



CESTNICK

TAX MATTERS

A cottage succession story to learn from

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I was shopping for a pair of shorts last week and saw some labelled “one size fits all.” I was skeptical. Sure enough, I couldn’t squeeze myself into them. Then I looked at the label a little closer: “One size fits all. Except you.” That was awkward. I’m pretty sure that only a fourth-grader – and a skinny one at that – would fit those shorts.

When it comes to your cottage, there’s no one-size-fits-all succession plan. Today, I want to share an approach taken by one couple whose kids are getting by just fine as they share the cottage mom and dad left to them.

The story

Bill and Marjorie bought a cottage many years ago and their children, who are now in their 60s with families of their own, recently inherited the property after Marjorie died in 2021. Bill had died in 2014. The couple wanted to defer the tax on the cottage until the second spouse passed away and to ensure that decisions around the cottage could be made even if they became unable to make them.

Also, the couple weren’t sure which of the kids would be financially equipped to

own the cottage, or which children and grandchildren would use the cottage most because some of them were talking about taking jobs in other parts of the world. Conversations with the kids didn’t really provide any clear answers.

Bill and Marjorie solved their problem by transferring the cottage to a trust – what is known as a Joint Partner Trust (JPT) under our tax law – about 10 years ago. Then, when Marjorie died, the trust became what I’ll call an “Asset Inheritance Trust” (AIT), which has provided flexibility around continued ownership of the cottage. Let me explain.

Joint Partner Trust

Think of a JPT as a substitute for your will with respect to the assets in the trust. You’ll still need a will to deal with anything you own outside of the JPT. But, after you’re gone, the JPT agreement deals with any assets that the JPT holds. You can transfer any assets – including a cottage or cabin – to a JPT, although you or your spouse have to be 65 or older to set one up.

Bill and Marjorie transferred their cottage to a JPT. There was no tax to pay

on this transfer (even though the cottage was not designated as their principal residence). The couple continued to control the cottage as trustees of the JPT, and when Bill died, Marjorie continued as trustee. Marjorie did name their oldest child as a co-trustee after Bill died, to ensure that decisions around the cottage would continue if something were to happen to Marjorie. There was no tax to pay on the cottage at the time of Bill's death.

When Marjorie died, there was a deemed disposition of the assets held in the JPT – the cottage in this case. There was tax to pay on a capital gain. This is no different than if Bill and Marjorie had continued to own the cottage personally and had left it to the kids.

As an aside, the JPT also allowed probate fees on the cottage to be avoided and provided some privacy that a will cannot. A will is a public document once you're gone, but the JPT trust agreement remains private within the family. It's also worth mentioning that the JPT had the ability to protect the cottage (and any other assets it might have held) from any second spouse had Marjorie remarried (which she didn't).

Asset Inheritance Trust

When Marjorie died, all three of their children became trustees, which then ceased to be a JPT (since both partners were now gone). In addition, new beneficiaries were added to the trust: The three siblings, and all of their children and grandchildren. And so, the JPT became a different type of trust – the AIT.

At any point in the future, the trustees of the AIT can choose to transfer the cottage to any one or more of the beneficiaries, which would effectively end the useful life of the AIT and it could be wound-up. The trustees have up to 21 years to decide who will ultimately own the cottage. On the 21st anniversary of the AIT its assets will be deemed sold, and any capital gain from the time of Marjorie's death will become taxable if the ultimate owners of the cottage are not established.

By the way, there will be no tax to pay when distributing the cottage to specific beneficiaries provided this happens before the 21st anniversary of the AIT. There will be no tax to pay until the beneficiaries who receive ownership sell the cottage, transfer ownership to someone other than a spouse, or die. The tax could even skip generations if it's a grandchild or great-grandchild of Bill and Marjorie who receive ownership.

If you consider setting up these types of trusts, make sure you speak to a tax pro.

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