Estate Planning for Non-Traditional Couples

Introduction

So-called “non-traditional” couples, including unmarried couples, married same-sex couples, and couples in second marriages, face distinct issues that may require specialized estate planning. Such couples do not always benefit from the same spousal rights, tax incentives, and legal presumptions as their traditional counterparts. For example, couples who are not married as it is defined under federal law may not take advantage of the federal unlimited estate and gift tax marital deductions, and they may be subject to gift tax for certain asset transfers made to their partners. An unmarried couple may not inherit under state intestacy laws if a partner dies without a Will. In addition, although Connecticut and New York allow same-sex marriage, the federal government and most states do not recognize these unions. Therefore, as a practical matter, married same-sex couples face many of the same estate planning challenges faced by unmarried couples. In contrast, couples in second marriages may find that they need to plan around their marital status in order to protect their accumulated wealth and future income, and to ensure that their children, especially children from first marriages, are provided for appropriately.

Non-traditional couples should plan ahead to protect themselves from the unintended consequences that may occur due to insufficient estate planning. With careful preparation, non-traditional couples can ensure that their property is distributed according to their wishes, transfer taxes are minimized, and end of life decisions are in line with their desires. Below is a discussion of some pertinent factors that non-traditional couples should consider when developing their estate plans.

Estate Planning Consideration for Unmarried Couples

Avoiding Intestacy Laws

There are several estate planning tools that an unmarried individual may use to guard against state laws that may otherwise disinherit his or her partner. These planning tools should also be considered by same-sex married couples, who are treated as unmarried for federal tax purposes. Wills, Revocable Trusts, and joint ownership can work in tandem to ensure that unmarried individuals dispose of their property according to their wishes and protect their surviving partners.

Wills and Revocable Trusts. Unmarried individuals should use wills and, as appropriate, revocable “living” trusts to ensure that their partners are beneficiaries of their estates. In addition, unmarried individuals may want to appoint their partners as trustees of any estate planning trusts they establish to ensure that their partners are authorized to manage their assets in the event of incapacity or death.

Joint Ownership. Unmarried individuals may use forms of co-ownership, including tenancy in common and joint tenancy with right of survivorship, to shape the scope of their shared property interests. But it should be kept in mind that there may be gift tax consequences with these types of arrangements, because federal law does not recognize a marital deduction for transfers between members of either an unmarried couple or a same-sex married couple. (See discussion of gift taxes, below.)
Tenancy in Common (“TIC”). Co-tenants may own different fractional shares of property, yet have the right to use the entire property. When a co-tenant dies, only that tenant’s share will be included in his or her estate. In most states, unless a deed specifies otherwise, unmarried couples are assumed to take title as tenants in common. One drawback to this form of ownership is that a surviving co-tenant in a tenancy in common arrangement does not automatically succeed to the interest of the other co-tenant. Accordingly, upon the death of one co-tenant, his or her fractional share of the property could pass to someone other than the surviving co-tenant. This problem can be addressed by including appropriate provisions in each co-tenant’s estate planning documents.

Joint Tenancy with Right of Survivorship (“JWROS”). Joint tenants with a right of survivorship each own an equal share of the property and have the right to possess the entire property. If one joint owner dies, the surviving tenant automatically becomes owner of the deceased tenant’s share, thus bypassing the probate system and providing a relatively inexpensive and efficient means to transfer property upon death. An unmarried couple must expressly provide in their deed that they are joint tenants with right of survivorship in order to own real estate in this manner. This form of ownership has a number of disadvantages. For example, when one tenant dies, the entire fair market value of JWROS property may be included in the decedent’s estate if the surviving tenant cannot prove that he or she contributed to the acquisition of the property. In addition, JWROS property is potentially subject to claims of creditors of both tenants.

Minimizing Transfer Taxes
Because they do not have the benefit of the unlimited federal marital deduction and other tax advantages, unmarried couples may want to consider various gifting strategies as a means of limiting the amount of estate tax due at the death of each member of the couple. Unmarried individuals may use traditional lifetime gifting options, such as outright gifts and gifts to conventional irrevocable trusts, as well as family limited liability companies, family limited partnerships, and more sophisticated trust arrangements to minimize their tax liability when transferring assets to their partners.

Traditional Gifting Strategies. Unmarried individuals can utilize federal and state gift tax exemptions and annual gift tax exclusions to make tax-free gifts to their partners or to trusts benefiting their partners. Under current federal tax law, individuals may give away up to $5 million during their lifetime without incurring any gift tax. Any federal gift tax exemption used during the donor’s lifetime reduces the estate tax exemption available at the donor’s death. Connecticut’s gift tax exemption is $2 million, and also reduces the donor’s estate tax exemption at his or her death. New York does not currently have a gift tax, but does have a $1 million estate tax exemption.

In addition, by using the annual gift tax exclusion, an unmarried individual may presently give up to $13,000 to his or her partner, and to an unlimited number of other individuals of their choosing, tax-free. They may also make unlimited direct payments of tuition or medical expenses for the benefit of whomever they like without using their annual gift tax exclusions or lifetime gift tax exemptions.

Family Limited Liability Companies (“FLLCs”) and Family Limited Partnerships (“FLPs”). Unmarried couples who plan to own property together should consider forming a FLLC or FLP to own the property instead. The applicable operating or partnership agreement will
then govern how the property will be managed, invested, and distributed, thus providing additional security to both partners in the event that one partner dies or the couple ends the relationship. While both structures offer a favorable single layer of taxation, if administered correctly, the FLLC structure has the added benefit of protecting the couple from any personal liability that might arise from ownership of the property.

When a FLLC or FLP structure is used, individuals may also be able to make gifts to their partners on a “discounted” basis, thereby reducing the property’s value for gift tax purposes and removing some of the income and appreciation on the property from the donor partner’s estate. But care should be taken. The gift and estate tax status of FLLCs and FLPs has received greatly enhanced scrutiny from the federal and state tax authorities in recent years. Furthermore, non-married couples moving assets into an LLC or partnership may face income tax issues not present when the entity is established by a traditional couple.

Sophisticated Trust Options. Among the gifting strategies available to non-traditional couples that use trusts are Irrevocable Life Insurance Trusts (“ILITs”), Qualified Personal Residence Trusts (“QPRTs”) and Grantor Retained Annuity Trusts (“GRATs”). An ILIT allows one member of the couple to transfer life insurance for the benefit of the other partner free of federal estate tax. Furthermore, an ILIT can be structured so that any funds remaining in the ILIT at the death of the surviving partner can pass to the next generation of beneficiaries, tax-free. If properly structured, an ILIT can also be used as a repository for gifts utilizing the donor’s $13,000 annual exclusion or even gifts utilizing the $5 million gift tax exemption. A QPRT is a means for one member of the couple to transfer a primary or vacation residence to the other partner on a highly discounted basis. The owner of the residence transfers the residence to a trust, retaining the right to use the residence for a set term of years. At the end of the term, the residence passes to the other partner or to a trust for his or her benefit. The value of the taxable gift is discounted to reflect the owner’s retained right to use the residence for the term of years. As such, a QPRT can allow the couple to transfer residential property using the minimum amount of gift tax exemption. A GRAT is a way for one member of a couple to transfer some of the growth in a financial asset to the other partner using little or none of the donor’s gift tax exemption. The owner of the financial asset transfers the asset to a GRAT, retaining the right to an annuity payment for a set term of years. At the end of the term, the remaining trust assets pass to the other partner or to a trust for his or her benefit. The value of the taxable gift is equal to the original value of the asset transferred to the trust minus the discounted present value of the owner’s retained annuity stream. Through proper drafting, a GRAT can be designed so that the taxable gift is near zero. As such, the GRAT can allow a partner to transfer the appreciation element of a financial asset to the other partner using little or no gift tax exemption.

The ILIT, QPRT and GRAT are techniques available to traditional and non-traditional couples alike. Certain other techniques are only available, or are particularly well suited, for non-traditional couples only. These include Grantor Retained Income Trusts (“GRITs”). Unmarried couples should consider utilizing GRITs to transfer property between themselves. When establishing a GRIT, the grantor (i.e., the creator of the trust) transfers property, preferably property that is appreciating in value but does not generate much income, such as undeveloped land or securities that do not pay dividends, into an irrevocable trust of which the other person is a beneficiary. The trust is required to pay any income earned from the trust property to the grantor for a defined number of years. At the end of that term,
the trust property is distributed to the beneficiary. Because of certain tax laws designed to thwart certain preferential intra-family transfers, a GRIT produces no tax benefit for a couple whose marriage is recognized under federal law. Likewise, a GRIT does not produce a tax benefit if the children of the donor are the beneficiaries of the trust. However, a GRIT can be a particularly useful technique for unmarried couples and same-sex married couples who want to transfer assets between members of the couple on a highly tax-advantaged basis. The benefit of using a GRIT over other estate planning strategies depends on a number of factors, including, among other things, the applicable federal interest rates, the age of the grantor, the length of the trust term, and the grantor’s available gift tax exemption.

A complete discussion of LLCs, LPs, ILITs, QPRTs, GRATs and GRITS and other sophisticated gifting strategies is beyond the scope of this Advisory. Those interested in these techniques should be sure to consult first with their professional advisers.

Incapacity and End of Life Decision Making
Unmarried individuals may utilize powers of attorney to authorize their partners to manage their personal and financial affairs if they become incapacitated. Advance medical directives and HIPAA waivers may be used to ensure that partners are empowered to access each other’s medical records and make critical decisions concerning their healthcare, including the withholding or withdrawal of life support in end of life situations. Unmarried individuals may also want to make arrangements for the disposition of each other’s remains.

Protecting Against Conflicts
Even if unmarried couples prudently utilize wills, trusts, and other estate planning vehicles to ensure that their property is distributed according to their wishes, familial conflicts may arise to thwart those carefully laid plans. Family members who refuse to accept an unmarried couple’s relationship may challenge their estate plan, alleging fraud, duress, undue influence or a lack of capacity. It is often advisable for unmarried couples to plan ahead for these conflicts by executing cohabitation agreements, having “no contest” clauses in their wills and trusts, documenting evidence of their capacity, and confirming their intent with respect to non-probate transfers.

- **Cohabitation Agreements.** Cohabitation agreements, which are similar to prenuptial agreements (discussed below), may help resolve factual disputes by clarifying the unmarried partners’ intentions regarding the distribution of their property. In such agreements, the parties should disclose the nature and value of their property, how expenses will be paid and by whom, how property will be divided in the event that the relationship dissolves, whether support obligations will continue after the termination of the relationship, and how property will be distributed at death. Such agreements should also address who will pay for debts upon the death of the first partner and, if there are additional beneficiaries, whether such debts will be allocated to such beneficiaries instead of to the surviving partner.

- **No Contest Clauses.** Sometimes family members may challenge a will or revocable trust that designates an unmarried partner as a beneficiary. In order to discourage such actions, these documents may include an “in terrorem” or “no contest” clause, which provides that any beneficiary who contests the will or revocable trust will forfeit his or her inheritance.

- **Evidence of Capacity.** An attorney may separately interview an unmarried couple in the presence of disinterested witnesses to confirm that they were of sound mind when
executing their estate plan, thus helping to overcome future claims of undue influence. An attorney may also obtain a statement of capacity from an unmarried individual’s physician.

- **Intent of Non-Probate Transfers.** Family members may contest non-probate transfers from bank accounts, investment accounts, life insurance and retirement accounts. Unmarried couples may help guard against such challenges by restating their beneficiary designations.

**Estate Planning Considerations for Same-Sex Couples**

Same-sex couples who have a limited form of legal union, such as a municipal domestic partner registry, or who are not in any form of legal union are, from a legal perspective, in much the same position as unmarried couples. Accordingly, such couples should review the estate planning considerations for unmarried couples, discussed above, in addition to the considerations discussed in this section, which are primarily addressed to same-sex couples who are in a marriage or legal union substantially equivalent to marriage, such as civil unions and domestic partnerships.

**Protecting Against Relationship Non-Recognition**

Though married same-sex couples may enjoy many of the same rights, benefits, tax incentives and legal presumptions under *state* law that are enjoyed by opposite-sex married couples, same-sex married couples enjoy very few, if any, of those advantages under *federal* law. The reason for this disparity is the federal Defense of Marriage Act (“DOMA”), a 1996 statute that prohibits the federal government from recognizing same-sex marriages and that permits states to refuse recognition of same-sex marriages performed in other states. In the wake of DOMA, many states followed Congress’s lead and passed their own constitutional amendments and statutes prohibiting same-sex marriage within those states, and in many cases, also prohibiting the recognition of such marriages performed in other states. Accordingly, a same-sex couple married in a state that recognizes same-sex marriage (e.g., Connecticut, New York) who later return to or becomes domiciled in a different state with a constitutional amendment prohibiting recognition of same-sex marriage (e.g., Florida, Texas) may find that they have lost the legal advantages that marriage provides, and are now treated as legal strangers to one another.

**Wills and Revocable Trusts.** A same-sex couple should use Wills and, if appropriate, Revocable Trusts to document their estate plan and avoid intestacy, and should consider naming each spouse as Executor and Trustee of the other’s Will and Revocable Trust. Couples using Revocable Trusts may also want to consider moving their assets into their Revocable Trusts during life in order to minimize the estate assets that will subjected to probate, and thus vulnerable to challenge, after death. In addition, the documents should clearly describe the identities of the beneficiaries and the circumstances under which they are beneficiaries. For example, the definition of “spouse,” “partner,” “wife,” or “husband” should describe the relationship between the spouses, identify the surviving spouse by name, and note that the survivor should be treated as a beneficiary regardless of whether the relationship is recognized in the state where the Will is eventually probated or that is the situs of the Revocable Trust.

**Powers of Attorney, Advance Medical Directives, HIPAA Waivers and Burial Arrangements.** As with unmarried couples, it is generally advisable for each spouse of a same-sex married couple to execute powers of attorney, advance medical directives and HIPAA waivers designating
the other spouse as his or her attorney-in-fact and health care representative to ensure that either spouse will be able to manage the other’s personal and financial affairs and make important healthcare decisions in the event of incapacity. Each spouse should also consider appointing the other to handle the disposition of their remains by executing an additional document. Individuals who have specific intentions regarding the disposition of their remains (e.g., cremation or burial in the family plot, ceremonies that should be performed) should articulate the details of such arrangements in writing.

Protecting Against Divorce

Prenuptial and Postnuptial Agreements. Couples who are not yet married should consider entering into a prenuptial agreement before their marriage in order to establish each party’s property rights and support obligations in the event of divorce. The agreement should include provisions allowing the agreement to be enforced through private arbitration as an alternative to a judicial proceeding. Couples already married and who did not enter into a prenuptial agreement may still enter into a postnuptial agreement to accomplish the same results.

Protecting Children

Same-sex couples face challenges concerning the legal parentage and inheritance of any children they raise together. In some situations, only one parent may have legally adopted a child. In other situations, a child is biologically related to one parent, as is often the case with children from prior relationships or children born through assisted reproductive technology, but is not biologically related to the other parent. In either case, the parent who has not adopted the child or who is not biologically related to the child may have no parental rights with respect to the child in the event that the adoptive or biological parent dies while the child is still a minor. Similarly, the child will not inherit from the non-adoptive or non-biological parent if that parent dies intestate. In the event the couple ends their relationship, the non-adoptive or non-biological parent may be denied custody or visitation rights.

Guardianship. A couple should consider appointing each other as Guardian of any minor children being raised by the couple. However, such appointments will not override the parental rights of a child’s other legal parent in situations such as a child born of a prior relationship. A couple may also tailor Wills and Revocable Trusts to clearly identify the children being raised by the couple, and to define “children” to include both children already born and after-born children with whom the testator will have a parental relationship, regardless of legal parentage.

Adoptions and Pre-Birth Orders. For the children of one but not both spouses (assuming there is no other legal parent), the couple may want to pursue a second parent or step-parent adoption of such children. For children that will be born through gestational surrogacy, the parents should consider obtaining a pre-birth order from a probate court ordering that the couple be listed as the child’s parents on his or her birth certificate.

Minimizing Transfer Taxes

A couple may use a variety of lifetime gifting strategies as a means to balance assets while minimizing gift and estate taxes for the donor spouse. Because same-sex couples are not recognized as married under federal law, they should consider the various gifting strategies outlined above with respect to unmarried couples.
Estate Planning Considerations for Opposite Sex Couples in Second Marriages

Couples in second marriages often find themselves facing unique challenges compared to what they faced in their first marriages. For example, one or both partners may have children from the prior marriage, whose interests the couple wants to protect in the event of divorce or the death of one of the partners. In addition, each partner has likely accumulated more assets and may be earning a higher income than at the time of the first marriage. One or both partners may have gone through a divorce, and the couple may want greater certainty and predictability regarding the division of property and potential support obligations in the event of another divorce.

Protecting Against Divorce

Prenuptial and Postnuptial Agreements. Couples who are contemplating a second marriage but have not yet married should consider entering into a prenuptial agreement in order to clearly establish each party’s property rights in the event of death or divorce. Couples who have already entered into a second marriage, but who did not negotiate a prenuptial agreement, may still enter into a postnuptial agreement. Couples who have entered into either a prenuptial or postnuptial agreement should ensure that their estate planning documents incorporate the relevant provisions of the agreement.

Protecting Children

Wills and Revocable Trusts. Couples in second marriages should consider bequeathing property to a marital trust for the benefit of the spouse, rather than to the spouse outright, with the remainder of the trust passing to the decedent’s children.

Retirement Accounts. In addition, to the extent the surviving spouse will have sufficient assets, the couple may want to consider designating their children (either outright or in trust) as the beneficiaries of their respective retirement accounts. This strategy will tend to lower the amount of required minimum distributions that must be taken from such accounts, thus continuing the deferral of income taxes.

Minimizing Transfer Taxes

Lifetime Qualified Terminable Interest Property Trusts. In addition to other lifetime gifting strategies that may be used to balance assets, a wealthier spouse, as grantor, may establish a lifetime marital trust for the benefit of the less wealthy spouse during his or her lifetime. (Such trusts are often referred to as Qualified Terminal Interest Property trusts, (“QTIPs”).) By doing so, the grantor avoids any gift taxes on the transfer, excludes the transferred property from the grantor’s estate, and causes the property to be included in the spouse’s estate instead, thus potentially avoiding estate tax on the transferred property by taking advantage of the spouse’s estate tax exemption. The grantor, by virtue of creating the trust, maintains control over the distribution of assets upon the spouse’s death, such as by providing that the grantor’s children become the beneficiaries instead of the spouse’s children.

Conclusion

Though non-traditional couples face unique challenges compared to traditional married couples, they have a wide range of estate planning strategies to choose from so that their estates will be distributed as they intend, gift and estate taxes will be minimized, and critical
decisions concerning their finances and healthcare will be made by trusted individuals during either partner’s incapacity. The choice of which strategies to employ in a particular situation, as well as their timing and execution, is a complicated matter that requires careful analysis. Individuals and couples should consult with a qualified estate planner to consider the facts and circumstances relevant to their situations before pursuing any of the strategies outlined above.

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