

# Advisory

## Considerations in Using a Domestic Contract

Family dynamics are unique and can be complicated to navigate. This is especially true when dealing with how family wealth should be shared and distributed. Whether it is a blended family, a young couple where one spouse owns or will be contributing more to the matrimonial home than the other or who owns or will be inheriting substantial assets, a spouse with an interest in a family trust set up by their parents, or one spouse looking to protect the family business, the use of a domestic contract should be considered, and can be an essential part of one's overall estate plan.

In this Advisory, we provide an overview of the role of a domestic contract and what some of the major considerations are for making one. In Advisory, "[Estate Planning and Marital Property Considerations](#)", we provide a general overview of Ontario's family law legislation and how it may affect an estate plan. This Advisory provides a more in-depth look into domestic contracts, in particular marriage contracts and cohabitation agreements.

### TYPES OF DOMESTIC CONTRACTS

A domestic contract is a defined term under Ontario's *Family Law Act*, (the "Act") and means any of a marriage contract, separation agreement, cohabitation agreement, paternity agreement or family arbitration agreement. For the purposes of this Advisory, any reference to the term "domestic contract" will refer to marriage contracts, separation agreements, and/or cohabitation agreements. In this Advisory, we deal primarily with cohabitation agreements and marriage contracts.

In general, a domestic contract is an agreement between two parties to deal with their respective rights and obligations during the relationship and/or upon the breakdown of their relationship, which can include death. It allows the parties to elect out of most aspects of the family property regime set out in the Act, and gives the parties freedom to choose their own property regime, and deal with a variety of matters, specifically:

- ownership in or division of property;

- support obligations;
- the right to direct the education and moral training of their children, but not the right to decision-making responsibility (formerly known as “custody”) or parenting time with respect to their children, except if it is a separation agreement; and
- any other matters in the settlement of their affairs.

A **marriage contract** is a domestic contract where two persons are married to each other or intend to marry each other and wish to enter into an agreement concerning their rights and obligations during marriage or on separation or death. As such, it can be a “pre-nuptial” contract, which is entered into before marriage, or a “post-nuptial” contract, which is entered into after marriage.

A **cohabitation agreement** is similar to a marriage contract; however, it applies to two persons who are cohabiting or intend to cohabit and are not married to each other. In the event the parties do marry, the cohabitation agreement will be deemed to be a marriage contract unless otherwise provided for in the cohabitation agreement.

A **separation agreement** refers to an agreement between two persons who cohabited either inside or outside of marriage but who are now living separate and apart. The agreement can deal with the same issues as a marriage contract or a cohabitation agreement, but can also set out terms related to the decision-making responsibility or parenting time with respect to any children.

It should be noted that there are certain rights and obligations that cannot be included in a domestic contract. Specifically, a domestic contract, other than a separation agreement, cannot deal with child support obligations, nor can it limit a married spouse’s possessory rights to a matrimonial home.

Overall, with some limited exceptions, the scope of a domestic contract can cover a wide range of topics and can be as broad or specific as the parties would like. For the purpose of this Advisory, we will focus on more limited domestic contracts or single-purpose domestic contracts, such as domestic contracts that modify the property division regime under the Act or protect gifts and inheritances.

## COMMON USES OF A DOMESTIC CONTRACT

A primary intent of Ontario’s family law legislation is to provide a default regime for equalization of family property between married spouses while also allowing married spouses to create their own property regime appropriate to their circumstances by way of a

domestic contract. In the event of a marriage breakdown, whether it is caused by a separation or death, unless otherwise provided for by a domestic contract, the Act provides for an equalization of family property between the spouses, as well as certain rules regarding a matrimonial home and support obligations. This equalization of family property is not a right given to common law partners under the Act.

As noted above, a domestic contract can modify what the Act provides with regard to equalization of property for married spouses. As well, outside of the Act, there are other legal doctrines that can give rise to property claims that can apply, such as certain trust claims for ownership of the other partner's property. For common law partners, a domestic contract allows common law partners to decide between themselves how they would like to treat their assets and divide their property in the event of a relationship breakdown, including in the event of death of one party, and to protect against property claims that might be made by their partner.

A domestic contract can be as broad as the parties would like in dealing with property rights and can include an entire waiver of each party's rights or potential rights to the other party's property, or it can be more specific and detailed and instead only carve out certain assets that should not be shareable between the parties (commonly referred to as "excluded property").

Some common uses of a domestic contract are discussed below.

### **Gifts and Inheritances**

Under the Act, gifts and inheritances received *after* the date of marriage are not included in the calculation of a spouse's family property, nor is any income or growth on the value of such gift or inheritance if the deed of gift, trust agreement or will expressly provides for this exclusion, but with certain exceptions. If the gift or inheritance is used to contribute to acquiring or maintaining a matrimonial home, including paying down a mortgage, it loses its exclusion. If the gift or inheritance is commingled with other assets so that it cannot be identified or traced, or if it is placed in a joint bank account by way of gift, then the gift or inheritance loses its exclusion and becomes family property, which would be subject to equalization.

Gifts and inheritances received before the date of marriage are treated differently. Any income from and appreciation during the marriage in the value of such gifts and inheritances is shareable and will be divided equally between the parties, although the value of the gift or inheritance at the date of marriage is deductible in the calculation for equalization of

property, unless it is a matrimonial home that is also owned at the date of separation or death.

A domestic contract can be used to specifically deal with any gifts and inheritances already received or which may be received in the future. If it is desired that any gift or inheritance received by either spouse is always kept separate and is not shareable, a domestic contract can provide for their treatment as excluded property, as well as the income and the growth and any substituted property, and that neither party has any rights or claims to the other's excluded property.

### **The Matrimonial Home**

A matrimonial home is typically the married spouses' primary residence, but can extend to cottages and vacation homes as well, and there can be an unlimited number of matrimonial homes.

The value of the matrimonial home, minus any liabilities, is subject to equalization and thus shareable between the spouses. This is the case even if the matrimonial home was a gift or an inheritance received by one spouse before the marriage, or after the marriage, provided it is still a matrimonial home on separation or death. This is also the case for any contributions made to the matrimonial home.

Even if one spouse brings a matrimonial home into the marriage that is owned on separation or death, contributes more to the matrimonial home, or his or her family contributes to the matrimonial home by way of a gift, the other spouse has an equal claim to the value of the home on a separation or death, unless provided otherwise in a domestic contract.

The Act does provide for certain rights to the matrimonial home that cannot be altered by a domestic contract. Under the Act, married spouses have an equal right to possession and a marriage contract cannot limit this right. So, for example, spouses cannot agree that one spouse has to leave the matrimonial home if they separate. Nor is either party entitled to dispose of or encumber any matrimonial home without the consent in writing of the other spouse.

### **Private Company Shares and Business Interests**

There is no special treatment given to shares in a private corporation or business interests under the Act.

On a relationship breakdown, the increase in value of such assets during the marriage are shared equally between the two spouses. This may not be the desired outcome for various

reasons: the private company shares may have been gifted to one spouse prior to the marriage and it is not intended that the increase in value and income generated be shareable; there is an intention to ensure the shares stay within the family and not be subject to any claims; an active business may be involved that one spouse has no involvement in and it is not desired that they be a shareholder; or there may be a shareholders' agreement that limits to whom the shares can be transferred.

To protect these shares and business interests, a domestic contract can provide that in the event of separation or death, a spouse's shares and business interests are not to be included in property division or cannot be used to satisfy any equalization payment or support owing to the other spouse.

### **Case Studies**

The case studies below highlight two common scenarios where a domestic contract should be considered.

#### **a. Sue and Jim**

*Sue and Jim have been together for two years and are now thinking of getting married. This would be Sue's second marriage and Jim's third marriage.*

*Sue has two children from her previous marriage: 19-year-old twins Jack and Sally. Jim has four adult children of his own: Adam, Betty, Chris, and Doug, all in their thirties.*

*Both Sue and Jim are successful entrepreneurs and have amassed their own independent wealth, which they wish to share with their own respective children. They both agree that they do not need the other to support them nor do they intend to support the other.*

*They are currently living in their own homes, but Sue and Jim's ultimate plan is for Sue to sell her home and move into Jim's home in the next year.*

*They aren't interested in commingling their assets and want to make sure that the other spouse does not have any rights or claims to their respective property in the event they break up or upon death. They want to ensure that what is Sue's will remain Sue's and what is Jim's will remain Jim's, and that they can freely leave their respective estate to their own children. Nonetheless, Sue wants to make sure that if Jim were to die before her, she would not have to immediately move out of his house, which concerns her, as she doesn't have the best relationship with Jim's children.*

*After much discussion, Sue and Jim agree that if Jim were to predecease Sue, she can remain in the house for a period of three years, all the household contents remain while she lives there, and Jim's estate will pay for any expenses. Jim also wants to give Sue the option to purchase the home if she wants to stay and own it.*

*In order to make sure there are no disagreements between the survivor and the deceased spouse's children, Sue and Jim decide to prepare a domestic contract to ensure that the survivor cannot make any claims to the other party's estate, and to set out Sue's right to stay in the home and to use the household contents after Jim's death, as well as her option to purchase the home. They both retain separate legal counsel, and together with their respective counsel, draft, negotiate, and execute a domestic contract that will be in effect throughout their relationship, whether or not they decide to marry.*

**b. The Miller Family**

*Bob and Judy Miller's oldest daughter, Alison, is getting married to her high school sweetheart, Adam. Alison and Adam are just starting out in their respective careers and have been living with Bob and Judy in order to save money.*

*Bob and Judy want to help Alison and Adam out and have decided to give Alison \$2,000,000 for her and Adam to purchase a home together, with a purchase price of \$2,000,000.*

*Although Bob and Judy love Adam and consider him a part of the family, Bob and Judy want to ensure that this initial gift is protected so that in the event Alison and Adam's relationship doesn't last, the \$2,000,000 gift remains with their family. They have discussed their concerns with Alison and have asked that she and Adam consider entering into a domestic contract.*

*Alison and Adam agree that Bob and Judy's generous gift should be protected. They are open to having a domestic contract, but want to ensure that it only deals with the purchase of their new home, any future gifts and inheritances either should receive, and the income and growth on them, as Alison and Adam have decided that everything else they currently have and will acquire during their marriage should be shareable.*

*In consultation with their lawyers, Alison and Adam agree that the home will be in Alison's name only for the time being, and that she would be entitled to a deduction of \$2,000,000 in the event of a relationship breakdown. They have agreed that any growth in the home would be shareable between them.*

*Alison and Adam also agree that in the event she predeceases Adam, she would provide Adam the option to live in the home rent-free for a period of one year, or for an indefinite*

*period of time if they have children. They also agree that in the event they have been married for at least ten years, they would both be put on title to the home, and the home would be shared equally between them upon a relationship breakdown.*

## **SPOUSAL SUPPORT**

Although a domestic contract can cover a variety of terms, including support obligations, under the Act, a court still has the authority to set aside any provision for support or waiver of right to support under a domestic contract. There is a high threshold test that must be met before it can do so.

A domestic contract can provide for a waiver of support and can specify certain limitations or restrictions regarding the calculation and payment of any support obligations. As an example, a domestic contract can provide that excluded property cannot be used to satisfy any support payments owed to the other party, and that it is not to be taken into account in the determination of a spouse's ability to pay support.

## **REQUIREMENTS FOR A VALID DOMESTIC CONTRACT**

### **Formalities**

The Act requires that a domestic contract or an agreement to amend or rescind a domestic contract must be made in writing, signed by the parties, and witnessed.

Each party must have the requisite legal capacity to enter into the agreement, meaning they are of the age of majority and have the required mental capacity to understand the nature and effect of the domestic contract. In limited circumstances, a minor may enter into an agreement so long as court approval is obtained. If a party does not have the requisite mental capacity, the Act does allow a guardian of property or attorney for property, provided that such guardian or attorney is not the spouse, or the Public Guardian and Trustee to enter into a domestic contract on such incapacitated party's behalf, subject to court approval.

Under the Act, the court is granted the power to set aside a domestic contract or a provision in it. This can be done if there was not full financial disclosure, if a party did not understand the nature or consequences of the domestic contract, or otherwise in accordance with the law of contract.

## **Financial Disclosure**

Under the Act, a court may set aside a domestic contract, or a provision in it, if either party or both parties fail to fully disclose their assets, debts, and other liabilities that were in existence at the time the domestic contract was made.

An important part of a valid domestic contract is that both parties provide full and frank financial disclosure. This includes providing information on any significant assets and liabilities, which may include inheritances received, any interest in a family trust, and other sensitive information, as well as the income of each party.

## **The Role of Independent Legal Advice**

Although the Act does not specifically require each party to obtain independent legal advice for a domestic contract to be valid, it is important for each party to have separate legal representation. The court can set aside a domestic contract, or a provision in it, if a party failed to understand the nature or consequence of the domestic contract, or otherwise in accordance with the law of contract. Each party having separate legal counsel can help ensure and show that each party clearly understands the effects of the contract and what their rights and obligations are to the other party. In addition, having separate legal counsel can help ensure and prove that the execution of the domestic contract is free of undue influence, duress, misrepresentation, and unconscionability—all grounds for setting aside a contract under contract law.

The Act does not specifically include a provision that a domestic contract is considered invalid if it is inherently unfair, however, case law holds the courts will consider this factor in deciding whether the domestic contract, or a provision in it, should be set aside.

## **THE PROCESS FOR A DOMESTIC CONTRACT**

The process for creating a domestic contract can take significant time, and it is important that adequate time is considered and allowed.

Generally, one party will initiate the process and retain a lawyer. With their lawyer, they will discuss what the general objectives for the domestic contract are, and what terms should be included in it. The lawyer will prepare a draft of the domestic contract to circulate and review with their client until it is ready to present to the other party. The other party will retain their own lawyer, and the draft contract will typically be sent to said lawyer for review and comment. The other party's lawyer will provide comments and perhaps suggest amendments to the contract.

Both parties will also need to provide full and frank financial disclosure. During the process, each lawyer may have certain questions or ask for further particulars about the financial information provided. The process may sometimes involve lengthy negotiations and multiple drafts until an agreement is concluded.

Once both parties are satisfied with the terms, the domestic contract will be signed by each party in the presence of a witness (which is typically their lawyer), and each lawyer will provide a Certificate of Independent Legal Advice that sets out, among other matters, that the lawyer provided legal advice on the contract, that the contract was freely entered into, and that the client understood the nature and effect of the contract.

It may be common practice, although not required by law, to execute at least four original copies of the domestic contracts so that each party and their counsel can retain an original contract for safekeeping.

Under current law, although it does appear a domestic contract can be signed with electronic signatures, it may depend on each lawyer's preference for execution and whether they will insist on wet signatures.

## **SOME CONSIDERATIONS IN MAKING DOMESTIC CONTRACTS**

### **a. Timing**

It is important to consider when the best time to enter into a domestic contract may be. It may be desirable to have the domestic contract signed and completed before cohabiting, and when parties intend to marry, generally well before the marriage date.

It is important to seek legal advice as soon as possible. Even the most straightforward agreement can take substantial time from the initial meeting with a lawyer to the signing of the domestic contract. Sufficient time is needed to draft the contract, review the contract with legal counsel, negotiate the terms of the contract, and then ultimately sign the contract.

### **b. Discussions with your spouse or partner**

Have you and your partner, spouse, or future spouse discussed whether a domestic contract makes sense for your circumstances? If so, have you discussed what the basic framework would be? Do you both have a general understanding of what the other's assets and financial circumstances are?

One of the first questions asked of a client looking to make a domestic contract is whether their partner is generally agreeable to having a contract. You do not want to be in a position

where your partner is surprised by the proposed terms of the contract, or even the idea of a contract itself. Lengthy negotiations can cause stress for the parties' personal relationships. It is important that they are generally on the same page with what their ultimate goals and objectives are for entering into a contract.

**c. What is considered "excluded property?"**

A domestic contract can provide a blanket waiver of each party's rights and claims to the other's property. But in some instances, the parties may want to only limit some of the other's rights and claims.

In the latter situation, each party should consider what assets they would like to leave "off the table"—that is, what assets are to be considered excluded property that is not shareable with the other in the event of a relationship breakdown including upon death.

The domestic contract could include other restrictions with respect to excluded property. For example, the contract could provide that such property cannot be used to calculate or satisfy any support payments, and/or that such property is only shareable if it is used for "family purposes" or is considered a "family asset," i.e., for any property used and enjoyed by both parties (and/or their children) for shelter, transportation, household, educational, recreational, social, or aesthetic purposes, just to name a few scenarios.

**d. Separation or divorce versus death**

As discussed above, a domestic contract can be used by parties to choose their own property division regime in the event of a relationship breakdown. A relationship breakdown can occur not only upon a separation or divorce, but also upon death. Parties may have a very different idea of how they would like to divide their assets and property upon death, versus what would happen if there is a relationship breakdown during their shared lifetime.

In some circumstances, parties may only want to provide for what happens to their assets upon the death of the first party, but not upon separation, including to support their estate plan, ensuring that the surviving spouse does not assert claims against property (for example, for equalization under the Act). In this case, clients may want to consider a single-purpose domestic contract that only addresses what happens on death and remains silent in the event the parties separate prior to death, leaving that to be negotiated if it occurs.

#### **e. The matrimonial home and other residences**

As discussed above, a matrimonial home receives special treatment under the Act. Because of the emotional attachment to a home, it is important to consider all possible scenarios and options for the treatment of the primary residence and any other family residence.

Some questions that should be discussed include, but are not limited to:

- How should title to the home be held?
- Is the home considered one party's excluded property? Or is it just its value at the date of marriage that is deductible, and any growth in the home is to be shared between both parties?
- How will contributions to the home be treated?
- Parties may want to consider including a formula in the domestic contract so that the party that does not own the home will be able to recoup any capital contributions made to the home during the relationship.
- If the parties separate, how long can the non-owning party stay in the home?
- On the death of the owner, does the surviving party have any rights to the home? If not, how long can they reside in the home and use the household contents until they must move out? If they are allowed to live there for a period of time, who covers the expenses—the surviving partner, the estate, or a combination of both?
- Should the non-owning party have an option to purchase the home from the estate of the owning party? If so, the domestic contract should set out the terms of such option to ensure a dispute does not arise between the survivor and the beneficiaries of the estate.
- Does the owning party want to leave the non-owning party a share in the home? Sometimes rights to the home may change as certain milestones are met. As an example, perhaps the non-owning party will be entitled to the home if the parties were together for an extensive period of time or if there are children of the relationship.

#### **f. Household contents**

The division of personal and household articles can often be contentious. When parties separate during lifetime, dividing these items may be easier as each party is able to vocalize which item was theirs and what items they would like.

Difficulty can arise when the relationship breakdown is as a result of the death of one party, and there is tension, and sometimes disputes, between the surviving party and the beneficiaries of the estate of the other party as to the ownership of personal and household articles.

The domestic contract can set out ownership of identified articles and how they should be divided upon separation or death. In considering how to divide the property, the parties should refer back to the treatment of the matrimonial home. For example, if the surviving party is allowed to remain in the home for a certain period of time after death, then it may make sense to include a provision that household articles remain in the home with the surviving party for the same period of time, and that the parties agree to keep a valid will in effect to carry out such provisions.

#### **g. Confidentiality**

As discussed above, one of the requirements for a valid domestic contract is full and frank financial disclosure. This may include providing the other party with sensitive information, not only with respect to each party's assets, but also information that will relate to other family members and family business interests, including certain gifts or inheritances they may receive or have received under a will or a trust.

Given the nature of the domestic contract, a party may wish the domestic contract to provide that each party agrees to keep the terms of the domestic contract confidential and will not disclose any information, with limited exceptions such as disclosure to certain professional advisors, if necessary. In addition, the parties may also wish to enter into a separate confidentiality agreement to set out in detail specific terms for confidentiality, including when and to whom disclosure can be made.

#### **h. Will plan**

Regardless of when the domestic contract is completed, it is important that it is reviewed in connection with a party's existing will plan or in the creation of a new will plan, to ensure that their will properly addresses any terms or obligations imposed on death by the contract. In some instances, the domestic contract may specifically provide for certain terms to be included in each party's will, and accordingly, each party's will would need to be drafted or updated to incorporate these terms.

#### **i. Insurance**

The parties may wish to consider whether life insurance should be required by either party in order to provide a form of security for any support payments or obligations that may arise

under the domestic contract, including in order to provide for additional benefits on death. The domestic contract may provide that a party is required to maintain a life insurance policy of a certain amount and designate the other party as beneficiary, as well as consequences for failure to do so.

## CONCLUSION

Just as every family is unique, so too are domestic contracts. Although the terms and conditions of each contract may differ, the overall objective remains the same: to set out the wishes of both parties with respect to how to deal with their property upon a relationship breakdown including death, as well as rights and obligations arising out of their relationship. Family dynamics can be challenging and difficult to navigate, and disagreements about how to treat such property can further complicate relationships. Taking the time to talk through and set out each partner's, spouse's, or future spouse's goals and objectives will minimize the likelihood of any potential conflict down the line. A domestic contract plays an important role in wealth protection and estate planning and is a sensitive matter that needs to be handled thoughtfully and carefully with experienced professional advice.

The comments offered in this Client Advisory are meant to be general in nature, are limited to Ontario law and are not intended to provide legal advice on any individual situation. Before taking any action involving your individual situation, you should seek legal advice to ensure it is appropriate to your personal circumstances.