

Collaborative Family Law

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Happy New Year to all! We are beginning 2015 with a series of newsletters highlighting the various professional roles of the collaborative team and the type of assistance each can bring to people undergoing separation. We begin with the Financial Edition, with articles by two of our members, Theo Schmidt and Terry Parkes.

Financial Separation: Not just cutting everything in half....

The financial agreement in a collaborative setting can actually be very creative. Often enough the separating people have preferences as to keeping certain assets or handling their income needs. In other cases they learn during our financial discussions what they could do in order to create **solutions that benefit the family** and everybody involved:

- **"Trading" assets and values** - one partner may want to keep the pension and the other one the house, or there is the wish to have the bigger car and less RRSP. Partners can shape their own list of items to keep or to transfer.
- **Exchange income for assets** (or vice versa) - one partner may need cash to start an education program or wants an enhanced monthly income for a while. On the other hand there may be less income need but a desire to keep a specific asset.
- **Establish long-term payment plans** - useful to cash out business shares, less liquid investments and Real Estate properties. Selling a company or a property under pressure is often not advisable as losses can occur, temporary price levels are too low or in many small businesses a rigid split or a high demand for cash can literally "kill" an enterprise.

- **Flexible support plans** - with defined support payments for certain periods instead of linear and table based amounts. Example: One partner sets out to build a small business / professional services - creating different cash needs during the first development phase and at later stages when the company / practice is settled in.
- Create a **"Children's Budget"** to share the parenting cost equitably and not cling to rigid table amounts. Most children benefit greatly from extracurricular activities and special events or they need tutoring to gauge their potential.
- Stay with **joint ownership** of properties and companies? In a true collaborative spirit separating couples sometimes decide to establish a purposeful business partnership - temporarily or even long-term - to take advantage of mutual use, rising price levels and affordable cash flows.

The Financial Specialist (FS) will assist in many ways:

- It starts with a thorough **inventory** of all assets & liabilities incl. accurate, fair and unbiased **valuations** - often with the help of Professional Realtors, Pension Actuaries, Business Valuators and Tax Consultants.
- Based on this inventory, there are discussions with the clients re: their **particular perspectives and needs** going forward. The FS provides **information and education**, gathers additional facts and numbers as necessary and looks at tax and fee consequences.

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- **Introduction of options and scenarios** - the FS delivers financial calculations to show "Pro's & Con's" and to support any decision making process.
- In some cases there is no immediate consensus re: treatment of items, valuations and payment terms. In his neutral role the FS can also provide proposals and guidance.

That sounds all fine but rather theoretical? Let's look at some "Real Life" examples:

A - One of the most frequently asked question is: "Can I buy my ex-partner out of the house?" If there is agreement in principle we have to do our "homework" to move on this:

What is the applicable value - looking at the latest tax assessment, a Realtor's Market Evaluation and a formal Property Appraisal. Any reasonable factors for adjustments?

Do the math - looking at the future employment income / support / possible rental income and see if **the financials work out** without creating budget pressures.

Talk to the bank / mortgage company to **secure financing** - we have to make sure that any commitment in the Separation Agreement to release the other partner is covered.

B - Betty was a 30% co-owner of the **family business** and the value of it came to \$300,000 - creating a \$90,000 claim for her. As there was not much cash available at all she agreed to convert her shares into Preferred Shares with fixed interest and a redemption schedule over 5 years. That helped Betty and made it affordable for the business.

C - Jill and Joe decided to keep the **vacation property** which had been in family ownership for decades. If they had sold upon separation there would have been a juicy taxable capital gain and a low sales price as the market was weak. They took turns to use the property for a number of years - much to the benefit of their children- and may consider transferring it to the children.

D - Jane had given up her Consultant job when the children were born. After the separation she needed **schooling to get back on track and a few years to rebuild her practice**. She agreed with Paul to modify the formal spousal support payments and get some education funds up front and a higher monthly support for a number of years - then a scaled down and decreasing support for another period.

The FP is available to discuss all issues in depth with the clients and the other Professionals involved. In a typical collaborative environment, **lawyers, coaches and specialists work together as a team and with their clients on a potential settlement structure**. This is a very "organic" and dynamic process and in sharing ideas, developing and evaluating options, comparing scenarios, etc. the best solutions are found to ensure a well-rounded and lasting agreement.

Not all assets are equal in the separation settlement

In the course of dividing assets between separating partners, the current fair market values are determined for the purpose of negotiating a mutually acceptable division of those assets between the separating parties. However, the income tax implications associated with the various types of assets must also be considered in assessing their relative values. Where a particular asset is split proportionately this may have little consequence, but where the trading of assets occurs, the significance of the income tax implications could be critical. In this article, I will discuss how income tax considerations could have a major effect on the current value of assets commonly included in a separation agreement. The collaborative team has members who can help review these issues and provide impartial guidance in determining their effect on the division of assets.

RRSPs, pensions and other deferred income plans

When funds are drawn from deferred income plans they are subject to income taxes. How is the current value affected by this income tax liability? This will be greatly influenced by the expected span of time from the present until withdrawals commence. The longer the span of time, the lesser the effect of income taxes on the current value. The expected income tax brackets of the recipients may also have to be taken into account. This can be a very complicated calculation based on a lot of assumptions. As such, it is usually best to split these items in proportion to the overall settlement division. However, where there are few other assets that cannot be split, trading may be necessary. If so, be aware of the income tax effects.

Non-registered investments

Where there are investment portfolios held directly (i.e., not in a registered plan such as an RRSP), the current values are generally ascertainable as the securities are usually publicly listed. The basic rule in the Income Tax Act concerning the transfers of assets between separating partners is that the receiving party (the transferee) assumes the same income tax position as the transferor. As such, any unrealized capital gains or losses inherent in the securities passes over to the transferee. The resulting income tax costs (or benefits in the case of losses) upon the subsequent disposition of these securities should be considered. At the sole discretion of the transferor, an election can be made on a property by property basis to have the transfer deemed to take place at the fair market value instead of the tax cost. The separation agreement should contain appropriate provision for this election being made (or not being made) to ensure certainty of the income tax position of the transferee.

Principal residence

In most separations, there is a family home. Frequently, the family home is to be retained by one of the separating parties. If the family home fully qualifies as a "principal residence" under the Income Tax Act, there would be no income tax implications to consider. However, there may be other circumstances existing that could taint the "principal residence exemption" under the Income Tax Act such as:

- The principal residence exemption applies to the residence itself and up to $\frac{1}{2}$ hectare of subjacent and adjacent land. Where more than $\frac{1}{2}$ hectare of land is involved, it is required to prove that the excess is necessary for the use and enjoyment of the property to qualify for the principal residence exemption. Apart from zoning restrictions, this may be a difficult test to meet.

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- The residence may have significant rental or business use which may prevent its full eligibility as a principal residence. If any capital cost allowance (the tax form of depreciation) has been claimed on the rental/business portion of the property, this will remove that portion from the exemption.
- The property may not have been a principal residence for the full period of ownership. As such a portion of the accrued gain may be taxable.

If the above or other situations exist to preclude a full exemption for the family home, the income tax cost will pass to the transferee in the same manner as noted above for investment portfolios. Also, the same election is available for the transferee to pass this property at its fair market value.

Other real property

In the same manner as portfolio investments, other real property (vacation property, rental property, business property, etc.) passes to the transferee at the transferor's tax cost. In the case of other real property, the possible recapture of capital cost allowance (or terminal loss) on the building(s) may exist in addition to the unrealized capital gain (or loss). These potential income tax costs or benefits need to be factored into the valuation of such properties. Again, the same election is available for the transferee to pass this property at its fair market value.

Capital gains deduction eligibility

Certain types of property may be eligible for the enhanced lifetime capital gains deduction of up to \$400,000 (50% of a capital gain of \$800,000). These include, a "qualified farm property", a "qualified fishing property", or shares of a "qualified small business corporation". Although there may not be an immediate income tax issue present with such assets, this could change if the remaining available portion of the \$400,000 lifetime deduction is or could be compromised by shifting the entire gain onto one of the separating parties. The election to transfer at fair market value could be used in such a case to provide the transferee with a greater tax cost.

Conclusion

The foregoing is only a cursory examination of some of the assets that may be involved in a separation agreement. It is intended to raise awareness of the income tax implications that may be present. If such items are present, you should ensure that your collaborative team includes a financial specialist that is conversant with income tax issues.

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Parkes & Company, Chartered Accountants
Member of the Collaborative Family Separation Professionals
Victoria, BC, Canada

Are you separating and wondering where to start? The mental health professionals who work as coaches with our collaborative team are offering a service which assists separating couples to choose the best process option for them in achieving a separation agreement. Please see the attached flyer for further information about this service. A referral is not required. To make an appointment, you may call the coach corresponding to the month in which you are making the call.

So We're Separating: Now What?

Information Sessions on Separation Options

You will meet with a coach for approximately one and one-half hours in a neutral process. We suggest that both you and your partner meet with the coach together in order to get the same information at the same time. If this is not possible an individual session can be arranged.

At an information session you will:

- gain information about separation and divorce choices
- discuss your situation and get help to choose which option is best for you
- explore the levels of conflict in your relationship
- get your questions answered
- get help finding resources specific to your needs

To set up your information session appointment, please see the schedule of coaches below. You can phone the coach who is listed during the month you wish to set up your session. All of our coaches are trained professionals who have many years of experience working with separation and divorce issues.

The cost for each session is \$125.00.

Schedule of Coaches – 2015

Month	Name	Phone #
JANUARY	Bob Blank	250-888-2170
FEBRUARY	Cally Farr	250-388-6684
MARCH	Charlotte Sutker	250-388-5826
APRIL	Marnie Olchowecki	250-813-3210
MAY	Pat Kirchner	250-413-3107
JUNE	Gloria Burima	250-589-0364
JULY	Cally Farr	250-388-6684
AUGUST	Bob Blank	250-888-2170
SEPTEMBER	Charlotte Sutker	250-388-5826
OCTOBER	Marnie Olchowecki	250-813-3210
NOVEMBER	Pat Kirchner	250-413-3107
DECEMBER	Gloria Burima	250-589-0364

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