**Asset or a Liability?**

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Do you have a separate recreational property or a rental property? If so this may apply to you:

Some years ago, Roy and Mary bought a cottage at the lake in their home province for about $50,000 and today it is worth about $750,000. Over the years, they have spent about $100,000 on improvements to the property and they kept all receipts to prove it. Roy and Mary, like many, think that it will be easy to pass the cottage on to their children and grandchildren. It may be far more costly than they think.

Roy and Mary mistakenly believed that they could simply gift the cottage to their children and postpone taxes on the gain. While the property can be gifted to a spouse or rolled over tax-free on death to the surviving spouse, when it transfers to children or grandchildren, taxes on the gain in value will be due.

They did the right thing by keeping all receipts for improvements as these expenses get added to the adjusted cost base (ACB) of the property. Quite simply, the ACB determines the cost of the property when figuring out the taxes owing. In Roy and Mary's case, their ACB would be $150,000 and the gain would be the difference between the value and the ACB, in this case 600,000.

If they sold the property today, current tax laws say that they would have to pay income taxes on half the total gain, which is $300,000. Depending on province of residence and assuming top tax rates, the tax bill could be between $117,000 and $144,750. If the property passes because of death, it is deemed to have been sold at that value and the tax liability becomes due right away, even though the cottage may not have been sold. This concerns Roy and Mary because they want the cottage to "stay in the family" so future generations can enjoy it.

Because their ultimate intent is for their heirs to get the cottage, there are some things they can do now to minimize the hassles and costs when the time comes.

Roy and Mary could give the cottage to their children now or sell it to them at a nominal price. While this can avoid probate fees and land transfer taxes, Canada Revenue Agency will still charge them capital gains tax based on the cottage's fair market value.

They could transfer the cottage into a trust, but this move would still trigger capital gains tax.

And then there's the 21-year rule.

A more viable and cost effective alternative for Roy and Mary is the use of life insurance. A policy that pays enough when they have both died to cover the income taxes at exactly the time it's needed would assure them that the cottage can stay in the family.

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