



Owning Second Homes

How cottages and other vacation properties affect an estate plan

Many of your senior clients likely own a vacation home and are pondering how to transfer the property to the next generation. You can help guide them through the process.

Timing is the first consideration. Clients that are well into retirement may want to consider a full or partial transfer in the near future. For others nearing retirement, these issues may not be as significant at this time. Other clients may see the second home as an integral part of their retirement lifestyle and prefer to leave the transfer decision until death.

Once the client's timing has been established, the next question is which children want to assume ownership responsibilities? And what is *their* preferred timing to take on this responsibility? Finally, does everyone understand what's involved in owning a second home? Do they have a good picture of the annual operating costs? And do they appreciate the time and energy that is required to maintain the place on a regular basis? Assuming this does not discourage the family members, then it's time to have a discussion of transfer options.

TRANSFERRING OPTIONS

Where there is interest in transferring ownership sooner rather than later, the sale of the vacation home to one or more of the children might be recommended. To assist with financing, the parents could hold a mortgage on the property, and the outstanding mortgage could be forgiven in the parents' wills. Otherwise, this debt could fall into the estate to be set-off against the child's entitlement under the will.

A sale triggers a disposition of the property and capital gains taxes might be payable, assuming it is not designated as a principal residence. If a mortgage is provided to the purchaser, taxes on the capital gain can be spread out for up to five years.

Joint ownership might be contemplated

where there is a desire to start the transfer process, with it becoming fully effective on death. Joint ownership is relatively simple way to transfer ownership to the children. On the death of the parent(s), the property will transfer directly to the child or children — avoiding probate delays and applicable fees/taxes.

On the downside, the transfer may trigger capital gains on the portion being transferred, assuming the property is not designated as your clients' principal residence. Your clients will need to determine how best to equalize the value of the gifted home with those children who won't receive an ownership interest.

The vacation home may also be transferred to an *inter vivos* trust for the ultimate benefit of one or more children. Unlike a transfer of full or partial ownership to the children, this allows your client to retain control over the property as trustee. Upon death, the residence can remain in the trust or be distributed to one of more of the children.

A trust arrangement can also protect the property from creditors of the beneficiaries and potential matrimonial property claims. Again, your clients would need to consider making equalization payments under their wills to those children who ultimately won't benefit from the second home. The client may also need to make ongoing contributions to the trust to fund related expenses.

The transfer of the second home to an *inter vivos* trust (other than to certain types of trusts known as life interest trusts) will take place at fair market value, and any capital gains must be reported. If the vacation property is designated as the principal residence, any gains can be sheltered from tax. Property held in the trust will also be deemed to be disposed of every 21 years. This deemed disposition can be avoided by transferring the cottage on a rollover basis to one or more beneficiaries under the

trust prior to the 21st anniversary.

Finally, if the decision is to defer any transfer until the death of the parents, then the transfer will take place via the client's (or his or her spouse's) will. A gift can be made directly to one or more children as co-owners or joint tenants, with any children who don't benefit from this gift receiving equalizing gifts under the will.

The gift may also be put into a testamentary trust created under the will. The terms of the trust should include provisions governing usage of the property, allocation of expenses, and what happens if a beneficiary no longer wants to use the residence. The trust could also be provided with sufficient cash to fund expenses while the rest of the estate gets sorted out.

Upon the client's death (or the death of the surviving spouse) there will be a deemed disposition of the vacation property at fair market value. If the property was being used as the principal residence, this gain may be sheltered from tax. The child or children who inherit the residence will have a cost base equal to its fair market value.

Should the property be held in a testamentary trust, there will be a deemed disposition of the property at fair market value every 21 years. Again, this disposition can be avoided by transferring the property to those children who want to continue to own the property before the end of the first 21-year period.

With proper guidance, your clients should be able to map out a strategy that keeps the vacation home in the family, and closes the door on family dissent. **E**

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