THE IMPORTANCE OF COHABITATION AGREEMENTS:

TOP TEN QUESTIONS UNMARRIED COUPLES SHOULD ASK BEFORE BUYING A HOME TOGETHER

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Are you one of the millions of couples today who are unmarried but planning on buying a home together? Whether for financial purposes, romantic inclinations, or simply convenience, unmarried couples who cohabitate are becoming the norm. What many couples do not realize until it is too late, however, is that unmarried co-habitators do not share in the same legal protections and tax benefits as married couples. Before couples become invested in their joint residence, and while things between the partners are good, they should consider several factors to protect themselves in the event of a break up, serious change in circumstances, or even death.

Whether you are thinking of purchasing a property together or sharing one partner's home, you should consider signing a cohabitation agreement before you start packing. Just as a prenuptial agreement protects the individual assets of married couples, a cohabitation agreement protects unmarried couples who live together.

1. HOW WILL THE DOWN PAYMENT AND CLOSING COSTS BE PAID?

Closing costs can add up quickly; thus it is essential to discuss what each party is prepared to contribute up front, especially if one partner is not prepared to provide his or her share of the down payment in time for closing. Since buying a home is one of the biggest purchases most people will make in their lifetimes, working out the financial details in advance will make the transaction a smoother process and set the table for how to make each party whole in the event there is a break-up.

2. WHO WILL OBTAIN THE MORTGAGE AND HOW WILL THE MORTGAGE PAYMENTS BE MADE?

Taking out a mortgage is a big obligation. Couples often agree that the partner with the better credit history or higher income should obtain the mortgage. In doing so, the parties will be eligible for the best interest rate and lowest payment. However, when only one partner is on the hook, having an agreement in place is even more important to protect him or her from the "what if" scenarios, such as agreeing to reallocate ownership interest if one partner loses their job and is unable to pay their portion of the mortgage.

3. HOW WILL THE JOINT RESIDENCE BE TITLED?

If you are a first-time homebuyer, how you take title to the property may seem inconsequential; however, the simple words "tenants in common" or "joint tenants" on the deed carry great importance. Joint tenants enjoy the benefits of rights of survivorship, meaning that the survivor inherits the property automatically upon the death of the other party. In contrast, tenants in common both hold an individual interest in the property, where both have the right to transfer their interest however they choose. A tenancy in common may be more practical for couples who want the option of severing their ties in the future, with the ability to either pass title separately to their family members or to buy or sell their interest in the future.

4. WHAT ARE THE TAX CONSIDERATIONS AFFECTING UNMARRIED CO-OWNERS?

Married couples have the choice of filing their income tax returns as "married filing joint" or "married filing separate." When choosing "married filing joint," all income and deductions are combined, and there is no tracing required to determine which spouse income or deductions properly belong to. Unmarried couples cannot avail themselves of filing a joint return. While sometimes this is a benefit, (i.e., not getting hit with the "marriage penalty tax," where two high income earners pay more taxes than if they had both filed as single), tracing deductions and determining the proper partner entitled to the deduction may not be so easy. For example, if one partner owns the house the couple lives in, but the other partner pays the real estate taxes, no one is entitled to the real estate tax deduction. The Internal Revenue Code provides that, in order to deduct real estate, you must be an owner of the property and be the party that actually paid the real estate tax bill. Additionally, if only one partner provides the down payment for a home purchase but the home is titled in both names, the down payment may be treated as a gift, whether that is the intent or not. Having an agreement in place and reviewing these items with your accountant is the best way to avoid increasing your income tax liability and gift tax exposure before it is too late.

5. WHO WILL PAY FOR REPAIRS, MAINTENANCE AND OTHER COSTS, AND HOW WILL MONTHLY EXPENSES BE PAID?

The initial fees of purchasing a residence can be overwhelming, especially when buying a "fixer-upper" or cooperative apartment in an expensive market like New York City. It is important to come to an agreement about how much each party can afford and how such payment may or may not impact their ownership interest. The ongoing costs of owning a home can be just as overwhelming. From mortgage and maintenance fees to parking, cable, phone, electric and landscaping, the list goes on and on. In most cases, parties informally choose to split these costs evenly. However, one size does not always fit all, and deciding how to handle expenses ahead of time will make things administratively easier for both parties.

6. HOW WILL CAPITAL IMPROVEMENTS BE PAID?

Although monthly costs may be easily split down the middle, capital improvements should be considered in a different category. This is because improvements made to real estate, such as installing a deck or upgrading the kitchen, increases the equity in the property. Therefore, it may be in the parties' best interest to allocate these costs in proportion to ownership or what each party is willing to contribute. By memorializing the proportion in advance, it will be easier to determine each partner's equity later on in the event of a sale or split of the property.

7. WILL A JOINT ACCOUNT BE UTILIZED?

Some couples feel that having separate bank accounts will prevent financial conflicts. However, other couples enjoy the flexibility, convenience and transparency of having all transactions relating to the home pass through a joint bank account. In either case, the parties should openly talk about a budget, as well as how deposits and withdrawals will be made.

8. WHAT WILL CAUSE THE HOME TO BE SOLD AND HOW WILL PROCEEDS BE DISTRIBUTED?

Selling a home under pressure may not only force a reduced price in order to expedite the transaction, but also complicate the disposition of the asset. It is advisable to agree in advance on how the logistics of selling the home will be handled, should the need arise, including choosing a real estate broker and agreeing on listing and sale prices. When the residence is being sold because a relationship is ending, it is in both parties' interest not to let emotions take the driver's seat.

9. HOW WILL THE POTENTIAL END OF THE RELATIONSHIP BE DEFINED?

Although this topic is an uncomfortable one, couples should decide before combining households under what circumstances the cohabitation will be considered to have ended, and whether one party will move out of the joint home (which one?). In an agreement, the end of the relationship can be defined however the couple chooses, i.e., being absent from the home for an extended period of time, cohabitating with another person, or simply giving notice to the other party. Additional questions to consider might include: if one party ends the relationship, can the other party buy him or her out? Must the other sell? How long does either party have until they must move out? In any event, boundaries should be set from the get-go to provide clarity and minimize future conflict.

10. WHAT WILL HAPPEN IF ONE PARTY DIES?

How do you feel about potentially owning your home with your partner's mother? Unmarried couples who own property as tenants in common and who do not provide for each other in their Last Will and Testament do not inherit the property of the other. However, if a cohabitation agreement is in place, the parties can decide how they would like their interest in the property to pass upon their death, rather than running the risk of ousting the other partner from their home or being forced to share title with the deceased partner's family members.

All the above factors share the common theme of determining a mutual goal between the parties, deciphering the tax and financial implications, and entering into a cohabitation agreement to protect both partners' interests. It is crucial to consider potential future consequences and probable conflicts, as well as a possible marriage or split between the parties. However, it should be noted that cohabitation agreements are not set in stone. The parties to a contract can always agree to amend, modify or terminate their agreement as circumstances change. The important objective is to come to a mutual understanding, consult with an attorney and accountant, and put it in writing while things between you and your partner are positive, future-facing, and both of you are happy and of a mind to collaborate.

ABOUT THE AUTHOR

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