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Winter escape or estate headache?

Plenty to consider before buying foreign real estate

Knowing tax exceptions can pay

When Canadians own property in the U.S. at the time of their death, estate tax generally applies on the fair market value of their property, says Doug McLarty, director of McLarty & Co. "In calculating an individual's taxable estate, certain deductions are available (including a non-recourse mortgage to finance U.S. real estate). A 'unified credit' is available, which effectively exempts a portion of the estate from estate tax liabilities."

For 2008, the effective estate tax exemption amount is $2 million US and will increase to $3.5 million in 2009, is repealed in 2010 and is $1 million in 2011," says Mr. McLarty. "For Canadian residents, the exemption is prorated, based on the value of their U.S. situs assets compared to the value of their worldwide assets."

The top estate tax rate is 45 per cent in 2008 and 2009, is repealed in 2010 and is 55 per cent in 2011.

PHOTO: DEBORAH BAIC

To help Canadians avoid getting blindsided by estate, taxation, insurance and other issues associated with foreign home ownership, Burlington, Ont.-based financial advisor Rick Goldring says the key is to make real estate buying decisions in concert with an overall retirement and estate plan. "It is when people make decisions without thinking of the repercussions that they get into difficulties," he says.

For many Canadians, bargain prices on vacation homes in Arizona, California and Florida are turning the dream of owning a slice of paradise into a real possibility. Many snowbird buyers, however, are also awakening to the fact that ownership comes with estate planning complexities.

When Liz Friedman and Robert Toth saw the asking price of the condo in a lovely 'active adult' development in St. Petersburg, Florida, they were extremely tempted to make an offer. A home near the ocean was one of their most cherished retirement dreams, and it was hard to believe they'd ever find a better deal. (According to Tampa Bay Online, median sales prices for homes in the area had fallen 27 per cent since the same month a year prior, from $178,900 to $131,400.)

While it can be very tempting to add 'buying a condo' to a holiday itinerary that includes 'touring the Everglades' and 'visiting Miami Beach,' the key is to make real estate buying decisions in concert with your overall retirement and estate plan, says Burlington, Ont.-based advisor Rick Goldring. "It is when people make decisions without thinking of the repercussions that they get into difficulties."

Buying a property outside the country without the benefit of sound advice can have unpleasant side-effects. "With foreclosures, for example, there are different ways that the foreclosure can be done to help minimize some of the taxes that will occur in the purchase, so it is a good idea to see someone knowledgeable in Canadian-U.S. tax issues before you buy," says Colleen Gibb, FCA, partner at Gibb Widdis in Ancaster, Ont.

Property taxes are another potential minefield. "A lot of the agents selling these properties are (quoting) the taxes the current owners are paying, but when a Canadian buys the property, they're finding their property taxes are three times higher because there is a different rate for non-residents," says Ms. Gibb.

Obtaining financing can also be more difficult for non-residents, says Doug McLarty, FCA, managing director of McLarty & Co, who owns a recreation property in Sarasota, Florida.

If you plan to rent the property for part of the year to reduce the expenses of ownership, the complexities increase. "There are taxation and compliance issues to consider. Normally, you would have to file a U.S. tax return for the rental property," he says.

Further, says Ms. Gibb, "Under the Canada-U.S. tax treaty, the U.S. can tax any rental income, so withholding tax is supposed to be collected by the person paying you rent; there are special forms you can file to have those withholding taxes reduced, if you know you're not going to have a profit for the year from your rental."

Some states also require sales tax be collected when renting on a short-term, vacation-rental basis, she says. "If you rent for a year and then find you were supposed to collect the sales tax, you'll be out-of-pocket, so it's important to be careful of that."

Even obtaining insurance may be an issue. "A lot of my clients have had trouble obtaining insurance; hurricane insurance may be very difficult to get, especially in Florida. And if the property is going to be vacant much of the time, it may violate the insurance policy," says Ms. Gibb.

There are many structures in which a property can be held to achieve an individual's estate planning goals, she says, but it is essential to articulate those goals in advance of the purchase. "Some people are using trusts, some are using partnerships – they all have benefits and pitfalls. Do you want to keep (the property) in the family by passing it onto the kids, or is it something that will be sold when Mom and Dad are too old to travel to Florida? By knowing those goals up front, we can help our clients decide on the best structure for them."

Another tool commonly used to deal with estate-tax liabilities is a 'joint and last-to-die' insurance policy, says Mr. McLarty, noting that potential estate tax liability can be reduced by obtaining a non-recourse mortgage (a mortgage that entitles the lender to have recourse only against the property mortgaged).

Today, with a team that includes their financial planner and an accountant and lawyer with expertise in cross-border issues, Ms. Friedman and Mr. Roth are ready to make an offer – with confidence that their caution today will ensure against unexpected, costly surprises down the road.

"When you buy a second property, whether it is in Canada or outside of the country, you have to be very aware of the complexity that you're potentially creating," says Mr. Goldring. "Often, it is the impetus for reviewing the whole estate plan." ■

Passing on the family cottage

Leaving a beloved family cottage to the next generation can be fraught with emotional peril, says financial advisor Rick Goldring. "In some cases, even though it was a second- or third-generation cottage, families I've worked with decided that it will be sold upon their death so they're not in a position where they have to favour one of their kids. Cottages and recreational property can be a noose around peoples' necks."

Estate planning in general is significantly more complex when you have a blended family, he says. "You really want to think through these issues very carefully and think about the possible repercussions, from the decision to own a recreational property to the eventual disposition of the property."

One great estate equalizer, he says, is life insurance. "It can pay the capital gains taxes in these situations, or allow one to leave the cottage to one child and have cash for the other children that will equalize the estate."

This supplement produced by Lori Bamber (www.randallanthony.com) for The Globe and Mail. Project Manager Richard Deacon (rdeacon@globeandmail.com).