Snapshots™

FAMILY COTTAGE ISSUES:
SELLING TO A THIRD PARTY

SELLING YOUR COTTAGE TO A THIRD PARTY IS THE MOST STRAIGHTFORWARD OPTION FOR DEALING WITH THE FAMILY COTTAGE. SINCE IT IS A REAL ESTATE TRANSACTION LIKE ANY OTHER, IT SHOULD NOT INVOLVE THE PERSONAL OR EMOTIONAL ISSUES THAT CAN ARISE AMONG FAMILY MEMBERS.

If you do not have any children to pass the cottage down to, if your family members cannot come to an agreement as to how to share the cottage, or if you would simply rather cash in the value of the property, then selling may be your preferred scenario. There are several tax issues that may come into play:

Capital Gains/Losses

When a cottage is sold, there will be a capital gain or loss, and half of that gain or loss must be considered for tax purposes. Two pieces of information are required to calculate a capital gain: the Fair Market Value (FMV) and the Adjusted Cost Base (ACB), with the difference between them being the capital gain or loss. Any costs relating to the purchase will increase the ACB, and any costs relating to the FMV will reduce the capital gain (or increase the capital loss).

Example

> Jody bought a cottage in 1991 for $200,000, which included real estate fees of $6,000. In 2011, she sold the cottage for $300,000 and had to pay real estate fees of $10,000. Her capital gain would be:
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> $300,000- $200,000 - $10,000 = $90,000 (Note: The $6,000 in real estate purchase fees are not part of the calculation because they are included in the purchase price of the cottage).
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> Half of this gain is taxable, so Jody would report a taxable gain of $45,000 when she does her 2011 tax return.

Valuation Day (V-Day)

Before 1972, there were no capital gains taxes, so if you are selling a cottage that was bought in 1971 or earlier, special tax rules come into play. The tax cost or ACB of the property is determined in one of two ways: the Valuation Day Method or the Median (or Tax-Free Zone) Method. If the property has increased in value over the years, the Valuation Day Method typically has the most advantages; I can provide you with additional details and information. The Median Method is used mostly by corporations and takes the median of the original cost, Valuation Day value, and the disposition (sale) value.

The Principal Residence Exemption (PRE)

This is one of the more favourable tax advantages available to the average Canadian and can help reduce or eliminate the capital gains you would have to pay when you sell a 'Principal Residence'. The PRE is typically used when you sell your home, but it can also be used on the sale of a cottage, and can offer advantages in certain situations. The PRE rules state that only one residence can be designated as a 'Principal Residence' by a family unit in a given tax year. That means that you can use the tax advantage for either a home or cottage, but not both—although the benefit can be shared between more than one property as long as both are not designated for the same tax year. You should study the relative unrealized capital gains on both properties (the capital gains you would have to pay if you sold both of the properties) to determine which property it makes the most sense to designate for your PRE. You may receive further tax advantages if you and your spouse owned both a cottage and a house before 1981. I can provide you with more information about the PRE.

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