CIBC PRIVATE WEALTH

# LOOKING TO TRANSFER YOUR VACATION PROPERTY TO FUTURE GENERATIONS?

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If you're thinking about passing along your family vacation home to future generations, then there are some tax and estate planning decisions to consider. If Canada's housing market remains as hot as it's been recently, the capital gains tax to transfer your vacation property could be substantial.

"Lurking under the surface of your idyllic retreat," warns Jamie Golombek, Managing Director, Tax and Estate Planning, CIBC Private Wealth, "may be a host of tax and estate planning issues." Neglecting these issues could cost you (or your heirs) a lot of cash, or even force the sale of the property. Let's take a look at some tax strategies that can help you either permanently avoid the capital gains tax or defer paying it for as long as possible.[1]

## Income tax considerations

Selling or gifting the vacation property in your lifetime, or owning the property when you die, will trigger a disposition for tax purposes. If the fair market value of the property has increased in value to more than what you paid for the property plus the cost of improvements, then there could be a hefty capital gains tax. If this happens, your heirs could be facing an immediate capital gains bill that could potentially compel them to sell.

Let's say that you acquired your cottage in Ontario years ago for $2.4 million and did $600,000 in renovations. The current appraised fair market value of your property is $5 million. If you wanted to gift this property to your children, during your lifetime or upon your death, at Ontario tax rates in 2022 the amount payable could be up to around $535,000[2]. So what options do you have?

### Principal residence exemption

The principal residence exemption (PRE) shelters a property from capital gains tax. While up until 1982 it was possible for both spouses to designate a property as their principal residence, the PRE can now only be applied to one property per family per year. The usefulness of claiming the PRE for a vacation property depends on a number of factors. If you own more than one property, you'll need to consider the current appreciation, potential future increases or decreases to the value, and the anticipated holding period of the unsold property.

### Life insurance

If it's feasible given your age and health, you can take out a life insurance policy in the amount of the expected capital gains tax. This is a great way to help ensure your heirs have the resources they need to pay for the property. Depending on the cost of the premiums, maintaining the insurance policy can be shared with the future inheritors of the property who will be the ultimate beneficiaries of the transfer.

### Family trust

One alternate way to own a vacation property is through a trust. For example, you might transfer your vacation property to a "trustee" who would administer the trust and its property for the benefit of your kids (the "beneficiaries.") When you use a trust for a property you currently own, transferring the property to a trust may trigger immediate capital gains tax. Alternatively, if you're purchasing a new property, or own one that has little or no accrued gain (or even an accrued loss), you may wish to complete the purchase or transfer through the trust. Buying or transferring the property into a trust, at this point, means that any potential future capital gains tax may be deferred until the trust's beneficiaries sell the property. This scenario obviously assumes that the property is ultimately rolled out to the trust's beneficiaries. Be sure to get tax advice here as your planning could be hampered by the 21-year rule, which causes a deemed disposition of the trust property every 21 years.

## Non-tax considerations

Do the kids even want your vacation property? If they do, how will you ensure it doesn't cause conflict? Can your kids afford the added expenses, or will they need help?

If you intend to leave your vacation property to your children, it's important to discuss your plans together first. What if they live too far away to use the property, or perhaps don't have the same attachment to it as you? Having an open dialogue with your beneficiaries can help you plan more effectively.

### Cottage sharing agreement

Assuming the kids do want it, a cottage sharing agreement is a great way to ensure that your good intentions don't cause conflicts in the future. Who will decide how many days per year your heirs are entitled to use the property? Who will be responsible for covering repairs or cutting the grass? With a little planning you can work together to build an agreement that helps to ensure that joint ownership of the vacation property remains cooperative.

### Sinking fund

Something you may want to consider to help ensure that your heirs can maintain the property is a sinking fund. Putting money aside in an investment account that's only drawn on for property expenses helps your heirs manage the added expense. Working a sinking fund into your financial plan now gives it more time to appreciate so it's ready when it's needed.

*Please note:* this article provides general information. If you'd like to learn more or have any other related questions, it's important to speak to your tax, legal, and insurance professionals.

[1] What's up dock? Tax & estate planning for your vacation property – Jamie Golombek 2021
[2] This assumes taxation at the highest marginal tax rate in Ontario