ALL IN THE FAMILY

Passing down a cherished property

June 2014

Passing down a family home from one generation to another requires more planning than many property owners may realize. While the idea of keeping the property in the family is filled with good intentions, without proper advance planning, grantors run the risk of leaving their heirs a legacy that may result in distress and disharmony.

LEGACY PROPERTY PLANNING INVOLVES UNIQUE CONSIDERATIONS

To understand why legacy properties involve strategic planning, consider this familiar life situation: A family vacation home is left to the grantor's children and his second wife. The children have families of their own and, depending on family dynamics, may not necessarily get along with one another or with their father's widow. Even if the relationship is loving and amicable, what happens if the property cannot accommodate all the families at once or if cash is required for repairs and maintenance?

"A major challenge with vacation homes or family compounds is that you're not going to get uniform usage among beneficiaries," explains Mike Papierski, senior asset manager in Northern Trust's Real Estate Group. "It's possible that some will come to resent the fact that they are not using it while others are. They may feel that the asset is not doing anything to benefit them." Even worse, some beneficiaries may consider the property a drain on their resources. While not every potential situation can be anticipated, it is important for you to work with your advisors to address such broad issues as usage and maintenance in your estate plans.

Identifying Potential Issues

Both trusts and wills, because of their flexibility, can be used to address such issues as ownership, usage, and maintenance. According to Kevin Harris, senior vice president in Northern Trust's Family Business Services, "regardless of the estate planning vehicle, the key to managing legacy type properties is to address the issues that are likely to arise." These might include usage rights, payment of expenses, renovation decisions, the parameters for renting the property and provisions for the ultimate sale or disposition of the property. Planning for these types of assets require flexibility to address not only the situation today but also the likely issues that may be encountered many years in the future.

Choosing the right vehicle

The three most common vehicles for managing a legacy property are dynasty trusts, family limited partnerships (FLPs), and limited liability companies (LLCs). Often, the best approach is for an LLC or FLP to hold the property for liability protection purposes and for the trust to hold the LLC or FLP interests. Trusts can also hold assets other than LLC or FLP interests, provide beneficiaries with cash flow, and allow them to control disposition of the legacy property through the exercise of limited powers of appointment. Trusts may also offer generation-skipping transfer tax advantages, plus the ability to appoint a corporate trustee to "keep the peace" among beneficiaries.

With an FLP or LLC, management control can be specified, interests can be weighted, and buy-out provisions can be included. Because these entities are treated as "pass-throughs" for income tax purposes, they may provide tax benefits (i.e., deductible real estate taxes) in some situations.

Both Papierski and Harris agree that distributing fractional interests of a vacation property outright to beneficiaries can create significant problems among them. They suggest that it generally makes more sense to keep a vacation property in a trust with sufficient cash to maintain it, or to place the property in an LLC or FLP in anticipation of distributing it at some point in the future.

Flexibility is important

To mitigate potential conflict, it is crucial to understand that the needs and desires of family members can change. "After-the-fact" planning is often the toughest way to resolve issues and may serve to undermine the family unity you sought to establish in the first place. Just as people's relationships to property change over time, so does the property itself. A secluded lakefront cottage on 10 acres may later be surrounded by hundreds of tract homes built after neighbors have sold out to developers. Or a home in a once modest neighborhood may now be worth 10 times its purchase price – and carry with it the weight of a large property tax. In a worst case scenario, financial considerations may require court intervention to sell the property if it doesn't make financial sense to retain it.

By its very nature, estate planning means that some people make plans that others will live by. It is important to get family members involved at the beginning of the planning process, particularly for legacy property, which carries fond memories and strong emotional ties.

FOR MORE INFORMATION

Wealth Planning Advisory Services at Northern Trust includes financial planning, family education and governance, philanthropic advisory services, business owner consulting, tax strategy and wealth transfer services. If you'd like to learn more, contact a Northern Trust professional at a location near you or visit us at northerntrust.com.