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Maintain family harmony while reducing taxes

Strategy 6 – Vacation home planning

Whether you own a lodge by the lake, or dream of escaping Canadian winters in a home down south, there are certain matters to consider before purchasing, or transferring, a vacation home.

Vacation home purchase strategies

Before committing a large amount of money to purchasing a second property, consider renting in a few desirable areas to test locations. Once you have selected an appropriate property, the next major decision is how you will finance the purchase. If you require a mortgage, speak to a professional advisor. But remember, for Canadian tax purposes, if the property is for personal use then interest is not deductible.

Succession planning

To some Canadians, it's paramount that they keep their vacation property in the family, transferring the home, and its memories, to their children. That's why it's important to structure the transfer correctly to avoid significant probate taxes or possible family disagreements. Consider the following approaches:

- If your children will inherit the property and you expect it to significantly appreciate, consider gifting it to your children today directly or through an inter vivos family trust. This still results in a disposition at market value, triggering capital gains, but it should help defer future capital gains and avoid probate taxes. If you sell the property to your children, you may be able to spread the capital gain over five years if you don't receive the full proceeds in the year of sale.
- Speak to your tax advisor about the pros and cons of transferring property to a Canadian corporation or nonprofit corporation.
- If the property value is high and you are over the age of 65, consider rolling it into an alter-ego or joint partner trust today to avoid probate taxes at death (especially in provinces with high probate taxes).
- Leave the vacation home to one or more family members in your Will. You could grant one or more children the option to purchase the property, allowing them to have the property as part of their share of the estate. You could instead create a trust to hold the vacation home.

- Life insurance can be used to pay capital gains taxes triggered by the disposition of the property when your estate is settled. Insurance also creates a pool of funds to pay children who are not interested in inheriting the property. (Alternatively, children who are interested can take out a mortgage to buy out siblings who aren't.) It can also provide the children with money to pay for the property's maintenance and expenses. Since your children will benefit from this insurance, consider asking them to pay the premiums.
- If more than one child will own the property, have them enter into a usage agreement to determine when and how they can use it and how expenses will be paid.

There are two key strategies to minimize capital gains tax on the disposition or deemed disposition of your vacation home during your lifetime or at death:

- Ensure any vacation home renovation costs are tracked, as the cost of the property for tax purposes and may reduce any future capital gain.
- Use your principal residence exemption to reduce or eliminate the capital gains tax on the property. However, only one principal residence can be designated per family unit for years after 1981. So if the principal residence exemption is used to minimize capital gains tax on the vacation property, then it cannot also be used on the city home for years after 1981.

U.S. real estate planning

If you are a Canadian who owns U.S. real estate, you may be subject to U.S. estate tax depending on the value of your property located in the U.S. and your worldwide estate. U.S. states may also impose a probate tax at death based on the value of real estate located in that state. To avoid state probate tax, some cross-border experts recommend owning the U.S. real estate through a revocable living trust.

The U.S. Estate Tax rates for 2017 reach a maximum of 40%. The estate tax exemption is $5.49 million for 2017. These rates and exemptions may be subject to retroactive changes as U.S. lawmakers address the issues surrounding U.S. Estate Tax.

If you are subject to U.S. Estate Tax, then you may consider some legitimate strategies to eliminate or reduce it, such as:

- Purchasing U.S. real estate through a trust or partnership may help to avoid U.S. estate tax. There are pros and cons with these two strategies, and you should consult with qualified cross-border legal and tax professionals to determine if these strategies are right for you.
- Having a "non-recourse" mortgage against your U.S. real estate. This special type of mortgage reduces the value of U.S. real estate subject to U.S. Estate Tax, dollar for dollar.

U.S. estate tax thresholds

For deaths in 2017, Canadians should keep these two thresholds in mind:	
US $60,000	If your U.S. assets (typically U.S. real estate and stock) are US $60,000 or less on death, then no U.S. Estate Tax is payable, regardless of the value of your worldwide assets.
US $5.49 wmillion	If your worldwide estate is US $5.49 million or less on death, no U.S. Estate Tax is payable, regardless of the value of U.S. assets. If your worldwide estate is greater than US $5.49 million on death, there could be U.S. Estate Tax on the value of the U.S. assets.