

Estate And Disposition Planning Issues For Same Sex Or Other Unmarried Couples

By **Andrew R. Lee, Esq.** *Lee & Gregory, P.C., Birmingham, MI*



ESTATE PLANNING FOR same-sex or non-married couples requires the estate planning attorney to focus on issues not present with married couples. With the lack of an unlimited marital deduction on death, no lifetime gift exemption to partners, and state intestacy laws that disinherit life partners, same sex or non-married couples need to execute estate planning documents and often implement creative living and testamentary gifting techniques to protect their loved ones, avoid disinheritance, and take advantage of both partner's unified credits.

herit his or her life partner or significant other. Furthermore, while counseling a gay or lesbian client, one might find that there are certain family members who never accepted the client's sexual identity, and therefore, the client would not favor assets passing assets to that family member. Well, under the Intestacy rules, that family member may in fact become a beneficiary, unless specific plans are made to direct assets to the intended beneficiaries.

Will

The Will is an important document in regard to designation of personal representative/executor.

When someone fails to plan for the disposition of his or her assets upon his or her death, the state's intestacy law determines the identity of beneficiaries. These laws are typically drafted to provide for the spouse and children of the decedent. How-

ever, a gay or lesbian life partner is not a spouse for purposes of intestacy laws, nor generally is a non-married opposite sex significant other in many states. Therefore, disposition planning through intestacy statutes is the quickest way for a client to accidentally disin-



A Probate Court may select a family member such as a sibling or parent, before it would select a life partner or significant other, in the absence of the client indicating his or her partner as the Personal Representative. However, keep in mind that solely having a Will, without also creating and funding a Revocable Living trust ("trust") often subjects the client to a probate proceeding, which is typically open to the public. The privacy factor of avoiding probate is often important to both married couples as well as unmarried couples. However, it could often be of even greater significance to the same-sex couple client because these clients may be concerned about others becoming aware of their relationship through the probate process.

Revocable Living Trust

The trust allows for more privacy, as it may allow clients to avoid a full probate proceeding. In addition, a client could list his or her own trust as a beneficiary on items such as life insurance or certain retirement accounts. Many gay or lesbian clients may be concerned about their advancement or job retention if they were to specifically list their life partner as their beneficiary on employer provided benefits. However, by listing his or her trust, which also happens to provide for the benefit of his or her life partner, the client would be able to avoid the issue of what would happen if his or her employer were to learn of his or her sexual identity. However, one needs to keep in mind, and advise the client, that a



Since Sec. 2056 of the Code does not allow for the deferral of estate taxes until the second death, same-sex couples and non-married heterosexual couples face the possibility of incurring an estate tax at the first death.

lump-sum payout may be required from a retirement plan, if payable to a client's trust, thus accelerating income tax recognition. Therefore, the attorney should pay close attention to the required minimum distribution rules of Sec. 401(a)(9), and other related sections, of the Internal Revenue Code (the "Code") to avoid lump-sum treatment, if possible.

Certificate of Trust

To further protect the privacy of the client, a certificate of trust should be drafted. This document, which in some cases is based on state statutes, typically only lists the title of the trust, the current and successor trustees, and the trustee's powers. Therefore, if the client were to list his or her trust as the beneficiary of workplace

benefits, he or she could provide the employer with the certificate of trust, rather than the actual trust, if evidence of the trust's existence were requested. Thus, the employer would not be privy to the dispositive terms in which the client has provided for his or her life partner.

Estate Taxes

Since Sec. 2056 of the Code (Marital Deduction) does not allow for the deferral of estate taxes until the second death, same-sex couples and non-married heterosexual couples face the possibility of incurring an estate tax at the first death. Therefore, one should examine whether there will be enough liquidity at the first death to cover the tax liability. Often, clients would want their surviving partner to be able to stay in their home after the first partner dies. This may require the purchase of a life insurance policy to provide for enough liquidity so that assets such as the home or a business would not need to be sold to pay Uncle Sam, and possibly their state governments.

Gift Taxes

It is not uncommon for life partners or significant others to have made gifts to one another during the course of the relationship. However, since the couple is not married, Sec. 2523 of the Code does not apply and thus anything over the gift tax annual exclusion amount is a taxable gift. This could raise a dilemma if a client engaged in planning that required the filing of a gift tax return. If a client has not treated prior transfers as taxable gifts, the attorney must consider whether he or she would want to prepare and sign the Form 709. Let us not forget that when a client placed his or her life partner or significant other on the title to his or her home, he or she made a gift to that individual. For example, let us assume that partners A and B live in a home worth \$500,000, and the home was originally purchased by and in the name of partner A. Before partner A and B were clients, A decided to have a deed drafted, adding part-

Play a vital role in The Seeing Eye® dog program.

For more than 70 years, bequests and other planned gifts have sustained The Seeing Eye, North America's oldest dog guide school. Our mission is to enhance the independence, dignity and self-confidence of blind people through the use of Seeing Eye dogs.

To name a puppy and help a blind person, call us.



The Seeing Eye
1111 Avenue C
 Manhattan, New York 10017-2315

Mari Morgan, Manager, Planned Giving
 Email: mmorgan@seeingeye.org • Phone: 973-639-4425



ner B to the title of the home. If we assume that there were no debt on the property, A provided all of the funds for the purchase of the home, and that A and B are the same age, then it is arguable that A made a gift of \$250,000 to B, when B's name was added to the title. This gift would count towards the cumulative amount of gifts in which partner A could make during his lifetime without the imposition of a gift tax liability. If the attorney were to later suggest an additional gifting program for A, that attorney would need to file a prior gift tax return. Therefore, it is crucial for the attorney to ask the clients if either one made or received gifts from the other. It is possible that the client could have made numerous unreported gifts in the past, over and above the exemption amount.

If this were the case, then gift taxes, interest and penalties could be currently accruing, should the IRS ever learn about the prior gifts. Although the IRS may not discover this issue while partner A is alive, but if discovered many years later upon an audit of the estate tax return (or a successor return should there be new form used upon the repeal of the estate tax), the interest and penalties alone effectively could cause to disinherit the other partner, and make Uncle Sam the primary beneficiary. Keep in mind that there is no tolling of the statute of limitations, if an "adequately disclosed" gift tax return were not filed. Also, properly prepared and filed gift tax returns could eliminate issues regarding the net worth of the donee upon an income tax fraud audit.

It is important to indicate in the planning whether the surviving partner has the right to continue residing in the residence shared with the deceased partner. If the home were partially or entirely in the name of the deceased partner, then the absence of such a provision could cause disputes between the surviving partner and whomever is listed as the ultimate beneficiary, upon the death of the surviving partner. For example, if part or all of the home were ti-



It is important to indicate in the planning whether the surviving partner has the right to continue residing in the residence shared with the deceased partner.

tled in the name of the deceased partner's trust, then the ultimate beneficiaries may believe that the surviving partner should be paying rent. Also, if there were a mortgage left on the property, the ultimate beneficiaries would likely expect the surviving partner to pay his or her share of that mortgage. The ultimate beneficiaries may contend that the mortgage payments should be made from assets of the surviving partner, rather than from assets of the decedent. However, the deceased partner may have been more financially secure than the surviving partner, and he or she may have wished that his or her surviving partner should be able to live in the home rent free, or without the liability of the mortgage payments. If this were the case, the trust document should make this fact clear and provide means to cover expenses, in order to avoid disputes between the surviving partner and the ultimate beneficiaries of the trust.

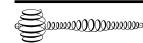
Relationship With Family Members

It is not uncommon for gay or lesbian clients to have less than harmonious relations with some of their family members. Therefore, these clients may want to be more careful when selecting which family members they would list as possible beneficiaries. Also, a cli-

ent may say that he or she has a good relationship with his or her family members, but when asked if he or she wants to name any family members as a co-trustee of the trust for the benefit of the surviving partner (upon the first death), the client might state that while he or she does get along well with his or her family, the family does not know about his or her partner, or they may know, but the topic is never discussed between the client and his or her family. Therefore, it often could be more difficult to find a co-trustee of a unified credit/applicable exemption trust. Without a co-trustee on the exempt trust, a drafting attorney could risk tainting these funds and subjecting them to inclusion in the estate of the surviving partner upon his or her death, if the client wishes to provide his or her surviving partner with more than the usual ascertainable standard language, thus creating a larger estate at the second death.

Children. Don't assume that just because clients are of the

DOYLE



NEW YORK

TRUST *and* ESTATE SERVICES

Doyle New York is one of the world's foremost appraisers and auctioneers of fine art, jewelry, furniture, decorations and other categories. For almost forty years, Doyle has built a reputation within the Trust and Estate community for achieving outstanding prices with expertise, integrity and service.

For information on our full range of services, please call
Joanne Porrino Mournet,
Executive Vice President,
at 212-427-4141,
ext. 227.



Sapphire and Diamond Pansy Pin.
From the Estate of Dorothy Strelsin.
Sold at Doyle New York for \$30,550.

DOYLE NEW YORK
AUCTIONEERS & APPRAISERS
175 E 87TH ST | NY, NY 10128 | 212-427-2730
DoyleNewYork.com

same sex or are unmarried that they do not have any children. It is more and more common for gay, lesbian, and other unmarried clients to have children. In some circumstance, both partners (whether in the gay or heterosexual unmarried circumstance) may have children from prior marriages or relationships. Proper planning would need to be implemented in order to provide for the children on both sides, if this were a goal of the clients. This could be accomplished by holding the share in trust for the surviving partner during his or her lifetime; the remaining assets would be properly split between the children on each side, in a manner pre-determined by the clients, after the second death. In addition, these days, many same-sex couples are raising children together. Only one parent might be the legal guardian of a child who is being raised both partners as their child. Therefore, proper guardianship and conservatorship appointment language needs to be drafted. The attorney should also look into whether second parent adoption is being recognized in his or her jurisdiction, as some jurisdictions around the country have started to allow both non-married partners to adopt children together.

The Joint Property Trap

Gay, lesbian, and other unmarried couples may want to hold all their assets with their life partner or significant other, jointly. While this may achieve the goal



If one partner has the majority of the assets, adding his or her partner as a joint owner on all of the assets could create a current gift tax liability.

of avoiding probate on the first death and avoiding the disinheritance of the life partner or significant other, it also creates some problems. First, if one partner has the majority of the assets, adding his or her partner as a joint owner on all of the assets could create a current gift tax liability.

Keep in mind that although the estate tax is set to be repealed in 2010, the gift tax will remain. Second, joint tenancy does not avoid probate at the second death, or deal with the issue of simultaneous deaths (e.g. both partners die in the same accident).

Third, joint ownership raises liability issues. If a client makes his or her partner the joint owner of assets, the assets are opened up to the claims of both partners' creditors. For example, if a client

were to add his or her partner on the title of a stock portfolio, and that partner were involved in an accident and was sued, these funds could be subject to that claim. Fourth, there may not be anything preventing the recipient partner from being able to go to a joint bank account and withdrawing the funds, even if that partner were not the contributor of the funds to that joint bank account. Therefore, one needs to balance the issues of building the other partner's estate versus giving the other partner too much access to the assets. A possible solution could be to first transfer the assets to a Limited Liability Company ("LLC"), controlled by the donor partner, and give the other partner a non-controlling interest in Limited Liability Company. The Operating Agreement could provide for buyout provisions with soft terms in the event of the breakup of the parties.

Although the approach of gifting through an LLC still raises gift tax issues, it could still be useful to prevent the donee partner from having too much access to the assets. However, in regard to the gift tax issue, the donor partner could argue that the value of the gift should be discounted, due to the donee partner's lack of control and the lack of marketability in the LLC interest. Furthermore, from a creditor protection point of view, a creditor of the donee partner may only be able to obtain a charging order, and thus only get at the LLC distributions that were actually made to the members. The Limited Liability Company and Limited Partnership Acts of many states include charging order provisions. A creditor who charges a partner's (or member's) interest in a partnership (or an LLC taxed as a partnership) only has the rights of assignee. The IRS has taken the position that an assignee of a partnership (or LLC) interest will be treated as a partner for income tax purposes, even if that assignee is not admitted as a full partner or member (Rev. Rul. 77-137). Thus, the creditor could face the recognition of taxable income that would

THE SOLUTION FOR YOUR CLIENTS WHO WANT TO HELP ANIMALS AND PEOPLE...



Millions of innocent creatures suffer and die each year in cruel and wasteful medical experiments. The National Anti-Vivisection Society wants to stop the hurting. We are dedicated to identifying humane solutions to human problems and to promoting the development of alternatives to the use of animals in testing, education and biomedical research. A bequest to NAVS is an opportunity to spare animal lives and make a lasting impact on future generations.

For more information, contact Mary Margaret Cunniff
The National Anti-Vivisection Society
53 W. Jackson Blvd, Suite 1552 Chicago, IL 60604
Telephone 1-800-888-NAVS (1-800-888-6287)

NAVS
CREATING ANSWERS FOR A CREDIT-FREE WORLD

© 1998 NAVS

flow through from the LLC, without the guarantee of LLC distributions. For this reason, some creditors do not always seek charging orders in LLCs which are taxed as partnerships, as it could put the creditor in an even worse financial position.

Possible Lack of Pension Benefit

Clients may be relying on the pension benefits of one of the partners to provide for retirement. Although pension benefits may pay a retirement benefit to the surviving spouse of a former employer, they do not always continue to pay the retirement benefit to the surviving life partner or significant other. Therefore, clients need to plan for the possibility that the partner with the pension may be the first to die. There might be a need to obtain life insurance on the life of the partner with the pension benefits, to replenish the loss of retirement funds upon the death of that partner.

Second Death Issues

Often, clients will indicate that the protection for and support of his or her life partner or significant other is the primary goal. In such circumstances, there is typically not as much of a concern about assets being exhausted by the primary beneficiary. Although providing for the surviving partner may be first goal of the clients, when it comes to the disposition of assets upon the second death, the two partners may have different goals from one another. In the traditional setting where a client is married and has children with his or her spouse, the balance of the funds typically pass to the children at the second death. However, if the gay or lesbian couple, or the unmarried heterosexual couple, has not raised children together, each partner may have different goals of who should receive their assets, after the second death. This situation is often similar to a married couple in a second marriage, where the two members of the couple have different dispositive terms in their trusts upon the second death. When clients want different ultimate benefi-



Often, clients will indicate that the protection for and support of his or her life partner or significant other is the primary goal. In such circumstances, there is typically not as much of a concern about assets being exhausted by the primary beneficiary.

ciaries in their separate trusts, this should impact how much control the attorney in his or her drafting should give to the surviving partner in his or her deceased partner's trust. In reality, the partners should probably retain different and independent legal counsel. In the absence of this the attorney should get a waiver of conflict signed to be placed in the file.

For example, if the trust requires a co-trustee to approve of distributions, in a similar situation to drafting a QTIP for a married couple, then there would be less concern about the funds being removed from the deceased partner's trust, and placed into the surviving partner's trust (which may have a different set of dispositive terms). However, if clients want their trusts to include 5 x 5 powers, or unlimited withdrawal rights, then the attorney should advise them that the surviving partner could use the withdrawal powers to drain the trust and disinherit the deceased partner's successor beneficiaries. Therefore, the client needs to balance the control given to his or her surviving partner with the goal of protecting contingent beneficiaries.


Beyond the Basics: Shifting Assets between life partners and Significant Others

It is often the goal of the estate planning attorney to equalize the estate of couples, in order to pro-

vide for the ability to take advantage of two unified credits/exemption amounts, regardless of the order of death. While it may often be easy to transfer assets between US citizen spouses, this does not hold true for non-married couples. Any gifts to a partner, over an above the annual exclusion amount (which is \$10,000 for year 2001), would be a taxable gift, which could ultimately create a gift tax liability. Therefore, in order to fund a life partner's or significant other's estate to give him or her enough assets to fund the credit/exemption, clients may need to make taxable gifts. However, there are ways to leverage these gifts. The discussion below gives various examples of ways to shift value from one life partner or significant other, to the other. In each example, the following assumptions are made: (a) partner with more assets is age 55; (b) partner with less assets is age 53; and (c) 7520 Rate is 6 percent.

Family Limited Liability Company (FLLC). The use of an FLLC


**American Foundation
for the Blind**



**Helen Keller's Cause
in the United States**

The American Foundation for the Blind (AFB) enables people who are blind or visually impaired to achieve equality of access and opportunity that will ensure freedom of choice in their lives.

For information about bequests or other planned gifts to AFB, or for a free copy of AFB's *Pooled Income Fund* video, contact Doris Dieter, Director of Planned Giving, at (212) 502-7622.

 American Foundation for the Blind

could be advantageous to a client who wanted to give assets away to his or her partner, but did not want to give up complete control over those assets. For example, if partner A wanted to make gifts to partner B in order to help balance out their estates, he could first contribute the assets to an FLLC in exchange for 99 percent non-voting and 1 percent voting membership interests in the FLLC. Partner A would then make a gift to partner B of a non-controlling (i.e., non-voting) interest in that FLLC. Through the use of non-voting FLLC membership interest, Partner A could give away up to 99 percent of the equity interest in the FLLC, while retaining the remaining 1 percent, which possesses the vote. In addition, gifts of interest that lack control or marketability could possibly be valued at a discount, thus leveraging the gift. For instance, if partner A were to give away an FLLC interest and the donee could not control the Company and there were no market in which to sell the FLLC interest, then partner A could claim that the FLLC interest, which he just gifted to his partner, is not worth 100 cents on each dollar.

Grantor Retained Income Trust (GRIT). Through a GRIT, one partner could transfer assets to the other partner and leverage the size of the gift. The grantor is assumed to have retained a value in the assets based on the term of the trust, and the current 7520 Rate. For example, a client, partner A, has an extra \$1,000,000 of stock, which she wanted to transfer to her life partner, partner B. If partner A were to transfer the stock outright to partner B, then she would have to write a check to the IRS for making a taxable gift (assuming the gift were made prior to the increase in the exemption amount and/or no prior gifts had been made). However, if the \$1,000,000 were funded in a GRIT, to be held in the trust for a period of 10 years, before going to partner B, then partner A would be deemed to have retained the benefit of the funds for that 10 year period, which is valued at \$504,750 (even though no actual distributions are made to the Grantor). Therefore, partner A would have made a taxable gift to her partner of \$495,250 (i.e., the



Through a charitable trust, a client could create a stream of payments for his or her partner during his or her partner's lifetime, while possibly also getting a current income tax deduction today.

difference between \$1 million and the \$504,750 value retained by the Grantor). Although this would require the filing of a gift tax return (Form 709), there would be no current gift tax liability owed, since the gift would still be below the \$675,000 exemption. Although GRITs can no longer be used by married couples, since life partners and non-married heterosexual couples are not related as defined under Reg. 25.2702-2(a)(1), the GRIT could continue to be used as a planning tool for non-traditional couples.

Partner A could use the same technique as the GRIT, and transfer her residence to her partner under the terms of a *Qualified Personal Residence trust*. (QPRT). Just as in the example above, if the home were worth \$1,000,000 and the term were 10 years, the value retained would once again be \$504,750, with a gift of \$495,250. In addition, in both the GRIT and the QPRT, if partner A outlives the term, she would have removed the growth in the transferred assets from her estate.

Grantor Retained Annuity Trust (GRAT) A GRAT is quite similar to a GRIT, however, with a GRAT there has to "actually" be payments to the Grantor. Let's assume that partner A were to transfer \$1,000,000 of assets into her GRAT, and she were to receive an annual annuity payment of 7 percent (i.e., \$70,000) for a period of 10 years. After that 10 year period, the re-

maining assets in the trust would belong to partner B. Partner A would be treated as if she retained an interest valued at \$492,415 (i.e., current value of \$70,000 per year for 10 years), therefore, this would create a gift in the amount of \$507,585. However, if it were determined for valuation purposes that a non-voting interest were subject to a discount of 20 percent, by first contributing her assets to a FLCC and later transferring an interest in her FLLC (which holds the \$1,000,000 assets) to the GRAT, the gift would be reduced to \$307,585, based on the same \$70,000 annual payout and the 10-year term. The lower gift could be created by valuing the assets at \$800,000 (i.e., based on a discounted value of the non controlling, unmarketable FLLC interest contributed to the GRAT), and thus the \$70,000 annual return would be computed as an 8.75 percent return, rather than a 7 percent return.

Charitable trusts. Through a charitable trust, a client could create a stream of payments for his or her partner during his or her partner's lifetime, while possibly also getting a current income tax deduction today. For example, if partner A puts \$1,000,000 into a *Charitable Remainder Annuity trust (CRAT)*, which pays her partner, partner B, a 5 percent annual payout (i.e., \$50,000), partner B would receive these payments during partners B's lifetime. Partner A would get a current income tax deduction in the amount of \$388,905, and she would have made a taxable gift of \$611,095 to her partner. In the alternative, partner A could set up a *Charitable Lead Annuity trust (CLAT)* in which the charity were to receive a 5 percent annuity payment (\$50,000) per year for 10 years, and then after 10 years, the assets would go to partner B. Under this scenario, partner A would have made a gift of \$631,995. If the CLAT were a grantor trust, then partner A would also receive an income tax deduction in the amount of \$368,005. However, if the CLAT were a grantor trust, then the donor would also continue to recognize the income and gains from that CLAT during the term of

See Partners, p. 71

**Partners,
Continued from p. 56**

the trust, without access to the assets to cover the tax bill. For this reason, many CLATs are drafted as non-grantor trusts, so that the donor does not recognize the income and gain from the assets in the trust, but also does not get an income tax deduction. The attorney would need to take into account the type of assets to be contributed to the charitable trust, and the client's ability to use the income tax deduction and cover possible tax liability from the trust, when determining whether to draft a grantor or non-grantor trust. Although both a CRAT and a CLAT would require the filing of a gift tax return (Form 709), there would be no current Gift Tax liability owed, since the gift would still be below the \$675,000 exemption (or the increased exemption for years after 2001).

Estate Tax Repeal

Much of the planning for gay and lesbian couples, as well as for other unmarried couples, often ends up focusing on disposition issues rather than estate tax issues. Therefore, even if the estate tax repeal were to last beyond 2010, the estate planning attorney's job of assisting the planning of these non-married couples should continue to flourish.

Conclusion

Whether the exemption is \$675,000 or \$3.5 million or whether there is an estate tax or not, planning for non-traditional relationships will continue to be necessary. Dispositive considerations and family dynamics play a large role in shaping this planning. It is important to listen to clients to ascertain their goals, and what issues face them, in order to assist them with the drafting of an estate plan that meets their needs. ◆

Andrew R. Lee is an attorney with the law firm of Lee & Gregory, P.C., in Birmingham, Michigan (BA, University of Michigan; JD, American University; and LLM in Taxation, New York University).

**EGTRRA,
Continued from p. 50**

2001 Act in the future, don't be complacent. Clients need an estate plan now just as much as they did before the laws changed. Take care to develop wills and trusts that anticipate coming changes and, if possible, provide the flexibility that will allow executors and trustees to adjust for the new laws after the fact. ◆

© *Chamberlain, Hrdlicka, White, Williams and Martin, 2001*

J. Scot Kirkpatrick represents many wealthy individuals and their businesses and advises them on all aspects of their estate, income tax and business planning. Mr. Kirkpatrick has been a frequent lecturer at various seminars on these subjects for attorneys, accountants, insurance agents and financial planners. In 1989, he became associated with the Chamberlain, Hrdlicka law firm and became a shareholder of that firm in 1992. Mr. Kirkpatrick is also head of the firm's Atlanta office trust and estates practice group. Mr. Kirkpatrick is a member of the American Bar Association and the State Bar of Georgia. Additionally, he is a member of the sections of taxation and real property, probate and trust of the American Bar Association as well as a member of the sections of fiduciary and taxation of the State Bar of Georgia.

Kim C. Martin is an associate in the estate planning group of Chamberlain, Hrdlicka. Before beginning work at the firm, she worked as a Tax Specialist in the state and local tax group of a large accounting firm. Ms. Martin received a Bachelor of Arts degree from the University of Virginia and a Juris Doctor degree from the University of North Carolina at Chapel Hill. She is a member of the State Bar of Georgia.

**Roy Adams:
The Best
just got
BETTER**

**The New Book
for 2001**

**Essential
Estate
Planning**

•
Updated

•
Expanded

•
Indispensable

•
**Available
Now!**

*If you only own one
reference book on estate
planning, this is it!*

TO ORDER:

- 1) Call Cannon at (706) 353-3346
- 2) Visit www.cannonfinancial.com

**Invest in
The Power of Learning™**

