GRITs for Gays and Other Unique Planning Opportunities for Same-Sex Couples[1]

By Scott E. Squillace

Scott E. Squillace discusses current developments to the legal status of same-sex marriages, and offers strategies (including GRITs) that allow same-sex couples to utilize planning techniques that are currently not viable for heterosexual married couples.

In May 2004 the world changed … at least with respect to gay couples in Massachusetts. That is when same-sex couples began to lawfully marry in the Commonwealth of Massachusetts. The Supreme Judicial Court of Massachusetts had ruled (in November 2003) that denying same-sex couples the right to marry violated the Constitution of the Commonwealth of Massachusetts.[2] Thus began anew the great national debate about gay marriage, which continues today. This year (2009) the Iowa Supreme Court issued a similar ruling in which it held that denying same-sex couples the right to marry violated its Constitution's Equal Protection provisions.[3] Since that ruling, Maine and New Hampshire have been added to the list of States that now provide same-sex couples with the right to legally marry in their States.[4] Whatever one's personal beliefs on this issue are, the trend seems clear for a macro-social change to occur over time, not dissimilar to that resulting from the Women's Suffrage movement, which took decades to happen. How this affects estate planning is complex and is still being figured out by many professionals across the country.

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The author wishes to acknowledge the assistance of his colleague, Carol Sneider Glick, Of-Counsel to the firm, for her invaluable insights and contributions to this article. Carol holds her LL.M. in Taxation from Boston University.

Legalized same sex marriage in Massachusetts in 2004, however, was not the beginning of the debate. The cases, and therefore the debate around same sex marriage, actually started in the 1970s with the first case decided by the Minnesota Supreme Court in 1971[5] in a decision not favorable to same-sex couples. The first judicial victory for same-sex couples' right to marry occurred in Hawaii[6] in 1993 (later undone by legislative action). The next successful case was in Vermont[7]—which followed with legislation that made it the first state to provide all of the same rights and privileges to same-sex couples as married couples when it enacted the Vermont Civil Union Statute.[8] Shortly thereafter, and at the beginning of a very new Clinton Administration, the Federal Government decided to take a position on this hotly contested social issue. On September 21, 1996, President

Clinton signed the Federal Defense of Marriage Act (DOMA).[9] DOMA defines marriage for all Federal purposes as a union between one man and one woman. Since then, 43 states have enacted "Mini-DOMA" statutes and state constitutional amendments, effectively banning same-sex marriages in those states.[10] Today, gay marriage is lawful in Massachusetts, Connecticut,[11] Iowa, Vermont, New Hampshire and the District of Columbia.[12] California has gone back and forth a bit. Its Supreme Court found gay and lesbian people to be a suspect class for constitutional law analysis and decided, in a landmark case, that not providing full marriage rights to people of the same sex violated its constitution.[13] That case was recently undone in part by a ballot initiative (known as Proposition 8)[14], which the California Supreme Court recently upheld while allowing the 18,000 marriages performed before the ban was passed to remain valid.[15] There is much social unrest now in California and many believe the debate there is not over. A new ballot initiative is likely.[16] Finally, New York's highest court has interestingly decided to recognize same sex marriages from other jurisdictions in its state[17] although it punted to the legislature to decide whether its residents in same sex relationships may legally marry. In addition, same sex marriage rights are now provided in a number of foreign countries: Australia, Canada, Belgium, The Netherlands, Denmark, Iceland, Sweden, Norway, South Africa and Spain, to name many.[18]

Marriage rights under state law can be considerable. Just looking at it from an end-of-life perspective, such rights would include: the right to make medical decisions; hospital visitation rights; spousal elective share rights; rights under intestacy laws; the right to claim a spousal decedent's remains; the right to make anatomical gifts and the right to make funeral arrangements. These are just a few of the rights now afforded to same sex spouses under state laws where marriage is allowed.

Regardless of whether a same sex marriage is recognized under state law, it is clear that same sex marriages for all Federal law purposes (including Federal Estate and Gift Taxes) are not recognized. There are an estimated 1,138 rights, privileges, and obligations that emanate from the status of marriage under Federal law and regulation.[19] Some of the more obvious ones include Social Security survivor pension benefits for widows and widowers, health care for spouses of Federal Government employees, and, of course, many tax laws such as filing joint (married) returns, gift splitting and unlimited spousal gifts.

Shortly after DOMA was enacted, a number of Federal agencies, including the IRS, promulgated regulations pursuant to its authority.[20] The IRS takes the position that same-sex couples who are lawfully married under state law are legal strangers for federal tax purposes. For same-sex partners sharing a life together, buying a home, raising children, and financing college educations, this ruling creates practical dilemmas on a daily basis. For example, when same-sex partners buy their first home, they must each source 50 percent of the down payment from their own funds or be subject to the gift tax rules. For couples who live together as a married couple, the issue of tracing assets throughout the marriage, not only for gift-tax but estate-tax purposes, becomes complex.

In addition, a variety of estate planning techniques normally available and relied upon by married couples are not available to same sex married couples. Some examples include the unlimited marital deduction for both estate and gift tax purposes, Qualified Terminable Interest Property (QTIP) treatment, Qualified Domestic Trusts (QDOTs), and age as a factor in determining whether a generation skipping transfer is made, to name a few.

But every cloud has a silver lining. Since gay couples are legal strangers for all Federal law purposes, some interesting planning opportunities can be found within these "nontraditional" families from which other "traditional" families are precluded. Essentially, the IRS cannot have it both ways: either same-sex couples are "related" or they are not. The Federal Government, and, therefore, the IRS, has decided that gay couples are (at least as of now) unrelated people. This should cause all estate planners to think back to all of the estate-planning techniques that have been curtailed by related-parties rules. This article presents several techniques that are uniquely suitable to same-sex couples under current Federal law that may be less appealing to traditional couples. The most significant of these, we believe, are Grantor Retained Income Trusts (GRITs), which are otherwise little used today. Essentially, GRITs provide a compelling way to transfer wealth at a discount from the wealthier to the less wealthy spouse or partner in same-sex couple relationships. (This technique works equally well for any unmarried, for Federal law purposes, couple—whether straight or gay.)

Other Practical Considerations for Practitioners Representing Same-Sex Couples

We are often contacted to assist, informally, other practitioners who have their first "gay" couple come in for estate planning work. The article details some moderately sophisticated tax planning techniques to consider with same-sex couples in doing their estate plans. Here are some other (nontax) very practical practice pointers for the counselor:

Terminology. Ask the question, "How do you prefer to refer to one another?" For example, many gay and lesbian couples still prefer to use the term "partner" or "domestic partner" instead of "spouse," "husband" or "wife." Others, feel very strongly about these hard fought for terms and want to be sure that, particularly in their legal documents, they are referred to as spouses. Our advice on this one: simply ask the couple at the beginning of the engagement what their preference is in terms of terminology. And, then be sure everyone in your office knows. There is no surer way to lose the confidence of this couple than to have an awkward moment by an unwitting team member when scheduling a follow-up appointment.

How "out" are they? Some couples are very "out" (meaning open about their relationship) with friends, family, coworkers, *etc*. Others are not. It is uniquely personal—and—relevant to the plan you will be doing. Particularly if natural family members are not included as beneficiaries or fiduciaries—you will want to know if they know. Again, simply (and delicately) ask the question, "Are you out to your family, friends and co-workers?" If not, try to understand what the parameters of their comfort zone are. While you are not the psychotherapist, you do need to know who knows what, particularly if you are later asked to assist with the administration of the plan.

Understand the money. Who makes it, who has it, who controls it. And, most importantly, how "combined" is it, or not? Often, in same-sex couples, one person has more than another. (I guess, this is true for most couples.) The issue, however, with same-sex couples is the unwitting gifting that may take place. Whereas heterosexual couples enjoy the benefit of unlimited spousal gifting, same-sex couples do not. Often times they unknowingly make gifts to one another. The most common occurrence of this is when they purchase their home (or second home.) You will want to know this and counsel on these issues. Gift tax returns (albeit late) may be advisable. Above all, they should be advised to keep very accurate records, so they can later prove to the IRS where the funding from joint property came from.

Don't assume anything with respect to children. It is not uncommon for same-sex couples to want to have a family, for instance. Do not assume just because they are biologically incapable of reproducing without intervention that kids are not in the plan. Again, ask, "Do you plan to have children?" If so, "Do you yet know if either of you would have your own biological children?"

Biological family vs. logical family. Many gay and lesbian people grow up in worlds that do not support them. As a result, they gravitate to a community over time that provides them love and support. One's closest people in the world may not be from one's biological family. Instead, they are from a "logical" family that consists of very close friends and often former partners. Ask about those close to your client, not just their biological family.

LGBT community and other politically correct references. The gay and lesbian community has transformed in the past decades. Since AIDS, it has by necessity been more "out" and over time has tended to be more inclusive. "Gay" is usually the term used to refer to men who like to have sex with and be with men. "Lesbian" is used for women in the same way. LGBT (or GLBT) is the combined term to include Bi-sexual and Transgendered people. Younger LGBT people sometimes refer to themselves as "queer," which is increasingly popular and no longer derogatory. For purposes of simplicity, in this article we have referred to gay or same-sex couples, but have intended to include all in the LGBT community. When working with people from this community, simply ask, again, if they prefer any particular reference.

GRITs for Gays

GRITs used to be one of several popular split interest gifting techniques used to transfer wealth at a discount from one generation to the next. A GRIT is, at its core, a simple discounting strategy that, today, lends itself well to same-sex couples wishing to transfer assets to one another. Simply put, the income interest gets paid out to the grantor over the term of the trust and the remaining interest (the "gift," which is discounted based on what is deemed to have been paid to the grantor) gets paid to the trust remainder beneficiary.

Here, in a little more detail, is how a GRIT works: the grantor makes a gift of property to an irrevocable trust (preferably, the gift should be an appreciable asset that is not expected to generate much, if any, income, such as land, certain business interests, or nondividend paying securities).[21] The terms of the trust would require that all income from the property (if any) be paid to the grantor for a certain number of years (the "trust term"), and at the end of that period of time the remaining property would be transferred to the remainder beneficiary or beneficiaries named in the trust. For gift tax purposes, the gift to the trust is deemed to be the present value of that remainder interest. The gift would be valued based on: (1) the current assessed value of the gift, (2) the Code Sec. 7520 Applicable Federal Rate (AFR)—3.2 percent as of December 2009[22], (3) the term of the trust and (4) the age of the grantor at the time of the gift. The gift is discounted based on essentially two factors: (1) the amount that is deemed paid to the grantor (which is calculated based on the value of the gift, the Code Sec. 7520 rate at the time of the gift and the trust term); and (2) the likelihood that the grantor will outlive the trust term (which is calculated, using the IRS mortality tables, based on the term of the trust and the age of the grantor). If the grantor does not outlive the trust term, all of the remaining property in the trust will be deemed to be part of the grantor's estate, in which case the grantor will be no worse off than if he or she had never made the gift in the first place. The gift can even be further discounted if the grantor retains a contingent reversion interest which would require that all of the trust property be paid over to the grantor's estate in the event the grantor dies before the end of the term. Since the property in the trust would in any event be deemed includible in the grantor's estate for estate tax purposes if the grantor dies before the end of the term, such a reversion has the benefit of further discounting the value of the gift while not increasing the estate taxes.

One of the clear benefits of a GRIT, as with any type of gift, is that, assuming the grantor survives the trust term, it allows the transferred asset to appreciate outside of the grantor's estate, thereby eliminating any estate or gift taxes on the amount of the appreciation. Also, even though the gift is discounted based on anticipated payments of income to the grantor, as described above, if the GRIT is funded, as suggested, with non-income producing property or low income producing property, no payments (or minimal payments) will be paid to the grantor. This will allow all or much of the property to remain in the trust and appreciate over time. On the other hand, a GRIT is also a good way to transfer property if the Grantor wishes to gift the property (to get the appreciation out of the grantor's estate or to lower transfer tax costs), but still wants to maintain some control over the property, continue to use the property or receive some income from the property (in which case the grantor would gift income-producing property) for a period of time. A GRIT can also provide a little insurance to the grantor who contributes non-income producing property to the trust by providing the grantor the right, similar to that required to be in a QTIP trust, to demand that the property in the trust be converted to income-producing property. For all of these reasons, a GRIT is a clearly favored discounting strategy if one has not fully utilized one's lifetime gift exemption amount which is, under current law, $1M. It could also be a favorable strategy for those who have utilized their life-time exemption and are expected to die with taxable estates (assuming, of course, that the estate tax is not repealed), since, as with any gift, there will be considerably less transfer tax cost than if the property were to remain in one's estate until death and, with a GRIT, the property can be transferred at a considerable discount.

Significant discounts can be obtained through the use of GRITs, even given the current low interest rates, which are unfavorable to GRITS. For example, assume a 40-year-old grantor puts $1M of nonincome-producing property into a GRIT for 10 years. The gift of the remainder interest may be calculated to be $734,810 (using a Code Sec. 7520 rate of 2.8 percent)—effectively getting a 26-percent discount on the value of the property transferred. The discount would be even greater if the Grantor was given a contingent reversion interest. Also, the higher the Code Sec. 7520 rates (which were at an all time low early in the year, but have since risen), the greater the discount one can receive. Longer trust terms, while riskier, will also obtain greater discounts. Finally, although one has no control over the age of the grantor, older grantors are less likely to live out the terms of a trust, and so the older the grantor, the more the gift will be discounted. (See the tables below for examples of the way some of these variables can affect the amount of the discount.)

So why is everyone talking about GRATs and not GRITs? Code Sec. 2702 changed the rules for the GRIT technique to no longer allow it for "Family Members."[23] Now, if transferring assets to close family members,[24] the value of the remainder interest must be a "Qualified Interest" (either an annuity or unitrust interest) in order to be a useful strategy.[25] This restriction, however, does not apply to same-sex couples or unmarried opposite sex couples for that matter. Although GRATs have their benefits, in general, we find that GRITs have far more advantages.

The wonderful difference between a GRIT and a GRAT is that GRITs do not require actual income payments to come back to the grantor if the asset transferred does not actually throw off income, whereas, GRATs require the annuity payment to the grantor in any event, and, of course, if done properly, can convey appreciation without transferring the underlying wealth. An additional (potential) benefit of GRIT over GRAT is the survivability issue. If a grantor does not outlive the term of the GRAT, we all know it fails, at least in part.[26] With a GRIT, unlike a GRAT, one could provide for a commutation power to the trustee that could possibly save it from failure upon the death of the grantor by permitting the trustee, prior to the grantor's death, to terminate the grantor's income interest by a transfer to the grantor of property equal in value to the grantor's remaining income interest in the trust, using the then applicable Code Sec. 7520 rate. There are, of course, situations in which GRATs could be preferable to GRITs, such as the use of zeroed-out GRATs to avoid any transfer tax cost and the use of very short term GRATs in situations where there is expected to be an immediate boost in the value of the gifted asset (although proposed amendments to the tax law could soon eliminate the use of short term GRATs).[27] (For a detailed comparison of the performance of GRITs vs. GRATs, see the insert below.)

Although GRITs have been cut off for use by heterosexual married couples, an "unrelated" (legally married) gay couple can still significantly benefit from this strategy. Let us say the couple wants to invest in a new business or develop land or real estate, or wants to transfer growth (not value) stock portfolio—something that likely will not produce income in the near term. Partner A (the wealthier one—who, of course, would need to have the objective of transferring some of his wealth to the less wealthy one in a tax-efficient way) would set up a GRIT and use some of his lifetime exemption amount (or pay the gift tax) for the gift of the remainder interest to Partner B-which will be valued (as above) using the Code Sec. 7520 rate to determine the remainder interest. The same could be true if the couple wanted to transfer wealth to the next generation, although care must be taken to ensure that they are legally "unrelated" for these purposes.

The transactions must be "arm's length" and, of course, all proper gift tax returns must be filed, but there is no reason under current law why this strategy, currently unavailable to other "family members," should not be fully available to unrelated gay families. Again, the IRS takes the view that we are not "family." (Interestingly, this strategy is equally useful to unmarried opposite sex couples—the aspect of making it interesting is not being related for Federal tax purposes.)

For a detailed analysis of the discounting benefit of GRITs and a comparison of the same strategy to a similar term GRAT, see the following examples.

GRITs. As stated above, GRITs are sensitive to the age of the grantor and Code Sec. 7520 rates. The older the Grantor and the higher the statutory rate, the smaller the taxable gift associated with the GRIT. Below are taxable gifts that would result at two different grantor ages and two different Code Sec. 7520 rates.

Table 1.

	2.80%	7.00%
40-year old	$734,810	$492,340
65-year old	$576,750	$386,440

GRIT Case Study

Essential facts:

- 40-year-old grantor
- Considering 10-year GRIT funded with $1M global stock portfolio (expects total return to be

10 percent, of which seven percent is expected capital appreciation and three percent is from dividend income)
- 2.8 percent current Code Sec. 7520 rate
- Taxable gift $734,810—gift tax due (45 percent) would be $330,664 (assuming life time gift tax exemption had been used)

Results: Initial GRIT calculation

$1M GRIT: fund a 10-year term GRIT with $1M; taxable gift calculated to be $734,810, so gift tax due would be $330,664.

Table 2.

	1-GRIT (7% Appreciation, 3% Dividend Yield)	2-GRIT w/ no income back to grantor (10% Appreciation)
GRIT/GRAT Funded	$1,000,000	$1,000,000
Taxable Gift	$734,810	$734,810
Gift Tax	$330,665	$330,665
Total Consumed	**$1,330,665**	**$1,330,665**
Ending Value to Beneficiary	$1,967,151	$2,593,742

On the left column (1), I have assumed the stock portfolio pays dividends of three percent and those dividends flow back from the GRIT to the grantor. On the right column (2), I have assumed the asset generates the same total return (10 percent), but that this return comes exclusively from capital appreciation (for example, a portfolio of nondividend paying stocks). Hence, all of the assets are retained in the GRIT over time. In both cases I have assumed any income taxes generated by the portfolio are paid by the grantor from outside the GRIT portfolio.

Tradeoff and initial conclusions:

For a 40-year-old grantor, funding a 10-year GRIT with $1M when the Code 7520 rate was 2.8 percent would cost the grantor $330,664 in gift taxes (assuming he had already used up his life time $1M exemption from gift tax). However, it can result in a significant tax savings over time. With an asset expected to return 10 percent (with only three percent coming from income), the GRIT transfers $1.97M—and if I assume that the asset is not income producing and earns the same total return (10 percent), the transfer is significantly higher, at $2.59M. Of course, if the grantor is older or the Code Sec. 7520 rate is higher, both likely scenarios, the gift taxes will be less.

How Do Some Alternatives Compare?

Table 3 compares different ways of making the same gift. The options are:
- Columns 1 & 2, as previously described.
- Column 3—Make a direct taxable gift of $734,810, pay gift tax, and put the remaining assets of $265,190 in a 10-year term GRAT (zeroed out).
- Column 4—Place $1,000,000 in a 10-year term GRAT that has a taxable gift of $734,710 (it is not zeroed out).
- Column 5—Take the entire $1,330,664 and place in a 10-year term GRAT (zeroed out). The entire $1,330,665 would be paid back to the grantor over the term of the trust, but the beneficiary would end up with all of the appreciation.

If a GRIT can be funded with an asset that is likely to produce little or no income, from an analytical perspective, it will be tough to beat. Alternative 2 puts the most money in the hands of the beneficiary by the end of the tenth year.

In looking at some alternatives, it seems clear that maximizing the direct gift is preferable to putting more money in the GRAT (*that is*, strategy 3 transfers more than strategy 4). But neither are as good as the GRIT with an asset that produces no income.

For grantors who like the idea of transferring wealth but are not willing to pay any gift tax today, strategy 5 is worth noting. Here I show putting all of the funds (what you would have otherwise put in the GRIT plus any

Table 3.

	1-GRIT (7% Appreciation, 3% Dividend Yield)	2-GRIT w/ no income back to grantor (10% Appreciation)	3-Maximize Direct Gift + GRAT	4-$1 mil. GRAT (not zeroed out)	5-$1.331 mil. GRAT
GRIT/GRAT Funded	$1,000,000	$1,000,000	$265,190	$1,000,000	$1,330,665
Taxable Gift	734,810	734,810	734,810	734,810	
Gift Tax	330,665	330,665	330,665	330,665	
Direct Gift			734,810		
Total Consumed	**$1,330,665**	**$1,330,665**	**$1,330,665**	**$1,330,665**	**$1,330,665**
Ending Value to Beneficiary	$1,967,151	$2,593,742	$2,149,909	$1,853,167	$1,224,344

gift tax payable on that GRIT) in a zeroed out GRAT. Over 10 years, the strategy can transfer a significant amount of assets without paying any gift tax and with ultimately no cost to the grantor. Unlike the GRIT, this is a strategy that benefits from a low interest rate.

Conclusion

GRITs, despite producing relatively high taxable gifts when interest rates are low, still look good today for certain clients. For assets that are likely to generate little or no income, GRITs can be a very good transfer vehicle (particularly for older grantors, because this would further reduce the taxable gift). For clients who do not want to pay gift tax, zeroed out GRATs are another compelling alternative.

Other Techniques

A QPRT—or the "House GRIT." This is a well-used technique to transfer one personal residence (or two if one of them is the principal residence) to related parties, as well as to "unrelated" parties, such as the same-sex spouse. A QPRT is actually a qualified form of a GRIT and works almost exactly like the GRIT discussed above, except that its use is limited to transferring personal residences. The grantor is assumed to receive income at the Code Sec. 7520 rate even though the property may (or may not—depending on if it is rented) produce any income. The grantor has the right to reside in the residence during the term. And, at the end of the term, the property passes to the remaindermen. The value of the remainder interest is taken into account when setting up the trust. One needs to outlive the term of the trust.

Traditionally, this technique is used by parents to pass property along to the children, getting the appreciation, over the term, out of the parents' estate and allowing the parents to transfer their house to their children at a significant discount. One of the downsides is losing the ability to get a step up in basis at death and making sure one outlives the term of the trust. It is possible, however, for the grantor to sell the house, preferably near the end of the term, and, because this is a grantor trust, still take advantage of the Code Sec. 121 exclusion from capital gain. At the end of the term, one could transfer the house to a new trust that gives the grantor the right to use and occupy the house in exchange for the payment of rent as long as the grantor desires. This arrangement has the advantage of keeping control of the house in the hands of the grantor, while also allowing the grantor to transfer additional assets to the QPRT beneficiary. When this technique is used by a same sex couple, one could have the remainder trust be for the benefit of the same sex spouse. The property is then kept in trust for the benefit of the same sex spouse at the end of the term and a third party could retain the right to change or add the beneficiaries to the trust, which could, however, create some estate inclusion issues for this third party. Those decisions will need to balance the overall goals and objectives verses need for control. After the term ends, the grantor (who would still need to survive the term for this technique to work) could purchase the house from the continuing trust so long as the grantor is not the owner for income tax purposes at the time of the purchase. This would have the effect of moving more value out of the grantor's estate, assuming the property appreciated during the term, and allow the couple to maintain effective control of the property.

Other discounting strategies for common ownership. Gay couples often own homes together and, as other couples, accumulate other assets together over time. We all know the perils of joint ownership: property may pass outside of the probate process, but such planning causes the interest to pass unprotected from creditors and future spouses/partners. Converting the home, therefore, from Joint Tenants with Rights of Survivorship (or, as is the case now in Massachusetts, Connecticut, and Iowa—Tenancy by the Entirety for the married couple) to Tenants in Common, and then into revocable trusts can present some sound planning opportunities, but one should be cautious before giving up the protection that a tenancy-by-the entirety provides. First, one can clearly designate to whom and in what way that asset is transferred not only at death, but in the event of a disability. Planners have long used the Revocable Living Trust (RLT) to govern such transfers. Real property, funded into the RLT, can provide an opportunity to protect that interest from creditors and other "predators," such as subsequent spouses at death. In addition, since it becomes a fractional interest, there is an opportunity to take a discount at death for a noncontrolling share.[28] Of course, a proper valuation is needed and consideration should be given to having each spouse not serve alone as the trustee of the decedent's RLT so that they do not lose the opportunity to claim that they do not have complete control of the asset. Probably most important in considering this technique is the need to achieve a discount, verses the creditor and other asset protection features that could be lost by giving up tenancy by the entirety. All these decisions should be made in the context of the other goals and objectives for the couple and not just have the 'tax' tail wag the proverbial dog.

Turn the vacation home into an investment property (Code Sec. 1031 like-kind exchange). Many people have a second (vacation) home. Often, that home is rented for part of the year. IRS rules about whether a second home can be treated as an investment property are fairly strict.[29] Under Code Sec. 280A(d)(1), a person's second home becomes a residence (and therefore cannot be claimed as investment property) when the owner uses the property for personal purposes for more than 14 days or 10 percent of the number of days during such year for which the unit is rented at the fair rental value.[30] Most vacation homes do not meet these criteria.

However, when the criteria are met, the opportunities can be meaningful. Investment properties provide owners with several important tax benefits, including deductions for interest, depreciation, and repairs, among others.[31]

Since gay couples are unrelated for Federal tax purposes, one partner could lease the home to the other partner in an arm's-length transaction and convert what was a second home into an investment property. BEWARE: the rules here are strict and apply equally to everyone. You must draft and execute a lease between the parties, at the market rate, and pay rent! The recordkeeper will prevail.

Later, when the couple wants to upgrade to a larger place (say for retirement purposes), then instead of realizing capital gains tax on the appreciation of the property, they could do a Code Sec. 1031 like-kind exchange.[32] Simple and complex like-kind exchange solutions are available for both real and personal property. The simplest solution is to simultaneously swap one property for another. Additionally, the couple may opt for a more complex, but more flexible solution, such as the deferred exchange, whereby an intermediary holds sale proceeds and acquires the replacement property. The couple must adhere to strict guidelines in identifying the replacement property.[33] A reverse exchange may also be used, whereby a replacement property is acquired before the other property is relinquished. A titleholder may be used for no more than 180 days during which time the couple must dispose of the relinquished property.

The capital gain tax on the property is deferred and, depending on the ultimate goals for the couple, the property may be transferred to the dying partner at death so as to receive a step up in basis and forever not realize those gains, provided the transfer happens more than one year before death.[34]

These are just a few ways in which gay couples can benefit from their current "unrelated" status under Federal law. But, watch this space. This is an extraordinarily dynamic area of the law. Recently, Gay & Lesbian Advocates & Defenders (GLAD), the organization who brought and argued the first gay marriage case in Massachusetts, filed suit in Federal District Court challenging the constitutionality of DOMA.[35] That case will take some time to work its way up to the U.S. Supreme Court, which may someday decide, like the Massachusetts, Connecticut, Iowa and California[36] high courts, that this group is a minority whose rights merit protection by the courts, and overturn DOMA and its progeny on constitutional grounds. That would be good news and bad news.

You can be the judge of that for you and your clients. Certainly, the unique techniques outlined here would disappear. This author believes that would be a nice problem for him, his husband and his clients to have.

Endnotes

1 To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, any tax advice contained in this article was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (1) avoiding tax-related penalties under the U.S. Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.

2 *Goodridge v. Dep't of Pub. Health*, 798 N.E.2d, 941, 969 (Mass. 2003).

3 *Varnum v. Brien*, __ N.W.2d __, No. 07-1499 (Iowa 2009).

4 Act of May 6, 2009, ch. 82, 2009 Me. Legis. Serv. ch. 82.

Act of June 3, 2009, ch. 59, 2009 New Hampshire Laws ch. 59.

5 *Baker v. Nelson*, 291 Minn. 310, 191 N.W.2d 185 (Minn. 1971).

6 *Baehr v. Lewin*, 852 P.2d 44, 67 (Haw. 1993).

In 1998, the Hawaii Constitution was amended to read: "The legislature shall have the power to reserve marriage to opposite-sex couples." Haw. Const. art. I, §23.

7 *Baker v. State*, 170 Vt. 194, 744 A.2d 864, 81 A.L.R.5th 627 (Vt. 1999).

8 2000 Vt. Adv. Legis. Serv. 91.

On April 7, 2009, the Vermont Legislature overrode the Governor's veto, becoming the fourth state to legalize gay marriage, and the first state to do so through the legislative branch. Timothy J. Alberta, *Vermont Becomes Fourth State to Allow Gay Marriage*, Wall Street Journal, April 7, 2009, available online at *http://blogs.wsj.com/washwire/2009/04/07/vermont-becomes-fourth-state-to-allow-gay-marriage/*. The House and Senate proposed the following amendment to Vt. Stat. Ann. tit. 15, §8 (2009): "Marriage is the legally recognized union of one man and one woman" will be amended to "Marriage is the legally recognized union of two people." See also, Keith B. Richburg, *Vermont Legislature Legalizes Same-Sex Marriage*, Washington Post, April 7, 2009, available online at *www.washingtonpost.com/wp-dyn/content/article/2009/04/07/AR2009040701663.html.*

In addition to Vermont, 5 other states have enacted legislation that provide for Domestic Partner or Civil Union rights for same-sex couples: Connecticut: Conn. Gen. Stat. §46b-38aa et seq.; New Jersey: N.J. Stat. Ann. §37:1-28, et al.; California: Cal. Fam. Code §§297, 297.5, enacted pursuant to A.B. 205, 2003-2004 Reg. Sess. (Cal. 2003); Oregon: H.B. 2007, 74th Leg., 2007 Reg. Sess. (Or. 2007); Washington: Rev. Code Wash. § 26.60.010, et seq., and see H.B. 3104, 60th Leg., 2008, Reg. Sess. (Wash. 2008) significantly expanding rights available to domestic partners; Maryland, e.g. Md. Code Health-Gen. § 6-101; Md. Code Estates & Trusts §4-501; Md. Code Real Prop. § 14-121; Md. Code Tax-Prop. §§12-101, 12-108.

9 Defense of Marriage Act, Pub. L. No. 104-199

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(1996), (codified as 1 U.S.C. §7 (1997)).

10 *See*, *www.marriagewatchdog.org/states/doma.htm*; Certain other countries confer various benefits and rights to those in same sex couple relationships, such as Finland, France, the United Kingdom and Germany.

11 *Kerrigan v. Comm'r of Pub. Health*, 957 A.2d 407, 412 (Conn. 2008).

12 The D.C. Council voted to recognize same-sex marriages performed in other states. There are plans to introduce legislation to recognize gay marriage. Nikita Stewart & Tim Craig, *D.C. Council Votes To Recognize Gay Nuptials Elsewhere*, Washington Post, Apr. 8, 2009, at A01, available online at *www.washingtonpost.com/wp-dyn/content/article/2009/04/07/AR2009040702200.html*.

13 In re Marriages Cases, 183 P.3d 384 (Cal 2008).

14 Cal. Const. art. 1, § 7.5.

15 *Strauss v. Horton*, --- Cal.Rptr.3d ----, 2009 WL 1444594 (Cal. 2009). The Court upheld Proposition 8, which amended the state constitution by limiting marriage to opposite sex couples, but interpreted Proposition 8 as only prohibiting the use of the term "marriage" for unions of same-sex couples. The Court affirmed that in all other respects same-sex couples would be accorded all the substantive rights and benefits incidental to marriage that opposite sex couples enjoyed, "including the constitutional right to enter into an officially recognized and protected family relationship with the person of one's choice and to raise children in that family if the couple so chooses." Strauss v. Horton, Tyler v. State of California and City & County of SF v. Horton, Opinion No. S168047, S168066 & S168078 issued May 26, 2009 at 92.

16 *See, e.g.,* Equity California, available online at *www.eqca.com*.

17 *Martinez v. County of Monroe*, 10 N.Y.3d 856, 889 N.E. 2d 495, 859 N.Y.S.2d 617 (2008).

18 The Netherlands was among the first to recognize same sex marriages in its civil code. Civil Code Act of December 21, 2000, Title 5, Article 30(1), amending Book 1, effective April 1, 2001, specified that one member of the couple must either be a Dutch citizen or else live in the Netherlands.

Belgium next granted all rights of marriage, but does not provide for the presumed paternity of a child born during the marriage and does not change the lack of provision (under Belgian law) for joint adoption by a same-sex couple. Both the Netherlands (1998) and Belgium (2000) have permitted both opposite and same-sex couples to enter registered partnerships. Reported in United Press International (January 31, 2003).

Canada's Civil Marriage Act, S.C. 2005, C.33, validated same-sex marriages in Canada.

Same-sex couples were lawfully allowed to marry in Spain effective June 3, 2005. They are permitted to adopt children together. "[Spain took] existing law [adding] a sentence saying that all married couples will have the same rights regardless of sex. [This] does more than any law in Europe to equate the rights of heterosexual and same-sex couples … [whereas] the Netherlands [has merely created] a category of rights that do not fully match those of heterosexual couples on subjects like adoption … ," according to the N.Y. Times, June 19, 2005, page 4.

South Africa, Norway and Sweden also permit same-sex marriage, the latter since April 1, 2009.

Same-sex marriages, while not performed, are recognized in Aruba (Dutch only), Israel, the Netherlands Antilles (Dutch only), and the Isle of Man. Registered partnerships are permitted in Andorra, Czech Republic, Denmark, Finland, France, Germany, Greenland, Hungary, Iceland, Luxembourg, New Zealand, Slovenia, Switzerland, the United Kingdom (called civil partnerships there according to Ian Curry-Summer, All's Well That Ends Registered, 159 and 203 (2005)), Uruguay and one province of Venezuela (according to Wikipedia).

Unregistered cohabitation exists in some regions of Argentina, Australia, Austria, Brazil, Colombia, Croatia, Israel and Portugal (according to Wikipedia). Legal recognition of same-sex couples is permitted in other regions of Argentina, the Australian capital territories, Tasmania and Victoria, in one Mexican state and Mexico's federal district.

19 Gov't Accountability Office, Defense of Marriage Act: Update to Prior Report, GAO-04-353R (2004), available online at *www.gao.gov/new.items/d04353r.pdf*.

20 "For Federal tax purposes, a marriage means only a legal union between a man and a woman as husband and wife." IRS, Publication 501, *Exemptions, Standard Deduction, and Filing Information*, (2008), available online at *www.irs.gov/publications/p501/ar02.html#en_US_publink100041740*.

21 But see Reg. § 20.7520-3 (b)(2)(ii) and (v) where example 2 indicates that no income need be paid to the grantor as long as the grantor-beneficiary has the right to demand that the trustee convert the property to income-producing property. These regulations may require some minimum income stream to grantor.

22 Rev. Rul. 2009-38, I.R.B. 2009-49, Dec. 7, 2009, available online at *www.irs.gov/irb/2009-49_IRB/ar09.html*.

23 Code Sec. 2702(a)(1)-(2) states, in part: "Solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member (as defined in section 2701(e)(2)) shall be determined as provided in paragraph (2).

(2) Valuation of retained interests.

(A) In general. The value of any retained interest which is not a qualified interest shall be treated as being zero."

24 Code Sec. 2704(c)(2) defines a "member of the family" as (A) an individual's spouse; (B) any ancestor or lineal descendant of such individual or such individual's spouse; (C) any brother or sister of the individual, and (D) any spouse of any individual described in subparagraph (B) or (C). Thus, a GRIT could also be used to transfer assets to more distant family members, such as to cousins or nieces and nephews.

25 Code Sec. 2702(a)(2).

26 Reg. §20.2036-1(c)(2).

27 *See* General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals (Dept. of Treasury, May 2009) p. 123.

28 IRS Valuation Training for Appeals Officers Coursebook 4-26-4-27 (CCH Inc. 1998).

29 Code Sec. 280A.

30 Code Sec. 280A(d)(1).

31 Stephen Fishman, *Top Ten Tax Deductions for Landlords*, available online at *www.nolo.com/article.cfm/pg/1/objectId/03E7A8D4-EB53-4711-97F91991D9A8468B/catId/8F8C3C1A-2347-419A-9C65B0B8C7762E3B/213/ART/* (last visited April 10, 2009).

32 Code Sec. 1031 (2009).

IRS, *Like-Kind Exchanges Under IRC Code Section 1031*, FS-2008-18 (2008), available online at www.irs.gov/newsroom/article/0,,id=179801,00.html.

33 Thayne Needles, *Review the Fundamentals of Section 1031 Like-Kind Exchanges*, Commercial Investment Real Estate Magazine, Jan./Feb. 2003, available online at *www.ciremagazine.com/article.php?article_id=126*.

34 Code Sec. 1014(e).

35 *Gill v. Office of Personnel Management et al*, No. 1:2009cv10309 (D. Mass. filed Mar. 3, 2009). *See* also *Commonwealth of Massachusetts v. United States Department of Health and Human Services et al*, 1:2009cv11156 (D. Mass. filed July 8, 2009).

36 The Supreme Court of California, in *In re Marriage Cases*, 183 P.3d 384, 402 (Cal. 2008), held that there was no compelling state interest in limiting marriage to opposite-sex couples. Proposition 8, adopted by voters on November 4, 2008 (effective November 5, 2008) overturned the case, adding a section to the California Constitution reading: "Only marriage between a man and a woman is valid or recognized in California." Cal. Const. Art. I, §7.5. As of April 2009, three suits have been filed to overturn Proposition 8. *San Francisco v. Horton*, No. S168078 (Cal. filed Nov. 5, 2008); *Strauss v. Horton*, No. S168047 (Cal. filed Nov. 5, 2008); *Tyler v. California*, No. S168066 (Cal. filed Nov. 5, 2008). In a combined decision on all three cases issued on May 26, 2009, the California Supreme Court upheld the validity of Proposition 8, but interpreted it only as " reserving the official *designation* of the term 'marriage' for the union of opposite-sex couples …, but leaving undisturbed all of the

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other extremely significant substantive aspects of a same-sex couple's state constitutional right to establish an officially recognized and protected family relationship and the guarantee of equal protection of the laws." *Strauss v. Horton, Tyler v. State of California* and *City & County of SF v. Horton*, p. 7 (May 26, 2009). The Court expressly affirmed its previous determination that "statutes according differential treatment on the basis of sexual orientation are constitutionally permissible only if they satisfy the strict scrutiny standard of review." *Id.* at 43.