New York Law Journal
Trusts&Estates
WWW.NYLJ.COM
An ALM Publication
VOLUME 244—NO. 55
MONDAY, SEPTEMBER 19, 2011

Closing the Gap

Same-sex estate planning following the Marriage Equality Act.

BY ALISON ARDEN BESUNDER

NEW YORK'S MARRIAGE EQUALITY ACT (the act) took effect on July 24, 2011. The act itself is simple: It allows marriage licenses to issue to same-sex couples and recognizes all same-sex marriages legally performed in any of the seven U.S. jurisdictions that expressly allow it.

Less simple is how same-sex spouses will manage their day-to-day financial and legal affairs in the wake of the act. As discussed in a prior article,[1] the act confers only state benefits. Since the federal Defense of Marriage Act (DOMA) defines "marriage" as solely between a man and a woman, and permits states to prohibit same-sex marriage and/or refuse to recognize same-sex marriages validly performed in other states, no federal legal rights are available to same-sex spouses. Same-sex spouses will continue to be excluded from federal support and protections such as the unlimited marital estate-tax deduction, social security, and the ability to gain citizenship based on marriage to a U.S.-citizen spouse until DOMA is repealed.

This article identifies some of the various concepts to consider when advising same-sex spouses in light of this conflict.

Estate Planning Issues

Same-sex spouses should execute the essential estate planning documents that all Americans should have, but which only 40 to 45 percent do: a last will and testament, a health care proxy, a living will (if desired), and a power of attorney.[2] For several reasons, a last will and testament is critically important for same-sex couples. A will can better meet the objectives of each testator, individually and as a couple, than merely resorting to the "operation of law" of intestacy and joint bank accounts.

Intestacy. Same-sex spouses should not assume that they will automatically inherit the other's property under the laws of intestacy. Although the act unquestionably allows a spouse to inherit in intestacy, if the decedent has biological or adopted children, the surviving spouse is only entitled to the first $50,000 plus one-half of the estate; the children will inherit the remainder without any testamentary trust protections in place.[3]

ALISON ARDEN BESUNDER *is the founding attorney of the Law Offices of Alison Arden Besunder in Manhattan, and is of counsel to Bracken Margolin Besunder in Islandia.*

This can have unintended consequences if the children are minors, spendthrifts, or the product of a prior marriage. For couples that remain unmarried, are only domestic partners, or whose marriage is void (perhaps because a prior divorce was not finalized), dying intestate could result in the entire estate passing to the decedent's children (or parents in the absence of children). Simply executing a will disposing of all or part of one's assets to the spouse or partner as named in the will avoids disruption of the intended plan. A will can also discourage probate contests with an appropriately structured "in terrorem" (or "no contest") clause. It can also include a credit shelter trust.

Non-probate assets do not substitute for a will. For similar reasons, same-sex spouses should not rely on "non-probate" assets such as joint accounts or "in trust for" accounts. For same-sex couples, joint accounts can create more complexity—and sometimes more taxes—than are necessary or warranted. Although a joint bank account is presumed to effectuate a gift of one-half of those assets, with an intention to pass the balance to the survivor at the death of one account holder, the presumption can be overcome with clear and convincing evidence that the account was one of "convenience" because the survivor did not contribute money to the account, or is not on the signature card.[4] The "joint account" that a decedent intended to go to a spouse can become unintentionally subject to challenge by the decedent's natural heirs (i.e., their children, parents, or perhaps siblings). The validity of the "joint" account is especially precarious if it was created pursuant to a power of attorney; even if there is a major gifts rider, it remains subject to challenge in the courts.

Creating "non-probate" joint accounts also presents gift and estate tax problems for same-sex couples. Adding a same-sex spouse to a joint account constitutes a taxable event if the "gift" exceeds the $13,000 annual exclusion. A federal gift tax is then due or an election to use part of a person's lifetime credit is required. The proceeds will then be subject to estate tax twice: at the death of the first spouse, and again at the death of the second spouse if the asset remains in his or her estate. This is because the IRS will include the entire value of a jointly held asset and include it in the gross value of the estate of the first to die absent proof of the surviving partner's contribution.[5] Opposite-sex spouses who jointly own property escape this result. Titling assets jointly to avoid probate also subjects them to creditors, equitable distribution in a divorce, or the surviving spouse's remarriage after the spouse's death. A jointly-owned home will be subject to a decedent's creditors unless the spouses own it as tenants by the entirety. Same-sex spouses should consider re-titling any jointly-owned real property as tenants by the entirety to avoid any tax or creditor disputes.

Additional documents. Same-sex spouses should consider executing additional documents to protect their interests and to avoid potential disputes in times of crisis. An Appointment of Agent for the Disposition of Remains dictates the client's wishes for funeral arrangements and unequivocally appoints the spouse (or other person) to implement those wishes. Priority of Visitation language should be incorporated into the health care proxy to ensure the spouse's priority to visit and determine visitors in a hospital. This can be particularly useful when travelling in non-gay friendly states or towns. A Nomination of Guardian corroborates the individual's desire for the spouse to serve as guardian if another blood relative seeks to have one appointed. For same-sex spouses with children who have not yet been adopted by the non-biological parent, a Nomination of Standby Guardian and Authorization to Make Medical Decisions for a Minor Child can be of critical benefit.

Same-sex spouses might also consider pre- or post-nuptial agreements (formerly called cohabitation or domestic partnership agreements when used for same-sex couples). Among other basic elements of a pre- or post-nuptial agreement, the agreement should consider how the couple intends to obtain a divorce if the relationship terminates. Although New York does not impose a residency requirement to marry here, a one-year residency is required to divorce. Those couples that marry in New York and move to another state that does not recognize same-sex marriage may not be able to obtain a divorce unless they move.[6]

A revocable trust might also be appropriate depending on the client's objective(s) and the family dynamic. A revocable trust affords flexibility of administration, allowing the trustor to amend, modify, or revoke the trust (for example, in the event of a relationship dissolution) while allowing for private administration of affairs in the event of disability or death. The trustor can serve as trustee with the spouse as co-trustee to manage the affairs. The trust ensures privacy as it is not publicly filed like a will, and does not require an "invitation to contest" as a Notice of Probate does. By contrast, a challenge to a will in probate can delay estate administration and deny a surviving spouse access to much needed funds.

We're Married! Now What?

Filing tax returns. The act applies to all taxes administered by the New York state Department of Taxation and Finances. Since the act, the terms "spouse," "marriage," "husband" and "wife" in all tax law or department documents include both same-sex and different-sex spouses, superseding the prior advisory opinion of the Commissioner of Taxation and Finance (see TSB-A-10(2)(1) (May 12, 2010)). This principally impacts estate and personal income taxes.

For estates of individuals dying after July 24, 2011, same-sex couples can make the same deductions, elections and valuations available to different-sex spouses are allowed for same-sex spouses, whether or not a federal estate tax return is filed.[7] On the state estate tax return, the estate may claim a marital deduction equal to that available to opposite-sex spouses under IRC §2056.

Same-sex spouses will begin filing New York state personal income tax returns as "married" for the 2011 tax year (same-sex spouses cannot amend a prior return or file a 2010 return using married-filing status). To complete the New York return, same-sex spouses must recalculate the federal income tax return using a married filing status and apply all federal rules for married taxpayers, but not submit the dummy "federal as if married" return to the IRS because the government (the IRS) follows the DOMA definition of marriage. Same-sex spouses must file the federal return as single or "head of household."[8]

Tax planning. Although minimizing estate taxes is not always the clients' primary objective, same-sex spouses risk a higher federal tax burden than opposite-sex couples because they remain "unmarried" under federal law until DOMA is repealed. Same-sex spouses are unable to make unlimited lifetime, tax-free transfers to each other as a result of §2040. Transfers from either or both spouses to a joint account to pay household expenses over a relationship's duration (which can span one or more decades) could easily consume the available federal lifetime credit, even if it remains at $5 million.[9] While opposite-sex spouses are entitled to utilize the "unused" portion of the decedent spouse's federal exemption (currently $5 million until Dec. 31, 2013) under a concept known as "portability," same-sex spouses do not enjoy this benefit.

There are limited methods of replicating the tax benefits available to opposite-sex couples. Those available are traditionally used for sophisticated or wealthy clients who are willing to both take the steps necessary to satisfy the law and pay the legal cost of doing so.

For example, assets that are anticipated to appreciate in value (such as real estate investments) can be transferred to more sophisticated trusts such as a qualified personal residence trust (QPRT) or grantor retained income trusts (GRIT) (or another form of an intentionally-defective grantor trust (IDGT)), which allows an individual to be the owner for income tax, but not estate tax, purposes. These trusts allow the grantor to receive income for a fixed term pursuant to a fixed formula. The remainder interest passes to the surviving partner after the expiration of the term. Any gift tax is paid at the trust's creation based on a discounted value of the remainder interest. The longer the term, the greater the discount.

However, the grantor must survive the "term." If the grantor dies before the term expires, the value of the asset reverts and will be included in the grantor's taxable estate at death. If the grantor survives the term, the assets pass to the surviving partner free of estate tax (and without consuming any exemption). The grantor pays the income tax on the trust assets, and this payment of taxes for the benefit of the remainder beneficiaries is not itself taxed as a gift or transfer. These devices can effectuate wealth transfer from a potentially taxable estate to same-sex spouses or children, often at a substantial discount.

Since same-sex couples that **marry in New York** and **move** to a **non-recognition state** may not be able to obtain a divorce unless they move back to New York, they should consider a **pre- or post-nuptial agreement** to detail how to dissolve the relationship.

Since a marriage is a business as well as a personal partnership, if appropriate, traditional methods of partnerships or limited liability companies can also be used to the clients' advantage. General or limited partnerships or an LLC can be used to transfer certain assets to the spouse, sometimes at a discounted valuation. A wealthy partner could transfer assets into a general or limited partnership. The transfer to the business is not a gift, and the business entity takes the asset at the contributor's basis. Alternatively, one spouse could create an LLC, exchange the property for shares, and gift shares of the LLC using the annual gift tax exclusion. Depending on any permissible valuation discount based on lack of control over the business management, this could allow transfers in excess of the annual gift tax exclusion amount.

Whatever technique is employed in representing same-sex spouses, care must be taken to avoid unwittingly triggering the federal generation-skipping transfer tax (GST). When two persons are not connected by a familial relationship by blood or recognized marriage, "generation" assignment is determined by reference to their ages. This can trigger a tax for testamentary or lifetime transfers to the other spouse's children from a prior marriage or biological children of the spouse who have not been adopted by the transferor.

At a more basic level, rather than transfer assets outright, the "monied" spouse could pay directly for educational and medical expenses of a spouse or children without incurring gift tax liability. That spouse could also "spend down" assets by paying for certain joint household expenses, and pay for mortgage payments and claim the interest as a deduction on his or her return to minimize taxable income. The same-sex spouse could also divest income and reduce his or her estate liability by purchasing a life insurance policy (either whole or term) on his or her own life and/or the spouse. An irrevocable life insurance trust can help defray any estate tax liability on the proceeds if appropriate. The purchase of long-term care insurance for both spouses can also be appropriate.

It bears repeating that regardless of the techniques employed, all same-sex couples—married or not—must engage in painstaking record-keeping to track contributions to joint accounts and jointly held property, as well as payment of household expenses. Computerized software allowing online downloads of deposits and spending (such as Intuit Quicken or Microsoft Money) can make this task less onerous.

Conclusion

Addressing the unique issues of same-sex couples requires creativity and often untested and unproven solutions through consultation with an estate planning attorney, financial advisor and accountant. With careful planning, it is possible to at least confer some, if not all, of the advantages enjoyed by married couples. Such planning is especially essential for same-sex couples to ensure proper disposition of their assets and minimize estate tax exposure, and prevent unnecessary litigation.

1. Besunder, Alison Arden, "For Love and Money," New York Law Journal, July 1, 2011.
2. "Wills and Estate Planning Survey," Lawyers.com (2009); Harris Interactive for Martindale-Hubbell Study (2007).
3. N.Y. EPTL §4-1.1 (2011).
4. New York Banking Law §§675, 678.
5. 26 U.S.C. §2040 (2011).
6. Same-sex couples have an additional restriction on their freedom and liberties as they are significantly disadvantaged if they want to move to any of the 41 gay-unfriendly states that have constitutional amendments or other laws restricting marriage to between a man and a woman. Currently only New Hampshire, Massachusetts, Connecticut, Iowa, Vermont, and Washington D.C. affirmatively permit same-sex marriage.
7. NYS Dept. of Taxation & Fin., Office of Comm. Advisory Opinion Unit, Technical Memorandum TSB-M-11(8)M (July 29, 2011). This departs from the general rule, which provides that when an estate tax return is filed for federal purposes the amounts used to compute the gross estate and any elections reported on the federal return are binding for New York state purposes. See TSB-M-11(9)M.
8. Same-sex spouses should consider whether to file a new Form IT-2104 (Employees Withholding Allowances Certificate) to reduce withholdings if they expect to owe fewer taxes as a result of the marriage (others may incur higher taxes as a result of the "marriage penalty" and may not want to reduce withholdings). Same-sex spouses should also notify employers to stop withholding New York state tax on the value of benefits (i.e., health care coverage) which will no longer be owed.
9. It has been suggested to the author that as an academic matter, one same-sex partner's payment of ordinary household and living expenses for the benefit of the other spouse would technically constitute a "gift" triggering an obligation to pay gift taxes if such payments exceeded the $13,000 annual exclusion. It is presumably doubtful that the IRS would affirmatively pursue such a position, even in an audit. Although the author is unaware of any rulings or advisory comments on this specific issue, any comments on this are welcomed.