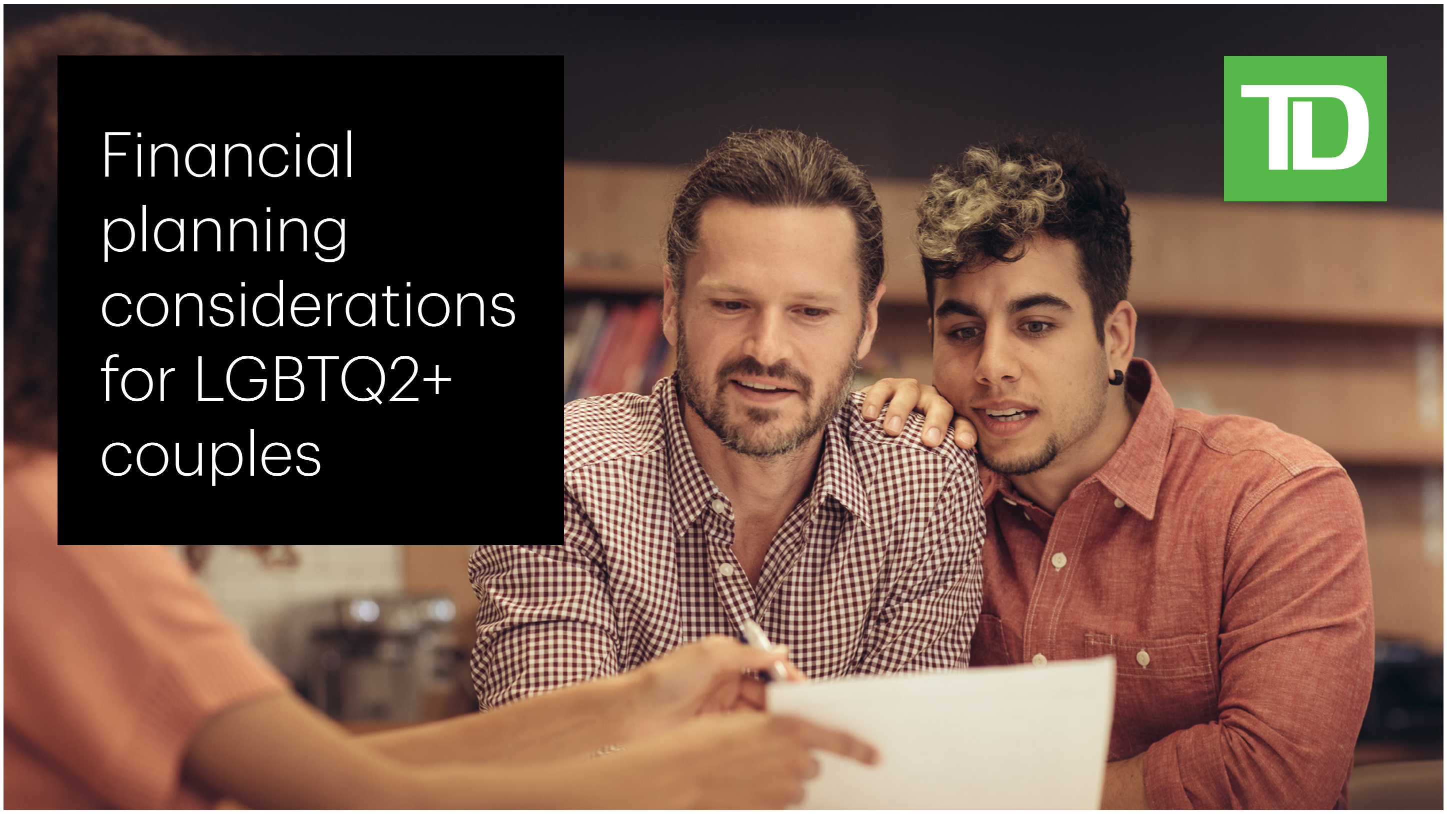
Financial planning considerations for LGBTQ2+ couples



Whether you are married, considering marriage or in a common-law union, a relationship is a major life commitment that should prompt you to review your financial, tax and legal situation. While a marriage or common-law relationship is a loving partnership between two people, it also carries with it legal and financial considerations. To ensure sound planning, it is necessary to have a good understanding of the tax, family law and estate implications of marriage and common-law relationships, as outlined in this article, and, where applicable, understand distinctions between married and common-law relationships. It should be noted that under Canadian law the distinction applies to the status of the relationship and not the sexual orientation of the couple, as both same-sex and opposite sex couples are recognized in the same manner. As some components described in this article fall under federal legislation and others under provincial legislation it is important to be aware of the laws that apply to you and your family situation before implementing any financial planning actions.

Tax Considerations

From a tax perspective, common-law couples are treated equal to legally married couples. The major difference is that married couples make a conscious decision to enter into a marriage whereas the definition of common-law relationship is based on certain criteria being met. For the purpose of the federal *Income Tax Act* (Canada)[1], you are a "common-law partner" if you cohabit with another person in a conjugal relationship, whether that person is of the same or opposite sex, if (a) that relationship has lasted at least 12 continuous months; (b) the two of you are legal parents of a child (including a natural or adopted child). Provincial legislation may vary on the length of cohabitation required for a common-law relationship to be recognized. If you are in a common-law relationship, ensure you are aware of the applicable criteria in your jurisdiction.

It is generally believed that in order to be a common-law couple, the two individuals must reside at the same address. However, from a tax and estate perspective, in particular, this can be refuted and cause issues down the line. Recent court decisions such as *Latner v. Climans* (2020 ONCA 554), confirmed that cohabitation is more than just a shared address and the law will consider how the couple represents themselves in their daily lives to determine if a common-law relationship exists.

In the "Tax Considerations" section of this article, references to "spouse" and "partner" are used interchangeably and include both married and common-law same sex relationships.

Tax filing and tax credits

- If your marital status has changed (this includes entering into a common-law relationship), you will need to inform the Canada Revenue Agency (CRA). Use CRA Form RC65 Marital Status Change for this purpose.
- Some tax advantages of being a spouse include the ability to claim a tax credit for a financially dependent partner, and to transfer credits and amounts (such as the age amount, disability amount, tuition amount and pension income amount) to a partner. In addition, credits based on receipted payments (such as charitable donations or medical expenses) may be combined by partners to maximize the tax credit.
- On the other hand, certain credits may be lost or reduced as a result of using the combined net family income to determine the income threshold. These include the GST/HST credit, and the Canada Child Tax Benefit.

Income splitting

One of the benefits of being a spouse is the availability of various income-splitting strategies which may be used to reduce the couple's overall tax bill.

In the case of Registered Retirement Savings Plans (RRSP) partners may take advantage of a **spousal RRSP**. Contributions to the plan are deductible from the contributor's income and the funds, once they are withdrawn, are fully taxable in the hands of the contributor's partner, thereby splitting income in retirement (subject to spousal RRSP attribution rules). This strategy is useful when there is an income disparity between the partners, perhaps one individual does not have sufficient RRSP contribution room or expects to receive higher retirement income from a pension or other sources.

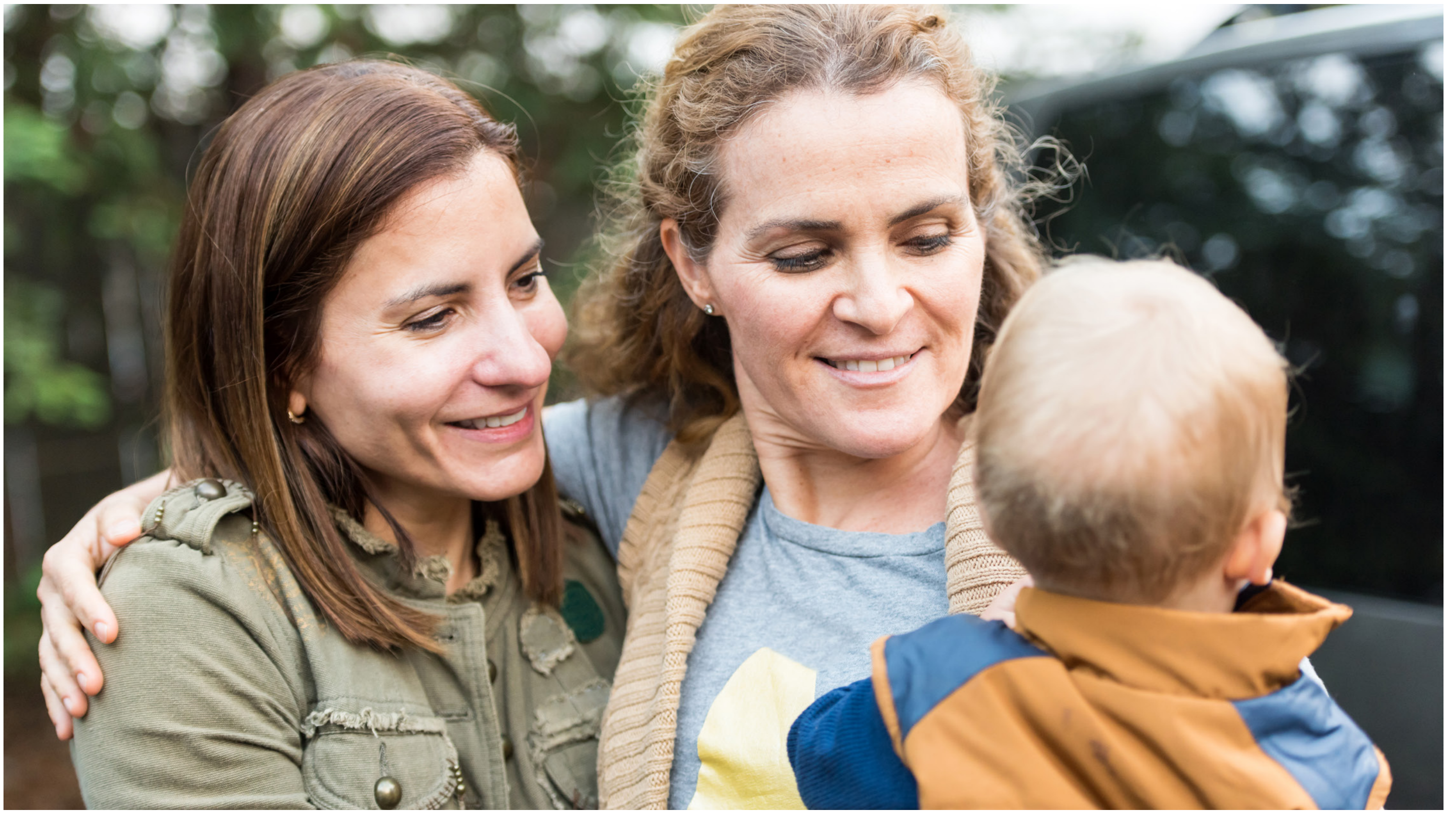
Partners may also **share their Canada Pension Plan (CPP)/Quebec Pension Plan (QPP)** payments. Provided both partners are over the age of 60 they may share a portion of the pension benefit earned during their time together. The calculation to determine the amount of the pension that can be shared will be different for each couple as it is based on the cohabitation period during their joint contributory period. It is important to note that pension sharing, once established, will remain in effect until one of the partners passes away, the relationship dissolves or both partners submit a cancellation request.

In addition, **pension income splitting** is permitted. Canadians who receive income which qualifies for the pension income amount may be eligible to allocate up to one-half of that income to their partner. At any age, pension income from a defined benefit or defined contribution pension plan may be split with a partner; while for those who are 65 years or older, incomes from an annuity and registered retirement income fund (RRIF) are also eligible to be split. Payments from the Canada Pension Plan (CPP), Quebec Pension Plan (QPP), and Old Age Security are not eligible for income splitting. Contrary to pension sharing, pension income splitting is determined on an annual basis when filing your tax returns. Therefore, couples can determine if and how much pension income to split each year, if desired.

Tax-deferred rollover of certain assets

At death, RRSP and RRIF assets can be rolled over on a tax-deferred basis to a surviving partner. This has the effect of extending tax-sheltered growth of those assets until the death of the surviving partner, or until the funds are withdrawn by the partner. Other capital property, such as non-registered assets or real estate, can also be rolled-over at the adjusted cost base.

During one's lifetime, non-registered assets can also be transferred to a partner without triggering capital



gains. However, as a result of income attribution rules, the transferor will be responsible for the tax on the investment income earned from the transferred asset as well as any gain or loss on the subsequent disposition of that asset, unless one implements a specific tax planning strategy, such as a prescribed rate loan.

The Tax-Free Savings Account (TFSA), permits tax-free growth of assets. This account can be transferred to a surviving partner tax-free following the death of the account holder where it can continue to grow on a tax-free basis.

Less favourable tax implications being in a spousal relationship

i. Application of income attribution rules

As discussed above, non-registered assets may be transferred on a tax-deferred basis from one partner to another during their lifetime. However, any subsequent investment income or gain earned on the transferred asset will be attributed back to the transferor, whereas the income generated on that income will be taxed in the hands of the transferee. Nevertheless, some income splitting strategies between partners can be implemented to avoid the attribution.

One such strategy is the use of a prescribed rate loan, which involves the higher-income partner lending a sum of money to the lower-income partner at a fixed interest rate prescribed by the government. If the borrower pays interest on the loan annually by January 30th of the following year, any investment earnings are taxed, minus the interest payment, at the borrowing partner's tax rate. Where a prescribed rate loan arrangement is implemented it is important to document the existence and conditions of the loan, as well as the desired outcome should the couple dissolve or one partner pass away.

ii. Reduced availability of the principal residence exemption

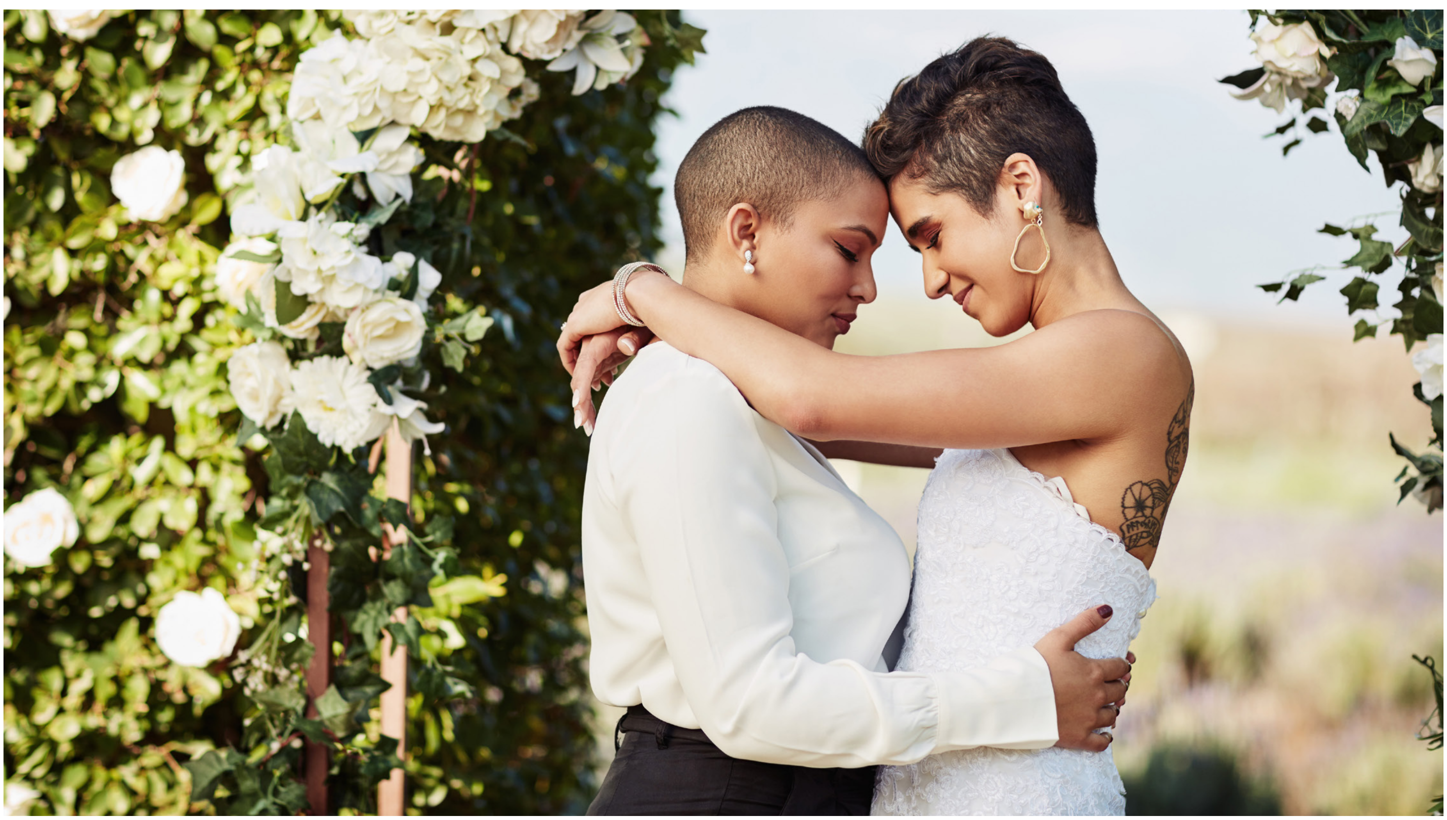
It is quite common for individuals to enter into a relationship each owning their own home. Some people naturally decide to move into one home and then sell the other immediately or at a later date. If this occurs subsequent to the marriage, the home they move into continues to qualify for principal residence status; however, the other home may become a secondary residence, as only one property per family unit may designated as a principal residence each year. When the secondary residence is sold capital gains may arise.

Family and Estate Law Considerations

Perhaps because common-law couples are treated equally to legally married couples for income tax purposes, many people are under the impression that common-law couples enjoy the same rights as legally married spouses in every aspect of their lives. In reality, this is not necessarily the case when it comes to family and estate law. While marriage and divorce are governed by federal legislation, family and estate law fall within provincial jurisdiction and can therefore vary from one province to another.

In certain provinces, there are still significant differences between the treatment of legally married and common-law couples, with respect to property rights, the matrimonial home, support obligations and intestate succession (dying without a valid Will). The very definition of "common-law" varies across the country and may range from two to three years of cohabitation or less if the couple are the parents of a child. In this regard the province with the most notable distinction in marital status is Quebec, as the provincial legislation is based on the principles of civil law and the term 'common-law' couple, although used colloquially, is actually correctly known as a 'de-facto' spouse.

When outlining estate planning objectives, you may be considering bequeathing funds to your chosen family, rather than a blood relative, or to a charitable organization that you support. These are perfect examples of where a legally drafted Will is absolutely necessary, otherwise an intestate succession (described in more detail below) will not go to your desired beneficiaries. From a tax planning perspective, where it is desired to leave funds to an individual that is not your partner, you will want to consider that they are not eligible for spousal rollover provisions. When considering supporting a charitable organization there are a few tax planning strategies that may be implemented that can reduce taxes to the estate and potentially enhance the support the organization receives. By understanding the projected value and breakdown of your estate, level of registered assets, non-registered, potential capital gains etc., you will want to ensure that your Will is drafted to support your beneficiary objectives in the most tax-efficient manner where possible.



Property division

Generally, provincial legislation views marriage as an economic partnership, and when marriage ends – whether as a result of separation, divorce and/or death – the spouses are commonly entitled to an equal share of the matrimonial assets accumulated during the period of marriage. However, in some provinces, the definition of "spouse" does not include a common-law partner for the purposes of property division.

Matrimonial home

Another difference between married and common-law relationships in some provinces has to do with ownership and/or possession of the matrimonial home. Whereas married couples may have equal rights to possession and ownership of the matrimonial home in certain provinces, this is not the case for common-law couples. Therefore, where a couple is not legally married, and the home is only registered in the name of one partner, the other partner may find themselves without recourse should the relationship dissolve or their partner passes away.

Spousal support

In most provinces, common-law partners have the right to seek support payments from their partners provided they meet the cohabitation period (a shorter time period may apply if the common-law partners are the parents of a child) set out in their province of residence. With the exception of Quebec where un-married couples cannot claim spousal support, which was confirmed by the Supreme Court of Canada in *Eric v. Lola* (2013 SCC 5).

Intestate succession

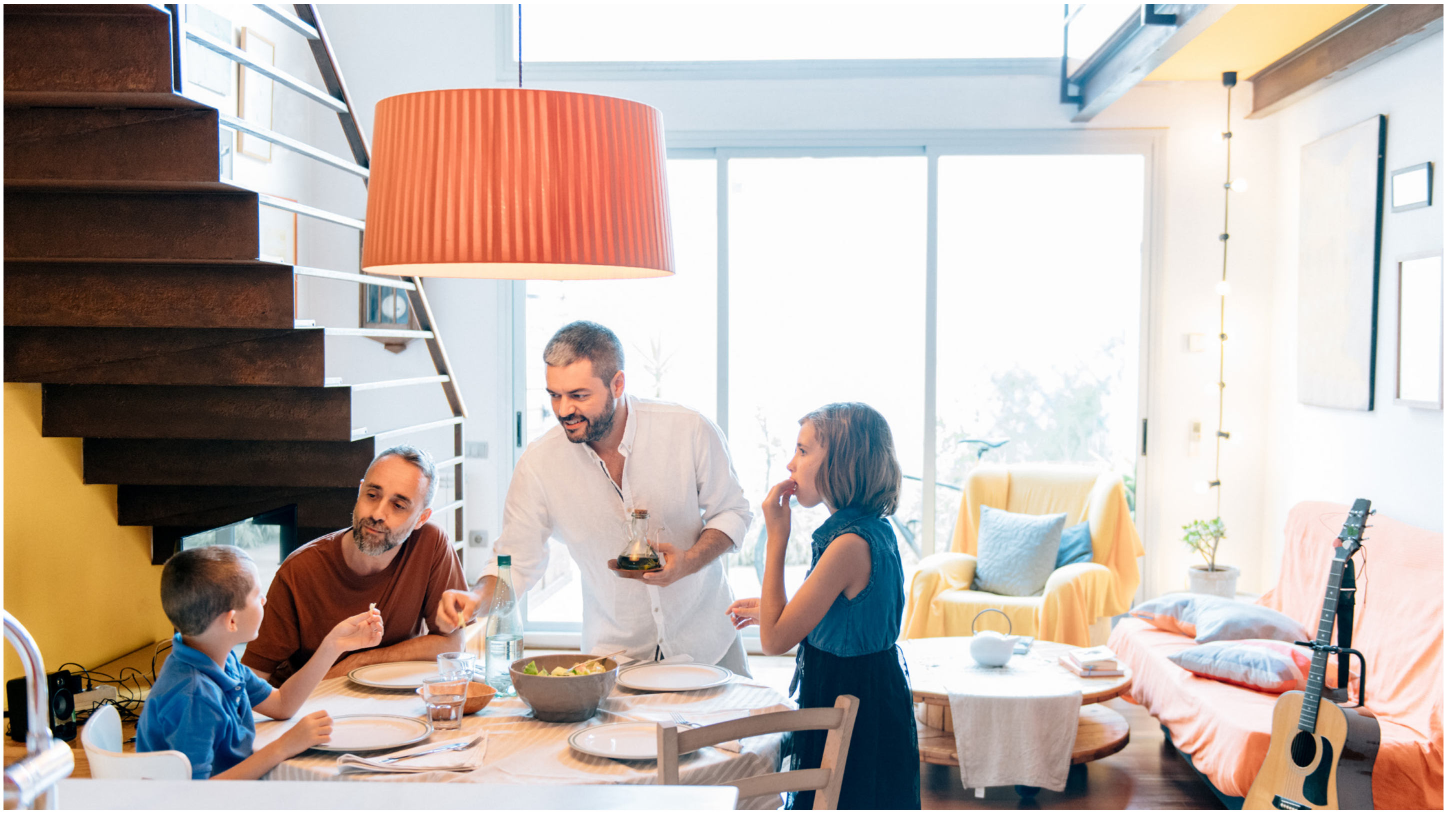
Generally under provincial legislation, the surviving spouse is entitled to an automatic share of the estate of a spouse who dies intestate. Some provinces provide a common-law partner with the same rights as those who are married but some do not. The result may be that if you die without a valid Will your blood relatives - not your partner - may inherit your property. The following outlines specific areas you may want to consider based on your situation, however first and foremost it is recommended to have your Will prepared by a lawyer to ensure that your estate settlement is aligned with your wishes and that the settlement process is as smooth and painless for any surviving family or friends.

Dependant relief

A surviving spouse may bring an action against their spouse's estate if they are not adequately provided for in their deceased spouse's Will. Many, but not all, provinces have similar rights for common-law partners. This may leave common-law partners in a difficult position, which may not have been the desire of the decedent, but without a valid Will, provincial intestate laws will automatically take effect.

Planning Ideas for LGBTQ2+ Couples

- Develop a financial plan together to reflect your new family situation: update net worth, cash flow and investment plans, explore ways to minimize your taxes and review your retirement and other long- term goals. Keep it up to date over time to capture any changes in situation or objectives.
- If you or your partner have minor children, review the child's education savings plan. With a combined household income it may now be possible to save more towards other goals such as funding the post- secondary education of a child. Be sure to appoint a legal guardian for the minor children in your Wills. It should be noted that where both partners are parents to the child, natural or adopted, they will automatically be the guardian of person of the child should one partner pass away. However, in the case where only one partner is the legal guardian of that child, should that partner pass away, the remaining partner will not have automatic legal rights to the child. As mentioned, the guardianship, if applicable, applies to the person of the child it does not automatically apply to any property the child may own or inherit. Therefore, planning for both the financial and well-being of any minor children is important in the event both partners pass away, and especially important if one partner is not currently a legal guardian.
- If you and your partner do not have children, you may already be providing support to other children such as nieces or nephews, or children of friends, or may wish to through your Will. Where it is desired that the support be towards the child's future education one option may be through a Registered Education Savings Plan (RESP). Leveraging a RESP may bring additional benefits, such as tax-deferred growth and government grants, however it also brings additional planning considerations. When setting up the RESP you will want to ensure that the



legal guardian of the child does not already have a RESP for that same child, you will also need the social insurance number of the intended beneficiary. If you do become the subscriber of the RESP you will want to ensure that your Will is updated to name a replacement subscriber. It is commonly understood that because there is a beneficiary named in the plan they would receive the funds upon the death of the subscriber, however unfortunately that is not the case. Without proper planning RESP assets are considered to belong to the subscriber and can be lumped into the estate while also triggering the repayment of government grants.

- Make sure your Wills are prepared or updated, since marriage commonly invalidates a Will made prior to marriage (unless it was made in contemplation of marriage). It is always recommended to have a lawyer draft your Will to ensure it is worded appropriately and addressees any applicable considerations under provincial law. An up to date Will can become even more important where the family dynamic or projected size of the estate may lead to issues down the line. For example, secondary marriages, blended families or uneven division of assets among beneficiaries may all lead to the Will being contested and draw out the settlement process, cause irreparable harm to the family as well as erode the value of the estate.
- Partners may not automatically have legal authority to manage each other's financial affairs or make health care decisions. Having Continuing Powers of Attorney drafted in which the partner is the designated attorney will ensure that they have the ability to handle your financial affairs or make health care decisions for you in the event of incapacity. Planning for these situations in advance will ensure your wishes are respected as well as reduce stress on the partner or other family members.
- Consider joint registration of assets such as bank accounts, principal residence, and cars "with right of survivorship" [Note: this strategy is not applicable in Quebec]. This enables the surviving partner to assume immediate ownership in the event of the death of the other partner. By excluding these assets from the deceased's estate, probate may also be avoided.
- Naming your partner as the beneficiary of your pension and registered plans aides in a smooth, tax efficient transition of assets, as funds can

be rolled over to the surviving partner on a tax-sheltered basis and may avoid probate. If it is your intention to name a beneficiary, please speak to your lawyer and have it documented in your Will. Note that in Quebec only insurance products can contain beneficiary designations, such as segregated funds, however other registered plans must be designated through the plan holder's Will.

- Reviewing your life, disability, and critical illness insurance needs helps ensure you have adequate coverage and have your desired beneficiary named in each policy. Naming a beneficiary directly on the policy can speed up the payout process and avoid probate, where applicable, however the policy can also be designated to the estate which will then flow through to the beneficiaries named in your Will.

Financial planning issues are often complex with multiple financial, tax and legal considerations. Whether you and your partner are married or common-law partners be aware of your rights, and what steps you can take to protect yourself and plan for smooth transitions through different life stages.

This article is presented for information purposes only. Speak to your TD advisor who can help you determine what is right for you and where necessary, seek additional professional accounting, tax or legal advice before proceeding on any course of action.

[1] https://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-272.html#docCont