Volume 1, Issue 3

NetWorth

8 Tips to Bulletproof Your Will

In Canada, you're allowed to distribute your estate as you choose; however, it's important to consider your personal circumstances, including common-law relationships, marital status, blended families, minors, adult children, and dependants. Bulletproof your Will to safeguard your wishes and avoid estate disagreements.

#1: Seek legal advice on your province's laws

Learn if you must provide for your spouse, minor children or adult children with disabilities. If you own assets outside Canada, rules may dictate who you include in your Will. Your financial professional can project the funds required to provide for family members.

#2: Hire an estate lawyer to minimize future conflict

Consider a cohabitation agreement or prenup if you want to give your new spouse less than the provincial minimum. Leave a percentage to your ex-spouse to provide for children from a previous marriage. In a blended family, an estate lawyer can help minimize disagreement.

#3: Draft your Will when healthy and of sound mind

Life can get busy, but make time to update your estate planning documents. Have significant health issues? Ask your doctor or a mental capacity specialist for a written statement that you have the mental capacity to create a valid Will.

#4: Consider signing your Will in a lawyer's office without your family

This way, no one can say you were pressured to give a certain family member a particular gift. Follow provincial rules about how to sign a typed Will and how many witnesses are needed.

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#5: Use life insurance to help equalize gifts among your children

For example, if you have a farm worth $500K and cash/investments worth $250K, you can give one child the farm and the other the cash/investments plus a $250K life insurance policy – or more to cover estate. A BMO Private Wealth professional can discuss other equalization strategies applicable to your situation.

#6: Explain your estate planning decisions

If you intend to distribute your assets unequally or leave someone out of your Will, announce it to your loved ones while alive or write a letter or affidavit. This helps beneficiaries understand and move on and prevent others from speaking for you.

#7: Choose an honest executor you trust

Creating a Will is personal, but keeping it secret may cause loved ones duress. Naming one person as both executor and one of the beneficiaries may create a conflict of interest, so consider a professional executor, such as BMO Trust. Also consider appointing a separate executor for your digital assets.

#8: Add a no-contest clause in your Will

Consider adding a clause stating that any beneficiary who challenges the Will to try to get more for themselves will forfeit their gift to another beneficiary, or a clause stating that if someone fails in challenging the Will they must pay all parties' legal fees out of their inheritance.

Plan ahead

Review your Will every few years to ensure it addresses all your current family members and assets, especially when you experience a change in your personal life or wealth status. Estate disputes can ruin family dynamics for generations and tie up needed funds in litigation.

Get good advice and update your estate plan and supporting documents to ensure your wishes are respected and your beneficiaries are protected.

Learn more from your BMO financial professional.

Canadian Ownership of U.S. Real Property

If you purchase a U.S. vacation property, it's important to understand U.S. reporting and tax issues around owning U.S. real property as well as Canadian tax implications.

U.S. estate tax

Unless the vacation property is transferred to your surviving spouse[1] (or qualifying spousal trust) upon your death, as a Canadian resident you would incur Canadian income tax in Canadian dollars on the unrealized capital gains due to a deemed disposition at fair market value.

You may also face U.S. estate tax if you have U.S. assets (real property, stocks, mutual funds, EFTs, etc.) worth US$60,000+, and your worldwide assets exceed US$12.92M in the year you die (the inflation-adjusted amount for 2023). The U.S. taxes the property's fair market value at death. A credit against Canadian federal income tax for U.S. estate tax payable on U.S. property can reduce the property's Canadian income tax obligation.

Direct ownership structures

i. **Individual ownership.** Married or common-law? The lower-net-worth spouse can assume ownership if their assets are US$12.92M or less for the 2023 tax year. Transfers between spouses may trigger a U.S. gift tax. If the U.S. estate tax liability cannot be eliminated, life insurance could fund the residual.

ii. **Joint tenancy with the right of survivorship** is the simplest structure to transfer assets at death. However, it is generally not recommended for Canadian couples who own U.S. real estate as the full value of the U.S. property may be subject to U.S. estate tax twice: when each spouse passes away.

  Spouses may sever their joint tenancy for a tenancy in common based on each spouse's original contributions, but a U.S. gift tax may be triggered.

iii. **Tenancy in common** lets each spouse have equal or unequal shares of interest, with the deceased's share passing to whoever they designate in their Will, not automatically to the surviving spouse. Each may direct their share to a spousal trust to reduce tax at death. Ask about a Qualifying Domestic Trust ("QDOT") to defer U.S. estate tax and Canadian income tax.

Owning through a Canadian discretionary resident inter-vivos

Upon death, the property is owned by the trust and is not subject to U.S. estate tax; however, the trust should purchase the property using funds from the individual who establishes it. Transfer funds into the trust before the purchase to avoid U.S. gift tax.

A Canadian resident trust is deemed to have disposed of all its capital property on the 21st anniversary of its creation. Draft the trust so the gain on a sale is not attributed back to the settlor, and ensure foreign tax credits are applied to avoid double taxation. You give up ownership and control to the trust, and cannot be a beneficiary or the trustee.

Ownership of a U.S. vacation property through a Canadian corporation

This does not effectively minimize U.S. estate tax exposure. The Canada Revenue Agency (CRA) deems personal use of a vacation property owned by a corporation established in 2005 or later as a taxable benefit. U.S. income tax on capital gains upon selling a property were much higher for a corporation than for a trust or individual, so this structure has not been recommended. However, the recently reduced U.S. corporate income tax rate (21%) has made this structure more attractive.

Ownership through a Canadian partnership

May minimize U.S. estate tax if the partnership elects to be treated as a corporation in the U.S., but this structure lacks definitive Internal Revenue Service (IRS) guidance.

A non-recourse mortgage

This type of mortgage reduces the value of U.S. situs property on a dollar for dollar basis, but may be difficult to obtain from a commercial lender.

A tenant renting a U.S. property from a Canadian owner

Must withhold 30% tax on gross rents unless the owner considers rent "effectively connected income." Speak with a cross-border tax specialist for further details.

Sale of U.S. real property

Upon selling your U.S. property there are U.S. and Canadian tax implications unless the buyer uses the property as a principal residence and the proceeds are less than US$300,000. An individual buying U.S. real estate from a non-U.S. citizen seller or resident must withhold 15% of the purchase price and remit it to the IRS. Ensure you speak with a cross-border tax specialist on how to decrease or eliminate this withholding amount.

Your gain/loss on a U.S. real property sale must be reported on a U.S. individual non-resident income tax return. A state income tax return may also be required. Maintain complete records of the purchase and capital improvements to determine the U.S. tax cost when selling.

You must also report the gain for Canadian income tax purposes (calculated in CAD). Claim U.S. income tax paid on the gain from the sale as a foreign tax credit, and include foreign exchange and any change in the property's U.S. dollar value.

Bottom line: Weigh your U.S. income and estate tax planning against the impact on your Canadian income tax.

Given the complexity of tax liabilities in both jurisdictions, consult a cross-border estate tax professional before purchasing U.S. property.

Learn more from your BMO financial professional.

[1] For ease of reference, spouse and common-law partner will be referred to as "spouse" in this article.

Valuating a Professional Practice

When selling, it's challenging to determine the right price and structure for your practice. An external valuator can provide an independent view of its value and set appropriate expectations when selling, admitting new partners, planning for succession, implementing a partner buy-sell agreement, or litigating.

Intangible vs. tangible assets

A professional firm's financial statement outlines tangible assets such as cash, accounts receivable, work-in-progress, furniture, and equipment at its depreciated or amortized book value. Intangible assets can include the personal goodwill of individual partners, but is not transferable. However, goodwill relating to the practice is commercially transferable. Firms with significant personal goodwill should institutionalize their practices and client relationships to enhance their commercially transferrable goodwill. For example, ensure each client has more than one point of contact.

Valuation and structure considerations

Valuation methods include multiples of earnings, discounted cash flows, rules of thumb, and the adjusted net asset approach. Typically, the main asset would be the work in progress (WIP), assuming a purchaser can access the client files and maintain the business with the existing book of business.

The valuator examines existing client files to determine the expected total fees and timing. Any potential value increase from book value to fair market value should reflect the excess margin available from existing commercial goodwill.

Two structuring options consider the valuation and sale of the WIP:

1. Calculate the present value, with payment up front. This transfers all the risk and possible additional upside/downside, such as a higher or lower realized profit margin, of each file to the purchaser.
2. Calculate the expected amount, then work on a payout plan as billings on these files are collected. This transfers risk to the seller, as they no longer run the file nor control whether the client stays.

Under these scenarios the payout includes the "profit" per file, not the total fees, as there are costs to complete each file by the new owner. This also assumes there are no other material assets or liabilities on the books and the company would be sold on a cash and debt-free basis.

A sale/purchase of WIP is structured as an asset deal (i.e., assets versus shares). Buyers typically prefer to purchase business assets over shares as they can choose the assets they want and aren't responsible for the existing business's liabilities. Also, a buyer can increase the tax cost of depreciable property to its current market value. However, sellers usually prefer a share sale for the lifetime capital gains exemption. If there is meaningful value in a company's brand and reputation and the buyer intends to continue a similar business, a share purchase might also appeal.

Seek professional advice

Set your goals, vision and exit plan early. Engage a financial professional to assist with negotiations – if you've never sold a business, engaging professional advice can help you make the right decisions.

Learn more from your BMO financial professional.

BMO Private Wealth

*Source: World Finance Magazine