

# The Federal and State Taxation Of Domestic Partner Benefits

by James Angelini and Jason Peterson

James Angelini is an associate professor of accounting and Jason Peterson is an assistant professor of business law and ethics at the Sawyer Business School of Suffolk University, Boston.

## I. Introduction

The definition of family is changing rapidly in America. The traditional model of an opposite-sex married couple with children is declining as more and more opposite-sex and same-sex couples are living together without marrying.<sup>1</sup> Therefore, the number of domestic partners is also growing. Furthermore, same-sex couples can legally marry in some states. These changes present challenges for employers offering fringe benefits, such as health insurance and education, to employees and their spouses or unmarried domestic partners. The employers face not only financial challenges but also challenges in complying with federal and state tax law.

This article examines the federal and state taxation of employee benefits extended to same- or opposite-sex spouses, dependents, and same- or opposite-sex domestic partners. Although there are many other tax issues regarding same-sex marriage, such as federal compared with state filing rules, community property issues, and estate tax differences, this article focuses on employee benefits.

In Part II we discuss the history of domestic partnerships and their varying state and employer definitions, as well as summarize the laws in each state while considering the impact of same-sex marriage. In Part III we discuss and illustrate the federal and state tax treatment of benefits provided

to spouses and domestic partners, either same- or opposite-sex. In Part IV we offer a summary and several predictions.

## II. Evolution of Domestic Partnerships

Fringe benefits are a common perquisite provided to employees and their families, including legal spouses.<sup>2</sup> Common examples include health insurance, disability insurance, life insurance, day care, flexible spending accounts, and others.<sup>3</sup> Some employers also offer benefits to same-sex domestic partners and fewer offer them to opposite-sex domestic partners.<sup>4</sup> Employers offer benefits to domestic partners primarily to attract the most qualified employees.<sup>5</sup> Employers also offer these domestic partnership benefits (DPBs) because of a sense of fairness and to avoid appearing discriminatory.<sup>6</sup> Cost is the biggest disincentive in offering domestic partner benefits.

### A. History

Domestic partnerships and DPBs have a short history. Tom Brougham is usually credited with creating the term in 1979.<sup>7</sup> In 1985 Brougham helped create the first municipal DPBs offered to government employees.<sup>8</sup> In 1982 *The Village Voice* was the first private employer to offer them.<sup>9</sup> In

<sup>2</sup>See "Domestic Partner Benefits: Facts and Background," Employee Benefit Research Institute, Feb. 2009, available at <http://www.ebri.org/pdf/publications/facts/0209fact.pdf>.

<sup>3</sup>*Id.*

<sup>4</sup>*Id.*

<sup>5</sup>*Id.* See also Maria O'Brien et al., "Same Sex Marriage and Its Implications for Employee Benefits: Proceedings of the 2005 Meeting of the Association of American Law Schools Sections on Employee Benefits, and Sexual Orientation and Gender Identity Issues," 9 *Emp. Rts. & Emp. Pol'y J.* 499 (2005).

<sup>6</sup>See "Domestic Partner Benefits" *supra* note 2.

<sup>7</sup>Leland Traiman, "A Brief History of Domestic Partnerships," *Gay & Lesbian Rev.*, July-Aug. 2008, at 1.

<sup>8</sup>*Id.* at 3.

<sup>9</sup>*Id.*; "Domestic Partnerships," *GLBTQ*, available at [http://www.glbtq.com/social-sciences/domestic\\_partnerships.html](http://www.glbtq.com/social-sciences/domestic_partnerships.html) (last visited July 28, 2011).

<sup>1</sup>Sharon Jayson, "Census Reports More Unmarried Couples Living Together," *USA Today*, July 28, 2008, available at [http://www.usatoday.com/news/nation/census/2008-07-28-cohabitation-census\\_N.htm](http://www.usatoday.com/news/nation/census/2008-07-28-cohabitation-census_N.htm).

1991 Lotus was the first publicly traded company to offer DPBs.<sup>10</sup> Since these early pioneers, there has been dramatic growth in the number of private, public, and government employers offering DPBs. About one-third of all employers<sup>11</sup> and one-half of large employers<sup>12</sup> provide benefits to partners of same-sex employees. Eighty percent of all *Fortune* 100 businesses and 75 percent of the largest law firms offer DPBs.<sup>13</sup> Even in these difficult economic times, many employers have continued to offer DPBs while cutting back on other benefits.<sup>14</sup>

## B. Definition

Neither federal law nor the Internal Revenue Code defines domestic partnership.<sup>15</sup> The Defense of Marriage Act (DOMA) makes it clear that same-sex couples do not meet the federal definition of marriage and are not spouses.<sup>16</sup> Thirty states have passed constitutional amendments that define marriage as between one man and one woman.<sup>17</sup> How-

ever, Massachusetts, courts have held that DOMA is unconstitutional.<sup>18</sup> More state challenges are sure to come.

Table 1 (p. 380) provides a state summary of laws regarding domestic partnerships, same-sex marriage, and civil unions and whether opposite-sex couples can enter into domestic partnerships. Six states (Massachusetts, Connecticut, Iowa, New Hampshire, New York, and Vermont) and the District of Columbia have legalized same-sex marriage.<sup>19</sup> Delaware, Hawaii, Illinois, New Jersey, and Rhode Island are the only states allowing new civil unions.<sup>20</sup> Twelve states have domestic partnership laws or the equivalent.<sup>21</sup> Two of the 12 states include opposite-sex couples only if they meet specific criteria. The most common restriction is age. The other eight have no restrictions regarding opposite-sex couples.<sup>22</sup> Employers must extend benefits to domestic partners in any state with a domestic partnership law.<sup>23</sup>

States with domestic partnership laws have varying definitions of a domestic partner. For example, California defines a domestic partnership as “two adults who have chosen to share one another’s lives in an intimate and committed relationship of mutual caring.”<sup>24</sup> California domestic partners must register as a domestic partnership to obtain legal benefits such as lower state taxes and community property rights.<sup>25</sup> Same-sex and some opposite-sex couples may register as domestic partners only if they:

- share a common residence (joint ownership is not required if they own a house, and the residence does not have to be their only residence);
- neither partner is married or in a domestic partnership with another person that has not been terminated, dissolved, or annulled;

<sup>10</sup>Branford Duncan and James Lock “Offering Domestic Partnership Health Benefits: An Economic Concern?” *Journal of Gay and Lesbian Medical Ass’n*, Vol. 5, Nov. 3, 2001, at 97.

<sup>11</sup>*Society for Human Resource Management*, June 1, 2008, available at [http://moss07.shrm.org/Research/SurveyFindings/Documents/08-0335\\_BenefitsSR\\_FINAL\\_.pdf](http://moss07.shrm.org/Research/SurveyFindings/Documents/08-0335_BenefitsSR_FINAL_.pdf).

<sup>12</sup>“Employer Benefits Health Survey,” *Kaiser Family Foundation and Human Research and Educational Trust*, Sept. 24, 2008, available at <http://ehbs.kff.org/pdf/7790.pdf>.

<sup>13</sup>“State of the Workplace 2007-2008,” Human Rights Campaign Foundation, at 9, available at [http://www.hrc.org/files/assets/resources/HRC\\_Foundation\\_State\\_of\\_the\\_Workplace\\_2007-2008.pdf](http://www.hrc.org/files/assets/resources/HRC_Foundation_State_of_the_Workplace_2007-2008.pdf).

<sup>14</sup>“More Coverage for Domestic Partners,” *Business Week*, Sept. 28, 2009, at 68.

<sup>15</sup>Toni Lester, “Adam and Steve vs. Adam and Eve: Will the New Supreme Court Grant Gays the Right to Marry?” 14 *Am. U.J. Gender Soc. Pol’y & L.* 253, 262, (2006). Generally, however, the two types of domestic partnership arise either when a state or municipality acknowledges the status of the couple or when the couples assert that they are in a relationship for the purposes of acquiring work-related benefits.

<sup>16</sup>Defense of Marriage Act, 1 U.S.C. section 7 (2006). However, President Obama has extended benefits to same-sex partners of federal employees but not to opposite-sex partners. See “Obama Extends Benefits for Gay Federal Workers,” Associated Press, June 3, 2010, available at [http://www.boston.com/news/nation/articles/2010/06/03/obama\\_extends\\_benefits\\_for\\_gay\\_federal\\_workers](http://www.boston.com/news/nation/articles/2010/06/03/obama_extends_benefits_for_gay_federal_workers).

<sup>17</sup>Tiffany C. Graham, “Exploring the Impact of the Marriage Amendments: Can Public Employers Offer Domestic Partner Benefits to Their Gay and Lesbian Employees,” 17 *Va. J. Soc. Pol’y & L.* 83, 84 (2009). Depending on the expansiveness of the constitutional amendment, same-sex marriage opponents have successfully challenged the offering of domestic partnership benefits. *National Pride at Work, Inc. v. Governor of Mich.*, 732 N.W.2d 139, 151 (Mich. Ct. App. 2007). See also Neely, Note, “Indiana Proposed Defense of Marriage Amendment: What Will It Do and Why Is It Needed?” 41 *Ind. L. Rev.* 245, 254-255 (2008).

<sup>18</sup>*Massachusetts v. United States Dep’t of Health and Human Serv.*, No. 1:09-11156-JLT, 2010 U.S. Dist. LEXIS 67927 (D. Mass. July 8, 2010).

<sup>19</sup>See *infra* notes 42-45 and accompanying text.

<sup>20</sup>See “Civil Unions & Domestic Partnership Statutes,” National Conference of State Legislatures (last updated July 2011), available at <http://www.ncsl.org/default.aspx?tabid=16444>. In New Hampshire and Connecticut, all civil unions are merged into marriage, unless annulled or dissolved. Vermont no longer recognizes civil unions but continues to recognize civil unions created before September 1, 2009. *Id.*

<sup>21</sup>*Id.*

<sup>22</sup>*Id.*

<sup>23</sup>See “States Offering Benefits for Same-Sex Partners of State Employees,” National Conference of State Legislatures (last visited July 28, 2011), available at <http://www.ncsl.org/default.aspx?tabid=16315>.

<sup>24</sup>Calif. Fam. Code section 297(a) (2004).

<sup>25</sup>*Id.* section 297(b)

- the two persons are not related by blood in a way that would prevent them from marrying in California; and
- both persons are at least 18 years of age.<sup>26</sup>

Also, both persons must be the same sex.<sup>27</sup> Opposite-sex partners can only qualify if one partner is 62 years of age or older and if both partners qualify to collect Social Security.<sup>28</sup> Further, both must be able to consent.<sup>29</sup>

Oregon provides another example. A domestic partner is “an individual joined in a domestic partnership,” and “domestic partnership” is:

a civil contract entered into in person between two individuals of the same sex who are at least 18 years of age, who are otherwise capable and at least one of whom is a resident of Oregon.<sup>30</sup> [It also means] . . . a person in a relationship with an employee, each of whom: 1) Is under no legal disability to marry the other person, but for the fact that each is of the same sex; 2) Desires a relationship of marriage under Oregon law and would enter into marriage with the other person, and only with the other person, if Oregon law permitted it; 3) Is committed to the care and support of the other person; 4) Is responsible for the needs of the other person; 5) Is responsible for financial obligations to others equivalent to such financial obligations that arise within a marriage recognized under Oregon law; and 6) Is not married and has no similar commitment and responsibility relative to any other individual.<sup>31</sup>

Other states have unique definitions, such as Hawaii, which allows domestic partnerships between blood relatives, such as a single mother and her adult son.<sup>32</sup> Many states have definitions with language that, if challenged, would be difficult to substantiate. For example, California’s requirement that couples live in “an intimate committed relationship of mutual caring.”<sup>33</sup>

More than 50 percent of *Fortune* 500 companies offer benefits for domestic partners and several states require employers to offer DPBs if they offer benefits to spouses.<sup>34</sup> Employers add to the defini-

tional confusion by creating their own definition of a domestic partnership. A typical definition is an individual who is:

- in an exclusive committed relationship (defined to be living with the eligible employee for at least three consecutive years immediately before the effective date of the extension of the Plan coverage);
- jointly responsible for common welfare (with shared financial obligations);
- neither married to anyone else nor a domestic partner of anyone else;
- not related by blood; and
- over the age of 18.<sup>35</sup>

Legislative attempts to define domestic partnerships have been made, but none have passed. For example, the Domestic Partnership Benefits and Obligations Act of 2003 is one of those attempts.<sup>36</sup> This legislation pertained to federal employees only and required filing an affidavit of eligibility by the couple.<sup>37</sup> In the affidavit, the employee and the domestic partner of the employee must attest that they:

- are each other’s sole domestic partner and intend to remain so indefinitely;
- have a common residence, and intend to continue the arrangement;
- are at least 18 years of age and mentally competent to consent to contract;
- share responsibility for a significant measure of each other’s common welfare and financial obligations;
- are not married to or domestic partners with anyone else;
- understand that willful falsification of information within the affidavit may lead to disciplinary action and the recovery of the cost of benefits received related to those falsification; and

A) are same-sex domestic partners, and not related in a way that, if the two were of opposite sex, would prohibit legal marriage in the state in which they reside; or  
B) are opposite-sex domestic partners, and are not related in a way that would prohibit legal marriage in the state in which they reside.<sup>38</sup>

Although there are common elements in those definitions, it is clear that a uniform definition of domestic partnership would be helpful. A uniform definition could be relied on to establish rights for

<sup>26</sup>*Id.* section 297(b)(1)-(4).

<sup>27</sup>*Id.* section 297(b)(5)(A).

<sup>28</sup>*Id.* section 297(b)(5)(B).

<sup>29</sup>*Id.* section 297(b)(6).

<sup>30</sup>Ore. Rev. Stat. section 150-316.007-(B)(1)(c) (2003).

<sup>31</sup>Ore. Rev. Stat. section 150-316.007-(B)(5)(a)-(f) (2003).

<sup>32</sup>Hawaii Rev. Stat. section 572C-2 (2006). Hawaii has a

reciprocal beneficiary law that provides limited rights to same-sex couples, similar to domestic partnership laws. *Id.*

<sup>33</sup>See *supra* note 24 and accompanying text.

<sup>34</sup>See “State of the Workplace 2007-2008,” *supra* note 13, at

1.

<sup>35</sup>IRS LTR Rul., 9431017 (May 4, 1994).

<sup>36</sup>Domestic Partnerships and Obligations Act of 2003, S. 1252, 108th Cong. (2003).

<sup>37</sup>*Id.* section 2(b).

<sup>38</sup>*Id.*

**Table 1.  
State Domestic Partnership Laws**

State	Domestic Partnership Laws?	Do Domestic Partnership Laws Include Opposite-Sex Domestic Partnerships?	Is Same-Sex Marriage Legal?	Civil Unions?
Alabama	N	NA	N	N
Alaska	Y <sup>g</sup>	N	N	N
Arizona	N	NA	N	N
Arkansas	N	NA	N	N
California	Y	Y <sup>b</sup>	N <sup>a</sup>	N
Colorado	N <sup>e</sup>	NA	N	N
Connecticut	N	NA	Y	N <sup>h</sup>
Delaware	N	NA	N	Y
District of Columbia	Y	Y	Y	N
Florida	N	NA	N	N
Georgia	N	NA	N	N
Hawaii	N <sup>e</sup>	N <sup>d</sup>	N	Y
Idaho	N	NA	N	N
Illinois	N	NA	N	Y
Indiana	N	NA	N	N
Iowa	N	NA	Y	N
Kansas	N	NA	N	N
Kentucky	N	NA	N	N
Louisiana	N	NA	N	N
Maine	Y	Y	N	N
Maryland	Y	Y	N	N
Massachusetts	N	NA	Y	N
Michigan	N	NA	N	N
Minnesota	N	NA	N	N
Mississippi	N	NA	N	N
Missouri	N	NA	N	N
Montana	N	NA	N	N
Nebraska	N	NA	N	N
Nevada	Y	Y	N	N
New Hampshire	N	NA	Y	N <sup>h</sup>
New Jersey	Y	Y <sup>f</sup>	N	Y
New Mexico	N	NA	N	N
New York	N	NA	Y	N
North Carolina	N	NA	N	N
North Dakota	N	NA	N	N
Ohio	N	NA	N	N
Oklahoma	N	NA	N	N
Oregon	Y	N	N	N
Pennsylvania	N	NA	N	N
Rhode Island	N	NA	N	Y
South Carolina	N	NA	N	N
South Dakota	N	NA	N	N
Tennessee	N	NA	N	N
Texas	N	NA	N	N
Utah	N	NA	N	N
Vermont	N	NA	Y	N <sup>h</sup>
Virginia	N	NA	N	N
Washington	Y	Y <sup>c</sup>	N	N
West Virginia	N	NA	N	N
Wisconsin	Y	Y	N	N
Wyoming	N	NA	N	N

<sup>a</sup>On May 15, 2008, the California Supreme Court ruled that same-sex couples should have the right to marry. A ballot initiative (Proposition 8) subsequently banned same-sex marriage on November 4, 2008. On August 4, 2010, the Ninth District Court ruled that Proposition 8 is unconstitutional, but stayed new same-sex marriages pending an appeal. Same-sex marriages that occurred from June 16, 2008 to November 4, 2008 are valid.

<sup>b</sup>California recognizes domestic partnerships for opposite-sex couples only when one partner is at least 62 years old and both are qualified to collect Social Security.

<sup>c</sup>Washington recognizes domestic partnerships for opposite-sex couples only when one partner is at least 62 years old.

<sup>d</sup>Hawaii allows domestic partnership to any couple that cannot legally marry. That would include same-sex couples but also opposite-sex couples prohibited from marrying because they are blood relatives, such as a mother and son.

<sup>e</sup>Colorado and Hawaii do allow “designated beneficiary agreements,” which confer some of the same rights as domestic partnerships.

<sup>f</sup>New Jersey recognizes domestic partnerships for opposite-sex couples only when one partner is at least 62 years old.

<sup>g</sup>Alaska has a limited domestic partnership law for state employees only, based on a Alaska Supreme Court decision (*Alaska CLU v. State of Alaska*). It does not apply to private employers.

<sup>h</sup>Vermont no longer recognizes civil unions but continues to recognize civil unions created before September 1, 2009. In New Hampshire and Connecticut all civil unions are merged into marriage, unless annulled or dissolved.

NA = Not applicable

Source: Author analysis of state laws. National Conference of State Legislatures, “Same Sex Marriage, Civil Unions and Domestic Partnerships,” June 27, 2011, available at <http://www.ncsl.org/default.aspx?tabid=16430>.

both public and private employers and their employees, and it would be useful for state and perhaps federal tax purposes.<sup>39</sup>

### C. Same-Sex Marriage

Employers began offering DPBs well before states began to legalize same-sex marriage. Attracting the most competent employees and perceived fairness are among the two most prevalent reasons employers offer DPBs.<sup>40</sup> Employers were concerned that it was discriminatory to offer benefits only to the legally married opposite-sex spouses of employees while excluding unmarried same- or opposite-sex domestic partners.<sup>41</sup> Same-sex marriage, however, provides employees the option to marry, so in those cases same-sex domestic partners have more difficulty challenging the employer's policy on the discrimination front. In 2003 Massachusetts became the first state to legalize gay marriage, and thus Massachusetts employers were the first to address the changing landscape of DPB policies.<sup>42</sup>

Since 2003 employers in five other states and the District of Columbia have begun resolving the same policy questions. In 2009 courts in both Connecticut and Iowa held that limiting the right of marriage was unconstitutional.<sup>43</sup> Later that year, Vermont and New Hampshire legalized same-sex marriage through legislative action.<sup>44</sup> More recently, New York legalized same-sex marriage.<sup>45</sup>

Those court decisions and the expansive legislation suggest that the population's attitude toward same-sex marriage has shifted. A recent study found that support for same-sex marriage was at its highest level since 2004, and a separate poll concluded that there was substantial growth in support of same-sex marriage over a 10-year period.<sup>46</sup>

<sup>39</sup>Arriving at a definition would provide fertile material for future research and study.

<sup>40</sup>See "Domestic Partner Benefits: Facts and Background," *supra* note 2.

<sup>41</sup>*Id.*

<sup>42</sup>*Goodridge v. Department of Public Health*, 798 N.E.2d 941, 969 (Mass. 2003).

<sup>43</sup>*Kerrigan v. Commissioner of Public Health*, 957 A.2d 407, 482 (Conn. 2008); *Varnum v. Brien*, 763 N.W.2d 862, 907 (Iowa 2009).

<sup>44</sup>15 V.S.A. section 8. The Vermont legislature overturned then-Gov. Jim Douglas's veto. "Legislature Legalizes Gay Marriage," *The Washington Post*, Apr. 7, 2009. See also Abby Goodnough, "New Hampshire Legalizes Same-Sex Marriage," *The New York Times*, June 3, 2009.

<sup>45</sup>Nicholas Confessore, "New York Allows Same-Sex Marriage, Becoming Largest State to Pass Law," *The New York Times*, June 24, 2011.

<sup>46</sup>See "Poll: Support for Same-Sex Marriage Grows," available at [http://www.cbsnews.com/8301-503544\\_162-4972643-503544.html](http://www.cbsnews.com/8301-503544_162-4972643-503544.html). "Same-Sex Marriages and Civil Unions," *Religioustolerance.org*. (last visited Dec. 2010), available at [http://www.religioustolerance.org/hom\\_marp.htm](http://www.religioustolerance.org/hom_marp.htm).

### D. Cost of Providing DPBs

A quantifiable measurement of the cost to employers for extending DPBs is limited, and this limitation only increases when including opposite-sex partners. A 2005 survey, however, did conclude that offering DPBs increased total benefit cost only by less than 1 percent according to 64 percent of employers and less than 2 percent according to 88 percent of employers.<sup>47</sup> A separate study in 2004 determined that small employers will incur only a negligible cost increase and that large employers will incur no more than a \$25,000 total cost increase.<sup>48</sup>

The studies, however, are limited both because of their age and because they do not include employers that offer DPBs to opposite-sex employees. Same-sex cohabiting couples represent a much smaller proportion of potential DPB recipients compared to opposite-sex cohabiting couples.<sup>49</sup> The 2000 U.S. census calculated that unmarried opposite-sex households outnumbered same-sex households by a ratio of 8 to 1.<sup>50</sup> The growth of unmarried, cohabiting opposite-sex couples increases the likely domestic partner population and the resulting costs of extending DPBs.<sup>51</sup>

The legalization of same-sex marriage further complicates tax matters. Before the Massachusetts Supreme Judicial Court's decision in *Goodridge v. Department of Public Health*, many employers offered benefits to same-sex domestic partners but not opposite-sex domestic partners under the theory that it is discriminatory to deny benefits to same-sex domestic partners because they could not marry. After *Goodridge*, would employers end benefits to same-sex domestic partners, since they could legally marry, or would they offer benefits to both same- and opposite-sex domestic partners, or would they end them for both? Our recent paper answered this question by survey, and it appears that employers in Massachusetts have largely responded by extending benefits to opposite-sex domestic partners rather than ending them for same-sex domestic partners.<sup>52</sup> That reaction was unanticipated because of the

<sup>47</sup>"Domestic Partner Benefits: Cost and Utilization," Human Rights Campaign Foundation, available at <http://www.hrc.org/resources/entry/domestic-partner-benefits-cost-and-utilization> (last visited July 28, 2011).

<sup>48</sup>M.V. Lee Badgett and Gary Gates, "The Business Cost Impact of Marriage for Same-Sex Couple 2" (2004), available at <http://www.hrc.org/files/assets/resources/businesscost.pdf>.

<sup>49</sup>U.S. Census Bureau, "Census 2000 Special Reports, Married-Couple and Unmarried-Partner Households: 2000," Feb. 2003, available at <http://www.census.gov/prod/2003pubs/censr-5.pdf>.

<sup>50</sup>*Id.*

<sup>51</sup>Jayson, *supra* note 1.

<sup>52</sup>See James P. Angelini and Jason Peterson, "Domestic Partner Employee Benefits for Same-Sex and Opposite-Sex (Footnote continued on next page.)

much larger cost of offering benefits to opposite-sex domestic partners, considering the larger population involved. If the employer reaction in Massachusetts is mirrored by employers in other states, the tax issues and costs of offering benefits to domestic partners will become much more significant. Given those trends and the likelihood that more states will legalize same-sex marriage, understanding the federal, state, and local tax issues should be of interest to all employers and governments.

### III. Taxation of Employee Benefits to Domestic Partners

#### A. Federal Taxation of Domestic Partner Benefits

The federal taxation of employee fringe benefits, including benefits provided to domestic partners, is fairly well settled, although cracks are appearing. Several categories of fringe benefits are deductible by the employer and also excluded from the employee's income.<sup>53</sup> Some of those benefits are not taxable when paid for the employee, and some benefits provided to the employee's spouse and tax dependents are also not taxable to the employee.<sup>54</sup> However, the employee will be taxed on benefits provided to either same-sex or opposite-sex domestic partners, and dependents of domestic partners, per the IRS.<sup>55</sup> This is because DOMA defines a spouse for federal purposes as two people of the opposite sex who are legally married.<sup>56</sup> Federal tax law does not recognize spouses in same-sex marriages, even if allowed by local law. To compensate for that extra federal tax, some employers, including at least one

municipality, pay the extra federal tax incurred by their employees for benefits provided to same-sex spouses.<sup>57</sup>

To further complicate matters, the IRS has issued three pieces of guidance that require domestic partners in California to split their income in the same way married couples would, according to the state's community property laws.<sup>58</sup> "Community property law" is a term of law that formerly applied only to marriage; however, in 2007 California extended community property treatment to registered domestic partners. The IRS, in a private letter ruling, extends that treatment to federal tax law, under the theory that federal law usually defers to state property law.<sup>59</sup> Therefore, all community property in California, including wages of either partner and tax credits, is split equally between the partners on their separate federal tax returns. That federal treatment of domestic partners in California appears to undermine the DOMA, but it is consistent with the Obama administration's stated intent to no longer defend DOMA.<sup>60</sup>

The only safe harbor for exclusion of benefits paid for a domestic partner is if the domestic partner is the employee's dependent as defined by IRC section 152. To qualify as a dependent, the domestic partner must be a qualifying relative.<sup>61</sup> A qualifying relative must meet several tests. The support test requires that the employee provides more than 50 percent of the domestic partner's support.<sup>62</sup> The gross income test requires that the domestic partner cannot have gross income greater than the exemption amount (currently \$3,700).<sup>63</sup> The citizenship test requires that the domestic partner must be a U.S. citizen, resident, or national, or a resident of Canada or Mexico.<sup>64</sup> The relationship test requires that the domestic partner must be a member of the employee's household<sup>65</sup> for the entire tax year, unless this violates local laws against cohabitation.<sup>66</sup> A few states do not allow cohabitation, so in those states

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Partners in the Era of Same-Sex Marriage: The Massachusetts Experience," *Business Law Review*, Vol. 44, Spring 2011.

<sup>53</sup>See generally IRC sections 74, 79, 85, 86, 102, 104, 105, 106, 117, 119, 125, 127, 129, 131, 132, 137, and 7702.

<sup>54</sup>*Id.*

<sup>55</sup>IRS LTR, 9717018 (Jan. 22, 1997); Priv. Ltr. Rul., 9850011 (Sept. 10, 1998). *But see* Tax Equity for Health Plan Beneficiaries, S. 1153, H.R. 2625, 111th Cong. (2009). This bill would amend the IRC to exclude from an employee's gross income accident and health plan benefits extended to eligible domestic partners. *Id.* S. 1153: Tax Equity for Health Plan Beneficiaries Act of 2009, Govtrack.us, available at <http://www.govtrack.us/congress/bill.xpd?bill=s111-1153>. This bill did not pass. More recently a bill (H.R. 2088) introduced on June 3, 2011, by U.S. Rep. Jim McDermott, D-Wash., would exclude from income health care benefits provided to domestic partners or same-sex spouses, available at <http://www.govtrack.us/congress/bill.xpd?bill=h112-2088>.

<sup>56</sup>See *supra* note 16 and accompanying text regarding DOMA. However, President Obama has said that his administration will no longer defend the constitutionality of DOMA, available at [http://www.cbsnews.com/8301-503544\\_162-20035398-503544.html](http://www.cbsnews.com/8301-503544_162-20035398-503544.html).

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<sup>57</sup>Johanna Kaiser, "Mass. City to Pay Wedded Gay Workers to Offset Tax," Associated Press, July 10, 2011. Unfortunately, this extra payment is also taxable.

<sup>58</sup>See LTR 201021048 (May 28, 2010); Chief Counsel Advice 201021049 (May 28, 2010) and Chief Counsel Advice 201021050 (May 28, 2010).

<sup>59</sup>See LTR 201021048 (May 28, 2010), p. 3.

<sup>60</sup>*Supra* note 16 and accompanying text.

<sup>61</sup>IRC section 152(a)(2) (2010).

<sup>62</sup>IRC section 152(d)(1)(C) (2010).

<sup>63</sup>IRC section 152(d)(1)(B).

<sup>64</sup>IRC section 152(b)(3)(A) (2010).

<sup>65</sup>IRC section 152(d)(2)(H) (2010).

<sup>66</sup>IRC section 152(f)(3) (2010).

**Table 2.**  
**Example: Federal Taxation of Health Insurance Benefits**

	<b>Opposite-Sex Spouse</b>	<b>Same or Opposite-Sex Domestic Partner</b>
Employer portion of health insurance for spouse or domestic partner = \$7,000 (50%)	Not taxable	Taxable wages = \$57,000
Employee portion of insurance for spouse or domestic partner = \$3,000 (50%)	Taxable wages = \$47,000 Deduct from wages <b>pre-tax</b>	Deduct from pay post-tax Taxable wages = \$57,000 <b>\$10,000 difference</b>
Employee Form 1040	No medical expense deduction on Schedule A for \$3,000	No medical expense deduction on Schedule A for domestic partner for \$10,000 unless domestic partner is a dependent. If domestic partner purchased and paid for their own policy (\$10,000) then deduct on domestic partner's Schedule A and if domestic partner's wages = \$50,000 the deduction = \$10,000 less \$3,750 (7.5% of \$50,000) = \$6,250. Plus total itemized deductions on Schedule A must exceed the standard deduction of \$5,800.

the domestic partner could not qualify as a dependent.<sup>67</sup> If any of those tests are not met, the domestic partner is not a dependent of the taxpayer and the benefits provided for the domestic partner would be taxable to the employee. Dependents of domestic partners will have to be tax dependents of the employee, not the domestic partner, in order to exclude from income benefits provided to them.

Table 2 provides an example illustrating the federal tax differences of providing health insurance to an employee's spouse or domestic partner, to help clarify the tax differences.

Let's assume an employee has wages of \$50,000. Assume total health insurance expense of \$20,000 for the employee and the employee's spouse or domestic partner. The employer pays \$14,000, and the employee pays \$6,000. Let's assume that 50 percent of the cost is for a spouse or domestic partner.

As Table 2 demonstrates, the after-tax cash flow differences are dramatic. All employees with an opposite-sex spouse enjoy tax-free employer-paid health benefits for the spouse and can essentially deduct the employee's portion (via lower taxable wages) and avoid the 7.5 percent of AGI floor and itemized deduction limitations.

## **B. State Taxation of Domestic Partner Employee Benefits**

Table 3 (next page) presents a summary of the state taxation of fringe benefits offered to spouses and domestic partners. State taxation of employee fringe benefits varies considerably by state. Generally, state laws follow federal laws for opposite-sex spouses, and no state taxes benefits for opposite-sex spouses.<sup>68</sup> However, state laws vary considerably regarding the state taxation of benefits offered to domestic partners, either opposite- or same-sex, and to same-sex spouses. States with same-sex marriage do not tax the benefits for same-sex spouses.<sup>69</sup> However, they may tax benefits paid to domestic partners, either same-sex or opposite-sex.<sup>70</sup> Some states, such as Massachusetts, New York, Iowa, Vermont, and New Hampshire, tax benefits provided to domestic partners under the theory that they could get married, regardless of whether they are opposite- or same-sex domestic partners. Connecticut and the District of Columbia do not tax domestic partner benefits, same- or opposite-sex, even though same-sex marriage is legal. Some states without same-sex marriage, such as California, Maine, New Jersey, Rhode Island, Washington, Wisconsin, and Oregon, do not tax domestic partner benefits.

Employers with employees who were married in other states face additional tax problems. Benefits provided to same-sex spouses are not taxable in the states with same-sex marriage. However, employers may have to withhold or pay taxes on benefits to

<sup>67</sup>As of this writing, only seven states have laws against cohabitation. However, a Supreme Court ruling, *Lawrence vs. Texas*, 539 U.S. 558 (2003), struck down sodomy laws in Texas. That decision makes it improbable that local laws against cohabitation would be enforceable.

<sup>68</sup>Author analysis. See also Heather Abrigo, "The Unintended Consequence of Providing Employee Benefits for Domestic Partners," 15 *J. of Pension Benefits* 18, 20 (2007).

<sup>69</sup>Author analysis.

<sup>70</sup>Author analysis.

**Table 3.**  
**State Taxation of Fringe Benefits**

<b>Tax Jurisdiction</b>	<b>Domestic Partners</b>	<b>Married — Same-Sex</b>	<b>Married — Opposite-Sex</b>
Federal	Taxable	Taxable	Not Taxable
Alabama	Taxable	Taxable	Not Taxable
Alaska <sup>c</sup>	Taxable	Taxable	Not Taxable
Arizona	Taxable	Taxable	Not Taxable
Arkansas	Taxable	Taxable	Not Taxable
California	Not Taxable	Not Taxable	Not Taxable
Colorado	Taxable	Taxable	Not Taxable
Connecticut <sup>b</sup>	Not Taxable	Not Taxable	Not Taxable
Delaware	Taxable	Taxable	Not Taxable
Florida <sup>c</sup>	Taxable	Taxable	Not Taxable
Georgia	Taxable	Taxable	Not Taxable
Hawaii	Taxable	Taxable	Not Taxable
Idaho	Taxable	Taxable	Not Taxable
Illinois	Taxable	Taxable	Not Taxable
Indiana	Taxable	Taxable	Not Taxable
Iowa	Taxable	Not Taxable	Not Taxable
Kansas	Taxable	Taxable	Not Taxable
Kentucky	Taxable	Taxable	Not Taxable
Louisiana	Taxable	Taxable	Not Taxable
Maine	Not Taxable	Taxable	Not Taxable
Maryland		Not Taxable	Not Taxable
Massachusetts	Taxable	Not Taxable	Not Taxable
Michigan	Taxable	Taxable	Not Taxable
Minnesota	Taxable	Taxable	Not Taxable
Mississippi	Taxable	Taxable	Not Taxable
Missouri	Taxable	Taxable	Not Taxable
Montana	Taxable	Taxable	Not Taxable
Nebraska	Taxable	Taxable	Not Taxable
Nevada <sup>c</sup>	Taxable	Taxable	Not Taxable
New Hampshire <sup>c</sup>	Taxable	Not Taxable	Not Taxable
New Jersey	Not Taxable	Not Taxable	Not Taxable
New Mexico	Taxable	Taxable	Not Taxable
New York <sup>a</sup>	Taxable	Not Taxable	Not Taxable
North Carolina	Taxable	Taxable	Not Taxable
North Dakota	Taxable	Taxable	Not Taxable
Ohio	Taxable	Taxable	Not Taxable
Oklahoma	Taxable	Taxable	Not Taxable
Oregon	Not Taxable	Taxable	Not Taxable
Pennsylvania	Taxable	Taxable	Not Taxable
Rhode Island	Not Taxable	Taxable	Not Taxable
South Carolina	Taxable	Taxable	Not Taxable
South Dakota <sup>c</sup>	Taxable	Taxable	Not Taxable
Tennessee <sup>c</sup>	Taxable	Taxable	Not Taxable
Texas <sup>c</sup>	Taxable	Taxable	Not Taxable
Utah	Taxable	Taxable	Not Taxable
Vermont	Taxable	Not Taxable	Not Taxable
Virginia	Taxable	Taxable	Not Taxable
Washington <sup>c</sup>	Not Taxable	Not Taxable	Not Taxable
West Virginia	Taxable	Taxable	Not Taxable
Wisconsin	Not Taxable	Taxable	Not Taxable
Wyoming <sup>c</sup>	Taxable	Taxable	Not Taxable
District of Columbia	Not Taxable	Not Taxable	Not Taxable

Source: Author analysis.

<sup>a</sup>Per author estimate. New York tax law regarding benefits to same- or opposite-sex domestic partners and same-sex spouses is tentative, pending guidance from the New York State Department of Taxation and Finance.

<sup>b</sup>In Connecticut we assume the domestic partnership is a registered civil union.

<sup>c</sup>These states do not have a personal income tax on wages so fringe benefits are not subject to state income tax. However, state unemployment taxes apply to wages and are paid by employers or employees.



same-sex spouses married in other states because their current home state may not recognize out-of-state same-sex marriages. Only New York and Maryland recognize same-sex marriages from other states.<sup>71</sup> California recognizes same-sex marriages from other states if they are essentially equivalent to California domestic partnerships, which is usually the case.<sup>72</sup> New Jersey recognizes marriages or civil unions in other states if they confer the same rights as civil unions in New Jersey.<sup>73</sup> Therefore, an employer in a state that does not recognize same-sex marriages in other states will have to treat benefits provided to an employee's same-sex spouse as taxable for state tax purposes, if the same-sex couple are married legally in another state but not in the state where the employee works.

#### IV. Summary and Predictions

This article discusses the federal and state taxation of employee fringe benefits of domestic partners and spouses. Federal tax law does not tax fringe benefits paid for opposite-sex spouses and dependents of employees. Federal tax law does tax benefits paid for domestic partners, unless they are tax dependents, and it also defines a spouse as a person of the opposite sex. State tax law generally does not tax fringe benefits to spouses and dependents. Six states and the District of Columbia allow same-sex couples to marry. States with same-sex marriage do not tax benefits provided to same-sex spouses but may tax same- or opposite-sex domestic partners. They may also tax benefits provided to same-sex spouses married in other states. States without same-sex marriage usually tax benefits provided to domestic partners and same-sex spouses married in other states but do not tax opposite-sex spouses. However, there are exceptions, and we predict that the states with the most liberal tax policy regarding benefits to domestic partners and same-sex spouses are the most likely to legalize same-sex marriage soon. We also predict that more litigation, possibly at the federal level, will occur.<sup>74</sup>

In states that allow same-sex marriage, a question arises whether it is discriminatory for employers to deny benefits to opposite-sex domestic partners while continuing to provide benefits to same-sex domestic partners. That distinction has been challenged in court.<sup>75</sup> Extending benefits to opposite-sex domestic couples is potentially very expensive because of the increasing number of couples cohabiting and the much larger opposite-sex domestic partner population. It also will dramatically increase the employer's federal and possibly state payroll taxes, such as FICA and unemployment taxes, when DPBs are taxable wages. However, ending benefits for same-sex and opposite-sex domestic couples will have negative effects on the employer's ability to recruit the best employees and may have negative publicity effects.<sup>76</sup> Ending benefits for all unmarried couples could force some same-sex couples to marry despite unique negative effects of marriage not applicable to opposite-sex couples.<sup>77</sup>

This report is useful for employers reviewing their domestic partner benefits policy and the taxation of those benefits. The erosion of DOMA and the extension of some DPBs to federal employees signal future changes in the federal taxation of domestic partner benefits.<sup>78</sup> As more states legalize same-sex marriage or civil unions, state tax laws also will change. If the trend by employers to provide benefits to both same- and opposite-sex domestic partners continues, both the expense and tax cost to employers and employees will accelerate. We predict that the rapid social move to cohabitation is a trend that will increase the cost of providing benefits to same- and opposite-sex domestic partners and the taxes created by those benefits. Because of this trend, we also predict increased pressure for tax law changes at both the federal and state levels. ☆

<sup>71</sup>See Jeremy Peters, "New York to Back Same-Sex Unions From Elsewhere," *The New York Times*, May 29, 2008, available at <http://www.nytimes.com/2008/05/29/nyregion/29marriage.html?pagewanted=all>. See also Aaron C. Davis and John Wagner, "Maryland to Recognize Gay Marriages From Other Places," *Washington Post*, Feb. 25, 2010, available at <http://www.washingtonpost.com/wp-dyn/content/article/2010/02/24/AR2010022405686.html>.

<sup>72</sup>FTB Publication 776, at 10, available at [http://www.ftb.ca.gov/forms/2008/08\\_776.pdf](http://www.ftb.ca.gov/forms/2008/08_776.pdf).

<sup>73</sup>See Civil Union Act, P.L. 2006, ch. 103, available at <http://www.state.nj.us/treasury/taxation/civilunionact.shtml#grossinc>.

<sup>74</sup>"Same-Sex Marriage, Civil Unions and Domestic Partnerships," (last updated July 14, 2011), National Conference of State Legislatures, available at <http://www.ncsl.org/default.aspx?tabid=16430>.

<sup>75</sup>See, e.g., *In re Putnam / N. Westchester Bd. of Coop. Educ. Servs. V. Westchester Cnty Human Rights Comm'n* (N.Y. App. Div., 2011). In this New York case, it was held that an employer's policy of denying benefits to opposite-sex domestic partners while providing them to same-sex partners was not discriminatory. Now that same-sex marriage is legal in New York this decision may be revisited.

<sup>76</sup>See, e.g., Thomas Coleman, "Boston Globe Takes a Wrong Turn on Employee Benefits," *Unmarried in America*, July 10, 2006, available at <http://www.unmarriedinamerica.org/column-one/7-10-06-boston-globe.htm>.

<sup>77</sup>See, GLAD, "Domestic Partnership Benefits Still Matter in the Age of Equal Marriage," Nov. 2009, available at <http://www.glad.org/uploads/docs/publications/dp-benefits-post-goodridge.pdf>.

<sup>78</sup>See "President Obama Extends Additional Benefits to Same-Sex Partners of Federal Employees," June 2, 2010, available at <http://blogs.abcnews.com/politicalpunch/2010/06/president-obama-extends-additional-benefits-to-samesex-partners-of-federal-employees.html>.

## State Tax Notes Correspondents

**Alabama:** Bruce Ely, *Bradley Arant Boult Cummings LLP*

**Alaska:** Joe Hanel; David Shaftel

**Arizona:** Pat Derdenger, *Steptoe & Johnson LLP*; Michael G. Galloway, *Quarles & Brady*; Joe Hanel

**Arkansas:** Rob Moritz

**California:** Lenny Goldberg, *California Tax Reform Association*; Chris Micheli, *Aprea & Micheli Inc.*; Kathleen K. Wright, *California State University, Hayward*

**Colorado:** Joe Hanel

**Connecticut:** Charles H. Lenore, *Day Pitney LLP*

**District of Columbia:** Kenneth H. Silverberg, *Nixon Peabody LLP*; Jacquelyn V. Helm

**Florida:** Joe Follick

**Georgia:** Peter Stathopoulos, *McGuireWoods LLP*; Tim L. Fallaw and Ethan Millar, *Alston & Bird LLP*; Victoria Johnson

**Guam/Northern Mariana Islands:** Stephen A. Cohen, *Taitano and Cohen LLP*

**Hawaii:** Lowell Kalapa, *Tax Foundation of Hawaii*

**Idaho:** Dave Wasson

**Illinois:** J. Fred Giertz, *Institute of Government and Public Affairs, University of Illinois*; Elizabeth Carvlin; Garland Allen

**Indiana:** Niki Lohrmann

**Iowa:** Elizabeth Carvlin

**Kansas:** Chris W. Courtwright, *Kansas Legislative Research Department*

**Kentucky:** Mark F. Sommer, Jennifer S. Smart, Mark A. Loyd Jr., and Michael A. Grim, *Greenebaum Doll & McDonald PLLC*; Charlie White

**Louisiana:** William M. Backstrom Jr., *Jones, Walker, Waechter, Poitevent, Carrère & Denègre LLP*; Victoria Johnson

**Maine:** James G. Good, *Pierce Atwood*; Douglas Rooks

**Massachusetts:** Linda Rosencrance

**Michigan:** Suzette Hackney

**Minnesota:** Dale Busacker, *Grant Thornton*; Elizabeth Carvlin

**Mississippi:** D. Carl Black Jr. and J. Paul Varner, *Butler, Snow, O'Mara, Stevens & Cannada PLLC*

**Montana:** Greg Tuttle

**Nebraska:** Elizabeth Carvlin

**Nevada:** John S. Bartlett

**New Hampshire:** William F.J. Ardinger, *Rath, Young, and Pignatelli, P.A.*; Lorna Colquhoun

**New Jersey:** Michael A. Guariglia, *McCarter & English LLP*; Jeff Pillets

**New Mexico:** Curtis W. Schwartz, *Modrall, Sperling, Roel, Harris & Sisk, P.A.*; Barry Massey

**New York State:** Craig Fields, *Morrison & Foerster LLP*

**New York City:** Irwin Slomka, *Morrison & Foerster LLP*

**North Carolina:** Jack Cummings, *Alston & Bird LLP*; Kay Miller Hobart

**Ohio:** Elizabeth Carvlin

**Oklahoma:** Kenneth L. Hunt, *Hall Estill*

**Oregon:** Tim Christie

**Pennsylvania:** Joseph C. Bright, *Cozen O'Connor*; Thomas Fitzgerald

**Puerto Rico:** Donald J. Reiser, *Martinez, Odell & Calabria*

**Rhode Island:** Neil Downing

**South Carolina:** Victoria Johnson

**South Dakota:** William Koupal, *Koupal Communications*

**Tennessee:** Michael D. Sontag, *Bass, Berry & Sims PLC*; Tom Humphrey

**Texas:** Bill Kidd, *Long News Service*; Eric L. Stein, *Ryan & Co., P.C.*

**Utah:** Dan Harrie

**Vermont:** Paul Hanlon

**Virgin Islands:** Marjorie Rawls Roberts, *Globalvest Management Co., L.P.*

**Virginia:** Craig Bell, *McGuire Woods Battle & Boothe LLP*

**Washington:** Dave Wasson

**West Virginia:** Thomas D. Miller

**Wisconsin:** Todd A. Berry, *Wisconsin Taxpayers Alliance*

**Wyoming:** Erin Taylor, *Wyoming Taxpayers Association* ☆