Tax Justice and Same-Sex Domestic Partner Health Benefits: An Analysis of the Tax Equity for Health Plan Beneficiaries Act

Michelle D Layser
I. Introduction

In May of 2009, a bill was introduced in Congress that, if passed, would eliminate the discriminatory federal tax treatment experienced by same-sex couples who receive employer-provided health benefits. This Article examines the proposed Tax Equity for Health Plan Beneficiaries Act of 2009, and explains why this proposed Act is important legislation necessary to eliminate a significant area of tax inequality in the Internal Revenue Code.

Under current law, the Internal Revenue Service allows taxpayers to exclude from income certain employer-provided health care benefits. This tax exclusion reduces costs to employers by reducing payroll taxes and compensation expectations, and it reduces the tax burden on individuals by lowering their taxable income. But the tax exclusion for employer-provided health benefits is not equally available to all taxpayers: gays and lesbians who receive health benefits for their same-sex spouses or domestic partners are unable to claim the exclusion. This unequal treatment results in significant tax inequities for same-sex couples.

Moreover, the number of gays and lesbians affected by this unequal treatment continues to increase as more states permit same-sex marriages, civil unions, and domestic partnerships. Despite recent setbacks, there have been significant advances for gay and lesbian rights in

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2 Critics of the exclusion argue that employer-provided health benefit exclusions actually increase overall health care costs by encouraging workers to absorb increases in health insurance premiums. See also infra note 204 and accompanying text. Thus, the exclusion may result in economically "inefficient and costly demands for health care and pressure on employers to hold down workers’ pay as insurance expenses rise." Jackie Calmes & Robert Pear, Administration is Open to Taxing Health Benefits, N.Y. TIMES, Mar. 15, 2009, at A1.
3 The most publicized of recent setbacks was Proposition 8 in California. See Jesse McKinley, California Releasing Donor List For $83 Million Marriage Vote, N.Y. TIMES, Feb. 3, 2009, at A13. Proposition 8, which passed with a 52 percent vote, amended the California state constitution to define “marriage” as between one man and one woman. Id. The vote came just five months after the California Supreme Court had declared same-sex marriage a fundamental right in California. The Court was asked to decide whether Proposition 8 was a legal amendment, and
recent years. Massachusetts became the first state to permanently allow same-sex marriage in November, 2003, with the state Supreme Court decision Goodridge vs. Massachusetts Department of Public Health. For years, Massachusetts stood alone as the only state to permit same-sex marriage, while others allowed civil unions or domestic partnerships. Then in 2008, California briefly became the second state to allow same-sex marriage. California voters acted quickly to eliminate California’s status as a same-sex marriage state through the ballot initiative Proposition 8, which amended the state constitution to prohibit same-sex marriage. But while California voters were approving Proposition 8, the Connecticut Supreme Court quietly granted same-sex marriage in its state, allowing Connecticut to replace California as the second state to allow same-sex marriage.

Since then, four other states have updated their laws to permit same-sex marriages: Iowa, Vermont, Maine, and New Hampshire.\textsuperscript{10} Same-sex marriage bills have also been introduced in Rhode Island and New Jersey, and a same-sex marriage bill is expected to be introduced in Washington D.C. later in 2009.\textsuperscript{11} State officials in New Jersey, which currently allows same-sex civil unions, have said that gay marriage in their state is “not a matter of ‘if’ but ‘when.’”\textsuperscript{12}

Meanwhile, an increasing number of employers are offering health benefits to same-sex partners of employees. These benefits are called domestic partner benefits. Currently, sixteen states and the District of Columbia offer employer-provided benefits to same-sex partners of state employees.\textsuperscript{13} And, in the private sector, increasing numbers of employers are providing benefits to domestic partners; currently, the majority of Fortune 500 companies make health benefits available to employees’ domestic partners.\textsuperscript{14}


\textsuperscript{14} Laura Smitherman, Benefits for Gays: Proposal Would Extend Health Coverage to State Employees’ Partners, BALT. SUN, Feb. 3, 2009, at 3A.
Yet, whatever advancements gays and lesbians make in their home states is limited severely by the federal Defense of Marriage Act ("DOMA"), which was enacted in 1996.\textsuperscript{15} DOMA, which has two parts, establishes that no state is required to recognize out-of-state same-sex marriages, and further defines "marriage" for all federal statutes as between one man and one woman.\textsuperscript{16} As a result, gays and lesbians who are married are not guaranteed\textsuperscript{17} recognition in any state but the one where their marriages were granted, and their marriages are never recognized for federal purposes. As of December 31, 2003, 1,169 federal laws turned on marriage.\textsuperscript{18} Of these laws, 81 were tax provisions in the Internal Revenue Code.\textsuperscript{19} Among the tax provisions that turn on marriage are provisions about the taxation of employer-provided health benefits.\textsuperscript{20} The effect of the non-recognition of same-sex marriages and other same-sex unions with respect to these provisions is unequal taxation. While married employees receive health benefits for their spouses on a tax-exempt basis, gay and lesbian employees who receive health benefits for their spouses or domestic partners are taxed on the full fair market value of those benefits.\textsuperscript{21} As a result, the average employee who receives domestic partner benefits pays $1,069 more taxes per year than married employees with the same

\textsuperscript{16} Id.
coverage. In addition, U.S. employers who offer domestic partner benefits collectively pay $57 million per year more payroll taxes than they would if domestic partner benefits were taxed the same way as spousal benefits. Not only does such unequal tax treatment present serious civil rights concerns, but it also reflects a questionable tax policy in light of the goals of expanding available and affordable health coverage while reducing the economic strains and administrative burdens faced by today’s companies.

The proposed Tax Equity for Health Plan Beneficiaries Act would erase the unequal tax treatment of domestic partner health benefits by extending the tax exclusion currently available for employer-provided health coverage for employees’ spouses to similar coverage for same-sex partners. Although the proposed Act is limited in scope and leaves much of the discriminatory tax treatment of same-sex couples in tact, it would effectively end most discrimination related to the taxation of domestic partner benefits.

As a senator in 2007, Obama co-sponsored the Tax Equity for Domestic Partner and Health Plan Beneficiaries Act (S. 1556), which was the companion bill to an earlier version of the proposed Act. Obama’s past support for the companion bill suggests that he will probably sign the Tax Equity for Health Plan Beneficiaries Act if it passes in Congress. This Article analyzes the proposed legislation and recommends that Congress pass the proposed Act.

Part II of this article discusses the tax status of same-sex couples under current law. Part III presents a brief overview of employer health benefits, explains the concept of domestic partner benefits. Part III explains the current tax treatment of domestic partner benefits under federal ands state tax law. Part IV examines the text of the proposed Tax Equity for Health Plan

22 Id. at 7.
Beneficiaries Act of 2009 to understand the scope and effect of the bill, to anticipate issues that will require attention from the IRS if the bill is passed, and to analyze the strategy employed by the proposed legislation. Finally, Part IV recommends passage of the proposed Act with slight modification to eliminate some remaining tax inequities in the area of health benefits not covered in the proposed statute.

II. Background: Status of Same-sex Couples Under Current Tax Law

The tax status of same-sex couples today can be traced to Hawaii in 1993. That year, the Hawaii Supreme Court held in Baehr v. Lewin that a law that restricted marriage to opposite-sex couples created a “suspect category” under the Equal Protection Clause of the state constitution. On remand, the law failed to pass strict scrutiny and was struck down as a constitutional violation, making same-sex marriage legal in Hawaii. The public reacted. In response to the “perceived assault against traditional heterosexual marriage,” Congress enacted DOMA in 1996. President Clinton has defended his decision to sign DOMA into law, stating that he viewed the legislation as a states’ rights measure as opposed to an anti-gay rights law. Hawaii no longer allows same-sex marriage, but DOMA remains on the books as the most expansive federal legislation about the status of same-sex couples. Among its many effects is to dictate the federal tax treatment of same-sex couples.

DOMA has two parts. The first part is codified at 28 U.S.C. § 1738C and states:

29 Hawaiian voters amended the state constitution by referendum to give the legislature authority to overrule Baehr v. Lewin. See Bob Mims, LDS Church Hails Votes Barring Gay Marriage; Gay-Marriage Foes Thank LDS Church For Financial Aid, SALT LAKE TRIB., Nov. 5, 1998, at A1. Same-sex marriage is no longer permitted in Hawaii.
No State, territory, or possession of the United States, or Indian tribe, shall be required to give effect to any public act, record, or judicial proceeding of any other State, territory, possession, or tribe respecting a relationship between persons of the same sex that is treated as a marriage under the laws of such other State, territory, possession, or tribe, or a right or claim arising from such relationship.  

This first part of DOMA suspends the Full Faith and Credit Clause with respect to same-sex marriage in order to allow states to choose whether or not to honor out-of-state same-sex marriages. The result is that same-sex couples have different rights available to them from state to state, and their relationships’ legal status can change when they cross state borders. This variable treatment of same-sex marriages extends to tax status; the tax status of same-sex couples differs from state to state.

The second part of DOMA, which is more significant for the purposes of this article, is codified at 1 U.S.C. § 7 and states:

Definition of "marriage" and "spouse." In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife.

The effect of this second part of DOMA is nonrecognition of same-sex marriages for all federal purposes. For federal tax purposes, married or partnered same-sex couples are treated as unrelated third parties. Married gays and lesbians may not file joint federal tax returns or married filing separately tax returns; they always assume the tax status of an individual for federal tax purposes.

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30 28 U.S.C. § 1738C.
As a direct result of the DOMA, the tax status of same-sex couples often differs from state level to federal level. Same-sex partners are never permitted to file joint federal tax returns; yet, as of summer 2009, nine of the eleven states that permit same-sex marriage, civil unions, or domestic partnerships also permit same-sex couples to file joint state tax returns. Same-sex spouses in Massachusetts, Connecticut, and California, for example, are required to file joint returns or married filing separate state tax returns. Though no official guidance has yet been released, same-sex spouses in Iowa, Vermont, Maine, and New Hampshire should also be permitted to file joint state tax returns. Members of same-sex civil unions in Connecticut, New Jersey, New Hampshire, and Vermont are also required to file joint state tax returns or married

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32 Eight states (California, Connecticut, Iowa, Massachusetts, New Hampshire, New Jersey, Oregon, and Vermont) plus the District of Columbia allow certain same-sex couples to file jointly. See infra Part II.  
33 See Kiplinger, Seven States and the District of Columbia Now Allow Same-sex Couples to File Joint Returns, http://turbotax.intuit.com/tax-tools/tax-tips/family/domestic-partners-tax-filing.html (last visited Apr. 16, 2009). Note that the Iowa Supreme Court declared same-sex marriage legal in Iowa on April 3, 2009. Prior to this time, Iowa had offered neither same-sex marriage nor domestic partnerships or civil unions. At the time this paper was written, it was too early for any official statements from the state of Iowa regarding the filing status of same-sex spouses in Iowa; however, it is reasonable to assume that the right to marry also entails the right to file jointly as spouses.  
35 Practically speaking, however, many same-sex spouses in Iowa will probably continue to file “separately on a combined return.” See Roth & Co., Same-sex Marriage in Iowa: The Tax Stakes, TAXUPDATEBLOG.COM, Apr. 3, 2009, http://www.rothcoa.com/archives/004655.php. “Most same-sex couples will not see a difference in their Iowa taxes as a result of [the] Supreme Court ruling allowing them to wed in Iowa. The Iowa tax system allows married couples to file ‘separately on a combined return,’ giving them each a run up the brackets. Most married couples file this way; only couples with a single earner and very little joint investment property normally file an Iowa return with ‘joint’ status.” Id.  
36 Nat’l Conference of State Legislatures, Same-sex Marriage, Civil Unions and Domestic Partnerships, http://www.ncsl.org/programs/cyf/samesex.htm (last visited Apr. 16, 2009). Note that on September 1, 2009, when Vermont’s new Marriage Equality Act goes into effect, civil unions will no longer be available in Vermont. VT. SEC’y OF STATE, NEW MARRIAGE EQUALITY BILL (CIVIL MARRIAGE) FREQUENTLY ASKED QUESTIONS (2009), http://www.sec.state.vt.us/Marriage_Equality_FAQs.pdf. Civil unions will remain available in Vermont through August 31, 2009, and all civil unions obtained through that date will remain valid. Id.
filing separately state tax returns.\textsuperscript{37} Whether same-sex partners in domestic partner states\textsuperscript{38} are permitted to file joint state returns varies; registered domestic partners in California, Oregon, and Washington D.C. are permitted to file joint state tax returns,\textsuperscript{39} but registered domestic partners in Maine\textsuperscript{40} and Washington must continue to file separate state tax returns.\textsuperscript{41} Hawaii recognizes “reciprocal beneficiaries,” a legal status that gives same-sex couples certain rights with respect to

\textsuperscript{37} CONN. DEP’T OF REVENUE SERVICES, FORM CT-W4 (2008) http://www.ct.gov/drs/lib/drs/forms/2008withholding/ct-w4.pdf (“Effective for taxable years beginning on or after January 1, 2006, parties to a civil union recognized under Connecticut law must file their Connecticut income tax returns as if they were entitled to the same filing status accorded spouses under the Internal Revenue Code.”); Vt. Dep’t of Banking, Ins., Sec. & Health Care Admin., Guide for Civil Union Partners in Vermont, http://www.bishca.state.vt.us/Civilunion/civilulguideweb.htm (last visited Apr. 16, 2009) (For the Vermont state return, civil union couples may elect to file a joint return or separate returns in the same manner as married couples filing jointly or ‘married filing separate.’); N.J. Dep’t of the Treasury, Civil Union Act, http://www.state.nj.us/treasury/taxation/civilunionact.shtml (last visited Apr. 16, 2009) (“While civil union couples have the right to a joint filing status under New Jersey Gross Income tax law, that right can only begin to be exercised in 2008 for tax year 2007.”). Note that New Hampshire does not impose a state income tax on earnings. \textit{See infra note 41.}

\textsuperscript{38} California, Oregon, Maine, Washington, and Washington D.C. allow same-sex registered domestic partners. Human Rights Campaign, Same-Sex Relationship Recognition Laws: State by State, http://www.hrc.org/issues/5366.htm (last visited Apr. 23, 2009) [HRC Relationship Recognition]. Note that in California, “the Supreme Court’s decision regarding same-sex marriages did not invalidate or change any of the Family Code statutes relating to registered domestic partners,” and domestic partnerships will remain available regardless of the availability of same-sex marriage in the state. Cal. Sec’y of State Debra Bowen, Frequently Asked Questions, http://www.sos.ca.gov/dpregistry/faqs.htm#question1 (last visited Apr. 16, 2009). Note that Maine same-sex marriages will probably replace domestic partnerships in Maine. At the time of writing this article, however, the status of the same-sex marriage bill was still unclear as a result of opponents’ intent to initiate a “people’s veto.” \textit{See} Goodnough, \textit{supra} note \textit{Error! Bookmark not defined.}. As such, it is reasonable to continue to consider Maine a domestic partner state until the same-sex marriage law is effective.


\textsuperscript{40} Note, however, that the recently enacted same-sex marriage bill in Maine may supersede domestic partnerships in that state, and same-sex spouses who marry under the new Maine law will probably be able to file joint state tax returns.

survivorship, inheritance, property ownership and insurance. But Hawaiian reciprocal beneficiaries may not file joint tax returns. In sum, nine states – California, Connecticut, Iowa, Maine, Massachusetts, New Hampshire, New Jersey, Oregon, and Vermont – plus the District of Columbia permit same-sex spouses or partners to file joint state tax returns.

Yet, while the ability of same-sex couples in some states to file joint state tax returns is generally a welcomed right, the process of filing joint state tax returns can be onerous for same-sex couples because of the inability to file such return on the federal level. To determine state taxable income, all states that impose an income tax identify some federal reference point, such as federal adjusted gross income or federal taxable income, as an income base that will be adjusted upwards and downwards depending on state inclusions, exclusions, and deductions. For married couples, this technique simplifies the process; once the couple files their federal tax return, they can easily import the relevant income figure into their state return and make the applicable adjustments. For same-sex couples filing joint returns, however, the process is complicated by dual filing status: same-sex couples may be treated as married under state law, but DOMA requires that they be treated as unmarried individuals under federal law. A common solution to this problem is to require the couple to prepare a “dummy” joint federal tax return. The couple completes the dummy tax return as if it was a married couple, and then the relevant figures can be used to file a joint state tax return. As a result, many same-sex couples are forced

42 HRC Relationship Recognition, supra note 38.
to prepare four returns: two individual federal returns, one dummy married-filing-jointly federal return, and one married-filing-jointly state return.\footnote{See, e.g., Oregon RDP Facts, \textit{supra} note 39 (“The federal government doesn’t recognize domestic partners as married individuals for federal tax (IRS) purposes. RDPs must continue to file as unmarried individuals on their federal returns. You must create an ‘as if’ federal return from which you will use the federal information to complete your Oregon return.”).}

The dual filing status of same-sex couples complicates tax planning by creating, at times, directly opposed tax planning strategies. For a simple example, consider a married individual who is beginning a new job in year 2, at which time his spouse will stop working. The couple may anticipate a significantly lower joint income in year 2, while the individual may anticipate a significantly higher individual income in year 2. If the income difference is great enough, it may affect marginal tax rates. In such a case, planning strategies compete: it is advantageous for the individual to accelerate income items to take advantage of the lower individual federal tax bracket in year 1, but it is advantageous for the couple to defer income items to take advantage of the lower joint state tax bracket in year 2.

Dual filing status makes tax preparation and filing more costly and time consuming. Because same-sex partners must prepare four tax returns – two individual federal returns, one dummy joint federal return, and one state return – the costs for tax preparation is higher for same-sex partners than for married couples who file only two returns – one joint federal return and one joint state return. As a result, same-sex couples who hire a professional to prepare their taxes must pay for four tax returns.\footnote{Eva Rosenberg, \textit{Giant Tax Headache for Gay Couples}, MSN \textit{Money}, \url{http://articles.moneycentral.msn.com/Taxes/PreparationTips/GiantTaxHeadachesForGayCouples.aspx}.} In fact, the cost of tax preparation for same-sex couples sometimes doubles the price of preparing an opposite-sex married couple’s tax returns.\footnote{\textit{Id}.} Same-sex couples who prepare their own taxes using commercially available tax preparation software also incur extra expenses, especially if they attempt to use the versions available online. A same-
sex couple that wishes to use the online version of TurboTax, for instance, must create three accounts – two individual accounts (for federal individual returns) and one joint account (for a joint state return) – for as much as $75 per account. A better strategy for these couples is to purchase a physical copy of the program, which costs between $60 and $100 and can file up to five returns. Finally, while a married couple may file two returns (one federal, one state), same-sex partners must file at least three (one state, two federal) and, therefore, must pay an extra fee if they file online.

It is against this backdrop – DOMA and the dual tax status tax world it creates for same-sex couples – that the following discussion about employer health benefits must be understood. After introducing the concept of domestic partner benefits, the next Part III details the tax treatment of domestic partner benefits under current law.

III. The Problem: Taxation of Domestic Partner Benefits Under Current Law

Most Americans who have worked for a large employer are familiar with the concept of employee health benefits. The system of employment based health benefits began as private voluntary initiatives in response to federal tax and labor laws, collective bargaining strategies of trade unions, and the political failure of universal health care proposals. In the 1930s, the system began a period of rapid expansion that would last until the 1960s. By 2008, health benefits were offered by 63 percent of employers, with 99 percent of large firms of 200 employees or more offering health benefits. Eighty percent of employees who were eligible for

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50 Id.
52 Id.
employer-provided health benefits in 2008 accepted coverage. Of these eligible employees, 46 percent elect single coverage, 19 percent elect single plus-one coverage, and 36 percent elect family coverage.

Health benefits are purchased by the employer for the employee under the employer’s health plan; however, the employee is generally required to make a contribution as well. The employee’s typical contribution amount varies depending on the type of plan–HMO, PPO, POS, HDHP/SO–but, on average, an employee who elected single coverage in 2008 contributed $721 over the course of the year, while the average employer contribution was $3,983. For family coverage, the average employee contributed $3,354 in 2008, while the average employer contribution was $9,325. With respect to single plus-one coverage, the average employee contributes $1,903, while the average employer contribution is $6,085. It is with respect to the taxation of these last two types of health benefits – family coverage and single plus-one coverage – that there is unequal tax treatment of the benefits received by same-sex couples.

Though employers have for a long time extended health benefits to employees’ spouses and dependants, extension of coverage to employees’ domestic partners – commonly called and referred to here as “domestic partner benefits” – is a more recent development. The first employer to offer domestic partner benefits was The Village Voice in 1982. The trend was slow to start; only a few employers per year added domestic partner benefits in the 1980s, and by

54 Id. at 51.
55 Id. at 53.
56 Id. at 2.
57 Id.
1990 there were still fewer than twelve employers and no Fortune 500 companies that offered domestic partner benefits. But by 1999, the HRC counted 2,856 employers that offered domestic partner benefits, observing:

“Many of the initial concerns surrounding domestic partner benefits have been resolved in the nearly two decades since they were first offered. When domestic partner benefits were first offered, the few insurance carriers that wrote such policies usually added a charge to cover any unexpected cost increase. Today, many insurance companies will cover domestic partners and most of those have stopped adding a surcharge.”

By 2008, the number of employers that offered domestic partner benefits had risen to 9,375, including: 57 percent of Fortune 500 companies; 39 percent of Fortune 1000 companies; 151 cities and counties; and 14 states and the District of Columbia. One recent study estimated that in 2007 about 166,000 people received domestic partner benefits.

The growing number of employers offering domestic partner benefits represents a significant advancement toward equal treatment of same-sex couples. Yet, same-sex couples’ access to employer-provided health benefits continues to face serious hurdles due to unequal tax treatment of domestic partner benefits. The HRC rightly observed, “[f]or employees that do receive partner benefits, disparities in federal law typically result in higher individual income taxes — as well as higher employer payroll taxes — unless the partner qualifies as a tax dependent of the worker.” As discussed below, very few domestic partners qualify for dependant treatment; therefore, the unequal treatment affects most same-sex couples.

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60 Id. at 9; M.V. Lee Badgett, Calculating Costs with Credibility: Health Care Benefits for Domestic Partners, 5 ANGELES 1 (2000).
63 Badgett, supra note 21, at 6.
65 See infra text accompanying note 75.
A. Federal Tax Treatment

The federal tax treatment of employer-provided health benefits is governed primarily by Internal Revenue Code sections 106 and 105. Section 106 controls employer-provided coverage under an accident or health plan; in other words, it determines the tax treatment of employer-provided health insurance. Section 105 controls the tax treatment of disability payments, medical reimbursements, and dismemberment payments.

1. Section 106: Employer-Provided Accident and Health Plans

   a. Section 106(a): Exclusion for Employer-Provided Health Benefits

      Under section 106(a), an employee’s gross income does not include “contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents.” The effect of section 106 is to exclude the value of employer-provided health benefits as long as the benefits are provided to the employee, the employee’s spouse, or the employee’s dependents. The advantage is twofold: first, the employee is permitted to exclude from income employer contributions to the health plan; second, the employee is permitted to make any employee contributions to the health plan from pre-tax income by way of a salary reduction.

      The first of these advantages – exclusion of the value of the health benefits – is the most straightforward. Contributions an employer makes to a health plan for the benefit of an employee, the employees’ spouse, or the employee’s dependent do not constitute income to the employee and are not reportable on the employee’s W-2. Aside from co-payments typically made from after-tax income, the employee receives all insurance benefits tax free.

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The second of these benefits – pre-tax contributions through salary reduction – is slightly more complicated. Typically, a salary reduction occurs when an employer gives an employee the option of either receiving cash or taking a salary reduction that will be applied towards health benefits. In other words, the employee may elect to receive health benefits instead of cash.\textsuperscript{67} Whether the value of those benefits (which equals the value of the salary reduction) are included in the employees’ income depends on application of code section 125.\textsuperscript{68}

Under section 125, an employee’s gross income does not include the value of any benefit received as part of a written plan under which employees may choose between cash and certain qualified benefits.\textsuperscript{69} A “qualified benefit” is “any benefit which . . . is not includible in the gross income of the employee by reason of” certain specified provisions of the Internal Revenue Code.\textsuperscript{70} Section 106 health benefits are qualified benefits; therefore, the value of a salary reduction attributable to section 106 health benefits is excludible from income.\textsuperscript{71}

In sum, together sections 106 and 125 permit the exclusion of both employee and employer contributions to employer-provided health benefits for the employee, the employee’s spouse, and the employee’s dependents. To understand the effect of 106 on same-sex couples and their families, one must first define “spouse” and “dependents.” The federal definition of “spouse” excludes same-sex spouses and all unmarried partners (same-sex or opposite-sex) and is limited to opposite-sex marriages. Whether health benefits for a same-sex partner are covered by section 106, then, hinges on the definition of “dependents.”

\textsuperscript{67} The tax rules governing salary reduction benefit plans, which are called cafeteria plans, are not limited to health benefit plans.\textsuperscript{68} Rev. Rul. 2002-3, 2002-1 CB 316; Prop. Reg. § 1.125-1(r)(1).\textsuperscript{69} I.R.C. §§ 125(a), 125(d). Note that this kind of written plan is called a “cafeteria plan.” I.R.C. § 125(d).\textsuperscript{70} I.R.C. § 125(f).\textsuperscript{71} See Id.
The Internal Revenue Service has held that if a domestic partner or same-sex spouse qualifies as a “dependent,” then the partner or same-sex spouse will qualify for the section 106 income exclusion offered to employees’ dependants. For an adult to qualify as a dependant, section 152 requires that the same-sex partner not only must live with the taxpayer as part of the taxpayer’s household, but also must meet restrictive income and dependency requirements:72 (1) the partner’s gross income must be less than the exemption amount of $3,650;73 and (2) over one-half of the partner’s financial support must come from the taxpayer.74 These income and dependency requirements exclude most domestic partners and same-sex spouses from classification as dependents. In fact, as of 2006 less than 5 percent of unmarried partners received dependent coverage, as compared to 36 percent of married people who received coverage through their spouses’ employee health plan.75

Since a domestic partner or same-sex spouse will never be treated as “spouse” for the purposes of section 106 and usually will not qualify as a “dependent,” in most cases domestic partner benefits will fail to qualify for the section 106 exclusion that is available for benefits received for opposite-sex spouses. Thus, the fair market value of the domestic partner benefits must be included in income and will be taxed as part of the employee’s income,76 and any salary reduction attributable to domestic partner benefits must be included in gross income.

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72 I.R.C. § 152(d)(1).
74 I.R.C. § 152(d)(1).
75 Michael A. Ash and M. V. Badgett, Separate and Unequal: The effect of unequal access to employment-based health insurance on same-sex and unmarried different-sex couples, Contemporary Economic Policy, Oct. 2006, 24, 4 p 582 at 588
76 Health Benefits For Domestic Partner-Dependents Not Taxed To Employees, FED. TAX WEEKLY, Oct. 2, 2003; see also I.R.S. Priv. Ltr. Rul. 200339001 (Sept. 26, 2003) (“The excess of the fair market value of the medical and dental coverage provided by Taxpayers to a domestic partner who does not qualify as a section 152 dependent of the employee, over the amount paid by the employee for such coverage, is includable in the employee's gross income and is subject to income tax withholding and employment taxes.”)

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The effect is best illustrated by an example. Assume two taxpayers are in the same 28 percent tax bracket.\(^7\) The first taxpayer is in an opposite-sex marriage and receives health benefits for his opposite-sex spouse. The second taxpayer is in a same-sex marriage and receives health benefits for his same-sex spouse. Both elect single plus-one coverage for their spouses.

As noted above, because of DOMA the same-sex couple’s marriage is not recognized for federal tax purposes. Benefits received for the second taxpayer’s same-sex spouse, therefore, are not treated as tax-free marital benefits. For this reason, the coverage received for the second taxpayer’s same-sex spouse are domestic partner benefits for tax purposes even though the taxpayer may have received the benefits through his employer’s marital benefits plan.\(^7\) The portion of the benefits attributable to domestic partner benefits is fully taxable.

To determine the amount attributable to domestic partner benefits, it is necessary to calculate the increased value from single coverage to single plus-one coverage. Assume that the

\(^7\) The 28 percent tax bracket was chosen for this example because higher income taxpayers are more likely to work for employers that offer health benefits. AM. MED. ASS’N, HOW THE GOVERNMENT CURRENTLY HELPS PEOPLE BUY HEALTH INSURANCE: THE EMPLOYEE TAX BREAK ON JOB-BASED INSURANCE 1 (2008), http://www.ama-assn.org/ama1/pub/upload/mm/478/govtbuyins.pdf. In 2006, the top 30 percent of taxpayers were in the 25 percent tax bracket or higher. Author calculations based on filing data from the I.R.S. statistical table. See Internal Revenue Serv., SOI Tax Stats – Individual Statistical Tables by Tax Rate and Income Percentile, http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133521,00.html (follow “2006” hyperlink for the “SOI Bulletin article - Individual Income Tax Rates and Tax Shares, Table 1”). The 28 percent tax bracket was chosen here to highlight the discriminatory effects that become more pronounced as the tax bracket increases. The discriminatory effects of sections 105 and 106 are greater at the 33 and 35 percent tax brackets. However, no increase in OASDI (Social Security) tax liability occurs at the 33 or 35 percent tax brackets because the 2009 cap on “wages” for OASDI purposes is $106,800, making the maximum OASDI tax liability $6,621.60. See Treas. Reg. § 31.3121(a)(1)(vii) (for FICA purposes, “wages” does not include amounts that exceed the contribution and benefits base, as designated in the Social Security Act section 230); Social Security Act 42 U.S.C. § 430. Therefore, the 28 percent tax bracket best demonstrates the discriminatory effects of the tax treatment of domestic partner benefits.

\(^7\) Married same-sex couples in Massachusetts, for instance, do not need their employers to offer domestic partner benefits in order to receive benefits for their spouses. Rather, they may receive benefits through their employers’ regular marital benefit plans. The benefits received, however, will not be taxed as marital benefits. Instead, the benefits received will be taxed as if they were received through a domestic partner benefits plan. For simplification purposes, then, all benefits received for same-sex spouses or partners can be referred to as “domestic partner benefits.”
taxpayers pay the national average for health insurance.\textsuperscript{79} As such, assume that single coverage costs $4,118,\textsuperscript{80} and the employer requires the employee to contribute $788, while the employer contributes $3,330.\textsuperscript{81} Single plus-one coverage costs $7,988,\textsuperscript{82} and the employer requires the employee to contribute $1,903, while the employer contributes $6,085.\textsuperscript{83} When the two employees stepped up from single coverage ($4,118) to single plus-one coverage ($7,988), the value of the coverage increased by $3,870 total. Of this total, the employee contribution increased by $1,115, and the employer contribution increased by $2,755.

For the opposite-sex couple, this $3,870 value is tax-free under section 106. But for the same-sex couple, this entire amount is taxable. Table 1 displays the added income tax burden attributable to health benefits for the two taxpayers.

Table 1: Effect of section 106 on Same-sex Partners on Income Tax\textsuperscript{84}

\textsuperscript{79} Note that the averages used in this example are 2006 averages. Health insurance premiums have increased in recent years. \textit{See Nat’l Coalition on Health Care, Facts on Health Care Costs} 1(2008), http://www.nchc.org/documents/Cost%20Fact%20Sheet-2009.pdf.


\textsuperscript{83} MEP Survey Table I.E.2., \textit{supra} note 58.

\textsuperscript{84} The numbers reflected in the chart show only the income tax consequences to the employee. As seen in later examples, there are additional payroll tax consequences to both employees and employers.
The second employee was taxed on the value of benefits received for his same-sex spouse. As a result of this added taxable income, the same-sex couple owed $1,084 more income tax than the married couple. This figure is almost identical to the actual burden borne by same-sex couples; in fact, a recent estimate found that the average employee who receives domestic partner benefits pays $1,069 more taxes per year than an employee who receives the same coverage for an opposite-sex spouse.\(^8^7\)

The added tax liability is even more pronounced for high income taxpayers. Assume, for instance, that the two taxpayers are in the highest tax bracket, which imposes a 35 percent marginal rate. In the 35 percent tax bracket, the taxpayer who receives benefits for his same-sex spouse will pay $1,355 more taxes than his co-worker who receives the same benefits for his opposite-sex spouse. Moreover, if Congress adopts President Obama’s proposal to raise the top

\(^{85}\) The tax-free amount is the amount attributable to single coverage.

\(^{86}\) The taxable amount is the amount attributable to domestic partner benefits. The amount attributable to domestic partner benefits equals the increase from single coverage ($4,118) to single plus-one coverage ($7,988), which is $3,870. As reflected in Table 1, above, the cost of the $3,870 domestic partner benefits is paid in part by the employee and in part by the employer. The employee, however, is taxed on the full $3,870 value of the domestic partner benefits.

\(^{87}\) BAGGETT, supra note 21, at 1.
marginal rate to 39.6 percent in 2011, the discriminatory effect at the highest tax bracket will become even greater. At the 39.6 percent rate, the employee who receives benefits for his same-sex spouse will pay $1,533 more taxes than an employee who receives the same benefits for an opposite-sex spouse.

2. Section 105: Disability Payments, Medical Care Reimbursements, and Dismemberment Payments

Section 105 controls the tax treatment of disability payments, medical reimbursements, and dismemberment payments. Section 105(a) sets forth the general rule that “amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income” to the extent such amounts are attributable to excluded employer contributions or are paid by the employer. Section 105(a) refers to disability payments. Disability payments are payments to cover lost wages from time away from work due to accident or sickness. Since no exclusion is available for any taxpayer with respect to disability payments, there is no discrimination between the tax treatment of opposite-sex married couples and same-sex couples under section 105(a).

Sections 105(b) and (c), however, make an exceptions to the general rule of inclusion. Section 105(b) excludes amounts “paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care . . . of the taxpayer, his spouse, and his dependents.” This section covers medical reimbursements. Medical reimbursements are

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89 I.R.C. § 105(a)
90 See Tax-Exempt Benefits from Accident and Health Plans (CCH) ¶ 6702.01.
91 I.R.C. § 105(b).
reimbursements paid directly or indirectly to the taxpayer for expenses incurred for medical care. 92

Section 105(c) excludes amounts that “constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement, of the taxpayer, his spouse, or a dependent” as long as such amounts are “computed with reference to the nature of the injury without regard to the period the employee is absent from work.” 93 This section applies to dismemberment payments. Dismemberment payments are payments made to compensate an employee for permanent “loss or loss of use of an appendage of the body, the loss of an eye, the loss of substantially all of the vision of an eye, and the loss of substantially all of the hearing in one or both ears.” 94 As discussed in greater detail in Part IV, the exclusion for dismemberment payments accounts for a relatively small portion of overall tax expenditures in the area of health benefits, but the exclusion can be a considerable benefit to the relatively small number of people who suffer from permanent disabilities that qualify them for dismemberment benefits. 95

Thus, both medical care reimbursements and dismemberment payments are excludible if they are for the benefit of the employee, the employee’s spouse, or the employee’s dependents. As with respect to section 106, same-sex spouses and partners do not fall within the scope of section 105; the value of medical care reimbursements and dismemberment payments to same-sex spouses and partners must be included in income. As in section 106, same-sex couples suffer discrimination under sections 105(b) and 105(c).

92 Treas. Reg. § 1.105-2.
93 I.R.C. § 105(c).
94 Treas. Reg. § 1.105-3.
95 See infra Part IV.C.
3. Health Flexible Spending Arrangements

A health flexible spending arrangement (health FSA) is a special kind of employer-provided benefit program that “provides employees with coverage which reimburses specified, incurred expenses.” Employees contribute to an FSA through salary reduction and employers may make contributions for specific coverage. Subject to maximum-reimbursement limits, employees may then seek reimbursement for qualified medical expenses from a health FSA.

The tax treatment of health FSAs is controlled by the section 125 cafeteria plan rules. Under section 125, if a health FSA meets specified requirements, the health FSA qualifies for the sections 106 and 105 exclusions. However, sections 106 and 105 will limit the health FSA exclusions to benefits provided to an opposite-sex spouse or to dependants so FSA reimbursements may not be made to a domestic partner.

The discriminatory effect of unequal access to health FSAs can significantly increase the tax burden for same-sex couples. Once again, assume two employees are in the 28 percent tax bracket. Both employees purchase $5,000 hearing aids for their spouses. The first employee, who purchased the hearing aid for his opposite-sex spouse, is eligible to receive a $5,000 reimbursement from a health FSA. Since the $5,000 is excluded from income, the employee saves $1,400 in taxes. The second employee, who purchased the hearing aid for his same-sex spouse, is ineligible for the health FSA reimbursement. As a result, the employee with a same-sex spouse will pay $1,400 more taxes than a colleague who purchased the same hearing aid for

\[96\] Prop. Reg. § 1.125-5.
\[97\] EXP ¶ 1254.05 Flexible Spending Arrangements, Income (USTR).
\[98\] Id.
\[99\] See supra note 69 and accompanying text.
\[100\] Id.
\[101\] See supra note 77.
an opposite-sex spouse. Table 2 demonstrates the discriminatory effect of health FSAs on the same-sex couple.

Table 2: Effect of Health FSAs on Same-sex Couples

<table>
<thead>
<tr>
<th></th>
<th>Opposite-Sex Spouses</th>
<th>Same-sex Spouses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount Paid for Hearing Aid</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Amount Funded with Tax-Free Income through Health FSA</td>
<td>$5,000</td>
<td>0</td>
</tr>
<tr>
<td>Amount Funded with Taxable Income</td>
<td>0</td>
<td>$5,000</td>
</tr>
<tr>
<td>Tax Liability (x 28%)</td>
<td>0</td>
<td>$1,400</td>
</tr>
</tbody>
</table>

4. Withholdings and Payroll Taxes

The unequal tax treatment of domestic partner benefits increases the tax burden on both employers and employees through payroll taxes. There are two main types of payroll taxes: social security taxes under the Federal Insurance Contributions Act (FICA), and unemployment taxes under the Federal Unemployment Tax Act (FUTA).\(^{102}\) Employers\(^{103}\) pay both of these taxes based on employees’ wages. As a result, when an employee’s wages increase, so does the employer’s tax liability. Since domestic partner benefits cause employees’ wages to increase, employers who offer domestic partner benefits are liable for increased payroll taxes. Payroll taxes are imposed as follows.

\(^{102}\) A less common payroll tax that is modified by the proposed Act is imposed pursuant to the Railroad Retirement Tax Act (RRTA). Under code section 3221, certain carrier employers are required to pay “an excise tax, with respect to having individuals in his employ, equal to the applicable percentage of compensation paid” to employees. I.R.C. § 3221. Section 3231 defines “compensation” for the purposes of RRTA taxes. I.R.C. § 3231(e). As defined by that section, “compensation” does not include amounts paid to or on behalf of an employee and its dependents “on account of sickness or accident disability or medical or hospitalization expenses in connection with sickness or accident disability or death.” Id. As with respect to social security and unemployment taxes, domestic partner benefits fall outside this definition.

\(^{103}\) Note that both employees and employers pay social security taxes in equal amounts.
The first type of payroll taxes, social security taxes, are paid by employees and employers in equal amounts. Both employees and employers pay social security taxes equal to 7.65 percent of wages. As such, the total tax liability for social security taxes is 15.3 percent. The second type of payroll taxes, unemployment taxes, are paid only by employers. Unemployment taxes are imposed on wages at a rate of 6.2 percent in calendar years 1988 through 2009, and at a rate of 6.0 percent in 2010 and following years.

Domestic partner benefits constitute wages for the purposes of both social security taxes and unemployment taxes. As a result, employers who offer domestic partner benefits are likely to have greater payroll tax liability than employers who do not offer domestic partner benefits. This increase in payroll taxes is not trivial. One study estimated that, on average, employers pay

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104 These taxes are also called "FICA taxes." FICA Taxes, Analysis/Federal Tax Coordinator (RIA) ¶ H-4546. There are two types of social security taxes: (1) the Old Age, Survivors and Disability Insurance (OASDI) tax and (2) the Medicare Insurance tax. Id.

105 Both employees and employers pay the OASDI tax at a rate of 6.2 percent. See supra note 104; I.R.C. § 3311(a). The 6.2 percent rate applies to all wages received after 1989. I.R.C. § 3311(a). Note that in 2009 OASDI taxes do not apply to wages over $106,800, making the maximum OASDI tax liability $6,621.60. See supra note 77. This wage ceiling is adjusted annually for inflation. Both employees and employers pay Medicare Insurance Tax at a rate of 1.45 percent. IRC § 3311(b). The 1.45 percent rate applies to all wages received after 1985. Id.

106 Code section 3121(a) defines wages for the purposes of social security taxes. Wages Defined for FICA Purposes. Analysis/Federal Tax Coordinator (RIA) ¶ H-4621. Under 3121(a), “employer payments . . . to or on behalf of an employee or his dependents under a qualifying plan or system . . . that are made under a workers’ compensation law and that are for disability that resulted from sickness or accident, are not wages for [social security tax purposes].” FICA Treatment of Disability Benefits. Analysis/Federal Tax Coordinator (RIA) ¶ H-4646. Also excluded from the definition of wages are payments made on behalf of an employee or his dependants under a qualifying plan or system on account of medical or hospitalization expenses in connection with sickness or accident disability, or death. I.R.C. § 3121. Domestic partner benefits are included in the definition of wages.


108 Unemployment taxes fund “payments of unemployment compensation to workers who have lost their jobs.” Id. The federal unemployment tax is imposed by I.R.C. section 3301. Section 3301 imposes on every employer: “an excise tax, with respect to having individuals in his employ . . . [on] the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c) ).” I.R.C. § 3301.

109 Code section 3306(b) defines wages for unemployment tax purposes. The 3306(b) definition mirrors the 3121(a) definition applicable to social security taxes; it excludes from the definition of “wages” amounts of payment made to “an employee or any of his dependents” under a plan or system established by the employer for its employees with respect to: sickness or disability payments made under a workers’ compensation plan, medical or hospitalization expenses in connection with sickness or accident disability, or death. I.R.C. § 3306. See supra note 106. Domestic partner benefits are not excluded from the definition of wages.

110 I.R.C. § 3301.

111 See supra notes 106 and 109.
$248 in social security taxes alone for every employee who receives domestic partner benefits for his or her same-sex partner.\textsuperscript{112} Altogether, United States employers pay “a total of $57 million per year in additional payroll taxes because of this unequal tax treatment.”\textsuperscript{113}

To illustrate the effect of inclusion of domestic partner benefits on payroll taxes, consider again the two couples from the example accompanying Table 1.\textsuperscript{114} Recall that the first taxpayer received single plus-one benefits for his opposite-sex spouse and incurred no taxable income attributable to health benefits. Further recall that the second taxpayer received single plus-one benefits for his same-sex spouse and incurred $3,870 taxable income attributable to domestic partner benefits. The amount of payroll taxes attributable to health benefits paid by the taxpayers’ employers are reflected in Table 3 below.

Table 3: Effect of Inclusion of Domestic Partner Benefits on Employers’ Payroll Taxes

<table>
<thead>
<tr>
<th>Value of Health Benefits</th>
<th>Opposite-Sex Spouses</th>
<th>Same-sex Spouses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Amount of Health Benefits</td>
<td>0</td>
<td>3,870</td>
</tr>
<tr>
<td>FICA Taxes (Social Security taxes) x 7.65%</td>
<td>0</td>
<td>296</td>
</tr>
<tr>
<td>FUTA Taxes (Unemployment taxes) x 6.2%</td>
<td>0</td>
<td>240</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>0</td>
<td>536</td>
</tr>
</tbody>
</table>

The employer of the employee who receives health benefits for his same-sex spouse will pay $536 more total payroll taxes than will the employer whose employee receives health benefits for his opposite-sex spouse, who will pay $0 payroll taxes on health benefits received.

At the margin, it is conceivable that the increased payroll tax burden on employers could encourage employers to hire a heterosexual worker over an equally or greater qualified gay or

\textsuperscript{112} \textit{Badgett}, supra note 21, at 6. Note that employees and employers pay equal amount in social security taxes.

\textsuperscript{113} \textit{Id.} at 7.

\textsuperscript{114} \textit{See supra} Part III.A.1.a.
lesbian worker. Moreover, the aggregate increase in payroll taxes is a disincentive to employers offering domestic partner benefits in the first place. Eliminating this inequity would be an important step toward ensuring equal treatment of gays and lesbians in the workplace.

Moreover, recall that social security taxes are paid in equal amounts by employers and employees. As a result, in addition to the $536 of payroll taxes paid by the employer, the employee will pay $296 in social security taxes. The total payroll tax imposed on the domestic partner benefits, therefore, is $832, as compared to the $0 payroll tax imposed on opposite-sex marital benefits. Table 4 displays the total tax paid on domestic partner benefits as a result of the tax inclusion.

Table 4: Total Taxes Paid on Domestic Partner Benefits Compared to Taxes Paid on Health Benefits Provided for an Opposite-Sex Spouse

<table>
<thead>
<tr>
<th></th>
<th>Opposite-Sex Spouses</th>
<th>Same-Sex Spouses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax Paid by Employee</td>
<td>0</td>
<td>1,084</td>
</tr>
<tr>
<td>Payroll Tax Paid by Employee</td>
<td>0</td>
<td>296</td>
</tr>
<tr>
<td>Payroll Tax Paid by Employer</td>
<td>0</td>
<td>536</td>
</tr>
<tr>
<td>Total Tax Attributable to Health Benefits Provided for Spouse</td>
<td>0</td>
<td>1,918</td>
</tr>
</tbody>
</table>

5. Amplifying Effect of Unequal Filing Status on Tax Liability for Domestic Partner Benefits

The examples up to this point have assumed that the two taxpayers share the same marginal tax bracket. This assumption allowed us to isolate the effect of the tax treatment of health benefits on same-sex couples. It is important to recognize, however, that the unequal tax treatment of domestic partner benefits is only one of many tax inequities faced by same-sex

116 This amount equals 7.65 percent of the $3,870 taxable value of domestic partner benefits.
partners. The most significant of these inequities—unequal filing status—can serve to exacerbate the problem of unequal taxation of domestic partner benefits.

The above examples assumed that two taxpayers shared a constant 28 percent tax bracket. In reality, however, individuals with same-sex and opposite-sex spouses often do not share the same tax bracket, even when they have the same combined income. The reason for the disparity is that opposite-sex spouses are permitted to file joint federal returns and use the married tax rate schedule, while same-sex spouses are each required to file as single individuals and use the single individual tax rate schedule. Since the joint married federal tax rate schedule is more favorable than the individual federal tax rate schedule, it is not uncommon for the same taxable income to be taxed at different tax rates depending on filing status. The disparate tax rates can exacerbate the problem of unequally taxed benefits.

Consider once again two taxpayers, one with an opposite-sex spouse and one with a same-sex spouse. Instead of assuming a constant marginal rate, this time assume that both taxpayers hold a job with a base salary of $180,000 per year, while their spouses have $5,000 per year income.\(^{117}\) Once again, both taxpayers receive health benefits for their spouses through

\(^{117}\) The relatively high salary of $180,000 per year was chosen for this example because it yields a taxable income of $172,617 that lands the same-sex couple in the 33 percent tax bracket once domestic partner benefits are taxed. See Rev. Proc. 2008-66, 2008-45 I.R.B. 1107 (amounts over $171,550 are taxed at the 33 percent marginal rate). Had the same-sex couple in the example been permitted to file jointly, their taxable income could have risen to $208,850 before it would have reached the 33 percent tax bracket, an amount $37,300 higher than the threshold faced by the same-sex couple under current law. \textit{Id.} The example focuses on a same-sex couple at the borderline between the 28 percent and 33 percent brackets in order to better compare the results to the outcome of previous examples that had assumed a 28 percent tax bracket for both taxpayers. It is important to note, however, that the same distortions will occur whenever an opposite-sex couple and same-sex couple occupy different tax brackets. Often, an employee with an opposite-sex spouse and an employee with a same-sex spouse can share a constant salary but occupy two different tax brackets. For example, an employee with an opposite-sex spouse with taxable income between $33,950 and $67,900 will be taxed at the 15 percent bracket if he files jointly, while an employee with a same-sex spouse who has taxable income between $33,950 and $67,900 will be taxed at the 25 percent tax bracket. Rev. Proc. 2008-66, 2008-45 I.R.B. 1107. Thus, although this example uses a high starting salary in order to demonstrate its point in light of prior examples, the amplifying effects of filing status will be seen at considerably lower income levels than the one used in this example.

\(^{118}\) The $5,000 income of the same-sex spouse is above the exemption amount and, therefore, disqualifies the spouse for dependent status. See note 73 and accompanying text.
single plus-one coverage. Remember that single plus-one coverage costs $7,988,\textsuperscript{119} and the employer requires the employee to contribute $1,903, while the employer contributes $6,085.\textsuperscript{120} Further recall that single coverage costs $4,118,\textsuperscript{121} and the employer requires the employee to contribute $788, while the employer contributes $3,330.\textsuperscript{122} Table 5 shows gross income of the two taxpayers.

Table 5: Effect of Section 106 on Gross Income

<table>
<thead>
<tr>
<th></th>
<th>Opposite-Sex Spouse</th>
<th>Same-Sex Spouse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Salary</td>
<td>180,000</td>
<td>180,000</td>
</tr>
<tr>
<td>Less Excluded Salary Reduction</td>
<td>(1,903)</td>
<td>(788)\textsuperscript{123}</td>
</tr>
<tr>
<td>Plus Included Employer Contribution</td>
<td>0</td>
<td>2,755</td>
</tr>
<tr>
<td>Gross Income</td>
<td>178,097</td>
<td>181,967</td>
</tr>
</tbody>
</table>

Note that the difference in gross income of the two taxpayers is $3,870, an amount equal to the value of taxable domestic partner benefits received by the second taxpayer.\textsuperscript{124} But the added income due to domestic partner benefits tells only the beginning of the story for these two taxpayers. Assume that it is the 2009 tax year and neither taxpayer itemizes deductions. The taxpayer with the same-sex spouse is married under federal law and will file a joint tax return, will take two $5,700 standard deductions,\textsuperscript{125} will take two $3,650 personal exemptions,\textsuperscript{126} and

\textsuperscript{119} MEP Survey Table I.E.1, supra note 82.
\textsuperscript{120} MEP Survey Table I.E.2, supra note 58.
\textsuperscript{121} MEP Survey Table I.C.1, supra note 80.
\textsuperscript{122} MEP Survey Table I.C.2, supra note 81.
\textsuperscript{123} The employee with the same-sex spouse will have a $1,903 salary reduction, an amount equal to the employee contribution for single-plus one benefits. The excluded amount, however, is only the $788 reduction attributable to single coverage. The remaining $1,115 of the employee contribution constitutes taxable income.
\textsuperscript{124} See supra Table 1.
will pay tax at the married filing jointly tax rate. In contrast, the taxpayer with the opposite-sex spouse will be treated as an unrelated third party to his husband: he will file a single return, take one standard deduction, take one personal exemption, and pay tax at the unmarried individual rate. Table 6 shows the taxpayers’ total tax liability.

Table 6: Effect of Filing Status on Income Tax Liability (2009 Tax Year)

<table>
<thead>
<tr>
<th>Gross Income</th>
<th>Opposite-Sex Spouses</th>
<th>Same-sex Spouses</th>
</tr>
</thead>
<tbody>
<tr>
<td>178,097</td>
<td>181,967</td>
<td>5,000</td>
</tr>
<tr>
<td>Spouse’s Income</td>
<td>5,000</td>
<td>0</td>
</tr>
<tr>
<td>Personal Exemptions</td>
<td>(7,300)</td>
<td>(3,650)</td>
</tr>
<tr>
<td>Standard Deduction</td>
<td>(11,400)</td>
<td>(5,700)</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>164,397</td>
<td>172,617</td>
</tr>
<tr>
<td>Marginal Rate</td>
<td>28%</td>
<td>33%</td>
</tr>
<tr>
<td>Income Tax Imposed</td>
<td>$33,474.25</td>
<td>$42,106.11</td>
</tr>
</tbody>
</table>

Thus, although both taxpayers had the same base salary and spouses with equal base salaries, the same-sex couple paid about $8,632 more taxes than their opposite-sex counterpart, a 26 percent increase in total tax liability. A large part of this difference is attributable to the opposite-sex couple’s ability to file jointly. Notice, however, the filing status discrimination

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130 The ability of married couples to file jointly has significant tax saving advantages due in part to income-splitting. Income splitting is when the aggregate income of a couple is divided so that both parties are taxed on one-half of the total income. The marital tax rates are designed to replicate the effect of income splitting; though the married couple pays tax on its combined income, the tax paid should roughly mirror what would be owed if the couple were two individuals engaging in income splitting. The effect is either a marriage-bonus or marriage-penalty. A marriage-bonus occurs when one spouse has a significantly higher income than the other spouse, as in the example used here. When a couple like couple A’s incomes is split, the couple essentially pays tax on the average of the two incomes; as a result, the marginal rate paid on all income is lower than if both paid as unmarried individuals. Conversely, a marriage-penalty occurs when both spouses have roughly the same income. When their income is aggregated, it may push the income into a higher tax bracket; as a result, the marginal rate paid on all income is
amplified the effect of the disparate treatment of domestic partner benefits. The opposite-sex couple’s gross income was reduced by $1,903, saving the taxpayer about $533 in taxes given the 28 percent marginal rate. The same-sex couple’s gross income was instead increased by $1,967, costing the taxpayer $604 in extra taxes.\textsuperscript{131} Taking into account the different marginal rates attributable to filing status, the disparate treatment of health benefits, then, accounted for about $1,137 difference in tax liability. This figure is $53 greater than the $1,084 estimate in the original example.\textsuperscript{132} Thus, this example shows the potential of other inequities in the tax code to exacerbate the problem of unequal taxation of domestic partner benefits.

What is most striking about the above example is how clearly the tax treatment of same-sex partners violates the fundamental principal of fairness that underlies the American tax system.\textsuperscript{133} The American tax system is a progressive tax system that is often justified by an “ability-to-pay” principal: taxpayers in lower brackets bear less of the tax burden than those with higher incomes because those with higher incomes have a greater ability to pay than those in the higher than if both paid as unmarried individuals. In most cases, though, joint filing and marital tax rates have a tax saving effect for married couples. On the other hand, the unmarried individuals tax schedule is the least advantageous of all tax schedules. Since same-sex couples–married, partnered, or otherwise–are treated as unmarried individuals for federal tax purposes, they are at a significant tax disadvantage even before considering the many deductions and exclusions that are available only to married couples. The effect of this disparate tax treatment is illustrated in the example. For a more complete discussion about income splitting as it applies to same-sex marriage, see generally Patricia A. Cain, Taxing Families Fairly, 48 Santa Clara L.R. 805 (2008).

\textsuperscript{131}The taxpayer with the same-sex spouse was pushed out of the 28 percent tax bracket and into the 33 percent tax bracket because the domestic partner benefits were taxed. As a result, $1,067 of the taxpayer’s income was taxed at the 33 percent rate. Domestic partner benefits accounted for $1,967 of income. $1,067 of the domestic partner benefits were taxed at the 33 percent rate, and the remaining $900 were taxed at the 28 percent marginal rate. This results in $604 taxes.

\textsuperscript{132}See supra Table 1. If both couples had remained in the 28 percent tax bracket, then the difference in tax liability would in fact have been $1,084 as in the prior example. The difference here is caused by the step-up of the same-sex couple’s tax rate to the 33 percent bracket. The step-up in this case was caused entirely by the inclusion of benefits, but there are many income levels that would result in different tax rates for same-sex versus opposite-sex couples. See supra note 117. It should be noted that an opposite-sex married couple filing jointly with $172,617 taxable income will remain well within the 28 percent tax bracket.

Based on the ability-to-pay principal, the progressive tax system seeks to achieve both “vertical equity” and “horizontal equity.” Vertical equity is achieved when “taxpayers with unequal incomes . . . pay amounts of tax which are sufficiently unequal to fairly reflect the differences in their incomes.” Horizontal equity, by contrast, is achieved when “taxpayers with equal incomes . . . pay equal amounts of tax.”

As seen in the above example, the tax treatment of same-sex partnerships fails to achieve either vertical equity or horizontal equity. In the example, both the same-sex couple and the opposite sex couple began with the same $185,000 income; yet, the same-sex couple paid 26 percent more taxes than the opposite sex couple. In addition, the two couples – which were both married under state law – were placed in different tax brackets; the opposite sex couple was in the 28 percent tax bracket, while the same-sex couple was taxed in the 33 percent tax bracket.

Countervailing policy reasons have been used to justify taxing married couples at a lower rate than individuals, violating horizontal equity to favor marriage. Namely, marriage has traditionally been the preferred family structure for raising children, and married couples are assumed to spend more disposable income than individuals for use toward child care; therefore, they should be taxed a lower rate than individuals. Given these assumptions, however, same-sex partnerships are more analogous to opposite-sex marriages than to unmarried individuals.

136 Id.
137 Id.
139 Id. at 29.
As of the 2000 census, 27 percent of same-sex couples had a child of their own under age 18 living in their home.\textsuperscript{140} A more recent study concluded that more than one in three lesbians has given birth, and one in six gay men have fathered or adopted a child.\textsuperscript{141} By contrast, “the percentage of households that were [opposite-sex] married-couple families with children under 18 decreased from 23.5 percent in 2000 to 21.6 percent in 2006.”\textsuperscript{142} Any argument, then, that same-sex couples should be taxed at the individual rate because they are less likely to have families to support should fail. Moreover, care for dependents is covered by the dependent exemption.

The ability-to-pay principal requires that same-sex partnerships be taxed at the same rates as opposite-sex marriages. Assume that both married couples in the example have one child living in the home. There is no reason to assume that the same-sex couple would have any greater financial ability to care for its child while paying a higher tax rate; rather, both couples have an equal ability to pay.

The policy goals that justify the progressive tax system require the equal tax treatment of same-sex partnerships. Eliminating inequities with respect to domestic partner benefits will be much needed progress towards ensuring that similarly situated same-sex and opposite-sex couples are taxed equally. This correction, however, will leave significant discrimination in place in other areas of the tax code that continue to violate equity and ability-to-pay principals.

\textsuperscript{140} http://adoption.about.com/gi/dynamic/offsite.htm?zi=I/XJ\&sdn=adoption\&cdn=parenting\&tm=23\&f=20\&tt=12\&bt=0\&bts=1\&zu=http%3A//www.urban.org/publications/411437.html

\textsuperscript{141} Id.

Thus, although legislation like the proposed Act that seeks to eliminate unequal taxation of health benefits represents an important step towards equal tax treatment for same-sex partners, it is only a first step.

**B. State Tax Treatment and the Complexity Caused by Federal Discrimination**

State tax laws tend to be derivative of federal tax laws because most states begin with income figures imported from federal returns. For this reason, when an employee’s federal gross income is increased due to domestic partner benefits received, in most states there will be a corresponding increase in the employee’s state tax liability.

In the few states where same-sex spouses or partners are permitted to file jointly, a “dummy” return process is intended to prevent the federal treatment of these couples from influencing tax liability at the state level. The theory behind the “dummy” return is that a same-sex couple can replicate a “married” tax return if the couple simply prepares a fake federal joint tax return as if the couple were married. But under the current system, it is not clear whether the dummy return process alone will eliminate inequities at the state level with respect to domestic partner benefits. Since opposite-sex marital benefits are covered by the sections 106 and 105 exclusions, no additional deduction is needed or available in the Internal Revenue Code to cover these amounts. Domestic partner benefits, however, are reported as wages on employees’ W-2 earnings summary, so the only way to avoid taxing these amounts is to deduct the value of domestic partner benefits from reported wages.

This leaves members of same-sex partnerships in a dilemma when preparing “dummy” returns: are they required to use the figures shown on their W-2 earnings summary, or can they adjust their reported income to treat amounts attributable to domestic partner benefits as if they had been excluded from income? If they use the figure reported on their W-2, there is no way
for them to actually reach their hypothetical “married” income, since no deduction is available to offset the included income, which would have been excluded if they had been married. To avoid this problem, the same sex partners can adjust their reported income to treat amounts representing the value of health care as if they had been excluded, for instance. Since the dummy forms are never filed, and thus would never be subject to audit, this may be a viable option as long as accurate records of the salary reductions are kept.

In the absence of affirmative state action, same-sex partners are faced with an unresolved procedural dilemma. Several states have, however, taken steps to address the issue. There are two main approaches, which this paper will refer to as the “California approach” and the “Massachusetts approach.” The California approach solves the problem by providing a state-level deduction for domestic partner benefits. The California deduction is based on California Revenue & Tax Code section 17021.7, which states that “[f]or purposes of this part, the domestic partner of the taxpayer shall be treated as the spouse of the taxpayer for purposes of applying only Sections 105(b), 106(a), 162(l), 162(n), and 213(a) of the Internal Revenue Code and for purposes of determining whether an individual is the taxpayer's "dependent" or "member of their family" as these terms are used in those sections.” Through this provision, California offers a deduction for amounts attributable to the enumerated health benefits. Importantly, domestic partner benefits are only excluded under California law for domestic partners registered with the

\[143\] Cal. Rev. & Tax Code § 17021.7 (West 2007); California Franchise Tax Board, What If I’m a Domestic Partner?. http://www.ftb.ca.gov/individuals/faq/dompert.shtml (last visited Apr. 25, 2009) [hereinafter Domestic Partner Answers]. Note that, rather than setting forth a blanket rule that domestic partners shall be treated as spouses for all purposes, the California Revenue and Tax Code enumerates certain I.R.C. provisions with respect to which domestic partners shall be treated as spouses. This may reflect a policy decision that the blanket rule, which would implicate up to 81 I.R.C. provisions, would be too burdensome to administer.

\[144\] Cal. Franchise Tax Board, Claiming Income, Exemptions, and Deductions, http://www.ftb.ca.gov/individuals/Same_sex_marriage/TaxRtn_claims_faq.shtml (last visited Apr. 25, 2009) (explaining that “[f]ederal tax law does not allow the same treatment of these [domestic partner] benefits for same-sex married couples. These deductions are taken as an adjustment on the Schedule CA (540) or Schedule CA (540NR).”).
state; unregistered domestic partners must pay California state tax on any domestic partner
benefits received.\(^{145}\)

Under the Massachusetts approach, by contrast, domestic partner benefits are excluded
by requiring employers to perform two sets of calculations when they determine employees’
taxable income.\(^{146}\) Massachusetts employers report income to the state and withhold taxes on
income that is taxable under Massachusetts law.\(^{147}\) The value of domestic partner benefits is not
taxable under Massachusetts law, so amounts attributable to domestic partner benefits are not
reported or withheld for state tax purposes.\(^{148}\) Massachusetts employers must include domestic
partner benefits in wages reported for federal tax purposes.

Affirmative steps like those made in California and Massachusetts are necessary for any
state that recognizes same-sex marriages to avoid duplicating the inequity at the state level. Of
the remaining states that legally recognize some form of same-sex relationship, the state tax
treatment of domestic partner benefits is as follows: Connecticut, New Jersey,\(^{149}\) Vermont,
Oregon, and the District of Columbia all follow the Massachusetts approach to exclude domestic
partner benefits; New Hampshire and Washington do not levy any income tax on state residents
and, therefore, do not tax domestic partner benefits; Iowa, Maine, and Hawaii currently tax

\(^{145}\) See Domestic Partner Answers, supra note 143.
\(^{146}\) Dep’t of Revenue, TIR 04-17: Massachusetts Tax Issues Associated with Same Sex Marriages,
http://www.mass.gov/?pageID=dorhomepage&L=1&L0=Home&sid=Ador (follow “For Businesses” link; follow
“Help & Resources” link; follow “Legal Library” link; follow “Technical Information Releases” link; follow “TIRs
– By Year(s)” link; follow “2004 Releases” link; follow “TIR 04-17” link) (last visited Apr. 25, 2009) [hereinafter
Massachusetts TIR 04-17]; Martin J. Benison, Comptroller, Taxability of Same Sex Spouse’s Health Insurance,
2520benefits.doc+massachusetts+deduct+%22health+benefits%22+same-sex&cd=1&hl=en&ct=chk&gl=us&client=firefox-a (last visited Apr. 25, 2009); MINTZ LEVIN COHN FERRIS
GLOVSKY AND POPEO LLC, MASSACHUSETTS DEPARTMENT OF REVENUE ISSUES (ITS FIRST) SAME SEX MARRIAGE
GUIDANCE: ASSESSING THE IMPACT OF EMPLOYEE BENEFITS PLANS 2 (2004),
ADVISORY].
\(^{147}\) MINTZ ADVISORY, supra note 146 at 2; Massachusetts TIR 04-17, supra note 146.
\(^{148}\) MINTZ ADVISORY, supra note 146 at 2; Massachusetts TIR 04-17, supra note 146.
\(^{149}\) Note that New Jersey does not tax domestic partner benefits received by members of legal civil unions, but the
state does tax domestic partner benefits received by same-sex couples who are not in a civil union.
domestic partner benefits. In addition to these states, Rhode Island, which does not recognize any form of same-sex partnership performed in-state, does not tax domestic partner benefits.

Note that Iowa taxes Iowa net income, which is federal adjusted gross income before the net operating loss deduction plus certain state-level adjustments. As such, in order for newly married same-sex couples in Iowa to receive equal state tax treatment, Iowa will need to take steps to exclude the value of domestic partner benefits for state wages purposes or to add a deduction for the imputed value of domestic partner benefits. Similarly, Maine uses the federal adjusted gross income as residents’ base state income. As such, to achieve state tax equality for same-sex couples that marry in Maine, the state will need to adjust its tax code.

IV. The Solution: Tax Equity for Health Plan Beneficiaries Act of 2009

In response to the unequal taxation of domestic partner benefits, the HRC and other organizations have recommended that employers “gross-up” the salaries of employees who receive domestic partner benefits in order to eliminate the unfair taxation. For example, the

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153 IOWA CODE § 422.7 (Lexis 2009).


155 GROSSING UP PROPOSAL, supra note 150 at 1.
same-sex employee in the last example paid an additional $1,433 taxes ($1,137 extra income
taxes due to domestic partner benefits and $296 extra social security taxes). In order to
“refund” the tax and eliminate the inequity, the employer can gross-up the employees salary by
giving the employee $1,906 cash ($1,433 to refund the extra tax incurred, and $473 to pay for the
33 percent tax on the $1,433 refund). In this way, the employer effectively pays the extra taxes
for the employee.

Although the gross-up approach has been adopted by at least some sympathetic
employers, there are problems with this approach. When the employer in the example above
grossed-up the employee’s salary by $1,906, the employer’s payroll tax burden increased.
Instead of paying extra payroll taxes on $3,870 extra income attributable to domestic partner
benefits, the employer must pay extra payroll taxes on $5,776 extra income. At the 13.85
percent payroll tax rate, the employer will pay $800 extra payroll taxes for the employee who
receives domestic partner benefits.

In sum, the employer that grossed-up the salary must pay $2,706 more for the employee
receiving domestic partner benefits than for the employee who received benefits for his opposite-
sex spouse. Meanwhile, grossing-up does not eliminate the tax inequity; it merely shifts the tax
incidence to the employer that provided domestic partner benefits. Consequently, the gross-up
solution is an inadequate response to the unequal tax treatment of domestic partner benefits.
Instead, Congress should act to eliminate the inequity at its source by amending the Internal
Revenue Code by passing the Tax Equity for Health Plan Beneficiaries Act of 2009.

156 See supra text accompanying note 132.
157 See supra text accompanying note 116.
158 See GROSSING UP PROPOSAL, supra note 150 at 2.
159Id. at fn. 6 and accompanying text. (citing United States Department of Labor, Advisory Opinion 2001-05A,
160 See text accompanying notes 105 and 110 (In 2009, payroll tax rates equal 7.65 percent social security taxes, 6.2
percent unemployment taxes).
The earliest version of the proposed Act was introduced on February 26, 2003, by Representative Jim McDermott of Washington. The Tax Equity for Health Plan Beneficiaries Act of 2003, which stalled in committee, would have added a subsection to Internal Revenue Code section 106 that read:

Coverage Provided for Eligible Beneficiaries of Employees.—In the case of employer-provided coverage under an accident or health plan for an eligible beneficiary (other than a spouse or child) of an employee, such coverage shall be treated for purposes of this section in the same manner as such coverage for the spouse of an employee is treated.

This early version of the bill, then, would have extended the section 106 exclusion of health benefits to domestic partner benefits, but it would not have extended the section 105 exclusions of medical care reimbursements or dismemberment payments to domestic partners, nor would it have addressed any other health-benefit related inequities. Moreover, it would not have adjusted code definitions of “wages” to reflect the new treatment of domestic partner benefits and, thus, may have introduced ambiguities to the IRC with respect to payroll taxes.

Representative McDermott reintroduced the Tax Equity for Health Plan Beneficiaries Act in the House on March 29, 2007. The proposed Tax Equity for Health Plan Beneficiaries Act of 2007 addressed many of the limitations of the previous 2003 version by including, among other amendments, amendments to section 105 and to sections defining “wages” for payroll tax purposes. The proposed Tax Equity for Health Plan Beneficiaries Act of 2007 broadly extended the exclusion to an undefined “qualifying beneficiary” and “any qualifying child who is a dependent of the eligible beneficiary.”

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162 Id.
In contrast, the proposed Tax Equity for Health Plan Beneficiaries Act of 2009 expressly defines “qualifying beneficiary” but declines to extend the exclusion to “any qualifying child who is a dependent of the eligible beneficiary.” This Part IV will analyze the Tax Equity for Health Plan Beneficiaries Act of 2009 to determine the scope and effect of the bill, to evaluate the effectiveness of the strategy employed by the proposed legislation, and to recommend that Congress revise and pass the proposed Act.

A. Scope and Effect of the Tax Equity for Health Plan Beneficiaries Act of 2009

1. Extending the 106 and 105(b) Exclusion to Certain Domestic Partner Benefits Provided to “Qualifying Beneficiaries”

The proposed Act extends both the section 106 exclusion for employer-provided health benefits and the section 105(b) exclusion for medical care reimbursements to include coverage provided to any “eligible beneficiary” of the employee.\textsuperscript{164} “Eligible beneficiary” is defined by the proposed Act as “any individual who is eligible to receive benefits or coverage under an accident or health plan.”\textsuperscript{165} The proposed Act thus extends the section 106 exclusion of employer-provided health care benefits to coverage provided for the benefit of a new classes of individuals: eligible beneficiaries of employer accident and health plans.

Because the meaning of “eligible beneficiary,” is derivative from how employers define eligible beneficiaries under their plans, the language of the proposed Act is not expressly limited to domestic partner benefits. Rather, the language extends the tax exclusion to any beneficiaries of employer health benefits that an employer designates in its health plan. Interestingly, 58 percent of large employers that offer domestic partner benefits also offer health coverage to

\textsuperscript{164} H.R. 2625, § 2(a)-(b).
\textsuperscript{165} \textit{Id.}
opposite-sex unmarried partners of employees.\(^\text{166}\) The language of the proposed Act would extend the exclusion for health benefits to benefits provided to these unmarried opposite-sex couples. Thus, the scope of the proposed Act in this area is broad, encompassing both same-sex domestic partner benefits and benefits provided to unmarried opposite-sex partners.

It is less clear, however, whether the proposed Act includes any implied limitation on what kind of relationship an individual must have to the taxpayer in order to be included as “an eligible beneficiary.” It is not enough to merely state that “an eligible beneficiary” may include either same-sex partners or opposite-sex unmarried couples. Cases may arise when an employer-provided health plan permits individuals to be included in the plan who are neither dependents of the taxpayer nor in a romantic relationship with the taxpayer. Though it seems unlikely that an employer would permit coverage of the friends of a taxpayer, one can easily imagine an employer-provided health plan that permits employees to elect coverage for a non-dependant child. In such a case, it seems likely that the phrase “eligible beneficiary” would extend the exclusion to coverage provided to the non-dependant child. If this result is not intended, then additional defining language in the Internal Revenue Code may be necessary to prevent this result.

2. Eliminating the Payroll Tax on Domestic Partner Benefits

The proposed Act also amends the definitions of “wages” for the purposes of withholding requirements, the social security tax, and the unemployment tax.\(^\text{167}\) The amendments, which are


\(^{167}\) Note that the proposed Act also amends the section 3231 definition of “compensation” for RRTA tax purposes. Currently, section 3231 exempts from the definition of “compensation” amounts paid under a plan or system to an employee and his dependents “on account of sickness or accident disability or medical or hospitalization expenses in connection with sickness or accident disability or death.” I.R.C. § 3231(e). TEHBA amends this language to extend the exemption to benefits provided to an employee’s “eligible beneficiary.” H.R. 2625 § 2(c)(2). In this way, the proposed Act amends the code to eliminate unequal tax treatment of domestic partner benefits with respect to RRTA taxes. See supra note 91.
all relatively similar, exempt “eligible beneficiaries” from the definitions wages for payroll tax
an withholding purposes. This series of amendments has the effect of eliminating payroll taxes
on domestic partner benefits.

First, the proposed Act amends the section 3401(a) so that benefits provided to an
“eligible beneficiary” would no longer be treated as wages for the purposes of withholdings. Second, sections 3121(a)(2) (social security taxes) and 3306(b)(2) (unemployment taxes) would
be amended to exempt from the payroll tax benefits provided to the employee’s “eligible
beneficiary.” Thus, the proposed Act amends the code to eliminate the unequal tax treatment
of domestic partner benefits with respect to payroll taxes.

3. Extending the Exclusion to Self-Employed Individuals

In addition to amending Internal Revenue Code sections 105 and 106, the proposed Act
amends the section 162 trade and business expenses deduction rules in order to make the
exclusion for domestic partner benefits available to self-employed individuals. Because self-
employed individuals do not receive benefits through a health-plan, the “eligible beneficiary”
language used to amend sections 105 and 106 is inapplicable in this context. Instead, the
proposed Act amends the current rules that allow self-employed individuals to deduct payments
for health benefits provided for spouses and dependants. The proposed Act modifies this
section to additionally allow a deduction for health benefits purchased for an individual who

168 H.R. 2625 § 2(c)(4). Employers are required to collect taxes from employees by withholding taxes from the
employee's wages when paid, either actually or constructively. Treas. Reg. § 31.3402(a)-1(b). “Wages” for
withholding purposes is defined by IRC section 3401 and “means all remuneration for services performed by an
employee for his employer, except for . . . specifically excluded types of remuneration.” Wages Defined for Income
Tax Withholding Purposes (RIA) ¶ H-4326; I.R.C. § 3401. “Wages” under 3401 generally includes the cash value
of benefits, but certain benefits are exempt from the definition. Most notable for the purposes of this article, section
Since domestic partner benefits are not excludible, they would not qualify for the 3401(a)(20) withholding
exemption. The act of withholding does not itself create economic inequities.

169 H.R. 2625 §§ 2(c)(1), 2(c)(3).

170 H.R. 2625 § 3(a).
meets certain modified dependency requirements.\textsuperscript{171} The modified dependency requirements are broad enough to include a same-sex (or opposite sex) adult partner of the taxpayer. Thus, the proposed Act would make the exclusion for domestic partner benefits available to self-employed individuals.

4. **Amending the Flexible Spending Arrangements, Health Reimbursement Arrangements, and Health Savings Account Rules to Permit Payments to Same-Sex Partners**

With respect to both flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs), the proposed Act would instruct the Secretary of Treasury to issue guidance of general applicability providing that medical expenses that otherwise qualify for reimbursement under either arrangement may be reimbursed regardless of whether the expenses are attributable to a person who is not a spouse or dependent but who is otherwise an eligible beneficiary.\textsuperscript{172} In addition, the proposed Act would amend the rules for Health Savings Accounts (HSAs) to permit purchase of health insurance for a “qualified beneficiary” from HSA funds.\textsuperscript{173}

**B. Evaluation of the Proposed Act: Strategy and Effectiveness**

As recently as March, 2009, married same-sex couples in Massachusetts have filed suit to challenge the constitutionality of DOMA.\textsuperscript{174} But in light of the prevalence of constitutional amendments banning same-sex marriage\textsuperscript{175} and the conservative makeup of the Supreme Court, it seems unlikely that DOMA will be judicially overturned in the near future.\textsuperscript{176} If and when

\textsuperscript{171} The proposed Act would allow a deduction for benefits purchased for one individual who is over 18 years old who has the same principal place of abode as the taxpayer. H.R. 2625 § 3(a); I.R.C. § 152.

\textsuperscript{172} H.R. 2625 § 5.

\textsuperscript{173} H.R. 2625 § 6.


\textsuperscript{175} At the time of writing, 30 state constitutions prohibited same-sex marriage. *Id.*

\textsuperscript{176} President Obama has spoken of the need to repeal DOMA, but he has been largely silent on the issue since his January 2009 inauguration. See *Id.*
DOMA is repealed or successfully challenged, the tax inequities addressed by the proposed Act will fall away and the battle for equal recognition of same-sex couples will be removed to the state level. At that time, there may be added pressure on states to move toward same-sex marriage in order to avoid harming their own citizens relative to gay and lesbian residents of other states.

Until DOMA is eliminated, however, DOMA prevents same-sex couples who achieve marriage-equality on the state level from receiving the same federal tax benefits as their opposite-sex married counterparts. The proposed Act represents an attempt to achieve tax equality for gay and lesbian couples by neutralizing the effects of DOMA with respect to health benefits. This section analyzes the strategy employed by the proposed Act and assesses its effectiveness as a step toward equal tax treatment of same-sex couples.

1. Analysis of the Strategy Employed by the Proposed Act

The proposed Act leaves the DOMA-mandated definition of “spouse” untouched but nevertheless extends to same-sex partners the favorable tax treatment of employer-provided health benefits. First, the proposed Act would make available to same-sex partners the section 106 exclusion of employer-provided health benefits, the section 105 exclusion for medical

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177 The proposed Act would survive any challenge based on DOMA. The proposed Act clearly does not violate the definitional prong of DOMA; the proposed Act leaves untouched the federal definition of “spouse” as the marriage of one man and one woman. Similarly, no challenge of the proposed Act under the full faith and credit prong of DOMA should succeed. Conservative groups may try to challenge TEPHPBA on the grounds that the law forces states to recognize same-sex marriages performed in other states. The argument here is that since state tax codes are derivative of the I.R.C., if the Code gives special benefits to same-sex spouses then states may unintentionally extend the same benefits to same-sex spouses. If the same-sex spouses married out of state but claimed benefits from a company in-state, then a state may object that the proposed Act violates DOMA. It seems unlikely, however, that such a challenge would succeed. No state is forced or required to import federal income tax law into their state tax code, and nothing in the proposed Act requires states to adopt these parts of the I.R.C. Rather than accept a DOMA challenge to the proposed Act, courts will probably suggest that states amend their tax codes. The proposed Act, therefore, appears to be squarely legal under DOMA. Given the unlikelihood of success and cost of litigation, even conservative states would be unlikely to challenge the proposed Act. The more interesting question is whether states would be likely to amend their state tax codes to ensure that domestic partner benefits are taxed. It seems likely that most states would not.
reimbursements, and the use of health FSAs. These amendments also bring domestic partner benefits within the scope of section 125 cafeteria plan rules in order to eliminate tax on salary reductions for domestic partner benefits. Second, proposed Act would amend section 162 to permit self-employed workers to deduct the cost of health insurance purchased for domestic partners, and begins to adjust the rules for FSAs, HRAs, and HSAs.

To achieve its goal of providing equal treatment for domestic partner benefits, TEHBA extends the tax treatment currently available to opposite-sex spouses to a new class of health plan beneficiaries. In most cases, the beneficiary class is the “eligible beneficiary,” but in other cases – as with respect to the section 162(l) amendments – the new class results from broadening the code’s existing definition of “dependent.” Whatever the approach, the result is the same: the proposed Act would create a class so broadly defined that it could include almost anyone to whom an employer extends health benefits pursuant to a plan regardless of the relationship between the health plan beneficiary and the employee.\footnote{Note, however, that the proposed Act does include some limiting language. See supra Part IV.A.1.a.i.} In taking this approach, the proposed Act relies on employers to act reasonably when defining their health plan eligibility.

It seems likely that employers will impose reasonable limitations on eligibility for health benefits; in theory, the proposed Act could become quite costly to the Treasury if access to employer-provided health benefits is overbroad. On the other hand, if employers exclude domestic partners from coverage, discrimination between opposite-sex and same-sex couples will continue in some companies since the proposed Act would not mandate extension of domestic partner benefits by employers.

From a gay-rights perspective, it is imperative to identify the circumstances under which the benefits of the proposed Act would best reach the gay and lesbian community. Any benefits under the proposed Acts are dependent on the availability of domestic partner benefits offered by
employers. When an employer offers domestic partner benefits, it must define “domestic partner” for the purposes of the plan. To define “domestic partner,” employers “can either define their own requirements or rely on existing legal documentation such as a domestic partner registration, civil union or marriage.” 179 The HRC recommends that employers that require proof of eligibility allow employees to submit a partnership affidavit in lieu of a government-issued document like a marriage license because “allowing only a state marriage license in a state that does not offer marriage would be unnecessarily restrictive.” 180 A partnership affidavit is a declaration signed by the employee and filed with a public or private employer to certify that the employee is in a domestic partnership as defined by the employer. 181 Partnership affidavits typically require confirmation that the employee and the employee’s partner are over 18 years of age, are not related to each other, live together, are not currently in a legally recognized relationship with a person other than that partner, that the individuals are fiscally and legally responsible for each other, and that they have been in an intimate relationship for a specified time period. 182 It should be noted that several of these common requirements – such as the cohabitation, mutual responsibility, and durational requirements – are rarely if ever required of an opposite-sex married couple seeking benefits for a spouse. 183

Employers, therefore, may choose (1) not to offer domestic partner benefits; (2) to limit domestic partner benefits to same-sex domestic partners (defined either with or without reference

180 Id.
183 Anatomy of a Domestic Partner Affidavit, supra note 181.
to legal marriage, registered domestic partnerships, or civil unions); and (3) to offer partner benefits to employees’ unmarried partners, whether same-sex or opposite-sex. The proposed Act must be evaluated with respect to each of these alternatives.

a. The proposed Act and Employers that do not Currently Offer Domestic Partner Benefits

Because the proposed Act only offers a tax benefit to same-sex partners when domestic partner benefits are received, any benefit to the gay and lesbian community only comes from employers that do not offer domestic partner benefits must be indirect. However, the proposed Act should increase the number of employers offering such benefits by eliminating a major complexity and the tax costs to employers that offer domestic partner benefits. As more employers offer domestic partner benefits, increasing numbers of gays and lesbians will have access to employer-provided health benefits that will receive favorable tax treatment.

Employers are not legally obligated to provide health insurance to their employees, and they offer health benefits to employees at least in part because of the tax exclusion. The Congressional Research Services states: “It is uncertain how much employers gain from the exclusion [for employer-provided health benefits] except from reductions in employment taxes, but even if they gained nothing directly, they would likely provide coverage in order to give their workers tax savings. In a competitive labor market, workers’ tax saving on one form of compensation might allow employers to reduce other forms.” By extending the tax exclusion to domestic partner benefits, the proposed Act provides an incentive for employers to offer domestic partner benefits to employees.

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185 Id. at 10-11.
Moreover, support for the proposed Act among businesses suggests that businesses are
cognizant of the proposed Acts potential to reduce costs to employers. As of April 2009, 56
companies had joined the HRC’s Business Coalition for Benefits Tax Equity, which is “a group
of leading U.S. employers that support legislative efforts to end the taxation of health insurance
benefits for domestic partners and treat them the same as health benefits for federally-recognized
spouses and dependents.”186 Among the members of the Business Coalition for Benefits Tax
Equity are large employers like Citigroup, Inc., General Mills, Inc., PG&E Corp., J.P. Morgan
Chase & Co., and Microsoft Corp.187 If the proposed Act is passed, then at least some employers
who do not currently offer domestic partner benefits may be induced to do so.

b. The proposed Act and Employers that Offer Domestic Partner Benefits

With respect to employers that offer domestic partner benefits, the proposed Act is
broadly written and will extend the income exclusion for employer-provided health benefits to
any employee who receives benefits for a domestic partner, no matter how “domestic partner” is
defined. An employer may either limit the availability of domestic partner benefits to employees
with proof of a legal marriage, registered domestic partnership, or civil union, or the employer
may independently define “domestic partner.” In light of employers’ freedom to define
“domestic partner” and the proposed Act’s silence on the issue, one must confront the question
of whether it would be better if the proposed Act were to limit the exclusion to those in legal
marriages, registered domestic partnerships, or civil unions.

As a thought experiment, assume that the proposed Act did impose a requirement that
domestic partnership be proven by registration with the state. An employee at San Diego State
University, where benefits are only available to California Registered Domestic Partners, would

186 Human Rights Campaign, Business Coalition for Benefits Tax Equity, Members,
187 Id.
receive tax-free domestic partner benefits under the proposed Act.\textsuperscript{188} Now assume that that same employee transferred to the University of Michigan (U-M) for work. U-M is prohibited under state law from providing domestic partner benefits.\textsuperscript{189} Instead, U-M offers “benefits for adult dependents who meet the requirements of the Other Qualified Adult (OQA) category,” which provides “coverage for an adult who shares a primary residence with the U-M employee” when all OQA requirements are met.\textsuperscript{190} Assuming the employee qualifies for the OQA benefits, he can elect to receive coverage for his partner. But will the benefits be excluded under the proposed Act?

In the example given, it is unclear whether the employee who relocates to Michigan would get the tax exclusion if the proposed Act were limited to registered domestic partners. On the one hand, the employee does have a registered domestic partnership in California. On the other hand, by operation of DOMA and Michigan’s own state laws, Michigan does not recognize the California Domestic Partnership. The benefits are granted based on independent criteria that are unrelated to partnership registration. It is not clear, then, whether a limited-version of the proposed Act would be available for the relocated employee.

What is glaringly obvious, on the other hand, is that many recipients of U-M’s OQA benefits would be subject to taxation on the benefits if the proposed Act were so limited, because Michigan residents simply do not have the option of registering as domestic partners. U-M’s OQA benefit program is a striking example of why restricting the proposed Act would be problematic: first, domestic partner benefits are often offered in states that do not permit legal

\textsuperscript{190} Univ. of Mich. Benefits Office, Domestic Partner, http://umich.edu/~benefits/events/dp.html (last visited Apr. 26, 2009). The University’s OQA requirements are that the employee is eligible for benefits, the employee does not already enroll a spouse for benefits, and that the other qualified adult has shared a residence with the employee for six continuous months in a capacity other than as an employee or tenant. \textit{Id.}
domestic partnerships; second, when domestic partner benefits are offered in a state that does not permit legal domestic partnerships, the benefits may not be called “domestic partner benefits” at all.

It seems clear, then, that the proposed Act has the greatest capacity to benefit the gay and lesbian community if it is available without restricting eligibility to legal marriages, registered domestic partnerships, or civil unions. Moreover, avoiding language like “domestic partners” ensures that the exclusion is available for all benefits that are domestic partner benefits in substance, regardless of what they are named. The argument against this approach is that the failure to limit the exclusion to same-sex couples with legal documentation may extend the benefit too far. For instance, what if an employer allows employees to elect coverage for their friends, without any documentation at all? This question will be addressed in the next section.

c. The proposed Act and Employers that Offer Benefits to Unmarried Opposite-Sex Partners

In addition to objecting to the proposed Act’s extension of the exclusion to same-sex partners, conservative groups are likely to oppose the strategy of extending the exclusion to eligible unmarried opposite-sex partners. Opponents of extending benefits to unmarried opposite-sex couples assert that heterosexual couples have the right to get married – and should get married if they want to receive spousal benefits – and extending spousal benefits to unmarried couples may discourage couple from committing to marriage.191 On the other hand, supporters of offering benefits to unmarried opposite-sex partners argue that non-traditional family types are increasingly common and the law should treat these families equally.192 Some

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192 Id. at 1010-1012.
have gone so far as to argue that that heterosexual couples have a “fundamental right” to choose not to marry.\textsuperscript{193}

It seems unlikely that the proposed Act would have much affect on heterosexual marriage behavior. While it is conceivable that eliminating the tax on benefits provided to unmarried opposite-sex partners would discourage marriage, in reality very few unmarried opposite-sex partners receive employer-provided benefits even when they are offered.\textsuperscript{194} The affected population, therefore, would be very small – and the portion of that population that is actually discouraged from marrying would be even smaller.

Social policy aside, a second concern is economic: if unmarried people – same-sex or opposite-sex – can all receive employer-provided health benefits and then exclude the income, at some point the proposed Act may become too costly. Yet, cost to the government should not require more restrictive exclusions. First, employers themselves are likely to limit plan eligibility. While it is tempting to imagine scenarios under which employees elect to receive coverage for their five closest friends, the reality is that employers are scaling back their health plans, not expanding them to ever growing classes of beneficiaries.\textsuperscript{195} Profit-conscious employers are unlikely to offer health coverage for broad classes of beneficiaries.

Second, even if employers do extend coverage to broad classes of eligible beneficiaries, patterns of health plan enrollment suggest that few employees would take advantage of such partner benefit plans. Currently, nine times as many same-sex couples take advantage of employer-provided partner benefits than do unmarried opposite-sex couples.\textsuperscript{196} Since few

\begin{footnotes}
\item[193] Id.
\item[194] See Michael A. Ash & M. V. Badgett, Separate and Unequal: The effect of unequal access to employment-based health insurance on same-sex and unmarried different-sex couples, 24 CONTEMP. ECON. POLICY 582, 588 (2006).
\item[195] See supra text accompanying note Error! Bookmark not defined..
\item[196] Ash & Badgett, supra note 194, at 588.
\end{footnotes}
unmarried opposite-sex couples take advantage of employer-provided health coverage in the first place, the cost of including them in the exclusion should not have much fiscal effect.

To be sure, if the current unfavorable tax treatment of domestic partner health benefits operates as a disincentive to elect coverage, then it is possible that some unmarried opposite-sex couples do not take advantage employer-provided health coverage because it is tax disadvantageous to do so. At the margin some employees may decline health coverage for their opposite-sex unmarried partners because they will be fully taxed on the value of the benefits. Given historic enrollment in these plans, however, it seems unlikely that enrollment would increase enough to significantly affect the cost of the proposed Act.

Moreover, even if the number of unmarried opposite-sex partners electing for employer-provided health benefits increases – thereby increasing the cost to the government – this should not be viewed as a strike against the proposed Act. Rather, given the nation’s current interest in providing every American with some form of health coverage, it may be useful to extend favorable tax treatment to unmarried opposite-sex partners in order to encourage people to seek health coverage from private employers. Health coverage from private employers is especially needed in cases where a person is ineligible for private health insurance coverage, as is the case for individuals with a history of cancer or other preexisting conditions.\(^\text{197}\)

2. The Tax Equity for Health Plan Beneficiaries Act of 2009 as a Step Toward Equal Tax Treatment of Same-sex Couples

The fact that the proposed Act broadly extends benefits to recipients of employer-provided health benefits, even when those beneficiaries are unmarried heterosexual partners may limit attacks based on the claim that the legislation seeks to legitimize same-sex partnerships.

The proposed Act does not single out same-sex couples for favorable tax treatment; rather, it makes favorable tax treatment of health benefits available to a greater number of Americans. Even some opponents of same-sex marriage may be receptive to the argument that same-sex couples and their families are entitled to equal treatment with respect to health benefits.198

The most important question to the gay and lesbian community, however, is whether the proposed Act is well drafted to eliminate tax inequalities in the area of employer-provided health benefits. Generally speaking, this question should be answered in the affirmative. The benefits to the gay and lesbian community are twofold: first, the proposed Act’s strategy of amending the payroll tax is reasonably likely to encourage greater number of employers to offer domestic partner benefits, making domestic partner benefits available to a larger portion of the gay and lesbian community; second, the proposed Act’s strategy of extending benefits to a broad, undefined class of eligible beneficiaries ensures that gays and lesbians in states that do not legally recognize their partnerships will nevertheless be able to receive tax-free benefits when partner benefits are available.

Interestingly, it is possible that the proposed Act may be especially valuable to gays and lesbians whose partnerships have no legal recognition. First, consider the claim that the proposed Act will increase access to domestic partner benefits. Same-sex spouses in states that permit same-sex marriage should already have full access to benefits through employer’s spousal benefit plans; the proposed Act is needed in these states to correct tax inequities, but it is not needed to ensure that same-sex spouses have access to benefits.199 In contrast, in states that do

199 Note, however, the argument that firms should offer domestic partner benefits to unmarried same-sex partners even in states where legal same-sex marriage is permitted. Cheryl Wetzstein, Massachusetts Firms Drop Domestic - Partner Benefits Same-Sex ‘Marriage’ Move Irks Advocates, WASH. TIMES, Dec. 9, 2004, at A1. If the goal is to expand the availability of domestic partner benefits regardless of whether same-sex couples are able to marry and access spousal benefits, then the proposed Act would advance this goal even in states that allow same-sex marriage.
not recognize same-sex marriages, employers must affirmatively offer domestic partner benefits before same-sex partners will have access to benefits. The proposed Act will encourage expansion of domestic partner benefits in the 44 states that do not allow same-sex marriage.

Tax benefits of the proposed Act also are likely to fall mostly on gays and lesbians who are not in marriages, registered domestic partnerships, or civil unions. Only eight states and the District of Columbia recognize same-sex marriages, domestic partnerships, or civil unions. Yet, the proposed Act is broadly written to cover domestic partner benefits received in states that do not permit domestic partnerships – even if the domestic partner benefits are received under a plan that does not call itself a domestic partner benefits plan.200 This feature of the proposed Act is significant because employer-provided domestic partner benefits are often available in states that do not recognize any form of same-sex relationships. Consider, for example, the 48 members of Forbes 200 Largest Private Companies that offer domestic partner benefits.201 Of those 48 companies, 37 – or 77 percent – are located in states that do not allow same-sex marriage, registered domestic partnerships, or civil unions.202 As large companies continue to add domestic partner benefits as a way to recruit talent,203 the availability of domestic partner benefits in states that do not recognize same-sex relationships will continue to rise.

In sum, gays and lesbians whose relationships are not legally sanctioned will be important recipients of the proposed Act’s tax benefits. Given the restrictions imposed by DOMA and the turbulent political climate with respect to gay and lesbian rights, gay rights advocates should be pleased with this result. A form of the proposed Act that limited its benefits

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200 See supra Part IV.B.1.b.
202 Id.
203 Vicki Smith, Making a Good Impression: WVU Candidate’s Humble Beginnings Resonate With Staff, CHARLESTON GAZETTE & DAILY MAIL, Mar. 5, 2009, at 1A.
to the minority of gays and lesbians who are lucky enough to reside in one of the nine locations that recognize some form of same-sex relationship – or, worse, in the four states that recognize same-sex marriage – would do little to advance the needs of the gay and lesbian community as a whole. Rather, such a limited version of the proposed Act would create disparate treatment of same-sex partners on the federal level. The federal taxation of domestic partner benefits should not depend on individual states’ attitudes toward same-sex marriage.

Because the proposed Act’s strategy avoids these pitfalls, it is a promising piece of legislation that would extend equal tax treatment to all gays and lesbians who receive domestic partner benefits, no matter where they reside. As increasing number of employers are encouraged by the proposed Act to recognize same-sex partnerships, an important message will be sent about the worth of same-sex relationships. For this reason, the proposed Act should be viewed as an important step toward equality for gays and lesbians. The next section recommends a revision to the proposed Act to make it even more effective at reducing unequal treatment of same-sex couples.

C. Recommended Revision to the Proposed Act

Interestingly, the most significant challenge to the proposed Act may actually emanate from the very concept of the tax exclusion for health benefits. Health benefit exclusions have long been criticized as an inadequate subsidy for health care that disproportionately favors high income individuals.\textsuperscript{204} The 110\textsuperscript{th} congress introduced five bills that would fully eliminate the tax exclusion for employer-related health insurance and two bills that would limit the exclusion to specified amounts.\textsuperscript{205} The 111\textsuperscript{th} congress is also confronting the issue, as one of the Obama


\textsuperscript{205}CRS REPORT, \textit{supra} note 184, at n.4.
Administration’s major health reform proposals is to place a cap on the exclusion. Among the arguments for eliminating or capping the exclusion is the criticism that the exclusion actually encourages workers to obtain greater health coverage than they would otherwise, leading workers to continue purchasing coverage even as the cost of insurance rises. Alternative tax treatment, the argument goes, may provide a brake on the increasing prices of health insurance. Proposed alternatives have included placing limits on the exclusion or replacing it with a capped deduction or credit. In its November 2008 report about the issue, the Congressional Research Service concluded:

A principal policy decision appears to be whether to maintain and possibly strengthen the employment-based system of health care. If that is the goal, then maintaining the exclusion might be appropriate since it is unclear what the effects of termination would be over time. If instead the goal were to move towards individual market insurance or an expansion of public coverage, then ending the exclusion should be given greater consideration.

The question of whether America should abandon the exclusion altogether and move toward individual market insurance or an expansion of public coverage is an important policy question that is beyond the scope of this article. Under the current system, employers are the principal

207 CRS REPORT, supra note 184, at 14.
208 Id.
209 Id.
210 Id. at 21-22.
211 The tax exclusion for employer-provided health benefits was debated during the 2008 Presidential campaigns of then Senator Barack Obama and Senator John McCain, and both candidates’ plans had tax implications. McCain wanted to eliminate the tax exclusion for employer-provided health care benefits and replace it with a credit. Jackie Calmes & Robert Pear, Administration is Open to Taxing Health Benefits, N.Y. TIMES, Mar. 15, 2009 at A1. At the time, Obama charged that McCain’s plan would erode companies’ health benefits plans and leave employees uninsured. Adam Nagourney & Jeff Zeleny, Economic Unrest Shifts Electoral Battlegrounds, NYTIMES.COM, Oct. 4, 2008, http://www.nytimes.com/2008/10/05/us/politics/05map.html?scp=16&sq=obama+health+care+campaign&st=nyt. Now that Obama is President, the Obama administration has begun to compromise its position, saying now that though the President “will not propose changing the tax-free status of employee health benefits, neither will he oppose it if Congress does so.” Calmes & Pear, supra note 211. Several bills before congress would, if passed, eliminate or limit the tax exclusion for employer-provided health benefits. See supra note 205 and accompanying
source of health insurance for nonelderly Americans, providing coverage to about 158 million people.\textsuperscript{212} For this reason, this article recommends alignment with the former goal of strengthening the employment-based system of health care. In furtherance of this goal, this article recommends the passage of the proposed Act.

Unlike its predecessors, the Tax Equity for Health Plan Beneficiaries Act of 2009 is significantly comprehensive and responds to a range of inequities arising from sections 106, 105(b), 162(l), 501(c)(9), and 125, while also addressing addresses corresponding effects on employers’ payroll taxes. A notable omission, however, is the proposed Act’s continuing failure to address section 105(c) dismemberment benefits inequities. Current section 105(c) excludes amounts that “constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement, of the taxpayer, his spouse, or a dependent” as long as such amounts are “computed with reference to the nature of the injury without regard to the period the employee is absent from work.”\textsuperscript{213} The existing rules do not extend the exclusion of dismemberment benefits to domestic partner benefits, and the proposed Act does not change these results.

Given the wide reach of the proposed Act, the failure to address the 105(c) inequity may reflect a drafting oversight. In light of the proposed Act’s comprehensiveness, there is no clear policy reason to single out and refuse to extend the 105(c) exclusion to domestic partner benefits. Moreover, the number of workers who claim dismemberment benefits for a domestic partner would be very low, making the cost of extending the exclusion to domestic partners minimal. In 2008, for example, the exclusion of premiums for accident and disability insurance cost the

\textsuperscript{212} Kaiser Survey, \textit{supra} note 53, at 1.

\textsuperscript{213} I.R.C. § 105(c).
government only 0.19 percent of the amount attributable to the exclusion for employer-provided health insurance and medical care.\textsuperscript{214}

Though the tax exemption for dismemberment benefits is only a modest expenditure to the government, the added tax burden on the small number of affected individuals can be significant. Dismemberment insurance policies typically range from $100,000 to $500,000 of coverage.\textsuperscript{215} An individual in the 28\% marginal tax bracket whose domestic partner receives a $100,000 payout from employer-provided Accidental Death and Dismemberment (AD&D) insurance will owe up to $28,000 more in taxes than an opposite-sex spouse receiving the same benefits. Thus, extending the exclusion of dismemberment benefits to domestic partner benefits would greatly benefit affected individuals without costing the government much lost revenue.

The symbolic value of fully eliminating tax inequities in the area of health care would be significant. Thus, the proposed Act represents a small but important step toward equal tax treatment for gays and lesbians, and the exclusion for dismemberment benefits is well within the scope of the proposed Act. The final approved version should amend section 105(c).

V. Conclusion

The treatment of same-sex couples under federal tax law is dictated by DOMA’s definition of marriage as between one man and one woman. As a result, same-sex couples who marry under state law or who enter into domestic partnerships or civil unions are nevertheless treated as unrelated third parties for federal tax purposes; therefore, same-sex couples are

\textsuperscript{214} Analytical Perspectives: The Budget of the United States 306 (2008)
\\url{http://www.whitehouse.gov/omb/budget/fy2008/pdf/spec.pdf} (the exclusion of premiums for accident and disability insurance cost the government $310 million, as compared to the $160,190 million attributable to the exclusion for employer-provided health insurance and medical care).

\textsuperscript{215} Discover Fin. Serv., AD&D Insurance FAQs,\\url{http://www.discovercard.com/insurance_center/faqs/add_insurance_faq.shtml} (last visited Apr. 27, 2009). \textit{See}, \textit{e.g.}, University of Southern California, Accidental Death & Dismemberment Insurance Enrollment, \url{http://ais-ss.usc.edu/helpdoc/WebEM/WebEMBeneEnrollAD.html} (last visited Apr. 27, 2009); Northwestern Univ., \textit{Accidental Death & Dismemberment Plan} 10 (2007).
\\url{http://www.northwestern.edu/hr/benefits/plans/add/pdf/spd-add.pdf}. 
ineligible for any tax benefit conferred upon spouses. Among the most significant of these benefits are the exclusions for employer-provided health benefits and medical care reimbursements. This unequal treatment results in significant tax inequities to both same-sex couples and to employers.

The proposed Tax Equity for Health Plan Beneficiaries Act of 2009, earlier versions of which were introduced in 2003 and 2007, seeks to rectify these tax inequities without running afoul of DOMA. The proposed Act leaves the definition of spouse untouched but extends these tax benefits to a new class of individuals that is broad enough to include domestic partners. In addition, the proposed Act is expansive enough to extend the benefit to some unmarried opposite-sex couples, raising questions about appropriate social and health policy goals.

This article argues that the strategy of extending the exclusion to both same-sex partners and some unmarried opposite-sex partners is appropriate because it will encourage employers to provide coverage to a greater number of individuals. First, the proposed Act would not only represent a step towards equal treatment and recognition of same-sex couples, but it would also encourage more employers to offer domestic partner benefits. Second, the proposed Act would likely expand the number of people eligible for employer-provided health coverage generally. Since employers are the primary source of health insurance in America, and since private health insurance is expensive and often has prohibitive eligibility requirements, it represents sound policy to extend eligibility to greater numbers of people. For these reasons, this article recommends the passage of the Tax Equity for Health Plan Beneficiaries Act of 2009 with only slight modification – the final version of the proposed Act should include an amendment to 105(c) to extend the exclusion for dismemberment benefits to domestic partners.