ROYAL LONDON

The smart move for cohabiting couples

What you need to know about Mortgage Protection and Inheritance Tax

Did you know that generally **only married couples and registered civil partners are exempt from inheritance tax?**

This means, if you're living with your partner and are not married to them, or in a registered civil partnership, **you may have to pay inheritance tax, even if you jointly own a house.**

Couples that live together and are not married or in a registered civil partnership, are often referred to as **cohabiting couples.**

When it comes to inheritance tax, cohabiting couples pay tax of 33%[1] on an inheritance above the current threshold of €16,250[1].

Here's how it works

Sue and John are an unmarried couple and buy a house in joint names valued at €400,000. **They both paid towards the €50,000 deposit and will jointly pay the mortgage**. They take out Dual Life Mortgage Protection for €350,000 to pay off the mortgage if one of them passes away.

In the first year John dies and the Mortgage Protection policy clears the mortgage:

- Sue already owns 50% of the property, so she inherits John's 50% of the property value.

50% x €400,000 = **€200,000**

- Sue must pay 33% inheritance tax on the amount she inherits above the threshold of €16,250.

33% x (€200,000 - €16,250) = **€60,638** Sue's tax liability

Dwelling House Exemption

It may be possible to inherit the family home from your cohabiting partner without paying inheritance tax, if you qualify for what's called the **Dwelling House Exemption[2]**.

According to the Finance Act 2016, you qualify for the Dwelling House Exemption and will not have to pay inheritance tax on a house if:

- The house was the only or main home of the person who died (this condition does not apply if you are a dependent relative[3]).
- You lived in the house as your main home for the three years before the person's death.
- You do not own, have an interest or a share in any other house, including one you acquired as part of the same inheritance.
- The house is your main home for six years after you receive the inheritance. This does not apply if you are over 65.

1. www.revenue.ie - Capital Acquisitions Tax (CAT) thresholds, rates and aggregation rules
2. www.revenue.ie - Exemption for Dwelling House
3. A dependent relative is defined as an individual aged 65 years or over, or permanently and totally incapacitated due to a physical or intellectual disability, and unable to earn a living.

If you are a cohabiting couple and the Dwelling House Exemption does not apply to you, **it is possible to structure your Mortgage Protection in a way that would help to fund, and in some circumstances may even reduce, your inheritance tax liability.** Your options will depend on whether you are setting up Mortgage Protection cover for the first time or whether it is already in place.

How Sue and John could fund for their potential inheritance tax liability when first setting up their Mortgage Protection policy – two examples are shown. Example 1 assumes that both Sue and John are earning, while example 2 is based on just one of them earning.

Example 1 – Both partners earning
Set up two Single Life policies

Rather than arranging one Dual Life Mortgage Protection policy, John and Sue could each set up their own Single Life Mortgage Protection policy, insuring each other's life for the full mortgage amount (of €350,000). This amount, as we have already seen, is the purchase price of the property of €400,000 less the deposit that they have paid of €50,000.

This is known as a Single Life, Life of Another policy. If they do it this way, they would also need to ensure they pay the premium on the policy they own **from a sole bank account funded by their own earnings, not a joint account** (so the key issue is whether they are both earning and therefore able to fund their own policy). Doing it this way means Sue's inheritance would actually be reduced in the event of John's death, and vice versa.

If John dies in the first year, it is the proceeds from Sue's policy that will clear the mortgage. Sue will effectively inherit the mortgaged portion of the house from herself and therefore be exempt from paying inheritance tax on that portion. Sue would still have to pay tax on the **mortgage free value** that she inherits:

- Sue inherits 50% of the remaining, mortgage free value of the property.

50% x (€400,000-€350,000) = **€25,000**

- Sue pays 33% inheritance tax on the amount she inherits above the threshold of €16,250.

33% x (€25,000 – €16,250)
= **€2,887.50 – Sue's tax liability**

Arranging two Single Life, Life of Another, Mortgage Protection policies and paying the premiums from their own funds means, in this example, **Sue's inheritance tax liability would be significantly reduced as Sue is the beneficiary and paid the premiums on the policy that paid out.**

Example 2 – One partner earning
Increase the amount of Dual Life Cover

If, however, only one of the two partners owned the property, the situation would be different. Let's assume that Sue owns the property on her own. Sue paid the deposit and as the sole earner, she pays the mortgage repayments and the premiums on their Mortgage Protection policy. They are mindful of the potential inheritance tax liability that would occur for John if Sue died. So they opt, with the agreement of their lender, to increase the amount of cover when they apply for their Dual Life Mortgage Protection, so there would be enough left over to pay towards the likely inheritance tax bill.

Instead of taking out just €350,000 cover to clear the mortgage, Sue and John increase the amount of cover on their policy by €189,012, bringing the total sum assured to €539,012. This additional cover, when paid out, would be enough to cover the cost of inheritance tax based on the current tax rules and value of their property. Details of how this amount is calculated are set out below.

€350,000 + €189,012 = **€539,012**

- In the first year Sue dies and the Mortgage Protection policy pays out €539,012 to the lender, as the policy was assigned. John is legally entitled to the balance of the policy proceeds after the mortgage debt of €350,000 has been cleared and receives €189,012 from the lender.
- John inherits the property under the terms of Sue's will, which is worth €400,000. The balance of the Mortgage Protection policy proceeds of €189,012 is also regarded as an inheritance from Sue as she paid all the premiums.
- Therefore, John's total inheritance amounts to €589,012.

€400,000 + €189,012 = **€589,012**

- John must pay 33% inheritance tax on the amount he inherits above the threshold of €16,250.

33% x (€589,012- €16,250)
= **€189,012 – John's tax liability**

Taking out the extra cover of €189,012 means John has enough to cover the inheritance tax liability on inheriting both the property and the balance of the Mortgage Protection policy proceeds seen in this example.

How Sue and John could cover the cost of inheritance tax if they've already got Mortgage Protection in place

In addition to their existing Dual Life Mortgage Protection policy, John and Sue could choose to take out two, Single Life, Life of Another insurance policies, covering each other for **€60,638** (the inheritance tax amount seen in the calculation 'Here's how it works' on page 1).

Sue insures John's life and pays the premiums; and John insures Sue's life and pays the premiums. In the event of John's death, Sue's policy will pay out to her. No inheritance tax is due on the proceeds as Sue is the beneficiary and paid the premiums. Sue could use the proceeds to pay the €60,638 inheritance tax bill noted in the calculation on page 1.

Again, they would each need to pay the premium on the policy they own from a sole back account funded by their own individual earnings.

Other considerations

Small Gift Exemption

If one party is not earning or does not have their own funds to pay the cost of insurance premiums themselves, they could avail of the annual Small Gift Exemption which is currently €3,000[4].

For example, if Sue does not have the funds to pay for the Single Life, Life of Another policy that we saw earlier, then she could receive a gift of up to €3,000 tax free annually from John. She could then use that money to pay the insurance premiums on her policy.

Section 72 Life Insurance

If Sue and John have other assets which they would inherit from one another then a Section 72 Life Insurance policy could be more beneficial. It can be taken out specifically to help pay inheritance tax. The money paid out, when it is used to pay inheritance tax, is not liable to tax.

Read our flyer *Protect your Legacy* for more information or speak to your Financial Broker.

[4] www.revenue.ie – Small Gift Exemption

For more information about protecting your finances as a cohabiting couple contact your Financial Broker.

Royal London received the award for Best Mortgage Protection at the 2020, 2019 and 2017 National Consumer Awards

Royal London
47–49 St Stephen's Green, Dublin 2
T: 01 429 3333 F: 01 662 5095 E: service@royallondon.ie
royallondon.ie

This flyer is for illustration purposes only and does not form any part of any contract. Before making a final decision you should read the full product brochure and policy conditions booklet as terms and conditions apply.