

Cottage planning

It's one of those perfect days at the cottage—the summertime retreat has been in your family for years. You are sitting on the dock in your favourite deck chair with a cool refreshing drink and a bestseller to read. The sky is clear and the gentle breeze keeps the heat from the sun at bay. It doesn't get any better than this. You love the cottage and hope it will stay in your family for generations to come.

How to keep the cottage in the family

But will it? Has your cottage appreciated in value? Will your estate be able to cover the tax liability? The primary concern about transferring the cottage to the next generation is the capital gains tax due when the cottage is sold or inherited. You can defer the payment with a spousal rollover upon your death. However, at your spouse's death the Canada Revenue Agency will want to be paid.

Before Insurance Planning	
Current Value	\$450,000
Adjusted Cost Base*	\$50,000
Capital Gain	\$400,000
Taxable amount (50% of total capital gain)	\$200,000
Estate's total tax liability (\$200,000@50% tax rate)	\$100,000

* Initial purchase price. Table is for illustrative purposes only.

After Insurance Planning	
Current Value	\$450,000
Adjusted Cost Base*	\$50,000
Capital Gain	\$400,000
Taxable amount (50% of total capital gain)	\$200,000
Estate's total tax liability (\$200,000@50% tax rate)	\$100,000
Insurance death benefit proceeds	\$100,000

* Initial purchase price. Table is for illustrative purposes only.

All too often, families are discovering that the tax owing is so high that they end up having to sell the cottage in order to pay the tax. Happily, there are other ways to fund the capital gains tax liability.

Pay the tax now

You can choose to trigger the capital gain now by transferring the cottage to a family trust. Your family will have to pay the tax on any future gains in value (trust rules stipulate that property held in a trust is deemed to be disposed of every 21 years).

Set aside the funds to pay the tax later

Estimate the potential gain in value and establish a fund where you and/or your heirs deposit money to cover the future tax liability.

Use a life insurance policy

The tax-free death benefit proceeds can be used to pay off the capital gains taxes due. If you have a spouse you may be able to reduce the costs of insurance by purchasing a joint second-to-die policy. The insurance pays out on the second death which is when the money is needed. The use of life insurance may result in the preservation of assets which otherwise may have required liquidation.

The end result

Parents or grandparents will now have peace of mind in knowing that they have not left their heirs with a looming tax liability. The tax can be paid using the proceeds from the life insurance policy. The cottage will be passed on as they had intended. Keeping the cottage in the family requires some careful pre-planning. For more information, speak with your BMO financial professional who will refer you to an Estate & Insurance Advisor (Financial Security Advisor in Quebec) from BMO Estate Insurance Advisory Services.