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Advisory

Estate planning and marital property considerations

Family law is complicated. How it intersects and interplays with estate planning and general wealth protection is a topic of key concern for many, including in respect of one's married children or those who plan to marry. In this Advisory, a brief overview of Ontario family law legislation is presented. Special issues involving gifts and inheritances, as well as the matrimonial home and the uses of marriage contracts are highlighted. A variety of general planning points are also summarized. For a comprehensive treatment of domestic contracts, please refer to our Client Advisory "Considerations in Using a Domestic Contract".

OUTLINE OF THE *FAMILY LAW ACT* (ONTARIO) (THE "ACT")

Basics of the Act

The Act came into force on March 1, 1986. A primary objective of the Act is to recognize marriage as an equal economic partnership, and if a marriage is terminated, whether on marriage breakdown or death, to provide for an equal division of most property acquired during the marriage.

The Act creates a formula for equalizing family property between married persons on marriage breakdown or death of the first spouse to die, as well as among other matters, providing rules regarding matrimonial homes, family and spousal support obligations and domestic contracts.

Under the Act, persons not legally married to each other *have no rights to equalization of family property with their common-law spouse*, although they may have a right to support and possible claims against each other's property under other legal principles to ensure fairness, including a monetary claim or requesting a court grant relief by imposing a "constructive trust" over property in their favour.

Formula for Equalization of Family Property on Marriage Breakdown or Death

In order to equalize family property, the formula under the Act provides for each spouse's assets to be valued, net of liabilities, on termination of the marriage, upon the earlier of the date of marriage breakdown or one day prior to the date of death of the first spouse to die. From this amount, the value of all assets owned at the date of the marriage, net of liabilities, is subtracted (except a matrimonial home if it is owned by one or both spouses at the date of the marriage and is also owned on the termination of the marriage) in order to arrive at each spouse's "net family property".

Calculation of Equalization Payment

The spouse with the smaller "net family property" value is entitled to make a claim against the other spouse with the larger "net family property" value, or on death of the first spouse to die, against the deceased spouse's estate, for one-half of the difference between the two values.

Certain assets do not have to be included in calculating each spouse's property for equalization purposes, most significantly, gifts and inheritances received from any person (other than his or her spouse) *after the date of the marriage*; income from such gifts and inheritances if the person who has made the gift or bequest has stated in writing that the income is to be excluded; life insurance proceeds; any property (other than the matrimonial home) whose acquisition can be traced as originating from these assets; and any property excluded by the spouses' domestic contract.

Special Considerations Regarding Gifts and Inheritances Received Pre-Marriage and Post-Marriage

The post-marriage increase in the value of gifts and inheritances and income arising from gifts or inheritances *which have been received prior to the date of the marriage* is included in the calculation of the value of each spouse's assets for equalization purposes, unless a domestic contract excludes it. Under the Act, as noted above, the capital value of gifts and inheritances received *during marriage* is excluded in the equalization calculation (unless this exclusion is lost as explained further below), and as well the increase in value of gifts or inheritances received during marriage and the income arising from such gifts or inheritances, if the person who has made the gift has stipulated that the gains and income is to be excluded in a deed of gift or in his or her will, is excluded. For this reason, it is common practice in Ontario for wills to include a special clause for this purpose.

Special Treatment of a Matrimonial Home

The Act accords special treatment to the matrimonial home, which includes not only a primary residence, but also cottages and other properties, if occupied by the spouses or by a spouse and their children as a family residence and at least one of the spouses has an 'interest' in the property. Accordingly, there can be more than one matrimonial home.

The *value* of the interest in a matrimonial home (not the property itself), net of liabilities, is subject to equalization. As noted above, an interest in a matrimonial home owned by one spouse at the date of marriage, and which is also owned on the date of termination of the marriage, is included in the calculation of the value of that spouse's assets, and is *not* deducted from the value of his or her property along with other property owned by the spouse at the date of the marriage. As well, an interest in a matrimonial home which was gifted or inherited during the marriage and is owned on termination of the marriage is *not* excluded from the value of a spouse's property on termination of the marriage, even though it is a gift or inheritance.

In addition, if a gift or inheritance received during marriage is used to purchase a matrimonial home, make improvements to or pay down a mortgage on a matrimonial home, the gift or inheritance *loses its exclusion* and must be included in equalizing family property.

In certain circumstances, a family trust may be a viable planning tool for holding a family residence that would otherwise qualify as a matrimonial home and prevent its full value from being included in an equalization calculation upon marriage breakdown or death. Recent Ontario appellate-level case law supports that a trust may be used to shelter the value of a family residence from future equalization claims if the trust beneficiary-spouse has no interest in the property itself, but only an interest in the trust. The interest in the trust on the date of marriage is deductible, but any increase in the value of the trust interest during marriage will be included for the purposes of the equalization calculation.

Equalization Claims on Death

On death, as noted above, the right to an equalization of property between spouses arises. This right is "one-way", and is only available to the surviving spouse; the estate of the first spouse to die cannot make an equalization claim against the surviving spouse.

Whether the surviving spouse wishes to take the benefits under the will of the deceased spouse (or under the laws of intestacy if the deceased spouse did not leave a valid will), or to elect to take what he or she is entitled to upon an equalization of property under the Act, can involve complex considerations, calculations and valuations.

In very general terms, the impetus to make an election will usually arise where less than one-half of the deceased's spouse's assets, including insurance and retirement plan proceeds, are left outright to his or her surviving spouse, and the surviving spouse is not satisfied with this arrangement.

DOMESTIC CONTRACTS

There are three general types of domestic contracts, namely marriage contracts, cohabitation agreements and separation agreements. We discuss only marriage contracts in this Advisory, however, cohabitation agreements should be considered by common-law spouses, or prospective common-law spouses, in order to determine how their property and other matters should be dealt with if the relationship terminates. Many of the issues and considerations discussed in this Advisory with respect to marriage contracts also apply to cohabitation agreements.

Marriage Contracts

What is a marriage contract? In essence, it is an agreement by which married spouses, or couples who are planning to marry, agree on their property rights, including property division, support and related issues during marriage and on its termination. The simple default formula for property division under the Act is thereby replaced by the parties own planning, which can be tailored to their individual circumstances.

The parties, with only a few exceptions, are free to determine their own regime, and whether they wish to elect out of the family property regime provided under the Act. Issues relating to child support, custody and access, as well as possession of a matrimonial home cannot be contracted for by the spouses to a marriage contract in such a way as to oust the Act or the jurisdiction of the court.

The scope of a marriage contract can either deal with only a narrow range of issues, such as rights and obligations on death, or it can comprehensively deal with a broad range of issues regarding property and support, both during marriage and on its termination. The rights and obligations provided on marriage breakdown, as opposed to death, often have different treatment.

Examples of Scenarios Involving Marriage Contracts

(a) One spouse has a residence or significant or special assets

Where a person is marrying with significant assets, including a property which will be the matrimonial home, a marriage contract between the person and his or her intended spouse

can exclude the entire value and/or the growth and income from these assets or both so they are not shareable. Alternatively, the marriage contract can deal with specified assets, such as gifts and inheritances, or shares of a family business, to exclude their value or provide a different sharing formula. A marriage contract can also provide for a deduction of the value of a matrimonial home at the date of the marriage to protect against its value being immediately subject to equalization, even though the marriage is short-lived.

(b) Estate planning purposes

Spouses can agree that they will take the benefits provided under each other's wills, provided certain agreed benefits are provided under it, and not make an equalization claim against each other's estate, in order to ensure that their will provisions are carried out. Such planning might apply where there is concern that an equalization claim might be made, given the provisions made for a spouse on death, including where there is a second or later marriage with children from a prior marriage, and each spouse wishes their children to be the sole or primary beneficiary of his or her estate.

Setting Aside Marriage Contracts

There are circumstances in which a court will set aside a marriage contract entered into by a couple, or declare certain provisions of it to be invalid.

A court can refuse to enforce spousal support provisions or the waiver of spousal support by one spouse if it determines that the provisions or waiver are unconscionable, if the spouse waiving support would instead be living on public assistance, or if there is a failure by the paying spouse to make the spousal support payments provided for in the marriage contract.

Marriage contracts can be set aside if one party fails to properly disclose all of their assets and income to the other party, if one spouse did not understand the nature and consequences of the marriage contract, or if there was undue influence, mistake or fraud by one or both of the spouses when entering into the marriage contract.

General Planning Points

- Ensure your will, or a will of a relative under which you or your family members who are resident in Ontario may inherit, has a clause in it to exclude income and growth in value on the beneficiaries' inheritances from being subject to equalization, and also that such a written declaration is made when a gift is made to a child, grandchild or other person.

- A domestic contract should be considered if one plans to marry and wishes to modify the regime of property division provided under the Act and/or support rights provided by the Act, particularly if (i) one has significantly different asset values from his or her intended spouse, (ii) owns the home in which he or she will be living with his or her spouse after marriage, (iii) anticipates receiving or has received in the past a large family gift or inheritance, including an interest in a family trust, or (iv) owns special types of property which require protection against claims that might be asserted on marriage breakdown or death, such as shares of a private company.
- If one is contemplating making substantial gifts to family member(s) during one's lifetime, including children or grandchildren, or understands he or she will be receiving a substantial gift, legal and professional advice should be sought on how best to plan and structure the gift, in particular where a matrimonial home is involved.
- Consider with professional advice whether a family trust is an appropriate vehicle for holding a property that may qualify as a matrimonial home to protect its value from potential equalization claims upon marriage breakdown or death.
- In structuring provisions for beneficiaries under one's will, consider with professional advice the use of a trust as opposed to outright gifts for a variety of beneficial reasons, including protection on matrimonial breakdown.
- Where desirable, gifts and inheritances should be segregated and careful records maintained, as well as property into which gifts and inheritances are transferred and property substituted for gifts and inheritances to protect their exclusion from the calculation of the value of assets on termination of the marriage.

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.