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MONEY MATTERS

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A house divided

Clients turn to specialists for help navigating complications of divorce

JOEL SCHLESINGER

IT may be tough to put a price tag on love. But a cost can certainly be put on the fallout of love gone wrong — just ask anyone who has been through a separation and divorce.

And it's likely not hard to find someone to survey — at least off the record — who has been through this financial and emotional grinder. According to a 2010 report by the Vanier Institute of the Family, 40 per cent of first marriages end in divorce.

From a legal perspective, a divorce is basically the dissolution of a business partnership — only much more complicated. On top of splitting up assets, it often involves parties in volatile emotional states and conflicts over child custody.

Not only does a matrimonial breakdown often require the unavoidable expertise of lawyers, but even legal eagles these days find themselves lacking the specific skill sets to deal with the complicated financial ramifications of splitting one household into two, says Winnipeg lawyer Calla Coughlin.

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SUBMITTED PHOTO

Family lawyer Seneca Longclaws (left), certified divorce financial analyst Tesia Brooks (right) and lawyer Calla Coughlin (inset), specialize in the collaborative divorce process.

Divorce financial-survival tips:

1. Money will almost always be an issue. Be prepared for protracted and often hotly debated discussions surrounding its allocation.
2. Be organized with all of the necessary statements about the family finances. That includes a list of all your property, including documents to prove ownership. Prepare a budget for both pre- and post-separation to provide proof of financial needs.
3. Know that a 50-50 split isn't always fair. For instance, real estate is a much different type of asset than cash or a pension. A pension can provide an income stream for life. With real estate, there are more costs than meet the eye: taxes, closing fees if sold, annual maintenance and mortgage payments.
4. A divorce often leads to a plethora of tax considerations. A change in marital status will affect how you pay tax. It's best to have an accountant help determine the tax implications, particularly when deciding on a settlement in which assets change hands.
5. Understand the true value of your house, pension and RRSPs. An RRSP value can be deceiving at first glance. An investment of $100,000 isn't worth as much as it appears to on paper because when it's withdrawn as income, it's taxed.
6. Get your pension accurately valued. These often are worth more than people realize. Defined benefit plans always have to be evaluated by a specialist.
7. Be sure the spouse paying for child support has life insurance. In fact, either caregiver in the relationship should have insurance to guarantee dependents will be cared for if one caregiver dies.
8. Get legal advice from a lawyer and financial advice from a financial expert. In some cases, a lawyer may also have expertise in finance, but it never hurts to seek out advice from more than one individual.
9. Get your will up to date with the correct beneficiaries.
10. Pre-qualify for a mortgage. Home upkeep can be expensive with just one income. It may turn out being responsible for repairs, cleaning, shovelling the snow and other chores is too big of a job for just one person. Downsizing may be in order. It's best to know ahead of time what you can afford.

— From handout for clients by Tesia Brooks, CDFA, CFP

Divorce

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"The best way to show clients all their options thoroughly is to have experts in those areas that I'm not, and financial issues are one of those areas," says the lawyer whose preference is family law. "I'm a legal expert, not a financial one."

The financial components of a divorce have many variables: tax implications, pension valuations, and calculating future cash flows. For this reason, some lawyers and their clients increasingly call on the services of a certified divorce financial analyst (CDFA).

"There's a lot more involved in separating than just splitting things down the middle," Coughlin says. "That means finding a legal expert or whatever other experts are appropriate, like divorce financial experts, to give you a good understanding of where you stand and that you do have choice within your situation."

Diana Shepherd is a spokeswoman for the Canadian Institute for Divorce Financial Analysts, which provides certification for CDFAs. She says "not all assets are created equal" in a divorce settlement.

But for both client and lawyer, it may be difficult to value assets unless they're familiar with family law, taxation and finance, and how all three of those aspects intersect.

For instance, some assets, when split, generate a tax bill for one or both spouses, which other assets do not.

"Is it really fair to say, 'I have $100,000 in cash and this piece of property is worth $100,000, so why don't you take the property and I'll take the cash?' " Shepherd says. "Well, it's very different because when you go to sell that property there might be a capital gain on it."

Winnipeg-based CDFA Tesia Brooks says there are often many different ways to allocate financial assets fairly in a divorce, and an analyst will try to come up with projections 10 or 20 years out to show as best as possible the consequences for one or both parties if they were to accept a proposed settlement.

"There could be half a dozen different ways to make it equitable for both parties," says Brooks, also a certified financial planner. "If they just look at one proposal, they could find that 10 years down the road, one person is flat broke as a result of the deal and the other has half a million bucks."

Analysts do not usually make recommendations directly to clients. Instead, they usually "flesh out" what the available options are and pass them on to the lawyer and client, who then decide what path to choose.

"It works well with a lawyer because I can give financial advice but I can't provide legal advice," she says.

While they can't provide advice, Shepherd says analysts — who take a home-study course that usually takes about three months to complete — are provided with the basics of matrimonial law in Canada to help guide their financial recommendations.

"It's not that they're ever going to be providing legal advice," she says. "In fact, they're specifically prohibited from that unless they're a lawyer, but at least they're going to know the ins and outs of how property distribution works in their particular province."

Often, analysts work with lawyers and clients in what is called the collaborative divorce process, which doesn't involve litigation.

"This is seen as a kinder, gentler process," says Shepherd, who is a CDFA.

The collaborative process involves both parties sitting down at the table with their respective lawyers to work out their settlement fairly.

"There's an official collaborative process in which people actually sign a contract," says Winnipeg lawyer Seneca Longclaws, adding the two parties are bound by the contract to work together in good faith for a resolution.

All discussions that take place in the collaborative process are deemed "without prejudice" — meaning if the process breaks down, they cannot be used in litigation against either party.

"If you choose to litigate afterward, there is a financial consequence to breaking that process," Coughlin says.

"You can't use the lawyers you just had. You have to get a new lawyer."

While the collaborative process isn't appropriate in all divorces — both parties must agree to it, which isn't always the case — it is often one of the least disruptive ways to settle the split-up.

"Litigation is adversarial," Longclaws says, whereas the collaborative process is all about working together without any hidden agendas.

The collaborative process often does likely add fee costs. Collaborative contracts even often stipulate both parties require the services of financial and family counselling experts. Still, it can be less costly in the long run than a protracted litigation battle that may go on for years, Coughlin says.

And in many cases, working toward a settlement without conflict leads to what will be best for everyone involved, Shepherd says.

"Some people are in the worst emotional state of their lives, and they are making these really big decisions that are going to affect the rest of their life," she says. "So if you can have a process that doesn't foster animosity and polarization, it's likely going to work out more fairly in the end for everyone."

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Small-business owner in her 60s has a difficult decision to make.

Property DILEMMA

Should two-home owner sell house or condo?

By Joel Schlesinger

RITA has a real estate dilemma. She owns a house and a condominium, but she says she likely can no longer afford to own both homes.

"I keep wavering between 'do I sell the house, or do I sell the condo?' " says the small-business owner in her early 60s. "I go back and forth like I'm on a see-saw."

It may sound like an ideal situation for most people. After all, it's a sellers' market.

But Rita's situation is unique. The home was once her principal residence before she moved into her common-law partner's condo a few years ago.

Since then, one of her adult children has lived in the home covering some costs, but Rita pays for the rest.

Last year, her partner died and left the condo to Rita. The problem was, his family had provided him with the condo, which actually had a no-interest mortgage. The condo deed was in his parents' names and was supposed to be passed on to him when they died.

To make a long and complicated tale of estate planning gone awry short, Rita gets to keep the condo on one condition: She will have to take over the mortgage of $183,000.

"My income wouldn't be enough for a bank to give me a mortgage, but I do have assets, so they might."

Rita has about $284,000 in savings and earns a $4,500 dividend payment monthly from her business and about $980 from CPP.

She has also received an offer from a developer to buy her home, offering $300,000. Rita says she has been told by a realtor she could get as much as $330,000.

One option is to sell the condo and use the proceeds to renovate her home, splitting it into suites. She'd live in one and rent out the others.

Another choice is to sell the home, pay off the mortgage on the condo and invest the rest. And, of course, there's the outside chance she could keep them both.

"I'm like a Jekyll and Hyde," she says. "Today, I'm saying it would be better to sell the house and use the money to pay down the mortgage and have cash left over — or is there some other thing that I haven't thought of?"

Unfortunately for Rita, there is no easy answer as to how she should proceed, says certified general accountant Tanis Olafson.

She really has three or four scenarios to choose from, so it's worth discussing all of them, looking at their drawbacks and benefits.

"If we look at keeping both properties and she were to renovate the house and rent out both suites, it might be doable but it would be very tight," says the accountant with Winnipeg-based Olafson and Jones Certified General Accountants.

Rita estimates her renovation to the home would cost about $100,000. She would need at least a $280,000 mortgage to cover the condo and the upgrades. At six per cent interest over 25 years, she would pay about $2,000 in monthly mortgage payments.

"If she believes she could generate enough in rental income, it could cover the mortgage payments and expenses," Olafson says.

"However, there is a lot more risk and potential downside because she would have to cover vacancies and major repairs — not to mention the additional work of being a landlord."

A slightly different scenario involves her daughter either buying the house or paying enough rent to cover expenses and the cost of the mortgage on the condo. But Rita says her daughter has no desire to pay more or purchase the home, even though she has a well-paying career.

Olafson says the inevitable financial reality is Rita will have to sell one of the properties and her daughter will have to find somewhere else to live.

On the surface, selling the condo seems like the least costly option. The condo still has a mortgage, and it has rather high condo fees.

But the aging home has its own costs: utilities and upgrades.

"Will she still want to cut the grass and shovel the snow in 10 or 20 years?"

Furthermore, she has a willing buyer for her home, whereas she was told by a realtor she'd be lucky to get $250,000 for her condo.

"If that's indeed the case, then I would say the most logical and profitable move would be selling the house now and living in the condo," Olafson says.

Still, other factors cloud the picture even more. Another consideration is her business. Rita wants to downsize her business, moving to a less costly location.

"Has she thought about living in the house in one suite and running the business out of the other?"

But Rita also has to consider the tax implications of selling one property over the other. Because she owns more than one home, she will have to choose a principal residence, which is exempt from capital gains on the proceeds of its sale.

"Capital gains are included in your income at 50 per cent of the profit from the sale, after deducting the adjusted cost base and any outlays or expenses incurred to sell the property," she says.

Depending on her income, Rita could end up paying about 23 per cent of the gain in taxes from the sale of a property that isn't declared her principal residence.

Choosing a principal residence isn't easy in this case, either, because Rita has quite a few variables that will play into the final decision.

"Who has title of the house? Who has title of the condo? Is it in the estate still? Was there a deemed disposition on her partner's death?" Olafson says.

"There are a whole bunch of things we don't know that will potentially have tax implications."

And on top of all of these considerations, Rita has her retirement to worry about, as well. Rita says she wants to work as long as she can because she has no business succession plan.

Because she likely cannot sell the business, she will have to rely on the profits from the sale of one of the properties and her savings to fund retirement. Olafson says Rita will likely have about $375,000 in RRSPs and other investments after she sells one of the properties.

"This is substantial, but realistically it doesn't replace her current income level for long," she says. "She definitely needs a retirement plan and soon."

Right now, Olafson says, perhaps Rita's best option is to get further financial planning and tax advice that will help flesh out in detail each scenario. At least then she will be aware of the potential financial benefits and drawbacks of each choice and can decide accordingly. In the end, Olafson says, it is likely to come down to her personal preference.

"These are difficult decisions, but quite honestly they are as much or even more qualitative than quantitative."

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MONEY MAKEOVER

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Rita's finances

▼ INCOME
Annual: $73,044 gross; $6,087 monthly ($4,500 work dividend, $987 CPP, $600 rental income)

▼ Expenses
Monthly: $5,997 (includes $1,200 for income tax and $1,000 for savings)

▼ Debts
Mortgage: $183,000 (she has yet to take over mortgage; interest rate to be determined)

▼ Assets
Savings: $34,497
TFSA: $10,180 in high-interest savings account
GICs: $15,086
RRSP: $224,362 (balanced portfolio)