Estate Planning Alert

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From the Estate Planning Practice of Hinshaw & Culbertson LLP

Hinshaw's Estate Planning Alert *includes reports on opportunities and challenges that may impact individuals' estate plans. This publication is designed to keep readers aware of such opportunities and challenges so that they may determine whether changes to their estate plans are necessary or desirable. Our goal is to provide the information necessary to ensure that readers are effectively providing for their loved ones, planning for the transition of their businesses, protecting their assets, and paying as little tax as possible. Comments or suggestions concerning the Estate Planning Alert should be directed to Stephen A. Frost.*

IRS to Treat Lawfully Married Same-Sex Couples as Married for All Federal Tax Purposes

The Internal Revenue Service (IRS) issued IR 2013-72 and Revenue Ruling 2013-17 on August 29, 2013. By doing so, the agency resolved a key issue left open by the U.S. Supreme Court in *U.S v. Windsor*, 570 U.S. ____, 133 S.Ct. 2675 (June 23, 2013). It is now clear that the IRS will treat lawfully married same-sex couples as married for all federal tax purposes, regardless of where the couple may reside.

U.S. Supreme Court Struck Down Section 3 of DOMA in Windsor

In *Windsor*, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA) as unconstitutional under the Fifth Amendment of the U.S. Constitution. Section 3 provided that same sex couples were not to be treated as married for federal law purposes. *Windsor* applies to all federal laws, not only federal tax laws.

Windsor was not clear how lawfully married same-sex couples are to be treated if they reside in a state that does not recognize same-sex marriages. The IRS answered this question in Revenue Ruling 2013-17. So long as a same-sex couple is lawfully married, the IRS will treat the couple as married for all federal tax purposes, no matter where they reside. *Windsor* applies to all lawful same-sex marriages regardless of whether the ceremony was performed in a state or foreign jurisdiction. However, it is limited to lawful same-sex marriages.

Revenue Ruling 2013-17 Does Not Extend to Partners in Domestic Partnerships or Parties in Civil Unions.

Revenue Ruling 2013-17 does not extend to partners in domestic partnerships or parties in civil unions. Because *Windsor* was limited to lawful marriages, domestic partnerships and civil unions are not treated as marriages for federal law purposes. The IRS made this clear in Revenue Ruling 2013-17 and the agency's related *Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions*. Same-sex couples in domestic partnerships or in civil unions may now wish to become lawfully married in a state that allows same-sex marriages in order to take advantage of these additional federal benefits.

Immediate Federal Tax Law Implications

Lawfully married same-sex couples will be treated as married for all federal income tax purposes, including, but not limited to: filing jointly (which is not always a positive), alimony deductions, innocent spouse relief, favorable IRA and qualified retirement plan beneficiary payment periods, and tax-free employee benefits (especially tax-free employer health coverage for spouses). Beginning in 2013, lawfully married same-sex couples must file federal income tax returns jointly or as married filing separately.

With regard to federal gift taxes, lawfully married same-sex couples will be allowed to transfer unlimited amounts of property between one another without subjecting themselves to gift taxes. They will also be allowed to split gifts and thereby maximize the combined gifting capacities.

With regard to federal estate taxes, lawfully married same-sex couples will be allowed to transfer unlimited amounts of property between one another at death. Marital trusts can now be used to protect lawfully married same-sex spouses while maximizing each spouse's federal tax-free amount. Portability of the unused federal tax-free amount of the deceased member of a lawfully married same-sex couple is also now possible.

Employers may file payroll tax refunds related to previously taxed health insurance and fringe benefits extended to lawfully married same-sex spouses; the IRS is expected to issue additional guidance on this point in the future.

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Actions to Take Now Related to Federal Tax-Related Matters

Lawfully married same-sex couples should file 2013 federal income tax returns and gift tax returns as married taxpayers. All other federal income tax returns and gift tax returns due, but not yet filed, should also be filed as married taxpayers. If a lawfully married same-sex partner died in 2012 or 2013 and the federal estate tax return has not yet been filed, the Form 706 should be filed as a married taxpayer. Transfers to the surviving spouse may be eligible for the marital deduction.

As a general rule, refund claims for federal income, gift and estate taxes must be filed within three years of the extended due date or within two years after the tax was paid, whichever is later. Because the U.S. Supreme Court struck down Section 3 of DOMA, refund claims are now possible unless the respective statutes of limitation have expired. All lawfully married same-sex couples should consider filing refund claims for all federal taxes paid (including income, gift and estate taxes) within the respective unexpired statute of limitations. Note, however, that not all lawfully married couples will benefit from filing joint income tax returns.

Lawfully married same-sex couples should also consider certain estate planning techniques, particularly the use of marital trusts and the portability of the decedent's unused tax-free amount. Balancing assets between the spouses tax-free should also be considered for estate tax planning purposes. In short, lawfully married same-sex couples should consider having their respective estate plans reviewed and updated.

Employers should also consider filing refund claims for payroll taxes paid related to previously taxed health insurance and fringe benefits extended to lawfully married same-sex spouses.

The federal tax benefits discussed here are highlighted because the IRS notice was the first major notice to be issued. However, remember that all federal laws are affected by *Windsor*.

Windsor's Implications Related to Other Federal Laws

Windsor applies to all federal laws, not only federal tax laws. Revenue Ruling 2013-17 clearly provides that all lawfully married same-sex couples must be treated as spouses under all qualified retirement plans, effective September 16, 2013. Therefore all lawfully married same-sex spouses should review and possibly amend their respective qualified plan beneficiary designation forms. Employers will need to amend their qualified retirement plans as soon as the IRS issues guidance.

The U.S. Department of Health and Human Services (HHS) recently issued a memo that all beneficiaries in private Medicare plans (i.e., Medicare Advantage programs) shall have equal coverage when it comes to care in a skilled nursing home where the lawfully married same-sex spouse lives. The memo also indicated that additional clarifications related to all HHS-administered benefits would be coming in the future.

To date, clarifications related to Social Security benefits and Veterans Administration benefits have not been issued.

The U.S. Office of Personnel Management has issued a memorandum providing that lawfully married same-sex spouses who have spouses working for the federal government are eligible for all employee benefits available to any other spouse.

Federal immigration rules appear to have been modified as well. According to an article in the *Sun-Sentinel*, a major South Florida newspaper, the foreign same-sex spouse of a U.S. citizen has already been granted a green card as would any other lawfully married spouse.

Although the federal government is treating all lawful same-sex marriages the same as opposite-sex marriages, the same is not true for the states.

Definition of Marriage for State Law Purposes Is Left to the States

The 50 individual states determine who is married for state law purposes. Further, Section 2 of DOMA provides that the individual states are not required to recognize same-sex marriages performed in other states. The U.S. Supreme Court did not strike down Section 2 of DOMA. Therefore, the definitions of marriage for state law purposes are left to the states.

Several property and other statutory rights remain dependent upon state law. Only spouses have homestead rights, intestacy rights, preference on being executors, the right to elect against a will, and the ability to hold real estate as tenants by the entirety. Similarly, only spouses have a right to community property, possible liability for family medical expenses, and a statutory preference as a health surrogate. Divorce laws, too, only apply to spouses. (The first same-sex divorce proceeding has already been filed in Colorado.) If the state of residence does not recognize a same-sex marriage, none of these rights will be conferred upon same-sex spouses for state law purposes — including for state income tax and state estate tax purposes.

Conclusion

To view copies of Revenue Ruling 2013-17, the IRS' *Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married Under State Law*, and the IRS' *Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions* please visit the online version of this publication on Hinshaw's website at http://www.hinshawlaw.com/newsroom-publications.html.

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