Journal of
# FINANCIAL PLANNING®
www.journalfp.net

Expanding the Body of Knowledge in the Financial Planning Profession

## Also Inside:



Joseph Kapp
*Financial Planner*
Lincoln Financial Advisors
4600 East West Highway, Suite 620
Bethesda, MD 20814
Joseph.Kapp@LFG.com
**PH:** 703.864.7777
**FAX:** 301.576.5058

Nicholas E. Burkholder
*Financial Planner*
Lincoln Financial Advisors
4600 East West Highway, Suite 620
Bethesda, MD 20814
Nicholas.Burkholder@LFG.com
**PH:** 202.250.1659
**FAX:** 301.576.5058



# SPENDING IN RETIREMENT
## Easing the Reins or Pulling Them In

Page 20

FPA FINANCIAL PLANNING ASSOCIATION
The Official Publication of
*The Heart of Financial Planning™*

MARCH 2008 | VOLUME 21 | NUMBER 3

# A Guide to Serving the Estate and Financial Planning Needs of Gay Men, Lesbians, and Same-Sex Couples

*by Joseph Kapp and Nicholas E. Burkholder*

*Joseph Kapp and Nicholas E. Burkholder are co-owners of a financial planning practice in Washington, D.C., catering to a largely gay and lesbian clientele. They write the Money column in* The Advocate*—the nation's largest source for gay and lesbian news and entertainment. They are frequent guest lecturers and have taught classes at the college level and at diverse forums including bar associations, Fortune 500 corporations, the World Bank, and the U.S. Departments of Commerce and State. Joseph can be reached at Joseph.Kapp@LFG.com. Nicholas can be reached at Nicholas.Burkholder@LFG.com.*

## Executive Summary

- Gay men, lesbians, and same-sex couples present significantly different financial and estate planning issues from traditional married couples. This article addresses those differences and shows planners how to work with this underserved niche market.
- Under federal law, same-sex couples may not marry. Yet there are 1,138 federal statutes in which marital status affects the ability to receive federal benefits. Furthermore, states have their own complex and often contradictory sets of laws in this area.
- Before the first client meeting, planners should review, among other things, their documents in order to avoid such terms as "Mr." and "Mrs." They also should review their software programs, which typically make calculations for couples on the basis that they are legally married.
- Estate taxes are a concern to same-sex couples because they cannot benefit from the unlimited marital deduction. Hence, the use of life insurance is often critical—yet it, too, presents planning challenges, such as the issue of insurable interest and being sure the insurance is out of a client's estate.
- Assets must be titled carefully when setting up jointly owned banking and investment accounts, or buying property, and clients may need to make creative use of the annual gift exclusion and the lifetime gift exemption. Same-sex couples may make especially good use of the grantor retained income trust.
- The advisor needs to inquire about the client's family situation, as family members may not know or approve of the client's sexual orientation, which can result in financial and legal complications upon death.
- Adoption of children is a common option, but complicated and typically expensive for many same-sex couples.
- More companies are offering benefits for same-sex domestic partners, but it's not always advisable for the partner to accept the offer because of potential income-tax liability.

When it comes to issues concerning financial and estate planning for gay men, lesbians, and same-sex couples, there are significant differences from traditional married couples. These differences are becoming increasingly apparent as states adopt laws specifically outlawing or permitting same-sex marriages or civil unions. Combined with religious, family, and societal attitudes toward gay men, lesbians, and same-sex couples, these issues quickly compound.

Understanding some basic concepts and being sensitive to the obstacles gay and lesbian clients face in their financial and estate planning will put an advisor ahead of most planners when formulating sound strategies for these underserved clients. It is not an overstatement to say that financial planners who focus on even some of the basic principles that uniquely affect gay men, lesbians, and same-sex couples will reap the rewards from this very loyal group of clients.

While it may seem like the opportunity to work with same-sex couples is limited only to cities with concentrated gay and lesbian populations like New York or San Francisco, the fact is that same-sex couples exist across the United States. In analyses of census data, *The Gay and Lesbian Atlas*[1] finds that 97 percent of U.S. counties have

senior citizens living in a same-sex partnership.[2] As a result, there potentially exists a planning opportunity for most advisors within their own community.

In this article, we address the unique financial and estate planning issues faced by gay men, lesbians, and same-sex couples, and how to work with this underserved niche market. More specifically, we address the importance of the client-advisor relationship within the context of the client's overall advisory team and the impact of various layers of law on same-sex couples' family dynamic, asset titling and structuring, and workplace benefits. We also present unique planning opportunities advisors can use to create wealth and unparalleled value for gay men, lesbians, and same-sex couples throughout the planning process.

## Background

At the federal level, the law is quite clear. Same-sex couples are "strangers" in the eyes of the law. The passage of the Defense of Marriage Act[3] (DOMA) in 1996 codified this view. DOMA does two things. First, it defines the term *marriage* for the purposes of federal law. The law states that "in determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife." Second, the law allows states to deny marriage-type relationships for same-sex couples even though the relationships may be recognized in other states.

The impact of the inability to marry is significant. A U.S. Government Accountability Office report in December 2003 identified 1,138 federal statutes in which "marital status is a factor in determining or receiving Federal benefits, rights, and privileges."[4] These benefits include access to Social Security and related programs; veterans benefits; benefits related to income, estate, and gift taxes; rules and procedures affecting immigration; and access to federal civilian and veterans benefits, to name a few. Same-sex couples are prohibited from filing joint federal tax returns or taking advantage of the unlimited marital estate and gift deductions. The inability to marry[5] creates an important distinction and is one of the rationales for some companies' decision to grant workplace benefits to the partners of their same-sex employees and not the unmarried partners of their heterosexual employees.

## State Issues

The issues become even more complex as you add a second layer of planning for state laws, as many of the state benefits conferred on married couples may also be out of reach for same-sex couples. Because family law is typically codified at the state level, each state has the power to adopt and modify its own laws, which significantly affects the estate and financial planning strategies available to financial advisors. In fact, many states are currently drafting laws affecting only same-sex partners, or have taxes that may unduly affect same-sex partners, such as state death and inheritance taxes. These laws run the gamut from being supportive to unfavorable.

In Massachusetts, for example, gay and lesbian couples are permitted to marry. Vermont is one of a growing number of states providing marriage-like protections in the form of civil unions. Although not called a marriage, civil unions convey many of the rights provided to married couples. The following is an excerpt from the Vermont Guide to Civil Unions, under the heading of "What are the legal consequences of civil union?"

> Parties to a civil union are given all the same benefits, protections and responsibilities under Vermont law, whether they derive from statute, administrative or court rule, policy, common law or any other source of civil law, as are granted to spouses in a marriage.[6]

Virginia is at the opposite end of the spectrum with state law (as of yet untested in court), which purports to forbid the creation of contracts or legal status that would convey to same-sex couples the same rights that marriage would convey. Specifically, Code Section 20-45.3 (popularly known as the Virginia Marriage Affirmation Act)[7] reads:

> A civil union, partnership contract or other arrangement between persons of the same sex purporting to bestow the privileges or obligations of marriage is prohibited. Any such civil union, partnership contract or other arrangement entered into by persons of the same sex in another state or jurisdiction shall be void in all respects in Virginia and any contractual rights created thereby shall be void and unenforceable.

Some jurisdictions, including Washington, D.C., have enacted a "Domestic Partnership" registry. In D.C., a same-sex couple can add each other to previously owned real estate without paying recording taxes (although care should be taken, as this can have the potential impact of triggering a federal gift tax). In addition, in D.C., same-sex couples are entitled to the same rights as family members to visit their domestic partners in the hospital, and they have the right to make decisions concerning the treatment of a domestic partner's remains after the partner's death. They also can file D.C. taxes jointly.[8] To take advantage of this, though, a couple must register as domestic partners with the D.C. Department of Health.[9] To illustrate the complexity, at the time of this writing, same-sex couples leaving an estate to a partner were still required to pay D.C. estate taxes on estates over $1 million, while married couples are not.

These fragmented, conflicting state and federal laws create confusion among

## The Importance of Trust

As with any advisory relationship, an advisor's success in the gay and lesbian community is directly related to the trust cultivated with clients. Developing trust with the gay and lesbian community may, however, may be more important than for heterosexual clients. Witeck-Combs Communications, a marketing company that specializes in the gay market, released a poll conducted by its partner Harris Interactive in June 2005. It found that "trusting and welcoming institutions are a far higher priority for gay, lesbian, and bisexual adults than for heterosexual respondents." The poll indicated that it is important that a financial institution not discriminate.[1] Therefore, an advisor who can develop trust with gay, lesbian, and same-sex clients may have a better chance of retaining these clients in the end if they maintain that trusted relationship.

### Preparation

Part of developing that trust comes from preparation. Advisors interested in working with this group of clients must become educated on the issues gay and lesbians face and be prepared and comfortable asking tough questions. By asking questions such as to whom the client is "out"[2] and whether there are potential hostile family members, the advisor communicates an understanding of the complexities that arise in planning for the gay and lesbian community. Gay and lesbian clients may not be "out" to everyone they know, like co-workers, other advisors they work with, or even family members. As a result, there may often be inconsistencies in a client's financial and estate planning.

It is important to recognize that gay and lesbian clients may not initially feel comfortable openly discussing their relationship. Lack of acceptance by their family or society may be the cause of this, and because the laws do not recognize their relationship, even same-sex couples who have been together for many years may not be accustomed to viewing themselves financially as a couple. Often, clients may be fearful that their advisor will judge their relationship. Varying and changing legislation means an advisor needs to be prepared and up to date on the most recent legislation, not only from a federal standpoint, but also across each of the jurisdictions in which they provide advice to clients. Exploring the Web sites of organizations like the Human Rights Campaign (www.hrc.org) will provide a wealth of information on all areas of gay, lesbian, bisexual, transgender, and same-sex planning issues.

### Communication

Communicating with gay and lesbian clients is important, as well. An understanding of general terminology and language of the community specific to the issues of same-sex couples is another important aspect in helping gay and lesbian clients feel comfortable with an advisor and develop a greater level of trust. Resources like the National Lesbian and Gay Journalists Association's English and Spanish *Stylebook Supplement on Lesbian, Gay, Bisexual and Transgender Terminology* are a good place to learn the terminology used in the gay and lesbian community.[3]

Language used by an advisor to describe relationships will give indications to gay and lesbian clients whether an advisor is familiar with their issues. Often, couples may prefer to refer to themselves as partners and may find it insulting if an advisor refers to them as "friends." Subtle signals, terms, and vocabulary an advisor uses can let clients know their advisor is fully aware of the sensitivities and the issues the gay and lesbian community faces, and engender greater trust and a better client experience.

### Endnotes

1. http://www.harrisinteractive.com/news/allnewsbydate.asp?NewsID=937.
2. The term "out" describes a gay man or lesbian who is open with others regarding their sexuality.
3. http://www.nlgja.org/pubs/style.html.

same-sex partners trying to piece together comprehensive financial and estate plans. Given this patchwork of laws, it is critical for advisors working with the gay and lesbian community to be familiar with the laws of their own jurisdictions and, more specifically, the financial and estate planning implications of how those laws play out in the lives of their gay and lesbian clients.

### Before the First Client Meeting

Before sitting down with gay and lesbian clients, advisors should make an effort to ensure that they are prepared to work with the gay and lesbian community. Aside from engendering trust (see sidebar "The Importance of Trust"), it is extremely important for advisors to think about how they present themselves and the information they provide to gay and lesbian clients. For example, it is imperative for an advisor to review the forms used with clients to ensure they do not presume heterosexuality.

Avoid using terms like "Mr." and "Mrs." or references to wife and husband, since these will point to an insensitivity regarding gay or lesbian relationships. Gay and lesbian clients may end up asking where they fit in

and whether an advisor's practice is truly willing and able to deal with their issues. Changing the terms in forms and documents to be less gender specific, such as "Client 1" and "Client 2," are likely to be less offensive. This is also beneficial for non-married heterosexual partners. Advisors may want to develop a set of templates specifically for same-sex clients. Having a gay attorney, gay accountant, or gay client review templates will go a long way toward ensuring that an advisor's "face" to their gay and lesbian clients is not offensive.

An advisor should also review software programs used to develop the economic and financial models when creating their financial and estate plans for the gay and lesbian community. It is our experience that financial planning software packages often automatically assume that if an advisor is planning for a couple, that the couple is married. When marriage is assumed, so are the unlimited marital and gift exemptions. As a result, projections for estate settlement costs and gift taxes are incorrectly portrayed.

In addition, there may be state-specific inheritance taxes levied on non-spousal heirs to take into consideration, which the software may not account for. The software also may assume the genders of the clients as being opposite sex or may automatically pre-populate both fields with the same last name. Before giving software outputs and illustrations to same-sex-couple clients, it is important to review the details for any mistakes, which will likely come across as insensitive or that their situation may be neither fully understood nor appreciated.

Finally, advisors may want to have clients sign a form authorizing the advisor to share information between the clients. This will ensure that the advisor has proof that he or she has the authority to share the sensitive personal and financial information of each of the unrelated parties with their respective partner.

## The Importance of Sound Estate Planning

As any financial advisor knows, nothing replaces sound estate and financial planning. For gay men, lesbians, and same-sex couples, the importance of putting together even simple estate planning documents cannot be emphasized enough. Because of religious and societal issues, gay men, lesbians, and same-sex couples often face a very real threat to the faithful execution of their financial and estate planning wishes. For these reasons and others, it is even more important for same-sex couples to leave expressly detailed instructions about the disposition of their assets and their remains, including drafting revocable trust and even potentially videotaping the final wishes, if there is a severe case of hostile families.

In addition to possible attack from hostile families, gay men, lesbians, and same-sex couples also face the impact of federal and state estate taxation. Because of the inability to marry, same-sex partners do not have the benefit of the unlimited marital and gift deductions. As a result, the advisor must take care to ensure the client knows the impact of these taxes.

Some states like Maryland and Pennsylvania impose inheritance taxes on assets that pass to non-spousal or non-familial beneficiaries. In Maryland, there is a 10 percent inheritance tax for non-spousal, non-familial beneficiaries, and in Pennsylvania, it is a staggering 15 percent. (Advisors can research state estate tax rates for their own jurisdiction quickly and easily through bankrate.com's online reference tool.)[10]

As with any overall estate planning, advisors should determine if there is a potential estate tax liability and which liquid assets the estate will use to pay such taxes. Like married couples and heterosexual domestic partners, life insurance may be a good option to provide liquidity and reduce estate shrinkage. But if the estate is near or likely to be over existing federal and state exclusion amounts, it is important to get the life insurance out of the estate of the insured, so as not to magnify an estate tax problem and lose the leverage that life insurance would otherwise provide upon death. The advisor can accomplish this in a couple of ways.

## Life Insurance Issues

One option is to place the life insurance in an irrevocable life insurance trust where the trust is the owner and beneficiary of the policy and the non-grantor partner is the trustee. The grantor can pay premiums on the policy with present-value gifts to the trust. This strategy removes the death benefit from the taxable estate of the decedent but must be handled with care, as placing the life insurance in an irrevocable trust is irrevocable and may become problematic in the event of a breakup.

A potentially more flexible and simple alternative is to structure cross-ownership of policies whereby each partner is the owner and beneficiary of a life insurance policy on the other. This allows the death benefit of the policy to avoid inclusion in the decedent's gross estate for estate tax calculation purposes. If a breakup occurs in this scenario, ownership can be transferred back to the insured partner with little difficulty. This transfer-of-ownership stipulation should be outlined in an agreement (drafted by an attorney) to avoid any conflicts and provide an easy transition of property in the event of a split. Be knowledgeable of transfer for value rules, the Goodman rule,[11] and that there are no divorce protections in most states.

Assuming a life insurance option is desirable, the next challenge is to actually obtain a policy. This often requires additional work for gay and lesbian couples in comparison with married couples. Because gay and lesbian couples are considered "strangers" in the eyes of the law, insurable interest is not automatically granted or inherent, as it is for married couples. As a result, to issue a life insurance policy insurance companies often require additional documentation to illustrate an insurable interest. Depending on the insurance company, a letter from the advisor explaining the nature of the relationship may suffice. Other companies may require greater proof such as bills or a mortgage statement showing mutual insurable interest.

The laws governing insurance policies

are enforced in part by the state laws in which the application and policy are completed and signed. In states where the general legal environment is particularly hostile, it may be prudent to have clients obtain their policies from an agent in a state where the laws are favorable. As an added precaution, for example, it may make sense for clients who live in the state of Virginia, whose laws are particularly hostile toward same-sex couples, to buy the life insurance policies in neighboring Washington, D.C., whose legal environment is much more favorable toward same-sex couples.

## Asset Ownership and Titling

When it comes to the distribution of a same-sex couple's joint estate, proper titling, ownership, and organization of assets is very valuable. Depending on applicable state law, same-sex partners can avoid probate by setting up joint banking or brokerage accounts. This strategy has its pitfalls, however, as it may create the potential for unintended gifts or inadvertently inflate the estate of the first owner to die, possibly resulting in an increase in taxation on assets left to a survivor.

With jointly owned accounts, gifts occur not when money is deposited into an account, but rather when assets are withdrawn from the joint account. Often with gay and lesbian couples, there is one party that earns more than the other. If contributions to the accounts are not equal, tax could be levied on the excess of contributions that are beyond the annual gift exclusion for the year in which withdrawals are made ($12,000 in 2008). If either partner's withdrawal exceeds this amount, a gift tax return may need to be filed. As a failsafe, the lifetime gift exemption is available ($1 million in 2008[12]); however, use of the lifetime exemption often makes more sense with partners where there is a large disproportion in accumulated assets or where there are highly appreciating assets in one partner's estate.

One example of an ideal application of the lifetime gift exemption entails making a present-value gift of highly appreciated or other income-producing assets to a common-law grantor retained income trust (GRIT). This is one strategy same-sex couples can take advantage of in a way that married or related parties cannot. In 1989, Congress prohibited the use of common-law GRITs for the transfer of assets to members of a family. A GRIT is an irrevocable trust, whereby the grantor places assets such as a residence, business, or other income-producing asset in a trust for a period of years. The grantor retains the rights to the income produced from the trust. Upon expiration of the trust, the assets are distributed to the beneficiary of the trust. The benefit of the GRIT is that assets placed in a GRIT are valued at a discount for federal estate tax purposes.[13] A gift-tax return must be filed acknowledging use of the lifetime gift exemption in order to avoid tax on the present value of the gift. For more details of how GRITs work in this type of arrangement, see the August 2004 article in this journal by Jon Gallo titled "Unique Estate Planning Opportunities for Gay and Lesbian Couples."

With real property titled as joint tenants with right of survivorship (JWROS), a gift can occur at inception of the purchase if the parties contribute disproportionate amounts for a down payment and the contribution difference between the parties exceeds the annual gift exclusion assuming the lifetime gift exclusion is not used. A gift also can be triggered upon paying down the mortgage note on the property if one party contributes an amount above his or her pro rata obligation that exceeds the annual gift exclusion assuming the lifetime gift exclusion is not used.

## Cumbersome Entanglements

To make a cumbersome entanglement of assets even more complex, when assets (including real property) are titled JWROS, the Internal Revenue Service will assume that the entire underlying asset values are included in the gross estate of the first to die, unless contributions can be proved. This estate inflation may trigger a major federal or state estate tax liability for the survivor if the taxable estate exceeds the respective exclusion amounts (federal estate tax exclusion amount of $2 million[14] per individual in 2008; state exclusion varies). With jointly held accounts, proving contributions may be cumbersome or difficult as accurate records over time may not be maintained or are lost.

Another issue with jointly titled accounts is that the person listed first on the account is usually considered the primary account holder by most financial institutions. As a result, the primary's Social Security number is likely to be used for income tax reporting purposes. The primary owner will receive the 1099 tax form for the interest and dividends received on the joint account. Since contributions to an account may be equal and because same-sex couples are not permitted to file joint federal tax returns, a primary account holder may need to make a nominee distribution and issue a 1099 to the other account holder in order to apportion the interest and dividends equitably. This becomes an even greater issue if one of the account owners is a high-income earner, as the issuance of a 1099 to correct the taxation of the portion of distribution belonging to a partner may raise an IRS-audit red flag.

Finally, titling accounts jointly leaves those assets vulnerable to be attached in a lawsuit (tenancy by the entirety, which avoids creditor attachment, is only allowed for married couples) and potential misuse of joint funds by a partner.

As a result of the issues outlined above, it often may make sense to separate jointly held assets by placing them in separate revocable trust accounts (which also controls distribution of the assets held in trust), or more easily through a Totten trust, also known as transfer or payable-on-death accounts (TOD or POD). The beneficiary of these trusts can be easily changed at any point if there is a change in the relationship. Moving assets from jointly held

accounts to individual/trust accounts (pro rata based on ownership) ought not to create a taxable event, as no sale of the underlying assets is necessary. In the case of real property, the deed on a residence can be re-titled to tenants in common with the two partners' respective revocable trusts as owners to reflect disproportionate contributions or note payments. It is important, however, to research whether transfer taxes will be owed with re-titling.

Advisors should use care and sensitivity when discussing with clients the splitting of assets. Clients may perceive that they are somehow decreasing the strength and validity of their relationship. Thus, it is important to show the financial impact of keeping assets jointly titled before any discussion of splitting accounts. The discussion of splitting assets may create an emotional roadblock to a very costly financial planning concern, so it is important to communicate and convey that this splitting of accounts in no way diminishes the relationship.

Educating gay and lesbian clients on how to structure their assets also may be helpful in the event of the dissolution of a relationship. The advisor should discuss the benefits and pitfalls of commingling assets and how financial assets might be split in the event of a breakup. Advisors may want to recommend that their client speak to an attorney about a domestic partnership or cohabitation agreement because of their inability to marry.

A partnership or cohabitation agreement spells out how to handle a variety of issues in a relationship. For example, it could outline who owned what piece of property before entering the relationship, how expenses are to be handled, how income earned while in the relationship will be handled, and how finances and purchasing decisions will be made. In addition, the document could define the terms of a potential breakup and how all the assets, such as life insurance, would be partitioned. It also should make provisions for a determination of how real estate would be valued, which is often the largest single asset a couple may own. Once again, it is important to note that not all states may recognize the validity of a partnership agreement. Even worse, most states have no laws relating to same-sex couple divorce, so there are no protections available.

## The Family Dynamic

It is always important to know one's client, regardless of their sexual orientation. But in dealing with gay, lesbian, or same-sex couples, this often means going into more detail about a client's family situation. Certainly, anytime there is a significant amount of wealth at stake, estate contests are possible. The social and religious issues gay and lesbian clients face may increase the likelihood of such a contest. Therefore, it is important for a savvy advisor to ascertain the family relationship and take the proper steps to reduce potential issues before they arise. Regardless of how good the family relationship is, an advisor should understand that upon death there is an increased likelihood for an attack on the assets by disaffected family members.

In some cases, a gay or lesbian client's immediate and extended family may not approve of his or her relationship. As such, without proper planning, it is possible that one or more members of the unaccepting family may step in at death to claim assets, overriding the deceased's wishes.

Alternatively, it may be that a partner in a same-sex relationship has not divulged his or her orientation or relationship to family members. Therefore, it is quite possible that a client's birth family is not even aware of the client's sexual orientation and thus may not find out until the client's death.

This occurred when a client of ours died and, upon finding letters he had written, out-of-town family members gained confirmation that their loved one was gay. We were in the unenviable position of working on the disposition of our client's estate and at the same time helping the family members work through issues relating to this client's sexual orientation.

Thus, special emphasis may be placed on the creation of trusts for probatable property to add an additional layer of protection and privacy from various parties who may step in to contest a gay man's or lesbian's final wishes.

An advisor also ought not to make assumptions about the structure of the family based on sexual orientation or assume that gay or lesbian couples neither have nor want children. In fact, many gay and lesbian couples may have children from a prior marriage or have a desire to become parents through adoption, surrogacy, or donor insemination. This only serves to add another layer of complexity to the family dynamic. Like any family, the client should take into account the financial impact of adding children to a same-sex family. In addition to the associated legal and planning costs, just the costs of having a child can be quite high. In fact, according to Growing Generations, a gay- and lesbian-owned surrogacy firm, costs associated with surrogacy alone can range between $115,000 and $150,000.[15]

Adoption is one of the most widely used alternatives for same-sex couples to start a family. But gay men, lesbians, and same-sex couples can face many hurdles, which may make adoption more difficult than for heterosexual couples. The laws of the state where the same-sex couple adopts will have a significant impact on the issues relating to the adoption. Some states, like California, Connecticut, Illinois, Massachusetts, New Jersey, New Mexico, New York, Oregon, Vermont, and the District of Columbia,[16] are "adoption friendly," in that they permit both parents in a same-sex relationship to adopt a child jointly.[17] Florida, on the other hand, explicitly prohibits gay and lesbian individuals or same-sex couples from adopting a child.[18] Further, other jurisdictions allow a judge to decide on a case-by-case basis or have an intermediate status called guardianship.

In jurisdictions where one partner is *not* permitted to adopt, in the event the "non-adoptive" parent dies intestate, the child could be unintentionally disinher-

ited. Absent other arrangements, assets will likely revert to the legal and biological family of the non-adoptive parent according to a state's inheritance laws, and thus may not pass to a desired partner or child. Conversely, if the biological parent dies intestate, his or her assets may go to the minor child instead of to the same-sex partner.

The drafting of traditional planning documents should be completed before beginning any adoption and be revisited once the child arrives. In addition to traditional estate planning tools like wills, trusts, living wills, burial declarations, and medical and general powers of attorney, other documents such as co-parenting and custody agreements ought to be created. These dictate how the couple will operate as parents and their rights relative to the child. In addition, all trusts that are created should have language that replicates the co-parenting and custody agreements. For example, if the desire is to have the surviving partner maintain control or obtain custody over the minor child, language ought to be included in the trusts that name the opposite partner as fiduciary over assets left to the child (outright or in trust) and also as guardian for the child's health, support, education, and maintenance. Collaborating with an attorney experienced in this area of law is crucial, as some states may not accept co-parenting agreements as valid.

## Workplace and Benefits

According to the Human Rights Campaign (HRC), a gay and lesbian civil rights group, in as many as 33 states it is still legal to fire someone based on their sexual orientation.[19] Similar to preparing for the possibility of layoffs, advisors may be wise to gauge the extent to which their gay or lesbian clients are open about their sexual orientation at work. Understanding the work environment of a client, an advisor can gauge whether it makes sense to recommend having a larger-than-normal emergency cash reserve in the event of an unexpected job loss.

Gay or lesbian clients may not be open about their sexual orientation at work. As a result, they may not be taking full advantage of all available employee benefits offered by their company. Due in part to organizations like the HRC and the National Gay and Lesbian Chamber of Commerce (NGLCC)[20], business and workplace attitudes toward gay men, lesbians, and same-sex couples are changing. Many companies now offer domestic partner benefits and treat same-sex couples like married couples.

A review of employee benefits ought to be taken before adding a domestic partner to those benefits. When companies offer benefits to same-sex couples (and non-married, opposite-sex domestic couples, for that matter), the benefits received by the non-married spouse are considered imputed income by the IRS and thus are taxable as income to the employee.

The company providing the benefits also will be responsible for any additional income or payroll taxes by offering these benefits to domestic partners. It is the experience of the authors that many same-sex couples may not realize they will pay income taxes on benefits they receive from a partner's employer.

According to the HRC, as many as 113 of the Fortune 500 companies offer domestic partnership benefits only to same-sex employees. The most-stated rationale behind this is that heterosexual domestic partners have the option of marrying and thus can qualify for benefits, whereas same-sex domestic partners do not have that option. (270 of Fortune 500 companies offer domestic partner benefits to both straight and gay non-married employees.)

Some companies take providing benefits a step further and recognize the disparity of taxing benefits for same-sex partners (since married couples are not taxed on such benefits to their spouses). For example, Discovery Communications, which owns the Discovery Channel, TLC, and Animal Planet, grosses up the salaries of its same-sex employees who have their partners on their insurance to cover the cost of the taxes that they would otherwise have to pay. This is, however, a very unusual practice.

As mentioned earlier, the laws regarding same-sex couples are constantly changing. As of the writing of this article, pending legislation titled the Tax Equity for Domestic Partner and Health Plan Beneficiaries Act would remove the additional imputed income tax burden faced by both gay and straight domestic partners.

## Employee Retirement Plans

Employee retirement plans are also an issue of concern. The plan documents outlining the policies and procedures for employer-provided retirement plans like 401(k)s typically require nonspousal beneficiaries to take the distribution in a lump sum upon the death of a plan participant.[21] This has the potential to push the surviving partner into a higher tax bracket and result in a much smaller remainder of the inherited asset. The passage of the Pension Protection Act of 2006 directly addressed this tax issue. Specifically, the act allows beneficiaries to open an IRA *after* the death of the participant (they have until the last day of the calendar year following the year of death) and stretch the income (and resulting taxation) over their lifetimes. But in January of 2007 the IRS issued notice 2007-7, giving employers the *option* of deciding whether to amend their retirement plan documents. At the time of this writing, by leaving assets in an old retirement plan, participants still retain a very real risk of having their partner (as beneficiary) receive a lump-sum distribution and incur a much larger tax bill than is otherwise necessary.

Unless a client is certain that a plan document has been modified to reflect the new changes, assets should be consolidated and rolled over to an individual retirement account upon departure from an employer. These assets, when moved to an IRA following separation from employment, may be "stretched" according to IRS rules over the life expectancy of the

designated IRA beneficiary. Some companies, as outlined in their retirement plan documents, may offer the ability to transfer 401(k)-type assets to an IRA while an individual is still employed, also known as an in-service 401(k)-to-IRA rollover. An advisor will want to determine if this is available. This option may provide greater flexibility in the event of an unexpected death and eliminate uncertainty as to whether provisions from the Pension Protect Act have been adopted. It is critical to review the rules of the rollover to ensure that it is performed correctly and in accordance with IRS regulations.

## The Advisory Team

The complexity of planning for same-sex couples even for basic planning underscores the importance of working with other professionals who are equally, if not more, familiar with the tax and legal issues facing their gay and lesbian clients. Financial advisors should seek out and establish a strong network of knowledgeable and experienced professionals who specialize and understand working with clients who are gay and lesbian. An experienced attorney and certified public accountant with a large gay and lesbian clientele can prove to be an invaluable resource to both the advisor and his or her clients. The financial advisor ought to serve as the "quarterback" of this team of advisors and will add significant value and service by communicating goals, coordinating plans, and creating continuity through a process that could otherwise be daunting, confusing, and fragmented for gay and lesbian clients. These specialist relationships may also prove to be beneficial for reciprocal client referrals and further access to the gay and lesbian community.

## In Closing

More so than other areas of financial planning, laws addressing same-sex couples change quickly. Same-sex benefits and gay marriage are a hot button electoral issue and, as such, seem to come to the forefront around every election cycle. As battles rage at the local, state, and federal level over the level of protection and recognition given to same-sex relationships, it is likely that this area will remain in flux.

Changing and unfavorable governmental policies, greater expenses and complexity with child rearing, the reality of employment discrimination, the need for asset protection from hostile families, and the inability to marry all dictate a significant demand for sound financial and estate planning for gay men, lesbians, and same-sex couples.

Although these issues may seem daunting, the good news is that having even a basic or cursory understanding of the issues will put you miles ahead of many of your peers in working with this underserved and extremely loyal niche market. It is truly an area where a small investment in time can pay off with large dividends.

*Joe Kapp and Nick Burkholder are registered representatives and investment advisor representatives with Lincoln Financial Advisors Corp., a broker/dealer (member SIPC) and registered investment advisor offering insurance through Lincoln affiliates and other fine companies. This information should not be construed as legal or tax advice. You may want to consult a tax advisor regarding this material as it relates to your personal circumstances. CRN200802-2013757*

## Endnotes

1. Gary Gates and Jason Ost, *The Gay and Lesbian Atlas*, Washington, DC: Urban Institute Press, 2004.
2. http://www.urban.org/publications/900627.html.
3. http://www.hrc.org/Template.cfm?Section=Center&CONTENTID=15330&TEMPLATE=/ContentManagement/ContentDisplay.cfm.
4. http://www.gao.gov/new.items/d04353r.pdf.
5. Couples in Massachusetts may marry and gain state-level protections but are not considered married under federal law.
6. www.sec.state.vt.us/otherprg/civilunions/civilunions.html.
7. http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+20-45.3; http://www.equalityvirginia.org/site/pp.asp?c=dfIIITMIG&b=181005.
8. http://dchealth.dc.gov/doh/cwp/view,a,3,q,573324,dohNav_GID,1787,dohNav,|33110|33120|33139|.asp#3.
9. http://hrc.org/Template.cfm?Section=Home&CONTENTID=28629&TEMPLATE=/ContentManagement/ContentDisplay.cfm#dp.
10. http://www.bankrate.com/brm/itax/edit/state/profiles/state_tax_DC.asp.
11. The Goodman rule states that if the policy is owned by someone other than the insured and the beneficiary is a third party, then at the death of the insured the benefit proceeds are considered a taxable gift.
12. http://www.irs.gov/businesses/small/article/0,,id=164878,00.html.
13. http://www.fpanet.org/journal/articles/2004_Issues/jfp0804-art4.cfm. 14.http://www.irs.gov/formspubs/article/0,,id=112782,00.html#estate_exclu_2003.
15. http://www.growinggenerations.com/parents.
16. http://www.hrc.org/Template.cfm?Section=Adoption&CONTENTID=19984&TEMPLATE=/TaggedPage/TaggedPageDisplay.cfm&TPLID=66.
17. ORS Section 109.309.
18. FLA. STAT. ch. 63.042(3). This law was upheld by the 11th Circuit Court of Appeals in 2004. *See Lofton v. Sect. of the Dept. of Children and Family Services,* 358 F.3d 804 (11th Cir. 2004).
19. http://www.hrc.org/Template.cfm?Section=Get_Informed2&CONTENTID=27968&TEMPLATE=/ContentManagement/ContentDisplay.cfm.
20. http://www.nglcc.org.
21. http://hrc.org/Template.cfm?Section=Home&CONTENTID=33539&TEMPLATE=/ContentManagement/ContentDisplay.cfm.