A new financial planning frontier for same-sex marriage

Advisers working with LGBT clients need to stay up on state laws, due to residency's big impact on retirement and estate planning.

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(William Neumann)

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Choosing color schemes and centerpieces aren't the only things on Susan Owens' to-do list as she prepares to get married May 23.

She and her partner, Laura Medvitz, are revamping their finances in a world where their marriage will now receive recognition on the federal level.

Ms. Owens, 55, Ms. Medvitz, 49, and their financial adviser, Michael Pellman Rowland of Morgan Stanley Wealth Management, are navigating a thicket of updates to the federal tax code and the Employee Retirement Income Security Act of 1974, as well as a patchwork of state laws, in the wake of a pivotal Supreme Court decision last June. That landmark case, United States v. Windsor, found Section 3 of the Defense of Marriage Act of 1996 unconstitutional.

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couples who are legally married.

This allows same-sex spouses to file their federal income tax returns as married. It also entitles them to tax benefits such as the ability to transfer assets to each other without additional taxes and to spousal and survivorship benefits for Medicare and Social Security.

Gay spouses now also receive additional protections under ERISA: They will be recognized for the purpose of determining survivor annuities and death benefits, and they must consent to beneficiary designations.

Notably, the Windsor decision and its effects aren't extended to couples who are in civil unions or domestic partnerships. Couples need to be legally married in a state that recognizes their union in order to qualify for those federal benefits.

For Ms. Owens and Ms. Medvitz, federal recognition finally gives them the legal protections for which they have eagerly waited over the course of their 22-year relationship. Not long after the ruling, the New Jersey couple became engaged.

“This is an enormous ruling with humongous implications,” Ms. Owens said. “It's now a right that we have, and these are exciting times.”

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Decades before progressive states and the federal government began recognizing same-sex marriage, it was common for gay couples to create financial planning work-arounds to ensure basic protections such as access to survivor benefits if one partner dies.

One such instance arose after a 1984 ruling denied gay couples an insurable interest in each other, meaning that one partner couldn't purchase life insurance coverage on the life of the other.

“The only way to get around that for planners was to say that these partners were in business together, and we'd have them buy a home,” said Thomas N. Tillery, vice president and chief compliance officer of Paraklete Financial Inc. “It's a home for the couple, but to the insurer, it's a piece of real estate in which they had joint interest.”

Other workarounds included the use of revocable living trusts as opposed to wills.

Revocable living trusts allow one partner to pass property to a survivor. Wills, on the other hand, always can be contested by family members.

All those planning methods now warrant a review, particularly if a couple is sitting on large amounts of life insurance and complicated trusts.

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financial picture will change post-marriage is still somewhat up in the air. Nevertheless, Mr. Rowland is laying the groundwork for the adjustments to the couple's portfolio after they get hitched.

Incomes combined, the two women will likely be in a higher tax bracket, so it might be time to look at investments with tax-advantaged growth or tax-free income.

“It may be more appropriate to think about municipal bonds,” Mr. Rowland said, “or look at other things that shelter taxes in general, such as contributions to retirement plans, tax-deferred investments like annuities or life insurance, and looking at dividends from stocks and interest from master limited partnerships.”

Post-marriage, it will also be time to look at the beneficiary and estate-planning documents, as well as ensuring that the accounts are properly titled.

“There's more of an advantage to eliminate the possibility that a property transfer could be contested in court,” Mr. Rowland said.

One big issue is the home that Ms. Owens built where both women now reside.

They can now share ownership without fear of additional taxes should the home pass from one

spouse to the other. Better yet, they are eligible for a $500,000 exclusion as a married couple filing jointly should they sell the home, compared with just $250,000 if they filed singly.

The couple's situation highlights post-Windsor-world changes.

Now same-sex couples, provided that they were married in a state that recognizes their union, are eligible for the marital deduction, which permits one person to pass assets to a spouse with no tax on the transfer. The estate tax exclusion — the credit that offsets estate taxes on a taxable estate of up to $5.34 million this year — is also portable for same-sex married couples, meaning that the unused portion of an exclusion for an individual who dies first passes to his or her spouse.

Tangles remain, however.

Although federal recognition makes for easier bookkeeping and tax filing, states can still opt not to recognize same-sex marriages. That complicates the tax-filing process.

There are 22 states that don't recognize same-sex marriage but also tell taxpayers that they need to reference their federal return when they file for state income taxes.

Whether states recognize a marriage can also

have a major impact on how couples and their advisers proceed with their estate plans.

For instance, Alan Zuschlag, 54, and Keith Miller, 50, both clients of Scott E. Squillace, an estate-planning attorney at Squillace and Associates, got married Oct. 10 in Washington. The two reside on a farm they own in Virginia — a state that doesn't recognize gay marriage.

Survivorship and retirement benefits were a big part of the decision to get married in the first place.

“We got married to commit to each other for life, but I used to joke that I was going to marry him for his pension,” Mr. Zuschlag said. “It came down to the idea that if I were to die and leave Keith the farm, he'd have to sell it to pay estate taxes.”

Mr. Zuschlag and Mr. Miller, who have been together for seven years, have had to revisit their plans for income during retirement, which is still years away.

Following the wedding, Mr. Miller, who is a railroad employee with Amtrak, had to update his beneficiary designation forms for his retirement plan so that Mr. Zuschlag is entitled to his pension benefits.

Typically, same-sex couples tend to designate nieces, nephews and other relatives as

beneficiaries. Under ERISA and post-Windsor, however, workers with same-sex spouses will require spousal consent in order to designate anyone else as a beneficiary.

What is still up in the air is Social Security. Benefits are provided based on the state in which a couple resides when they file a claim.

MUSICAL STATES

Mr. Squillace came up with a contingency plan.

“If Alan were to get hit by a bus, Kevin would have to take residence in D.C. for a while and apply for benefits,” Mr. Squillace said. “When you start collecting benefits, you can move where you want.”

The solution is only a practical fix, rather than a legal one. If the Social Security Administration began requiring proof of domicile, it would be harder to make this work.

Since Mr. Zuschlag and Mr. Miller reside in a non-recognition state, Mr. Squillace had to come up with work-arounds to ensure that Virginia doesn't challenge their estate plans.

In this case, the men married in Massachusetts — a recognition state — and do all their financial planning there. Couples in non-recognition states also sometimes move their assets to a state that

recognizes their marriage and appoint a co-trustee there, too.

“You have a jurisdictional connection, and you get out from under the other state's non-recognition position with respect to other assets,” Mr. Squillace said.

Advisers wanting to work with lesbian, gay, bisexual and transgender clients will have to stay current on the changing state laws and realize how their clients' residences can shape not just their retirement planning but their estate planning and where they hold their assets.

“This is changing all the time,” Mr. Squillace said.

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