



By John Peart, LL.B., CFP, TEP

Cottage Trusts

What are they and why have them?

How can you not like a cottage? With sun shimmering on the water, people swimming, boats going by and maybe a loon calling. Wouldn't it be wonderful to make sure this scene and place is maintained forever for your children and grandchildren?

Creating a cottage trust to own your cottage is one easier way to get closer to forever. There needs to be some forethought before creating a cottage trust and it does not work for everyone, however, it may be worth exploring the basics.

What is a Trust?

A trust is a common law concept that has existed for centuries. It requires a person or entity to create the trust (the "settlor"). It requires people or entities (the "beneficiaries") to benefit from the trust. It requires something (such as a cottage) to be transferred from the settlor to the trust. It requires person[s] or entities (the "trustee[s]") to hold the "something" for the beneficiaries. It requires a purpose (the terms upon which the property is being held). In the case of a cottage trust, parents might transfer ownership of a cottage to trustees other than the parents (perhaps the children) to hold the cottage for the parent's children, grandchildren or other beneficiaries.

Creating a Cottage Trust

There are two methods to create a cottage trust. It can be done on death through a Will (use the cottage until death and establish a trust within your Will to hold the cottage)—this is called a "testamentary cottage trust". It can be done during a person's lifetime through a cottage trust document and transferring the cottage to trustees —this is called an "inter vivos cottage trust".

Testamentary cottage trust (cottage trust by Will)

Wills invariably contain trusts for variety of reasons - the most common to allow a person's Estate Trustee to administer the person's Will and carry out the deceased's testamentary wishes. As all of the deceased's property becomes part of their estate and is dealt with through their Will, the deceased's Will can state that the cottage shall be held by the

deceased's estate upon whatever terms that are contained in the Will. The Will might say that the cottage will be held for the benefit of the deceased's children and grandchildren and cannot be sold for a period of years. The Will might also say that at the end of that time, any one or more of the then living beneficiaries would be able to purchase the cottage with the remaining beneficiaries receiving the sale proceeds in lieu.

Inter vivos cottage trust (cottage trust while alive)

A person does not have to wait until death to transfer the cottage into a trust. They can do so during their lifetime by signing a trust document that appoints certain persons or entities as trustees and then transferring the cottage to the trustees to hold the cottage upon the terms set out in the trust document.

Considerations

The primary benefit in establishing a cottage trust is its relative permanence and the preservation of something for future generations to have. Creating a cottage trust either through a will or while alive is often the easiest part of the process but it might not be for everyone. Consider the following:

Income tax

It is hard to escape Canada Revenue Agency (CRA). On death, you are deemed by the Income Tax Act to sell everything that you own including your cottage. Capital Gains tax arising on this "sale" is added to the deceased's final income tax return and taxes are payable. On death, the deceased's Will may provide that the cottage will be held in trust through a testamentary cottage trust but the deceased through their estate will pay any capital gains tax on the cottage.

Transferring a cottage into a cottage trust during a person's lifetime will also trigger capital gains based on the value of the cottage when that person (the settlor) transfers it to the trustees of the cottage trust. In this case, the settlor must pay the capital gains tax arising from the transfer to the inter vivos trust.

Maintenance

Where will the funds come from to pay the property taxes as well as maintain and repair the cottage and infrastructure? Will the deceased or the settlor also contribute cash as well as the cottage to the cottage trust to ensure that the minimum operating costs are covered or will the Will or cottage trust document require the beneficiaries to pay these costs? What happens if improvements are wanted—who pays for these and who owns them once they are constructed (the trust or the beneficiary who paid for them)?

Operation of the trust

Whether testamentary or inter vivos, a cottage trust document needs to contain wording as to how the trust is to operate. As well as wording for maintenance/repair/improvement as above, the trust document must set out how the trust property is to be operated: who uses the property; what happens if the property is no longer used; replacement of trustees; is there a method of terminating the trust?

Additional costs

There are additional costs associated with any type of trust after it is established. Accountants will have to be retained, lawyers (occasionally), and perhaps other professionals such as engineers, appraisers and the like. How are these people to be paid?

This is a very technical area and the documentation creating the trust –whether on death or while alive— must be done correctly. A lawyer must be retained to ensure that the proper steps are followed. At the end of the day, however, with wording in the trust document to cover most - if not all - eventualities and give and take on the part of the beneficiaries, keeping a cottage in the family to be used for successor generations can be something to enjoy and treasure. Whether or not it will work in a particular case will depend on the specific situation.

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