

Headaches for Same-Sex Couples

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Same-sex couples can get married in five states and the District of Columbia—and in New York starting July 25. But the happily-ever-after part doesn't necessarily extend to their personal finances.

Such couples still can't file a joint federal tax return, share retirement benefits, shield each other's assets from estate taxes or benefit from many other tax breaks provided through federal law.

As a result, same-sex couples who marry have to stay on guard, doing even more financial and legal planning, in some cases, than those who don't choose to tie the knot.

"Same-sex couples who get married in New York will find they have some, but not all, of the benefits and burdens of being married," says John Olivieri, a partner in White & Case's private-client group in New York.



Terry Wong

As of 2008, there were an estimated 565,000 same-sex couples across the U.S., including about 32,000 who were married and 80,000 registered as reciprocal beneficiaries or domestic partners or united in civil unions, according to U.S. Census Bureau data analysis by the Charles R. Williams Institute on Sexual Orientation Law at the University of California at Los Angeles. New York had

45,761 same-sex couples at that point. (The 2010 Census data with same-sex-couple figures are still being released state-by-state.)

Connecticut, Iowa, Massachusetts, New Hampshire, Vermont and Washington, D.C., now issue marriage licenses to same-sex couples. California did so for part of 2008, and those marriages remain valid. Four states allow civil unions among same-sex couples, and seven, plus the District of Columbia, grant some state-level spousal rights through domestic partnerships.

The problem: Under the Defense of Marriage Act of 1996, passed by a Republican Congress and signed by President Bill Clinton, the federal government doesn't recognize same-sex marriage—even if it is blessed by a state government. So it's important to weigh what same-sex families stand to gain—or not—by getting married.

State Rights

As long as the couple continues to live in a state that recognizes their same-sex marriage, many state-based rights extend to them, often including rights surrounding hospital visitation and emergency medical treatment, inheritance, workers' compensation benefits if a spouse dies at work, health insurance and pension benefits for spouses of public employees, and divorce—including alimony. (One note: Lawyers still recommend that same-sex couples have health-care powers of attorney naming their partners, in case they travel somewhere that doesn't recognize their union.)

The downside is that you also assume liability for your spouse's debt—and have the obligation to support your spouse during marriage or divorce. Also, if you have inherited a large asset yourself, you may have to share it now—unless you enter a prenuptial agreement spelling out what remains with each partner in the case of a split.

Tax Headaches

Anything involving federal taxes for same-sex couples can turn into a quagmire quickly.

Since they still have to file their federal income-tax returns as individuals, many same-sex couples wind up filling out tax forms no fewer than four times: Separately with the federal government, then a "dummy" joint federal return, and finally a married-filing-jointly state return based on the pretend federal one, says Nicole Pearl, an estate-planning partner at McDermott Will & Emery in Los Angeles.

Filing separate state and federal tax returns can get complicated fast. California, Nevada and Washington, for example, allow same-sex couples to register as domestic partners and are also so-called "community property" states, which generally treat income and property acquired during marriage as belonging equally to both partners, no matter who earned it. Since same-sex domestic partners can't file joint federal tax returns, each is required to report half of the combined community income earned by the individual and his or her partner on the individual's single federal return.

Simply writing half of your income on a single return could trigger an audit, says Melissa Labant, a tax expert with the American Institute of CPAs. Say the couple earns \$10,000 in interest income, reported on a 1099 form. That means each individual would have to report \$5,000. However, "if the \$10,000 on the 1099 doesn't match up with the amount on the tax return, it will kick out an examination letter," she warns.

To avoid the problem, you could report \$10,000 in income, she says, "then on the next line down, you'd note the amount reported on the partner's tax return. The bottom line would say \$5,000."

Death and Inheritance

The biggest problems may not come until death do you part. Although same-sex spouses are legally entitled to inherit assets from each other whether there's a will or not, since inheritance is governed through state law, they don't have federal rights.

Same-sex spouses can't inherit retirement plans as easily as opposite-sex spouses, because they are regulated federally. Husbands and wives can have defined-contribution-plan assets, such as a 401(k) account, transferred into individual retirement accounts in their own names. But unlike opposite-sex spouses, same-sex spouses would have to transfer such accounts to inherited IRAs and start taking distributions each year, rather than allowing the tax-deferred assets to continue to potentially accumulate tax-free earnings.

Another difference: Opposite-sex spouses can leave each other unlimited assets without owing any estate tax. The break is called the "marital deduction," and it drives much of estate planning. Since the federal government doesn't recognize same-sex marriages, such assets could be taxed when they go to the surviving spouse—even if they were held in joint accounts, Ms. Pearl says. And if those assets remained upon the second spouse's death, they could be taxed again.

Assets aren't subject to estate tax until they exceed \$5 million—but that limit reverts to \$1 million in 2013. To prevent having the same assets taxed after each spouse dies, she recommends leaving assets in an irrevocable trust for the surviving spouse's benefit. "You would owe estate tax at the first death on the amount that goes into the trust, but not at the second death," she says.

There is one way to take advantage of the federal government's lack of recognition of same-sex marriage: Such couples can set up a "grantor-retained income trust," a type of trust that family members aren't allowed to create for one another. You put an asset into a trust and retain the right to income from it. You have to pay gift tax on that asset, but the Internal Revenue Service would subtract a standard rate of return from the asset's value, and you would owe tax on that discounted amount—whether the asset produces income or not, says Mr. Olivieri, in New York.

"I have recommended to a number of same-sex couples that they do this," he says.

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