Keeping the "Family" in the Family Cottage!

THE PATH TO SUCCESS FOR COTTAGE SUCCESSION

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The Cottage Conundrum

Most cottagers would love to ensure their children and grandchildren have the opportunity to participate in the pleasures of cottage life.

Increasing demand and rapidly rising waterfront real estate prices mean most children won't be able to buy their own. Finding a way to pass on your cottage may be the only option for future generations to share this extraordinary life experience.

The Cottage Conundrum is that the tax system, financial realities and family dynamics are all critical obstacles to achieving that generous goal.

FINANCIAL HURDLES

1. Parental pressures
   - Payment of ongoing expenses
   - Non-income producing asset
2. Calculating capital gains tax
3. Funding capital gains tax
4. Transfer while alive or after death?

Some of these obstacles are financial:
Can the parents afford to preserve the cottage for their lifetimes in order to pass it on to the children? Payment of the ongoing expenses for electricity, municipal taxes, insurance, repairs and maintenance may become onerous for seniors, particularly when the costs keep increasingly annually while their income is fixed. "Locking up" the value of the cottage as non-income producing property also has a detrimental effect on the parents, whose cash flow and ability to meet other financial needs could be much improved if the cottage was sold and the money invested.

Even if the parents are in a position to retain the cottage to pass on to their children, capital gains tax on the transfer to the kids is also a substantial issue. Given the huge increases in value in waterfront property over the decades, the resulting capital gains tax could be tens, even hundreds of thousands of dollars. How will this tax bite be funded - life insurance, savings, sale proceeds of the primary residence, mortgage on the cottage itself?

Since the capital gains tax liability increases with each passing year, there is motivation to transfer during the parents' lifetime at a lower cost. However, to do so will trigger the capital gains tax liability sooner rather than later, when life insurance proceeds are not available, the primary residence is still in use, and savings may be required for future needs. The right solution for one family may be the wrong one for their neighbors.

FAMILY CHALLENGES

THE FOUR C'S…

1. Choosing children
2. Compensation questions
3. Co-ownership concerns
4. Coping with financial differences

Quite distinct from the financial hurdles are the family challenges. Most motivated families, with the assistance of their professional advisers such as lawyer, accountant and financial adviser, will find a way to overcome the money matters. However, the family issues confronting the cottage succession are equally important. Everyone hopes to keep the cottage in the family, but no one wants to leave a legacy of family strife by doing so.

Does the cottage go to all of the children; or only to those who are interested in the cottage; or those who can afford to maintain it; or those close enough to use it regularly; or those that get along together well?

If the cottage doesn't go to all the children for whatever good and valid reasons, what happens to other child or children? Are they simply left out, with an inheritance of diminished value compared to the others? Can they be compensated in some other way?

If more than one child ends up with the cottage will they work well together, or could differences of opinion become disputes, and the cottage a bone of contention instead of a waterfront paradise?

When cottage costs are confronted, especially large ones, what happens if one of the children is unable to come up with his or her fair share of the expenses? And if he or she can't, what happens to the happy family cottage?

CHOOSING CHILDREN

- Interest
- Geography
- Affordability
- Personalities

Various factors need to be considered when deciding which child or children should be chosen to carry on with the cottage.

One critical consideration is the level of interest of a particular child. If he or she is not enthusiastic about cottage ownership, with all the responsibilities and expenses that involves then including him or her in the cottage plans will only lead to friction and dissension.

Geography is relevant too. A child who lives far away may love the cottage, but if he or she is so distant it can seldom be used, then again problems will follow. A child who only uses the cottage a few days a year may feel unfairly treated if asked to pay the same portion of the costs as those who live nearby and enjoy the cottage frequently. Distant children will also not be in a position to contribute equally to maintenance and chores, which may be resented by the closer ones who then carry most of the load.

Cottagers know how expensive it can be to keep a cottage going. A child who is struggling financially may find it impossible to pay his or her fair share of the expenses. You may not be dong that child any favours by imposing the cottage burden upon him or her.

Don't overlook personalities either. If the kids always get along well together, wonderful. If they fight like cats and dogs, then perhaps leaving the cottage to more than one will be a formula for disaster, with a For Sale sign to follow.

COMPENSATION QUESTIONS

- Ignore or compensate?
- Apples and oranges
- Financial compensation
  - By Will, from insurance or other assets
  - By cottage owner children
- Life interest for excluded children

If not all children are chosen or willing to carry on with the cottage, should the others be compensated or ignored? A parent who wishes to provide some balance among the children may decide to leave the non-cottage owning child more of the other estate assets, or provide insurance to even things out.

If the estate assets are not sufficient to do this, then perhaps the cottage owning children should themselves contribute to the compensation, by leaving them the cottage on condition that the excluded child receives a certain sum from the new owners.

In addition to financial compensation, a child who is not included for whatever reasons in full cottage ownership may be provided a life interest. This would ensure that he or she is able to enjoy the cottage while alive, but would not be responsible for sharing the full costs, nor to leave an interest in the cottage to their heirs.

CO-OWNERSHIP CONCERNS

- Too many chiefs…
- Agreements avoid adversity
    - Operation, sharing costs and tasks
    - Restrictions on transfer
    - Exit strategy
    - Role of parents
    - Involve the kids
- Learning curve

While the parents are alive and involved, they usually provide the leadership and guidance for the family. If there are competing wishes for usage periods or different ideas for improvements, the parents will normally make the final decision. Cottage life proceeds peacefully.

When the parents are no longer involved, then differences of opinion may escalate to disputes and result in deadlocks. If all kids are equal owners, then no one can outvote the other. A disgruntled child may decide to sell his or her interest to a third party to be rid of the problem, or even force the sale through court action.
A Cottage Sharing Agreement negotiated and implemented while the parents are active can make all the difference between a short and unhappy period of sibling ownership, and a stable and continuing structure for future generations to enjoy the cottage.

FINANCIAL DIFFERENCES

- Impact on cottage ownership
- Agreement provisions
    - Expenditure priorities
    - Mandatory reserve
- Will solutions
    - Testamentary trust

Not all children are the same, and not all children's pockets are equally deep. If the septic system packs it in, there's no choice but to repair or replace it, often at a cost of many thousands of dollars. One brother may be able to pay his share out of petty cash, while his sister may be too strapped to contribute. Does the well off one pay for both? Does the cottage go unused until the struggling one saves up enough money? Either will lead to dissension, resentment, guilt and hard feelings.

What if one child wants to build a bunkie to accommodate a growing family, while another can't afford the cost or doesn't want the view of the lake obstructed?
Again, a Cottage Sharing Agreement can provide a structure to deal with these issues in a business-like way, preserving family harmony. A mandatory reserve built into the ongoing cottage budget can relieve the strain when an unexpected expense hits home.
With their Wills, parents can also designate a certain portion of their estate be set aside specifically for cottage purposes, to provide a financial reserve to act as a safety net for financial stresses.

WORDS FOR THE WISE

1. *DON'T DELAY*
   The sooner you start on your cottage planning process, the more likely your success will be. Some plans should be implemented right away to maximize the benefits, while others take time to mature. If you delay, you may miss your opportunity for the former, or be too late for the latter.

2. *GET GOOD HELP*
   You and your goals are the critical component of the planning, but don't try to do it all by yourself. Accountants are necessary to provide certainty to the tax consequences, while lawyers to create safe and effective structures for succession. Other experts who can contribute are appraisers, insurance brokers and financial planners. Get professional help to ensure optimum results for your family.

3. *LEAVE A LEGACY*
   If you ignore cottage planning, then you leave a potentially nasty can of worms for your loved ones to untangle. This can waste time and money, and most importantly squander family goodwill. Leave a legacy of love and take the necessary steps to sort out your own cottage succession path.

Sharing the Family Cottage

COTTAGE SHARING AGREEMENTS

- *Passing the torch*
- *Protecting the parents*
- *Providing for children*
- *Preserving the cottage*

While the parents are alive and involved, they usually provide the leadership and guidance for the family. If there are competing wishes for usage periods or different ideas for improvements, the parents will normally make the final decision. From habit and respect, the children generally go along. Cottage life proceeds peacefully.

When the parents are no longer involved, then differences of opinion may escalate to disputes and result in deadlocks. If all kids are equal owners, then no one can outvote the other. A disgruntled child may decide to sell his or her interest to a third party to be rid of the problem, or even force the sale through court action.

A Cottage Sharing Agreement negotiated and implemented while the parents are active can make all the difference between a short and unhappy period of sibling ownership, and a stable and continuing structure for future generations to enjoy the cottage.

The Cottage Sharing Agreement fulfils two important purposes:

1 It is a transition vehicle, safely passing the cottage ownership and control from one generation to the next, retaining the rights and pleasures of the parents while ensuring that the children will be the stewards for the next generation.

2 It is a structure for the children when the parents are no longer involved in the cottage, ensuring that the financial responsibilities, sharing usage issues, division of labour and a fair, mutually agreeable method of dispute resolution is in place to steer clear of the inevitable rough waters.

SHARE THE JOY

Usage

- *Free for all or taking turns?*
- *Exclusive period allocation*
- *To rent, or not to rent?*

A pleasure of the family cottage is that it perpetuates and nurtures family relationships. It is a focal point for family interaction and enjoyment. But with shared usage comes the need to address some significant questions, such as:

- Can all children use the cottage all the time, or will there be periods of exclusive usage for each child?
- If there are exclusive periods, how or by whom are those periods allocated?
- Can children bring friends as guests, or will it be family members only?
- Can a child rent the cottage during his or her turn, if he or she cannot use the cottage personally?

The Cottage Sharing Agreement process brings such topics to light, permits discussion among the family members, and formalizes the terms that all agree can be accommodated and accepted as a natural consequence of shared usage and overlapping interests.

SHARE THE LOAD

- *Cottage obligations*
- *Division of labour*
- *Sharing expenses*
    - *Equally*
    - *In proportion to usage*
    - *As affordable*

Maybe your children always agree on everything, but many families risk running into serious difficulties among themselves sooner or later. Some of the issues will be mundane, others will be major. All these considerations have the potential to create friction:

- Who will open and close the cottage?
- Who is responsible for making sure the utility bills, municipal taxes and insurance premiums are paid on time?
- Should the ongoing costs of the cottage be shared in proportion to usage or adjusted for affordability, or simply split evenly?
- How are collective decisions made for changes, improvements or additions?

The Cottage Sharing Agreement process will sort out the tasks, fairly distribute the burdens, ease constructive decision making and reduce possible resentments.

SHARE THE COSTS

- *Owner contributions*
- *Discretionary reserve*
- *Expenditure priorities*
    - *Routine*
    - *Mandatory*
    - *Elective*
    - *Personal*

Children are not all the same, and children's pockets are not all equally deep. This reality can lead to real problems. For example, if the septic system packs it in there's no choice but to repair or replace it. The cost may be many thousands of dollars. A brother may be able to pay his share out of petty cash, while his sister may be too strapped to contribute. An uncomfortable dynamic arises:

- Does the cottage go unused until the struggling one saves up enough money?
- Does the strapped one have to take out a loan to contribute?
- Does the better off sibling pay for both?

Any of these approaches can lead to dissension, resentment, guilt and hard feelings. Again, the Cottage Sharing Agreement provides a structure to deal with these issues in a fair, predictable and business-like way, preserving family harmony.

A discretionary reserve built into the ongoing cottage budget can relieve the strain when an unexpected expense hits home.

KEEP IT IN THE FAMILY

- *Restrictions on transfer*
  - *Prohibition/forfeiture*
  - *Exit strategy*
    - *Right of first refusal*
    - *Discounted price*
    - *Staged purchase*
- *Inheritance*

Passing on legal ownership isn't the point of the cottage succession process, only a milestone along the way. It's just as important to make sure it stays in the family afterwards. Should a disgruntled or financially strapped child be able to sell his or her share to someone outside the family?

Without a Cottage Sharing Agreement, any owner can apply to Court to have the property sold and his or her share paid out. With a Cottage Sharing Agreement the owners agree to give up this legal right to force a sale for their mutual protection and benefit, and accept other provisions to withdraw.

One approach is to prohibit the sale entirely, but that is drastic. A child/owner may have a legitimate need to be released from cottage ownership. A preferable approach is to create a responsible exit strategy, like providing the other owners with a right of first refusal and a reasonable payout mechanism.

No one lives forever, so the Cottage Sharing Agreement provides for a safe inheritance path upon the death of an owner:

- Does the share go to the surviving spouse, who may later remarry?
- Or is it preferred that the share passes to the deceased owner's children?
- Should the surviving spouse have a life interest, ensuring continued access to the cottage?

A critical goal is to retain the cottage for future generations. The Cottage Sharing Agreement can effectively address the inevitable issues of inheritance.

AVOID ADVERSITY

- *Unanimous/Majority/Veto*
- *Dispute resolution procedures*
- *Rules and regulations*

No matter how co-operative the children are, it is inevitable that some issues will result in differing opinions. A prime purpose of the Cottage Sharing Agreement is to provide ways to prevent a difference of opinion developing into sibling friction or escalating into a deadlock or full-blown family dispute.

When there are choices on how to proceed, and differences of opinion among the owners, some matters may be best dealt with by a simple majority. This would work well for non-critical decisions such as redecoration or usage.

Larger and more complicated issues may require unanimous approval, such as additions to the cottage or a sale to non-family members.

The Cottage Sharing Agreement will clearly identify those issues which will be resolved by simple majority, and which ones need unanimous agreement. It may also provide for amicable approaches such as mediation in certain circumstances.

It's unrealistic to pretend that differences of opinions will never arise, or that such differences will always be defused by family goodwill. With a Cottage Sharing Agreement providing structure and dispute resolution provisions, most issues can be resolved long before they become problems.

Although every child may not be equally happy with the outcome, he or she will at least accept the result as fair because all children agreed beforehand on the method of resolution.

Minor matters, like not leaving perishable food in the frig or empty gas tanks for the next sibling's turn can be avoided with Rules and Regulations that clarify expectations and prevent inadvertent and unnecessary irritations.

FAMILY COUNCIL

Annual meeting to:

- *Establish budget*
- *Divvy up usage*
- *Set repair/improvement priorities*
- *Delegate responsibilities*

Many Cottage Sharing Agreements provide for a Family Council, a routine time or date for the family members/owners to get together to discuss and decide upon cottage matters.

Often these are annual meetings, usually in the winter off-season. Important business items include setting a budget for payment of the operating expenses and agreed upon necessary or desirable repairs and improvements. Each family member/owner will know how much must be contributed to the cottage coffers to keep all ticking along for the year, and can adjust his or her own finances accordingly.

If the Cottage Sharing Agreement provides for periods of exclusive usage, then the Family Council is the most appropriate time and place to figure out who gets which block of time.

Considering significant matters like the need to repair cottage problems or the wish to improve cottage facilities can be covered during the Family Council, with the budget taking these into account. And the Council can decide how to allocate the responsibilities for the upcoming year, as to the payment of bills, opening and closing, organization of chores etc.

As a welcome bonus, the Family Council becomes a regular opportunity for busy children and their families to get together to co-operate positively. Reinforcing family ties is always a good thing!

GETTING STARTED

- *Role of parents*
- *Involve the kids*
- *Timelines to keep on track*
- *Get good help*
- *Don't delay!*

Parents are stewards, maintaining the cottage for their generation and nurturing the next one to take over in turn.

It’s important to have the cottage capital gains tax and financial aspects sorted out of course. It’s equally important to take all available steps to ensure that the cottage succession doesn’t clear the financial hurdles only to take a tumble over family issues. Taking the lead on getting a Cottage Sharing Agreement with the kids is a critical part of the parents’ legacy.

It is often essential for parents to initiate the Cottage Sharing Agreement process, but consultation and involvement with the children is a crucial component. Imposing the parents’ well intentioned vision of how the cottage should operate when they’re no longer involved seldom leads to real “buy-in” by the children which is necessary to make a lasting success of the cottage succession.

Achieving a Cottage Sharing Agreement may seem like a complex and daunting task, but the process can be broken down into bite-sized pieces. Setting a realistic timeline to check off the stages helps keep the Cottage Sharing Agreement process moving along in the right direction and to a successful conclusion.

Expert legal assistance to start the process and keep it heading in the right direction saves time, trouble and increases the chance of success.
And there’s no better time to start than today!

HOME FREE!

- *Cottage Sharing Agreement process = early warning system*
- *Avoid the ostrich syndrome*
- *Put the “success” in cottage succession!*

The Cottage Sharing Agreement process provides another crucial family benefit, as a reliable indicator of the likelihood of success of the ownership by the next generation.

The Cottage Sharing Agreement will add value while the parents are alive and participating, but it’s critical function is to keep the cottage on track when the parents are no longer involved. The children must accept the approaches, since it’s the children who will live with the results.

If despite everyone’s best efforts to obtain the Cottage Sharing Agreement one or more of the children can’t or won’t agree with the provisions acceptable to the other owners, it’s much better to learn that at an early stage.

Instead of lighting the fuse on a time bomb that now can clearly be predicted to eventually blow up in the face of the owners, the parents with this early warning can rethink and adapt the cottage succession plan to prevent a potential meltdown over the inevitable cottage issues.

But once the cottage succession plan is sorted out and the Cottage Sharing Agreement is signed up in the healthy spirit of co-operation and compromise, then all family members can be confident that their cherished cottage will remain a family treasure for generations to come!

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in the Family Cottage!