



TAX MATTERS

## Five common tax questions you asked about cottages

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My daughter has been contemplating how to pass the time at the cottage this summer.

"Dad, I'd like to be a mosquito catcher," she said. "I'm getting eaten alive anyway." Turns out that mosquito catchers were for real in the past and they did get paid. These folks would catch mosquitoes on six-hour shifts, endure mosquito bites and hope to avoid malaria.

"Sarah, I don't think your top priority at the cottage should be mosquito catching," I said. The cottage is for swimming, wakeboarding, sleeping, eating, reflecting on life and finding answers to personal finance questions about cottages. [My previous column on cottages](#) sparked many questions from readers.

I'd like to answer a few today.

### **What are the tax implications when kids inherit a cottage property? How do they figure out their adjusted cost base and taxes owing?**

If you transfer your cottage to the kids (during your lifetime or on death), you could face tax since you'll be deemed to have sold the property at fair market value. Your principal residence exemption could be available to shelter any gain from tax. (See next question.) Your kids will inherit the property at the fair market value at the time of the transfer, so they'll only face tax on gains in value from that date onward. If you're a U.S. citizen or the property is located in the United States, there could be U.S. gift or estate taxes on a transfer.

### **I sold my city home five years ago and now rent. I'm thinking of selling my cottage now. Can I sell it tax-free?**

The principal residence exemption may be available to shelter a gain on a cottage from tax. For each calendar year, you can designate only one property as your principal residence. To completely avoid tax on the cottage, you'll have to designate it as your principal residence for every year you owned it (less one year – thanks to a formula in our tax law). But some of those calendar years may already be spoken for if you sheltered your city home from tax when you sold it. The result? It's likely that only part of the gain on your cottage can be sheltered from tax. (See my [article](#) from April 11, 2012, for more on this.)

### **When more than one person owns a cottage, what's the difference between owning the property as 'joint tenants' versus 'tenants in common'?**

When a property is held in joint tenancy, and one owner dies, the property then belongs to the surviving joint tenants. The last joint tenant to die ends up owning the property alone, and his or her will dictates who then gets the property. Probate fees are avoided on the death of a joint tenant (other than the last one standing). Tenants in common is different: Each owner in this case will own their proportionate share (with two people, each would own one half) of the property and each can leave their share to someone in their will.

### **I've decided to leave my cottage to my son when I'm gone, and some investments (worth a little less than the cottage) to my daughter. Are there any problems you see with this?**

First, I'll assume you're okay with your daughter inheriting a little less than your son. Fair doesn't always mean equal, in the eyes of some parents. Second, there could be a greater inequity than you realize. If you owe a tax bill at the time of your death, where will the dollars come from to pay the tax? If your son inherits the cottage as a specific bequest, then the taxes will be paid from the investments you plan to leave your daughter. She could be left even less than you think while your son inherits the full value of the cottage. You could solve this by leaving all of your assets equally to the kids but providing your son the right of first refusal to buy the cottage from your estate at fair market value.

**I have made improvements to my cottage over the years but don't have receipts to substantiate the amounts. What should I do?**

Make your best estimate of the cost of the improvements you've made. Add these amounts to your original cost to arrive at a current adjusted cost base for the property. If you ever sell or transfer your cottage be sure to use this new adjusted cost base figure. If the taxman comes asking for proof of the improvements (unlikely), you'll probably win the battle as long as the amounts are reasonable and it's obvious you've made those improvements.

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