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TOOLBOX

A PLACE IN THE SUN

A tax-efficient retirement abroad means becoming a non-resident.

Bill and Mary Smith, 61 and 60 respectively, are planning to retire this winter. They have Canadian friends who retired to the Lake Chapala area of Mexico. Although the Smiths want to spend time with their adult children and grandchildren in Canada, they are also interested in enjoying Mexico's climate and culture.

Before making any decisions, however, the couple needed advice relating to topics such as taxation, asset management, real estate, insurance and healthcare, immigration and estate planning. Bill and Mary have laid out the following objectives:

- achieve tax-efficient incomes during their retirement;
- address health insurance coverage while living in Mexico;
- understand how to gain legal residence in Mexico; and
- create an appropriate estate plan.

The couple has an approximate net worth of \$1.2 million comprised of the following assets: \$400,000 personal residence, \$500,000 in RRSPs and \$300,000 in non-registered investments. Mary and Bill will also soon be receiving reduced CPP pensions along with additional pension income from their respective past employment. Mary's total pension income will be \$2,500 a month, and Bill will receive a total pension income of \$3,000 a month.

Addressing the tax-related matters, their advisors suggested they become non-residents of Canada and set up the appropriate residential ties for Mexican residency. The purpose of non-residency is to receive tax-efficient incomes. The biggest question was whether or not to sell their home in Canada or keep it and rent it out at arm's length. The Smiths decided to sell and use a portion of the proceeds to purchase



housing in Mexico, with the remaining money to be added to their investment portfolio.

The other major tie to Canada was family. Since their children were grown adults, they were not a factor in the residency tests. The Smiths reviewed in detail the remaining ties to Canada and decided to cancel such items as provincial health plans, memberships, deposit box and car registrations. They also learned they could dispose of some personal assets via selling or gifting to the children. They could keep items including certain bank accounts and investment portfolios, each of which was registered as non-resident accounts with their banks and financial advisors.

Upon their advisors' advice, the Smiths decided to create a "defence file" to document all matters relating to the severing of residential and social ties to Canada. The defence file would contain such things as sale documents for the house and

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car, garage sale advertisements, letters containing notification of their status change from Canadian residents to non-residents, as well as change of address to Mexico. The defence file would also contain documents to prove their new residency such as house purchase or lease agreement, utility bills, copies of immigration papers and local bank statements. (Note: The CRA will always look at what ties to Canada have been severed and what ties to the new country exist to prove residency status. While such information may never be needed, it may be difficult to accumulate after the fact.)

As non-residents, the taxation of the Smiths' Canadian-source income looked quite different than if they had remained residents. They decided to convert their RRSPs to RRIFs. Peri-

odic pension payments attract a 15% withholding tax versus taking the funds out as lump sums and incurring a 25% withholding tax. With the notification of non-residency, all company and government pension incomes have the reduced tax rate of 15%. In addition, the non-registered portfolio has significant tax benefits for the non-resident, as Canadian interest and dividend incomes incur a 15% withholding tax rate while capital gains become tax-free. Their tax liability to Canada has been significantly reduced.

The couple determined their existing life insurance policy was sufficient and in force long enough not to be affected by the residency change. The Smiths inquired about the impact of their move on their long-term care and critical illness policies. While critical illness insurance requires only a single

assessment to determine eligibility, long-term care requires ongoing assessment. However, this may be impractical to do from Mexico. The Smiths decided to review these policies directly with their agent.

The process of becoming non-residents also included the termination of the couple's provincial healthcare plan. As a result, a replacement was necessary. They established an independent healthcare policy since traditional travel insurance wouldn't provide coverage for the length of time the Smiths required. Although Mexico offers its own socialized healthcare plan, IMSS, it is not immediately available to new residents of Mexico as FM-3 immigration status is required. Additionally, since IMSS only provides services in Mexico, non-residents are well advised to supplement this with a private healthcare plan.

With respect to immigration, the Smiths applied for FM-3 immigration status. This is the easiest way to reside in Mexico, as the applications are processed rapidly and routinely. As well, residents can bring in household goods tax-free within three months of securing status. While the immigration status must be renewed annually, the Smiths do not have to give up their Canadian passport.

The Lake Chapala area has a substantial Canadian expatriate community, making the transition into a new lifestyle that much easier. Upon learning, however, that rental opportunities are not abundant there, the Smiths decided to buy a house.

In recent years, Mexico has provided two means for non-Mexicans to own real estate: by direct deed or by bank trust. Although a bank trust is only

available as an option on the coast or near a border, the Smiths' location of interest allowed for a choice. A bank trust has a closing cost and modest annual administration fee associated with it, but has the added benefit of the ability to designate beneficiaries to the trust. To establish legal residency, the Smiths purchased a home and selected a bank trust to designate their children as beneficiaries and simplify their estate plan.

The Smiths reviewed their Canadian will to ensure all assets (both Canadian and foreign) were addressed. With a bank trust, their home in Mexico would automatically become the property of the designated beneficiaries without the need for a Mexican will. The advisors recommended independent advice from a lawyer.

The Smiths initially plan to spend

five to seven years in Mexico. Returning to Canada will not be difficult as the Smiths now know how to set up normal residential ties in Canada by acquiring housing, enrolling in health-care plans, getting a driver's licence and contracting for utilities. They should also consider having their investment portfolio valued at the date of entry to trigger a new cost basis on those assets.

With proper planning and implementation of the above strategies, the Smiths can feel confident about achieving a rich and rewarding retirement. **AE**

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