



# Quarterly Exchange

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## 5 times when you should update your Will



**If you've done your Will, it may be time to dust it off and see if you are still comfortable with what you've written. Here are five occasions when you should re-evaluate what your wishes are.**

Here's a sobering fact: Just under half of all Canadians have made a Will.<sup>1</sup> That may seem like a shocking number given how detrimental it is for a family if a breadwinner dies without one. But for those who have taken the time and effort to make one: Congratulations, you're ahead of the game, but the job is not complete. According to Domenic Tagliola, a Tax and Estate Planner with TD Wealth, updating your Will as events dictate is an ongoing responsibility to yourself and your family. If your Will is out of date, it can cause delays, conflicts between family members and hardships if funds meant for your loved ones are held up in court for years.

"Circumstances change. How you think about transferring your wealth and who it will go to will be different at age 30 than when you're 70," he says. It's why he recommends updating your Will every three to five years. "Laws change, people change, wealth grows, and your outlook shifts as

you walk through life. Your Will has to catch your intentions and wishes, not from 25 years ago but right now," Tagliola says.

If it's been a long time since you thought about the content of your Will, here are five triggers that may signal it's time to update it.

### **1) When a child turns 18**

"When your children reach the age of majority, they can receive your assets as adults — that's the top reason to review your Will," says Tagliola. When children are minors, one purpose of a Will is to appoint a guardian to your children and also to arrange a trust for their assets. But by the time they reach 18, your assets have likely grown substantially. Your children may no longer need a guardian but there can still be a need for a trust for any funds they might inherit so that they don't receive large sums of money all at once. Many parents may even prefer setting up a trust for mature adult children: If the children have complicated financial circumstances, parents may wish to keep the funds out of the hands of ex-spouses or creditors.

## 2) When your executors and administrators grow old

Many people appoint relatives to be executors, guardians, accountants and trustees for their children. However, as those people grow old you may wish to re-evaluate and appoint new people. After all, you don't want an executor to pre-decease you, or you may also want your children to be executors at some point. Secondly, as people get older, their financial affairs might become complicated. You may wish to have a more competent executor handle your affairs or even a professional, says Tagliola. Many people turn to a trust officer from a trust company to be the executor. While there is a cost, a trust officer brings expertise and experience to the disbursement of the Will and can be a neutral party if there are any disagreements among beneficiaries.

## 3) When someone gets married...or divorced

Needless to say, family affairs can get complicated, but your Will must reflect your intentions no matter your situation or any bumps along the family road. This can of course include a marriage breakdown, a second marriage or a common-law relationship. Tagliola points out that a second marriage by either spouse invalidates any previous Will: Any earlier provisions for children are suddenly undone. He also points out that, depending on the province you live in, a common-law relationship can also complicate estate planning since, in some provinces, these relationships are not recognized. That means in some cases a newlywed of one day could be entitled to more rights within family law than a common-law partner of 40 years. These discrepancies need to be reviewed and adjustments made to the Will if someone wants to ensure their loved ones are looked after. Relying on what you believe the law will do can be a costly mistake, says Tagliola.

## 4) When you retire

Since your financial situation changes when you retire, Tagliola recommends reviewing your Will with an eye toward alleviating any taxes your estate would be required to pay when you pass on, including probate tax. At this stage, you may choose to make a gift of real estate and other personal affects to your beneficiaries. Giving assets away to family members while you're alive, if done properly, can alleviate tax issues, and may allow you to see your loved ones enjoy your gift. Changes to



estate planning may also include giving to charities since there can be significant tax deductions if donations are made. Your Will should reflect these new changes to your finances.

## 5) Whenever laws change

"If there are significant changes in tax law or significant changes in legislation, you have to be aware of that and make plans accordingly," says Tagliola. He says that the courts have recently clarified some points of law that have helped estate and tax lawyers fine-tune their clients' Wills. Any change in law could send you back to your lawyer's or accountant's office to ensure that your plans can still be carried out. Beyond that, you should probably check your Will every five years just to remind yourself of the content of your plans and to ensure you still feel comfortable with the decisions you've made, given the time that's passed.

Tagliola says the values of assets can change over time. If someone writing a Will promised a daughter a cottage and a son a stock portfolio, the values may have diverged sharply over the decades. The result could create family animosity which is probably the last thing someone would have wanted.

"Only by keeping your Will up to date can you ensure that you'll be looking after your affairs and family properly," Tagliola says.

— Don Sutton, *MoneyTalk Life*

<sup>1</sup>"What 'will' happen with your assets? Half of Canadian adults say they don't have a last will and testament," Angus Reid, Jan. 23, 2018, accessed June 17, 2020, [angusreid.org/will-and-testament/](https://angusreid.org/will-and-testament/).

## Cottage Succession Planning



The cottage occupies a special place in the hearts of many Canadians. It is often associated with joyful family memories. When the topic of succession planning arises many cottage owners are often anxious to preserve the cottage for future generations to ensure its continued enjoyment by children and grandchildren. There are a number of considerations associated with cottage succession planning, the most prominent of which involve taxation and mode of future ownership. This article will explore each of these considerations and outline some possible planning opportunities with the use of a fictitious family scenario.

Meet Shane and Jane Money, a couple in their early 60s. Shane and Jane own a home in a large Canadian city as well as a cottage located 2 hours outside the city. They purchased the cottage 25 years ago for \$150,000 when their children were small. Their son, Eric, and their daughter, Erica, enjoyed spending summers at the cottage as children. Although both children are happily married with children of their own, the entire family still gathers at the cottage regularly during summer months. As Shane and Jane approach retirement this year, they are starting to think about handing down the cottage to the next generation. The following are considerations they may need to explore and address through planning.

### Capital gains tax

Shane and Jane are contemplating leaving the cottage in their wills to Eric and Erica. However, since the value of vacation properties have appreciated steadily throughout Canada, this would typically lead to potential capital gains tax as a result of deemed disposition rules upon their death. The current value of their cottage is about \$750,000.

To calculate capital gains, subtract the adjusted cost base (ACB) of the property from its fair market value. In this regard, note that:

- ACB is the price paid plus the cost of all capital improvements made: for example, if the cottage owner spent \$50,000 to add a deck and made other upgrades to the cottage, the \$50,000 should be added to the ACB. Receipts should be saved to prove what was spent on improvements. Note, however, that only capital expenditure qualifies - regular maintenance costs do not. Also, only amounts actually paid to others qualify - the owners' personal labour costs ("sweat equity") cannot be included.
- If the cottage was acquired prior to 1972, the ACB is the value as of December 31, 1971, since capital gains tax was not imposed in Canada until 1972.
- If the cottage owner elected to realize accrued gains on the cottage in their 1994 income tax return, by using the \$100,000 lifetime capital gains exemption prior to its elimination in 1994, then the ACB could have been "stepped up". The ACB for the purpose of capital gains calculation will then be the ACB indicated on the 1994 tax return.

### Possible strategies to deal with the tax liability

#### Use the principal residence exemption to eliminate the tax liability on the cottage

While Shane and Jane have a primary residence in the city, they may wish to consider claiming the principal residence exemption to shelter the accrued capital gains of the cottage instead (assuming

both properties meet the rules associated with the principal residence exemption). A key element to this strategy is to determine which of the two properties has the largest average capital gain per year and to designate that property as the principal residence.

**Note:** prior to December 31, 1981, it was possible for each family member to designate a separate principal residence for capital gains purposes. Since 1982, however, the rules were changed to restrict the principal residence designation to one residence per family unit per year.

#### Use life insurance to pay the tax liability

Designating the cottage as principal residence may not completely eliminate the capital gains tax burden on death (all else being equal) - while the capital gains on the cottage may be eliminated as a result of the principal residence exemption, the primary city residence may now be exposed to capital gains tax liability. If Shane and Jane would like to ensure that, on their deaths, there will be sufficient funds in the estate to pay the capital gains tax along with other taxes arising on death, they may consider buying life insurance.

On death, there will still typically be a capital gains tax liability; however, the tax-free insurance proceeds received can be used to offset the tax bill. The main consideration with this approach is the payment of insurance premiums. Given their ages, the Moneys may encounter insurance premiums which are quite high, especially if they have any pre-existing health issues.



Then there is also the question of who should be paying the premiums. Since the life insurance would be put in place for the benefit of the children (assuming they are the estate beneficiaries), Shane and Jane may feel that the children should contribute to the payment of the premiums.

### **Deal with the capital gains tax liability now**

Another option for managing future tax exposure is to “freeze” the value of the cottage now and deal with the potential tax liability associated with the current accrued capital gains. The merit of this approach is that the tax liability becomes predictable. After all, if the cottage continues to grow in value, the potential capital gains tax associated with the property could be compounded. There is of course a downside with this strategy: the capital gains tax becomes immediately payable, so the Moneys will need to come up with the resources to pay the tax bill right away.

If the Moneys decide to take this route, there are a number of additional considerations that may need to be evaluated. For example, they could (i) gift the cottage to their children now, (ii) sell the cottage to them, or (iii) enter into a joint tenancy with right of survivorship (JTWROS) with Eric and Erica.

If Shane and Jane are to gift the cottage to their children now, they should be aware that:

- Although no consideration is received when the cottage is gifted, the cottage will be deemed to pass to the children at fair market value for tax purposes.
- In addition, they may be concerned about their right to the use and enjoyment of the cottage during their lifetime. One possible way to deal with this is for Shane and Jane to retain a life interest in the deed of gift.

What if Shane and Jane are to sell the cottage to the children instead?

- In this scenario, if the sale price is less than fair market value, Shane and Jane will still be deemed to have sold the cottage at fair market value for tax purposes while Eric and Erica will be considered to have acquired the property at the sale price. This may lead to double taxation in the future if Eric and Erica were to subsequently sell the property.
- One approach to managing the potential tax liability is to structure the sale in such a way that Shane and Jane take back a mortgage (typically an interest-free loan) from the children. By doing so, they may be able to spread the capital gains

out over a five-year period rather than report the entire gain in the year of the sale by utilizing what is known as a “capital gains reserve”. In addition, by having the value of the cottage tied up in the form of a mortgage, the asset may be protected from potential creditors of the children (including any former spouses). As part of broader estate planning, the Moneys may also direct that any unpaid balances under the mortgage be forgiven under their Wills (where applicable).

- Land transfer tax should also be factored into any decision involving the transfer of property by way of a sale.

With respect to the JTWROS solution:

- In addition to the possible immediate capital gain tax liability, Shane and Jane may still have a future capital gains tax liability upon death if the value of the cottage continues to increase. For example, upon the death of the first spouse, the deceased spouse will be subject to a disposition for 2/3 of his/her interest on the cottage, with the remaining 1/3 subject to a taxdeferred spousal rollover.
- Aside from the capital tax liability issue, once Eric and Erica are on the title, the cottage may be exposed to potential creditors/family law claims of the children.
- A transfer of property by parents to adult children for no consideration typically gives rise to a presumption of resulting trust. This is generally true whether the transfer is direct to the children or into a JTWROS arrangement. As a result, probate planning (where applicable) may need to be reviewed further.





### **Modes of shared ownership**

Addressing the potential tax liability resulting from a transfer in ownership of a family cottage often garners much of the attention when it comes to cottage succession planning. However, the question of how best to structure the future ownership of the property is arguably as important.

In an effort to maintain a harmonious relationship between Eric and Erica, Shane and Jane may wish to consider the various approaches to shared ownership and what option(s) best suit the overall family dynamic. For example, questions such as “How will use of the cottage be allocated between Eric and Erica?”, “How should the ongoing costs of the cottage be shared?”, “What happens if Eric wants to sell his share of the cottage but Erica doesn’t?” may need to be addressed.

### **Cottage co-ownership agreement**

A possible alternative to having the children own the cottage outright as joint tenants, may be the use of a co-ownership agreement. With this approach, matters related to the above questions, as well as other decision-making and dispute resolution procedures are documented in advance. Where Shane and Jane wish to retain a life interest in the cottage, they may consider speaking with their legal representative regarding the merits of a co-ownership agreement which can help define the roles, rules and responsibilities of each co-owner.

### **Cottage trust**

While a well drafted cottage co-ownership agreement may assist with minimizing potential friction between family members, another option the Moneys may wish to explore is the use of a trust which may provide additional benefits if they intend to “keep the cottage in the family” for subsequent generations to come. Shane and Jane could create an inter vivos trust during their lifetime or a testamentary trust in their Wills to pass the cottage to the children. Typically, when establishing a trust that holds real property such as a cottage, additional property like cash and/or investments are also added to the trust. The additional proceeds can then be set aside to be used exclusively for cottage purposes. This way all maintenance, taxes and repairs can be paid for out of the cottage trust, which may reduce the financial burden on the part of Eric and Erica.

Often, a key to a successful trust arrangement is that the trust be flexible and agreeable to those involved as this may help lower the chances of any future bickering among the heirs that could turn into future disputes or litigation.

One of the potential pitfalls of trusts is that they are typically subject to deemed disposition rules every 21 years. This may lead to potential tax issues each time the trust is deemed to have disposed and reacquired the property within the trust. Furthermore, there may be costs associated with creating and/or maintaining the trust on an ongoing basis. These costs should also be considered when exploring the merits of using a trust arrangement as part of cottage succession planning.

## Other considerations

### **Cottages located in the U.S. and potential cross-border tax issues**

For Canadian citizens who reside in Canada (i.e., those who are regarded as “non-resident aliens” for U.S. tax purposes), cottage succession planning for real property located in the United States presents additional challenges and planning considerations.

Owning real property in the United States can potentially expose Canadians to the U.S. estate tax regime. Without proper planning, this could lead to additional costs upon death. In some instances appropriate planning may need to be implemented prior to the actual purchase of the property.

### **Non-financial elements**

One non-financial consideration that is often overlooked during the succession planning process is the level of interest of a particular child or children. If one or more children are not interested in the use and enjoyment of the family cottage or if geography or other factors pose as challenges in the child’s involvement in the cottage, consideration may need to be given to whether equalization measures are taken to provide some balance as part of broader estate planning by parents or grandparents.


This may involve leaving the non-cottage owning child(ren) more of the other estate assets, or exploring the use of life insurance in an effort to balance the overall distribution of wealth.

Irrespective of the potential planning strategies noted earlier, Shane and Jane may wish to obtain the children’s input prior to undertaking any planning and talk to Eric and Erica to find out if they are prepared to share the cottage and agree with the arrangements that their parents have in mind. The next step may involve engaging the appropriate professional advisors to discuss and potentially execute the agreed upon strategy.

*This article is presented for information purposes only. Speak with your TD Advisor and qualified tax and legal advisor before proceeding on any course of action.*







## Financial lessons learned from COVID-19

**The pandemic may have hit your wallet hard. Here are some lessons we can learn from this unprecedented time.**

The reverberations of the COVID-19 global pandemic have been a wake-up call for many of us as we scratch our heads over our finances: Are our wallets in disarray or have we come through this pandemic well? Are we prepared for what comes next or should we re-evaluate our outlook? Ryan Lanaus, a financial planner with TD Wealth Financial Planning, says many of us may not focus on our finances until a crisis hits.

“I’ve talked to many people over the past month, some incredibly anxious, and once I’ve talked to them about how well-balanced their portfolio is, the nervousness goes away,” he says. “I’ve found that when you put events into perspective and give them faith in the decisions they’ve made, they are relieved.”

Lanaus says now can be a good time to look at your overall financial picture and even make some changes. Here are five lessons we’ve learned during the COVID-19 pandemic that could help you gain confidence during any financial crisis

### **Lesson No. 1: Spread your investments out**

The market drop in the wake of the COVID-19 pandemic has shown us the wisdom in diversifying our investments, Lanaus says. That means not putting all our eggs into one basket in case that basket gets upset. In recent months, some investments performed considerably worse than others. For example, travel-related companies such as airlines, for example, were struck harder than gold mining companies. Some types of investments

offer different characteristics such as income or dividends, and some types are by their nature less volatile than others, such as utilities (low) vs technology shares (high). By putting a percentage of your funds into different types of investments, as you can through balanced mutual funds, for example, you minimize the chance that one economic event will harm all your investments equally. But if all you own are growth-oriented mutual funds or high-tech funds, depending on your situation, you may wish to expand your investments into different classes.

### **Lesson No. 2: Invest for the long term**

It may not seem fair to see investments you’ve held for years lose a good chunk of their value in a couple weeks, but the short, sharp drop only emphasizes the long-term nature of successful investing. It takes time, patience — and these days — an abundance of resilience to build up a portfolio for a long-term goal. Investing is a focused business and there are few elements more important than the effect that compounding interest can have on small but regular savings over the years. To see how compound interest works and to learn how your investments could grow over time, check out this compound interest calculator. There will be setbacks, like the one we are now moving through. But we know looking at historical data, that even in the darkest days, the markets bounce back and go on to greater heights. Lanaus recalls the last recession when giant companies were falling: The world survived, and we have thrived. He points out that abandoning some investments during a downturn may temporarily ease a sense of panic, but believes many stocks will rebound. Those who sold at the bottom of the market would miss the

chance to enjoy the comebacks that follow. If you had sold then, you would have had to deal with losses and not enjoyed any of the comebacks we are now experiencing.

### **Lesson No. 3: Check your risk tolerance**

The markets may have also played a role in raising your personal anxiety, so we should also talk about how you, the investor, may be reacting. Your level of worry has to do with how much risk you can manage, both in your investing plan and as a human with your money on the line. Every investment carries some level of risk. While Guaranteed Income Certificates (GICs) carry less risk, they may not be enough to achieve the investment goal you want. On the other end of the scale, shares of junior resource companies can conceivably bring stunning returns, but are hazardous as many fail to become profitable. Most investors should have a balance of investments to mitigate risk and align to their tolerances. So, if you were comfortable with your investments during the recent market weakness, you may not need any changes to your investments. If you are still biting your finger nails, perhaps it's time to settle on what investments make you feel comfortable through good times and bad.

### **Lesson No. 4: Debt can drag you down**

Your personal pocketbook may have been hit hard in the past few months. For many impacted by the recent economic turmoil, living paycheque-to-paycheque may have made things worse. This is especially true if it forces you into racking up high-interest credit card debt to see yourself through. It may be shocking how easily unnecessary spending can eat into our finances. The lesson learned is to avoid getting yourself into that vulnerable position in the first place. Lanaus says that could mean it's time to re-evaluate your budget and financial plan. One simple way to see if you are in good shape is if you are able to pay off your credit cards monthly. If not, tracking how much money is coming in and going out can be one way to get back on track. You can connect a savings plan with some sound goals, such as a retirement plan, an education plan for your kids, and even an emergency plan. If you are meeting the needs of sensible goals, you may be in good shape. If you're not, your spending and saving habits may need work. In many cases, you can track your spending habits using a banking app, such as TD Myspend.

### **Lesson No. 5: Reflect on this unique time**

There's no doubt that this has been a sobering experience for Canadians and the whole world. But if you have escaped the brunt of COVID-19 and its

economic consequences, you might think about non-financial lessons that are to be had. Perhaps you are spending more time with family than ever before — maybe under uncomfortably close circumstances. Hopefully we've all learned how to be efficient and happy while living on top of each other, how to cope with your own and each other's stress and how to handle a world where toilet paper is a hot commodity and the hockey season just...stops and...starts up again in a bizarre new form. If you are cooking more and eating out less, you are probably saving more money (and becoming a better cook). You might want to consider making that a permanent lifestyle change along with taking a daily walk and calling your mom every few days. Everybody's experience of this time will be unique, and everyone will have a different story to tell. With any luck, this time has reminded us what's really vital to us.

Investing, saving, and planning activities, as well as taxation, life insurance and an estate plan, must be closely connected to one another and be directed towards your goals, such as retirement at a certain age with a certain amount of funds. We may all have dreams but if you really want to make them happen, Lanaus says, it's time to start working out what they will cost. If you do have a retirement plan in mind, you may want to run some numbers through this retirement calculator. Without a well-rounded plan, individual tactics may actually work against you. With all the lessons you've learned during this time, you may want to give your finances a new start, whether by yourself or with a financial professional to help ensure you're in good shape to make your financial plans become realities.

— Don Sutton, *MoneyTalk Life*



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