Wealth Strategies

Life Is Better at the Beach

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Whether it's a cabin on Lake Martin, a beach house on 30A, or a place in the North Carolina mountains, for families fortunate to have such a place, more than anything it's where memories are formed that will span generations.

Passing that home on to the next generation and beyond can be m ore difficult than it seems. Too often family members will argue over how to manage the property: keep or sell, buy-out one or the other, utilize individually or together (and schedule visits), pay ongoing expenses, etc.

The older generation often thinks "…the kids will work it out among themselves." Unfortunately, that's the exception rather than the norm. So, what is to be done?

Endow the House

One of the primary issues around keeping a vacation home within the family is the cost of keeping the home up. There's maintenance, property taxes, insurance, mortgage payments, renovations, and repairs. Where one child can readily contribute, another is faced with school tuition, college funding, and other on-going costs associated with raising several grandchildren.

Making a dedicated liquidity source available is key. By delivering a guaranteed and liquid benefit at the time of transfer, many, if not all, of the cash flow issues in a multigenerational legacy property can be resolved. Proceeds from a life insurance policy may be used to clear the mortgage, establish a cash reserve for ongoing expenses, and even buy out an heir who doesn't want to inherit an ownership interest. And if successive generations continue to fund the property trust with life insurance, it's very possible a precious legacy asset can remain in the family for a long time.

Build a Structure for the House

Generally, there are 3 Ways to Pass Down the Family Vacation Home

1. Direct Transfer of Ownership

Pros: An easy transaction; low cost to establish.

Cons: Little or no protection from creditor claims and the divorce of a new interest holder; lacks methods for resolving disputes or transferring interests. One lesserknown legal problem is that any tenant-in-common co-owner of a property can force its sale. A child may decide he can't afford his share of the expenses; lives too far away to use the property; and/or he wants to convert his ownership share into cash.

He could ask his siblings to buy him out. If they are unable or unwilling to do so, the child can either sell his share to an outside investor or use the courts to force a sale of the property.

2. Trust

Pros: Useful tool for laying out a road map of agreement between the new home interest holders; estate planners are familiar with them; simpler (fewer legal formalities) than LLCs; relatively low cost to establish.

Properly implemented, the trust segregates an asset (in this case, the vacation home) from the owners' personal liabilities and provides a governance model for equitable distribution of privileges and obligations among the several owners. There are clearly defined management responsibilities for the trustees, delineating how to pay the bills, maintain the property, determine policies for use, and regularly report on the financial and physical condition of the home.

Cons: Inflexible and cumbersome for dispute resolution and property management. The issues around trust structures can be nuanced and complicated.

3. LLC

Pros: Perpetual existence; flexible for amending; limited personal liability; creditor protection. An Operating Agreement can be designed to address management issues, including scheduling, and voting process.

Cons: Its formalities may make it complex; depending on the state, it may be costly to establish and maintain

TAXATION: With all forms of ownership transfer, there may be income-, gift- and estate-tax implications. Prior to executing the transfer, there should be a complete analysis of the estate, gift, income, and property taxes to prevent unintended tax consequences. We can collaborate with your attorney and tax advisors to provide that planning.

As always, make sure to consult with your tax advisor before implementing any tax-related planning approach.

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