Advanced Planning Strategies

By Scott E. Squillace and Carol Sneider Glick

Whether to Wed? Interesting State Estate Tax Issues for Gay Couples[1]

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An increasing number of gay and lesbian clients and prospective clients seek advice from our firm about whether, from a tax and/or legal perspective, it makes sense for them to get married. We all understand that there are many other reasons to consider this important institution. Leaving aside, however, the important societal, religious, family and relationship issues (among others), we often help same sex couples (both in Massachusetts, the first state to fully recognize same sex marriage,[2] and outside Massachusetts) consider whether there are important legal and/or tax advantages available to them from this newly available right.

This article will consider some of these factors—listing both "pros" and "cons"—and then dive deep into one issue, unlimited marital deduction for state estate tax purposes, which is an area still very much in flux. Certain states that recognize same sex marriage also have a state estate tax that could apply to estates at [what used to be] a "lower" level than the Federal level.[3] Other states that do not provide same sex marriage rights to its residents may nevertheless recognize such marriages lawfully performed in other jurisdictions and provide the same benefits at death to a surviving spouse of a same sex couple as it would provide to the spouse of a heterosexual couple, notably, the unlimited marital deduction. In either case, having the ability to have an unlimited marital deduction at least for state estate tax purposes can make a meaningful difference for the surviving (same-sex) spouse. Of course, until Federal law changes in this area—there is no unlimited marital deduction for Federal estate tax purposes for a same sex surviving spouse.[4]

There are, of course, many benefits stemming from the recognition of same sex marriage. Yet, as with

many good things, if it seems too good to be true, it often is. The final wrinkle, which these authors believe is very much still evolving from a legal perspective, is whether the unlimited marital deduction is (or should be) available in those states that recognize same sex marriage even if they do not allow a separate QTIP election in their state estate tax filing process.

By way of illustration, we discuss below in some detail three jurisdictions that have de-coupled from the federal estate tax and now have a separate state estate tax and also recognize some form of same sex marriage. We then analyze the question of whether an unlimited marital deduction is currently available to the surviving (same sex) spouse for state estate tax filing purposes based on current law and regulation. The three jurisdictions are: 1) Massachusetts, 2) Washington, DC and 3) New York. The short answer today is: 1) Yes (Mass.), 2) No (or not yet) (DC) and 3) Maybe (or who knows) (NY). Read on.

But, first, let's consider the "Whether to Wed" question.

Again, there are many important (often more important) reasons to consider marriage beyond those that relate to taxes. We do not pretend here to consider those aspects of marriage. (Nor do we mean, in any way, to be disrespectful of this important institution.) Instead, we focus narrowly here on the question (typically arising for same sex couples who have long been together and do not feel compelled, for whatever reason, to now "get married") on whether there are important legal and/or tax reasons that suggest they now should.[5]

Our list of "cons" include (and is not limited by) the following:

- Consequences for division of property and alimony in the event of divorce and/or the need to now consider a pre-nuptial agreement;
- Could have disadvantageous Federal tax consequences for California residents given new regulations for treatment of community property;
- Divorce is hard, and harder if you move to or live in a jurisdiction that will not recognize and therefore take jurisdiction over the marriage for a divorce;[6]
- Increased complexity for state and federal income tax filings; may have 'marriage penalty' if DOMA is repealed; and
- Medicaid—spousal impoverishment requirement.

Our list of "pros" include:

- Rights for families and children, including intestacy inheritance rights;
- Spousal elective share rights (many of the "pros" here could be a "con" depending on one's perspective of the issue);
- Standing to sue in wrongful death and other tort actions for loss of consortium and other claims;
- Spousal rights to collect in worker's compensation cases;
- Unlimited marital deduction for [certain—see below] state estate tax liability;
- Health and other benefit plan benefits from both private and public employers;
- The many federal benefits if/when DOMA is repealed, such as social security survivorship benefits, veteran benefits, etc.; and
- The ability to make nondisqualifying gifts to the other spouse in order to qualify for Medicaid benefits.

The following states currently have, either by legislation or judicial decision, adopted the full legal rights, benefits and obligations of marriage for same sex couples: Massachusetts, Connecticut, Vermont, Iowa, New Hampshire and the District of Columbia. In addition, there are a variety of states that provide certain rights and protections to same sex couples by way of Domestic Partnership and/or Civil Union statutes, such as: California, Oregon, Washington, Hawaii, New Jersey, Wisconsin and Nevada. The latter are beyond the scope of this article, but the reader should know that some of the same tax issues arise in those jurisdictions for state estate tax purposes.

So, let's focus now on when (and where) the unlimited marital deduction for state estate tax purposes is a compelling reason (among others) for clients to marry. The issue is broader than just the six U.S. jurisdictions where same sex marriages may be performed, since some states (such as Massachusetts)[7] now recognize same sex marriage but DO NOT have a residency requirement and, therefore, out of state couples can come into the jurisdiction just for the purpose of marrying and then return to their home state to live. The question then becomes, what is it that they take home with them if they are married in a state that recognizes same sex marriage and return to one that maybe does not? In some states (such as Tennessee or Ohio), it's clear that they will currently receive no legal or tax benefits from marrying, but there are many other states where the potential benefits are not so clear.

Our personal favorite today is New York (the native state of one of us), which does not allow same sex marriage for its residents, but may recognize these

marriages if validly performed elsewhere.[8] The question then becomes how does this policy translate for state estate tax purposes? Will a surviving spouse of a married same sex couple living in New York be able to inherit from his or her spouse free of any New York (NY) estate tax, the same as the spouse of a heterosexual couple could?

In the case of NY decedents dying after January 1, 2004, current NY law (NY Tax Code §951 et seq.) requires a NY state estate tax return (Form ET-706) to be filed if the decedent had a federal gross estate (plus federal adjusted taxable gifts) of $1M or more. A federal form 706 is required to be appended to the NY return, even if no federal return is required to be filed. The amount of any deductions, including marital deductions, is determined by reference to the federal estate tax return (Form 706). After taking the amount of the gross estate essentially from the federal return and deducting the total amount of allowable federal deductions, the NY estate tax is calculated by deducting a unified credit of no more than $345,000 (the amount of federal unified credit allowed to be taken on an estate of one million dollars), meaning that a New York estate tax will be due on any net estate over $1M. There is no provision in the law for a separate state QTIP election to be taken on the NY return, which would seem, then, to preclude the surviving spouse of a same sex marriage from making any such election.

Interestingly, however, specific guidance was issued by the NY Department of Taxation and Finance on March 16, 2010, to address the issue of QTIP elections in years such as 2010 when no federal estate tax returns are required.[9] The Guidance provides that if no federal return is required, a 2009 federal return must be filled out and attached to the NY return, and then a QTIP election may be made on the attached "pro-forma federal estate tax return." This has interesting ramifications for same sex (as well as heterosexual) couples. For estates where no federal return is required, this would seem to leave open the possibility of attaching a federal return in which a marital deduction is taken for the amount of the net estate that exceeds $1M and otherwise qualifies for the marital deduction. The Guidance goes on to state with regard to such a QTIP election that "the value of the QTIP property for which the election is made must be included in the estate of the surviving spouse."[10] However, if the property is left in a QTIP trust, and no federal QTIP election is actually made, then the property cannot be included in the federal gross estate of the surviving spouse. We suppose the best that the NY Department of Taxation and Finance could do to enforce this would be to require that upon the death of the surviving spouse that such NY "QTIP'd" property be included in the surviving spouse's NY gross estate, but there does not appear to be any current provision for this in the law.

Looking forward, however, to 2011 and the return of the federal estate tax (and the possibility that Congress will agree on an amendment that will increase the amount of the federal estate tax exemption to some amount over $1M), for estates that exceed the federal filing requirement, one will only be able to take a marital deduction on the NY return in the amount of the deduction actually made on the federal return. To make sure of this, we called the NY Dept. of Taxation and Finance, and asked them directly whether separate QTIP elections could be made on the NY and Federal estate tax returns, and were told that a marital deduction may only be taken on the NY return if it is listed as a marital deduction on Schedule M of the Federal Form 706.

So why should we care since New York is not one of the states that currently recognizes same sex marriage for its residents? Well, NY Governor David Paterson issued a directive to all NY state agencies on May 29, 2008, directing them to recognize same sex marriages performed in other states or countries where such marriages are legal.[11] Prior to that, in February, 2008, the NY Supreme Court, Appellate Division, Fourth Judicial Department, issued a unanimous decision stating that same sex marriages performed in other states must be recognized the same as foreign opposite sex marriages are recognized.[12] Despite the Governor's directive, we could find no reference to this directive or any other guidance on how to handle out-of-state same sex marriages on the NY Department of Taxation and Finance Web site or elsewhere. We then made two separate phone calls to the NY Department of Taxation and Finance and spoke to two different people in their Estate Tax Department. Neither person was aware of the Governor's directive regarding out-of-state same sex marriages, and both stated that same sex marriages are not recognized in New York and that if a marital deduction is not taken on the federal estate tax return attached to the NY return, then it cannot be taken on the NY return. Despite this, the current state of the law in NY requires that same sex marriages lawfully performed out of state be recognized. So, stay tuned to see what happens when a couple married outside

of New York moves to the state and dies with a state estate tax liability. For planning purposes, it is clearly uncertain what the treatment would be. One thing is for sure: your client will never be able to argue that the unlimited marital deduction should be available to him/her as a surviving spouse if they are not married before one of them passes.

The District of Columbia (DC) does recognize same sex marriage and handles estate tax returns and DC marital deductions in a manner very similar to the way it is handled in NY. In DC, estates of decedents dying with gross estates over $1M are required to file DC estate tax returns (Form D-76, or D-76 EZ if the entire estate is left to the surviving spouse or to charity) with federal 706 returns (even if no federal return is required to be filed) attached. Like NY, one can only take a marital deduction on the DC return if a marital deduction is taken on the federal return on Schedule M. Form D-76 EZ, however, while requiring that Form 706 as well as Schedule M and O of the Federal 706 be attached, only implies, but does not expressly state, that a marital deduction must be listed on Schedule M of the federal return in order to qualify it as a marital deduction on the DC return.

To clarify whether a separate QTIP election could ever be made on the DC return, we telephoned the DC tax department and spoke to someone who was very helpful. In response to our question regarding the ability to take separate QTIP elections on the DC and Federal estate tax forms, the Department acknowledged the issues raised by their requiring marital deductions to be listed on Schedule M of the federal return, but nevertheless confirmed that it was a requirement and that separate QTIP elections could not be made.

As in NY, however, we would assume that for estates that have gross estates valued below the federal filing requirement, one could list on Schedule M all assets in excess of $1M that would be eligible for a marital deduction, thereby avoiding both DC and federal estate taxes upon the death of the first spouse. Like NY, this could not be done for estates for which a federal estate tax return would actually need to be filed with the IRS (such as, for estates of decedents dying in 2009 with gross estates over $3.5M). One other option might be available in DC: For couples who are willing to leave all of their assets to the surviving spouse and/or to charity, we would advise filing a Form D-76 EZ and trying to take a DC marital deduction for all assets left to the surviving spouse, even though not all (or any) of such assets are listed on Schedule M of the federal Form 706. There is, of course, no guarantee that this method will be accepted.

Massachusetts is easy. We were the first state to recognize same sex marriage and we allow a separate state QTIP election here. One simply attaches a 1999, pre-EGTRRA, federal 706 to the Massachusetts estate tax return to file the return.

Other states where this issue arises are Connecticut,[13] where a state QTIP election for surviving spouses of civil unions and same sex marriages is allowed; Vermont, where no separate state QTIP election is currently offered (but, like DC, probably should be and is a case of the regulations not yet being reconciled with new law recognizing same sex marriage[14]); and Rhode Island and Maryland, states that recognize certain out-of-state same sex marriages and have a separate state QTIP election, but may not recognize same sex marriage for this purpose.

In addition, certain other states that recognize domestic partnership and/or civil unions deal with this issue as follows: New Jersey does not normally offer a separate state QTIP election, except for same sex couples[15]; Oregon does offer a state QTIP election for same sex couples if registered as Domestic Partners in Oregon[16]; and Washington will allow state QTIP elections for same sex couples starting in 2014.

So, whether to wed is, of course, a terribly complex question for everyone. Whether to do it for state estate tax reasons, however, is at least an interesting one today. Stay tuned as the law in this area evolves. One thing is for sure: no surviving spouse of a same sex couple will be able to try to claim an unlimited marital deduction for state estate tax purposes unless, at the very least, they are married at the time of the first spouse's passing.

Endnotes

[1] © 2010 All rights reserved. Scott E. Squillace, Esq. principal and founder of Squillace & Associates, P.C. a boutique life and estate planning law firm with offices in Boston and Washington, DC. The author wishes to express his gratitude to his colleague, Carol Sneider Glick, LL.M. and Of Counsel to the firm, who co-authored this article. For more information about our practice with same sex couples, visit us at *www.squillace-law.com*.

[2] *See Goodridge v. Dep't of Pub. Health*, 798 N.E.2d 941 (Mass. 2003), in which the MA Supreme Judicial Court held that denial of marriage to same sex couples violated the equality and liberty provisions of the Massachusetts Constitution.

[3] For analytical purposes, we will, for the most part, not discuss the effect of the 2010 Federal Estate tax regime and only consider what 2009 was and what 2011 is currently slated to be.

[4] In 1996, the United State Congress passed the "Defense of Marriage Act" (DOMA), which was signed by President Clinton. 1

U.S.C. § 7 (2010) (effective Sept. 21, 1996). DOMA provides that, for purposes of federal law, marriage is defined as "a legal union between one man and one woman as husband and wife" and a "spouse" is defined as referring "only to a person of the opposite sex who is a husband or wife." The act requires that the definitions apply "in determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States." The IRS has applied DOMA in its interpretation of the Internal Revenue Code. I.R.S. Priv. Ltr. Rul. 200339001 (Sept. 26, 2003). DOMA also permits states to legally discriminate against same-gender marriages or other unions performed in other states. 28 U.S.C. § 1738C (2010) (effective Sept. 21, 1996).

DOMA is subject to certain constitutional challenges currently in several Federal Courts. So far, at the District Court level, DOMA has been declared unconstitutional. Appeals are pending. *See Commonwealth of Mass. v. Dep't of Health and Human Serv's*, No. 09-cv-11156-JLT (D. Mass. 2010); *Gill v. Office of Pers. Mgmt.*, 699 F. Supp. 2d 374 (D. Mass. 2010); *Perry v. Schwarzenegger*, 704 F. Supp. 2d 921 (N.D. Cal. 2010) (declaring California's Proposition 8 unconstitutional).

[5] It is estimated that there are over 500 rights under state law that affect marriage status. For an overview of the catalog of just one state's laws affected by marital status, see NCLR's publication, Left at the Altar: a Partial List of Marital Rights and Responsibilities that are Denied to Same-Sex Couples and Their Families in California which is available at NCLR's Web site: *www.nclrights.org*.

[6] *See, e.g., Chambers v. Ormiston*, 916 A.2d 758 (R.I. 2007); Judge Dismisses Divorce Filed by Gay Texas Couple, AP Newswires (April 2, 2003).

[7] *See*, Eric Moskowitz, Senate votes to repeal 1913 law, July 16, 2008, available online at *www.boston.com/news/local/articles/2008/07/16/senate_votes_to_repeal_1913_law/*.

[8] New York's highest court ruled that there was no constitutional right to same-gender marriage. *Hernandez v. Robles*, 7 N.Y.3d 338 (2006). Subsequently, a lower court in New York held that New York would recognize same-gender marriages performed elsewhere. *Martinez v. County of Monroe*, 50 A.D.3d 189 (N.Y. App. Div. 4th Dep't 2008). And, in an intestate estate, New York Courts have held the surviving partner of a couple married in Canada was entitled to the spousal inheritance. *Estate of Ranftle*, 241 N.Y.L.J. 22 (N.Y. Sup. Ct. 2009); but *see, Langan v. St. Vincent's Hosp.*, 25 A.D.3d 90 (N.Y. App. Div. 2d Dep't 2005), *rev'g Langan v. St. Vincent's Hosp.*, 196 Misc. 2d 440 (N.Y. Sup. Ct. 2003) (where a New York appellate court reversed a trial judge who had held that a surviving civil union partner had the right to sue under New York law as a spouse for the wrongful death of his partner); and NYS Dep't of Taxation & Finance Advisory Opinion Petition No 1090921A (May 12, 2010) (where a same sex couple lawfully married outside New York and now resident in New York was not permitted to file a joint state income tax return).

[9] *See* TSB-M-10(1)M (March 16, 2010).

[10] *Id.* (citing I.R.C. § 2044 and NY Tax Law §954).

[11] See Cheryl Robinson, New York to recognize gay marriages, May 29, 2008, available online at *www.cnn.com/2008/US/05/29/nygay.marriage/index.html*.

[12] Martinez, *supra* note 8.

[13] Connecticut Dep't of Revenue Services, SN2005(10): 2005 Legislation Repealing the Succession Tax and Amending the Connecticut Gift Tax and the Connecticut Estate Tax, available online at *www.ct.gov/drs/cwp/view.asp?A=1514&Q=304232*.

[14] Vermont has a special provision for income tax purposes, which allows couples of civil unions and same sex marriages to file a federal return labeled "Recomputed for VT purposes" as if the couple were married for federal purposes, but the same provision does not seem to apply for estate tax purposes (at least not yet). *See* VT Dep't of Taxation Web site, Individual Income, available online at *www.state.vt.us/tax/individualcivilunions.shtml*.

[15] State of New Jersey Treasury Dept., Division of Taxation Web site: Important Provisions and Filing Requirements

"A taxpayer may not make one election for Federal purposes and another for State purposes with the following exception. If the decedent was a partner in a civil union and died on or after February 19, 2007, survived by his/her partner, a marital deduction equal to that permitted a surviving spouse under the provisions of the Internal Code in effect on December 31, 2001, is permitted for New Jersey estate tax purposes. In these cases, the 2001 Form 706 should be completed as though the Internal Revenue Code treated a surviving civil union partner and a surviving spouse in the same manner." [emphasis added]

[16] Oregon Dep't of Revenue Web site, Inheritance Tax, Aug. 31, 2010, available online at *www.oregon.gov/DOR/BUS/inher-general.shtml*; *Id.*, Registered Domestic Partners in Oregon, Jan. 12, 2010, available online at *www.oregon.gov/DOR/PERTAX/RDP.shtml*; Julie Garber, Estate Taxes by State—Understanding Oregon Estate Taxes, May 13, 2009, available online at *http://wills.about.com/b/2009/05/13/estate-taxes-by-state-understanding-oregon-estate-taxes.htm*.