





The Demise of Federal DOMA

New Financial Planning Strategies for Pennsylvania Same-Sex Couples

By James Lange

In 2009, Thea Spyer died in her sleep of a heart complication called aortic stenosis, and when she died, Edith Windsor lost her wife and partner of almost 50 years. Such a loss would be a devastating blow to anyone, but for Ms. Windsor the heartache was compounded by a disastrous financial complication. Legally married in New York state, she filed her spouse's federal estate tax return claiming the unlimited marital deduction upon her wife's death. All legally married U.S. citizens may inherit from their spouse without paying any estate taxes. But Edith was denied that benefit because the federal government and, by extension, the Internal Revenue Service did not recognize her marriage. She was forced to pay an incredible \$363,053.



The U.S. Supreme Court in *U.S. v. Windsor* declared Section 3 of DOMA to be unconstitutional as a deprivation of the equal liberty for all people protected by the Fifth Amendment.

The problem was that Section 3 of the federal Defense of Marriage Act (DOMA) denied all federal benefits of marriage to same-sex couples; the word “spouse” referred only to a person of the opposite sex who was a husband or a wife — even if the marriage was legal under that state’s law.

Their home state, New York, officially recognized their marriage in 2008 and, since spouses enjoy an unlimited marital deduction, no state inheritance tax was due.

Sadly, on the federal level, Edith Windsor had to pay for her wife’s passing not only in grief but also in bundles of cash.

A legal battle, not only for Windsor’s right to the exemption but ultimately for marriage equality, started in 2010 in the Southern District of New York and lasted nearly three years before ending up in the U.S. Supreme Court. In June 2013, in a landmark 5-4 decision, the U.S. Supreme Court in *U.S. v. Windsor* declared Section 3 of DOMA to be unconstitutional as a deprivation of the equal liberty for all people protected by the Fifth Amendment.

Justice Anthony M. Kennedy, joined in the majority by Justices Stephen G. Breyer, Ruth Bader Ginsburg, Sonia Sotomayor and Elena Kagan, wrote the court’s official opinion. Dissenting opinions were written by Justices Samuel A. Alito Jr. and Antonin Scalia and by Chief Justice John G. Roberts Jr. Justice Clarence Thomas joined Scalia’s dissent in whole and Alito’s dissent in part.

This ruling did not decide the overall constitutionality of same-sex marriage. It did, however, declare that for federal estate tax purposes a marriage cannot be narrowly defined as solely between a man and a woman.

Beyond *Windsor*: The True Meaning of DOMA’s Downfall

This ruling created many questions but perhaps the most important was how the IRS and other federal agencies would treat same-sex couples in states such as Pennsylvania that do not recognize same-sex marriage.

Just as practitioners were trying to figure out what to make of this case, the IRS released Revenue Ruling 2013-17. The ruling determines that after *U.S. v.*



Windsor the terms “spouse” and “marriage” had to be gender neutral. The IRS would treat all married couples the same for federal tax purposes. This ruling ensured uniformity in application of the Internal Revenue Code. Primarily, the IRS understood that striking down Section 3 had implications beyond the estate tax issue at its core. The interpretation of tax code terms as gender specific would now raise serious constitutional questions. Moreover, the ruling stated that efficiency was a major factor in its decision. As the IRS does not collect or maintain information on a taxpayer’s gender, it is simply easier to treat all married couples as equal.

Revenue Ruling 2013-17 also concluded that if a couple was married in one of the jurisdictions that recognize same-sex marriage — California, Connecticut, Delaware, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New Jersey, New York, Rhode Island, Vermont, Washington and the District of Columbia — and moved to a non-recognition state, the couple would still be considered married for all the purposes of the Internal Revenue Code. That means, however, that if a same-sex

couple is “married” in Pennsylvania and lives in Pennsylvania (or any other non-recognition state), their marriage will not be recognized by the IRS.

What this revenue ruling further clarified was that even if the marriage resulted from “forum-shopping,” the IRS would still recognize it. Therefore, if a Pennsylvania couple drives across the border to New York or Maryland just to get married, similar to couples who elope to Las Vegas, their marriage will be deemed valid for purposes of the Internal Revenue Code.

Fundamentally, the IRS determined that the state-of-domicile rule would wreak administrative havoc if the agency did not adopt a uniform rule of recognition. For instance, if a same-sex couple legally married in their home state moved to a state that did not recognize their marriage, the attribution of the spouses’ property interests could change, thus impacting anyone involved in property transactions. Additionally, the IRS cited administrative burdens for employers with employees who work out of state or in more than one state as well as tax issues for married couples who live separately in two states that have different marriage laws. The IRS claimed these complexities would lead to uncertainty for all parties involved and make administration unduly difficult. In other words, the IRS knew that if it didn’t release this revenue ruling, it was going to spend an eternity in court, and it would probably lose.

The Situation for Pennsylvania Residents

In light of the *Windsor* case and the subsequent IRS ruling, the door is wide open for the same-sex marriage movement to seek the logical conclusion: legal same-sex marriage throughout the United States. Pennsylvania has recently become one of the battleground states.

Since 1996 Pennsylvania has had a statute on the books that limits the definition of

The IRS in Revenue Ruling 2013-17 determined that after *U.S. v. Windsor* the terms “spouse” and “marriage” had to be gender neutral.





One thing is clear. LGBT citizens who are residents of our commonwealth, and indeed LGBT citizens across the entire nation, must re-evaluate their estate and tax planning.

marriage to the legal union between “one man and one woman.” The Pennsylvania statute also refuses to recognize same-sex marriages that are legal in other states. On July 9, 2013, against the backdrop of the powerful *Windsor* verdict, the American Civil Liberties Union filed a lawsuit in Pennsylvania on behalf of 23 plaintiffs. The attorney general of Pennsylvania, Kathleen Kane, refused to defend the statute, as she believes it to be unconstitutional. At a news conference at the National Constitution Center in Philadelphia, Kane stated, “It is now the time here in Pennsylvania to end another wave of discrimination.” Gov. Tom Corbett, who has spoken out about the importance of defending the statute, has been named the defendant in her stead.

While the lawsuit is ongoing and we are uncertain of its ultimate outcome, one thing is clear. LGBT (lesbian, gay, bisexual and transgender) citizens, those who are residents of our commonwealth and indeed LGBT citizens across the entire nation, must re-evaluate their estate and tax planning. While Pennsylvania residents are this article’s primary focus, please note that the analysis and advice contained herein is applicable in a majority of non-recognition states. Those who live in another state should see a competent adviser in that state before taking action.

There are critical areas in which Pennsylvania same-sex couples (even if legally married in another state) do not enjoy the same rights as opposite-sex married couples.

The Pennsylvania Inheritance Tax Situation

For Pennsylvania inheritance tax purposes a married same-sex couple cannot take advantage of any benefits available to individuals in an opposite-sex marriage. The same-sex couple is treated as if they are unrelated. This means that there is a 15 percent tax assessed on assets passing to the same-sex partner as opposed to a zero percent tax for an opposite-sex married couple.

For example, assume that Joe has a \$1 million house and \$100,000 in savings. Joe dies and leaves everything to his husband, Sam, whom he legally married in New York. Pennsylvania doesn’t care where they were married or even if they were married. Pennsylvania will not treat them as a married couple and Sam will be assessed a tax of \$165,000. Unless there are other resources, Sam may have to sell the house to pay the taxes.

Gifting is now an important planning tool for Pennsylvania couples who were legally married in a jurisdiction that

Advice to Consider for Same-Sex Couples

By James Lange

Though advice will obviously differ on a case-by-case basis, here are a few action points that same-sex couples in Pennsylvania should consider.

1

If you want to get married (despite all the risks and problems of traditional marriages), travel to a state where marriage equality exists and tie the knot. Of course, we would recommend being prudent and that you consider such unpleasant but often necessary legal documents as prenuptial agreements and other property agreements. While being legally married will not help Pennsylvania residents with regard to state laws and state tax issues or federal laws that defer to the state laws, it will offer benefits for federal estate and income tax purposes.

2

Apply for Social Security benefits and survivor benefits when you feel it is appropriate. Currently the Social Security Administration is urging same-sex couples to apply for benefits regardless of the legality of their marriage in their state. Even couples with civil unions or registered domestic partnerships are encouraged to apply. The Social Security Administration has indicated that if and when changes are made to allow Social Security benefits for these partnerships, the administration would backdate benefits to the date of filing.

Caution must be exercised in applying for Social Security benefits for same-sex couples just as for traditional couples. We often recommend deferring application for Social Security in order to receive higher benefits later. Social Security planning should be examined on a case-by-case basis. The uncertainty of the law for same-sex couples makes the planning even more complex.

3

Act now to prepare or amend your wills and trusts to include special provisions regarding the disbursement of your assets that are consistent with current laws but include special provisions in case same-sex marriage is legal at the time of your or your spouse's death.

4

Discuss advance health care directives with your spouse and advisers. It is the right of every American to have an advance health care directive, and hospitals are obligated to honor them when they are appropriately drafted and legally binding.

5

It is often prudent to pre-plan your funeral arrangements. In many instances partners in same-sex relationships who aren't legally married where they reside have no say in how their loved ones are laid to rest. In Pennsylvania a simple legal document known as a Statement of Contrary Intent may be prepared, and arrangements can be made with funeral directors to give same-sex couples the right to carry out the wishes of their departed loved ones.

→ page 34



→ from page 33

6

Technically, because Section 3 of DOMA was found to be unconstitutional, the statute is deemed to have been invalid or void from the outset. This means that same-sex couples who were married legally in a jurisdiction that allows for same-sex marriage have always been legally married, according to the federal government. Therefore, those same-sex married couples who would have paid less in federal taxes had they filed jointly or claimed a marital deduction upon the death of their spouse now have grounds to file an amended return. Generally the IRS allows a taxpayer to file an amended return three years from the date the return was filed or two years from the date the tax was paid, whichever is later. Have a discussion as soon as possible with your CPA or tax attorney about taking advantage of this ruling. However, understand that filing an amended return is optional. Some couples might actually owe additional taxes to the IRS for previous years if they were required to file reflecting a married status. A conversation with your tax adviser, followed by a tax assessment for “married filing jointly” vs. “two single taxpayers” would be sensible. Then, depending on the result, either you or your CPA could file amended returns and request a refund. In addition, for tax year 2013 and thereafter and for taxpayers filing an original tax return on or after Sept. 16, 2013, same-sex married couples generally must file as either married filing separately or jointly.

7

Same-sex couples who are legally married will be treated as married for all federal tax purposes, including income and estate and gift tax purposes. This applies to all federal tax provisions where

being married is a factor, including but not limited to filing status, personal and dependency exemptions, employee benefits and contributing to an IRA. A qualified retirement plan must treat a same-sex spouse as a spouse. Same-sex spouses are now able to rollover (transfer) their deceased spouse’s benefits into their own IRA, enabling them to receive benefits over their lifetime and to delay minimum required distributions until age 70 ½. This means all IRA and retirement plan beneficiary forms should be reviewed with the new interpretation in mind. Under the appropriate circumstances the financially stronger and/or spouse closer to death should consider making gifts to his or her spouse. For wealthier couples, consider large gifts to take advantage of the unlimited federal marital gift deduction, which could save huge sums in taxes.

8

Consider purchasing life insurance to protect your spouse and to cover any transfer taxes incurred by your spouse upon your death if Pennsylvania does not legalize same-sex marriage in your lifetime. Life and long-term-care insurance can also help protect your assets and keep you and your spouse in charge of your money and your future. One particularly useful insurance tool for same-sex couples is a combination life and long-term-care insurance policy that will cover the costs of long-term care during your life and pay out what you don’t use of the coverage as a death benefit. Life insurance is typically paid to a named beneficiary and beneficiary designations bypass probate, allowing you to control those funds directly. ♦

There are critical areas in which Pennsylvania same-sex couples (even if legally married in another state) do not enjoy the same rights as opposite-sex married couples.

→ from page 32

recognizes same-sex marriage but who now reside in one that does not. Transfers from one person to another that are made more than one year prior to death will escape the 15 percent Pennsylvania inheritance tax. This means that appropriate gifting between spouses in same-sex marriages will eliminate the assessment of 15 percent in state inheritance tax on the transfer of assets to the surviving spouse. (See recommendation No. 7 in the accompanying list of action points.)

Social Security for Pennsylvania Residents

Another problem facing Pennsylvania couples in same-sex marriages is in the area of Social Security.

Here is an example of how Social Security works for an opposite-sex marriage. Take, for instance, the option of taking a survivor benefit on your spouse's earning record. In this example Paul is married to Sue. Paul, who is age 66, receives Social Security benefits of \$3,000 per month. If Paul dies, Sue will get a survivor benefit in the same amount Paul was receiving, if his benefit was larger than Sue's.

But if Paul is married to Jeff and lives in Pennsylvania, even if legally married in a state where same-sex marriages are recognized, Jeff would not receive any Social Security benefits based on Paul's earnings record. The Social Security Administration, even though it is a federal agency like the IRS, has a different standard for state of domicile: It recognizes the law of the state of residence, not

where the marriage took place (which is also known as the state of celebration). So running over the border to New York to get married, only to come back to Pennsylvania to reside, will not ensure Jeff's ability to collect Social Security as Paul's surviving spouse. Paul and Jeff must be legally married in a state that recognizes gay marriage, and, at the time of application, Paul must have been living in a state where the marriage was recognized in order for Jeff to receive benefits.

While this may change in the future, as of this moment the letter of the law says that Jeff will not receive any survivor benefits in Pennsylvania. For some couples this makes the risk of the financially stronger partner dying even more devastating for Pennsylvania residents.

However, an August 2013 press release from Carolyn Colvin, acting commissioner of the Social Security Administration, reported that the agency had already begun processing some same-sex retirement spousal claims and would continue to process claims as additional instructions are received. Additionally, the Social Security Administration's Program Operations Manual System indicates that even though you must be living in a state that recognizes same-sex marriage when you apply for spousal and survivor Social Security benefits, once your application is approved you and your spouse may move anywhere you like and continue to receive benefits. (See recommendation No. 2 in the accompanying list of action points.)

→ page 36



When it's decided, bring your questions to PBI.

Whether the issue is DOMA, voting rights or another legislative decision, PBI and its knowledgeable volunteer faculty and authors provide insights into the latest developments and strategies and how they affect multiple practice areas.

Exceptional CLE includes sharing knowledge with expert faculty and peers. Bring your unique perspectives and questions about the latest court decisions, and PBI will provide you with all you need to know.

Find out more about PBI's upcoming live seminars and online CLE at pbi.org. Registration is available today for January/February 2014.

800-932-4637

Follow PBI @PBICLE, Facebook, LinkedIn and Google+.

→ from page 35

What Should Pennsylvania Same-Sex Couples Do to Protect Their Finances?

The issue of marriage equality is in constant flux. It was difficult to finish this article, as new information and insight was constantly presenting itself. In light of the shifting legal landscape, it seems that the best course of action for same-sex couples who are contemplating marriage is to take advantage of the new rights available but remain defensive in their retirement and estate planning to ensure that their wishes are carried out.

The legal landscape for same-sex couples remains uncertain in Pennsylvania. However, it is essential that same-sex couples take action to protect their financial future and their ability to act for each other in life and death situations.

It is essential to get qualified legal and tax advice to protect and preserve your assets as well as to protect the rights and interests of your surviving spouse. Establishing a relationship with a trusted adviser can help you pave the way to your goals, both in the current legal environment and into the future as the law evolves. ♦



James Lange

For over 30 years I've been helping couples and families with retirement and estate planning. In 2002, I saw that your community, the LGBT community, was being grossly underserved in the retirement and estate planning world so I devised

some good strategies. Now, with new laws advancing equality, there are even greater opportunities for same-sex couples to ensure financial security and wealth for generations to come. We want you to take advantage of your legal rights and we want to assist you in protecting yourself and your family against the legal inequities that you continue to suffer. No matter what your situation, we will find a way to put you and your family in the best retirement, tax, and estate planning position you can be in.

To learn more about my firm and how I can help you to protect you and your family's financial future, please click on this link:

<http://outestateplanning.com/contact-us/>