Manulife

Tax, Retirement & Estate Planning Services

Wealth Transfer Strategy 1

Keeping the family cottage in the family

Those planning to pass on the cottage to their children may not realize the potential tax bomb that awaits. Many cottages have increased significantly in value over their purchase price and 50 per cent of this increase could be taxable at death. If not planned for, your estate may be forced to sell the cottage to pay the tax instead of transferring it to the children.

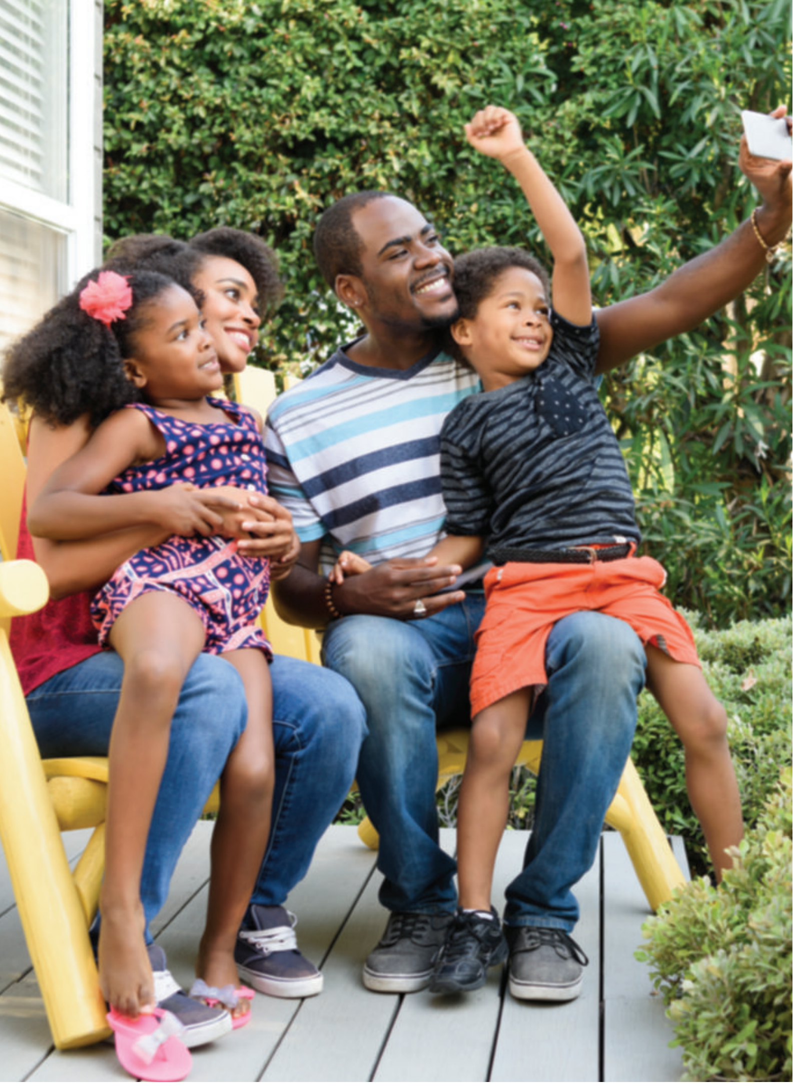
An in-depth look at the issues

For many individuals it is important that the cottage stays in the family so that their children (and grandchildren) can continue to enjoy it.

When you die, assets can be transferred to your spouse tax-free, but a transfer to your children may trigger a capital gains tax that must be paid before the children (or other heirs) can enjoy the property. Canadian households can only protect one property from tax on capital gains which usually means that the transfer of the cottage to the children may not be exempt from tax.

Over the years many cottages and other vacation properties have increased significantly in value and are now worth substantially more than their purchase price. At death, 50 per cent of this increase in value is subject to taxation. This could trigger a significant capital gains tax liability for your estate.

If your estate does not have sufficient assets, it may be forced to sell the cottage to pay the tax, which means the cottage would not stay in the family. Many people are simply unaware of this tax time bomb.



Consider selling the cottage to the kids now

By selling the cottage to your children today instead of transferring it at death, you can cap the tax liability and pass the responsibility for any future capital gains to your children. In addition, because the cottage is transferred outside of your estate, it can avoid the time and costs associated with the settling of an estate as well as avoiding potential claims against your estate from creditors or other interested parties.

While selling the cottage today may trigger a taxable capital gain, you can spread the payment out over five years if you take a mortgage back from your kids. If you are feeling generous, you can make the mortgage interest-free and forgive any remaining balance in your will so that your children will own the cottage with no debt payable.

Don't try and reduce your capital gain by selling the cottage for a nominal price. The Canada Revenue Agency will calculate your capital gain based on the fair market value (FMV) and when your kids sell the cottage, their cost base will equal the nominal price, resulting in double taxation.

Selling your cottage today can also provide you with a much-needed source of income. Not only do the costs of maintaining the cottage disappear but you can also use the mortgage payments to fund your retirement, pay for that dream vacation, or retire earlier.

Example

Sara, a 65-year-old widow, owns the family cottage and wants to make sure that it passes to her children. She is concerned about the impact of the potential tax liability at death.

Original Cost	FMV Today	Capital Gain Today	Tax Payable Today	Future Value in 20 Years (on Death)	Capital Gain in 20 Years (on Death)	Tax Payable in 20 Years (on Death)
$100,000	$500,000	$400,000	$90,000	$1,603,568	$1,503,568	$338,303

For illustration purposes only. This table assumes that 50 per cent of capital gain is taxable at a personal rate of 45 per cent, and that the value of the cottage increases at a rate of six per cent per year.

If Sara were to sell the cottage today she would trigger tax payable of $90,000, which could be reduced to $18,000 per year if spread out over five years. The mortgage payments could be used to pay the tax for the first five years and then to fund her retirement.

Conversely, if Sara transferred the cottage 20 years from now at death, it would result in a tax liability of $338,303.

If her estate has insufficient assets to pay the tax it may be forced to sell the cottage instead of transferring it to her children as she had intended.

So, paying some tax now could save Sara's estate a lot of taxes at her death – a fact that may decide whether the cottage stays in the family.

Ideal Candidates

Individuals with a home and a cottage:

- Who want to pass the cottage on to the next generation
- Who would like to cap their tax liability on the cottage
- Who could use some extra retirement income

Take Action

If this strategy is right for you, you should:

- Set the sale price at least equal to the FMV of your cottage
- Take back a mortgage from your children with payments structured over at least five years
- Consider forgiving the mortgage in your will so that your kids will receive the cottage free of any debt

Investment options available through Manulife Investments

Manulife Segregated Fund Contracts combine the growth potential offered by a broad range of investment funds, with the unique wealth protection features of an insurance contract. Through Manulife segregated fund contracts, investors can help minimize their exposure to risk through income, death and maturity guarantees, potential creditor protection features, and estate planning benefits – all from a single product or insurance contract.

The Manulife Investments Guaranteed Interest Contract (GIC) offers competitive rates plus investment options that include Basic, Escalating Rate and Laddered GIC Accounts. Investors benefit from a guarantee on their principal investment and from several different investment options that can diversify and add flexibility to their portfolio. Manulife Investments GICs can be an ideal solution for conservative investors looking to help grow their wealth, but who are also concerned about minimizing risk.

Manulife

For more information, please speak with your advisor or visit **manulife.ca/investments**

MK1805E 02/19