The New York Marriage Equality Act and the Income Tax

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Patricia A. Cain*

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INTRODUCTION

In some ways, the most important aspect of the Marriage Equality Act\(^1\) was its effect on state tax matters. That is because for most other purposes, New York had already recognized valid marriages from other jurisdictions.\(^2\) As a result, lesbian and gay New Yorkers who married in nearby states like Massachusetts or Connecticut were already married in the eyes of New York State officials, except for purposes of state taxation.

The state’s position on marital status for tax law purposes changed on July 24, 2011, when New York began recognizing and authorizing same-sex marriages celebrated within the State of New York.\(^3\) On July 29, 2011, the New York State Department of Taxation and Finance announced as follows:

The Marriage Equality Act . . . was signed into law . . . on June 24, 2011 [by Governor Andrew M. Cuomo]. One purpose of the Act is to provide that all marriages, whether of same-sex couples or different-sex couples, will be treated equally under all laws of the state. Accordingly, the Act applies to all taxes administered by the Tax Department as of the effective date of July 24, 2011.\(^4\)

While the announcement clarifies that the Marriage Equality Act applies to all New York taxes, it is not altogether clear what the consequences of this new rule may be; the Department of Taxation and Finance has, thus far, not provided much guidance. Here is the sum total of the Department’s advice, provided on their website:

Same-sex married couples must file using a married filing status for tax year 2011 and after[.]

- You must file your New York personal income tax return(s) using a married filing status even though your marital status isn’t recognized for federal purposes. Because the law only applies starting for tax year 2011, you can’t amend a prior year return using a married filing status.

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\(^4\) Id.
To complete your New York return you must re-compute your federal income tax return (including all credit forms, schedules, and other attachments) using a married filing status, applying all the federal rules for married taxpayers. Don't submit this federal as if married return to the IRS. Use it only to complete your New York return and keep it with your tax documents.

If you make estimated tax payments you should recompute your estimate based on a married filing status. In order to file the "federal as if married" return, same-sex married couples will need to identify all the rules that apply to spouses at the federal level. As a result, when reporting on a joint basis for New York purposes, these taxpayers will often find that amounts of income, gains, losses, and deductions will be different from the amounts reported on their federal returns. This essay identifies some of these differences, with a particular focus on the problem of computing "basis" for income tax purposes. If the Marriage Equality Act fully trumps existing tax statutes so that all married couples will be taxed the same under state law, then it is likely that same-sex couples will have to wrestle with a problem that I call the problem of non-uniform basis.

The different tax treatment of same-sex spouses under federal and state tax laws creates some difficulties for same-sex spouses. Their taxes become more complicated. But, as I conclude, the movement toward equality is a good one. And the difficulty in applying these two separate tax regimes to same-sex couples is likely to lead toward real equality in the end.

I. BACKGROUND

New York State has been an important battleground in the fight for recognition of same-sex marriage for at least two decades. In 1989, the New York Court of Appeals handed down an important decision in support of state recognition of same-sex couples. Braschi v. Stahl Associates did not directly raise the question of same-sex marriage, but it was a case ahead of its time in recognizing a same-sex couple as "family" for purposes of applying a rent control law and thereby according a surviving...

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same-sex partner of a long term relationship the same rights under the law that an opposite-sex spouse would have enjoyed. But several years later, the New York courts refused to extend this holding to find that a surviving partner could be considered a surviving “spouse” for purposes of intestate succession. To claim spousal status, one must actually have entered into a marriage, and in the early 1990s, there was no state or foreign jurisdiction that authorized same-sex marriages. A more direct challenge to the New York marriage statutes was made several years later in Storrs v. Holcomb, but ultimately on appeal that case was dismissed for failure to include the State Department of Health as a necessary party.

The same-sex marriage landscape changed dramatically in 2001 when the Netherlands became the first country to enact legislation authorizing same-sex marriage. Canada followed when first the Ontario courts, and then British Columbia courts ruled that a failure to provide for same-sex marriage was a charter violation. And, in 2004, Massachusetts became the first state in the United States to authorize and recognize same-sex marriage.

Because New York, unlike so many other states, had not passed a statute banning same-sex marriage or declaring that it was contrary to the public policy of the state, two routes to recognition of same-sex marriage were available in the court system. Supporters of same-sex marriage could pursue test litigation claiming that the state’s failure to recognize such

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7 Id. at 53–54.
11 Storrs, 666 N.Y.S.2d at 837.
12 Act Opening the Institute of Marriage, Burgerlijk Wetboek [BW] bk. 1, art. 30(1) (Neth.).
14 See Goodridge, 798 N.E.2d at 969 (staying entry of judgment for 180 days so that marriages were not available until May 2004).
marriages violated the state’s constitution. Alternatively, same-sex married couples, validly married in Canada or Massachusetts, could pursue individual claims as they arose (e.g., at death of a spouse) that their foreign marriages should be recognized by the state.

The test litigation over same-sex marriage generally was pursued in the case of Hernandez v. Robles. It was ultimately unsuccessful. In 2006, the New York Court of Appeals ruled 4-2 against the right of same-sex couples to marry. At the same time, however, litigants seeking to have their foreign same-sex marriages recognized in New York were more successful. Their success can be traced to a 2004 informal attorney general opinion pointing out that while the state might not authorize same-sex marriages, recognition of such unions under principles of comity or conflict of laws was a distinctly separate legal issue. In 2004, the state comptroller then issued an opinion that the state’s Retirement System would recognize Canadian same-sex marriages. While the New York Court of Appeals has never definitely ruled that foreign same-sex marriages entered into before passage of the Marriage Equality Act must be recognized by the state, a number of individual lower appellate court decisions recognized such unions in specific contexts.

Before passage of the Marriage Equality Act, however, no New York court or administrative agency was willing to grant spousal status to a same-sex spouse for purposes of state tax law. The New York State Office of Tax Policy made that position clear on April 4, 2006, when it issued an advisory opinion confirming that same-sex marriages would not be recognized for purposes of the

15 See, e.g., Hernandez v. Robles, 855 N.E.2d 1, 12 (N.Y. 2006).
17 855 N.E.2d at 1.
18 Id. at 12 (Rosenblatt, J., taking no part).
19 2004 N.Y. Op. Att’y. Gen. 1. “Whether the Domestic Relations Law permits same-sex marriages performed in New York has no bearing on whether New York will recognize as spouses those parties to a same-sex marriage (or its legal equivalent) validly performed under the law of other jurisdictions.” Id.
21 See Eickman, supra note 2, at 5–6.
state income tax.\textsuperscript{23} The opinion explained that because state income tax returns are based on federal income tax numbers, there is a state statute that specifically requires taxpayers to use the same filing status at the state level as they use at the federal level.\textsuperscript{24} The Defense of Marriage Act (DOMA)\textsuperscript{25} does not recognize same-sex marriages at the federal level.\textsuperscript{26} Thus, couples in such marriages must file their federal taxes using the filing status “unmarried individuals.”\textsuperscript{27} The New York statute, Tax Law section 651(b)(1), says that if you file separately at the federal level you must file separately at the state level.\textsuperscript{28}

More directly on point, and creating another and perhaps even clearer barrier to joint filing status, was section 607(b) of the Tax Law. It provides:

Marital or other status. An individual’s marital or other status under section six hundred one, subsection (b) of section six hundred six and section six hundred fourteen shall be the same as his marital or other status for purposes of establishing the applicable federal income tax rates.\textsuperscript{29}

Section 601 sets the rates for taxpayers based on filing status (married and unmarried), section 606(b) grants a household credit, calculated in part on the basis of marital status, and section 614 sets the amount of the standard deduction which varies on the basis of marital status.\textsuperscript{30}

Section 607(a) supplements these definitional rules by

\textsuperscript{23} See N.Y. State Dep’t of Taxation & Fin. Technical Mem. TSB-A-06(2)I (Apr. 4, 2006). The request for the opinion came from a New York taxpayer who was legally married in Canada. Id. The request was pursued on his behalf by Lambda Legal Defense and Education Fund. Id.

\textsuperscript{24} Id.; N.Y. TAX LAW § 651(b)(1) (McKinney 2006).


\textsuperscript{26} 1 U.S.C. § 7.

\textsuperscript{27} 26 U.S.C. § 1(c) (2006).

\textsuperscript{28} N.Y. TAX LAW § 651(b)(1). This provision applies only to husbands and wives, and it says that if they filed separately at the federal level, they must file separately at the state level, and if they filed jointly at the federal level, they must file jointly at the state level. Id. § 651(b)(1)–(2). Then New York Tax Law section 607(b) provides that marital status for federal law purposes is controlling. Id. § 607(b). Logically, this would mean that the married couple is not considered husband and wife and so section 651(b) would not really apply to them. Instead, since section 607(b) requires them to be considered unmarried for tax purposes, they would follow the state tax rules that apply to unmarried taxpayers.

\textsuperscript{29} Id. § 607(b).

\textsuperscript{30} Id. §§ 601(a)–(b), 606(b)(2)(A)–(B), 614(a)–(b).
providing that, in general, any word used in the New York tax statutes will have the same meaning as that word when used in a similar context in the Internal Revenue Code (IRC), "unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute."\footnote{Id. § 607(a).} As a result, although same-sex marriages could be recognized as valid marriages for a myriad of state law purposes, New York tax law had effectively incorporated into state tax law the federal definition of spouse. That meant that DOMA applied in New York to tax issues even though it did not apply to other issues.

That position changed on July 24, 2011. The State Department of Taxation and Finance made that clear in its July 29 proclamation.\footnote{See N.Y. TSB-M-11(8)C, supra note 3.} Thus, the Marriage Equality Act trumps the language in section 607(b). Under section 607(a), the Marriage Equality Act clearly requires a different meaning for the word "spouse" under state law than the meaning assigned that term at the federal level. DOMA no longer applies to state tax law. This fact makes federal and state tax rules no longer uniform.

II. THE DIFFICULTIES CAUSED BY THE NON-UNIFORMITY OF FEDERAL AND STATE TAX LAW

In addition to the right to file a joint tax return, there are numerous federal tax rules that apply only to spouses. The tax rates that apply to two spouses filing a joint return are different from the tax rates that apply to two unmarried taxpayers filing two separate returns.\footnote{See 26 U.S.C. § 1(a), (c) (2006). For current 2012 rates, see Rev. Proc. 2011-52, 2011-45 I.R.B. 701.} Sometimes these rates produce a benefit and sometimes they produce a detriment. Generally the detriment at the federal level occurs when both spouses are earners.\footnote{Roberton Williams, The Tax Policy Briefing Book: Taxation and the Family: What are Marriage Penalties and Bonuses?, TAX POLICY CENTER, http://www.taxpolicycenter.org/briefing-book/key-elements/family/marriage-penalties.cfm (last updated Apr. 4, 2008).} For example, two single taxpayers making $50,000 each will pay a combined tax bill of $12,512,\footnote{Claiming the standard deduction and one personal exemption each, they will have taxable income of $40,500 each and will owe $6,256 each in federal taxes.} while the same two
taxpayers, if married, will pay a tax bill of $16,381. The New York tax rates do not create marriage penalties in the way that the federal rates do. The rates for married filing separately are exactly the same as for single taxpayers. However, at high income levels, filing jointly can sometimes create a slight penalty.

The difficulties that are caused by reporting as single at the federal level while filing as married at the state level result from the fact that New York bases the computation of taxable income heavily on the IRC, and the IRC has a number of special rules that apply to spouses. Taxpayers who filed under the IRC as single, and in fact continue to file at the federal level as single, are not apt to be familiar with many of these rules. Same-sex married couples cannot simply combine the figures from their single federal forms and import them into a new joint state return. Instead, they must complete an entirely new joint federal return, which must take into account special rules such as the following:

1. If one spouse itemizes deductions the other spouse cannot claim the standard deduction even if that spouse files separately.
2. Spouses can exclude up to $500,000 of gain from the sale of a principal residence even if the residence is owned by only one spouse. Two unmarried individuals who sell their home can exclude only $250,000 per owner.
3. Sales between spouses are not recognized as sales under the

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36 Combined, their taxable income, after standard deduction and two exemptions, will be $81,000, and the tax due on $81,000 is $16,381. See Williams, supra note 34 (providing examples of marriage penalties and bonuses).
38 See id. For example, at taxable income of $500,000, the joint return rate produces a tax bill of $35,956, whereas the tax bill on two single taxpayers with $250,000 each of taxable income would be $17,228, for a combined bill of $34,456, about $1,000 less than the joint tax liability. Note that for large amounts of adjusted gross income, there are additional computations that affect the amount of the final tax bill. See id. at 60–61.
41 Id. § 121(b)(2)(A).
42 Id. § 121(b)(1).
federal tax law. As a result, no gain or loss can be recognized on the transfer and the transferee spouse will take the transferor spouse's basis. This same non-recognition rule applies to transfers of property at divorce.

4. When a taxpayer's employer covers the cost of health insurance for the employee's spouse, that benefit is not taxable income to the employee. In most cases, that benefit will be taxable to the employee whose same-sex spouse is included in the employer's health plan.

5. Two spouses, whether they file jointly or separately, are entitled to deduct only $3,000 of any net capital loss against ordinary income. Two unmarried taxpayers are entitled to deduct $3,000 of any such losses each.

6. Two unmarried taxpayers, one with capital gains and one with capital losses, cannot offset gains and losses, but two spouses who file jointly can offset such gains and losses.

7. Alimony paid by an ex-same-sex spouse is never deductible at the federal level under DOMA but may be deducted at the state level if it otherwise qualifies under section 215 of the IRC.

8. The amount of qualified mortgage interest deduction is different for two single taxpayers than it is for a married couple.

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43 Id. § 1041(a).
44 Id. § 1041(c).
48 Id.
49 See id. § 1222.
51 See 26 U.S.C. § 163(h)(3)(B)(ii). That section limits the amount of qualified acquisition indebtedness to $1 million per taxpayer, but only $1 million total for a married couple. Id. The same is true regarding qualified home equity indebtedness of $100,000. Id. § 163(h)(3)(C)(ii). See also Patricia A. Cain, Unmarried Couples and the Mortgage Interest Deduction, 123 Tax NOTES 473, 484–87 (2009) (reviewing domestic partner benefits). But see Sophy v. Comm'r, Nos. 16421-09 & 16443-09, 2012 U.S. Tax Ct. LEXIS 9, at **11–16 (T.C. Mar. 5, 2012) (holding that two unmarried taxpayers who were co-owners of two qualified residences were limited to the same $1.1 million of qualified debt as a married couple). The IRS position appears to be that the indebtedness limits are to be applied "per residence" rather than "per taxpayer," but even applying that rule, the two single taxpayers should have been entitled to deduct interest.
9. Gifts between spouses are not subject to the gift tax because there is a 100 percent marital deduction. The same tax-free treatment of transfers at death is available for spouses. While New York does not have a gift tax, it does have an estate tax which recognizes a 100 percent marital deduction for spousal transfers at death.

10. There is a special estate tax rule for jointly-owned property. For unmarried joint tenants, the full fair market value of the property is included in the estate of the first joint tenant to die unless the surviving joint tenant can prove original contribution to the purchase of the property. This rule does not apply to spouses. Only half of the value of the property will be included in the estate of the first spouse to die.

None of these federal rules apply to same-sex spouses because of DOMA. Yet they all should apply for purposes of filing the New York joint return. Thus, for example, if one spouse's employer covers the non-employee spouse on the company's health plan, the wage amount entered on the employee's real federal return should be higher than the wage amount entered on the mock federal return. And, if each spouse claimed capital losses of $3,000 against ordinary income, they should have to reduce that $6,000 combined loss to $3,000 on the mock federal return.

It is questionable whether the New York Department of Taxation and Finance has sufficiently alerted same-sex spouses to these issues. On its website, the department refers taxpayers to the IRS website for information about federal taxation and states further:

The Tax Department doesn’t answer federal tax questions, including questions about:

on the debt on the two residences to the extent the “per residence” debt did not exceed $1.1 million and not limited to $1.1 million in debt overall. See id. at 17.


53 Id. § 2056.


56 Id. § 2040(b)(1).
elections available to married taxpayers,
* limitations on deductions and credits for married taxpayers,
* determining income and losses for married taxpayers.  

Other states that have dealt with these issues provides some guidance regarding these differences to same-sex spouses within their borders. For example, Massachusetts explains that employer-provided health care benefits may be treated as taxable imputed income at the federal level, but will not be taxed at the state level.  

Massachusetts, a state with its own estate tax separate from the federal estate tax, has advised same-sex spouses that the joint tenancy rule for inclusion of property that applies at the federal level will not be applied at the state level.  

In addition, Massachusetts same-sex spouses are advised that they can claim the unlimited marital deduction at the state level.  

The Massachusetts Tax Department provides answers to a number of other tax questions that affect same-sex spouses.

California also provides guidance on these issues. California recognizes valid same-sex marriages entered into before Proposition 8 was passed on November 4, 2008. It also recognizes same-sex marriages from other jurisdictions entered into after that date, although it does not call them marriages. Instead, such relationships are given all the rights and responsibilities that marriages are given. Registered Domestic Partners (RDPs) in California are similarly treated the same as spouses in most respects and are treated completely the same for state tax purposes. The Franchise Tax Board has published two documents to give guidance to taxpayers. One publication is directed at same-sex spouses. The other is directed at RDPs.
In addition, the California FTB revamped its tax return forms to take into account most of these differences and offers same-sex partners the option of using California Schedule CA (California adjustments to federal income) to account for these differences rather than forcing the couple to complete a mock joint federal return. For couples with no adjustments or with minor adjustments, this option might prove quicker than completing an extra mock return.

One thing is certain, using a different filing status for federal and state returns creates additional problems for same-sex spouses. Their tax preparation costs may increase and they are less likely to be confident about doing their own tax returns. More guidance from the state would be helpful.

III. THE BASIS PROBLEM

A taxpayer's basis in property is used to determine gain or loss upon sale. If A purchases Blackacre for $10,000, then her cost basis in Blackacre is $10,000. If A receives Blackacre as a gift from someone else, her basis generally will be the donor's cost. Finally, if A inherits Blackacre then A's basis will be the fair market of the property at death. But here, inherit has a special meaning. Basically, A must receive the property from the decedent in a transaction that was subject to the estate tax.

A. A Simple Example of the Problem

Assume spouse A sells spouse B a 50 percent interest in A's vacation home. The federal rule is that sales between spouses are not recognized for tax purposes. Thus, under IRC section 1041, A has no gain and B takes A's basis rather than a basis equal to the current purchase price. But this federal rule doesn't apply to same-sex spouses because of DOMA. At the federal level A would

See Publ'n 737, supra note 65.
70 Id. § 1015. The basis rule may be different if the fair market value of the property at the time of the gift is lower than the donor's basis, but the general rule is that donee takes donor's basis. Id.
71 Id. § 1014.
72 See id. § 1014(b)(1)-(10).
73 Id. § 1041.
report a gain and B would claim a cost basis in the home equal to the purchase price. At the state level, because the marriage is recognized and because the effect of the Marriage Equality Act is to treat all New York spouses the same at the state level, the gain would not be recognized. Not only does this different treatment affect the current reporting of income (which will be lower at the state level than at the federal level because of the nonrecognition of gain), it also creates different tax consequences going forward. B will have a cost basis for her 50 percent interest at the federal level and a carryover of A’s basis at the state level. Then once the property is sold, the gain or loss thereon will be different for federal tax purpose than it is for state purposes.

This basis problem was recognized early on by the California Franchise Tax Board (FTB) when California first approved joint filing for RDPs. 74 In the end, however, the only detailed guidance about this problem was with respect to tax-favored accounts such as individual retirement accounts (IRA). 75 Because a same-sex partner cannot be a spouse under the federal law, computations regarding the IRA will differ at the state and federal level thereby creating a different basis in the account for federal and state tax purposes. California instructs their taxpayers affected by this that they will in some cases have a “California-only” basis in such accounts. 76

Despite the lack of formal guidance, the FTB has made it clear that the differing tax treatment at federal and state level will sometimes create a different basis for certain types of property. 77 For example, under IRC section 1014, when one spouse dies owning community property, even though only 50 percent of it is included in the decedent’s estate for estate tax purposes, the surviving spouse may nonetheless get a full 100 percent step up in basis. 78 In other words, there is a special rule, limited to

74 See State of Cal. Franchise Tax Bd., Focus Group: Filing by Registered Domestic Partners 1–2 (2006), available at https://www.ftb.ca.gov/forms/RDP FocusGrpInfo.pdf. This was a meeting of interested parties with the FTB to discuss the issues that might arise from the joint return filing rules for RDPs. I participated by conference call. The group raised a number of issues that the FTB had not addressed. That list includes: “Differences between federal and state basis for recordkeeping purposes.” Id. at 2.
75 See generally id. (discussing IRA advice for taxpayers).
76 Publ’n 737, supra note 65, at 5–6; Publ’n 776, supra note 66, at 5.
community property, under which the surviving spouse’s 50 percent share of the community takes the same fair market value at death basis as the deceased spouse’s half takes. This rule will apply at the state level for California RDPs and same-sex spouses, but because of DOMA, not at the federal level.

B. A More Complex Problem

The New York State Department of Taxation and Finance has not issued any specific guidance for same-sex spouses regarding the problem of non-uniform basis. On July 29, 2011, the same day that the department issued the technical memorandum concluding that the Marriage Equality Act was intended to apply to state taxes, the department issued another technical memorandum addressing questions raised by the difference between the federal and state estate taxes. One specific issue it addressed was the treatment of property in an estate of a 2010 decedent. At the federal level, an estate could elect out of the federal estate tax for the year 2010. If such an election was made, then the property in the estate would not be entitled to the step up in basis that is usually accorded property acquired from a decedent. Instead, for federal income tax purposes, such property would be subject to special carryover basis rules.

What would the basis rule be for New York state income tax purposes in such a situation? New York after all has its own

80 California RDPs are entitled to the same tax treatment as opposite sex spouses and since opposite sex spouses get the double step up in basis at the state level, it follows that RDPs should benefit from the double step up as well. See Publ’n 737, supra note 65. While the double step up in basis rule is not specifically mentioned in this publication, I have been assured by staff at the FTB that the Board assumes that the RDPs are entitled to the double step up in basis at the state level. See E-mail from Susan Maples, FTB Tax Practitioner Liaison, to Patricia Cain, Inez Mabie Distinguished Professor of Law, Santa Clara University (Jan. 23, 2012, 1:47 PM PST) (on file with Albany Government Law Review).
83 Id.
estate tax and did not adopt the one-year repeal of that tax in 2010.\textsuperscript{87} As a result, fair market value of the property at death would be subject to the New York estate tax. But New York has no separate basis rule akin to section 1014 at the state level and so it was unclear what the basis rule should be. The department concluded as follows:

Although the date of death value must be used for purposes of the New York State estate tax, the New York State personal income tax is based on the information reported on the federal income tax return, including income and federal adjustments to income. As a result, when the assets transferred upon the individual's death are subsequently sold, the same modified carryover basis used to report any capital gain/loss for federal income tax purposes must be used for New York State personal income tax purposes.\textsuperscript{88}

While this pronouncement has nothing to do with same-sex spouses, it does create a conundrum under New York tax law. Gains and losses for most taxpayers apparently must be computed using whatever the federal basis rules are.\textsuperscript{89} Thus, for estates of decedents who died in 2010 and elected out of the federal estate tax and into carryover basis rules at the federal level, gains and losses upon sales of that estate property must be computed using the federal carryover basis rules rather than the fair market value at death rule that otherwise would apply. This is true even though New York has its own estate tax and even though the assets in such estates may be fully taxable by the state of New York. In other words, this Technical Memorandum appears to conclude that a separate state-only basis is not possible under New York income tax law because of its dependence on federal law.

Was the Marriage Equality Act intended to reverse that rule? Logically, it should reverse the rule. And, that it the conclusion in states such as California that dealt with these differences between federal and state tax law as applied to same-sex spouses or partners. But the conclusion in this New York technical memorandum gives me pause as to whether New York will follow California, especially when the basis rules are a product of section 1014 regarding property acquired from a decedent.

Here's how the question could arise in the section 1014 context.

\textsuperscript{88} N.Y. Dep't of Taxation & Fin. Technical Mem. TSB-M-11(9)M, at 3 (July 29, 2011) (emphasis added).
\textsuperscript{89} Id. at 2–3.
Assume A dies in New York with an estate valued at $5 million. There is no federal estate due because the current exemption amount is $5 million.\(^9\) But the New York exemption is only $1 million.\(^1\) Fortunately, for same-sex spouses, the Marriage Equality Act creates a marital deduction for gifts made to same-sex spouses.\(^2\) A’s estate planner, having thought ahead, puts $1 million of the estate in a credit shelter (bypass) trust and the remaining $4 million in a qualified terminable interest property (QTIP)\(^3\) trust for the benefit of surviving spouse B. The QTIP trust should qualify for the marital deduction at the state level. It would not at the federal level because of DOMA. It is not an issue at A’s death because the estate is not large enough to trigger a federal estate tax.

But what happens at B’s death? The assets in the QTIP will be included in B’s estate for state tax purposes, but not in B’s estate for federal tax purposes. Why? Because of DOMA and the fact that A and B are not recognized as spouses. As a result, the QTIP assets will escape the federal tax at B’s death—which, after all, is why A’s estate planner structured A’s estate plan to include a QTIP in favor of B. Since a QTIP is merely a life estate it will not be included in B’s estate at the federal level, unless the QTIP election available for spouses is made and honored.

If New York insists on using the same date of death basis rule that is applied at the federal level, then the property in the trust will have a basis equal to the property’s fair market value as of A’s death, not as of B’s death. That result may make good sense as applied to a non-taxable federal estate. In my example, if A and B were opposite-sex spouses they would be in the same position as the same-sex spouses. Neither couple would need the marital deduction to reduce federal taxes. Basically, A and B would be put to an election to treat the QTIP as taxable at B’s death for federal tax purposes and get the step-up in basis or to treat it as a bypass trust for federal tax purposes and forego the possible step up in basis.

But what if same-sex spouse A dies with a $10 million estate and puts $9 million in the QTIP trust in order to avoid any state

\(^1\) N.Y. Tax Law § 951 (McKinney 2006).
\(^3\) 26 U.S.C. § 1022(e)(5)(A)(i)–(ii) (defining qualified terminable interest property as “property (i) which passes from the decedent, and (ii) in which the surviving spouse has a qualifying income interest for life”).
estate tax? The opposite-sex spouse will do the same to avoid New York estate taxes, but will only elect QTIP treatment at the federal level for $5 million of the QTIP amount. For this spouse, the $5 million in the QTIP will be taxed at the federal level at B's death and the property will enjoy the step up in basis. In this situation, to equalize state income tax treatment between same-sex and opposite-sex spouses, I believe the property in the same-sex QTIP should be entitled to a step up in basis to the same extent as the step up available to the opposite-sex QTIP. New York can do nothing about the tax inequality at the federal level, but it should do what it can to create tax equality at the state level. That will require clarifying the basis rules that are affected by the differential tax treatment.

CONCLUSION

So long as DOMA remains effective, same-sex spouses in New York will find themselves applying a more confusing set of rules for state income tax purposes that opposite-sex spouses apply. The Marriage Equality Act was intended to create tax equality at the state level. But, given the interplay of federal and state tax rules, real tax equality is not possible.

The burden of trying to conform to DOMA at the federal level and yet create equality at the state level is particularly apparent in tax law because the state law is so dependent on the federal law. The burden will not just be on the individual taxpayers. It will also be a burden on the state that has to come up with effective rules to get around the full brunt of DOMA at the state level. This phenomenon is likely to make the state of New York and its citizens even more aware of the ways in which DOMA is unfair. As a result, some have suggested that tax law has a special role to play in the path toward true equality for same-sex couples.

94 That is because she only needs a $5 million marital deduction to produce a zero federal tax liability. See id. § 2010(c)(3)(A).