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The Same Sex Marriage Tax Shelter: What's Love Got To Do With It?

Stephen T. Black

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THE SAME SEX MARRIAGE TAX SHELTER: WHAT'S LOVE GOT TO DO WITH IT?

*Stephen T. Black**

I.	Introduction.....	606
II.	The Tax Benefits of Marriage.....	608
	A. Single Economic Unit	609
	B. Transfers Between Spouses.....	610
	C. Preferential Rates, Standard Deductions, and Earned Income.....	610
III.	Same Sex Marriage in the United States.....	611
	A. Partnerships and Marriage.....	612
	B. Husband/Wife Partnerships.....	612
	C. Comparison of Marriage Taxation and Partnership Taxation.....	614
	1. Contributions.....	615
	a. <i>Gains</i>	615
	b. <i>Losses</i>	616
	c. <i>The Lesson?</i>	617
	2. Characterization	617
	3. Contributions of Encumbered Property	619
	4. § 1031 Exchanges	619
	D. Other Issues	620
	E. Judicial Doctrines.....	621
	1. Sham Transactions	621
	2. Step Transaction Doctrine.....	622
	F. Sham Weddings.....	623
	1. Immigration and False Marriages	623
IV.	Multiparty Marriages and Tax Shelter Opportunities.....	624
	A. Disregarded Marriages	625
	1. North Dakota.....	625

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2. Delaware	627
B. Converted Unions.....	627
1. Washington	627
2. New Jersey–Washington Shelter	628
C. State-Centric Definitions.....	629
D. Tax Consequences.....	630
1. Contributions.....	630
2. Characterization	632
3. Swaps and Distributions	632
E. Bigamy Laws.....	632
1. Texas	633
2. Utah.....	634
3. New York.....	635
F. State Concerns.....	635
1. Would States Allow This?	635
3. Interstate Concerns.....	636
V. Conclusion	638
VI. Epilogue	639

*Then he got an idea. An awful idea. The Grinch got a wonderful,
awful idea!¹*

I. INTRODUCTION

The Supreme Court recently decided *United States v. Windsor*,² which called into question the status of tax equality for family units. But even more unsettling is the fact that *Windsor* also called into question the status of the entire tax system.

Since 1948, the U.S. tax system has provided for joint filing for married couples. This was a response to perceived unfairness in the tax system because a Supreme Court case granted different tax treatment to couples that lived in community property states.³ This change codified treatment of a married couple as an economic unit.

Treatment of a married couple as an economic unit has profound implications for the tax system. Tax law allows favorable tax rates and ignores otherwise taxable transfers between partners in a marriage

1. DR. SEUSS, *HOW THE GRINCH STOLE CHRISTMAS* (1957).

2. *United States v. Windsor*, 133 S. Ct. 2675 (U.S. 2013).

3. See Stephen T. Black, *Same Sex Marriage and Taxes*, 22 *BYU J. PUB. L.* 327, 332-33 (2008).

relationship. Arguments about some of the more troubling aspects of this arrangement were set aside because, for the most part, it worked.

However, individuals now pushing for recognition as a same sex couple have claimed that they, too, should be entitled to be treated as an economic unit. This not only raises questions about whether any couple should be treated as an economic unit, but also, if so, which couples should be treated as such.

For example, at one point prior to the adoption of joint filing, married couples tried to form business partnerships for the purpose of equalizing their income and reducing taxes. Courts fashioned ways to test whether a married couple was really a partnership for tax purposes. However, there are no reported cases of people wanting to form marriages for tax purposes (although there are many cases dealing with sham weddings for immigration purposes).

This may be explained by the fact that marriage has always been surrounded with non-tax incidents and responsibilities—societal norms surround what it means to be married, to be a husband or wife, and to be divorced. In essence, the stigma of marriage and divorce precluded the use of marriage as a tax shelter, even though the tax benefits could be substantial.

Consider the following example:

Example 1. Harry and Wilma get married in June. Harry owns a building, which has increased in value. He transfers it to Wilma, and she gives him \$2 million. There is no tax consequence to this exchange, even if the couple divorces in January.⁴

To date, this type of marriage tax shelter has not been high on legal planners' lists. Because of the costs attached to the marital relationship, the fact that the parties would have to be of opposite gender, and the difficulty surrounding termination of the relationship, many would not consider entering into a marriage for tax purposes alone. However, post-*Windsor*, is this still the same?

Example 2. Jill and Jane get married in November. Jill owns a building, which has increased in value. She transfers it to Jane, and Jane gives her \$2 million. There is no tax consequence to this exchange, even if the couple divorces in January.

It has long been an axiom that while state law determines what rights parties have, the federal tax impact (or benefits) flowing from those rights are solely a matter of federal law. In fact, one decision of the

4. 26 U.S.C. § 1041 (2012).

U.S. Supreme Court warned that this balance between federal and state laws must be treated with respect. “In looking to state law, we must be careful to consider the substance of the rights state law provides, not merely the labels the State gives these rights or the conclusions it draws from them. Such state law labels are irrelevant to the federal question”⁵

In changing the concept of marriage in our society, has it become easier and more tempting for individuals to use “marriage” as a tax vehicle? That is, could a buyer and a seller of the \$2 million building decide to forego the imposition of tax by getting married?

This Article is concerned with the seemingly blind way the majority opinion in *Windsor* dealt with tax questions and the resulting train wreck of law. In its rush to answer some questions, the Court has apparently forgotten that a careful balance between federal and state law even exists.

But why wring our hands?

Whenever a court throws decades of legal principles out the window, several doors of legal planning opportunities are opened—in this case, opened wide! This Article examines how wide, and asks whether the tax planning opportunities post-*Windsor* threaten the stability of the tax system and the stability of marriage. Part II of this Article discusses the federal tax benefits married couples receive when treated as a single economic unit. In Part III, the Article examines the use of partnerships and marriages to attain tax benefits for the parties involved. Next, Part IV discusses the possibility of tax shelter opportunities through the use of multiparty marriages, which are now possible in light of the *Windsor* decision. Finally, Part V concludes.

What has love got to do with it, after all?

II. THE TAX BENEFITS OF MARRIAGE

The U.S. tax system allows a married couple to be treated as a single economic unit.⁶ For this reason, income can be shared between the couple,⁷ there are no recognized gains or losses on transfers between the couple,⁸ and the marital unit enjoys preferential rates on income.⁹

5. U.S. v. Craft, 535 U.S. 274, 279 (2002).

6. 26 U.S.C. § 6013 (2012). See also Judith Treas, *Money in the Bank: Transaction Costs and the Economic Organization of Marriage*, 58 AM. SOC. REV. 723, 723-34 (1993).

7. 26 U.S.C. § 6013. See also James Alm & Leslie A. Whittington, *The Rise and Fall and Rise . . . of the Marriage Tax*, 49 NAT'L TAX J. 571, 571-89 (1996); Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1389-1463 (1975).

8. 26 U.S.C. § 1041(a)(1).

This would make marriage a ripe target for tax shelters and planning, if marriage did not come with so many other strings attached.¹⁰

A. *Single Economic Unit*

The law treats married couples as an economic unit.¹¹

No baseline of economic activity has been legislated by which to measure whether married individuals are functioning as an economic unit. The mere fact of marriage acts as a proxy, leading to the presumption that the married taxpayers are functioning as an economic unit. Once presumed, the tax code bestows certain benefits and imposes certain restrictions on the married taxpayers.¹²

In the days prior to joint filing, couples tried to achieve this status through a variety of means,¹³ including contractual arrangements and forming partnerships.¹⁴ Many of these arrangements were an effort to avoid a marriage penalty: the higher tax that results when a couple's income is taxed in only one partner's hands. Splitting the income between two taxpayers allows the couple to take advantage of the second spouse's lower rates and thus reduce the overall tax burden, even if only one spouse earns the income.

Example 3. Before marriage, Husband's \$200,000 income placed him in the 33% bracket and generated a tax of \$50,130.75. After his marriage, and due to the fact that he can now split his income via joint filing, the couple is in the 28% bracket and their tax liability drops to \$43,465.50 . . . more than \$6,000 lower.

9. 26 U.S.C. § 1 (2012).

10. Perhaps it is just these strings that have precluded tax planners to use marriage as a planning device. See, e.g., Cara Buckley, *Gay Couples, Choosing to Say "I Don't,"* N.Y. TIMES (Oct. 25, 2013), http://www.nytimes.com/2013/10/27/style/gay-couples-choosing-to-say-i-dont.html?_r=0 ("marriage imposes financial burdens and legal entanglements. Still others see marriage not as a fairy tale but as a potentially painful chapter that ends in divorce."); KAY HYMOWITZ ET AL., KNOT YET: THE BENEFITS AND COSTS OF DELAYED MARRIAGE IN AMERICA (2013), available at <http://nationalmarriageproject.org/wp-content/uploads/2013/03/KnotYet-FinalForWeb.pdf>; Lisa Selin Davis, *All But the Ring: Why Some Couples Don't Wed*, TIME (May 25, 2009), <http://content.time.com/time/magazine/article/0,9171,1898346,00.html>.

11. 26 U.S.C. § 6013.

12. Kelly A. Moore, *The Curious Case of Dr. Jekyll and the Estate Tax Marital Deduction: Should Prenuptial Agreements Alter the Relationship?*, 33 N. ILL. U. L. REV. 255 (2013). See also Bridget J. Crawford, *One Flesh, Two Taxpayers: A New Approach to Marriage and Wealth Transfer-Taxation*, 6 FLA. TAX REV. 757, 768 (2004).

13. *Poe v. Seaborn*, 282 U.S. 101, 108-09 (1930); *Lucas v. Earl*, 281 U.S. 111, 113 (1930).

14. See *infra* Part III.B.

B. *Transfers Between Spouses*

Although transfers between other parties, including those related to each other, may be taxable, transfers between spouses have not been. This concept can be traced to two early cases heard by the Board of Tax Appeals.

In *Burkhart v. Commissioner*, the husband attempted to pay his wife for her duties as a housewife.¹⁵ In *Appeal of Robinson*, the wife attempted to pay her husband for giving up his seafaring life.¹⁶ In both cases, the court ignored the payments. In both cases, the court assumed that there could be no income realized by the transferee, and the *Robinson* court made this conclusion about the attempted transfer:

“It is also argued that, in case the entire amount of the trust income is determined to be income to the taxpayer [wife], the part thereof going to the husband was under the contract a business expense to the taxpayer. We think it plain enough without discussion that this agreement between them was purely a family arrangement arising out of the marital relation, and that it was not entered into by the taxpayer for pecuniary profit.¹⁷”

Example 4. Husband and Wife maintain separate checking accounts, and each holds separate property (in either a community or non-community property jurisdiction). Wife purports to “buy” land that Husband owns for \$100,000, and she transfers the cash to him in exchange for a deed to the land. Husband does not recognize gain or loss, and Wife takes Husband’s basis in the land.

C. *Preferential Rates, Standard Deductions, and Earned Income*

Since the late 1940s, married couples have been able to file their tax returns using a joint status, combining their separate items of income and loss, and are entitled to a possible lower tax rate on their joint income. This, at times, gives rise to a marriage penalty or bonus, as the couple’s tax liability is compared to two corresponding individuals with the same income.

Differences in income tax liabilities caused by marital status are embodied in a number of tax code provisions, beginning with separate rate schedules for married couples and single individuals. The most important other differences are those in the standard deduction and the

15. *Burkhart v. Comm’r*, 11 B.T.A. 275 (1928).

16. *Appeal of Robinson*, 4 B.T.A. 504 (1926).

17. *Id.* at 506. *See also* Black, *supra* note 3, at 342-43 (citing *Robinson*).

earned income tax credit (EITC). Those factors cause most two-earner couples in which husband and wife have roughly equal incomes to pay more tax than they would if they could file individual tax returns, incurring what has become known as a “marriage penalty.” At the same time, couples with just one earner or in which husband and wife have quite different incomes generally pay lower taxes as joint tax filers than they would if they could file as single taxpayers. Those couples receive what analysts have termed “marriage bonuses.”¹⁸

III. SAME SEX MARRIAGE IN THE UNITED STATES

Currently, 35 states plus the District of Columbia allow same sex marriage,¹⁹ 4 states have provisions for civil unions, and 8 states provide for domestic partnerships.²⁰ However, the statutes are far from uniform. In fact, the rights, responsibilities, and benefits vary widely, and in coming years will see more changes as legal issues are ironed out.

I have written previously²¹ that laws involving the creation and extension of benefits to couples in marital or quasi-marital relationships cannot depend on the intent of those parties to engage (or not to engage) in certain personal relationships—e.g., having children—and as a result, those laws have to settle for being generally applicable. If they are generally applicable, then it follows that anyone could form one of these unions, regardless of the motivation behind the decision.

If so, then could we create unions that are taxable as marriages for federal (and state) purposes but that act like business entities? That is, could we strip the emotion and stigma from the relationship and view it as any other business partnership?

18. CONGRESSIONAL BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX xiii (1997), available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/0xx/doc7/marriage.pdf>; See also *Tax Topics: Marriage Penalty*, TAX POLICY CTR., <http://www.taxpolicycenter.org/taxtopics/Marriage-Penalties.cfm> (last visited Apr. 19, 2015) (“Tax legislation since 2001 has substantially reduced marriage penalties and increased marriage bonuses by raising the standard deduction for couples to twice that for single filers and by setting the income range of 10 and 15 percent tax brackets for couples to twice that for individuals. Legislation also raised the starting point for the EITC phaseout range by \$3,000 for married couples.”).

19. Map, *Same-sex Marriage in the United States*, CNN (last updated Apr. 3, 2015, 12:51 PM), <http://www.cnn.com/interactive/us/map-same-sex-marriage/>.

20. Nat’l Conference of State Legislators, *Civil Unions and Domestic Partnership Statutes*, NCSL (last updated Nov. 18, 2014), <http://www.ncsl.org/research/human-services/civil-unions-and-domestic-partnership-statutes.aspx>. This includes legislation which provides broadly available benefits in the state, and is not limited to a particular group. For example, in some states certain benefits are provided to domestic partners who are state employees.

21. Black, *supra* note 3, at 327-57.

A. Partnerships and Marriage

History teaches us that when tax rates get too high, taxpayers start to look for alternatives to paying high taxes. In 1946, when the nominal top tax bracket was 91%,²² some taxpayers considered forming partnerships with their spouses in an effort to take advantage of the other spouse's lower tax bracket.

Under current U.S. tax law, "a partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses."²³ The test is objective and does not rely upon the intent of the parties.

B. Husband/Wife Partnerships

"It is for this reason, among others, that we said in *Helvering v. Clifford*, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny."²⁴

A partnership may be found to exist even when the parties do not believe one exists, since the determination is a question of law and not of objective belief.²⁵ However, the mere fact that one of the parties owns or conducts a business does not necessarily establish a partnership unless there are other indicia of a partnership. Relevant factors include contribution by each partner to capital, an agreement to share profits and losses, and an agreement to share the assets and liabilities of a business.²⁶

In the marital or cohabitation context, the parties already have a relationship. To prove the existence of an additional partnership relationship in addition to the social relationship, there must be both an agreement and sufficient consideration.²⁷

22. IRS, INSTRUCTIONS FOR FORM 1040, U.S. INDIVIDUAL INCOME TAX RETURN 4 (1946), available at <http://www.irs.gov/pub/irs-prior/i1040-1946.pdf>.

23. *Mauldin v. Comm'r*, 155 F.2d 666, 667-68 (4th Cir. 1946).

24. *Comm'r v. Tower*, 327 U.S. 280, 291 (1946).

25. See *Schilpp v. Schilpp*, 380 So. 2d 573, 576 (Fla. Dist. Ct. App. 1980) (husband and wife were partners in air conditioning business at time of divorce despite contention that failure to file partnership tax returns before breakup of marriage indicated there was no partnership).

26. *In re Ward*, 6 B.R. 93, 95 (Bankr. M.D. Fla. 1980). See also FLA. STAT. ANN. § 620.8202(1) (West, Westlaw through 2015 1st Reg. Sess. of 24th Legis.).

27. See *Botsikas v. Yarmark*, 172 So. 2d 277, 278-79 (Fla. Dist. Ct. App. 1965) ("Mutual promises to live together in meretricious or illegal relationship not sufficient consideration to support agreement of partnership."). See also *Cannova v. Carran*, 92 So. 2d 614, 620 (Fla. 1957) (en banc) (no joint enterprise in absence of agreement to enter undertaking in which parties have community of interest).

There are no cases that require a husband and wife to be treated as a business partnership for tax benefits. Instead, there is a line of cases from the 1940s where the court scrutinized the relationship of husbands and wives claiming to be business partners and frequently held they could not file as a business partnership.²⁸

In one of the early cases, *Lorenz v. Commissioner*, the tax court noted that business partnerships between a husband and wife must be “scrutinized closely with a view to determine whether the partnership is bona fide.”²⁹ To be recognized as a business partnership the court must see credible evidence of acts, facts, and circumstances to show the alleged spouse’s actual participation in the business.³⁰ From the facts, the court determined they could not conclude that the business was a valid partnership, and the couple could not file as such for income tax purposes.³¹

The Supreme Court in *Commissioner v. Tower* looked more closely at the requirements for a business partnership and found that a mere paper reallocation of income among family members was not a genuine business partnership.³² The *Tower* decision confirmed the standard of special scrutiny for transactions between husband and wife that would reduce family taxes.³³ It reasoned that the outcome of a husband-wife partnership, though legal in the state, is that the income from the husband’s efforts continues to be used for the same purposes before the partnership, and “failure to tax it as the husband’s income would frustrate the purpose of 26 U.S.C. § 22(a)”³⁴ Justice Hugo Black also noted in the opinion, “there can be no question that a wife and a husband may, under certain circumstances, become partners for tax, as for other, purposes.”³⁵ However, she must invest capital, substantially contribute to the control and management, or perform vital additional

28. See *Lorenz v. Comm’r.*, 148 F.2d 527 (6th Cir. 1945); *Tower*, 327 U.S. at 291; *Lusthaus v. Comm’r.*, 327 U.S. 293, 297 (1946); *Maudlin v. Comm’r.*, 155 F.2d 666, 668 (4th Cir. 1946); *Hougland v. Comm’r.*, 166 F.2d 815, 816 (6th Cir. 1948).

29. *Lorenz v. Comm’r.*, 3 T.C. 746, 751 (1944), *aff’d*, 148 F.2d at 528. *But see* Katherine D. Black, Stephen T. Black & Michael D. Black, *When a Discount Isn’t a Bargain: Debunking the Myths Behind Family Limited Partnerships*, 32 U. MEM. L. REV. 245, 276-77 (2002) (discussing the Tax Court’s apparent reliance on formalities alone in the decision of *Estate of Strangi v. Comm’r.*, 115 T.C. 478 (2000)).

30. *Lorenz*, 3 T.C. at 751.

31. *Id.* at 754.

32. *Tower*, 327 U.S. at 292.

33. *Id.* at 291.

34. *Id.*

35. *Id.* at 290.

services, as set out by 26 U.S.C.A. (I.R.C. 1954) §§ 1, 61, 701, 702.³⁶

Following the reasoning laid out in the *Tower* decision, in 1948 the Sixth Circuit Court of Appeals decided the husband was correct to file all the income from a “partnership agreement” between his mother and his wife.³⁷ Although he had transferred interests to his wife and his mother, there was no change in the management or control, and neither contributed any vital services.³⁸

The Supreme Court in *Commissioner v. Culbertson* was forced to look deeper at the issue and determine “whether an intention to contribute capital or services sometime in the future is sufficient to satisfy ordinary concepts of partnership, as required by the *Tower* case.”³⁹ The Court explained that its *Tower* decision emphasizes the importance of participation in the business partnership during that specific tax year.⁴⁰ In addition, it stated the final test is not “vital services” or “original capital,” but is “whether the partnership is real within the meaning of the federal revenue laws.”⁴¹ Finally, the Court noted although many decisions had come down that found no business partnership existed, there is not a virtual ban on partnerships composed of the members of an intimate family group.⁴²

However, by the end of the 1940s it was clear that courts were very strict when determining whether a wife was in a legitimate business partnership with her husband. The Supreme Court even noted the temptation that married couples faced to file as a business partnership for the sake of tax savings.⁴³

C. *Comparison of Marriage Taxation and Partnership Taxation*

What’s the big deal? If husband and wife are married *and* conducting a business together, won’t their income all be taxed the same anyway?

Not necessarily.

Because of the way our tax system works—including the progressive rate structure, the separate capital gains system, and other provisions including the alternative minimum tax—it is entirely possible

36. *Id.*

37. *Houglan v. Comm’r*, 166 F.2d 815, 816 (6th Cir. 1948).

38. *Id.*

39. *Comm’r v. Culbertson*, 337 U.S. 733, 738-39 (1949).

40. *Id.* at 740.

41. *Id.* at 741.

42. *Id.* at 753.

43. *Id.* at 754.

for there to be differences in tax liability depending on whether the couple chooses to report their income via a joint return or a partnership return.⁴⁴ The following are some examples.

1. Contributions

a. Gains

Let us assume that A and B are married and have started a business. A has \$100 cash to contribute, and B has property worth \$100 that she paid \$50 for. If A and B form a partnership, their opening balance sheet looks like:

	Adj Basis	Book		Adj Basis	Book
Cash	100	100	A	100	100
Property	50	100	B	50	100

This reflects the proper allocation of bases and the understanding that A and B now own partnership interests while the AB partnership

44. One commentator has written:

The income tax law largely follows the partnership model of marriage in its treatment of spouses during the marriage and upon its termination. Husbands and wives may file a joint income tax return which allows them to combine their incomes and deductions for tax purposes. The joint return presumes that married couples share or pool their incomes; otherwise there is no logical justification for this pooling. Tax consequences at divorce are roughly analogous to those that occur when a partnership breaks up. There are two types of distributions in connection with a divorce: property divisions and alimony. Spouses recognize no gain or loss on the division of property at the time of termination of the marriage and their basis in the property is the basis the marital partnership had. The analogy does not work smoothly, however, because spouses (unlike partners) have no tax bases in their partnership interests that is independent of the partnership's basis in the property it holds. In partnership law, a partner's basis in the partnership places limits both on how much money she can receive from the partnership tax free and on the basis she will have in any partnership property distributed to her. These limits do not exist for a property division that occurs incident to a breakup of a marriage. Most alimony, on the other hand, is analogous to a guaranteed payment or a distributive share made in liquidation of a partner's interest. Even a two-member partnership is not considered terminated until the departing partner's entire interest is liquidated. Consequently, an alimony payment would be ordinary income to the partner (payee spouse) and deductible to the partnership (and hence the payor spouse). There is no dependency deduction for a spouse since each spouse is considered an equal; instead each spouse is entitled to a personal exemption.

Marjorie E. Kornhauser, *Theory Versus Reality: The Partnership Model of Marriage in Family and Income Tax Law*, 69 TEMP. L. REV. 1413, 1431-33 (1996).

now owns the assets they contributed.⁴⁵

Further, let us assume that shortly after formation, the partnership decides to sell the property for \$110. We are told by the government that B should take the pre-contribution gain of \$50, and that A and B should each share the post-contribution gain of \$10, for \$5 each.⁴⁶

Is that the same if A and B did not form a partnership? No.

In the non-partnership scenario, we must ask whether the property was held as separate property by B, or if it was transmuted into marital or community property. If separate property, then the gain of \$60 would belong solely to B; if marital/community property, the gain would be shared at \$30 each.

Very exciting—but does it matter? Maybe. If A and B choose to file a joint return, then no, it does not matter. But if they choose to file separately,⁴⁷ then how the gains are allocated between them may matter.

b. Losses

What happens if the property was sold for \$40?

In the case of a partnership, there are two losses to contend with. The *book* loss, or the \$60 drop from the parties' expectation that the property was worth \$100, is allocated evenly.⁴⁸ The *tax* loss, or the \$10 drop from what B paid (\$50), is also allocated evenly. This produces a balance sheet that looks like this:

	Adj Basis	Book		Adj Basis	Book
Cash	140	140	A	95	70
			B	45	70

This allows B to share her tax loss today and creates the potential for shifting a bigger loss to A in the future at the expense of a gain to B in the future.

In the non-partnership scenario, we again must ask how the property was held. If it was separate, the \$10 *tax* loss is B's, while if it was marital property, the \$10 tax loss is shared. Note, however, that in the marriage context, there is no future shifting of gains and losses.

45. 26 U.S.C. §§ 721- 723 (2012).

46. 26 U.S.C. § 704(c) (2012).

47. 26 U.S.C. § 6013(a) (2012) (stating that “[a] husband and wife may make a single return”).

48. That is, assuming that A & B agreed to share losses evenly.

c. *The Lesson?*

Contributions behave as expected. We are leery of partnerships being used as a device to shift gains or losses from one partner to another, therefore 26 U.S.C. § 704(c) allocates the pre-contribution gain of \$50 to the partner who contributed the property.

With the loss example, partnerships are viewed in two ways. First, one might question whether the property was in fact worth \$100 if it was ultimately sold for \$40 after contribution.⁴⁹ Second, there is a tendency to view partnerships as comprised of independent adults who look after their own interests, and therefore, if the partnership incurs a loss, how the parties choose to split it is fine, as long as the economics of the matter mirror the tax consequences.⁵⁰

In the marriage context, however, it is assumed that marriage partners have committed their assets to a community and want to share all income and losses equally. It therefore does not make any sense to carry forward future gains and losses since the couple has agreed to pool all the income anyway.

2. Characterization

Things get a bit more interesting when dealing with the characterization of the gains and losses. Assume that A from the previous example is a physician, and his wife, B, is a securities broker. If the securities contributed by B would have been inventory when held by her, does it become a capital asset when held by the partnership (or the marital union)?

Congress was worried about such attempts to change the character of property contributed to a partnership when it enacted 26 U.S.C. § 724.

Congress was concerned that, under certain circumstances, a taxpayer could alter the character of gain or loss merely by contributing property to a new or existing partnership. In particular, the conversion of capital to ordinary losses by contributing securities to a dealer partnership allowed a taxpayer to receive the benefits of capital gain taxation on appreciated securities (by selling them individually) while

49. *See Sammons v. United States*, 433 F.2d 728 (5th Cir. 1970) (taxpayer was deemed to receive a constructive dividend when a paper bag business was sold for below market value from a corporation wholly owned by the taxpayer to another corporation indirectly controlled by the taxpayer).

50. And thus the future gain/loss split is appropriate, since A was anticipating the property being worth \$100; and so we give him a future loss and B a future gain to account for the \$50 pre-contribution gain that was never realized.

deducting ordinary losses on the sale of securities which had declined in value (by having the dealer partnership sell them and allocate the resulting loss to the taxpayer). Congress believed that these potential abuses should be prevented by preserving the pre-contribution character of contributed (or substituted basis) property in appropriate cases.⁵¹

So, for example, if B contributes securities worth \$100 for which she paid \$50 to the AB partnership, is the resulting \$50 gain ordinary (as it would be if she sold them) or capital (as it would be if the partnership or A sold them)?

Section 724 indicates that for the next five years, the AB partnership will have to treat the gain as ordinary, since the securities are “tainted” with B’s characterization.

However, there is a real issue when deciding whether items of income should be reported by looking at the partnership as an entity or as a group of individuals.⁵²

But what about the AB marriage?

Cases are legion that state the following principal: “whether property sold by taxpayer at profit was property held by taxpayer primarily for sale to customers in course of his trade or business, within meaning of statute, is essentially a question of fact and, necessarily, each case turns upon its own particular facts.”⁵³ But when B transfers the property into A’s hands and A sells the securities, A is not a dealer. The securities are not inventory to him, and therefore, he argues that he is entitled to report the gain as capital.

Now, to be sure, if this process is repeated over and over, it would be correct to determine that the securities have become “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business”⁵⁴ and to tax the gain as ordinary. But what if the sales made by A are infrequent? What if they are not regular?

Could the couple use a quick, “Vegas-style” marriage to accomplish through the marriage laws what Congress sought to avoid through the use of a partnership? After all, the incentives are tantalizing. Ordinary income is taxed at a maximum rate of 39.6%, while long term

51. Staff of J. Comm. on Taxation, 98th Cong., Gen. Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, 234-35 (Comm. Print 1984).

52. See Mary Louise Fellows, *Partnership Taxation: Confusion in Section 702(b)*, 32 TAX L. REV. 67 (1976).

53. See, e.g., *Bauschard v. Comm’r*, 279 F.2d 115 (6th Cir. 1960); *United States v. Winthrop*, 417 F.2d 905 (5th Cir. 1969); *Scheuber v. Comm’r*, 371 F.2d 996 (7th Cir. 1967).

54. 26 U.S.C. § 1231(b)(1)(B) (2012).

capital gains are taxed at a maximum of 15%.⁵⁵ On a sale resulting in a gain of \$1 million, that's a tax savings of over \$200,000.

3. Contributions of Encumbered Property

In a partnership context, the partners are also treated as separate when one partner tries to contribute property that is subject to a loan. The reason for this is that the partnership, now treated as a separate entity, will be paying off the loan, which results in an improved financial position for the contributing partner, but which, except for this rule, would not be subject to tax. Thus, to the extent the loan is greater than the contributor's basis, the contributor recognizes gain.

Assume that B's property is still worth \$100, and B paid \$50 for it but has taken out a loan of \$60. Upon contribution, B should recognize \$10 of gain.

In the marriage, 26 U.S.C. § 1041 again simplifies matters. Unless this is a transfer in trust,⁵⁶ we simply do not care—tax-wise. Note that in a partnership context, this can skew the reporting of income, since B could have received the loan proceeds, tax-free, and then transferred the property to the partnership, which would then pay off the loan.

4. § 1031 Exchanges

Section 1031 allows a taxpayer to postpone payment of taxes on the sale of property by “[reinvesting] the proceeds in similar property as part of a qualifying like-kind exchange.”⁵⁷ This section only applies to investment and business property, and so a taxpayer cannot swap his or her primary residence for another home, but can swap a rental property (i.e., investment property) for other rental or investment property.

Section 1031 stipulates that the properties must be of “like-kind” in order to qualify, and “like-kind” is a term of art. “Most real estate will be like-kind to other real estate. For example, real property that is improved with a residential rental house is like-kind to vacant land.”⁵⁸ On the other hand, real and personal property are never like kind to the other, and the rules for like-kind personal property are more restrictive (i.e., cars and trucks are not like-kind).⁵⁹

55. 26 U.S.C. § 1(h) (2012)

56. 26 U.S.C. §1041(e) (2012).

57. DEPT. OF THE TREASURY, INTERNAL REVENUE SERVICE, FS-2008-18, LIKE-KIND EXCHANGES UNDER IRC CODE SECTION 1031 (2008).

58. *Id.*

59. *Id.*

Furthermore, the IRS realizes that a direct exchange of one property for another is difficult; for this reason delayed exchanges or exchanges involving multiple parties and properties can take place. For example, Adam wants to sell an apartment building that has appreciated in value, and Bob offers to purchase it for cash. Adam would like to continue to hold some type of commercial property and wants to structure the transaction as a like-kind exchange. However, the chance of finding suitable commercial property whose owner is willing to trade for Adam's property is remote.

Adam could structure a three-party exchange, consisting of Adam (seller), Bob (buyer), and Carl (the seller of replacement commercial property suitable to Adam). Bob purchases Carl's property and then exchanges it for Adam's property, and Adam has deferred the tax on the exchange of his property.

In an exchange, receipt of cash by the taxpayer for his relinquished property would forfeit the availability of 26 U.S.C. § 1031, and thus a third party is frequently necessary. For example, a taxpayer sells his property, and the cash is then held by an intermediary. When suitable replacement property is found, the intermediary subsequently uses the cash to buy the new property.

Section 1031 exchanges are complicated. There are timing and other restrictions that can cause the transaction to become taxable. However, a tax-free exchange pursuant to 26 U.S.C. § 1041 is not subject to the same rules. Thus, A and B are contemplating a like-kind exchange but would fail to meet one of the requirements (e.g., the exchange would take too long, the properties are not like-kind, or the properties are not of similar value, and thus boot is required). A § 1031 exchange would fail.

However, if A and B enter into a same sex union, § 1041 would cover the transaction, and A could walk away with B's property and no gain, B could walk away with A's property and no gain, and § 1031 has just been undone.

D. Other Issues

There are other issues that would be taxed differently in a marriage and a partnership, but they fall outside the scope of this article.⁶⁰

60. For example, treatment and allocation of debt (26 U.S.C. § 752), allocations of income/loss, allocations of depreciation, contributions of services/income only interests, 26 U.S.C. § 83 issues, loss limitations, the gain and treatment of partners and the partnership upon admission of new partners, tax treatment of terminations, and the treatment of non-US citizen partners, to name a few.

E. *Judicial Doctrines*

The government has long taken the position that some transactions, which technically fall within the law, are nonetheless impermissible because they reach a result that Congress did not intend.

As a result, the IRS and the courts have crafted judicial doctrines to combat these types of transactions. While presented as separate doctrines, there is sufficient confusion and overlap in their application to treat them together.

1. Sham Transactions

Sham transactions involve the argument that the taxpayer has used form over substance to perpetrate a tax fraud.⁶¹ One of the earliest cases is that of *Gregory v. Helvering*.⁶²

Petitioner in 1928 was the owner of all the stock of United Mortgage Corporation. That corporation held among its assets 1,000 shares of the Monitor Securities Corporation. For the sole purpose of procuring a transfer of these shares to herself in order to sell them for her individual profit, and, at the same time, diminish the amount of income tax which would result from a direct transfer by way of dividend, she sought to bring about a 'reorganization' under section 112(g) of the Revenue Act of 1928. . . . To that end, she caused the Averill Corporation to be organized under the laws of Delaware on September 18, 1928. Three days later, the United Mortgage Corporation transferred to the Averill Corporation the 1,000 shares of Monitor stock, for which all the shares of the Averill Corporation were issued to the petitioner. On September 24, the Averill Corporation was dissolved, and liquidated by distributing all its assets, namely, the Monitor shares, to the petitioner. No other business was ever transacted, or intended to be transacted, by that company. Petitioner immediately sold the Monitor shares for \$133,333.33. She returned for taxation, as capital net gain, the sum of \$76,007.88, based upon an apportioned cost of \$57,325.45. Further details are unnecessary. It is not disputed that if the interposition of the so-called reorganization was ineffective, petitioner became liable for a much larger tax as a result of the transaction.⁶³

The Court, in agreeing with the IRS, held:

The whole undertaking, though conducted according to the terms of

61. *Gregory v. Helvering*, 293 U.S. 465 (1935); *Knetch v. U.S.* 364 U.S. 361 (1960).

62. *Gregory*, 293 U.S. at 465.

63. *Id.* at 467.

subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.”⁶⁴

Many authors have dealt with the advisability of a test designed to detect artifice and shams, and how those tests weaken or enhance the tax system.⁶⁵ In truth, what Mrs. Gregory was attempting to do involved a business transaction which the government thought the taxpayer planned for tax purposes. One of the least well kept secrets in business today is that taxpayers do exactly that—plan business transactions to take advantage of tax rules. Taxpayers frequently disguise the transaction in business clothing, citing non-tax reasons so as to avoid the imposition of the form-over-substance argument.

However, when the artifice is not a business relationship, but a marriage, do the same rules apply? Can one claim that a marriage entered into for tax benefits (or any other benefits, for that matter) is not as real as one entered into for non-tax reasons?

What are the reasons for a valid marriage anyway?

Is a marriage of short duration still valid if, after “eloping” to Las Vegas, the couple realizes the folly of their ways on Monday morning? And will it be federal law that determines whether the marriage is a sham? If so, the sham transaction doctrine has just been seriously curtailed by the Supreme Court in *Windsor*.⁶⁶

2. Step Transaction Doctrine

The step transaction doctrine is in effect another rule of substance over form; it treats a series of formally separate ‘steps’ as a single

64. *Id.* at 470.

65. See, e.g., Richard Gordon & Andrew P. Morriss, *Moving Money: International Financial Flows, Taxes, and Money Laundering*, 37 HASTINGS INT’L & COMP. L. REV. 1 (2004); Richard J. Kovach, *Taxes, Loopholes and Morals Revisited: A 1963 Perspective on the Tax Gap*, 30 WHITTIER L. REV. 247 (2008).

66. “DOMA’s unusual deviation from the usual tradition of recognizing and accepting state definitions of marriage here operates to deprive same-sex couples of the benefits and responsibilities that come with the federal recognition of their marriages. This is strong evidence of a law having the purpose and effect of disapproval of that class. The avowed purpose and practical effect of the law here in question are to impose a disadvantage, a separate status, and so a stigma upon all who enter into same-sex marriages made lawful by the unquestioned authority of the States.” *United States v. Windsor*, 133 S.Ct. 2675, 2693 (2013).

transaction if such steps are in substance integrated, interdependent, and focused toward a particular result. There is no universally accepted test as to when and how the step transaction doctrine should be applied to a given set of facts.⁶⁷

If a marriage produces tax savings for a couple, but then ends in divorce, could a court use the step transaction doctrine to undo the transaction?

“The end result test is based upon the actual intent of the parties as of the time of the merger. It can be argued that any test which requires a court to make a factual determination as to a party’s intent promotes uncertainty and therefore impedes effective tax planning.”⁶⁸

F. *Sham Weddings*

1. Immigration and False Marriages

Marriage fraud has been prosecuted, inter alia, under 8 U.S.C. § 1325 and 18 U.S.C. § 1546(a). The Immigration Marriage Fraud Amendments Act of 1986 amended § 1325 by adding § 1325(c), which provides a penalty of five years imprisonment and a \$250,000 fine for any “individual who knowingly enters into a marriage for the purpose of evading any provision of the immigration laws.” Under 8 U.S.C. § 1151(b), “immediate relatives” of U.S. citizens, including spouses, who are otherwise qualified for admission as immigrants, must be admitted as such, without regard to other, ordinary numerical limitations. The typical fact pattern in marriage fraud cases is that a U.S. citizen and an alien get married. They fulfill all state law requirements such as medical tests, licensing, and a ceremony. But the U.S. citizen is paid to marry the alien in order to entitle the alien to obtain status as a permanent resident of the United States; the parties do not intend to live together as man and wife. A legal issue arises where the parties tell the INS they are married, and they subjectively believe they are telling the truth because they have complied with state marriage requirements. The Supreme Court has ruled that the validity of their marriage under state law is immaterial to the issue of whether they defrauded INS.

There have been situations where a bona fide marriage turns sour but the alien induces the U.S. citizen spouse to maintain the marriage as a ruse only as long as necessary for the alien to obtain status as a permanent resident alien. There is a line of cases holding that the

67. *Penrod v. Comm’r*, 88 T.C. 1415, 1428-29 (1987) (citations omitted).

68. *Id.* at 1430.

viability of the marriage, if initially valid, is not a proper concern of the INS. *United States v. Qaisi*, 779 F.2d 346 (6th Cir. 1985); *Dabaghian v. Civilleti*, 607 F.2d 868 (9th Cir. 1979), and cases cited therein. However, the Immigration Marriage Fraud Amendments of 1986, 8 U.S.C. § 1186a, were designed, inter alia, to eliminate the Qaisi type loophole by establishing a two-year conditional status for alien spouses seeking permanent resident status, and requiring that an actual family unit still remain in existence at the end of the two year period.⁶⁹

There is no such federal statute for tax purposes. In fact, if Justice Anthony Kennedy is to be believed, any such federal statute would be of questionable constitutional validity. “The avowed purpose and practical effect of the law here in question are to impose a disadvantage, a separate status, and so a stigma upon all who enter into same sex marriages made lawful by the unquestioned authority of the States.”⁷⁰

IV. MULTIPARTY MARRIAGES AND TAX SHELTER OPPORTUNITIES

With all the opportunities that marital tax planning may provide post-DOMA (Defense of Marriage Act), the question could reasonably be asked: Are we limited to just two parties to a marriage?⁷¹

The answer is “no.”

Justice Antonin Scalia’s dissent in the *Windsor* decision only scratched the surface.⁷² Because of the differences in state laws allowing

69. U.S. ATTORNEYS, CRIMINAL RESOURCE MANUAL: MARRIAGE FRAUD – 8 U.S.C. § 1325(C) AND 18 U.S.C. § 1546, at § 1948, available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/crm01948.htm (last visited Apr. 19, 2015) (citing *Lutwak v. United States*, 344 U.S. 604 (1953) (followed in *United States v. Yum*, 776 F.2d 490 (4th Cir. 1985); *Johl v. United States*, 370 F.2d 174 (9th Cir. 1966); *Chin Bick Wah v. United States*, 245 F.2d 274 (9th Cir. 1957), cert. denied, 355 U.S. 870 (1957)); but see *United States v. Lozano*, 511 F.2d 1 (7th Cir. 1975), cert. denied, 423 U.S. 850 (1975); *United States v. Diogo*, 320 F.2d 898 (2d Cir. 1963); but cf., *United States v. Sarantos*, 455 F.2d 877 (2d Cir. 1972)).

70. *Windsor*, 133 S. Ct. at 2693.

71. Samuel D. Brunson, *Taxing Polygamy*, 91 WASH. U. L. REV. 113, 127 (2013),

72. *Windsor*, 133 S. Ct. at 2708 (Scalia, J., dissenting) (citing William Baude, *Beyond DOMA: Choice of State Law in Federal Statutes*, 64 STAN. L. REV. 1371 (2012); *Godfrey v. Spano*, 920 N.E.2d 328 (N.Y. 2009)):

To choose just one of these defenders’ arguments, DOMA avoids difficult choice-of-law issues that will now arise absent a uniform federal definition of marriage. Imagine a pair of women who marry in Albany and then move to Alabama, which does not “recognize as valid any marriage of parties of the same sex.” Ala.Code § 30-1-19(e) (2011). When the couple files their next federal tax return, may it be a joint one? Which State’s law controls, for federal-law purposes: their State of celebration (which recognizes the marriage) or their State of domicile (which does not)? (Does the answer depend on

same sex unions, marriages, and partnerships, it is possible for a couple to enter into a new same sex union even if one or both of the parties are already in a marriage (same sex or otherwise).

Let us see how some of these might be constructed.

A. *Disregarded Marriages*

A disregarded marriage happens when one jurisdiction does not recognize the union created by another jurisdiction. This allows a couple in the second jurisdiction to create a union (the “second union”) between one of the couple in the first union and a third party. For example, if A and B are married in one state, but that marriage is not recognized in Texas, Texas could issue a marriage license for A to marry C in Texas.

Disregarded marriages create difficult questions of both state and federal law involving tax and property issues.

1. North Dakota

Recently, the North Dakota Attorney General, Wayne Stenehjem, issued a letter opinion regarding a man who had entered into a same sex marriage in a state that allows such relationships. The man asked about the possibility of obtaining a marriage license to marry a woman in North Dakota, which does not recognize same sex marriages.⁷³

It is my opinion because explicitly prohibited by state constitution and statutes, an individual’s previously valid same-sex marriage in another state is not legally recognized in North Dakota and he or she may be issued a valid marriage license here. Further, it is my opinion that since the North Dakota Constitution prohibits the recognition of such a union, the individual would not be committing a criminal violation in this state by indicating he or she was “Single/Never Married” on a signed marriage application.⁷⁴

Example 5.

whether they were just visiting in Albany?) Are these questions to be answered as a matter of federal common law, or perhaps by borrowing a State’s choice-of-law rules? If so, which State’s? And what about States where the status of an out-of-state same-sex marriage is an unsettled question under local law?

73. Eric M. Johnson, *North Dakota Says Man in Same-Sex Marriage May Wed Woman Too*, REUTERS (Dec. 18, 2013, 7:04 PM), <http://www.reuters.com/article/2013/12/19/us-usa-northdakota-marriage-idUSBRE9BH11520131219>.

74. Letter Opinion (2013-L-06) from Wayne Stenehjem, Attorney Gen., to Richard J. Riha, State’s Attorney, Burleigh Cnty. (Dec. 12, 2013), *available at* <http://www.ag.nd.gov/Opinions/2013/Letter/2013-L-06.pdf>.

1. J and K, both of the same gender, get married in IL.
2. L and M, also of the same gender, get married in IL.
3. Afterward, K and L travel to ND for the weekend, and they get married.

The J+K ~ L+M group is now treated under the law how? What if J and M also travel to ND and get married?

For ND purposes, J+M and K+L are married. For IL purposes, J+K and L+M are married.

For federal purposes, the result is more complicated. In 2013, the IRS issued a ruling stating that for federal tax purposes, a same sex couple is “married” if the individuals are lawfully married under state law; that generally, a marriage of same sex individuals that was validly entered into is valid for federal law even if the married couple is domiciled in a state that does not recognize the validity of same sex marriages; and that registered domestic partnerships, civil unions, or other similar relationships which are not called “marriages” under the laws of that state are not marriages for federal tax purposes.⁷⁵

This means that, arguably, all the marriages from the above example could receive federal recognition (which our system is not designed to address) or, if the issue were litigated, could create issues of first impression for many courts and legislatures.

What if the four of them move to a community property state? Does their property, or in the case of California, their income, get shared?⁷⁶

If so, how does this differ from a JKLM partnership (taxed under subchapter K⁷⁷)? Marriages are not subject to partnership anti-abuse rules and do get the benefits of 26 U.S.C. § 1041 (which allows “spouses” to transfer, tax-free, property between themselves). Marriages may elect to file jointly (except that current § 1040 only imagines marriages with two spouses), and while spouses are allowed to file separately, they are not generally subjected to the special rules of 26 U.S.C. § 704 (which governs allocations of income and loss between partners). There are other issues,⁷⁸ both on the federal and state level, but one can begin to see that there may be an advantage, tax-wise, to being able to have a second (or more!) spouse.

75. Rev. Rul. 2013-17, 2013-38 I.R.B. 201.

76. See *Poe v. Seaborn*, 282 U.S. 101, 118 (1930).

77. 26 U.S.C. §§ 701-777 (2012).

78. See Brunson, *supra* note 71, at 133-35.

2. Delaware

Delaware law defines a “civil union” to be a legal union under Delaware law.⁷⁹ Parties may enter into a Delaware civil union only if they are not in a marriage, a Delaware civil union, or a “substantially similar legal relationship.”⁸⁰ What is substantially similar is not defined.

Does this mean that parties to another state’s civil union could enter into a second civil union in Delaware, because Delaware does not recognize the first?

B. *Converted Unions*

Currently, IRS Revenue Ruling 2013-17 applies only to same sex marriages.⁸¹ Whether Congress or the IRS will recognize other types of unions is an open question, but is there any way to convert a civil union to marriage?

1. Washington

Thirty four states do not provide for same sex marriage. Washington, however, not only recognizes out-of-state unions as registered domestic partnerships, but it converts them to Washington marriages. How will the IRS treat these?

With a 2009 expansion of the law (Chapter 26.60 RCW) originally passed in 2007, registered domestic partners were afforded nearly all statewide spousal rights.⁸² However, this expansion was challenged by a ballot measure to repeal the additional benefits, Referendum 71, which passed in November 2009. Washington’s domestic partner law remains unchanged and provides a full scope of domestic partner benefits.⁸³ Referendum 74 was passed in the November 2012 general election legalizing same sex marriage.

However, Washington recognizes out-of-state civil unions and domestic partnerships.

A legal union, other than a marriage, of two persons that was validly formed in another jurisdiction, and that is substantially equivalent to a domestic partnership under this chapter, shall be recognized as a valid domestic partnership in this state and shall be treated the same as a

79. DEL.CODE ANN., tit. 13, § 201(1) (West, Westlaw through 80 Laws 2015, ch. 3).

80. *Id.* § 202.

81. Rev. Rul. 2013-17, 2013-38 I.R.B. 201.

82. WASH. REV. CODE ANN., 26.60 (West, Westlaw through ch. 4 of the 2015 Reg. Sess.).

83. *Id.*

domestic partnership registered in this state regardless of whether it bears the name domestic partnership.⁸⁴

Referendum 74 limits domestic partnerships in Washington to couples in which at least one of the persons is 62 years of age or older. This new provision became effective June 30, 2014. Any state registered, same sex domestic partnership where neither party is 62 years of age or older is automatically converted into a marriage as of June 30, 2014, unless dissolved or converted to marriage prior to that date.⁸⁵

This means that there is an argument that a non-Washington civil union could be recognized in Washington and converted into a Washington marriage.

Washington defines a domestic partnership as one registered in Washington, or one that is “substantially equivalent.”⁸⁶

2. New Jersey–Washington Shelter

New Jersey defines a civil union to be one established pursuant to New Jersey law⁸⁷ and requires that the parties to a New Jersey civil

84. *Id.* § 26.60.090.

85. *Id.* § 26.60.100(3)(a).

86. Washington’s requirements to *enter* into a domestic partnership may not be the same as what constitutes a *substantially equivalent* domestic partnership.

Requirements. (Effective June 30, 2014.)

To enter into a state registered domestic partnership the two persons involved must meet the following requirements:

- (1) Both persons share a common residence;
- (2) Both persons are at least eighteen years of age and at least one of the persons is sixty-two years of age or older;
- (3) Neither person is married to someone other than the party to the domestic partnership and neither person is in a state registered domestic partnership with another person;
- (4) Both persons are capable of consenting to the domestic partnership; and
- (5) Both of the following are true:
 - (a) The persons are not nearer of kin to each other than second cousins, whether of the whole or half blood computing by the rules of the civil law; and
 - (b) Neither person is a sibling, child, grandchild, aunt, uncle, niece, or nephew to the other person.

Id. § 26.60.030.

87. N.J. STAT. ANN. § 37:1-29 (West, Westlaw through L.2015, c. 24):

Definitions relative to civil unions.

2.As used in this act:

“Civil union couple” means two persons who have established a civil union pursuant to this act.

“Civil union license or civil union certificate” means a document that certifies that the persons named on the license or certificate have established a civil union in this State in compliance with this act.

“Civil union” means the legally recognized union of two eligible individuals of the same sex established pursuant to this act. Parties to a civil union shall receive the same benefits and protections and be subject to the same responsibilities as spouses in a marriage.

union not be a party to another civil union, domestic partnership, or marriage in New Jersey; not be of the same sex; and be at least 18 years of age.⁸⁸

This means that parties to out-of-state unions could establish chains of civil unions using New Jersey's definition, since the out-of-state unions would not pose a barrier to forming new civil unions in New Jersey.

Example 6. A and B formed a valid civil union in a state other than New Jersey. C and D did also. B and C travel to New Jersey, and since they are over 18, of the same gender, and are not a party to another New Jersey civil union, B and C are eligible to enter into a New Jersey union.

However, as previously mentioned, federal law does not treat New Jersey civil unions as marriages for tax purposes.

A, B, C, and D now travel to Washington. If their unions are "substantially equivalent" to a domestic partnership in Washington, RCW 26.60.100 now automatically converts their relationships (A+B, C+D, and the New Jersey B+C) into Washington marriages.

C. *State-Centric Definitions*

A number of states have same sex union laws that purportedly apply only to unions formed in that state.⁸⁹ These laws may have reciprocity provisions or allow other states' residents to enjoy the same benefits if they meet eligibility requirements. While this creates the potential for disregarded unions, it also opens the possibility of "creating" void unions to be used in another state, which would then recognize the void union.⁹⁰

Other types of statutes apply to out of state unions that are "substantially" the same as that state's unions. None of these statutes

88. *Id.* § 37:1-30:

3. For two persons to establish a civil union in this State, it shall be necessary that they satisfy all of the following criteria:

- a. Not be a party to another civil union, domestic partnership or marriage in this State;
- b. Be of the same sex; and
- c. Be at least 18 years of age, except as provided in section 10 of this act.

89. *See, e.g.*, R.I. GEN. LAWS ANN. § 15-3.1-1 (West, Westlaw through ch. 555 of the Jan. 2014 sess.).

90. *See* VT. STAT. ANN. tit. 15, § 4 (West, Westlaw through the 2013-2014 Vt. Gen. Assembly (2014)) ("Civil marriages contracted while either party has a living spouse or a living party to a civil union is legally married or joined in civil union to a living person other than the party to that marriage shall be void.").

define “substantially,” which leaves the likelihood of litigation later.⁹¹

Further, not all states recognize or provide for “same sex divorce.” What may be a dissolved marriage in one state may still be a valid marriage in another, and this could be used to enter into multiparty marriages.

D. Tax Consequences

Having established that such multiparty unions are possible under current law, several questions could be raised about the continued viability of such planning. First, what if a state tried to restrict the availability of such unions? Second, what would happen if a state tried to take away the status of a union already formed, but formed by those that the state considered not the “true” objects of the law? Third, could a state change the law mid-stream to restrict some of the consequences discussed below?

1. Contributions

Let’s assume the ABCD union is ready to do business and organizes itself with the following assets:

	Asset	Basis	Value
A	Cash	100	100
B	Equip	10	100
C	Land	70	100
D	IP	5	100

If ABCD were organized as a partnership and received an offer to sell its land to an interested buyer for \$120, there would be \$50 of gain. Assuming that the land had been held for longer than one year, that gain would be long term capital gain,⁹² and the first \$30 of gain would be allocated to C;⁹³ the remaining \$20 would be divided four ways, with A,

91. Both Washington and Connecticut have this type of statute. For example:

A person is eligible to marry if such person is:

(1) Not a party to another marriage, or a relationship that provides substantially the same rights, benefits and responsibilities as a marriage, entered into in this state or another state or jurisdiction, unless the parties to the marriage will be the same as the parties to such other marriage or relationship.

CONN. GEN. STAT. ANN. § 46b-20a(1) (West, Westlaw through Jan. 1, 2015).

92. 26 U.S.C. § 1222(3) (2012) (assuming that the partnership was not a dealer in land.)

93. 26 U.S.C. § 704(c) (2012).

B, C, and D each getting \$5.⁹⁴

What would happen if ABCD were a marital union? First, there is no entity to transfer assets to. State law may presume there to be a marital community, either in the form of a common law pooling of assets⁹⁵ or an actual community property scheme. However, there is not presumed to be a transfer of assets to that community, but rather a transmutation of assets from separately owned to community owned,⁹⁶ and in any event, the tax law does not care. Code section 1041 states, “No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse”

This generally means that spouses may freely transfer assets among themselves without any tax consequences (including being able to shift the basis to a spouse).⁹⁷ There is a notable exception where the spouse is a nonresident alien.

Assuming all parties are U.S. residents, how is the gain shared in a marital union? Post-*Windsor*, there exists an interesting anomaly. Advocates for the repeal of DOMA have argued that the federal government should follow state law in deciding whether a couple is “married.” Since a host of federal benefits, including tax benefits, follow that status of “married,” following state law would allow those states who wish to experiment with the definition of marriage to allow those citizens to also reap the benefits.

But we have a difficult situation, since we have two couples, A+B and C+D, who are married in State 1 but have also arranged matters so that A+D and B+C are treated as married in State 2. So which state law controls?

One option is to allow both laws to grant marital benefits; essentially, treat all parties as “married.” Our tax system is not set up for multiple spouses, so this would cause some waves. We could, however, hypothesize that what should happen is to allow all the parties to split their incomes equally.⁹⁸ This would mean that upon the sale of the land for \$120, the \$50 gain would be split at \$12.50 each.

This raises another problem: how do four persons file a joint return?

94. *Id.*

95. Kornhauser, *supra* note 44, at 1431-33; *but cf.* *Bridges v. Bridges*, 125 Cal. App. 2d 359, 362 (Cal. Dist. Ct. App.1954).

96. See Joan M. Krauskopf, *The Transmutation and Source of Funds Rules in Division of Marital Property*, 50 MO. L. REV. 759, 761-62 (1985).

97. 26 U.S.C. §1041(b) (2012).

98. See *Poe v. Seaborn*, 282 U.S. 101, 118 (1930).

2. Characterization

Returning to the previous example, when the ABCD union agrees to sell the land for \$120, do they report the gain as capital (subject to a maximum tax rate of 20%)⁹⁹ or as ordinary? Does it matter which member of the union sold the land? If C, who contributed the land, is a real estate developer, the land should be inventory in his hands, and the resulting gain would be ordinary. But what if D negotiates for and consummates the sale?

Land stays put. What if the assets that are sold are movable and are sold by another member of the union, and in another state from the state in which C is domiciled?

3. Swaps and Distributions

Returning to the first two examples at the beginning of the article may serve to illustrate the difficult issues our system faces.¹⁰⁰ F owns a building worth \$2 million, which has a \$1 million basis. If G buys F's building for \$2 million in cash, F recognizes \$1 million of gain.

However, if F and G are part of a marital union, 26 U.S.C. §1041 provides for the non-recognition of the \$1 million gain. It is simply gone.

If it is possible to enter into multiple marriages, and if federal law recognizes those marriages, then the temptation exists for parties to marry a buyer of their property in order to avoid the tax. That temptation is a serious threat to the continued viability of the U.S. tax system.

E. Bigamy Laws

The Model Penal Code defines bigamy as a misdemeanor and polygamy as a felony.¹⁰¹ While the two are related, they are not the same crime. Bigamy ensues when the actor "contracts or purports to contract another marriage," while polygamy requires the actor to marry or cohabit "with more than one spouse at a time in purported exercise of the right of plural marriage."¹⁰²

According to Joel Feinberg in *Moral Limits of the Criminal Law*: "Righteously, flaunting one's illicit relationships, according to the Code, is apparently a morally aggravating circumstance, more punishable than

99. 26 U.S.C. §1(h) (2012).

100. See *supra* Part I.

101. MODEL PENAL CODE § 230.1 (2013).

102. *Id.*

its clandestine and deceptive counterpart.”¹⁰³

Before Christianity became the official religion of the Roman Empire, Diocletian and Maximilian passed strict anti-polygamy laws in 285 CE that mandated monogamy as the only form of legal marital relationship, as had traditionally been the case in classical Greece and Rome. In 393, the Byzantine Emperor Theodosius I issued an imperial edict to extend the ban on polygamy to Jewish communities. In 1000, Rabbi Gershom ben Judah ruled polygamy inadmissible within Jewish communities.

According to feminist historian Sarah McDougall, the Christian European insistence on monogamy and its enforcement arose as a consequence of 16th Century Islamic incursions into Central Europe and the advent of European colonialism within the Americas, Africa and Asia, which exposed European Christians to cultures that practised polygamy. As a consequence, nominal Christian male bigamists were subjected to unprecedented harsh punishments, such as execution, galley servitude, exile, and prolonged imprisonment. McDougall argues that female bigamists were not as harshly punished due to women’s perceived inferiority and absence of moral agency.¹⁰⁴

J, K, L and M, desiring to form a business, enter into marriages as explained above. None have been married before, and all are male. They then move to Texas to conduct business operations. Will they be criminally liable for engaging in bigamy?

Note that bigamy is a separate crime and does not necessarily impact the validity of a person’s second marriage, in that state or another. That validity is determined pursuant to the marriage statute.

1. Texas

Texas makes it a crime for one legally married to “[purport] to marry or does marry a person other than his spouse in this state, or any other state or foreign country, under circumstances that would, but for the actor’s prior marriage, constitute a marriage.”¹⁰⁵ Since this is a Texas

103. JOEL FEINBERG, 3 MORAL LIMITS OF THE CRIMINAL LAW 402 (1989).

104. *Bigomy*, WIKIPEDIA, <http://en.wikipedia.org/wiki/Bigamy> (last visited March 31, 2015). See also The Week Staff, *Brazil’s Groundbreaking Three-Person Civil Union*, THE WEEK (Apr. 30, 2012), <http://theweek.com/article/index/232665/brazils-groundbreaking-three-person-civil-union>; Joanna L. Grossman, *Beware the Undissolved Civil Union: Massachusetts’ Highest Court Says That A Subsequent Marriage is Polygamy*, VERDICT (Aug. 21, 2012), <http://verdict.justia.com/2012/08/21/beware-the-undissolved-civil-union>; Paul Belien, *First Trio “Married” in the Netherlands*, BRUSSELS J. (Sept. 26, 2005, 11:08 PM), <http://www.brusselsjournal.com/node/301>.

105. TEX. PENAL CODE ANN. § 25.01 (West, Westlaw through the end of the 2013 3rd called

criminal statute, it must be read to mean a marriage within the state of Texas. Thus, if the second marriage would not constitute a marriage within Texas, then the act of entering into the second marriage would not be a crime in Texas.

2. Utah

76-7-101. Bigamy – Defense.

1. A person is guilty of bigamy when, knowing he has a husband or wife or knowing the other person has a husband or wife, the person purports to marry another person or cohabits with another person.
2. Bigamy is a felony of the third degree.
3. It shall be a defense to bigamy that the accused reasonably believed he and the other person were legally eligible to remarry.¹⁰⁶

Utah prohibits cohabitation and marriage, but does it prohibit a civil union while married? “‘Cohabiting’ means residing with another person and being involved in a sexual relationship with that person.”¹⁰⁷ So if the second relationship were non-sexual, there would be no cohabitation. If the second relationship is also not a marriage,¹⁰⁸ then there should be no

sess. of the 83rd legis.):

(a) An individual commits an offense if:

(1) he is legally married and he:

(A) purports to marry or does marry a person other than his spouse in this state, or any other state or foreign country, under circumstances that would, but for the actor’s prior marriage, constitute a marriage; or

(B) lives with a person other than his spouse in this state under the appearance of being married; or

(2) he knows that a married person other than his spouse is married and he:

(A) purports to marry or does marry that person in this state, or any other state or foreign country, under circumstances that would, but for the person’s prior marriage, constitute a marriage; or

(B) lives with that person in this state under the appearance of being married.

(b) For purposes of this section, “under the appearance of being married” means holding out that the parties are married with cohabitation and an intent to be married by either party.

(c) It is a defense to prosecution under Subsection (a)(1) that the actor reasonably believed at the time of the commission of the offense that the actor and the person whom the actor married or purported to marry or with whom the actor lived under the appearance of being married were legally eligible to be married because the actor’s prior marriage was void or had been dissolved by death, divorce, or annulment. For purposes of this subsection, an actor’s belief is reasonable if the belief is substantiated by a certified copy of a death certificate or other signed document issued by a court.

106. UTAH CODE ANN. § 76-7-101 (West, Westlaw through 2014 Gen. Sess.)

107. *Id.* § 78B-6-103(11).

108. However, Utah also has prohibited such unions pursuant to its Constitution.

(1) Marriage consists only of the legal union between a man and a woman.

(2) No other domestic union, however denominated, may be recognized as a marriage or given the

crime of bigamy. And if it were, Utah provides a defense based on the reasonable belief that the second (or more) marriage was legal.

3. New York

People erroneously believe that bigamy – being married to more than one person – is illegal in New York. The truth is more complicated. Penal Law 255.15 provides that “A person is guilty of bigamy when he contracts or purports to contract a marriage with another person at a time when he has a living spouse, or the other person has a living spouse.”

Thus, the act of marrying is prohibited, but the state of being married to two people is not (legally the second marriage is a nullity). I represented someone charged with bigamy years ago. The charges were dismissed because the act of marriage was more than five years prior to the commencement of the prosecution, and thus the prosecution was barred by the statute of limitations (the case was merely re-marriage without divorce, not a man living with two wives).¹⁰⁹

F. State Concerns

1. Would States Allow This?

“Every year in the United States, there are approximately 2.5 million weddings, and the wedding industry has grown to an empire of 40 billion dollars per year.”¹¹⁰ This number is estimated to be \$55 billion by another study.¹¹¹ For 2013, there were 87,159 weddings in Las Vegas that generated \$2.4 billion of revenue.¹¹²

The marriage “industry” is closely tied to tourism and is a major

same or substantially equivalent legal effect.

UT. CONST. art. 1, § 29 (ruled unconstitutional by *Kitchen v. Herbert*, 755 F.3d 1193 (10th Cir. 2014)).

109. Griswel, *Bigamy Itself is Not Illegal in New York*, Comment to *Harems Accepted in the West*, DANIEL PIPES MIDDLE EAST F. (Jun. 1, 2007, 9:44 AM), <http://www.danielpipes.org/comments/95633>.

110. *Wedding Industry in the United States*, WIKIPEDIA, http://en.wikipedia.org/wiki/Wedding_industry_in_the_United_States#cite_note-1 (last updated Jan. 7, 2015).

111. *United States Complete Wedding Report*, WEDDING REPORT, <http://www.theweddingreport.com/wmdb/index.cfm?action=db.viewdetail&t=s&lc=00&setloc=y> (last visited Apr. 7, 2015).

112. *Las Vegas-Paradise, NV – (Metropolitan Area) Complete Market Report*, WEDDING REPORT, <http://www.theweddingreport.com/wmdb/index.cfm?action=db.viewdetail&t=m&lc=29820&setloc=y> (last visited Apr. 1, 2015).

financial boon for many states.

But these “shelter” marriages are not the type that most wedding planners think about (the Las Vegas weddings mentioned above average 130 guests). These are the type of arrangements that happen with as much fanfare as filing incorporation documents.

Delaware might provide a better example of what benefits may accrue to a state or states that actively promote such arrangements:

- Over 50% of U.S. publicly traded corporations and 60% of the Fortune 500 companies are incorporated in Delaware;
- In fiscal year 2005, revenues collected by the Division reached a record \$626.1 million;
- LLC tax revenues \$63.4 million;
- UCC general fund revenues \$13.8 million;
- Revenue from incorporations accounted for 22 percent of Delaware’s general fund;
- Income from customers’ requests for expedited service (24-hour, same day, two-hour or one-hour) was \$17.5 million (which more than covered the Division’s operating expenses of \$9.2 million).¹¹³

The point is simply that a state could find a large financial benefit from encouraging (i.e., legalizing) multiple marriages for tax purposes.

3. Interstate Concerns

What will happen when these marriages cross state lines?¹¹⁴

113. *Delaware Means Business: Ever Wonder Why Most U.S. Businesses are Established in Delaware?*, SIXWISE.COM, <http://www.sixwise.com/newsletters/06/05/17/delaware-means-business-ever-wonder-why-most-us-businesses-are-established-in-delaware.htm> (last visited Mar. 31, 2015); Alex Mayyasi, *Is Delaware a Tax Haven?*, PRICEONOMICS (Aug. 13, 2013), <http://priceonomics.com/is-delaware-a-tax-haven/>; Leslie Wayne, *How Delaware Thrives as a Corporate Tax Haven*, N.Y. TIMES (Jun. 30, 2012), http://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html?_r=0.

114. Catherine Martin Christopher, *Will Filing Status Be Portable? Tax Implications of Interstate Recognition of Same-Sex Marriage*, 4 PITT. TAX. REV. 137, 150 (2007).

The cost of being wedlocked might not be self-evident. After all, what is the harm in being trapped in a void marriage? As it turns out, the harms can be significant. A same-sex couple validly married in one jurisdiction remains in that valid marriage despite the fact that the couple, or a member of the couple, resides in a jurisdiction that does not recognize their marriage. The couple’s legal union will be recognized by the growing number of jurisdictions that recognize same-sex unions. As a result, if a member of the couple moves to, or even travels through a recognizing state, the individual will be considered married in that state. Likewise, if the non-recognizing state where the couple resides changes its policy and becomes a recognizing state, suddenly the couple—previously unable to get a divorce because the marriage was void—will be married. Married couples seek divorce for a myriad of reasons. Those reasons include the

Windsor, which held DOMA unconstitutional, contains an important discussion on the states' authority to define marriage.¹¹⁵ When the constitution was adopted, states "possessed full power over the subject of marriage and divorce . . . [and] the Constitution delegated no authority to the Government of the United States on the subject of marriage and divorce."¹¹⁶ Because of this authority, "the Federal Government, through our history, has deferred to state-law policy decisions with respect to domestic relations."¹¹⁷ As a general rule the federal courts do not adjudicate "issues of marital status," even if there is a basis for federal jurisdiction.¹¹⁸ In its decision, the Court noted it was unnecessary to decide whether the federal definition of marriage in DOMA that intruded on the state power was a violation of the Constitution.¹¹⁹

From the *Windsor* dicta, it is clear that the federal government wanted to point out its ability to impose restrictions on how states choose to define marriage. The Court pointed out that Congress has the authority to "make determinations that bear on marital rights and

pragmatic—such as distribution of property, assignment of spousal support, and division of debt, and the emotional—such as finality and repose. Married couples also seek divorce knowing that without a divorce decree neither partner can remarry. This last reason is likely the most important because, although couples can sometimes handle the pragmatic and emotional issues surrounding the end of marriage on their own, there is no way couples can legally divorce—thereby allowing the individuals to remarry—absent judicial intervention. As the Supreme Court counsels, "we know of no instance where two consenting adults may divorce and mutually liberate themselves from the constraints of legal obligations that go with marriage . . . without invoking the State's judicial machinery." It is for these reasons that married same-sex couples, regardless of the state in which they live, need access to divorce.

Indeed, married same-sex couples in states that do not recognize same-sex unions understand the importance of divorce and have sought it out. Too many courts, however, have refused to allow access to divorce, basing that refusal on two related but distinct rationales. Some courts have asserted that they do not have subject-matter jurisdiction over same-sex divorce, while other courts have maintained that same-sex divorce is not a claim for which relief can be granted. Both of these conclusions, however, are wrong. Assertions regarding lack of subject-matter jurisdiction over same-sex divorce have been justified by misguided readings of state DoMAs and misunderstandings of state court jurisdiction. Similarly, the conclusion that courts cannot provide relief to same-sex couples seeking divorce is based on misinterpretations of the requirements of state DoMAs. Moreover, refusing to allow same-sex couples to divorce violates long-standing principles of equity and violates rights guaranteed by the federal Constitution.

Mary Patricia Byrn & Morgan L. Holcomb, *Wedlocked*, 67 U. MIAMI L. REV. 1, 3-6 (2012).

115. See *United States v. Windsor*, 133 S. Ct. 2675, 2689-93 (U.S. 2013).

116. *Id.* at 2691 (quoting *Haddock v. Haddock*, 201 U.S. 562, 575 (1906)).

117. *Id.* at 2691.

118. *Id.*

119. *Id.* at 2692.

privileges.”¹²⁰ The Court also made it clear that limited federal laws that regulate the meaning of marriage in order to “further federal policy” are constitutional.¹²¹

Prior to the decision, states chose how to define marriage and consequently assessed state taxes accordingly. On the other hand, the federal government collected taxes accordingly to its interpretation of marriage, which was between one man and one woman.¹²² After *Windsor*, the federal government has decided for federal tax purposes that it will rely on the individual state’s definition of marriage when collecting taxes, with a few limitations.¹²³

V. CONCLUSION

In the 1940s, couples were trying to avoid the high tax rates by forming partnerships. The federal courts, interpreting federal tax law, determined that such partnerships were, in large measure, not valid partnerships, but were mere attempts to cloak a marital sharing of income and expenses as a business entity. Today, we can foresee the opposite to be possible—using the new “marriage,” civil union, and domestic partnership laws of the 50 states to fashion a business entity that gets taxed as a marriage.

This is not good news for the federal government, which already faces criticism of a tax code that is large and unwieldy to all except specialized practitioners. This is especially true when the creation of such relationships gives a state a financial benefit and when the “solution” to the resulting wreck of the federal tax system involves the federal government, again, to closely examine what it means to be a family for tax purposes—an argument that all three branches of the federal government have been more than happy to leave to the states.

What will happen if and when these types of relationships begin to surface? The federal tax code is not geared to deal with multiparty marriages or marriages that are entered into for tax purposes.¹²⁴ It seems that the federal government will have one of two options to prevent widespread gaming of the tax system: (1) prosecute those marriages that are not “real” or (2) remove the concept of marital benefits from the tax code. Either solution is fraught with peril.

120. *Id.* at 2690.

121. *Id.*

122. 1 U.S.C. § 7 (2012).

123. *See* Rev. Rul. 2013-17, 2013-38 I.R.B. 201.

124. At least, not in large part. While it can be argued that many couples consider the financial benefits of marriage to be part of the “package,” we have not had to deal with tax-driven marriages.

In an era where states' rights are given higher consideration than federal tax concerns, it may be possible to use the disparity between state laws to craft a marriage tax shelter. However, the resulting damage to the federal tax system will leave all Americans, married or not, singing:

What's love got to do, got to do with it

Who needs a [tax]

*When a [tax] can be broken?*¹²⁵

VI. EPILOGUE

On June 26, 2015, as the final edits were being made to this article, the U.S. Supreme Court issued a ruling in *Obergefell v. Hodges*¹²⁶, which held that the Fourteenth Amendment requires a state to license a marriage between two people of the same sex and to recognize a marriage between two people of the same sex performed in another state.

While that would seem to be the end of the matter, I would like point out that the laws of the various states on the matter of same sex marriages are still not uniform, even after *Obergefell*. Requiring a state to license a marriage and having a state statute that actually does so are not the same thing. Even among the states before *Obergefell*, the law of marriage was not uniform.

I would also like to point out that immediately after the decision was handed down, several states suspended issuing licenses, announced that their clerks and judges could decide not to issue licenses, or considered doing away with all licenses completely. The resolution of these actions may take some time to see.

In the meantime, the question remains: is it possible to use what promises to be a ripe field of differing marriage laws to gain a tax advantage for business or personal tax purposes? If so, what options will the federal government have if such a "loophole" proves to be a serious drain on federal revenues?

The *Obergefell* majority observed that "these cases involve only the rights of two consenting adults whose marriages would pose no risk of harm to themselves or third parties." I only wish I could agree.

July 2015

125. TINA TURNER, *What's Love Got To Do With It*, on PRIVATE DANCER (Capitol Records 1984).

126. The best reference for the case is: *Obergefell v. Hodges*, 2015 WL 2473451 (2015).