



CESTNICK

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TAX MATTERS

## Four things to consider when transferring the cottage to the kids

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My friend John has a cottage – with an outhouse. Oh, there’s plumbing in the cottage, but the outhouse is a second option when nature calls and the bathroom is occupied.

We were walking by his property recently, and a thought crossed my mind: As my kids contemplate the idea of buying a house, an outhouse might be the only thing that’s in their price range.

Like John, we’re going to eventually give our cottage to the kids – so they’ll benefit from owning real estate one day. But there are things to consider when transferring a cottage to your heirs. Consider these four issues.

### Avoid a double tax hit

If you’re going to transfer the cottage during your lifetime, be aware that doing this improperly can cause a double tax problem. Suppose you own a cottage worth \$700,000 with an adjusted cost base (ACB) of \$300,000. There are different ways to transfer the property to the kids. Some would prefer to sell the cottage to them for an amount below fair market value.

In our example, suppose you sell to the kids for, say, \$300,000. You would be deemed to have sold the cottage for the fair market value of \$700,000. This would trigger a \$400,000 capital gain (\$700,000 less the ACB of \$300,000) and could result in tax on that gain. But the ACB for your kids will be the \$300,000 they paid for the property. If the kids sell the property in the future for, say, \$700,000, they’d pay tax on a \$400,000 capital gain. This is true even though you’ve already paid tax on that gain. This is a double-tax problem. (As an aside, you may be able to use your principal residence exemption to shelter all or part of the gain from tax.)

So, selling for less than fair market value is never a good idea. Instead, you could gift the cottage to the kids. This would still be treated as a deemed disposition at fair market value, and that \$400,000 gain could be taxable in the year of the gift. Or you could sell to the kids for full fair market value and take back a promissory note as payment. Any unpaid portion of that note could be forgiven in your will if you don’t plan to collect the full amount, or any amount, from the kids.

If you choose this last idea of selling by way of a promissory note, you'll still pay tax on the \$400,000 capital gain, but you can spread that tax over a period as long as five years using something called the "capital gains reserve" if you structure the promissory note and the collection of any sale proceeds properly (speak to a tax professional about this).

### **Control of the property**

If you transfer ownership of the cottage during your lifetime, you could be giving up control over the property. If your intention is to continue using the cottage yourself, you may want to think twice about simply giving up control, which can also mean giving up use on your terms.

It's possible to transfer ownership but keep what is known as a "life interest" in the cottage. This is an arrangement that would give you a right to use the cottage while you're alive – but it's fairly complex from a tax and legal perspective. You should talk to your lawyer about options if you want use and control of the cottage after transferring title.

### **Exposure to creditors**

Once you transfer ownership of the cottage to the kids, be aware that it becomes an asset of theirs that could be subject to the claims of creditors or could even be impacted by a marriage breakdown if a child goes through a divorce. Again, if your plan is to continue using or trying to control the property

after you transfer ownership, exposure to the claims of third parties is something you need to consider. In many cases, transferring ownership upon death may be the best option to ensure you can spend the rest of your days enjoying time at the cottage.

### **Type of joint ownership**

If the cottage does pass to your kids, you should think about whether they'll own the cottage as "joint tenants," or as "tenants in common." In the case of joint tenants, surviving joint owners will own the cottage when one of the joint owners dies. The deceased owner may still have some tax to pay if the property has appreciated in value, but the cottage itself will simply continue to be owned by the surviving joint owners. If the intention is for a deceased owner's share of the property to pass to their own heirs, this can only happen if the property is held as tenants in common. Speak to a lawyer about the differences here and set things up in a way that works best for your family.

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