How to successfully navigate the financial side of splitting up

By Perpetual Private Insights
7 September 2020

Splitting from your long-term partner can be emotionally devastating. Unfortunately, on top of the painful personal decisions, you also need to make big financial decisions. Decisions which could have a significant impact on your future. If you have significant assets, or complex business or financial structures to consider, then it's especially important to get professional taxation and financial advice.

The need for quality financial advice following a relationship breakdown

By receiving professional financial advice, you're more likely to avoid costly mistakes and put yourself in the best possible financial position for the future. While every person's situation is different, these are the areas which most commonly cause difficulties for our clients; and where we assist them to get back on their feet:

1. Short, medium and long-term financial plans
2. Family trusts and other financial structures
3. Estate plans and wills
4. Insurance
5. Self-Managed Super Funds (SMSFs)
6. Business structures

Short, medium and long-term financial plans

In an ideal world, if you split from your partner you would have a Financial Agreement (FA) in place. A FA is the formal term for a 'prenuptial agreement' or prenup — it sets out exactly how you and your partner would split your assets if you separate. According to Sharon Parker, Lead Partner at Fordham, a specialist part of Perpetual:

"Unfortunately, I see that few couples have a FA in place. If you don't have a FA, at least have a good understanding of your financial position. It's very hard to go through a relationship breakdown while trying to learn about your financial situation at the same time. Getting this understanding as early as possible is crucial and a good adviser will help you with this."

Once you understand your financial position, the next step is to look at any immediate financial needs. How are you going to pay for food, rent, mortgages, transport and other daily essentials?

After these early steps are put in place it's important that you move quickly to establishing a firm foundation for your medium and long-term financial plans. According to Perpetual Private Senior Financial Adviser Carolyn O'Reilly:

"This includes putting together a budget, reviewing your cash flow and sources of income to ensure ongoing expenses can be met, like debt obligations and children's' schooling. You should also review whether your existing bank accounts and credit card arrangements are suitable. Where you have joint accounts or cards in place it may be worthwhile assessing the appropriateness of these arrangements".

The longer term is often about building, or re-building, your wealth and savings and putting in place a new retirement plan. If you have a new partner, setting up a FA to protect your wealth may well be advisable – and specialist legal advice on this topic is a good place to start. It's also worth noting that you and your new partner would require separate legal representation when setting up a FA.

Family trusts and other financial structures

Australian families use trusts to help manage their income, protect their wealth and minimise tax obligations. In the case of a relationship breakdown, consideration of how trust assets are treated when dividing up assets can be crucial.

Sharon Parker suggests: "Get a good understanding of your financial structures and how they're set up. If you don't know, seek professional advice and ask questions until you do understand".

There are many different types of family trusts, but one form commonly used is called a 'discretionary trust'. When a relationship breakdown occurs, assets owned by a family trust may be added to the communal pool of assets and then divided up as part of the financial settlement process, but this is not always the case. It depends on many things including the particulars of how and why the trust was set up, exactly what is written in the deed, who manages the trust and also who has benefited from the trust over time. This can be even more complicated if any trusts are controlled by external parties and neither you nor your partner plays an active part in management.

As well as understanding the financial structures which are already set up, if you are due to receive assets as part of the financial settlement it's also a good time to consider what financial structures are right for your future. Depending on your situation, trusts can be useful from a tax perspective as well as to help protect your assets. For example, if you receive an asset in your name and then meet a new partner in the future, this asset is likely to then become jointly owned by you and your new partner. If your new relationship breaks down, then your asset may be part of the financial settlement with your new partner. A family trust with a carefully drafted trust deed can mitigate this risk.

In all cases, whether your relationship involves one or more trust structures, or you're thinking about setting one up, seeking expert advice is imperative.

Estate plans and wills

When you separate from your partner you are likely to need a new will, estate plan and powers of attorney. As a separation does not revoke a will, consider how your new situation changes your wishes for what happens to your hard-earned wealth if you pass away, or who will make decisions on your behalf in the event of incapacity is important. For example, ask yourself the following questions:

- Do you know how your assets would be divided in the event of your death? Are you happy with this?
- If your existing Power of Attorney permits your former spouse to act as your Attorney, are you comfortable for your ex-partner to be able to make financial or life decisions for you if you are incapacitated?
- Similarly, are you comfortable for your ex-partner to be the executor of your will if you die?
- Are you confident you know who would be given care of your children if you are incapacitated or die, and are you happy for this to be the case?
- Are you happy for your ex-partner to receive the inheritance they would be entitled to if you die while you are separated, but before your financial settlement becomes final?

If you answer no to any of the questions above, then a review of your estate plan could be a good idea. Sound taxation and financial advice complements the estate planning process, to help give you the most financially effective outcome.

Insurance

Our need for insurance changes throughout life, so this is a good time to review your insurance policies. Home and Contents insurance is one that is probably top of mind, given your new situation, but Life, Total and Permanent Disability (TPD) and Income Protection insurances shouldn't be forgotten either.

These insurance policies may have been set to take into account the combined income and circumstances of both you and your partner and may need to be updated or cancelled. Be sure to seek specialist advice here, as cancellation of any insurance may mean that it is unable to be obtained in future; or if it is, on substantially different terms. For example, premiums for any new insurance policies may be a lot higher if your medical circumstances have changed since the original cover was established. Another consideration is that for many people, as they age and grow their wealth, their need for life insurance lessens as their children become financially independent.

Self-Managed Super Funds (SMSFs)

Dealing with superannuation in the event of a relationship breakdown can be complex. Things can get even more complicated, however, if there is a Self-Managed Superannuation Fund (SMSF) involved. Sharon Parker explains:

"We often see that people set up SMSFs to acquire property. When a relationship breakdown occurs, the only way to meet the terms of the financial agreement may be to sell the property. This might cause many different difficulties, for example it may not be the best time to sell or there could be related businesses paying rent to use the property. This is where specialist legal and taxation advice is definitely required".

"One of my current clients is in that exact situation. Now the relationship has broken down and they are in a very difficult position as they need to sell the property to deal with their superannuation, but the business is dependent on renting it."

In financially complex situations like this, it's important to receive expert advice to help you unravel the complexity and arrive at a fair settlement that's acceptable for both parties.

Business structures

Businesses are another area which can become complicated in a financial settlement following a relationship breakdown. If you are joint owners in a business, or if either of you works in the business, you should seek expert advice to help you understand exactly what your position is. Your adviser can help you to:

- Understand exactly what structures exist right now. There are different options and possibilities depending on whether you are operating the business through a partnership, a trust or a company. Working through the most appropriate option for the business in the future and effecting the strategy to reach the desired end goal will need expert taxation assistance.
- Understand the ownership agreement that is in place. If an agreement isn't yet in place, your adviser can help create a clear and thorough agreement for you. This agreement should cover a variety of eventualities, such as what happens if one of you dies or is incapacitated, if the business goes bankrupt, or if the business is sold.
- Be clear on how business decisions are made, to help ensure that the business can continue to operate smoothly both during and after the relationship breakdown. Depending on the size and nature of the business, additional factors may be involved in major business decisions, such as shareholder voting, which your adviser can help you to navigate.
- Understand how profit is divided up. This is an important consideration when going through a relationship breakdown, as careful planning is necessary to ensure you will have the appropriate levels of cashflow and savings to maintain your current lifestyle.
- Understand and reach an agreement that is fair and acceptable to both parties. This can often include working closely with your family law adviser to provide relevant financial information and projections that underpin the settlement negotiation or court process.
- Work through an appropriate solution for the control of the business once the legal process has finalised, as well as advice on how to tax-effectively transition to the next generation in later years.

What many of her clients find important, according to Carolyn O'Reilly, is having a trusted adviser they can turn to during this emotionally difficult time: "I've helped many different clients through these situations and one thing which is important every single time is having someone on your side that can explain complex things to you and help you to make these important financial decisions."

Sharon Parker agrees:

“Superannuation and taxation rules are constantly changing. It’s important to get expert advice throughout the relationship breakdown process specific to your situation. Having an adviser by your side to help you negotiate through the various steps can be invaluable in coming to an outcome that is appropriate for your situation. Your adviser can also be the person to provide support and sound advice during what can often be a very difficult time involving negotiations, difficult conversations and often compromise. And once agreement has been reached an adviser can also help you in re-building wealth, maintaining any business interests and assist you in navigating the rest of your wealth journey."