



Are you sure your family cottage will stay in your family?

SOMETIMES A LITTLE PLANNING CAN MAKE YOUR DREAMS FOR THE FUTURE COME TRUE.

HERE'S THE PROBLEM:

When you die, your assets can be transferred tax-free to your spouse. However, when your spouse dies after you, and the assets are passed on to your children or other heirs, this transfer may result in a significant tax bill. And this tax is paid before your heirs get anything.

An asset such as your principal residence is exempt from this type of taxation. Generally, your cottage won't be exempt and it will be considered a capital asset. Consequently, it may trigger a capital gains tax liability at death.

With the recent real estate boom in Canada, cottages and other vacation properties have increased significantly in value. These properties are now worth substantially more than their purchase price. At death, 50% of this increased value is subject to taxation.

Are you aware of the impact this capital gains tax liability could have on your estate? A lack of proper planning could mean that your family cottage won't stay in your family. Your estate might need to sell it to pay the tax.

It's a tax time bomb that most people are unaware of and don't plan for.

WHAT ARE YOUR OPTIONS?

There are a number of strategies you can implement to limit your tax liability or to provide the cash to pay the tax liability after your death. It's important to make the best choice for your situation.

Your options include the following:

- You and/or your family can start saving today
- Your heirs can borrow the required funds from a bank
- Your estate can sell the asset
- You can purchase life insurance to cover the growing tax liability
- You can sell the cottage to your children today and transfer the future tax liability to the next generation

SELLING TODAY

Let's explore that last option in more detail. If you sell the cottage to your children today instead of transferring it at death, your tax liability is capped and any future growth in the value of the cottage will be taxable when the asset passes to the generation that follows your children – in other words, to your grandchildren. The cottage will belong to the people you select (i.e., your children). Furthermore, because the transfer of the cottage occurs outside your estate, the property should be protected from any potential claims against your estate by creditors or other interested parties. You also eliminate probate fees,

which may be charged on the value of the cottage upon your death, enhancing the size of your legacy. Selling your cottage today may trigger a taxable capital gain for you in the current tax year. However, if you sell the cottage and take a mortgage back from your children, you can spread that capital gain over up to five years. If you decide to sell the cottage to your children, you can make the mortgage interest-free and forgive the mortgage balance in your will so they receive the cottage with no debt or taxes payable.

While you may be tempted to sell the cottage for a nominal price to reduce your capital gain, be warned that the Canada Revenue Agency (CRA) will charge its capital gains tax based on the property's fair market value, regardless of the price you and your children agree upon. In addition, when your children eventually sell or pass on the cottage, the government will calculate the capital gain based on the low (or non-existent) price your children paid to you, resulting in double taxation.

Selling your cottage today can also provide you with a much-needed source of income. Maintaining a cottage can be an expensive drain on your retirement assets, and you may not be in a position to afford to set aside money or purchase life insurance to cover the expected tax liability at death. When you sell your cottage, not only do the related expenses disappear but the sale proceeds can be used to fund your retirement, allowing you to take that dream vacation, pursue your interests and hobbies, or retire earlier.

If you invest the annual payments you receive from your children, you can accumulate significant assets that you may use to enhance your retirement and/or pass on to your heirs. Insurance investments provide the benefits of death and maturity guarantees and the ability to name a beneficiary and avoid probate. Such a strategy could also increase the size of your legacy.

So, paying a little tax now could save a lot of taxes in the future – and might very well be the deciding factor that enables your cottage to stay in the family.

Here's an example that shows the challenge many cottage owners face:

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

This table assumes that 50% of the capital gain is taxable at a personal rate of 45%, and that the value of the cottage increases at a rate of 6% per year.

As the table illustrates, by selling the cottage today you trigger tax payable of \$90,000. This amount can be reduced to \$18,000 per year if spread out over five years, and can be funded by the mortgage payments you receive from your children. This compares favourably to transferring the

cottage upon your death, 20 years from now, and triggering a tax bill of \$338,303. The latter approach could result in the cottage having to be sold if there were insufficient assets in your estate to cover such a large amount.

Manulife Investments is the brand name identifying the personal wealth management lines of business offered by Manulife Financial (The Manufacturers Life Insurance Company) and its subsidiaries in Canada. As one of Canada's largest integrated financial services providers, Manulife Investments offers a variety of products and services including: segregated funds, mutual funds, annuities and guaranteed interest contracts. Manulife and the block design are registered trademarks of the Manufacturers Life Insurance Company and are used by it and its affiliates including Manulife Financial Corporation.

www.manulife.ca/investments

 **Manulife Investments**
With you every step of the way®