

Planning for major life transitions

Separation and divorce planning

Separation and divorce are major life events that can have significant tax, estate and financial planning obligations. It is a difficult time with a lot of change, but it is important to be proactive in planning how to reduce the impact of potential liabilities.

For tax purposes, spouses are considered to be separated if they have been living “separate and apart” for at least 90 days as a result of a breakdown in their relationship and have not reconciled during this period.

It is important to inform CRA of a change in marital status — it may affect eligibility for benefits and tax credits. If a person’s marital status has changed, they are no longer eligible for spousal tax planning opportunities.

During divorce, transfers of property between spouses are generally tax deferred. Once transferred, selling an asset can shift capital gains implications.

When a tax-deferred rollover occurs, attribution rules typically don’t apply, but there can be exceptions, so it is important to get tax and legal advice.

Division of assets

The parties may need to consider how they will divide assets. Each person should obtain independent legal advice to understand the law in their jurisdiction, as it varies from province to province.

These differences include, but are not limited to:

- Whether common-law partners are treated the same as married spouses.
- Which assets may be exempt from an equalization payment or division.

Typically, there is a written separation agreement confirming the division of assets prepared by a lawyer and signed by both parties. If the parties cannot agree, it may go to litigation for a judge to decide.

Assets include and are not limited to government pensions, registered plans (RRSPs, RRIFs, TFSAs, RESPs, RPPs, LIRAs, etc.), property, vehicles, personal effects and corporate assets.

Support payments

One spouse may be required to pay the other financial support payments, either as scheduled payments or as a lump-sum payout. Scheduled support payments are usually taxable for the recipient and deductible for the payor. Lump-sum payments are generally not taxable for the recipient and not deductible for the payor, but there are exceptions.

Note: Legal fees paid by the recipient relating to obtaining such support, may also be tax deductible.



Estate planning

It is essential to review and update estate planning documents, including:

- The individual's will.
- Trust deeds.
- Power of attorney.
- Health care directives.
- Beneficiary designations.

Although the separation agreement/court order may discuss beneficiary designations, it is crucial to ensure beneficiary designations on an individual's accounts reflect their current wishes. Failure to do so could result in litigation. It is also important to consider that the terms of a separation agreement may determine whether to change the beneficiary designation later. For example, an individual may be required to keep their former spouse as the beneficiary of a life insurance policy to cover future child support obligations if they die.

Seek the advice of a lawyer when updating estate planning documents. In most cases, an individual shouldn't wait until obtaining a divorce decree to update the documents. Most individuals would not want their former spouse to make decisions on their behalf should they become incapacitated.

Note: There are risks when using online programs to generate wills without receiving advice from a lawyer.

Separation and divorce planning checklist

Obtain independent legal advice.

Notify the CRA of change in marital status.

Seek tax advice on transferring property between spouses.

Estate planning

Review and update the will to ensure it reflects current wishes. Remove former spouse as an executor or beneficiary if necessary. The estate lawyer should review the signed separation agreement.

Update trust deeds, consider restructuring any family trusts.

Revise power of attorney to name the new person to make financial decisions in the event of incapacity, as well as health care directives.

Change beneficiary designations on all accounts (government pensions, registered plans and life insurance policies) as long as the signed separation agreement does not state otherwise.

Consult a lawyer to ensure all changes are legally sound and to understand any restrictions in your separation agreement.

Protect inherited assets

Keep any inherited assets in separate bank accounts and in the individual's sole name. Do not mix inherited assets with marital property to ensure they are excluded from division. Consult with a lawyer in the province as each jurisdiction has its own legislation with respect to the division of inherited assets on divorce.

By following these steps, an individual can help ensure that the financial and legal aspects of their marital breakdown are managed effectively, reducing potential liabilities and stress.



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