Chapter 1: Marriage Tax Aspects

Corrections were made to this workbook through January of 2015. No subsequent modifications were made.

According to the IRS, there are more than 200 Code provisions and Treasury Regulations that include the terms "spouse," "marriage," "husband," "wife," and "husband and wife." All of these terms are now interpreted by the IRS as gender neutral.[1] Therefore, all of the **tax provisions** that refer to or relate to marital status apply to married same-sex couples as well as married opposite-sex couples.

The change in federal treatment of same-sex couples and the differences in local recognition create many questions and dilemmas for taxpayers in same-sex unions and their tax advisors. This chapter includes material specifically relevant to same-sex couples within each topic.

U.S. V. WINDSOR AND THE DEFENSE OF MARRIAGE ACT (DOMA)

On June 26, 2013, the U.S. Supreme Court issued a historic ruling in *U.S. v. Windsor*.[2] The ruling declares that the federal government must recognize any same-sex marriages that are valid under state laws. Prior to this ruling, §3 of the Defense of Marriage Act (DOMA) prohibited the federal government from recognizing any same-sex marriage. The Supreme Court ruled that this prohibition is unconstitutional because it violates the equal liberty of persons under the 5th Amendment.

The Supreme Court ruling did not address §2 of DOMA, which permits each state to determine whether it will recognize same-sex marriages performed in other jurisdictions. Therefore, under current law, a same-sex couple who is legally married in one state may be treated as unmarried by another state that does not recognize same-sex marriages.

Same-sex couples residing in states that do not recognize their union can marry in one of the states that do recognize same-sex marriages. These couples will be in the opposite situation of the taxpayer in *Windsor*, whose marriage was recognized by her state of residence but disregarded by the federal government.

Same-sex couples living in states that **prohibit same-sex marriage but allow lesser forms** of legal recognition, such as civil unions, may get married in another state and also register in their home states. For couples seeking the broadest range of marital rights, this may be the best method of securing those rights.

1. Rev. Rul. 2013-17, 2013-38 IRB 201.
2. *U.S. v. Windsor*, 133 S.Ct 2675 (2013).

STATES THAT ALLOW SAME-SEX MARRIAGES

As of the date this book was published, the **District of Columbia** and the following **states recognize same-sex marriages.**[3]

State	Effective Date	Status of Civil Unions
California	June 16, 2008	Suspended on November 5, 2008, then reinstated June 28, 2013
Connecticut	November 12, 2008	Civil unions converted to marriages on October 1, 2010
Delaware	July 1, 2013	Civil unions converted to marriages on July 1, 2014
Hawaii	December 2, 2013 [4]	
Illinois	June 1, 2014 [5]	Couples in civil unions have the option to retroactively convert to marriage
Iowa	April 24, 2009 [6]	
Maine	December 29, 2012	
Maryland	January 1, 2013	
Massachusetts	May 17, 2004	
Minnesota	August 1, 2013	
New Hampshire	January 1, 2010	
New Jersey	October 21, 2013 [7]	
New Mexico	December 19, 2013	
New York	July 24, 2011 [8]	
Oregon	May 19, 2014	
Pennsylvania	May 20, 2014	
Rhode Island	August 1, 2013	
Vermont	September 1, 2009	Civil unions replaced by marriages
Washington	December 6, 2012	

Note. As of the date this material was published, cases were proceeding through the court systems challenging state bans on same-sex marriages for every non-recognition state in the United States.[9] The Supreme Court will ultimately be asked to decide this issue but has not yet announced that it will do so.

3. Except where otherwise noted, information is from *Where State Laws Stand*. [www.freedomtomarry.org/pages/where-state-laws-stand] Accessed on Jun. 16, 2014.

4. *Special Session SB1_HD1*. 27th Legislature, 2013. Hawaii State Legislature. [www.capitol.hawaii.gov/measure_indivSS.aspx?billtype=SB&billnumber=1&year=2013b] Accessed on Nov. 11, 2013.

5. *Illinois Legislature Votes to Legalize Same-Sex Marriage*. Ohlheiser, Abby. Nov. 5, 2013. Yahoo! News. [http://news.yahoo.com/illinois-legalize-gay-marriage-221700365.html;_ylt=AwrTWVXRe4BSnVQAn1fQtDMD] Accessed on Nov 11, 2013.

6. *Unanimous Ruling: Iowa Marriage No Longer Limited to One Man, One Woman.* Eckhoff, Jeff, and Schulte, Grant. Apr. 3, 2009. Des Moines Register. [www.desmoinesregister.com/article/20090403/NEWS/90403010] Accessed on Dec. 5, 2013.

7. *These Are the Next Gay-Marriage Battlegrounds.* Dockterman, Eliana. Nov. 10, 2013. Time Magazine.com [nation.time.com/2013/11/10/these-are-the-next-gay-marriage-battlegrounds/?hpt=hp_t3] Accessed on Aug. 12, 2014.

8. *Marriage Equality in New York City: Questions and Answers for Same-Sex Couples and All Those Who Wish to Marry Here.* Office of the City Clerk, City of New York. [www.cityclerk.nyc.gov/html/marriage/same_sex_couples.shtml] Accessed on Dec. 5, 2013.

9. *Gay Marriage States.* [www.statesthatallowgaymarriage.com/north-dakota-no-longer-the-last-state-with-unchallenged-same-sex-marriage-law] Accessed on Aug. 6, 2014.

FILING STATUS FOR FEDERAL INCOME TAX PURPOSES

In general, a taxpayer's filing status depends on whether they are considered married or unmarried. Except for couples with special circumstances (discussed later in this section), the laws of the state of residence **usually** determine whether taxpayers are:

1. Married,
2. Married but legally separated under a divorce or separate maintenance decree, or
3. Unmarried.

Marital status for tax purposes is determined by the taxpayer's status on the last day of the tax year and applies retroactively to the whole tax year.[10]

FILING STATUSES[11]

There are five filing statuses for federal income tax purposes. **Taxpayers who qualify for more than one status may use the one that benefits them the most.**

1. **Married filing jointly (MFJ).** Taxpayers can choose MFJ as their filing status if they are considered married and both spouses agree to file a joint return. They are considered married if, on the last day of the tax year, they meet **any** of the following tests.
   a. They are married and living together.
   b. They are living together in a common law marriage (if recognized by state law).
   c. They are married and living apart **but not legally** separated under a decree of divorce or separate maintenance. (However, if a taxpayer lives apart from their spouse and qualifies as head of household, the taxpayer is considered unmarried.)
   d. They are separated under an interlocutory (not final) decree of divorce.
2. **Married filing separately (MFS).** Taxpayers who are considered married and who do not qualify for another status may choose to file separate returns. If one of the spouses refuses to file a joint return, the other must file MFS if they do not meet the requirements to use one of the other filing statuses. The following special rules apply to taxpayers who file MFS.
   a. The tax is generally higher than on a joint return.
   b. The exemption amount for figuring the alternative minimum tax (AMT) is half that allowed on a joint return.
   c. The taxpayer cannot take the credit for child and dependent care expenses in most cases, and the amount they can exclude from income under an employer's dependent care assistance program is limited to $2,500 (instead of $5,000 on a joint return). However, if the taxpayers are legally separated or living apart, they may be able to file a separate return and still take the credit. See the Joint Return Test in IRS Pub. 503, *Child and Dependent Care Expenses*, for more information.
   d. They cannot take the earned income credit.
   e. They cannot take the exclusion or credit for adoption expenses in most cases.
   f. They cannot take the education credits, the deduction for student loan interest, or the tuition and fees deduction.

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10. IRS Pub. 501, *Exemptions, Standard Deduction, and Filing Information.*

11. Ibid.

g. They cannot exclude any interest income from qualified U.S. savings bonds that were used for higher education expenses.

h. The capital loss deduction limit is $1,500 (instead of $3,000 on a joint return).

i. The following credits and deductions are reduced at income levels half those for a joint return.

   i. The child tax credit

   ii. The retirement savings contributions credit

   iii. The deduction for personal exemptions

   iv. Itemized deductions

j. If one spouse itemizes deductions, the other cannot claim the standard deduction. If both claim the standard deduction, the basic standard deduction is half the amount allowed on a joint return.

k. If the spouses lived together at any time during the tax year:

   i. They cannot claim the credit for the elderly or the disabled, and

   ii. They must include in income a greater percentage (up to 85%) of any social security or equivalent railroad retirement benefits received.

3. **Head of household (HoH).** To qualify for HoH status, a taxpayer must be either unmarried or considered unmarried on the last day of the year. The taxpayer is **considered unmarried** on the last day of the tax year if they meet **all** the following tests.

   a. They file a separate return.

   b. They paid more than half the cost of keeping up their home for the tax year.

   c. Their spouse did not live in their home during the last six months of the tax year, or the couple is separated under a decree of separate maintenance.[12]

   d. Their home was the main home of a qualifying person for more than half the year or they provided over half of the costs of maintaining a home for a parent.

   e. They can claim an exemption for a qualifying person. If the only reason that they cannot claim the exemption is because the noncustodial parent claims the child using the rules for children of divorced or separated parents, this test is met.

4. **Qualifying widow/widower with dependent child.** Taxpayers are eligible to file 2014 returns as a qualifying widow or widower with a dependent child if they meet **all** the following tests.

   a. They were entitled to file a joint return with their spouse for the year their spouse died. It does not matter whether they actually filed a joint return.

   b. Their spouse died in 2012 or 2013, and the taxpayer did not remarry before the end of 2014.

   c. They have a child or stepchild for whom they can claim an exemption. This does not include a foster child.

   d. The child lived in their home all year, except for temporary absences.

   e. They paid more than half the cost of keeping up a home for the year.

5. **Single.** A taxpayer's filing status is single if they are considered unmarried and they do not qualify for another filing status.

> **Note.** Many governmental websites state that same-sex married couples must file as MFJ or MFS. However, like any couple, one of the spouses may qualify to file as HoH if the couple is physically separated before the marriage is legally terminated.

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12. IRC §7703.

SPECIAL CIRCUMSTANCES

Same-Sex Marriages[13]

Same-sex couples who were legally married in jurisdictions that recognize their marriages are treated as married for federal tax purposes **retroactive to the date of the marriage.** A **jurisdiction** for these purposes includes any **local, state,** or **foreign** government having the legal authority to sanction marriages.

Recognition of same-sex marriages by the IRS began on September 16, 2013. However, taxpayers who wish to amend returns filed prior to that date to reflect their actual marital status may do so, as long as the statute of limitations for the earlier period has not expired. Because there has been a great deal of uncertainty about the rights created by marriage in different jurisdictions, same-sex couples may have entered into legal relationships multiple times with the same partners. For federal tax purposes, the laws of the jurisdiction where the marriage **occurred** control which filing status applies. Accordingly, it is critical for practitioners to establish when the **first legally recognized marriage occurred.**

Same-sex couples residing in states that do not recognize same-sex marriages are still recognized as married for federal tax purposes if they were legally married in another jurisdiction.

Example 1. Pat and Chris are a same-sex couple who have lived in Texas all of their lives. The state of Texas has a constitutional provision that prohibits the state from recognizing same-sex unions. After the state of California started allowing same-sex marriages in 2008, Pat and Chris were married while vacationing in Los Angeles. The marriage was performed on November 3, 2008, and was valid under California laws.

Neither the federal government nor the state of Texas recognized their marriage as valid at the time. Based on the Supreme Court's decision in *Windsor,* the IRS now recognizes the couple as having been married since 2008 even though the state of Texas does not recognize their marriage.

For federal tax returns filed on or after September 16, 2013, Pat and Chris must file as MFJ, MFS, or HoH, if applicable. For returns filed prior to this date, they may amend the returns to change their filing statuses if the statute of limitations is still open.

The effective date of the marriages of residents of Delaware,[14] Illinois,[15] and Washington[16] may be earlier than the date on their marriage certificate. For relationships that were previously recognized as civil unions, the effective date of the marriage might be retroactive to the date the couple entered into a civil union if the state requirements are met.

Example 2. Denise and Kimberly entered into a civil union in Illinois on June 2, 2011. In July 2014, they applied to the county clerk to have their union converted to a marriage under Illinois law. Their marriage is now considered to have occurred in 2011 by both the federal and state governments. They **must** amend their 2013 federal return filed in April 2014 to reflect their retroactive marriage. They may choose to amend their 2011 and 2012 income tax returns (which were filed prior to September 16, 2013) if it is beneficial for them to do so.

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13. Rev. Rul. 2013-17, 2013-38 IRB 201; *Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married under State Law.* Nov. 20, 2013. [www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples] Accessed on Nov. 22, 2013; and *Answers to Frequently Asked Questions for Domestic Partners and Individuals in Civil Unions.* Sep. 19, 2013. [www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions] Accessed on Nov. 15, 2013.

14. *House Bill No. 75.* State of Delaware. [http://legis.delaware.gov/LIS/lis147.nsf/vwLegislation/HB+75/$file/legis.html?open] Accessed on Nov. 11, 2013.

15. 750 ILCS 75/65(b). See Bill Status of SB0010. Illinois General Assembly. [www.ilga.gov/legislation/fulltext.asp?GAID=12&SessionID=85&GA=98&DocTypeID=SB&DocNum=10&LegID=68375&SpecSess=&Session=] Accessed on Nov. 18, 2013.

16. *Notice Regarding Same Sex Marriage and Domestic Partnerships.* Washington Secretary of State. [www.sos.wa.gov/corps/domesticpartnerships/Notice-regarding-same-sex-marriage-and-domestic-partnerships.aspx] Accessed on Nov. 15, 2013.

Common Law Marriages[17]

Taxpayers whose relationship is recognized as a common law marriage are considered married for federal tax purposes. A common law marriage is one in which the participants never entered into a formal marriage under their state's laws, but they have consented to be considered married. The requirements to be considered married under the common law provisions vary by state, but most states that have such provisions require that the couple publicly present themselves as married.

Nine states and the District of Columbia have provisions to allow common law marriages.

1. Alabama
2. Colorado
3. Iowa
4. Kansas
5. Montana
6. Rhode Island
7. South Carolina
8. Texas
9. Utah

If a couple enters into a common law marriage in one of these states and then moves to another state that does not have a provision to recognize common law marriages, the marriage is still recognized by the new state of residence and the federal government.

Annulled Marriages

A court decree of annulment holds that no valid marriage ever existed. Taxpayers who obtain annulments are considered unmarried for the entire period that the marriage purportedly existed. If a couple who obtained an annulment filed joint returns for earlier years, they **must** file amended returns to use the single or HoH status for all tax years that are affected by the annulment and not closed by the statute of limitations for filing a tax return.[18]

Example 3. Richard and Dorthea were married in 2011. They filed joint returns for 2011, 2012, and 2013. In 2014, Dorthea discovers that Richard had lied to her about many things concerning his prior life. Dorthea files for an annulment. If the annulment is granted, Richard and Dorthea must each file amended returns for all three years to change the MFJ returns into separate returns filed as single taxpayers.

Death of a Spouse During the Year

If a taxpayer's spouse died during the year, the deceased person and the survivor are considered married for the whole year for filing status purposes. If the surviving spouse remarries before the end of the tax year, the deceased spouse's filing status will be either MFS or HoH (if qualified).

In subsequent years, if the surviving spouse does **not** remarry, the survivor must file as single unless they have a qualifying child living with them. If the survivor does have a qualifying child and meets the rest of the applicable tests, they may file as a qualifying widow or widower (QW) for two tax years following the year of death and as HoH after that.

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17. *Marriage Laws of the Fifty States, District of Columbia and Puerto Rico.* Legal Information Institute, Cornell University Law School. [www.law.cornell.edu/wex/table_marriage] Accessed on May 4, 2014.

18. Rev. Rul. 76-255, 1976-2 CB 40; see also IRS Pub. 504, *Divorced or Separated Individuals.*

Married Persons Living Apart

If the taxpayers live apart from each other and meet certain tests, they may be considered unmarried even if they are still legally married. If certain tests are met, a taxpayer may be able to file as HoH even if they are not divorced or legally separated. The tests that must be met to be considered unmarried are listed earlier in this section.

Couples Who Are in Civil Unions or Domestic Partnerships

Civil unions and domestic partnerships are legal designations created by various governmental bodies to extend at least some benefits of legal recognition to particular couples under the laws of that jurisdiction without using the word "married." These legal statuses may be available to both same- and opposite-sex couples, depending on the jurisdiction. Couples in **civil unions,** registered **domestic partnerships,** and similar relationships are **not** treated as married for federal income tax purposes.[19]

STATUTE OF LIMITATIONS

The federal **statute of limitations** is generally three years from the date the return was filed or two years from the date the tax was paid, whichever is later.[20] However, the deadline for a married couple to change from filing separate returns to filing a joint return expires three years from the **original due date** of the return **without** regard to extensions.[21] Historically, the IRS has taken the position that this limitation applies in both of the following situations.

- A married person has filed as MFS.
- A married person has erroneously filed a return as single or HoH.[22]

The IRS has not addressed whether it will hold married same-sex couples to this shorter statute of limitations. If a same-sex couple wants to amend returns beyond the normal statute of limitations date, there is an appellate court case that could be used as precedent in making the claim that the statute should not apply. In *Glaze v. U.S.*,[23] the court noted that the couple's **legal marital status was unknown** at the time the returns were filed. This court's ruling specifically addressed **only** the shorter limitation for couples wishing to amend separately filed returns, but the court stated:

> *the limitation period set forth in Section 6013(b)(2) was not applicable to this case because decedent's administrator could not have filed a joint return within the meaning of Section 6013(b)(1) prior to the jury determination that William Currie and June Barrow were married at the time of Currie's death. . .*

The IRS has announced that it will only follow the holding in this case if the taxpayers live in the 5th or 11th circuits.[24] The 5th and 11th circuits include Texas, Louisiana, Mississippi, Georgia, Alabama, and Florida.

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19. Rev. Rul. 2013-17, 2013-38 IRB 201.
20. IRC §6511(a).
21. IRC §6013(b)(2)(B).
22. Rev. Rul. 83-183, 1983-2 CB 220.
23. *Glaze v. U.S.*, 641 F.2d 339 (5th Cir. 1981).
24. Chief Counsel Notice, CC-2006-010. Mar. 02, 2006. [www.irs.gov/pub/irs-ccdm/cc-2006-010.pdf] Accessed on Nov. 17, 2013.

JOINT AND SEVERAL LIABILITY[25]

When taxpayers file a joint income tax return, the law makes both the taxpayer and the spouse responsible for the **entire** tax liability. This is called joint and several liability. Joint and several liability applies not only to the tax liability shown on the return but also to any additional tax liability, interest, and/or penalties that the IRS later assesses. Any additional assessments related to an MFJ return are the responsibility of both taxpayers, even if the additional liability is due to the income, deductions, or credits of just one spouse (or former spouse). Even when the taxpayers have a divorce decree that states which taxpayer is liable for unpaid taxes, the IRS may attempt to collect the debt from either of the taxpayers who filed a joint return.

Married people who did not file joint returns but who lived in community property states may also be held liable for additional taxes, interest, and/or penalties attributable to an item of community income. Community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

Under certain circumstances, a taxpayer may request relief from the joint and several tax liabilities that are attributable to the other spouse. **Form 8857, *Request for Innocent Spouse Relief,* is used to apply for the relief.**

Four types of relief are available.

1. Innocent spouse relief
2. Separation of liability relief
3. Equitable relief
4. Relief from liability for tax attributable to an item of community income

INNOCENT SPOUSE RELIEF

To qualify for innocent spouse relief, all of the following conditions must apply.

1. The taxpayer filed a joint return with the spouse.
2. There is an understatement of tax on the return that is due to erroneous items of the spouse. **Erroneous items** include any income, deduction, credit, or basis omitted from or incorrectly reported on the joint return.
3. The taxpayer can show that when they signed the return they did not know and had no reason to know that the understated tax existed (or was unaware of the extent to which the understated tax existed).
4. Taking into account all the facts and circumstances, it would be unfair to hold the taxpayer liable for the understated tax.

Example 4. Bill and Willamina were married and filed a joint return for 2010. Unbeknownst to Willamina, Bill had unreported gambling winnings of $100,000 in 2010. Bill had "reinvested" the winnings promptly upon receipt and had nothing to show for his efforts. At the time the 2010 return was filed, Willamina was not even aware that Bill had ever entered a gambling establishment.

In December 2011, the couple was divorced. In 2013, Willamina received a notice from the IRS that the tax liability on the joint return was understated due to the unreported income. The notice also included penalties and interest.

Willamina applied for and received innocent spouse relief for the liability after she was able to demonstrate that she had no knowledge of the unreported income.

25. Instructions to Form 8857.

SEPARATION OF LIABILITY RELIEF

The taxpayer may be allowed separation of liability relief for any understated tax shown on a joint return if the spouse with whom they filed the joint return is deceased or the taxpayer and that person:

1. Are now divorced,
2. Are now legally separated, or
3. Have lived apart at all times during the 12-month period prior to the date the taxpayer files for relief.

However, if, at the time the taxpayer signed the joint return, they knew about any item that resulted in part or all of the understated tax, then the request will not apply to that part of the understated tax.

Example 5. Ronald and Margaret were married and filed a joint return in 2010. At the time, Ronald owned a repair shop and Margaret was a homemaker. From his business income, Ronald made monthly deposits into a joint personal account, which Margaret used to pay the household expenses.

In 2012, the IRS selected the return for audit. The stress of the scrutiny made Ronald unbearable to live with, and Margaret moved in with her mother on October 5, 2012.

During the audit of Ronald's sole proprietorship, the IRS found that he had underreported his Schedule C, *Profit or Loss From Business,* income by $200,000 for the year. The IRS assessed taxes, penalties, and interest against both Ronald and Margaret for the full amount owed.

On November 1, 2013, Margaret applied for separation of liability relief. At that time, she and Ron were still fighting over the terms of the divorce in court. The IRS determined that because they lived apart for over 12 months prior to filing for relief, Margaret was eligible to file for relief under this provision. However, the IRS also determined that at least half of the unreported income went to support the couple's joint lifestyle and that Margaret should have known that the income on the return was understated based on the amounts deposited into the personal account that she managed. The IRS only granted Margaret relief from the liabilities related to the income that she was not reasonably expected to know was omitted from the 2010 joint return.

EQUITABLE RELIEF

Equitable relief may be granted when none of the other types of relief apply and the IRS determines that it is unfair to hold the taxpayer liable for the unpaid or understated tax. In October 2013, the IRS issued Rev. Proc. 2013-34,[26] which includes new guidance for evaluating applications for equitable relief. Among other changes, this revenue procedure gives greater deference to the presence of abuse than the previous procedures. The IRS now recognizes that the issue of abuse can be relevant with respect to the analysis of other factors and can negate the presence of certain factors.

Rev. Proc. 2013-34 also liberalized the conditions under which refunds can be issued. In both understatement and underpayment cases, an applicant is eligible for a refund of separate payments they made only when they can show that their own funds were used to make the payment. An applicant is not eligible for refunds of payments made with the joint return, joint payments, or payments that the other spouse made. However, an applicant may be eligible for a refund of their portion of a joint overpayment from another year that was applied to the liability, to the extent that they can show that they provided the funds for the overpayment.

26. Rev. Proc. 2013-34, 2013-43 IRB 397.

The following conditions must be met before the IRS will grant a taxpayer equitable relief.

1. The claim for relief must be timely filed. The determination of a timely filed claim is based on whether the taxpayer is asking to be relieved of unpaid liabilities or requesting a refund of amounts paid.

   a. If the applicant is applying for relief from a liability or a portion of a liability that remains **unpaid,** the request for relief must be made on or before the collection statute expiration date (CSED). The CSED is the date the limitation period on collection of the income tax liability expires under IRC §6502. Generally, that period expires 10 years after the **assessment** of tax, but it may be extended by other provisions of the Code (such as an installment agreement).

   b. Claims for credit or refund of amounts paid must be made before the expiration of the limitation period on credit or refund under IRC §6511. Generally, that period expires three years from the time the return was filed or two years from the time the tax was paid, whichever is later.

Note. This definition of "timely filed" under **condition 1a** is much more taxpayer-friendly than the deadlines imposed under earlier revenue procedures, which were generally limited to two years.

2. The taxpayer and the spouse must **not** have transferred assets between themselves as part of a fraudulent scheme to protect the assets.

3. The nonrequesting spouse must **not** have transferred disqualified assets to the applicant.[27]

   The term **"disqualified asset"** means any property or right to property transferred to the applicant by the other taxpayer if the principal purpose of the transfer was the avoidance of tax or the payment of tax. In general, any transfer that is made within the year before the date of the first letter of proposed deficiency is presumed to have as its principal purpose the avoidance of tax or the payment of tax. The first letter of proposed deficiency for this purpose is the one that gives the taxpayer an opportunity for administrative review in the IRS Office of Appeals. However, this time period does not apply to any transfer pursuant to a decree of divorce or separate maintenance or to any transfer that did not have as its principal purpose the avoidance of tax or payment of tax. Typically, if the nonrequesting spouse transferred disqualified assets to the applicant, relief is only available to the extent that the income tax liability exceeds the value of the disqualified assets.

   However, even if there were a transfer of disqualified assets, the applicant may be eligible for relief if:

   a. The nonrequesting spouse abused the applicant,

   b. The nonrequesting spouse maintained control over the household finances by restricting the applicant's access to financial information, or

   c. The applicant did not have actual knowledge that disqualified assets were transferred.

4. The applicant must **not** knowingly have participated in the filing of a fraudulent joint return.

27. IRC §6015(c)(4)(B).

5. In most cases, the income tax liability from which the applicant seeks relief must be attributable (either in full or in part) to an item of the nonrequesting spouse or an underpayment resulting from the nonrequesting spouse's income. If the liability is partially attributable to the applicant, then relief can only be considered for the portion of the liability attributable to the nonrequesting spouse.

   The IRS will consider granting relief **regardless** of whether the understatement, deficiency, or underpayment is attributable (in full or in part) to the applicant if any of the following exceptions apply.

   a. **Community property.** The attribution is solely due to the operation of community property law. If an item is attributable or partially attributable to the applicant solely due to the operation of community property law, then for purposes of Rev. Proc. 2013-34, that item (or portion thereof) is considered to be attributable to the nonrequesting spouse.

   b. **Nominal ownership.** If the item is titled in the name of the applicant, the item is presumptively attributable to the applicant. However, the presumption is rebuttable.

   c. **Misappropriation of funds.** If the applicant did not know, and had no reason to know, that funds intended for the payment of tax were misappropriated by the nonrequesting spouse for the nonrequesting spouse's benefit, the IRS will consider granting equitable relief although the underpayment may be attributable in part or in full to an item of the applicant. The IRS will consider granting relief in this case only to the extent that the funds intended for the payment of tax were taken by the nonrequesting spouse.

   d. **Abuse.** If the applicant establishes that they were the victim of abuse prior to the time the return was filed, and that, as a result of the prior abuse, the applicant was not able to challenge the treatment of any items on the return or was not able to question the payment of any balance due reported on the return for fear of the nonrequesting spouse's retaliation, the IRS will consider granting equitable relief. The IRS will consider granting the relief even if the deficiency or underpayment was attributable in part or in full to an item of the applicant.

   e. **Fraud committed by nonrequesting spouse.** The IRS will consider granting relief even though the item giving rise to the understatement or deficiency is attributable to the applicant if the applicant establishes that the nonrequesting spouse's fraud is the reason for the erroneous item.

Note. The fraud exception was added by Rev. Proc. 2013-34.

Example 6. Use the same facts as **Example 5,** except that the repair shop was operated as an S corporation with Margaret as the sole shareholder. Therefore, 100% of the unreported income legally belonged to Margaret even though she was not part of the operation of the business. Margaret does not qualify for separation of liability relief because the income is in her name. Under these circumstances, Margaret would ordinarily be held accountable for the income she should have known was underreported. However, she can apply for equitable relief because the business was only nominally in her name.

Example 7. Use the same facts as **Example 6,** except that Ronald was an abusive spouse. Because of the abuse, Margaret was too fearful to question the income reported on their joint return. Under these circumstances, Margaret could be granted full relief from all of the liabilities related to the joint return.

After a taxpayer has proven to the IRS that they meet the preceding conditions, **the IRS evaluates whether the taxpayer is entitled to equitable relief.** Each application for relief is judged on the particular facts and circumstances of the taxpayer's situation. The eight criteria that follow are meant to be a guide for IRS employees, and factors not on the list may also be taken into account by the reviewer. The reviewer is also authorized to give varying weights to the factors based on the circumstances of each request. In addition, Rev. Proc. 2013-34 specifically states that the existence of abuse or financial control may affect how the other factors are considered.

1. **Marital status.** If the applicant is still married to the nonrequesting spouse, this factor is neutral. If the applicant is no longer married to the nonrequesting spouse, this factor weighs in favor of relief. An applicant is treated as no longer married to the nonrequesting spouse only in the following situations.

   a. The applicant is divorced from the nonrequesting spouse.

   b. The applicant is legally separated from the nonrequesting spouse under applicable state law.

   c. The applicant is a widow or widower and is not an heir to the nonrequesting spouse's estate that has sufficient assets to pay the tax liability.

   d. The applicant has not been a member of the same household as the nonrequesting spouse at any time during the 12-month period ending on the date the IRS makes its determination.

2. **Economic hardship.** If a taxpayer will suffer economic hardship if relief is not granted, this weighs in favor of granting the relief. If the applicant will not suffer economic hardship from paying the liability, this factor is neutral.

   An economic hardship exists if satisfaction of the tax liability in whole or in part will cause the applicant to be unable to pay reasonable basic living expenses. The rules used to evaluate this factor are similar to those used to evaluate offers in compromise.[28] The IRS considers an applicant's current income, expenses, and assets. In determining the applicant's reasonable basic living expenses, the IRS takes into account such facts as whether the applicant shares expenses or has expenses paid by another individual.

> **Note.** Under the old procedures, a lack of financial hardship weighed against the applicant.

3. **Knowledge or reason to know.** If the applicant did not know and had no reason to know of the item giving rise to the understatement or underpayment, this factor weighs in favor of relief. If the applicant knew that the tax was understated or not paid, or if the applicant should have known that the tax was understated or not paid, this factor weighs against the applicant. However, in situations in which the applicant was abused or under financial control of the nonrequesting spouse, this factor can weigh in the applicant's favor even though they knew of the understatement or underpayment. Actual knowledge of the item giving rise to the understatement or deficiency is not weighed more heavily than any other factor.

> **Note.** Under the old revenue procedures, actual knowledge weighed against the applicant more heavily than the other factors. Also, the old procedures did not clearly indicate that the existence of abuse or financial control could mitigate knowledge of the understatement or underpayment.

   The following facts and circumstances are among those considered in determining whether the applicant had reason to know of the liability.

   a. The applicant's level of education

   b. Any deceit or evasiveness by the other spouse

28. Rules covering offers in compromise are found in Treas. Reg. §301.6343-1(b)(4).

c. The applicant's degree of involvement in the activity generating the income tax liability

d. The applicant's involvement in business or household financial matters

e. The applicant's business or financial expertise

f. Any lavish or unusual expenditures compared with past spending levels

g. The applicant's knowledge of conditions that would indicate that the nonrequesting spouse was unlikely to pay the tax liability (Such conditions include prior bankruptcies, financial difficulties, past issues with the IRS or other creditors, and general tendencies not to pay bills.)

In cases involving an underpayment of taxes that was reported correctly, the applicant may use the fact that an installment agreement was submitted to show that the applicant reasonably believed that the tax was being paid by the other party. For this to apply, the request for an installment agreement must have been filed by the later of 90 days after the due date for payment of the tax, or 90 days after the return was filed. The request must have included a plan for paying the tax, interest, and penalties in installments large enough to satisfy the liability within a reasonable time. Furthermore, it must not have been unreasonable for the applicant to believe that the nonrequesting spouse would be able to make the payments contemplated in the requested installment agreement.

Note. The installment agreement provision was added by Rev. Proc. 2013-34.

4. **Abuse by the nonrequesting spouse.** If a taxpayer can prove that they signed a joint return under duress, the return is not considered a joint return. The individual under duress is not jointly and severally liable for the tax shown on the return or any deficiency in tax with respect to the return. The IRS must adjust the return to reflect only the tax liability of the individual who voluntarily signed the return, and the liability is determined using the rates for MFS returns.[29]

   An applicant who cannot prove duress may be able to establish that they were the victim of abuse, which should be considered in allowing equitable relief from the tax liability. All the facts and circumstances are considered in determining whether an applicant was abused. Abuse can include physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate the applicant, or to undermine the applicant's ability to reason independently and be able to do what is required under the tax laws. Abuse of the applicant's child or other family member living in the household may also be considered part of the abuse of the applicant. In addition, the impact of a nonrequesting spouse's alcohol or drug abuse is also considered in determining whether an applicant was abused.

5. **Legal obligation.** A divorce or similar decree that assigns responsibility for payment of outstanding tax obligations can be used in evaluating the applicant's request for equitable relief. This factor weighs in favor of relief if the nonrequesting spouse has the sole legal obligation to pay the outstanding income tax liability pursuant to a decree. If the decree shows that the applicant has the sole responsibility of paying the liability, this factor weighs against the applicant.

   This factor is neutral if the decree requires the other spouse to pay the liability but the applicant knew or had reason to know at the time of the decree that the nonrequesting spouse would not pay the income tax liability. This factor is also neutral if the decree assigns responsibility to both parties, if the spouses are not separated or divorced, or if the decree is silent on the issue of outstanding tax liabilities.

   The fact that the nonrequesting spouse has been relieved of liability for the taxes at issue as a result of a discharge in bankruptcy is disregarded in determining whether the applicant has the sole legal obligation.

29. Rev. Proc. 2013-34 references Treas. Reg. §1.6015-1(b), which references Treas. Reg. §1.6013-4(d).

6. **Significant benefit.** If the applicant significantly benefitted from the unpaid or understated tax liability, this factor can weigh against the applicant.[30] A "significant benefit" is any benefit in excess of normal support. For example, if the applicant enjoyed the benefits of a lavish lifestyle, such as owning luxury assets and taking expensive vacations, this factor weighs against relief. If, however, the nonrequesting spouse controlled the household and business finances or there was abuse, then this mitigates this factor so that it is neutral.

   If only the nonrequesting spouse significantly benefitted from the unpaid tax or understatement and the applicant had little or no benefit, or if the nonrequesting spouse enjoyed the benefit to the applicant's detriment, this factor weighs in favor of relief.

   If the amount of unpaid tax or understatement is immaterial so that neither taxpayer received a significant benefit, this factor is neutral.

7. **Compliance with income tax laws.** If the applicant has made a good faith effort to comply with the income tax laws in the taxable years following the year at issue, this weighs in the applicant's favor.

   In cases involving divorced or married taxpayers filing separate returns, the tax years that are considered are those that occurred after the divorce or separation. If the applicant is compliant for those years, this factor weighs in favor of relief. If the applicant is not compliant, this factor weighs against relief. If the applicant made a good faith effort to comply with the tax laws but was unable to fully comply, this factor is neutral. For example, if the applicant timely filed an income tax return but was unable to fully pay the tax liability due to the applicant's poor financial or economic situation, then this factor is neutral.

   In cases in which the applicant remains married to the nonrequesting spouse and they continue to file joint returns together after requesting relief, this factor is neutral if the joint returns are compliant with the tax laws but weighs against relief if the returns are not compliant.

Note. Under the old revenue procedures, subsequent compliance by the applicant was a neutral factor. Under the new procedures, it weighs in favor of granting equitable relief.

8. **Mental or physical health.** The applicant's physical and/or mental health can also be a factor in the evaluation of the application for relief. When evaluating this factor, the IRS considers the nature, extent, and duration of the condition, including the ongoing economic impact of the illness. It is in the applicant's favor if they were in poor mental or physical health:

   a. At the time the relevant return or returns were filed,

   b. At the time the applicant reasonably believed the return or returns were filed, or

   c. At the time the applicant requested relief.

   If the applicant was in neither poor physical nor poor mental health, this factor is neutral.

30. See Treas. Reg. §1.6015-2(d) for more information.

COMMUNITY PROPERTY RELIEF

Taxpayers who are married and live in a community property state must follow community property laws when filing a joint return. Generally, these laws provide that the taxpayer and their spouse are both entitled to half of the total community income and expenses. However, relief from these attribution laws is available under the following conditions.

1. The taxpayer did not file a joint return for the tax year.
2. The taxpayer did not include the item in gross income on their separate return.
3. The income belonged to their spouse or former spouse.[31]
4. The taxpayer can establish that they did not know of, and had no reason to know of, that item.
5. Given all the facts and circumstances, it would not be fair to include the item in the taxpayer's gross income.

INJURED SPOUSE[32]

The Department of Treasury's Bureau of Fiscal Service (BFS), which issues IRS tax refunds, is authorized by Congress to conduct the Treasury Offset Program (TOP). Through this program, a refund or overpayment due to a taxpayer may instead be used to pay one of the following types of debt.

- Past-due child support
- Federal agency nontax debts
- State income tax obligations
- Certain unemployment compensation debts owed to a state

The BFS takes as much of a taxpayer's refund as is needed to pay off the debt and sends it to the appropriate agency. Any portion of the refund remaining after the offset is issued to the taxpayer. All of a joint refund may be taken to satisfy the debt of either one of the taxpayers who file an MFJ return.

The BFS sends the taxpayer a notice if an offset occurs. The notice reflects the original refund amount, the offset amount, the agency receiving the payment, and the address and telephone number of the agency. If the taxpayer believes they do not owe the debt or if they are disputing the amount taken, they must contact the agency receiving the payment. If a notice is not received, the taxpayer may contact the BFS TOP call center at 800-304-3107 or 866-297-0517 (TDD).

If a joint refund is seized and only one of the taxpayers is responsible for the debt, the other taxpayer may request **their portion** of the refund by filing **Form 8379,** *Injured Spouse Allocation*. Form 8379 may be filed with the original joint tax return, with an amended joint tax return, or by itself after an offset notice is received.

If the form is paper filed with a joint return, "INJURED SPOUSE" should be written in the top left corner of the first page of the joint return. The IRS processes the Form 8379 before the offset occurs. However, the IRS warns taxpayers that if the form is filed with an original or amended **joint** return, it may take 11–14 weeks to process the return. For this reason, some taxpayers may file MFS instead of MFJ if the combined taxes are comparable.

31. As attributed under IRC §879(a).

32. *Topic 203 — Refund Offsets for Unpaid Child Support, Certain Federal and State Debts, and Unemployment Compensation Debts*. April 16, 2014 . [www.irs.gov/taxtopics/tc203.html] Accessed on May 22, 2014.

If Form 8379 is filed by itself, it must show both spouses' social security numbers in the same order as they appeared on the joint income tax return. The injured spouse (the one who did not owe the debt) must sign the form. To avoid delays, the instructions must be followed carefully, and all required forms must be attached. Form 8379 should be sent to the Service Center where the original return was filed. It generally takes at least eight weeks for the IRS to process the form.

The IRS computes the injured spouse's share of the joint refund. A taxpayer may inquire whether a nonfederal tax debt is owed and whether an offset will occur by contacting the BFS TOP call center at 800-304-3107 (TTY/TDD 866-297-0517).

> **Example 8.** Alex and Kyrie got married in 2013 and filed a joint return. Alex made $20,000 and had no federal income taxes withheld. Kyrie made $30,000 and had $4,500 of federal income taxes withheld. Their joint federal tax liability was $3,611. They were expecting a refund of $889.
>
> Kyrie was furious when she received the notice that the refund had been taken to pay Alex's unpaid student loans. Their tax preparer advised Kyrie to file the following Form 8379 and to wait patiently for it to be processed. Because all of the withholding was Kyrie's, she is entitled to receive the entire amount of the original refund.

For Example 8

Form **8379** (Rev. Novermber 2012) Department of the Treasury Internal Revenue Service

Injured Spouse Allocation

▶ **Information about Form 8379 and its separate instructions is at *www.irs.gov/form8379.***

OMB No. 1545-0074

Attachment Sequence No. **104**

Part I **Should You File This Form?** You must complete this part.

1 Enter the tax year for which you are filing this form. ▶ 2013 Answer the following questions for that year.

2 Did you (or will you) file a joint return?

☒ **Yes.** Go to line 3.
☐ **No.** **Stop here.** Do not file this form. You are not an injured spouse.

3 Did (or will) the IRS use the joint overpayment to pay any of the following legally enforceable past-due debt(s) owed only by your spouse? (see instructions)

• Federal tax • State income tax • State unemployment compensation • Child support • Spousal support
• Federal nontax debt (such as a student loan)

☒ **Yes.** Go to line 4.
☐ **No.** **Stop here.** Do not file this form. You are not an injured spouse.

Note. If the past-due amount is for a joint federal tax, you may qualify for innocent spouse relief for the year to which the overpayment was applied. See *Innocent Spouse Relief,* in the instructions for more information.

4 Are you legally obligated to pay this past-due amount?

☐ **Yes.** **Stop here.** Do not file this form. You are not an injured spouse.

Note. If the past-due amount is for a joint federal tax, you may qualify for innocent spouse relief for the year to which the overpayment was applied. See *Innocent Spouse Relief,* in the instructions for more information.

☒ **No.** Go to line 5.

5 Were you a resident of a community property state at any time during the tax year entered on line 1? (see instructions)

☐ **Yes.** Enter the name(s) of the community property state(s) ____________.
Skip lines 6 through 9 and **go to Part II** and complete the rest of this form.
☒ **No.** Go to line 6.

6 Did you make and report payments, such as federal income tax withholding or estimated tax payments?

☒ **Yes.** Skip lines 7 through 9 and **go to Part II** and complete the rest of this form.
☐ **No.** Go to line 7.

7 Did you have earned income, such as wages, salaries, or self-employment income?

☐ **Yes.** Go to line 8.
☐ **No.** Skip line 8 and go to line 9.

8 Did (or will) you claim the earned income credit or additional child tax credit?

☐ **Yes.** Skip line 9 and **go to Part II** and complete the rest of this form.
☐ **No.** Go to line 9.

9 Did (or will) you claim a refundable tax credit (see instructions)?

☐ **Yes.** **Go to Part II** and complete the rest of this form.
☐ **No.** **Stop here.** Do not file this form. You are not an injured spouse.

Part II **Information About the Joint Tax Return for Which This Form Is Filed**

10 Enter the following information exactly as it is shown on the tax return for which you are filing this form. The spouse's name and social security number shown first on that tax return must also be shown first below.

First name, initial, and last name	Social security number	If Injured Spouse, check here ▶
First name, initial, and last name shown first on the return: Alex Tribeck	Social security number shown first: 123-45-6789	☐
First name, initial, and last name shown second on the return: Kyrie Tribeck	Social security number shown second: 987-65-4321	☒

11 Check this box only if you are divorced or legally separated from the spouse with whom you filed the joint return and you want your refund issued in your name only . . . . ☐

12 Do you want any injured spouse refund mailed to an address different from the one on your joint return? ☐ **Yes** ☒ **No**
If "Yes," enter the address.

Number and street ____________ City, town, or post office, state, and ZIP code ____________

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 62474Q Form **8379** (Rev. 11-2012)

For Example 8

Form 8379 (Rev. 11-2012) Page **2**

Part III **Allocation Between Spouses of Items on the Joint Tax Return** (see instructions)

Allocated Items	**(a)** Amount shown on joint return	**(b)** Allocated to injured spouse	**(c)** Allocated to other spouse
13 Income: **a.** Income reported on Form W-2	**50,000**	**30,000**	**20,000**
b. All other income			
14 Adjustments to income			
15 Standard deduction or Itemized deductions	**12,200**	**6,100**	**6,100**
16 Number of exemptions	**2**	**1**	**1**
17 Credits (**do not** include any earned income credit)			
18 Other taxes			
19 Federal income tax withheld	**4,500**	**4,500**	
20 Payments			

Part IV **Signature.** Complete this part only if you are filing Form 8379 by itself and not with your tax return.

Under penalties of perjury, I declare that I have examined this form and any accompanying schedules or statements and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Keep a copy of this form for your records	Injured spouse's signature		Date	Phone number (optional)
Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed / PTIN
	Firm's name ►			Firm's EIN ►
	Firm's Address ►			Phone no.

Form **8379** (Rev. 11-2012)

UNRECOGNIZED RELATIONSHIPS VERSUS MARRIAGES

This material uses the word **"unrecognized"** for relationships that the **IRS does not recognize as marriages,** including two single adults cohabiting, a couple in a civil union, and a couple in a domestic partnership. This section explains the tax effects of various Code provisions on couples, depending on their legal status.

THRESHOLDS

A number of Code provisions take effect only after the taxpayer's income reaches certain thresholds. If there were no marriage penalty, all of the thresholds for couples filing MFJ would be twice the thresholds of individuals filing as single. However, several Code provisions impose a **significant tax increase** on married higher-income taxpayers. On the other hand, if a higher-income taxpayer marries a person with low income or no income, the couple realizes a tax decrease.

Tax Brackets

The 2014 marginal tax brackets follow. Note that for tax rates above 25%, the income brackets for couples filing MFJ are less than twice the level of taxpayers filing single.

	Single		MFJ		MFS		HoH	
Tax Rate	**Over**	**Not Over**	**Over**	**Not Over**	**Over**	**Not Over**	**Over**	**Not Over**
10%	$ 0	$ 9,075	$ 0	$ 18,150	$ 0	$ 9,075	$ 0	$ 12,950
15%	9,075	36,900	18,150	73,800	9,075	36,900	12,950	49,400
25%	36,900	89,350	73,800	148,850	36,900	74,425	49,400	127,550
28%	89,350	186,350	148,850	226,850	74,425	113,425	127,550	206,600
33%	186,350	405,100	226,850	405,100	113,425	202,550	206,600	405,100
35%	405,100	406,750	405,100	457,600	202,550	228,800	405,100	432,200
39.60%	406,750		457,600		228,800		432,200	

Overall Limitation on Itemized Deductions

The overall limitation on itemized deductions is often called the Pease limitation.[33] After a taxpayer's income exceeds certain levels, the amount of the itemized deductions that they can claim is reduced. The threshold amounts are based on filing status. For 2014, the thresholds are as follows.[34]

Filing Status	Threshold Amount
Single	$254,200
MFJ and QW	305,050
MFS	152,525
HoH	279,650

The following deductions are **not** subject to reduction.[35]

1. Medical expenses
2. Investment interest
3. Casualty or theft losses
4. Gambling losses

The Pease limitation reduces itemized deductions by the lesser of:

- 3% of the amount of adjusted gross income (AGI) that exceeds the threshold, or
- 80% of the amount of the itemized deductions otherwise allowable.

All other limitations that apply to itemized deductions, such as the 2%-of-AGI limitation, are applied first, prior to the calculation of the Pease limitation.[36]

> **Note.** For an example showing the application of the Pease limitation, see the 2013 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: New Legislation.

33. The Pease limitation is named after Donald Pease, the Ohio congressman who helped develop it. See *Tax Policy Center.* 2010. Urban Institute, Brookings Institution. [www.taxpolicycenter.org/press/press-resources-pease.cfm] Accessed on May 20, 2014.

34. Rev. Proc. 2013-35, 2013-47 IRB 537.

35. IRC §68(b).

36. IRC §68(d).

Personal Exemption Phaseout

For taxpayers whose income exceeds certain thresholds, the amount of personal exemptions that they can claim is phased out. For 2014, the personal exemption amount is $3,950.[37] The phaseout ranges for 2014 follow.[38]

Filing Status	Phaseout Begins	Phaseout Ends
Single	$254,200	$376,700
MFJ and QW	305,050	427,550
MFS	152,525	213,775
HoH	279,650	402,150

The **reduction** of the exemptions equals 2% for each $2,500 (or fraction thereof) that the taxpayer's AGI exceeds the applicable threshold. For MFS taxpayers, the reduction is 2% for each $1,250 (or fraction thereof) by which AGI exceeds the threshold amount.[39] The personal exemption phaseout never reduces the deduction for exemptions by more than 100%.

Note. For an example that shows the application of the personal exemption phaseout, see the 2013 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: New Legislation.

The Net Investment and Additional Medicare Taxes

The 3.8% net investment income tax[40] (NIIT) and the 0.9% additional Medicare tax[41] first became effective for tax years beginning in 2013. Both taxes apply to modified adjusted gross income in excess of the taxpayer's threshold amount. The threshold amount is determined by filing status.

Filing Status	Threshold Amount
MFJ	$250,000
MFS	125,000
Single, HoH, QW	200,000

Note. For more information on the NIIT and the additional Medicare tax, see the 2014 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Affordable Care Act Update.

37. Rev. Proc. 2013-35, 2013-47 IRB 537.
38. Ibid.
39. IRC §151(d)(3).
40. IRC §1411.
41. IRC §3101(b)(2).

Earned Income Credit[42]

The amount of earned income credit (EIC) that a taxpayer qualifies for is based on a combination of factors including the number of children, the amount of earned income received during the year, and the taxpayer's filing status. As shown in the following table, for single taxpayers with one child, the credit is phased out at $38,511 in 2014. However, the credit is phased out for MFJ taxpayers at $43,941. Two single taxpayers who both work and qualify for EIC may see a significant difference in the amount of EIC they receive if they marry.

Number of Children	2014 Maximum EIC	Completely Phased Out Single	Completely Phased Out MFJ
0	$ 496	$14,590	$20,020
1	3,305	38,511	43,941
2	5,460	43,756	49,186
3 or more	6,143	46,997	52,427

Example 9. Jeanette and Edward each have a child who lives with them. Each has earned income of $25,000 in 2014 and no investment income. They will each qualify for over $2,000 of EIC (a total of over $4,000) if they do not marry. However, if Jeanette and Edward get married, their combined income of $50,000 will be greater than the phaseout limitation for a couple filing MFJ with two children; therefore, they would not be entitled to any EIC.

Individual Retirement Arrangement (IRA) Deduction[43]

The IRA deduction is affected by the taxpayer's AGI. If a single taxpayer is covered by a retirement plan at work, the deductible amount of any IRA contribution is phased out when their 2014 AGI is between $60,000 and $70,000.[44] For taxpayers filing MFJ when both are covered by retirement plans, the 2014 phaseout range is between $96,000 and $116,000.

If only one spouse is covered by an employer's retirement plan, the phaseout range is between $181,000 and $191,000. Consequently, if a taxpayer not covered by an employer plan marries a taxpayer with such a plan, it is possible the taxpayer without a plan will no longer be able to deduct a traditional IRA contribution.

Example 10. Teddy and Carrol are two successful models who file as single taxpayers. In 2014, Teddy earns $160,000 and participates in his employer's retirement plan. Therefore, Teddy is ineligible to deduct a traditional IRA contribution. Carrol earns $55,000, is not covered by an employer's retirement plan, and deducts a $5,500 contribution to her traditional IRA.

If Teddy and Carrol get married in 2014, they will have joint income of $215,000. Consequently, Carrol will no longer be able to deduct her contribution to a traditional IRA because the couple's joint income exceeds the top phaseout amount of $191,000.

42. *Preview of 2014 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates.* Dec. 30, 2013. [www.irs.gov/Individuals/Preview-of-2012-EITC-Income-Limits,-Maximum-Credit--Amounts-and-Tax-Law-Updates] Accessed on May 22, 2014.

43. IRC §219(g)(3)(B).

44. *IRS Announces 2014 Pension Plan Limitations; Taxpayers May Contribute up to $17,500 to Their 401(k) Plans in 2014.* Oct. 31, 2013. [www.irs.gov/uac/IRS-Announces-2014-Pension-Plan-Limitations;-Taxpayers-May-Contribute-up-to-$17,500-to-their-401(k)-plans-in-2014] Accessed on Jun. 17, 2014.

Roth IRA Contribution[45]

Taxpayers whose income exceeds certain thresholds may not make contributions to Roth IRAs. For a taxpayer filing as single or HoH, the phaseout range in 2014 is $114,000 to $129,000.[46] For taxpayers filing as MFJ, the phaseout range is $181,000 to $191,000.

Example 11. Use the same facts as **Example 10.** Teddy will not qualify to make a Roth IRA contribution in 2014 regardless of whether he and Carrol get married. Carrol can make a Roth IRA contribution if she remains single but will not be able to make a Roth IRA contribution if they get married, because their combined income of $215,000 exceeds the top of the MFJ phaseout range.

HEAD OF HOUSEHOLD FILING STATUS

Generally, married taxpayers file as MFJ or MFS. Taxpayers in unrecognized relationships generally file as single or HoH. To file as HoH, a taxpayer must meet the tests discussed earlier in this chapter, including being "considered unmarried."

When a couple is in an unrecognized relationship, one of the taxpayers may qualify to file as HoH despite the fact that the couple cohabitates. If one of the taxpayers qualifies as HoH, getting married will most likely increase the couple's combined federal income taxes.

Example 12. Kay and Jean joined in an Illinois civil union in January 2013. They each earned $40,000 in 2013. Jean has a 17-year-old son, Justin, from a previous relationship. The three of them live in Jean's home.

Kay and Jean choose to have their civil union **retroactively** converted to a marriage in June 2014. They **must** amend their 2013 federal tax returns to reflect their legal status as a married couple. The federal income tax cost of amending the returns is $614, as shown in the following table.

	Kay (Single)	Jean (HoH)	Combined	MFJ
AGI	$40,000	$40,000	$80,000	$80,000
Standard deduction	(6,100)	(8,950)	(15,050)	(12,200)
Exemptions	(3,900)	(7,800)	(11,700)	(11,700)
Taxable income	$30,000	$23,250	$53,250	$56,100
Tax	4,058	2,854	6,912	7,526
Combined tax in unrecognized relationship				(6,912)
Federal tax cost of being in a recognized marriage				$ 614

Note. People in unrecognized relationships may not use their partners to qualify for HoH status. "Significant other" is not one of the specified related individuals in IRC §§152(c) or (d) that qualifies the taxpayer to file as HoH.

45. IRC §219(g)(3)(B).

46. *IRS Announces 2014 Pension Plan Limitations; Taxpayers May Contribute up to $17,500 to Their 401(k) Plans in 2014.* Oct. 31, 2013. [www.irs.gov/uac/IRS-Announces-2014-Pension-Plan-Limitations;-Taxpayers-May-Contribute-up-to-$17,500-to-their-401(k)-plans-in-2014] Accessed on Jun. 17, 2014.

QUALIFYING CHILD

The following five tax benefits are directly tied to having a qualifying child.

1. Dependency exemption
2. Child tax credit
3. EIC
4. HoH filing status
5. Child and dependent care credit

Note. For more information about the definition of a "qualifying child," see the 2011 *University of Illinois Federal Tax Fundamentals,* Chapter 3: Filing Status and Dependency Exemptions. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

Caution. The preceding five tax benefits cannot be individually separated. Generally, each qualifying child can only be used by one taxpayer, even if the taxpayer does not qualify for all of the benefits.

The benefits can **only** be divided to allow the **noncustodial** parent to claim the dependency exemption and child tax credit. Two parents living together cannot divide the benefits, even if one has legal custody and the other is legally considered the noncustodial parent.

A number of tax benefits require that the taxpayer be eligible to claim the dependency exemption for the child in order to qualify for the tax benefit. For example, the education credits are tied to the dependency exemption.

There are four core tests that must be met to be a **qualifying child** under each of the five tax benefits.[47] Each benefit also has additional requirements. The taxpayer must be able to answer "yes" to each of these tests in order for the child to be a qualifying child.

1. **Residency test.** Did the child live with the taxpayer for more than six months of the year? Alternatively, for purposes of the dependency exemption and child tax credit, has the noncustodial parent received Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent?*
2. **Relationship test.** Is the child the taxpayer's son, daughter, stepchild, adopted child, or foster child? Or is the child the taxpayer's sibling or stepsibling? Or is the child a descendant of any of these?
3. **Age or disability test.** Is the child under age 19, under age 24 and a full-time student, or totally and permanently disabled?
4. **Joint return test.** Has the child filed a joint return for the tax year in question? If so, did the child only file to claim a refund of taxes withheld?

If both taxpayers are the child's parents and the parents do not file a joint return, either parent may claim the child for the benefits connected with the child. If a child is a qualifying child of more than one person, the parent has the priority right to claim the child on their tax return over another relative such as a grandparent.

Note. See IRC §152(c)(4)(B) for the tie-breaker rules if both parents claim the same qualifying child on their separate returns.

47. IRC §152(c)(1).

As indicated under the second test, **stepchildren** are considered related to a taxpayer.[48] This is true even after the marriage has ended due to the death of the biological parent or divorce from the biological parent.[49] The IRS defers to the definition of stepchild under state law to determine whether a child is related to a nonbiological parent when the parents are in an unrecognized relationship.[50]

The IRS's position regarding stepchildren is highly favorable to taxpayers in federally unrecognized unions whose relationships **are recognized by their state** of residence. These taxpayers are considered unmarried for federal tax purposes and typically file two returns. Using the state's definition of stepchildren may allow these taxpayers to maximize the tax benefits associated with a qualifying child in a way that married taxpayers cannot.

Example 13. Emily and Peter entered into a civil union in Illinois in 2013. Emily's daughter, Robin, became Peter's stepdaughter under Illinois law at the time of the union. They were intrigued to learn that the IRS would recognize Robin as Peter's stepchild despite not recognizing the union as a marriage.

When filing their 2013 tax returns, Peter and Emily completed both of their returns to compare who would receive the highest tax benefit from claiming Robin. Emily's 2013 income was significantly higher than Peter's. If she claimed Robin on her return, she qualified for the HoH filing status, Robin's exemption, the dependent care credit, and the child tax credit. However, her income was too high to qualify for the EIC.

If Peter claimed Robin on his return, he qualified for Robin's exemption, the dependent care credit, the child tax credit, the additional child tax credit, and the EIC. Peter did not qualify as HoH because Emily provided over half the costs of keeping up the home.

Observation. A taxpayer who is considered a stepparent in one state due to the taxpayer's unrecognized relationship with the biological parent in that state may not be considered a stepparent if they move to another state. This is one reason why many legal professionals advise same-sex couples to secure the parental rights of both parties through legal adoption of the child by the nonbiological parent.

Dependency Exemption for Children of Divorced or Separated Parents

General Guidelines.[51] Although the five tax benefits tied to the definition of qualifying child require that the child live with the taxpayer, the custodial parent may allow the noncustodial parent to claim the dependency exemption and child tax credit. If otherwise qualified, the custodial parent may still file as HoH and claim the EIC and child and dependent care credit. This provision applies only when the parents are actually divorced or separated. If the parents are cohabiting, the five benefits may not be split between two returns.

Example 14. Dean and Gail were divorced in 2010. Together, they provided over half of the support of their daughter, Rachel, in 2013. Gail qualified as the custodial parent because Rachel spent more nights at Gail's house than at Dean's house that year.[52] Gail filed as HoH and claimed the EIC. Gail gave Dean a signed Form 8332, releasing the right to claim Rachel's exemption for 2013.

Same-Sex Parents. Prior to the Supreme Court's decision in *Windsor*, DOMA prevented the same-sex spouse of a biological parent from automatically being recognized as a parent to the child. Only those who took additional legal steps to have the nonbiological parent recognized as the child's parent were legally recognized as parents for tax purposes.

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48. IRC §152(f)(1)(A)(i).

49. IRS Pub. 501, *Exemptions, Standard Deduction, and Filing Information.*

50. *Answers to Frequently Asked Questions for Domestic Partners and Individuals in Civil Unions.* Sep. 19, 2013. [www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions] Accessed on Nov. 18, 2013.

51. IRC §152(e)(2).

52. Treas. Reg. §1.152-4(d)(1).

If a couple separated and the extra legal steps had not been taken, the nonbiological noncustodial parent could not claim the dependency exemption for the child, even if the custodial parent agreed to release the exemption. This was true regardless of the amount of support the noncustodial parent provided.

Because children born in wedlock and stepchildren are now considered legally related to both same-sex parents even after a divorce or separation, it might be beneficial for taxpayers who were previously married to amend their returns to allow the noncustodial parent to claim the dependency exemption and related tax benefits.

Example 15. Allen and Matthew were married in Iowa in 2010. In 2011, they had a son, Justin, using a surrogate mother to carry the child. Matthew is the biological father. Allen did not adopt Justin. In 2012, the couple divorced.

Under the terms of their divorce agreement, Allen paid alimony and child support to Matthew, who did not work in 2012. On his 2012 return filed in April 2013, Allen could not deduct the alimony payment because the federal government did not recognize Matthew as a former spouse.[53] Allen was also not allowed to claim Justin as a dependent, because the federal government did not recognize Allen as Justin's parent.

However, post-DOMA, Justin is considered Allen's child because he was born while Allen and Matthew were married. Allen may amend his 2012 return to claim the alimony payments. He may also amend his return to claim Justin's dependency exemption and the child tax credit after he has obtained a signed Form 8332 from Matthew.

Earned Income Credit

The EIC is a significant tax credit for many taxpayers. As mentioned earlier in this chapter, the credit can be as high as $6,143 for the 2014 tax year for taxpayers with three or more qualifying children.[54] The amount of the credit varies depending on the income of the taxpayer, the number of qualifying children, and the filing status of the taxpayer. MFS taxpayers cannot claim the credit.

Typically, when an unmarried person who has been receiving the EIC marries, the combined income of the newly married couple reduces or eliminates the amount of EIC the couple receives compared to the amount previously received. The difference can be substantial.

Example 16. Alana and Tim are cohabiting; they have not formed any type of legally recognized relationship. Alana has three children from a previous relationship. The following table compares the projected differences in the 2014 tax results if Alana and Tim remain unmarried versus if they marry.

	Alana (HoH)	Tim (Single)	Unmarried (Combined)	Married (MFJ)
Wages	$20,000	$20,000	$40,000	$40,000
Standard deduction	(9,100)	(6,200)	(15,300)	(12,400)
Exemptions	(15,800)	(3,950)	(19,750)	(19,750)
Result	($ 4,900)	$ 9,850	$ 4,950	$ 7,850
Taxable income	$ 0	$ 9,850	$ 9,850	$ 7,850
Income tax	$ 0	$ 1,028	$ 1,028	$ 788
Nonrefundable child tax credit	0	0	0	(788)
EIC	(5,680)	0	(5,680)	(2,612)
Refundable child tax credit	(2,550)	0	(2,550)	(2,212)
Net taxes (refunds)	($ 8,230)	$ 1,028	($ 7,202)	($ 4,824)
Combined refund in unrecognized relationship				7,202
Net tax increase if married				$ 2,378

53. IRC §71(b)(1)(A).

54. Rev. Proc. 2013-35, 2013-47 IRB 537.

Couples in unrecognized relationships with children who are biologically or legally related to both taxpayers can maximize the amount of EIC they receive. Assuming that both parties agree, the couple may decide which children to claim on each return in a way that maximizes the total tax benefits related to those children.

The IRS decision to recognize the states' definitions of stepchild for couples in domestic partnerships and civil unions may be one of the most important factors to consider for couples in unrecognized relationships. It has significant tax ramifications for couples considering amending their prior returns or considering marriage.

Example 17. In 2005, Kim and Dee decided to have a child. Dee gave birth to Ben later that year. Kim did not adopt Ben despite the fact that she was a stay-at-home mom to him from 2005 through 2009. In 2010, Ben started preschool and Kim went back to work part-time. She earned $13,000 in wages during 2010 and had no other income. Dee earned $50,000 in 2010.

Because they were not in a legally recognized relationship, Dee and Kim filed separate returns for 2010. Dee claimed Ben as a qualifying child for the HoH filing status, the dependency exemption, and the child tax credit. She did not qualify for the EIC. Her total federal taxes were $3,151 after the making work pay credit.

For 2010, Kim filed as single with no dependents. She was not related to Ben, and therefore could not claim him as a qualifying child. She received a $65 refund due to the making work pay credit and the EIC for people with no children.

Dee and Kim's combined federal taxes for 2010 were $3,086 ($3,151 − $65).

Observation. If they were married for federal tax purposes in 2010 and filed a joint return, their taxes would have been $3,464.

Example 18. Use the same facts as **Example 17,** except that Dee and Kim enter into an Illinois civil union in 2011. Under Illinois law, they have all the rights and responsibilities of a couple joined in marriage, except the right to use the word "married."

At the time they filed their 2011 returns, they did not know that the IRS would consider Ben related to Kim. They filed their returns in the same manner as they had the previous year.

The federal taxes on their original returns for 2011 totaled $3,815 ($3,511 for Dee and $304 for Kim).

After learning that the IRS will recognize Ben as Kim's stepchild for federal tax purposes, Kim and Dee discussed their 2011 returns when they visit their CPA during the 2013 filing season. He told them that Ben can only be a qualifying child on one tax return.

On an amended 2011 return, Dee did not claim Ben as a qualifying child. Consequently, she cannot use the HoH filing status, nor can she claim his exemption or the child tax credit. **Her revised federal taxes are $6,256.**

On Kim's amended 2011 return, she claims Ben's exemption and the refundable child tax credit. She also qualifies for the EIC. She cannot file as HoH because Dee provided over half of the costs of maintaining the home during the tax year. Her revised return shows an overpayment of $4,094. By filing an amended return, she receives a refund of the $4,094 plus the $304 she paid with the original return.

After amending their returns, Kim and Dee realize a net tax savings of $1,653, as shown in the following table.

	Dee	Kim	Total
Revised tax liability	$6,256	($4,094)	$2,162
Less: 2011 taxes on original return	(3,511)	(304)	(3,815)
Net tax increase (decrease)	$2,745	($4,398)	($1,653)

Observation. If Kim and Dee were married for federal tax purposes in 2011 and filed a joint return, their 2011 taxes would have been $4,199. This is $2,037 ($4,199 − $2,162) more than their net taxes for the year as a couple in a civil union.

Example 19. Use the same facts as **Example 18,** except that Dee and Kim had another child, Amelia, in 2012. According to Illinois' civil union law, Amelia is recognized as the child of both Dee and Kim. Their incomes are the same as in the previous year. Their original returns for 2012 showed the following.

- Dee filed as HoH and claimed **both** children as qualifying children for purposes of the dependency exemptions and child tax credit. Her net taxes were $1,869, which she paid on April 15, 2013.
- Kim filed as single and did not claim either of the children. Her net taxes were $255 after taking the EIC for a single person. She also paid her taxes on April 15, 2013.
- Their combined federal taxes on their original returns totaled $2,124.

Based on the new guidance from the IRS, their CPA, Betsy, recalculates their 2012 returns two more times. In the first iteration, Betsy shifts Ben's exemption and associated benefits to Kim's return. Betsy calculates the following results.

- Dee can file as HoH claiming only Amelia as a qualifying child. She can claim one dependency exemption and $1,000 of child tax credit. Her net taxes would be $3,439.
- Kim can file as single claiming Ben's dependency exemption, the EIC for one child, and the refundable child tax credit of $1,000 for one child. Her net taxes would be an overpayment of $4,169. (Kim cannot file as HoH because Dee provides over half of the household expenses.)
- Their total combined taxes would be an overpayment of $730. This is a decrease in tax of $2,854 from the original returns ($2,124 + $730).

First Iteration

	Dee	Kim	Combined
Revised tax due/(refund)	$3,439	($4,169)	($ 730)
Less: 2012 taxes on original return	(1,869)	(255)	(2,124)
(Overpayment)/ additional tax due on amended return	$1,570	($4,424)	($2,854)

In the second iteration, the CPA moves both Ben's and Amelia's exemptions and associated benefits to Kim's return. This yields the following results.

- Dee would have to file as single with no dependents. She cannot file as HoH because she does not have a qualifying child. Her total taxes due would be $6,099.
- Kim can file as single and can claim both dependency exemptions, the EIC for two children, and the refundable child tax credits totaling $2,000 for both children. She cannot file as HoH because Dee pays more than half of the household expenses. Her net taxes would be an overpayment of $6,710.
- Their new combined taxes total an overpayment of $611. This is a decrease in tax of $2,735 from the original returns ($2,124 + $611).

Second Iteration

	Dee	Kim	Combined
Revised tax due/(refund)	$6,099	($6,710)	($ 611)
Less: 2012 taxes on original return	(1,869)	(255)	(2,124)
(Overpayment)/ additional tax due on amended return	$4,230	($6,965)	($2,735)

Dee and Kim choose to amend their 2012 returns to shift only Ben to Kim's return (iteration 1).

> **Observation.** If Dee and Kim were **married** for federal tax purposes in 2012 and filed a joint return, their taxes for 2012 would have been $2,519, which is **$3,249 more** than their net overpayment of $730 on their amended returns (using iteration 1). If Kim and Dee convert their civil union to a marriage in 2014, they will see an increase of over $3,000 per year in federal and state income taxes.

ITEMIZED DEDUCTIONS

Itemized Deductions versus Standard Deductions on Separate Returns

If a couple in an unrecognized relationship files separate returns, one taxpayer may itemize deductions while the other claims the standard deduction. Couples taking advantage of this rule should make sure that the allowable expenses are paid by the taxpayer who itemizes.

Example 20. Gene and Kay live together in an unrecognized relationship. They have one child. Gene files as HoH and itemizes his deductions. His 2013 itemized deductions of $13,000 consist of state withholding, real estate taxes, mortgage interest, and charitable contributions, none of which are affected by AMT. All of the home expenses and charitable contributions are paid from his own funds. Kay files as single. Her only Schedule A deduction is state tax withholding of $2,000, so she uses the standard deduction instead of itemizing.

If they were married, their Schedule A deductions on their 2013 MFJ return would total $15,000 ($13,000 + $2,000). Their taxes on a MFJ return would be $802 more than their combined taxes are in an unrecognized relationship.

	Gene (HoH)	Kay (Single)	Unmarried (Combined)	Married (MFJ)
AGI	$40,000	$40,000	$80,000	$80,000
Standard/Itemized deductions	(13,000)	(6,100)	(19,100)	(15,000)
Exemptions	(7,800)	(3,900)	(11,700)	(11,700)
Taxable income	$19,200	$30,000	$49,200	$53,300
Tax	$ 2,246	$ 4,058	$ 6,304	$ 7,106
Combined tax in unrecognized relationship				(6,304)
Federal tax cost of being in a recognized marriage				$ 802

If a married couple files separate returns, both spouses generally must use the same deduction method (either itemizing or taking the standard deduction). However, if a married taxpayer qualifies as HoH, that taxpayer may itemize or use the standard deduction regardless of which method the other one uses.[55] The reverse is not true. The spouse who must file using the MFS status has a standard deduction of zero if the one filing as HoH itemizes.[56]

Combining Itemized Deductions on Amended Returns

If one spouse in a same-sex marriage incurred significant deductible expenses in years when the marriage was not recognized by the IRS, it may benefit the couple to amend their prior returns.

55. IRS Pub. 501, *Exemptions, Standard Deduction, and Filing Information.*

56. IRC §63(c)(6)(A).

Example 21. Ken and Joe were married in Iowa in 2010. They filed as single for federal tax purposes for 2010, 2011, and 2012. In 2012, Joe was injured when their friend Barbie's townhouse fell on him. Joe was out of work for the rest of the year, and his medical expenses exceeded his 2012 income. Based on the following facts, Ken and Joe will benefit from filing amended returns for 2012 to combine their income and deductions on an MFJ return.

	Ken (Single)		Joe (Single)		Ken and Joe (MFJ)	
AGI		$80,000		$30,000		$110,000
Medical expenses	$ 3,000		$35,000		$38,000	
Less: 7.5% floor	(6,000)		(2,250)		(8,250)	
Allowable deduction above 7.5% floor	$ 0		$32,750		$29,750	
Other Schedule A deductions	12,000		1,500		13,500	
Total Schedule A deductions	$12,000	(12,000)	$34,250	(34,250)	$43,250	(43,250)
Exemptions		(3,800)		(3,800)		(7,600)
Taxable income		$64,200		($ 8,050)		$ 59,150
Tax		$12,086		$ 0		$ 8,006
Tax on original return						(12,086)
Refund from amending returns						$ 4,080

OTHER PROVISIONS

Dependency Exemption for the Spouse or Domestic Partner

Generally, a taxpayer's spouse cannot be claimed as a dependent of the taxpayer. However, a partner who resides with the taxpayer for the entire year may be claimed as a dependent if all of the other tests are met. See IRS Pub. 501, *Exemptions, Standard Deduction, and Filing Information,* for more information on the dependency tests for unrelated persons.

Note. There is a special Code provision allowing a taxpayer who is not filing a joint return to claim the personal exemption of their spouse. This exception only applies when the spouse has **no** gross income for the tax year and is not a dependent of anyone else.[57]

Taxable Social Security Benefits

Taxpayers in an unrecognized relationship who both collect social security benefits may incur additional taxes if they get married. Social security benefits become taxable for single taxpayers when modified AGI plus half of the social security benefits exceeds $25,000, whereas the benefits become taxable for MFJ taxpayers at a threshold of $32,000.

For taxpayers who are in a same-sex marriage and who both collect social security benefits, it might not be beneficial to file amended returns for years prior to federal recognition of their marriage.

57. IRC §151(b).

Example 22. Chris and Kelly both receive $25,000 per year in pension benefits and $12,000 in social security benefits. The following table shows the actual tax results from their 2012 federal returns that they both filed as single taxpayers and the result if they amend the returns to file jointly.

	Chris (Single)	Kelly (Single)	Married (MFJ)
Pension income	$25,000	$25,000	$50,000
Taxable social security	3,000	3,000	20,400
AGI	$28,000	$28,000	$70,400
Standard deduction	(7,400)	(7,400)	(14,200)
Exemptions	(3,800)	(3,800)	(7,600)
Taxable income	$16,800	$16,800	$48,600
Tax	$ 2,089	$ 2,089	$ 6,424
Combined tax in unrecognized relationship			(4,178)
Federal tax cost of being in a recognized marriage			$ 2,246

Taxable Social Security Benefits on Separate Returns[58]

Generally, 85% of the social security benefits a MFS taxpayer receives during the year are taxable. **This rule does not apply to spouses who did not live together at any time during the year.** The rule also does not apply to taxpayers in unrecognized relationships, because they generally do not file returns using the MFS status. Therefore, taxpayers considering converting their unrecognized relationships to marriages should include the additional taxes on their social security benefits when considering the tax consequences of such conversions.

> **Note.** For more information about the taxation of social security benefits, see the 2014 *University of Illinois Federal Tax Workbook,* Volume C, Chapter 5: Elder Issues.

Sale of Principal Residence[59]

Taxpayers who meet the ownership and use tests may exclude up to $250,000 ($500,000 for MFJ taxpayers) of gain on the sale of a principal residence. However, this exclusion may be used only once every two years. The one-home-in-two-years rule is the same for both single and married taxpayers. Therefore, if a taxpayer and a prospective spouse both own homes before marriage and plan to purchase a new home after they are married, they should consider selling both current homes before getting married. If they wait, they will lose one of the §121 exclusion amounts.

58. IRS Pub. 915, *Social Security and Equivalent Railroad Retirement Benefits*.

59. IRC §121.

Example 23. Dudley lives in the family home that his grandfather gifted to him in 1963. His basis in the home, including all of the improvements he made, is $20,000. Susan lives in a condominium that she purchased in 1990. Her basis in the home is only $10,000 because she rolled over the gain from the sale of her previous home that she sold in 1989. Both homes are worth about $300,000 in 2014.

Dudley and Susan plan on getting married in 2014, selling both homes, and moving to a beachfront property. Their tax advisor suggests that they sell both homes, move to the beachfront home, and get married in 2015.

She shows them the following table.

	Single		MFJ	
	Dudley's Home	**Susan's Home**	**Dudley's Home**	**Susan's Home**
Sales price	$300,000	$300,000	$300,000	$300,000
Less: basis	(20,000)	(10,000)	(20,000)	(10,000)
Gain	$280,000	$290,000	$280,000	$290,000
Less: exclusion	(250,000)	(250,000)	(0)	(500,000)
Taxable gain	$ 30,000	$ 40,000	$280,000	$ 0
Combined taxable gain	$ 70,000		$280,000	

Note. For more information about the sale of a principal residence, see the 2014 *University of Illinois Federal Tax Workbook,* Volume C, Chapter 3: Capital Gains and Losses.

Employer-Provided Health Insurance

Many taxpayers purchase health insurance through their employers on a pretax basis for their spouses and families.[60] In addition, employers may pay part of the premiums for family coverage on a tax-free basis. This may be one significant financial incentive for couples to marry.

Before *Windsor*, taxpayers who obtained health insurance through their employers for their same-sex partners paid income and social security taxes on these benefits. If these taxpayers were married under state law at the time, they may amend prior year returns (for which the statute of limitations is open) to claim a refund of the taxes paid on the premiums.[61]

Note. Employees who have been taxed on employer-provided fringe benefits provided to their same-sex spouses, including spousal health insurance, should receive a refund of overwithheld social security and Medicare taxes from their employer. If the employee is unable to obtain the refund from their employer, they may file Form 843, *Claim for Refund and Request for Abatement*, with an explanation of the attempts made to obtain the refund from the employer.

The employees should also receive a Form W-2c, *Corrected Wage and Tax Statement*, showing the correct amount taxable for income tax purposes.

60. Treas. Reg. §1.106-1.

61. *Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married under State Law.* [www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples] Accessed on Dec. 3, 2013.

Example 24. Lawrence and Terrence were married in Connecticut in January 2012. Lawrence works for a multinational insurance company. His company offers health insurance to its employees and their spouses. Terrence is a homemaker and has no income of his own.

Lawrence elected to purchase health insurance for Terrence as soon as they were married. The insurance premium of $6,000 ($500 per month) was deducted from his wages after taxes in 2012. In 2013, after the Supreme Court decision in *Windsor*, his employer adjusted his 2013 wages to classify the premiums as pretax. His 2013 Form W-2, *Wage and Tax Statement*, reflects the proper amount of taxable income. Lawrence also receives a Form W-2c, *Corrected Wage and Tax Statement,* from his employer for 2012.

Lawrence amends his 2012 return to change his status from single to MFJ. His tax accountant informs him that this change by itself reduces his 2012 taxes by $9,757. Amending the return to exclude the health insurance premiums from his gross income reduces his taxes by an additional $1,950.

	Original (Single)	Amended (MFJ)
Wages	$200,000	$194,000
AGI	$200,000	$194,000
Itemized deductions	(37,000)	(37,000)
Personal exemptions	(7,600)	(7,600)
Taxable income	$155,400	$149,400
Federal income tax including AMT	$ 41,932	$ 30,225
Federal tax savings from amending return		$ 11,707
Less: tax savings from change in filing status		(9,757)
Tax savings by excluding premiums from income		$ 1,950

Observation. In the preceding example, Lawrence does not have to file an amended Connecticut return for 2012. When the original return was filed, Connecticut recognized their 2012 marriage for income tax purposes. The state allowed the couple to file a joint return and to exclude the health insurance premiums from their income.[62]

Taxpayers in relationships that are recognized by the state but not by the federal government may be able to obtain health insurance for their partners through employer-provided plans. However, the premiums paid by the employee and the employer are subject to both federal income tax and employment taxes. State treatment of the premiums varies by jurisdiction.

Adoption Credit

The IRS specifically addresses the issue of **second-parent adoptions** in the frequently asked questions (FAQ) for same-sex couples that are posted on **www.irs.gov.** The adoption credit cannot be claimed when the parents are married to each other.[63] However, the adoption credit **can** be claimed by the adopting parent who is in an unrecognized relationship with the other parent.[64]

62. *Instructions for Connecticut Resident Income Tax Return.* State of Connecticut. [www.ct.gov/drs/lib/drs/forms/2012forms/incometax/ct-1040booklet.pdf] Accessed on Nov. 17, 2013.

63. IRC §23(d)(1)(C); see also *Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married under State Law.* Nov. 20, 2013. [www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples] Accessed on Nov. 22, 2013.

64. *Answers to Frequently Asked Questions for Domestic Partners and Individuals in Civil Unions.* Sep. 19, 2013. [www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions] Accessed on Nov. 15, 2013.

The following table summarizes the adoption credit rules for 2010 through 2014.[65]

	2010	2011	2012	2013	2014
Maximum adoption credit	$ 13,170	$ 13,360	$ 12,650	$ 12,970	$ 13,190
Phaseout begins (MAGI)	182,520	185,210	189,710	194,580	197,880
Phaseout ends	222,520	225,210	229,710	234,580	237,880
Refundable	Yes	Yes	No	No	No

The adoption credit could be a significant factor in deciding not to amend the prior year returns to change the filing status of a married same-sex couple to MFJ.

Example 25. Rosie and Michelle were married in New York in 2012. The couple spent $15,000 in adoption fees and legal expenses in 2012. Their daughter, Dakota, was born in August 2012, and she moved in with Rosie and Michelle when she was adopted in December 2012.

Rosie's 2012 AGI was $200,000. Michelle's 2012 AGI was $50,000. They both filed their federal returns as single for 2012 because the federal government did not recognize their marriage at that time. Neither parent claimed Dakota as a qualifying child because she did not live with them for more than half of the time she was alive in 2012.[66]

For 2012, the couple compared their returns to see which one should claim the adoption credit. Because Rosie's income was in the phaseout range, her maximum credit would be $9,395.

Michelle's maximum credit would be $12,650. However, the amount of the credit that Michelle could claim in 2012 was limited to the amount of her 2012 income tax. Michelle's 2012 tax was $6,099. The remaining $6,551 of the credit would carry forward to her 2013 return.

At the time they filed their returns for 2012, they assumed that their marriage would continue to be disregarded for federal tax purposes. **They chose to claim the entire credit on Michelle's 2012 return and claim the remaining credit when she filed for 2013.**

For 2013, they must file as MFJ or MFS now that the IRS recognizes their marriage. Taxpayers filing MFS do not qualify for the adoption credit.[67] The $6,551 credit carryforward from Michelle's 2012 return on which she used the single filing status is claimed on their joint 2013 return.

If Rosie and Michelle amended their 2012 returns to file jointly, their combined incomes would exceed the phaseout range for the credit and they would not qualify for any adoption credit.

Note. The adoption credit may also be a significant reason for a couple to choose to remain in an unrecognized relationship instead of choosing to be married, at least while an adoption is in process.

The amount of the adoption credit for a couple in an unrecognized relationship who adopt a child together is limited to the same maximum credit amount allowed per adoption as that available to a couple in a recognized marriage. The partners may not both claim a credit for the **same** adoption expenses. However, a couple in an unrecognized relationship may **allocate** the total expenses paid between them in any manner they choose.

65. Rev. Proc. 2009-50, 2009-45 IRB 617; Rev. Proc. 2010-40, 2010-46 IRB 663; Rev. Proc. 2011-52, 2011-45 IRB 701; Rev. Proc. 2013-15, 2013-5 IRB 444; and Rev. Proc. 2013-35, 2013-47 IRB 537.

66. IRS Pub. 501, *Exemptions, Standard Deduction, and Filing Information.*

67. IRC §23(f)(1).

Example 26. Nancy and David are unmarried. In 2014, they adopt a son; $15,000 of their adoption costs are eligible for the credit. Nancy and David's 2014 incomes are projected to be around $190,000 and $60,000, respectively. They ask their tax advisor, Gideon, whether it is advisable for them to marry in 2014 or put off the marriage another year. Gideon tells them to wait until 2015 because their projected combined income of $250,000 would exceed the phaseout range for the adoption credit.

Nancy and David also ask Gideon how they should allocate the expenses between them on their 2014 returns to achieve the maximum tax benefit. Gideon concludes that to maximize the 2014 tax benefit, no more than $8,325 of the expenses should be allocated to David. If David claims the first $8,325 of expenses, Nancy must reduce the maximum amount of credit she can claim by the amount of expenses used on David's return. Nancy's credit is then limited to $4,865 ($13,190 maximum credit − $8,325).

	Nancy (HoH)	David (Single)
Exemptions	2	1
AGI	$190,000	$60,000
Standard deductions	(9,100)	(6,200)
Exemptions	(7,900)	(3,950)
Taxable income	$173,000	$49,850
Federal income tax (including AMT)	$ 40,390	$ 8,325
Maximum credit before limitation based on current year tax	13,190	13,190
Lesser of tax or maximum credit		8,325
Amount of adoption expenses used by David	(8,325)	
Maximum amount of expenses that can be used by Nancy	$ 4,865	

Observations for Example 26.

1. Instead of allocating some of the expenses to Nancy, David could carry forward any unused portion of the adoption credit for up to five years.[68]
2. If Nancy's income exceeds projections, her available adoption credit could be phased out. For 2014, the adoption credit begins to phase out under IRC §23(b)(2)(A) for taxpayers with modified AGI in excess of $197,880 and is completely phased out for taxpayers with modified AGI of $237,880 or more.[69]
3. The adoption credit is allowed as a credit against AMT.[70]

68. *Adoption Benefits FAQs*. Mar.14, 2013. [www.irs.gov/Individuals/Adoption-Benefits-FAQs] Accessed on Nov. 22, 2013.

69. Rev. Proc. 2013-35, 2013-47 IRB 537.

70. IRC §26(a).

Inherited IRAs[71]

When traditional IRAs are inherited by spouses, the spousal beneficiaries have the following three choices.

1. They may treat the IRA as their own by designating themselves as the account owners.
2. They may treat the IRA as their own by rolling it over into their own IRA or, to the extent it is taxable, into one of the following.
    a. Qualified employer plan
    b. Qualified employee annuity plan (§403(a) plan)
    c. Tax-sheltered annuity plan (§403(b) plan)
    d. Deferred compensation plan of a state or local government (§457 plan)
3. They may treat themselves as the beneficiaries of the IRA rather than treating the IRA as their own.

If a taxpayer inherits a traditional IRA from **anyone other than their deceased spouse,** they cannot treat the inherited IRA as their own. This means that the following rules apply.

1. The taxpayer cannot make any contributions to the IRA.
2. The taxpayer cannot roll over any amounts into or out of the inherited IRA. However, they can make a trustee-to-trustee transfer as long as the IRA into which amounts are being moved is set up and maintained in the name of the deceased IRA owner for the benefit of the taxpayer as beneficiary.
3. The taxpayer may be required to take the entire account by the end of the fifth year following the year of the account owner's death.

The status of the beneficiary as a spouse also affects the calculation of the required minimum distributions (RMD) for years after the year of the account owner's death. The rules for calculating the RMD are complex and are not covered in this material.

> **Note.** For further details regarding the RMD rules, see the 2013 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 3: Advanced Individual Issues.

71. IRS Pub. 590, *Individual Retirement Arrangements (IRAs).*

TAXPAYERS EMPLOYED BY THEIR DOMESTIC PARTNER[72]

Businesses are often required to treat employees who are related to the owners differently than unrelated employees. Spouses are always treated as related parties under the attribution rules for tax provisions subject to related party restrictions. In contrast, wages paid to a partner in an unrecognized relationship are treated the same as wages paid to any other employee.

A vast number of tax provisions require transactions between related parties to be treated differently than transactions between unrelated parties. Following are some examples of these provisions.

1. Generally, wages paid to a sole proprietor's spouse **are subject to social security and Medicare taxes but not federal unemployment taxes.** This is also true if the employer is a disregarded entity that is treated as a sole proprietorship.
2. Generally, fringe benefits provided to an employee-spouse are deductible by sole proprietorships and are not taxable to the employee-spouse.
3. If the business is an S corporation, shareholders who own more than 2% of the stock and the shareholder's family members must pay income taxes on most fringe benefits paid by the corporation on their behalf. However, these benefits are generally not subject to social security, Medicare, and federal unemployment taxes.
4. If the business provides its employees with retirement benefits and the retirement plan is subject to top-heavy provisions, the spouse must be included as a related party in these calculations.
5. Health insurance premiums paid on behalf of related party employees are not eligible for the IRC §45R small employer health insurance tax credit.

ESTATE AND GIFT TAXES

U.S. v. WINDSOR

The taxes at issue in the *Windsor*[73] case were estate taxes paid by a same-sex spouse after her wife died. In its ruling, the Supreme Court summarized the facts as follows.

> *Edith Windsor and Thea Spyer met in New York City in 1963 and began a long-term relationship. Windsor and Spyer registered as domestic partners when New York City gave that right to same-sex couples in 1993. Concerned about Spyer's health, the couple made the 2007 trip to Canada for their marriage, but they continued to reside in New York City. The State of New York deems their Ontario marriage to be a valid one. See 699 F. 3d 169, 177–178 (CA2 2012).*
>
> *Spyer died in February 2009, and left her entire estate to Windsor. Because DOMA denies federal recognition to same-sex spouses, Windsor did not qualify for the marital exemption from the federal estate tax, which excludes from taxation "any interest in property which passes or has passed from the decedent to his surviving spouse." 26 U.S.C. §2056(a). Windsor paid $363,053 in estate taxes and sought a refund. The Internal Revenue Service denied the refund, concluding that, under DOMA, Windsor was not a "surviving spouse."*

Note. Gift tax issues are covered in depth in the 2013 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 3: Advanced Individual Issues.

72. IRS Pub. 15, *(Circular E), Employer's Tax Guide.*

73. *U.S. v. Windsor*, 133 S.Ct 2675 (2013).

Spouses are given a number of exemptions and rights under the federal estate and gift tax Code sections that no other class of persons receives. Therefore, in applying the Code to same-sex couples or their survivors, it is imperative to understand whether the couple qualifies as married under the law.

As previously discussed in this chapter, the IRS stated in Rev. Rul. 2013-17 that it will recognize same-sex marriages as of the date the marriage was legally established, regardless of whether the couple resides in a jurisdiction that recognizes the marriage. The IRS does **not** recognize civil unions, domestic partnerships, or similar relationships. However, the states vary on the recognition, rights, and responsibilities that they grant to these relationships that are not marriages.

SPECIAL ESTATE AND GIFT TAX PROVISIONS FOR SPOUSES

Unlimited Gifting

Gifts to spouses are not subject to gift tax.[74] In addition, gifts to spouses do not reduce the taxpayer's lifetime gift exemption. If a gift tax return included gifts to a same-sex spouse and the statute of limitation is still open for that return, the return should be amended to exclude those gifts.

Gift Splitting

Married taxpayers who give gifts in excess of the annual exclusion amount ($14,000 for 2013 and 2014) may agree to treat the gifts as if half of the gift were given by one spouse and the other half by the other spouse.[75] This allows married taxpayers to give twice as much before the lifetime limit on gifts is affected. If a gift tax return was filed for gifts given by one spouse that could have been split with the other spouse, the return should be amended to split those gifts, subject to the other spouse's consent and the statute of limitations.

Unlimited Transfers upon Death

Interests in property that transfer to the decedent's spouse are excluded from the decedent's taxable estate.[76] Qualifying transfers include those that the surviving spouse takes:[77]

1. As the decedent's legatee, devisee, heir, or donee;
2. As the decedent's surviving tenant by the entirety or joint tenant;
3. As an appointee under the decedent's exercise of a power or as a taker in default at the decedent's nonexercise of a power;
4. As a beneficiary of insurance on the decedent's life;
5. As the surviving spouse taking under dower or curtesy (or similar statutory interest); and
6. As a transferee of a transfer made by the decedent at any time.

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74. IRC §2523(a).

75. IRC §2513.

76. IRC §2056(a).

77. Instructions for Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return.*

Deceased Spousal Unused Exclusion

For an estate of any decedent dying during 2014, a basic exclusion amount of $5.34 million is used for determining the amount of the unified credit against estate tax.[78] The exclusion amount applies both to a donor's taxable gifts made during the donor's lifetime and to the donor's estate at death. In addition, a **portability** provision associated with the basic exclusion amount allows an election to be made to pass the unused portion of a deceased person's exclusion amount to a surviving spouse.[79] This is referred to as the deceased spousal unused exclusion (DSUE) amount. The election must be made on a timely filed Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return.* Portability of the unused portion of the estate tax exclusion applies for deaths occurring on or after January 1, 2011.

Example 27. Wilma and Barney were married in New Hampshire in 2010. Wilma died in November 2013. Her estate was valued at $7 million. She left $3 million of her assets to Barney and the remainder ($4 million) to her daughter, Peggles.

The $3 million left to Barney is excluded from Wilma's taxable estate. The estate tax exemption for 2013 was $5.25 million. After subtracting the $4 million that went to Peggles, $1.25 million of Wilma's estate tax exclusion was unused.

The executor of Wilma's estate timely files Form 706 in order to make the election to transfer Wilma's unused exclusion to Barney. Thus, Barney is entitled to a DSUE of $1.25 million.

Barney had assets of his own prior to inheriting a portion of Wilma's estate. He does not remarry and does not make any taxable gifts. When he passes away in 2014, his estate is worth $6 million. His taxable estate is calculated as follows.

Estate value	$6,000,000
Less: 2014 exclusion	(5,340,000)
Taxable estate before applying the DSUE	$ 660,000
Less: Wilma's unused DSUE	(1,250,000)
Net taxable estate	$ 0

Treasury regulations require the portability election to be made on a **timely filed return.** The regulations further specify that when a return is not filed on time, the IRS will treat the estate as if the executor had explicitly chosen not to make the election. However, the IRS has provided a method[80] for certain estates to request an extension of time to make the DSUE election. To qualify, **all** four of the following must be true.

1. The estate was **not required** to file an estate tax return.
2. The estate did **not file** an estate tax return.
3. The decedent passed away after December 31, 2010, and on or before December 31, 2013.
4. The decedent was a citizen or resident of the United States on the date of death.

To make the election, the executor must file a complete and properly prepared Form 706 **on or before December 31, 2014**. The following phrase must be included at the top of this Form 706.

"FILED PURSUANT TO REV. PROC. 2014–18 TO ELECT PORTABILITY UNDER §2010(c)(5)(A)."

78. Rev. Proc. 2013-35, 2013-47 IRB 537.

79. IRC §2010(c).

80. Rev. Proc. 2014-18, 2014-7 IRB 513.

This method does not apply to estates that have already filed Form 706. To amend returns for the purpose of making the DSUE election, an estate may request an extension of time to make the portability election by applying for a letter ruling under the provisions of Treas. Reg. §301.9100-3. For IRS guidance regarding a **simplified method** for obtaining an extension to make a portability election on Form 706, see Rev. Proc. 2014-18.

> **Note.** A surviving spouse cannot use the unused generation-skipping transfer tax (GSTT) exemption of a predeceased spouse.[81]

Qualified Terminable Interest Property[82]

Qualified terminable interest property (QTIP) is property placed in a trust for the benefit of the surviving spouse but with another party (or parties) designated to receive the property after the surviving spouse dies. An executor of an estate has an option to deduct the value of assets transferred to a QTIP trust as if the assets were left to the surviving spouse. In general, trusts established under this provision pay the surviving spouse the income earned by the transferred assets for the lifetime of the survivor. The QTIP assets previously deducted are added back into the survivor's estate at their current value upon the death of the survivor.

The election[83] to exclude transfers made to a QTIP trust may be made with Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return,* on or before the due date of the return, including extensions. If a timely return is not filed, the election may be made on the first estate tax return filed by the executor after the due date. The election is irrevocable.

The retroactive application of these provisions for surviving same-sex spouses is limited to estates in which:

1. The estate funded a trust for the decedent's same-sex spouse,
2. That trust qualifies under the QTIP provisions, and
3. The due date of the return has not passed or no estate tax return was filed by the due date.

IRC §2032A Special-Use Valuation Method

Under IRC §2032A, an estate may elect to value certain real estate based on its current use instead of its best use. The following are **some** of the key requirements to qualify for the special valuation method.

1. The real estate must be used for farming or in the decedent's business **(qualified use).**
2. The decedent **or a member of the decedent's family** must have been materially participating in the use of the property during five of the last eight years before the decedent passed away.
3. The property must pass to a **qualified heir**.
4. The property must continue to be used for the qualified use by the qualified heir and/or their family for at least 10 years.

81. Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," Scheduled for Consideration by the United States Senate.* JCX-55-10 (Dec. 10, 2010).

82. IRC §2056(b)(7).

83. Treas. Reg. §20.2056(b)-7.

Qualified Heir. The term "qualified heir" includes the following members of the decedent's family.

1. Ancestors
2. Spouse
3. Children
4. Stepchildren
5. Siblings
6. The spouses of any child, stepchild, or sibling

For married same-sex couples or for families that include married same-sex couples, the recognition of same-sex marriages may qualify property that otherwise would not meet the requirements.

Example 28. Lilly and Jane were married in Delaware on July 1, 2013. Lilly owned part of a farm that had been in her family for generations. Lilly's brother farms the land along with his own share of the land.

After Lilly died, Jane inherited the portion of the land that Lilly owned. Previously, Jane was not considered a qualified heir because the federal government did not recognize her marriage to Lilly.

Example 29. Buddy and Jethro were married in Massachusetts in 2005. Buddy owned a bed and breakfast establishment on Martha's Vineyard, which he personally operated until he retired in 2006 at the age of 50. When Buddy retired, Jethro took over the day-to-day management of the business. Buddy died on April 15, 2013. At that time, ownership of the property transferred to Buddy's daughter, Elly May.

Previously, the property would not have qualified for the IRC §2032A valuation method because Buddy did not materially participate in the operation of the business for five out of the last eight years. However, post-*Windsor*, Jethro's management of the business qualifies as material participation by a family member, and the executor may elect to use the special method to value the property if Elly May agrees to the election. In addition, Jethro is considered a member of Elly May's family for purposes of meeting the ongoing material participation requirement for the 10 years following Buddy's passing.[84]

Election. Treasury regulations[85] require that the election to use the IRC §2032A valuation method be made with a **timely filed** estate tax return. If the final values have not been determined before the due date of the return, the regulations allow the executor to file a protective election with the timely filed return in anticipation of the estate meeting all of the requirements of §2032A.

Rev. Rul. 2013-17 states that it can be relied upon for the purpose of amending returns to obtain a credit or refund for **any overpayment** of tax related to the definition of marriage for same-sex couples, provided the applicable statute of limitations has not expired. If real property would have qualified for the special-use valuation but no election was made due to DOMA, it may be worthwhile to pursue filing a claim for refund of any estate taxes overpaid as a result. However, it is not clear at this time whether the IRS will grant an exception to the regulations in this situation.

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84. IRC §2032A(e)(2).

85. Treas. Reg. §20.2032A-8.

Note. If estate executors file amended returns to make the §2032A election, they may want to file Form 8275-R, *Regulation Disclosure Statement*, with the amended returns. As long as the statute of limitations has not expired, the IRS or the courts might find that the time for making the elections has not expired, despite the wording of the applicable regulations. It may be persuasive to reference the logic used by the appeals court in *Glaze v. U.S.*[86]

1. The executor was barred from making the election on a timely filed return because the IRS would not recognize the marriage as of the due date of the return.
2. The executor could not have known by the due date of the return that the Supreme Court would declare DOMA unconstitutional.
3. Courts may interpret the law to allow a refund of excess taxes paid, "subject only to the limitation that the plain language of [IRC §6511] will not be ignored."

Transfers in Settlement of Marital Rights

Certain claims of a former spouse against the estate are deductible from the taxable value of the estate.[87] The claims must have been agreed to in writing as part of a settlement of the former spouse's marital rights. In addition, the divorce must have occurred within one year prior to the date of the agreement or within two years after the date of the agreement.

An executor who filed Form 706 for an estate that paid such claims to a former same-sex spouse should amend the return to exclude the claim from the taxable value. Even if no tax was due with the return, the provision might be useful in increasing the amount of DSUE transferring to a surviving spouse. However, in that case, if the deadline for making the DSUE election has passed, this deduction may not prove useful.

If no return was filed, the payment of the claim may be deducted from the estate's value on a late-filed return. This may make it possible to transfer a larger amount of DSUE to a surviving spouse if the DSUE election is accepted as being timely made.

Installment Payments[88]

An estate may elect to pay part of the estate tax in installments if the gross estate includes an interest in a closely held business. To qualify, certain tests must be met. To determine whether these tests are met, property that is owned jointly by the decedent and the surviving spouse is treated differently than other property. Joint ownership includes property held as joint tenants, tenants by the entirety, tenants in common, and under community property laws.

The installment provision is usually invoked if the value of the estate is high but the liquid assets are insufficient to pay the estate taxes. An executor in this situation should review the qualifying tests and the jointly owned assets to see if the estate qualifies for this provision.

AMENDING RETURNS

The federal **statute of limitations** is generally three years from the date the return was filed or two years from the date the tax was paid, whichever is later.[89] For gift tax returns, the statute of limitations begins running only after an adequate description of the gift has been included with the Form 709 that was filed for the year of the gift.[90]

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86. *Glaze v. U.S.*, 641 F.2d 339 (5th Cir. 1981).
87. Instructions for Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return.*
88. IRC §6166.
89. IRC §6511(a).
90. IRC §6501(c)(9).

Individuals in same-sex marriages who filed **gift tax returns** should consider filing corrected gift tax returns for any years not barred by the statute of limitations. Corrected gift tax returns should be filed to exclude spousal gifts and/or make use of the gift-splitting provisions (discussed earlier in this section).

Surviving same-sex spouses who were married at the time of their spouses' deaths and who paid **estate taxes** should file claims for refunds of the taxes for any years not barred by the statute of limitations. Even if estate taxes were not paid, it may be beneficial for estates to file or amend Form 706 to take advantage of special provisions applicable to spouses.

To amend Form 706,[91] another Form 706 is filed. "**Supplemental Information**" is written across the top of page 1 of the form that contains the corrected information, and copies of pages 1, 2, 3, and 4 of the original return are attached to the amended return.

To amend Form 709,[92] another Form 709 is filed. **"Amended Form 709 for gift(s) made in (year)"** is written across the top of the form that contains the corrected information, and copies of pages 1, 2, 3, and 4 of the original return are attached to the amended return.

If taxes were paid with the original Form 706 or Form 709, the taxpayer may qualify to file a claim for refund. Form 843, *Claim for Refund and Request for Abatement*, is used to request refunds for these types of taxes. The corrected Form 706 or Form 709 must be attached to Form 843.

91. Instructions for Form 706.

92. Rev. Proc. 2000-34, 2000-2 CB 186.