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Eight Key Estate Planning Opportunities Arising from the Supreme Court's Decision on Same-Sex Marriage

On June 26, 2015, the US Supreme Court ruled that a state ban on same sex marriage is unconstitutional, in violation of the equal protection clause of the Fourteenth Amendment. The landmark ruling in the combined cases known as *Obergefell v. Hodges*[1] struck down every state ban on same-sex marriage in the country, and by virtue of this ruling, Section 2 of the Defense of Marriage Act (DOMA) was also struck down, which declared that states have the right to deny recognition of same-sex marriages licensed in other states.

Two years ago in *United States v. Windsor* the Supreme Court found that Section 3 of DOMA was unconstitutional, which had prevented the federal government from recognizing same-sex marriages for the purpose of federal laws or programs, even if the marriage was legal where performed. As a result of *Windsor*, same-sex married couples have enjoyed most of the same federal benefits that opposite sex couples receive, such as spousal benefits for federal employees. However, in *Windsor* the Supreme Court stopped short of declaring that same-sex marriage bans are unconstitutional, electing instead to limit its ruling to Section 3 of DOMA. In the two years since *Windsor*, states were still permitted to deny marriage licenses to same-sex couples, although most state bans had been challenged in state or federal court and were making their way through the legal process. This inconsistency with marriage laws across the country is what eventually led to the *Obergefell* case reaching the Supreme Court.

In *Obergefell*, in the named plaintiff case, a gay couple living in Ohio flew to Maryland to get married on July 11, 2013, because Maryland had legalized same-sex marriage, which was still banned under Ohio law. One of the partners died in October 2013 while domiciled in Ohio. Even though the couple was legally married, the Ohio Department of Health refused to list the survivor as the surviving spouse on the decedent's death certificate because Ohio did not recognize same-sex marriages, and the survivor filed suit. The case made its way to the Supreme Court, and two questions were presented to the Supreme Court: (1) whether the Fourteenth Amendment requires a state to license a marriage between two people of the same sex (relevant to the combined cases from Michigan and Kentucky, and (2) whether the Fourteenth Amendment requires a state to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out of state (relevant to the combined cases from Ohio, Tennessee and again Kentucky). The first question was the larger constitutional question that the Supreme Court did not address in *Windsor*, but was forced to confront in *Obergefell*. The Supreme Court ruled in the affirmative on both questions. Justice Kennedy, who delivered the opinion for the 5-4 majority, wrote "the right to marry is a fundamental right inherent in the liberty of the person, and under the Due Process and Equal Protection Clauses of the Fourteenth Amendment couples of the same-sex may not be deprived of that right and that liberty. The Court now holds that same-sex couples may exercise the fundamental right to marry. No longer may this liberty be denied to them."

On the date of the *Obergefell* decision, 37 states and Washington DC already recognized same-sex marriage, and 13 states had bans on same-sex marriage—all of which are now unconstitutional. Of the 13 states that had bans in place, 11 of the laws were on appeal, including the four states that had their marriage bans being reviewed by the Supreme Court in *Obergefell*. As a result of this decision, all 50 states and Washington, DC now must recognize same-sex marriages and issue marriage licenses to same-sex couples.

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[1] The combined cases challenged same-sex marriage bans in Ohio, Tennessee, Michigan and Kentucky.

Recognition of Same-Sex Marriages by Federal Agencies

After *Windsor* but prior to the ruling in *Obergefell*, federal agencies had to confront the inconsistency in state laws and set guidance on how they would determine whether an individual was legally married. For example, if an individual was legally married in California but died as a resident of Ohio, a federal agency would need to determine if the individual was married under federal law and whether the surviving spouse was entitled to any federal benefits. In the wake of *Windsor*, federal agencies issued their own guidance on whether they would follow the "place of celebration" rule, i.e., by referring to the law of the jurisdiction where the marriage took place, as the US Department of the Treasury and the Internal Revenue Service (IRS) did, or the "place of domicile" rule, i.e., by referring to the law of the jurisdiction in which the couple is resident or domiciled, in determining whether married same-sex couples should be treated as "married" under federal law.

As a result of the Supreme Court's decisions in *Windsor* and *Obergefell*, states uniformly recognize same-sex marriage and all federal agencies will recognize them regardless of where the marriage was performed. No matter where a couple is married or is domiciled, the marriage is recognized by every state and by the federal government.

Estate Planning Opportunities as a Result of Supreme Court's Decisions

The Supreme Court's ruling in *Obergefell* prevents any state from denying marriage licenses to same-sex couples, and as a result of *Windsor* the federal government must recognize those marriages as valid. However, keep in mind that the Supreme Court limited the scope of its decision in *Windsor* to "lawful marriages," and as a result, the decision does not require the federal government to recognize so-called "marriage equivalents," such as civil unions and domestic partnerships. In the wake of both *Windsor* and *Obergefell*, here are some planning opportunities for same-sex couples:

1. Get married to take advantage of the unlimited marital deduction.

Now that same-sex marriage is legal in all 50 states and Washington DC, those couples who have been holding off getting married or who have entered into civil unions or domestic partnerships should get married if they desire to take advantage of the federal benefits afforded to married couples, such as the unlimited marital deduction from federal estate and gift tax. As a result of *Obergefell*, couples living in states where they were previously denied a marriage license can now apply for a marriage license and will not be forced to travel to a state where it is recognized. Those same-sex couples who are in a civil union or domestic partnership should consider applying for a marriage license, even if the state laws provide the same benefits of marriage to civil unions or domestic partnerships (such as in California), because as of the date of this article, federal law only affords those same federal benefits to legally married couples.

Federal recognition of marriages of same-sex couples leads to the availability of the unlimited marital deduction from federal estate tax and gift tax for transfers between same-sex spouses, and couples no longer have to rely on an individual's applicable exclusion amount from federal estate tax and federal gift tax (the "Applicable Exclusion Amount"—currently $5.43 million, adjusted annually for inflation). In addition, under the so-called "portability" provisions of federal gift and estate tax laws, under certain circumstances a surviving spouse of the same sex also will be entitled to use any portion of the deceased spouse's unused Applicable Exclusion Amount (DSUE), allowing the surviving spouse to make additional tax-free gifts and reduce the amount of estate taxes owed upon the surviving spouse's death. A same-sex couple that is legally married can now take advantage of the same planning opportunities that have been available to opposite-sex couples for decades. As was argued in many of these same-sex marriage cases, the word "marriage" does have significant meaning, and the Supreme Court agrees.

However, despite the many estate tax benefits for married couples, there also are a number of interesting estate planning advantages available to couples who do not wish to get married (whether same sex or opposite sex). To the extent a couple is looking at marriage from a tax perspective, the couple should weigh the pros and cons of the decision.

2. Review current estate planning documents to ensure that the amount and structure of any spousal bequests remain appropriate.

Existing estate planning documents may have been drafted with the assumption that any gift or bequest to a spouse of the same sex over and above the individual's Applicable Exclusion Amount would be subject to federal estate tax (currently at a rate of 40 percent). However, that assumption is no longer true, and such gifts and bequests, if properly structured, are now entitled to the

unlimited marital deduction. Accordingly, a married same-sex couple may wish to modify their estate planning documents to provide that any assets included in their estates in excess of the Applicable Exclusion Amounts will pass to the surviving spouse, either outright or in a properly structured marital trust for the spouse's benefit, thus deferring all federal estate taxes until the death of the surviving spouse.

Estate planning documents may also be revised, if appropriate, to include a separate marital trust that is designed to permit a spouse to use any of the individual's unused Federal GST Exemption that remains after the individual's death.

3. Review retirement account beneficiary designations and joint and survivor annuity elections to ensure that they remain appropriate.

A surviving spouse is entitled to roll over a decedent spouse's retirement account into the surviving spouse's retirement account without being required to take minimum distributions or lump sum distributions until such time as the surviving spouse ordinarily would be required to take minimum distributions (usually upon attaining age 70½). As a result of *Windsor*, this benefit is now available to married same-sex couples, and married same-sex spouses should consider naming each other as the beneficiary of his or her retirement accounts in order to defer income tax recognition as long as possible.

With regard to any retirement plans that are covered by the Employee Retirement Income Security Act of 1974 (ERISA), the spouse of a participant in such a plan may automatically be a beneficiary of the retirement plan as a result of the *Windsor* decision. Accordingly, if a participant in an ERISA-covered plan (e.g., a 401(k) plan) wishes to designate someone other than his or her spouse as a beneficiary, such participant will need to obtain the consent of his or her spouse to make such a designation effective. Prior to *Windsor*, consent was not needed from a spouse of the same sex. However, after *Windsor*, such consent is now required. Separately, if a participant previously made an election to waive joint and survivor annuity benefits after the date of the marriage, the participant may be able to make a new election at this time, and a new election may be required in order to be valid if the marriage is newly recognized under *Windsor*.

Similarly, as a result of *Obergefell*, state employment benefits previously denied to same-sex spouses in states with same-sex marriage bans are now available to them. Married same-sex couples should review their employer's benefits policies to ensure that they are given the same spousal benefits granted to opposite-sex couples.

4. Consider replacing individual life insurance policies with survivor policies.

Many same-sex spouses previously purchased individual life insurance policies of which the other spouse is the beneficiary (either directly via beneficiary designation or indirectly through a life insurance trust) in order to provide the surviving spouse with sufficient liquid assets that may be used to pay federal estate taxes due upon the death of the first to die. With the unlimited marital deduction and DSUE now available to married same-sex couples, as explained above, there may be little or no need for such liquidity upon the death of the first spouse to die. Thus, a married same-sex couple should consider whether such policies should be maintained or replaced with so-called "second-to-die" policies that pay benefits only upon the death of the surviving spouse. Such policies provide liquidity to children or other beneficiaries of the married same-sex couple, and are generally less expensive than individual policies having the same death benefits.

5. Consider splitting gifts between spouses.

Until now, each spouse could make gifts only up to the annual exclusion amount from federal gift tax and federal generation-skipping transfer tax (the "Annual Gift Tax Exclusion Amount" and the "Annual GST Exclusion Amount," respectively—each currently $14,000) without using any portion of his or her Applicable Exclusion Amount. Going forward, however, each spouse may now make gifts from his or her own assets and, with the other spouse's consent, have such gifts deemed to have been made one-half by the other spouse for purposes of federal gift tax and GST tax laws. Both spouses acting together in this way currently may give up to $28,000 to any individual without using any portion of either spouse's Applicable Exclusion Amount. (Note that the Annual GST Exclusion Amount does not always apply to gifts made in trust).

6. Consider converting separate property to community property.

For same-sex couples living in community property states, it may be advantageous from a tax perspective to convert certain separate property into community property. For example, if a couple's primary residence is one partner's separate property, transmuting the property into community property would enable the couple to receive a step up in basis upon both spouses' deaths so that their children may inherit the property with a higher tax basis.

7. Amend previously filed federal estate, gift and income tax returns and state income tax returns.

In the wake of *Windsor*, on August 29, 2013, the Treasury and the IRS issued Revenue Ruling 2013-17 holding that, for purposes of administering all federal tax laws including those pertaining to income, gift and estate taxes, married same-sex couples who were lawfully married in any jurisdiction (domestic or international) will be treated as married regardless of whether the jurisdictions in which such couples are resident or domiciled recognize the marriage.

As a result of the 2013 ruling, married same-sex couples generally are required to file their federal income tax returns with a "married filing jointly" or "married filing separately" filing status. In addition, same-sex couples who were married in prior years may, but are not required to, file original or amended tax returns within the statutory limitations period, which is ordinarily three years from the date the tax return was originally due or filed (if on extension) or two years from the date the tax was paid, whichever is later. Accordingly, although time is running out, married same-sex couples may still be able to amend tax returns for the year 2012 and obtain a refund of any overpayment.

For example, if one spouse previously made taxable gifts to the other spouse, it may be possible to amend the donor's prior gift tax returns and retroactively claim the marital deduction for the gifts made in those years, or in cases where a decedent spouse's estate paid federal estate taxes on assets that were inherited by a surviving spouse of the same sex, it may be possible to amend the decedent spouse's federal estate tax return and retroactively claim a refund for the estate taxes paid (subject to the limitations period discussed above). Additionally, to the extent that either spouse previously used a portion of his or her Applicable Exclusion Amount or paid gift taxes or GST taxes by making gifts to third parties over and above his or her respective exclusion amount, it may be possible to amend prior federal gift tax returns in order to retroactively split such gifts with the other spouse. (For more detail, see the June 28, 2013 advisory entitled "**Estate Planning Opportunities Arising from Recent Landmark Supreme Court Decisions Concerning Marriages of Same-Sex Couples**".)

Both spouses may also amend prior year income tax returns to change their filing status from single to married filing jointly and obtain a refund if the amount of tax owed based on their married filing status is less than that owed based on their prior single status, again subject to the limitations period described above. Additionally, as a result of *Obergefell*, those married couples living in states that did not previously recognize same-sex marriages may be able to amend more recently filed state income tax returns for the years 2012, 2013 or 2014, depending on the laws in such states.

8. Non-citizen spouses should consider seeking permanent residency and/or becoming citizens.

Until the *Windsor* decision, non-citizen spouses were not eligible for citizenship or permanent residency on the basis of their marriage to a spouse of the same sex who was a US citizen. Now, non-citizens may be eligible for permanent residency or citizenship on that basis. Though there are many benefits to becoming a permanent resident or citizen, there are also numerous tax and non-tax consequences that should be carefully considered before making such an important decision.

We Can Help

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