

Will you still love me tomorrow?

The tax and financial consequences of marriage and divorce for couples in Quebec.

I don't know if you're like me, I like old songs. This tune, Will You Still Love Me Tomorrow, has been looping in my head since I was invited as a speaker for a presentation in honor of International Women's Day. This song resonates with me a lot especially in this era of short life relationships.

Either our couples end because we no longer love each other like in the song, or the confinement at home because of the Covid-19 resulted in the sudden death of our romantic relationships, whatever the reason for separation, I would like to share with you some advice in the event of divorce or separation.

The decision to divorce or separate has a big impact on our finances. Tax planning plays a vital role in the wealth management of all Canadians. If we pay less tax, more is available for personal use. As we all know, the Income Tax Act (ITA) can be complicated and difficult to understand for most lawyers, accountants and tax specialists, let alone the average Canadian, and can become even more complicated when family law rules are involved. The decision to marry, divorce or live in a common-law relationship, for example, can have a huge impact on tax planning and wealth management. In today's society, the average age of men and women when they get married has gradually increased. This likely indicates that individuals are more established in their careers and have had the opportunity to acquire valuable assets before their marriage. For some, protecting these acquired assets can be very important, and family law and income tax rules can show us how. With the constantly changing family structure, it is important to consider the effect of family law rules on taxation and the ways in which individuals can protect their interests at any stage in the life cycle of a couple.

First, I would like to talk about common-law relationships, which is a relationship in which two unmarried people live together in a "marriage" relationship. Whether or not a couple is considered common-law depends on the laws that apply to their situation. For example, to be considered a common-law couple under the Canada Pension Plan Act, a person must live with their partner for one year.

However, in Quebec for the purpose of the Quebec Pension Plan, the person qualified as a spouse or common-law partner can be recognized as a spouse or surviving spouse if that person has lived together with the deceased during the 3 years preceding the death.

If a child is born or is to be born of their union, if the couple has adopted a child or if one of the spouses has adopted a child of the other, a single year of common life is enough.

For deaths occurring after April 4, 1985, same-sex common-law partners can also apply for a surviving spouse's pension.

For the purpose of the Income Tax Act (ITA), a common-law partner is a person with whom you are not legally married, with whom you live in a conjugal relationship and at least one of the following situations applies:

- He or she has lived with you in a conjugal relationship for at least 12 consecutive months;
- He or she is the parent of your child at birth or adoption;

or

- He or she has custody and control of your child and your child is entirely dependent on this person for support.

It is also essential to mention once again that in Quebec de facto spouses do not benefit from certain protections reserved for married couples, in particular in the event of separation or death. Common-law partner:

- Does not benefit from the protection of the family residence if only one of the spouses is the owner or tenant of the residence;
- Has no right to the division of property in the event of separation;
- Is not entitled to a "compensatory allowance" for the work carried out during the de facto union for the benefit of her/his spouse;
- Does not have the right to request maintenance for her/ him in the event of separation;
- Does not inherit in the event of the death of her/his spouse if the latter has not made a will or if she/he has not designated her/him as heir in her/his will.

In the event of a breakdown, if you are in a common-law relationship, your only recourse is to set up a contract of common life before your relationship turns sour.

De facto spouses who separate may request the sharing of their employment income registered with the Quebec Pension Plan during the period of their union. This sharing is not automatic, unlike married or civil union spouses. The spouses must both request it. Remember again that for the purpose of the Quebec Pension Plan, you must live at least 3 years together if you do not have children together.

Please note that, except in Quebec, if certain conditions are met, almost all Canadian jurisdictions provide that common law spouses can apply for spousal support.

The default matrimonial regime in Quebec is the partnership of acquests if you are married after July 1, 1970 and you do not have a marriage contract. Warning; regardless of your matrimonial property regime, the law dictates that marriage entails the creation of a family patrimony made up of certain assets of the spouses regardless of which of the two holds property rights over these assets. So, the family patrimony law is automatic and applicable to all married or civil union couples. The family patrimony consists of the following assets: the family residences, the furniture which adorns them, the motor vehicles used for the transportation of the family and the rights accumulated during the marriage under a pension plan.

Inheritance and donation are excluded from the family patrimony, property that was a gift or a bequest to one of the spouses before or during the marriage. Be careful, do not mix the sums with the family patrimony, for example do not use the inherited money to buy the family house!

Now let's look at some tax rules regarding separated or divorced couples:

Division of property:

1 Spousal Rollover: Income Tax Act allows us to rollover between spouses without immediate tax consequences subject to certain conditions. Warning! When the transfer of property takes place at a time when the parties are no longer spouses or common-law partners, the transfer must be made in accordance with the court order or an agreement.

2 Principal Residence Exemption: Spouses have two choices for making the transfer, either the rollover between spouses at the cost of property, or a taxable transfer at fair market value using the principal residence exemption.

In the court case of Balanko vs. The Queen, the trustees of the Estate of the Late Ms. Balanko appeal an income tax assessment for 2003, dated April 8, 2013, to be permitted to designate as principal residence Ms. Balanko's former property in Whistler, B.C.

Ms. Balanko and her spouse Dr. Balanko were separated since 1983, pursuant to a written separation agreement Ms. Balanko in 1991 transferred ownership of the property to Dr. Balanko for one dollar. In 2003 Dr. Balanko sold the Whistler property. The Minister has calculated that a capital gain of \$243,009 was made in the disposition and was attributed to Ms. Balanko. In short, the lesson from this story is that Ms. Balanko's estate was unable to provide a written agreement for the separation of property. In rendering his decision, Justice Rip stated that "the absence of a written separation agreement required by law is a more serious omission than the lack of receipts to prove an expense". The Balanko decision effectively serves to recall the strict requirements of section 54 of the I.T.A. and the lack of discretion on the part of the Court to ignore situations where a taxpayer has failed to meet one or more of the clear legislative requirements of the provision.

3 Registered Pension Fund Transfers- RRSP, RRIF, RPP, DPSP:

In all cases, the recipient must be entitled to the payment under a decree, order, judgment of a court, or under a written agreement relating to a division of property between the individual's current or former spouse or common-law partner in settlement of rights arising from the breakdown of their relationship. The parties must be living separate and apart at the time of the transfer due to a breakdown of their relationship.

I must add an important point here; when entering into a separation agreement, it is necessary to forecast the future tax cost to the transferee.

4 Transfers of a life insurance policy or an annuity: The ITA provides relief provisions when a life insurance policy is transferred as part of the settlement of rights following the breakdown of a marriage or a common-law relationship. For the transfer of the life insurance policy to be eligible for a transfer at cost, the following conditions must be met: The transferee must be a spouse, common-law partner or former spouse or common-law partner, and when is a former spouse or common-law partner, the transfer must be made in settlement of rights following the breakdown of the marriage or common-law relationship; and the transferee and the transferor must be residents of Canada for income tax purposes at the time of the transfer.

5 Attribution rules: Even if the rollover provisions apply to a transfer, capital property transferred between spouses may still be subject to the rules of the articles concerning the attribution of income and capital gains to the author of the transfer. Note that the attribution rules cease to apply after divorce or after separation from bed and board.

In the case where the spouses are the shareholders of a private corporation, the division of the corporation's assets becomes very complicated. Note that if one of the spouses is the sole shareholder

of the couple, such a division is not necessary in Quebec, the corporate veil does not need to be removed.

The rules and choices relating to the division of property in a private corporation are complex and require a careful and arduous work. Here are the alternatives if we must divide the shares or property in a private company:

- Transfer of shares: Pay attention to anti-avoidance rules
- Redemption of shares
- Divisive reorganizations

The divisions of matrimonial property, routine or complex, can be completed in many different ways. A tax specialist should carefully consider the implications of the various methods in consultation with the client and their family lawyer. To maximize overall tax efficiency, a collaborative approach by all interested parties will often be required.

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