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## How to pass on the family cottage without destroying your family in the process

By Ted Rechtshaffen

*The family cottage is the home of so many memories, and it's hard to imagine selling it - but figuring out how to pass it on to your children might...*



Your beautiful family cottage has been in the family for 60 years. Your parents helped build it at a time when most people had never heard of your lake.

Today, you are fully retired, and your "cottage" could probably sell for \$1.5 million, but you are not interested in selling - you want to keep it in the family. That is the easy part. How to make it work is much harder.

"The family cottage is an asset that people love, but it can destroy the family," warns Barry Fish, founder of the firm of Fish & Associates.

Fish and his partner Les Kotzer should know. As co-authors of the book *The Wills Lawyers: Stories of Money, Inheritance, Greed, Family and Betrayal*, they are often faced with clients who want to find the best way to keep the cottage in the family. But, even when the clients' children want to keep the cottage things don't always go smoothly.

"Often, the spouses create a problem as they don't have the same emotional attachment to the family cottage," Kotzer says.

But let's get back to the cottage that you own with your spouse. You are now both in your early 70s, you have three grown children and six grandchildren.

Families can be complicated and it's best to look at yours clearly if you're considering this kind of bequest. For this scenario, let's say your challenges include:

- A big capital gains bill when the property passes to the next generation. If, for example, your cottage was worth \$150,000 on Jan. 1, 1972 (when capital gains taxes came into play), and you have put in \$150,000 of capital expenses since then, your \$1.5-million cottage would have a \$1.2-million capital gain. Most likely this will create a \$300,000+ tax bill when ownership is passed to your children.
- One of your three adult children lives 3,000 kilometres away and never uses the cottage.
- Another of your adult children loves the cottage - as long as he doesn't have to spend any money on it.
- The third child loves the cottage, and is more than willing to spend money on it. You are just not sure how long his marriage will survive.
- Your two daughters-in-law refuse to be in the same room at the same time.

Faced with those challenges, what is the likelihood that this cottage will still be in the family 10 years after you both are gone? Not every family situation is quite this difficult to stickhandle, but if you want to keep the cottage in the family, here are a few steps to consider.

### **Talk to your children about the cottage - do they even want it?**

The best way to find this out is to have the conversation. You can start by saying that it is your hope that the cottage can stay in the family for generations, but you need to understand whether each child wants the cottage - especially if they factor in taking on the financial and maintenance responsibilities as well. Often children love the cottage as long as the parents pay for everything and do most of the work. Sometimes the love dwindles when actual money and work are part of the mix.

It may be that after having these conversations, you realize that only one of your three children actually wants the cottage. If that is the case, then the planning issue may focus on how to leave the cottage to one child while being fair and equal to all three.

If it turns out that none of the three children want the cottage and its responsibilities, then the only logical solution is simply to determine the point at which the cottage is sold. This will avoid many complicated issues even if your hope was to pass the cottage along.

### **How to make things fair if leaving the cottage to one child**

Start by determining the likely size of your estate. If you have done a financial plan and have a reasonable estimate of your after-tax estate size, you can start to sort through the process of making things fair.

Let's assume that the total estate including the cottage will be \$3.6 million, and the cottage is estimated to be worth \$1.8 million at the time the estate will be divided. Now there is a bit of a problem. If the total estate size was \$5 million, this would be easier, but if the cottage is worth more than a third of the estate, there needs to be some equalization.

At first glance, if one child receives a cottage worth \$1.8 million and the other two split \$1.8 million, then somehow the 'cottage child' should have to pay out the other two \$300,000 each to make things equal. This may not be possible, depending on the wealth of the "cottage child."



Illustration by Chloe Cushman/National Post

If the parents are determined to keep the cottage in the family, one option is to take out joint last-to-die life insurance that will pay out \$300,000 to the two children who do not inherit the cottage. This will help to address the imbalance. There will likely still be some imbalance as the cost of the insurance isn't free. Hopefully this might mean that the cottage child only has to come up with \$300,000 or less to make it all work.

So let's say everyone's happy. All the kids feel they are dealt with fairly at this point, on paper. Now imagine the reality. It is much more complicated. Among the issues might be:

- Dad dies five years later at age 78, and Mom decides she would like the 'cottage child' to take over the cottage at that point. It looks like the 'cottage child' received their inheritance long before the other two. Because there would be a large capital gains bill that would have to be paid for on actual transfer of ownership, they decide to put this off until Mom dies. Now 'cottage child' gets the cottage and agrees to pay most costs - but Mom still covers some because she said she would. This isn't fair to the other kids who have received nothing at this point. Mom doesn't feel comfortable gifting any funds at this stage.
- When Mom dies 10 years later, it turns out that things aren't valued the way everyone thought they would be 15 years earlier, when Mom and Dad made the plan. The cottage is now worth \$2.1 million, and the rest of the estate is only worth \$1.5 million including the \$600,000 of insurance. Cottage child doesn't have the \$900,000 it would take to make it all fair, but promises to pay out \$300,000 each now, and the difference over 10 years. He had to mortgage the cottage just to get the \$600,000. The other siblings are not happy that they have to wait another 10 years to get what their sibling essentially received 10 years earlier.
- The spouse of cottage child isn't happy. They have essentially owned the cottage for years, but suddenly it is making them poorer. Not only do they have to pay all the taxes and upkeep and mortgage bills, but they are on the hook for them for another 10 years. Somehow this doesn't seem fair.

As you can imagine, even if the cottage child had plenty of money to cover things off, there is still a lot of room for discrepancies and imbalances along the way.

### **How to make things fair if two children want the cottage**

If the two more local children both want the cottage, then it may be easier to treat the two of them fairly, but it can remain very tricky to keep things fair with the third child.

As in the previous example, life insurance can be taken out on one or both parents with the beneficiary being the third child - to help smooth over some financial issues. Ongoing planning may be required and adjustments made every few years in order to try to keep the will and estate up to date and equal.

The biggest risk now becomes the ongoing management of the cottage, which is now owned equally by two families. Does one family use it more than the other? Does one family leave the cottage tidy and in order, and the other ... well, let's just say they are less tidy. Who gets to use it on the May long weekend? Which family does more work on the cottage? If there are costly repairs, does one family want to do them now and the other want to put it off? Who gets to choose the new furniture now that you both have agreed how much you dislike the old furniture? By the way, now that one of the children has remarried, do the stepchildren have the right to book Canada Day next year? They really want to show off their new family cottage to their friends.

Between the financial balancing act and the family balancing act, passing the cottage along can be very difficult to make work.

I know I sound like the anti-cottage guy again. I know that there are cases where the family cottage has been able to be passed down for a couple of generations and things have worked out mostly well. I understand that for many families, the cottage is the tie that binds the broader family together. If there is enough family harmony to begin with, and the financial and tax side can be sorted out, then there is a decent chance of making it work.

But in the rest of these situations, I would suggest selling the cottage, and splitting the money equally. It can be a much simpler way to keep family harmony. At that point, if it makes sense, one or more of your children can decide to buy themselves a cottage, either together or separately, and create new memories for their own families. They can even invite their siblings' families up to the cottage as much (or as little) as they would like.

*Illustration by Mike Faille/National Post*

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## **References**

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