

# WealthHealth

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## Your Cottage – More Good Times Means Planning Now

When it comes to your estate planning, money can be easily divided in many ways. But you can't divide dad's vintage sports car or mom's diamond ring. Or the family cottage. Powerful emotions and good family times are associated with your home-away-from-home. If you want to ensure cottage memories live on for future family members, you'll need to invite some very practical planning and logic around finances, taxation and money through the front door.

### TALK ABOUT IT, AND KEEP TALKING

If your goal is to ultimately pass your cottage on to your adult children, you all need to speak openly and frankly about your wants, your finances and family dynamics. A family meeting

may be needed. What if one child doesn't enjoy it or want it, or can't afford the ongoing costs? What if siblings don't want to share it or take responsibility equally, or can't get along? What are the plans for the next generation? Get it all out into the fresh air. If things are unclear, the situation could become unpleasant or even toxic.

### PLAN FOR SHARED OWNERSHIP

If everyone decides the best plan is to have more than one family member share your cottage, you should take the time and energy to create a plan and cottage agreement that sets out all details for the use and maintenance of the property for all parties.

Some key points to think about:

- Who wants to own the cottage?
- Who wants to use it and when? What's the system to determine who, when and how?
- Will the cottage be sold or gifted? If it's to be sold, who has the financial ability to pay?
- What are all the maintenance costs and can family members afford to pay?
- Who's going to do the work – handle finances, arrange or do regular outside and inside maintenance, clean, monitor security?
- How are decisions about renovations, new appliances or furniture, or recreation toys going to be made, and who pays?
- Are there divorce or blended family considerations to navigate?

Different family members, and their spouses, are sure to have different answers to these questions depending on their family life stage, financial stage, beliefs and values. Clarity around how these questions will be dealt with and regular review of the plan are important.

## PAYING THE TAX BILL

Selling your cottage or transferring ownership can generate a sizeable income tax bill, whether you do it while you're alive or at your death. When you transfer ownership of a vacation property to anyone other than your spouse, you must report it on your tax return and it will be deemed to be disposed of at fair market value despite what price was paid. The transfer will trigger a taxable capital gain if there has been an increase in value since you bought the property and potentially a large tax bill.

There are some strategies you can use to offset or reduce capital gains taxes:

- Use life insurance. The tax-free proceeds of a life insurance policy make cash available for distribution to beneficiaries and can be used to offset the tax bill.
- Consider declaring the cottage your principal residence, which isn't subject to capital gains taxation. You can have only one principal residence for tax purposes, so consider designating the cottage if it has appreciated in value more than your house and your immediate family uses it often.

- Use your 1994 capital gains exemption. The federal government eliminated the \$100,000 lifetime capital gains exemption in 1994. At that time, taxpayers could take advantage of a special provision to "crystallize" remaining unused lifetime room.
- Consider transferring ownership while you're alive. You can transfer ownership of the cottage to a trust that names your children as beneficiaries. This will trigger an immediate capital gain, but from that point on, gains will be taxable to your heirs. They won't pay those taxes until they sell the property or transfer ownership.

## OPTIONS FOR OWNERSHIP

If you intend to leave your cottage to your children equally, consider putting the property in their names as tenants in common. With this strategy, each owner has a divided interest in the property and can transfer their share to whomever they want, either during their lifetime or when they die.

You could have your cottage property held by a family trust, either in your will or while you're alive. To note, rules were amended in a recent federal budget to eliminate the use of the principal residence exemption on properties owned by a family trust after Dec. 31, 2017.

Sometimes owners will transfer their cottage to one child, with the understanding this child will hold the cottage for the benefit of all the children. This sounds simple, but could cause problems later if all the siblings can't agree or individual situations (financial or personal) change. This is called a "bare trust"

arrangement because there's no trust agreement that sets out how the property will be managed, and it's probably something to avoid.

## DON'T – DO NOTHING

Your main goal for the long weekend at the cottage may be to do nothing, but that's not a wise goal for your estate planning. You could leave your adult children to figure it out after you're gone, but this is a risky strategy if you really want the cottage to remain in your family – and maintain family harmony. If you haven't figured out the financial implications for your heirs, your beloved cottage may have to be sold.

Tax rules, ownership structures and trusts can be complex. There are many options and strategies you can use to prepare for transition of your cottage to heirs and reduce taxes.

You should always seek professional advice from your financial advisor, tax professional and estate planning advisor or lawyer and be clear about your wants and intentions. Together you can determine what's best for your family and your own unique situation.

## IN FUTURE ISSUES



### Financial Impacts of Divorce

If you're among the tens of thousands of Canadians who will divorce this year, you need to understand and prepare for the financial implications for you and your family. In a future issue, we'll cover some of the key things to think about to help you prepare.



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