

Your Plan for the Family Vacation Property

Designing your plan for future ownership of the family cottage, cabin or other recreational real estate can be challenging. Here are some things to consider.

Get Input From Your Family

Parents may agonize over a complex plan only to learn later that their children have no interest in ownership once the parents pass away. If your children are not sure, or their lives are still unsettled, your plan needs to be flexible.

Look at the Numbers

An accurate picture of your net worth is essential in order to achieve comprehensive and effective estate planning. Consider the value of the property relative to the value of your whole estate. The value of recreational properties commonly increases significantly. There may not be sufficient funds in the residue of the estate to compensate children who do not want the property. In the right circumstances, acquiring a life insurance policy to fund such equalization is appropriate.

Remember the Taxes

The principal residence exemption is available for recreational use properties upon declaration (or election) of that property as the principal residence. For years of ownership after 1981, a married couple can only claim the exemption for one property for any particular year of ownership. Usually the exemption is used on the family home. Taxes on the cottage or recreational real estate is typically payable by your estate, not the beneficiary.

While your vacation property may have increased in value significantly since it was purchased, it may also be the case that your city residence has increased significantly in value. If so, a decision would have to be made the time of either an actual

or a deemed disposition of one of the properties, whether or not to utilize the Principal Residence Exemption to the actual or deemed disposition. If you do not apply the Principal Residence Exemption to the property being disposed of, you may have the opportunity to reduce the capital gains tax payable by increasing the Adjusted Cost Base (ACB) of that property. Therefore, it is important to track and update the ACB of your vacation property by keeping documents reflecting the original cost of construction or acquisition, and supporting documents reflecting additional costs for betterment (versus maintenance), improvement and renovation of the property. These expenses can be deducted from the proceeds of sale, thus reducing the gain. Note that in addition, probate tax may apply to the fair market value of the vacation property upon death of the owner, unless the property is held in a trust, a corporation (this ownership structure is not recommended), or by way of joint tenancy with right of survivorship.

Provide for Liquidity if Necessary

If your estate has a shortfall because of the taxes or because the property is the major asset of your estate, consider ways to provide additional funds in your estate. Instead of a specific gift of the property, you can give your children the option to purchase it. The children can use all or a portion of their inheritance to fund the purchase. The proceeds will be available to the estate to pay the taxes and distribute to other beneficiaries. As mentioned earlier, insurance may also be a funding solution. The children could purchase the insurance on their parents' lives to provide the funds to pay the taxes owing by the estate or to fund the purchase price so that funds will be available for other beneficiaries.

Set Up a Testamentary Trust to Manage Multiple Users

If family members will be sharing the recreational property, or if multiple buildings or parcels of land need to be kept together, a Trust can provide for easier management and less risks than co-ownership. Trustees would be appointed, usually one to represent each family group. They would make the decisions about time allocations and repairs, and would pay insurance, taxes and utilities. The Trustees' decisions must be made in accordance with the terms and guidelines you set out in the Trust created. A maintenance fund should be created to provide for major expenditures. Property in the Trust will be deemed sold at fair market value every 21 years, so you may want to provide for a plan to wind up the Trust before the 21st anniversary of your death. Children can be given the option to enter into their own arrangements for co-ownership or be bought out. An option to sell the property and distribute the proceeds should also be included.

Consider a "Cooling Off" Trust

A long-term Trust may not be practical if children will not cooperate, or if you know in advance that they will not get along. A short-term Trust, one for 5 years or less can be used as an alternative to give children time to recover from their grief, and examine their own financial situations in light of their inheritance. During this period the children can sort out whether they are interested in continuing to use, or perhaps own, the property. Postponing the decision can be a good way to avoid conflict that may arise in the year after death when emotions may be running high, and children are not sure of what they want or whether they can afford it.

Decide When to Transfer the Property

If you want to transfer the property to children during your lifetime, the transfer will trigger any gain on the property and tax may be payable. This also applies to a transfer to a Trust, except for an alter ego or joint partner Trust, available only if you are 65 or older. One disadvantage of an inter-vivos Trust (a Trust created while you are alive), is that you may lose control over the property, which can lead to problems if your intention is to continue using the property during your lifetime. Another disadvantage is that a transfer to children could expose the property to the children's creditors or family law claims, and unexpected events may make you regret your decision. For example, what if your child dies before you or decides to sell the property?

Get Professional Advice

While every family situation is unique, estate planning professionals are experienced in helping you look at all the options, and selecting a solution that produces the right result for you. The expense of good advice is well worth it, particularly when succession of recreational real estate is involved. Your BMO Nesbitt Burns Investment Advisor can help introduce you to an estate planning professional advisor.

Note: Some terms are capitalized for purposes of greater clarity in the context of this discussion only.

The comments included in this publication are not intended to be a definitive analysis of tax applicability or trust and estate law. The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances. © "BMO (M-bar Roundel symbol)" and "Making Money Make Sense" are registered trade-marks of Bank of Montreal, used under licence. "Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Corporation Limited, used under licence. BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltée are indirect subsidiaries of Bank of Montreal and Member-Canadian Investor Protection Fund.

All insurance products and advice are offered through BMO Nesbitt Burns Financial Services Inc. by licensed life insurance agents, and, in Quebec, by financial security advisors.

Member-Canadian Investor Protection Fund



Making money make sense®