpose. The preamble also acknowledges that states have intentionally chosen not to designate domestic partnerships, civil unions, and similar arrangements as marriages and, except when prohibited by statute, the IRS has traditionally looked to the states to define marriage.

EFFECTIVE DATE

The final regulations apply to taxable years ending on or after September 2, 2016. The definitions of terms related to marital status for prior periods are set out in Rev. Rul. 2013-17.[11] While Rev. Rul. 2013-17 became obsolete on September 2, 2016, individuals may continue to rely on its guidance as it relates to employee benefit plans and plan benefits (to the extent not modified, superseded, obsoleted, or clarified by subsequent guidance).[12]

APPLICATION TO TRANSFER TAXES

The recognition of same-sex marriage has had a significant impact on legacy planning and the application of transfer taxes on same-sex couples. The following chart illustrates the difference in estate taxes on the death of the first spouse where the entire estate is left to the surviving spouse. For purposes of the example, assume the decedent has an estate of $10,000,000 and leaves the entire estate in trust for the surviving spouse.

	Before Recognition of Same-Sex Marriages	After Recognition of Same-Sex Marriages
Gross Estate	$10,000,000	$10,000,000
Unified Estate Tax Exemption	$5,450,000	$5,450,000
Marital Deduction for Marital Trust (QTIP)	Not Available	$4,550,000
Estate Tax Due	$1,820,000	$0
Amount Passing in Trust for Surviving Spouse	$8,180,000	$10,000,000

Note that the tax results would be the same if the decedent left the assets outright to the surviving spouse rather than in trust; provided, however, that after recognition of same-sex marriages, the entire estate would qualify for the federal estate tax marital deduction and the survivor would be able to use the deceased spouse's unused estate tax exemption amount under the portability rules.

TAKE-AWAYS

- While it is impossible to change specific provisions throughout the Code and Treasury Regulations to be gender neutral, the final regulations have assigned gender-neutral definitions to the terms "spouse," "husband," "wife," and "husband and wife" to achieve the same result.

- Note that, while the recognition of same-sex marriage is a significant social change, not all couples aspire to be legally married for tax or other reasons. Any couple in a domestic partnership, civil union, or other relationship that is considering marriage should understand that, from a federal law perspective, marriage can result in the application of the marriage penalty, the reduction of certain deductions, or the potential loss of Social Security benefits from a prior marriage.

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[1] *United States v. Windsor*, 133 S. Ct. 2675 (2016).
[2] *Obergefell V. Hodges*, 135 S. Ct. 2584.
[3] TD 9785, August 19, 2016.
[4] REG-148998-13, November 9, 2015.
[5] Treas. Regs. §301.7701-18(a).
[6] Treas. Regs. §301.7701-18(b)(1).
[7] Treas. Regs. §301.7701-18(b)(2).
[8] Common law marriages can be entered into in Alabama, Colorado, District of Columbia, Iowa, Kansas, New Hampshire, Montana, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas and Utah.
[9] See also, Revenue Ruling 58-66, 1958 (1 CB 60), treating common law marriage as valid, lawful marriage for federal tax purposes.
[10] Treas. Regs. §301.7701-18(c).
[11] 2013–38 IRB 201.

[12] *See*, Notice 2013–61, Notice 2014–37, Notice 2014–19, Notice 2014–1, and Notice 2015–86.