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CESTNICK

TAX MATTERS

Tips to ensure your cottage can pass to the next generation

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Maybe you've heard about the wealthy man who was explaining how he became a billionaire. "I bought an apple for 50 cents, then polished it and sold it for $1. Then I took that dollar and bought two more dirty apples, polished them, then sold them for $2. At the end of my first week, I had made $356. But the story isn't over. The following month, my uncle died, and I inherited a billion dollars."

An inheritance can change a life forever. But an inheritance doesn't have to be money. Passing the family cottage to the next generation can be an incredibly meaningful inheritance. The 2023 Re/Max Cottage Trends Report revealed that 51 per cent of those who own or plan to buy a cottage said the chance to pass it down to family was a key motivator to buy.

The report also suggests that 74 per cent of cottage owners believe they'll be able to pass the cottage to the next generation with proper planning, although just 57 per cent of expected inheritors are confident that they'll be able to pay the continuing related costs.

Here are some tips to help ensure your cottage can successfully pass to the next generation.

Determine the interest of your kids

It may not make sense to leave the cottage to all your kids. Some may not want, or be able, to use the retreat. If one of your children has no interest in the cottage, or lives far away, sharing ownership of the cottage may not make sense for him or her. But don't make assumptions here. Have an actual conversation with your kids about the cottage and their interest in sharing ownership.

You might consider equalizing the estate so that if one child gets the cottage and another doesn't, you could leave other assets – or perhaps life-insurance proceeds – to the child not receiving the cottage so that each inherits approximately the same value.

Create a cottage agreement

If more than one child is going to own the cottage, make sure you prepare – during your lifetime and with the involvement of your kids – a cottage agreement. Business owners who have partners almost always create a shareholders' agreement to govern their relationship and issues related to co-ownership. A cottage should be no different.

A cottage agreement should address issues such as: how to allocate time at the cottage to each owner, rules regarding guests, rules about cleaning (what is the expectation about tidying up after staying, and what to do with bedding or food in the fridge), how costs will be shared, who will ensure bills are paid, how routine maintenance and repairs will be looked after, succession of the cottage (can an heir leave their interest in the cottage to a spouse, or must it be left to the next generation?), and how major decisions will be made (such as whether to renovate or sell the cottage).

Consider a cottage fund

Depending on the financial means of your kids, paying for the continuing costs to maintain the cottage could be a challenge. Last week I mentioned that it would not be uncommon for a cottage to cost between $10,000 and $20,000 annually for property taxes, insurance, utilities, repairs and maintenance, and paying for the continuing cost of toys, such as a boat, personal watercraft, ATV or snowmobiles.

You might consider setting aside enough funds in a trust to look after all or part of these costs. If, for example, you want to provide your heirs with $10,000 annually to help cover cottage costs, you could set aside about $300,000 in a trust, which could conservatively generate $10,000 to $15,000 before tax annually, leaving enough after taxes to meet your objective for support. A life insurance policy for $300,000 could meet this need.

Manage the tax on a transfer

When you eventually transfer ownership of the cottage to the next generation there could be tax to pay. You could use your principal-residence exemption to shelter any gain from tax, but this would limit your ability to fully shelter any other home from tax. Consider deferring any tax as long as possible by not transferring ownership until you, and your spouse if you have one, have passed away.

If you insist on transferring ownership during your lifetime, you could spread the tax over five years by selling to the kids for fair market value but take back a promissory note that is not due for five years. You'll be required to pay one-fifth of the tax each year over that period – regardless of whether you collect on the note. You can always forgive the promissory note in your will if you don't expect the kids to ever pay you cash. Speak to a tax pro to set this up properly.

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