

Wills, Trusts & Estates

Planning for succession of a cottage or vacation home: Consider the taxes

By **Susannah Roth and Margaret O'Sullivan**



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(June 4, 2018, 8:39 AM EDT) -- Concerns about inheritance of the cottage or vacation property, including who, how and when are often worrisome for owners. In our last article, we discussed personal and emotional considerations in planning for the succession of a cottage (or other vacation home). This article will focus on the tax issues to be reviewed when planning for a cottage or vacation home.

Of great significance for vacation homes which have gained in value is dealing with the potential capital gains tax burden. Barring a tax-free rollover to a spouse, significant capital gains taxes may be payable on transfer of the property or immediately on an owner's death. This will be of particular significance where beneficiaries will wish to keep the property but the remaining estate assets will not cover the taxes owing.

Most owners of vacation homes in Ontario are also aware of the potential probate fee burden on an estate in passing on the property to beneficiaries, assuming the property is not passing to a joint owner with right of survivorship, which might be the case for a spouse or other joint owner. Probate fees in Ontario (Estate Administration Tax) amount to approximately 1.5 per cent of the value of the property (e.g. \$15,000 for a \$1M property).

Both capital gains tax and probate fees, unless otherwise provided for, are payable from the owner's estate. Proper consideration of the size of this tax burden and how it will be funded is important, especially where only some family members will take ownership of the vacation home, but the residue of the owner's estate will be left to different family members, or where there are not enough liquid assets to pay the taxes owing on the owner's death without sale of the vacation home, or where funds from the estate are also required for other purposes, including providing for the needs of surviving family members.

Also, it is important to remember that some beneficiaries may be counting on their financial inheritance to fund future projects or retirement, and such plans can create considerable problems in a succession plan.

Vacation properties outside of Canada can pose additional tax and succession problems for Canadian-resident owners' estates. By far the greatest number of vacation homes outside Canada owned by Canadian residents are in the U.S. If the Canadian-resident owner is not a U.S. citizen (where a different set of considerations apply), owning U.S. real property brings the Canadian owner's estate within the U.S. gift and estate tax regime. As a result, U.S. vacation homes may require additional planning in order to adequately provide for the potential U.S. estate tax burden arising on death.

U.S. estate tax on U.S. real estate owned by a Canadian resident who is not a U.S. citizen is calculated based upon the value of the U.S. property owned at the owner's date of death. There is an available tax credit, and two options for its calculation. One method is calculated based on the value of all U.S. property in relation to the owner's worldwide estate, and the other option is a basic credit of approximately US\$14,000.

The top U.S. estate tax rate is 40 per cent. In 2018, if an owner's worldwide estate is valued at \$11.2M or less, no U.S. estate tax should be payable by their estate. If an owner's worldwide estate

exceeds US\$11.2M, (and for such purpose a number of assets are included, including certain life insurance proceeds and most jointly owned property) there is an exposure to U.S. estate tax. The U.S. tax rates are permanent, subject to future legislation. Individual advice is required to calculate U.S. estate tax exposure given its complexity.

Non-residents of Canada who own Ontario vacation homes or cottages face unique planning concerns regarding Canadian capital gains tax and succession issues. For example, there are special opportunities available to ensure there is no double taxation on death in both Canada and the U.S. under tax treaty provisions between Canada and the U.S.

In planning for succession of the cottage or other vacation home, tax issues must be considered. First steps include finding out what the potential tax burden associated with the cottage will likely be and consider how this liability will be funded. If there is a liquidity issue, the owner can then consider available options, such as life insurance, if the tax burden will not easily be payable by the beneficiaries or estate, so that the beneficiaries enjoyment isn't derailed by an unfundable tax burden, for example.

This is the second in a three-part series. Read part one here. Matrimonial considerations in cottage and vacation home succession will be discussed in our next article.

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