MANAGING THE VACATION HOME

Balancing Finances, Family Memories and Future Plans.

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Planning for the family vacation home often involves deeply personal considerations. Whether it be a place filled with many happy memories of long summer days spent in laughter and play, or a mountain property for winter recreation, sentimental assets create an associated need to balance family dynamics with financial realities.

FRAMING THE CONVERSATION

The owners of the property—who are often the senior generation—should first consider what they envision for the property. Do they want their children and grandchildren to continue to use the property for family vacations? Planning for the successful transfer of the family vacation home involves determining whether or not expectations align with the interests and preferences of the younger generations. It is important to have a conversation with family members to clarify and carefully consider options. Consideration should be given to the following:

- Making family members aware of the plans.
- Do the heirs have any interest in using the property?
- Is it practical to expect the family to continue to use the property? For example, if the home is used for the 4th of July, how can the four children and ten grandchildren use a house with five bedrooms?
- If the house cannot be used by the entire family concurrently, how will the children decide who gets to use the property and when?
- How will the property be managed and maintained?

If planning does not align with expectation of the transferees—and their economic realities—the intentions of the owners may not be fulfilled.

HOW PROPERTY IS HELD

The way in which property is held—meaning, how it is owned/titled—will form the conversation regarding planning options. At its most basic, the property may be owned outright. Therefore, the owners may generally use and dispose of the property as they please. However, if the family's lake house is held by the parents as joint tenants with the right of survivorship, while both parents are alive they both have an undivided right to use the property. At the death of the first parent, the property will pass to the surviving spouse. If the remaining spouse leaves the property to multiple children, by will or deed, the children may own the property as "tenants in common." However, each child will be able to freely sell or dispose of his/her interest in the property.

PLANNING OPTIONS

One option to consider is the use of a Qualified Personal Residence Trust (QPRT). The grantor transfers property to a trust for the benefit of the family, but retains an interest in the property for a term of years and, usually, a reversionary interest as well. The value of the interest transferred to the family, deemed a gift to the family, is the full fair market value of the property minus the value of the interest retained by the grantor. The value to the beneficiaries is determined in relation to the 7520 rate, the interest rate used to value certain charitable interests, at the time of transfer (2.4% in May 2014). Therefore, any future appreciation to the property will not be considered for transfer tax purposes. The retained value will be for a predetermined term of years, so this planning option may not be advisable if the grantor may not have a long life expectancy. If the grantor does not survive the trust term, the entire value of the property will be included in the estate of the grantor for federal estate tax purposes.

At the end of the term, the QPRT may be structured to transfer the property outright to the children or to hold the property in trust for their benefit. However, once the property is transferred at the end of the term, the grantor cannot continue to freely use the property as before. Continuing to use the property, as if the grantor still owned the property, might result in the full value of the property being included in the grantor's estate for estate tax purposes. Therefore, the grantor should consider a leasing arrangement, such as renting the property for fair market value, from the new owners.

Another option is to transfer the property into a limited liability company (L.L.C.). Interests in the L.L.C. may then be transferred to the children, either immediately or over a period of time, and most likely at a discount due to the closely held, non-marketable nature of the interests. When gifting interests in the L.L.C., owners may consider taking advantage of the annual gift tax exclusion amount ($14,000 in 2014) to minimize the transfer tax consequences. In order to receive the transfer tax benefits as well as the benefits of limited liability for members and treatment as a passthrough entity, meaning the tax would be paid by the owners not the L.L.C., the family should be mindful of the need to respect the formalities of the L.L.C.

COMPLETING PROPER PLANNING

Any transfer should include planning for expenses, upkeep, and maintenance. Determining if the intended recipients are willing to maintain the property and establishing a plan for administration will ensure the validity of any planning structure, while helping to keep the valued property in the family. Because maintaining a property can be time-consuming and costly, having honest conversations with family members is a vital part of the process. A plan should be established to pay expenses and manage the property.

At the outset, a plan should also consider the possibility that a family member may wish to dispose of his/her interest in the property. Discussing the possibility of first offering to sell an interest to the other family members, or drafting into any agreement that the family should have the opportunity to buy the interest before anyone outside the family has the option, will help keep the property in the family. However, clearly defining roles and expectations remains the critical component of successfully transferring the family vacation home to the next generation.

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