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Office relocation

Please note my new office address and fax number as listed above.



Who will get the family cottage—the taxman or someone you choose?

It will soon be time to get the cottage ready for summertime visits with family and friends—if the weather ever warms up. As you read this article, you are probably saying “I’m on holidays, give me a break! I don’t want to think about finances!” Well, if you are a cottage owner, this may be the best time to think about estate planning and what will happen to the cottage.

Do you want the cottage to stay in the family? Do your children/grandchildren want the cottage? Would some of them prefer a cash gift rather than to be part owner of the cottage? What about the financial responsibility of the property upkeep—all children/grandchildren

may not be in a financial position to increase their commitments. Would the upkeep/responsibility fall on the shoulders of the one who lives nearby, while others who live out of the area have limited use?

Another thing to think about is the taxman. With property values appreciating, you could have a substantial capital gain and income tax liability (50% of capital gain is considered taxable income.) In the event your estate didn’t have sufficient cash to pay the income tax owed, would the beneficiaries of the cottage be able to raise sufficient cash, or would the cottage have to be sold to pay the taxes owed? This is why estate planning is so important—so that your wishes take precedence.

This topic is too large to cover in detail in this article, so my purpose is to make you aware of the potential liability and the importance of estate planning—to ensure that your executors are able to carry out your wishes.

At death, the property can pass from one spouse to the other without triggering a capital gain; however, change in ownership to someone other than your spouse will trigger a capital gain.

Prior to 1982, each spouse could use the “principal residence exemption” for a property—

Who will get the family cottage...continued

for example, one could declare the residence and the other could declare the cottage. In this way, taxable capital gains could be avoided.

Since 1982, there can only be one property designated as a principal residence (for example—either residence or cottage) per family unit at any one time. It is not necessary to designate a property until the time of sale (when you are calculating your capital gain) and it can be designated for certain years during the period of ownership. Usually you would designate the property with the greater increase in value over a particular period as your principal residence.

On your 1994 income tax return, you could have filed an election to report a capital gain on property owned on February 22, 1994. If you did, you were able to take advantage of the \$100,000 lifetime capital gain exemption available at that time. Using fair market value (FMV)—you disposed of your property on February 22, 1994 and reacquired it on February 23, 1994. This election will have an impact on your adjusted cost base (ACB) when you calculate capital gains at the time of disposition.

There are many strategies (all have their pros and cons) that can be used to help keep your cottage in the family.

1. Buying life insurance. You could purchase sufficient life insurance (joint-last-to-die insurance if you have a spouse) to cover the tax liability. If you don't want to pay the premiums, perhaps your beneficiaries could pay the premiums—it could mean the difference between keeping the cottage in the family or being forced to sell it to pay the taxes. The accumulated cost of insurance could be less than the potential tax liability.

2. Transferring ownership now.

Selling it to beneficiaries. If you sell it now, you give up ownership/control of the property and a capital gain based on fair market value (FMV) will be triggered. The beneficiaries would be responsible for any capital gains on future growth. To avoid double taxation, it is best to sell it at FMV—as this is the amount that will be used when calculating your capital gain, while the purchase price will be used when calculating the new owner's gain. If you financed the purchase over a five-year period, you could spread your capital gain over the same period. You could use the proceeds to help pay the income taxes due or fund your retirement—basically you have converted an asset into cash. Or, if no principal payments were required, you could choose to forgive the debt in your will.

Gifting it to beneficiaries. Gifting is similar to selling, but you will not be receiving any funds to help with your tax bill, and you will have reduced your net worth.

Transferring it to a trust. There will be legal costs to set up the trust, and it may or may not trigger a capital gain—depending on your age. You retain control of the property, and transfer ownership to the beneficiaries at a later date—deferring the growth (while in the trust) until the beneficiaries dispose of the property.

Estate planning is an important process and professional advice is recommended to ensure that your executor is able to carry out your wishes. Also, you don't want the taxman to become your largest beneficiary at the expense of your loved ones. What better time to discuss the fate of your cottage than when you are enjoying its pleasures with family?

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