



CESTNICK

TAX MATTERS

Stanley Cup pursuit reignites debate about taxes on player salaries

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I met a guy last week who owns vacant land two hours north of Toronto. He's already ordered a tiny home for the property that he plans to use as a cottage, and to rent out for extra income. The crazy thing? He bought the home on Amazon. Really. If you're looking for a tiny, prefabricated home and want it delivered by Father's Day – no problem.

The gentleman had all kinds of questions about cottages – and so do many Canadians. Today, I want to answer five common questions about cottage ownership.

I understand that I can sell my cottage free of tax. Is this true?

Maybe. In most cases you're able to use your principal residence exemption (PRE) to shelter any capital gain on the sale of your cottage. All that's required is that you "ordinarily inhabit" the place – even for a short time – at some point each year. And if you've earned any rental income from the property, no problem, but this must have been ancillary to the use of the cottage as a residence.

Clever planning can make a cottage transfer tax-smart

How to make cottage life more affordable and save tax dollars too

One more point: The property flipping rules in our tax law came into effect on Jan. 1, 2023, and will deem any profit on the sale to be business income if you've owned the cottage for less than 365 days. If these rules apply, you can't claim the PRE to shelter the profit from tax.

Can we deduct the cost of renovations we're making to our cottage this year?

In some situations, but it's not recommended. If you're renting out the cottage and looking for tax deductions, you may be able to claim capital cost allowance (CCA) for the improvements – which generally allows you to deduct the cost of those improvements over a few years. The problem, however, is that you'll jeopardize the PRE later on a sale of the cottage if you've claimed CCA on any part of the property.

If the cottage is primarily being used to earn income, then you won't be able to claim the PRE anyway. In this case, you might consider claiming some CCA on the property to reduce your taxes.

Even if you don't rent out the cottage, track the cost of your improvements because these can be added to your adjusted cost base of the cottage and could reduce taxes later on a sale or transfer.

What are the tax implications of using our cottage for both personal and rental purposes?

I'm seeing many people renting out their cottages for part of the summer this year. If you do, you'll have to report any rental income you earn but can claim a deduction for many costs, such as a portion of repairs and maintenance, property taxes, utilities, propane, insurance, mortgage interest, and more.

If you change the use of the cottage so that it's primarily (more than half the time) a rental property you'll be deemed to have sold the cottage at fair market value. You may be able to shelter any gain using the PRE on the change in use. You can also make a special election to allow you to continue designating the property as your principal residence for up to four years after the change in use. Visit a tax pro if you want to make this election since there are specific guidelines to follow.

I'd like to give my cottage to my kids. How will this affect my taxes?

If you transfer ownership of the cottage to your kids you'll be deemed to have sold it at fair market value. This could trigger a taxable capital gain. While you might be able to use your PRE to shelter the gain

from tax, it could make sense to save the exemption for another home you own.

Another idea is to sell the cottage to the kids for fair market value. Instead of cash, they could pay you by a promissory note. That note can be structured so that you have a right to payment over five years, which will allow you to pay tax on the capital gain over five years. If your intention is to give (not sell) the cottage to the kids, you can simply avoid collecting on the promissory note, then forgive the note on your death with no negative tax consequences for the kids.

How do we successfully leave our cottage to our kids to share after we're gone?

In most families it's possible for siblings to successfully share the cottage. The best idea is to sit down with them and put together a cottage agreement. The agreement will address things like setting a schedule for use of the cottage, general rules around having guests, performing maintenance work, and how to make decisions or solve disagreements about the cottage, among other things.

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