

Estate Planning Opportunities for Same-Sex Couples After DOMA

by:

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On June 26, the Supreme Court of the United States issued a groundbreaking decision involving same-sex marriage when it ruled that Section 3 of the Defense of Marriage Act, also known as DOMA, is unconstitutional. The ruling impacts financial and estate planning for same-sex couples living in jurisdictions that recognize same-sex marriage. It also creates an opportune time for same-sex couples to review their estate plans and ensure that they are appropriately structured to take full advantage of the estate planning options that now exist.

Defense of Marriage Act

DOMA was enacted in 1996 and applied to more than 1,000 federal statutes and regulations. Section 3 of DOMA defined the word "marriage" in any federal law or regulation (including those that address employer benefits) to mean only "a legal union between one man and one woman as husband and wife." It further defines the word "spouse" to mean only a "person of the opposite sex who is a husband and wife." In other words, Section 3 disallowed federal recognition of a same-sex marriage that is valid under state law.

United States v. Windsor

In *United States v. Windsor*, Edie Windsor and Thea Spyer, a same-sex couple who resided in New York, married in Canada in 2007. At that time, New York did not allow same-sex marriages to be performed within the state but did recognize those performed legally in other jurisdictions. In 2009, Ms. Spyer died and left her estate to Ms. Windsor. At the time of Ms. Spyer's death, DOMA prevented the Internal Revenue Service (IRS) from recognizing their marriage. As a result, the IRS did not allow the use of the unlimited marital deduction for federal estate tax purposes and denied Ms. Windsor's refund request for the federal estate taxes paid on her inheritance of Ms. Spyer's estate. Without DOMA, Ms. Windsor's inheritance would have qualified for the unlimited marital deduction and Ms. Spyer's estate would have paid no federal estate taxes. However, Ms. Spyer's estate paid \$363,053 in federal estate taxes because of DOMA. Ms. Windsor filed a lawsuit for a refund of the federal estate taxes paid, claiming that the definitions of "marriage" and "spouse" in Section 3 of DOMA violate the Equal Protection Clause of the United States Constitution.

In *United States v. Windsor*, the Court held in a 5-4 vote that Section 3 of DOMA is unconstitutional as a deprivation of the equal protection of persons that is guaranteed by the Fifth Amendment of the Constitution. As a result of the Court's decision, the federal government is prohibited from placing any classification on the recognition of marriages. The Supreme Court held that marriage is a state issue and classifications of such must be left to the states. This means that same-sex couples currently residing in a jurisdiction¹ that permits and recognizes marriage between same-sex couples will now be eligible for and subject to more than 1,000 spousal rights and responsibilities afforded under federal law.

Federal Estate and Gift Tax Planning – After Windsor

For federal purposes, same-sex couples who are legally married are now treated the same as opposite-sex married couples as a result of the *Windsor* decision. This means that many federal tax-related benefits that were previously afforded only to opposite-sex married couples are now legally available to same-sex married couples. In estate planning, such benefits include, but are not limited to:

Unlimited Marital Deduction – allowing spouses to transfer an unlimited amount of assets to each other, either during life or at death, without having to pay any federal estate or gift tax, provided that the recipient is a U.S. citizen. The use of the unlimited marital deduction allows a deferral of federal estate taxes at the death of the first spouse.

Gift Splitting – splitting of gifts to third parties for annual exclusion purposes. Each individual is entitled to gift an amount equal to the "annual exclusion amount" (currently \$14,000) to donees. A married individual may transfer two times the annual exclusion amount (i.e., \$28,000) to a donee if his or her spouse agrees to "split" the gift.

Retirement Plans – naming the spouse as the beneficiary under a qualified retirement account.

Rollover Rights – allowing the spouse to "roll over" a qualified retirement account. By rolling over the account, the surviving spouse may (1) consolidate the account with his or her own retirement accounts; and (2) use his or her own age to calculate required minimum distributions, which would result in delaying required minimum distributions if the deceased spouse were older than the survivor (i.e., extending the ultimate payout of the account).

Portability – electing portability of the deceased spouse's unused applicable exclusion amount. Each individual is entitled to an "applicable exclusion amount," which currently is set at \$5.25 million and is adjusted for inflation. This amount can pass to individuals at death without causing a federal estate tax liability. Portability allows a surviving spouse to use the deceased spouse's unused applicable exclusion amount, thereby permitting the survivor to transfer \$10.5 million (in 2013) at his or her death without incurring any federal estate tax.

Joint Income Tax Return – filing joint income tax returns, which can produce a lower combined tax than the total tax paid by the same-sex spouses filing as single persons.

- Simplifying the basis and contribution rules with respect to jointly owned property.
- Eliminating adverse tax consequences for the transfer of property pursuant to a marriage settlement agreement.
- Granting certain Social Security, Medicare and Medicaid benefits.
- Accessing veteran's spousal benefits.
- Obtaining employer health coverage for the same-sex spouse.

The above-mentioned benefits can result in greater tax savings for same-sex couples. In addition, these benefits allow an extension of government programs to same-sex couples. These benefits also can apply retroactively. A statute that is unconstitutional is deemed to be *void ab initio*, that is, void from the outset. This means that DOMA should be treated as never having existed and that same-sex married couples always should have been treated the same as opposite-sex married couples for federal law purposes. In years before 2013, some same-sex married couples would have paid less in federal taxes had they been permitted to file joint federal income tax returns or claim the marital deduction upon the death of a spouse or upon a lifetime gift to the spouse. These taxpayers should file amended tax returns as soon as possible. There may be some, however, for whom the ability to file amended tax returns may be closed due to the passage of the applicable statute of limitations. The statute of limitations is usually three years from the date a return is filed. Therefore, time is of the essence and it is important for same-sex married couples to seek immediate guidance as to whether there is an opportunity to file an amended federal tax return and seek a refund of taxes paid.

The *Windsor* decision did leave questions unanswered. The Court's decision did not deal with the provision of DOMA that lets states refuse to recognize same-sex marriages performed in other states. The Court's holding did not address the impact of its decision on civil unions, domestic partnerships or similar state law concepts. In addition, the Court did not decide whether federal marital rights are available to same-sex spouses who reside in a state that does not recognize same-sex marriage. These matters remain unresolved. However, there may be further estate planning opportunities for same-sex married couples in the future, depending on how the law in this area evolves. We will continue to keep you updated on the law in this area.

A Word to the Wise

We encourage our clients in same-sex marriages who have engaged in estate planning, or those who have waited to see an opportunity in the law, to contact any of the attorneys in our Trusts, Estates & Personal Planning Practice Group to discuss the potential impact of the *Windsor* decision on their financial and estate planning. It is important to ensure that your estate plan is structured to take advantage of benefits allowed by the *Windsor* decision. As a threshold matter, same-sex couples will need to determine whether they can take the position that they have a "lawful marriage" for federal law purposes.

For same-sex couples who wish to marry, we encourage you to contact us to discuss the financial implications of marriage and enter into the appropriate premarital agreement if necessary.

In addition, there are retrospective opportunities. In certain circumstances, same-sex married couples may be entitled to a refund of income, estate or gift taxes paid during the last three years. However, these opportunities are time-sensitive as there is a three-year limit on amending federal income, gift and estate tax returns. Therefore, it is important to discuss sooner rather than later the effect of *Windsor* on your planning.

¹Currently, there are 13 states that permit and recognize marriage between same-sex spouses: California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont and Washington. The District of Columbia also permits and recognizes same-sex marriage.

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