Tax Implications of Same Sex Marriages in NY

The Marriage Equality Act in New York[1] applies to all taxes administered by the New York State Tax Department. While same sex couples rejoice over this legislation, tax practitioners now must evaluate how to handle the various issues raised. This article addresses, with respect to same sex marriages, the filing status for personal income tax and estate tax at the state and federal levels, as well as possible additional exposure to NYS collection action and NYS residency audits.

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Personal Income Tax

Same-sex married couples must file New York State income tax returns using a married filing status, either married filing jointly or married filing separately, even though for federal purposes, the married filing status for same-sex couples is not recognized. For taxpayers who use the calendar year as their tax year, the first tax year implicated by the new law is the 2011 tax year; the new law is not retroactive. New York State applies a "snapshot" rule: Same sex married couples who are married on the last day of the 2011 tax year, for example, must file in New York State as married; marital status before or after the last day of the tax year is irrelevant.

The New York individual income tax return requires various figures reported on the federal return (e.g. federal income, deductions, and credits) to compute the state income tax. Same sex couples, however, cannot file federal income tax returns as married because the Defense of Marriage Act[2] prohibits such action. As a result, same sex couples must prepare two sets of federal returns:

- Filing status as single or head of household, one for each spouse. These federal returns are actually filed with the IRS; and
- Filing status as married filing jointly (one return) or married filing separately (two returns, one for each spouse).

These "dummy" federal returns are prepared only for purposes of computing the New York income tax; they are not filed.

Estate Tax

Similar to the approach for income tax, the taxable estate of a deceased

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spouse from a same sex marriage in New York must be computed as if the spouse were married for federal estate purposes. In other words, a "dummy" Form 706 must be prepared to compute the New York taxable estate of the deceased same-sex spouse. This Form 706 is in addition to the Form 706 that is filed, if required, that treats the same-sex spouse as single or head of household.

One should note that several items may be included in the deceased same sex spouse's "dummy" Form 706 but not in the filed Form 706, such as the marital deduction, Q-TIP property, qualified joint interests, and gifts to third parties. Keep in mind that for the 2011 tax year, New York requires an estate tax return only if the decedent's taxable estate exceeds $1 million, and the IRS requires an estate tax return only if decedent's taxable estate exceeds $5 million.

New York State Tax Liabilities

Married taxpayers filing a joint income tax return are jointly and severally liable for any tax liability arising from that tax year. In New York, same sex couples may now file joint NYS income tax returns. Inevitably, due to either insufficient tax payments during the year or an examination resulting in a deficiency, some same sex couples will face NYS collection action on their joint tax liabilities.

There are various avenues available for collection relief from NYS tax liabilities, such as an Installment Payment Agreement or an Offer in Compromise. For joint tax liabilities of same sex couples, NYS will require detailed financial information of both spouses, even if the liability arose from income or deductions

relating to only one spouse. This information is provided to NYS on DTF-5, Statement of Financial Condition and Information. The DTF-5 requires disclosure of each spouse's assets, liabilities, income, and expenses. If each same sex spouse instead files separately, however, NYS may not require the non-liable spouse's financial information for purposes of setting up an Installment Payment Agreement. Is the same true for Offers in Compromise?

Under a new law, eligibility to participate in the Offer in Compromise program has been expanded to include individual taxpayers who demonstrate that collection in full of a NYS tax liability will cause the taxpayer "undue economic hardship." As of the writing of this article, the Commissioner of Taxation and Finance is developing regulations to define "undue economic hardship." Accordingly, it is unclear whether NYS will require disclosure of the non-liable spouse's financial information as part of the Offer submission. Because of this possibility, for same sex couples as with different sex couples, unmarried taxpayers with NYS liabilities contemplating marriage should consider submitting an Offer, if one seems feasible, before getting married.

For federal liabilities, it is unclear whether the analysis for collection alternatives will change by the passage of the Marriage Equality Act; what is clear is that same-sex couples cannot be assessed for joint federal tax liabilities. For IRS Installment Agreement and Offer in Compromise purposes, it remains to be seen whether the IRS will view a non-liable same sex spouse on equal footing with a mere roommate.

Residency Considerations

New York State conducts audits of taxpayers to determine residency status in order to be certain that a person claiming to be a nonresident of the state is paying the appropriate tax. Nonresidents generally pay tax to the State on income earned in New York, for example, but a New York City resident should pay NYS and NYC tax on the resident's worldwide income. A comprehensive discussion about residency in New York is beyond the scope of this article. Nevertheless, a brief overview of possible residency issues arising from the Marriage Equality Act makes it clear that practitioners should be mindful of the various implications when advising clients.

Same sex married couples filing as married in New York may be on the State's radar for residency audits, particularly if one spouse with significant out-of-state source income files as a nonresident and the other spouse files as a resident. A taxpayer is considered a NYS resident if deemed (a) a statutory resident or (b) domiciled in New York. Under either test, a change in filing status from single to married may subject the taxpayer to residency scrutiny.

A taxpayer is a statutory resident if he (1) maintains a permanent place of abode in NY and (2) spends more than 183 days in NY. Suppose a same sex spouse with substantial intangible income lives in New Jersey, works full-time in New York, and marries a taxpayer who is a statutory resident and maintains an apartment in New York. Prior to the marriage, he might be a nonresident, taxed only on his New York income. After the marriage, however, NYS may take the position that the New York dwelling is a permanent place of abode for both spouses. The result could be that both spouses are found to be statutory residents and thus the couple would be subject to NYS and NYC tax on their worldwide income.

The domicile test is based on five primary factors and numerous other factors, and looks to determine where the taxpayer's true home lies. One of the five primary domicile factors is Family Connections. A taxpayer claiming a change in domicile to somewhere outside New York State may have a more difficult time meeting the burden of proof for the domicile change if the taxpayer's same-sex spouse lives in New York.

Conclusion

In the context of personal income tax, estate and gift tax, NYS tax collections, and NYS and NYC residency, it is evident that there are many implications resulting from the enactment of the Marriage Equality Act. Careful analysis of the particular facts and circumstances for each same sex couple is required as we embark upon the application of the new law.

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1. N.Y. Domestic Relations Law § 10-a (McKinney 2011).
2. 1 U.S.C. § 7 (2006).