

Canadian Financial Planner

Winter 2006

In this edition of the Canadian Financial Planner, we shall review financial planning issues related to second residences, such as a cottage or ski chalet. We shall not examine the tax issues related to rental income generated from these properties. For an analysis of issues related to rental income from recreational properties, please refer to the November issue of the Canadian Tax Planners Newsletter.

Although less than 10% of families own a second property, the value of these properties has escalated in many parts of Canada, as the demand significantly exceeds the supply. The most desirable properties are mostly taken, unless the purchaser is prepared to drive incredible distances to parts of the province that have not yet been developed. As baby boomers reach retirement age, many have a desire to acquire a cottage, but many current owners do not view their property as an investment, rather as a family asset to be passed on to their children. The escalation in property values is not only a deterrent for new purchasers, but has resulted in two significant issues for current owners:

- 1) municipal taxes are normally based on property values and many cottage owners have seen significant increases; and
- 2) if the owners decide to transfer property at some time in the future to their children, there may be a large unrealized capital gain if the property is transferred to anyone other than a spouse.

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We shall review the following financial planning issues related to recreational properties:

- tax considerations on the eventual disposition of the property
- options to transfer title within the family group
- options for funding the transfer
- resolving family issues related to property transfers

Tax Considerations on Disposing of a Cottage

Calculating Capital Gains – Capital gains as they relate to cottages can be summarized by the following four rules:

- a capital gain or loss is calculated by subtracting the cost of the asset (technically the adjusted cost base) from the proceeds of disposition, normally the sale price. If there is a gain, 50% of that amount is included in income
- there are transactions other than a sale that may result in a deemed disposition of an asset for income tax purposes, such as gifts, death, insurance proceeds for assets that were damaged or stolen and becoming a non-resident
- if an asset is transferred to a spouse, the adjusted cost base does not change. The couple has the option of filing an election with their tax return to have the transfer occur at fair market value, if such an election is to the family's advantage
- there is a deemed disposition at death and the deceased is deemed to receive fair market value for the assets. An exception to this rule is assets transferred to the surviving spouse, who is allowed to take over the deceased spouse's adjusted cost base

Note – The remainder of this article is only available to subscribers of the Canadian Tax Planners Newsletter. If you elect to subscribe and wish to receive a copy of this newsletter, advise us accordingly and the complete article will be forwarded by return mail.

