

# CHAPTER 21

## Estate Planning for Unmarried Partners

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## § 21.01 INTRODUCTION

There are many obvious benefits to marriage, which have spawned the much celebrated debate about according those benefits to committed but unmarried partners. There are obvious detriments to marriage as well, as it is the only contract one can enter into that requires court approval to terminate. From an estate planning perspective, many estate planning devices favor married couples—particularly those that involve the marital deduction. There are any number of loopholes to favored estate planning devices over the years that have been “plugged” for spouses but not for unmarried partners. This article is therefore simply a basic estate planning review, but in the context of unmarried partners.

## § 21.02 WILLS AND TRUSTS

### [1] Need for Estate Planning for Unmarried Partners

A will is the basic building block of almost every estate plan. It directs the disposition of property and appoints fiduciaries to carry out one’s wishes. A will can create trusts to take effect upon one’s death to minimize taxes and to provide support or protection for one’s beneficiaries. It can name guardians for one’s minor children and record one’s wishes for their care. A will can also be used to give burial instructions and make anatomical gifts.

Unless an individual provides otherwise, upon her death, her assets will be distributed according to the state’s law of intestacy. Pursuant to the law of most states, if an individual dies intestate and is survived by a spouse and children, her property will generally be divided among her spouse and her children according to various

formulae, and then, if the individual has no spouse or children, her property will pass to various blood or adopted relatives generally depending upon the degree of consanguinity. The determination of what constitutes a “spouse” is a matter of state law, although the 1996 federal Defense of Marriage Act (“DOMA”), for purposes of interpreting federal statutes and administrative regulations, rulings, or interpretations, defines “marriage” exclusively as a “legal union between one man and one woman,” and “spouse” as “a person of the opposite sex who is a husband or a wife.”

Unmarried couples do not enjoy the protections and benefits that are unique to marriage. For example, unmarried partners are not entitled to an intestate share and do not have the statutory right to demand an elective share, as spouses do. Also, in community property states, unmarried partners would not qualify as spouses to take a community share of property. Unmarried partners can hold property as joint tenants with rights of survivorship, but they cannot hold property as tenants-by-the-entirety. Oral agreements and understandings between unmarried spouses are also not recognized under state law. Moreover, ERISA requires a spouse to be the beneficiary of at least 50 percent of the other spouse’s retirement benefits (unless the spouse consents to a different arrangement), but provides no such protection to same-sex couples, domestic partners or other non-spouses. Furthermore, common law marriage is available only in opposite sex unions in those states that recognize it in the first place. There are no tax benefits accorded unmarried partners, nor any presumptions as to entitlement to catastrophic or similar benefits.

Same-sex relationships are now recognized to varying degrees in several states, like Massachusetts (marriage); Vermont and Connecticut (civil union); New Jersey, Maine, Oregon, and the District of Columbia (domestic partnership registration); and California and Hawaii (reciprocal beneficiary registration). Domestic partnership is also available in certain local municipalities. New York state employees and residents of certain counties or cities (including New York City) may register for domestic partnership status. The same is true in San Francisco, where residents can obtain domestic partnership status separate from that offered by the state; city residents can apply for both local- and state-level benefits. However, even where same-sex relationships are recognized for estate planning purposes, any benefits and protections afforded by state recognitions are generally only available to residents of those states. DOMA prevents the Federal government from recognizing same-sex unions for any Federal purposes, including tax purposes, and limits same-sex benefits and protections to matters of state law only.

If an unmarried individual does not make specific provisions for her partner, by will or otherwise, then upon her death, her surviving partner will likely receive nothing. The surviving partner could be left without any assets and could even become homeless, yet be responsible for bills and loans that were accumulated together with

her or her late partner. Therefore, if it is the intent of unmarried partners to benefit each other, it is important that they plan ahead.

To state what may be obvious, if the unmarried partners are not of the same sex, they may obtain the benefits available to a married couple by entering into a marriage before the death of one of the partners. This will work even in the case of a deathbed marriage, although such a marriage may be subject to challenge by family members if the ailing partner's capacity is diminished.

If the families of the unmarried partners do not approve of their lifestyle or relationship, the families may seek to challenge their wills on the grounds of lack of testamentary capacity, improper execution, undue influence or fraud or mistake. The unmarried partners may wish to take steps to minimize the risk of challenges to their wills, *e.g.*, they could support the disposition of assets contained in their wills by naming each other as the beneficiary of life insurance and/or by owning property jointly. They could also make gifts to family members in their wills and include *in terrorem* or "no contest" clauses that would disinherit an unsuccessful will contestant. A trust for same-sex partners would also help avoid the assets of a same-sex decedent becoming subject to the decedent's surviving relatives.

It should be noted that the separation of unmarried couples or domestic partners does not automatically revoke a will disposition to the partner. In contrast, in most states, where a spouse is appointed as a fiduciary and/or is named as a beneficiary under a will, the subsequent divorce of the spouses will revoke such appointment or disposition of property, unless the testator expressly provides otherwise.

## [2] Transfer Taxes

Three Federal transfer taxes currently may apply when property is transferred: the estate tax, the gift tax and the generation-skipping transfer ("GST") tax. All states have an inheritance and/or an estate tax, a few have a gift tax and most have a GST tax.

### [a] Estate Tax

Upon a decedent's death, her estate will be subject to estate tax. The estate tax exemption eliminates the estate tax that would otherwise be due on the first \$2 million of taxable transfers. The estate tax exemption amount increased to \$2 million on January 1, 2006. It will increase as follows until the estate tax is repealed or otherwise amended:

<b>Decedents dying in:</b>	<b>Exemption Amount</b>
2008	\$2.0 Million
2009	\$3.5 Million
2010	Repeal

The highest estate tax rates will decrease as follows:

<b>Decedents dying in:</b>	<b>Highest Tax Rate</b>
2008-09	45%
2010	Repeal

The Federal estate tax is currently scheduled to be repealed on January 1, 2010 and reenacted with 2001 rates and exemptions on January 1, 2011, with the result that the “repeal” lasts for one year only.

*The marital deduction.* A married individual can leave assets to a spouse who is a United States citizen and receive the benefit of the unlimited estate tax marital deduction provided by Section 2056(a) of the Internal Revenue Code (the “Code”), effectively deferring estate taxation on those assets until the surviving spouse gives them away or dies.

Although domestic partners may be treated as spouses for certain purposes, they are not recognized as such for tax purposes. The estate tax marital deduction is not available to unmarried persons. On each partner’s death an estate tax will be assessed on assets in excess of the deceased partner’s estate tax exemption. Transfers to unmarried partners in payment of services rendered, if properly structured, might qualify for a debt deduction, but they would then be subject to income tax.

*The charitable deduction.* Assets given to charities qualify for the estate tax charitable deduction and are therefore free of estate tax. If the assets are given to a trust that has non-charitable beneficiaries as well, special rules must be observed (see below).

### **[b] Gift Tax**

Transfers that one makes during lifetime may also be subject to transfer tax. As with the estate tax, there is an exemption from gift tax for transfers under a certain amount. The exemption for lifetime gifts increased to \$1 million on January 1, 2002.

Unlike the estate tax and its exemption, the gift tax will not be repealed and its exemption is not scheduled to increase. However, the highest gift tax rate will decrease with the highest estate tax rate and, as of January 1, 2010, the gift tax rate will be the highest personal income tax rate, currently scheduled to be 35% at that time.

*Annual exclusion gifts.* In addition to the \$1 million exemption, individuals can make annual gifts of property not exceeding \$12,000 to an unlimited number of individuals without incurring a gift tax. Although a married individual can elect to “split” gifts with her spouse and thereby give \$24,000 of annual exclusion gifts per individual, unmarried couples cannot take advantage of gift-splitting. Each partner can make a separate gift of \$12,000, but one partner cannot double the amount of the gift coming from her sole assets by having the other partner consent to be deemed a donor.

*Medical and educational expenses.* Payments made directly to the provider of

medical or educational services are excluded from taxable gifts and can be made in unlimited amounts on behalf of any number of donees.

*Marital deduction.* Transfers of assets between married partners are tax-free. Transfers between unmarried partners, however, can be taxable gifts subject to the annual exclusion limits and the lifetime exclusion of the donor. Gifts of luxury items like jewelry or cars can be subject to gift tax if the value of such items exceeds the annual exclusion amount and the donor has already utilized his lifetime exemption. Unmarried partners must be aware of the possibility that the payment of living expenses by one of them may be seen as a potentially taxable indirect gift to the other. If such a gift is in excess of the annual exclusion amount, the donor will be required to file a gift tax return.

Because the marital deduction to defer the payment of estate taxes is not available to unmarried partners, lifetime gift planning is more important for them in reducing estate taxes. However, given the possibility that the unmarried partner may have a non-taxable estate due to the planned estate tax repeal or increase in estate tax exemption, and the current probability that the gift tax exemption will stay at \$1 million, it will be particularly important to consider gift planning that does not result in the payment of a gift tax.

*Charitable deduction.* Assets given to charities qualify for the gift tax charitable deduction and are therefore free of gift tax. If the gift is made to a trust that has non-charitable beneficiaries as well, special rules must be observed (see below).

*Divorce.* Property settlements entered into within the three year period commencing one year prior to divorce are presumptively presumed to be for full and adequate consideration, and therefore not subject to gift tax (I.R.C. 2516). There is no such safe harbor for property settlements when unmarried partners separate.

### [c] GST Tax

The GST tax is a flat tax assessed at the highest federal estate tax rate (currently 45%) and is payable on transfers to individuals two generations or more below the transferor's generation (*e.g.*, grandchildren and great-grandchildren, *etc.*), whether outright, in trust or by distributions from trusts. However, gifts of \$12,000 to a skip person are subject to an annual exclusion similar to the annual gift tax exclusion, although somewhat different rules apply to gifts in trust. Each individual has a lifetime GST exemption of \$2,000,000 that is applicable to outright gifts as well as to other transfers, including transfers in trust or by will and distributions from trusts. Beginning in 2004, the GST exemption for gifts during lifetime or transfers at death began to increase with the estate tax exemption, and the GST tax rate decreased with the highest estate tax rate. Like the estate tax, the GST tax is scheduled to be repealed on January 1, 2010 and reenacted with 2001 rates and exemptions on January 1, 2011.

The generation assignment of unmarried partners is not based on family relation-

ships, as with married partners. Rather, the generation assignment of unmarried partners is based on the relative ages of the unmarried partners. Any individual that is between 12-1/2 and 37-1/2 years younger than the transferor is in the first generation below the transferor, and there is a new generation every 25 years thereafter.

If an individual marries another who is a generation or more younger than he is, his spouse will nevertheless be treated as being in the same generation for GST purposes and transfers made to the spouse will be free of GST tax (and gift and estate tax). Unmarried partners are unable to transfer assets to much younger partners and avoid the GST tax in this way.

It should be noted that, for unmarried partners, the ability to utilize the second partner's GST exemption by splitting gifts is unavailable, as is the ability to use the deceased partner's GST exemption on the death of the second partner through a reverse QTIP election (Section 2652[c][3] of the Code).

### **[3] Lifetime Gifts vs. Testamentary Gifts**

Transfers subject to gift tax are, in the long run, more cost effective than transfers subject to estate tax. This is because the gift tax is calculated in a "tax exclusive" manner and the estate tax is calculated in a "tax inclusive" manner. In the case of a gift, the donor pays gift tax only on the amount of the gift. Therefore, the amount of gift tax is not included in the tax base. At death, however, estate tax is assessed on the gross amount of the decedent's assets at death, including the amount in the estate that will ultimately be used to pay the estate tax. To illustrate, at the highest gift tax rate of 45%, \$1.45 million of property (in both gift and gift tax) is required for the recipient to receive \$1 million by gift, but just under \$1.82 million of property (in both legacy and estate tax) is required for the recipient to receive \$1 million at death.

Another difference between lifetime gifts and transfers at death is that lifetime gifts do not result in a "step-up" in basis. The donee takes the donor's adjusted basis (a "carry-over" basis) in the gifted property. Therefore, with any gifting technique, one has to consider the combination of (i) the gift tax paid on the gift of assets and (ii) the capital-gains tax that will be paid by the donee upon the eventual sale of the assets as compared to the estate taxes that would have been paid on the appreciated value of the assets had no gift been made.

### **[4] Common Gift Techniques**

#### **[a] Outright Gifts**

If the donor is comfortable enough to make a sizeable gift, the donor may give the gift tax exemption amount (the \$1 million that each person may give to anyone without incurring gift tax) to her children or other beneficiaries, either outright or in trusts to which the donor could apply part of her GST exemption. To the extent the donor gives away property in excess of that amount, the donor will pay Federal gift tax. By giving

property away during the donor's lifetime, however, the donor passes any income and appreciation earned on such property between the time of the gift and the time of her death to her beneficiaries, tax-free. Also, until the repeal of the estate tax, to the extent the donor pays gift taxes on gifts to her beneficiaries, the donor reduces her estate by the amount of gift tax paid (assuming the donor survives the gift by three years) and pays tax at the lower gift tax level.

If the donor concludes that a particular gift plan may not be appropriate for the donor or the donor's needs for the future, this does not mean that the alternative is to do nothing. Annual gifts to as many family members or friends (and their spouses) as the donor can name, as well as payment of tuition and medical expenses, are equally effective means of reducing the donor's taxable estate, but in significantly smaller and more manageable bites. In this manner, if the donor were to make gifts totaling, say, \$60,000 or \$120,000 in one year and then concluded in the following year that those gifts had an adverse impact on her lifestyle, the donor might choose not to make gifts the following year, or decide to make them in a reduced amount. Annual gifts give the donor complete control over how much to give and when to give. Anything the donor gives, however, will save roughly 45 cents on the dollar in estate taxes at today's highest tax rates.

#### **[b] 2503(c) Trusts**

When a minor receives property, legal and practical problems can arise because a minor does not have the legal capacity to manage his or her own financial affairs. The creation of a 2503(c) trust can avoid these problems. Section 2503(c) of the Code permits the \$12,000 annual exclusion (discussed above) to apply when property is transferred into a trust for the benefit of a minor. The property and income from that trust may be used for the benefit of the minor until he or she reaches 21 years of age. However, if the grantor wants to enjoy the full benefit of the annual exclusion, the trust must provide that the principal may be paid to the beneficiary at age 21. If the beneficiary does not withdraw the property at age 21, then it can continue in further trust. Unlike a Uniform Transfers to Minors Act account, the income from this trust will not be subject to the so-called "kiddie" tax.

#### **[c] Qualified Personal Residence Trust (QPRT)**

The grantor places her residence in trust for herself for a period of years (for example, 10 years). At the end of that period, the trust terminates and the residence passes to her beneficiaries. Because the grantor retains the use of the house for, in this example, 10 years, the amount of the gift to her beneficiaries is not the current fair market value of the residence (assume \$1.5 million) but rather the present value of their right to receive the residence in 10 years, which will be somewhat less than half. (The exact discount will depend upon the prevailing interest rates and the grantor's age at the time of the transfer to the QPRT.) If the grantor still has her gift tax exemption



available, there may be no Federal gift tax. If the residence doubles in value over the 10-year period, when the trust terminates, the trust beneficiaries will receive a \$3 million residence with no further estate or gift tax consequences. The longer the term of the QPRT, the smaller the value of the gift, but the lower the likelihood that the grantor will survive the trust term. Because the beneficiaries receive the residence as a gift rather than as a bequest, they do not get a step-up in basis. Therefore, if the grantor's basis in the residence is \$200,000 and the residence is worth \$3 million, at the end of the trust term, the trust beneficiaries would recognize a \$2.8 million capital gain if they sold the house. They would avoid, however, the estate tax on \$3 million. At the QPRT termination, title to the residence will pass to the trust beneficiaries or to a trust for their benefit. The grantor then pays the beneficiaries fair market rental each month, also free of gift-tax implications. Because certain Treasury Regulations that apply where family members are the beneficiaries of a QPRT do not apply where domestic partners and/or other unrelated parties are the beneficiaries, the grantor may purchase the residence from the trust at no gain or loss just prior to the expiration of the trust term so that cash or other assets may pass to the remaindermen in place of the residence and the residence can then be passed to the grantor's beneficiaries at a stepped-up basis. For a QPRT to work efficiently, the grantor must survive the trust term. If the grantor dies during trust term, the value of the residence at the time of her death is included in her estate. This, however, is no worse than had she done nothing.

**[d] GRIT's**

A "GRIT" is a Grantor Retained Income Trust. The grantor places an asset that she expects to appreciate in a trust to "freeze" it at its gift tax value but retains a right to income for a specified term. That retained income interest in the property serves to minimize the value of the gift. Although the income that the grantor receives during the term of the trust would be includible in her estate, post-transfer appreciation would not be, if the grantor survives the trust term. Chapter 14 of the Code was enacted to address the perceived abuse of this type of transaction among "applicable" family members. It ensures that any gift tax value assigned to a remainder interest comports with the reality of the transaction and the economic value of the retained interest. Under Chapter 14, any interest in the trust retained by the grantor or applicable family member is assigned a value of zero if the interest is not a qualified interest. Without a qualified interest, there is no reduction of the taxable gift to reflect the value of the retained interest. Personal residence trusts and QPRT's are the only forms of GRIT's that are still viable options where the transfer involves members of the grantor's immediate family. As Chapter 14 deals with intra-family transactions and does not apply to unmarried couples, GRIT's are still a powerful tool available to unmarried partners. The downside, as with the QPRT, is that assets receive no step-up in basis at the grantor's death if the assets contributed to the GRIT have appreciated in value. Also, if the grantor does not survive the trust term, the trust assets are includible in the

grantor's estate at their fair market value as of the date of the grantor's death. As with the QPRT, such a result is no worse than if the grantor had done nothing.

**[e] GRAT's and GRUT's**

A "GRAT" is a Grantor Retained Annuity Trust and a "GRUT" is a Grantor Retained Unitrust. The grantor places assets in trust for herself for a period of years (for example, 10 years). At that time, the trust terminates and the assets pass to the trust beneficiaries. Because the grantor retains the use of the assets for, in this example, 10 years, the amount of the gift to the beneficiaries is not the current fair market value of the assets (assume \$1.5 million), but rather the present value of their right to receive the assets in 10 years. The discounted value will depend upon both the length of the term and the size of the guaranteed annuity (a dollar amount fixed throughout the term of the trust) or unitrust amount (a fixed percentage of the trust assets, but recalculated annually). The higher the retained annuity or unitrust rate, the lower the value of the gift, but the less likely that the assets will generate sufficient income and growth to pay the required distributions without consuming principal. The longer the term of the GRAT or GRUT, the smaller the value of the gift and the lower the annual payment required, but the lower the likelihood of surviving the trust term.

GRAT's and GRUT's are most useful for investments whose total rate of return substantially outperforms the assumed Internal Revenue Service discount rates prevailing at the time of the gift. It is particularly useful for non-publicly traded assets and fractional interests in assets, where values can be greatly discounted, thereby substantially raising the effective yield of the gifted assets and in some cases, avoiding gift and estate taxes entirely. As with QPRT's and other GRIT's, the trust property has a carry-over basis and the grantor must survive the trust term for the property to be not includible in the grantor's estate.

**[f] Charitable Split Interest Trusts**

Transfers in trust for charitable purposes can generate substantial Federal income and estate tax savings. The grantor can pay the charity in one of two ways. First, the grantor can pay the charity the principal of a trust at the end of a set term of years, with the grantor's beneficiaries receiving the income from the trust for a set term. Alternatively, the client can pay the charity from the trust for a set term of years, with the grantor's beneficiaries receiving the principal of the trust at the end the term.

**[i] CRT's**

The creation of a charitable remainder trust ("CRT") involves the transfer of assets, by gift or by will, to a trust, requiring the payment of an annuity (in the case of a charitable remainder annuity trust [a "CRAT"]) or a unitrust amount (in the case of a charitable remainder unitrust [a "CRUT"]) to an individual (or individuals). In the case of a CRT, the annuity or unitrust amount may not be less than five percent of the value of the trust assets. In addition, a CRUT may provide for the payment of the lesser of

the unitrust amount and the trust's actual income. A CRT's term may not exceed 20 years or the life or lives of the beneficiaries. The remainder at the end of the CRT's term is paid to charity.

The value of the charitable contribution deduction is the actuarial value of the right to receive the remainder of the trust at the end of the CRT term. For unmarried partners, the marital deduction for the life or term interest in a CRT is unavailable. If someone other than the grantor will be receiving the annual payments, the right to receive such payments will be subject to gift tax at the time the trust is created. Since a CRT is income tax-exempt, it can sell low-basis assets and pay no capital gains tax, and permits diversification and higher current yields. However, beneficiaries may later be taxed on this otherwise untaxed gain to the extent the annuity or unitrust payments exceed the CRT's actual income.

#### **[ii] CLT's**

The grantor could also create (either during her lifetime or under her will) a charitable lead annuity trust ("CLAT") or a charitable lead unitrust ("CLUT") out of some portion of the grantor's current assets or out of some portion or all of the assets that remain in her estate at the time of her death. CLAT's and CLUT's are similar to GRAT's and GRUT's, except that instead of retaining the lead interest, the grantor gives the lead interest to charity. CLAT's and CLUT's can be structured so as to eliminate estate tax, and even GST tax, entirely. The grantor's ultimate beneficiaries, however, should already own enough property to be able to afford to wait until the termination of this trust to receive the property. If the total rate of return of the trust outperforms the assumed Internal Revenue Service discount rates prevailing at the time of the gift, or the grantor's death, the ultimate trust beneficiaries will receive the trust property free of all estate, gift and, under some circumstances, GST taxes when the trust terminates.

#### **[g] The Private Foundation**

The donor can control the charitable private foundation, subject to the limitation that the assets must be maintained for charitable purposes. This enables a donor to make charitable contributions to the private foundation, without having to determine immediately the ultimate recipient of such funds, or how those funds will ultimately be devoted to charitable purposes. In addition, foundations can be used as the recipients of low-basis stock, while providing income tax deductions for full value. However, there is a limit to the amount of closely-held corporation stock that private foundations can hold, making these assets less attractive candidates for donation.

#### **[h] "Defective" Grantor Trusts**

Most irrevocable lifetime trusts are structured to avoid both future income taxation to the grantor and inclusion of the assets in the grantor's estate for Federal estate tax purposes. However, under the grantor trust rules of Sections 671 through 678 of the

Code, the grantor is treated as the owner of all items of income, deduction and credit of a trust if the grantor, the grantor's spouse or, in some cases, a "nonadverse" or "related or subordinate party" subservient to the wishes of the grantor holds certain powers over or interest in the trust. Unmarried couples do not fall within the spousal attribution rules or the definition of a "related" or "subordinate" party (unless, perhaps, the partners enter into an employment relationship). Accordingly, they will be much less likely to obtain inadvertent grantor trust status.

If the grantor's beneficiaries are in relatively high income tax brackets and the grantor wishes to transfer assets to an irrevocable trust for their benefit, the grantor may wish to consider establishing an intentionally "defective" grantor trust for the benefit of her beneficiaries. Such a trust will permit the grantor to shift wealth but keep the burden of its income taxation even though all of the trust's income will be paid to or held for the beneficiaries. Under current law, the grantor will not pay gift tax for this shift in tax burden. Note that the "defect" is an income tax effect only, and the trust will not be subject to estate tax in the grantor's estate.

#### **[i] Utilization of the GST Tax Exemption**

Every individual is allowed a \$2,000,000 GST tax exemption. A donor may transfer up to \$2,000,000 in assets, by gift or by will, to a long-term trust for "skip" persons (*i.e.*, grandchildren and great-grandchildren or other ultimate beneficiaries). Payment of the income from this trust should not be mandatory during the term of the trust. The trustees should have discretion to use both income and principal in the event of beneficiary need. The trust can run for the full applicable "perpetuities" period, or even longer, if set up in a jurisdiction with no perpetuities limitation. The allocation of the donor's GST exemption to such a transfer ensures that final distributions from the trust to remote descendants or other beneficiaries will be subject neither to estate nor GST tax. The donor will be best served by allocating this exemption to property that is likely to appreciate most significantly as of the time of the original transfer, because this will ultimately produce a larger savings when the transfer to lower generations occurs.

### **[5] Assets Requiring Special Planning**

#### **[a] Retirement Plans**

Retirement plans accumulate geometrically during one's life because of income tax-free compounding, but the assets are subject to two levels of taxation simultaneously upon one's death. As a result, one's beneficiaries can receive, if both taxes are applicable, less than 20 cents on the dollar after taxes.

There are various estate-planning strategies applicable to retirement assets. First, if the donor otherwise planned to make charitable gifts, they should be made first out of retirement assets. In this manner, both the income tax and the estate tax will be avoided.

Another useful strategy that can be employed with retirement assets, if available, is to designate that they be paid over the life expectancies of the donor, the donor's children or other beneficiaries. In this manner, while the retirement assets will be subject to a full estate tax, the income tax recognition can be spread out over the balance of the lives of the donor's beneficiaries, with continued tax-free growth generally unchanged by accumulating for 10 to 15 years after the donor's death.

Although a surviving spouse may rollover a deceased spouse's qualified plan or IRA into his own plan, such rollovers are not available to unmarried partners. That means that the surviving partner must commence receiving distributions and paying tax on those distributions soon after the death of the participant partner. This can be particularly problematic if the plan requires a lump-sum distribution or the death of the participant partner.

Another strategy with retirement assets is to withdraw so much of the assets as will avoid any applicable surcharge, recognize the current income tax, and use the balance to purchase life insurance that will replace the amount of the plan's assets that will be consumed by taxes at the time of the donor's death.

#### **[b] Insurance**

If the client owns or plans to purchase life insurance, the client should consider creating a life insurance trust to hold any existing life insurance policies or to purchase new life insurance. If the client creates a life insurance trust, transfers existing policies into it and survives the transfer by three years, the insurance proceeds will pass to the beneficiaries free of both estate and income tax, and perhaps gift tax as well. If the client transfers money to the trust and the trust makes the initial purchase of life insurance, even if the client does not survive the purchase by three years, no portion of the proceeds will be taxable in her estate.

The principal of the trust may provide needed liquidity to cover estate taxes in the grantor's estate or in the estate of the last to die of the grantor and the grantor's partner. The trust principal can remain in trust for the trust beneficiaries or be paid to them outright, free of an estate tax.

Survivorship insurance is insurance that is paid only upon the death of the survivor of the client and another person (usually, but not always, a spouse). Because payment is postponed until the occurrence of two deaths, the premiums on such policies are significantly lower than life insurance on only one life. Survivorship life insurance contemplates the payment of insurance proceeds at the second death to help the client's beneficiaries pay estate taxes. This is especially useful if the two estates consist largely of unmarketable assets such as a closely-held corporation or other business, a farm, other real estate, or an art collection. The client may choose to place survivorship life insurance in a trust to render it free of estate tax and to make the proceeds available in the hands of the trustees for the payment of estate taxes by purchase of assets from

the estate or by lending cash to the estate.

Life insurance may be more important for the unmarried individual. Paying estate taxes with the proceeds of life insurance held in a trust may be a useful option to one who is not willing to undertake aggressive gifting strategies that might otherwise be required to reduce estate tax. Also, if the individual's family does not approve of the individual's lifestyle or partner, a gift of property in a will may be subject to a will contest by the family. If the partner is named as the beneficiary of a life insurance policy, it is more difficult to bring a contest and may be more difficult to find out that the assets have been transferred.

#### [6] Avoiding Will Contests

Same-sex partners should take further precautions to ensure the proper execution of their wills:

- Observe formalities of execution.
- Specific statements regarding omissions of certain family members may also help prevent contests. Stating negatively why a certain family member has not been provided for can be problematic because such statements may incite the family member to challenge the will or be grounds for a testamentary libel claim. On the other hand, making positive statements about why a same-sex partner has chosen to benefit the partner over his or her blood relatives can protect the will from contest.
- Retaining separate legal representation for each party can help protect the will from later challenges. Even if partners are represented by the same attorney, same-sex partners may also consider executing their will separately or even interviewing separately with their attorney. Although same-sex partners may desire to be treated as much like a "married" couple as possible, the possibility of will contests on grounds of undue influence, collusion, etc., cautions towards taking extra measures that will shield their will from challenge.
- Partners should consider executing more than one will with substantially similar terms six months to a year apart. This approach will create a further disincentive for others to challenge the will in the first place, in addition to providing another level of protection in case of suit.
- Maximizing use of non-testamentary methods for passing assets will also limit the vulnerability of a decedent's assets to challenges. Many of these methods are covered in this outline.
- Consider the use of *in terrorem* clauses, if they are valid in the state

of the person's domicile.

- Consider whether under the circumstances it might make sense for the client to discuss her plans with her family, to avoid unnecessary surprise, and attendant surmise that the surviving partner exercised undue influence.

## § 21.03 CHILD GUARDIANSHIP

### [1] Appointment of Guardian

#### [a] Lifetime

##### [i] Permanent Guardian

Some states permit a parent to file a petition or otherwise consent to judicial appointment of a guardian. Since court approval for this type of guardianship is sought while the parent is competent and alive, the parent can actively participate to persuade the court to accept this guardian designation and, if necessary, can make an alternate designation. Other states will only consider the appointment of a guardian following the parent's incompetency or death.

##### [ii] Standby Guardian

Many states allow a parent who is competent to designate a guardian for her child to be available on a "standby basis," either following or prior to disability or death of the parent.

The standby guardian assumes her duties immediately upon the adjudication of incapacity or the death of the last surviving natural parent or adoptive parent of the child.

The standby guardian usually can serve as such during the period following incapacity or death, but court approval will be required for the short-term standby guardian to become the permanent guardian.

##### [iii] Temporary Guardian

A parent can grant care and custody of a minor child to a temporary guardian to make all necessary arrangements for the care, education and well-being of her minor child, including, but not limited to, enrolling the child in school and arranging for her medical care.

Usually, the parent will provide that such a grant of care and custody is effective immediately and is not affected by subsequent disability or incompetence.

To encourage third parties to accept the grant, the parent should release any persons from any legal liability whatsoever for honoring the grant.

**[b] Testamentary Appointment of Guardian**

Nearly all states permit parents to make a testamentary appointment of a guardian of a minor.

**[2] Requirements**

The formal requirements for the appointment of a guardian vary among the states. In most states, the appointment of a guardian is subject to court approval and possibly also judicial appointment. Even though the courts are not required to appoint the designated guardian, many will do so. Generally, however, a surviving legal parent, especially a natural parent, is granted custody over a designated non-parent, unless such proven unfit or detrimental to the child's welfare.

If the parent anticipates that the state will not recognize a particular designated guardian, the parent should still name a guardian in the hope that a court will honor such a designation and should designate an alternate guardian in the event the court does not appoint the first designated guardian.

Each state has its own age limit for an individual to qualify to act as a guardian.

In some states a child over a specified age may nominate her or her own guardian, subject to court approval. In addition, some states allow a child above a certain age to challenge or terminate an appointment (other than a court appointment) of a guardian.

In designating a guardian for a minor child, a parent should consider, among other things, the guardian's age and maturity level, how the guardian and the child get along, where the guardian resides and whether the child will have to move from familiar surroundings, whether the guardian can afford to serve as such and whether the guardian should also be the person that handles the child's finances.

**§ 21.04 POWERS OF ATTORNEY**

A power of attorney is a document by which an individual (called the principal) authorizes another individual (called the agent or the attorney-in-fact) to make legal decisions and transactions on her or her behalf.

For a power of attorney to be valid, the principal must have sufficient mental capacity when signing it, *i.e.*, he must be aware that he is signing the document and must understand its nature and effect.

The principal and the agent are in a contractual agency relationship, which is controlled and enforced by statutory and common law.

The agent stands in the shoes of the principal and is, in effect, her alter ego with respect to transactions authorized by the power of attorney.

A power of attorney authorizes the agent to perform any of the functions named therein. The powers granted may be limited to specific transactions or acts or to access



to a specific bank account. Typically, however, a power of attorney will grant broad authority to take all appropriate actions incident to ownership and management of the individual's asset's including powers to access bank accounts, sell securities, file tax returns, renew leases, receive funds from third parties and make gifts of up to \$12,000 per year to the principal's intended beneficiaries.

A power of attorney can be effective upon execution or can be made to be effective at a future time or upon the happening of a specified event. The latter type of power of attorney is commonly called a "springing" power of attorney.

Powers of attorney generally terminate upon the principal's incapacity. However, a "durable" power of attorney will continue to be effective after the principal's incapacity. All powers of attorney will terminate upon the principal's death. Together with a health care proxy, discussed below, the durable power of attorney may help to avoid the time and cost of guardianship proceedings in the case of disability. This may be especially important in the case of an unmarried couple, where the family may contest the guardianship petition of the unmarried partner.

Some third parties are reluctant to accept the standard statutory form of power of attorney. Banks and other financial institutions often request that their own power of attorney forms be utilized, ostensibly for their own protection. Although some states have a statutory monetary penalty for failing to accept the statutory form, the penalty is not significant enough to avoid the third-party's resistance. If the power of attorney is to be used with banks or other financial institutions, it may save time and trouble to execute their power of attorney form if the principal is capable of doing so. Third parties are even more reluctant to accept "springing" powers of attorney where there is an issue of establishing that the specified event has occurred to cause the power to "spring" into effect. If the principal's hesitancy in preparing a standard power of attorney is the potential for abuse, that principal might be advised to name two agents and require that they act jointly, even if that does create logistical problems.

The principal must exercise caution and care in the appointment of an agent because the powers granted can be very broad and can be subject to abuse.

Several original powers of attorney should be executed because some third parties that rely upon such power may insist on keeping an original for their records.

A power of attorney that is valid in one state may not be valid in other states. If the principal will be moving to another state or divides her time between two states, it would be a good idea for the principal to execute a power of attorney for the other state as well.

#### **§ 21.05 HEALTH CARE PROXY (POWER OF ATTORNEY FOR HEALTH CARE)**

A patient that has capacity and can personally communicate her wishes to accept or refuse any medical treatment.

The law varies from state to state as to who, if anyone, can make health care decisions for a patient that does not have capacity and has not executed a health care proxy. In some states, not even family members or close friends are legally entitled to make health care decisions for an incapacitated patient and therefore no one will be authorized to discontinue life support. In other states, medical providers are permitted to take direction from family members (even in face of the patient's own written directions).

An unmarried partner does not have the rights of a spouse and therefore cannot sign a release for surgery, even if he knows her partner's wishes. Moreover, the patient's family can bar the partner from seeing the patient in the hospital. The partner's only option is to seek relief from the court, a process that is time-consuming and costly and likely to be opposed.

A patient that lacks capacity or is otherwise unable to communicate may, if he executes an advance directive called a health care proxy, also known as a power of attorney for health care, have her wishes with respect to health care communicated on her behalf by her agent or proxy.

A health care proxy is a document by which a patient formally authorizes another to make health care decisions for him if he not able to communicate. It allows physicians to discuss a patient's medical treatment with the named agent, even if the agent is not related or married to the patient.

The capacity required to execute a health care proxy is a low one. Some states, including New York, provide that a patient is presumed to have capacity to execute a health care proxy.

Together with the durable power of attorney, discussed above, the health care proxy can be useful in avoiding a costly guardianship proceeding in court, which, in the case of unmarried couple, may be contested by the family.

Health care proxies are readily accepted by health care providers.

Artificial nutrition and hydration, commonly known as feeding tubes, will not be withheld or withdrawn unless the patient's wishes in this regard are known by the health care agent. This statement can be put directly in the health care proxy or can be put in another document called a living will, discussed below.

The authority of the health care agent commences when the physician determines in writing that the patient is incapacitated.

A patient can revoke a health care proxy orally or in writing to the agent, by the revocation of a subsequent health care proxy or by any other act evidencing a specific intent to revoke. If the revocation is in writing, the patient should send the document of revocation to the agent and to the physician.

It should be noted that the separation of unmarried couples or domestic partners

does not automatically cancel the health care proxy. In contrast, where a spouse is designated as a health care agent, the divorce or legal separation will automatically cancel the health care proxy, unless the patient specifies otherwise.

A health care proxy that is validly executed in one state will most likely be accepted in other states.

### § 21.06 LIVING WILL

A living will is a document that expresses a patient's wishes about the type and duration of medical procedures that he wants if he is unable to communicate such wishes at the time of treatment.

A living will does not designate a health care agent but can be used by such an agent to establish what the patient's wishes are.

Most often, a living will is used to direct the cessation of life support if the patient is suffering from a terminal condition and is unable to communicate or is in a vegetative state and recovery is not expected.

The patient should discuss her wishes with the agent and should advise the agent of how strongly he wants to refuse treatment so that the agent can determine at what point to rely on the living will to advocate for the cessation of treatment.

For an unmarried adult, a living will is the best method to ensure that her wishes will be noted and carried out.

It is possible for a conflict to arise between the directions provided by a designated health care agent and those contained in a living will. Accordingly, it is advisable for both documents to provide a consistent direction to resolve the conflict, *i.e.*, the documents should provide that any conflict is to be resolved in favor of either the agent or the living will.

A living will may be revoked, altered or amended at any time by a competent person.

Many states have enacted a living will statute. As a declaration of wishes, a living will is likely to be accepted by other states.

### § 21.07 ADULT ADOPTION

An unmarried adult may wish to adopt another adult for a variety of reasons:

- To establish a family relationship for purposes of entitlements and other benefits.
- To create a legal and emotional bond to each other,
- To establish an heir to inherit under an existing will or trust.

The ability to create inheritance rights for an adult through adoption varies from

state to state. Some courts hold that adult adoption rights are less than child adoption rights. Other courts presumptively include all persons adopted as adults among those who qualify as members of a class of children. The outcome of these cases often is determined by the precise wording of the statutory language. Even where statutory language indicates that adopted adults may qualify as members of a class, courts will not necessarily interpret the law in that manner.

Some attorneys are drafting the definition of “issue” in wills and trust agreements so as to exclude adopted adults.

Recognition of adult adoption varies from state to state. Some states statutorily allow adults to adopt another adult. Some states have restrictions regarding the relation of the adoptee to the adopter.

The highest court of one state, Iowa, has held that an adopted adult will not ordinarily be included in a class gift from a stranger to the adoption unless the adult was taken into an adoptive home as a minor and reared as a member of the adopting parents’ family. This concept has become known as the “*loco parentis* rule.”

It should be kept in mind that, while marriage is revocable by a divorce, adoption is generally irrevocable. Still, even though the adoptive relationship cannot be revoked, the adoptee can be completely disinherited, unlike a spouse.

#### § 21.08 BURIAL INSTRUCTIONS

Historically there was no recognized property interest in the body. It was often described as a “quasi-property” interest, with next-of-kin acting as a type of trustee to see to the details of burial or other disposal.

Under English common law, there was no property interest in corpses, which were deemed to belong to the public. Lord Edward Coke wrote in his 1644 treatise regarding the burial of cadavers that they are “*nullius in bonis*” or “goods of no one” and belong to ecclesiastical authorities—a statement that became the basis for non-recognition of human body parts as property.

English law evolved from judicial efforts to prevent unauthorized disinterments and to avoid second-guessing family burial decisions after the fact.

American common law established a quasi-property right, vested in the next-of-kin, for the limited purpose of burial or other disposal. There was no commercial property interest in corpses, in part because it was believed that remains of a human body are not inherently valuable. Whether a change in market demand would alter this reasoning remains to be seen.

For a discussion of the legal complexities involved in determining the proper disposition of a partner’s body upon death in same-sex couples, *See*, Jennifer E. Horan, “*When Sleep at Last Has Come*”: *Controlling the Disposition of Dead Bodies for Same-Sex Couples*, 2 J. Gender Race & Just., 423 (1999) (arguing that courts should

give the power to control disposition to the person closest to the decedent and ensure that same-sex partners are included in the definition of spouse).

A Decedent cannot control his or her own burial. Essentially such direction is usually guided by (a) the decedent's wishes, (b) rights of family members and (c) state statutes that prioritize decision-making authority—each state regulates this area differently. While there seems to be a preference to accommodate a decedent's wishes regarding the disposal of his or her remains, this is nowhere an absolute right. Authority over the body rests with the surviving family members. Even the interests and desires of surviving family members can be outweighed by societal norms or public health concerns. This area requires statutory and perhaps Constitutional reform in order to protect and enforce a decedent's wishes. Some states, including Arkansas, Arizona, California, Colorado, Delaware, Idaho, Illinois, Louisiana, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Oregon, South Dakota, Texas, Utah, and Virginia have recently enacted legislation to cure this problem. Some statutes are more effective than others.

As the foregoing hopefully demonstrates, while there remain many estate planning advantages to being married, some of those benefits are merely perceived benefits and are either deferrals or simply neutral, and in other cases, marriage actually imposes a limitation on what can be accomplished. The challenge is to find the correct advantage in each situation.

