



Snapshots[™]

FAMILY COTTAGE ISSUES: USING A TRUST

A TRUST CAN BE A VERY USEFUL AND FLEXIBLE PLANNING TOOL WHEN IT COMES TO PASSING ON YOUR COTTAGE TO FUTURE GENERATIONS. THERE ARE TWO WAYS THAT YOU CAN USE A TRUST WHEN TRANSFERRING A COTTAGE:

Holding the Cottage in Trust

Inter Vivos Trusts

An inter vivos trust is created when you transfer your cottage (or any other assets you have) into a trust while you are still alive. The person you appoint trustee then becomes the legal owner of the property and will manage and deal with the trust assets (which would include the cottage) as you have specified in the trust deed, for the benefit of the beneficiaries named in the trust—such as your children. By establishing a trust, you have some control over how the cottage is managed after you pass. This can ensure a transfer that is fair for all of your beneficiaries and hopefully avoids or reduces disagreements.

Testamentary Trusts

A testamentary trust is established when you die, usually through your Will. In this situation, the cottage is transferred to the trust after your death, according to your (the settlor of the trust) instructions. As with an inter vivos trust, you can establish the terms of the trust to ensure ongoing, equitable treatment for your beneficiaries.

When you transfer an asset such as a cottage into an inter vivos or testamentary trust, it is considered for tax purposes to have been sold at Fair Market Value (except in the case of a spousal trust). This will most likely result in a taxable capital gain. You may be able to use the Principal Residence Exemption (PRE) to reduce or eliminate the tax payable, but this will depend on your particular circumstances. Otherwise, some tax will have to be paid. I can provide you with more information on the PRE.

In the case of an inter vivos trust, as the cottage owner you should be prepared to pay the resulting tax. With a testamentary trust, though, your estate will be responsible for paying any resulting tax—which will reduce the final value of the assets your beneficiaries receive. If you want to avoid this situation, you should plan to have enough cash in the estate to pay for the resulting taxes. You can do this, for example, by taking out life insurance and naming the estate as the beneficiary.

Maintenance Trusts

Instead of transferring your cottage into a trust, you might instead transfer the cottage directly to your children and then establish a trust that contains money to pay for the ongoing maintenance of the cottage. This arrangement should avoid many of the problems that can surface when co-owners of a cottage are faced with sharing the maintenance costs.

Alter Ego and Joint Partner Trusts

Alter Ego and Joint Partner Trusts are both a type of inter vivos trust into which you transfer your cottage while you are still alive. An alter ego trust is an inter vivos trust established for your (the cottage owner's) personal benefit. A joint partner trust is an inter vivos trust established for the benefit of both you and your spouse or common law partner. The main advantage of these trusts is that, if they are properly structured and maintained, the transfer of the cottage into the trust is not considered a "deemed disposition", or a sale at its Fair Market Value. This means that you can defer any capital gains on the trust (resulting from the "sale" of the cottage) until your death. There are specific rules regarding these trusts and they should only be established with the help of a qualified professional. I can certainly provide you with more information.

Probate

Probate fees are, essentially, death taxes and are applied to the assets in your estate. All of the provinces except Quebec have probate taxes. One way to avoid probate fees on a cottage is by using an inter vivos trust, since the cottage will not form part of the your estate. You should keep in mind that probate taxes are generally not that high when compared to income taxes, so consider whether establishing a trust to avoid probate fees makes sense in the context of your overall financial plan and objectives.

Professional Assistance

Trusts are very useful and flexible, but it is important that you seek qualified legal and tax advice before attempting to establish the trust(s).

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