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FINANCIALPLANNING

Determining the best way forward is a formidable but achievable task

Divorce

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With roughly half of Canadian marriages ending in divorce, many people view "Till death do us part" as a quaint concept. Divorce is now so commonplace that Statistics Canada no longer keeps track.

No one gets married expecting a break up, but prudence suggests consideration of a marriage contract or pre-nuptial agreement before cutting the cake. The wide range of emotional implications of divorce includes bitterness, anger, and perhaps even relief. Even before the divorce is finalized, one thing is for sure: former spouses have to start the rest of their lives all over again.

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Many of the financial foundations previously taken for granted while married require immediate attention, including wills, powers of attorney, financial advice, banking, even where you live.

Divorce can be a contract that will follow you around the rest of your life, but it is to your benefit to engage the help of experienced and trusted professionals to ensure your financial and legal houses are in order as you move forward.

A professional can help with the seemingly endless to-do list

There are many related issues that a professional can help steer you through. It can seem an endless list of challenges that one faces as a divorced person—such as retaining a new lawyer, a new executor for your estate, changes to beneficiaries of your registered and non-registered accounts and a current and up-to-date estate directory. You may no longer have health benefits that came with your former spouse—now what? Have you thought about long-term care? What about general insurance for your car and your new home?

Determining the best way forward requires serious thought. The task is formidable but achievable. Keep in mind this effort directly affects the future for you, your children, and future generations.

A wide range of financial and tax issues must be dealt with

Divorcing spouses must consider a wide range of financial and tax-related issues. When you were married, your spouse was likely the beneficiary of your Registered Retirement Savings Plans, meaning they would receive that money tax free when you die. But that tax-free privilege extends only to a spouse. If you want to leave your RRSPs to your children now, the funds are 100 per cent taxable on your death. The good news is that there are steps that can be taken to mitigate that tax bite.

If the former spouse was the one with life insurance, this is probably a good time for you to look into getting some yourself and leaving it tax-free to your children. There are many kinds of life insurance available. It may be part of the divorce agreement to get insurance on the working spouse to ensure a continuation of cash for spousal and child support.

Division of assets

Your lawyer and accountant will be able to help you split the family assets and a financial planner may help with estate planning and tax minimization.

In Ontario, the value of any kind of property bought by a spouse during the marriage and still exists at separation must be divided equally between the spouses. In addition, any increase in the value of property owned by a spouse since the date of marriage must be shared. There are some possible exceptions to this, including gifts or inheritances received during the marriage that originated from someone other than a spouse and were not used to help towards a matrimonial home.

The tax implications of accepting RRSPs in lieu of property

Splitting RRSPs can be very challenging, from the perspective of equalizing the assets of two spouses, or from a tax point of view. Sometimes, one spouse can opt to take all or some of the RRSPs in lieu of property because it looks easier to split the matrimonial property in terms of amounts of current value: "You take the house, I'll take the RRSPs." But an RRSP is not cash. Every time you take out money from an RRSP, you are taxed and this is no different at times of divorce. For example, if your spouse has $1 million in an RRSP to give you as part of the equalization payment for other property, you have to remember to account for taxes. So if you have a personal tax rate of, say, 50 per cent, that RRSP is really worth only $500,000 after you have paid the taxes.

I am working with a client right now with a marriage obligation to give $500,000 to his second spouse, with the balance of his estate going to his children. He had originally left $300,000 in RRSPs to his wife and $100,000 to the children, and later became aware of the taxation issue for the children, so he purchased life insurance to make up for difference and made his second spouse the beneficiary of 100 per cent of his RRSPs.

Pension assets, both the Canada Pension Plan and any employer plan, may also be subject to splitting. Some plans, especially defined benefit pension plans, may be more difficult to value than a defined income plan, and have a list of rules that need to be followed.

Remarriage

Many people are remarrying for a second or third time following divorce or the death of a first spouse—or even marrying later in life for the first time. Several considerations need to be taken into account when this happens, including whether your soon-to-be spouse has any debts, what kind of financial goals he or she has as well as ongoing obligations from previous relationships.

There are more pre-nuptial agreements in second marriages because many people come in with their own assets and responsibilities to their own children. A marriage contract in these situations is especially important to specify how assets will be divided if you and your spouse separate or one of you dies. If you die before your spouse and it is a second marriage, you would likely not want your assets to transfer in full to your second spouse or to her "new" husband's children. Things need to be set up properly with professional advice.

In second and subsequent marriages, where spouses are older, insurance and estate planning can be singularly important for their financial futures. If you become disabled, insurance is essential to ensure income for the second spouse, and also to maintain your financial obligations to children from a first marriage.

Another high-net-worth client was recently remarried to a much younger wife. They both had children from previous marriages and he agreed to provide his first wife with $1 million per year for each of the next 20 years for herself and the children. His company ownership is in trust and essentially not owned by him so it cannot be touched by any creditors. In the end, they agreed to take out life insurance to ensure the income obligations would continue to be paid on the husband's death and the premiums were set up to be paid in a separate trust to guarantee compliance with the divorce agreement.

Wills and Powers of Attorney

Many people are unaware that getting divorced will revoke the gifts in the will which are left to the divorced spouse and any appointment of the spouse as executor is also revoked. The will is read as though the divorced spouse had predeceased the deceased spouse. Upon marriage, a will made prior to the date of marriage becomes invalid (unless the will is expressly made in contemplation of marriage). So after a divorce, if the spouse re-marries, they need to be sure that they update their will, or make one in contemplation of the remarriage. Getting a new will in place immediately in a second marriage will reflect your wishes and ensure that your children are looked after. This will likely also include getting new powers of attorney, executors, trustees and guardians if minor children are involved.

Charitable donations

And then there are those who are interested in leaving a legacy, a charitable donation that will endure through the next generations of their family. As a married couple, you may have agreed or disagreed on which charitable endeavours to support and now that you are no longer together you have the opportunity to continue with or switch to your favourite charity. Having a spouse provides a tax benefit as all assets transfer tax-free to a surviving spouse through a spousal roll-over.

Without a spouse, all assets are deemed to be disposed on death at market value and taxes are due.

Now is the time to consider ways to leave larger sums to charities of your choice or set up a foundation to be remembered for leaving lots of money to charity versus a large tax bill to the Canada Revenue Agency.

As an example, the proceeds of a life insurance policy are usually many times greater than the value of the premiums. Life insurance usually leads to a larger charitable gift than donated cash. Bear in mind that life insurance proceeds flow immediately to the designated beneficiary and typically avoid estate taxes.

Divorce is often a difficult and emotional time. Getting help from experienced financial and legal professionals will ease the process as you begin a new life with the peace of mind that comes from knowing your affairs are in order and you aren't paying more taxes than are necessary. ❒

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