

Planning Update for Married Same-Sex Couples

On June 26, 2013, in *Windsor v. U.S.*, the United States Supreme Court ruled that Section 3 of the Defense of Marriage Act (DOMA) was unconstitutional. Section 3 of DOMA provided that only individuals of opposite sex were to be recognized as “spouses” or as “married” for purposes of federal law.

Currently, thirteen states¹ and the District of Columbia recognize same-sex marriage.

The *Windsor* decision substantially impacts tax and estate planning for married same-sex couples. As a result of this decision married same-sex couples should have their estate plans reviewed. In addition, with over 1100 Federal laws impacted, couples should also review items such as their employee benefit plans, income tax filings and retirement plan designations.

Estate Tax

Married same-sex couples can now take advantage of the unlimited marital deduction by making estate-tax free testamentary transfers to each other, effectively eliminating any estate tax at the death of the first spouse. For New York State estate tax purposes, married same-sex couples have been able to use the unlimited marital deduction for decedents dying on or after July 24, 2011, due to the enactment of New York State’s Marriage Equality Act. Recently, the New York State Department of Taxation and Finance issued a memorandum that, as a result of *Windsor*, estates of married same-sex couples for decedents dying before July 24, 2011 also qualify for the marital deduction. Accordingly, if the statute of limitations has not yet passed, an estate may file amended Federal and New York State estate tax returns for a refund. The statute of limitations is generally the later of three years from the due date of the estate tax return or two years from the date the tax was paid.

Additionally, married same-sex couples can now use portability to transfer a deceased spouse’s unused federal transfer tax exemption to a surviving spouse. For example, assume neither spouse has used any portion of his or her respective federal transfer tax exemption amount (currently, \$5.25 million, indexed for inflation). Upon the death of the first spouse, the executor can elect to transfer the remaining \$5.25 million of unused exemption to the survivor, providing the surviving spouse with a federal transfer tax exemption of \$10.5 million (plus inflation adjustments on the survivor’s own exempt amount).

Gift Tax

Under DOMA, gratuitous transfers between married same-sex couples did not qualify for the unlimited marital deduction and also reduced the donor spouse’s lifetime federal transfer tax exemption amount. Married same-sex couples can now make unlimited lifetime transfers to each other free of gift tax and without reducing the donor’s federal transfer tax exemption amount. In addition, married same-sex couples can now elect to make gifts to others by “splitting” the gift. This

¹ The states which issue licenses for same-sex marriages are California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont and Washington.

means that if one spouse makes a gift to someone other than his or her spouse, the gift can be treated as having been made one-half by each spouse. This allows a gift to a third-party by one spouse to qualify for two annual exclusions of \$14,000 each, or up to \$28,000 total (as indexed for inflation).

Income Tax

Federal recognition of marital status for married same-sex couples can also confer certain income tax advantages. Married same-sex couples can now file joint federal income tax returns entitling them to benefits such as combined exemptions, combined income exclusions (e.g., gain from sale of a personal residence), and non-recognition of gain or loss on transfers between them, potentially resulting in lower income tax liabilities. Married same-sex couples should be mindful, however, that federal recognition of their marital status may also result in some adverse income tax consequences, such as potentially higher income tax rates as a result of the so-called “marriage penalty”.

With respect to retirement benefits, the surviving spouse of a married same-sex couple who has been named as the beneficiary under a qualified retirement account can now “roll over” the account into an account in his or her own name. This can potentially extend the ultimate payout of the account, resulting in a longer term for the deferral of income taxation. Married same-sex couples should be mindful, however, that federal recognition of their marital status will now require a written waiver from the participant’s spouse if the participant wishes to name a non-spouse beneficiary to his or her qualified plan.

Asset Protection

Marital status is often a critical factor in one’s asset protection planning. As but one example, only married couples can own their residence (and, in certain states, intangible assets, as well), as “tenants by the entirety”. This form of joint ownership protects the assets from creditor claims brought against one spouse but not against the other spouse.

Retroactive Application

Since the Supreme Court held that Section 3 of DOMA was unconstitutional, Section 3 of DOMA is, by law, null and void from its inception. Accordingly, married same-sex couples should be treated the same as married opposite-sex couples from the time of their marriage even when the marriage pre-dated *Windsor*.

This has many potential implications for federal tax purposes. For example, married same-sex couples who would have incurred lower federal tax liabilities had they been permitted to file joint federal income tax returns, claim the marital deduction upon the death of a spouse, or who paid a gift tax or reported the use of federal transfer tax exemption for a gift from a same-sex spouse, should consider filing amended tax returns or protective claims for refunds (assuming the statute of limitations for doing so has not yet expired). In addition, transfers made in prior years may have to be revisited to determine how the possible retroactive application of this decision may affect the tax results.

It is important to note however, that the IRS has not issued any guidance on the retroactive application of the *Windsor* ruling and proper tax counsel should be sought on this issue.

Marital Agreements

Existing marital agreements for same-sex couples may need to be updated as they may not reflect the intention of the parties regarding their rights and obligations. For example, waivers of automatic spousal death benefits in retirement plans may not have been addressed in such agreements, since pre-*Windsor*, the automatic spousal death benefits were not applicable. Also, the use of tax-beneficial qualified domestic relations orders (QDROs) to divide retirement plans in the event of divorce may not have been anticipated. Further, the parties may have provided in their agreement for a specified level of spousal support, without factoring in the post-*Windsor* consequences - that the payment of support could be structured as deductible to the payor and taxable to the recipient on the federal level and that Social Security would be available.

Divorce

Under *Windsor*, if a same-sex couple marries and lives in New York (or another state that recognizes same-sex marriage), the couple is entitled to the same federal and state benefits as are available to a married opposite-sex couple. An issue arises, however, if the married same-sex couple moves to a non-recognition state and wants a divorce. In this instance, the couple may not be eligible for a divorce in the original state because New York and most states require residency in the state for some period of time prior to initiating a divorce; and the current state may not grant the divorce because it does not recognize same-sex marriage. This issue is unresolved and the *Windsor* decision provides some basis for challenges to state law. In the meantime, it is helpful to provide choice-of-law provisions in premarital agreements stating that New York law will govern and that the New York courts will be used to the fullest extent possible.

Same-Sex Couples and Different Jurisdictions

While it is clear that married same-sex couples living in jurisdictions that recognize same-sex marriage will be eligible for federal tax benefits, it remains to be seen how federal law will apply in jurisdictions which do not recognize same-sex marriage or only recognize domestic partnerships and civil unions. Additionally, it is unclear how federal law will apply to a same-sex couple that married in a jurisdiction that recognizes same-sex marriages, but currently reside in a jurisdiction that does not recognize same-sex marriages.

Conclusion

Married same-sex couples should consult with one of our attorneys as soon as possible to determine the impact of the Supreme Court's ruling on their income taxes and estate planning documents and to preserve any rights they may have to file refund claims.



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Gideon Rothschild
Co-Chair
212.554.7806
grothschild@mosessinger.com

Irving Sitnick
Co-Chair
212.554.7821
isitnick@mosessinger.com

Carole M. Bass
212.554.7877
cbass@mosessinger.com

Lori Anne Douglass
212.554.7803
ldouglass@mosessinger.com

Daniel S. Rubin
212.554.7899
drubin@mosessinger.com

Alvin H. Schulman
212.554.7888
aschulman@mosessinger.com

Ira W. Zlotnick
212.554.7870
izlotnick@mosessinger.com

Eli Akhavan
212.554.7859
eakhavan@mosessinger.com

Kerrie C. Horrocks
212.554.7827
khorrocks@mosessinger.com

Alan H. Kupferberg
212.554.7805
akupferberg@mosessinger.com

Kara Rademacher
212.554.7849
krademacher@mosessinger.com

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Moses & Singer LLP
The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
Tel: 212.554.7800, Fax: 212.554.7700

2200 Fletcher Avenue
Fort Lee, NJ 07024

Tel: 201.363.1210, Fax: 201.363.9210
Abraham Y. Skoff, Esq.
Managing Attorney for New Jersey

10 Cuttermill Road – Suite 201
Great Neck, NY 11021
Tel: 516.498.8828, Fax: 516.498.8810
James Alterbaum, Esq.
Managing Attorney for Long Island



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