Cottage Succession Planning

If you own a family cottage or cabin, have you considered a plan for its succession? Although the serenity of the family cottage or cabin may provide a wonderful getaway for many, it is difficult to escape from the tax issues associated with the property's ownership.

Capital Gain on Disposition

You may be faced with a tax liability on the appreciation in value of a family cottage or cabin when it is disposed of, whether the property is sold, gifted during your lifetime, or considered a deemed disposition at death. While there are tax rules that will allow you to gift the property to your spouse at death or during your lifetime at cost, such transfers only result in a deferral, not the elimination, of any capital gains tax.

At the time of a sale, the capital gain subject to tax is calculated as the difference between the proceeds received on the sale and its adjusted cost base (ACB).

In the case of a gift or a deemed disposition on death, the capital gain subject to tax will be based on the fair market value of the property and its ACB.

Don't forget — any capital improvements to the property can be added to your ACB, thereby reducing your capital gain. Remember to retain any records in respect of those amounts spent on renovations!

Principal Residence Exemption

It may be possible to shelter the capital gain on the disposition of your family cottage or cabin from tax by using your Principal Residence Exemption (PRE).

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In order for the family property to qualify as a principal residence it must be "ordinarily inhabited in the year". The Canada Revenue Agency (CRA) has stated that a seasonal residence would be considered to be "ordinarily inhabited in the year" by a person who occupies it only during their vacation, provided the main reason for owning the property is not to produce income (although incidental rental income is acceptable).

Before applying the PRE to the sale of your cottage or cabin, you must recognize that each "family unit" (consisting of you, your spouse and unmarried minor children) can claim the PRE on only one principal residence per year. Therefore, if you own multiple residences with accrued gains, you will need to determine the most effective way to utilize the PRE based on your situation.

Future Generations? Form a Non-Profit Organization

If you intend to pass the property on to future generations of family who share its use and wish to avoid incurring capital gains taxes, you may consider establishing a non-profit corporation.

Here, the non-profit corporation would own the property for the long-term benefit of the family. Family members, as members of the corporation, would pay membership fees to use the property. However, there would be no tax to pay as the generations continued to use the cottage or cabin until the time the property was sold.

Under this scenario, there may be tax to pay on the transfer of the property to a non-profit organization. However, you may be able to shelter any gains with the PRE. As the cottage is no longer directly owned by you upon transfer to the corporation, there may be implications under family law depending on the province of residence. As well, professional fees may be required to maintain the corporation's records and other operating requirements may be necessary to keep a non-profit status, so obtaining expert advice is advised.

Ensure a Plan is in Place

The enjoyment of the cottage or cabin can be even more satisfying knowing that a succession strategy for the property is in place. As always, seek the assistance of a tax professional regarding your particular situation to determine the best path forward.

Contact your Canaccord Genuity Wealth Management Investment Advisor today.