

LEGISLATIVE ALERT MEMORANDUM¹

THE CHANGING LEGAL LANDSCAPE FOR MARRIED SAME-SEX COUPLES: DID DOMA UNDO ITSELF?

BACKGROUND

In 1996, Congress enacted the Defense of Marriage Act (“DOMA”).² Section 3 of DOMA defined marriage as a legal union between one man and one woman as husband and wife, and the term “spouse” meant an individual of the opposite sex who is a husband or wife. DOMA’s Section 2 expressly prohibited federal government agencies from providing benefits to any couples who did not match DOMA’s definition of spouse or whose relationship did not match DOMA’s definition of marriage. Therefore, same-sex couples who were in civil unions, Registered Domestic Partnerships, or lawful same-sex marriages were prevented from taking advantage of the more than 1,000 federal benefits, many of which were financial, that were provided to opposite-sex married couples. Section 2 of DOMA also provided that the individual states were not required to perform or recognize same-sex marriages. Thus, DOMA also explicitly permitted states to disregard the Full Faith and Credit Clause of Article IV of the United States Constitution.

Responding to DOMA, and specifically Section 2, more than half of the states enacted “mini-DOMAs” or reformed their states’ constitutions to expressly ban same-sex marriage.

In practical terms, through DOMA, the United States Congress removed the ability of same-sex couples in loving, committed relationships to fully provide for and financially protect their families in life and upon death without paying a significant premium. Gifts to partners or spouses exceeding a certain value were taxable. A partner could not be designated a primary beneficiary on a qualified retirement plans without experiencing a taxable event.³ Partners and spouses were prohibited from visiting each other in emergency rooms under any conditions, even during life-threatening emergencies or end-of-life circumstances. Couples were not allowed to provide a loving home to children who were in the adoption

¹ **IRS Circular 230 Notice:** To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code of 1986, as amended, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

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² 1 U.S.C.A §7.

³ A qualified retirement plan is one that is defined by the IRS, a federal agency.

system and desperately needed caring parents and stable families. If couples wanted to provide substantially for their families in the event of death, they had to buy extra life insurance and have complex estate plans prepared that cost much more to prepare than those for comparable opposite-sex married couples. Finally, couples had to be careful about where they lived, not just with respect to friendly, quasi-friendly, or unfriendly states, but also with respect to particular state counties.⁴

Summarily, *DOMA* created a second-class status for loving, committed, LGBT relationships and promoted and perpetuated socio-economic discrimination against LGBT families.

DOMA'S UNINTENDED CONSEQUENCES

Despite DOMA's enactment, some states and communities nevertheless recognized the violation of rights LGBT couples faced and refused to prohibit same-sex partnering. On the contrary, many states provided same-sex couples with benefits similar to opposite-sex married couples. Some states allowed or provided Registered Domestic Partnerships, others civil unions, and finally and eventually, same-sex marriage.⁵ New organizations, such as Lambda Legal, were started to combat DOMA and additional discriminatory practices perpetrated against LGBT individuals and families. These new battalions helped already established organizations, such as the American Civil Liberties Union ("ACLU"), in the fight to obtain equal rights for the LGBT community. Therefore, community groups and social justice organizations were effectively galvanized, and the struggle for LGBT equal rights gained positive traction and momentum despite, and perhaps even because of, DOMA.

A watershed moment in the fight for LGBT marriage equality occurred this summer when the U.S. Supreme Court heard and ruled on the cases, *U.S. v. Windsor* ("*Windsor*") and *Hollingsworth v. Perry* ("*Perry*").⁶ *Windsor* involved the question of whether a surviving spouse of a lawfully married same-sex couple was entitled to an estate tax refund based on the marital deduction provision of the Internal Revenue Code ("Code"). *Perry* addressed whether a state court could overrule a constitutional referendum that prohibited same-sex marriages.

The Internal Revenue Service ("IRS"), a *federal* agency, regulates federal government taxes. Thus, pursuant to DOMA, the answer to the *Windsor* question was clearly 'no'.

⁴ "Friendly" states are those that recognize same-sex marriages, e.g., Iowa; "quasi-friendly" states are those that recognize same-sex relationships, providing some type of benefit, though not providing same-sex marriage, e.g., Wisconsin; "unfriendly" states are those that do not, e.g., Indiana.

⁵ In 1999, California passed the Domestic Partners Act, Vermont mandated equal treatment for same-sex couples; in 2004, Massachusetts passed same-sex marriage; in 2005, Connecticut passed civil unions; in 2006, New Jersey passed civil unions; in 2008, California passed same-sex marriage, Maryland passed domestic partners; in 2009, Iowa passed same-sex marriage, Vermont passed same-sex marriage, Maine passed same-sex marriage (overturned later), Nevada passed domestic partners, Wisconsin passed domestic partners, New Hampshire passed same-sex marriage, District of Columbia passed same-sex marriage; in 2011, Illinois passed civil unions; in 2012, New York passed same-sex marriage, Washington passed same-sex marriage, Maryland passed same-sex marriage; in 2013 Rhode Island passed same-sex marriage, Delaware passed same-sex marriage, Minnesota passed same-sex marriage, and Illinois passed same-sex marriage.

⁶ *United States v. Windsor*, 133 S. Ct. 2675 (2013); *Hollingsworth v. Perry*, 133 S. Ct. 2652 (2013).

According to DOMA, a surviving spouse of a lawfully married same-sex couple was not entitled to an estate tax refund based on the Code’s marital deduction provision because the marriage and spouses were not to be recognized by the IRS as such. However, the defendant in *Windsor* (“Edie”) argued that her Fifth Amendment rights were being violated.⁷ The New York court agreed with Edie but Bipartisan Legal Advisory Group (“BLAG”), on behalf of the IRS, appealed the case based on DOMA.⁸ The Supreme Court ruled in favor of Edie, stating that Section 3 of DOMA was unconstitutional and that the IRS was wrong in denying refunds in such cases as Edie’s, where a same-sex couple was lawfully married.

Perry came before the Supreme Court because of a perceived conflict between a state court’s ruling and its legislature. In May 2008, a California state court ruled prohibition of same-sex marriage violated California’s constitution. Several months later, a referendum, Proposition 8, was placed on the state’s ballot. Proposition 8 asked whether same-sex marriage should be banned in California per a state constitutional amendment. The referendum vote was affirmative; however, thousands of same-sex marriages had already taken place.

A couple sued and a California district court ruled Proposition 8 unconstitutional on Fourteenth Amendment equal protection grounds.⁹ The case went to the Ninth Circuit Appellate Court, which ruled against the proponents of Proposition 8, who subsequently appealed the case to the Supreme Court. The Supreme Court did not consider the actual decision of the Ninth Circuit Appellate Court, but instead considered whether Proposition 8 proponents could even bring the suit. At the conclusion of briefs and arguments, the Supreme Court sent the case back to the appellate court, stating that the appellate court was wrong because the proponents of Proposition 8 lacked the ability to even bring the case before a court, that is, Proposition 8 proponents lacked “standing.” This decision cleared the way for same-sex marriages in California, leaving the question concerning the constitutionality of same-sex marriage still open for decision in the ultimate court, the U.S. Supreme Court.

Windsor and *Perry*, while initially considered good “first steps,” proved to be defining moments in the fight for LGBT marriage equality. By declaring Section 3 of DOMA unconstitutional, the *Windsor* ruling not only paved the way for equal tax treatment for lawfully married LGBT couples, but for equality in the federal government, as discussed later. Furthermore, by allowing the California District Court decision to stand, which provided that banning same-sex marriage was unconstitutional, *Perry*’s ruling solidified the ground for same-sex marriages at least in friendly states. Because of the U.S.’ three-branch government system, agencies can make their own rules and regulations, but the rules and regulations still must comply with the “law of the land,” and that law is the United States Constitution as interpreted by the U.S. Supreme Court. Thus, if the Supreme Court states a law, rule, or regulation violates the Constitution, then the law, rule, or regulation is either struck down completely, such as DOMA’s Section 3, or changed.

⁷ The Fifth Amendment guarantees persons equal protection under the laws of the federal government.

⁸ The Bipartisan Legal Advocacy Group (“BLAG”) was a group of representatives from the U.S. House of Representatives who decided to defend DOMA and the U.S. in *U.S. v. Windsor*.

⁹ The Fourteenth Amendment guarantees persons equal protection under the laws of the individual states.

PRACTICAL CONSIDERATIONS FOR ILLINOIS LGBT COUPLES

After the *Windsor* decision, the federal government provided substantial preliminary guidance with respect to equalizing the rules and regulations for LGBT families. Specifically, the IRS, Department of Labor (“DOL”), Social Security Administration (“SSA”), and Veterans’ Administration have spoken. More guidance is needed, however. Also, even more interesting is the fact that additional challenging issues, discussed below, are now emerging based on the guidance provided thus far.

Next, in a historical moment, Illinois passed the Religious Freedom and Marriage Fairness Act (“Marriage Fairness Act”), allowing for the recognition and providing of same-sex marriages in Illinois.¹⁰ Consequently, the financial and estate planning scenarios for married LGBT couples in Illinois have changed dramatically.

SAME-SEX MARRIED COUPLES

Financial Planning

- **Taxes.** In the wake of *Windsor*, the IRS issued a ruling, Revenue Ruling 2013-14, mandating that lawfully married same-sex couples receive equal federal tax treatment for all federal tax issues, regardless of the couples’ state residency, “the place of celebration” standard. The ruling also required agencies whose rules and regulations are derived through the IRS should follow suit.¹¹ The IRS then issued Notice 2013-61 which stated that employers and employees could receive refunds on FICA withholding overpayments.¹² Next, the Department of Labor (“DOL”) released Notice 2013-04, mandating Employment Retirement Income Security Act (“ERISA”) plans comport with IRS guidance.¹³
 - *The primary issue, which involves income and estate taxes, is whether the tax return or returns should be amended.* The question of amending returns is based on the Code’s rules and regulations on retroactivity and the date of the couple’s marriage. The Code’s Section 6511 states that a tax return may be amended within three (3) years of the filing date or two (2) years of payment, whichever is later.¹⁴ If a couple was married before either of these dates, then the couple should revisit their tax returns to determine if amending the return or returns is feasible or would be beneficial. Where should a couple look in terms of potential changes? A couple should consider areas where taxes were paid on what would have been non-taxable benefits, such as withholding, health insurance, flexible spending accounts (“FSAs”), and other employee benefits.

¹⁰ 2013 IL S.B 10(NS) November 5, 2013.

¹¹ Rev. Rul. 2013-17 (IRS RRU), 2013-38 I.R.B. 201, 2013 WL 4607583

¹² Notice 2013-61 (IRS NOT), 2013-44 I.R.B. 432, 2013 WL 5311477

¹³ Opinion No. 2013-04A (E.R.I.S.A.), 2013 WL 5314459

¹⁴ 26 U.S.C.A §6511.

- The second issue is the *Windsor* issue. If a spouse died and the surviving spouse had to pay an estate tax because the government did not recognize the marriage at the time, the surviving spouse may be eligible to receive a refund. The IRS owed Edie more than \$363,000.00.
- *Illinois Wrinkles:*
 - Illinois' statute of limitations is three (3) years within filing but one (1) year within payment, which is different from the IRS statute of limitations.
 - Additionally, Illinois only recognized civil unions as of June 1, 2011. Thus, when considering the statutes of limitations, if a couple was married in June of 2009, the couple may consider amending their 2010 tax return for federal purposes if payment was made in 2010; but, for Illinois purposes, the couple can review only as far back as 2011, unless payment was made in 2012.
- *Overall Wrinkle:*
 - Like opposite-sex married couples, same-sex married couples may have to pay more taxes if an amended return is filed. Accordingly, *just because a couple contemplates and reviews previously filed returns does not mean returns should automatically be amended.*
- **Wealth Preservation.** With a recognized spouse, a lawfully married same-sex couple can take advantage of various wealth preservation strategies that were previously only available to opposite-sex married couples. Several of these strategies also overlap estate planning mechanisms.
- **Retirement Planning.** Spousal beneficiary designations on qualified retirement plans are now available to same-sex spouses. This benefit is related to the tax treatment because a lump sum payout, limiting the payout to a 5-year stretch, or rolling retirement proceeds over into an inherited IRA is no longer required. Therefore, there is less chance for a spouse to experience an adverse taxable event under these circumstances.

Estate Planning

Married opposite-sex couples have long enjoyed beneficial tax treatment by the IRS, which flowed through to their estate plans. DOMA, as mentioned above, removed the possibility of this treatment from married same-sex couples. However, the *Windsor* decision and the Marriage Fairness Act have changed that. *Married same-sex couples can now take advantage of most of the estate planning strategies that opposite-sex married couples have always enjoyed.*

Married same-sex couples may employ marital deduction trusts, Qualified Terminable Interest Property trusts (“QTIPs”), and elect federal portability.¹⁵ Same-sex spouses can establish Special Needs Trusts (SNTs) for each other and, if needed, have conduit trusts prepared.¹⁶ LGBT spouses may establish Qualified Personal Residence Trusts (“QPRTs”) or Grantor Retained Annuity Trusts (“GRATs”) using spousal gift transfers to maximize the strategy. Also, they no longer need to buy vast amounts of life insurance as a “creative” way to compensate for the lack of spousal benefits. Even the traditional Irrevocable Life Insurance Trust (“ILIT”) is more palatable now that a same-sex spouse can be a trustee rather than someone completely outside of the family.

On a simpler scale, married same-sex couples may also use joint wills and joint trusts, as long as the attorney preparing the trust is mindful of the choice of law provisions.

Finally, many of the retirement benefits that were previously unavailable or triggered significant taxable events for married same-sex couples, such as 401(k)s and qualified annuities, must be considered more favorably when drafting estate plans for couples in a post-*Windsor*, Marriage Fairness Act world.

What has not changed in estate planning for married same-sex couples is the treatment of instruments typically governed by contract law, such as powers of attorney and related advanced healthcare directives. However, the spousal enrollment rights under the Health Insurance Portability and Accountability Act (“HIPAA”), which were not available pre-*Windsor*, are available now.

Estate Administration

Unlike a pre-*Windsor*, pre Marriage Fairness Act world, as mentioned above, the surviving spouse of a married same-sex couple will be able to roll over the proceeds of an ERISA qualified retirement plan into his or her own retirement plan without triggering a significant taxable event. This, of course, presumes the primary beneficiary designation has been changed. If not, same-sex spouses should change their designations to read “LEE JAMES, SPOUSE,” for example. Furthermore, because of *Windsor*, the possibility of full retroactivity regarding ERISA retirement and pension plans should be considered. In so considering, a current surviving spouse should contact the plan administrator and request a review of the distribution or an illustration including a revised distribution schedule based on a revised actuarial table – that of the surviving spouse’s estimated lifespan and not the deceased spouse’s.

Surviving same-sex spouses, on a federal level, still must deal with a patchwork of rules and regulations applicable to surviving spouse benefits. For example, the SSA will provide benefits to an LGBT surviving spouse only if the deceased spouse resided and died in a state that recognized same-sex marriage, the “place of residence” standard, and the date of recognition was on or before the date of that couple’s marriage. Additionally, the retroactivity of the benefits provision has yet to be determined. Finally, the SSA also requires proof of marriage. Thus, if a couple was married in Iowa and moved to Illinois, where one spouse died on November 6, 2013, the surviving spouse will not be entitled to his or her deceased loved one’s benefits.

¹⁵ Illinois does not provide portability for anyone.

¹⁶ Conduit trusts are sometimes needed when establishing trusts that will hold retirement proceeds.

The Veterans' Administration also bases its provision of benefits on the "place of domicile" standard.

CIVIL UNION COUPLES

Financial Planning

- **Taxes.** The federal government does not recognize civil unions or Registered Domestic Partnerships. In the eyes of the IRS, couples are either married or not. Thus, if an LGBT couple does not convert their civil union into a marriage or does not get married, the IRS will treat the couple as single individuals who are cohabiting and the couple must file their federal tax returns as such.
 - *Illinois Wrinkle:*
 - Civil union couples in Illinois currently enjoy the same state tax treatment as opposite-sex married couples. However, Illinois civil union couples should be mindful of the statute of limitations for filing returns, as discussed above in the section for married same-sex couples.
- **Wealth Preservation.** Many advanced planning strategies use trust vehicles that are derived through the Code and specifically apply to married couples. Because the IRS does not recognize civil unions, these techniques cannot be used by civil union couples. However, civil union couples can take advantage of other strategies such as Domestic Asset Protection Trusts ("DAPTs"), Limited Liability Companies ("LLCs"), and off-shore plans that are not based upon marital status. Additionally, because the federal government does not equate civil unions with marriage, senior LGBT couples who are in civil unions will not lose government benefits, such as a large portion of their Social Security income, like they would if they were, in-fact, married.
- **Retirement Planning.** Illinois provides civil union couples with all the benefits of married couples. Accordingly, if an Illinois retirement plan, a state-sponsored teachers' retirement plan, for example, provides for a spouse, then the partner in a civil union can also obtain the benefit. However, a significant number of retirement plans are governed by the federal government, which precludes civil union couples from taking advantage of the benefits afforded opposite-sex married couples. Given the treatment of civil union couples by the federal government, as mentioned above, senior LGBT couples should cautiously weigh the benefits of marriage against the government benefits they may receive as perceived single individuals but under one household.

CONCLUSION

The year 2013 has been a year of rapid positive change in the equality landscape for same-sex couples, especially those in Illinois who are or intend to become lawfully married. At the beginning of the year, couples were forced to pay large sums of money to provide for and protect their families, monies that opposite-sex couples in loving, committed relationships did not have to pay because of the benefits provided by having the legal status of marriage. Two United States Supreme Court decisions, *U.S. v. Windsor* and *Hollingsworth v. Perry*, however, cleared the way for marriage equality for LGBT families with respect to financial discrimination. The IRS followed the way by mandating complete equal tax treatment for lawfully married same-sex couples on a federal level irrespective of where the couple resided – friendly or nonfriendly state, affording couples hundreds of financial benefits not previously available. The DOL, likewise, followed with respect to ERISA retirement plans. Other agencies, however, have now created another patchwork by basing their award of benefit claims on “place of domicile” instead of “place of celebration.” Thus, the federal landscape is still fraught with landmines, though fewer than before and in view.

Yet, by passing the Religious Freedom and Marriage Fairness Act, Illinois removed most obstacles from married or engaged same-sex couples who decide to reside in our state. Married same-sex couples in Illinois can now take advantage of financial and estate planning strategies that were previously only available to opposite-sex married couples. Above, we discussed a number of places where caution still should be taken when considering the various strategies, but this has definitely been a strong and positive year for same-sex couples in loving, committed relationships residing in Illinois. Accordingly, *The Law Offices of Max Elliott encourages couples to review your plans and taxes, consider marriage, if you have not already, and continue supporting your advocates because, though much has been accomplished, our work is not yet complete.*