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TAX MATTERS

Three ways to keep the cottage in the family and the taxman at bay

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There was a day a few years ago when my cottage was much simpler to look after. I used to drive to Muskoka on the first long weekend in the summer and, in a total of 12 minutes, have the place ready to go. It was called a tent, and it came with a skylight – a rip in the canvas. You heard me right – canvas. Those were the good old days. I've asked my kids who would like to inherit that old tent that I inherited from my grandfather. I get the same response today as I did a few years ago: Silence. Crickets chirping.

Since that time we've purchased a place a little more luxurious. It's an actual cottage with walls, a roof and a toilet. In addition to debating about the best type of bathroom tissue for our septic system, we're now having a debate around the succession of the place. We've decided to keep the cottage in the family and transfer it to the kids – one day. Carolyn and I could choose to make that transfer during our lifetimes, or after our deaths. Today, let me share the ways to transfer the cottage while you're still around.

1. Make a gift
If you choose to give the cottage to your kids during your lifetime, you'll be deemed to have sold the property at fair market value on the day you make the gift. If the place has appreciated in value, you'll trigger a capital gain at that time. Now, you may be able to shelter the transfer from tax using your principal residence exemption (PRE; most cottages will qualify as a principal residence) but you might prefer to save the exemption for your city home if it has the larger capital gain per year of ownership. If you do make a gift, you'll generally lose control of the cottage but could still retain the right to use it by way of an agreement with your heirs.

2. Sell it to the kids
Selling to the kids can work well if you need the cash for financial support and they have the means to pay you. As with a gift, you'll face tax on any capital gain but can generally shelter that gain from tax using your PRE. A word of caution: Don't try to sell them the cottage for less than fair market value. You see, you'll be deemed to have sold it for fair market value anyway. Further, your kids' adjusted cost base will be the low sales price they actually pay. That can give rise to double taxation (once in your hands and once in your kids' hands) on the value between your low sales price and the true fair market value. You'd be better off selling it to them for fair market value and take back a promissory note for part of the sales price if you don't want them to have to come up with cash for the full value. You can forgive the note on death with no adverse tax consequences.

3. Use a family trust
Holding the cottage in a trust can allow you to control and use the cottage even while it's not owned by you directly. The trust will also generally shelter the cottage from creditors and probate fees. When transferring your cottage to a trust, you'll be deemed to have sold it at fair market value, which could trigger tax. Again, you may be able to shelter any gain using the PRE. Be aware that, every 21 years, the trust will be deemed to have sold its assets at fair market value, which could create a tax hit at that time. There are ways to deal with this issue; speak to a tax pro about it. Finally, if the trust sells the cottage at a profit later, it can generally claim the PRE to shelter the gain, but this may preclude each beneficiary from designating his or her own home as their principal residence for those same

years, so it may be best to first distribute the cottage from the trust to a particular beneficiary before a sale so that the other beneficiaries are not affected by the sale. The bottom line? Visit a tax pro to talk about options if you're going to sell. More on this topic next time.

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