



CESTNICK

TAX MATTERS

Four myths about cottage ownership

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We were at the cottage recently and the weather was beautiful. It was sunny and 30 degrees one day. Carolyn was determined to make sure that the family wasn't going to get sunburned, so she bought sunscreen. It was SPF 80.

"Carolyn, this sunscreen is crazy. I squeeze the bottle and a sweatshirt basically comes out," I said. "Tim, I've heard that the sun at the cottage does more damage to your skin than sun in the city" she replied. "I think that's a myth," I countered. There are some other myths that come to mind when I think about the cottage. Let me share a few today.

Myth 1: Leaving the cottage to the kids to share is a straightforward exercise

I understand the desire to leave the cottage to the kids so that they can share it when you're gone. But don't make the mistake of thinking that simply naming your children as equal heirs in your will is all you need to do. It's not that straightforward.

To ensure that your kids can effectively share the cottage, it's important to work with them to create a Cottage Agreement.

This agreement will set out the ground rules for how the cottage will be shared. The agreement should address issues like use of the cottage (how will weeks be allocated?), rules around guests, sharing costs, paying the bills, physical labour, general rules of use, and succession guidelines.

Myth 2: Leaving the cottage to one child and assets of equal value to the others make sense

I knew a gentleman who owned a cottage worth \$1-million and other investments worth the same amount. Upon his death, the cottage was left to his son because he was the only one who used it. He left his daughter with the \$1-million in investments, figuring that he was treating them equally. But he wasn't.

You see, he owed \$188,000 of taxes on the cottage when he passed away because the property had appreciated in value, and he didn't have the principal residence exemption (PRE) available since he had used it on his city home earlier. How did the taxes get paid? The \$1-million portfolio had to be used to pay the taxes since he had no other liquid assets. The result? His daughter paid the

tax bill out of her inheritance while her brother inherited the full value of the cottage. So, she received less than her brother. This was never the intention.

A better plan? He could have left all the assets to the two children equally and given his son a right of first refusal to buy the cottage from the estate, or otherwise ensured that the two children shared the tax burden.

Myth 3: Placing the cottage in joint names with the kids will save taxes

Many people think that they can put the cottage into joint names with the kids and avoid taxes at the time of passing away. Not true. While joint ownership will allow you to avoid probate fees, you'll still be deemed to have sold your share of the cottage when leaving it to the kids upon your death. A tax-free transfer only takes place between spouses.

Further, you could face a tax bill when putting your kids on title as joint owners since you'll be changing the beneficial ownership of the cottage. You may be better off simply waiting until you die to give the kids ownership. Similarly, if you want to transfer full ownership of the cottage to the kids today, you could pay some tax if the cottage has appreciated in value. While the PRE may be available to shelter any gain from tax, you might want to preserve the PRE for your city home. Talk to a tax pro about what's best for you.

Myth 4: Renting the cottage to others is definitely a smart financial move

Renting out the cottage can be a good way to collect some income to help cover maintenance costs. Just be careful. Renting the property to earn a little income is fine if the primary purpose of the cottage remains as a personal-use property for your family. But if you change the primary use of the property to be income-producing, you may have a problem because of the "change in use" rules in our tax law.

Those rules will deem you to have sold, and to have reacquired, the cottage on the date you change the use to an income-producing property. This could result in a tax bill on any capital gain on the property. Again, you might be able to use your PRE to shelter this gain, but this could expose your city home to taxes later, so you'll need to get some tax advice on this.

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