

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Leno, et al. Analyst: LuAnna Hass Bill Number: AB 1967

Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: February 12, 2004

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: California Marriage License Nondiscrimination Act

SUMMARY

This bill would change the definition of marriage to a civil contract between two persons.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to end discrimination against same-sex couples seeking marriage licenses in California.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2005, and operative for tax returns filed for taxable years beginning on or after January 1, 2005.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state tax laws provide guidelines for determining a taxpayer's filing status when filing an income tax return. For example, federal law states a husband and wife can file a joint income tax return even though one of the spouses has no gross income or deductions, except in the following cases:

- One of the spouses was a nonresident alien at some time during the taxable year;
- The spouses have different taxable years, subject to exceptions; and
- Where one or both spouses died during the taxable year, subject to exceptions.

Subject to limitations, an individual who files a separate tax return for a taxable year where a joint return could have been filed may subsequently file a joint return with their spouse for that same taxable year.

Board Position:

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Department Director

Date

Gerald H. Goldberg

5/12/04

For purposes of state income tax law, adjusted gross income (AGI) is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, minus specific deductions. For purposes of computing limitations based upon AGI, such as miscellaneous itemized deductions where only the portion that exceeds 2% of the AGI may be deducted, the taxpayer would use the AGI that is required to be shown on the federal tax return for the same taxable year.

Generally, under state law an individual must use the same filing status for their California income tax return that was used on their federal income tax return filed for the same taxable year. If the Franchise Tax Board (FTB) determines that the taxpayer's federal filing status was incorrect, FTB may revise the state return to reflect the correct filing status. A husband and wife may file separate returns if, during the taxable year, either spouse was an active member of the armed forces or a nonresident with no California income. Otherwise, a spouse may not file a separate return for any taxable year where a joint return has already been filed after the filing period for either spouse to file a separate return has expired. In addition, no joint return can be made if the husband and wife have different taxable years, subject to exception. State tax law also provides guidelines for determining a taxpayer's filing status in the event of the death of one or both spouses. Subject to limitations, an individual who files a separate tax return for a taxable year where a joint return could have been filed may subsequently file a joint return with their spouse for that same taxable year.

Under federal and state income tax law, spouses who file a joint tax return are each responsible for the accuracy of the return and for the full tax liability for that tax year. These obligations apply regardless of which spouse earns the income. The concept of obligating each spouse separately for all of the tax liability reflected on the joint return is called joint and several liability. Under certain circumstances individuals who file joint returns may be eligible for relief from joint and several liability.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions. These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. In addition, state law provides general rules that apply to the division of credits among two or more taxpayers, such as a husband and wife or partners in a business. State law also provides that any credit limitation applies at both the entity and individual taxpayer level, unless otherwise specified.

The terms taxpayer, individual, person, husband, and wife, and the determination of marital status are defined within the state income tax law. In addition, the term domestic partner is defined by reference to Family Code Section 297, which states that California recognizes a domestic partnership as being established when specified requirements are met. State tax law provides that the taxpayer's domestic partner be treated as the spouse of the taxpayer for purposes of determining various tax benefits relating to medical expenses, such as:

- medical expenses deductible as an itemized deduction,
- medical expenses deductible as an adjustment to gross income for self-employed individual health insurance,
- an exclusion from gross income for employer-provided accident and health insurance,
- an exclusion from gross income for medical expense reimbursement if the expense was not previously deducted, and
- long-term health care insurance deductible as a medical expense.

Federal law, under the Defense of Marriage Act, defines marriage as a legal union between a man and woman and spouse refers only to a person of the opposite sex who is a husband or a wife. In addition this Act provides that no State is required to give effect to any public act, record, or judicial proceeding of another State respecting a relationship between persons of the same sex that is treated as a marriage under the laws that that State.

State law, under the Family Code, defines marriage as a personal relation that arises out of a civil contract between a man and a woman. All real or personal property, wherever situated, that is acquired by a married person during the marriage while living in California is considered community property.

THIS BILL

This bill would change the definition of marriage to be a personal relationship arising out of a civil contract between two persons. In addition, this bill would specify that existing gender-specific terms in the law would be considered gender-neutral for the purpose of administering the rights and responsibilities of spouses.

Therefore, this bill could be interpreted to allow spouses in a same-sex marriage to file a joint state income tax return and be treated as spouses for purposes of state income tax laws.

IMPLEMENTATION CONSIDERATIONS

As stated above, this bill would change the definition of marriage under Family Code Section 300. However, Family Code Section 308.5 provides that only a marriage between a man and woman is valid or recognized in California. Further, AB 205 (Goldberg, Stats. 2003, Ch. 421) created community property rights for domestic partners and stated that domestic partners shall use the same filing status that they used or would have used for federal income tax purposes. This bill specifies that gender specific terms in current law would become gender neutral. The department is unclear whether this bill would allow spouses in same-sex marriages to be treated as spouses for purposes of state income tax laws. If that is the intent of the bill, then implementing this bill would require some changes to existing tax form instructions and information systems, which could be accomplished during the normal annual update. However, the department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- California personal income tax returns use the federal AGI to begin the calculation of state income tax. Since spouses in a same-sex marriage would file separate federal tax returns, it is unclear what the federal AGI figure would be in order to begin the calculation of state income tax.
- As stated under "State/Federal Law" above, for purposes of computing limitations based upon AGI, the taxpayer would use the AGI that is required to be shown on the federal tax return for the same taxable year. Therefore, federal AGI determines, among other tax items, the 2% floor on itemized deductions, the AGI floor on medical expenses, the state percentage of the federal child and dependent care credit, and the phase out of exemption credits. Since spouses in a same-sex marriage would be required to file separate federal tax returns, it is unclear what the federal AGI figure would be in order to compute the limitations.
- The department uses automated systems to compare taxpayer return information to files received from other state and federal agencies, including the Internal Revenue Service (IRS).

The automated systems search through IRS records by Social Security Number and name and compare information on the taxpayer's federal income tax return to the information on the California income tax return. Since current law generally requires the filing status of the taxpayer for the state tax return to be the same filing status as on the federal return, the systems have the ability to verify joint returns based on the primary taxpayer's information. Since spouses in a same-sex marriage are required to file separate federal income tax returns and this bill could allow those persons to file a joint state income tax return, the department anticipates a delay in the ability of the automated systems to compare taxpayer information. The systems would be required to run through the federal information more than once as the systems search for the primary taxpayer and the secondary taxpayer individually because each taxpayer would have a separate return at the federal level. The systems would need additional programming and testing prior to being operational.

- This bill could be construed to allow spouses in a same-sex marriage to be treated as joint owners for all provisions regarding income taxes, including division of income and credits. However, if this is the intent, department staff recommends a clarifying amendment within the Revenue and Taxation Code to specify the exact provisions where persons in a same-sex marriage would be considered spouses. Department staff is available to work with the author's office to draft amendments to resolve this concern.

LEGISLATIVE HISTORY

AB 205 (Goldberg, Stats. 2003, Ch. 421) gave registered domestic partners the same rights, such as community property rights, that are granted to and imposed upon spouses in a civil marriage. In addition, the act specified that a domestic partner shall use the same filing status for state income tax purposes that was used or would have been used for federal income tax purposes. Further, it specified that earned income may not be treated as community property for state income tax purposes.

AB 25 (Migden, Stats. 2001, Ch. 893) allowed several existing taxpayer benefits for medical expenses and health insurance benefits to include a taxpayer's domestic partner and a domestic partner's dependents.

OTHER STATES' INFORMATION

Few states have addressed tax concerns relating to same-sex marriages or domestic partners through legislation. Below are the findings for three states.

Vermont enacted a same-sex civil union law that provides eligible persons of the same sex with an established relationship all the same legal benefits, protections, and responsibilities under law that are granted to married couples. For state income tax purposes, the parties to a civil union may file a joint income tax return and will be taxed in the same manner as married persons.

Hawaii defines domestic partners as reciprocal beneficiaries. Those partners who are legally registered receive some of the same rights and benefits of marriage. State income tax law does not provide reciprocal beneficiaries with income tax benefits or allow joint income tax returns.

Massachusetts does not allow domestic partners to file joint income tax returns.

Two counties in Oregon and one city in New York have begun issuing marriage licenses, but the impact on the tax systems of these two states is unclear.

FISCAL IMPACT

Implementing this bill would require some changes to existing tax form instructions and information systems, which could be accomplished during the normal annual update. However, the department anticipates customer service contacts from taxpayers seeking clarification of the tax laws with respect to same-sex marriages. Further, the automated systems that compare federal and state tax information for audit purposes would need additional programming and testing. Department costs for the additional contacts and to program and test the systems are anticipated to be \$120,000 for fiscal year 2004/2005.

ECONOMIC IMPACT

Revenue Estimate

Approximate Revenue Impact For Every 4,000 Married Same-Sex Couples Assume Operative January 1, 2006 (\$ Millions)			
Fiscal Year	2005-06	2006-07	2007-08
Revenue Loss	Minor loss	-\$1	-\$1

A minor loss does not exceed \$500,000.

This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

It was assumed that under this bill, affected taxpayers would be required to file income tax returns as married filing joint or as married filing separate.

This rule-of-thumb estimate is based on the approximately 4,000 marriage licenses issued for same-sex partners in San Francisco between February 11 and March 12, 2004. This amount was grown by 10% annually to get a 2006 figure of approximately 4,900 licenses.

Statistics for state personal income tax returns show that if two people previously filing as single or as head of household are required to file as married filing joint or married filing separate, 59% would pay less income tax and 12% would pay more income tax, with the remaining people unaffected. The average tax change for those paying more would be an increase of about \$755. Those paying less would pay about \$475 less. Applying these amounts to the 4,900 couples results in an average revenue loss of about \$1 million annually:

$$\begin{aligned}
 &4,900 \text{ (marriage licenses issued)} \times 59\% = 2,900 \text{ (couples that would pay less tax)} \\
 &2,900 \times \$475 \text{ (average tax savings)} = \text{\$1.4 million (revenue loss)} \\
 &4,900 \text{ (marriage licenses issued)} \times 12\% = 580 \text{ (couples that would pay more tax)} \\
 &580 \times \$755 \text{ (average tax increase)} = \text{\$.4 million (revenue gain)} \\
 \hline
 &\text{Total Revenue Loss } (-\$1.4 \text{ million} + \text{\$.4 million}) = \text{\$1.0 million}
 \end{aligned}$$

The 4,035 licenses issued cannot be reliably extrapolated to represent the California population as a whole. However, it can be said that for every 4,000 same-sex couples whose filing status would change to married, the average loss of personal income tax revenue would be around \$1 million.

ARGUMENTS/POLICY CONCERNS

This bill could have an impact on federal income tax law since those laws rely on each states' laws regarding married persons and their property. Currently, since California is a community property state, spouses who file separate federal income tax returns are required to split the incomes of each spouse to be claimed on each return. Federal income tax law does not recognize same-sex marriages. However, depending on federal interpretation, and since federal law relies on state laws regarding community property, spouses in a same-sex marriage could be able to claim half of each others' income on their separate federal returns (single filing status). Depending on the individual circumstances of the taxpayer, this bill could result in spouses in a same-sex marriage paying less federal income tax.

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