



Estate Planning for the Vacation Property

Few assets generate the kind of emotion associated with the family vacation property. Whether it is a cottage, farm, ski chalet, or a condominium in a warm locale, estate planning for this asset can be a significant challenge, and the lack of proper planning can result in costly tax consequences, as well as hurt feelings among family members.

In Canada, a portion of the increase in value of certain assets from the date of acquisition to the date of disposition is subject to capital gains tax. The principal residence is one exception. Since Canadians are entitled to only one principal residence, however, the capital gains tax will usually apply to the vacation property. When the property is left to a spouse, the capital gains tax is deferred until the death of the second spouse. When the vacation property has been in the family for many years, this tax, which is triggered by death or by the sale of the property to a third party, can be significant.

If there is not enough liquidity in the estate after death to pay the capital gains tax, the property may have to be sold. This is usually contrary to the vacation property owner's desire to have the property remain in the family to be enjoyed by future generations. One way of addressing this issue is to purchase life insurance, assuming the vacation property owner is in good health and insurance can be obtained at a reasonable cost. The estate will receive the proceeds of the life insurance tax-free and can use those funds to cover any capital gains tax liability.

A second option is to transfer the property to the next generation during the lifetime of the owner, either outright or as joint tenants, or to transfer the property into a family trust. Although this will trigger a capital gain in the name of the owner at the time of the transfer, any future gains will accrue in the names of the next generation property owners. This may make sense if the next generation is the primary

users of the property in any event.

Where the property is transferred to more than one owner, whether before death or after, a co-ownership agreement is highly recommended. The agreement should address such issues as the payment of ongoing repairs and maintenance, the payment of large capital expenditures such as a new roof or new windows, and what to do if an owner fails to fulfill his or her obligations in this regard. The agreement should speak to what happens if one of the owners dies or becomes incapacitated, the division of responsibilities among owners for tasks such as paying bills and performing routine property maintenance, and could also include a schedule for use of the property (or a method for determining the schedule) in each year.

Aside from possible tax consequences, there can be other complicating factors in dealing with vacation properties. What if only one child uses the property but does not have the financial ability to maintain it himself, and/or buy out his siblings? Since there may be family members who are not interested or cannot afford to co-own the vacation property, a discussion as to the best method of dealing with this asset on death would be wise. If the property is dealt with in the Will rather than transferred prior to death, granting each child, in a pre-determined order, a first right of refusal to purchase the property, as well as establishing a method for valuing the property, should be considered.

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