

How Self-Employment Tax Applies to California RDPs and Same-Sex Married Couples (Revisited)

By David M. Fogel, EA, CPA

Introduction

In the September/October 2011 issue of the *California Enrolled Agent* magazine, Joe Calderaro, EA and I discussed how self-employment tax applied to California Registered Domestic Partners (RDPs) and same-sex married couples. We discussed the IRS's position that if one of the partners carried on a business, and if the income from the business was community income under California law, self-employment tax had to be paid by both partners.

In the previous article, we addressed whether the IRS's position was constitutional. On June 26, 2013, in *U.S. v. Windsor*, the U.S. Supreme Court essentially declared that it wasn't.¹

As a result of the Supreme Court's decision, if the income from a self-employed business is community income of a same-sex married couple under California law, only the spouse that carries on the business is liable for self-employment tax. But this doesn't change the IRS's position in the case of California RDPs.

California Registered Domestic Partners

The California Domestic Partner Rights and Responsibilities Act of 2003,² which became effective January 1, 2005, provides that RDPs shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under the law as are granted to and imposed upon married spouses. Under an amendment, as of January 1, 2007, earned income of RDPs is treated as community income.³

In Chief Counsel Advice,⁴ the IRS announced that since federal law respects state law property characterizations, the federal tax treatment of community property should apply to California RDPs. Consequently, for tax years beginning after 2006, a California RDP is required to report one-half of the RDP's community income, whether received as compensation for personal services or as income from property. The IRS also issued a letter ruling that reached the same conclusion.⁵

California Same-Sex Married Couples

In 2008, the California Supreme Court extended marriage to include same-sex couples.⁶ Later that year, California voters passed Proposition 8, which banned marriage of same-sex couples.⁷ In 2010, a federal District Court declared Proposition 8 unconstitutional,⁸ which was upheld on appeal.⁹ On June 26, 2013, the U.S. Supreme Court held that the plaintiffs didn't have standing to appeal the District Court's ruling.¹⁰ The law, as it now stands, is that Proposition 8 is unconstitutional and that marriage of same-sex couples is legal in California.

IRC §1402(a) and its Applicability to RDPs and Same-Sex Married Couples

IRC §1402(a) defines net earnings from self-employment. IRC §1402(a)(5)(A) provides that when the income from a business is community income, the income will be treated as net earnings from self-employment "of the spouse carrying on such trade or business" except where the business is jointly operated by both spouses.¹¹ So, if the net income from a sole proprietorship is community income, self-employment tax is imposed on the spouse carrying on the trade or business.¹²

The word "spouse" in IRC §1402(a)(5)(A) is defined by the 1996 Defense of Marriage Act or "DOMA" (P.L. 104-199) as "a person of the opposite sex who is a husband or wife." This definition doesn't include RDPs who are not characterized as husband or wife, and it doesn't include same-sex married couples.

Consequently, the IRS took the position that the community income rules of IRC §1402(a)(5)(A) didn't apply, and therefore, the community income of a business operated by one RDP or by one spouse of a same-sex married couple had to be split with the other RDP/spouse for purposes of self-employment tax so that both RDPs/spouses had to pay self-employment tax.¹³

On June 26, 2013, the U.S. Supreme Court declared the "spouse" definition in DOMA as unconstitutional. On August 29, 2013, the IRS issued a revenue ruling¹⁴ in which it provided guidance relating to the Supreme Court's ruling. The IRS ruled that:

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- Same-sex marriages will be recognized for all federal tax purposes;
- A same-sex marriage validly entered into in a state that permitted such marriages will be recognized for federal tax purposes even if the married couple is now domiciled in a state that doesn't recognize the validity of same-sex marriages; and
- RDPs will **not** be treated as spouses unless their relationship is recognized as a marriage under state law.

The California Domestic Partner Rights and Responsibilities Act of 2003 does not recognize a registered domestic partnership as a marriage.

The ruling is to be prospectively applied as of September 16, 2013, the date that it was published in the Internal Revenue Bulletin. Affected returns that are filed after September 15, 2013 must follow the ruling. Returns filed before September 16, 2013 may be left alone or amended (at the taxpayer's choice) as long as the statute of limitations hasn't expired.

The effect of the revenue ruling on self-employment tax is:

- In the case of a same-sex married couple, if one of the spouses carries on a business, and if the income from the business is community income under California law, self-employment tax only needs to be paid by the spouse carrying on the business; and
- In the case of RDPs, if one of the partners carries on a business, and if the income from the business is community income under California law, self-employment tax must be paid by both partners on their respective shares of the community income of the business.

Conclusion

The U.S. Supreme Court's decision in *U.S. v. Windsor* to strike down the definition of "spouse" in DOMA affects hundreds of provisions in federal law, many of them relating to taxation. But I haven't seen anyone discuss the impact on self-employment tax. Hopefully, this article clarifies how this decision affects self-employment tax for a California same-sex marriage and California RDP.

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¹ *United States v. Windsor*, 570 U.S. ___, 133 S.Ct. 2675 (2013), 2013-2 USTC (CCH) ¶50,400.

² AB 205, Chap. 421.

³ SB 1827, Chap. 802.

⁴ Chief Counsel Advice 201021050 (5/5/2010).

⁵ Letter Ruling 201021048 (5/28/2010).

⁶ *In re Marriage Cases* (2008), 43 Cal.4th 757, 183 P.3d 384.

⁷ Cal. Const., Article I, §7.5.

⁸ *Perry v. Schwarzenegger*, 704 F.Supp.2d 921 (N.D. Cal. 2010).

⁹ *Perry v. Brown*, 671 F.3d 1052 (9th Cir. 2012)/.

¹⁰ *Hollingsworth v. Perry*, 570 U.S. ___, 133 S.Ct. 1521 (2013).

¹¹ IRC §1402(a)(5)(B) provides a similar rule for the distributive share of income from a partnership; such income is self-employment income of the partner and not the partner's spouse.

¹² The same holds true regarding partnerships. The entire distributive share of a married partner's income from a partnership trade or business is attributable to that partner for purposes of self-employment tax even if such income is considered community income. If both spouses are partners, then any self-employment tax is allocated based on their distributive shares.

¹³ See Pub. 555, *Community Property*, pp. 6-7 (2013).

¹⁴ Rev. Rul. 2013-17, 2013-38 I.R.B. 1. See also IRS News Release IR-2013-72.

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