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High Net Worth Divorce

The Wealthy Can Afford Divorce, but That Doesn't Make it Easier
By Philip Porado

Dividing more assets means couples face legal complexities, and sometimes more heartaches.

Traditionally, the first few months of the year is a time to take stock. Unfortunately, for some couples, such reflection can lead to the conclusion it's time to part ways. Statistically, divorce filings accelerate during the first few months of the year.

Psychologists liken the range of emotions experienced by those going through divorce to what happens after the death of a loved one. And, much like a death in the family, it can play havoc with the financial pictures of those involved.

While divorce isn't easy for anyone, it can be particularly complex for wealthy families. Ownership of family businesses, multiple properties, and offshore assets – and the more frequent presence of prenuptial agreements or marriage contracts – means lawyers and wealth managers will have more paperwork to comb through to ensure all parties, including future heirs, are treated fairly.

All that review is expensive, especially when disagreements spur one or more parties to move matters to the courtroom.

"A lot of wealthy people initially try to do a collaborative process, but oftentimes it ends up going to some sort of litigation because there tend to be a lot of assets involved – and it's sometimes hard to value those assets," says Sarah Bull, Partner and Portfolio Manager at KJ Harrison in Toronto. "There's complexity associated with wealth."

Emotional shocks

It can take a long time to accumulate significant wealth (excepting inheritors, of course), which means divorces for most high-net-worth couples take place later in life. These so-called grey divorces can come with a high degree of emotional stress for one or both partners; and while the one who's been blindsided will usually continue to be solvent, that doesn't begin to deal with the emotions.

"Some of the harder cases involve later divorces, particularly women clients who don't want to accept that it is happening," says Sheila Holmes, Counsel and Certified Family Law Specialist with JK Hannaford Barristers in Toronto. "You can't answer the question, 'How can he do this to me after 40 years of marriage?' "

Although it's no longer gender specific, in most families one half of the couple will act as the household's chief financial officer. If divorce happens, that means the other person can be left with an inadequate grasp of their finances and net worth – which is why Bull counsels both members of the couples she works with to improve their understanding of the family's balance sheet.

"After divorce, you need to protect yourself," she says. "You need to surround yourself with good advisors. You need to build up your own team of people who you trust and will educate you on things going forward, and make sure things don't get dropped through the cracks."

What falls through? Things like ensuring the correct powers of attorney are in place, that the individual starts to look at the wealth as his or hers – and not the couple's –and that he or she gets the correct tax advice for this new phase of life.

Lori Duffy, a partner with Toronto law firm WeirFoulds, says she recommends people involved in divorce proceedings change the beneficiary designations on insurance policies, RRSPs, RRIFs and TFSAs, adding, "Any changes that we would recommend on beneficiary designations for estate planning should be approved by the family law lawyer to ensure that we aren't effecting assets that may be important in the property settlement."

Protecting property

Financially, divorce often boils down to who owned what – and when. But it's not the quantity of assets that causes problems; it's the specifics surrounding how each asset was acquired. What the parties share when a marriage breaks down, Holmes says, is the value of assets acquired during that marriage.

Lawyers will look at what each party owned on the date of the marriage, and what they owned when they separated. Each asset is valued based on the date of separation – a date that can be tricky to establish, Holmes notes, because sometimes spouses can be deemed to have separated even if they remain under the same roof.

"It's very fact dependent. Did they go to parent-teacher things together; did they go to the opera together? Or did they live separately in the same residence?" she says. "It's kind of complicated and it can be very costly. If these go to trial it's hugely expensive."

And, notes Bull, ownership of a cottage can make things trickier because, "it's a family cottage, or someone likes it more than the other, or that's where all the memories with the kids are."

Further complications emerge from inheritances, says Holmes, and they're frequently gender based. "A woman in a marriage will often receive an inheritance from a grandparent and she will use it to renovate the kitchen and pay down the mortgage," she says.

By contrast, a lot of male clients who receive inheritances will invest the proceeds. "So one person has lost the inheritance because it has gone into shared property. The other has retained it," Holmes adds. "When people are receiving an inheritance, they really should get advice. There's no problem with you giving something away or sharing it with your spouse, but you should know what will happen."

Foremost among many couple's assets is the matrimonial home, which can include not only the principal residence, but cottages and even boats if it can be determined the family spent a significant amount of each year on the water.

Again, the date of separation determines the value to which each half of the couple is entitled. But it can be tricky because sometimes one spouse ceases going to the cottage – as in cases where one spouse unexpectedly finds a husband or wife there with someone else.

Holmes dealt with one such matter in which a wife hadn't gone to her cottage for eight years, and was able to establish the home's value at the date she'd last been there. "She didn't have to pay the increase in value for those eight years," Holmes says. "It was in her favour economically."

Sources of wealth

Where a family's wealth comes from also impacts the complexity of the divorce process.

"If they accumulated the wealth themselves, it can be a bit easier," says Holmes, who adds she tries to take couples down a path towards mediation because it's simpler and cheaper – provided both parties are emotionally ready to come to an agreement.

"Trust fund adults can be problematic because they didn't personally earn that money. It might have been a grandparent who earned it," she says. "They usually have less to share and it's structured through trusts or agreements; or there is a marriage contract that says, 'Those particular assets came from my grandfather and they stay mine.' "

And, says Duffy, ownership of a family business will make things infinitely more complex. A spouse who has never worked in the business may end up with some level of ownership; which raises questions about whether they will now take an active role in the company, or if some other remuneration is feasible. Usually, such pay outs come in the form of shares in the company, though they frequently come with shareholder agreements restricting what can be done with those shares.

"Most likely, the settlement will be such that the person who doesn't have the business experience will not get direct ownership of the shares," Duffy says. "If you are going to accept shares of the corporation as a property settlement, you want to ensure what benefits those shares will be provide. For example, will they carry sufficient votes to give the former spouse a voice on the board of directors? Will they provide priority to dividends? And what are they entitled to if the company is wound up?"

Holmes and Bull both note it's also critical to get valuations of the business from the date of marriage, and at the date of separation, to determine how much wealth accumulated inside the company while the couple was together.

Making the money last

Source of funds will play heavily into a wealth manager's ability to give a clear personal finance picture to a client going through divorce.

“When you’re divorced, depending on whether you’re the spouse who owes money or the spouse who’s receiving money, your cash flow changes. Your income changes, because you’re now a single income earner,” says Bull. “Your spouse has a house. You have a house. Your expenses increase. Whoever is managing your portfolio needs to really understand how the risk and return objectives and income requirements on the portfolio have changed.”

If a client tells her they’re getting divorced, or even considering it, she likes to meet with them immediately to begin working up strategic plans to ensure that person can continue to fund their lifestyle. At minimum, a client will be moving from two household incomes to one, and in the case of grey divorce the spouse frequently has to determine how to make the proceeds from a lump sum payment, and subsequent support payments, fund his or her remaining years.

“It allows you to have less of an emotional conversation and more of a rational conversation. You’re able to say, ‘I’ve done some planning around the numbers. This is what it’s looking like.’ And you’re able to bring them to a place that makes sense,” Bull says. “Being able to do some of those financial scenarios really helps get control over a very uncontrollable situation.”

In cases where someone’s received a lump sum, she’ll break down what the client will be able to spend annually, and what rate of return is needed on the invested portion of that capital. Those numbers are revisited quarterly and clients are asked about their short- and long-term goals for the money – everything from buying a larger house to doing something to benefit the kids.

The heartbreak scenario, says Bull, happens when someone waits too long to consult a competent professional. If a divorcee starts working with an advisor who doesn’t grasp the need for capital preservation and puts the lump sum into too risky a portfolio, a sharp market correction can obliterate a large percentage of that wealth, forcing the client to make lifestyle adjustments.

“For women or men who don’t work and get a lump sum amount, that’s all they have to live on for the rest of their lives,” says Bull. “That’s where it’s hard for me, because I have to tell people they have to go backwards.”

Use professionals proactively

Duffy notes it’s important to use lawyers and other professionals efficiently “because we’re not inexpensive.” She emphasizes the need to come to the table prepared with bank account information and data on all the household’s assets and how they’re owned.

“Make sure you answer all the questions and give them all the details; even though you think it’s none of their business,” says Duffy. “An estate lawyer needs to know everything.”

Once you’re in separation mode, says Duffy, it’s wise to redo your will. Even if you don’t yet have a property settlement, you need to make sure your soon-to-be ex isn’t named as your estate trustee, or as your attorney for property or personal care. Plus you may want to cut them out of your will.

“And then, once you’ve got your property settlement and you know what your assets are going to be,” she says, “we can do a more detailed plan.”

If a matrimonial home is jointly owned by husband and wife, one of the parties will often call her and say, 'I need you to sever that joint tenancy because I want to make sure my 50 per cent goes to my kids and that he doesn't get the whole property by right of survivorship.'

"It's easy enough to do that separation, but it also can exacerbate issues between the couple. I always work with the family law lawyer before we take any of those kinds of steps to ensure that property isn't already on the negotiating table," says Duffy. "If not, then we may go ahead and do that kind of work."

In the event a prenuptial agreement is in place, Holmes advises clients to assume the property side of the document is iron clad. "You might read in the papers about one case that overturned the contract," she says. "It's rare. You can't rely on it and it's more often than not on the spousal support issue."

Hidden assets

Sometimes, people don't come entirely clean about their assets during the divorce process. Holmes notes asset concealment is easier for business owners, since the layers within a corporation's accounting provide places to stash cash.

Lawyers will look at bank transfers to determine if funds are going to undisclosed accounts either within Canada or offshore. "It's not unheard of," she says, "But you have to have some evidence to start with because it's a costly process. We'd also, frankly, wonder if we're finding it."

Bull adds she'll sometimes see a T-4 with a number that doesn't jibe with the four fancy cars in the driveway. "That's when you know it just doesn't make sense," she says.

More commonly, though, says Holmes, "A lot of spouses think their spouse is doing this and there's no evidence."

That can lead to some intense conversations, including one in which a lawyer may ask, 'If you're getting $10 million, does it really matter if it should be $12 million?'

"The client says, 'Yes, because there's no way they're getting away with that,' " says Holmes.

Philip Porado is a veteran, Toronto-based journalist who specializes in financial and business topics. Prior to immigrating to Canada in 2004, he covered securities compliance, housing and economic policy, architecture and urban planning, politics, and technology for several publications and news services in Washington, D.C.