New York State Bar Association

Tax Section

Report on New York State Tax Issues Relating to Same-Sex Unions

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Report No. 1090

New York State Bar Association
Tax Section

Report on New York State Tax Issues Relating to Same-Sex Unions[1]

In New York State, active consideration is being given to legislation that would extend to same-sex couples the opportunity to attain the same legal status, for state law purposes, as currently applies to opposite-sex married couples.[2] Whether that status is defined as marriage, union, partnership or by some other term, the underlying concept of these proposals (collectively referred to herein as "same-sex unions") is that same-sex couples who formalize their relationship in the prescribed manner would have state law rights and responsibilities equivalent to those accorded to opposite-sex married couples under New York State law.

This Report provides technical commentary relevant to the objective of attaining legal equivalence in the New York state and local taxation of same-sex couples and opposite-sex married couples. In the context of New York's tax laws, obtaining equivalence in the state (and local) tax treatment of same-sex unions raises a number of unique and rather complex issues. This is due in large part to the fact that New York's tax laws are based in many respects on the federal tax laws, yet for federal purposes same-sex unions are not recognized. Specifically, legislation, referred to as the "Defense of Marriage Act," provides as follows:

> In determining the meaning of any Act of Congress, or of any ruling, regulation or interpretation of the various administrative bureaus and agencies of the United States,

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[1] This report was prepared by Carolyn Joy Lee and Robert J. Levinsohn, with assistance from Kirk Wallace. Helpful comments were received from David Hariton, Stephen Land, Michael Schler and Jeffrey Schwartz.

[2] As discussed infra, the New York State Bar Association has proposed legislation, and California, Connecticut, Hawaii, Massachusetts and Vermont have already adopted varying forms of state legislation along these lines.

> the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife.[3]

Federal tax laws are subject to DOMA, and therefore do not recognize same-sex unions. As a result, parties to same-sex unions are treated as two unmarried individuals for all purposes of federal taxation; they file federal income tax returns as two single individuals, and compute their federal taxable income, as well as their federal tax liability, as if they are single. Achieving pure equivalence in New York's taxation of same-sex couples, as compared to their opposite-sex counterparts, therefore would require that New York's tax laws be "decoupled" from the federal tax laws in *every* instance in which marital status is relevant to the application of the tax laws.

Translating the federal "nonmarried" treatment of same-sex couples into "married" status for New York tax purposes will involve a variety of technical issues. This Report outlines those issues, provides some examples of the practical questions that will arise, and suggests alternative statutory approaches for incorporating into New York law provisions that address the New York tax treatment of same-sex unions.

It must be noted at the outset that the questions presented in considering equivalence in state and local taxation of same-sex couples are neither simple nor straightforward. Because New York has premised much of its tax system on federal conformity, and because same-sex unions are not recognized for federal tax purposes, it is not possible to create a truly level playing field for New York tax purposes without introducing tremendous complexity into New York's tax laws. This complexity can be managed, and need not deter New

[3] Defense of Marriage Act ("DOMA"), Pub. Law 104-199 §3(a), 1 U.S.C. §7 (Sept. 21, 1996).

York's legislature from making whatever decision it deems best for New Yorkers. There should however be no illusions -- pure equivalence in taxation will not be easy to achieve.

Because pure equivalence is complex, and is not the only option, this report also discusses a variety of alternative options. New York can indeed enact legislation and provide administrative guidance as necessary to treat same-sex couples as married for all state and local tax purposes, regardless of the computational and compliance burden that would place on the affected couples, and on state tax administrators. At the opposite end of the spectrum, New York could eschew equivalence in taxation altogether, and make no attempt to treat same-sex couples as married for tax purposes. In between these two extremes lie a range of other possibilities.

The tax laws could, for example, simply provide that the New York taxable income of a same-sex couple is calculated by adding together the separate incomes reported on their federal single returns, making the modifications generally applicable to all New York taxpayers, and applying the rates applicable to joint returns. Alternatively, the Legislature could make more nuanced judgments as to which areas of the tax law are particularly important to the State's broader policy goals -- for example the federal tax rules for married persons that relate to dependents, property transfers between spouses, inheritance, and "divorce" -- and could enact New York tax rules that achieve equivalence for same-sex couples in those targeted areas.

This report does not suggest which option is best -- for same sex-couples, for New Yorkers generally, or for the tax system more specifically, Ultimately, that is a fundamental question of policy. Rather, we attempt to explore and explain the issues and alternatives, so that the Legislature and others may have a better understanding of the choices, and of their likely consequences.

At the end of the day, and while the technicalities and details can be complex, the overarching policy question of how best to address the New York State taxation of same-sex couples distills itself into several "big picture" questions, and several alternative options. The real task thus lie in considering which of the available options best accomplishes the Legislature's intended treatment of same-sex couples.

I. Background

On November 18, 2004, the New York State Bar Association[4] issued a "Report and Recommendations of the Special Committee to Study Issues Affecting Same-Sex Couples" (the "2004 Report").[5] In its Conclusions and Recommendations, a majority of the Special Committee that authored the 2004 Report rejected an "ad hoc" or "piecemeal" approach involving amendments of individual statutes one-by-one, in favor of a straight-forward amendment of the Domestic Relations Law "to explicitly open marriage to same-sex couples."[6] A plurality of the Special Committee favored an amendment providing for "same-sex marriage."[7] The remainder of the majority considered same-sex marriage as one of three options, the other

[4] The Tax Section is a part of the New York State Bar Association ("NYSBA"), but has not heretofore been formally involved in the NYSBA's consideration of these matters.

[5] In Parts I D. and G, the 2004 Report summarized the impact of marital status on, respectively, the federal income tax and federal transfer taxes. Tax consequences are also discussed in Part IC. of the 2004 Report, dealing with employment benefits and retirement planning. This Report supplements the 2004 Report, and in certain cases makes corrections to technical points made therein.

[6] 2004 Report, pp. 357-8.

[7] See 2004 Report, Part IV C.3.a.

two being domestic partnership and civil union.[8] The "three option" position was adopted by the NYSBA's House of Delegates at its meeting on April 2, 2004.[9]

In adopting this position, it appears that the House of Delegates approved the conclusion that "all nine members of the majority strongly believe that the Legislature should enact comprehensive legislation extending to same-sex couples the rights now extended to opposite-sex couples," and affording "same-sex couples the ability to obtain the comprehensive set of rights and responsibilities attendant to civil marriage."[10]

Subsequent to the issuance of the 2004 Report, a New York State Supreme Court Justice ruled that, insofar as it would bar same-sex couples from marrying, New York's Domestic Relations Law is unconstitutional as in violation of Article 1, Sections 6 and 11 of the New York State Constitution.[11] The crux of this ruling was that all provisions of the Domestic Relations Law are to be construed to apply equally to either men or women.

The treatment of same-sex couples under New York law may be resolved by a simple amendment to the Domestic Relations Law, as recommended by the plurality in the 2004 Report, or by an affirmance of the Hernandez decision by the Court of Appeals. In either case, however, the New York tax treatment of same-sex married couples will be, at best, confusing, given that much of New York's substantive tax law is currently premised on the federal tax law, under which same-sex couples are never treated as married.

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[8] 2004 Report, Part IV C.3.b.

[9] As noted above, all options are referred to in this Tax Section report as a "same-sex union."

[10] 2004 Report, p. 366.

[11] Hernandez v. Robles, New York Law Journal, February 7, 2005, p. 18, appeal denied ___ N.Y.2d ___ (March 31, 2005), appeal now pending in the First Department. By contrast, Samuels v. N.Y.S. Dept. of Health, which upheld the existing statute, is now on appeal to the Third Department.

II. Specific Issues Affecting New York Taxes

A. The Income Tax

1. Filing Status.

Perhaps the most common tax question presented by same-sex unions is whether the couple will be able to file joint state income tax returns. This question is more complex than it first seems, involving issues of the *rate* structure that will apply to a couple's taxable income, and whether and how the separate federal incomes, expenses, etc. of two individuals will be *combined* in calculating the amount of the couple's taxes.[12] Moreover, while it is frequently assumed that joint returns are more favorable to taxpayers, that assumption frequently is incorrect. A brief overview of the issues affected by an individual's filing status will illustrate both the complexity of this issue, and the variety of possible outcomes for New York taxpayers.

(a) Tax Rate Structure.

The federal income tax laws have long divided individual taxpayers into four filing status categories, based to some degree on marital status. Unmarried individuals generally filed under "single" status, although in certain cases an unmarried individual is eligible to file as a "head of household."[13] Married individuals either file a "joint" return, or file two "separate" tax returns. New York State likewise has a four-status filing regime: single, joint, separate and head of household.[14]

Historically, at both the federal and New York level, there have been differences in the tax rate structures applied to each filing status. The question whether a same-

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[12] Questions of joint and several liability also are implicated.

[13] See I.R.C. §§1, 2(b)(1); section II. A.2, below.

[14] N.Y. Tax Law §601.

sex married couple will be permitted (or required) to file a joint return therefore entails a question of the tax rate structure that will be applied to their income.

New York's individual personal income tax rates operate entirely independently of federal tax rates. For example, New York does not have a separate tax rate for capital gains, although currently a 15% capital gains rate is provided federally.[15] Because New York's tax rates are not based on federal rates, it is fairly simple as a technical matter to provide that same-sex couples can or must file New York tax returns on a joint basis, and to apply the same tax rates as are applicable to opposite-sex married couples filing joint returns.

Whether joint filing status produces a lower (or higher) tax burden is a much more complicated question, for which there is no uniform answer. For example, under the phenomenon commonly referred to as the "marriage penalty," joint filing status has tended to produce a federal benefit when one member of a couple earns significantly more than the other; but to produce a federal detriment (i.e., a higher tax bill) when members of a couple earn substantially equivalent amounts. Appendix I to this Report sets forth a detailed exposition of the varying taxes produced under joint vs. single returns, and provides certain data that is relevant in analyzing this issue. In New York, the personal income tax rate structure has changed over the years, in some years imposing a "marriage penalty" and in other years not; this further complicates the analysis.

The simple fact is that one cannot reliably infer from the structure of the tax law itself that any one filing status is inherently more beneficial, in terms of New York's personal income tax rates, than any another. Equivalence in the New York tax treatment of same-sex couples would simply require that the law treat them as married, such that they file

[15] I.R.C. §1(h). By contrast, the maximum federal tax rate on so-called "ordinary income" is 39%. I.R.C. §1.

joint or separate returns, and be precluded from filing under a single or head-of-household status. For some same-sex couples this equivalence will be beneficial, for others not, but in that respect only they would be no different from their opposite-sex counterparts.

(b) Head of Household Status.

As noted, both federal and New York Tax law provide a "head of household" filing status. This status is available to an individual who is not married at the close of the taxable year, is not a surviving spouse, and meets certain requirements for maintaining as his or her home the principal abode of certain defined relatives or dependents.[16] In New York State, the rate structure for head of household status generally has been "roughly halfway" between the rates applicable to married taxpayers filing joint returns and those applicable to single and separate filers.[17]

If the parties to same-sex unions are treated as equivalent to opposite-sex couples, then they would file joint or separate New York returns, and could not file as a head of household, even if one spouse (or both) does file federally as a head of household. If on the other hand same-sex couples are required to file as single or head-of-household in New York (i.e., do not file as married), then a subsidiary question arises as to whether a child of one spouse could be considered a "qualifying child" of the other, for head-of-household filing purposes.[18]

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[16] I.R.C. §2(b)(1), N.Y. Tax Law §§601(b), 607.

[17] See the 2004 Report, at p. 39. The same is generally true for City income tax purposes as well.

[18] See I.R.C. §§2(b)(1)(A)(i), 152(c), (d)(2).

(c) Combining Incomes, etc. in Joint Returns.

Another feature that stems from joint filing status is the two taxpayers' ability/obligation to report all items of income, gain, loss, deduction and credit one return. This has a several implications.

(i) Netting.

Subject to various limitations on claiming losses,[19] joint filers are able to net the income or gain of one member against the deductions or losses of another member. In some cases this is beneficial; in others not. For example, a husband's capital losses may not be currently deductible if he filed a separate return, but could be used to offset his wife's capital gains on a joint return. In this situation, joint filing confers a benefit on the married couple. On the other hand, a husband's capital gains may be offset by his wife's ordinary losses on a joint return -- an unfavorable result that might prompt a married couple to file separately.

(ii) Phase-Outs.

There are a number of tax provisions that "phase out" above certain income levels. As explained in the 2004 Report, in some cases these phase-out provisions may tend to favor single filers, because "more total income will be subject to the phase-out" on a joint return "than if the phase-out were applied against each spouse's income separately."[20] Where the ceiling on the phase out is the same for a joint return as for a separate return, the phase-out ceiling will be reached more quickly by the larger amount of the combined income on a joint return than by the amounts of income on each of two returns filed separately; in that instance there can be a benefit to filing single returns, as compared to joint or married-filing-separately.

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[19] For example, the federal "at risk" rules of I.R.C. §465, and the passive loss rules of I.R.C. §469.

[20] See the 2004 Report, at pp. 42-43.

The rather confusing federal and New York State rules that phase out itemized deductions[21] provide an example of phase-out provisions, and of the difficulty of generalizing in this area. First, there is an overall federal limitation on itemized deductions, which currently applies where adjusted gross income ("AGI") is in excess of $142,700.[22] This federal AGI limit is the same whether the return is single or joint; for married persons filing separately, the AGI limit is halved. Thus, if two unmarried individuals each have federal AGI of $142,700 in 2004, their deductions would not be limited by the federal phase-out. But if they were married, they would together reach the $142,700 limit, and some portion of their federal itemized deductions would be disallowed.

The federal disallowance of itemized deductions based on the AGI limit flows into individuals' New York tax returns, with some adjustments to reflect the "modifications" to income prescribed in the New York Tax Law.[23] In the case of a same-sex couple, however, the individuals are not considered as married for federal law, and therefore their federal limitations under I.R.C. §68 would have been calculated separately. If treated as married under New York Tax Law, then the phase-out on federal itemized deductions will need to be recalculated, based on the combined incomes of the couple, and using the then-applicable federal limit for married couples filing jointly (or alternatively the halved limit for couples filing separately).

In addition to the federal phase-out of itemized deductions that is imported into the calculation of New York taxable income, New York also imposes a separate

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[21] I.R.C. §68, N.Y.Tax Law §615(f).

[22] Federal Form 1040 (2004), Instructions p. B-1.

[23] See N.Y. Tax Law §612(b) and (c).

disallowance regime on individuals' itemized deductions, requiring further subtractions in calculating state taxable income.[24] Under this complex New York provision, joint return filers are in a better position in calculating some subtractions, but in a worse position in calculating other subtractions. Again, generalizations are impossible, as the results under the New York formula are heavily fact-sensitive.

There are a variety of other income tax provisions under which phase-out provisions may be filing-status neutral, or may be more or less favorable depending upon filing status.[25] The point, again, is simply that numerous instances exist in which, on the exact same facts, the total tax burden applicable to two individuals will differ, depending upon whether they file two single returns, one joint return, or two separate returns. While the details are complex, the question for New York's legislature is rather simple: whether to conform same-sex couples' New York filing status to their federal filing status (i.e., single), recognizing that does not provide equivalence in tax treatment; or whether instead to treat same-sex couples as married (specifying as well the mechanism for determining whether that married couple files joint or separate New York tax returns), recognizing that the treatment of these couples as married (i) will affect their total tax burden, in different ways; and (ii) will require some rather complex state-specific computations to achieve state-tax equivalence.

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[24] Increasing percentages of deductions are disallowed based upon New York AGI and filing status. N.Y. Tax Law §615(f); N.Y.C. Admin. Code §1303.

[25] Other examples of this rather confusing area include the deduction for student loan interest (I.R.C. §221; 2004 Report, p. 42, IRS Form 1040 (2004), Instructions p. 28) (ceiling is doubled for joint filers, but deduction is capped at $2,500, and married couples must file jointly to qualify); and the itemized deductions allowed for medical expenses. (I.R.C. §213). Phase-outs affecting the federal credit for retirement savings contributions (I.RC. §25B) and federal personal exemptions (I.R.C. §151), while noted in the 2004 Report, have no New York counterparts; and thus do not appear to be relevant.

(d) Standard Deductions.

Both federal and New York law allow a "standard" deduction for individuals who choose not to claim itemized income tax deductions. New York's standard deductions are not derived by reference to federal law, but instead are specifically set forth in New York's Tax Law.[26]

As specified in the current personal income tax ("PIT") statute, the standard deductions are $7,500 for single taxpayers; $14,600 for joint filers; and $6,500 for married individuals filing separately. There is, therefore, a difference of $1,600 between the allowance for married joint filers ($14,600) and that accorded two married separate filers ($13,000); and a difference of $2,000 between the allowance for two single taxpayers ($15,000) and that accorded two married separate filers ($13,000).

The policy reason for these disparities is not apparent. This does, however, serve to illustrate another instance, albeit of smaller dollar significance, in which marital status affects filing status, which in turn affects the computation of one's New York tax.

(e) A Specific New York Problem in Conforming the Filing Status of Same-Sex Couples to that of Opposite-Sex Couples.

The premise of the 2004 Report is that, under New York's laws, same-sex couples would be treated in all respects in the same manner as their opposite-sex married counterparts. In the context of determining joint vs. separate filing status, however, pure equivalence in tax treatment cannot be achieved in New York without changing the current treatment of opposite-sex married couples somewhat. Yet as the foregoing discussion illustrates,

[26] N.Y. Tax Law §614.

maintaining a difference between the filing status treatment of same-sex couples, as compared to opposite-sex couples, can translate into different amounts of tax.

New York's current tax law generally makes the New York filing status dependent upon the federal. Specifically, New York's Tax Law provides as follows:

> "(b) Husband and wife.
>
> (1) If the federal taxable income of husband or wife, both of whom are residents, is determined on a separate federal return, their New York taxable incomes shall be separately determined.
>
> (2) If the federal taxable income of husband and wife, both of whom are residents, is determined on a joint federal return, their New York taxable income shall be determined jointly.
>
> (3) If neither husband or wife, both of whom are residents, files a federal return:
>
> (A) their tax shall be determined on their joint New York taxable income, or
>
> (B) separate taxes may be determined on their separate New York taxable incomes if they both so elect.
>
> (4) If either husband or wife is a resident and the other is a nonresident or part year resident,[27] separate taxes shall be determined on their separate New York taxable incomes unless such husband and wife determine their federal taxable income jointly and both elect to determine their joint New York taxable income as if both were residents."[28]

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[27] In addition to the exception from joint filing in §611(b)(4) where one spouse is a nonresident or part year resident, the 2004 Resident Income Tax Return Packet, at page 18, sets forth other exceptions where the address or whereabouts of one spouse is unknown, or where one spouse refuses to sign a joint New York return. These exceptions require objective evidence of alienation from the filing spouse.

[28] N.Y. Tax Law §611(b). See also §612(f) ("If husband and wife determine their federal income on a joint return but are required to determine their New York income taxes separately, they shall determine their New York adjusted gross incomes separately as if their federal adjusted gross incomes had been determined separately"); §615(b) ("A husband and wife, both of whom are required to file returns under this article, shall be allowed

New York thus predicates the state income tax filing status of resident married couples on their federal status -- a resident couple who files a joint federal return *must* file a joint New York return; and a resident couple filing separate federal returns *must* file separately in New York as well. The only divergence between federal and New York filing status contemplated under New York's current law is that, under certain, specified circumstances, married couples who file jointly for federal purposes may file separately for New York purposes; no situation is contemplated where individuals who file single or separate returns for federal purposes might file a joint return for New York purposes.

This presents a dilemma, with several possible outcomes. If New York law is not changed, then New York's same-sex couples will be precluded from filing joint New York returns, because they necessarily must file as single individuals under federal law. If same-sex couples are *required* to file jointly in New York, they would be denied the right, currently available to opposite-sex couples, to file separate returns in New York just as they have filed separately (in fact singly) for federal purposes. However, if same-sex couples can file either joint or separate New York returns, regardless of their federal returns (single), then they effectively would be treated more favorably than New York resident opposite-sex couples, who generally must conform their New York filing status to their federal filing status.

The one solution that would provide equivalence in filing status would be to permit all couples to elect joint or separate New York filing status, irrespective of their federal

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New York itemized deductions only if both elect to take New York itemized deductions . . . The total of the New York itemized deductions of a husband and wife whose federal taxable income is determined on a joint return, but whose New York taxable incomes are required to be determined separately, shall be divided between them as if their federal taxable incomes had been determined separately." The relevant provisions of the New York City Administrative code for the New York City income tax, Adm. Code §§11-707(b) and 11-1711(b), are analogous to the corresponding provision of Tax Law §§607(b) and 611(b); §616(b).

filing status. Such an amendment can readily be drafted; it would, however, change the longstanding New York State treatment of couples, perhaps to the detriment of the fisc.

Another approach, albeit one not achieving complete equivalence, would be to permit same-sex couples a one-time election to choose their filing status -- married or separate. This would provide less flexibility than the annual choice of filing status available to opposite-sex married couples, yet in a sense would be more flexible, in permitting same-sex couples to choose a federal/state divergence that is unavailable to couples who are treated as married for federal purposes.

(f) Treatment of Filing Status in Other States.

A number of states have recently enacted legislation providing for same-sex marriage and for some degree of equivalence in state law treatment. These states' treatment of filing status is of interest, but ultimately does not provide a clear resolution of New York's issue.

In Massachusetts, the general rule is that resident married couples may choose whether to file jointly or separately. In the context of Massachusetts' recognition of same-sex unions, effective May 16, 2004, the Massachusetts Department of Revenue opined that a Massachusetts same-sex couple can either file a Massachusetts joint return, or can file as married persons filing separately.[29] Parties to same-sex unions cannot file as single taxpayers in Massachusetts, nor, generally, can they file as heads of households. In Massachusetts, however, since married couples historically have had the option of choosing joint or separate filing status, without regard to their federal status, Massachusetts' rule for same-sex couples in effect treats all

[29] MA Technical Information Release 04-17, July 7, 2004. Note that Massachusetts is currently considering legislation to replace same-sex "marriages" with "civil unions."

couples equivalently -- all have the right to select a Massachusetts filing status independent of the federal.

In Vermont, parties to a Vermont "civil union" are allowed to choose to file either as "Civil Union Filing Jointly" or "Civil Union Filing Separately."[30] Oddly enough, however, married couples generally must conform their state filing status to their federal. In Vermont, therefore, parties to a civil union have somewhat greater flexibility in selecting their filing status.

In Connecticut, a statute taking effect October 1, 2005 provides that "[p]arties to a civil union shall have all the same benefits, protections and responsibilities . . . as are granted to spouses in a marriage . . . ."[31] It further provides that any "term that denotes the spousal relationship" will include parties to a civil union.[32] However, Connecticut's existing tax law is fundamentally the same as New York's, requiring resident married couples to conform their Connecticut filing status to their federal filing status. It is therefore unclear how the new Connecticut statute will be interpreted.

In California, the statute provides that all registered, former and surviving "domestic partners shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, courts' rules, government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses."[33] In its proposed

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[30] VT Stat. Ann. §5812 (L.2000, P.A. No. 91, §21).

[31] CT Pub. Act No. 05-10 §14.

[32] Id. §15.

[33] CA Family Code §297.5.

form, the California legislation would have further provided that domestic partners could file joint tax returns, and be taxed in the same manner as married couples for California state income tax purposes. As enacted, however, California's statute mandated conformity to the federal status, thus precluding same-sex couples from filing joint returns. [34]

Hawaii has domestic partner legislation, but that specifically does not include equivalence in taxation. In the District of Columbia, where no legislation has yet been enacted, the Office of the Attorney General first ruled[35] that a couple married under Massachusetts' same-sex marriage statute could file on a joint basis, subject to the District's reservation of the right to revisit this determination at a later date; however the District later reversed course.[36] The District (like Massachusetts) generally permits married couples who file joint federal returns to choose either to file a D.C. joint return or to file separately (but on the same return form); if it extends the same choice to same-sex couples, D.C. would achieve equivalence in tax treatment.

2. Marital Status and the Computation of Income.

There are numerous instances in the Internal Revenue Code where the computation of taxable income is affected by marital status. Appendix II to this report is a list of Internal Revenue Code provisions in which terms such as “married” “husband” “wife” or

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[34] The California has since considered but rejected legislation extending "marriage" to same-sex couples, most recently voting against this proposal on June 2, 2005. Interestingly, in non-tax related family law matters, the existing California law expressly ignores federal status, specifying that to the extent that provisions of California law adopt, refer to, or rely upon, provisions of federal law in a way that otherwise would cause registered domestic partners to be treated differently than spouses, registered domestic partners shall be treated by California law as if federal law recognized a domestic partnership in the same manner as California law. Section 297.5(e) of the California Family Code, as amended by Section 4 of AB205.

[35] See BNA Daily Tax Report No. 76, April 21, 2005, page H-1.

[36] See BNA Daily Tax Report No. 86, May 5, 2005, page H-1, and D.C. Tax Ruling 2005-01 (May 3, 2005).

"spouse" appear. A review of this list illustrates the many and varied instances in which the federal tax law reflects a different rule, or special treatment, for circumstances involving a married couple.

In some cases the federal rules are designed to favor married couples, for example facilitating property transfers without the recognition of gain. In other cases the federal rules reflect the notion that a married couple is a single entity. Thus, for example, the hours a husband and wife spend working on an activity are added together to determine whether that business is "active" or "passive"[37]; and a husband and wife count as only one shareholder in determining qualification for S corporation status.[38]

Once again, it is impossible to generalize. There are aspects of the federal tax law under which marital status confers a benefit, and others under which the tax law's treatment of the married couple precludes their ability to engage in tax planning that an unmarried couple could accomplish. In some cases the exact same federal rule may be advantageous to one married couple, and disadvantageous to another, depending upon the nature of the question and the couples' particular factual situations.

The question presented here is how these different federal provisions impact New York's consideration of legislation that prescribes equivalence in the state law treatment of same-sex couples. Specifically, under the current structure of New York's personal income tax (or "PIT"), taxpayers calculate their New York taxable income by starting with federal taxable income, and making "modifications" that adjust the amount of the federal taxable income to produce New York taxable income. The modifications currently prescribed in the personal

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[37] I.R.C. §469.

[38] I.R.C. §1361(c)(1)(A)(i).

income tax include, for example, add-backs of federal deductions taken for state income taxes; and recomputations of depreciation to reflect New York's decoupling from the federal "bonus depreciation" enacted in 2002 (retroactive to September 11, 2001).[39]

Modifications like the add-back of state income taxes are relatively easy for taxpayers to apply, because the dollar amount of the modification is apparent on the face of the federal return, and the add-back is one simple calculation. Modifications like New York's decoupling from federal bonus depreciation are much more complex. In this case, taxpayers must add back to federal income the amount of the federal depreciation deduction claimed with respect to each affected asset in each year of the federal cost recovery period, then recalculate depreciation on the cost basis of such assets under New York's different cost recovery system, and claim the recomputed New York State depreciation amount in each year of the recovery period. If an asset is disposed of in a taxable transaction, the amount of the federal gain frequently will differ from the amount of the New York State gain, given the smaller amount of New York depreciation taken, so the taxpayer must subtract from federal income the federal gain, and substitute instead the amount of gain calculated based on the "New York basis."

Pure equivalence in the New York taxation of same-sex couples will require that such couples not only apply the "standard" New York modifications, but also that they recompute their federal taxable incomes to import into their New York returns any different income tax treatment that would have obtained in each year of the marriage had the couple reported their federal income tax as a married couple in that year. This additional layer of adjustment could be implemented under the existing structure of the personal income tax, by starting with federal income and making additions and subtractions; or it could be implemented

[39] N.Y. Tax Law §§612(b)(3), (k).

by prescribing that the couple prepare an alternate federal tax return, as if married, and then proceed with the New York modifications as currently prescribed in the personal income tax. Whatever methodology is prescribed, however, the underlying concept is that pure equivalence in state and local taxation of same-sex couples requires, as a technical matter, that (i) we identify each instance in which the federal treatment would have been different had the federal tax laws recognized the couple as married, and (ii) we then recalculate New York taxable income by applying the rules that would have applied federally, had the Internal Revenue Code taken cognizance of the marriage.

Of the states that have thus far adopted legislation to equalize the tax treatment of same-sex couples, only Massachusetts has provided any substantive guidance on the manner in which individuals are to calculate their taxes, and this guidance is rather limited.[40] If pure equivalence is to be achieved in New York, we believe that it will be crucial that taxpayers be given comprehensive guidance to ensure that all relevant adjustments are made, in the form of return instructions, or Technical Service Bulletins issued by the Department of Taxation & Finance. This guidance would need to detail each of the elements of a couple's federal taxable income that potentially could be different if they were treated as married, and detail the adjustments necessary to translate the federal taxable income of two single filers into the New York taxable income of a married couple. While such guidance clearly would be voluminous, it seems necessary; given the breadth of the affected areas, the complexity of the tax laws, and the variety of different types of adjustments that must be made, it simply is not reasonable to assume

[40] See MA Technical Information Release 04-17. Vermont has prescribed that same-sex couples are to prepare a federal return as if married, and use that to report Vermont taxable income, but has not provided any further guidance advising taxpayers of the technical adjustments this entails.

that individual taxpayers could, on their own, implement a simple instruction to recalculate their federal income as if married.

Four examples, below, serve to illustrate instances in which the computation of the amount of one's federal income is affected by marital status. These examples also illustrate the different types of recomputations that would be required under pure conformity in New York. As shown by these few examples, this can be a rather complex undertaking. Unfortunately, there are numerous other (and different) instances in which recalculation of federal income would be necessary, and could affect multiple taxpayers, and multiple tax years.

(a) Inter-Spousal Transfers and Alimony

The federal income tax includes a variety of provisions designed to provide simplicity and predictability in the income tax treatment of transfers made between spouses or incident to a divorce.[41] Under these provisions, (i) alimony can be claimed as a deduction by the spouse (or former spouse) paying alimony or separate maintenance; (ii) alimony is taxable income to the recipient; (iii) payments of child support are neither deductible to the payor nor income to the payee; (iv) transfers of property are nonrecognition events, producing neither gains nor losses to the transferor; and (v) a spouse acquiring property from the other spouse takes a carryover basis, and on his or her eventual taxable disposition of the property will use that basis to calculate taxable gain or loss.

In contrast to the special rules prescribed federally for married (or once married) persons, transfers between unmarried couples are not subject to any special federal rules. A property transfer might be considered a gift for federal income tax purposes, and thus potentially subject to gift tax. Alternatively, a transfer of encumbered property might constitute

[41] See I.R.C. §§71, 215, 1041.

a sale, triggering gain or loss based on the amount of the encumbrance less the basis. A transfer in payment of a legal obligation to the transferee would be considered a taxable sale, with the amount realized based on the full value of the property.

Same-sex couples likely will engage in transfers of property during the course of their union. Moreover, New York's treatment of same-sex couples as legally united presumably will entail as well rules for the dissolution of that union, and these in turn will implicate the income tax treatment of transfers and payments made between the divorcing couple.

If New York simply conforms to the federal computation of taxable income, then the reporting required of same-sex couples would not be particularly complicated – it would follow their federal returns. However, in that event same-sex couples clearly would not be treated in a manner equivalent to their opposite-sex counterparts under New York's tax law. Particularly as concerns the dissolution of a union, there would exist two parallel but different sets of law, one for same-sex couples and the other for opposite-sex couples. This likely would create some differences in the structure and implementation of their respective divorces.

If on the other hand New York prescribed pure equivalence in the taxation of same-sex couples, then a variety of modifications would need to be made to compute the individuals' New York taxable income(s). Specifically: (i) a spouse or former spouse paying alimony or separate maintenance under New York law to the other spouse would claim a New York deduction for that alimony; (ii) the recipient of the New York alimony would report the alimony as New York taxable income; (iii) the treatment of child support would be the same as the federal (since New York has no gift tax, the federal gift tax implications of paying child support to a same-sex spouse's child are irrelevant); (iv) any gain or loss reported federally on a

transfer of property between same-sex spouses would be reversed; and (v) a transferee of such property would recalculate any relevant federal depreciation, gain and loss on that property, in all relevant future years, to reflect his or her New York carryover basis in the property.

(b) Sales of a Personal Residence

The federal income tax allows individuals to exclude from taxable income a portion of the gain recognized on the sale of a primary residence.[42] For single taxpayers the exclusion is currently $250,000; for married taxpayers the exclusion is $500,000. In addition, in determining whether a residence qualifies as the "primary" residence eligible for the gain exclusion, married persons can take into account not only their own use of the home, but also the use of the spouse. For unmarried taxpayers, qualification requires that they themselves satisfy the use tests prescribed in the Code.

For a same-sex couple, the seller's federal exclusion will be limited to $250,000; and will be available only if the seller meets the use tests.[43] To achieve equivalence under New York's tax law, therefore, modifications would be required (i) to permit the sale of a federally nonqualified residence to qualify for a New York exclusion if the seller's same-sex spouse meets the use test; and (ii) to allow an exclusion from New York taxable income of up to $500,000 of taxable gain.

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[42] I.R.C. §121.

[43] Obviously if a same-sex couple owns the relevant residence jointly, and in fact both satisfy the use tests, their federal exclusion can in fact be equivalent to a married couple's exclusion.

(c) Grantor Trust Rules

The federal income tax law prescribes a special set of rules for the taxation of trusts. Briefly, income earned by a trust can be taxed to the trust, or can be taxed to the beneficiaries receiving distributions from the trust.[44]

In lieu of this regime for taxing trusts and their beneficiaries, however, the Internal Revenue Code also prescribes "grantor trust" treatment for certain trusts.[45] Treatment as a grantor trust means that, rather than considering the trust as a separate entity for income tax purposes, the trust's income, deductions, etc. are instead reported by the grantor. Thus, even though the trust exists as a separate legal entity, for income tax purposes the grantor trust is disregarded, and the income, deductions, gains, losses and credits of the trust are reported on the grantor's tax return, as if the grantor directly owned the assets and engaged in the activities of the trust.

Grantor trust status can be predicated upon the retention of certain powers or rights by the grantor, or by the spouse of the grantor.[46] These federal income tax rules appear to be premised on the concept that a spouse is considered to be under the control of, or a proxy for the wishes or interests of, the grantor, such that it is appropriate to treat the spouse's rights and powers as those of the grantor.

Individuals who enter into same-sex unions in New York presumably are no different from their opposite-sex counterparts insofar as issues of control, proxy or self-interest are concerned. That would lead to the conclusion that New York's tax law should

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[44] See I.R.C. Subpart J.

[45] See I.R.C. §§671 et seq.

[46] See, e.g., §§672(c), (e).

include modifications that treat a trust as a grantor trust if a same-sex spouse possesses any of the attributes specified in the Code.

Implementing that type of equivalence would, however, require that New York decouple from the federal income tax filings of the relevant parties, in a number of different ways. Income, etc. reported federally by the trust, or by the beneficiaries of the trust, would have to be reversed for New York state and local purposes. Trust income, etc., then would have to be reported on the grantor's individual New York tax return (presumably either a joint return or a married-filing-separately return). This treatment would obtain in each year in which the trust was considered a grantor trust for New York purposes, but not a grantor trust for federal tax purposes. Obviously, if multiple jurisdictions are involved, the state tax reporting among the potentially affected trusts, beneficiaries and grantors could become even more complex.

(d) Attribution Rules, Loss Disallowance, Etc.

The Internal Revenue Code includes a variety of rules prescribing special tax treatment for transactions and situations that involve related persons. Under these rules, a transaction with a spouse is accorded a different federal income tax treatment than the same transaction would entail if engaged in with an unrelated person.

For example, a taxpayer selling a property at a loss to an unrelated person may be entitled to claim that loss as a deduction in computing his or her taxable income, but the same sale, at the same loss, to a related person (to or an entity owned by a related person) would not give rise to a deductible loss.[47] If a taxpayer owes money, and that debt is acquired at a discount by a related person, the taxpayer has current cancellation-of-indebtedness ("COD")

[47] I.R.C. §267.

income; but if the person acquiring the debt is unrelated, the taxpayer does not have income.[48] A shareholder receiving a distribution in redemption of his or her stock in a corporation may have a capital gain (and basis recovery) if the remaining shareholders are unrelated, but a dividend if the remaining shareholders are related.[49] The treatment of the redeemed shareholder will affect the amount of the distributing corporation's earnings and profits; and that, in turn will affect the treatment of future distributions to other shareholders.

In each of these cases, New York can achieve pure equivalence in the taxation of same-sex and opposite-sex couples, by requiring that the incomes of the same-sex couple be recomputed to reverse out the federal treatment that followed from the couple's unrelated status under the Code (and DOMA), and to substitute the federal tax result that would obtain if the Code recognized the couple as married. Losses that were reported federally would have to be added back; COD income that did not exist federally would have to be computed and included on the New York return (as would the later interest accruals that follow such a COD event under federal law); a redeemed shareholder would reverse the federal gain reported and substitute a dividend (i.e. would have no basis recovery reflected in his or her New York return); subsequent years' New York returns, and the returns of other affected taxpayers, could be recomputed as well.

(e) The Mechanics of Computing Taxable Income for Same-Sex Couples

As the few examples set forth above illustrate, achieving pure equivalence in the computation of the taxable incomes of same-sex couples requires, at least potentially, numerous adjustments to translate the federal taxable income of two single persons to a New

[48] I.R.C. §108(e)(4).

[49] I.R.C. §302.

York taxable income of a married couple. One way to accomplish this conversion would be to dictate that same-sex couples should ignore their federal tax returns as actually filed, and instead prepare a mock federal return "as if" the couple were considered married for federal purposes as well.

The difficulty with the "mock return" approach is that the data transmitted to New York State on same-sex couples' state income tax returns would not necessarily correlate to the information reported to the IRS on the couples' single returns. This may well make it more difficult for New York to rely on federal information sharing to verify reported items; the New York reported items would not necessarily correlate to the federal, and the mock return would provide no road map to enable ready comparison of federal and state reporting.

For this reason, it may be preferable to make the adjustments that translate federal single incomes to New York married income by utilizing the same "modification" approach as currently prescribed in Article 22. While perhaps more cumbersome, the modifications will allow New York to track each specific change that translates federal income to the intended New York income.

Pure equivalence in the computation of taxable income is thus technically attainable. However it will require that numerous taxpayers make many potentially significant modifications to their federally reported income. Equivalence simply is not attainable by announcing that members of a same-sex union should fill out their New York returns as if they were married. Properly implemented, true equivalence entails a detailed and highly technical translation of two federal "single" tax returns into one "married" return, and concomitant adjustments to every other affected return. And unfortunately, the number and variety of instances in which these kinds of adjustments would have to be made are potentially quite large.

In short, the complexity that would be entailed in requiring that individual taxpayers (i) identify all instances in which their federal treatment is not applicable in New York; (ii) determine what their federal income(s) would be if the Code recognized the same-sex marriage; and (iii) make all the necessary modifications to compute New York income correctly, in all affected years and for all affected taxpayers, is potentially enormous, and would burden not only the members of same-sex unions but potentially other taxpayers as well.

This complexity clearly would also burden the administration of New York's tax laws. The New York State Department of Taxation & Finance would have the responsibility of ensuring that same-sex couples report their New York incomes correctly. It thus would fall to the Department to promulgate guidance, and any necessary forms or returns, to implement the modifications, so that same-sex couples will have the tools necessary to translate their federal taxable income to New York taxable income. Moreover, given the complexity of the issues, and the difficulty of making every modification correctly, it likely would entail additional audit and enforcement activity to ensure that same-sex couples are in fact reporting their New York taxable incomes on a basis equivalent to their opposite-sex counterparts. Whether this would give rise to concerns that same-sex couples may be "targeted" for New York tax audits is, of course, not knowable at this point, but another concern.

3. Credits.

Unlike items of gross income and deductions, the New York income tax does not directly take federal tax credits into account. However, New York does have some credits of its own, and these require consideration as well.

(a) Earned Income Tax Credits.

To qualify in 2004 for the New York State and (new in 2004) New York City earned income credits, a taxpayer (i) must have claimed the Federal EITC for 2004, and (ii) must not have investment income of more than $2,650.[50] A prerequisite to the State and City credits thus is eligibility for a federal EITC. However, a federal EITC will not be available in cases where eligibility is premised upon the presence of one or more qualifying children, and the non-biological parent spouse has no independent relationship to the other spouse's child, since federal law does not recognize the marriage. To achieve equivalence, therefore, New York needs to decouple its EITC from the federal.

On the flip side, in cases where a federal EITC is available to a single taxpayer who has no children, New York's recognition of a same-sex union, and a concomitant obligation to file joint New York returns, could render New York's EITC unavailable if the couple's combined investment income exceeded $2,650.

(b) Child Care Credits.

Under both the IRC and the New York Tax Law (for New York State only) a credit is available for "employment related expenses" of an individual who maintains a household including a "qualifying individual."[51] "Employment related expenses" are expenditures for household services or for the care of a qualifying individual, if incurred to enable the taxpayer to be gainfully employed.

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[50] See New York State 2004 Resident Income Tax Return Packet, p. 69.

[51] I.R.C. §21, as amended by the Working Families Tax Relief Act of 2004 (P.L. 108-311); New York Tax Law §606(c). New York State and City have nothing corresponding to the federal child tax credit.

One category of qualifying individual[52] is a "qualifying child" under 13. If a qualifying child resides with both parents during the taxable year, and the parents do not file a joint return, the child is treated as the qualifying child of the parent who has the higher adjusted gross income.[53] Another category of qualifying individual is any person who is physically or mentally incapable of caring for himself or herself, who has the same principal place of abode as the taxpayer for more than one-half of the taxable year, and who meets the federal income tax definition of "dependent."[54] A third type of qualifying individual is a disabled spouse of the taxpayer.

The New York credit[55] is a percentage of the credit allowable under federal law whether or not claimed for the taxable year. The availability of New York's credit to either partner in a same-sex union should not be affected by New York's recognition of the marriage, where the federal credit is based on a nondisabled minor or on a disabled dependent; whichever partner claims the credit federally should be eligible to do so for New York purposes

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[52] Defined in I.R.C. §152(a)(1) and (c) (as amended by P.L. 108-311) as an individual who is the taxpayer's child or a child's descendant, or the taxpayer's brother, sister, stepbrother, stepsister or a descendant of any such relative, who has the same principal place of abode as the taxpayer for more than one-half of the taxable year, and who has not provided over one-half of his own support for the calendar year in which the taxpayer's taxable year begins. Under §152(f)(1), a child includes a stepchild, foster child, or legally adopted child.

[53] I.R.C. §152(c)(4)(B).

[54] This definition includes (1) a "qualifying child;" and (2) a "qualifying relative," in each case as defined. See I.R.C. §152. In any instance where qualification requires a specified relationship, the New York credit would have to be "retested," taking into account the union that is ignored federally.

[55] N.Y. Tax Law §606(c).

as well.[56] And unlike the EITC, the availability of the credit for a disabled dependent is not limited to situations where there is a biological or other legal relationship to a dependent.[57]

However, with regard to a disabled spouse, parties to a same-sex New York marriage would not automatically qualify for the federal credit -- they would instead have to prove qualification as a dependent. To achieve equivalence with opposite-sex couples, therefore, New York would have to decouple its credit from the current linkage to the federal credit allowed.

There do not appear to be any other credits under the New York State or City tax laws where the existence of a marital relationship is relevant.

B. Estate and Gift Taxes

The discussion here will be limited to New York's estate tax and the generation-skipping transfer tax, inasmuch as the New York gift tax has been repealed.

1. Estate Tax.

(a) Federal Rules.

The 2004 Report[58] outlines the advantage given to a married couple for federal estate tax purposes, through the allowance of an unlimited marital deduction for particular types of bequests to a surviving spouse, generally bequests made outright or in the form of certain "qualified terminable interests" (typically a life estate or a trust providing for all

[56] If joint New York returns are required, specific amendment of Tax Law §606(c) to provide that the New York credit is the prescribed percentage of the combined §21 credits on the separate Federal returns might be appropriate.

[57] See I.R.C. §152(d)(2)(H).

[58] Part I.G.2, pp. 69-71.

trust accounting income to be paid to the surviving spouse for life) with respect to which a "qualified terminable interest property" ("QTIP") election is made.[59] These federal benefits are availably only to individuals who are recognized as married for federal tax purposes.

It should be noted that the federal estate tax currently is somewhat in a state of limbo. The maximum rate is being phased down through 2009.[60] The federal tax is to be terminated (temporarily) as of January 1, 2010,[61] but then the federal estate tax is scheduled to be fully reinstated beginning January 1, 2011.[62]

As a corollary to these transitions, the federal credit formerly allowed for state death taxes[63] has been terminated for decedents dying after December 31, 2004,[64] and replaced by a deduction for state death taxes.[65] As provided in the federal law,[66] however, there is no federal tax, and thus no deduction or credit, for the decedents dying in 2010. The credit for state death taxes would however be reinstated, in full, on January 1, 2011.

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[59] A disposition to or for the benefit of a surviving spouse who is not a citizen of the United States must satisfy additional requirements in order to qualify for the marital deduction. IRC §2056(d). The balance of the property qualifying for the marital deduction not consumed or gifted by the surviving spouse during the surviving spouse's remaining lifetime is includible upon the death of a surviving spouse in the surviving spouse's gross taxable estate.

[60] I.R.C. §2001(c)(2).

[61] I.R.C. §2210(a).

[62] P.L. 107-16, §901(a)(2).

[63] I.R.C. §2011.

[64] I.R.C. §2011(f).

[65] I.R.C. §2058.

[66] P.L. 107-16, §901(a)(2).

(b) New York's Estate Tax.

New York has elected to deal with the evanescent state of the federal estate tax by maintaining the provisions of its estate tax providing for the New York estate tax to be imposed based on the federal law[67] as in effect on July 22, 1998.[68] Thus, New York continues to impose its estate tax, regardless of the fluctuating condition of the federal tax, based upon the federal statutes as of July 22, 1998.

As with New York's income tax, therefore, New York's estate tax is based fundamentally on the federal tax statutes (albeit as of 1998). Under the federal estate tax, a same-sex spouse is not recognized as a spouse, and transfers to or for the benefit of a same-sex spouse that would qualify for the marital deduction in the case of an opposite-sex marriage therefore cannot be deducted in calculating the federal taxable estate. In order to attain equivalence in the taxation of same-sex couples, a statutory amendment would be required to qualify transfers to same-sex spouses as deductible for New York estate tax purposes and to include in the New York gross taxable estates of such surviving spouses the remaining value, if any, of property for which a New York or other applicable QTIP election has been made. Under such an amendment, the New York estate tax due in respect of the deceased same-sex spouse could be calculated by starting with the federal taxable estate, and then allowing deductions for New York purposes for transfers to the same-sex spouse that would qualify for the marital deduction in the case of opposite-sex marriages, as well as any other necessary adjustments that result from the difference between federal nonrecognition and New York State recognition of the

[67] I.R.C. §2011.

[68] New York Tax Law §§951(a), 952(a).

couple as married.[69] As with the income tax issues addressed above, consideration should be given to whether such changes would be implemented and reported through New York modifications to the federal estate tax return, or by preparing a "mock" federal return "as if married," and then proceeding with the New York modifications as they now exist for opposite-sex couples.

2. Generation Skipping Transfer Tax.

(a) Federal Rules.

As explained in the 2004 Report,[70] the federal Generation-Skipping Transfer ("GST") Tax Apples to *inter vivos* or testamentary transfers to persons two or more generations younger than the transferor, with automatic application of the tax to transfers to an unrelated transferee who is more than thirty-seven and one-half years younger than the transferor. Married persons (or formerly married persons) are presumed to be of the same generation. The children of the transferor or of the transferor's spouse, whether by blood or by legal adoption, and the spouses of such children, are presumed to be only one generation younger than the transferor. Further rules specify the generational assignments for lineal descendants of the transferor's grandparents, and for lineal descendants of the grandparents of a transferor's spouse.[71]

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[69] Another relevant provision of the federal estate tax law relates to the treatment of jointly owned property. Ordinarily, where property is held by the decedent and another person as joint tenants with right of survivorship, the entire value of the property is included in the decedent's gross estate, except such part as is shown to have originally belonged to such other person, and never to have been acquired from the decedent for less than adequate and full consideration. (In case of such an acquisition, there is excepted from the value of the property only such part as is proportionate to the consideration furnished by the other person.) IRC §2040(a). On the other hand, where property is owned jointly solely by the decedent and spouse, only one-half of the value is included in the decedent's gross estate. IRC §2040(b). Again, a statutory amendment would be necessary to make the latter provision applicable to same-sex couples legally married under New York law.

[70] Part I.G.3, p. 71-3.

[71] I.R.C. §2651(b)(1) and (2).

Like the estate tax, the Federal GST tax is in a phase-out process. There was a credit for a generation-skipping transfer tax actually paid to a state on any generation-skipping transfers (excluding so called "direct skips") resulting from the death of an individual, which credit is no longer applicable to generation-skipping transfers after December 31, 2004.[72] In addition, the federal GST tax is to be inapplicable to transfers made in 2010,[73] but will be reinstated with respect to transfers made after December 31, 2010.[74]

(b) New York's GST.

Again, as in the case of the estate tax, New York has effectively decoupled itself from the fluid state of the federal GST tax, by continuing to provide that its GST tax is imposed in an amount equal to the maximum amount of the credit for state GST taxes that was allowed under federal law as in effect on July 22, 1998.[75] (Despite the repeal of the New York gift tax, the New York GST tax still applies with respect to certain generation-skipping transfers that may occur with respect to property held in either *inter vivos* or testamentary trusts.[76])

Here again, because the New York GST tax remains coupled to the federal provisions as in effect in 1998, the legalization of same-sex unions in New York would not, absent a corresponding change in New York's tax laws, change the determination of which transfers are subject to the New York GST tax. And as noted above, given the marriage-based

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[72] I.R.C. §2604(c).

[73] I.R.C. §2604.

[74] P.L. 107-16 §901(a).

[75] N.Y. Tax Law §§1020(a), 1021(a), 1022. A special rule apportioned the federal credit where more than one state was involved.

[76] N.Y. Tax Law §1021(c).

generational presumptions of the GST tax, status as "married" can be relevant in determining whether transfers to or for the benefit of (i) a same-sex spouse of the transferor, (ii) a child or other relative (e.g., a niece) of a same-sex spouse, and (iii) a same-sex spouse of a transferor's child (or step-child) are generation-skipping transfers. To attain equivalence in the application of New York's GST tax to same-sex couples, it thus is necessary to enact New York legislation that changes the definition of "spouse" (etc.) under New York's GST tax. The New York tax payable with respect to a particular generation-skipping transfer would then be calculated under the federal rules as in effect in 1998, but making any specific changes that are occasioned by New York's broader definition of marriage.

C. Employment Benefits and Retirement Plans

1. Health Coverage.

(a) Federal Rules.

Gross income of an employee does not include the monetary value of employer-provided health coverage and reimbursements received through an employer-provided health plan, whether provided to the employee, his spouse or his dependents.[77] A domestic partner or same-sex spouse could qualify as a dependent if he or she meets the requirements of the Code.[78]

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[77] See the 2004 Report, Part I.C.1, pp. 27-9.

[78] A non-spouse, non-child individual who, for the taxpayer's taxable year, has the same principal place of abode as the taxpayer, is a member of the taxpayer's household, has gross income of less than $2,000 as adjusted ($3,100 in 2004), and with respect to whom the taxpayer provides over one-half the support for the calendar year in which such taxable year begins. I.R.C. §152, amended by the Working Families Tax Relief Act of 2004 (P.L. 108-311).

If a same-sex spouse does not meet all of the requirements for "dependent" status, however, any health benefits extended to such individual by the other spouse's employer would result in taxable income to the employee spouse, and would be subject to income tax withholding.[79]

(b) New York Issues.

Since all the terms of Article 22 of the Tax Law have, in general, the same meaning as when used in a comparable context in the Internal Revenue Code,[80] legalization of same-sex unions in New York would not, in se, change the federal treatment of benefits in respect of same-sex spouses as taxable. Again, therefore, to establish equivalence in the tax treatment of such benefits, legislation would be needed to decouple New York's treatment of these benefits from the federal.

2. ERISA Issues.

The treatment of individuals and of plans under the Employee Retirement Income Security Act ("ERISA")[81] merits particular note when considering New York's tax treatment of same-sex couples. Again, under DOMA, a same-sex couple will not be considered as married under any provision of federal law, including ERISA. Furthermore, ERISA includes a "preemption provision" under which states are affirmatively prohibited from imposing taxes (or other laws) that affect an ERISA-qualified plan.[82]

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[79] See 2004 Report, pp. 28-29.

[80] N.Y. Tax Law §607(a).

[81] Pub. Law 93-406, I.R.C. §§401 et seq.

[82] Specifically, ERISA §514(a) (29 U.S.C. §1144(a)) provides that "the provisions of [ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan . . . ." See also Morgan Guar. Trust v. Tax Appeals Tribunal 80 N.Y. 2d 44, 50 (N.Y. 1992) (ERISA precludes states from imposing any tax that relates to a benefit plan "in more than a tenuous, remote or peripheral way"); McKinsey

Given ERISA's preemption rule, New York State cannot enact legislation that purports to affect the qualification of a plan, based upon its treatment of same-sex couples. It would be a clear violation of the preemption rule, for example, for New York State to assert that a plan was disqualified for state tax purposes, and thus subject to state income tax, for failing to treat same-sex couples in the same manner as opposite-sex couples are treated.

A somewhat different question might arise if New York's income tax laws were to prescribe a different treatment of individual plan participants -- for example imposing tax on an individual, or providing an individual an exemption from tax, based upon a plan's terms regarding same-sex couples. States have the right, notwithstanding ERISA, to choose not to impose income taxes at all on individuals;[83] or to impose tax measured by something other than federal taxable income.[84] It might be possible to provide differing tax treatment of New York individuals based on the terms of a plan. However, given the scope of ERISA's preemption rule we question whether differing income tax treatment of plan beneficiaries would in fact be permissible. Moreover, whether such differentiation is desirable as a policy matter is another important question.

Another issue that arises when considering the interface of ERISA with an objective of equivalence in the taxation of same-sex couples is the possibility that specific plans might be drafted to provide benefits to same-sex couples on a basis commensurate with the benefits available to opposite-sex couples. Where the federal ERISA rules are not based on marital status, plans may be able to offer comparable benefits to same-sex couples without

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Master Retirement Plan Trust, DTA No. 817551 (N.Y.S. Tax Appeals Tribunal, May 8, 2003) (New York's unrelated business income tax on ERISA plans is preempted).

[83] See, e.g., Florida, Nevada.

[84] See, e.g., New Jersey's former tax on individuals' gross income.

compromising the plan's ability to qualify under ERISA. For example, a plan may be able to offer joint and survivor annuity benefits to any participant, whether considered married under federal law, or only under New York law (or not at all), without impairing the plan's qualification.

On the other hand, there are elements of ERISA that are specifically tied to spousal status. For example, ERISA prohibits the assignment of benefits, except to a "spouse" pursuant to a qualified domestic relations order in connection with a divorce. Given DOMA, that use of the term "spouse" means *only* an opposite-sex spouse. If, in a well-intentioned attempt to treat same-sex employees equivalently, an employer drafted the terms of a particular plan to permit an assignment of benefits to a same-sex spouse, that would constitute a federally prohibited assignment, and a plan incorporating such a provision would run afoul of ERISA. (Because this would not be a direct result of state action purporting to regulate the plan, but instead is due to a flaw in the plan itself, ERISA's preemption rule would not appear relevant, and could not be invoked to "save" this plan from federal disqualification.)

Obviously, any plan's failure to satisfy the federal ERISA rules could have significant adverse consequences for the plan, and for all of the plan's participants (not just same-sex couples).[85] This kind of issue should therefore be recognized as a potential trap for the unwary, and an area in which clarity and education may be important to protect plans and plan participants from costly errors.

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[85] For a further discussion of ERISA and same-sex marriage laws see To Be or Not To Be: The Impact of Same Sex Marriages on Employee Benefits, The Milliman Employee Benefits Research Group, Milliman Consultants and Actuaries, October 15, 2004 (available at www.milliman.com).

III. Legislative Approaches

There are a variety of different approaches that could be followed in amending New York's existing tax laws to achieve equivalence, or the chosen extent of equivalence, in the taxation of same-sex couples, as compared to their opposite-sex counterparts. Set forth below are several different approaches. We note that statutory amendments to implement equivalence, or even partial equivalence, in state taxation of same-sex couples would not only entail changes to such individuals' federally reported income, but in some cases could also affect the income of other persons (e.g., trust beneficiaries).

A. Blanket Legislation

One approach, which appears to be that taken most recently by the State of Connecticut, is to enact blanket legislation prescribing that same-sex couples are to be treated as married for all purposes of New York law.[86] This approach is relatively simple in terms of legislative drafting. It may, however, be overly simplistic in certain technical respects. For example, New York's joint-vs-separate return issue, addressed in Part II. A.1.(e) and (f), above, would not be clarified to any meaningful extent by such an enactment. More broadly, given that New York's tax laws specifically reference federal tax laws, and same-sex persons are not considered as married in calculating federal taxes, overly simple and generic language would likely create a

[86] Sections 14 and 15 of Connecticut Pub. Act No. 05-10 provide as follows: "Sec. 14 (NEW) (Effective October 1, 2005) Parties to a civil union shall have all the same benefits, protections and responsibilities under law, whether derived from the general statutes, administrative regulations or court rules, policy, common law or any other source of civil law, as are granted to spouses in a marriage, which is defined as the union of one man and one woman. Sec. 15 (NEW) (Effective October 1, 2005) Wherever in the general statutes the terms 'spouse', 'family', 'immediate family', 'dependent', 'next of kin' or any other term that denotes the spousal relationship are used or defined, a party to a civil union shall be included in such use or definition, and wherever in the general statutes, except . . . section 14 of this act, the term 'marriage' is used or defined, a civil union shall be included in such use or definition."

great deal of confusion in the application of the tax laws, and would in many instances fail to adequately describe the desired tax treatment of same-sex couples.

B. Generalized Amendments to the Tax Laws

A different approach would be to specifically amend the Tax Law, or perhaps each of the PIT (Article 22), Estate Tax (Article 26), Generation Skipping Transfer Tax (Article 26-B), to incorporate equivalence in treatment into the Tax Law itself. For example, the "General Provisions and Definitions" section 605 of Article 22 could be amended to add two new subsections, as follows:

> "(d) This Article shall apply to individuals who are parties to a same-sex union (or surviving parties thereto) as if the federal Internal Revenue Code (and any other revenue act of the United States) recognized such same-sex union, and considered the parties as spouses, in the same manner as provided under the New York [Domestic Relations] Law.
>
> (e) In applying any provision of the Internal Revenue Code for any purpose under this Article, any reference to "married," "spouse," "husband," "wife," "widow," or similar terms shall include partners in a same-sex union that is recognized under New York Domestic Relations Law, even if not so recognized under federal law."[87]

C. Specific Tax Law Amendments

A third approach would be to include in the Tax Law more finely-tuned amendments, reflecting the specific context in which the same-sex marriage is to be recognized. By way of example:

[87] Obviously, the specific language used in the Tax Law would need to conform to the ultimate statutory language used in the Domestic Relation Law, or elsewhere.

- The New York provisions that define marital status,[88] would be amended to add the following language to (b), as well as a new subsection (c):

> "provided however that individuals who are parties to a same-sex union shall be treated as married, and shall be treated the same as a 'husband and wife' wherever such terms (or terms similar thereto) appear in other sections of this article."
>
> "(c) 'Same-sex union' shall mean [refer to relevant provisions of Domestic Relations or other laws]." In applying relevant provisions of the Internal Revenue Code or the Tax Law, any reference to "married," "spouse," "husband," "wife," "widow," or similar terms shall include partners in a same-sex union.

- The provisions relating to filing status, [89] would (subject to resolving the substantive issues addressed above) be amended to add the following language:

> ", provided however that, in the case of parties to a same-sex union, their New York tax shall be determined jointly."

- New York's credit for household and dependent care services[90] would be amended to add the following paragraph:

> "(6) In the case of parties to a same-sex union, the reference in paragraph (1) hereof to the credit allowable under section twenty-one of the internal revenue code for the same taxable year shall be deemed to refer to the sum of such credits as so allowable on their separate federal returns."

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[88] N.Y. Tax Law §607(b).

[89] N.Y. Tax Law §611(b)(1).

[90] N.Y. Tax Law §606(c).

- New York's "modifications" to be subtracted from federal adjusted gross income in calculating New York income[91] would be amended to add the following paragraph:

> "(38) In the case of parties to a same-sex union, in calculating loss on the sale or other disposition by one spouse of property acquired by gift from the other spouse, the excess of the adjusted basis of such property to the donor spouse at the time of the gift over the fair market value of such property at such time."

- Without attempting to provide precise language, Article 26 of the Tax Law would be amended to provide that, in the case of parties to a same-sex union, any bequest by one of such spouses to the other, either outright or in another form that would qualify for a federal estate tax marital deduction, will be treated as if made between spouses that are recognized as legally married under federal law in determining the maximum amount allowable against the estate tax as a credit for state death taxes under Code §2011 (as in effect on July 22, 1998). Likewise, Article 26 would be amended (i) to provide for an inclusion of "QTIP election property" in the gross taxable estate of a surviving same-sex spouse, and (ii) to provide that, in the case of property jointly held by such spouses, they would be treated as if they were legally married under federal law in determining the portion of the value of such property that is includible in the gross estate of one of such spouses.

- Again without attempting to provide precise language, Article 26-B of the Tax Law would be amended to provide that, in determining generation assignment for

[91] N.Y. Tax Law §612(c).

purposes of the New York generation-skipping transfer tax, parties to same-sex unions would be treated as spouses.

- Each instance of disparity between the treatment of items of income, gain, loss, deduction, credits or basis under particular provisions of the Internal Revenue Code, as compared to the treatment under New York's Tax Law as amended to recognize same-sex unions, could further require corresponding amendments prescribing the addition or subtraction modifications that are required, in each case, to translate federal income to New York income.[92]

Obviously, this approach is considerably more cumbersome as a drafting matter, and will require ongoing updating as New York's Tax Laws are amended in the future. This approach may, however, prove to be more useful over the long term, by specifically and technically addressing situations in which a more finely-tuned statutory amendment better serves to achieve equivalence in tax treatment, without creating inconsistencies or undue confusion.

D. Partial Decoupling from Pure Equivalence

As set forth above, the federal income tax law contains numerous provisions under which the status of two individuals as married, or not, affects the computation of their federal taxable income. A directive to same-sex couples to apply New York's tax laws as if their marriage were recognized for federal income tax purposes requires -- if properly complied with -- an analysis of all of the potentially relevant federal rules in which marital status matters, and modifications

[92] See N.Y. Tax Law §§612(b), (c), (d), 615(b), (c), (d). Compare also §§612(e), 615(e).

of separate federal incomes to reflect the recalculated "as if married" federal income(s).[93] Equivalence is not simply a matter of adding two incomes together and reporting the sum on a joint return; there potentially are dozens of substantive changes that are required to achieve equivalence. It therefore bears repeating that, while pure equivalence is technically attainable, the task can be quite complex, and entail considerable (and possibly multi-taxpayer and multi-year) decoupling from the federal income tax.

Because pure equivalence is complex and burdensome, a different approach might be to follow a policy of equivalence in certain aspects of New York tax, but yield to the administrative advantages of federal conformity in other aspects of New York tax. New York could, for example, recognize same-sex unions in its definition of "spouse" for estate and GST tax purposes, in its tax treatment of alimony and transfers of property between spouses or incident to a divorce, and in its taxation of employee benefits, yet could opt for federal conformity in areas where equivalence is considered less important as a policy matter (for example, the classification of a stock redemption as a dividend, or not, under Code §302).

Another approach to partial equivalence would be to provide for the filing of joint New York income tax returns by same-sex couples, but mandate that the amount of income imported into the New York joint return is to be based upon the federal taxable income reported by the two same-sex spouses on their federal (single) returns. This approach would treat same-sex couples as equivalent to their opposite-sex counterparts in regards to matters such as New York's tax rate brackets, the netting of income and loss, and the various New York phase-outs. It would, however, otherwise follow the federal treatment of a same-sex couple as two single persons in

[93] Depending on the New York filing status, this could be one joint income, or two incomes of married individuals filing separately.

calculating taxable income, thus eliminating the conformity issues (e.g., the treatment of grantor trusts, and applications of the federal attribution rules, etc.).

Other variations are possible. New York could, for example, add the two federal incomes together, but also provide that same-sex couples are to be treated as spouses for purposes of New York's estate and GST taxes. New York could even couple a generalized instruction to add together the two federal income amounts with limited New York modifications that fine-tune taxable income to achieve equivalence in specific targeted areas, for example alimony.

These kinds of approaches would not achieve pure equivalence. They would further require that the Legislature undertake a section-by-section review of the relevant provisions of the Internal Revenue Code, and make numerous policy choices as to whether, in any given context, the goal of primary importance is equivalence in the treatment of married couples, or instead conformity to federal computations of income. Partial decoupling is nonetheless technically possible, and a potential compromise between pure equivalence and efficient tax administration.

E. Local Tax Laws

As appropriate, conforming amendments corresponding to those described above would also be made to the corresponding provisions of the New York City Administrative Code, and possibly the related enabling legislation as well.

IV. Conclusion

As this report illustrates, the taxation of individuals is not a simple subject. In both the federal tax laws and the laws of New York there are numerous highly technical provisions, and complex layers of computations that, in a number of cases, seem to have no internal logic, and no overall coordination. Yet this is the system we have.

The issue addressed herein is attaining equivalence in the New York state and local tax treatment of individuals who are not considered married for federal income tax purposes, but are considered married for New York purposes. In some cases, equivalence is relatively easy to achieve, both legislatively and in the application of New York's tax laws to the affected individuals. Applying the same New York income tax rates to same-sex and opposite-sex couples, and recalculating New York's estate tax to allow deductions for transfers to a same-sex spouse are, for example, quite easy to legislate, and relatively easy for individuals and tax administrators to understand and apply.

In other respects, however, equivalence in taxation becomes more complex, given New York's fundamental premise of conformity to federal law, and the large number of federal tax provisions that are affected by marital status. Again, it is not particularly difficult to draft legislation that achieves equivalence in New York taxation. However, in the application of the amended tax laws to the affected individuals, particularly where decoupling calculations must be made for multiple taxpayers and/or over multiple years, pure equivalence clearly will create significant complexity.

That complexity, like all complexity, can be managed. No doubt new computer programs would be developed to assist individuals in identifying the changes that are necessary to translate

their federal single returns into New York state returns as a same-sex couple. However, complexity does burden the system. And inevitably, particularly where the taxation of individuals is involved, complexity leads to breakdowns in compliance, and to difficulties in administration. Finally, because there would be no federal support, either in interpretation or in enforcement, for a tax regime that recognizes same-sex unions, it will fall to New York's tax administrators to interpret and enforce whatever rules are legislated for same-sex unions.

It is in a sense ironic, given the overall objective of the 2004 Report, yet it is inescapable that the implementation of a New York tax regime that provides pure equivalence in the state and local tax treatment of same-sex couples will, in the end, give rise to a new and rather complex subset of tax laws that will apply to only this particular demographic group. Ultimately, it is the province of the New York Legislature and the Governor to decide which policy New York will pursue, and the means by which that policy will be reflected in statutory changes. The Tax Section is, as always, available to provide technical assistance in that regard.