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Relationship Breakdown: Tax Implications

Introduction

Ireland has seen been both dramatic and welcome changes to the landscape of formalising and dissolving relationships over the last two decades. Among other things, we have seen a historical shift in modernising our tax code and moving it towards equality for all couples.

We started the journey in 1995, with the divorce referendum passing by an incredibly tight 0.3% margin. The resultant Family Law (Divorce) Act 1996 allows a court to grant a decree of divorce where it feels confident that all of the applicants are aware of the alternatives to divorce and that there is no possibility of reconciliation. The tight margin was arguably due to a perceived worry that the "floodgates" would open and divorce rates would skyrocket. However, these fears have not yet been reflected in the statistics.[1]

In 2011 Ireland enacted the Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010. This Act introduced a statutory civil partnership registration scheme for same-sex

1 Eurostat statistics show that Ireland continues to have one of the lowest divorce rates in Europe, at 0.6 per 1,000 people; the UK has a rate of 1.9 per 1,000; and the EU average is 2 per 1,000.

couples under which registered civil partners had broadly the same rights and obligations as married couples. Certain rights for cohabiting same-sex and opposite-sex couples were also catered for under the Act. Although they are not entirely equal from a legal standpoint, since 2011 all married couples and registered civil partners are treated the same way for tax purposes. Since the Civil Partnership Act was enacted on 1 January 2011, nearly 1,800 civil partnerships were registered in Ireland.

On 16 November 2015 the Marriage Act 2015 was enacted, whereby same-sex couples can marry and have the same rights and obligations as opposite-sex couples. It is also possible for a couple in an existing civil partnership to marry. Since this date, civil partnership is no longer available to new couples. Couples who entered into a civil partnership before the enactment of the Marriage Act 2015 can, of course, continue as civil partners and are protected by the 2010 Act. Their rights and obligations are not affected by the Marriage Act 2015, and they can continue to be taxed in the same way as married couples.

The final legislative change came in the Family Law Act 2019, which passed by a landslide 82.1%[2] and was commenced on 1 December 2019. It reduced the period for which a couple must be "living apart" before being entitled to apply for a decree of divorce from four out of five to two out of three years. It also included a definition of "living apart" to give certainty to the courts on the interpretation of the term.[3]

The inevitable repercussion of these changes is that there are now a plethora of tax and legal issues for couples to grapple with: in the establishment of a formal relationship and the creation of new legal and tax rights and obligations but also in the untangling of those rights and obligations where there is a breakdown of the relationship.

Foreign-Registered Relationships

The Department of Justice and Equality maintains a list of all foreign marriages and civil partnerships recognised in Ireland. Revenue recognises registered foreign marriages and civil partnerships for tax purposes. If the foreign-registered marriage or civil partnership is recognised, then the couple will be taxed in the same way as an equivalent Irish couple. Certain information must be provided to Revenue to ensure securing married tax treatment:

- both partners' PPSNs,
- the date of the registered relationship,
- the jurisdiction of the registered relationship and
- the title of the registered relationship.

1. Since the passing of the Marriage Act 2015, civil partnerships registered abroad are no longer recognised as civil partnerships in Ireland.[4]
2. Same-sex marriages that were entered into before 16 November 2015 are now entitled to be recognised in Ireland.
3. The Family Law Act 2019 also provided for the recognition of all foreign divorces granted in the European Union (to include Britain and Gibraltar after Brexit). Previously, foreign divorces were valid in Ireland only if they were recognised here under the Domicile and Recognition of Foreign Divorces Act 1986. An application to court can be made to have a foreign marriage or divorce recognised in Ireland.[5]

Tax Implications of Each Formal Relationship

Marriage

A valid marriage ceremony[6] bestows considerable tax benefits on the couple.[7]

2 www.justice.ie

3 The definition clarifies that spouses who live in the same home as one another are considered to be living apart if they are not living together as a couple in an intimate and committed relationship. The Act also sets out that a relationship does not cease to be an intimate relationship merely because the relationship is no longer sexual in nature.

4 This applies for any civil partnership after 16 May 2016.

5 Family Law Act 1995.

6 Under the Marriage Act 2015 and/or a recognised foreign marriage.

7 Please see https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-44/44-01-01.pdf for further information.

There are reliefs across all tax heads for most transactions between spouses and special income tax rules that allow pooling of incomes, tax rate bands, losses and allowances. In summary, no capital acquisitions tax[8] (CAT), capital gains tax[9] (CGT) or stamp duty[10] will arise in relation to the transfer from one spouse to another. Any capital losses available to one spouse can be used by the other spouse.

A requirement for the CGT exemption to apply is that the spouses must be "living together" at the time of the transfer and the receiving spouse would be within the charge to Irish CGT on a disposal of the asset.

This might seem like a minor point, but there are many real-life situations where couples are no longer living together but have not formalised their break-up and unwittingly create a tax charge in transferring assets presuming that they qualify for the spousal exemption.

Married couples can opt to be jointly assessed to income tax (again, if they are living together) and can avail of some tax benefits such as the sharing of Case I and II losses and excess Case V capital allowances.

Separation

Separation can come in a variety of arrangements: voluntary separation with no formal agreement in place; voluntary separation with a formal written agreement in place; or judicial separation on foot of a court order.

A separation agreement is a binding legal contract that deals with certain arrangements between the parties such as division of assets, access rights, maintenance arrangements and succession rights. The agreement should provide for the date of separation (for divorce purposes) and cannot be used to deal with pensions. Where there is a court-ordered judicial separation, pension adjustment orders may be included in the terms of the order, but they are more commonly dealt with during the divorce when there is an actuarial value of the pension available.

One of the most important points in relation to a separation is that, regardless of whether it is informal, formal or court-ordered, it does not affect the legal marital status of the couple (i.e. legally they remain spouses until they divorce). This has relevance for succession rights[11] but also for the tax treatment of separated couples. The couple technically cease to be eligible for the CGT and income tax treatment afforded to married couples, as both taxes have a requirement that the spouses be living together. It is worth noting that there is provision for separated spouses to elect to be jointly taxed for income tax purposes but that option is not available for capital gains tax purposes.

Income tax

When a married couple decide to separate or live apart, one of the first tax consequences is the change in their income tax status. Both formal and informal separations are recognised for income tax purposes. There must, however, be an intention by the parties to end the marriage. The date on which the separation is likely to be permanent is of the utmost importance, as it is from this date that the income tax changes come into effect.

It is worth noting that the Family Law Act 2019 introduced a definition of "living apart" for legal purposes, but is not yet known whether Revenue will adopt this definition. It is the view of the author that it makes sense to adopt the definition for tax purposes in order to provide clarity and continuity.

Separated spouses are treated as singly assessed from the date of separation unless they have validly elected for joint assessment and maintenance payments are made under a legally enforceable arrangement. The couple must submit a joint election in writing, signed

8 Sections 70 and 71 CATCA 2003.
9 Section 1028 TCA 1997.
10 Section 96 SDCA 1999.
11 Entitlement to the legal right share and no automatic revocation of a will.

by both, before the end of the tax year. If such an election is made, any maintenance payments are ignored and, if both spouses have income, separate assessment will apply.

If this election is not made in the year of separation, the assessable spouse is entitled to the married allowance and married bands and is taxed on the joint income to the date of separation, and after the date of separation they are taxed on their own income only. The non-assessable spouse is assessed only on their own income from the date of separation to the end of the tax year and is entitled to the single allowance and rate band.

Where the maintenance payment is voluntary[12] and one spouse is wholly or mainly maintaining the other spouse (i.e. the payment represents over 50% of the dependent spouse's income), the paying spouse will be entitled to the married tax credit but not the married standard rate band. As a rule of thumb, Revenue grants the married tax credit provided that maintenance payments to the spouse exceed income earned in that spouse's own right.

Either spouse may be entitled to the single person child carer credit provided that the child:

- is under the age of 16 at the start of the tax year; or
- if over the age of 16, is receiving full-time education at any university, college, school or other educational establishment; and
- resides with him or her for the whole or part of the year.

Capital gains tax

From the date that the separation is likely to be permanent, any transfer of assets between spouses is not exempt from CGT. The permanence of the date of separation is a matter of fact.

The date on which the separation becomes permanent is important as it is not only the relevant date for income tax and CGT but also the date on which the two-year requirement[13] to be entitled to apply for a divorce starts.

Assets transferred from one spouse to another under a deed of separation or by court order[14] after the granting of a decree of judicial separation can still avail of the exemption.

Any transfer of an asset to the other spouse will be treated as if the asset was acquired from the spouse making the disposal for a consideration of such an amount as would secure that on the disposal neither a gain or loss would accrue to the spouse making the disposal. The acquiring spouse is treated as acquiring the asset on the same date and for the same amount as the spouse disposing of the asset, with the effect that any uncrystallised capital gains tax liability transfers along with the asset.

To the extent that losses crystallised by a spouse have not been used by that spouse, any remaining unused losses as at the date of likely permanent separation can be used only by the spouse in whose favour they arose. That spouse can utilise those remaining losses against any gains arising after the date of likely permanent separation.

By concession, in the year of separation general Revenue practice is to treat couples as married for CGT purposes.

Stamp duty

Separation, whether it is informal or formal, does not change the stamp duty exemption available for spouses whose marriage is recognised as valid in Ireland[15] at the date of the transfer.

Capital acquisitions tax

Separation does not change the gift/inheritance exemption available to spouses whose marriage at the date of the gift/inheritance is recognised

12 This is common where the separation is informal.
13 Since 1 December 2019.
14 Section 1030 TCA 1997.
15 Section 96 SDCA 1999.

as valid in Ireland.[16] On separation, whether it is a formal or informal separation, all assets transferred between spouses are exempt as there is no change in their legal status as a married couple.

Divorce

It may come as a surprise to many that until the ninth century, under Brehon Law (ancient laws of Ireland), divorce was legal in the State where there was mutual consent. From the twelfth century onwards the Roman Catholic Church began insisting that marriage was an "indivisible bond". The Irish Constitution at Article 41.3.2 stated: "No law shall be enacted providing for the grant or dissolution of marriage".

Since the enactment of the Family Law (Divorce) Act 1996, it would appear that the attitude to divorce has tempered somewhat. The enactment of the Family Law Act 2019, on foot of a landslide referendum majority, half the amount of time for which people have to stay apart before qualifying to apply to divorce their spouse.

Despite much belief to the contrary, it is not a requirement that the couple be formally separated before applying for a divorce. Since 1 December 2019 it is a stipulation that before a court can grant a divorce in Ireland, the parties must have been living apart from one another for a period amounting to two out of the previous three years[17] before the application is made.

Unlike separation, divorce will have the effect of severing the spousal relationship for all tax and legal purposes. As the couple will be treated as strangers-in-blood for tax purposes after the divorce, it is essential that all asset transfers and property divisions are captured and dealt with as part of the court order granting the decree of divorce, as significant tax charges can apply after the event. This is also the case for orders from foreign courts that are recognised as valid in Ireland.

It is crucial to the tax treatment that the basis for the transfer of the asset is established in the context of a divorce, as each of the "dissolution of marriage" exemptions refers to specific legislation. To qualify for the relevant exemption, the transfer must occur under one of the specific provisions. The exemption will still apply even if the actual transfer takes place after the court order grants the decree of divorce.

Income tax

As with separated couples, in certain circumstances divorced couples may opt for joint assessment for income tax purposes. For joint assessment to apply, both partners must be resident in Ireland for tax purposes in that year of assessment and remain unmarried. If there is not a valid election for joint assessment, the divorced couple will be singly assessed in respect of all income, with the relevant single credits and rate bands applying to each party.

Capital gains tax

If the transfer of assets forms part of the divorce decree order, then the transfer of assets from one ex-spouse to the other pursuant to such an order will not give rise to any CGT liability in the hands of the transferring ex-spouse.[18] The asset(s) will be deemed to have passed from one ex-spouse to the other at original cost and been acquired by the receiving ex-spouse at the same time as the transferring ex-spouse acquired the asset. Any uncrystallised gains thereby transfer with the property.

Any transfers after the divorce that are not provided for under the terms of the divorce agreement will be liable to capital gains tax.

Stamp duty

All transfers of property from one spouse to the other where the transfer is made pursuant to a court order are exempt from stamp duty.[19] The exemption will not apply where the

16 Sections 70 and 71 CATCA 2003.
17 Before this date the requirement was four out of the previous five years.
18 Section 1031 TCA 1997.
19 Section 97 SDCA 1999.

property, although transferred under a court order, is conveyed to a person other than one of the partners to the marriage. Once they are divorced, any transfer of assets between former spouses that are not part of the divorce agreement will be liable to stamp duty in the normal course.

Capital acquisitions tax

Property transfers between former spouses on foot of a court order governing a divorce will be exempt from capital acquisitions tax.[20] Once they are divorced, any transfer of assets between former spouses that are not part of the divorce agreement will be liable to capital acquisitions tax and the spouses will be treated as strangers-in-blood and entitled only to the Group C tax-free threshold.[21]

Maintenance payments

The rules for the taxation of maintenance payments[22] are very straight forward and are based on whether they are made on foot of a formal or an informal arrangement and whether they are made for the benefit of the spouse or the children.

In the case of a formal separation,[23] where a previously married couple have opted for single assessment, maintenance payments for the benefit of the other party to the marriage are deductible in calculating the payer's total income.[24] Similarly, they are taxed as taxable income[25] on the recipient. However, if an election for joint assessment has been made, the payments are ignored.

Maintenance payments for the upkeep of children are always ignored, regardless of the method of taxation. Therefore, the payer will not be entitled to a deduction for payments made in respect of children, and the payments will not be taxed on the recipient.

Where a maintenance payment is voluntary (i.e. not legally enforceable), there will be no entitlement to a tax deduction for the paying spouse, and the recipient will not be subject to tax on the payment. As noted above, the payer will be entitled to the married tax credit[26] where the maintenance payment forms the whole or most of the recipient spouse's income.

Maintenance payments made under a settlement agreement arising from a divorce obtained outside the State will qualify for relief, provided the divorce is recognised in the State and the maintenance payments have been made in accordance with the agreement.

Cohabitants

The Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010 ("the 2010 Act") came into law in Ireland on 1 January 2011. The Act sets out certain rights for couples that are cohabiting and is indifferent as to whether the couple are same-sex or opposite-sex. The changes to the law were timely, as the number of cohabiting couples is rising. The 2016 Census shows that of the 1.22m families in Ireland, 152,302 are cohabiting.

A definition of "cohabitant" is set out in s172 of the 2010 Act is "one of two adults (whether of the same or the opposite sex) who live together as a couple in an intimate and committed relationship and who are not related to each other within the prohibited degrees of relationship or married to each other or civil partners of each other".

The 2010 Act amended a number of laws to extend rights already available to opposite-sex cohabitants to same-sex cohabitants:

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20 Section 88 CATCA 2003.

21 At the time of writing, the Group C tax-free threshold is €16,250.

22 Section 1025 TCA 1997.

23 The maintenance payment will be legally enforceable as it will be made on foot of a legally binding contract or court order.

24 Also deductible for PRSI and USC.

25 Schedule D, Case IV.

26 But not the married standard rate tax band.

- The Residential Tenancies Act 2004 was amended to provide that a same-sex cohabitant of a deceased tenant has the same entitlement to inherit a tenancy as an opposite-sex cohabitant of a deceased tenant.
- The Civil Liability Act 1961 now provides that a same-sex cohabitant of a deceased person has the same entitlement that an opposite-sex cohabitant has to sue for damages in the event of the cohabitant's wrongful death.
- Qualified cohabitants are now entitled to be informed about the registration of an enduring power of attorney under the Powers of Attorney Act 1996.

The tax benefits extended to married couples and civil partners do not apply to cohabiting couples; they are instead treated as single persons.

However, former cohabitants may be entitled to various tax benefits on certain property transfers and maintenance arrangements[27] on the dissolution of the cohabitant arrangement or the death of a cohabitant. The payments and transfers must be as a result of a court order under the Redress Scheme. These benefits can be summarised as follows:

- Maintenance payments granted by way of court order to a financially dependent former cohabitant may be entitled to broadly the same tax relief as applies to former spouses.
- A court-ordered transfer of property from a former cohabitant may qualify for relief from stamp duty[28] and from CAT and CGT.[29]

There are certain conditions that must be met to be a qualifying cohabitant for the purposes of these reliefs. The couple must have been cohabiting for at least:

- two years if the couple are the parents of dependent children and
- five years in all other cases.

Redress Scheme

The redress scheme provides for a broadly similar range of orders as are available to married couples when they separate or divorce. The aim is to provide protection for a financially dependent member of the couple if a long-term cohabiting relationship ends through either death or separation.

If a qualified cohabitant satisfies the court that he or she is financially dependent on the other cohabitant and that financial dependency arises as a result of the relationship or the end of the relationship, the court may make various redress orders where it satisfies itself that it is just and equitable to do so. In considering whether to make a redress order, the court may have regard to certain factors, including:

- the financial circumstances of the parties,
- the rights and entitlements of any spouse or former spouse, civil partner or former civil partner,
- the existence of any children,
- the duration of the parties' relationship,
- the contributions made by each cohabitant, including contributions made in looking after the home,
- the effect of the earning capacity of each cohabitant or the responsibilities assumed by them during the period they lived together and
- the conduct of the parties where it would be unjust to disregard it.

The court may make redress orders, including property adjustment orders, pension adjustment orders, compulsory maintenance orders and related orders such as earnings attachment orders. A cohabitant may also apply for provision to be made from the estate of a deceased cohabitant. All redress applications are heard *in camera* in the Family Law Courts.

27 Please see https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-44b/44b-01-01.pdf for further information.

28 Section 97A SDCA 1999.

29 Section 1031R TCA 1997.

In a slight divergence, court orders under the Redress Scheme may not affect the rights of spouses or former spouses but may affect the rights of civil partners or former civil partners.

Generally, all such orders must be applied for within two years of the end of the relationship, or one of the parties must have died within two years of the making of the application. Any application for provision from the estate of the deceased partner must be made within six months of an application for a grant of probate. Such orders usually will lapse and will no longer be available if a cohabitant marries.

The 2010 Act recognises legal agreements between cohabitants regularising their affairs, including agreements made before the Act. This allows any cohabitant planning to live with or living with their partner to make a formal arrangement regarding their joint financial affairs. Where the cohabitant agreement is intended to be legally binding,[30] the parties must have received independent legal advice and observed contract law requirements and the agreement must be in writing and signed by both parties.

The agreement may make provision to exclude the Redress Scheme. This is a departure from agreements of a similar nature between married couples, where it is not possible to exclude a right to apply to court for various orders. That said, a court will always have a discretionary ability to set aside an agreement or part of an agreement where its enforcement would lead to an injustice.

Maintenance payments

The maintenance payment must be made on foot of a court order following an application under the Redress Scheme by a qualifying cohabitant pursuant to s175 of the 2010 Act.[31] Tax relief for a maintenance payment is allowed only for payments made for the support of the qualified cohabitant; a deduction is available to the paying former cohabitant, with the recipient former cohabitant taxable under Schedule D, Case IV. Tax relief is available only where the former cohabitant remains unmarried and does not form a civil partnership[32] (foreign or Irish).

Capital gains tax

The transfer of a property by either of the cohabitants to the other cohabitant on foot of a court order under the Redress Scheme on an application under s174 of the 2010 Act will be treated by the person disposing of the asset as if no gain or loss arose on the disposal. Obviously, any subsequent disposal will be chargeable to CGT in the normal course. The transfer of property or chargeable assets between cohabitants in any other circumstance is subject to CGT in the normal course.

Capital acquisitions tax

The receipt of property pursuant to a court order under the Redress Scheme is not subject to CAT. Where there is a gift or an inheritance otherwise than by court order under the Redress Scheme, cohabitants are regarded as strangers-in-blood for CAT purposes. Gifts and inheritances between cohabitants do not qualify for the exemption from CAT that applies to married couples.

Cohabitants are subject to the Group C CAT threshold of €16,250, with any gift or inheritances in excess of this threshold taxable at the prevailing rate (currently 33%).

Dwelling-house relief under s86 CATCA 2003 may apply to the inheritance of a property by a cohabitant without having to look to the Redress Scheme but only in very particular circumstances. Dwelling-house relief will exempt an inheritance of an interest in a property where the property inherited was the main home of the deceased cohabitant before their death and the recipient cohabitant had

30 Can be relied on in court.

31 Section 1031Q TCA 1997.

32 Only relevant pre-15 November 2015 (Irish) and 15 May 2016 (foreign).

also lived in the property as their main home for the three years before the death.

The recipient cohabitant must not have an interest or share in any other property at the date of death and must continue to live in the property for six years after the date on which they received the inheritance. If the dwelling-house exemption does not apply, a cohabitant will be liable to pay 33% CAT on the value of the inheritance that exceeds €16,250.

Stamp duty

The transfer of a property by either of the cohabitants to the other cohabitant on foot of a court order under the Redress Scheme pursuant to an application under s174 of the 2010 Act will be exempt from stamp duty.[33]

Conclusion

The taxation of relationships and their dissolution can be complicated. The complications arise from the fact that there are no uniform rules under the various tax heads, with different rules applying to cohabiting couples and married couples and the tax rules varying from the legal rules. The impact of the different rules cannot be underestimated and, as with all things law and taxation, timing is of the essence. It cannot be overstated how important timely advice is to manage the tax impact and tax exposures for both parties in what is already undoubtedly a hugely charged situation.

Read more on taxfind From Irish Tax Institute Revenue Tax and Duty Manual 44-01-01

33 Section 97A SDCA 1999.