Protection Cover for Cohabiting Couples

A Technical Guide for Financial Advisers

1 in 10 people are co-habiting in Ireland. Are you one of them?

The trend for couples to co-habit, rather than marry, has become increasingly more common in Ireland.

With the implementation of the Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010 rights similar to those of a married couple have been conferred on registered civil partners and qualified cohabitants. Though it must be mentioned that the rights extended are different for both.

The details of all the amendments are not relevant for the purposes of this Guide but what is important to mention here is that while the Act did amend the Succession Act to allow civil partners automatic rights to each others estates on death, no such entitlement has been granted to cohabitants, though they can apply for such provision out of their deceased cohabitants estate.

Also of note is the fact that the changes to Capital Acquisitions Tax legislation in Finance (No. 3) Act 2011 will only be of benefit to registered civil partners. No exemptions or reliefs from CAT have been given to cohabiting couples.

So, while a qualified cohabitant may apply for provision out of their deceased cohabitants estate, they will still have to pay inheritance tax on anything they receive as a result of that application.

Most people are aware that all benefits passing between married couples are exempt from Inheritance and Gift Tax. Up until recently, this relief only applied to "legal spouses". As a result of the changes in Finance (No 3) Act 2011 this 'spouse' exemption has now been extended to registered civil partners. All other cohabiting couples are still treated as strangers for Inheritance and Gift Tax purposes.

The stranger threshold for Inheritance Tax is €15,075 (Dec 2012). Inheritances in excess of €15,075 are subject to tax at 33%.

For more details about the legislative changes resulting from the Civil Partnership Act and Finance (No 3) Act please refer to our document titled "Civil Partners and Cohabitants - Life Assurance Issues" on Bline.

Arranging protection cover for cohabiting couples

As you can see from the above, registered civil partners are now treated in the same way as legal spouses from a succession act and an inheritance tax perspective. As the same rights and exemptions have not been given to other cohabiting couples you still need to be aware of the following areas when advising these clients :

- Family Home Relief
- Mortgage Protection
- Other Assets
- Personal Protection
- Use of the small gifts exemption

We will look at each of these areas separately and outline the tax and legal implications and the possible solutions to some of these problems.

Family Home Relief

The Finance Act 2000 introduced a complete exemption from Inheritance Tax on the value of "a dwelling", provided the person inheriting the property satisfied certain conditions – basically that it was, and continues to be, their home. This is commonly referred to as "family home" relief.

The relief is available to any individual who satisfies the conditions and not just to qualified cohabitants.

To qualify for the exemption the person who inherits the home must:

- have occupied the house as their sole or main dwelling for three years prior to the date of the inheritance,
- at the date of the inheritance does not hold an interest in any other dwelling house,
- continue to occupy the house as their sole or main residence for 6 years after the date of the inheritance.

What this means is, once a couple have been living in the house for 3 years, regardless of which of them own the house, paid the mortgage or the mortgage protection policy, there will be no Inheritance Tax liability on the value of the house if the above conditions are met.

If the above conditions are not met then there could be significant tax implications for the survivor.

Note:
Where the dwelling house is passed as a gift during the life of the original owner of the property there are additional conditions to be met.

Mortgage Protection

John and Mary buy a house in joint names. They contribute equally to the deposit, mortgage repayments and joint mortgage protection policy.

John dies in the first year of the mortgage (House valued at **€500,000**).

Mary inherits 50% of property (assuming held as joint tenants).

The mortgage is cleared by the Mortgage Protection Policy.

Threshold for Mary is **€15,075** with tax at 33% on **€234,925 = €77,525**.

Options

Increase Mortgage Protection policy by €80,000

Possible tax on €40,000 at 33% is €13,200

or

Life of another policy for €80,000

If Mary had made no contribution to the purchase of the house then she would inherit 100% of the value of the house and she would be faced with a tax bill of €160,025.

After three years family home relief may apply assuming all the other conditions are met.

Other Assets

With the possible exception of the family home, the total value of all assets is liable to Inheritance and Gift Tax, regardless of how long the couple are living together. Where a cohabiting partner inherits other property, or a death benefit under an insurance policy, the €15,075 threshold could easily be exceeded.

Personal Protection

When you are structuring a life assurance policy for your cohabiting clients, whether or not Inheritance Tax will be paid on any payout from the contract will be decided by two things :

- Who will receive the policy proceeds on death (the beneficiary)?
- Who paid the premiums on the policy?

If the beneficiary did not pay the premiums, or if the beneficiary is not the legal spouse or registered civil partner of the person who paid the premiums, the policy proceeds will be liable to Inheritance Tax.

Example 1

John Brown takes out Life Cover of €100,000 on his own life and pays the premiums by direct debit from his own bank account. John dies and based on the terms of John's Will the €100,000 is paid to his cohabitant partner Mary Smith.

Assuming Mary inherited no other assets, the liability to tax is as follows:

Mary's taxable inheritance is €100,000.

Threshold €15,075 exempt.

Balance €84,925 taxed at 33% = **€28,025**.

Example 2

John Brown and Mary Smith take out "Dual Life" Cover of €100,000 John and Mary are joint owners, and pay premiums out of their joint account.

John dies and the €100,000 is paid to his cohabiting partner Mary Smith because she is the surviving policy owner.

Assuming Mary inherited no other assets, and Revenue agree that she has paid 50% of the premiums, she will be taxed on 50% of the benefit.

So, Mary's taxable inheritance is €50,000.

Threshold €15,075 exempt.

Balance €34,925 taxed at 33% = **€11,525.**

Example 3

Mary Smith takes out a "Life Policy" with Life Cover of €100,000 on John Brown's life i.e. Mary is the proposer / policy owner with John as the life assured. Mary pays the premiums by direct debit from her own bank account.

John dies and the €100,000 is paid to his partner Mary Smith, as she is the legal owner of the policy.

Mary has no liability to Inheritance Tax, as she is both the beneficiary and the person who paid the premiums.

Small Gifts Exemption

The examples given assume both parties are in a position to contribute to the cost of the policy. Where one party is financially dependant on the other, then no matter how the policies are arranged, on the death of the person who financed the policy the survivor will take a taxable inheritance equal to the full value of the policy.

One way of avoiding the potential taxable inheritance for someone who does not have their own means of income would be to avail of the annual Gift Tax Exemption of €3,000 (Feb 2012). For this to work, it is vital that the donor first gifts the €3,000 to the beneficiary, who then uses it to pay the premium on the life of another policy. A simple way of setting this up would be for the donor to set up a Direct Debit to the beneficiary's bank account, and then the beneficiary could effect the life of another policy and pay the €3,000 or part of the premium from his/her own bank account.

Summary

When advising cohabiting couples

When putting in place "mortgage protection" type cover arranging the cover on a joint life first death basis may give rise to a potential tax liability. The sum assured could be increased to cover this potential liability. The amount of increased cover will depend on the percentage of the property inherited by the survivor and what, if any, contribution they have made to the mortgage.

When putting in place additional "family protection" type cover arranging the cover on a single life "life of another" basis will avoid any potential liability to inheritance tax but only where the proposer actually pays the premium i.e. the proposer must have independent financial means.

If the policy is effected on a dual life basis then the cover will need to be increased to take into account the potential tax liability. The amount of increased cover will again depend on the percentage inherited by the survivor and what, if any, contribution they have made to the policy.

Where a couple are planning to marry, or register as civil partners in the near future, they may decide that it is more practical to have a jointly owned policy in the long term. So they may be happy to take the risk that in the (hopefully unlikely) event of death before they "tie the knot" a tax liability may arise.

If a couple have other substantial assets it may be more prudent for them to either effect Section 72 cover on a single life basis nominating each other as the beneficiary of the policy, or alternatively each of them could effect a "life of another" policy on the other to cover any potential tax liability.

For more details about the legislative changes resulting from the Civil Partnership Act and the Finance Act please refer to our document titled "Civil Partners and Cohabitants - Life Assurance Issues" on Bline

The legal and tax information included in this technical guide is correct as of December 2012 but is subject to change. The examples included in this document are not based on any real individual circumstances and should not be constituted as advice in any particular instance.

We advise that your client seeks professional Tax and Legal Advice as the information given is a guideline only and does not take into account your clients particular circumstances.

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