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Estate Planning for Nontraditional Families and Individuals

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I. Introduction

A. What is estate planning?

1. An ongoing process for accomplishing lifetime goals and for planning for the disposition of assets at death.

2. The critical consideration is the ongoing nature of the process. It is not a one-shot deal, but changes as personal needs and objectives change and outside factors that can influence the plan (such as tax laws) change.

B. What is different in planning for the Lesbian Gay Bisexual and Transgender (LGTB) community?

1. For couples: Absence of spousal protections and benefits

2. For individuals: Goals may be different

3. Need to plan for hostile families or homophobic/insensitive institutions

II. Seven Reasons to Do an Estate Plan

The following considerations apply to everyone—not just the LGBT community—but have special relevance for us.

A. Reduce your gift and estate taxes.

1. The government taxes transfers of property both during lifetime (gift taxes) and at death (estate taxes). (We will refer to gift taxes and estate taxes collectively as transfer taxes.)

2. Under current law for deaths occuring before January 1, 2004, the first $1,000,000 of assets that you give away during lifetime or at death are exempt from transfer taxes. This is known as the exclusion amount. The exclusion amount (again under current law)

for the estate tax will increase in several steps to $3,500,000 by 2009, and the top estate tax rates will be gradually reduced from 55% to 40%. This is the result of estate tax reform legislation passed in June 2001.

3. Again, under current law the estate tax is scheduled for repeal in year 2010; however, the repeal provision "sunsets" in 2011. Therefore, as it stands now, the estates of those dying after December 31, 2010, will again be subject to estate and gift tax with a return to $1,000,000 as the exclusion amount.

4. Once you exceed the exclusion amount, transfer taxes are steep and highly progressive. The next dollar above $ 1,000,000 currently would be taxed at a 37% rate and the rate rises quickly to 50% for transfers in excess of $3,000,000.

5. Everything an individual owns at death is potentially subject to estate taxes, including retirement benefits and life insurance proceeds. As a result, it is surprisingly easy to reach the $ 1,000,000 amount (even though you don't feel particularly "rich").

6. A second, additional tax, known as the generation skipping transfer tax, can apply to transfers to grandchildren or to individuals who were more than 37 ½ years younger than the decedent. The GST tax is imposed at the highest marginal rate applicable to estate taxes (e.g., 50% in 2002).

B. You choose, rather than the state, who will receive your property at death.

1. Government does estate planning for you if you don't: every state has an intestacy statute that governs the distribution of your estate if you don't have a will.

2. The statutes vary from state to state, but tend to follow what most people in a traditional family probably would do -- leave property to spouse and children. In the absence of either and without a will, property passes to parents, then to siblings. There is no provision in the intestacy statute for unmarried domestic partners.

3. A critical consideration: the intestacy statute is rigid. You cannot get around it by trying to argue in court that this is what the decedent would have done if he or she had, in fact, made out an estate plan.

C. Control your funeral and burial arrangements.

Your wishes for funeral and burial arrangements can be expressed in your will or in other documents (and can also be pre-arranged by contract). This can be a particularly important issue if there are differing views between family members and a non-spouse partner or if you simply would prefer that your partner make your funeral and burial arrangements.

D. Select your choice for guardian for your minor children.

Although the Probate Court makes the ultimate decision with respect to appointing guardians for minor children, judges generally will give great weight to the person or persons named in the decedent's will—again, this could be especially important for an LGBT biological parent naming a partner who has not adopted (or any unrelated person).

E. Determine how and when your beneficiaries will receive your property.

1. If you die intestate, all property that passes from your estate will be distributed outright to your heirs, as required under the statute.

2. The only exceptions are for spouses, minor children and otherwise incompetent people (that is a legal term), for whom rigid rules exist.

3. There are multiple reasons why you may not want a person to receive property outright, including:

   - Uncomfortable and/or inexperienced with handling money.
   - Needs protection from creditors.
   - Eligibility for government benefits may be affected

F. Satisfy charitable inclinations in a way that provides you with significant income and estate tax benefits.

With proper planning, there are some important steps you can take, both during lifetime and in your estate plan, to benefit charities of your choice and to take advantage of available income and estate tax benefits.

G. Peace of mind.

This is the reason that probably gets overlooked the most.

III. Special Issues for LGBT Families and Individuals.

A. Spouses are "protected" under the law.

1. This is the overarching concern for LGBT families, i.e., the special treatment (almost always favorable) that spouses receive under the law that non-spouses do not.

2. Pending lawsuits in New Jersey and Massachusetts seek the right to marry for same sex couples, and marriage is already legally sanctioned for same-sex couples in parts of Canada and the Netherlands.

3. Regardless of whether same sex couples gain the right to marry in some states and despite the progress in other countries, the Federal Defense of Marriage Act remains an obstacle to equal treatment.

B. How spouses and traditional families are treated differently.

1. The unlimited marital deduction: spouses can make unlimited transfers to each other, both during lifetime and at death without transfer tax consequences. (Note: this only applies if the transferee spouse is a U.S. citizen, but even for spouses that are not U.S. citizens there are special rules that are more favorable than rules for non-spouses.)

   - Estate tax: by leaving everything to a spouse, married couples can defer federal estate taxes entirely upon the death of the first spouse. Non-traditional families will owe estate taxes upon the death of the first partner on all amounts above the exclusion amount.

   - Lifetime gifts: anyone can give anyone else $11,000 per year without gift tax consequences (annual exclusion). Any amount above the annual exclusion—except for gifts to a spouse—will reduce that person's lifetime exclusion amount and the person will have to pay gift and estate taxes when the exclusion amount is used up entirely.

   - The tax code has a broad definition of what constitutes a gift that doesn't always comport with what a layperson would think is a gift. For example, if two non-married partners maintain a joint checking account, technically one partner makes a gift to the other unless each partner's

withdrawals from the account are exactly proportional to their respective contributions. Similar problems arise if both partners have equal interests in their home but the income to pay the mortgage is contributed disproportionately by one partner.

- "May-December" spouses (i.e., where one spouse is substantially older than the other) are treated the same way as any other spouses. Partners who are not spouses are assigned to generations for GST purposes strictly on the basis of chronological age. If the age differential of two non-traditional partners is more than 37.5 years, any "gifts" between them (recalling how the concept of a gift is broadly defined) technically would also be subject to GST taxes.

2. Intestacy laws.

Although the laws vary from state to state, almost all laws give preferential treatment to the surviving spouse (if any) and then dispose of the rest of the estate to blood or adopted relatives, generally depending on some measure of the closeness of degree of kinship (i.e., siblings would benefit before second cousins). In Massachusetts, if you die intestate and without a spouse, your estate will go first to any children you have, but after that it will pass to your parents, then your siblings and so on, with the ultimate beneficiary (if there is no surviving spouse or relatives by blood or adoption) being the Commonwealth of Massachusetts. There is no provision in the Massachusetts intestacy statutes (or, to the best of our knowledge, in the intestacy statutes of any other state) that makes any provision for a partner who is not a spouse or a relative by blood or adoption.

3. Protection from disinheritance

Almost all states have statutory provisions that prevent a spouse from being entirely disinherited. In Massachusetts, for example, the surviving spouse can "elect against the will" of a deceased spouse and receive a specific portion of the estate even if the deceased spouse's will left a smaller amount to the surviving spouse. (The amount depends upon whether there are issue or kindred living at the decedent's death, and can be given outright or as a life estate depending on the value of the decedent's estate.) Anyone else, including a partner in a non-traditional family, could be totally disinherited.

4. Retirement benefits

- Under federal pension law (ERISA), a spouse must be the beneficiary of at least 50% of the other spouse's retirement benefits (e.g., 401(k) plan) unless the spouse consents in writing to a different arrangement. No such protections are given to anyone else, including partners who are not spouses.

- Upon the death of a surviving spouse, individual retirement accounts can be rolled over into the surviving spouse's own IRA, which can extend the minimum distribution period. Different rules apply if a non-spouse is the beneficiary of the IRA. Probably of greater importance is that any assets, including retirement plan assets, which pass to a surviving spouse are not subject to estate taxes at the first spouse's death.

- In a non-traditional family, at the first partner's death, the retirement plan assets cannot be rolled over into the surviving partner's own IRA. Recent changes in distribution rules for retirement benefits have eased some of the burden this used to create with respect to allowing the surviving partner to extend the minimum distribution period. Nonetheless, the retirement benefits are now included in the first partner's estate at full value. Moreover, if the firt-to-die's assets are heavily concentrated in retirement benefits and other non-liquid assets, the surviving partner (beneficiary) might have to withdraw assets from the retirement benefits just to pay the estate taxes, which would trigger an additional income tax liability for the surviving partner, thus depleting the surviving partner's assets even further.

- Employer pension plans often require a non-spouse to take survivor's benefits in a lump sum without an option—usually available to spouses—to extend payments over the beneficiary's life.

5. Status in probate court proceedings.

Unresolved disputes (i.e., disputes that are not resolved by a will or contract) will end up in probate court, which necessarily involves substantial costs and delays, as well as an uncertain outcome. The

courts may favor blood relatives over partners who are not spouses in connection with such issues as the disposition of your remains and guardianship for your children (unless, of course, these issues were addressed in your estate plan).

C. A word of caution.

Even a carefully constructed estate plan is not fail-safe. Parents or siblings of a person who has been in a non-traditional family may contest his or her will. Nonetheless, the estate plan will be strong evidence in the event of a will contest.

IV. Basic Components of an Estate Plan: What They Are, What They Do and Why You Need Them

Where the law disempowers non-traditional families because of the presumptions and preferable treatment given to the traditional family relationships, your estate planning documents can empower non-traditional families with rights and responsibilities over their property during life and after death. Most importantly, these documents ensure that a partner receives the property you want him or her to receive and plays the role in administering your estate that you want that person to have.

A. Will

1. The will is an important document because it allows you to control the disposition of your property and your remains at your death. As discussed above, without a will, the intestacy statutes apply; these statutes protect only spouses and relatives of the decedent by blood or adoption. If you want your partner to share in your estate, a will is absolutely necessary.

2. In your will, you can also name the guardian of your minor children. This may be particularly important for LGBT families, where a person would want his or her partner to be the child's guardian rather than a family member. In the end, the court will decide who would be the best guardian for the child, but the court will generally give strong preference to the person named in the will.

3. In your will, you also name the executor of your estate. The executor is the person entrusted with carrying out the wishes expressed in your will, and distributing the property as required in your will. Naming your partner as your executor may give him or her more control after your death and circumvent disputes between the partner and family members.

B. Durable General Power of Attorney

1. This document gives a person (called the "attorney in fact" or agent) the ability to handle the principal's financial affairs during his or her lifetime even if he or she is incapacitated. This includes paying the person's bills and having access to the safe deposit boxes, bank accounts, etc. This is a big responsibility, as the attorney in fact can even do estate planning on behalf of the incapacitated individual, executing all documents except for a new will.

2. The power of attorney can take effect immediately upon executing the document or only upon the principal becoming incapacitated.

3. This is a particularly important document to have in non-traditional families because it gives a partner the right to handle the principal's financial affairs in the absence of joint ownership of the assets or a legally recognized relationship between the partners.

4. The principal (you) can also designate in your durable power of attorney the person you would want to be named as your guardian, should that become necessary. This power is especially important because the courts cannot be depended upon to always appoint the person and LGBT individual would have chosen—often blood relatives would be picked.

C. Health Care Proxy and Memorandum

1. A health care proxy is a document that allows a designated person (called the "health care agent") to make health care decisions for you if you become incapacitated and cannot make these decisions for yourself.

2. The health care proxy goes hand-in-hand with a health care memorandum or, as it is sometimes called, a "living will." The health care memorandum provides a set of guidelines for the health care agent and lets him or her know what your health care preferences are (for example, whether you want to be kept on life support if you are in a coma). This is not a legally binding document, but can be very useful in providing the agent with a set of guidelines to follow when making health care decisions for you.

3. As with the durable general power of attorney, this is a particularly

important document for LGBT individuals because it can give a partner (not the next-of-kin) the right to make health care decisions for the principal in the absence of a legally recognized relationship between the partners.

D. Revocable Trust

1. A revocable trust is an instrument created during the lifetime of the creator (also known as the "donor") that names a trustee to hold and take care of your property in accordance with the terms laid out in the trust instrument. The trustee is under a fiduciary obligation to carry out the trust's terms faithfully.

2. The revocable trust is an important vehicle because it can give a person, whether a spouse or a partner, the right to receive income and principal after death of the first-to-die and can require that the remaining estate pass to other persons (such as children, nieces or nephews) whom the donor wants to benefit.

3. The revocable trust also provides creditor protection for beneficiaries, which means that the trust principal cannot be reached by the beneficiary's creditors to pay the beneficiary's debts.

4. A revocable trust can also be funded during the donor's lifetime, and used to manage the donor's financial affairs if the donor cannot or does not want to do so. The donor can name his partner as trustee and in that way ensure that his partner will have control of his finances while he is incapacitated.

5. Revocable trusts are not probate documents. As such, assets that are in a revocable trust at the time of the decedent's death escape probate (though not estate taxes). In Massachusetts, this is not likely to have any significant financial consequences (some states have probate fees that are based on a percentage of the assets in the probate estate). The bigger consideration here is that the probate process is time consuming and public. A revocable trust affords a considerably greater measure of privacy, and avoiding probate can be advisable in the case of hostile blood relatives.

V. Other Estate Planning Devices Useful for LGBT Families and Individuals.

A. Life insurance policies and trusts

1. Life insurance can be used in conjunction with irrevocable trusts to

pass on assets to a specific beneficiary while maximizing estate tax savings.

2. The Donor creates an irrevocable trust for the benefit of a named person and the trust purchases a new life insurance policy on the Donor's life. The Donor makes annual gifts to the trust, which the trustee then uses to pay the insurance premiums.

3. If the Donor's powers over the life insurance policy are sufficiently restricted, the insurance proceeds will pass to the trust free of estate taxes upon the Donor's death and the money can be used to generate income for the named beneficiary (under the terms of the trust).

4. This can be a helpful method for getting life insurance proceeds to the beneficiary you want while minimizing estate and gift taxes. If the trust is properly structured, your annual gifts to the trust will qualify for the annual exclusion, so that there may be no transfer tax consequences at all.

B. Nominee Trusts and QPRT's for Real Estate

1. Nominee trusts are entities that hold legal title to real estate for the benefit of one or more beneficiaries. The trust and the original schedule of beneficiaries generally are recorded at the Registry of Deeds. Subsequent transfers generally do not have to be recorded and thus can remain private.

2. Qualified personal residence trusts (or "QPRT's") are a method for transferring ownership of real estate at a discounted transfer tax cost. This is a complicated arrangement that involves transfer of ownership of the property to a trust for a certain number of years, while you retain the right to live on the property during that time period. At the end of the period, the trust beneficiaries receive the property outright. You are subject to gift taxes upon transferring the property to the trust, but the value of the transfer is less than the full value of the property because you retained the right to live on the property for the term of the trust. This is an especially helpful device for transferring ownership of a vacation home or a primary residence that you want to hand down to a partner or a lower generation.

C. GRAT's and GRIT's for income producing assets

1. The acronyms stand for grantor retained annuity trusts and grantor

retained income trusts. The idea is that the Donor transfers assets to an irrevocable trust and retains the right to receive income from the trust for a period of time. The income can be either a fixed amount (GRAT) or a fixed percentage of the value of the trust (GRIT). At the end of the trust period, the trust assets are distributed to the named beneficiaries.

2. This is a helpful device for transferring financial assets at a discounted transfer tax cost. You are subject to gift taxes upon transferring assets to the trust, but the value of the transfer is less than the value of the assets because you have retained the right to receive income from the assets for the term of the trust.

3. Although there are some complications and disadvantages here (for example, the trust assets will be included in your estate if you die before the term of the trust ends), this can be especially helpful for transferring assets that you expect to appreciate substantially over the next several years, such as stock in a start-up company.

D. CRAT's and CRUT's for charitable gifts

1. The acronyms stand for charitable remainder annuity trusts and charitable remainder unitrust. The idea is that the Donor transfers assets to an irrevocable trust and receives income from the trust either for a period of time, for the Donor's lifetime or for the lifetime of the Donor and another named beneficiary (or beneficiaries). The income can be either a fixed amount (CRAT) or a fixed percentage of the value of the trust (CRUT). At the end of the trust period, the trust assets are distributed to named charitable beneficiaries.

2. The Donor receives an income tax deduction for the value of the charity's interest when the trust is funded (which will be less than the full value of the assets because of the Donor's ongoing income rights) and the value of the assets is excluded from the Donor's estate at death (unless there are other income beneficiaries before the trust property is distributed to the charitable beneficiaries).

3. The trust can sell appreciated assets that it receives from the Donor and capital gains taxes can often be deferred (or avoided altogether) on the sale.

4. There are some complications and restrictions here, as well, but this can be especially helpful for transferring low basis, low yielding stock without incurring immediate capital gains, while

still receiving income for the life of yourself and possibly your partner and satisfying charitable inclinations.

VI. Other Estate Planning Techniques

A. Gift planning

Maximizing the use of annual exclusion gifts—either outright or in trust—can be an effective method for reducing transfer taxes.

B. Charitable giving

Charitable gifts allow income tax deductions during life and reduce estate taxes at death. In addition to specific betquests or lifetime gifts to named charities, individuals may also want to consider gifts to a donor-advised fund or a special purpose fund that benefits certain causes or communities.

C. Planning for generation skips

Properly planning the use of the GST exemption can allow you to pass greater amounts of wealth to grandchildren or more remote generations without incurring generation skipping transfer taxes.

D. Education funding

Proper planning allows you to set up vehicles for funding education for younger generations (children, grandchildren, nieces, nephews, godchildren, etc.) while minimizing any transfer taxes associated with such gifts.

E. Wealth management

Your financial assets can be professionally managed through the use of funded trusts.