Alimony Repeal, Marriage Alternatives, and the Taxation of the Family: A Broader View

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Tax Law Needs Couples Therapy: Alimony, Voss, and Policy Considerations in Taxing Divorced and Unmarried Couples

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I. Pre-Windsor State of Relationship Recognition

Before 2013, all same-sex couples—whether legally married, in a civil union or domestic partnership, or simply cohabiting—were treated the same for U.S. federal tax purposes. None of these couples’ relationships was legally recognized for federal income, gift, or estate tax purposes. In contrast, different-sex marriages have always been recognized for federal tax purposes, and even some marriage alternatives entered into by different-sex couples appear to have benefited from legal recognition. This created a sharp divide in the tax treatment of couples based on sexual orientation—couples in different-sex relationships benefited from the relative certainty regarding the tax treatment of marriage while same-sex couples were left adrift in a sea of uncertainty.

Historically, federal tax law (like other areas of federal law) generally deferred to state law when determining who is married. For more than eighty years, this meant that same-sex relationships were not recognized for federal tax purposes because no state permitted same-sex couples to marry. Following the Hawaii Supreme Court’s decision in *Baehr v. Lewin*, however, Congress feared that this deference to state law might soon force the federal government to legally recognize same-sex relationships. In response, Congress enacted (and President Clinton signed into law) the federal Defense of Marriage Act, which defined *marriage* as a union of “one man and one woman.” As states began to extend legal recognition to same-sex couples, the effect of this provision was to deny same-sex couples in legally recognized relationships access to the relative tax certainty that marriage affords, relegating them instead to a tax wilderness in which their treatment was uncertain, burdensome, and fraught with legal peril.

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3 74 Haw. 530 (1993).

II. The Tax Wilderness

Before the advent of marriage equality, whenever a same-sex couple pooled all or a portion of its income and investments and one partner earned more than the other, the couple confronted the enigmatic task of characterizing the annual net transfer from the higher-earning partner to the lower-earning partner (the “net interspousal transfer”) both for income and for gift tax purposes.

For income tax purposes, the higher-earning partner might be treated as making a gift each time the utility bills were paid, a trip were made to the grocery store, or a withdrawal were made from the ATM. If so, the higher-earning partner would continue to pay tax on her wages, and the lower-earning partner would have no income tax inclusion as a result of receiving those gifts. Alternatively, the pooling might be characterized as a support arrangement. In that case, the higher-earning partner would still be subject to tax on her wages, while the lower-earning partner would again have no income tax inclusion as a result of receiving the support payments. A more frightening alternative would require both partners to pay tax on the portion of the higher-earning partner’s income that was transferred to the lower-earning partner—on the ground that it technically constitutes “income” to each of them. Yet another possibility was that the net interspousal transfer could represent some combination of the above (e.g., part support, part gift; part support, part income; or part gift, part income).

For gift tax purposes, a net interspousal transfer might be treated as a taxable gift. Or, depending on the facts and circumstances, the transfer might instead be characterized, in whole or in part, as a nontaxable payment made in exchange for rendering domestic services or for furnishing some other consideration in money or money’s worth. Alternatively, the net interspousal transfer might be characterized as a nontaxable support payment. Yet another possibility was that the transfer could represent some combination of the above (e.g., part nontaxable support payment, part taxable gift or part nontaxable payment for services, part taxable gift).

If a net interspousal transfer were treated as a taxable gift, then, for same-sex couples, the gift tax would effectively be transformed from a wealth transfer tax into a consumption tax. Same-sex couples would not only have to worry about paying gift tax on transfers of stocks and

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7 I.R.C. § 102.
8 Cain, supra note 5, at 115–16.
10 See Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates & Gifts ¶ 10.2.6, Westlaw (database updated 2018); Cain, supra note 5, at 116.
12 Cain, supra note 5, at 125; Wolk, supra note 11, at 1275–81.
13 Wolk, supra note 11, at 1277–78. For gift tax purposes, “[a] consideration not reducible to a value in money or money’s worth, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.” Treas. Reg. § 25.2512-8 (as amended in 1992); see also Comm’r v. Wemyss, 324 U.S. 303 (1945); Merrill v. Fahs, 324 U.S. 308 (1945).
securities, real property, and other assets that they accumulate as they grow old together, but would also have to worry about paying gift tax on every rent or mortgage payment, every purchase of clothing, and even food.\footnote{See Patricia A. Cain, Death Taxes: A Critique from the Margin, 48 CLEV. ST. L. REV. 677, 696 (2000); Patricia A. Cain, Heterosexual Privilege and the Internal Revenue Code, 34 U.S.F. L. REV. 465, 474–76 (2000) [hereinafter Cain, Heterosexual Privilege]. They would not, however, have to worry about certain payments for tuition or medical care. I.R.C. § 2503(e).}

As soon as the total of wealth transmission and consumption transfers from the higher-earning partner to the lower-earning partner exceeded the gift tax annual exclusion (\$15,000 in 2019, but only \$13,000 in 2009),\footnote{Rev. Proc. 2018-57, § 3.43(1), 2018-49 I.R.B. 827; Rev. Proc. 2008-66, § 3.30(1), 2008-45 I.R.B. 1107.} the higher-earning partner would begin spending down her lifetime unified credit (\$11.4 million in 2019, but only \$1 million for gift tax purposes in 2009).\footnote{I.R.C. § 2505(a) (2009); Rev. Proc. 2018-57, supra note 16, § 3.41.} Any same-sex couple with jointly held property and a significant disparity in income could easily have found (and still could easily find) itself exceeding the annual exclusion each year. Once the unified credit had been exhausted, which was a distinct possibility over the course of a long-term relationship (or a series of long-term relationships) before the recent sharp rise in the gift and estate tax unified credit,\footnote{See Cain, supra note 15, at 745–76.} the higher-earning partner would begin paying gift tax on both wealth transmission and consumption transfers (at a rate of 40% in 2019 and of 41% in 2009).\footnote{I.R.C. § 2001(c); I.R.S. Instructions for Form 709, at 12 (2009).} Thus, for same-sex couples, gift taxation could not be dismissed as the product of an overactive or misdirected imagination; rather, it was a very real possibility whose importance could not be trivialized or ignored.

Furthermore, when the income and gift tax consequences of a net interspousal transfer were considered together, the tax cost might have been even higher than it initially appeared. Because the income tax and the gift tax operate independently, the characterization of a net interspousal transfer need not be consistent across these taxes.\footnote{See, e.g., United States v. Davis, 370 U.S. 65, 69 n.6 (1962) (“In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes.”); Comm’r v. Beck’s Estate, 129 F.2d 243, 246 (2d Cir. 1942) (“Perhaps to assuage the feelings and aid the understanding of affected taxpayers, Congress might use different symbols to describe the taxable conduct in the several statutes, calling it a ‘gift’ in the gift tax law, a ‘gaft’ in the income tax law, and a ‘geft’ in the estate tax law.”).} In other words, a net interspousal transfer might be characterized as income to both partners for income tax purposes and as a taxable gift from the higher-earning partner to the lower-earning partner for gift tax purposes.\footnote{See Cain, supra note 5, at 124–25.} Consequently, a portion of the income of the higher-earning partner might be subject to triple taxation.

To get an idea of what triple taxation might look like, consider a simple example\footnote{This is taken from Infanti, Sodomy Statute, supra note 1, at 788 n.65.}: Assume that the higher-earning partner of a single-earner lesbian couple had \$100,000 in income for the 2003 taxable year. The couple were advanced in years, had paid off their home, and had no children (or, at least, no children at home). The couple pooled their income and shared their expenses equally. Under this scenario, the higher-earning partner would have paid \$19,708 in income tax on her income (assuming that she took the standard deduction and two personal exemptions). Ignoring state taxes, that left the couple with \$80,292 on which to subsist.
For the sake of simplicity, assume that one-half of the higher-earning partner’s after-tax income (or $40,146) was the amount of the net interspousal transfer for the year. Using average tax dollars, the transfer has already borne $9,854 (½ x $19,708) in income tax in the hands of the higher-earning partner (i.e., the before-tax transfer was $50,000, or one-half of the higher-earning partner’s gross income). In the hands of the lower-earning partner, this $40,146 would have been subject to another round of income tax, with the lower-earning partner having been required to pay $6,659 in income tax on the transfer (assuming no other income, no personal exemption, and a standard deduction of only $750). Assuming that the higher-earning partner has just exhausted her gift tax unified credit, $29,146 of the net interspousal transfer ($40,146 less the $11,000 annual exclusion) would have been subject to gift tax at a rate of 41%, producing an additional $11,950 in tax.

In total, the net interspousal transfer would have borne $28,463 in income and gift tax, for an effective tax rate of 56.9% ($28,463 ÷ $50,000). In contrast, a married couple’s tax bill on the same transfer (based on average tax dollars and a single round of income tax) would have been only $7,554, for an effective tax rate of 15.1% ($7,554 ÷ $50,000).

During this pre-Windsor period, the IRS did very little to clear up this uncertainty. When it did act, questions arose about whether the IRS was faithfully interpreting the tax laws or acting based on ideological or political motivations. For instance, in 2005, California extended its community property regime to registered domestic partners, which raised a question regarding whether domestic partners could split their income (often to their advantage) between their two “single” federal income tax returns under the landmark case of Poe v. Seaborn. In a much-criticized decision, the Bush administration took the position in 2006 that domestic partners could not split their income because Seaborn applied only to married couples. But with a change in administration came a change in legal position. In 2010, the Obama administration issued guidance that reversed course and, eliding the question of relationship recognition, concluded that the application of state property law to domestic partners would be respected for federal tax purposes.

Same-sex couples also faced significant problems upon the dissolution of their relationships. Because their relationships were not recognized, same-sex couples were excluded from the alimony inclusion/deduction regime of §§ 71 and 215, and they could be taxed on the division of their property upon divorce or separation due to the inapplicability of § 1041. Not being recognized “spouses,” they also were unable to take advantage of qualified domestic relations orders with respect to the division of retirement plans under § 414(p).

III. ... But Not for Different-Sex Couples

This tax wilderness was, of course, not exclusively inhabited by same-sex couples pre-Windsor. The same rules applied to unmarried different-sex couples as well. But these different-sex couples had options—they could, of course, marry and obtain the relative tax certainty of that relationship status. And when creating marriage alternatives for same-sex couples, some states

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opened those statuses to some or all different-sex couples, too. With no statutory barrier to
treating these different-sex couples as *married* for federal tax purposes, H&R Block sent an
inquiry to the IRS in 2011 asking whether a different-sex couple who had entered into an Illinois
civil union could file a joint federal income tax return. In keeping with basic tax principles that
look to substance (rather than form) in determining tax consequences, the IRS responded that
the different-sex couple could file jointly because civil unions and marriages are legally
equivalent under Illinois law. Word of this position circulated among the tax bar, and the
Illinois Department of Revenue even relied upon it when advising different-sex civil union
couples that they could file joint income tax returns at both the federal and state levels. With
this interpretation, which was fully consistent with basic tax principles, the expectation was that
the eventual demise of the federal Defense of Marriage Act would extend legal recognition not
only to same-sex couples who were married but also to same-sex couples who had entered into
civil unions and domestic partnerships—not because they preferred civil unions or domestic
partnerships to marriage but because it was their only option for relationship recognition under
then-applicable state law.

V. *Post-Windsor Treatment of Marriage Alternatives*

In 2013, the U.S. Supreme Court decided *United States v. Windsor*, which declared the portion of
the Defense of Marriage Act that applied to the federal tax laws unconstitutional. Shortly
following this decision, the IRS issued Revenue Ruling 2013-17 to implement the *Windsor*
decision; however, at the very end of that ruling, the IRS included a short paragraph reversing its
pre-*Windsor* position and denying legal recognition to marriage alternatives. What made this
decision to accord decisive importance to the label attached to a relationship most surprising was
that the position was accompanied by no legal analysis whatsoever—despite the position’s being
at odds with the IRS’s earlier (and from a tax perspective, quite appropriate) consideration of the
substance of the legal rights and obligations of the relationship rather than its form.

Following the Supreme Court’s decision in *Obergefell v. Hodges* extending marriage equality
across the country, the IRS moved to enshrine the position that it took in Revenue Ruling 2013-
17 in regulations. Proposed regulations were issued in 2015. In the preamble to the proposed
regulations, the IRS provided three reasons for denying legal recognition to marriage
alternatives: (1) states that created marriage alternatives “have intentionally chosen not to
denominate those relationships as marriages”; (2) recognizing these relationships might upset the
expectations of couples (read: different-sex couples, as they were the only ones who had a choice
among relationship statuses pre-*Windsor*) who entered into those relationships to reap greater

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28 E.g., CAL. FAM. CODE § 297(b)(4)(B) (West, Westlaw through ch. 1016 of 2018 Reg. Sess.); 750 ILL. COMP.
STAT. ANN. 75/10 (West, Westlaw through P.A. 100-1144 of 2018 Reg. Sess.).
30 Letter from Pamela Wilson Fuller, Senior Technician Reviewer, Branch 2, Internal Revenue Service, to Robert
31 Amy S. Elliott, *IRS Memo Indicates Civil Unions Are Marriages for Tax Purposes*, 133 TAX NOTES 794 (2011);
*Individuals: Same-Sex Civil Unions*, ILL. REVENUE (2012), http://www.revenue.state.il.us/individuals/same-sex-
civil-unions.htm [https://web.archive.org/web/20120221025408/http://www.revenue.state.il.us/Individuals/Same-
Sex-Civil-Unions.htm].
34 Anthony C. Infanti, *The Moonscape of Tax Equality: Windsor and Beyond*, 108 NW. U. L. REV. COLLOQUIY 110,
124 (2013).
federal benefits (under Social Security, for example) than they would if they were “married”; and 
(3) “no provision of the Code indicates that Congress intended to recognize as marriages civil 
unions, registered domestic partnerships, or similar relationships.” Commenters, including the 
ABA Tax Section, strongly criticized the IRS’s decision to deny legal recognition to marriage 
alternatives, explaining at length precisely why the IRS’s purported rationale was deeply flawed 
and did little more than enshrine in law the very discrimination that the Supreme Court aimed to 
end through its decisions in Windsor and Obergefell. Nonetheless, the IRS stood fast to its 
position, rejecting all of these comments as “not persuasive.”

At present, Treasury Regulations § 301.7701-18(c) states:

The terms spouse, husband, and wife do not include individuals who have entered 
into a registered domestic partnership, civil union, or other similar formal 
relationship not denominated as a marriage under the law of the state, possession, 
or territory of the United States where such relationship was entered into, 
regardless of domicile. The term husband and wife does not include couples who 
have entered into such a formal relationship, and the term marriage does not 
include such formal relationships.

Thus, no couple who has entered into a civil union, domestic partnership, or other alternative 
status is currently able to take advantage of the certainty that marriage brings for federal tax 
purposes, regardless of why they entered into that status or how closely the rights and obligations 
of that status mirror those of a marriage.

V. Conclusion

The repeal of the alimony inclusion/deduction regime effective in 2019 has given rise to a hue 
and cry. But for all of the protest, the repeal of this regime does little more than take a very 
small step toward equalizing the treatment of marriage and its alternatives.

After all, same-sex couples in marriage alternatives have never had access to the alimony 
inclusion/deduction regime (though different-sex couples do appear to have had such access 
before Revenue Ruling 2013-17 was issued). Some of these couples may, after the Windsor 
decision, have voluntarily chosen the status to reap anticipated (though, in the case of Social 
Security and even tax, perhaps no actual) benefits just as different-sex couples have done all 
along, while others might have chosen a marriage alternative because of a principled opposition 
to a legal status from which they were long excluded by law and still others might be stuck in 
one of these alternative relationship statuses because of the breakdown of their relationship or the 
death or incapacity of one of the partners. Yet, all of these same-sex couples—now accompanied 
by different-sex couples in these alternative relationship statuses—still find themselves 
inhabiting an uncertain tax wilderness when it comes to determining the income and gift tax 
consequences of their lives together, and they find the path to the dissolution of their 
relationships not only complicated by lack of access to §§ 71 and 215 but also by the taxability 
of their property settlements due to the inapplicability of § 1041 and by their inability to take

37 Id. at 64,379.
38 See Infanti, Marital Hegemony, supra note 1, for a summary and discussion of all of these comments.
40 Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11051, 131 Stat. 2054, 2089 (2017); Am. Bar Ass’n, Resolution 
102A (2018), available at https://www.americanbar.org/content/dam/aba/images/abanews/2018-AM-
Resolutions/102a.pdf.
advantage of qualified domestic relations orders under § 414(p) to govern the division of retirement plans.

Why isn’t the hue and cry about the treatment of already privileged married couples who now cannot deduct their alimony payments when their relationships end not accompanied by a protest regarding the tax injustice that the IRS has worked on couples in civil unions and domestic partnerships—both while their relationships remain intact and when they dissolve—by refusing recognition to relationships that are the equivalent of marriages under state law? If §§ 71 and 215 are to be restored to the Internal Revenue Code, shouldn’t this restoration be accompanied by legislation that effectively overrules Treasury Regulations § 301.7701-18(c) by defining marriage to include equivalent relationships under state or foreign law? Or, even better, why not work toward broader, more inclusive reforms that would make the Code relationship-neutral rather than simply expanding the circle of privileged relationships? Rather than focusing only on the narrow question of the repeal of the alimony inclusion/deduction regime, those interested in the taxation of the family—and more importantly, in working toward a more just tax system—should use this opportunity to think about the broader issues that are at stake in the debate over how to take relationships into account for tax purposes.