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TAX MATTERS

3 things to consider when buying a family cottage

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If you were born between 1965 and 1980, then you're a member of Gen X. Like most Gen Xers I remember walking 10 blocks along a busy road, by myself, to get to kindergarten, drinking from the garden hose, eating fish sticks, riding in the back of my family's wood-panelled station wagon without a seatbelt, and reading the TV Guide to see what was on television.

According to the 2023 Re/Max Cottage Trends Report, Gen Xers are now driving activity in the cottage market. The "trillion-dollar transfer" – which describes the level of wealth that is transferring from baby boomers to their children, the Gen Xers – along with the search for more affordable housing markets, has put Gen X in the lead in recreational property purchases.

The report shares states that 11 per cent of Canadians own a cottage or cabin, just as many are aiming to purchase one, and that 36 per cent of Canadians are attracted to the quality of life that a cottage can afford compared to an urban lifestyle. To make a purchase more affordable, 18 per cent of those who plan to buy a recreational property expect to rent it out for additional income. Some are selling their city homes and moving to cottage country full-time rather than remaining in expensive urban markets. After all, COVID-19 has taught us that working remotely for many is very doable and has its benefits.

So, with cottage season upon us, I want to share some things to consider if you're looking to buy a property.

Ownership name

When buying a cottage there's always a debate about who should own the place. Should you put it in your name, or the name of your spouse, a child, or in a trust or corporation?

A cottage can qualify as a principal residence, which can allow you to sell the property fully or partly tax-free by using the principal residence exemption (PRE). Most people want to preserve the ability to use the PRE on the cottage by purchasing the place in their personal name. Business owners will often put the property in the name of a spouse to protect the cottage in the event of a lawsuit related to their business activities.

A property owned by either a trust or corporation won't qualify for the PRE, so many tax professionals will advise against these vehicles if using the PRE is important. Now, some folks don't care about the PRE (they're happy to use this exemption on the city home instead) and will use a trust or corporation because the funds to be used for the purchase are already in those entities. In this case, you could face a taxable benefit for the personal use of an asset owned by the trust or corporation, which could require paying rent to your own trust or corporation to avoid tax on the benefit.

As for buying a cottage in the name of a child? It's usually a bad idea. If your child ever faces a marriage breakdown or is sued, the cottage could be an asset up for grabs. You'll also jeopardize your child's ability to use the PRE on a home they might have already purchased, or plan to purchase, and you may have little or no control over the property if you don't own it.

Tips for sharing the family cottage

Renting the property

Renting out your cottage part-time will open the door to claiming deductions for a portion of your mortgage interest, property taxes, utilities, maintenance, and other costs. But your rental activities should be ancillary (less than half the time) to the personal use of the property as a residence, otherwise you could jeopardize use of the PRE to shelter any gain on a sale later.

In addition, be aware that if you ever convert a personal-use cottage to a property that is primarily used for rental, you'll be deemed to have sold the property on the date of the change in use, which could trigger a capital gain if the property has appreciated in value. You may be able to shelter the gain with the PRE, but this could jeopardize your ability to use the PRE on your city home.

Continuing costs

If you want to buy a cottage, don't forget to account for the money needed to cover annual costs. In addition to mortgage payments, you'll need cash to pay for property taxes, insurance, utilities, and repairs and maintenance. And if you buy the toys that often accompany a cottage, like a boat, personal watercraft, ATV, snow mobiles, and the like, don't forget the cost of gas, insurance, storage, and repairs for those things as well. Over all, it's common to experience continuing costs of between $10,000 and $20,000 each year – or more, for more expensive properties.

Next week, I'll talk about things to consider if the cottage is to be a legacy for the next generation.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca