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A GUIDE TO CHARITABLE GIVING FOR PROFESSIONAL ADVISORS

Estate Planning for Same-Sex Married Couples in Massachusetts—Looking Ahead

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Following the Massachusetts Supreme Judicial Court's decision in Goodridge, attention has shifted from whether same-sex couples in Massachusetts would be able to marry, to the practical economic aspects of their marital partnership, including how to own assets, estate planning, and income tax planning. Federal law still does not recognize same-sex marriages and, consequently, couples legally married in Massachusetts are denied the very significant federal tax benefits available to all other married couples. Massachusetts does recognize the marriage for tax purposes, and the Massachusetts Department of Revenue has issued guidance to assist couples and their advisors in tax planning. Comprehensive estate planning is essential to minimize estate taxes, and to take advantage of the tax planning opportunities that in fact exist under current federal law. The following list of planning tips, while not exhaustive, is a useful place to start:

1. **Determine whether to file joint Massachusetts income tax returns.** While same-sex couples cannot file their federal returns jointly, they may file their Massachusetts returns jointly. In TIR 04-17, the Department of Revenue provided guidance on the adjustments that must be made between the federal and Massachusetts filings for this purpose. It will make sense to look objectively at the relative income and deductions available to the parties, the complexity of the returns, and the cost to prepare the returns differently for federal and state purposes before deciding how to file for Massachusetts purposes. It remains unclear whether couples who file joint Massachusetts returns must compute their state tax liability separately for purposes of their federal filings, further complicating the decision to file jointly. For federal purposes, taxpayers may footnote the required filing singly status to note that the taxpayer is legally married under Massachusetts law, reserving the right to amend the return should federal law recognize the marriage.

2. **Make annual exclusion gifts, if appropriate, to reallocate asset ownership and reduce the size of the wealthier spouse's taxable estate.** Because transfers of asset ownership between same-sex spouses are not protected by the federal gift tax marital deduction (which, in most cases, makes it possible for spouses to transfer assets between them without limit as to value), tax-free transfers from one spouse to the other are limited to $12,000 per calendar year. Transfers in excess of the $12,000 are taxable, although aggregate gifts up to $1,000,000 will be sheltered by the federal gift tax exemption;

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gifts in excess of the gift tax exemption and annual exclusions will require the payment of federal gift tax. Note that gift tax is paid by the donor, not the recipient of the gift; Massachusetts does not have a gift tax. Making annual exclusion gifts each year is a tax-free way to shift wealth from one spouse to the other and to other beneficiaries as well. Making gifts in excess of the annual exclusion can reduce the Massachusetts estate tax, and shift the appreciation in value from and after the date of the gift to the recipient, thereby reducing overall estate taxes. Taxpayers should review whether joint ownership of assets created in prior years resulted in a taxable gift, even if that was not intended. For example, taking title to a home jointly if the spouses did not contribute equally to the acquisition cost can result in a taxable gift from the spouse who made the larger contribution.

3. **Determine who will own real estate that generates significant tax deductions.** Because same-sex couples must still file tax returns singly for federal income tax purposes, it will be important to consider who has or should have legal ownership of real property, and, therefore, the obligation to pay certain deductible expenses, such as real estate taxes. The person who has the legal obligation to pay such an expense and makes the payment may take the deduction for income tax purposes; if a non-owner of the property makes the payment, no deduction is allowed, and the payment instead will be treated as a gift from the person making the payment to the person having the obligation to make the payment. However, transfers of property owned by one spouse to joint ownership by the spouses and disjointing jointly-held property should be done only after carefully considering the transfer tax consequences because in many cases such transfers are taxable gifts.

4. **If both spouses work, and if health insurance is available to both through their respective employers, consider whether it is more expensive to have family coverage through one employer, or individual coverage through each spouse's employer.** If family coverage is provided, the cost of the coverage for the non-employee spouse will be treated for federal income tax purposes as taxable income to the employed spouse; the cost of coverage for the employed spouse is not taxable. Couples should compare benefits available with the net cost to the couple based on premium contributions, deductibles and co-payments required, as well as income tax consequences for the spouse's coverage.

5. **Consider which spouse will make charitable contributions for the year.** Because same-sex couples must file separately for federal income tax purposes, charitable contributions may provide greater income tax benefits to one spouse versus the other. The spouse who intends to take a charitable deduction should make the contribution, and one spouse should not make contributions to satisfy charitable pledges made by the other spouse as such contributions may be treated as a taxable gift, as well as taxable income as relief of debt. Contributions made with appreciated stock may be more tax efficient than contributions made in cash as the value of the gift in most cases is the fair market value of the asset, and appreciation above basis need not be recognized as gain by the taxpayer.

6. **Consider realigning asset ownership to match gains and losses for tax purposes.** If one of the spouses has significant capital losses, or the potential for generating losses by selling an asset before year end, and the other spouse has assets that can be sold at a gain, consider whether it makes sense to transfer assets from one spouse to the other, even in excess of the $12,000 annual gift tax exclusion amount, in order for one spouse to be able to match gains and losses for income tax purposes. The income tax savings may significantly outweigh the gift tax obligation, and any gift taxes paid increase the income tax basis in the gifted assets. Note that the spouse

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who receives assets by gift receives carryover basis in the gifted property, which is the donor's tax basis (adjusted for gift tax paid, if any), or, if the fair market value of the gift on the date the gift is made is less than the donor's basis, the fair market value on the date of the gift becomes the basis for purposes of calculating loss.

7. **Determine which taxpayer will claim children as dependents for tax purposes.** It may be more advantageous for one of the spouses to claim children as dependents, and it may be possible to claim the spouse as a dependent as well. Legal recognition of the marriage is not required to claim someone as a dependent, but the taxpayer must supply more than half of the support for the calendar year and the dependent's principal residence must be the same as the taxpayer's principal residence. Such support may constitute a taxable gift if there is no legal obligation of support.

8. **If possible, consider delaying transactions until 2008.** In general, absent an increase in tax rates, delaying recognition of income is usually advantageous. Opportunities to defer income, including exercising stock options and participating in deferred compensation plans, may make sense. On the other hand, the 2008 election may foreshadow a significant change in tax rates, and it may well be that capital gains rates are as low now as they may ever be.

9. **Review retirement plan beneficiary designations.** Retirement plans are governed by ERISA, a federal law that requires the spouse to be the beneficiary of most retirement plans (although interestingly, not IRAs), unless the spouse consents to permit a different beneficiary to be named. ERISA does not currently apply to same-sex couples, and therefore, there is no presumption that the spouse is the beneficiary of a qualified retirement plan if no designation is made. Having a "designated beneficiary" can reduce the minimum required distributions from qualified plans, thereby permitting the plan balances to accumulate on a tax-deferred basis, and a review of the present beneficiary designation can eliminate costly future problems from an inadvertent failure to have a designated beneficiary. The recently-enacted Pension Protection Act does one very positive thing by permitting a same-sex spouse who inherits a retirement account to roll over the death benefit from a qualified plan and withdraw payments over the longer of (a) the plan participant's life expectancy (even though deceased), or (b) the beneficiary's life

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expectancy, assuming the plan participant survived his or her required beginning date. Note that with a rollover IRA, the beneficiary can make additional contributions to the account (which was not the case with an inherited IRA).

10. **Update the Will and other estate plan documents.** In Massachusetts, marriage revokes a Will, and many couples married this year without executing codicils in contemplation of the marriage, or updating their estate plan documents after marrying, thereby leaving the couple unintentionally with no estate plan documents in place. The Massachusetts intestacy statute, which would apply in such cases, does not provide for the entire estate to pass to a surviving spouse at death, and in addition, will likely result in greater estate tax due at the first spouse's death.

11. **Premarital Agreements and Divorce.** First, the good news—in Massachusetts, couples can by contract fix their rights and obligations in the event of death and/or divorce. Whether the agreement will be enforceable if the couple moves to another state is not certain, but an out of state court could enforce it as a contract. Now the bad news—for heterosexual married couples, the income and gift tax rules provide for no tax consequences to either party for property settlements, and clear direction about the taxability of alimony to the recipient and deductibility to the payer. For same sex couples, these rules are not applicable, and could produce either taxable income to the recipient of a property settlement, or gift tax to the payer. Not only is there a difference in the identity of the taxpayer, but the tax rate may differ significantly under the two tax systems. There is no clear law, so careful attention must be paid to the desired net-after-tax result and consistency of tax reporting.

Despite the significant benefits that are not available to same-sex couples, there are planning opportunities available that will provide immediate tax benefits.

About the Author

Shari A. Levitan *chairs the Holland & Knight LLP's New England Private Wealth Services Group. She is widely regarded as an authority on estate and business succession planning matters, and has been interviewed by NPR, Reuters and the Associated Press. She has extensive experience advising clients in the areas of estate planning, business succession planning, estate administration, trust administration, pre- and post-nuptial agreements, the creation and operation of charitable foundations, the related areas of estate, gift, generation-skipping transfer tax and income taxation, and bioethics issues related to estate planning. In addition, she has extensive experience in dispute resolution, representing trustees in disputes with beneficiaries and with co-trustees.*

Ms. Levitan's work involves counseling business owners, corporate executives, multinational clients, same-sex couples and high-net worth individuals and their families in developing and implementing tax-efficient wealth transfer strategies that are consistent with their personal philosophies and objectives. In addition to advising professional trustees, she provides specialized planning services to business owners and executives with significant corporate benefits. Additionally, she advises clients on planning issues involving children born through assisted reproductive technologies (ART).

A Fellow of the American College of Trust and Estate Counsel and American Bar Foundation, Ms. Levitan is active in local, nonprofit organizations where she serves in a number of leadership roles. Ms. Levitan was named "Best Lawyers in America" for 2006, 2007, and 2008. In 2006, Ms. Levitan was named one of Massachusetts' top 50 lawyers by Super Lawyers.

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ADVISOR PRACTICE TOOLS

- Planned Giving Design Center
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- Advisor Event announcements

CASE/LEGISLATIVE UPDATES

IRS Announces November 2007 CFMR—For purposes of determining the present value of an annuity, an interest for life or a term of years, or a remainder or a reversionary interest, Revenue Ruling 2007-66 indicates the charitable federal midterm rate under section 7520 for November 2007 is 5.2%; unchanged from the October rate of 5.2% and down 0.6% from the September rate of 5.8%.

House Passes AMT Tax Patch Bill—House Ways and Means Committee Chair Charles B. Rangel, D-N.Y., has announced committee passage of H.R. 3996, the Temporary Tax Relief Act of 2007 that, according to Rangel, would "prevent more than 23 million families from a tax increase under the alternative minimum tax (AMT)." Regarding charitable provisions, the bill would extend tax-free distributions from individual retirement plans for charitable purposes; extend enhanced charitable deductions for contributions of food inventory, computer technology and equipment; and extend the special rule encouraging contributions of capital gain real property for conservation purposes.

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