Renovate your cottage with taxes in mind

The summer cottage is a quintessential part of life for many Canadians. If you have one, you would do well to stay up to date on the various tax rules that apply to cottage owners, including those that concern renovations.

Since 1982, tax rules in Canada have stipulated that a couple may own only one principal residence between them. Since 1992, when the capital gains exemption on real estate was eliminated, all gains on real estate not considered to be a principal residence are taxable when the property is sold, gifted or considered to have been sold.

That's why it's important to understand which renovations will increase your adjusted cost base – and therefore decrease the capital gains you realize and the corresponding tax you'll pay – if you sell the cottage.

Your adjusted cost base is what you paid for the cottage plus any capital expenses. The difference between your adjusted cost base and how much you sell the cottage for is your capital gain.

For example, if you bought the cottage for $100,000 and you're selling it for $150,000, that's going to result in a capital gain of $50,000, and you'll pay tax on 50% of it as per regular tax rules.

But if during the time you owned the cottage you spent $15,000 on renovations that could be considered capital expenses, the spread between your cost base and selling price will narrow somewhat (to $35,000 in this example), reducing the tax due.

"Generally, a capital expense is a larger expense, used to replace or substantially transform a structure,". "Rebuilding a deck or dock, building a septic field or foundation, or installing insulation should all count as capital expenses. Refinishing the floor, painting the walls or replacing the odd board will not qualify." Keeping receipts for anything that might be a capital expense.

Cheaters never win

He would also like to dispel a myth – the notion that to pass on the family cottage tax-free, you can simply sell it to your kids for $1. Your kids can pay you whatever you like, but you still have to pay tax on the difference between the deemed market value and the adjusted cost.

"That $1 transaction actually creates a double taxation,".

First Ottawa will charge its capital gains tax based on the properties' fair market value regardless of the price you and your kids agree upon. Secondly, when your kids eventually sell or pass on the cottage, the government will calculate the capital gain based on the $1 purchase price your children paid to you. In short, don't sell it for a buck!

You may want to consider reviewing your specific situation with a tax specialist or financial planner. Meanwhile, don’t misplace your receipts.