

# Estate Planning for the Family Cottage

The "lazy hazy" days of summer are here and many of us will be leaving the city life to enjoy our favorite "home away from home" our family cottage. For many these properties represent the second largest financial investment we will make. There is, however, an important difference between this property and your primary residence! On the last death of you and your spouse there will likely be a significant tax liability.

## Tax considerations

Prior to 1982 it wasn't important to plan around the eventual sale of a second property because each spouse could own a separate property and designate it as his or her principal residence. Beginning in 1982 this was no longer possible as a couple could only designate one property between them as a principal residence. In addition to this, beginning in Feb. 1992, the \$100,000 capital gains exemption was modified to exclude capital gains on most real property and in Feb 1994 it was completely eliminated. All of this has had the effect of forcing us to develop ways to pass the cottage on in a tax efficient manner.

## Who should the property go to?

For some there is a greater concern than the future tax liability. The question of who to leave the property to is paramount. The best solution may not be to leave it equally to all children. The children may not have the same interest in its future use and a cash bequest, from other estate assets, may be more appropriate to those who would not want the property. You may want to have an open discussion with children or grandchildren to determine who has an interest in using the property and paying the costs of future maintenance.

## Can Life Insurance be used?

Life insurance can be a very cost-effective method of providing liquid cash to pay any capital gains. Insurance can be purchased on the single owner of the cottage or, as is most often the case, on the joint owners (mom and dad.) The policy would be a "joint last to die" and because two people are insured, the cost will be less than either could buy individually. The proceeds of the insurance are tax free to the beneficiaries. In some cases the beneficiaries of the cottage and the insurance may be able to pay the premiums. The only potential downfall to this solution is that the owner(s) of the cottage must be in good enough health to qualify for the insurance. Because this may not be the case, let's look at another solution.

## Transfer to a Trust

Consideration should be given to transferring a cottage to an 'inter-vivos' (living) trust if there is currently a small capital gain (the transfer of the cottage asset into the trust triggers capital gains). However, this would effectively transfer any future capital gains to the beneficiaries.



A 'discretionary' trust can be useful because, as mentioned earlier, it may not be clear as to which children may even have an interest in the property. The transfer can take place into this trust and the owners will have unlimited use of the property as well as complete control. This would allow time to decide who the beneficiaries will be. At some later date the property can be rolled out of the trust to the beneficiaries, at the value it was rolled into the trust originally. This will have the effect of deferring tax until the property is sold.

If the parents are over 65 an 'alter ego' or 'joint partner' trust could be used. With these types of newer trusts there is no deemed disposition of property when the cottage is transferred into the trust. (For a description of these trusts see Big Picture article AE & JP Trusts – New Estate Planning Opportunities.)

### A Word of Caution

There have been suggestions that the cottage can be transferred into joint names with the eventual beneficiaries. While this may have the effect of passing the property by "rights of survival" at death, it has major drawbacks. If this is done there will be a capital gain at the time of transfer, the property would be in "joint control" with all owners and it would be subject to claim if there were a marriage breakdown or by creditors of any of the owners. This is clearly not a good solution.

### Conclusion

The family cottage can be a source of great enjoyment and fond family memories. For many of us it is important to plan for the appropriate transfer and to provide for liquid cash to pay any taxes. By taking a small amount of time today to plan for this event, a great deal of expense and frustration can be avoided in the future.

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