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Avoiding disputes over family property

MONEY 401

If it's not done, bitterness can set in, says **Ellen Roseman**

My three brothers and I had no major fights when dividing our parents' property after they died. But then, we didn't own a family cottage.

"The number one issue that families fight about in estates and succession is the family cottage," says Barbara Benoliel, who has a PhD in psychology and works as a dispute mediator.

"More than business assets or personal assets, the cottage represents to all family members their good times together. Everyone has a stake in the future of the family cottage or vacation place."

Suppose your parents bought a waterfront lot on Lake Muskoka 50 years ago. They put up their own small building and added to it over the years.

The cottage could be worth \$1 million when they die. Most of that would be a capital gain, leaving an income tax bill of about \$240,000.

With a principal residence, there's never any tax on the growth in value, even when the owner dies. But there's no capital gains exemption for a sec-

ond home.

"The cottage may eat up all the cash, leaving nothing for the family," says Ted Rechtshaffen, president of TriDelta Financial Partners in Toronto.

If there aren't enough liquid assets in the estate, the executors may have to sell the cottage to pay the final tax bill. This can cause bitterness among adult children who want to keep it in the family.

To make sure the cottage doesn't have to be sold, your parents can buy a life insurance policy to cover the taxable gain (assuming they're healthy enough to get insurance coverage and they can afford the premiums). The adult children would be named as beneficiaries.

Parents who own two homes can decide which one is their principal residence for tax purposes. They should designate the cottage if it has a bigger taxable gain than the city home — even if they live in the cottage for only part of the year.

A family cottage can be the source of sibling rivalry if you want to keep it and others don't. How can you agree among yourselves?

"Emotions play a big part," Rechtshaffen points out. "You feel that Mom and Dad would have wanted to keep the cottage. You buy out your siblings, forcing yourself to go bankrupt as a

result. It's an extreme situation, but it can happen."

Advisers often tell older people to sell the family cottage before they die to avoid disputes. Adult children can use their inheritance to buy a cottage if they want one.

Remember that the grandchildren may not have the same great memories as you do. They can have good times at any cottage.

Siblings who want to keep the family cottage should consider shared ownership, Benoliel says.

"You can pay a management fee to one family member. Or you can hire outside managers, so no one has to get involved with it on a day-to-day basis."

To make things fair, each family can pay rent to use the cottage — and share the income when it's rented out to others.

A principal residence can also lead to family feuds. What if one adult child lives there and wants to stay on after the parents die?

The surviving parent may leave the property to all the children in the will. The sibling who wants it has to get an accurate appraisal — maybe several appraisals — so the others won't feel they're cheated when they sell their share.

Sometimes, parents are advised to register a home in joint ownership with their kids to avoid probate tax.

This can lead to "tax avoidance horror stories," says financial planner Kurt Rosentreter.

For example, an 80-year-old mother makes her son co-owner of her home. He gets a divorce and his ex-wife gets part of the home in a property settlement.

A 75-year-old asks her daughter to help manage her rental

property and gives her joint ownership of it. The mother doesn't realize she has a capital gain and a big tax bill to pay, since she's considered to be selling half the property to her daughter.

Meanwhile, the daughter has to declare half the rental income. Her husband persuades her to embezzle money from the mother to pay the income tax.

Suppose you're an adult child and your mother asks you to be added as a joint owner to the house. Is it in your best interest?

Not necessarily, says estate planning expert Sandra Foster.

If you already own a principal residence, your share of your mother's property could be considered an investment property. You may have to pay tax on any profits earned on your share when it is eventually sold.

If you don't have your own

home and live in your mother's place, you could lose the ability to participate in some government programs for first-time home buyers, such as the RRSP loan program, "because technically, you would be an owner," she says.

Parents can register their children as joint owners of a cottage. But they have to remember the potential tax consequences in the year they transfer title, since this is considered a sale for tax purposes.

Problems can arise: What if one of the owners declares bankruptcy? Could the parents end up sharing the cottage with a child's ex-spouse?

Here is Foster's advice for older parents who are ready to give up ownership of the cottage and all the responsibilities that go with it.

"You could give it or sell it to the children at fair market value and then enter into an agreement giving you the right to use the cottage," she writes in *You Can't Take It With You* (Wiley, \$27.99).

"You could also hold a mortgage on the cottage to protect your own interests.

"Keep in mind, though, that life can be very different when you are the guest and your adult children are the owners."

■ Next week, we look at what happens when family members die without a will.

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