The Estate (and Other) Tax Ramifications of Same-Sex Maryland In Maryland

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Mr. Franke received his A.B. from Kenyon College in 1969; his J.D. from Washington and Lee University in 1973; his L.L.M. (Taxation) from George Washington University in 1983. He was admitted to the Maryland Bar in 1974 and has practiced in Annapolis since 1976.

Mr. Franke is past-chair of the Council of the Estates and Trusts Law Section of the Maryland Bar Association. He is a Fellow of the American College of Trust and Estate Counsel and has served as an Adjunct Professor of Law at the University of Baltimore, School of Law. He has been, and is included in The Best Lawyers in America (Trusts and Estates) consistently since 2001, listed in the Maryland Super Lawyers (Estate Planning and Probate) consistently since 2007 being named "Top 50" or "Top 100" lawyers statewide for the last three years, and named the Top Annapolis estate and trust lawyer by What'sUp Annapolis in a survey of Anne Arundel County lawyers since 2009. He has received an AV rating from Martindale-Hubbell for over 20 years. The law firm has been listed as a Tier 1 Estates and Trusts firm by US News since 2011. He is a member of various local and national bar associations.

He has published articles on tax and other topics related to his professional interests, including: *"Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract,"* ACTEC Journal, Winter 2010; *"Asset Protection and Tenancy by the Entirety,"* ACTEC Journal, Spring 2009; *"Perfect Ambiguity: The Role of the Attorney in Maryland Guardianships,"* Maryland Journal of Contemporary Legal Issues, 1996.

Mr. Franke also has participated, as a lecturer, in various continuing education programs for lawyers, including: *"Asset Protection, An Overview For Maryland Estate and Trust Lawyers,"* (MSBA 2013)*; A Beneficiary's Right to Information,"* (MSBA 2012); *"Trust Litigation: The Enforcement of Beneficiary Rights,"* (MSBA 2011); *"Asset Protection: An Overview for Maryland Estate and Trust Lawyers,"* (MSBA 2010); *"Back to the Future, Schoukroun and the Spousal Election,"* Hot Topics in Elder Law, (MICPEL 2009); *"A Match Made In Heaven – Using Tenancy*

by the Entirety for Creditor Protection Without Sacrificing Estate Planning," (MSBA 2009); *"Asset Protection – A Guide for Maryland Estate and Trust Lawyers,"* (MICPEL Advance Estate Planning Institute 2006); *"Revocable Inter Vivos Trusts,"* (MICPEL 2004 and 2006); *"Valuation Discounting,"* (MICPEL 2003; MSBA 2002 and 2003); *"Business Valuation,"* (MICPEL 1998); *"Family Partnerships,"* (MICPEL 1996); *"Avoiding Probate - Will Substitutes,"* 1996; *"Basic Estate Planning,"* (MICPEL 1993).

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THE ESTATE (AND OTHER) TAX RAMIFICATIONS OF SAME-SEX MARRIAGE IN MARYLAND[1]

1.0 Background.

1.1 The Federal Statute. The Defense of Marriage Act ("DOMA") contains two provisions of note:

- Section 3 of DOMA amended the United Stated Code to define marriage as "only a legal union between one man and one woman as husband and wife, the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife." This definition applied to any act of Congress and any ruling, regulations or interpretations of the various administrative bureaus and agencies of the U.S.

- Section 2 of DOMA stated that no state is required to recognize a same-sex marriage that is valid in another state. The purpose of Section 2 of DOMA was to remove "full faith and credit" from operations as applied to same-sex marriages.

1.2 Maryland Law.

1.2.1 **The Civil Marriage Protection Act**. The 2012 Maryland General Assembly passed H.B. 438 which provided for changing the definition of "marriage." Before H.B. 438, Family Law § 2-210 provided that "only a marriage between a man and a woman who are not otherwise prohibited from marrying is valid in this State." (Emphasis added). H.B. 438 struck the phrase "a man and a woman" and substituted for it the phrase "two individuals."

H.B. 438 also provided that religious orders or bodies are not required to solemnize or officiate any particular marriage if it violates its theological doctrine or teaching.

H.B. 438, however, had an effective date that was automatically deferred until a referendum by the electorate voted it up or down. This contingency occurred, the measure withstood recall, and it became effective as of January 1, 2013.

[1]

1.2.2 *Port v. Cowan*, 426 Md. 435 (May 18, 2012). After H.B. 438 passed but before the referendum, the Maryland Court of Appeals decided that, regardless of the outcome of the referendum, Maryland would recognize a same-sex marriage if valid where that marriage was performed. Judge Harrell wrote the opinion for the Court of Appeals. No dissents were filed.

Port v. Cowan involved an action for divorce by a same-sex couple who were validly married under the laws of another state. Ironically, the couple married in 2008 in California a few months before California passed Proposition 8 which changed the California Constitution so as to prohibit same-sex marriage. [As discussed below, subsequently the U.S. Court of Appeals concluded that Proposition 8 violates the Fourteenth Amendment of the Constitution].

The issue before the Maryland Court was whether Maryland would apply the doctrine of comity and honor the foreign marriage to enable its courts to entertain the doctrine. "Under the doctrine of comity, long applied in our State, Maryland courts 'will give effect to laws and judicial decisions of another state or jurisdiction, not as a matter of obligation, but out of deference and respect.'" *Port* at 444. (quoting *Wash. Suburban Sanitary Comm'n. v. CAE – Link Comp.*, 330 Md. 115, 140 (1993)).

Generally, Maryland courts apply the doctrine of Lex Loci Celebrationis and liberally recognize valid foreign marriages. Thus, for example, Maryland will recognize a common law marriage formed in D.C., although Maryland does not recognize such marriages. *Henderson v. Henderson,* 199 Md. 449 (1952). See also, *Blaw-Knox Const. Equip. Co. v. Morris,* 88 Md. App. 655 (1991). (A couple's two day sojourn in Pennsylvania was enough to establish a marriage for a wrongful death claim).

In order for the doctrine of comity to apply, however, the law of the other

state must not be "repugnant" to the public policy of Maryland or contrary to a Maryland statute.

Family Law § 2-201 before it's 2012 amendment, of course, limited marriage to that of a man and a woman for marriages performed in Maryland. It did not, however, prohibit recognition of a same-sex marriage validly entered into in another state. Indeed, the *Port* court observed: "On at least eight occasions, the Maryland General Assembly failed to amend § 2-201 to preclude valid out-of-state same-sex marriages from being recognized in Maryland." *Port* at 448.

"The bar in meeting the 'repugnancy' standard is not intentionally very high …" *Port* at 449. The Court found, as a matter of law, that same-sex marriage is not "repugnant" to the public policy of Maryland:

> We conclude also that the parties' same-sex marriage is not "repugnant" to Maryland "public policy," as that term is understood properly in applying the doctrine of comity in modern times. Admittedly, "public policy" is an amorphous legal concept. "It is agreed, however, that wherever found and identified, that public policy prohibits generally conduct that injures or tends to injure the public good. *Md.-Nat'l Capital Park &Planning Comm'n v. Wash. Nat 'l Arena*, 282 Md. 588, 605-06, 386 A.2d 1216, 1228 (1978) (quoting *Egerton v. Brownlow*, 4 H.L. Cas. 1, 196 (1853)). The primary sources of public policy (and where typically we look to divine it) are the State's constitution, statutes, administrative regulations, and reported judicial opinions. *Adler v. Am. Standard Corp.*, 291 Md. 31, 45, 432 A.2d 464, 472 (1981) (quoting *Md-Nat'l Capital Park & Planning Comm 'n.* 282 Md. at 605-06, 386 A.2d at 1228). Although courts are not confined to these emanations of public policy in their search, secondary sources are perceived generally as less persuasive. *See Adler*, 291 Md. at 45, 432 A.2d at 472.

Thus, before Family Law § 2-201, as amended in 2012, became law, a valid same-sex marriage established in another state would be recognized for divorce purposes. Arguably, the *Port* decision would have broad application beyond divorce. The changes to Family Law § 2-201, of course, renders the speculation unnecessary.

1.3 *U.S. v. Windsor*, 570 U.S. ___ (June 26, 2013). The Supreme Court struck down § 3 of DOMA so that the surviving spouse in a same-sex marriage recognized in New York State could qualify for the federal estate tax marital deduction.

Edith Windsor and Thea Spyer lived together in New York City for over 40 years. When New York City passed its domestic partnership law in 1993, they registered as domestic partners. In 2007, concerned about Ms. Spyer's health, they went to Ontario, Canada and married. The State of New York deems their Canadian marriage as valid. [In 2012, New York enacted a statute authorizing same-sex marriages but Ms. Spyer died before this became law.]

When Ms. Spyer died in 2009, she left her entire estate to Ms. Windsor. Because of DOMA, the unlimited marital deduction did not apply and Ms. Windsor was forced to pay $363,053 in federal estate taxes. She filed a refund suit in the U.S. District Court for the Southern District of New York claiming DOMA violated the equal protection clause of the U.S. Constitution.

The Court held that § 3 of DOMA violates the Equal Protection Clause of the Constitution. Justice Kennedy wrote the majority opinion, joined by Ginsburg, Breyer, Sotomayor and Kagan. Chief Justice Roberts, Justice Scalia, Justice Thomas and Justice Alito filed dissenting opinions.

In his opinion, Justice Kennedy points to the virtual exclusive right of the states to define and regulate marriage:

> State laws defining and regulating marriage, of course, must respect the constitutional rights of persons, see, *e.g., Loving v. Virginia,* 388 U.S. 1, 87 S.Ct. 1817, 18 L.Ed.2d 1010 (1967); but, subject to those guarantees, "regulation of domestic relations" is "an area that has long been regarded as a virtually exclusive province of the States. "*Sosna v. Iowa,* 419 U.S. 393. 404, 95 S.Ct. 553, 42 L.Ed.2d 532 (1975).

> The recognition of civil marriages is central to state domestic relations law applicable to its residents and citizens. See *Williams v. North Carolina.* 317 U.S. 287. 298, 63 S.Ct. 207, 87 L.Ed. 279 (1942) ("Each state as a sovereign has a rightful and legitimate concern in the marital status of persons domiciled within its borders"). The definition of marriage is the foundation of the State's broader authority to regulate the subject of domestic relations with respect to the "[p]rotection of offspring, property interests, and the enforcement of marital responsibilities." *Ibid.* "[T]he states, at the time of the adoption of the Constitution, possessed full power over the subject of marriage and divorce ... [and] the Constitution delegated no authority to the Government of the United States on the subject of marriage and divorce."

New York exercised its right to define marriage and sought to extend equal treatment to same-sex couples as enjoyed by heterosexual couples:

> The States' interest in defining and regulating the marital relation, subject to constitutional guarantees, stems from the understanding that marriage is more than a routine classification for purposes of certain statutory benefits. Private, consensual sexual intimacy between two adult persons of the same sex may not be punished by the State, and it can form "but one element in a personal bond that is more enduring." *Lawrence v. Texas.* 539 U.S. 558, 567, 123 S.Ct. 2472, 156 L.Ed.2d 508 (2003). By its recognition of the validity of same-sex marriages performed in other jurisdictions and then by authorizing same-sex unions and same-sex marriages, New York sought to give further protection and dignity to that bond. For same-sex couples who wished to be married, the State acted to give their lawful conduct a lawful status. This status is a far-reaching legal acknowledgment of the intimate relationship between two people, a relationship deemed by the State worthy of dignity in the community equal with all other marriages. It reflects both the community's considered perspective on the historical roots of the institution of marriage and its evolving understanding of the meaning of equality.

DOMA, however, distinguished between same-sex marriage and heterosexual marriage. It creates an unequal subset within the class of married couples:

> DOMA's principal effect is to identify a subset of state-sanctioned marriages and make them unequal. The principal purpose is to impose inequality, not for other reasons like governmental efficiency. Responsibilities, as well as rights, enhance the dignity

> and integrity of the person. And DOMA contrives to deprive some couples married under the laws of their State, but not other couples, of both rights and responsibilities. By creating two contradictory marriage regimes within the same State, DOMA forces same-sex couples to live as married for the purpose of state law but unmarried for the purpose of federal law, thus diminishing the stability and predictability of basic personal relations the State has found it proper to acknowledge and protect. By this dynamic DOMA undermines both the public and private significance of state-sanctioned same-sex marriages; for it tells those couples, and all the world, that their otherwise valid marriages are unworthy of federal recognition. This places same-sex couples in an unstable position of being in a second-tier marriage. The differentiation demeans the couple, whose moral and sexual choices the Constitution protects, see *Lawrence*, 539 U.S. 558, 123 S.Ct. 2472, and whose relationship the State has sought to dignify. And it humiliates tens of thousands of children now being raised by same-sex couples. The law in question makes it even more difficult for the children to understand the integrity and closeness of their own family and its concord with other families in their community and in their daily lives.

Justice Kennedy points out that the DOMA definition of marriage impacts over 1,000 federal laws. Thus, DOMA touches many aspects of married and family life: from health care benefits, taxes, burial in veterans' cemeteries, even whether the kidnapping or murder of a "member of the immediate family" of a federal judge or law enforcement officer is a federal crime. Justice Kennedy's opinion upholds valid same-sex marriages as marriages equally worthy as federal equal protection of the laws:

> The federal statute is invalid, for no legitimate purpose overcomes the purpose and effect to disparage and to injure those whom the State, by its marriage laws, sought to protect in personhood and dignity. By seeking to displace this protection and treating those persons as living in marriages less respected than others, the federal statute is in violation of the Fifth Amendment.

1.3.1 *Hollingsworth v. Perry,* 570 U.S. ____ (June 26, 2013). *Hollingsworth* was a companion case to *Windsor* that was to address whether California's Proposition 8 – an amendment to the state constitution making marriage only between a man and a woman –

violates the Equal Protection Clause. It was dismissed for lack of standing. This effectively upheld the lower court's ruling finding Proposition 8 unconstitutional.

Both *Windsor* and *Hollingsworth* had unusual standing issues. In *Windsor*, the executive branch notified Congress it would cease defending the constitutionality of DOMA. House of Representatives voted to intervene in the litigation without opposition by the Department of Justice. In *Windsor*, although the Department of Justice did not defend DOMA, Treasury did not grant the refund. This combination – Congress supplying a surrogate litigant when the executive branch declined to defend DOMA and Treasury not granting a refund – satisfied the Court's justiciable dispute requirements.

In *Hollingsworth*, on the other hand, the Court determined that no justiciable dispute existed when California failed to defend its state version of DOMA once a lower court struck the law. There the appellants, acting as surrogates under California laws of procedure, lacked a "personal, particularized injury."

Justice Kennedy dissented: "The Court's reasoning does not take into account the fundamental principles or the practical dynamics of the initiative system in California, which uses this mechanism to control and to bypass public officials – the same officials who would not defend the initiative, an injury the Court now leaves un-remedied." Of the *Windsor*, majority, only Justice Sotomayor joined Justice Kennedy in *Hollingsworth* to support this consistent federalism position.

1.3.2 The Mixed Message of *Windsor* and *Hollingsworth*. Much of the *Windsor* case rests on the fundamental right of a state to define marriage. Once defined, the application of DOMA created a disfavored, second class of married couples in states that recognized same-sex marriage.

If decided on its merits, *Hollingsworth* would have addressed whether a state is constitutionally permitted not to recognize same-sex marriage. This is a broader issue then whether, once permitted, federal law can treat validly married couples differently based on whether the marriage was between one man and one woman. This broader question was not addressed by the Supreme Court.

The *Hollingsworth* "dream team" of Theodore Olson and David Boies are challenging Virginia's laws prohibiting same-sex marriage. The Virginia 2006 state constitutional amendment bars same-sex marriage and the recognition of such marriages that are valid elsewhere. The case ("Bostic") would not have the standing issues present in *Hollingsworth* and would take on DOMA § 2 and § 3 directly.

2.0 Rev. Rul. 2013-17: Federal Taxation of Same-Sex Marriage After *Windsor*. On August 29, 2013, the IRS issued Rev. Rul. 2013-17 to clarify the effect of *Windsor* on the federal tax level.

Windsor, of course, held that a New York decedent who was validly married under New York law at the time of her death must be treated as such regardless of § 3 of DOMA. In large part, this ruling was based on a State's unique power to determine what constitutes a valid marriage.

Windsor did not address, however, the situation of a couple validly married in a state that recognizes same-sex marriage who move to a state prohibiting it. Is that couple married for federal tax purposes? The Maryland *Port* case used comity as the basis for recognizing the state of the ceremony as creating a valid marriage in Maryland. Virginia has a constitutional provision stating that it will not honor a marriage performed elsewhere. Section 2 of DOMA, of course, explicitly authorizes such law.

Rev. Rul. 2013-17 addresses that issue and holds that, if validly married in a state recognizing same-sex marriage, the couple is married for all federal IRC purposes:

> There are more than two hundred Code provisions and Treasury regulations relating to the internal revenue laws that include the terms "spouse," "marriage" (and derivatives thereof, such as "marries" and "married", "husband and wife," "husband," and "wife.") The Service concludes that gender-neutral terms in the Code that refer to marital status, such as "spouse" and "marriage," include, respectively, (1) an individual married to a person of the same sex if the couple is lawfully married under state law, and (2) such a marriage between individuals of the same sex. This is the most natural reading of those terms; it is consistent with Windsor, in which the plaintiff was seeking tax benefits under a statute that used the term "spouse," 133 S. Ct. at 2683; and a narrower interpretation would not further the purposes of efficient tax administration.
>
> In light of the Windsor decision and for the reasons discussed below, the Service also concludes that the terms "husband and wife," "husband," and "wife" should be interpreted to include same-sex spouses. This interpretation is consistent with the Supreme Court's statements about the Code in Windsor, avoids the serious constitutional questions that an alternate reading would create, and is permitted by the text and purpose of the Code.

Thus, *Windsor* will be applied for all federal tax purposes regardless of the residency of the couple if the marriage is valid where performed. It does not, of course, address non-tax issues so post-*Windsor* cases like *Bostic* will be necessary to further clarify the law.

Rev. Rul. 2013-17 cautions that marriage does not include domestic partnerships, civil unions or similar formal relationships recognized under state law that are no denominated as a marriage.

2.1 Notice IR-2013-72. Along with Rev. Rul. 2013-17, the IRS issues Notice IR 2013-72 to provide guidance with respect to filing income tax returns as a result of *Windsor* and Rev. Rul. 2013-17.

For 2013, married same-sex couples must either file jointly or married filing separately. Generally, in two earners households, this will mean that they will pay higher taxes than if filing separately, unmarried as was the case before Rev. Rul 2013-17. This is the effect of the so-called "marriage penalty" which is caused by the graduated tax brackets. [There is also a potential "marriage bonus" when one spouse earns little relative to the other spouse.]

Other income tax changes include altering the tax filing status of same-sex married couples with children. Before Rev. Rule 2013-17, one spouse would file unmarried, head of household and claim the children while the other spouse would file single. Now, those couples would file a joint return with the children claimed as dependents on that joint return.

Notice IR-2013-72 permits, but does not require, amendments for all "open" years.

3.0 The Estate Planning Implications of Same-Sex Marriages in Maryland. Given that *Windsor* was, in fact, an estate tax case, its impact on estate planning in Maryland was sweeping and direct. *Windsor*, coupled with Family Law Art. § 2-201, means that for all state purposes and all federal estate tax purposes same-sex marriages are accorded the same treatment as other marriages. Because Maryland recognizes same-sex marriage, state law rules governing married persons will inform the estate planning.

Thus, for example, married same-sex couples may hold property as tenants-by-the-entirety. This opens opportunities for such couples to create estate plans balancing asset protection yet have in place by-pass trusts that can be created at the first death (if appropriate) by disclaimer. In Maryland, there will be no mismatching of state law and federal estate tax law. Even with Rev. Rule 2013-17, a same-sex married couple in a non-recognition state might be able to use by-pass trust planning or portability to effectively double-up the federal credit

equivalency, but they would not be able to create an entireties tenancy. In Maryland, all planning that would be appropriate for heterosexual married couples will be advisable for same-sex married couples. This includes:

- Use of the marital deduction. This is, of course, what *Windsor* involved.

- Same-sex married couples may hold property as tenants-by-the-entirety. This opens up significant asset protection planning opportunities (the use of disclaimer testamentary trusts when estate tax planning is needed and use of tenant-by-the-entirety trusts under Est. & Trusts § 14-113 when credit shelter trust tax planning is not the focus).

- All of the estate planning concepts used to minimize Maryland and federal estate taxes will work equally well for same-sex married couples. This includes the Maryland Inter Vivos QTIP asset protection/estate planning will work (Est. & Trusts § 14-116, effective 10/1/13), as well as every other technique from marital trusts to gift splitting are now available.

3.1 Other Implications. As noted by Justice Kennedy, DOMA's definition of marriage was "applicable to over 1,000 federal statutes and the whole realm of federal regulations." The impact of *Windsor* accordingly will ripple through the federal code. These include:

- Rev. Rul. 2013-17 makes clear that same-sex spouses will receive equal treatment with respect to retirement benefits – plan rollovers, pension survivor benefits.
- As the family law practitioners have already discovered, the right to marry also carries the right to divorce. See *Port v. Cowan*, 246 MD. 435 (2012). The IRs pronouncements mean qualified domestic relation orders (QDROs) are available and, the favorable tax treatment to dividing up property under IRC § 1041 will apply.