Wealth Management

Keeping the family cottage in the family with insurance

Whether you call it a cottage, chalet, camp or cabin, it's your family's special place to relax and enjoy the great outdoors. For many families, it's a place filled with happy memories that's been in the family for generations, and will be for generations to come.

When you pass along your cottage, you are also passing along a potentially large tax bill.

But keeping the cottage in the family from one generation to the next isn't always as easy as it might seem. There are many issues to consider, including how the taxes will be paid.

Consider ways to reduce taxes

When you pass along your cottage, you are also passing along a potentially large tax bill, which your beneficiaries may or may not be able to afford. Depending on their financial situation, your beneficiaries may be forced to sell the family cottage simply to cover the taxes. There are two main types of tax to consider – capital gains taxes and probate taxes.

Capital gains taxes

If your cottage has been in the family for many years, its value has probably increased dramatically. The property your family bought for a few thousand dollars might be worth a few hundred thousand dollars today. Even property bought within your lifetime might have experienced this type of exponential growth.

This increase in value can result in a very large, taxable capital gain, which is triggered when you pass along the property to anyone other than your spouse, including your children. However, there are several ways you can address this tax bill, and even reduce or defer it.

Calculating capital gains tax

When you pass along your cottage to anyone other than your spouse, the government views it as having been sold at current market value – a "deemed disposition." The capital gain on this deemed disposition is taxable.

The following example shows how there can be a $95,625 tax bill in 2016 on a cottage purchased for only $75,000 in 1986.

Deemed disposition in 2016:	$500,000
Purchase price in 1986:	$ 75,000
Total capital gain:	$ 425,000
Capital gains taxable (50% of total):	$ 212,500
Taxes payable at 45% marginal rate:	$ 95,625

Most real estate values have substantially increased in recent years. When children inherit the family cottage the estate must pay the capital gains tax based on the appreciated value. There may not be sufficient liquid assets to pay the tax and provide a fair inheritance for children who will not inherit the cottage. For some this could mean selling their prized asset. There are options to satisfy the tax bill and avoid asset liquidation.

Gift the property ahead of time

Simply giving your cottage to your intended beneficiaries ahead of time is one way to defer future capital gains taxes. If you expect your cottage to significantly increase in value, consider giving it to your beneficiaries sooner rather than later since the tax is payable in the year the gift is made. This results in a much smaller capital gain than the one that would be triggered in the future, assuming the property increases in value. After the gift is made, any future gains will be taxed in the names of those beneficiaries receiving the gift, when they sell it or give it away at a much later date, and won't be included in your final tax return when your estate is settled.

Cover the tax bill with an insurance policy

The most common way for property to be passed on to the next generation is through a bequest made in your Will. When your property is bequeathed to anyone other than your spouse, it triggers a taxable capital gain, which your beneficiaries may not be able to afford. However, you can cover this tax bill through a life insurance policy, which provides a benefit that can be used to offset the expected tax bill when your estate is settled.

Family cottage case study – insurance solution

Sam and Susan (both age 60 and insurable) have two adult children, Jim and Jane. Jane lives nearby and will inherit their cottage. Jim lives in another province. Sam and Susan have arranged in their Wills that their assets are to be divided equally between Jim and Jane, with Jane's share to include the cottage. Today the cottage has a fair market value of $500,000 and was purchased in 1986 for $75,000.

Should the cottage appreciate in value at 3% per year, the capital gains tax at Susan's age 90 is $256,192. As a result, Jane's share of the estate is reduced by the taxes payable on the cottage – thereby reducing her inheritance. This amount must be paid before Jim and Jane receive their inheritance. Sam and Susan wish to conserve their assets for their children and minimize the estate impact of the capital gains tax.

After considering three options (gift today, setting money aside in their investment portfolio, or purchase life insurance with guaranteed level premiums for ten years), Sam and Susan decided to purchase a joint life insurance policy where the insurance benefit will be paid upon the death of the survivor of Sam and Susan. In their situation this represented the least cost to them. It also allowed them to maintain control of the cottage and preserved more of their estate for their children.

To learn more, contact us today.

		Gift today	Non-registered investment		Joint life insurance	
Age	Capital gains tax (on estate)	Amount of capital gains tax paid	Annual deposits to be paid for 10 years	Estate value	Annual deposits to be paid for 10 years	Estate value
60	$95,625	$95,625	$8,666	$8,993	$8,465	$255,000
65	$113,543		$8,666	$48,574	$8,465	$255,000
70	$134,616		$8,666	$107,613	$8,465	$255,000
75	$158,396			$131,519		$255,000
80	$186,313			$162,418		$255,000
85	$218,675			$202,809		$255,000
90	$256,192			$256,192		$255,000

Source: Age 60, non-smoker – Canada Life, Joint-Last-To-Die, Limited 10, Universal Life insurance, February 10, 2016. Non-registered investment portfolio: 6% rate of return, balanced portfolio and 45% tax rate. These values are for illustration purposes only and are not guaranteed.

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