ESTATE PLANNING FOR THE UNMARRIED ADULT

Wendy S. Goffe

Graham & Dunn PC
Pier 70, 2801 Alaskan Way, Suite 300
Seattle, Washington 98121-1128
(206) 340-9633 (direct)
wgoffe@grahamdunn.com
www.grahamdunn.com

Ms. Goffe is a shareholder with the law firm of Graham & Dunn PC, Seattle, Washington. She is also an Adjunct Instructor at Seattle University Law School. She is a Fellow of the American College of Trust and Estate Counsel and a member of the ACTEC Journal Editorial Board. She has a comprehensive estate planning practice that involves all aspects of estate planning for high net worth individuals and families, advising both individuals and charitable organizations concerning planned giving, probate, and trust administration. She is member of the YWCA Planned Giving Committee, The Nature Conservancy Planned Giving Committee, The Seattle Foundation Professional Advisory Council, and the Children's Legacy Council of the Children's Hospital Foundation. She is a past member of the Executive Committee of the Estate Planning Council of Seattle, the Acquisition Committee of the Tacoma Art Museum, the Executive Committee of the WSBA Real Property, Probate and Trust Section, and the Ethics Committee of Valley Medical Center. She is also a past member of the Board of Directors and Grants Committee of The Women's Endowment Foundation, a supporting foundation of the Jewish Community Endowment Fund, Seattle, Washington.

Materials Revised April 2009

CONTENTS

Page

I. INTRODUCTION 1

II. ETHICAL ISSUES OF JOINT REPRESENTATION 2

III. SAME-GENDER MARRIAGE AND THE DEFENSE OF MARRIAGE ACT 4

IV. COHABITATION AGREEMENTS AND SIMILAR ARRANGEMENTS 16

V. WILLS, REVOCABLE TRUSTS, AND NONPROBATE TRANSFERS 21

VI. METHODS TO MINIMIZE TAXES 24

VII. CHARITABLE PLANNING. 46

VIII. PLANNING FOR PERSONAL NEEDS 53

IX. STRATEGIES TO MINIMIZE CONFLICT 57

X. CONCLUSION 59

Exhibit A – Drafting for Assisted Conception and Posthumously Conceived Children 61

Exhibit B – Bibliography of Internet Resources 62

The information contained in these materials is for educational and instructional use only. No warranty, express or implied, is made as to their use. Any tax advice contained in this outline was not intended or written by the author to be used and it cannot be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Any tax advice contained in this outline was written to support, within the meaning of Treasury Department Circular 230, the promotion or marketing of the transactions or matters addressed by such advice because the author has reason to believe that it may be used or referred to by another person in promoting, marketing or recommending an entity, investment plan or arrangement to one or more taxpayers. Before using any tax advice contained in this outline, a taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

© Wendy S. Goffe 2009

I. INTRODUCTION

The term "non-traditional family" is a catchall phrase that includes unmarried couples, either homosexual or heterosexual, with or without children. It may include a stepfamily, children from the prior marriages or relationships of one or both of the parents, and possibly mutual children of the couple, as well.

Increasingly, American adults reside in a household as members of an unmarried couple. These couples may be heterosexual or homosexual, or they may not be involved romantically in any way, such as in the case of siblings or close friends. Furthermore, these couples may wish to include each other and their respective descendants as part of their estate plans.[1]

State and federal laws contain default statutes giving spouses rights, including the right to handle funeral arrangements, rights under intestacy statutes, and Social Security survivor benefits. As of December 31, 2003 there were 1,138 federal statutory provisions under the United States Code pursuant to which marital status is a factor in determining eligibility for rights, benefits or privileges.[2]

For the most part, unmarried couples -- unlike their married counterparts -- do not have a set of laws governing the division of property or providing for support payments upon the dissolution of their relationship. Children are particularly vulnerable when unmarried relationships end because of the different application of laws to unmarried couples.

In the estate planning realm, unmarried couples cannot take advantage of transfer tax marital deductions under Sections 2056 or 2523 of the Internal Revenue Code of 1986 (referred to herein as the "Code" or "I.R.C."), or gift splitting under I.R.C. §2513. Members of unmarried couples may be subject to gift tax for supporting one another or dividing shared property. Unmarried couples must prepare wills or other estate planning vehicles to assure a distribution of their assets upon death in a manner different from that provided by the intestacy statute of the decedent's resident state. In addition, unmarried couples, especially same-gender couples, often experience legal difficulties when arranging funerals for deceased partners.

As with estate planning for any individual or couple, the issues may be divided into five categories: (i) practices to ensure that property is distributed appropriately; (ii) methods to minimize transfer taxes; (iii) charitable gift planning; (iv) planning for personal needs such as appointment of financial and healthcare decision makers, funeral arrangements, guardianship and custody of minors; and (v) strategies to minimize conflict. Each of these topics will be dealt with below. This paper will begin with an examination of the current state of the law with respect to same-gender marriage, and a discussion of ethical issues in connection with the representation of unmarried couples.

Estate planning for the non-traditional family is only a special application of general estate planning principles and practices. However, unmarried couples often require a more individualized and resourceful approach to their estate planning. There are also a number of techniques only available to unmarried unrelated adults, and those opportunities will also be

---

[1] *See* Ralph C. Brashier, *Inheritance Law and the Evolving Family* (2004) for an excellent examination of the historical and evolving concept of family as it relates to U.S. inheritance law.

[2] *See Letter from Dayna K. Shah, Associate General Counsel of the GAO, to The Honorable Bill Frist, Senate Majority Leader (*January 23, 2004) *available at* http://www.gao.gov/new.items/d04353r.pdf.

discussed. The purpose of this paper is not to provide a detailed analysis of particular technical aspects of estate planning. Instead, it focuses on various estate planning tools and the objectives that they accomplish, with an emphasis on their use in connection with planning for the client in a non-traditional family.

II. ETHICAL ISSUES OF JOINT REPRESENTATION

Like married couples, non-married couples tend to seek estate planning with their partners. So long as the estate planning process is limited to planning for the disposition of assets upon death, and planning for incapacity, the interests of the two parties are not likely to conflict. However, the process often extends to consideration of current ownership and transfer of assets, which are areas in which each party may have potentially adverse interests.

Lawyers and clients are relatively free to define the nature of their legal representation: (i) individual representation; (ii) separate simultaneous representation of both members of a couple; (iii) joint representation; or (iv) intermediary representation. The same conflict analysis applies to each of the four forms of representation, which are discussed below.[3]

A. Types of Representation.

When determining the appropriate type of representation, ABA 2007 Model Rule of Professional Conduct (hereinafter "RPC") 1.7(b), concerning conflicts of interest with current clients, should be considered. It provides, in part, that:

> Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.

A state's rules of professional conduct concerning confidentiality affect the extent to which the lawyer for joint clients may disclose to one client relevant information that was communicated to the lawyer by the other client. Washington's RPC 1.6(a) provides, in part, that "A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, and the disclosure is impliedly authorized in order to carry out the representation…." Pursuant to RPC 1.6, under certain circumstances, the same lawyer may represent two unrelated individuals with related, but not necessarily identical interests. The fact that the goals of the

---

[3] *See* Jennifer Tulin McGrath, "*The Ethical Responsibilities of Estate Planning Attorneys in the Representation of Non-Traditional Couples*," 27 Seattle U. L.Rev. 75 (2003) for a thorough analysis of the various forms of representation .

clients are not identical does not necessarily create a conflict that precludes the lawyer from representing both members of the couple. Withdrawal from representation may be required in conjunction with any of the four options if disclosure issues arise.

It is important to note that the marital privilege, which bars a spouse from testifying as to any communications between spouses without the consent of the other spouse, does not apply to unmarried couples.[4]

1. Separate Representation.

Separate representation by different attorneys presents serious limitations on either attorney's abilities to plan for a couple. Neither attorney has access to full and complete information for both parties. Thus, effective gift and tax planning is difficult, if not impossible. However, this may be the only model of representation available if clients are unwilling to share confidences with each other and where separate representation of both individuals is not possible because the attorney determines that the parties are directly adverse. RPC 1.7(a) provides that:

> [A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> > (1) the representation of one client will be directly adverse to another client; or
> >
> > (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

2. Separate Simultaneous Representation.

Separate simultaneous representation of both individuals by one attorney is possible if the requirements of RPC 1.7(b) can be met: The attorney determines that the clients will not be adversely affected by joint representation and they consent. However, it is likely that rather than enhance an attorney's ability to represent both clients, the risks of breaching the confidentiality of either client under separate simultaneous representation may hinder the attorney from representing either client effectively.

3. Joint Representation.

By far the most common form of representation is joint representation. RPC 1.7 requires an attorney to determine whether the interests of both parties may be met with this type of representation, and the attorney must believe that the potentially conflicting interests of the parties are subordinate to their common objectives.[5] With this model of representation, the clients must consent to the sharing of information between them and the attorney, which

---

[4] *See, e.g.,* RCW 5.60.060(1).

[5] McGrath*, supra* n.3, at 121.

substantially eliminates the risk that the attorney will violate the duty of confidentiality under RPC 1.6 by revealing confidences of one member of the couple to the other.[6]

4. Intermediary Representation.

Under certain circumstances, RPC 1.7 permits an attorney to represent two clients simultaneously, as the intermediary, if the attorney reasonably believes that this form of representation will benefit both clients, and will not materially prejudice either client.[7] However, the nature of the relationship is not as an advocate for either party. It is unclear whether representation as an intermediary may be provided within the scope of RPC 1.7 in the estate planning context; between two unmarried adults, it may be difficult to distinguish business planning from estate planning. Representation in this capacity is barred where litigation is a possibility or where negotiations are likely to be hostile. The lawyer should insist on separate representation when the parties' interests are clearly adverse.

B. Memorialization of Form of Representation in an Engagement Letter.

Ideally, at the initial meeting with a client, the lawyer should describe the various models of representation available and determine what type of representation will best serve the client. An agreement as to the type of representation to be used should be memorialized in writing in the form of an engagement letter. A client's expectations of confidentiality, and any agreement or understanding concerning the lawyer's ability to disclose, should also be defined in the engagement letter. The letter should be signed by the attorney and countersigned by the client or clients.

In the absence of a shared understanding of the lawyer's relationship with the clients, the lawyer should presume that the representation is joint.[8] All confidences are presumed shared in joint representation.[9]

III. SAME-GENDER MARRIAGE AND THE DEFENSE OF MARRIAGE ACT

A. The Defense of Marriage Act.

1. Federal Legislation.

The federal Defense of Marriage Act,[10] (hereinafter "DOMA"), specifically defines marriage as a legal union between one man and one woman as husband and wife. It further provides that a state shall not be required to give effect to any public act or judicial proceeding of any other state respecting marriage between persons of the same sex if the state has determined that it will not recognize same-gender marriages.

---

[6] *Id*. at 122.

[7] McGrath*, supra* n.3, at 124.

[8] *See American College of Trust and Estate Counsel Commentaries on the Model Rules of Professional Conduct* 66 (3d ed. 1999).

[9] *Report of the Special Study Committee on Professional Responsibility: Comments and Recommendations on the Lawyer's Duties in Representing Husband and Wife*, 28 Real Prop. Prob. & Tr. J. 765, 771 (1994).

[10] Pub.L. No. 104-199, 110 Stat. 2419 (1996) (codified at 1 U.S.C. §1 and 28 U.S.C. §1738C).

2. State Legislation.

To date, 41 states have adopted statutory versions of the DOMA, or have legislation banning same-gender marriage predating the federal DOMA, and 30 have constitutional language defining marriage.[11] Washington was the 36th state to adopt the DOMA in 1998, when it passed legislation defining marriage as a civil contract between a male and a female.[12] To reinforce its position, the legislature concurrently passed a law specifically prohibiting marriage for couples consisting of "other than a male and a female."[13] Illinois passed a statutory version of the DOMA in 1996.[14]

3. Comity.

Generally, states are required by the U.S. Constitution and by federal law to give full faith and credit to the acts, records, and proceedings of other states.[15] There is a limited exception where the strongly held public policy of a state would be violated.[16] Thus, the DOMA allows states to refuse to grant full faith and credit to same-gender marriages, even if lawful in the state entered into.[17]

Whether foreign same-gender marriages will be recognized is a separate issue. Comity is the recognition that one nation allows to the legislative, executive, or judicial acts of another nation. Comity is discretionary when recognition of foreign law does not violate public policy.[18] Comity

---

[11] National Conference of State Legislatures, Same Sex Marriage, Civil Union and Domestic Partnerships, http://www.ncsl.org/programs/cyf/samesex.htm (last visited Feb. 14, 2009).

[12] RCW 26.04.010(1).

[13] RCW 26.04.020(1)(c).

[14] 750 Ill. Comp. Stat. 5/213.1.

[15] U.S. Const. art. IV, §1. ("Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state. And the congress may by general laws prescribe the manner in which such acts, records, and proceedings shall be provided, and the effect thereof.") *See* Joseph W. Singer, *Same Sex Marriage, Full Faith and Credit, and the Evasion of Obligation*, 1 Stanford Journal of Civil Rights and Civil Liberties 1 (Spring 2005) for a thorough discussion of the application of the full faith and credit clause to same-sex marriage.

[16] *Pacific Employers Ins. Co. v. Indus'l Accident Comm'n*, 306 U.S. 493, 501, 59 S.Ct. 629, 83 L.Ed. 940 (1939).

[17] *See Restatement (Second) of Conflicts of Laws* §283(2) (1971) providing that a marriage will be recognized as valid if legal at the time it was entered into, unless it violates the strong public policy of another jurisdiction having the most significant relationship to the couple at the time they entered into the marriage.

[18] Generally, marriages that are valid in the place entered into are valid elsewhere unless recognition of such marriage would offend a strong public policy of the jurisdiction asked to recognize it. *Restatement (2d) of Conflict of Laws* §283(2) (1971). A related issue beyond the scope of this paper is whether the DOMA prohibits a transgender marriage. *See* John A. Fisher, *Sex Determination for Federal Purposes: Is Transsexual Immigration Via Marriage Permissible Under the Defense of Marriage Act?,* 10 Mich. J.Gender & L. 237 (2003). *See also* Elena P. Bishop & Noel Myricks, *Sex Reassignment Surgery: When Is a "He" a "She" for the Purpose of Marriage in the United States?"* 18 Am. J. Fam. L. 30 (Spring 2004). For an analysis of the cases that have dealt with the legality of transgender marriage, *see* Helen G. Berrigan, *Transsexual Marriage: A Trans-Atlantic Judicial Dialogue*, 12 Law & Sexuality 87, 116 (2003). *See also* Exhibit C for additional Internet resources on this and other related topics.

implies that the U.S. should recognize a foreign same-gender marriage if entered into legally.[19] But a state may use its DOMA as its rationale for denying legal recognition of a foreign same-gender marriage as against public policy. A marriage entered into in Canada by a same-gender couple will be recognized in New York because it is not contrary to New York law.[20]

B. Same-Gender Marriage and Legal Relationships in Selected Jurisdictions.

Civil union is a separate legal status providing most, if not all, of the rights and responsibilities afforded married couples under state law. It is currently available in Connecticut,[21] New Hampshire,[22] New Jersey,[23] and Vermont.[24] While not valid if contracted for in New York, the New York court has held that, with few exceptions, state agencies should recognize marriages solemnized in Canada, Massachusetts and other states where it is legal.[25]

Domestic partnership refers to a committed relationship between two individuals who are not married. Some employers and municipalities recognize domestic partnerships. In addition, the following states maintain domestic partnership registries: California (in addition to marriage), Maine,[26] New Jersey (in addition to civil union),[27] the District of Columbia (passed in 1992 but not put into effect until 2002 for budgetary reasons),[28] Oregon,[29] and Washington. The rights and responsibilities of a domestic partnership vary greatly among jurisdictions. California and Oregon provide almost all of the same rights and responsibilities that apply to married couples.

Hawaii is the only state to recognize reciprocal beneficiaries. This status affords any couple not eligible to marry under the law a handful of rights and responsibilities, discussed below.

Connecticut, Iowa, Massachusetts and Vermont are currently the only states that recognize marriage for same-gender couples.

At the time of this writing the opinion in *Varnum v. Brien*, Iowa Supreme Court No. 07-1499 (filed April 3, 2009) overturned Iowa's same-gender marriage ban. It would allow marriage beginning 21 days from the date of filing, April 24, 2009, unless a petition for rehearing is filed prior to that date. Vermont's legislature voted on April 7, 2009 to override Governor Jim Douglas's veto of a bill that would allow same-gender marriage, making it the 4th state to legalize same-gender marriage.

---

[19] Bernard L. McKay, *Estate Planning for the Gay and Lesbian Couple*, 6 CCH Journal of Practical Estate Planning 43, 44 (Feb./March 2004).

[20] *Martinez v. County of Monroe*, 850 N.Y.S.2d 740 (N.Y.App. Div. 2008); *accord*, *Beth R. v. Donna M.*, 853 N.Y.S.2d 501 (N.Y.Sup. Ct. 2008).

[21] 2005 Conn. Acts 05-10.

[22] 2007 N.H. Laws ch. 457A.

[23] New Jersey Public Law 2006, c. 103.

[24] *See* Vt. Stat. Ann. tit. 15, §1204.

[25] *Martinez v. County of Monroe*, 850 N.Y.S.2d 740 (2008). *See also In re Estate of Ranftle*, No. 4585/08, 241 NYLJ 34, (col. 2) (New York Cty. Surrogate's Ct. Feb. 4, 2009).

[26] 2003 Me. Laws 672, codified in scattered sections of the Maine Code.

[27] N.J. Stat. Ann. §26:8A.

[28] DC Law 9-114, effective June 11, 1992.

[29] The Oregon Family Fairness Act, 2007 Or. Laws ch. 99.

Illinois State Representative Greg Harris has introduced The Religious Freedom and Marriage Fairness Act a number of times February of 2007. Each time it has died in committee. On February 17, 2009 he introduced The Religious Freedom Protection and Civil Union Act, House Bill 2234, which would permit civil unions.[30] At the time of this writing it was back for a third reading before the full House of Representatives.

California, Connecticut, Hawaii, Massachusetts, Vermont and Washington are discussed in more detail below.

1. California.

California's domestic partnership laws predate the recent same-gender marriage cases.[31] Its statewide domestic partnership registry became effective on January 1, 2000.[32] As discussed below, California briefly permitted same-gender marriage in 2008.

Since January 1, 2002, California has offered domestic partner benefits to state employees, as well as a domestic partner registry.[33] California's domestic partner laws grant legal rights to same-gender couples (and to unmarried heterosexual couples age 62 years and older) who file a Declaration of Domestic Partnership with the Secretary of State.[34] These rights include hospital visitation, medical decision-making, estate administration, partial inheritance rights, wrongful death standing and the ability to use the stepparent adoption process.[35]

As of January 1, 2005, California's Domestic Partner Rights and Responsibilities Act of 2003 expanded the rights of domestic partners to include nearly all rights and also responsibilities of spouses under state law.[36] These rights and obligations include hospital visitation,[37] rights to be appointed conservator[38] and make medical decisions,[39] for an incapacitated partner, inheritance rights equivalent to the rights of a surviving spouse,[40] the right to use the stepparent adoption

---

[30] http://www.ilga.gov/legislation/BillStatus.asp?DocNum=2234&GAID=10&DocTypeID=HB&LegId=44055&SessionID=76.

[31] *See Marriage Cases*, No. CJC-04-004365 (San Francisco Super. Ct. 2004), *sub nom.* Proposition 22 Legal Defense & Education Fund v. City & County of San Francisco, appeal docketed, No. S135603 (Cal. filed June 9, 2005).

[32] 1999 Cal. Stat. 588.

[33] 1999 Cal. Stat. ch. 588, relating to domestic partnerships, added Calif. Family Code §297-299.6, Calif. Govt. Code §22770 (formerly Calif. Govt. Code §22867), and Calif. Health & Safety Code §1261.

[34] Cal. Fam. Code §297.

[35] *See* 2001 Cal. Stat. 893.

[36] 2003 Cal. Stat. 421. For a thorough analysis of the current state of the law as well as its historical development, *see* Sondra J. *New Domestic Partnership Legislation and Its Impact on Estate Planning and Administration*, 10 California Trusts and Estates Quarterly 4 (Spring 2004).

[37] Cal. Health & Safety Code §1261.

[38] Cal. Probate Code §2681(b).

[39] Cal. Probate Code §4716.

[40] Cal. Probate Code §6401.

procedure,[41] joint responsibility for debt,[42] and the right to request support from each other upon dissolution of the relationship.[43]

The 2003 Act afforded couples the same community property rights as married couples.[44] Unless opted out of, these rights are retroactive to the date the couple registered as domestic partners.[45] Because the gift tax marital deduction of I.R.C. §2523 does not apply to domestic partners, the creation of community property may trigger a federal gift tax liability.[46]

Beginning for the 2007 tax year, California registered domestic partners may file their State income tax returns as "married filing jointly," or "married filing separate."[47]

For domestic partnerships of less than five years in duration, and not involving children, property interests or debt, and meeting a number of other requirements, the partnership may be dissolved by filing a form with the Secretary of State.[48] If the partnership does not meet all of the requirements for a nonjudicial dissolution, the superior courts have jurisdiction over the dissolution of a domestic partnership, as with marital dissolution.[49]

On May 15, 2008, the California Supreme Court issued its opinion in *In re Marriage Cases*, 76 Cal. Rptr. 3d 683 (2008), finding that the California Constitution mandates that same-gender couples have the right to marry. The Court held that reserving marriage for opposite-gender couples, while permitting same-gender couples only to enter into domestic partnerships, violates the state Constitution. In addition, the Court found that prohibiting same-gender couples from marrying deprives them of equal protection under the law.

Chief Justice George wrote that:

> [I]n view of the substance and significance of the fundamental constitutional right to form a family relationship, the California Constitution properly must be interpreted to guarantee this basic civil right to all Californians, whether gay or heterosexual, and to same-sex couples as well as to opposite-sex couples.[50]

The decision became effective and California began permitting same-gender marriage on June 15, 2008. However, Proposition 8, also known as the California Marriage Protection Act, which

---

[41] Cal. Fam. Code §9000-9007.

[42] Cal. Fam. Code §910.

[43] Cal. Fam. Code §4330-4339.

[44] Cal. Fam. Code §760.

[45] Opting out must be done in a written agreement similar to a premarital agreement, prior to becoming domestic partners, the form of which is governed by Cal. Fam. Code §1600-1620. Cal. Fam. Code §297.5(k)(2).

[46] *See* Allphin*, supra n.36*, at 7-11 for an analysis of this risk and planning suggestions, as well as a discussion concerning other pitfalls as a result of the creation of community property. *See also* Robert W. Laversin, *Tax Pitfalls for Domestic Partners*, 25 California Lawyer 20 (May 2005).

[47] 2006 Cal. Stat. 802, eff. Jan. 1, 2007.

[48] Cal. Fam. Code §299(a).

[49] Cal. Fam. Code §299(b).

[50] *Id.* at 701.

limits marriage to one man and one woman under California law, was passed on November 4, 2008, effectively terminating the right to same-gender marriage. This law is being appealed. It is unclear if the same-gender marriages performed in California prior to the passing of Proposition 8 will remain valid.

2. Connecticut.

In October of 2008, the Connecticut Supreme Court ruled that same sex couples have a constitutional right to marry.[51] The Court announced that sexual orientation is a quasi-suspect class under the Equal Protection clause of the State Constitution, and therefore it is entitled to a heightened level of scrutiny. The Court said that same sex couples suffer a constitutional harm, and that a separate but equal scheme of civil unions did not pass constitutional muster. In its decision, the court emphasized that civil unions are not equal to marriage even though they share all of the same rights and that the name itself was enough to offend Equal Protection. They also recognized that civil marriage has a long history in our culture, but civil unions are a recent construct. Therefore, the civil union scheme created in fact not an equal institution, but an inferior one.

3. Hawaii.

In 1997, Hawaii adopted legislation granting equal rights to same-gender couples and their families in many areas of the law, now known as "The Reciprocal Beneficiaries Act."[52] Additional rights have been granted since then.

Hawaii law allows same-gender couples to become "reciprocal beneficiaries." The Hawaiian legislation applicable to reciprocal beneficiaries is broken into three categories:

(i) The first group conveys intangible, but great emotional value. These include the ability to visit a partner in the hospital (Haw. Rev. Stat. §323-2), the right to make anatomical gifts on behalf of a partner (Haw. Rev. Stat. §327-3) and make medical decisions under certain circumstances (Haw. Rev. Stat. §323-2 and §327E-2).

(ii) The second group carries substantial value, and represents a commitment to provide rights substantially similar to those provided by marriage. These rights include equal inheritance rights (Haw. Rev. Stat. §560:2-301), rights to health insurance similar to married couples (Haw. Rev. Stat. §431:10A-601), other insurance benefits such as discounts to public workers (Haw. Rev. Stat. §87A-23(5)), general equality in many areas of retirement benefits (Haw. Rev. Stat. §88-1), the ability to bring a wrongful death lawsuit (Haw. Rev. Stat. §663-1 and §663-3), the ability to own property in tenancy by the entirety (Haw. Rev. Stat. §509-2), and the same application of state estate tax as applicable to married couples (Haw. Rev. Stat. §560:3-916).

---

[51] *Kerrigan v. Comm'r of Pub. Health*, 289 Conn. 135, 957 A.2d 407 (2008).

[52] 1997 Haw. Sess. Laws 383. This Act represents the reaction of Hawaii's legislature to the decision in *Baehr v. Lewin*, 74 Haw. 530, 852 P.2d 44 (1993), in which Hawaii's Supreme Court found that there was no fundamental right to same-sex marriage under the Hawaiian Constitution, but it did determine that the marriage law denied the same-sex couples equal protection, in violation of art. 1, §5 of the Hawaii Constitution.

(iii) The third group grants rights of a more general nature with limited economic value or great value but limited application. These include the right to receive payment for saved up vacation days on behalf of a deceased public employee (Haw. Rev. Stat. §388-4), the right to paid bereavement time off for the death of a family member (Haw. Rev. Stat. §386-34), and the same eligibility for disaster loans as married couples (Haw. Rev. Stat. §209-28 & §209-29).

4. Massachusetts.

Massachusetts was the first state to recognize same-gender marriage. In *Goodridge v. Dept. of Public Health*,[53] the Massachusetts Supreme Court granted same-gender couples the right to marry as of May of 2004. Massachusetts began issuing marriage licenses to same-gender couples on May 17, 2004. Those married couples have all of the rights and responsibilities of marriage under Massachusetts state law including the automatic right of inheritance, exemption from state inheritance tax, and child custody and visitation rights. On July 31, 2008 this right was extended to non-resident same-gender couples, even if their marriage would not be recognized in their state of residence. This repealed a 1913 law prohibiting marriages that would not be legal in the parties' state of residence.[54]

5. Vermont.

Vermont's civil union statutes became effective July 1, 2000.[55] While civil union is not marriage, eligible couples are allowed many of the benefits and protections of married couples, including the right to: (i) inherit without estate tax; (ii) file a joint state tax return; and (iii) make medical decisions for each other. Civil union statutes apply as if the Federal Income Tax Code recognized civil union as a valid marriage. While a marital deduction applies to parties in a civil union for Vermont estate taxes, there is no reduction in federal estate tax. Dissolution of a civil union is equivalent to a marital dissolution. However, to dissolve a Vermont civil union, at least one party must reside in Vermont for one year, which has created a hardship for non-Vermont residents who have entered into a civil union and now seek a dissolution.

6. Washington.

In two cases brought by the ACLU in Washington, Washington's Defense of Marriage Act was ultimately found to be constitutional.[56] The first case, *Andersen v. King County*,[57] was brought by eight same-gender couples seeking the right to marry in Washington. Judge William L. Downing held in their favor and ruled that Washington's prohibition against same-gender marriage is an unlawful violation of the plaintiffs' constitutional rights to equality, liberty and privacy.[58]

---

[53] 440 Mass. 309, 798 N.E.2d 941 (2003).

[54] Mass. Gen. Laws ch. 207, §11 (1913).

[55] Vt. Stat. Ann. tit. 15, ch. 23.

[56] Washington's Defense of Marriage Act defines marriage as a civil contract between a male and a female. RCW 26.04.010(1). It also prohibits marriage for couples consisting of "other than a male and a female." RCW 26.04.020(1)(c).

[57] No. 04-2-04964-4 SEA, 2004 WL 1738447 (King Cty. Super. Ct. Wash. Aug. 4, 2004), *rev'd*, 158 Wn. 2d 1 (2006).

[58] *Memorandum Opinion and Order on Cross Motions for Summary Judgment* 22 (August 4, 2004).

Both sides agreed to a direct appeal to the Washington State Supreme Court, and the Order was stayed pending that review. The appeal was filed on September 1, 2004 and consolidated with *Castle v. Washington*,[59] in which the Court ruled in favor of eleven same-gender couples, and found the DOMA unconstitutional, in violation of Washington's Privileges and Immunities Clause.[60]

In the consolidated appeal, the State Supreme Court reversed the lower courts and found that the legislature is not prohibited from defining marriage as a civil union between a man and a woman, to the exclusion of same sex couples.[61]

In response to this ruling, Washington's legislature passed a domestic partner registry act that went into effect on July 22, 2007.[62] The legislature recognized that many Washington residents are in intimate, committed relationships with persons to whom they are not legally married, and many of whom are not permitted to marry. The legislature also recognized that these relationships benefit the individuals involved, and their families, by providing a source of mutual support for the financial, physical, and emotional health of those individuals and their families. The public has an interest in providing a legal framework for these relationships where the parties are unable to legally marry.

Same gender couples, because they are not permitted to marry, did not have the same access (prior to the enactment of Washington's domestic partner registry) that married couples have to certain rights and benefits, such as those associated with hospital visitation, health care decision-making, organ donation decisions, and other issues related to illness, incapacity, and death. Furthermore, while many (but not all) of the rights granted by the 2007 bill could have been acquired by private agreement, doing so was often costly and complex.

The legislature also recognized that it would benefit individuals and the public to extend domestic partnership rights to different gender couples where either member, or both, are at least 62 years old. While these couples are able to marry legally in Washington, certain social security and pension survivor benefits make the financial cost prohibitive. For this reason, the protections of the bill were extended to these couples as well.

Accordingly, the Act allows certain same gender couples and unmarried different gender couples, one of whom is 62 or older, to register as domestic partners with the Washington Secretary of State as of July 23, 2007.[63]

The Act granted 29 rights, including the following:

A. The ability to grant informed consent for health care for a patient who is not competent under RCW 7.70.065;

---

[59] No. 04-2-00614-4, 2004 WL 1985215 (Thurston Cty. Super. Ct. Wash. Sept. 7, 2004).

[60] Washington Constitution art. I, §12.

[61] *Andersen v. King County*, 158 Wn. 2d. 1, 138 P.3d 963 (2006) (*en banc*) Justice Barbara Madsen wrote for the plurality that "limiting marriage to opposite-sex couples furthers procreation, essential to survival of the human race, and furthers the well-being of children by encouraging families where children are reared in homes headed by the children's biological parents." *Id*. at 10.

[62] Laws of 2007, ch. 156, codified at RCW 26.60.

[63] RCW 26.60.030.

B. Health care facility visitation rights under RCW 26.60.070;

C. The ability of health care providers to disclose financial information about a patient without the patient's authorization to the patient's registered domestic partner under RCW 70.02.050(e);

D. Automatic revocation of the designation of a domestic partner as the beneficiary of non-probate assets upon termination of the domestic partnership (but not revocation of a gift under a Will) under RCW 11.07.010;

E. Automatic revocation of a power of attorney granted to the registered domestic partner upon termination of the domestic partnership under RCW 11.94.080;

F. Title and rights to cemetery plots and rights of interment under RCW ch. 68.32;

G. Rights to authorize autopsies and to request copies of autopsy reports and records under RCW 68.50.101 & 68.50.105;

H. Rights to control the disposition of the remains of the deceased domestic partner under RCW 68.50.160;

I. The right to consent to the removal of human remains from a cemetery plot under RCW 68.50.200;

J. The ability to make anatomical gifts under RCW 68.64.080;

K. The right to have one's name on the death certificate of a deceased registered domestic partner as the survivor under RCW 70.58.175;

L. The ability to inherit assets of the estate under intestate laws when the registered domestic partner dies without a will under RCW 11.04.015;

M. The right to become administrator of the estate of the registered domestic partner if the registered domestic partner dies without a will or if the named personal representative declines or is unable to serve under RCW 11.28.120;

N. The right to file a wrongful death action and be a beneficiary (if a domestic partner is killed due to the negligence or other tort of another person, his or her partner may bring a wrongful death action to recover for lost financial support and companionship) under RCW 4.20.020 & .060;

O. The right to serve as attorney-in-fact for the registered domestic partner, even though he or she may be the principal's physician, physician's employee or the owners, administrators or employees of the healthcare facility or long-term care facility where the principal resides or receives care under RCW 11.94.010; and,

P. The right to fulfill eligibility requirements to receive same benefits accruing to a spouse of a public employee of Washington State (including the right to use sick leave to care for a domestic partner or domestic partner's child) under RCW ch. 41.05.

Registrants must share a common residence, be over the age of 18 and members of the same gender, or one member of the couple must be over 62 for opposite gender couples.[64] The parties cannot be married or a member of another domestic partnership.[65] The parties may not be related in a manner that would prohibit marriage and must have the mental capacity to consent.[66]

Declarations of state registered domestic partnerships are filed with the Secretary of State along with a filing fee as set by the Secretary of State to cover costs, provided the fee does not exceed fifty dollars.[67] The declarations must be notarized and signed by both parties.[68] The Secretary of State is required to provide a certificate of state registered domestic partnership to each party on the declaration, maintain a permanent record of each declaration, and submit a record of the declaration and certificate to the state registrar of vital statistics.[69]

A domestic partnership created by a subdivision of the State is not a registered domestic partnership.[70] However, subdivisions of the State that provide benefits to domestic partners of employee must recognize a registered domestic partnership to satisfy any registration requirements of the subdivision.[71]

The Secretary of State is required to maintain a list of jurisdictions that have notified the Secretary of State that the jurisdiction is using the definition of domestic partnership created in the bill in order to provide benefits to its employees.[72] The Secretary of State is required to post this list on the web page and send a copy of the list to partners along with the certificate of domestic partnership.[73]

Second Substitute House Bill 3104 passed March 12, 2008 and effective June 12, 2008, expanded and amended Washington's Domestic Partnership Act (hereinafter the "HB 3104").

A legal relationship between members of a *same-gender* couple, other than a marriage, created in a different state and that is substantially equivalent to a Washington domestic partnership will now be recognized in Washington.[74] This recognition does not extend to different-gender couples registered as domestic partners in another state. Accordingly, they would have to register in Washington to obtain recognition here.

HB 3104 extended rights and responsibilities provided to spouses in various areas of law to state registered domestic partners. These rights and responsibilities are generally in the areas of: dissolutions; community property; estate planning; taxes; court process; services to indigent veterans and other public assistance; conflicts of interest for public officials; and guardianships.

---

[64] RCW 26.60.030.

[65] RCW 26.60.030(3).

[66] RCW 26.60.030.

[67] RCW 26.60.040.

[68] *Id.*

[69] *Id.*

[70] RCW 26.60.060.

[71] *Id.*

[72] RCW 26.60.060(1)(b).

[73] *Id.*

[74] Sec. 1101, codified at RCW 26.60.090.

C. Income Tax and Other Ramifications of Same-Gender Marriage and Civil Unions.

The federal tax ramifications of civil unions, domestic partnerships and same-gender marriage are still relatively untested. Below is an analysis of a few of the issues that may arise.[75]

1. Joint Return Filing.

The Code provides, in part, that "[A] husband and wife may make a single return jointly of income taxes under subtitle A."[76] In IRS Chief Counsel Advice 200608038, the Service concluded that California domestic partners must file separate returns and report personal earnings separately, rather than 50% by each member of the couple, as with married couples in community property states. In *Technical Information Release 04-17: Massachusetts Tax Issues Associated with Same-Sex Couples* (7/7/04), the Massachusetts Department of Revenue provided guidance on the adjustments that need to be made between the state and federal tax returns.

Because married couples may aggregate both income and deductions, it is possible that they may have an advantage when determining alternative minimum tax, and deductibility of various types of losses and deductions.

For couples that file jointly for state tax purposes but separately for their federal returns, they may want to consider footnoting the filing single status on the federal return and indicating that they reserve the right to amend the return if federal law later recognizes the marital deduction for their relationship.

2. Head-of-Household Status.

To qualify for head of household status, two tests must be met: (i) The tax payer may not be married or a surviving spouse at the end of the taxable year, and (ii) must maintain a household which constitutes, for more than one-half of the taxable year, the principal residence of a child, step-child, or a descendant of a child of the taxpayer, or any other person who is a dependent of the taxpayer under I.R.C. §152, if the taxpayer is entitled to a deduction for the taxable year for such person under I.R.C. §151.[77]

It may be possible for one partner in a civil union or domestic partnership to claim head-of-household status for purposes of federal income tax. However, head-of-household status is not permitted absent a legal relationship under state law. Thus, it may not be available to members of a civil union or domestic partnership in states that do not recognize that legal status.

3. Dependency Exemptions.

I.R.C. §151(e) allows a taxpayer to claim a dependency exemption if: (i) the cohabitant receives 50% or more of his or her support from the taxpayer; (ii) is considered a household member of the taxpayer; and the (iii) relationship of the taxpayer and the cohabitant does not violate local

---

[75] *See* Frank S. Berall, *Tax Consequences of Unmarried Cohabitation*, 18 Practical Tax Lawyer 55 (Winter 2004) (hereinafter "Berall, *Tax* Considerations"), for a thorough discussion of this topic.

[76] I.R.C. §6013(a).

[77] I.R.C. §2(b)(1)

law.[78] But, non-relative dependents may be recognized if the taxpayer provides a majority of their financial support and they are not being claimed as dependents on another taxpayer's return. Like head-of-household status, dependency exemptions are only allowed to cohabitants whose relationship is legal under local law. [79] Thus, parties to a civil union, domestic partnership or same-gender marriage may be ineligible for a dependency exemption if residing in a state that has passed DOMA legislation, even if the other prongs of the test can be met.[80]

4. Obligation of Support.

Donative transfers between non-spouses may be taxable gifts if in excess of the annual exclusion, which is $13,000 in 2009. Yet, parties to a civil union or same-gender marriage have a legal obligation to support each other. Accordingly, support in excess of the annual exclusion from one partner to the other could still be characterized as a gift under I.R.C. §2503(b) or taxable compensation under I.R.C. §61 even if required by state law.[81] However, in TAM 8135932 the IRS suggests that where a legally enforceable obligation to support exists pursuant to local law, certain transfers would not be treated as gifts (however, the transfers at issue in this case were found not to be pursuant to legal obligations).

5. Division of Property Upon Separation or Divorce.

There are generally no tax consequences for a division of property at divorce.[82] Transfers of property and payments between ex-spouses pursuant to a written settlement of marital property rights, or for support of minor children of the marriage, are deemed for adequate consideration, and therefore not a gift, even if the transferor did not actually receive adequate consideration in return for payments to the transferee.[83] These rules do not apply to couples terminating a non-marital relationship.[84] But, these rules should apply to same-gender married couples if the relationship of the parties is legal in the jurisdiction where they reside, unless the IRS uses the DOMA as a rationale for disregarding the relationship.

---

[78] I.R.C. §152(b)(5).

[79] *See* Notice 2008-5, 2008-2 I.R.B. 256 (allowing a dependency exemption deduction for children of the taxpayer's unmarried "friend" where the "friend" was not required by I.R.C. §6012 to file an income tax return and did not, in fact, file a return).

[80] In *Leonard v. Commissioner of Internal Revenue*, T.C. Summary Opinion 2008-141, Docket No. 12719-07S (Nov. 4, 2008), the Tax Court permitted a pro se taxpayer to take dependency exemption deductions for the two grandchildren of her "friend," an adult woman with whom the taxpayer had been living for 11 years. The opinion, however, was designated by the court as non-precedential under I.R.C. §7463(b). In this case, the taxpayer had furnished more than one-half of the cost of maintaining a joint household for herself, her friend and the friend's two grandchildren. Ordinarily, the IRS would not permit a taxpayer to take a dependency exemption for an unrelated person's grandchildren. However, because her friend was not required to file an income tax return, and did not file a return (her income was below the minimum threshold for filing), the Tax Court permitted the deductions by the taxpayer. The pro se taxpayer also reported AGI of less than $30,000 for the year in question.

[81] Berall, *Tax Considerations, supra n. 75*, at 58.

[82] I.R.C. §1041.

[83] I.R.C. §2516. The parties must divorce within the three-year period that begins one year before the agreement is executed.

[84] *See Reynolds v. Commissioner.*, TC Memo 1999-62 in which the Tax Court held that settlement proceeds upon termination of a non-marital relationship were treated as sale proceeds, not compensation.

If the IRS does not recognize same-gender marriages, gain and loss will be recognized on the transfer of appreciated property, at the termination of the relationship.[85] It is not yet clear how the law will be applied upon dissolution of a civil union or a domestic partnership.

IV. COHABITATION AGREEMENTS AND SIMILAR ARRANGEMENTS

A. Background.

Unmarried couples are able to enter into legal relationships through bilateral contracts that define the rights, duties, obligations, responsibilities, and other parameters of their relationship. Like a prenuptial agreement, the purpose of a cohabitation agreement is to create a degree of certainty for a couple with respect to how expenses will be handled, how income will be shared or separated, how assets will be acquired and under whose name, what will happen to assets in the event the relationship terminates, and how disputes are to be resolved. The parties have tremendous flexibility in deciding how comprehensive they want the agreement to be. Most courts now enforce explicit agreements between unmarried persons as long as the consideration is severable from the sexual aspect of the relationship. Consideration based on sexual services will invalidate any agreement.[86]

B. Washington Law in the Absence of a Written Agreement.

Whereas California confers rights of cohabitants based on an implied or an express contract, Washington confers rights on cohabitants based merely on their status as such.[87] A line of cases has developed in Washington that has the effect of eliminating unjust enrichment when an unmarried couple separates with no prior agreement.[88] These cases all depend upon whether an intimate committed relationship existed.[89]

The relevant factors for finding an intimate committed relationship in Washington include, but are not limited to: "[c]ontinuous cohabitation, duration of the relationship, purpose of the relationship, pooling of resources and services for joint projects, and the intent of the parties."[90]

---

[85] I.R.C. §1001.

[86] Frank S. Berall, *Estate Planning Considerations for Unmarried Same or Opposite Sex Cohabitants*, 23 Quinnipac L.Rev. 361, 383 (2004) (hereinafter "Berall, *Estate Planning Considerations*"). *See also* Linda J. Ravdin, 849 Tax Mgmt. (BNA), *Marital Agreements*, A-48-49 (2003).

[87] But Washington confers the rights afforded by the Registered Domestic Partnership Act only to domestic partners registered pursuant to the Act. *See supra* n.62-74 and accompanying text.

[88] *See, e.g., Vasquez v. Hawthorne*, 145 Wn. 2d 103, 33 P.3d 735 (2001); *Marriage of Pennington*, 142 Wn. 2d 592, 14 P.3d 764 (2000); *Connell v. Francisco*, 127 Wn. 2d 339, 898 P.2d 831 (1995); *Marriage of Lindsey*, 101 Wn. 2d 299, 678 P.2d 328 (1984); and *Meretricious Relationship of Sutton*, 85 Wn. App. 487, 933 P.2d 1069*, rev. denied,* 133 Wn. 2d 1006 (1997).

[89] Various terms have been used to describe relationships meeting the legal standard for the just and equitable distribution of property. Earlier cases used the term "meretricious relationship." *See Relationship of Eggers*, 30 Wn. App. 867, 871 n.2, 638 P.2d 1267, 1270 n.2 (1982). Washington state courts have defined a meretricious relationship as, "a stable, marital-like relationship where both parties cohabit with knowledge that a lawful marriage between them does not exist." *Connell v. Francisco*, 127 Wn. 2d at 346, 898 P.2d at 834. However, this term carries with it a negative connotation. More recently, the Court has used the phrase "intimate committed relationship." *Olver v. Fowler*, 161 Wn. 2d 655, 168 P.3d 348 (2007).

[90] *Pennington*, 142 Wn. 2d at 601, 14 P.3d at 770 (citations omitted).

Additional factors include: whether the parties held themselves out as a couple, whether the parties named each other as beneficiaries on life insurance and employee benefits, and in their estate planning documents, and whether the couple parented children together. Not all of the factors are required but, taken as a whole, they must show the existence of a stable marital-like relationship.[91] Washington law does not distinguish between same gender and different gender unmarried couples when applying these factors.[92]

In the absence of a prior agreement, a court must examine the relationship of the parties, and the property accumulated during the relationship, and make a "just and equitable" distribution of that property.[93] Property acquired during the relationship is presumed to belong to both parties.[94] If the presumption of joint ownership is not rebutted, the court may look to RCW 26.09.080, Washington's dissolution statute, for guidance as to the fair and equitable distribution of property acquired during the relationship.[95] The distinction between marital dissolution cases and cohabitation property division cases is that property that would have been separate property had the couple been legally married is *not* subject to equitable division.[96]

C. Illinois Law

Illinois is one of the few remaining states to deny property rights to unmarried cohabitants.[97] This position was recently affirmed in *Costa v. Oliven*.[98] *Costa* involved a man seeking property rights from a woman after a 24-year relationship. Eugene Costa gave up his career to raise and home-school the couple's daughter. He asked the court to impose a constructive trust for his benefit, and he asked for an accounting of Catherine Oliven's income and assets, and payment of wages for his services while he essentially acted as Oliven's employee. He referred to their arrangement as a '"quasi-marital relationship," with all the indicia of a marital type relationship, including love, trust, mutual responsibilities and intimacy.'[99] The Illinois Court of Appeals affirmed the lower court's dismissal of the Costa's complaint and in doing so, relied on the 1979 Illinois Supreme Court's decision in *Hewitt v. Hewitt*.[100]

In *Hewitt*, the trial court had dismissed a woman's claim for an equitable share of the couple's property based on implied contract, constructive trust, and unjust enrichment.[101] The trial court

---

[91] *Id*. at 603, 14 P.3d at 770.

[92] *Gormley v. Robertson,* 120 Wn. App. 31, 38, 83 P.3d 1042, 1046 (2004).

[93] *Marriage of Lindsey*, 101 Wn. 2d 299, 304, 678 P.2d 328, 331 (1984) (citations omitted).

[94] *Pennington*, 142 Wn. 2d at 602, 14 P.3d at 770 *citing Connell*, 127 Wn. 2d at 351.

[95] *Id.* at 607-608.

[96] *Connell*, 127 Wn. 2d at 351-2, 898 P.2d at 837.

[97] Two states – Illinois and Georgia -- do not recognize the legal rights of cohabitants. Lindey I. Parley & Alexander Lindey, *Lindy and Parley on Separation Agreements and Antenuptial Contracts* (2d ed. 2000). *See* Richard A. Wilson, *The State of the Law of Protecting and Securing the Rights of Same-Sex Partners in Illinois Without Benefit of Statutory Rights Accorded Heterosexual Couples*, 38 Loyola University Chicago Law Journal 323 (2007) for an in depth discussion of the state of the law applicable to unmarried cohabitants in Illinois.

[98] 365 Ill. App. 3d 244, 849 N.E.2d 122, appeal denied, 221 Ill. 2d 633 (2006).

[99] *Id.* at 245, 849 N.E.2d at 123.

[100] 77 Ill. 2d 49, 394 N.E.2d 1204 (1979).

[101] *Id*. at 53, 394 N.E.2d at 1205.

dismissed her complaint and indicated that such claims must be based on a valid marriage.[102] The appellate court reversed, based on the reasoning of *Marvin v. Marvin* that the woman had a valid cause of action based on an express oral contract.[103] The Illinois Supreme Court reversed based on public policy considerations. It held that the woman's "claims are unenforceable for the reason that they contravene the public policy, implicit in the statutory scheme of the Illinois Marriage and Dissolution of Marriage Act, disfavoring the grant of mutually enforceable property rights to knowingly unmarried cohabitants."[104]

Notwithstanding *Hewitt* and its progeny, the Illinois court has recognized claims based on constructive trust where assets have been titled in the name of one partner but actually paid for by the other partner.[105]

In Illinois, it is incumbent upon the parties to enter into a written agreement regarding the ownership of their party. Better yet, unmarried couples ought to title their property in both of their names and document the financial contributions of the parties.

Even when a couple is willing to rely on a state's default rules, because of the migratory nature of individuals, the fact that the laws of multiples states may apply and the fact that oral agreements are both difficult to prove and to enforce, the couple's intent should be clearly stated in a written agreement.

D. Drafting Cohabitation Agreements

Cohabitation agreements may be oral in some states.[106] Because the goal of the domestic partnership agreement or cohabitation agreement is to eliminate any factual disputes and ambiguities about what the parties intended, a written agreement is preferable. The following are some of the more important issues that should be addressed in the agreement.

1. Recitals. The agreement should contain recitals that document the circumstances of the parties at the time the agreement is entered into and outline their intention with respect to creating the agreement. The recitals should set forth the date the parties began living together and a brief history of the couple's relationship together. The recitals should demonstrate, based on the facts, and not on boilerplate provisions, that an enforceable contract with good and valuable consideration exists between the parties.

---

[102] *Id*. at 54, 394 N.E.2d at 1206.

[103] *Id*. at 55, 394 N.E.2d at 1206 *citing Marvin v. Marvin*, 557 P.2d 106 (Cal. 1976).

[104] *Hewitt* at 66, 394 N.E.2d at 1206.

[105] In *Spafford v. Coates*, 118 Ill. App. 2d 566, 455 N.E.2d 241 (Ill. App. Ct 1983), the court recognized claims by one cohabitant against another where one had contributed funds toward a purchase titled in the other's name and the fact of their relationship was not a basis for the claim. *But see Ayala v. Fox*, 206 Ill. App. 3d 538, 564 N.E.2d 920 (1990) (plaintiff's claim to an interest in joint purchases denied because the relationship of the parties could not be separated from the monetary consideration invested).

[106] *See Relationship of Eggers*, 30 Wn. App. 867, 638 P.2d 1267 (1982) (the court held that express oral contracts between persons living together are enforceable) and *Whorton v. Dillingham*, 202 Cal. App. 3d 447 (1988). *See also,* Richard M. Horwood *et al.*, 813-2nd Tax Mgmt. (BNA), *Estate Planning for the Unmarried Adult,* A-44 (2003).

2. Disclosure of assets and liabilities. As with prenuptial agreements, both parties must disclose the nature and value of their property. Depending upon the applicable state law, it is possible that the same principles applicable to prenuptial agreements may also apply to cohabitation agreements, including the ability to set aside the agreement could be set aside in the absence of full and fair disclosure.

3. Expenses while living together. The agreement should address how expenses will be handled during the relationship, how assets purchased will be titled, and any post-termination support commitments. Many of these issues can and should be provided for in the Will of the partners as well as in the cohabitation agreement.

4. Dispute

5. Dispute Resolution. It is advisable to include dispute resolution provisions. If the parties agree to mediation or arbitration, the agreement should specify who would pay the mediator/arbitrator. The agreement should also indicate when the parties might abandon mediation for either arbitration or going directly to court. In addition, if attorneys or court costs are involved, it should cover how these costs will be paid for as well.

6. Marriage. If marriage is a legal option for a couple, they should indicate whether they intend the agreement to remain in effect should they marry. Alternatively, the agreement may terminate upon marriage, at which time the couple would be required to enter into a new agreement or rely on the state default rules applicable to married couples. If marriage would not be legal, a couple should not state an intent to live as husband and wife, thereby creating a possibility in certain states that the agreement will be found void because it violates public policy.[107]

7. Choice of Law. Because of the mobile nature of couples in our society, a choice of law provision is also advisable. Confirm that the state law where the parties reside at the time of execution allows such agreements and its particular provisions.[108] Assuming that the agreement is enforceable in the state where executed, the parties may want to include a provision such as the following: "To establish reasonable certainty in their respective financial affairs, the parties agree that, without regard to where they may reside or be domiciled in the future, or where any or all of their real or personal property may be located, all property rights of the parties and their rights under this Agreement shall be determined according to the substantive laws of [state where executed], without

---

[107] Berall, *Estate Planning Considerations, supra* n.86*, at* 383-384.

[108] Linda J. Ravdin, *Marital Agreements*, *supra* n.86 at B-1101-1107, for a table by state indicating the enforceability of domestic partnership agreements regarding property and support. *See also* William A. Reppy, Jr., *Choice of Law Problems Arising When Unmarried Cohabitants Change Domicile*, 55 SMU L. Rev. 273 (Winter 2002) for an examination of the issues affecting cohabitants with respect to choice of law rules after the termination of the relationship or the death of one member of the couple.

regard to conflict of law rules applicable in [state where executed] or in any state in which they may later reside."

8. Provisions for conception of children and parenting.

(a) Agreements regarding parenting violate public policy.[109] However, the agreement of the parties may still carry some weight with the court. Accordingly, the couple may want to try to agree in advance, and document, how they will handle issues such as primary parent/custody, visitation and how the children will be raised, keeping in mind that the best interest of the children, as determined by the court, will ultimately prevail.[110] Similar provisions for pets may also be documented.

(b) Some states, including Washington, recognize the equitable concept of the "de facto" parent, in the absence of a legal adoption. The Washington Court of Appeals adopted the following four-part test to determine the existence of a *de facto* parent-child relationship, as follows:

> (1) the natural or legal parent consented to and fostered the parent-like relationship; (2) the petitioner and the child lived together in the same household; (3) the petitioner assumed obligations of parenthood without expectation of financial compensation; and (4) the petitioner has been in a parental role for a length of time sufficient to have established with the child a bonded, dependent relationship parental in nature.[111]

(c) While the *de facto* parent stands in legal parity with a legal parent, because it is an equitable remedy and not statutory, a written agreement would always be preferable to assuming that this remedy will be available. In the absence of either a biological parent-child relationship or a legal adoption, there is little certainty with respect to the rights and responsibilities between an adult and child.[112]

(d) If a couple has or plans to store genetic material, they may want to deal with its use and or disposition in the cohabitation

---

[109] *See, e.g.,* RCW 26.09.070(3). *See also, Unif. Premarital Agreement Act* §3(b) (1983), 9C U.L.A. 35, 43 (2001) ("The right of a child to support may not be adversely affected by a premarital agreement.").

[110] "The agreement may be considered by the court, in light of the circumstances and knowledge of the parties when the agreement was made, but it is not enforceable." *Marriage of Littlefield*, 133 Wn. 2d 39, 58, 940 P.2d 1362, 1372 (1997).

[111] *Parentage of M.F.*, 141 Wn. App. 558, 563, 170 P.3d 601 (2007) *citing Parentage of L.B.*, 121 Wn. App. 460, 487, 89 P.3d 271 (2004). *Parentage of L.B.*, 155 Wn. 2d 679, 122 P.3d 161 (2005), *cert. den.*, 126 S. Ct. 2021, 164 L.Ed. 2d 806 (2006).

[112] *See* http://www.hrc.org/ for an analysis of adoption laws on a state-by-state basis. Not all states permit second-parent or same-gender adoptions.

agreement (if they have not already entered into a separate agreement covering these issues). The couple should document their plans to use that material to conceive children, and whether those plans should be altered if the couple does not stay together or if one member of the couple dies.[113] Exhibit A contains one form of provision that could be used in a will or trust to define eligible beneficiaries, in light of the various types of assisted conception, during and after the lifetime of a parent.

(e) While the Uniform Parentage Act deals with the donation of sperm, ova and surrogacy, the laws on these issues vary from state to state, and are in flux.[114] Any type of assisted reproduction agreement should be documented in writing that includes the intent and expectation of the parties. Donor and surrogacy agreements are beyond the scope of this outline.[115] But, it is important to note that because the law is so uncertain in this area, it is critical to include a severability clause allowing an unenforceable provision to be severed from the remainder of an agreement.[116]

V. WILLS, REVOCABLE TRUSTS, AND NONPROBATE TRANSFERS

A. Wills.

Wills present a problematic area for same-gender couples. A testamentary gift to an unmarried partner, especially a same-gender partner, is often subject to challenge by the decedent's relatives.

There are certain powers that are often statutorily limited to exercise under a will, including: the ability to name a guardian of minor children[117]; the exercise of a testamentary power of appointment;[118] and gifts of tangible personal property by separate writing.[119] Thus, in some

---

[113] *See* Kathryn Venturatos Lorio, *Conceiving the Inconceivable: Legal Recognition of the Posthumously Conceived Child*, 34 ACTEC Journal 154 (Winter 2008); Carole M. Bass, *What If You Die, And Then Have Children? Know How to Plan for Offspring Who Are Born – Sometimes Even Conceived – Posthumously. A State-by-State Guide*, 145 Trusts & Estates 20 (April 2006). It may be possible, in come jurisdictions, for a non-biological parent who has not adopted a child, to seek custody under the doctrine of de facto parentage.

[114] Washington adopted the Uniform Parentage Act in 2002. *See* RCW §§26.26.700-740. *See also* Susan N. Gary, *We are Family: The Definition of Parent and Child for Succession Purposes*, 34 ACTEC Journal 171 (Winter 2008).

[115] *See* Charles P. Kindregan, Jr. & Maureen McBrien, *Assisted Reproductive Technology: A Lawyer's Guide to Emerging Law and Science* (ABA 2006) for sample agreements and a checklist of issues to be covered.

[116] *Id*. at 295.

[117] RCW 11.88.080. However, effective July 24, 2005, RCW 11.88.080 was amended to permit the designation of a guardian for a minor child in a durable power of attorney, effective either upon the death or incapacity of the parent/principal. This designation may also authorize an agent to make health care decisions on behalf of the minor if no other parent or legal guardian is available to give consent.

[118] RCW 11.95.060(2).

[119] RCW 11.12.260.

instances, having a will is critical. Under certain circumstances, other forms of testamentary transfers, such as joint tenancy with right of survivorship or revocable living trusts, both discussed below, may also be used as will substitutes.

B. Revocable Trusts.

Many clients establish revocable trusts to transfer assets to a partner outside of probate. Revocable trusts are also useful as vehicles for the management of a client's assets in the event of incompetence. Some practitioners advise that if a client anticipates that his or her will may be contested, it may be prudent to establish a revocable trust, which may be more difficult to challenge on theories such as incompetence or undue influence. If the estate is not taxable, then the beneficiary need not ever report receiving the gift. But, if there is a taxable estate, estate tax apportionment between family members and a surviving partner may compromise a beneficiary's ability to keep the receipt of assets entirely confidential from a decedent's family members.

C. Beneficiary Designations.

Clients should confirm beneficiary designations for bank accounts, investment accounts, life insurance and retirement accounts. They may also consider restating those designations in their will or revocable trust as additional evidence in the event of a challenge by hostile family members.

D. Miscellaneous Considerations and Definitions.

With any estate planning document, definitions need to be carefully considered.

1. Partner.

In Washington, RCW 11.12.051 provides for the revocation of a provision in a will for a spouse upon divorce, and RCW 11.07.010 provides for the revocation of a beneficiary designation naming a spouse as beneficiary of certain nonprobate assets. No equivalent statutes apply to a partner upon separation. Therefore, it is important to define "partner" carefully. A partner may be "the person with whom the testator is living at the time of death," but consideration should also be given to the possibility of temporary job relocation or one person having moved to a residential care facility.[120] One option is to provide specific guidelines for the personal representative, who would make a final and binding determination as to whether an individual was a partner at the time of death.

The following is an example of a definition of life partner:

> The term "Life Partner" shall be deemed to mean __________, unless and until one of the following circumstances should occur:
>
> (a) If our Washington State domestic partnership registration is recognized in the state in which we are residing, and either of us files for dissolution, termination or annulment of such Washington State domestic partnership registration in a state that recognizes such registration; or

[120] Gail E. Cohen, *Estate Planning for the Unique Needs of Unmarried Partners*, 30 Estate Planning 188, 189 (April 2003).

(b) __________ and I marry, and subsequently either of us files for dissolution, termination or annulment of the marriage in a state that recognizes such marriage; or

(c) __________ and I reside in a state that does not recognize the Washington State domestic partnership registration or a subsequent marriage of __________ and me, and I deliver to the Personal Representative/Trustee a signed, written instrument declaring that __________ is not my Life Partner.

2. Parent and Child.

Similarly, the terms "children" and "descendants" should be defined to include children of a partner, who are neither biologically related nor adopted, but whom the testator intends to provide for. It should also be kept in mind that anti-lapse statutes[121] may not protect descendants of a predeceased child of a partner. Consideration should be given as to whether those individuals should still be provided for even if the relationship with the partner has ended.[122]

Assisted conception raises a number of moral, ethical as well as legal issues for clients. The definition of "parent" and "child" should also be carefully considered when science may have made those definitions ambiguous. One issue that must now be considered is whether any genetic material has been stored, and what the plans are to use that material to conceive children. The law is in flux, and inconsistent from state to state, with respect to children conceived after the death of a parent.[123]

3. Tax, Debt and Expense Allocation.

Another important component of an estate plan is the tax, debt and expense allocation clause in the will or revocable trust. Estate plans often allocate tax, debts and expenses of administration to the residue. Alternately, a plan may rely on the state's default statutes,[124] which generally provide that each beneficiary of an asset will bear a pro rata share of taxes and expenses of administration.

The effect of the state statute regarding abatement of assets to pay tax, debts and expenses should also be considered when drafting a will or revocable trust.[125]

Even when a client elects to rely on a state's default allocation rules, because of the migratory nature of clients and the fact that the laws of multiples states may apply, the client's intent should be clearly stated in the testamentary documents.

---

[121] *e.g.* RCW 11.12.120.

[122] Cohen, *supra* n.120, at 189-190.

[123] Bass, *supra* n.113, at 21.

[124] *E.g*,. RCW ch. 83.110A, Washington Uniform Estate Tax Apportionment Act.

[125] *See, e.g.,* RCW ch. 11.104A, Washington's Principal and Income Act; RCW ch. 83.110A, Washington's Uniform Estate Tax Apportionment Act; and RCW 11.10.010, Washington's general abatement scheme that applies when no other specific rule applies.

4. Drafting for the Marital Deduction.

Consider drafting documents in anticipation of a state and federal marital deduction.

VI. METHODS TO MINIMIZE TAXES

A. Defining the Rights of Unmarried Partners to Jointly Owned Property.

1. General Federal Estate and Gift Tax Considerations.

The rules allowing transfers between spouses to avoid transfer or income taxes do not apply to unmarried couples.[126] Accordingly, any transfers between partners may be taxable (subject to the I.R.C. §2503(b) annual exclusion, the donor's available applicable exclusion, and the exclusion from gift tax for tuition and medical expenses under I.R.C. §2503(e)).

2. Indirect Gifts Arising From Pooled Expenses.

The value of taxable gifts between unmarried partners becomes difficult to quantify in the context of shared living expenses. When partners pool income and one party receives more income than the other, pooling may cause a net transfer to the party with less income, resulting in a taxable gift. This result may be partially ameliorated by entering into a contractual arrangement between the partners providing for mutual and adequate consideration. The amount of the gift is the difference between the value of the property transferred and the consideration received.[127] However, the exchange of consideration sufficient to make a promised transfer enforceable for state contract law purposes will not necessarily prevent some part of the transfer from being a gift for federal tax purposes, unless the transferor receives consideration having an economic value equal to the property transferred.

To the extent a net transfer from the greater income earner to the lower income earner is viewed as being paid in consideration for the lower income earner's love, emotional support, or other services upon which a monetary value may not be placed, the transfer is a gift.

If the contractual arrangement provides that the net transfer from the higher income earner to the lower income earner is an advance to be repaid upon the happening of some event, i.e. the lower income partner finishing school, or becoming gainfully employed, or the higher income partner retiring, the couple will be treated as being in a debtor-creditor relationship. These types of arrangements should be avoided unless the arrangement provides for adequate stated interest and the advanced sums will actually be repaid. Sections 163(h), 1274 and 7872 of the Code address below-market interest and gift loans by imputing interest income in the amount of the applicable federal rate to the creditor, taxing the creditor as making a gift of the interest, and denying the debtor's interest deductions. If the debt is never repaid, I.R.C. §61(a)(12) treats the amount advanced as income to the debtor from the discharge of indebtedness. Section 7872(c)(2)(A) of the Code provides a *de minimis* exception for gift loans between individuals for amounts of $10,000 or less. Thus, generally, for smaller loans there is neither imputed interest nor a taxable gift.

---

[126] I.R.C. §2056(a), §2523(a), and §1041.

[127] I.R.C. §2512(b).

3. Joint Tenancies.

Joint tenancy ownership of assets is one of the most popular estate planning devices for unmarried couples. When contributions by both parties are equal, and where the intentions of both parties with regard to management and disposition of the assets are identical, joint tenancy is an efficient and economical estate planning tool. Joint tenancy in the nontaxable estate may avoid the need for disclosure to family members at the time of the disposition. And if a joint tenancy is challenged, the presumption of a gift of funds in joint tenancy must be rebutted by clear and convincing evidence of a contrary intent, which is typically difficult to overcome.[128]

(a) Joint Tenancy May Result In An Unintended Gift.

For the client with a taxable estate, joint tenancy can result in unintended consequences. When an asset, such as a house, is purchased in joint tenancy, if the parties contribute equally to the purchase, then acquiring the asset in joint tenancy is not a taxable event. However, if one partner purchases or contributes to an asset (other than a bank account or U.S. bonds), and has it conveyed to himself and his partner in joint tenancy with right of survivorship, then the purchase constitutes an immediate gift of the value of the transfer in excess of the annual exclusion.[129]

Upon the death of one joint tenant, the entire value of the jointly held property is included in the decedent's gross estate, unless it can be shown that the surviving joint owner actually contributed to the acquisition of the asset.[130] The burden of proof is on the taxpayer and may be difficult to sustain without meticulous record keeping. If clients intend to own real property in joint tenancy, they should document their intentions, their contributions to points and the down payment, mortgage payments, and home improvements.

There is an exception to the present gift rule for joint bank accounts and U.S. bonds: The transfer, and thus a completed gift, does not occur until the joint holder withdraws money from the account.[131]

(b) Non-Tax Disadvantages of Joint Tenancies.

In addition to the tax disadvantages, there are other problems with joint tenancies. A joint owner of a bank account can withdraw the other party's money from the account without the party's consent or knowledge.[132] This could be avoided by requiring two signatures on an account.

Assets titled jointly, such as real estate, stock, or a motor vehicle, cannot be sold without the consent of both joint owners. This protects the owners, but it also often results in a deadlock between partners on the appropriate disposition of an asset.

---

[128] RCW 30.22.100(3).

[129] Treas. Reg. §25.2511-1(h)(5) and I.R.C. §2503(b).

[130] I.R.C. §2040(a) and Treas. Reg. §20.2040-1(a)(2).

[131] Treas. Reg. §25.2511-1(h)(4).

[132] RCW 30.22.110. Washington does not have a statutory equivalent to RCW 30.22.110 applicable to securities accounts. Rev. Rul. 69-148 provides that a joint tenancy securities account constitutes a completed gift except when the account agreement allows the donor to remove assets from the account without the consent of the donee. Thus, unless an account agreement allows for a unilateral withdrawal, a securities account does not constitute a completed gift.

(c) Drafting Recommendations.

Some practitioners recommend that partners establish a partnership or limited liability company to take title to a home, to facilitate accurate record keeping, and also to provide protection against a creditor or a partner forcing partition. But, using an entity for a principal residence acquisition will prevent the partners from using the exclusion for capital gain on sale under I.R.C. §121.[133] This exclusion is available to persons, but not entities.

Alternatively, legal title could be held in a revocable title holding trust with a separate schedule of beneficial interests. The trust agreement could further define how the beneficial interests are to be adjusted over time based on the relative financial contributions of the partners.

B. Adult Adoption.

1. Purpose of Adult Adoption.

One method by which same-gender couples have sought to obtain some certainty with respect to their estate planning intentions is to have one partner adopt the other.[134] There are several motivations behind this planning technique, including establishing a family relationship for purposes of entitlements and other benefits (i.e. Social Security, health insurance, survivor benefits), the desire to create a legal bond with another individual, and to establish a legal heir and secure inheritance rights.[135] Because estate intestacy laws do not allow for the distribution of a decedent partner's estate to his or her surviving partner, some unmarried couples resort to adoption, rather than rely solely upon other more conventional estate planning techniques.

Another reason an adult may wish to adopt a partner is to bring the adoptee within the class of beneficiaries under a pre-established estate planning instrument. One partner may be a beneficiary of a trust providing for distribution of her share to her descendants upon her death, but if she has none, then to some other specified group of individuals. In this case, adoption may bring the partner into the permissible class of recipients of the trust share upon the death of the current income beneficiary. Before reaching the conclusion that adoption will bring an individual into a class of beneficiaries, there must be a careful examination of the dispositive intent set forth in the instrument.

Adult adoptions may provide an effective way to eliminate the status, as heirs, of the adopter's relatives, so that they no longer have standing to contest an estate plan. Considering the

---

[133] The Taxpayer Relief Act of 1997, Pub.L. No. 105-34, 111 Stat. 788, amended I.R.C. §121 (formerly providing a one-time exclusion of gain from sale of a principal residence by an individual who has attained age 55) and permits exclusion of up to $250,000 of gain by an individual or $500,000 by a married couple on the sale or exchange of a principal residence, if the property was a principal residence for 2 of the last 5 years.

[134] For a thorough discussion of this topic *see* Terry L. Turnipseed, Associate Professor of Law, Syracuse University College of Law, *Scalia's Ship of Revulsion Has Sailed: Will Lawrence Protect Adults Who Adopt Lovers to Help Ensure Their Inheritance From Incest Prosecution*? (2008), http://works.bepress.com/terry_turnipseed/2.

[135] *See* Gwendolyn L. Snodgrass, *Creating a Family Without Marriage: The Advantages and Disadvantages of Adult Adoption Among Gay and Lesbian Partners*, 36 Brandeis J.Fam.L. 75 (1997-1998).

frequency of challenges by relatives claiming that a decedent's partner exerted undue influence over the decedent, the adoption strategy appears attractive to many unmarried partners.[136]

The statutory treatment of adoption and its effectiveness differs from state to state.[137] Not all states permit adult adoption,[138] and some require the adoptee to be younger than the adopter.[139] The possibility of prosecution for incest in the applicable state should also be considered before opting for this planning method.[140] Washington's incest statute, RCW 9A.64.020, only applies to adopted descendants *under* the age of eighteen.[141] But Illinois' incest statute would make such adoptions illegal.[142]

It is important to carefully consider who will adopt from whom. The partner who is likely to die first should be the adopter. Another concern is that an adoptee loses the right to inherit by intestacy from biological relatives. Adult adoption also triggers income tax considerations such as dependency exemptions and head of household status that should be considered, and clients need to understand that it is unlikely that an adoption may later be revoked or renounced once final.

2. <u>Estate Planning Opportunities Following the Adoption of a Partner – Transfers of a Trade or Business.</u>

Many estate planning opportunities arise once a partner has been adopted. Two particularly notable techniques are discussed below:

(a) Special Valuation Rules of Section 2032A.

Section 2032A of the Code provides a special valuation rule for real property used in farming or a trade or business, with a maximum reduction in value of $1,000,000 in 2009. Section 2032A allows the qualified real property to be valued at its actual use, rather than its highest and best use. To qualify, the "decedent or a member of the decedent's family" must have owned and used the property for the qualifying use before death, the property must pass to a "member of the decedent's family," and the property must continue to be used for the qualifying use by a "member of the decedent's family."[143] Members of the decedent's family are defined to include:

---

[136] For information concerning adoption in Washington, *see Washington Family Law Deskbook*, ch. 60 (Wash. St. Bar. Assoc. 2d ed. 2001 and Supp. 2006).

[137] *See* Terry L. Turnipseed, Associate Professor of Law, Syracuse University College of Law, *Scalia's Ship of Revulsion Has Sailed: Will Lawrence Protect Adults Who Adopt Lovers to Help Ensure Their Inheritance From Incest Prosecution?* (2008), http://works.bepress.com/terry_turnipseed/2 for a thorough analysis of this topic.

[138] *Id*. at 10 (citing Arizona, Florida, Idaho, Nebraska, New Jersey, Ohio and Puerto Rico).

[139] *Id*. n. 75

[140] *Id*. at 17-24.

[141] *But see Restatement (Second) of Conflicts of Law* §290 cmt. c (1971) (providing that a state may disallow inheritance in connection with out-of-state adoption where inheritance would violate strong local public policy); *Restatement (First) of Conflict of Laws* §143 cmt. a, illus. (1934) (providing an example when adoption in one state will not be recognized for inheritance purposes in another state that does not permit such adoption).

[142] 720 Ill. Comp. Stat. 5/11-11(2).

[143] I.R.C. §2032A(b).

(i) an ancestor; (ii) the decedent's spouse; (iii) a lineal descendant of the decedent, the decedent's spouse, or the decedent's parents; or (iv) the spouse of such lineal descendants.[144] Although the definitions of I.R.C. §2032A are based on legal relationships, and therefore do not recognize informal relationships, they do include adopted children, stepchildren, sons- and daughters-in-law, and half-blood relations.[145] Thus, I.R.C. §2032A may provide planning opportunities to non-traditional families in the right circumstances.

(b) Section 6166 Election to Pay Estate Taxes on Qualified Businesses in Installments.

Section 6166 of the Code was passed to mitigate the pressure on an illiquid estate to sell a decedent's interest in a closely held company in order to pay estate taxes. Section 6166 allows a personal representative to pay estate tax in installments, on that portion of the estate tax for a decedent who was a U.S. citizen or resident that is attributable to a closely held business interest, over a maximum 14-year period. Section 6166 is highly technical, but some of its provisions are summarized below.[146]

The first payment of tax is due not more than five years after the date the estate tax return is due. A portion of the property ($1,330,000 in 2009 plus the applicable exclusion amount) is subject to estate tax at 2%.[147] The interest rate on deferred estate tax in excess of the 2% portion is 45% of the underpayment rate determined under I.R.C. §6621.

Section 6166 requires that at least 35% of the adjusted gross estate must consist of an interest in a closely held business that was an active trade or business in which the decedent or a member of his family holds a minimum percentage ownership interest.[148]

An interest in a closely held business is defined, for purposes of Section 6166, as (i) an interest as a sole proprietorship carrying on a trade or business, (ii) an interest as a partner/member in a partnership/LLC carrying on a trade or business, if 20% or more of the partnership/LLC is included in the gross estate, or if the partnership/LLC had no more than 15 partners/members, and (iii) stock in a corporation carrying on a trade or business if 20% or more of the value of the corporations stock is included in the gross estate or if the corporation had no more than 15 shareholders.[149]

"Member of the family" is defined as including only brothers and sisters, spouses, ancestors, and lineal descendant, including adoptees.[150] Again, because of this restrictive definition, under the right circumstances, this may provide an excellent estate planning opportunity.

---

[144] I.R.C. §2032A(e)(2).

[145] *Id.*

[146] *See* Louis A. Mezzullo, 809-2nd Tax Mgmt. (BNA), *Estate Planning for Owners of Closely Held Business Interests* at Section III (2002) for an analysis of this topic.

[147] I.R.C. §6166(j).

[148] I.R.C. §6166(b).

[149] I.R.C. §6166(b)(1).

[150] I.R.C. §6166(b), I.R.C. §267(c)(4).

An estate will often attempt to claim the benefit of both I.R.C. §2032A and I.R.C. §6166. The differences between the family relationship definitions of these two sections may result in a non-traditional family qualifying for one, but not the other.

C. The Generation-Skipping Transfer Tax.

1. Background.

In addition to estate and gift taxes, there is a generation-skipping transfer ("GST") tax on transfers to grandchildren and other persons "assigned to a generation which is 2 or more generations below the generation assignment of the transferor."[151] The GST tax is a flat rate equal to the maximum estate tax rate (45% in 2009).[152] The IRS imputes a generation as 25 years for unrelated beneficiaries. Every taxpayer has a $2,000,000 exemption from the GST tax.[153] Like the exemption equivalent sheltered by the unified credit, the GST exemption can be allocated to transfers during life, to transfers upon death, or partly to each.

(a) Generation Assignment -- Family Members.

Each person is assigned to a particular generation to determine if a transfer is a generation skip.[154] Generation assignments are based on lineage for transfers to family members, and age for transfers to non-family members.[155] The age of an individual is irrelevant for generation assignments based upon family relationships.

(b) Generation Assignment -- Non-Family Members.

Transfers to someone other than a family member are based on the transferee's age relative to the transferor. Any person not more than 12 ½ years younger than the transferor is assigned to the transferor's generation.[156] Any person between 12 ½ and 37 ½ years younger is assigned to the first generation below the transferor.[157] Each 25-year increment thereafter represents a new generation.[158]

Where unmarried partners are separated by a great age difference, a transfer in excess of the exemption may result in the application of the GST.

---

[151] I.R.C. §2613(a)(1).

[152] I.R.C. §2641.

[153] The GST exemption amount is now equal to the estate tax applicable exclusion amount under I.R.C. §2010(c) for the year in which the generation-skipping transfer is made ($2 million in 2006, and $3.5 million in 2009), and for year 2010, the GST tax will be repealed in its entirety (and thus there will be no GST exemption amount). I.R.C. §2641. In 2011, the GST exemption is scheduled to revert back to $1,100,000 (plus post-2002 inflation adjustments). I.R.C. §2664. *See* Sebastian V. Grassi, Jr., *Income, Gift and Estate Tax Aspects of Crummey Powers After the 2001 Tax Act, Part 1*, 18 Probate & Property 37 (Jan./Feb. 2004) and Sebastian V. Grassi, Jr., *Income, Gift and Estate Tax Aspects of Crummey Powers After the 2001 Tax Act, Part 2*, 18 Probate & Property 48 (March/April 2004).

[154] I.R.C. §2651.

[155] *Id.*

[156] I.R.C. §2651(d)(1).

[157] I.R.C. §2651(d)(2).

[158] I.R.C. §2651(d)(3).

2. Adoption to Avoid the Application of the GST.

A valid adoption of an unrelated individual, who would otherwise be considered a skip-person, may avoid the generation assignment rules based on age, and allow application of the generation assignment rules based upon lineage from the transferor.

However, under regulations that went into effect on July 18, 2005, the IRS will analyze whether there is a bona fide parent/child relationship, or if the adoption was primarily for GST tax-avoidance purposes. This determination is made based upon all of the facts and circumstances, but the following requirements must be satisfied: (i) a legal adoption took place between the adoptee and the adoptive parent; (ii) the adoptee is a descendant of a parent or the adoptive parent (or the adoptive parent's spouse or former spouse); (iii) the adoptee is under the age of 18 at the time of the adoption; and (iv) the adoption is not primarily for GST tax-avoidance purposes.[159]

D. Partnerships and Limited Liability Companies.

One way to leverage transfers from one partner to the other is to establish a partnership or LLC for federal income tax purposes. If a couple can show they are a "syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on," they may establish a partnership under Subchapter K of the Code.[160] An arrangement may be classified as a partnership for federal income tax purposes even if it does not qualify as a partnership for state law purposes.[161]

Given a good faith business venture, an unmarried couple could enter into a partnership/LLC agreement, open a joint partnership/LLC account, acquire an employer's identification number from the Service, and file income tax returns for the entity. Partnership/LLC agreements allow for great flexibility and, assuming certain conditions are met, the couple can take advantage of the nonrecognition provisions contained in Subchapter K, such as the ability to distribute out partnership/LLC assets without the recognition of gain or loss, so long as the value of the assets received by a partner/member do not exceed his or her basis in the entity.[162] Note, however, a joint undertaking merely to share expenses is not a partnership absent a business purpose.[163]

In addition to the opportunities discussed above, a partnership/LLC can provide asset protection. The creditor of a partner or member may receive an assignee interest in any distributions from the entity to the partner/member. But assuming the entity is treated as a partnership for income tax purposes, when income is not actually distributed, the potential for the receipt of "phantom income" often serves as a deterrent to creditors. An entity may similarly serve as a deterrent to hostile family members.

Partnerships and LLCs can be advantageous where one partner/member wants to give property to the other without giving up control over that property. Gifts of partnership or LLC interests from one partner/member to the other, if structured properly, may be discounted for lack of control and lack of marketability to leverage the amount of property that may be transferred within the I.R.C.

---

[159] Treas. Reg. §26.2651-2(b).

[160] I.R.C. §761(c).

[161] Treas. Reg. §301.7701-1(c).

[162] I.R.C. §731(a).

[163] Treas. Reg. §1.761-1(a).

§2503(b) annual exclusion amount.[164] Furthermore, as discussed below, unmarried partners are not subject to the limitation on restrictive agreements imposed by I.R.C. §2703.

E. Life Insurance.

Life insurance, if available, is an excellent way to: (i) provide liquidity for the payment of estate taxes; (ii) give a surviving partner the funds necessary to create a stream of income; and (iii) afford a surviving partner the funds to buy out a business partner or associate. When clients are relying on the pension and/or social security benefits of one partner for their retirement years, and neither would be available to the surviving partner, life insurance is an important consideration for replacement of that income.

By purchasing life insurance and naming a partner as beneficiary, a couple may accomplish a wealth transfer at death similar to a testamentary disposition. An advantage of life insurance is that it allows the insured to retain inter vivos power to cancel the policy or alter the beneficiary designation.

Life insurance may also afford a couple privacy and confidentiality that may not be available with other estate planning tools. If the beneficiary of a policy, instead of the insured, holds all incidents of ownership of that policy, and if there are no estate tax considerations, the beneficiary of the proceeds does not have to report the receipt of the proceeds. However, if estate tax is an issue, privacy and confidentiality will be lost: A Form 712 must be filed with the federal estate tax return indicating the recipient and amount of the proceeds.

1. Insurable Interest.

I.R.C. §7702 requires life insurance policies to be "life insurance" under applicable state law. State insurance law generally provides that a contract of life insurance is not valid unless the policyholder has an "insurable interest" in the life of the insured.[165]

Traditionally, a policyholder is treated as having an insurable interest if any of the following exist: (i) a familial relationship with the insured; (ii) a reasonable expectation of advantage from the continuance of the insured's life; (iii) common ownership of property; or (iv) a business relationship between the beneficiary and the insured.[166] The policy behind the insurable interest requirement is to discourage wagering arrangements and abusive uses of insurance.[167]

An insurable interest must exist at the time the insurance is issued.[168] Some states also require that the policyholder have an insurable interest at the time the proceeds are collected.[169] Provided that the latter rule does not apply, an insured may procure a policy on his own life and transfer it to someone who does not have an insurable interest. Where an irrevocable life insurance trust is

---

[164] *See* Richard L. Lavoie, 831-3d Tax Mgmt. (BNA), *Valuation of Corporate Stock* (2006) for a discussion of valuation discounts.

[165] *See* RCW 48.18.060.

[166] *See* RCW 48.18.030.

[167] *See* Mary Ann Mancini & Howard M. Zaritsky, *Insurable Interests? Après Chawla, le Deluge?*, 32 ACTEC Journal 194 (Winter 2006) (hereinafter "Insurable Interests").

[168] *Id*. at 196.

[169] *See e.g.*, N.Y. Ins. Law §3205.

involved (discussed below), it has been suggested that insurable interest issues may be avoided by procuring the life insurance and creating the trust under the laws of a state where an insurable interest exists.[170]

2. Income and Estate Tax Consequences of Life Insurance.

Life insurance proceeds paid by reason of the death of the insured are not generally subject to income tax.[171] Proceeds are included in an insured's gross taxable estate if they are payable to or for the benefit of the insured's estate, or if the insured retained any incidents of ownership in the policy.[172] Because the marital deduction does not apply to an unmarried couple, the proceeds of a life insurance policy could be subjected to estate tax twice: Once upon the death of the insured and a second time upon the death of the survivor, if the money has not previously been spent.

When the owner of a life insurance policy predeceases the insured, the policy is an asset of the deceased owner's estate, and as such, is subject to estate tax like any other assets owned by the decedent at the time of his or her death. This consequence can be avoided by having a trust own a policy.

3. Irrevocable Life Insurance Trusts.

One technique for excluding life insurance proceeds from an insured's estate is to have a third person or trustee own all incidents of ownership in a policy. The transfer of a policy to a trust, or the purchase of a policy by a trustee, is preferable to an outright gift. An outright transfer of a policy to a domestic partner may be problematic if the relationship terminates. If the transferor is the one paying the premiums, he or she always has the option of allowing the policy to lapse.

The taxation of life insurance proceeds can be avoided under present law if a trust owns all incidents of ownership in a policy (*e.g.*, the right to surrender, revoke, assign, pledge or borrow against the policy or change the beneficiary).[173] A trust holding life insurance is commonly referred to as an irrevocable life insurance trust ("ILIT").

A trust may be drafted to exclude the partner as a beneficiary if the relationship terminates. Moreover, the terms of the ILIT may provide that, at the death of the insured, the proceeds may be made available to the insured's estate to create liquidity through loans between the trustee of the trust and the insured's personal representative.

In most states, a fiduciary may use trust funds to purchase life insurance on the life of a beneficiary or the life of another in whose life a beneficiary has an insurable interest.[174] In addition, an insured may obtain a policy on his or her own life and freely transfer ownership of that policy to a new owner.[175] In some states, it is not clear whether a trust can obtain a policy that will ultimately benefit someone without an insurable interest, in all states. In those states

---

[170] *Insurable Interests?*, *supra* n.167, at 224.

[171] I.R.C. §101(a)(1).

[172] I.R.C. §2042(1) & (2).

[173] I.R.C. §101(a)(1).

[174] *See, e.g.,* RCW 11.100.120.

[175] *See, e.g.,* RCW 48.18.360.

where insurable interest is an issue, in spite of the potential estate tax consequences, it may be preferable to have the insured purchase a policy and gift it to an ILIT.

(a) The Mechanics of the Irrevocable Life Insurance Trust.

An ILIT is operated as follows: Each year, the grantor transfers money to the trust in an amount slightly greater than the amount sufficient to cover the annual premium on the policy.[176] The beneficiaries are given withdrawal rights each year (the right to demand distribution of a stipulated amount of the trust corpus) for a limited period of time following the gifts to the trust, so that each transfer qualifies for the gift tax annual exclusion. This right is known as a "Crummey" right of withdrawal, and its purpose is to qualify the gift as a present interest and therefore eligible for the annual exclusion from gift tax.[177] Once the beneficiary's demand power expires (assuming it goes unexercised), the funds may be accumulated in the trust. In the first year, the trustee uses the cash to purchase life insurance, typically on the life of the grantor. Thereafter, the trustee uses the cash to pay the annual premium. There are several additional technical requirements that must be observed in order for the proceeds to be excluded from estate taxation.[178]

A trust agreement may provide that the grantor's partner is to be the beneficiary of the policy proceeds, provided that the insured and her partner are in a committed relationship at the time of her death. If not, the trust agreement could provide for the proceeds to be distributed to other beneficiaries.

A potential insured can allocate a portion of his or her generation-skipping transfer tax exemption to the trust each year that is equal to the value of the year's gifts to the trust, and by these allocations, the entire trust corpus (including the insurance proceeds payable upon the insured's death) can be sheltered from the GST tax for multiple generations. The GST exemption is allocated (on a timely filed Form 709 United States Gift (and Generation-Skipping Transfer Tax Return), only to the cash transferred to the trust to pay the premiums.[179] The insurance proceeds typically exceed the total premiums by a substantial amount. As a result, the life insurance trust offers an opportunity to "leverage" the use of the GST exemption.

(b) The Transfer of a Preexisting Policy.

---

[176] For a more detailed explanation, *see* Howard M. Zaritsky & Stephan R. Leimberg, *Tax Planning With Life Insurance: Analysis With Forms 2d* (1998) and Richard C. Baier, *Drafting Flexibility Into An Irrevocable Life Insurance Trust*, 19 Probate & Property 62 (Sept./Oct. 2005) (hereinafter "Zaritsky & Leimberg").

[177] In *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968), the court held that by creating a window of time during which beneficiaries of certain trusts may exercise a demand power to withdraw funds that are added to the trust, the gifts subject to the withdrawal are present interests that qualify for the gift-tax annual exclusion under I.R.C. §2503(b).

[178] *See* Zaritsky & Leimberg *supra* n.176, at 165.

[179] Alternatively, allocation of GST exemption may be made on a late filed return, in which case GST exemption would be allocated in an amount equal to the actual value of the insurance purchased, as of the first day of the month of filing the late return, which in most cases is less than the amount of cash contributed to purchase that insurance. Treas. Reg. §26.2642-2(a)(2). *See* Kathryn G. Henkel, *Estate Planning and Wealth Preservation: Strategies and Solutions* at §5.05(2)(a) (1997). However, a late allocation cannot be made if the insured individual dies before the actual date of filing the return. *Id.*

Whether the insured is expected to die within three years is a critical consideration when planning for an insurance trust. Where a preexisting policy is transferred to a trust, if the insured does not survive for three years following the date of the transfer, the proceeds generally will be subject to tax in the insured's estate.[180] However, if the trustee purchases the insurance from its inception, the proceeds will be excludable from the insured's estate, without the application of the three-year rule applicable to transferred policies, provided that the insured did not retain any incidents of ownership that would cause inclusion of the trust property in his or her estate.

4. Using Partnerships and LLCs With Life Insurance.

Partnerships and LLCs can be useful for domestic partners who desire to transfer life insurance policies between themselves. Where an existing life insurance policy is transferred for valuable consideration, the transfer for value rule provides that proceeds received at the insured's death are exempt from income tax, but only to the extent of the sum of the consideration paid and the premiums subsequently paid by the purchaser of the policy.[181] The transfer for value rule does not apply, however, where the transfer is to the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder. Thus, a life insurance policy may be transferred, with or without consideration, to a partnership, without causing the life insurance proceeds to lose their tax-free character.

The IRS concluded in PLR 9309021 (March 5, 1993) that a partnership could be created solely for the purpose of owning insurance. The anti-abuse rules (Treas. Reg. §1.701-2), however, are intended to eliminate the use of a partnership when the principal purpose of the partnership is to reduce substantially the partners' aggregate federal tax liability in a manner that is inconsistent with Subchapter K of the Code. In order to avoid running afoul of the anti-abuse rules, it is a good idea to use an entity that has some other purpose besides owning insurance.

5. Private Split-Dollar Life Insurance Arrangements.

Split-dollar is a method used to finance life insurance premiums where the owner of the policy and a third party agree to split the responsibility for paying premiums and the right to receive the policy proceeds.[182] Split-dollar insurance arrangements are commonly used in the employment context, where the employer provides the money for most or all of the premiums, but the employee's beneficiary gets most of the death benefit. In exchange for paying the premiums, the employer retains the right to a portion of the prematurity cash value, or the death benefit, equal to the premiums paid by the employer. Thus, the employer ultimately gets all of its money back.

---

[180] I.R.C. §2035(a)(2).

[181] I.R.C. §101(a)(2). *See* Lawrence Brody & Stephan R. Leimberg, *Avoiding the Tax Trap of the Transfer for Value Rule*, 32 Estate Planning 3 (October 2005) and Lawrence Brody & Stephan R. Leimberg, *Using a Transactional Analysis to Avoid the Transfer for Value Rule*, 32 Estate Planning 3 (Nov. 2005) for a through analysis of the transfer for value rule.

[182] For a complete explanation of the income, estate and gift tax consequences of split-dollar arrangements, *see* Donald O. Jansen, *Taxation of Split Dollar Life Insurance Arrangements under the Final Regulations*, 29 ACTEC Journal 285 (Spring 2004), Charles Ratner, *The Post-Split Dollar World*, 142 Trusts & Estates 18 (December 2003) (hereinafter "Ratner, *The Post-Split Dollar World*"), and Charles L. Ratner & Stephan R. Leimberg, *A Planner's Guide to Split-Dollar After the Final Regulations*, 31 Estate Planning 3 (Jan. 2004).

Split-dollar insurance may be used in non-employment situations as well, in which case it is referred to as "private split-dollar." A common structure for this arrangement between unmarried couples is for the wealthier partner to make annual exclusion gifts to an ILIT owning a policy on his life. The less wealthy partner is named beneficiary of the trust, but has no control over the incidents of ownership in the policy. The trustee of the ILIT uses the amounts gifted to the trust to pay a portion of the premium equal to the economic benefit to the beneficiary (the value of the pure life insurance protection). The wealthier partner will pay the remainder of the premium directly. In exchange for the direct premium payments, the Trustee agrees to repay the premiums out of the policy proceeds or cash surrender value. Each year, the amount paid directly by the wealthier partner is treated as a loan to the trust. If interest is paid at or above the AFR, the imputed interest rules of I.R.C. §7872 would not apply. If the interest is at a below-market rate, the annual forgone interest will be treated as an additional gift to the trust. Alternatively, the arrangement could be treated as an economic benefit, in which case the economic buildup in the policy would be taxed annually.[183]

It is generally recommended that the arrangement be treated as a series of loans, where interest is paid or accrued at the applicable federal rate, and not as an economic benefit arrangement, to avoid taxation on the equity buildup in the policy.[184] When an ILIT is structured as a grantor trust and the payments are treated as a series of loans, the grantor would typically make a gift to the trust equal to the loan interest or, but the interest payments from the trust back to the grantor/insured would not be treated as income to the grantor.

Unlike in the employment situation, it has been suggested that the policy should not be assigned as collateral. This prevents the entire insurance proceeds from being included in the insured's estate under I.R.C. §2042(2), because of a retained incident of ownership in the policy. Instead, the trust would retain all rights and interests with respect to the term insurance component of the policy. But, there is a significant risk that without a collateral assignment, the plan might not qualify as a split-dollar arrangement. Treasury Regulation §1.61-22(b)(1) requires that the payor of the premiums must be able to recover those premiums from, or have them secured by, the proceeds of the life insurance policy.[185] Alternatively, it may be possible to provide a collateral assignment limited to the right of repayment to the insured in the event of surrender of the policy or death of the insured.[186]

Private split-dollar arrangements may prove useful where a wealthier partner would like to finance the purchase of a life insurance policy by the less wealthy partner, but retain a right to those premium payments. However, the best practices under the new regulations are yet to be determined.

6. Viatical Settlement.

---

[183] *See also* PLR 200747011 for a discussion of private split-dollar arrangements between individuals and a revocable trust.

[184] *See* Treas. Regs. §§1.61-22(j)(1)(ii), 1.83-6(a)(5)(ii)(A), 1.301-1(q)(4)(i) & 1.7872-15(n) and Ratner, *The Post-Split Dollar World supra* n.182, at 20.

[185] Donald O. Jansen, *Split Dollar Has Split – So How Do We Finance Premiums Now?*, 38 Inst. on Est. Plan ¶1300 (2004).

[186] *Id.*

A viatical settlement is the sale or assignment of a life insurance contract to a third party.[187] The third party then becomes the beneficiary under the policy and assumes the premium payments. Similarly, the receipt of accelerated death benefits has allowed terminally ill persons to receive a portion of their life insurance benefits prior to death. The Health Insurance Portability and Accountability Act of 1996 ("HIPAA")[188] addressed the income tax consequences of viatical settlements and accelerated death benefits.[189] Prior to the enactment of HIPAA, sale proceeds and accelerated death benefits generated taxable income to the insured. Furthermore, I.R.C. §2035 applied to such transfers, which provides that if a life insurance policy is transferred by gift by the insured within three years of death, the policy proceeds will be included in the transferor's gross estate.

HIPAA enacted I.R.C. §101(g), which excludes certain death benefits and payments from the insured's gross income. To qualify for this exclusion, the insured must be either "terminally ill"[190] or "chronically ill"[191] and the sale or assignment must be to a "qualified viatical settlement provider."[192]

Additional rules limit the amounts that may be received tax-free in any year under a viatical settlement arrangement. Amounts in excess of the prescribed limits are subject to capital gains treatment.

The purpose of the HIPAA legislation was to allow the proceeds of a viatical settlement or an accelerated death benefit to be spent on medical expenses or to maintain the insured's standard of living. However, viatical settlements can be used by healthy individuals as well to obtain cash, which can be gifted or spent. If the proceeds do not fall within the scope of I.R.C. §101(g)(2), amounts realized will be included in gross income to the extent of gain from the transaction, under I.R.C. §1001(a).[193] Not all states permit the sale of policies by individuals who are not terminally ill.

If a client anticipates taking advantage of viatical settlement or accelerated death benefits, it is important that he or she retain all of the incidents of ownership in the insurance policy to preserve these planning options.

---

[187] *See* Damien Ríos, *An Introduction to the Use of Viatical and Life Settlements*, 31 Estate Planning 533 (Nov. 2004) for a thorough examination of this topic.

[188] Pub.L. No. 104-191, 110 Stat. 1936, 2067.

[189] *See* Bernard Eizen & Victor S. Levy, *New and Expanded Uses of Viatical Settlements in Insurance Planning*, 26 Estate Planning 475 (Dec. 1999).

[190] An individual who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death within 24 months. I.R.C. §101(g)(4)(A).

[191] An individual who is determined by a licensed health practitioner as (i) being unable to perform, without substantial assistance, at least 2 activities of daily living for at least 90 days due to a loss of functional capacity; (ii) having a similar level of disability as defined in regulations; or (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. I.R.C. §101(g)(2)(B)(iii).

[192] A qualified viatical settlement provider is defined as a person, meeting certain licensing and disclosure requirements, regularly engaged in the business of purchasing or taking assignments of life insurance contracts on the lives on insured individuals who are terminally ill or chronically ill. I.R.C. §101(g)(2)(B).

[193] *See* Andrew H. Hook & Thomas D. Begley, Jr., *Lawyering for Older Clients: A New Paradigm – Part 1*, 32 Estate Planning 48, 54 (April 2005) for a discussion regarding calculation of gain in this context.

F. Estate Freezes and Planning Under Chapter 14.

Unmarried couples are able to take advantage of planning opportunities available under Chapter 14 of the Code that are unavailable to married couples.

1. Purpose of Chapter 14.

Chapter 14 deals with transfers among traditional family members, and addresses perceived abuses in certain transactions, known as "freeze" transactions, used to pass property from one generation to the next at a reduced transfer tax cost.[194] This type of transaction essentially involved a gift by a member of the older generation to members of the younger generation to "freeze" the gift at its gift tax value. Any post-gift appreciation was removed from the donor's gross estate and shifted to the donee. Techniques, such as retaining an interest in or imposing restrictions on the property, were used to maximize the value of the retained interest or restrictions and as a result, minimize the value of the gift. The purpose of Chapter 14 is to ensure that the value assigned to a retained interest or restriction for gift tax purposes comports with the economic reality of the transaction.[195]

Because unmarried partners are not considered family members within the definition of Chapter 14, certain techniques that are limited or no longer available to married partners under Chapter 14 remain available to unmarried couples, which are discussed below.

2. Section 2701 – Transfers of Interests in Corporations and Partnerships.

(a) Types of Transactions Affected by Section 2701.

Section 2701 of the Code imposes gift tax on certain transfers of an interest in a corporation or partnership.[196] Section 2701 is triggered when: (i) the transferor makes a transfer to, or for the benefit of, "a member of the transferor's family,"[197] and (ii) "an applicable family member"[198] retains an interest immediately after the transfer.

(b) Valuation of Interests Subject to Section 2701.

---

[194] Chapter 14 was added to the Code as part of the Omnibus Budget Reconciliation Act of 1990, Pub.L. No. 101-508, §11602, 104 Stat. 1388, §1388-491, as amended by the Small Business Job Protection Act of 1996, Pub.L. No. 104-188, §1702f, 110 Stat. 1755, §1870, generally effective for transactions after October 8, 1990.

[195] *See* Adena W. Testa, 835-2nd Tax Mgmt. (BNA) *Chapter 14* (1999) for a thorough discussion of Chapter 14.

[196] I.R.C. §2701(a)(1)(B).

[197] A member of the transferor's family is defined as the transferor's spouse, lineal descendants of the transferor or the transferor's spouse, and the spouse of any such lineal descendant. I.R.C. §2701(e)(1); Treas. Reg. §25.2701-1(d)(i). Stepchildren are included as members of the transferor's family because they are descendants of the transferor's spouse.

[198] An applicable family member includes the transferor's spouse, an ancestor of the transferor or the transferor's spouse, and the spouse of any such ancestor. I.R.C. §2701(e)(2); Treas. Reg. §25.2701-1(d)(ii). Thus, I.R.C. §2701 applies to a transfer when certain interests are retained by the transferor (or the transferor's spouse) or by persons who are senior to the transferor.

The value of the gift subject to I.R.C. §2701 is equal to the transferor's entire interest before the gift, less the value of the rights and interests retained by the transferor. Unless the retained rights meet certain requirements or are otherwise excluded from the statute, the value of the retained rights will be considered zero and the value of the gift will be equal to the value of the entire interest prior to the transfer.

(c) Transfers Outside of Section 2701.

Transfers between unmarried partners or transfers by one partner to the child of the other partner are not considered transfers between family members under I.R.C. §2701 and thus the special valuation rules should not apply with respect to valuing the interests retained by the donor and transferred to the donee. Instead, normal valuation techniques and rules are used, without taking into account the requirements of Chapter 14. Thus, the partner with greater wealth can transfer assets to a partnership, retain a noncumulative preferred return and a preference upon liquidation, and transfer to his partner, or partner's child, a junior equity interest that carries with it the right to all future appreciation.

Presumably, the gift of the junior equity interest will be small at first, and thus it will have little value for gift tax purposes. All appreciation will accrue to the junior equity interest as the value of the entity increases, and if the rights associated with the preferred interest are not exercised, the shift of wealth is magnified even more.

3. Section 2702 – Transfers in Trust.

(a) Types of Transactions Affected by Section 2702.

I.R.C. §2702 addresses the valuation of transfers in trust where the transferor (or an applicable family member)[199] retains an interest in the trust. Suppose an individual creates a trust for the benefit of his or her family member, with the remainder to his or her children. Unless the interest in trust is a qualified interest, it will be valued under I.R.C. §2702 at zero.[200] In most cases, this means that the entire value of property transferred to the trust would be treated as a taxable gift, even though the value of the gift to the remainder beneficiaries may actually be less (using traditional valuation rules applicable to arm's length transaction that would apply Treasury valuation tables).

If the gift in trust is instead a "qualified interest," it will be valued under I.R.C. §7520 and subtracted from the value of the entire property to determine the value of the property gifted.[201]

(b) Permissible Transfers Under Section 2702.

A qualified interest includes the right to receive an annuity payment from a grantor retained annuity trust (GRAT),[202] the right to receive a unitrust payment from a grantor retained unitrust

---

[199] An applicable family member is defined as: (i) an individual's spouse; (ii) any ancestor or lineal descendant of the individual or the individual's spouse; (iii) any sibling of the individual; or, (iv) any spouse of any individual described in the prior categories. I.R.C. §2702(e) (referencing I.R.C. §2704(c)(2)).

[200] I.R.C. §2702(a)(2).

[201] I.R.C. §2702(a)(2)(A).

(GRUT),[203] and the right to remain in a residence held in a qualified personal residence trust (QPRT).[204]

Unrelated parties are not subject to the valuation provisions of I.R.C. §2702. Thus, it is not necessary to use a GRAT, a GRUT, or a QPRT. Instead, unrelated parties are still able to use split-interest purchases, establish common law grantor retained interest trusts (GRITs), and some of the restrictions applicable to related parties with respect to QPRTs do not apply.

(1) Grantor Retained Interest Trusts.

A grantor retained interest trust ("GRIT") is an irrevocable trust, in which the grantor retains an income interest for a term of years, and at the end of the term, the trust estate is paid to a named individual or individuals, provided that the grantor is then living.[205]

GRITs were very popular prior to the enactment of Chapter 14. But Chapter 14 eliminated their use if the remainder beneficiary was a "family member." Because an unmarried partner does not fall within the definition of family member as defined in I.R.C. §2702(e), a GRIT can be an excellent way to allow a wealthier partner to provide an income stream during the retained trust term and allow the principal to pass at a reduced transfer tax value at the expiration of the term.

The grantor of a GRIT places property in an irrevocable trust and retains the right to income for a specified term. Ideally, highly appreciating property will be used to fund the trust and the growth

---

[202] A GRAT is typically created by transferring (ideally) high-yield assets into an irrevocable trust, while retaining the right to a qualified annuity interest for a specified term. At the termination of which the trust property passes to remainder beneficiaries. The amount of the taxable gift is reduced by the value of the grantor's annuity interest. The value of the retained interest is determined under IRS actuarial tables which value the interest based on the value of the property transferred, the term of the trust, the size of the annuity, and the I.R.C. §7520 rate in effect in the month of transfer. If the trust investments outperform the I.R.C. §7520 rate used to value the gift, the excess inures to the benefit of the remaindermen and will not be subject to transfer tax. If the grantor dies during the retained term, the trust property is included in the grantor's gross estate. If the grantor survives the retained term the trust property, along with any appreciation, passes without further estate or gift tax.

[203] With a GRUT the grantor transfers income-producing assets into an irrevocable trust. The grantor retains the right to receive payments equal to a percentage of the value of the assets, revalued annually. A GRUT is also a qualified interest under I.R.C. §2702(b), but has little estate planning utility.

[204] The QPRT is a type of irrevocable trust that is used to transfer an interest in a residence at a discounted value at the end of a defined term. Treas. Reg. §25.2702-5. The trust lasts for a term of years (no more than 20), during which time the grantor can retain ownership of the house. At the end of the term the house would pass to the remainderman (presumably, the grantor's partner), shifting any appreciation during the trust term to the remainderman. If properly structured, the value of the gift to the remainderman escapes the valuation provisions of I.R.C. §2702, and instead the gift is valued under valuation rules applicable to third-party transactions. The tax advantages of a QPRT depend on the grantor surviving the trust term. If the grantor does not survive the trust term, the entire value of the trust's interest in the residence at the grantor's death will be included in the grantor's estate for estate tax purposes. Therefore, the estate and gift tax advantages will be lost, but the effect will usually be the same as if the QPRT had not been established. When the grantor establishes the QPRT there is an immediate taxable gift of the remainder interest in the residence, the value of which is less than the value of the residence, because the value of the grantor's right to use the residence for the trust term is subtracted from the fair market value of the residence. The longer the trust term, the lower the value of the reportable gift to the remaindermen.

[205] *See* Mark W. Smith, *Reconsider the GRIT*, 144 Trusts & Estates 24 (Dec. 2005)

and therefore the amount passing to the remainder beneficiary or beneficiaries will exceed the projections for gift tax purposes.[206]At the end of the term, the property may remain in trust or be distributed outright for designated beneficiaries (typically the grantor's partner or the partner's children). If the grantor survives the term, then the property is excluded from the grantor's gross estate. If the grantor dies before the end of the term, the corpus would be includable in the grantor's estate.[207]

The benefit of the GRIT is that the fair market value of the property transferred is reduced by the value of the grantor's retained interest in determining the gift tax value of the transfer.[208] The value of the retained income interest, like the value of a GRAT's annuity interest, is based on the value of the property transferred, the length of the retained term, the grantor's age (if the grantor retains a contingent reversionary interest), and the I.R.C. §7520 rate in effect in the month of the transfer. Any appreciation in the trust property is transferred to the remainder beneficiaries, provided the grantor survives the trust term.

(2) Qualified Personal Residence Trusts.

If one partner establishes a qualified personal residence trust ("QPRT") for the benefit of an unrelated party, they are not subject to the sale prohibitions otherwise applicable to QPRTs.[209] Thus, the opportunity for a sale between a grantor and a trust holding the grantor's personal residence remains available. The grantor may purchase the residence from the trust just prior to the expiration of the grantor's retained term so that cash or other assets pass to the remaindermen in place of the residence. Because this is a transaction between a grantor and his or her wholly owned grantor trust, no gain or loss is recognized by the grantor.[210] Moreover, if the grantor owns the residence at death, the grantor's estate, and the ultimate beneficiary, will receive the benefit of a step-up in basis under I.R.C. §1041 to the date-of-death value of the residence.

It is also important to note that it is not entirely clear whether unrelated parties may establish QPRTs with cotenancy interests in a residence. The issue arises because: (i) the property must have its primary use as the grantor's residence, (ii) the grantor must have the exclusive right of occupancy, and (iii) the property may not be used other than as a residence when the grantor is not there.[211] Shared occupancy is permissible, so long as it is at the sufferance of the grantor. There are no rulings concerning QPRTs established by cotenants that are not also spouses.[212]

---

[206] Mark W. Smith, *supra* n.205, at 26.

[207] I.R.C. §2036(a).

[208] Treas. Reg. §25.2512-5(d)(2).

[209] *See* Jeremy T. Ware, *Using QPRTs to Maximum Advantage for Wealthy Clients*, 32 Estate Planning 34 (Nov. 2005) for a general discussion concerning QPRTs. For trusts created after May 16, 1996, Treas. Reg. §25.2702-5(c)(9) requires a QPRT's governing instrument to prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse, at any time during the original retained term and at any time after the original term interest during which the trust is a grantor trust.

[210] I.R.C. §671 and Treas. Reg. §1.671-2(b). *See also,* Rev. Rul. 85-13, 1985-1 C.B. 184.

[211] Treas. Reg. §25.2702-5(b)(2)(iii).

[212] Natalie B. Choate, *The QPRT Manual: The Estate Planner's Guide to Qualified Personal Residence Trusts* ¶2.3.02 (2004).

Therefore, the regulations suggest that the exclusive right of occupancy requirement precludes the establishment of QPRTs with cotenancy interests if the cotenants/donors are not also spouses.[213]

Where a cotenant with a non-spouse wishes to establish a QPRT, one approach to accomplish the exclusive occupancy requirement is to have that cotenant lease the property from the other co-tenants during the QPRT term.[214]

(3) Split-Interest Purchases.

Because of the disadvantages of a QPRT, clients may want to consider some of the alternatives. One is the split-interest purchase. A split-interest purchase involves the division of the total purchase price: One person contributes an amount equal to his or her life interest value or an interest for a term of years, while the other person contributes an amount equal to the value of the remainder interest following the termination of the term interest. If the joint purchasers are applicable family members for purposes of I.R.C. §2702, the person acquiring the term interest is treated as acquiring the entire property and then transferring the remainder interest to the other purchaser, and the retained interest (generally a life estate) is valued at zero unless the retained interest constitutes a qualified interest.[215]

If the joint purchasers are not applicable family members, the valuation rules of I.R.C. §2702 do not apply to the transaction. Again, all appreciation in the purchase is shifted to the survivor at the end of the term of years.[216]

(4) Sale of a remainder interest.

Another QPRT alternative is the sale of a remainder interest. The sale of a remainder interest may also be preferable to a QPRT because the seller may retain use of the residence for life, instead of a term of years, rent-free. It also avoids the concern that the grantor might not survive the QPRT term.

This technique is not without risk. Undervaluation of the remainder interest could cause the remainder interest to be brought back into a life tenant's estate under I.R.C. §2036. To withstand scrutiny, the purchasers of the remainder interest should use funds held for some time and not merely received as a gift just prior to the transaction. The sale of a remainder interest also needs to comply with the personal residence trust and qualified personal residence trust regulations set forth in Treas. Regs. §25.2702-5(a).[217]

If the residence is sold during the lifetime of the life tenant(s) and the proceeds are not reinvested in a replacement residence, or converted to a qualified annuity trust, the proceeds must be paid to the life tenant. One alternative would be to provide in the purchase and sale agreement of the

---

[213] John A. Hartog, *QPRTs for Co-Tenancy Interests – Do they Work?*, 6 California Trusts and Estates Quarterly 4 (Fall 2000).

[214] Natalie B. Choate, *The QPRT Manual, supra* n.212, at ¶2.3.02.

[215] I.R.C. §2702(c)(2).

[216] *See* Robert S. Schwartz, *IRS Approves Split-Purchase Qualified Personal Residence Trust*, 13 Probate & Property 54, 55 (March/April 1999) for an analysis of this topic.

[217] *See* PLR 200840038.

remainder interest that the sale of the residence during the lifetime of the life tenant(s) is prohibited.

Whereas with a QPRT or life estate, the life estate or primary beneficiary of the trust must pay for maintenance, utilities, insurance, taxes and repairs; where the remainder interest has been sold, the payment for improvements by the life tenant is treated as an additional gift.

Mortgage interest is the responsibility of the life tenant. But, principal payments are considered additional gifts unless the debt is secured by property other than the residence prior to the sale of the remainder or transfer to the QPRT. Or the grantor could retain the obligation and enter into an indemnification agreement with the trust or remainder beneficiary in the event the lender attempts to realize on the security interest.

4. Section 2703 – Valuation of Restrictive Agreements.

(a) Types of Transactions Affected by Section 2703.

Section 2703 of the Code applies to buy-sell agreements and other options and restrictions on the right to acquire or use property. IRC §2703 provides that certain restrictive agreements will not be considered in valuing corporate or partnership interests for estate and gift tax purposes.

Unlike the other sections of Chapter 14, I.R.C. §2703 applies to all restrictive arrangements, regardless of the identity of the parties. An arrangement covered by I.R.C. §2703 may be contained in a partnership agreement, articles of incorporation, bylaws, or a shareholder agreement.[218] A right or restriction "implicit in the capital structure of the entity" may also trigger the application of I.R.C. §2703.[219] Section 2703 treats the lapse of certain rights, such as voting and liquidation rights, as a gift by, or includible in the gross estate of, the owner of the lapsed right.

The definition of "family member" under I.R.C. §2703 is considerably broader than under the other Chapter 14 sections. A "family member" includes family members as defined in Treas. Reg. §25.2702-1(a)(1): The transferor's spouse; lineal descendants of the transferor or the transferor's spouse; and the spouse of any such lineal descendant. Thus, nieces, nephews, stepchildren, and siblings-in-law are included in this definition. A "family member" may also be "any other individual who is a natural object of the transferor's bounty."[220]

The regulations do not define "natural objects of the transferor's bounty."[221] Accordingly, it is not clear whether domestic partners may escape the application of I.R.C. §2703, or whether the Service will attempt to use this language to extend this section's coverage.

(b) Valuation Under Section 2703.

---

[218] Treas. Reg. §25.2703-1(a)(3). *See* Edward A. Renn & N. Todd Angkatavanich, *Sabotaged: Don't Let a Buy-Sell Agreement Blow Up an Estate Plan*, 145 Trusts & Estates 52 (April 2006) for an analysis of buy-sell agreements in the estate planning context.

[219] *Id.*

[220] Treas. Reg. §25.2703-1(b)(3).

[221] *See* Richard M. Horwood, *et al.*, 813-2nd Tax Mgmt. (BNA), *Estate Planning for the Unmarried Adult* at A-24 (2003) for a discussion of the meaning of this phrase.

Generally, a right, option or agreement which restricts the sale or use of property is disregarded for valuation purposes, unless: (i) it is a bona fide business arrangement; (ii) it is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (iii) its terms are comparable to similar arrangements entered into by persons in an arm's-length transaction.[222] If an agreement meets all three tests, then the IRS will consider the agreement in determining value. Furthermore, if unrelated individuals own more than 50% of the interests in the business, the tests are deemed to be satisfied.[223]

Failure to meet all three of the tests may subject the arrangement to I.R.C. §2703(a). Thus, even non-family members may need to show that a business arrangement was the result of an arm's-length negotiation for full and adequate consideration.[224] But, the IRS generally presumes that a person's own self-interest will prevent that person from entering into agreements to transfer property to non-family members for less than full and fair value.

A right or restriction is considered to meet each of the three tests if more than 50% by value of the property subject to the right or restriction is owned directly or indirectly by individuals who are not members of the transferor's family.[225] Thus, the issue as to whether the transferee is a family member will most likely be determinative of whether the restriction will be respected for valuation purposes.

An agreement meeting all three tests may be used to freeze the value of preferred interests, pay out income to the preferred partner/member and deflect future growth to the other class of interests, typically the poorer partner, and/or that partner's children, in this context.

5. Section 2704 – Lapsing Rights and Restrictions.

I.R.C. §2704 treats the lapse of certain rights as a taxable transfer. Between family members, if a lapse occurs at death, the value of the right -- in addition to the individual's interest in the corporation or partnership -- is included in the individual's estate. I.R.C. §2704 also disregards for gift tax purposes "applicable restrictions"[226] on the ability of an entity to liquidate if family members possess the power to remove the applicable restriction.[227]

In certain family-controlled LLCs and partnerships, valuation discounts obtained through restrictions on liquidation may be disregarded for purposes of valuing the transferred interest under I.R.C. §2704(b). Under that provision, if there is a transfer of an interest in a partnership/LLC among family members, and the transferor and members of the transferor's family control the partnership/LLC, then restrictions on the transferor's liquidation rights that are

---

[222] I.R.C. §2703(a) & (b).

[223] Treas. Reg. §25.2703-1(b)(3).

[224] Treas. Reg. §25.2703-1(b)(2).

[225] Treas. Reg. §25.2703-1(b)(3).

[226] An applicable restriction is one that limits the ability of an entity to liquidate if: (i) the restriction lapses, in whole or in part, after a transfer of an interest to or for the benefit of the transferor's family; or (ii) after the transfer, the transferor or any member of the transferor's family has the right to remove the restriction. I.R.C. §2704(b)(2); Treas. Reg. §25.2704-2(b).

[227] I.R.C. §2704(b)(1).

more restrictive than the state law default provision will be disregarded, resulting in a higher transfer tax value.

The restrictions under I.R.C. §2704 should not apply to lapsing rights and restrictions between non-family members.[228]

For example, a restriction on a member's ability to withdraw from an LLC, which lapses upon the death of a certain member, would be ignored for valuation purposes if the LLC were among family members. Similarly, a lapsing right to liquidate the entity, to receive a guaranteed liquidation value, and/or to receive a preferred return, would also be ignored if applied to family members. However, those restrictions will be recognized for purposes of applying discounts when valuing an unrelated partner's interest in the entity for estate tax purposes.

Unmarried partners should be able to take advantage of substantial discounting opportunities through the use of partnerships, LLCs, and other entities with restrictive provisions, allowing interests in these entities to be transferred between partners at death or during their lifetimes at a reduced transfer tax cost.

G. Miscellaneous Strategies To Transfer Wealth Between Partners

Many other transactions prohibited between family members are permitted between unmarried partners. Each of these strategies can be used to transfer wealth to the less wealthy partner.

1. Annual Exclusion and Similar Gifts.

In addition to annual exclusion gifts from the wealthier partner to the less wealthy one, unmarried couples can take advantage of the exclusion for the payment of educational, health and dental expenses (including health insurance premiums), so long as they are made directly to the provider.[229] Educational expenses may include tuition (but not books, supplies, room, board or other living expenses) and medical expenses may include doctor and hospital bills, medically necessary home improvements, costs of necessary home health care providers and anything else that an individual would be allowed to deduct on an income tax return as an unreimbursed medical expense under I.R.C. §213. One person can also pay another's long-term health care insurance provided that the "eligible long-term care premiums" limits of I.R.C. §213(d)(10)(B) are not exceeded.

2. Sale to Recognize Loss.

The disallowance of losses on sale or exchange of property to another family member under I.R.C. §267 does not apply. Thus partners may sell stock to each other to recognize losses so long as there is adequate consideration. As a result, the purchase price becomes the transferee's basis.

3. Hiring a Partner as an Employee.

---

[228] I.R.C. §2704(c)(2) defines the term "member of the family" with respect to any individual as: (i) the individual's spouse; (ii) any ancestor or lineal descendant of the individual or the individual's spouse; (iii) any sibling of the individual; and (iv) any spouse of any individual described in the prior categories.

[229] I.R.C. §2503(e).

One partner may own a professional services corporation that the other partner provides services for. This avoids the high tax rate professional service corporations are subject to when the services are provided by an owner. In many instances, one partner may be able to employ the other for services for which they would otherwise have to pay an outside party. Of course, the income received must be reported by the recipient partner.

Business owners who hire their partner can deduct a portion of the cost of health insurance and long-term care insurance as a fringe benefit.

4. Installment Sales.

To create a stream of income for the wealthier partner and transfer assets to the less wealthy partner, one partner may sell rental property to the other in return for a promissory note under I.R.C. §453. This has the effect of transferring income from one partner to the other, while preserving a stream of income to the former owner of the rental property in the form of interest income on a note, which may be recognized over time.

5. Private Annuities.

Another way to create a stream of income for the wealthier partner and transfer assets to the less wealthy one is to have one partner sell property to the other exchange for a private annuity. A private annuity is a contract that provides for specified payments to the named annuitant during the annuitant's lifetime.[230] This is similar to the installment note arrangement, but under a private annuity, the payments never cease so long as the annuitant is alive, even if the annuitant outlives his or her life expectancy. The disadvantage of the private annuity is that, unlike promissory notes used with installment sales, private annuities cannot be secured, putting the annuitant at risk that the buyer may default. Furthermore, under proposed regulations, gain or loss must be recognized at the time of the exchange rather than deferred. The regulations are intended to apply to any property exchanges entered into on or after October 18, 2006, with a delayed effective date of April 18, 2007, for transactions involving an unsecured sale to an individual of property not subsequently disposed of by the individual within two years.[231]

6. Stock Redemptions.

I.R.C. §302(a) provides that a redemption of stock "shall be treated as a distribution in part or full payment in exchange for the stock," if any of the exceptions set forth in I.R.C. §§302(b)(1)-(4) apply. The exceptions apply if the redemption is not essentially equivalent to a dividend (with no reduction for basis), and the redemption proceeds will therefore be taxed as ordinary income, rather than capital gain.[232]

Typically, a complete redemption of a shareholder's interest in a company will fall under the exception of I.R.C. §302(b)(3), and result in the proceeds of the redemption being subject to capital gain treatment. Where a member of a family group is redeemed, and other members of the group of related parties owns stock in the company, the attribution of stock ownership rules under I.R.C. §318 prevent the exiting shareholder from falling under the exception of

---

[230] *See* Edward P. Wojnaroski, 805-2nd Tax Mgmt. (BNA), *Private Annuities and Self-Canceling Installments Notes* (2002).

[231] Prop. Reg. §1.72-6 (Oct. 17, 2006).

[232] I.R.C. §302(b)(1).

I.R.C. §302(b)(1) (because the redeemed shareholder's stock will continue to be attributed back to the exiting shareholder).

But, where unrelated partners own a closely held business together, the attribution of stock ownership rules do not apply. Thus, the ability to accomplish a substantially disproportionate redemption of stock or a complete liquidation of a shareholder's interest under I.R.C. §302(b) may be available. As a result, the value of the stock redeemed may be treated as capital gain, rather than a dividend.

7. Retirement Benefits.

Most pension plans cease payments at the death of an unmarried employee. However, some plans may provide for a "term certain" form of benefit payout, which allows a set amount to be paid out to the employee, and if not then living, named beneficiaries, over a predetermined number of years. This election is typically less favorable as one for an employee and a surviving spouse. But, it can provide some benefit to an unmarried surviving partner where no other benefits would be available if the employee partner were to die earlier than expected.

8. Transfer on Death Deeds and Community Property Agreements.

In states where Transfer on Death deeds may be used or where couples may use a community property agreement effective at death to transfer property to the survivor, these should be considered. They avoid probate, do not require an immediate transfer, and one partner may continue to control his or her property during life.

It is also important to keep in mind that clients who move from a community property state to one that has adopted the Uniform Disposition of Community Property Rights a Death Act ("UDCPRDA")[233] could benefit by preserving the community property treatment of any property traceable to community property. To that end, property placed in a joint trust should apply the factors set forth in Rev. Rul. 66-283, describing a joint trust holding community property of a California husband and wife.

VII. CHARITABLE PLANNING

When unmarried partners share the same intent with respect to their charitable giving (although conceivably even when they do not), a number of planning opportunities exist. Because they are unable to take advantage of the marital deduction, unmarried couples often perceive that there is less available to give to charity. Some of the vehicles described below may actually allow one partner to transfer more wealth to a partner than he or she would be able to transfer otherwise. Most of the vehicles discussed below also have the benefit of avoiding probate, which often reduces the likelihood of challenges from family members or other individuals who may be hostile to the surviving partner.[234]

A. Charitable Remainder Trusts.

---

[233] States that have adopted the UDCPRDA are: Alaska, Arkansas, Colorado, Connecticut, Florida, Hawaii, Kentucky, Michigan, Montana, New York, North Carolina, Oregon, Virginia, and Wyoming. http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-udcprda.asp.

[234] Chris Yates, *The Unmarried Penalty: Gift, Estate Tax, and Other Considerations for Unmarrieds*, Gift Planner's Digest (Sept. 26, 2000).

In general, a charitable remainder trust ("CRT") is an irrevocable trust that makes payments – at least annually – to one or more beneficiaries, at least one of which is not a charitable entity, for a term of not more than 20 years, or for the life or lives of the individual beneficiaries.[235] It is also possible, to a certain extent, to define the trust term with respect to both a term of years and one or more lives.[236] When the non-charitable interest or interests terminate, the remainder interest passes to one or more qualified charitable organizations.[237]

A CRT may be structured as either a charitable remainder annuity trust ("CRAT") or a charitable remainder unitrust ("CRUT"). A CRAT pays the noncharitable beneficiary a fixed dollar amount that is specified in the trust agreement and that is neither less than 5% nor more than 50% of the initial value of the trust's assets. Thus, the payout from a CRAT does not vary from year to year. A CRUT pays a fixed percentage (no less than 5% and no more than 50%[238]) of the value of the trust property as valued annually, meaning distributions can fluctuate based on the increase or decrease in value of the trust. Because the distributions from a CRAT cannot increase over time, it is less frequently used than is a CRUT.

A CRT is exempt from income tax unless it has unrelated business taxable income, which is taxed at a rate of 100%.[239] Tax is paid by each annuity or unitrust beneficiary as distributions are received, according to the four-tier system set forth in I.R.C. §664(b). As a result, the trustee may receive appreciated assets and then liquidate them and reinvest the proceeds, without immediate capital gain tax consequences.

In the year of funding, the grantor of an *inter vivos* CRT may claim an income tax charitable deduction for the present value of the remainder interest that will pass to charity, subject to certain restrictions.[240] One of those restrictions is that, to qualify as a CRT, the actuarial value of the remainder eventually passing to charity must be at least 10% of the value of the trust estate at the date the trust is funded.[241] A CRT may have multiple beneficiaries, either concurrently or serially, although additional recipients reduce the likelihood that the trust will meet the 10% threshold. Similarly, a CRT is rarely available for use with very young beneficiaries (unless the trust term is limited to a period of years), because their longer life expectancies will also tend to cause the amount actuarially anticipated to pass to charity to fall below the 10% threshold.

A testamentary CRT can be a useful tool, especially in planning for large retirement accounts. Estate and income tax costs can be mitigated by leaving a retirement plan to a testamentary CRT rather than outright to a surviving partner. Using a CRT will allow the surviving partner to receive income from the retirement account, subject to income tax only upon receipt. The estate

---

[235] *See* Robert J. Rosepink, *Charitable Remainder Trusts and Pooled Income Funds*, 865 Tax Mgmt. Portfolio (2000) and Sanford J. Schlesinger & Martin R. Goodman, *Back to Basics: A Primer for Charitable Remainder Trusts*, 32 Estate Planning 9 (March 2005) for a thorough discussion of this topic. Another useful planning tool, but one beyond the scope of this article is the nonqualified CRT. *See* J. Michael Pusey, *What if the Estate Tax is Repealed? Part I*, http://www.pgdc.com/usa/item/?itemID=73249 (June 24, 2003) and the footnotes thereunder for a discussion of this technique.

[236] I.R.C. §664(d).

[237] I.R.C. §§664(d)(1) & (2).

[238] I.R.C. §664(d)(1)(A).

[239] I.R.C. §664(c).

[240] I.R.C. §170(f)(2) and I.R.C. §2522(c)(2).

[241] I.R.C. §664(d)(1)(D) & I.R.C. §664(d)(2)(D).

of the deceased partner will receive a charitable deduction for the present value of what will eventually pass to charity.

An *inter vivos* CRT created by one partner for the benefit of other partner may give rise to gift tax consequences upon formation. A gift on formation can be avoided by having the grantor create a CRT for the grantor's life, followed by the life of the partner, with a retained right to terminate the survivorship interest.[242] The resulting gift will be the same if the partner survives the grantor and if the grantor did not exercise the right, but the present value of the survivorship income interest will be included in the grantor's taxable estate.[243]

Some commentators have suggested that the retained right to terminate could be further limited to situations where the relationship has terminated.[244] Alternatively, instead of a reserved testamentary power to terminate the surviving partner's interests, for the security of the named surviving partner, the grantor partner may agree to make a completed gift but build into the trust a provision that if the relationship terminates, so does the surviving partner's interest. In any event, this kind of plan can lead to some insecurity on the part of the potential surviving beneficiary. On the other hand, it can create some security for the grantor, who may not necessarily feel comfortable with the otherwise irrevocable nature of the CRT.

Creation of a CRT may have gift or estate tax consequences because the marital deduction is not available.[245] However, the charitable deduction for the value of the remainder passing to charity will lessen the tax due as a result of conferring a benefit on the other partner.

CRTs with unrelated grantors should generally be avoided. The IRS determined, in PLR 9547004 (August 9, 1995) that a CRT established by a husband, wife and 6 grandchildren qualified as an association, rather than a trust, under Treas. Reg. §301.7701-2(a)(1), and thus could not qualify as a CRT. Whether the IRS would rule similarly if a CRT were formed solely by an unmarried couple using only jointly owned property has not been tested. Even though the cautious approach would be to form separate trusts, it could be that public policy considerations would cause the IRS to rule differently than in PLR 9547004.

B. Charitable Lead Trusts.

A charitable lead trust ("CLT") could be used to provide a stream of income to one or more charities for a term of years or for the life or lives of one or more individuals, and thereafter

---

[242] Treas. Reg. §1.664-2(a)(4) & Treas. Reg. §1.664-3(a)(4).

[243] Treas. Reg. §25.2511-2(c).

[244] Jerry Simon Chasen & Elizabeth F. Schwartz, *Estate and Gift Tax Planning for Nontraditional Families*, 15 Probate & Property 6, 10 (Jan./Feb. 2001). In a similar situation involving a heterosexual divorce, the IRS ruled that a CRT containing a termination provision if the parties divorced, as well as a provision that one spouse could terminate the interest of the survivor by will, was permissible. PLR 9511029 (March 17, 1995). *See also* PLR 200430012 (July 23, 2004) in which the I.R.S. ruled that a contingency to terminate a CRAT upon the earlier of the surviving spouse's death or remarriage was a qualified contingency.

[245] In addition, if an inter vivos CRT is established by a donor for the benefit of his or her partner, and if the donor dies before the partner and has retained the right to change charitable beneficiaries, one commentator has asserted that under certain circumstances, the overall transfer tax cost might be higher than if the right to change charitable beneficiaries had not been retained by the donor. Alan F. Rothschild, Jr., *Designing and Documenting Charitable Gifts*, posted on the Planned Giving Design Center web site, http://www.pgdc.com/tsf/item/?itemID=310036 (Nov. 9, 2005).

provide support for a partner. At the end of the charitable lead term, the trust terminates and the trust estate can be paid to the partner, as well as to children. Like a CRT, a CLT may be structured to pay a unitrust amount or an annuity, although the payment, as a percentage of the initial value of trust assets (annuity trust) or of the value of trust assets as it may change from year to year (unitrust) can be less than 5% or more than 50%. In addition, if the trust is to last for a term of years, the period may be longer than 20 years. Finally, whereas CRTs are tax-exempt entities when administered properly, CLTs are taxable trusts.

If structured as a grantor trust (usually as a result of the donor reserving a reversionary interest, in which case nothing is distributed to a partner or to children when the trust ends), the grantor would receive an income tax deduction in the year the trust is funded, for the present value of the payments made to charity. No gift tax is due because a gift tax charitable deduction applies to the present value of the payments to charity, with the balance reverting to the donor and therefore not being treated as a gift. During the term of the grantor CLT, the donor is taxed on the income but does not receive a further charitable contribution deduction for the payments to charity.

More typically, however, *inter vivos* CLTs are structured as non-grantor trusts, in which case the grantor receives at the time of transfer a gift tax charitable deduction for the present value of the payments to charity during the trust term. This means he or she is treated as having made a taxable gift equal to the present value of the noncharitable remainder interest. Nevertheless, the trust, not the grantor, will be taxed on the income passing to charity during the term of the trust. Interestingly, if the trust lasts long enough or has a high enough payout rate, the amount subject to gift tax can be reduced to zero.

Care should be devoted to determining which scenario makes sense for a particular client, based, in part, on whether he or she would benefit from the immediate income tax charitable deduction for the grantor CLT, or if the client would prefer a non-grantor CLT in order to pass wealth on to others and to avoid the annual income tax liability of the grantor CLT. Particularly if a non-grantor CLT is being contemplated, the client should give thought to funding it with assets that are likely to increase in value significantly, thereby leveraging the impact of the gift tax charitable deduction.[246]

It is important to take into consideration the rules regarding permissible measuring lives when a charitable lead trust is established for the life of one or more individuals.[247] Each remainder beneficiary must be a lineal descendant or spouse of a descendant of the individual lives used as measuring lives, which would include stepchildren and step-grandchildren. Thus, the measuring lives must be chosen carefully.

The testamentary CLT may be used as a substitute for a marital deduction type trust. In this situation, the gift to the remaindermen would be included in the donor's estate, but the gift to charity would qualify for the estate tax charitable deduction. A testamentary CLT is generally used when children and/or the surviving partner do not need immediate access to the funds (perhaps because a CRT has been established concurrently to provide a stream of income during

---

[246] Of course, when assets are distributed to the remainder beneficiaries, those assets retain the donor's cost basis, even if the donor has since died. In other words, there is no step-up in basis in connection with the donor's death, and a beneficiary could recognize substantial gain upon sale of an asset that had been in the trust.

[247] Treas. Reg. §1.170A-6(c)(2)(i) & (ii). There must be less than a 15% probability that persons who are not lineal descendants of the measuring individuals will receive any portion of the trust corpus.

the term of the CLT), as the non-charitable beneficiaries will not receive their interest until the CLT terminates.

Because the individual beneficiary of a CLT does not receive distributions until the term of the trust has expired, and then only if he or she survives the charitable term, this vehicle works best for younger individual beneficiaries, particularly children and grandchildren.

CLTs are far less common than CRTs, likely due to the relatively larger value of assets needed for a CLT to be applicable. Still, in the proper circumstances, a CLT can be useful, often in combination with a CRT.

C. Charitable Gift Annuities.

Couples may also consider using a charitable gift annuity ("CGA") to satisfy their charitable intentions while securing a stream of payments that benefit one or both members of the couple for life. A CGA is like a CRT in that the donor receives in the year the payments are arranged an income tax charitable deduction for part of the value of the assets contributed. Unlike a CRT, however, payments may be made to no more than two persons (whether consecutively or on a joint-and-survivor basis), and they may not be made for a term of years.

Thus, a CGA involves a gift to a specific charity, in exchange for the charity's promise to pay an annuity. By contrast, a CRT is indeed a trust arrangement and can potentially benefit many charities. A CGA could be for the life or lives of *any* two persons, although typically it would be for the life of the donor, the life of the partner, or both lives.

An unmarried couple's use of a CGA presents potential disadvantages. For example, if appreciated property is used to fund the annuity, the taxable gain, calculated under the bargain sale rules, must be fully recognized by the donor in the year the annuity is created (unless the donor is the sole or initial annuitant, in which case the gain may be prorated over the donor's life expectancy calculated as of the time payments begin).[248]

In addition, if the annuity is created by one member of the couple and payable to the other, there are very likely to be gift tax consequences upon formation. If the annuity is paid first to the donor and then to the partner, or if the partner is an annuitant of a deferred payment gift annuity, then the gift tax annual exclusion – which applies only to gifts of present interests – will not be available to offset any portion of the present value of the payments. Therefore, in certain cases, the donor might consider retaining in the gift annuity contract a right to revoke the partner's annuity interest, either on a testamentary basis or during the lifetime of the donor.[249]

In lieu of establishing a CGA during life to benefit a partner, a donor could do so through his or her will.[250] Alternatively, the donor could arrange now for a CGA to be funded upon death with a distribution from his or her IRA.[251] Finally, even though technically a CGA could be funded with

---

[248] Treas. Reg. §1.1011-2(a)(4).

[249] Frank Minton, Edith Matulka and J. William Zook, Jr. *Charitable Gift Annuities: The Complete Resource Manual* 2:11-22 (2003).

[250] *Id*. at 20:17-19 (April 22, 2002).

[251] *Id* at 16:17-20 and PLR 200230018 (.

assets owned jointly by both members of a couple,[252] the simpler and preferable approach would separate CGAs established by each of the partners with his or her own assets.

D. Pooled Income Funds.

A pooled income fund ("PIF") is a taxable trust established and administered by a public charity.[253] A donor to a PIF irrevocably transfers assets (usually cash or publicly-traded securities other than municipal bonds) to a trustee. The assets of all donors who have contributed to the PIF are commingled and invested like a mutual fund. Donors to the fund receive units of participation in the fund based on the pro rata value of their contributions relative to the total value of the fund. Each year for life, a variable share of the total income from the fund is paid to the donor and/or other beneficiaries designated by the donor. The term of the non-charitable interest may not be for a period of years. It must be for the life of the beneficiary or beneficiaries.[254] Qualified contingencies are not specifically authorized to be used to terminate a beneficiary's interest, nor are they prohibited.[255] At the death of the beneficiary or beneficiaries of the units associated with the donor's contribution, a proportionate share of the assets of the PIF is conveyed to the charity.

For an *inter vivos* transfer of assets to a PIF, a donor is entitled to both income and gift tax charitable deductions in the year of the gift, based on the present value of the remainder interest passing to charity.[256] Likewise, a testamentary contribution to a PIF results in an estate tax charitable deduction for the present value of the remainder interest. A donor does not generally recognize gain or loss on the transfer of property to a pooled income fund.[257] Instead, the fund takes on the basis and holding period of the assets transferred. However, where the gift is to someone other than the charity and the donor, he or she makes a taxable gift of the income interest (or the applicable portion thereof) that benefits the other person or persons.

A donor can postpone a taxable transfer to another individual recipient by retaining a testamentary right to revoke that interest, causing the gift to be incomplete.[258] However, the donor should not retain a lifetime right to revoke.[259] If a power to revoke has not been retained,

---

[252] *Charitable Gift Annuities: The Complete Resource Manual*, *supra* n.249, at 2:14.

[253] The technical requirements for a pooled income fund are set forth at I.R.C. §642(c)(5). *See* John H. Clymer, *Pooled Income Funds: A Good Vehicle for Smaller Charitable Gifts*, 24 Estate Planning 310 (Aug./Sept. 1997) and *Pooled Income Fund,* posted on the Planned Giving Design Center web site, http://www.pgdc.com/usa/item/?itemID=60848 (last viewed Jan. 15, 2008) for a comprehensive analysis of pooled income funds.

[254] Treas. Reg. §1.642(c)-5(b).

[255] There is no equivalent to the qualified contingency provision under I.R.C. §664(f) for charitable remainder trusts, applicable to pooled income funds.

[256] Inter vivos gifts are covered by I.R.C. §170(f)(2)(A) & I.R.C. §2522(c)(2), and testamentary gifts by I.R.C. §2055(e)(2).

[257] Treas. Reg. §1.642(c)-5(a)(3). There is an exception, however, for debt-encumbered property, the transfer of which is treated as a bargain sale. I.R.C. §1011(b).

[258] Treas. Reg. §1.642(c)-5(b)(2).

[259] *See* Mary C. Hester & Lizbeth A. Turner, *Retaining a Right to Revoke an Interest in a Charitable Plan*, 32 Estate Planning 26, 27 (June 2005) for a complete discussion of the tax consequences of a retained right to revoke.

then the present value of the future income payments to be received by the non-spouse/non-donor recipient is considered a present interest gift.

A PIF can be an attractive charitable giving vehicle for a donor with certain highly appreciated assets because neither the donor nor the PIF is taxed on any of the gain, so long as the PIF always pays out all of its income. Nevertheless, the payments made by a PIF are fully taxable as ordinary income to the recipient, whereas the payments made by a CRT or a CGA are often taxed more favorably. Finally, relatively few charities maintain PIFs, and those PIFs that do exist often make payments at relatively modest rates (i.e., below 5%), so this technique will be an option only in a limited number of cases.

E. Gifts of Remainders Interests in Personal Residences.

A couple may benefit from giving a personal residence to a charity, subject to the reservation of a life estate. The home involved must be a personal residence, but need not be the primary residence.[260] Reasonable surrounding grounds, determined by the customary lot size in the area, may also be included in the charitable gift. The gift of the remainder interest could take effect at the end of one or two lives, or a term of years.[261]

While the gift itself is made by means of a simple deed, there should also be separate documentation regarding the rights and responsibilities of the charity and of the life tenant or tenants. Customarily, life tenants will be required to pay property taxes, utilities, liability and casualty insurance, maintenance expenses, and similar costs.

If the donor makes the gift during life, he or she receives income and gift tax charitable deductions for the present value of the charity's remainder interest. In addition, if the property is appreciated the donor does not recognize any capital gain. If the gift is made on a testamentary basis, the donor's estate is entitled to an estate tax charitable deduction for the present value of the charity's remainder interest.

This arrangement is most useful with a residence that is not subject to a mortgage and for couples that do not intend to pass the property on to further generations or heirs. If one partner makes the gift, it might be possible for the other partner to re-acquire the gifted property from the charity at a later date, as only the remainder interest will need to be purchased. Additional options exist if the life tenant –whether the donor or the partner – wants or needs to move out of the residence. He or she can rent the property to another tenant; contribute the remaining life interest to the charity (perhaps for a CGA) and receive a deduction for the present value of the remaining life interest; or agree with the charity to sell the property and divide the proceeds according to the respective interests of the parties.

F. Simple Wills.

Even though subject to probate, and therefore to challenge by disapproving family members, basic charitable bequests can make sense for unmarried couples with estates modest enough in size that they likely will not be subject to transfer taxes. Indeed, the so-called "I love you" will that is suitable for many married couples can also work well for people who are not married,

---

[260] A farm is defined as land that is used for the production of agricultural products, including crops or timber. Treas. Reg. §1.170A-7(b)(4).

[261] Treas. Reg. §1.170A-7(b).

provided they agree on the ultimate beneficiaries of their estates. Naturally, if there are children or other descendants to be considered, one partner's will may need to differ from the other's. Yet in many cases, an "all to my partner if she survives me but otherwise all to charity" disposition will be practical.

G. Disclaimer Planning.

For a couple with excess assets and charitable intent, qualified disclaimers can be used to further that intent. A qualified disclaimer allows the disclaimed interest to be treated for federal tax purposes as if it had never been transferred to the individual disclaiming, thus avoiding gift or estate tax.[262] A disclaimer must be completed within nine months of the interest being created and it must be in writing. As a result of the disclaimer, the property must pass to an individual or organization other than the disclaimant without any direction by the disclaimant (exceptions apply with respect to disclaimers resulting in property passing to a spouse).[263]

In the unmarried couple context a will may provide that any assets disclaimed by a surviving partner are to pass to a particular charity. As a result, the asset will be treated as if it passed directly from the decedent to charity, and be eligible for an estate tax charitable deduction equal to the value of the property disclaimed. Nevertheless, because a disclaimed interest may not result in the disclaimed property passing to or for the benefit of the disclaimant, a disclaimer to a charitable vehicle where the disclaimant will have a life income interest, such as a CRT or CGA, will not be qualified, and therefore ineligible for an estate tax deduction.

VIII. PLANNING FOR PERSONAL NEEDS

Because unmarried partners do not have the benefit of a family relationship, it is important that they name agents to make financial and health care decisions while they are alive, and for burial decisions at death.[264]

A. Durable Powers of Attorney and Guardianship.

The durable power of attorney grants another person (the "attorney-in-fact" or "agent") the authority to act on the principal's behalf during the principal's life, including any periods of incapacity. Generally, the principal executing the durable power of attorney would designate his partner as primary attorney-in-fact and one or more alternate attorneys-in-fact if the partner is unable or unwilling to serve. The primary advantage of this document is that it avoids the need for expensive, cumbersome guardianship proceedings in the event of disability. As with testamentary documents, clients should be aware that a durable power of attorney designation is not revoked by the termination of a relationship.

---

[262] I.R.C. §2046 & §2518.

[263] Treas. Reg. §25.2518-2(e)(1)(ii).

[264] For a thorough discussion of this topic, s*ee* Horwood, *supra* n.221, at A-43. *See also* Matthew R. Dubois, *Legal Planning for Gay, Lesbian and Non-Traditional Elders*, 63 Alb. L.Rev. 263 (1999) for a discussion of the unique issues faced by the elderly in non-traditional relationships, as well as an analysis of estate planning issues for the indigent client in a non-traditional relationship, including Medicaid and other entitlement programs. *See* Diane Lourdes Dick, *The Impact of Medicaid Estate Recovery on Nontraditional Families*, 15 U.Fla. J.L. & Pub. Pol'y 525 (Summer 2004) for an analysis of the effect of Medicaid estate recovery (the federally mandated recovery of assets from estates of individuals who received Medicaid long-terms care assistance) on unmarried couples.

In Washington, certain powers must be specifically stated in the power of attorney in order for the attorney-in-fact to be authorized to perform such acts.[265] The powers that may be especially important for the unmarried couple, include the power:

1. To execute, amend or revoke any trust agreement;

2. To fund, with the principal's assets, any trust not created by the principal;

3. To make a gift from the principal;

4. To create or change survivorship interests in the principal's property or in property in which the principal may have interest;

5. To designate or change the designation of beneficiaries to receive any property, benefit or contract right on the principal's death;

6. To give consent to an autopsy or postmortem examination;

7. To make a gift of the principal's body parts under the Uniform Anatomical Gift Act;

8. To give consent to, or prohibit, any type of health care, medical care, treatment or procedure; or

9. To direct the withholding or withdrawal of artificially supplied nutrition or hydration.

A durable power of attorney may be used to nominate a guardian and alternates, in the event the appointment of one is necessary.[266] In the absence of a power of attorney (or in the absence of a durable power of attorney nominating a guardian, if one is necessary), the court may appoint any person it finds suitable as guardian, which may not be the person the principal may have considered most suitable while still competent.[267]

A "springing" durable power of attorney (one that takes effect upon the disability or incompetence of the principal) may be problematic as a result of the HIPAA regulations concerning the confidentiality and disclosure of health care information.[268] A typical springing durable power of attorney requires an opinion of a health care professional as to disability or incompetence to be effective. However, HIPAA may prevent a physician from disclosing medical information without the authorization of the patient, who would not be able to give a valid authorization if already incompetent. To avoid this Catch-22, a durable power of attorney could be effective immediately, or the principal could either execute a separate HIPAA authorization or the durable power of attorney should contain a HIPAA authorization to allow a

---

[265] *See* RCW ch. 11.94 (Washington's power of attorney statute).

[266] RCW 11.88.010(4).

[267] RCW 11.88.020.

[268] 45 C.F.R. §§164.500-.534.

physician to disclose protected health information for purposes of the springing power to be effective.[269]

B. Medical Powers of Attorney.

The medical power of attorney may be a separate document. It appoints an agent to make decisions regarding medical care and treatment on behalf of the principal (or these powers may be included in the durable power of attorney). The same agent may be named in both documents; however, it is not necessary to do so. A medical power of attorney should specifically grant a partner visitation rights and the power to control other visitors, in order to eliminate visitation by hostile family members. In Washington, a medical power of attorney may also be used to allow a mentally ill person to express his or her wishes with respect to mental health treatment.[270]

In Washington, in the absence of a medical power of attorney, RCW 7.70.065 provides that the following individuals may give informed consent on behalf of an individual unable to consent, which includes (i) the patient's spouse or registered domestic partner; (ii) children of the patient who are at least eighteen years of age; (iii) parents of the patient; and (iv) adult brothers and sisters of the patient. It provides no authority to the unmarried partner.[271]

C. Health Care Directives.

The health care directive, also known as a “living will,” is a statutory document authorizing the withdrawal or withholding of life-sustaining procedures for a terminal condition if death is imminent.[272] It may include provisions regarding the withdrawal or withholding of hydration and intravenous nutrition.[273] In the absence of a directive, the wishes of the principal may not be able to be carried out.[274]

D. Burial, Cremation and Funeral Instructions, and Organ Donation.

Making arrangements for funerals, disposition of remains, and burial or cremation is critical for unmarried couples. Washington law provides that “[a] valid written document expressing the decedent’s wishes regarding the place or method of disposition of his or her remains, signed by

---

[269] *Id.* RCW 70.02.030 sets forth the requirements for a valid authorization to disclose the health care information of the principal.

[270] RCW 71.32.010.

[271] *See* Rebecca K. Glatzer, *Equality at the End: Amending State Surrogacy Statutes to Honor Same-Sex Couples, End-of-Life Decisions*, 13 Elder L.J. 255 (2005) for an examination of the many statutory approaches to surrogate decision making for same-sex and unmarried couples.

[272] RCW ch. 70.122.

[273] RCW 70.122.030(1).

[274] Washington also has the Physician Orders for Life-Sustaining Treatment (“POLST”) form, a document developed by Washington health care professionals as a standardized method to summarize a patient’s wishes regarding life-sustaining treatment. The form is intended to be portable and must be on file with a particular physician in order for it to be followed. The form allows an individual to express his or her wishes with respect to resuscitation, various types of medical interventions, antibiotics and artificial nutrition. This form must be completed with the assistance of an attending physician and both the patient and the preparer must sign it. It is printed on a bright green card stock to make it visible in a patient’s file.

the decedent in the presence of a witness, is sufficient legal authorization for the procedures to be accomplished."[275] In the absence of enforceable, written instructions, state law creates a hierarchy of persons who have the authority to make these decisions, and the unmarried partner of a decedent is not found in that hierarchy. In the absence of instructions, the following individuals are authorized to make arrangements: (i) the surviving spouse; (ii) the surviving adult children of the decedent; (iii) the surviving parents of the decedent; (iv) the surviving siblings of the decedent; (v) a person acting as a representative of the decedent under the signed authorization of the decedent.[276] However, the statute does provide that prepaid arrangements are not subject to cancellation or substantial revision by survivors.

Instructions regarding disposition of remains may be in a will or in a separate document. If the instructions in a will comply with the requirements for instructions regarding the disposition of remains, they are considered valid, regardless of the will's validity. Nevertheless**,** instructions separate from a will are usually preferable, because of the increased likelihood that the instructions will be found prior to any alternate arrangements being made. Clients should also tell their partner or other trusted friend where to find the instructions.

The instructions should set forth the client's intentions with respect to funeral and burial arrangements, disposition of remains including disposition of anatomical parts, and any arrangements already made and paid for.

If an individual wishes to donate organs upon death, the best way to evidence that wish is through a Uniform Donor wallet card. The Washington Department of Licensing provides the opportunity for residents to register their intent to donate organs on the back of the their driver's license.

E. Estate Planning for the Transgender Client.

While planning for the transgender client is beyond the scope of this paper, there are a few issues that are discussed below.[277]

Legal name change is an important step for a transgender adult. Each state has a different procedure by which this may be accomplished.[278] In Washington this is done in district court and may be completed in one day.[279] Illinois law allows an Illinois resident to change his or her name by filing a petition in the circuit court of the county in which he or she resides.[280]

Next a client is likely to change the gender on government issued documentation such as a driver's license, birth certificate, green card, military identification, professional licenses, pilot

---

[275] RCW 68.50.160(1).

[276] RCW 68.50.160(3).

[277] For a thorough and thoughtful analysis of this topic, *see* A. Spencer Bergstedt, *Symposium: Issues in Estate Planning for Same-Sex and Transgender Couples and the Transgender Client*, 30 W. New Eng. L.Rev. 675 (2008). This section is based, in part, on his materials.

[278] *See* www.drbecky.com/birthcert.html for a summary of name change rules and procedures in the U.S. and Canada.

[279] RCW 4.24.130.

[280] 735 Ill. Comp. Stat. 5/21-101. *See* the Illinois State web site for the procedure and contact information: http://www.idph.state.il.us/vitalrecords/gender.htm.

license and other state issued identification. In our mobile economy, legal photo identification is crucial. It is important that photo identification match the current identification of a client. Without this identification, an individual's ability to travel, drive, have access to financial institutions and credit, obtain employment and security clearances, make certain purchases, obtain medical treatment, enter government buildings and a whole host of other activities will be severely limited.

Each state sets its own procedure for name and gender changes on a driver's license, but usually some type of evidence of adoption of a different gender is required. Birth certificates are harder to change. Some states provide by statute how they may be changed and some states do not allow changes. Those that allow amendment may issue new birth certificates or simply strike out the old information and write in the new.

The Department of Homeland Security (for U.S. Passports) and the Social Security Administration require proof of sexual reassignment before allowing a change of gender identification, which limits the ability of most transgender individuals to change these documents (since reassignment surgery is not necessarily opted for by all transgender adults). While not as important as a driver's license, on a daily basis, it may lead to a gender mismatch, which could be brought to the attention of an employer and other agencies requesting various legal documents. The Social Security Administration may notify an employer if the information they have on file associated with an employee does not match the information provided by the employer. This is known as a "No-Match" letter.[281]

When drafting powers of attorney and Wills, in addition to the other provisions that might be included, it is important to make statements about the principal's identity, using names and pronouns consistent with the principal's identity that he or she is to be identified by. It is also advisable to give the fiduciary the right and the directive to preserve that identity postmortem.

IX. <u>STRATEGIES TO MINIMIZE CONFLICT</u>

The practitioner and the testator should understand the grounds for contesting a will, such as improper execution, incompetence of the testator, duress, undue influence, and fraud. Family members, especially those unhappy or surprised about learning that a loved one was gay or lesbian, or unwilling to accept that a relationship existed between partners who never married, may challenge a will, alleging fraud, duress, undue influence, or mental incapacity of the decedent. The possibility of disgruntled family members disputing an estate plan is far greater with unmarried couples.[282]

To deter will contests, practitioners use a number of strategies discussed below:[283]

---

[281] *See I-9 No Match Letters: Frequently Asked Questions* at the website for the National Center For Transgender Equality, http://www.nctequality.org/Resources/NoMatch_employees.pdf and *Transgender People and Passports,* http://www.nctequality.org/Resources/NCTE_passports.pdf for information on changing one's passport.

[282] Kathleen Ford Bay, *Estate Planning for Unmarried Couples: What's Different and What's the Same?*, 2004 American College of Trust and Estate Counsel Annual Meeting at 3.

[283] For additional drafting recommendations to avoid conflict over an estate plan, *see* Bruce Stone and Bruce S. Ross, *Bombproofing the Estate Plan to Anticipate and Avoid Litigation*, 2001 American College of Trust and Estate Counsel Annual Meeting at 4.

A. *In Terrorem* Clauses.

In terrorem clauses are only useful if a potential contestant is actually in danger of losing something.[284] Unless a client is willing to give a potential contestant a gift, such a clause may only create a false sense of security.[285] If a client insists on including an *in terrorem* clause, and they are willing to make a gift to the person or persons they are concerned about, below is a sample clause to consider:

> If any beneficiary hereunder shall in any way, directly or indirectly, contest or object to the probate of this Will, or dispute any provision hereof, or exercise or attempt to exercise any right to take a share of my estate against the provisions of this Will, or institute or prosecute, or be in any way, directly or indirectly, interested or instrumental in the institution, or prosecution, of any action, proceeding, contest or objection, or give any notice for the purpose of setting aside or invalidating this Will, or any provision hereof, then all provisions for such beneficiary or for his or her descendants contained herein shall be void, and I give the property or share of my estate to which such beneficiary or his or her descendants would have been entitled hereunder in like manner as if such beneficiary and all his or her descendants were then deceased, or if such beneficiary is a corporation or other entity, that it had ceased to exist prior to my death. No provision of this article shall apply to Article ___ or to any religious, charitable, scientific, literary or educational organization, a bequest to which is deductible for federal estate tax purposes.

B. Include a Statement That the Omission of a Family Member Is Intentional.

It is generally not recommended to make statements in a will as to why certain individuals have not been provided for. Such statements may incite an individual to contest a plan where, in the absence of such a statement, that person might not have.[286] Worse, it might be grounds for a testamentary libel claim.[287] Alternatively, a client might consider making positive statements about why the client has chosen to benefit his or her partner over others.[288]

C. Videotaping of Document Execution

Videotaping should only be used with extreme caution. "Many people do not come across well on videotape and if you rehearse the ceremony on film, the other side will undoubtedly want to see the entire video, not just the polished product."[289] Similarly, tape recording should be avoided. In *Discipline of Miller*,[290] the drafting attorney recorded the signing ceremony in a failed attempt to demonstrate his client's testamentary intent. At the drafting attorney's

---

[284] Bay*, supra* n.282, at 7.

[285] *Id.*

[286] *Id.* at 8.

[287] *Id. See also* Paul T. Whitcombe, *Defamation by Will: Theories and Liabilities*, 27 J. Marshall L. Rev. 749 (1994).

[288] *Id.*

[289] *Id.* at 9, *citing* Gerry W. Beyer, *Videotaping the Will Execution Ceremony – Preventing Frustration of the Testator's Final Wishes*, 15 St. Mary's L.J. 1 (1983).

[290] 149 Wn. 2d 262, 269, 66 P.3d 1069 (2003).

malpractice trial, the Court relied on the tape recording as evidence that the testator did not understand the scope of the gift that she made (to the drafting attorney in violation of Washington's RPC 1.8(c)).

D. Obtain Evidence of the Client's Capacity at the Time of Execution.

It is also strongly recommended that the attorney extensively interview the client, in the presence of the witnesses, regarding his or her intent, his or her assets, and the objects of his or her bounty.[291] The attorney should keep detailed notes of this meeting, signed and dated by the witnesses.[292] Witnesses should be articulate, and likely to make a good impression if asked to testify.[293] The attorney may also obtain a statement from the client's physician as to the client's capacity. Some attorneys videotape the execution. However, as discussed above, this might well be used as evidence supporting a lack of competency.

E. Periodic Re-Execution of Estate Planning Documents.

When competency is likely to be an issue, and even when it is not, it is recommended that the client re-sign the same estate planning documents periodically, without destroying prior versions, even if the content changes little from one version to the next, so that a contestant would need to set aside a series of documents rather than just one to bring a successful contest.[294] Repetition also provides evidence of a client's intent.

F. Maintain Standardized Procedures.

It is important to have standardized procedures for execution of any documents. If irregularities in the execution of a particular document are later alleged, the fact that all documents are executed according to the same procedure may be sufficient to overcome the allegation, even if the witnesses are unable to recall the details of the event. Execution of documents outside of the presence of the drafting attorney should be strongly discouraged. But when this is not possible, a standardized memorandum of instructions should be delivered to the client along with the documents to be signed. If possible, it is recommended that the attorney request that after the execution, the client sign and return the instructions to indicate that they were complied with. The signed instructions should be retained in the client file.

G. Confirm Intent With Respect to Nonprobate Transfers.

Unhappy family members may also challenge nonprobate transfers. Accordingly, attorneys may want to consider placing a statement in a will that any nonprobate transfers were intended by the decedent, and were not for mere convenience while the decedent was living.

X. CONCLUSION

---

[291] Elaine DuCharme, *Estate Planning for Non-Traditional Families*, 28 Real Property Probate and Trust Newsletter (Wash. St. Bar Assoc.) Summer 2000, at 1, 5.

[292] *Id.*

[293] Bay, *supra* n.282, at 6.

[294] *Id.*

Even in states where same-gender marriage and civil quasi-marital relationships are permitted, the DOMA makes it unclear how federal law will apply. As states are persuaded to adopt same-gender marriage or some form of quasi-marital relationship, it will be necessary to develop a new body of law to define the rights and responsibilities that come with it. Until parity is brought to the laws applicable to unmarried couples, the bias in favor of married couples that is inherent in the transfer tax laws means that unmarried couples will often bear a heavier estate and gift tax burden.

The estate plans of unmarried partners, and partners in marriages not legally recognized, needs special attention to insure that their objectives are met with a minimum of income, gift, and estate tax, as well as a minimum of conflict. Unmarried partners need to understand that no default legal structure exists in the absence of an estate plan, as there is for married couples. Their advisors need to understand the disparities in the law relative to unmarried couples, and need to be able to recommend steps, if any, to mitigate the lack of parity with married couples. Furthermore, family dynamics and hostile family members often play a large role in shaping the plan of an unmarried couple. It is critical to consider this when recommending a plan, and to take steps to reduce the risks.

EXHIBIT A

Drafting for Assisted and Collaborative Conception and Posthumously Conceived Children.[295]

1. A child born as a result of assisted conception shall be considered a child of the individual whose status as such child's parent determines whether such child becomes a beneficiary under this instrument. An individual shall be considered the natural parent of a child:

   i. If such child was conceived using (a) such individual's ovum or sperm and the ovum or sperm of such individual's spouse, (b) such individual's ovum or sperm and the ovum or sperm of a donor other than such individual's spouse, or (c) the ovum or sperm of a donor and the ovum or sperm of such individual's spouse;

   ii. Regardless of whether such ovum was fertilized *in utero;*

   iii. Regardless of whether the fetus was carried to term by such individual or such individual's spouse; and

   iv. Regardless of whether such child has been legally adopted by such individual if such adoption is required under applicable law at the time of such child's birth to establish that such individual is such child's parent.

2. Any individual who may be considered a natural parent of a child solely because of having donated ovum or sperm or having acted as a surrogate mother and who would not otherwise be a beneficiary under this instrument, and any other individual who is related to such individual by consanguinity or affinity, shall not be a beneficiary under this instrument.

3. A genetic child of a parent who was deceased at the time of such individual's conception shall be deemed to be a descendant of such parent only if:

   i. such individual was born within the Three Hundred (300) day[296] period after such parent's death;

   ii. such parent gave permission for the use of his or her genetic material to the surviving parent in connection with the conception of such individual by such parents in an instrument that was signed by the deceased parent; and

   iii. such deceased parent would have had legal rights and obligations as a parent of such child upon his or her birth under local law.

---

[295] This has been adapted, in part, based on provisions provided by Carlyn McCaffrey, Weil, Gotshal & Manges LLP.

[296] Pursuant to RCW 26.26.116, Washington's statute regarding the presumption of paternity in the context of marriage.

EXHIBIT B

Bibliography of Internet Resources

1. LAMBDA Legal – Gay Rights By State: http://www.lambdalegal.org/our-work/states/.

2. Legal Marriage Court Cases – A Timeline – U.S. Constitutional cases from 1971 – Present: http://www.buddybuddy.com/t-line-1.html.

3. Same-gender Marriage – a Selective Bibliography of Legal Literature: http://law-library.rutgers.edu/resources/SSM.html.

4. Transgender Law & Policy Institute – Transgender Legal Resource Site: http://www.transgenderlaw.org/

5. Immigration Equality – An organization seeking equal application of U.S. Immigration laws and for those facing discrimination due to sexual orientation: http://www.immigrationequality.org/.

6. ABA AIDS Coordination Project – a Committee of the ABA to Educate the Bench, Bar and Public about Legal Issues Concerning HIV/AIDS: http://www.abanet.org/AIDS/home.html.

7. Project Inform's AIDS Advocacy Resource List: http://www.projectinform.org/advo/resources.shtml/.

8. Human Rights Campaign – A comprehensive web site dealing with a wide range of legal issues, including marriage, for the gay, lesbian and transgender community, and a section providing information concerning state adoption laws: http://www.hrc.org/.

9. Legal Marriage Alliance of Washington – Provides extensive information on the status of same-gender marriage by state and by country: http://www.lmaw.org.

10. Wikipedia contains entries on several topics including same-gender marriage, the history of legislation and the status of legislation worldwide: http://en.wikipedia.org/wiki/Same-sex_marriage.

11. A compilation of links on transgender legal resources can be found at http://www.nctequality.org/Resources/links.html including: The Transgender Law and Policy Institute: http://www.transgenderlaw.org/ and The ACLU's compilation of transgender legal resources: http://www.aclu.org/lgbt/transgender/index.html.