Keeping the Family Cottage Preserving Your Estate

By: Mike Magreehan, CFP May 2005 Submission

Ah, the family cottage – rich with enjoyment and overflowing with memories. Wouldn't it be a shame if your family was forced to sell the cottage? It sure would – considering you could have easily prevented it.

Canadian cottages have experienced a dramatic increase in value because of the real estate boom; being worth substantially more than their purchase price.

This is great news – as long as you remain alive. However, if you want the cottage to remain in your family after you and your spouse pass away, you will need to do some proper planning today.

You see, when you pass away, your assets can be transferred tax free to your spouse. However, upon the death of your spouse, and your assets are passed onto your children or other intended beneficiaries, this transfer can result in a severe tax bill.

The problem is that when the second spouse passes away, the increase in value of the cottage becomes taxable as a capital asset. And unlike your principal residence, the cottage is deemed part of the estate, and is therefore, subject to capital gains taxation. In other words, half of the increase in property value is taxable. Add in any RRIF assets or non-registered savings to your estate, and this bill can be detrimental to the amount of money that you pass along to your children and grandchildren.

There is good news. That is, only half of the capital gain is taxable. The bad news is that on too many occasions, a lack of proper planning forces a cottage to be sold in order to pay for the unforeseen tax bill. Coupled by this fact is that most people do not realize that they need to plan for this event.

In order to provide for this inevitable tax bill, and to keep your cottage in the family, you have a few options. For instance, you could start saving today, your heirs could apply for a bank loan, your estate could sell the cottage, or you could arrange life insurance to cover the growing tax liability.

Life insurance is usually the most cost-effective and most suitable tool. Not only does it provide a lump sum exactly when the money is needed, it helps ensure that your heirs receive exactly what you intended.

Consider this example – assume your cottage was purchased 30 years ago for $50,000. It would not be uncommon for your cottage to be worth in excess of $400,000 today. If the cottage formed part of your estate, $350,000 would be the capital gain, and the substantial tax bill could cost your estate as much as $80,000.

The question is, where will your estate come up with the needed money? On too many occasions, your children are forced into selling the cottage to come up with the necessary money.

The government will always get their fair share of tax, so you need an action plan to ensure that your intended beneficiaries receive their inheritance according to your wishes, and not the government's. This includes the continued enjoyment of the cottage.

Life insurance can be very flexible and it can be tailored to suit your lifestyle. A Certified Financial Planner can assist you in analyzing your unique situation, and recommending a customized solution that meets your needs.

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