MoneySense

4 ways to pass on the family cottage

Minimizing tax is only one factor to consider when passing on the family cottage

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You can't spend an afternoon paddling rivers or jumping off a dock without wondering where we, as Canadians, would be without cottage life. Yet, the joy of living a bit rough—with the bugs, the loons and everything in between—can, unfortunately, become a source of stress as aging parents start to ponder how to pass on the family cottage to the next generation.

Despite what you might think, “there is no one size fits all solution when it comes to estate planning and cottages,” explains says Tarsem Basraon of TD Wealth. “It really does depend on a person’s circumstances and goals.”

To help you make a more informed decision, here are four strategies for passing the cottage on to the kids:

No. 1: Pass it on before you die

One common solution, says Basraon, is to gift the cottage while you’re still alive. This typically only works if you no longer want to use or visit the cottage, says Basraon, and you only have one child that can take ownership of the property. By gifting the cottage now, you’re able to pay the current tax burden—the tax on capital gains that have accrued from when you first purchased the cottage to the fair market value of the property when you gave it to your child. “Keep in mind,” says Basraon, “once gifted, the cottage is no longer your asset and this means your child could sell it, or it could become an exposed asset if, say, your child were to go through a divorce.”

Still, if you do decide this is the best option, consider gifting the cottage over a period of five years. “By stretching the gift over five years, you could avoid a large one-year tax bill,” explains Basraon. But to make sure this is right for you, make sure the added yearly income from the incremental sale of the cottage doesn’t push you into a tax bracket that would prompt a clawback of government income support, such as Old Age Security. As a general rule of thumb, you can claim up to $72,000 in income before clawbacks kick in. “That’s why it’s important to seek out professional advice on these matters,” says Basraon.

In some cases, says Basraon, it may make sense to structure the five-year “sale” of the cottage using a formal promissory that would show the fair market value of the cottage. “The note would be worded in such a way that the parent could collect the proceeds from the “sale” over five years,” explains Basraon. Keep in mind, your kids don’t actually need to transfer money to you, says Basraon and you can always “forgive the promissory note in your will.”

Doing it this way, says Basraon, ensures that you qualify for the reserve as per the Canada Revenue Agency rules. Of course, Basraon is quick to point out that if you are considering this strategy, consult with a tax professional first.

No. 2: Gift it in the will

Another option is to leave the cottage to your children in your will. You have two options if you choose this route, says Basraon: You can name your heirs in your will, who become co-owners of the asset, or you can create a trust that owns the cottage and each heir gets a portion of the trust. “A trust is popular for those who want more control over what happens to the cottage.” By using a trust, you can allocate funds and these funds can be used to maintain the property. Better still, the trust will protect the cottage from any legal disputes that may arise, including bankruptcy, liens and divorce.

However, since the set-up and maintenance of trusts cost money—usually about 1% to 2% of the asset’s value, a fee that’s paid each year—most people opt to simply pass on the property through their will. “If this the route you take, consider requesting your kids to sign a co-ownership agreement that stipulates who is responsible for the bills and maintenance of the property,” says Basraon, “that way everyone is aware of the responsibility that comes with this reward.” This agreement can also stipulate how joint-owners can go about selling their portion of the asset. “It’s a great tool to address potential future conflict,” says Basraon, “just keep in mind that an agreement isn’t always easy to enforce.”

No. 3: Use insurance

Another way to address the capital gains tax burden when passing the cottage on to family members is to allocate funds from a life insurance payout. You can simply state that the funds from a life insurance policy should be used to pay the capital gains tax owed by your estate, or you can make the cottage trust the beneficiary of the insurance policy; upon your death, the insurance money would go to the trust and your heirs would then pay the outstanding taxes on the cottage with this money.

No. 4: Just sell it

The final option is to simply sell the cottage and then gift the proceeds to your kids. To do this, you can stipulate in your will that upon your death the cottage should be sold and, once all taxes and transaction costs are paid, the remaining money should be split among your kids. “Then, they can use their share to purchase their own cottages,” says Basraon.

The difficulty with this option is that the family cottage won’t survive for generations within your family, but it’s also the cleanest, easiest way to transfer the value of the asset to the next generation.