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Trusts and Estates

Tax and Estate Implications of Same-Sex Marriage in Pa.

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On May 20, in *Whitewood v. Wolf*, No. 1:13-cv-1861 (M.D. Pa. May 20, 2014), U.S. District Judge John E. Jones III of the Middle District of Pennsylvania struck down Pennsylvania's ban on same-sex marriage, ruling that it violates both the due process and equal protection clauses of the U.S. Constitution. The next day, Gov. Tom Corbett announced that he would not appeal the ruling, making Pennsylvania the 19th state to legalize same-sex marriage. This ruling effectively provides same-sex married Pennsylvanians with the same state law marital rights, benefits and obligations as any other married couple in Pennsylvania. In this article, we will summarize some of the rights, benefits and obligations in the income tax and estate planning arena that married same-sex couples who are Pennsylvania residents will now need to be mindful of as they arrange their financial affairs.

By way of background, last year, the U.S. Supreme Court, in *United States v. Windsor*, 133 S. Ct. 2675 (2013), recognized certain federal rights for same-sex married couples by ruling that Section 3 of the Defense of Marriage Act (DOMA), which limited marriage to a union of one man and one woman, was unconstitutional. The *Windsor* matter specifically involved the availability of the marital deduction from the federal estate tax to the surviving member of a same-sex married couple. In the aftermath of that decision, the Internal Revenue Service issued Revenue Ruling 2013-17, declaring that it would recognize, for federal tax purposes, all same-sex marriages that were considered legal in the state of the marriage, regardless of a couple's current residence. Consequently, all married same-sex couples are now required to file their federal income tax returns with a married filing status. For many such couples, this reduces the amount of federal income taxes owed, but, for some higher earners, this results in higher federal income taxes due to the "marriage penalty." For estate tax purposes, however, the ruling has reduced or completely eliminated federal estate taxes owed due to the availability of the marital deduction (and portability of any unused exemption)—a great result for same-sex married couples. However, this was only the case as it related to federal taxes, and, until the *Whitewood* case, the same result did not apply for Pennsylvania tax purposes.

Despite the need to file federal returns as "married" individuals, prior to the *Whitewood* decision, same-sex married couples living in Pennsylvania were required to file separate

"single" Pennsylvania income tax returns. Although this did not appear to have much of an effect on a couple's Pennsylvania income tax burden, it did result in an administrative burden and cost. This burden of having to file separate single returns has now been eliminated in Pennsylvania, and married same-sex couples must now to file their Pennsylvania income tax return as "married" individuals. This greatly simplifies the process for the taxpayer and the state.

The Pennsylvania tax change resulting from the *Whitewood* ruling with the greatest economic impact appears to be with respect to the Pennsylvania inheritance tax. Before the ruling, the Pennsylvania inheritance tax on the transfer of property at death from one same-sex spouse to another was imposed at the highest rate of 15 percent (by comparison, the rate is 4.5 percent for transfers to lineal descendants or 0 percent for transfers to spouses). Following *Whitewood*, the Pennsylvania inheritance tax has been reduced to 0 percent on the transfer to a decedent's legally married same-sex spouse. In recent cases where the 15 percent inheritance tax was already paid on the transfer to a same-sex spouse (i.e., if they were legally married in another state at the time of the decedent's death), there may be an opportunity to amend prior-year Pennsylvania inheritance tax returns to claim a refund.

Given the significance of the Pennsylvania inheritance tax changes to same-sex married couples, it is important that same-sex couples carefully review and, most likely, update their estate planning documents in order to be sure that they take advantage of the marital deduction for both federal estate tax and Pennsylvania inheritance tax purposes. To the extent that a will provides that property is to pass in trust for a same-sex surviving spouse, there are certain provisions that are required in order for the trust to qualify for the marital deduction, both for federal and state purposes.

In addition to reexecuting wills and other trust documents, same-sex married couples should also review their beneficiary designation forms for life insurance, retirement plans and annuities to make sure that the spouse is properly named and designated as such, where desirable. For Employee Retirement Income Security Act-qualified plans, if a spouse is not named as beneficiary, the spouse may now need to sign a waiver. If the required waiver is not properly signed, and someone other than the spouse is named as beneficiary, the spouse will nevertheless likely receive all or part of the benefit in accordance with federal law and the terms of the qualified plan.

Another item for review is title to property. Spouses who jointly own property should consider whether it now makes sense to retitle the property into "tenants by the entirety," a special type of joint ownership of property with rights of survivorship that is only allowed between spouses. There are creditor protection features built into this type of ownership structure, so that the property may be protected from the creditors of one spouse while the non-debtor spouse is still living.

While marriage is now a right for same-sex couples, so will be divorce. Thus, it is inevitable that there will be divorces among same-sex couples who legally marry. For those who have not yet married, a prenuptial agreement should be considered in certain situations where the individuals want to protect certain property rights during and after the marriage. Prenuptial agreements are also important to protect rights to property upon not only divorce, but, also death since, in Pennsylvania, a surviving spouse has an elective share right, giving him or her the right to receive up to one-third of the assets of the decedent spouse's estate. These rights can be waived in a prenuptial agreement. For those couples who were already

married in another state, now that Pennsylvania will recognize that marriage, a postnuptial agreement should be considered instead.

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