Family Cottage and Recreational Property Strategies
Presenter

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  - Speaker on Tax, investing, and Properties.
Family Dynamics and the Cottage

- Keep a common interest alive
- Centre for the family to keep in touch and engaged with each other, siblings and parents.
Ingrained into our DNA

- A place to relax and get away from the busy city.
- Has increased in value over the years, which should continue.
- Where your children and grandchildren will want to come to visit you.
- A place for the children to build memories.
Death and Taxes

- Do the kids want to keep the cottage and are they willing to pay for it?
- They say they do, but if it limits their lifestyle, they may rather pay down debt with inheritance.
- Do they want to share it, or does one want it and can afford it more?
Death and Taxes

- What do you do with the other children?
- If joint, how do they share maintenance costs, etc.; or major costs?
  - i.e. One wants to upgrade and build bigger cottage; the other does not mind the old cottage.
- You choose your friends, not your family.
Death and Taxes

- If they get along well, have few conflicts and similar values, it might work.
- The likelihood of more than 3 getting along is pretty low.
- You cannot control conflict after death, so try not to.
Death and Taxes

- Tax-free rollover if left to spouse.
- Cottages are subject to capital gains taxes – ½ of gain will be taxable.
- You cannot transfer for tax purposes at anything less than fair market value.
  - i.e. Transfer into joint name with kids is still a disposition unless done properly.
Your Advisors have a plan
Strategies

- The principal residence exemption can be elected on any property used principally for personal use.
  - Owned cottage since 1991 – cost $160,000;
  - Sold original house for large gain in 1996;
  - Sold current condo in 2011 but gain was only $20,000;
  - Plan on selling cottage in 2015 for $360,000 with gain of $200,000.
Strategies

- Total tax if election on condo = $35,000
- Total tax if no election on condo = $12,000
- Total savings = $23,000
Strategies

- Do not elect on condo when sold in 2011 but pay capital gains tax on this sale
  - Actual gain $20,000; and
  - Tax owing $4,600.
- Elect on cottage when sold in 2015, as principal residence
  - Gain $200,000
• Principal residence election on cottage:
  • 1996 – 2015 = 20 +1;
  • 1991 – 2015 = 25; and
  • $200,000 \times \frac{21}{25} = $168,000.

• Taxable gain = ($200,000 - $168,000) \times \frac{1}{2} = $16,000

• Tax owing $7,400

• Total tax = $12,000 ($4,600 + $7,400)
Barriers to Succession

- Financial capital and understanding:
- Human capital and resources.
- Advisory capital, many are just afraid of succession and the issues surrounding it.
- Accountant is a quarterback who is afraid to get sacked.
• If you did elect on condo in 2011
• Tax owing on sale of condo = $0
• Principal residence election on cottage:
  • 2011 – 2015 = 5 +1
  • 1991 – 2015 = 25
  • $200,000 x 6/25 = $48,000
  • Taxable gain = ($200,000 - $48,000) x ½ = $76,000
  • Tax owing $35,000
• Total tax = $35,000 ($0 + $35,000)
• Savings by not electing on condo = $23,000 ($35,000 - $12,000)
Divorce and Recreational Property

- For marital purposes a cottage or recreational property is family property.
- So when a child inherits, buys or is gifted this property:
  - Provided it is used for enjoyment by their family;
  - Is included in family property even if gifted, bought or inherited from the parent;
  - If there is a divorce, ½ of the property goes to the spouse.
Appearances can be deceiving
So Imagine

- You leave the property to your 2 children
- One gets divorced and has to pay ½ of the value to their spouse.
- What do they do now???
- A marriage contract may work but it must be finalized before the wedding.
Strategy

- If the cottage is gifted during lifetime, lend the money to the kids to buy the cottage.
- You might have to pay the land transfer tax.
- Cottage is joint, loan is joint, so at least it reduces the loss by the loan amount.
- But after death this stops working as a loan is repaid or forgiven.
Probate Avoidance

- Probate fees in Ontario are 1.5% of the assets.
- If the property is joint with your spouse, there are no probate fees until the last spouse dies.
- Don’t throw the baby out with the bathwater.
- Transfers to joint name sometimes may leave the asset out of the will.
Recent Probate Update

- If transferring to joint name the courts assume not intended to be a legal transfer.
- If transferred prior to death to son #1, and no documentation indicating intent:
  - Courts assume the asset should still be included in the estate, i.e., Not sole property of son #1 but sibling beneficiaries have an interest in the property.
Probate Update

- So document your intent.
- If your intent is solely for probate purposes it's not a disposition for tax purposes.
- May lead to estate litigation.
- Alter Ego trust may be set up to avoid probate without risk of joint problems.
- But you still owe the capital gains tax on death.
Cottage Tax Strategies

- Consider life insurance but costs often outweigh the benefits.
- Maybe kids will pay premiums?
- Transfer the cottage to the kids before the gain gets too large.
- Transfer outright to joint name.
Cottage Tax Strategies

- We recommend you take a promissory note for divorce and creditor proofing purposes.
- A joint tenancy puts all of you at risk if there is financial or marital difficulty.
- Make your intent clear ie. must be a real transfer to minimize capital gains tax.
- A co-owner may go to court to force the sale.
Cottage Tax Strategies

- Consider a co-ownership agreement to outline expectations for:
  - Who pays the bills;
  - Who cuts the lawn;
  - Who pays for renovations; and
  - Restrictions on sale, i.e. parent must consent to sale.
The kids have to agree
Cottage Trusts – Intervivos

- Still a deemed disposition so the tax must be paid.
- Works if you are buying a cottage now or if a gain has been small to date.
- Take back a demand mortgage to defer any gain over 5 years.
Cottage Trusts

- Mortgage also gives you more control over the property.
- Trust normally needs to be dissolved after 21 years, i.e. assets transferred to the kids or tax paid on the accumulated gain.
- May protect you somewhat against a claim by the child's spouse.
Cottage Trusts

- Parents maintain control over the property during the life of the trust.
- Should set out clearly the costs of operation and who pays what, who gets whatever when.
- Granting a life interest to parent no longer an alternative.
- Normally funded by a loan or gift from the parents.
Cottage Trusts

- Child may use the principal residence exemption but if one child uses it, all trust beneficiaries are deemed to have used it.
- Consider using separate trusts but that may make ½ of the value open to spouse claim in a divorce.
Pros and Cons of Trusts

- Costly to form and maintain.
- Record keeping requirements.
- Only lasts for 21 years.
- Deals with capital gains and probate issues.
- May be able to skip a generation to grandchildren.
- Transfer is taxable so not so good if large gain.
Testamentary Trusts – Post Death

- Leaves the cottage to a trust for the beneficiaries.
- Still must pay tax on death.
- Must be funded by the estate and costly to maintain.
- Who inherits it when it must be decided?
- Complicated and ugly but it does work in some instances.
- Can skip a generation but must have an end date.
Tips - Recreational and Principal Residences

- Keep copies of documents for any renovation costs, i.e. kitchen, additions, and original purchase documents.
- No need to keep expense records for repairs new roof, carpet, etc.
- Every time you sell a principal residence review if you should elect principal residence exemption.
Tips

• If you bought prior to 1982, there is a way to increase your cost base to the value in that year if:
  • Both you and your spouse owned the cottage and principal residence individually;
  • Prior to 1981 each spouse had their own principal residence exemption;
Tips

• Ensure that at the time of death on sale that the property is held in only 1 persons name;
• If you bought before 1971, then you need an appraisal and your gain is measured from that date;
• You may have used your 100,000 capital gains exemption to increase your cost base.
US RECREATIONAL PROPERTY
-THE GOOD-
-THE GOOD-

- Lowest prices in years and Canadian $ is above par? Disconnect between US and Canada.
- Low interest rates but must borrow in Canada.
- Prices seem to be at bottom but no rush, you probably have a couple of years in some cases.
-THE GOOD-

- Florida Keys, and Miami Beach are recovering but Cape Coral area has 17 years of inventory.
- Sales in the Keys have 1/3\(^{rd}\) of people moving there to upgrade, 1/3\(^{rd}\) buying second homes, 1/3\(^{rd}\) investors buying to flip and make 30-50k.
- Prices have leveled off with some actually starting to increase in more valuable areas.
-THE GOOD-

- In the Keys you can buy waterfront properties starting at $300,000 and non-waterfront from $150,000 +,.. a 50% discount from the highs.
- Water temperature – 75 to 90 degrees
- Air temperature – 70 to 90 degrees almost always!
- Cottage country for Florida, but no beaches.
-THE BAD-

- If you rent you must file US tax returns or be subject to 30% withholding tax on rental.
- State tax of 11% is charged on rentals to short term tenants of your property.
- Must fumigate often, bugs are big!
- Carrying costs, condo fees, taxes, insurance, hydro can be costly.
-THE BAD-

- Watch out for Hurricanes! (Buy newer, they are built to withstand)
- Salt water and humidity is hard on everything.
- Mortgages are not available in US but you may use a Homeline loan on your house in Canada as security for a Canadian Property.
-THE UGLY-

• Buying a property can be a painful especially if it is a bank foreclosure or short sale.
• Once you make an offer you don’t know how long it will take to be approved.
• You should be careful about the following:
  • Don’t buy a house in a ghost town;
  • Have your accountant review the condo corporation’s books to ensure solvency;
THE UGLY

- Review condo corporation’s minutes to see if there are any special assessments coming.
- Ensure you have a home inspection if at all possible!
- If it is part of a golf course community, make sure the golf course is solvent and not going into bankruptcy or financial difficulty.
Bondy’s Laws of Real Estate

- Location, location, location!
- Easy to get to, by car if a cottage.
- The less stop lights the better!
- Small town environment.
- Safe for anyone to stay alone, even Grandma.
Bondy’s Laws of Real Estate

- Always safer if it’s just 1 road or limited access.
- Access to airports should be 1 – 2 hour drive maximum.
- Nearby to grocery, and other necessities.
- Buy waterfront or as close as possible if you can, they aren’t making any more of it!
- The right place at the right price is key.
Fish when the fishing is good
Bondy’s Laws of Real Estate

- They can build a lot of golf courses in Florida (millions of areas of bare land)
- There are thousands of condos and properties not on or near the water that are extremely cheap. Buyer beware!
- You often get what you pay for.
BUT.....

- In Canada consider lake access so buy across the street or very near the lake. Lake front is often too expensive.
$399,000 Canal Front, Keys
$800,000, pool, hot tub, 75’ dock
Otter Lake, Parry Sound,$800,000
$900,000, dbl lot, infinity pool
4 BR, 2700 sf,
Grand Bend-$900k, 2 bedroom
$3,500 1br, with outhouse
Sale of US Property

- Taxable in the US on your gain in US dollars.
- Withholding tax of 10% of gross sale proceeds unless you get a certificate that allows less tax to be withheld.
- OR sale price under 300k and used by the buyer as principal residence.
Sale of US Property

- Keep your signed original documents as they will be needed to obtain a tax certificate that allows lower rate of withholding.
- Must file US tax return to get refund.
- Then report Canadian gain, pay tax in Canada less the tax paid in the US.
Death and US Estate Tax

- Obama passed it so exemption is now 5m instead of 1m.
- Expires again in 2013 unless extended then exemption goes back to 1m.
US Estate Tax

• Estate tax returns are complicated and you cannot deal with or sell the asset until you have filed the return.

• YOU MAY BE EXEMPT IF:
  • If total assets owned in the US are worth < $60,000 US.
  • If total assets of an individual are < 1.2 million in US dollars.
Estate Tax

- Assets subject to estate tax in the US include:
  - US real property
  - Vehicles, boats, jewelry, personal effects
  - Direct shares or bond investments, i.e. Apple, etc.
  - Whether held personally or in RRSP’s even though held in Canada
Estate Tax

- Do I really have to worry?
  - Yes, if a total individual total net worth of over 5 million dollars, 10m if married.
  - Remember for Estate tax assets Life insurance proceeds are included in your net worth.
  - You still need to go through the pain of filing a US estate tax return.
Estate Tax

- If you have significant net worth, the unified tax credit is reduced by the pro-rata share of your world wide assets.
- If you are subject to estate taxes the rate is 35%.
- If you have a Canadian gain on your property you can use this as a tax credit against the tax owing.
## Simple Example

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>World Wide Assets</td>
<td>6 million</td>
</tr>
<tr>
<td>Life Insurance</td>
<td>2 million</td>
</tr>
<tr>
<td>Total World Wide Assets</td>
<td>8 million</td>
</tr>
<tr>
<td>US Real Estate</td>
<td>1.5 million</td>
</tr>
<tr>
<td>US Investments &amp; Other</td>
<td>.5 million</td>
</tr>
<tr>
<td>Total US Assets</td>
<td>2.0 million</td>
</tr>
<tr>
<td>If US assets</td>
<td>Estate Tax Payable</td>
</tr>
<tr>
<td>--------------</td>
<td>-------------------</td>
</tr>
<tr>
<td>$2 million</td>
<td>$249,000</td>
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<tr>
<td>$1 million</td>
<td>$114,450</td>
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<tr>
<td>$500,000</td>
<td>$47,625</td>
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</table>

But if you are married, the property left to your spouse, and not held jointly. The unified tax credit is doubled and in the above cases no US estate tax is payable.
US Strategies

- Hold title as tenants in common and not joint tenants (most common in Canada) or as joint with co-ownership agreement.
- No right of survivorship but you need to prove that your spouse had their own funds to contribute to the purchase.
- This stops the IRS from including 100% of the property value in the descendants estate for tax purposes.
Beware

- Non-recourse loan agreement reduces the value of the estate by the amount of the mortgage.
- Not used so commonly anymore as no US lender.
- Watch for direct investments in US securities.
- Your advisor can buy ADR’s, special funds, etc. for you that are not treated as US securities.
- US securities if held in Canadian corporation are not subject to estate taxes.
Beware

- Single purpose corporations no longer work, are not eligible for ½ capital gains tax rate in US.
- Do not use corporate ownership as there is risk that if for personal use to be deemed to be a shareholder payment so 100% taxable.
- DO NOT USE US LLC as significant tax problems arise.
For worldwide estates over 10m

- Strategies are used to confuse the IRS so few of them are bulletproof.
- Form a Canadian Trust but be careful that funds are loaned to fund it and that the parent does not look like an owner.
- Parent may have to pay fair value rents.
For worldwide estates over 10m

- Form a US limited partnership owned by a Canadian Limited partnership funded by a Canadian Trust.
- The partners are the children so that any gains flow to them or the parents but may not work if IRS sees through the partnership.
- Hide the ownership behind as many barriers as possible.
For worldwide estates over 10m

- Beware US gift tax which applies to US properties, ie. You cannot gift your property or funds during you life to be used to buy US property.

- Very complicated and detailed professional advice is needed and IRS may still look through it.
Other Alternatives
Mexico

- Mexico's charm: coastal towns, natural beauty, and colonial and cosmopolitan cities.
- Affordable and beautiful beachfront property
- Rich and diverse history
- Quality medical care/prescriptions at a fraction of the cost
- Cable TV, high-speed Internet, cell phone service
Mexico

- Prices are still strangely high in many places relative to the US. Ie. Same price for condo as in Southern US.
- Currency value is down due to US dollar fall.
- Financing is very expensive, and closing costs can be up to 20% of the cost of the property.
- Right now not the deal that it used to be except in certain remote developing areas.
Mexico

- Cost of construction- $65 to $120 per square foot.
- Ocean front lot-$50,000 to $300,000.
- Property taxes and insurance-extremely low, under $1,500.
- Other costs of living are extremely low so the perfect place if you want a low cash burn rate.
Tips and Traps of Buying Property

- The lower costs of property and the lower cost of living may be just the answer for those of reduced financial means after the recent debacle in the stock market.
- Recently reported violence in border cities finally are driving values down.
- Spanish is necessary and not that hard to learn.
Barrier s to Success

- Not members of CAFÉ
- Smaller communities
- Support group is friends in diverse businesses
- No resources or mentoring available other than Dad.
Tips and Traps of Buying Property

- Don’t drive at night anywhere in Mexico, there are cows and horses on the road.
- Don’t wear flashy jewelery or expensive items, less is best.
- Especially be careful to travel in daylight hours in border cities.
Mexico

- **Foreigners are not allowed to directly own real property within 50 kilometers of the beach or 100 kilometers from an International border.**
- **There are 2 methods that allow you to own property in the Restricted Zone.**
  - Fideicomiso or Bank Trust.
  - Mexican Corporation-if Business/rental related
Fideicomiso or Bank Trust.

- A Bank Trust established to own personal use property.
- Established with a Mexican Bank and costs $3500 to $7,000 to set up.
- Annual fees $450 to $600 to file.
- Lasts 50 years with 50 year possible extension.
Fideicomiso or Bank Trust.

- Generally not for business purposes however the property can be rented.
- You and your spouse are beneficiaries of the Fideicomiso and your children may also be named beneficiaries.
- So transition to beneficiaries is easier.
- Still subject to Capital Gains tax in both Canada and Mexico similar to USA.
Other Countries-Bahamas.

- Bahamas-Residency card allowed if you purchase a residence for more than $500,000 US. Cannot work unless work permit obtained.
- As an island, cost of living is very high. All in US dollars.
- Easy to own property and take title.
- Prices are still fairly high compared to the US but have fallen dramatically.
Other-Belize, Costa Rica, Turks

- Determine if common law country, British background, or Civil Law-Spain or French Background.
- We are familiar with Common law, and Civil Law is substantially different. Civil based on legislation not case law. No presumption of innocence. BE CAREFUL!
- Prices are down, but surprisingly higher than US sometimes.
Collins Barrow Can Help!

If you would like to discuss anything further please contact:

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Thanks