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Expert Analysis

For Love and Money: Inequalities Remain Despite Same-Sex Marriage

On Friday, June 24, 2011, Governor Andrew Cuomo signed legislation granting same-sex couples the right to marry. Same-sex couples will be able to begin marrying in New York later this summer when the new law goes into effect on July 24.[1] The new law offers marriage equality to more than 50,000 gay couples in New York State, affording them a number of state-based economic and legal benefits and rights that were previously limited to married couples of the opposite sex.

New York is now the sixth and most populous state to legalize same-sex marriage, joining Massachusetts, Connecticut, Vermont, Iowa and New Hampshire, as well as Washington D.C.[2] Rhode Island and Maryland recognize foreign same-sex marriages in certain contexts but do not statutorily permit same-sex marriage to be performed there; California remains in flux.[3]

Known to lawyers but perhaps not all clients, marriage is a state-based right that confers a "bundle of rights" on two individuals. Unfortunately, individual state recognition of same-sex relationships—whether in the form of a civil union, domestic partnership, or marriage—has no bearing at the federal level because the Defense of Marriage Act (DOMA) limits the definition of "marriage" to a union "between a man and a woman." This limited definition denies same-sex couples the automatic bundle of rights (more than 1,000 statutes and regulations, from joint filing of federal income tax returns to transferring fishing licenses between spouses) that are afforded opposite-sex married couples under federal law.

This means that even with New York's new law, same-sex spouses will not enjoy the same federal benefits as their opposite-sex counterparts—among them the unlimited marital deduction, unlimited spousal transfers, survivor and spousal Social Security benefits, the ability to take unpaid leave under the Family and Medical Leave Act when a spouse is ill, or even spousal privilege of communications in federal court—until DOMA is repealed. DOMA's demise may come soon but has not yet arrived.[4] Until then, all same-sex couples must be proactive to protect their legal rights.

By
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Some of the disparities that remain as a result of the conflict between federal and New York state law are discussed below.

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Estate Planning

A last will and testament is critical for everyone. It was especially critical before the new law to financially protect a same-sex partner and children and ensure distribution of assets to them and not another blood relative. Before the new law, a same-sex spouse risked having his or her assets pass in intestacy to his or her parents if he or she died without a will. The new law avoids this often unintended result and resolves the previous uncertainty as to whether a Surrogate's Court would allow a same-sex spouse to inherit in intestacy under EPTL 4-1.1.[5]

Now, a surviving same-sex spouse (and any biological or adoptive children) will be first in line to inherit the decedent's assets in intestacy. If the decedent has children, however, possibly from a prior marriage or relationship, the surviving spouse's distribution is limited to $50,000 plus one-half of the estate, with the balance distributed to the decedent's children, and not any children of the surviving spouse who were not yet adopted by the decedent.

Family members of same-sex spouses must also specifically tailor their estate planning documents to include the children of a same-sex marriage. Simply stating "my brother's children or issue" is not sufficient if the "child" is not the brother's biological child and has not yet been adopted.

Estate and Income Tax Issues

Married couples are treated as if they have one "pocketbook." They enjoy unlimited transfers in life and an unlimited marital deduction at death without incurring gift or estate taxes. Same-sex couples who marry in New York will not enjoy this benefit at the federal level. Unfortunately there are limited means to replicate these tax benefits. The federal estate tax exemption is currently $5 million until Dec. 31, 2012. Assets above that amount will be taxed. While the exemption may protect many same-sex spouses from owing any federal estate tax, they will not enjoy the "portability" benefit in the new federal estate tax law, which allows an opposite-sex surviving spouse to use the unused portion of a decedent spouse's exemption.

Same-sex spouses will enjoy state-based estate tax benefits. However, New York State allows a marital deduction to surviving spouses who make a QTIP (Qualified Terminable Interest Property) election on their federal estate tax return. Since same-sex spouses will presumably not be permitted to properly make a QTIP election on their federal estate tax return until DOMA is repealed, the method of effectuating a state-QTIP election for same-sex spouses will remain an open question.

Same-sex spouses residing in New York will be able to file their state income tax returns jointly. They will not, however, be able to file a joint federal income tax return and may pay more in preparer's fees (or time) to prepare a "dummy" joint federal return (to calculate data necessary for the

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state return), and then file separate federal tax returns. This may actually prove to be a benefit, however, as the couple may escape the "marital penalty" often suffered by the aggregated income of opposite-sex spouses. Same-sex spouses will also continue to be burdened by the extra federal income tax imposed on health insurance benefits received by one spouse from the other spouse's employer.

The biggest consequence to same-sex spouses is the inability to make unlimited lifetime transfers. Gifts in excess of $13,000 (for 2011) are subject to federal gift tax. Opposite-sex spouses are entitled to unlimited transfers without incurring gift tax or eroding the availability of the estate tax exemption. Because of DOMA, same-sex spouses will continue to be limited to $13,000 annual gifts and will have to file a gift tax return for any gifts in excess of that amount, electing either to pay the tax or use part of their lifetime exemption of $5 million. This seemingly large amount can quickly dissipate if, for example, one spouse adds the other to a deed to real property, thereby making a gift of 50 percent of the property's value.

Real Estate

The gift tax problem is magnified in the context of real estate. When a husband or wife transfers part or whole ownership of real property to the other spouse, there is no taxable consequence, and no tax is due on the transfer. Same-sex couples face significant consequences from the same transaction. Not only will the transfer absorb the available exemption, and trigger a gift tax return, but the joint property will risk being subject to estate tax not once, but twice if the spouses fail to keep proper records evidencing their respective contributions: first upon the death of the first partner, and again at the death of the second partner if it remains in his or her estate. In order to establish contribution, same-sex couples must keep documentation to prove monetary contribution to the property, either in the purchase price or continued maintenance.

Life Insurance

A common misconception is that life insurance is entirely "tax-free." While death benefit proceeds are income-tax-free, they are not estate-tax-free unless the beneficiary is a spouse. Life insurance can be an essential component of estate plans for same-sex couples as it is often an effective way to provide liquidity to satisfy any estate taxes due as a result of the absence of the marital deduction.

Unless it is structured properly, however, the life insurance proceeds themselves may be taxed. An effective technique to avoid this tax is to create an Irrevocable Life Insurance Trust (ILIT) which will own the policy and direct the distribution of the proceeds at death, leaving the gross proceeds available to satisfy estate taxes and provide support for the surviving partner.

Retirement Accounts

Only federally recognized "spouses" can elect a spousal rollover of an inherited IRA. A "spousal IRA" becomes the spouse's own IRA and allows the surviving spouse to delay required minimum distributions (RMDs) until they are 70½ (although they may do so before then). Non-spouse beneficiaries can still take an "inherited IRA" but must start taking RMDs the year after the decedent's death. The beneficiary cannot wait to take distributions until they reach 70½.

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It is also critical to maintain accurate primary and contingent beneficiary designations on all retirement accounts, annuities, and life insurance policies. For same-sex spouses, it is essential to name the spouse by his or her individual name, and not simply by stating "my spouse" as a beneficiary designation. If the "spouse" is not recognized by federal law at the time of death, the designation will lapse and be ineffective. Absent an enforceable designation, the asset will be paid to the estate, potentially resulting in an unintended distribution. As IRAs comprise an increasing amount of clients' estates, the payment of an IRA to an estate could also heighten the possibility of a will contest by disapproving or disinherited blood relatives.

Children

Children born to same-sex couples must be adopted by the non-biological parent(s) in order to be recognized as an heir and inherit unless that child is specifically named and identified in the non-biological parent's will. Adoption also protects the non-biological parent's visitation and custody rights in the event of a separation or divorce. Adoption may not always be possible where the child is born to a prior heterosexual marriage and the biological parent is still alive. In such situations, the will must specifically name the child.

Even before the passage of gay marriage, the New York State Legislature amended DRL §110 to permit "two adult unmarried intimate partners to adopt a child together" and replacing the references to "husband" and "wife" with the phrase "a married couple." It also enacted laws to allow the name of a petitioner for adoption who died prior to the completion of the adoption to be included on the new birth certificate as a parent. Domestic Relations Law §§113-a and 115-e; Public Health Law §4138. Yet, countless statutory references to "husband and wife" will likely require amendment to accommodate for the change to New York State's definition of marriage.

Conclusion

Although New York State's historic legislation brings parity and equality to thousands of same-sex couples in this state, full equality will not be achieved until DOMA is repealed. Until federal law conforms to cultural realities, same-sex couples will not enjoy many of the federally based legal advantages opposite-sex spouses enjoy. While careful planning is important for everyone, it will remain absolutely crucial for same-sex spouses residing in New York.

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1. New York State is expected to generate as much as $184 million to the state's economy during the three years following same-sex marriage approval, derived primarily from the increase in visitors from other states who come to New York to marry or attend weddings. W. Thompson, Jr., Office of the New York City Comptroller, Love Counts: The Economic Benefits of Marriage Equality for New York, June 2007.

2. Argentina, Belgium, Canada, Iceland, the Netherlands, Norway, Portugal, South Africa, Spain and Sweden also allow same-sex marriages to be performed in their jurisdictions.

3. Proposition 8—an initiative to "[c]hange [] the California Constitution to eliminate the right of same-sex couples to marry in California"—narrowly passed in 2008 with 52 percent of the vote. A California District Court held Proposition 8 to be unconstitutional. *Perry v. Schwarzenegger*, C 09-2292 (VRW), Docket Entry #708 (N.D.C.A. Aug. 4, 2010). The U.S. Court of Appeals for the Ninth Circuit heard oral argument in December 2010 and certified to the California Supreme Court the question of whether the proponents of the Proposition 8 initiative can defend the law when the state officials named in the complaint refused to do so. The District Court decision has been stayed pending the resolution of the Ninth Circuit appeal. In the meantime, the 18,000 same-sex couples that were legally married before the passage of Proposition 8 remain valid due to a court ruling.

4. The Obama administration declared on Feb. 23, 2011, that it would no longer defend DOMA. This means that the Department of Justice will no longer defend the law, marking a serious logistical setback for DOMA's defense. Even if DOMA is repealed, however, if same-sex spouses move to a state that does not recognize same-sex marriage, they will be excluded from state benefits as well as any federal benefits or programs that look to state law to determine eligibility. This severely restricts the available jurisdictions to which same-sex couples might retire or relocate for employment. Proposed federal legislation called the "Respect for Marriage Act" seeks to resolve this issue by repealing DOMA; it would allow the federal government to provide benefits to same-sex spouses even if they reside in a state that does not recognize the marriage.

5. Compare *In re Rantfle*, 81 A.D.3d 566 (1st Dept. 2011) (holding a same-sex partner to be a decedent's "surviving spouse and sole distributee" under EPTL 4-1.1 and that citation of probate need not issue to anyone under SCPA §1403(1)(1)) with *In re Diba*, 28 Misc.3d 1207(A) (Bronx Surr. July 8, 2010) (noting that same-sex spouses were excluded from the benefits of EPTL 4-1.1(a)(1) and Domestic Relations Law §6).