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Commingled Finances

Although several states allow same-sex couples to marry, they still face unique planning challenges

By Martha C. White
September 1, 2011

The client arrived in Deb Neiman's office too late - her much-wealthier partner had already died. The deceased woman didn't have a will and hadn't named her partner as a beneficiary on many of her IRAs. There was no documentation of the client's contributions to the costs of the couple's shared home. "Her standard of living for retirement looked bleak," says Neiman, principal of Neiman & Associates Financial Services in Arlington, Mass., and co-author of Money Without Matrimony: The Unmarried Couple's Guide to Financial Security.

Two people may share a home, children and bank accounts, and yet have the same legal status as strangers. Planners are seeing more couples, both straight and gay, whose financial lives are intertwined without the benefit of full legal protection. As people live longer, many older couples remain unwed - to avoid money conflicts with stepchildren or to keep Social Security and pension benefits linked to former marriages.

Meanwhile, gay couples are marrying - but only under state law. Married same-sex couples are not recognized by federal law. In July, New York joined five other states and the District of Columbia in granting marriage licenses to same-sex couples.

Advisors working with these clients need to take extra steps in all the issues that couples face. Estate planning actions - updating beneficiary information, putting assets in the less wealthy partner's name or buying life insurance on the wealthier partner - could have avoided the situation Neiman's client faced.

INSURANCE WRINKLES

In general, unmarried and same-sex couples face problems with health insurance. In a small but growing group of big companies, a partner in such a relationship can be added to a health plan but will face a penalty - imputed income, In a federally recognized marriage, the portion of the premium paid by an employer to insure a spouse is not taxed. That's not true for unmarried or same-sex couples.

Dana Levit of Paragon Financial Advisors in Newton, Mass., recalls a case in which an employer included the value of the benefit on the employee's W-2 at $6,000. "They wound up paying about $1,800 more in taxes," says Levit, who is president of the board of PridePlanners, an online organization of financial professionals serving gays and lesbians.

Another option is to define one partner as a health care dependent if the pair live together and the insured partner provides more than half of the other partner's financial support over the course of a year. Federal rules on a health care dependent are less strict than the regulations on a tax dependent; in the case of a tax dependent, for instance, the dependent can earn no more than $3,700 in a year. There is no income cap to qualify as a health care dependent.

Long-term-care insurance and disability insurance are even more important for co-habiters or same-sex married couples, in part because of gift-tax rules, which kick in at $13,000 a year. A client could spend more than $13,000 on household expenses when a partner is ill or disabled, says Stuart Armstrong, a financial planner with Centinel Financial Group in Needham Heights, Mass. No tax is owed above $13,000, but a return must be filed that records the payments against a lifetime maximum of $5 million. Federal law does permit a partner to pay medical bills directly to a hospital or doctor without having the payments count toward the lifetime limit.

When it comes to qualifying for Medicaid coverage for nursing home care, same-sex partners recently got a break. In April, the Department of Health and Human Services ruled that states may treat them as legal spouses under the Medicaid rules. But there are limits to how much one spouse can retain if the other spouse receives Medicaid coverage for nursing home care.

IF THEY SPLIT

For same-sex couples, "the most important thing marriage does at the state level," according to Levit, is "create a system for divorce." Still, federal rules govern many divorce issues.

In a straight divorce, a judge generally splits retirement plan assets down the middle in a qualified domestic relation order, and there are no taxes. But when either an unmarried heterosexual couple or a gay couple divide a retirement account, one partner may need to pull money out and pay income tax, plus the 10% early withdrawal penalty. "Make sure lower-income spouses max out their 401(k)s" to get as much in each partner's name as possible, Levit advises.

Planners should think of each member of an unmarried couple as an individual because this is the way their assets will be divided in case of a breakup, says Susan Moore, founder and president of Moore Financial Advisors in Watertown, Mass. When a husband and wife have 401(k) accounts, the law lumps them together and views them as a single pool of money. But an unmarried couple won't have a qualified domestic relation order to help distribute assets fairly if they split. If married same-sex couples; divorce, the state will require them to split their assets, but since their marriage isn't recognized at the federal level, they won't have the protection of a qualified domestic relation order, either.

Getting everything in writing is crucial. Neiman says one couple she advised were married in Massachusetts but had only a verbal agreement on how to divide property if they broke up. When that day came, they discovered that the state didn't recognize their verbal agreement. "It was a total mess," Neiman says. In the end, the partner with a fatter retirement account paid her ex-wife out of her share of the profit from the sale of their home and avoided taxes and penalties on an early withdrawal.

TRANSFER ASSETS

For strong relationships, when one partner is significantly wealthier, Levit transfers wealth to the less well-off partner in yearly $13,000 chunks. To add another name to a house deed, the owner must file a gift-tax return and remember that half of the appraised value counts toward the lifetime maximum.

Federal estate taxes apply above $5 million for unmarried couples. In a state that recognizes same-sex marriage, a couple can transfer assets without triggering state taxes, just as a heterosexual married pair could. Otherwise, state estate taxes apply after $1 million.

In a federally recognized marriage, a spouse can inherit a retirement account and roll it over into a new or existing one in his or her own name. In a same-sex marriage, a surviving partner can inherit an account and roll it over, but must immediately begin withdrawals. This is an improvement over an earlier regulation, which required an unmarried partner to liquidate the account right away.

PROTECT SURVIVORS

A surviving spouse can receive Social Security benefits and often is entitled to pension benefits. But partners don't get Social Security benefits, and a pension may or may not permit a nonspouse to make a claim. One option is for the pension holder to take the benefit as a lump sum and convert it into an immediate annuity with survivorship benefits.

In all but a handful of states, assets, like securities and accounts, can be transferred upon death to another party, avoiding probate. Levit suggests this to clients worried that relatives or others might try to contest a will. Although the transfer-on-death option doesn't exempt an asset from estate taxes, the estate doesn't have to file a gift-tax return.

For unmarried and same-sex couples, "there's no implicit rule that says that your partner will inherit your possessions; whereas if you're a married, heterosexual couple, that's implied with 'I do,'" Neiman says. "Without that, things have to be made explicit in writing."

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