In the Wake of the *Whitewood* and *Windsor*:
What Real-Estate Lawyers Should Know (or Anticipate)
Regarding Same-Sex Marriage in Pennsylvania

By William J. Maffucci, J.D.*

On May 20, 2014, Judge John E. Jones III of the United States District Court for the Middle District of Pennsylvania declared that provisions of Pennsylvania's Domestic Relations Code that prohibited same-sex marriages were unconstitutional. *Whitewood v. Wolf*, 2014 U.S. Dist. Lexis 68771, 2014 WL 2058105. His decision was effective immediately; with a stroke of the pen he liberated same-sex couples from centuries of common law, legislation, and custom. "By virtue of this ruling," he explained, "same-sex couples who seek to marry in Pennsylvania may do so, and already married same-sex couples will be recognized as such in the Commonwealth." Slip op at 38.

Reactions to *Whitewood* were rapid, fervid, and diverse. It may take decades to discern the full impact of the decision and dozens of others that have been handed down in the torrent of change throughout the country over the past year. But I don't want to wait that long. I want to know now how *Whitewood* will affect my life as a real-estate lawyer.

My immediate question was perhaps the most important: Can same-sex spouses hold title to real property as tenants by the entirety?[1] That they would *want* to do so is obvious; it would extend to them protections afforded historically only to a husband and wife: A judgment entered against one but not both of them would not effect a lien against the property, and the judgment creditor could not execute upon the one spouse's interest in the property.

At the time I write this (October 2014), no reported decision of a court sitting in Pennsylvania has addressed the issue. And yet every real-estate lawyer who was willing to participate in my straw poll (and I solicited hundreds of them) opined or predicted that, yes, same-sex spouses must be or will be recognized as able to own property as tenants by the entirety. (Some were even offended that I thought the issue might be open.)

I, too, predict that the courts will eventually recognize a same-sex entireties estate. But I wonder how the issue will reach the courts. After all, it isn't an issue that readily gives rise to the kind of contention that leads to litigation. A person's political or religious fervor on the issue of same-sex marriage might inspire political action, but there are only a few ways, logically, in which people could resort to the courts to resolve the specific issue of whether same-sex married couples should be recognized as holding property as tenants by the entirety.

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1 The traditional term is "tenants by the entirety." But courts and commentators now use that term interchangeably with "tenants by the entireties." Even LADNER PENNSYLVANIA REAL ESTATE LAW ("LADNER"), recognized as the leading treatise on conveyancing in Pennsylvania, uses both. *See* 1 LADNER § 8.04 (passim).

One way the issue might reach the courts is in resolution of a title dispute. In Pennsylvania a judgment entered automatically effects a lien upon real property owned by the judgment debtor (at the time the judgment was entered) and located in the county in which the judgment is entered. If the judgment debtor happens to be a co-owner of the property, holding the property with the other owner or owners as tenants in common or as joint tenants, but that co-owner or those co-owners are not also defendants in the judgment, the judgment is nonetheless a lien on the judgment debtor's interest in the property.

As noted above, a different rule applies with regard to property owned by husband and wife holding as tenants by the entirety. A judgment against just the husband or just the wife does *not* effect a lien on the judgment debtor's interest in entireties property (unless the non-debtor spouse dies before the property is conveyed), and therefore the property can be conveyed by the married couple to a third party free and clear of the judgment.

Now imagine that a same-sex married couple owns Pennsylvania real property, that there is a judgment against one of the spouses that was entered in the county in which the property is located (that judgment having been entered after the couple acquired the property), and that the couple wants to sell the property to a third party. Will the prospective purchaser's title company agree to insure the title free and clear of any lien effected by the judgment? Maybe not, particularly if the deed to the couple did not expressly state that they would hold title as tenants by the entirety.[2] Instead, I think, the title company might refuse to insure over the lien unless the parties obtained a court order declaring or determining that the judgment effected no lien upon the property. The parties could seek such an order by bringing an action for a declaratory judgment or an action to quiet title.

Another way for the issue to reach the courts is in connection with execution proceedings brought by a judgment creditor of one but not both of the same-sex spouses. Just as in Pennsylvania a judgment creditor can obtain a lien upon the judgment debtor's interest in real property that the judgment debtor co-owns with non-spouse parties who are not also named in the judgment, in Pennsylvania a judgment creditor can execute upon the judgment debtor's interest in that property.

It is not unreasonable to expect that eventually the holder of a Pennsylvania judgment against one but not both spouses of a same-sex marriage will seek to execute upon that spouse's interest in real property that is owned jointly by the spouses (particularly if the deed to the spouses did not specify that they would hold it as tenants by the entirety), that the judgment debtor or the spouse will either object to the execution or move to have the execution set aside (under Pa. R.C.P. 3121) or claim that the property is exempt from execution (under Pa. R.C.P. 3123.1), and the issue will be joined for the court.

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[2] When a man and a woman are already married and acquire Pennsylvania real estate in a deed that identifies them as "husband and wife" (or "man and wife"), there is a presumption that they will hold title as tenants by the entirety even if the deed nowhere so specifies. LADNER § 8.04(b), at 8-16. The issue of whether a same-sex couple would be entitled to the same presumption is slightly different than the issue of whether that couple is capable of owning any property as tenants by the entirety. Fewer of the real-estate attorneys I solicited for my straw poll had an opinion about the matter, but those who did unanimously opined or predicted that same-sex couples would be entitled to the presumption.

Despite the sense that recognition of a same-sex entireties estate is inevitable, some lawyers who have begun to draft deeds to same-sex married grantees have hedged their bets: They have included a contingency provision, inserted after the clause specifying that the couple is taking title as tenants by the entirety, that, in the event a court or other competent tribunal refuses to recognize the validity of that estate, the deed will automatically be deemed to have conveyed title to the couple as joint tenants with a right of survivorship. This is important to prevent the presumption, should a court conclude that the same-sex spouses cannot own the property as tenants by the entirety, that they hold the property as tenants in common (with no right of survivorship).

Regardless of whether or when the courts or legislature ultimately confirm that same-sex spouses may hold Pennsylvania real property as tenants by the entirety, same-sex spouses who wish to do so must not make a common mistake made by opposite-sex spouses who marry after one of them had acquired the property. The marriage does not automatically convert title to the estate by the entirety. Rather, to become entireties property the original owner must literally convey it from himself or herself, as grantor, to both spouses, as tenants by the entirety. LADNER § 8.04(c), at 8-17.

Although same-sex marriage is new in Pennsylvania, one real-estate issue arising from it has already arisen hundreds of times throughout the commonwealth: When a same-sex spouse owns real property individually and wishes to convey it either to both spouses as tenants by the entirety or to the other spouse to hold individually, is the conveyance exempt from transfer tax under the exclusion available to conveyances "between husband and wife"? Again, as of this writing, the issue is not addressed in any reported Pennsylvania decision. But the issue has been addressed repeatedly by the officers who are obligated to collect the tax: recorders of deeds.

In September I contacted all of Pennsylvania's recorder of deeds to ask whether they have adopted a policy on the issue, either individually or through the Pennsylvania Recorder of Deeds Association ("PRODA").[3] I received responses from nine of them (or their deputies).[4] None of the respondents were aware of any formal policy having been adopted, although the issue was to be addressed at an upcoming PRODA meeting. But, with one exception,[5] the respondents confirmed that, in the meantime, they have accepted and or would accept deeds between same-sex spouses, without requiring the payment of transfer-tax, provided the Statement of Value identifies the parties as married and claims the exemption.

That the recorders are accepting deeds between same-sex spouses without requiring payment of transfer tax was not, however, definitive. Rather, as several of the recorders explained, they flag (or, as one deputy put it, "green sheet") deeds between same-sex spouses before delivering them to Harrisburg. "It is up to the Department of Revenue to determine whether transfer taxes are due," one explained to me. "We . . . will record the deed

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3 PRODA's website is www.parecorderassoc.com.

4 The respondents were from the counties of Allegheny, Beaver, Centre, Chester, Montgomery, Pike, Union, Washington, and York.

5 One respondent took no position on the issue.

with or without the transfer tax as long as it is worded that they are married. We send them to the Department of Revenue and they determine if the tax was due or not."

I contacted John D. Brenner, Jr., Deputy Chief Counsel of the Department of Revenue, to see whether his office had adopted a policy on the matter. He said that, although there is no official policy or publication, in practice the DOR will recognize the marriage, and will not require payment of the tax, as long as the couple had been married at the time of the transfer.

Mr. Brenner emphasized that the couple must have been formally "married," whether in Pennsylvania or in another jurisdiction that recognizes same-sex marriage; the exemption is not awarded to a same-sex couple that is merely in a civil union. He added that the DOR is also accepting exemptions in connection with refunds, provided the refund request is timely (i.e., brought within three years) and the couple was married at the time of the conveyance.

Curiously, in Philadelphia, in which a 3% supplemental transfer tax is paid on taxable conveyances, bringing the total tax to 4% (even though a supplemental tax of only 1%, bringing the total tax to 2%, is paid in almost every other Pennsylvania county), same-sex couples were relieved of the obligation to pay the supplemental tax several years before they could legally marry. This was the effect of Philadelphia Code § 19-1405(28), which was approved in November 2007:

> A transfer between financially interdependent persons, except that a subsequent transfer by the grantee within one year shall be subject to tax as if the grantor were making such transfer, and provided such persons first file a sworn affidavit with the Revenue Department certifying their status as financially interdependent persons. The Revenue Department shall by regulation specify any additional evidence such persons must submit to establish their eligibility for this exemption except where individuals are registered as Life Partners pursuant to § 9-1123, in which case such registration shall be deemed adequate evidence of eligibility.

Recognition of same-sex marriage in Pennsylvania pursuant to *Whitewood* also raises real-estate-related tax questions. For these there is a bit more guidance, because the IRS and other jurisdictions that recognize same-sex marriage have been addressing the questions during the year after the Supreme Court of the United States handed down *United States v. Windsor*, 133 S. Ct. 2675, 186 L. Ed.2d 808 (June 26, 2013), which struck down key provisions of the Defense of Marriage Act.

Windsor authorized same-sex spouses to file their federal-tax returns as "married" persons, whether they did so as "married filing jointly" or "married filing separately." But does the decision *obligate* a same-sex spouse to file as a married person, or may a same-sex spouse still elect to file as a single person?

The IRS has addressed this and several related same-sex issues. In a FAQ sheet available at http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples, the IRS stated that "[f]or tax year 2013 and going forward, same-sex spouses generally *must* file using a married filing separately or jointly status." A2 (italics added here). *See also* Revenue Ruling 2013-17, http://www.irs.gov/pub/irs-drop/rr-13-17.pdf. And as pointed out by one of the attorneys I consulted (who happens to be engaged to his same-sex partner), the actions of a same-sex spouse in choosing to file as a "single" taxpayer would be tantamount to a misrepresentation to the government.

Why is this issue relevant? Because filing as a married person does not always have positive tax consequences.[6] Sometimes two unmarried persons who as a practical matter pool their income will collectively be obligated to pay less in taxes than they would if they were able to file as married persons. This is principally true because of what is commonly called the "marriage penalty": pooling income and filing jointly often subjects both spouses to a higher tax rate than the rate that would have been applicable if both had filed as single persons.[7]

The marriage penalty does not regard real estate specifically. But there are other tax disadvantages to "married" filers that do have particular relevance to real estate:

1. Annual Maximum Deductibility Limits For Passive Rental-Real-Estate Losses. As a general rule a person can offset only passive losses against passive income. But before *Windsor* and *Whitewood*, these exceptions applied:

- For married persons filing jointly: If one or both married spouses actively participated in a passive rental-real-estate activity and suffered a loss, the loss can be deducted up to $25,000 against non-passive income (subject to certain phase-out adjustments if the married income exceeds $100,000).

- For a married person filing separately: If the filer participated in a passive rental real-estate activity and suffered a loss, he or she could deduct the loss up to $12,500 against non-passive income (subject to certain phase-out adjustments if the filer's income exceeds $50,000). But note: The special allowance for passive losses is applicable only if the two spouses lived apart for the entire year. No loss is allowed when they lived together for any part of the year.

- For an unmarried person: Each unmarried person who participated in a passive rental real estate activity and suffered a loss could claim the

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6 I am particularly indebted to Elizabeth A. Cummings, C.P.A., for the analysis in this section.

7 The availability of many deductions, the phase-out of certain credits, and the taxability of certain types of income are tied to the calculation of adjusted gross income. So filing jointly can increase your adjusted gross income. This limits deductions in some cases and causes a higher percentage of certain types of income to become taxable. For example, the calculation of itemized deductions that become deductible on the final tax return is a function of AGI. Once other types of income reach a certain threshold, Social Security income becomes 85% taxable. On the other hand, the "marriage penalty" can sometimes be avoided when one spouse has substantial income and the other has little, because in that situation the earning spouse might benefit from the losses of the other.

same deduction as a married couple filing jointly: up to $25,000 against non-passive income (subject to certain phase-out adjustments if the income exceeds $100,000).

As a result of *Windsor* and *Whitewood*, the members of a same-sex married couple may file jointly. But there is a disadvantage to doing so rather than each continuing to file as a single person: The married couple filing jointly can collectively deduct only $25,000, whereas two single persons could each deduct up to $25,000, for a total of $50,000.[8]

2. Annual Maximum Deductibility Limits for Capital Losses. Married persons (same sex or heterosexual) who file jointly can deduct up to $3,000 in capital losses. A married person who files separately may deduct only up to $1,500 of the same losses. But single persons may each claim the same deduction that a married couple filing jointly may claim: up to a $3,000 capital loss annually.

Again, the fact that same-sex spouses (after *Windsor* and *Whitewood*) may now file jointly as a married couple does not benefit them, because it limits their collective deduction to $3,000 rather than the total $6,000 that they could have collectively claimed if filing as single persons.

3. Maximum Mortgage Interest Deduction Debt Limitations. Both before and after *Windsor*, a married couple and a single filer have each been entitled to deduct interest on up to $1 million of primary mortgage debt. But a married taxpayer filing separately can deduct interest on only a maximum of $500,000 in primary-mortgage-loan debt. In addition there is a correlative deduction of interest on up to $100,000 (married filing jointly or single) and $50,000 (married filing separately) on home-equity mortgage debt.

If both spouses in a same-sex marriage were separately indebted under two different $1 million principal-mortgage loans, their obligation to file tax returns as married persons would limit them to deducting mortgage interest on only one of the $1 million mortgage loans. If they were still permitted to file as single persons, they would still be able to deduct mortgage interest on a total of $2 million in principal-mortgage loan debt. If only one spouse were obligated on the mortgage debt and the couple filed jointly, the other spouse would still enjoy the benefits of the deduction for the interest paid when filing jointly, but only to a maximum of interest on $1 million of principal-mortgage-loan debt. The other spouse's taxable income would be reduced by this tax deduction even though that spouse is not obligated on the mortgage.

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8 The $25,000 limitation on passive losses from real-estate activities does not apply, however, to a "real estate professional" who meets all of the requirements of IRC § 469(c)(7): (i) more than 50% of the personal services of the taxpayer during the tax year are performed in real-property trades or businesses in which they materially participate and (ii) the taxpayer spends more than 750 hours of service during the year in real property trades or businesses in which they materially participate.

4. Annual Net Investment Income Exemption For the Net Investment Income Tax. The Affordable Care Act imposed a 3.8% surtax on net investment income ("NII"), which is income from investments (including real-estate investments) less certain expenses and fees. The tax is owed only if the taxpayer has NII equal at least to the lesser of (i) actual net investment income or (ii) the excess of the taxpayer's modified adjusted gross income over a statutory threshold amount that depends on marital status: $250,000 for married couples filing jointly, $125,000 for married couples filing separately, and $200,000 for single taxpayers.

The obligation of same-sex spouses, after *Windsor*, to file as married (either jointly or separately) eliminates the option of being subject to the $200,000 threshold that each of them could have chosen by filing as a single person.

Not all of the real-estate-related consequences of being required to file as married persons are detrimental to same-sex spouses.

1. Marrying raises the gain the spouses can exclude from taxation under IRC § 121 (when the tests for the exclusion are met) upon the sale of their principal residence. Single filers, including single people who jointly own a property, can exclude $250,000 between them. Married filers can exclude $500,000.

2. Marrying also enables a same-sex spouse to increase the value of real estate that he or she can give without triggering a gift tax. Each year a donor who is single may give a donee up to $14,000 without triggering a gift tax. The gift need not be cash; it can be real estate valued at up to $14,000. If the donor is married, his spouse or her spouse, too, can give the same donee a gift of real estate valued up to $14,000 annually. Suppose an unmarried donor has the ability to give real estate valued up to $28,000, and suppose that donor is in relationship with a person who does not have the ability to give the same donee a gift. By marrying and pooling their assets, the donor who has the ability to make a gift of real estate valued up to $28,000 may do so, without triggering a gift tax, by specifying the other spouse as the donor of up to $14,000 of the real estate.