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Special Feature

A Reminder About The Importance Of Proper Planning For Same-Sex Couples

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The Massachusetts Supreme Judicial Court's November decision finding a constitutionally protected right for same-sex couples to marry provides an important reminder regarding estate planning for same-sex couples.

While Massachusetts may one day soon sanction same-sex marriages (and will thus make unique estate planning issues there), same-sex couples everywhere (including Massachusetts) should be sure they memorialize their intentions regarding their estate planning.

The bottom line: estate planning is a particularly important task for same-sex couples. That's because if they fail to make appropriate arrangements while they are alive, their assets will pass under the traditional "background" rules (e.g. laws on intestate succession) - and the traditional rules aren't favorable to non-traditional families. Indeed, same-sex couples need a properly crafted estate plan to ensure the implementation of their intentions regarding incapacity planning, wealth transfer on death, and even tax issues.

So what should we advise same-sex couples to do?

Decision-making in case of incapacity

One of the most important issues a same-sex couple must consider is decision-making in case one of them becomes ill. Same-sex couples need good health care decision planning much more than married heterosexual couples. This is so, because under the standard background rules, first a spouse, but if none, then biological family members will be given preference to make health care decisions and financial decisions.

While many same-sex couples have heard the terms "durable power of attorney" (appoint

someone to manage assets), "health care surrogate" (appoint someone to make health care decisions) and "living will" (declare your intention not to remain on machines), we must stress the vital need to execute them. Without such, any hospital will turn to biological family members for health care directions and your client's same-sex partner will have no say in these most important decisions.

Should they execute wills or establish trusts?

You also need to consider with your clients all the other basic estate planning tools like wills and revocable trusts. At a minimum, you can assume they need new wills to make sure that their assets pass as they wish on death. Again, the state background rules on intestate succession favor passing assets to spouses and biological relatives. So if your clients want to leave assets to their partners on death, new wills are needed.

Many same-sex couples may actually prefer to use revocable trusts because they avoid probate, thus achieving a degree of greater privacy, and also helping minimize challenges by disgruntled family members. We all know that any plan can be challenged, but the likelihood of successfully challenging a revocable trust plan seems less than a will, at least for the fact that the clients not only execute the trusts but then they also go through the effort of funding them. Moreover, they reaffirm the trusts all the time by titling future assets in trust name and paying expenses from trust accounts. While I cannot prove that trust contests succeed less frequently than will contests, there is a sufficient logic to support that presumption.

Should same-sex clients "equalize" assets or share all expenses?

Many same-sex clients ask if they can put assets in their partner's names to make their estates equal. They probably should not. The gift tax rules come into play if they transfer assets and the results may be unfavorable. Same-sex couples are limited in how much they can give one another each year by the annual gift tax exclusion, which is currently $11,000 per year. But they are also limited in how much they can either give during life or pass tax-free on the death of the first partner to the applicable exclusion amount ($1.5 million as of Jan. 1, 2004). That means that gifts in excess of $11,000 trigger a gift tax return and use part of the $1.5 million exemption, and total gifts (and/or estates) in excess of $1.5 million will face taxes where married couples would not.

That doesn't mean your clients cannot equalize (or at least partially equalize) the estates. For example, if it is vitally important to your clients as a couple and if their assets are not over $1.5 million, theoretically they could equalize all the assets. They would have to file a gift tax return, but they would not have to pay any cash to meet the gift tax (the $1.5 million credit would be partially used up, but they wouldn't have to pay anything out-of-pocket).

Further, for many same-sex couples, putting their primary residence in joint names is an important psychological step. In many cases, this can be accomplished - again so long as the house is not too valuable - without paying any gift tax (just using some of the credit).

As an estate planner, you may be used to always advising clients to avoiding paying gift tax. But in the context of advising gay couples, the psychological benefits of joint ownership of the home (and/or other assets) might outweigh any adverse tax impact, and you need to be comfortable advising the clients.

Other gifting is possible, but may not be advisable. As planners, we should advise clients that, if they gift fully half of their assets to a partner, they should consider the impact on a potential dissolution of the relationship. If one partner makes a completed gift of assets to the other partner (even if only for estate planning purposes), and if the couple later breaks up, those gifted assets belong to the gift-recipient partner.

An option for the wealthier partner in a same-sex couple may be to make smaller annual gifts - under the $11,000 annual exclusion. That would help slowly equalize the two estates without

depleting the wealthier partner's full tax exemption and would offer some protection from the impact of dissolution by only passing assets over time as the couple remains together.

Should they have joint bank accounts and other joint assets?

A recurring theme in estate planning for same-sex couples is that they cannot just "pool" assets into joint names like a married couple. There are gift tax issues to joint assets.

The exact rules actually depend on the nature of the assets and state law.

Some joint assets are treated as gifts immediately when they are titled jointly - real estate, for example. The titling of a stock certificate (or bond) is generally treated the same way.

But for bank accounts, for example, just putting money into a joint bank account is usually not a taxable gift so long as the contributor has the right to withdraw without the other partner's consent. On brokerage accounts, that's generally the rule too. Again, these would depend on your particular state's law and you should be comfortable advising your clients on your state's particular laws.

Bottom line, though, in general, is the use of joint accounts can be problematic. Even if there isn't a gift on funding, who wants to prove how much each member of the couple contributed and/or took out? For example, if one client contributed a lot more then his partner, over time, it is possible that the partner may wind up "overdrawn." If so, is there an obligation on the wealthier client to seek reimbursement from his partner? Probably so, and if he doesn't enforce it, then that is probably a gift.

On the other hand, if a joint account is desired for household expenses, then it might be advisable for both partners to have separate accounts for the bulk of their assets, and to then contribute a monthly amount from each separate account into that joint account. That would be easy to trace and since all contributions are equal there should be no gift tax issues.

Do clients need a "cohabitation agreement"?

A cohabitation agreement is simply an agreement entered into by non-married cohabiting partners. These agreements may cover issues including:

- How the expenses will be divided during the relationship;
- Distribution of property upon the death of one partner;
- Distribution of property if the relationship goes south;
- Support for the financially less well-off partner;
- Protecting the more affluent partner against future claims for support if the couple splits up;
- Compensating a homemaker partner;
- Dealing with debts; and/or
- Determining health care rights and obligations.

As part of a well-conceived plan, a cohabitation agreement might be wise for many same-sex couples because it could address many of the concerns that generally arise. In such an

agreement, they couple could declare how assets will be titled, how to pay mutual expenses, how to dispose of property on death or dissolution of the relationship, and how health care and medical decisions will be made.

The bottom line of this whole discussion is that planning for same-sex couples is challenging and important. There is more to it then just understanding the basic tax laws. You also need to consider the unique needs and circumstances of your same-sex clients as a couple.

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