

## TAX IMPLICATIONS FOR THE LGBTQ\* COMMUNITY

### I. INCOME

#### *a. Head of Household Fallacy*

- i. IRC § 2, *Definitions and Special Rules*, defines “head of household” with three tests:
  1. Not married at the end of a tax year;
  2. Not a surviving spouse at the end of a tax year; and,
  3. Maintains an abode that, for more than ½ of the tax year is his principal residence.
- ii. IRC § 152 defines “dependent” as someone who is a qualifying child or a qualifying relative – a domestic partner does not fall into either category.

#### *b. Personal residence exemption - \$250K*

- i. Must reside in the property for any two of the past five years (look at income tax returns)

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\* Anyone who wants to be a relationship with someone and receive preferential tax status.

- ii. Must be on the deed
- iii. Must have check issued to both partners at closing

## II. GIFT

### a. *What elements comprise a gift?*

- i. Donative intent
- ii. Relinquishment of dominion and control
- iii. Acceptance

b. Most courts are willing to impose a constructive trust on property that a person contends was gift. See Minieri v. Knittell, 188 Misc.2d 298, 727 NYS2d 872 (2001), 2001 NY Slip Opinion 21274, 6/8/2001 NYLJ 20 (col 3). The facts of this case read like the old lesbian joke about bringing a U-Haul to a third date.<sup>†</sup> Here are the facts in chronological order:

- 9/96: the couple met;

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<sup>†</sup> While no dissolution of a relationship is a laughing matter, the author wonders whether or not the plaintiff had proper guidance in terms of her quest to “protect” the defendant. It would be interesting to know, for instance, whether or not the account Representative at Republic National Bank or at Smith Barney ever discussed with plaintiff the issue of gifting assets in an amount over the then applicable annual exclusion. It would also be interesting to know whether or not the real estate closing attorney for the New York City condominium or the Hamptons property ever discussed with plaintiff the issue of gifting, or suggested a domestic partnership agreement. Finally, did the plaintiff’s accountant file gift tax returns????

- 10/96: the defendant moved into the plaintiff's home, however the couple never registered as domestic partners.‡
- 11/96: plaintiff opened up a joint checking account and money market accounts in Republic National Bank with the defendant. Plaintiff made most of the contributions.
- 7/97: plaintiff purchased a Manhattan condominium and placed that property in to joint names with the defendant. Plaintiff used her own funds and credit to purchase the condominium.
- 4/98: plaintiff opened a joint account at Smith Barney. The account was funded by plaintiff.
- 10/98: plaintiff purchased in East Hampton home and placed the title into joint tenancy; again, plaintiff's own funds and credit.
- 2/99: plaintiff transferred her own account at Prudential into a joint account.
- 3/99: plaintiff purchased a Ford Explorer with her own funds and placed title into joint names.

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‡ Administrative Code of the City of New York § 3-241.

- 9/99: a domestic partnership ended – almost 3 years to the date they met
- 11/99: two months later plaintiff executed a deed to sever title from joint tenancy to tenancy in common, and did the same for the East Hampton property.

c. Gifts of real estate

- i. Fallacy: when a sole owner of property adds a domestic partner to the title of house, the value of the gift is (about) fair market value less the mortgage. False! The gift is actually the fair market value of the real estate – not net equity – because the mortgage is a personal debt that is secured by real estate. The parties are required to obtain an appraisal and the Donor of the property is required to file a gift tax return if the value of the property is greater than \$12,000 (and including all other gifts given to the same donee that year).
- ii. Alternative: create a contingent gift by using a domestic partnership agreement as a tax-savings

vehicle.....can avoid gift tax today, but will have to pay estate tax later.....

- iii. Fallacy: the new person on the deed has a basis equal to the fair market value at the time he received the gift – as evidenced by the gift tax return, FALSE! The proper calculation of basis for the purpose of calculating capital gains: the donee takes at the donor's basis. NO STEP UP!!

d. Gifts of joint bank accounts

- i. Federal law takes two positions:

- 1. No gift until the co-tenant removes a portion of the account
- 2. Rely upon state law to interpret definition of joint account

- ii. State law – need to look long and hard at the statutes. For instance, in NY:

- 1. There is a statutory presumption under §675 of the NY Banking Law that, in the absence of fraud or undue influence, the depositor intended to make a present gift of one-half of the balance in the account, together with

any accretions, to the joint tenant she places on the account with her, and further intended that the joint surviving tenant take the balance in the account upon her death.

2. If the account is opened in joint name without words of survivorship, there is a presumption under a different statute (EPTL §6-2.2) that the depositor intended to create a tenancy in common. This presumption is also to the effect that the depositor intended to make a present gift of one-half of the funds, together with any accretions, to the other tenant. However, upon the death of the depositor, only one-half of the balance in the account is payable to the surviving tenant, with the balance payable to the depositor's estate.

### III. ESTATE

- a. IRC § 2040, *Joint Interests*, defines the inclusion of the value (FMV, not net equity) of joint property in an estate – here are the general rules:

- i. Unmarried: 100% inclusion, with surviving co-tenant required to prove contribution
  1. Increases value of estate and can cause liquidity problems
  2. Survivor gets a step-up in basis
- ii. Married: 50% inclusion.
  1. No worries about an increase in value of estate because unlimited marital deduction results in no estate tax on the first death.
  2. Survivor gets the benefit of a step-up on ½ of the property

#### IV. METHODS OF PROPERTY OWNERSHIP

##### WHY IS THIS IMPORTANT??

- CREDITOR'S RIGHTS
- ESTATE TAX CONSEQUENCES
- GIFT TAX CONSEQUENCES

##### 1. Outright

- a. Sale opportunities:
  - i. Life insurance
  - ii. LTC
  - iii. Disability

2. Tenancy by the entirety. A tenancy-by-the-entirety is a special form of joint tenancy between husband and wife. Unlike an ordinary joint tenancy, if the property is owned as tenants-by-the-entirety, neither spouse can transfer his or her interest or convert the ownership into a tenancy-in-common without the consent of the other. Also, there is automatic creditor protection – Wonderful Wanda is protected from Debtor Dan’s creditors.
  - a. Inconsistency between the states: Some states permit a husband and wife to own both real and personal property as tenants by the entirety. Other states permit tenancies by the entirety only for real property, but not for personal property. Still other states (“community property states”) do not permit tenancies by the entirety at all.
  - b. Non-probate property.
  - c. Estate tax presumption:  $\frac{1}{2}$  included in first to die’s estate. Result:  $\frac{1}{2}$  of the property retains the surviving spouse’s basis; the other  $\frac{1}{2}$  gets a step-up in basis. This presumption can be overcome by proof of contribution. This can create a planning opportunity if the wealthy spouse dies first.
  - d. Sale opportunities:
    - i. Life insurance
    - ii. LTC
    - iii. Disability
3. Joint tenants with right of survivorship. In a joint tenancy with right of survivorship, the property automatically passes to the survivor. However, either joint tenant can sever the joint tenancy and convert the ownership into a tenancy in common. No creditor protection for non-debtor – property gets to be sold and co-tenant has to prove contribution to recover.
  - a. Non-probate property.
  - b. Estate tax presumption: FMV on date of death is 100% includible in the first co-tenant’s death. Therefore, burden is on the surviving co-tenant to prove contribution in order to reduce estate tax. Is there a planning opportunity here?
  - c. Sale opportunities:
    - i. Life insurance
    - ii. LTC
    - iii. Disability

4. Tenancy in common. In a tenancy-in-common, each co-owner owns an undivided interest in the property (does not necessarily need to be ½ of the property). Each co-owner can sell or encumber his or her interest. If one co-owner dies, his or her interest passes in accordance with the terms of his or her will or by intestacy. No creditor protection here, either.
  - a. Probate property.
  - b. Estate tax presumption: the amount that passes through the estate is taxed at FMV.
  - c. Sale opportunities:
    - i. Life insurance
    - ii. LTC
    - iii. Disability
  
5. Convenience Accounts. These accounts are also known as “power of attorney” accounts. The primary owner gives an attorney-in-fact the ability to remove funds from the account, but only for the benefit of the primary owner. The “power” ceases upon death. This account is created by statute, but currently, very few permit this kind of account. Watch for new legislation on these types of accounts.
  - a. Probate property.
  - b. Estate tax presumption: the amount that passes through the estate is taxed at FMV.
  - c. Sale opportunities:
    - i. Life insurance
    - ii. LTC
    - iii. Disability
  
6. Transfer on death. Usually used for marketable securities (stocks, bonds). Property that is owned by one person only; upon death, the property passes outside of the owner’s will to the person designated upon the moment of death. New York just became one of the last two states to adopt TOD legislation in January, 2007!
  - a. Non-probate property.
  - b. Estate tax presumption: 100% included in the owner’s estate.
  - c. Sale opportunities:
    - i. Life insurance
    - ii. LTC

iii. Disability

7. Corporate Entities: Family Limited Partnerships (FLPs)/Limited Liability Companies (LLCs)

- a. Great method for succession planning, if it is done correctly!
  - i. Control must be relinquished
  - ii. A “correct” proportion of cash &/or investable assets placed into the FLP
- b. Interest held by decedent are probate property
- c. Sale opportunities:
  - i. Life insurance funding for buy-sell agreement
  - ii. Retirement accounts for management (read: family members) and employees
  - iii. Group LTC
  - iv. Group disability
  - v. Group health insurance
  - vi. Directors’ and Officers’ / Errors & Omissions
  - vii. Property & Casualty

8. Trusts

- a. Sale opportunities:
  - i. Life insurance
  - ii. LTC – depending on the need for the trust

9. Retirement accounts

- a. Focus on Beneficiary designations
- b. Know how to properly effectuate spousal rollovers

## REFERENCES

### INTERNAL REVENUE CODE

26 USCA § 2

#### ➡§ 2. Definitions and special rules

##### (a) Definition of surviving spouse.--

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##### (b) Definition of head of household.--

**(1) In general.**--For purposes of this subtitle, an individual shall be considered a head of a household if, and only if, such individual is not married at the close of his taxable year, is not a surviving spouse (as defined in subsection (a)), and either--

**(A)** maintains as his home a household which constitutes for more than one-half of such taxable year the principal place of abode, as a member of such household, of--

**(i)** a qualifying child of the individual (as defined in [section 152\(c\)](#), determined without regard to [section 152\(e\)](#)), but not if such child--

**(I)** is married at the close of the taxpayer's taxable year, and

**(II)** is not a dependent of such individual by reason of [section 152\(b\)\(2\)](#) or [152\(b\)\(3\)](#), or both, or

**(ii)** any other person who is a dependent of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such person under [section 151](#), or

**(B)** maintains a household which constitutes for such taxable year the principal place of abode of the father or mother of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such father or mother under [section 151](#).

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

##### (2) Determination of status.--For purposes of this subsection--

**(A)** an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married;

**(B)** a taxpayer shall be considered as not married at the close of his taxable year if at any time during the taxable year his spouse is a nonresident alien; and

**(C)** a taxpayer shall be considered as married at the close of his taxable year if his spouse (other than a spouse described in subparagraph (B)) died during the taxable year.

**[(D) Redesignated (C)]**

##### (3) Limitations.--Notwithstanding paragraph (1), for purposes of this subtitle a taxpayer shall not be considered to be a head of a household--

**(A)** if at any time during the taxable year he is a nonresident alien; or

**(B)** by reason of an individual who would not be a dependent for the taxable year but for--

**(i)** [subparagraph \(H\) of section 152\(d\)\(2\)](#), or

(ii) [paragraph \(3\) of section 152\(d\)](#).

**(c) Certain married individuals living apart.**--For purposes of this part, an individual shall be treated as not married at the close of the taxable year if such individual is so treated under the provisions of [section 7703\(b\)](#).

**(d) Nonresident aliens.**--In the case of a nonresident alien individual, the taxes imposed by [sections 1](#) and [55](#) shall apply only as provided by [section 871](#) or [877](#).

**(e) Cross reference.**--

For definition of taxable income, see [section 63](#).

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26 USCA § 152

➡ **§ 152. Dependent defined**

**(a) In general.**--For purposes of this subtitle, the term "dependent" means--

- (1) a qualifying child, or
- (2) a qualifying relative.

**(b) Exceptions.**--For purposes of this section--

**(1) Dependents ineligible.**--If an individual is a dependent of a taxpayer for any taxable year of such taxpayer beginning in a calendar year, such individual shall be treated as having no dependents for any taxable year of such individual beginning in such calendar year.

**(2) Married dependents.**--An individual shall not be treated as a dependent of a taxpayer under subsection (a) if such individual has made a joint return with the individual's spouse under [section 6013](#) for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

**(3) Citizens or nationals of other countries.**--

**(A) In general.**--The term "dependent" does not include an individual who is not a citizen or national of the United States unless such individual is a resident of the United States or a country contiguous to the United States.

**(B) Exception for adopted child.**--Subparagraph (A) shall not exclude any child of a taxpayer (within the meaning of subsection (f)(1)(B)) from the definition of "dependent" if--

- (i) for the taxable year of the taxpayer, the child has the same principal place of abode as the taxpayer and is a member of the taxpayer's household, and
- (ii) the taxpayer is a citizen or national of the United States.

**(c) Qualifying child.**--For purposes of this section--

**(1) In general.**--The term "qualifying child" means, with respect to any taxpayer for any taxable year, an individual--

- (A) who bears a relationship to the taxpayer described in paragraph (2),
- (B) who has the same principal place of abode as the taxpayer for more than one-half of such taxable year,
- (C) who meets the age requirements of paragraph (3), and
- (D) who has not provided over one-half of such individual's own support for the calendar year in which the taxable year of the taxpayer begins.

**(2) Relationship.**--For purposes of paragraph (1)(A), an individual bears a relationship to the taxpayer described in this paragraph if such individual is--

- (A) a child of the taxpayer or a descendant of such a child, or
- (B) a brother, sister, stepbrother, or stepsister of the taxpayer or a descendant of any such relative.

**(3) Age requirements.**--

**(A) In general.**--For purposes of paragraph (1)(C), an individual meets the requirements of this paragraph if such individual--

- (i) has not attained the age of 19 as of the close of the calendar year in which the taxable year of the taxpayer begins, or
- (ii) is a student who has not attained the age of 24 as of the close of such calendar year.

...

**(B) More than 1 parent claiming qualifying child.**--If the parents claiming any qualifying child do not file a joint return together, such child shall be treated as the qualifying child of--

- (i) the parent with whom the child resided for the longest period of time during the taxable year, or
- (ii) if the child resides with both parents for the same amount of time during such taxable year, the parent with the highest adjusted gross income.

**(d) Qualifying relative.**--For purposes of this section--

**(1) In general.**--The term "qualifying relative" means, with respect to any taxpayer for any taxable year, an individual--

- (A) who bears a relationship to the taxpayer described in paragraph (2),
- (B) whose gross income for the calendar year in which such taxable year begins is less than the exemption amount (as defined in [section 151\(d\)](#)),
- (C) with respect to whom the taxpayer provides over one-half of the individual's support for the calendar year in which such taxable year begins, and
- (D) who is not a qualifying child of such taxpayer or of any other taxpayer for any taxable year beginning in the calendar year in which such taxable year begins.

**(2) Relationship.**--For purposes of paragraph (1)(A), an individual bears a relationship to the taxpayer described in this paragraph if the individual is any of the following with respect to the taxpayer:

- (A) A child or a descendant of a child.
- (B) A brother, sister, stepbrother, or stepsister.
- (C) The father or mother, or an ancestor of either.
- (D) A stepfather or stepmother.
- (E) A son or daughter of a brother or sister of the taxpayer.
- (F) A brother or sister of the father or mother of the taxpayer.

(G) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

(H) An individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to [section 7703](#), of the taxpayer) who, for the taxable year of the taxpayer, has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.

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**(e) Special rule for divorced parents, etc.--**

**(1) In general.--**Notwithstanding subsection (c)(1)(B), (c)(4), or (d)(1)(C), if--  
(A) a child receives over one-half of the child's support during the calendar year from the child's parents--

(i) who are divorced or legally separated under a decree of divorce or separate maintenance,

(ii) who are separated under a written separation agreement, or

(iii) who live apart at all times during the last 6 months of the calendar year, and--

(B) such child is in the custody of 1 or both of the child's parents for more than one-half of the calendar year, such child shall be treated as being the qualifying child or qualifying relative of the noncustodial parent for a calendar year if the requirements described in paragraph (2) or (3) are met.

**(2) Exception where custodial parent releases claim to exemption for the year.--**For purposes of paragraph (1), the requirements described in this paragraph are met with respect to any calendar year if--

(A) the custodial parent signs a written declaration (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year, and

(B) the noncustodial parent attaches such written declaration to the noncustodial parent's return for the taxable year beginning during such calendar year.

...

**(f) Other definitions and rules.--**For purposes of this section--

**(1) Child defined.--**

(A) **In general.--**The term "child" means an individual who is--

(i) a son, daughter, stepson, or stepdaughter of the taxpayer, or

(ii) an eligible foster child of the taxpayer.

(B) **Adopted child.--**In determining whether any of the relationships specified in subparagraph (A)(i) or paragraph (4) exists, a legally adopted individual of the taxpayer, or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer, shall be treated as a child of such individual by blood.

(C) **Eligible foster child.--**For purposes of subparagraph (A)(ii), the term "eligible foster child" means an individual who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

**(2) Student defined.--**The term "student" means an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins--

(A) is a full-time student at an educational organization described in [section 170\(b\)\(1\)\(A\)\(ii\)](#), or

(B) is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational organization described in [section 170\(b\)\(1\)\(A\)\(ii\)](#) or of a State or political subdivision of a State.

**(3) Determination of household status.**--An individual shall not be treated as a member of the taxpayer's household if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law.

**(4) Brother and sister.**--The terms "brother" and "sister" include a brother or sister by the half blood.

**(5) Special support test in case of students.**--For purposes of subsections (c)(1)(D) and (d)(1)(C), in the case of an individual who is--

(A) a child of the taxpayer, and

(B) a student,

amounts received as scholarships for study at an educational organization described in [section 170\(b\)\(1\)\(A\)\(ii\)](#) shall not be taken into account.

**(6) Treatment of missing children.**--

**(A) In general.**--Solely for the purposes referred to in subparagraph (B), a child of the taxpayer--

(i) who is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of such child or the taxpayer, and

(ii) who had, for the taxable year in which the kidnapping occurred, the same principal place of abode as the taxpayer for more than one-half of the portion of such year before the date of the kidnapping,

shall be treated as meeting the requirement of subsection (c)(1)(B) with respect to a taxpayer for all taxable years ending during the period that the child is kidnapped.

**(B) Purposes.**--Subparagraph (A) shall apply solely for purposes of determining--

(i) the deduction under [section 151\(c\)](#),

(ii) the credit under [section 24](#) (relating to child tax credit),

(iii) whether an individual is a surviving spouse or a head of a household (as such terms are defined in [section 2](#)), and

(iv) the earned income credit under [section 32](#).

**(C) Comparable treatment of certain qualifying relatives.**--For purposes of this section, a child of the taxpayer--

(i) who is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of such child or the taxpayer, and

(ii) who was (without regard to this paragraph) a qualifying relative of the taxpayer for the portion of the taxable year before the date of the kidnapping,

shall be treated as a qualifying relative of the taxpayer for all taxable years ending during the period that the child is kidnapped.

**(D) Termination of treatment.**--Subparagraphs (A) and (C) shall cease to apply as of the first taxable year of the taxpayer beginning after the calendar year

in which there is a determination that the child is dead (or, if earlier, in which the child would have attained age 18).

**(7) Cross references.--**

For provision treating child as dependent of both parents for purposes of certain provisions, see [sections 105\(b\)](#), [132\(h\)\(2\)\(B\)](#), and [213\(d\)\(5\)](#).

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26 USCA § 2040

■ **§ 2040. Joint interests**

**(a) General rule.--**The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: **Provided**, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: **Provided further**, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

**(b) Certain joint interests of husband and wife.--**

**(1) Interests of spouse excluded from gross estate.--**Notwithstanding subsection (a), in the case of any qualified joint interest, the value included in the gross estate with respect to such interest by reason of this section is one-half of the value of such qualified joint interest.

**(2) Qualified joint interest defined.--**For purposes of paragraph (1), the term "qualified joint interest" means any interest in property held by the decedent and the decedent's spouse as--

**(A)** tenants by the entirety, or

**(B)** joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.