Recreational properties across borders

Estate planning informing vacation planning

For decades, Canadian parents have piled their kids and pets into the car for the weekend trek to the nearby cottage, cabin or chalet.

These days, it is not uncommon to have a vacation property in another province or outside the country altogether. That's an extra layer of complexity to contend with when thinking about selling or transferring the family getaway, including preparing for estate and capacity planning.

Wills and estate transfers

Generally, a Canadian Will is effective to deal with a person's real property (real estate) in the home province, and personal property wherever it may be. In order to deal with real estate elsewhere, the Will has to be proven to the satisfaction of the courts/law in that other jurisdiction. While this is not an impossible task, it carries with it additional cost, time and potential uncertainty.

A second Will where the property is located?

With that in mind, it may be desirable to plan ahead by executing a second Will in that other jurisdiction. In so doing, it is crucial that the second Will doesn't inadvertently revoke the person's main Will, or otherwise alter distribution. An open dialogue between the lawyers in the two jurisdictions should keep plans aligned.

Discussions with the foreign lawyer should include gaining an understanding of tax obligations (currently and for the estate), and legal responsibilities of the executor. This may necessitate adjustments in the home Will, or at least some informal guidance.

Alternatively, it could lead to naming a distinct second executor, with appropriate allocation of powers and constraints between the two. This knowledge may even affect the owner's longer term intentions for the property.

Incapacity while owning or being abroad

Arguably, the estate transfer is the easy situation as compared to responding to a crisis while an owner is living. For one thing, death is obvious, but incapacity not so much so. And while an estate transfer is a property matter, there are both property and personal issues to address while a person is living, with attendant greater urgency.

The act of naming substitute decision-makers has been a recommended part of estate planning for decades. The traditional term "power of attorney" (POA) is still used in many jurisdictions, and is otherwise understood as a generic reference even if other formal phrasing applies. And while it is usually intended that the power be exercised wherever the grantor or property may be, challenges can arise when foreign elements are involved.

Each jurisdiction has its rules on the execution process, witnessing, allowable language and format – sometimes requiring official forms – any part of which may be at odds with the home jurisdiction's rules. Even if there are no such formal impediments, there can be delays (and associated costs) as individuals, health care workers and businesses assure themselves of their obligations, perhaps even requiring them to seek their own legal advice before being able to take instructions.

One may ask why there isn't a common form and rules to get around these complications? Indeed, efforts have been made to do just that over the last decade through recommendations from the Uniform Law Conference of Canada and the Uniform Law Commission in the United States. However, it's up to each province and state to decide whether to adopt these recommendations, and to date only a handful have gone that far.

Parallel POA planning

As with Wills, it may be desirable to have POA documents drawn up in the foreign jurisdiction in order to expedite action at critical times. In addition to the provisos about guarding against revocation and having open communications, some further questions should be canvassed:

- Can the same person be named in both jurisdictions? Are there practical/logistical/linguistic concerns that may lean toward naming a different person in the foreign jurisdiction?
- What events may cause an appointment to be revoked (eg., marriage, separation, bankruptcy)? If such rules differ between the jurisdictions, how will that be reconciled?
- What is the scope of the attorney's activity for each of the jurisdictions? Where there is a gap, how will this be handled?
- If it is intended that the home jurisdiction attorney has 'final say', is this possible under the foreign jurisdiction's rules? How can an attorney be removed?
- Is compensation allowed/required/prohibited, and do the planning documents together guard against double-compensation?
- What checks are there to assure appropriate accounting and accountability for each attorney's actions?

Tax points to ponder – Property in the United States

Given our geographic proximity, most of this cross-border planning will be with our neighbour to the south – or to the north if you're crossing to Alaska. In fact, it is critical to appreciate that just like our provinces, each American state has its own rules. Accordingly, each individual/couple/family will need to cater their planning to their home province and the state that welcomes them.

And despite that we are near neighbours, we also can't forget that the United States is a foreign country with its own tax rules. Like Canada, there are income tax powers at both the sub-national (state) and federal levels. Here are some important tax matters affecting Canadian owners and sellers of US recreational property.

Tax reporting on sale, including principal residence

Sale of a US property must be reported on a seller's Canadian tax return, on a US federal return, and on a US state's return if there is a state income tax. Capital gains are taxable in both countries, with the US gain based on the change in property value, and the additional factor of the exchange rate affecting the Canadian calculation. In theory, there could be a capital gain on one side of the border and a capital loss on the other. Ordinarily though there will be a gain for both, and Canada generally allows a foreign tax credit for US tax on a sale.

The Canadian principal residence exemption (PRE) can apply to property outside of Canada. The property may still be exposed to capital gains tax on the US side, as a foreign tax credit could not be claimed in Canada, since the PRE claim would result in no associated Canadian tax against which to use that credit.

Withholding tax on sale

When a foreign owner sells US real estate, the purchaser is required to withhold up to 15% of the selling price and remit that to the US Internal Revenue Service (IRS). The percentage can be reduced depending on the selling price and whether the purchaser intends to occupy the property. The withholding rate may be further reduced or eliminated if the seller obtains a certificate confirming that the ultimate US tax liability will be lower than the withholding rate. Otherwise, the seller can recover the tax by filing a US tax return following the sale.

US estate return and US estate tax

At a Canadian owner's death, the executor for that non-resident must file a US estate tax return if the fair market value at death of the decedent's US situated assets exceeds $60,000, regardless whether any tax is due.

As to that tax liability, real estate owned by a Canadian is US-situs property for the purposes of the US estate tax, but only if their worldwide assets exceed the exemption threshold, which is US$12,060,000 in 2022.

For more information, please consult your financial advisor and tax professional.