Failing to think around the corner-- When Financial Planning and Divorce collide

No one plans for a divorce, or perhaps it is fairer to say that few do. Many people do, however, try their hand at tax planning, estate planning, or creditor-proofing, often at the urging of their financial planner or accountant. Two common approaches to such plans are the transfer of assets into a trust for the benefit of a spouse or children, or the transfer of assets directly into the hands of a spouse or child. The missing ingredient in too many of these plans is consideration of the implications if a couple later divorce. The mere fact of the financial pressures and scrutiny that accompany a separation may bring problems with the initial plan to light. If the trust was not properly created or the asset transfer properly implemented this may be uncovered in the context of negotiations between the parties, or worse, in litigation in open court. The divorce may precipitate the unravelling of deals carelessly throw together. On the other hand, separation and divorce may be the moment that a spouse realizes the full implication of having given away or sold assets during the relationship. It is not at all unusual for a separated spouse to realize for the first time in her family lawyer's office that transferring the house or her business to her partner or children actually resulted in a loss of ownership and control. Some spouses have focussed solely on the tax benefits or creditor proofing aspects of a transfer without receiving advice or fully comprehending the implications – that they may not get the asset back.

If a spouse has transferred an asset directly into the other's name without receiving any payment it is possible to argue that the spouse is still the beneficial owner of the property. The recipient has the burden of proving that the transfer was intended to be a gift at the time it was made. Yet there is a real risk in any such case if the other spouse is not cooperative that the asset will be difficult to recover without the expense of a lawsuit. And any lawsuit of this type will depend on how the judge perceives the credibility of each party which also creates uncertainty in the result.

Financial plans that require the creation of trusts can also create difficulties that manifest after separation. If a spouse has during a relationship transferred a business or land to a valid trust for the benefit of the other spouse or children and is a trustee of that trust, he or she will have fiduciary responsibilities to the beneficiaries of the trust. If the spouse or parent has dipped into the trust assets or income or has engaged in any self-dealing with the trust, he or she has likely breached fiduciary duties and may face significant exposure to claims from the beneficiaries.

On the other hand, if the trust was not properly created in the first place, the entire arrangement may be set aside. A sham trust is one that on the surface may look like a proper trust but which fails to comply with all the requirements of a trust. It is not enough to have a formal trust deed that appears to impeccably describe a trust. Courts have and will find that the arrangement is nothing more than a sham if the original owner of the assets had no intention to lose control of them or the profits. If all the owner did was sign some documents based on financial advice to avoid taxes without any real intention of settling them on a trust for the benefit of others, there is no trust. That means that for tax purposes the original owner is liable to the Canada Revenue Agency and for family law purposes if he or she separates, the value of the underlying assets will be shared in the property division and any potential income taken into account for child or spousal support purposes.

Planning driven solely by tax planning or creditor proofing may ensnare the unwary. It is always worth taking into account all eventualities when undertaking a significant re-organization of assets and in getting careful advice on all the implications.