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IRS Informal Guidance on Civil Unions Raises More Questions than It Answers

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Last week, an informal letter from the Internal Revenue Service (IRS) issued to the tax preparation company H&R Block on August 30, 2011 surfaced publicly. In the letter, an IRS official opined that opposite sex *civil union* partners in Illinois are treated as *married* for federal income tax purposes because the State of Illinois regards them as married. The letter limits the opinion to opposite sex couples presumably so that the opinion would be consistent with the Defense of Marriage Act (DOMA), which limits the term "spouse" for federal purposes to a person of the opposite sex from the primary taxpayer. (As discussed in our March 8, 2011 client alert, Departing from Prior Practice, DOJ Declines to Defend Section 3 of the Defense of Marriage Act, at President Obama's direction the Department of Justice will no longer defend the constitutionality of DOMA in court; however, it remains valid law until repealed.)

In its letter, the IRS stated that:

> [T]he status of individuals of the opposite sex living in a relationship that the state would treat as husband and wife is, for Federal income tax purposes, that of husband and wife. [The Illinois law] provides that "[A] party to a civil union is entitled to the same legal obligations, responsibilities, protections and benefits as afforded or recognizes [sic] by the law of Illinois to spouses. . . ." Accordingly, if Illinois treats the parties to an Illinois civil union who are of opposite sex as husband and wife, they are considered "husband and wife" for [Federal tax filing purposes]."

Here is a copy of the IRS letter.

Although the IRS letter responds to a specific question asked by H&R Block (*i.e.*, whether an opposite sex civil union couple may file a joint tax return), the response raises more questions than it answers, particularly with respect to employee benefit plans. For example, if the official IRS position is really that opposite sex, civil union partners are to be treated as married if state law treats them as "husband and wife," then this view arguably would apply equally in the context of employee benefits plans and would not be limited to the filing status of various taxpayers.

Currently, five states recognize civil unions and grant the partners rights equivalent to marriage – Delaware, Hawaii, Illinois, New Jersey and Rhode Island. We also note that many more states recognize a form of "domestic partnership" that is somewhat akin to the civil union laws in other states. Therefore, a separate but important question raised by the IRS letter is whether this position would apply equally to domestic partnerships in those states that recognize these other relationship classifications.

If this informal letter's stated position reflects a broader view that opposite sex civil unions are treated as marriages for federal tax purposes, then this modest little advisory letter to a tax preparation firm has broad implications well beyond its modest presentation. For example, it would mean that employers would *not* be required to impute income for federal tax purposes for the value of employer-provided health coverage provided to an employee's opposite sex partner in a civil union (and possibly even a domestic partner union) that is the equivalent of a marriage under state law. However, because of DOMA, employers still would be required to impute income for federal tax purposes for the value of employer-provided health coverage provided to an employee's *same*-sex partner in a civil union (and domestic partner union). This bifurcated tax treatment would further complicate the administration of these benefits.

Moreover, if this logic were extended into the tax-qualified retirement plan context, civil union partners (and domestic partners) also would have rights to spousal protections under those retirement plans. This could lead to some interesting issues, because, among other things, retirement plan sponsors ordinarily would not know whether its employees are parties to a civil union. This status question has thus far not generally been relevant to the administration of these plans.

In any event, it is important to bear in mind that this advice letter to a tax preparer regarding the proper tax return filing position for its civil union clients has no precedential effect on other taxpayers. It is not formal guidance from the IRS or a restatement of well-established law. We would expect that if the IRS were to make a wholesale shift of its view on the federal tax treatment of opposite sex civil union partners, it would do so in a more fully considered and somewhat more formal approach. The bottom line is that this letter is not the final word on these questions. We are hopeful that the IRS will provide additional guidance in the near future. Until then, employers should discuss these issues with qualified benefits counsel to determine how the IRS's informal guidance should apply to the tax treatment of opposite sex civil union partners under employee benefit plans that are governed by federal law.

Please contact any of the lawyers listed on this alert if you have questions.

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