Separation, Divorce and Your Financial Plan

July 2022

Separation from a spouse or common-law partner can be a distressing and difficult experience. It is important to understand how a relationship breakdown may affect your future financial situation. Your wealth is comprised of the assets and property owned by you and your former spouse or common-law partner and will be profoundly impacted by a separation or divorce.

The laws relating to a relationship breakdown can be extremely complex, and there are overlapping jurisdictional considerations. Therefore, it is very important that you seek professional legal advice before you make the decision to separate or divorce from your spouse or common-law partner. The decisions made early in the process could affect your rights in the future.[1]

Although separated and divorced individuals have similar financial and tax planning considerations, there are some nuances in the tax law which may affect separated and divorced individuals differently. In addition, family law varies according to the jurisdiction where you are resident. For instance, certain rights expire once a couple is divorced, so you should ensure that all aspects of the division of family property are addressed before obtaining a divorce certificate.

Ending a relationship can be a major life event which requires you to adjust your personal financial plan and assess the value of any assets that will be divided. The situation can be further complicated when there are children involved, and there are rights to child or spousal support to be considered. The right to child or spousal support is separate from the right to an equalization payment or division of family property.

This article focuses primarily on the financial and tax implications of a breakdown in a relationship and will address issues relating to both married and unmarried (i.e., "common-law") spouses.

Tax implications

The division of property is complicated by the tax consequences relating to the transfer of an asset to a spouse. When family assets are divided between spouses during a separation, there may be tax implications attached to those assets based on their values before, during and after the end of the relationship.

For the purposes of the Income Tax Act, common-law couples who have lived together in a conjugal relationship for a period of at least 12 months, or who have lived together for a shorter period but are raising a child together, are treated in the same manner as married spouses. Common-law couples who cease to cohabit because of a breakdown in their relationship are deemed to be cohabiting until the separation has lasted at least 90 consecutive days.

The tax implications of a separation and the application of the rules under the Income Tax Act can be very complicated, and may vary considerably depending on personal circumstances. It is advisable to seek professional tax advice to determine the after-tax value of all family assets to ensure an equitable division.

It's a matter of family law

It makes a difference if the relationship was a marriage – which is governed by federal law – or a common-law relationship, which is subject to provincial or territorial statutes. The division of assets subsequent to a relationship breakdown is a provincial or territorial concern and there are variations across the country depending on where you live. Another important factor is whether or not you have a domestic contract such as a cohabitation agreement or marriage contract in place.

Generally, a couple who ends their relationship will separate first, and then divorce afterwards. As there are certain rights that expire once a couple is divorced, it is extremely important to ensure that all aspects of any division of property are addressed before signing a final separation agreement or obtaining a divorce certificate.

If you do decide to separate, the exact date on which the separation starts should be determined and noted. The date of separation may be important for various reasons. In some jurisdictions, it is the value of property at the date of separation which is relevant when dividing property and, in many jurisdictions, certain rights will only continue for a certain time after the date of separation.

Formalize it with a separation agreement

In most cases, the best method to address the issues of separating spouses arising from a separation is to formalize them in a written separation agreement. Prior to signing a separation agreement, it is imperative that each spouse provide full financial disclosure and obtain independent legal advice regarding the implications of family law in the jurisdiction where the couple resides regarding the agreement.

The separation agreement will formally address the details of the separation and how certain tax benefits or implications of the separation will affect both parties:

- If one of the spouses will be making spousal support payments and whether they will be tax deductible.
- If the separating couple would like to transfer property such as a Registered Pension Plan, RRSP or RRIF without triggering any immediate tax consequences.
- Clarifying the entitlements to (and tax implications of) the principal residence exemption of both spouses both during and after the marriage or common-law relationship.
- Whether the separating spouses wish to elect out of the potential attribution of capital gains on assets sold by either spouse after the time of separation if any of the assets were transferred on a tax-deferred rollover basis to the other spouse.
- The impact on tax filings such as the spousal credit, pension income-splitting and tax-deferred rollovers.

It is advisable to have the separation agreement drawn up by a legal professional to ensure that all relevant aspects are covered.

Division of family property

If you are married, subject to the terms of any existing domestic contract, the value of all family property will be divided or equalized regardless of which spouse holds title to the asset. However, the definition of family property and the way it is to be divided varies from jurisdiction to jurisdiction.

Common-law couples cannot assume that the family property laws of their jurisdiction will apply to them. In many cases, family property laws do not provide for the division of family property between separating common-law partners.

Only married couples can make a court application to have their assets divided according to provincial legislation. However, certain jurisdictions have amended their legislation to entitle common-law partners to apply for a division or equalization of family property after meeting certain preconditions, such as living together for a certain period or registering their relationship with the provincial government. In addition, a common-law partner may be able to claim in the courts that their partner has experienced an "unjust enrichment," which may entitle him or her to be compensated using a "constructive trust" argument.

Which assets are shareable?

The assets shareable under provincial or territorial family law legislation vary from jurisdiction to jurisdiction. The value of all assets that were acquired during the marriage are shareable, including properties, vehicles, furniture and personal effects. In addition, pensions, RRSPs, RRIFs or other retirement assets are shareable to the extent that they were acquired or appreciated over the course of the marriage. In some jurisdictions, the matrimonial home enjoys a special status and the entire value of the home is subject to division regardless of when it was acquired. Some assets may be specifically excluded, such as gifts or inheritances.

In some provinces, a separated spouse is not actually entitled to a portion of any particular asset that their spouse may own, but rather, they are entitled to an equalization payment.

In general terms, this equalization process essentially involves totalling the net assets owned by each spouse on the date of separation, subtracting the net assets owned on the date of marriage, and then the spouse with more assets pays an amount to the other spouse to equalize their assets.

The process of dividing family assets can be very complicated and arduous, and there are many issues that must be resolved. Outlined here are a few key issues to consider:

- Which assets must be included in the calculation? Are all of the assets owned by either spouse to be considered? Will the value of some assets acquired prior to marriage be excluded? Or will some assets be excluded because of a special status (e.g., a matrimonial home) or because they are inheritances or gifts?
- How much are the various assets worth? Is there an inherent tax liability that must be considered when determining the after-tax value of each asset? Should the value of an asset, such as a pension, be discounted to take account of the fact that it may not be accessible for some time?
- How will payment be made from one spouse to the other? Most individuals won't have liquid funds available to make a large cash payment to the other spouse.

It is critical to seek legal advice from a family law professional in your jurisdiction to understand the implications of the statutes as they apply to your personal circumstances and the division of shareable property.

Review your estate plan

When a marriage or relationship breaks down, it is a good time to review your estate plan to ensure that it reflects your current life situation and your final wishes. In other words, how you want your assets to be distributed on your death.

Update your Will
Usually couples make each other the beneficiary of their estate in their Wills and/or appoint each other to be the executor. Depending on the jurisdiction in which you live, a separation or divorce may or may not impact certain gifts given under your Will. Therefore, it is recommended to review your Will and consult with a legal professional about the implications on your Will based on the jurisdiction where you are resident.

Review your beneficiary designations
Generally, most couples will designate each other as the beneficiaries of their registered plans and life insurance policies. Following a separation or divorce, it is important to review the beneficiary designations on RPPs, RRSPs, RRIFs, TFSAs and life insurance policies to ensure they still reflect your intentions.

Review titles of property held jointly
Couples usually own real estate such as the family home as joint tenants with rights of survivorship, which means your ex-spouse will receive such assets in the event of your death, regardless of the terms of your Will (except in Quebec, where there is no "right of survivorship" on jointly held assets). You may want to consider changing the registration of these assets to tenants in common, or dividing the assets so that they can be left according to your intentions in your Will.

When you separate, you should speak with your legal professional about your estate plan and the changes that may be required to reflect your current situation, your obligations under the terms of your separation agreement or divorce order and your intentions for your assets on your death.

Conclusion

The end of your relationship with your spouse or common-law partner will mean changes to some of your life goals and any estate or tax planning undertaken to achieve those goals. Your life goals may be tied to the ownership of certain assets or family property, which will be affected by the breakdown of your relationship.

For more information, please speak with your BMO financial professional.

[1] Matrimonial property laws in Quebec differ from the common-law provinces' matrimonial or family law regimes in the rest of Canada. This article does not focus on issues pertaining to Quebec Civil Code. It is advised to seek professional legal advice if you and your spouse are in a matrimonial or civil union in Quebec.

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