



## Family Wealth Institute

### Planning for Unmarried Couples

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The number of unmarried couples is on the rise. In the ten year period from 1990 to 2000, the U.S. Census Bureau estimated that the number of unmarried couples in the U.S. increased by 72%. To be fair, we know that the Census Bureau didn't really start looking for this segment of the population until 2000, but once they started, they were thorough. Initial Census reports from 2000 indicated that the Bureau had identified 5.5 million unmarried couples. In follow up studies, the Bureau fine tuned their questions and, in 2006, reported about 6.4 million unmarried couples. Based on the 2006 Census reports, the *New York Times* reported that only 49.7% of U.S. households consist of a married couple, leading the paper to announce that "To be Married is to be Outnumbered."

Unfortunately, planning is more complicated for these couples. From a tax point of view, planning is more difficult because unmarried couples cannot take advantage of Federal rules that allow for tax-free transfers between one spouse and another. On more basic issues, unmarried couples may not be legally recognized to act for each other. Whether dealing with a bank, a court or a hospital, unmarried couples must frequently outline their desires in legal documents, while "family members" are authorized to act merely based on their family status.

Federal tax rules allow a husband and wife to transfer property back and forth without any tax implications. Unmarried couples do not have this ability, and they are often caught unaware. For example, a husband can pay 100% of his wife's living expenses, but an unmarried partner who pays for more than \$13,000 of his partner's living expenses during a year has technically made a taxable gift of every dollar over \$13,000. During her lifetime, a wife may move assets to and from her husband (assuming a U.S. citizen) as often as she wants without any Federal gift tax problems, but an unmarried partner who transfers more than \$1 million to her partner (regardless of citizenship) cumulatively over her lifetime will make a taxable gift of everything beyond \$1 million. Finally, a husband may leave everything he owns to his U.S. citizen wife through his estate plan without causing any Federal estate taxes, but an unmarried partner can only leave \$3.5 million to his partner (reduced by any lifetime taxable gifts) before his estate owes Federal estate taxes.

It's easy to say that unmarried partners face more tax implications, but what does that really mean? Here are some surprising examples:

- > A \$10 million estate can pass free of estate taxes to a surviving husband or wife because the first \$3.5 million is shielded from the estate tax and the balance escapes the estate tax because it passes to a surviving spouse. But \$6.5 million of a similar estate passing a surviving partner will be subject to the estate tax -- at a 45% tax rate to boot!
- > Life insurance proceeds that are paid to a surviving husband or wife usually pass to the survivor free of income tax and free of estate tax. But proceeds that pass to a surviving partner if the insured owned or had any incidents of ownership in the policy.
- > Most states follow the unlimited spousal transfer rules when it comes to property tax reassessments. As a result, a husband may transfer real property to his wife when they get married (or any time during the marriage) without the property being reassessed for property tax purposes, but if an unmarried partner does the same thing, the property may be reassessed immediately. What's worse, if the property is transferred from one unmarried partner to another at death, the reassessed property taxes may be so high that the surviving partner cannot afford to keep the property.
- > Holding other assets in joint names can create extra tax problems. As with real estate, a wife can add her husband's name to her bank and investment accounts without causing any tax issues. But when one unmarried partner adds the other on to title of such assets, she will be deemed to have made a gift of 50% of the account value (although the IRS won't try to tax it until the newly added partner uses the money). If the partners don't keep ongoing records about additions to the account and uses of it, then the IRS may attribute ownership to both partners, causing double estate taxation of the assets.

Taxes are not the only concern for unmarried couples. Unless you happen to live in a state that gives your relationship legal status (as a domestic partnership, a civil union or a marriage), then you will probably find that financial institutions and medical facilities refuse to allow unmarried couples to act for each other. You may not be able to sign checks or make investment decisions for your partner or decide how he or she should be treated by doctors unless you have effective powers of attorney in hand and the mental and emotional wherewithal to stand up for yourself. If the situation spins out of control, court involvement may be necessary, but regrettably most courts will favor spouses and other family members over unmarried partners. To avoid this, your powers of attorney should include a clear statement about who a court should appoint to make decisions for you.

So what are unmarried couples to do?

- > The couple should seek out professional advisors who are familiar with these issues. Attorneys can help in a variety of ways – from helping you understand your state’s rules for unmarried couples to drafting accurate and effective documents. Accountants can help you understand the tax implications of living together and advise you on record keeping patterns that will be helpful in the event of an audit. Financial advisors can help you coordinate separate financial assets into an integrated financial plan.
- > The couple should know and understand what each of their legal documents provide and they should review them regularly. Powers of attorney are effective only if they express current wishes. A power of attorney that’s many years old may not do that. More importantly, these documents draw their power from statutes enacted by each state’s legislature. If the statutes change but a document doesn’t, then it may become necessary to ask a court how the power of attorney should be interpreted.
- > They should consider designating a professional fiduciary in their estate plans. Unfortunately, a surviving partner may be surprised by a family’s conduct after a death. While the couple thought their families were comfortable with their living arrangement, prejudices often surface after death. A professional fiduciary should not be subject to the emotions of the situation. Instead, a professional will be bound to administer the estate based on the terms of the estate planning documents. Although there will be a fee to the professional, this money usually turns out to be worth its weight in gold.
- > As assets are accumulated during the lifetime of the couple, be very aware of ownership, sources of the funds used to acquire ownership, as well as title. Keep good, consistent, and clear records. If there is an ability to share or shift ownership at inception, it will likely reduce both the cost and complexity of making changes at death. But a strong note of caution here ... shared ownership can make it more complicated to manage and more expensive to split up if the relationship terminates before death. Agree in advance how shared assets will be operated, income split, expenses paid, and how ownership will be decided in the event of a break up of the relationship. Do this before you acquire the asset. Do it in writing!
- > In some situations, one partner may be the breadwinner, while the other partner provides services at home. Transferring funds from the income earner and wealth creator to the at-home partner who provides traditional non-income services for the couple is subject to the transfer tax rules with rates as high as 45%. It might



be less expensive to compensate the at-home partner through salary to take advantage of tax brackets that begin at 15%.

- > Insurance can be the great equalizer and provide necessary liquidity and security to the less wealthy partner. But make sure the policy is not owned by the insured. If gifts of premium are needed, be aware of the gift tax consequences. An irrevocable life insurance trust can be a useful vehicle for owning, receiving, and managing the policy and death proceeds. Be sure to discuss this with your legal counsel.

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