Wealth Management

Canaccord Genuity

VACATION HOME SUCCESSION:

The Capital Gains Tax Conundrum

As September wraps up, families across the country are enjoying their final cottage visits for the season. While they make a great place to come together and build memories, vacation homes also have the potential to create stress when being passed down through generations. When preparing for the succession of a secondary residence, here are five questions to consider:

1. WHAT IS A SECONDARY RESIDENCE?

A primary residence is where you live most of the time, whereas a secondary residence is where you live from time to time. If you only visit your vacation home seasonally, it is considered a secondary residence.

2. WHAT TAX PROBLEMS DO FAMILIES FACE WHEN PASSING DOWN A VACATION HOME?

A secondary residence is subject to capital gains taxation upon succession, whether by gift or death. In many cases, this can become a financial burden for those inheriting the property.

For example, if a cottage has been in a family for 30 years —first purchased for $100,000, and now worth $700,000— this signifies a $600,000 increase in value. This could lead to a hefty tax bill, expected to be paid upon disposition, just for the inheritor to keep the property that was gifted or left to them in a will.

3. CAN YOU AVOID PAYING A CAPITAL GAINS TAX BILL?

Some people believe that there are tax maneuvers that can be used to help reduce a capital gains tax bill. This is false.

While there isn't a way to evade these taxes, you can be proactive and plan ahead of time to help ensure your heir(s) can afford the bill.

4. ARE THERE WAYS TO HELP YOUR HEIR(S) PREPARE FOR THE TAX BILL?

One of the best solutions to avoid burdening your heir(s) with a large tax bill is to have a life insurance policy in place. By doing so, you can help create liquidity for your estate and ensure your they have adequate cash to cover the tax bill down the road. If you have enough permanent life insurance in place already, you can have a chunk of that sliced off for the tax bill—and this doesn't necessarily have to be a separate policy.

Whether or not you choose to go this route can depend on how much wealth, or other investments, you already have.

5. WHAT ABOUT THE EMOTIONAL SIDE TO THE PROPERTY?

Aside from capital gains taxes, an estate equalization problem can also arise if there are complicated family dynamics or differing interests that exist…

What if the property is left to two siblings who don't get along? If they can't share that cottage peacefully, is there an agreement between them as to who covers what expenses? Is there an amount of money in place to cover the expenses of maintaining the second home? If one sibling just wants the cash, would the other sibling have the financial ability to buy them out of the property? Or, what if neither of them want the burden of dealing with an additional home?

Leaving someone a vacation home seems like the perfect gift… until it isn't. When preparing for the succession of a secondary residence, it's important for family members to discuss their wishes and understand the associated tax implications.

Do you have a practical succession plan in place?
Contact us today to discuss.