Can your kids **afford** to INHERIT the family cottage?

Always want the family cottage to stay in the family? Without some planning, leaving the cottage to your kids could mean leaving them with a giant capital gains tax bill.

Early in their marriage, Pat and Marlene caught the cottage fever after summers of cottaging in rented properties. When the couple had their two daughters, they envisioned having a summer home where they could entertain their massive extended family, and the kids could grow up playing around nature. Seventeen years ago, they decided to buy just north of the exclusive Muskoka area. "We bought the cottage for $97,000," Pat laughs. Now, he's laughing all the way to the bank; the two-acre lot, 400ft of waterfront and spacious Adirondack-style cottage has gone up exponentially, as they have all over the country. Cottage prices in hot markets like Whistler or Mont Tremblant can hit $1,500,000. "It was a great investment," Pat says. "Not just for the real estate value, but for the joy it's given my family."

Pat and Marlene's cottage conundrum is not a unique one. Many cottage owners plan to pass the cottage on to their children – all of whom could have a challenge managing their capital gains.

When you die, any secondary property you own (think cottage, ski chalet, any property you don't live in full time) and leave to your kids in a will is deemed to be sold to your kids at fair market value. If the property value has gone up, that means that capital gains taxes will be owed to the Canada Revenue Agency (CRA). "If there's a big tax bill attached to the cottage, that can really strain the rest of the estate," says **Ian Lebane**, a Will and Estate Planner, at TD Wealth. "A lot of people bought cottages in the 50s and 60s for low amounts, and they've really appreciated. If you're in one of the hot cottage areas, you could be looking at appreciation in the millions of dollars." So if you are a cottage owner, here are a few things you can talk to an advisor about in planning your cottage legacy so that your kids can afford it.

Co-own the Cottage with your Kids

To save and defer capital gains tax, you could add your children to the deed, making them co-owners of the property. If the property value has gone up, it would trigger a capital gain on the portion of the cottage that your children now own (at fair market value), and you would pay the tax on that now. When you die, your kids would pay tax on the capital gains from your portion of the cottage they just inherited. The Risks? When you co-own a cottage, it isn't "just yours" anymore. You may not be able to do what you want -- since you are no longer the sole owner. And the other co-owner, your child, may have issues that impact you. "There may be some pitfalls," says Lebane. "Sometimes, kids have creditors. So this is an asset that creditors can go after."

> **"A lot of people bought cottages in the 50s and 60s for low amounts, and *they've really appreciated.*"**
>
> IAN LEBANE, Will and Estate Planner, TD Wealth

Gift It Now

Another option is giving the cottage to your kids right now. That would trigger a capital gain and you would have to pay the capital gains tax up until the time you gave it to them. "You'll still pay some of the tax," says Lebane, "but if the property values are going up, you'll be arresting the growth for capital gains." One of the risks is that if cottage property values fall, you might be paying more now than you need to. And like before – if your kids own the cottage before you die – they, or someone involved with them (creditors, ex-spouses) may have different plans for the cottage than you do.

Spread it Out

By selling the cottage to your children and receiving a promissory note (or an I.O.U. in simpler terms) from them for the price of the cottage, you may be allowed to spread your payable capital gains tax over 5 years. If the note is worded in such a way that says you will collect on the mortgage over a 5-year span, then the CRA will allow you to spread out the tax payable over that time. Your children don't actually need to pay you for the cottage, and you can forgive the debt in the will, meaning that the cottage will be owned by your children with no further taxes owing.

Trust the Trusts

If you are concerned about what might happen if your kids own the cottage while you're alive, you may want to look at implementing a trust. A trust is a vehicle which allows a trustee to manage the property and use of it by the beneficiaries. There are trusts that you can use for the cottage while you are alive, or that will go into effect when you die. Whenever transferring the property to a trust, you would still pay capital gains tax as if you sold it at fair market value. But once in a trust, your children could still use the cottage as you see fit. And since a trust is meant to be a temporary arrangement, it will give your children and the trustee a few months or years to decide whether one child will buy out the others, or it will ultimately end up for sale, and all the while, the property will remain protected from creditors. If you think a trust is right for you, talk to a professional who specializes in trusts – as trust planning can be a complex matter.

A Slice of Life (Insurance) Can Help

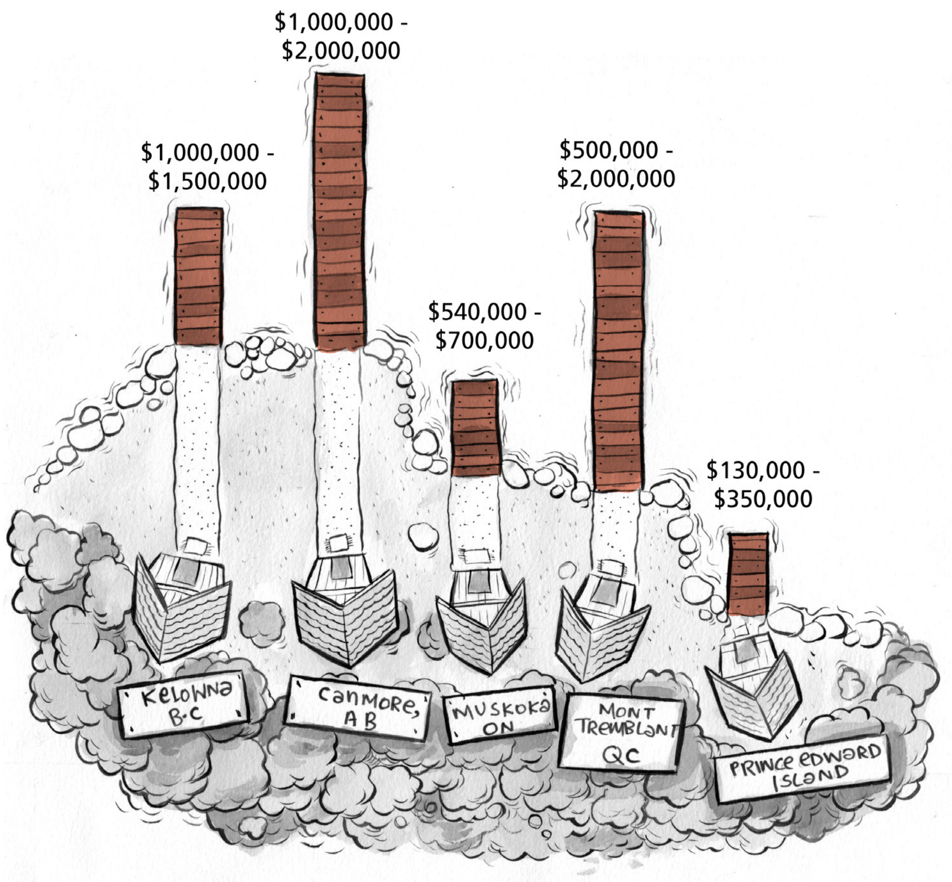
While buying life insurance won't eliminate the tax bill upon death, it can provide needed cash to pay those taxes where the plan is to keep the cottage in the family and not sell it after you're gone. "If you are a couple looking to pass the cottage down, you can purchase life insurance called 'joint last to die' on the second death," divulges Lebane. "It's economical, and your heirs will receive the benefit when the tax liability is due." You might also consider buying enough insurance to help fund all or part of the annual maintenance costs going forward.

Make it a Primary Residence

With the increase in the demand for cottage properties, in some cases your cottage might be worth more than your family home. If that's the case, you may wish to switch your primary residence to your cottage. Don't worry, you don't actually have to move to the cottage; as long as you reside in it for a part of the year, CRA will allow you to use it as your principal residence for tax purposes. The switch will trigger capital gains tax on your old primary residence, but it may save you some money in the long run.

Range of Cottage prices across Canada in 2015

SOURCE: Royal LePage "2015 Recreational Property Report Price Summary"



Do They Even Want It?

"After all this," Pat laughs, "the kids might sell the cottage anyway." And sure enough, that's a possibility for many families trying to pass down the cottage. Property taxes, maintenance fees, and the time commitment may deter those with an inherited property from keeping it. "We're going to do what we can," says Pat. "In the long run, it's not going to be our decision."

"We often overestimate the value that the kids put on having the cottage when we are gone," says Lebane, an experienced cottager himself. "A big reason kids are enamoured with the cottage is because their parents are paying for it. When the kids have to pay for it, often they don't want it."

But for those who are committed to keeping it in the family, a few of the strategies above can help make the family cottage a multi-generational experience. - *Written by Denise O'Connell, MoneyTalk Life*