TAB 3

Tax & Estate Planning Issues Respecting Marriage Contracts

Barry S. Corbin
Fraser Milner Casgrain LLP

Marriage Contracts:
Drafting and Advising Post-*Hartshorne*

LET RIGHT PREVAIL

The Law Society of Upper Canada | Barreau du Haut-Canada

Continuing Legal Education

TAX & ESTATE PLANNING ISSUES RESPECTING MARRIAGE CONTRACTS

Barry S. Corbin

Fraser Milner Casgrain LLP

Introduction

In representing the client whose marital relationship has broken down, the knowledgeable family law practitioner will be alert to income tax and estate planning issues. That is hardly surprising, since financial considerations are almost always front and centre for one or the other – or both – of the parties to the relationship. Those considerations – whether in negotiating a separation agreement or in advocating for a particular form of court order -- can represent either pitfalls to be avoided or settlement opportunities.

While financial considerations are also present in the negotiation of a marriage contract, they rarely reflect the same element of immediacy. For the most part, they are focused on what the grounds rules will be in the event of a future contingency that, one assumes, would be welcomed by neither of the parties. None the less, here too there are income tax and estate planning issues to which the family law practitioner must be attuned.

This paper will not distinguish between the more usual scenario where the marriage contract is a pre-nuptial agreement and a marriage contract entered into some time after the wedding takes place. However, the context in which the marriage contract is being negotiated will determine the extent to which the various issues addressed in this paper are important to one or the other of the parties.

Income Tax Issues

Before embarking on a discussion of various income tax issues, some preliminary observations are in order:

a) The term "marriage contact" is not defined in the *Income Tax Act*. In fact, it does not appear anywhere in the statute. Instead, marriage contracts are recognized in the taxation statute in a slightly oblique fashion via the term "written agreement". Of course, depending on the context, that term may also, or alternatively, encompass a separation agreement. (Indeed, that is the very reason why most income tax issues should be explored in the context of marriage contracts to the same extent as they are addressed in the context of separation agreements.)

b) In the last dozen years, the income tax rules have undergone an extraordinary metamorphosis in the context of marital relationships. There have been two watershed developments:

I. Amendments to the *Income Tax Act* in the early 1990s put common law spouses on substantially[1] the same footing as legally married spouses for all purposes of the *Income Tax Act*, effective with the 1993 taxation year.[2] Thus, the income tax commentary on marriage contracts will have substantially the same application to cohabitation agreements as well.[3] (However, for the purposes of this paper, the commentary will refer to "marriage" and "spouse".)

---

[1] The choice of the descriptor "substantially" is deliberate. When a marriage breaks down, it normally goes through the "separation" phase first. At that point, certain income tax rules that were applicable prior to the separation will continue to apply because the parties are still legal spouses. On the other hand, certain other income tax rules that are contingent, inter alia, on a separation, will be applicable. If the marriage breakdown proceeds to the "divorce" phase, some of the rules applicable to legal spouses will cease to apply, while a number of those that came into play as a result of separation will continue to apply. Unlike a marriage, neither the commencement nor the termination of a common law relationship involves a legal formalism. Consequently, the taxing statute must look to factual considerations to determine when that relationship began and when it ended. Evidently, a person who is a party to a legal marriage can, over time, have up to three different marital statuses, while a person who is a party to a common law relationship can have only two. For that reason, one cannot expect to find absolute symmetry in the tax consequences flowing from each type of relationship.

[2] In fact, a number of decisions in the Tax Court of Canada have suggested that those amendments have an impact that reaches back further than 1993. See *Money & Family Law,* vol. 18, No. 10, October 2003, "Irreconcilable Differences?"; see also *Ritchie v. The Queen*, Tax Court of Canada, June 13, 2003 (2002-3898(IT)I).

[3] The terms "common-law partner" and "common-law partnership" are defined in subsection 248(1) of the *Income Tax Act*. Two persons may be "living common law" without constituting common-law partners of one another for income tax purposes.

II. Effective with the 2001 taxation year,[4] same-sex conjugal relationships acquired substantial income tax parity with both legal spouses and opposite-sex common law spouses.[5]

As suggested earlier, many of the same taxation topics that warrant consideration in the context of a separation agreement merit discussion in the context of marriage contracts. Those topics being dealt with in this paper will be addressed in the following sequence:

1. income tax attribution rules;
2. joint and several liability;
3. tax-free rollovers;
4. principal residence exemption; and
5. taxation of support payments.

---

[4] Transitional provisions permitted two individuals who would have met the new definition of "common law partner" (had it existed in the *Income Tax Act*) in 1999 or in 2000 to elect to have the new rules apply from the 1999 or 2000 taxation year, as the case may be. Here again, perfect parity falls short. For example, subsection 252(3) of the *Income Tax Act* contains an expanded definition of each of the terms "spouse" and "former spouse" of a particular individual (for certain purposes of the taxing statute). Each of those terms includes "another individual *of the opposite sex* who is a party to a void or voidable marriage" (emphasis added). Evidently, it will take a legislative change or a judicial pronouncement to eliminate the distinction reflected in the italicized words.

[5] Recent judicial decisions in each of Ontario, British Columbia during the past 16 months have enabled same-sex partners to tie the knot in any of those provinces. The Yukon Territories government has recently announced its intention to make a legislative change to the same effect. However, as dramatic as these developments have been, from an income tax perspective they have been virtually inconsequential. For income tax purposes, same-sex partners who marry simply change their status from "common-law partners" to "spouses".

Income Tax Attribution Rules

As a general rule, where property has been transferred between individuals who are, or who later become, spouses of each other, there will be attribution to the transferor of all income or capital gains derived from that property (or from substituted property) during the marriage.[6] Such attribution will cease in the event the transferor dies or becomes a non-resident.

Subsection 74.5(1) of the *Income Tax Act* provides that there will be attribution of neither income nor capital gains to the transferor if the property has been transferred between the spouses at fair market value. Suppose the property has been transferred pursuant to a marriage contract. Has the recipient of the property, by entering into the marriage contract and thereby releasing certain rights under provincial matrimonial law, given fair market value consideration? The Canada Customs and Revenue Agency has rejected that argument.[7]

Each of these attribution rules is affected by separation, but in different ways. Following marital breakdown, income derived in the period following the separation will not be attributed to the transferor, but capital gains arising from the transferee's

---

[6] Subsections 74.1(1) and 74.2(1) of the *Income Tax Act*. There is also a "corporate attribution rule" in subsection 74.4(2) of the *Income Tax Act* that can arise when property is transferred to a corporation by an individual, if the individual's spouse or common-law partner is a shareholder of the corporation. The complexities of this attribution rule preclude a detailed commentary here.

[7] See Technical Interpretation no. 9316125., dated November 22, 1993.

disposition of the property prior to a divorce[8] will be attributed to the transferor, unless there is a joint election between the parties in accordance with subsection 74.5(3) of the *Income Tax Act*.

There is no reason that parties to a marriage contract cannot include an agreement to file a joint election not to have capital gains attribution apply to any disposition of capital property that occurs in the event of a subsequent separation. In fact, this is a better time to reach a consensus on this issue than in the usually acrimonious period following separation. The filing of the joint election referred to in subsection 74.5(3) is time sensitive. In order that the capital gains attribution rule not apply on a subsequent disposition by the transferee, the transferor must file the joint election with his or her income tax return for the taxation year in which that disposition occurs or for any preceding taxation year.[9] If the matter is not concluded in a separation agreement on a timely basis, and if the parties have not been divorced by the time of the disposition, the transferor will be saddled with the tax consequences of the capital gain realized by the transferee.

---

[8] This is one example where the tax rule respecting spouses necessarily differs from the tax rule respecting common-law partners. While capital gains attribution ceases to apply when a married couple divorces (thereby no longer being spouses), it will cease to apply once the parties to a common-law partnership have ceased to cohabit in a conjugal relationship for a continuous period of 90 days (thereby ceasing to be common-law partners under the tax statute's definition of that term, even if no joint election against capital gains attribution is filed.

[9] There is nothing in paragraph 74.5(3) of the *Income Tax Act* that requires the person filing the joint election to have already transferred capital property to his or her spouse. Nor is there any requirement that a particular property which is the subject of the joint election be identified. Accordingly, each spouse could be protected against a future capital gains attribution following marital breakdown by filing the joint election with his or her tax return as soon as possible.

As noted earlier, one way to avoid income and capital gains attribution with respect to capital property transferred between the spouses (either before or during marriage) is to fashion the transaction as a sale at fair market value in accordance with the rules set out in subsection 74.5(1) of the *Income Tax Act*. If this alternative is not feasible, one might suggest that a marriage contract require the transferee to indemnify the transferor on account of any income tax liability resulting from the attribution rules. After all, it seems inherently unfair for the transferee to be enjoying the income or capital gains derived from the property, while inflicting the corresponding tax liability on his or her spouse.

<u>Joint and Several Liability</u>

The *Income Tax Act* contains a number of provisions that seek to impose joint and several liability on two or more persons. Those provisions are intended to facilitate the administration and enforcement provisions of the taxing statute that might otherwise be thwarted through various property transfers. In the context of marital relationship, the most important of these provisions is subsection 160(1). There are two conditions that must be satisfied in order that this subsection will be applicable:

(a) There is a property transfer between two individuals.

(b) The transferor and transferee are spouses at the time of the transfer, or they become spouses at some time thereafter.

If those conditions are satisfied, the transferee will be exposed to the risk of a joint and several liability with the transferor on account of the transferor's tax liability (arising from the income tax attribution rules) based on the income derived from, or gains resulting from the disposition of, the transferred property (or substituted property).

There is a second risk of joint and several liability with the transferor if two additional conditions are met: (i) the transferor has an unsatisfied tax liability (the "tax owing") at the time of the transfer; and (ii) the transferee paid less than fair market value for the transferred property. In that case, the transferee will have joint and several liability equal to the lesser of (i) the tax owing, and (ii) the amount by which the transferee underpaid the transferor for the property transferred.

Two examples will illustrate these joint and several liability rules (in reverse order):

1. Suppose that prior to A's marriage to B, A gives B a diamond engagement ring with a fair market value of $20,000. Suppose also that at the time of the transfer, A owes income taxes of $300,000. After the marriage, B will be exposed to a joint and several liability for $20,000 on account of A's tax liability existing at the time of the gift.

2. Now suppose that shortly after the marriage, A pays the full amount of his tax liability and then transfers to B, for no consideration, a rental

property. Suppose that the net rental income for the year is $30,000. Because of the income attribution rules, A will be obliged to include that amount in his income. If he is at the top marginal rate (assumed to be 50%), he will have an additional tax liability of $15,000. B will be jointly and severally liable for that tax liability. If B later sells the property, realizing a capital gain of $40,000, the capital gain attribution rules will require A to include that capital gain in his income, giving rise to a $10,000 tax liability. B will be jointly and severally liable with A for that tax liability.

Moreover, if the Minister assesses B on account of this joint and several liability at any time after December 20, 2002 (even if the assessment relates to a property transfer that preceded that date), that assessment will bear interest at prescribed rates, with no cap on the interest component.

Worse still, once the transferee's joint and several liability arises under subsection 160(1), it will not disappear in the event of a separation. Family law practitioners will be familiar with subsection 160(4), which provides an exception to the joint and several liability rule in subsection 160(1). However, that exception applies only in the context of property transfers made (pursuant to a court order or to a written separation agreement) while the parties "were separated and living apart as a result of the breakdown of their marriage".

Where parties are about to enter into a marriage contract, consideration might therefore be given to the inclusion of two provisions: firstly, if property has been previously transferred between the parties, a representation as to the tax liability of the transferring party at the time of the transfer; and secondly, an agreement by each party to indemnify the other on account of any joint and several tax liability that may arise under subsection 160 of the *Income Tax Act*.

Principal Residence Exemption

The *Income Tax Act* provides an exemption from capital gains for disposition of a principal residence. For taxation years after 1981, spouses are entitled to only one principal residence exemption between them.[10] Suppose that each of two persons planning to marry has a property that qualifies as his or her principal residence – for example, one of them owns a recreational property, while the other owns a property that the couple plans to use as their city home. It would be prudent for the parties to agree in a marriage contract, for the year of marriage and for future taxation years, which of the two properties is to qualify as the principal residence for the two of them. This would avoid any issue that might arise on a subsequent separation -- say because one of the properties had to be sold. Otherwise, whichever of the parties turned out to be the property vendor would win the race for designation of the principal residence during the marital years.

[10] See the definition of "principal residence" in section 54 of the *Income Tax Act*.

The problem of entitlement to the principal residence exemption is potentially more acute than one might think. It may surprise family law practitioners to learn that the struggle over that entitlement could continue for years after separation. Why is that? Surely once there is a separation, each of the parties ought to be free once again to enjoy access to his or her own principal residence exemption. Unfortunately, that is not how the relevant tax provision reads.

Paragraph (c) of the definition of "principal residence" in section 54 of the *Income Tax Act* provides that for taxation years after 1981, an individual taxpayer cannot designate a property as his or her principal residence for a particular taxation year if another property has been so designated for the same taxation year by a person who was the taxpayer's spouse throughout that particular taxation year. This prohibition is not applicable if the taxpayer's spouse was "throughout the year living apart from, and was separated under a judicial separation or written separation agreement from, the taxpayer." In other words, a factual separation will not, absent a divorce, allow each party to claim the principal residence exemption for a particular taxation year. There must be a separation resulting from a judicial separation or a written separation agreement.

This evidently brings into play the jurisprudence regarding the term "written separation agreement." That jurisprudence holds that two persons cannot be separated pursuant to a written separation agreement unless the agreement includes a statement that the parties have agreed to live separate and apart. Clearly, a marriage contract will not meet that requirement, even if it contains a provision that contains language declaring that in the event of separation, the marriage contract will be deemed to be a separation agreement. Accordingly, a marriage contract should declare who has the entitlement to the principal residence exemption for any taxation year prior to the year of a divorce[11] and should give that person some further protection against the contingency of a defaulting spouse.

<u>Tax-Free Rollovers</u>

a) Capital Property

When capital property is transferred between spouses, the transferor has the choice as to whether the transfer will be a taxable one or, if certain residence criteria are satisfied,[12] a tax-deferred one. If the transferor does nothing, the default of a rollover will apply (if the residence criteria are met). If the transferor wishes to opt out of the tax-deferral, he or she simply so indicates in the income tax return for the taxation year in which the transfer of the property took place.[13] The availability of the

[11] Here is another instance of incomplete parity in the tax rules between spouses, on the one hand, and common-law partners, on the other hand. Ninety continuous days of separation is enough to terminate a common-law partnership. Accordingly, even if there is no written separation agreement between former common-law partners, separate entitlements to the principal residence exemption will be restored to each of them for the taxation year in which they separate (provided the separation occurs not later than October 2nd in that year) and for each taxation year that follows the year of separation.

[12] Subsection 73(1) of the *Income Tax Act* requires that both the transferor and the transferee be resident Canadians at the time of the transfer.

[13] There is no prescribed form for that purpose.

tax deferral is not contingent on the spouses' continuing to live together. It will apply during the period after separation and before divorce in precisely the same manner as it does during the period after marriage and before separation.

If the marriage contract contemplates a transfer of capital property between the spouses during marriage, the solicitor acting for the intended transferee spouse will want to discuss with his or her client whether the transfer should be made on a taxable or a tax-deferred basis. The same is true if the marriage contract contemplates a transfer of capital property between the spouses following the marriage breakdown but prior to a divorce. Even if the transfer occurs after divorce, the same option is available if the transfer between the spouses is made "in settlement of rights arising out of their marriage".[14]

b) Retirement Savings Plans and Retirement Income Funds

There are only two circumstances in which an annuitant's retirement savings plan ("RSP") or retirement income fund ("RIF") can be transferred on a tax-deferred basis to a spouse's RSP or RIF, as the case may be: firstly, in the context of a property division in settlement of rights arising out of the marriage; and secondly, where the annuitant dies and is survived by a spouse who is entitled to the RSP or RIF as a consequence of the annuitant's death.

---

[14] See paragraph 73(1.01)(b) of the *Income Tax Act*.

In the case of marriage breakdown, the relevant provision is subsection 146(16) of the *Income Tax Act*; in the case of the annuitant's death, the relevant provision is subsection 146.3(14) of the taxing statute. In either case, the surviving spouse can transfer the money or property to his or her RSP or RIF. For the most part, the rules governing RSPs have their counterparts relating to RIFs. However, in the context of marriage contracts, there is at least one distinction in the wording that warrants comment.

Each of subsections 146(16) and 146.3(14) contemplates a transfer made in settlement of property rights arising out of, or on the breakdown of, the marriage. Both subsections also require that the transfer be made pursuant to a court order or written agreement. However, in the case of the RSP rule, the written agreement must be a "written separation agreement."[15]

Can a marriage contract – or at least the portion of it that deals with a separation scenario -- constitute a "written separation agreement"? If so, the distinction in the language of the two subsections is of no moment. The jurisprudence respecting the term "written separation agreement" has historically required there to be a statement in the agreement that the parties have agreed to live separate and apart.

---

[15] The term "written separation agreement" has been undergoing a gradual exorcism from the *Income Tax Act* in recent years. It appears that the differing terminology between these two subsections may be nothing more than a temporary anomaly. Until it was amended by S.C. 2003, c.15, s. 82(4), applicable after 2003, subsection 146.3(14) used the term "written separation agreement". It is possible that on the next occasion when subsection 146(16) is amended, the term "written agreement" will be substituted for the term "written separation agreement".

However, in most of those decisions, the issue being examined was whether the parties were separated pursuant to a written separation agreement[16] – and not whether payments or transfers were being made pursuant to a written separation agreement.

In the former context, a statement that the parties had agreed to live separate and apart would certainly appear to be essential. However, in the context of a marriage contract that contains provisions that address the marriage breakdown contingency, it would take no severe twisting of the language for a court to find that the marriage contract constituted a written separation agreement for the purposes of subsection 146(16). One final comment bears observation here. Although the term "written separation agreement" is not defined in the *Income Tax Act*, the term "separation agreement" is inclusively defined in subsection 248(1) of the statute:

> "separation agreement" includes an agreement by which a person agrees to make payments on a periodic basis for the maintenance of a former spouse or common-law partner, children of the marriage or common-law partnership or both the former spouse or common-law partner and children of the marriage or common-law partnership, after the marriage or common-law partnership has been dissolved, whether the agreement was made before or after the marriage or common- law partnership was dissolved.

One might therefore argue that to the extent that the marriage contract calls for support payments to be made by one party to the other after divorce, it qualifies as

[16] The various provisions in the *Income Tax Act* that formerly required the parties to be living separate and apart pursuant to a written separation agreement now refer to that separation arising as a result of the breakdown of the marriage.

a "separation agreement" under this extended definition -- and hence as a "written separation agreement".

Taxation of Support Payments

Marriage contracts do not often deal with the issue of the payment of support in the event of the breakdown of the marriage.[17] More often, the contract either (i) is silent on the question of what obligation, if any, either spouse will have to the other, or (ii) declares that the rights of either spouse to support on marital breakdown will be determined in accordance with the *Family Law Act* or the *Divorce Act*, as applicable.

Where the contract does include a provision for spousal support payments in the event of separation, what are the tax rules governing those payments when they are made? In order that a payment be taxable to the recipient and deductible to the payer, the payment must qualify as a "support amount". That term is defined in subsection 56.1(4) of the *Income Tax Act* as follows:

> support amount" means an amount payable or receivable as an allowance on a periodic basis for the maintenance of the recipient, children of the recipient or both the recipient and children of the recipient, if the recipient has discretion as to the use of the amount, and
>
> (*a*) the recipient is the spouse or common-law partner or former spouse or common-law partner of the payer, the recipient and payer are living separate and apart because of the breakdown of their marriage or common-law

[17] Where a marriage contract calls for one spouse to provide financial support to the other during the relationship, such payments will be neither taxable to the recipient nor deductible by the payer. The definition of "support amount" in subsection 56.1(4) of the *Income Tax Act* includes a requirement that "the recipient and the payer are living separate and apart because of the breakdown of their marriage". Although this definition was introduced at the time the new rules for taxation of support payments took effect on May 1, 1997, previous rules contained the same requirement.

> partnership and the amount is receivable under an order of a competent tribunal or *under a written agreement*; or
>
> (*b*) the payer is a natural parent of a child of the recipient and the amount is receivable under an order made by a competent tribunal in accordance with the laws of a province.
>
> [emphasis added]

Since a marriage contract would fall within the scope of the term "written agreement", one can readily conclude that the same rules governing the taxation of spousal support payments under a separation agreement would govern the tax treatment of spousal support payments made under a marriage contract. This paper will not delve into the myriad of statutory provisions, jurisprudence and Canada Revenue Agency administrative positions relating to the tax treatment of spousal support payments made under a separation agreement.

Suppose the marriage contract contemplates the payment of child support in the event of a marriage breakdown? New tax rules respecting child support payments came into effect on May 1, 1997. Under that new regime, the tax treatment of child support payments will depend on whether the marriage contract has a "commencement day." That term is defined in subsection 56.1(4) as follows:

> "commencement day" at any time of an agreement or order means
>
> (*a*) where the agreement or order is made after April 1997, the day it is made; and
>
> (*b*) where the agreement or order is made before May 1997, the day, if any, that is after April 1997 and is the earliest of

(i) the day specified as the commencement day of the agreement or order by the payer and recipient under the agreement or order in a joint election filed with the Minister in prescribed form and manner,

(ii) where the agreement or order is varied after April 1997 to change the child support amounts payable to the recipient, the day on which the first payment of the varied amount is required to be made,

(iii) where a subsequent agreement or order is made after April 1997, the effect of which is to change the total child support amounts payable to the recipient by the payer, the commencement day of the first such subsequent agreement or order, and

(iv) the day specified in the agreement or order, or any variation thereof, as the commencement day of the agreement or order for the purposes of this Act

Evidently, a marriage contract made before May 1, 1997 (the date that ushered in the so-called "new regime" under which child support is neither taxable to the recipient nor deductible by the payer) will not have a "commencement day" unless one of the conditions in paragraph (b) of the definition has been met. So, for example, even where a marriage breakdown occurs in 2004, the old tax rules would still apply to child support payments made pursuant to the marriage contract – in the absence of a subsequent change to the quantum of the payments under a court order, a variation of the marriage contract or a new agreement.[18]

Suppose the marriage contract calls for support payments to be made by the estate of a deceased spouse – whether or not the marriage broke down prior to the death of the deceased spouse. How will those payments be treated for income tax

[18] See the Canada Customs and Revenue Agency's Technical Interpretation no. 2000-001227, March 21, 2000.

purposes? Referring to the definition of "support amount" set out earlier, one can see that the recipient and the payer must be living separate and apart by virtue of the breakdown of their marriage. After the death of one of the spouses, they clearly are not both living, let alone living separate and apart. The payments will therefore not be taxable to the recipient or deductible by the estate.[19]

Estate Planning Issues

Using a Will in Aid of a Marriage Contract

It is not uncommon for a separation agreement to impose on one of the parties to the agreement (the "obligor spouse") an obligation to deal with his or her estate in a particular manner upon death. For example, the other spouse (the "obligee spouse") may be entitled to receive either a lump sum payment or continuing periodic payments from the obligor spouse's estate. Alternatively, the obligor spouse may be required to devise particular real property in a specified manner. Similarly, a marriage contract may include provisions that call for payments to be made, in the event of the obligor spouse's predecease, to the obligee spouse. Frequently, any such

---

[19] On a very narrow reading of the definition of "support amount", one could postulate a scenario in which the payments would be taxable to the recipient. Suppose that A and B, former marital partners, have obtained a divorce. Suppose that A re-marries C and they enter into a marriage contract that calls for C's estate to make periodic support payments to A in the event of C's predecease. Finally, suppose that B is appointed C's executor. The payments made by B to A are made pursuant to a written agreement; namely, the marriage contract. They are also made at a time when A and B are former spouses, living separate and apart because of the breakdown of their marriage. Strangely, there does not appear to be any requirement that the written agreement have been made between the same two parties whose marriage has broken down.

post-mortem payment(s) will be based on a formula that is tied to the number of years of wedded bliss: that is, the quantum increases for every year the married couple lived together prior to the obligor spouse's death.

Where a financial obligation is imposed on the obligor spouse's estate, one typically finds in the marriage contract (or separation agreement) a requirement that the obligor spouse have a will that includes a dispositive provision that reflects the contractual obligation. From the obligee spouse's perspective, such a provision is unnecessary. From the obligor spouse's perspective, it is simply a poor idea.

Why is such a provision unnecessary? The typical marriage contract will contain a provision declaring that it is to be binding upon the parties' respective heirs, executors, administrators and assigns. In such a case, it will not matter that the obligor spouse has failed to comply with the requirement to include specified dispositive provisions in his or her will – or, indeed, that the obligor spouse died without a will. His or her personal representatives will be bound to carry out the terms of the contract, even if it means acting contrary to the terms of the will, if there is one, or to make a distribution that deviates from the applicable intestate succession rules if there is no will.

Why is such a provision a bad idea for the obligor spouse? Suppose that, after his or her death, the obligor's personal representative learns that the obligee spouse has failed to disclose significant financial assets, or that there is some other ground on which the marriage contract can be set aside. What good would it do to have the contract set aside if the will has an independent legal status? There are limited grounds on which a will can be found to be legally ineffective: lack of testamentary capacity; failure to comply with the formalities of execution, undue influence and fraud. It is hard to see how a court could set aside a will on the basis that the marriage contract that required it to contain a specific provision was set aside. Who is to say that the obligor spouse, if presented with the facts disclosed to his or her personal representative, would not have left the will unchanged?

There is a better course of action, in the author's view; one that protects the obligee spouse's legal position, but only to the extent necessary. It should be enough for the obligor spouse to be required to include a statement in his or her will that alerts the executor to the existence of the marriage contract. For example:

> I wish to advise my executors that I am a party to a marriage contract with □, dated the □ day of □, □, under which contract I may have obligations that survive my death.

In this way, the obligor spouse is not prejudicing a decision by his or her personal representative to seek to have the contract set aside after his or her death.[20]

---

[20] As noted earlier, there are a number of provisions in the *Income Tax Act* whose operation is dependent upon a property transfer's having been made as a consequence of the death of an individual. For example, subject to certain statutory conditions, subsection 70(6) provides for a tax-deferred transfer of capital property from a deceased taxpayer to his or her surviving spouse or common-law partner, where the capital property has been transferred as a consequence of the death of the taxpayer. Where a marriage contract calls for the transfer of capital property from the obligor spouse to the obligee spouse, but the former spouse's will makes no provision to that effect, would

Joint Tenancies to Avoid Probate Taxes

Ontario's tripling of probate taxes in 1992 -- to $15 per $1,000 of estate value in excess of $50,000 -- has driven many an individual to take steps to minimize the value of his or her estate on death or to avoid the need to have his or her will probated. Putting property into joint ownership with a right of survivorship is a popular device – likely because it is a relatively inexpensive step. Since significant net worth is often tied up in the matrimonial home, joint tenancy is often how title is registered, irrespective of who paid for the property.[21]

However, in this regard, due regard must be had for section 14 of the *Family Law Act*:

> The rule of law applying a presumption of a resulting trust shall be applied in questions of the ownership of property between husband and wife, as if they were not married, except that,
>
> (a) the fact that property is held in the name of spouses as joint tenants is proof, in the absence of evidence to the contrary, that the spouses are intended to own the property as joint tenants; and
>
> (b) money on deposit in the name of both spouses shall be deemed to be in the name of the spouses as joint tenants for the purposes of clause (a).

---

such a transfer qualify for the tax deferral? An argument could be made that this situation would fit within subsection 248(23.1) of the *Income Tax Act*. That subsection deems a transfer made to a surviving spouse or common-law partner "as a consequence of the laws of a province relating to spouses' or common-law partners' interests in respect of property as a result of marriage or common-law partnership … " to be a transfer as a consequence of the death of the other spouse or common-law partner.

[21] Whether the joint tenancy will be effective to avoid probate taxes on the value of the jointly held property will depend on whether there is a will that must be submitted to probate and, if so, whether the property encompassed by that will includes the beneficial interest of the true owner.

Evidently, where registered title is not to govern beneficial entitlement, a marriage contract would be the appropriate place to address the spouses' contrary intention that would rebut the statutory presumption. For example, if each of the spouses has made a substantial financial contribution (whether equal or unequal) to the acquisition of the property, they may have intended that the true ownership would be a tenancy in common, leaving the estate of the first of them to die as an owner of an undivided one-half interest in the matrimonial home. Or, where only one of the spouses has made a financial contribution to the acquisition of the property, it may be the parties' intention and understanding that true ownership belongs solely to that contributor.[22]

<u>Beneficiary Designations</u>

There are very specific rules for making and revoking beneficiary designations in respect of "plans" under Part III of Ontario's *Succession Law Reform Act*. Where a spouse is prepared to make a beneficiary designation in a marriage contract so as to ensure that the other spouse will receive the plan benefits, care should be taken to see that the rules are rigorously complied with.

---

22 Even if the marriage contract declares that registered joint tenancy does not tell the true story, there may still be issues relating to the matrimonial home. For example:

1. Irrespective of the true ownership, the surviving spouse has the right of rent-free occupancy for 60 days after the deceased spouse's death. A marriage contract cannot defeat that entitlement.

2. Ownership interests in the matrimonial home may still be subject to the special rules regarding calculation of a spouse's net family property.

Use of Joint Partner Trusts

In 1972, capital gains became subject to taxation for the first time. With that new regime came a number of new features. Notable among them was the ability to transfer capital property, either during the marriage or on death, to a spouse or to a trust for the exclusive benefit of the spouse during his or her lifetime. After 1999, it became possible for a person who had attained age 65 to transfer property on a tax-deferred basis to a trust for the exclusive benefit of himself or herself and his or her spouse (for so long as at least one of them was living). The so-called "joint partner trust" has become a popular device in those jurisdictions with high probate taxes (Ontario and British Columbia having the dubious honour of being, respectively, the highest and second-highest probate tax jurisdictions). By disposing of property prior to one's death, one can sharply reduce the probate tax value of one's estate.

In the author's view, the joint partner trust has another useful application, in light of the Ontario Court of Appeal's decision in *Stone v. Stone*[23] a few years ago. In that case, a husband and wife had been in a marriage of some 24 years' duration when the husband discovered he was suffering from a terminal illness. It was a second marriage for each of them and each of them had adult children from a first marriage. The husband's net worth was substantial; the wife's net worth was modest by comparison.

[23] 55 O.R. (3d) 491.

On learning of his impending death, the husband embarked on a program of divesting himself of most of his high-valued assets in favour of his children. He was concerned not to see a significant part of his net worth ultimately pass to his wife's children via a net family property equalization claim. All of these transfers took place behind his wife's back. The husband's will left the wife a negligible inheritance. When, after her husband's death, the wife became aware of his prior actions, she coupled her *Family Law Act* application for an equalization claim with an application to set aside the transfers under Ontario's *Fraudulent Conveyances Act*. She succeeded in both the lower court and the Ontario Court of Appeal.

Although the author has been sharply critical of the appellate court's analysis, it is his view as well that the husband made a number of errors in carrying out his plan.[24] Firstly, he set the plan in motion shortly before his death, making it quite easy for the court to conclude that the plan was motivated by his desire to defeat his wife's equalization claim; secondly, he effected all of the transfers in secrecy; and thirdly, he left his wife a very tiny portion of what was his net worth before he carried through with the various property transfers to his children.

To be fair, however, when Mr. Stone re-married in the early 1970s, Ontario's matrimonial property laws were far from enlightened. Even the *Family Law Reform Act, 1978* — as revolutionary as it might have seemed at the time – had not yet been

[24] See *Money & Family Law*, Vol. 15, No. 1, January 2000, "No More Ways to Leave Your Lover?" and *Money & Family Law*, Vol. 16, No. 9, September 2001, "*Stone*(d) in the Court of Appeal".

enacted. Mr. Stone would have had little incentive to seek a marriage contract to protect his business and property interests. Of course, by the time the *Family Law Act* was in the legislative firmament, he would have had little leverage to procure such a marriage contract.

With our vastly different legislative landscape, marriage contracts have become commonplace. An individual in the same position as was Mr. Stone would do well to seek a marriage contract. Even if the spouse could not be persuaded to give up the right to make an equalization claim against the estate of the based on the individual's predecease, he or she might be receptive to the idea of a marriage contract that expressly permitted – or even mandated – the settlement of a joint partner trust (assuming it was made after the settler spouse had attained age 65) that would make reasonable provision for both spouses and direct that the trust property remaining on the death of the last spouse to die would pass to the settlor's children. In the contract, the other spouse would acknowledge that the eventual creation of the joint partner trust would not constitute a transaction subject to attack under Ontario's *Fraudulent Conveyances Act*.

<u>Marriage Contracts at the Behest of the Parents</u>

It is not uncommon for a parent of one of the parties to the marriage contract to be a principal architect of that contract. This is often seen when the parent intends to protect the child's current assets or future gifts or inheritance from an involuntary sharing with the future son-in-law or daughter-in-law. The family law practitioner should tread cautiously here, lest he or she be found to have succumbed to undue pressure from the parent, as was evidently the case in the recent successful negligence claim by the daughter of a domineering parent (albeit in the context of the drafting of a separation agreement) in *McClenahan v. Clarke*, January 29, 2004, Aitken, J., Ont. S.C.J.

Conclusion

In this paper, the author has sought to illustrate that many of the income tax and estate planning considerations that inform the family law practitioner's negotiation of a separation agreement or advocacy in pursuit of a particular court order can assume a similar degree of importance in the context of a marriage contract negotiation. The family law practitioner who recognizes these issues can do his or her client a substantial service in crafting a marriage contract that avoids potential problems and capitalizes on opportunities.

2317005_1