**AICPA SAMPLE CLIENT LETTER ON DOMA RULING POTENTIAL TAX IMPACT**

Dear Client:

RE: Tax and Planning Impact of Supreme Court’s Ruling in the Defense of Marriage Act (DOMA) Same-Sex Marriage Rights Case

**Background**

On June 26, 2013, the U.S. Supreme Court ruled on a landmark case related to same-sex marriage (SSM) ([*United States v. Windsor*](http://www.supremecourt.gov/opinions/12pdf/12-307_6j37.pdf)). The 5-4 decision changes the application of federal tax rules for married same-sex couples. Generally, the ruling should enable same-sex married couples to obtain the same treatment under federal rules as has been available to heterosexual married couples. Federal agencies are working on issuing guidance on the effect of the *Windsor* decision, including whether federal rules treat a couple as married based on the state of celebration (where the marriage was performed) or state of domicile (where the couple lives). In late August, the IRS released guidance stating that for federal tax purposes, a marriage is recognized if validly entered into in a domestic or foreign jurisdiction that has the legal authority to sanction marriages. Thus, for federal tax purposes, the IRS is following the state of celebration rule to determine if a couple is married. The Departments of Labor, Defense and Homeland Security have also adopted a state of celebration rule. However, it is important to realize that the Social Security Administration, by law, currently uses a state of domicile rule.

Same-sex couples who have not been legally married are unaffected by this ruling until their marital status is legally changed according to domestic or foreign country law.

The case has broad federal tax planning and compliance implications. This letter will provide:

* An overview of the Supreme Court’s decision and what it may mean for you;
* Considerations with respect to estate, retirement, income tax, and health and welfare benefits plans; and
* Actions to consider with respect to long-term planning and tax return preparation.

**Tax Implications**

Federal tax treatment now available to legally married same-sex couples includes:

* Joint filing of federal income tax returns
* Amending of prior tax returns
* Pre-tax basis of employer-provided health-care benefits
* Deductible and includable alimony
* Income tax-free transfers between spouses
* Lifetime gift tax-free property transfers to spouses
* Estate tax relief for surviving spouses
* Spousal IRA contributions, rollovers, required minimum distributions

**Filing of Tax Returns**

Guidance from the IRS issued in August 2013 provides that any original return, amended return, claim for refund or credit, filed on or after September 16, 2013 by a same-sex married taxpayer must use a married filing status. So, extended 2012 returns filed after September 15, 2013 must use the married filing joint or married filing separately status, similarly for 2013 returns and beyond.

**Amending of Tax Returns**

Consideration should be given to amending federal income tax returns and gift and estate tax returns (for years that are still open under the tax law’s statute of limitations) to change marital and filing status and other information that will alter the tax calculations and potentially result in a lower tax liability. State tax implications also should be reviewed. Returns may be amended to correct filing status, dependents, income, deductions, or tax credits. Couples may want to estimate the income tax liability that would have been due in previous years if the couple had been able file a joint return. Even basic items are impacted, such as standard deductions, child-related tax credits, and phase-outs of certain benefits, such as the education expense deduction. Another example of a tax change is where one spouse could have had capital losses on investments in prior years that the other spouse’s gains would offset if they could have filed joint federal returns. However, the “marriage penalty” could be applicable for some couples and the married filing joint or married filing separate filing status may result in a higher tax liability, especially high-earning couples where both spouses are working. Each situation will need to be reviewed carefully. The guidance from the IRS does not require the filing of amended returns for 2012 and earlier years.

**Excludable Employer-Provided Fringe Benefits**

Employer-provided fringe benefits for the same-sex spouse of an employee will now be excludable from gross income. Employers should stop including this benefit in income as of September 16, 2013. The IRS issued guidance on September 23, 2013, on how employers can claim a refund of Social Security and Medicare taxes that they and the employee paid on these benefits for prior years, as well as amounts withheld during the current tax year.

Also, now that taxes should no longer be a factor, some couples may want to re-evaluate their health insurance choices. One spouse may now be able to move onto the other’s more generous plan, which may also be more affordable. You should check with your employer to see if perhaps an open enrollment period was created for this purpose.

Also, even if not changing health plans, you can file an amended return to obtain a refund of taxes you paid on those benefits in previous years that are still open for amending (generally returns filed within the last three years). We can discuss this option with you in more detail so you can see the tax effect of other changes that would occur on the amended return when you change your filing status.

**Adoption Credit**

Some couples will need to consider the impact of amending past returns on the adoption tax credit and whether the change in federal filing status will have an impact on the credit.

**Deductible and Includable Alimony**

Married same-sex couples who later divorce should be able to take a deduction for alimony, which would be includable in the income of the recipient. Previously married same sex couples who are now divorced may be able to amend returns for the same reason.

**Income Tax-Free Transfers of Property Between Spouses**

Gain or loss should not be recognized on the transfer of property between same-sex spouses or between former spouses incident to a divorce. It remains unclear how previous transfers and the basis of those assets will be affected. The IRS may issue further guidance on this point.

**Gift and Estate-Tax Free Transfers/Unlimited Marital Deduction**

Married same-sex couples may claim the unlimited marital deduction for federal estate and gift tax purposes, allowing a spouse to transfer an unrestricted amount of assets to his or her spouse at any time, including at the death of the transferor, free from gift and estate taxes. The unlimited marital deduction is considered an estate preservation tool because assets can be distributed to a surviving spouse without incurring estate or gift tax liabilities. Some couples that set up trusts to avoid double taxation on assets being passed along to their partners may find that a trust is no longer necessary now that assets can be passed directly to a spouse tax-free. Others may want to update their trusts to give their spouses tax-free access to the trust’s income or principal, an option this is now available to married same-sex couples.

In addition, married same-sex couples can now elect to split gifts in order to take advantage of doubled annual gift tax exclusion ($14,000 for 2013, for a total tax-free gift of $28,000). Married same-sex couples may also share assets without being subject to gift taxes. For example, prior to the ruling, couples that owned a house together but did not equally split mortgage payments and other expenses may have had those expenses covered by one spouse be subject to gift taxes if they exceeded $14,000 annually. Now that same-sex marriages are recognized for federal tax purposes, some married same-sex couples may feel more comfortable adding their spouse’s name to the property title, knowing that they have more flexibility on how they choose to split those expenses and with no gift tax implications.

**Portability of Unused Estate Tax Exemption Amount**

The American Taxpayer Relief Act of 2012 extended permanently the concept of portability, which generally allows the estate of a surviving spouse to utilize the unused portion of the estate tax applicable exclusion amount ($5.1 million in 2012, and $5.25 million in 2013) of his or her last predeceased spouse. Now, the surviving spouse of a married same-sex couple can take advantage of portability of the unused estate tax exemption amount of his or her deceased spouse.

**Related Party Rules**

Same-sex married couples who are now considered married for federal income and gift and estate purposes are subject to related party rules.  This could impact the tax consequences of transactions between same-sex spouses.  Prior to this ruling, married same-sex couples were treated for tax purposes as not related for certain transactions such as selling property between them and recognizing a loss. After this ruling, recognition of this same loss would not be allowed under the related party rules.

**Spousal IRA Contributions, Rollovers, and Required Minimum Distribution**

Married same-sex couples now have many more retirement plan options and issues to consider, including spousal IRAs, contributions, beneficiary designations, rollovers, and required minimum distribution (RMD) rules. Married same-sex couples with the only beneficiary a spouse who is more than 10 years younger can now use the joint table rather than the “uniform table” for distributions. A surviving spouse can now consider whether to make a spousal rollover of a deceased spouse’s IRA or 401(k). The IRS has promised further guidance regarding both prospective and retroactive changes to pension plans, IRAs and retirement distributions.

**Other Federal Benefits**

In addition, below are some of the federal benefits or protections that may now be available to legally married same-sex couples:

* Social Security, Medicare, and Medicaid benefits
* Certain veterans benefits, such as pensions and survivor’s benefits
* Military spousal benefits
* Family medical leave rights
* Spousal visas for foreign national spouses
* Private pension benefit options (e.g., survivor annuities)
* Application of the thresholds for the tax penalties and health insurance subsidies available under the Patient Protection and Affordable Care Act

**Income and Estate and Gift Tax Planning Issues**

Some of the specific individual income tax and estate and gift tax planning issues that may be impacted and should be considered are:

* **Income Tax Planning Issues**
  + Joint tax returns
  + Amended income tax returns
  + Estimated tax payments for 2013
  + Income tax returns beyond the statute of limitations
  + Rollover IRAs at death
  + Spousal IRA contributions and rollovers
  + IRA required minimum distributions
  + Review of the designated beneficiary on retirement and other benefits provided by an employer
  + Divorce tax issues
  + Application of the adoption tax credit
* **Estate & Gift Tax Planning**
  + Updated estate plans and documents
  + Inter vivos gifts
  + Amended gift tax returns
  + Gift and estate tax returns beyond the statute of limitations
  + Portability of unused applicable lifetime exemption
  + Grantor trusts
  + Spousal rollover
  + Beneficiary designations
  + Retirement plans
  + Community property rules
  + Marital Agreements

**Guidance From the Federal Government**

The Supreme Court’s DOMA ruling generally means that married same-sex couples are entitled to the same federal benefits as heterosexual couples, but it does not necessarily make financial planning and tax compliance for married same-sex couples less complicated. Also, it may take time to fully implement the Supreme Court’s decision. Marriage is the “trigger” for more than 1,000 tax and benefit provisions in the Tax Code and other federal statutes.

Federal government agencies, including the Treasury Department and Internal Revenue Service, will continue to review and modify rules and regulations. Employers will need to review and revise their policies and procedures regarding benefits and withholding. Married same-sex couples will need to consider the new rules and policies, including their tax situation. Affected couples should consider updating their estate plans based upon the estate and gift tax impact, as well as their financial plans.

There may be some state tax issues to address as well. For example, federal employees may be entitled to certain benefits that others are not, and states likely will need to clarify what the state tax treatment is if the state does not recognize same-sex marriage. Also, for couples living in states that do not recognize same-sex marriage, the state will likely provide guidance on how to obtain the federal tax amounts to file state income tax returns.

We expect that various IRS publications and website information that provide guidance to married individuals will likely be revised.

In the meantime, if you would like to discuss this further, I am available at ….

Sincerely,

CPA