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Domestic Partners

*30 WHAT DOES RECENT CHIEF COUNSEL ADVICE MEAN FOR SAME-SEX MARRIED COUPLES?

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IRS Chief Counsel Advice 200608038 clearly addresses the income tax filing obligations of registered domestic partners in community property states. This article analyzes the possible ramifications of the Advice for same-sex married couples.

There has been discussion about recently issued IRS Chief Counsel Advice 200608038 (the 'Memo') and its conclusion that California domestic partners must file separate returns and report all their personal earnings (not one-half the income acquired by each member of the union). This debate is positive as it helps shed light on the meaning of the Memo.

Here's the key language in the penultimate paragraph of the Memo:

The Supreme Court's decision in Poe v. Seaborn dealt with Washington's community property law, which applied to a husband and wife. We do not believe that the Poe v. Seaborn decision applies to the application of a state's community property law outside the context of a husband and wife. In our view, the rights afforded domestic partners under the California Act are not 'made an incident of marriage by the inveterate policy of the State.' The relationship between registered domestic partners under the California Act is not marriage under California law. Therefore, the Supreme Court's decision in Poe v. Seaborn does not extend to registered domestic partners.

The Memo creates a new and different question that appears unanswered: what if California or some other community property state adopted a same-sex 'marriage' law making the relationship between same-sex married couples exactly equivalent to marriage of heterosexual couples under state law? And what if the rights afforded same-sex couples in such state are deemed incidents of marriage by, and the inveterate policy of, the state?

Little has been mentioned about what might be viewed as a logical extension of the negative application of the Memo. Indeed, reading only the Memo, it would seem reasonable that if a community property state did adopt a same-sex marriage law, each member of that union would be entitled (perhaps would be legally obligated) to file a return reporting half the income earned by the couple. If that is true, the Memo might have significant application for same-sex couples under future legislation.

The logic of the Memo leaves open the potential conclusion that each member of such a sanctioned same-sex marriage should be entitled under Poe v. Seaborn [FN1] to report half the income on each person's return. Indeed, that may be their legal obligation.

Further, if that logic applies for a same-sex marriage in a community property state, does the Memo *31 have any meaning to a married same-sex couple in a non-community property state, such as Massachusetts?

Analysis

California law on domestic partners. As we know, California is a community property state. By law, all property acquired by a married person in California while married is community property, giving each spouse a present equal interest in the property. [FN2] Consequently, California spouses who file tax returns as 'married filing separately' include in gross income one-half of the combined income earned by both spouses.

The seminal issue of Chief Counsel Advice 200608038 was whether a member of a qualified domestic partnership in California (who must file a federal tax return individually) should include and report (and pay tax on) one-half of the combined income or 100% of his or her personal income.

As stated in the Memo: 'Since 1999, California has extended certain rights of married couples to domestic partners who register their partnership with the California Secretary of State. A registry of such domestic partnerships has been maintained by the California Secretary of State since 2000.' The Memo goes into great detail about the history of California's Domestic Partner Rights and Responsibilities Act of 2003 (the 'Act'), which as modestly amended in 2004, became effective in 2005. Interestingly, the Act as proposed would have allowed joint state income tax returns, but as enacted the Act required filing state income tax returns under the same status as federal law.

Federal income tax rules for community property states. On the issue of how married residents of community property states file federal income tax returns, the Memo starts by noting that IRC Section 61(a)(1) provides that gross income means 'all income from whatever source derived,' including compensation for services such as fees, commissions, fringe benefits, and similar items.

Next, the Memo reminds us that a taxpayer's gross income generally includes all the income earned by that taxpayer. Citing to Lucas v. Earl, [FN3] the Chief Counsel notes that a taxpayer may not shift the tax burden of his or her earned income to another person--not even by a marital contract between a husband and wife in a non-community property state. However, in community property states, the rules differ. The Memo cites to Poe v. Seaborn as the key holding for the exceptional treatment of income in a community property state:

In Poe v. Seaborn, the Supreme Court concluded that 'the wife has, in Washington, a vested property right in the community property, equal with that of her husband; and in the income of the community, including salaries or wages of either husband or wife, or both.' Accordingly, the Court held that husband and wife were entitled to file separate returns [there being no joint returns then], each treating one-half of the community income as his or her respective income. See United States v. Malcolm, 282 U.S. 792 (1931), which applied the rule of Poe v. Seaborn to California's community property law.

Finally, the Memo reminds us that the case law relating to income-splitting in community property states has always arisen solely in the context of spouses. The Memo cited: Goodell v. Koch, [FN4] Hopkins v. Bacon, [FN5] Bender v. Pfaff, [FN6] and Harmon. [FN7]

The open issue--What about a married same-sex couple? As noted above, the U.S. Supreme Court has decided that the property rights of citizens living in community property states should be determined at the state level--not the federal level--at least for the basic income tax rule of what to report. As a result of Poe (and other cases), it is clear that a member of a couple in a community property state who files separately should report one-half the income of the couple.

If that's the case, then the questions raised and not answered are: what happens if a community property state does indeed adopt a same-sex marriage law? And what if in those states, for state property purposes, each member of the same-sex marriage is treated exactly identically for purposes of community property?

The logic of the Memo indicates that state law should control. Further, while federal laws may prohibit such a couple from filing a joint return (see the discussion of the federal Defense of Marriage Act, below), the Poe decision and the Memo leave open the possibility that each member of the same-sex marriage should report one-half the income earned by both members.

Given that this issue was not addressed (and maybe not even considered) in the Memo, and no community property state has adopted a same-sex marriage law, this is an exploration into the*32 'what ifs' of the future. Nevertheless, it seems that a future advisor to a same-sex married couple might point to this Memo to support the argument that a same-sex married couple (unlike a registered domestic partnership) does have a vested (state) property right to one-half of the whole income, and thus the federal income tax rules must follow that analysis.

What about the federal Defense of Marriage Act? Absent from the Chief Counsel Advice is any mention of the federal Defense of Marriage Act ('DOMA '). [FN8] DOMA is a federal law passed by Congress and signed by President Clinton on 9/21/96. DOMA provides in pertinent part:

- Any state may deny a marriage-like relationship between persons of the same sex even where such has been recognized in another state; and
- For purposes of federal law (which presumably includes federal income tax law), 'marriage' is defined as 'a legal union between one man and one woman as husband and wife' and is available only to couples of the opposite sex.

Accordingly, DOMA specifies that for federal purposes (which one would interpret to include the application of the federal Tax Code), the definition of marriage is only a legal union between one man and one woman. Given the rule in DOMA, would a claim for equal income recognition by a married same-sex couple in a community property state be permitted? As DOMA is not mentioned in the Memo, perhaps the Memo leaves open the possibility that while DOMA would require a same-sex married couple to file separate returns, state law might decide what constitutes 'income' to the members of the couple. This seems an odd result, given the broad tones of DOMA and the federal definition of income in the Tax Code, but if the Poe decision allows states to define elements of marriage, then would the IRS have to acquiesce on this issue?

While it appears clear the IRS could rely on DOMA and refuse to allow a same-sex married couple to file a joint tax return--even if they live in a community property state which allows same-sex marriage (someday)--would the IRS have to allow the couple to report half the income of each? The Memo and Poe indicate state law is to be considered in this aspect of defining income. Further, it is not clear that DOMA directly resolves this potential issue--and again, in the Memo, DOMA was not mentioned.

Having noted here the issues left open by the Memo, it seems impossible to make any generalizations about the application of DOMA precisely since it was not mentioned. If DOMA does in fact override all state marriage laws as to any federal income tax matter, then the potential extension of the logic of this Memo may fail. However, the potential extension of the Memo's logic expressed here (that the logic seems to allow recognition of half the income) seems available for a future same-sex married couple--if a community property state ever permits such.

Could the Memo affect married same-sex couples in non-community states? The logic of the Memo (emphasizing that the California domestic partner law is not equivalent to marriage), plus its failure to note DOMA, give reason for a short pause to consider whether a married same-sex couple in Massachusetts (for example) could possibly rely on the Memo in some way.

Obviously, there are many same-sex married couples in Massachusetts looking for some guidance on how to deal with their (currently) unique tax situations. They have issues to address, such as: If they can file a joint return for state income tax purposes but a separate one for federal, how do they allocate the state income tax paid for purposes of the federal income tax deduction?

The Memo, however, does not address same-sex married couples in a non-community property state. And given the second prong of DOMA (defining marriage), it appears clear that a same-sex married couple must file separate returns, each reporting his or her income. In a non-community property state (like Massachusetts), when a member of a same-sex marriage files a separate federal income tax return, it also appears clear that the person would report all of his or her personally earned income. There is no real corresponding argument in a non-community property state to include one-half of the couple's income.

Conclusion

The Memo clearly addresses the income tax filing obligations of registered domestic partners in community property states. The Memo concludes that members of that domestic union must file a separate return and must report their own personal income. Each may not report one-half of the income earned by the couple.

The Memo, however, does not even consider the impact of DOMA, and does not address the potential tax consequences for a married same-sex couple if same-sex marriage is legalized in a community property state. Moreover, the Memo may provide a basis for such a same-sex married couple in the future to argue for inclusion of one-half of the couple's income on each member's individual return.

The Chief Counsel Advice concludes that domestic partners in community property states must file separate returns and must report their own personal income.

According to the Chief Counsel Advice, a domestic partner in a community property state may not report one-half the income earned by the couple.

The Chief Counsel Advice does not consider the impact of the federal Defense of Marriage Act.

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[FN1]. 282 U.S. 101, 9 AFTR 576 (S.Ct., 1930).

[FN2]. Cal. Family Code § § 760 and 751, cited in Chief Counsel Advice 200608038.

[FN3]. 281 U.S. 111, 8 AFTR 10287 (S.Ct., 1930).

[FN4]. 282 U.S. 118, 9 AFTR 580 (S.Ct., 1930).

[FN5]. 282 U.S. 122, 9 AFTR 580 (S.Ct., 1930).

[FN6]. 282 U.S. 127, 9 AFTR 582 (S.Ct., 1930).

[FN7]. 323 U.S. 44, 32 AFTR 1411 (S.Ct., 1944).

[FN8]. Pub. L. No. 104-199.

33 Est. Plan. 30, 2006 WL 1086778 (W.G.&.L.)

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