



## Together but Separate

Planning for unmarried couples of all stripes is a challenge, but can be done. Here's what to keep in mind

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In its most unromantic sense, a legal marriage is the creation of an economic unit, and there are over 1,100 federal rights and responsibilities that support that unit's survival. The 2000 census showed that almost half of the adult U.S population is unmarried, and this number is expected to grow significantly as the population ages.

According to Deb Neiman, co-author with fellow advisor Sheryl Garrett of *Money Without Matrimony* (to be published in June 2005 by Dearborn), the unmarried world divides into three categories:

Younger couples, who are heterosexual men and women who choose to postpone marriage, not marry at all, or who are divorced and choose not to remarry

Older couples, who are older heterosexual men and women eligible for Social Security benefits—including seniors, widows, and widowers—who opt not to marry or remarry for family, financial, or personal reasons

Same-sex individuals, who are couples or life partners but who cannot legally marry except in the state of Massachusetts. These marriages are not recognized under Federal law due to the 1996 passage of the Defense of Marriage Act that defines marriage as exclusively between opposite-gendered partners. Forty-three states have laws that ban recognition of same-sex marriage, and as of February 2005, 17 states have proposed constitutional amendments limiting marriage and/or other forms of relationship recognition.

It's important to remember that financial planning strategies for unmarried couples are, in many cases, based on contract law rather than the traditional legal protections provided by family law. "Unmarried couples need to approach the economic commitments of their relationship as a business partnership," says Neiman, "because coupling isn't really so different from the legal commitment of marriage." Despite societal pressures and many individuals' assumptions, the marriage pact is, from a legal standpoint, neither a spiritual, a religious, nor a personal commitment, she says. In signing a marriage license, a couple agrees to uphold the laws that govern marriage, including property rights, tax issues, and the effects of the dissolution of the marriage from divorce or death.

“Unmarried partners, on the other hand, have no such legal framework,” Neiman points out. “They have no access to divorce courts or automatic property distributions, and must set up their own rules with their own documentation and agreements.”

Financial planners will find they must partner with attorneys who can implement the contract law necessary in many unmarried financial planning strategies. The fundamental decisions, though, rest with the client couple. It may be necessary for each unmarried partner to be represented by their own attorney to work out a fair and equitable solution to the planning questions. The financial planner should expect to play a key role assisting her clients in developing a plan acceptable to both.

## A Case Study

So how do these guidelines play out in the real world? In the following case study, Pat and Chris have been together for 18 months and cannot legally marry in their state. They want to put their “financial house” in order but aren’t sure how to go about it. They ask other unmarried couples how they handle their finances, but find that there is no prototype. Each couple does it their own way, and unmarried couples frequently disregard the impact of their planning, or lack thereof, on taxes, gifting, and estates.

After much discussion, Pat and Chris identify the following objectives:

- 1 Select company benefit options, including investments in their retirement plans, based on which company provides the more robust package
- 1 Sell Pat’s condo and buy a home
- 1 Have one or possibly two children (whether one or both will be a birth mother to be decided later)
- 1 Fund their offspring through college
- 1 Take an annual vacation
- 1 Save for retirement
- 1 Consider plans if Chris wants to start her own consulting company later
- 1 Prepare for the possibility Pat may need more schooling if she wants to specialize in her employment area.

To accomplish those goals, they draw up a checklist that must include the following issues that highlight the differences in planning for married and unmarried couples:

## Moving In Together

**Married.** When one spouse moves into the other’s home in a community property state and the owner adds his spouse on the title, a non-taxable gift is made because of the unlimited marital deduction. The home is owned jointly and no reassessment occurs. The homeowners’ insurance covers the couples’ contents.

**Unmarried.** When Chris moves in with Pat, the house still belongs to Pat. If Pat adds Chris to the deed, this constitutes a taxable event and counts against the lifetime gift exemption. If Chris lives in the condo,

she needs a renter's insurance policy for her assets because Pat's homeowner's insurance won't cover Chris's belongings.

### **Buying a New Home Together**

**Married.** It is immaterial from a tax standpoint who places the down payment, who pays the property tax, or who pays the mortgage.

**Unmarried.** If Pat makes the down payment with the proceeds from the condo and the house is held as Joint Tenants With Rights of Survivorship (JTWROS), a gift was made to Chris for half the down payment. Since there isn't an unlimited marital deduction, this gift goes against the lifetime exclusion.

If Chris pays the mortgage and property tax, she is making a taxable gift to Pat since she is relieving her of a debt obligation.

### **Titling the House**

**Married.** When the first spouse dies, the house will receive a step-up in basis if held as community property. For property held as Joint Tenants with Right of Survivorship, half of the property will receive a step up in basis.

**Unmarried.** Property cannot be held as community property and thus is not eligible for the full step up at the first partner's death. If the house is held JTWROS, the IRS will assume that the first to die owns the entire property and will include the full value of the property in the estate unless the couple have kept good records and can prove otherwise. It is often advisable for unmarried couples to maintain separate bank accounts to establish a trail of individual contributions. If the payments are made from a joint account, it is often more difficult to demonstrate that both partners contributed to the ownership of the house.

### **Income Tax Filing**

**Married.** Couple files a joint tax return.

**Unmarried.** Couples will need to allocate Schedule A deductions (e.g., property taxes, charitable contributions).

### **Company Benefits**

**Married.** Health insurance benefits are not taxed as W-2 income for the employee. Additionally, under the Family and Medical Leave Act of 1993, workers are granted up to 12 weeks of unpaid leave to care for a sick spouse or child. Employees are also entitled to take leave when they have (or adopt) a child.

**Unmarried.** If the company provides health care benefits for domestic partners, the cost of these benefits is considered W-2 income to the employee and is fully taxable. The Family and Medical Leave Act does not cover unmarried families and companies are not required to grant time off.

### **Defined Benefit Plans**

**Married.** If the employee dies before retirement, the surviving spouse can receive the payment stream.

**Unmarried.** Many companies only provide survivor benefits to a legal spouse. The pensions of unmarried employees are often forfeited.

### **Defined Contribution Plans**

**Married.** A surviving spouse often has the option to roll the defined contribution plan into an IRA, thus extending the period of tax-deferred growth.

**Unmarried.** Non-spousal beneficiaries are often required to withdraw the assets in the qualified plan immediately, thus losing the tax-advantaged status and stretch-out opportunities.

### **IRA Issues**

**Married.** Spousal rollover of an IRA gives the married partner full ownership of the account and the ability to treat the asset as her own. This can be a great tax advantage if the surviving spouse is much younger, since it allows the asset to stretch its tax-deferred growth.

**Unmarried.** Since unmarried couples are legal strangers to one another, a surviving partner is treated as any other beneficiary with minimum distributions required to begin immediately.

### **Social Security**

**Married.** If collecting Social Security, when one spouse dies and has the larger pension, the surviving spouse will get the larger payout. If a spouse dies, there are survivor benefits.

**Unmarried.** Social Security does not recognize unmarried couples and does not allow a surviving partner to collect survivor benefits. Additionally, if a surviving partner has stayed home to raise children and has not accrued the requisite quarters of employment, they will not be entitled to receive the spousal benefits.

### **Investment Assets**

**Married.** Because of the unlimited marital deduction, adding a spouse's name to an account is not a taxable event nor is it a taxable event if that spouse then withdraws assets from the account.

**Unmarried.** A completed gift occurs if a partner is added to an account and then withdraws funds. Titling financial assets is extremely critical and complex for unmarried couples who intend to share an investment portfolio.

### **Children**

**Married.** Stepparent adoption options are available.

**Unmarried.** Unmarried couples may or may not be able to cross-adopt or use stepparent adoption rules, depending on the state. The non-birth parent may not have any parental rights if the birth mother dies, even if the non-birth parent is raising the children. This can become a serious issue if the family of the birth parent claims rights to the children and a legal adoption of the unmarried couple's children has not been made.

### **Dissolution Issues**

**Married.** Family law creates a systematic method for dividing property that has accumulated during the relationship and acknowledges both partners' contributions to the growth of the wealth. This is reflected in that the division of marital assets—including retirement accounts and real property—is treated as a non-taxable event.

**Unmarried.** When there is no legal recognition of the couple, there is no system in place to protect both partners' interests at the dissolution of the relationship or recognition for Qualified Domestic Relations Orders (QDROs) that spell out the division of retirement plan assets. There are also no laws that apply to the equitable division of jointly owned property. In some states, family law applies, but is not recognized for federal tax purposes.

### **Stay-at-Home Parents**

**Married.** Spousal IRA is available for the stay-at-home parent.

**Unmarried.** No spousal IRA is available for the stay-at-home parent. No Social Security will flow from the wage earner to the unmarried partner in retirement.

### **Necessary Legal Documents**

Both married and unmarried couples must implement the following legal documents at a minimum to protect their families:

- ┆ Durable power of attorney for property and assets
- ┆ Medical power of attorney and advance directive
- ┆ Estate documents identifying guardian
- ┆ Will or trust
- ┆ Partner authorization for disposition of remains
- ┆ Domestic partner agreement for dissolution of relationship.

Pat and Chris have some demanding work ahead of them as they sort through the options that will keep their financial house in order. They need to discuss how they will support a family; what needs to be done for the stay-at-home parent to be treated fairly in the event of a split; who will be guardians of their children in the event of their deaths; and how they will compensate for benefits that married people receive but they do not.

Financial planners have a major role in helping couples like Pat and Chris, and all unmarried couples who must deal with the realities of their financial planning challenges. Starting is essential. There is nothing prudent about waiting to make financial decisions until the equal financial rights of unmarrieds are accepted and legislated by society.

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California.



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