



CESTNICK

TAX MATTERS

A family trust could be the right home for your family cottage

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One of the things I appreciate about our cottage is the skylight. Okay, it's actually a hole in the roof and it's not supposed to be there. But a guy is coming on Friday to fix it – and the tree that fell creating the problem has already been cut up for firewood. Last weekend I said to the kids “One day, all of this will be yours – minus the hole.”

Despite the odd repair and maintenance to keep the cottage running, it's a place where memories have been made, and our kids will one day inherit the place – in a trust. Today, let me talk about family trusts and when you might consider one for your cottage.

The trust

A trust is a legal relationship between three parties – the settlor (who creates the trust by transferring an asset to the trust), the trustee (who makes decisions around and manages the asset; there can be more than one trustee), and the beneficiaries (who are to benefit from the asset).

A formal trust is created by way of a trust agreement that spells out who the

parties to the trust are, the powers of the trustee, and more. A trust that you might use to own your cottage can be created during your lifetime – called an inter vivos trust – or upon your death by way of your will – called a testamentary trust.

[Tim Cestnick: Tax tips and traps you should know about if you own a cottage](#)

The benefits

Let me say first that setting up a trust is not for every cottage owner. But a trust does separate ownership of the cottage from use of the place. Since you won't own the cottage in your personal hands, any future growth in value will not be taxable to you and you'll avoid probate fees on death on the cottage value.

The trust also provides a governance vehicle so that family members (the beneficiaries) share use of the cottage while the trustee(s) – which could be you or your spouse, and eventually the kids – hold and control the property. (Speak to a tax pro about who the settlor and trustees should be, because it matters.) A trust could protect the

cottage from the claims of creditors who may make a claim against a beneficiary (speak to a lawyer about whether a trust will protect the cottage from a claim in a marriage breakdown; this can vary by province and is a special case).

So, an inter vivos trust can effectively allow you to gift the cottage to the kids before your death without giving the kids outright control. You could maintain use of the cottage during your lifetime.

The taxes

If you transfer an existing cottage to a trust, you'll be deemed to have sold the property at fair market value. You may be able to shelter any capital gain using the principal residence exemption (PRE), but this could affect your ability to claim the PRE on any other residence, so speak to a tax pro first.

If you set up a testamentary trust in your will, you'll still face a deemed disposition of the cottage at death. But again, the PRE could be available to shelter any gain from tax.

Once in a trust, any gain on the sale of the cottage will be taxable either in the trust, or in the hands of the beneficiaries – the trustee can generally make this decision depending on the trust agreement wording. Most family trusts won't be entitled to claim the PRE (there are some exceptions for special types of trusts such as spousal, alter ego, joint partner, orphan or disability trusts), but if the property is distributed – generally tax-free – to the beneficiaries before a sale they may be able to use their PREs if they have “ordinarily inhabited” the cottage.

Finally, every 21 years most trusts will be deemed to have sold their capital

property, so if the cottage has appreciated in value, a tax bill could arise unless planning is done. One option is to cause the cottage to “vest indefeasibly” in the beneficiaries. This doesn't require actually transferring title to the beneficiaries, but the trustee would have to make a resolution that the beneficiaries would have a fixed, unconditional right to the cottage with no other conditions required for them to take ownership.

The scenarios

When does it make sense to consider a trust to hold a cottage? If you value a trust as a succession tool that can simplify governance over the property during your lifetime, or after you're gone, a trust can make sense. If you want to defer taxes or want to protect the cottage from mismanagement or potential creditors, a trust can work. If you can envision giving your beneficiaries an unconditional right to the cottage 21 years from now then a trust can make sense – otherwise you'll likely be transferring the cottage back to your name in 21 years.

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