

PLANNING FOR THE VACATION HOME

AVOIDING PITFALLS AND PRESERVING A LEGACY

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A family's second or vacation home is a key part of the estate planning discussion. Families usually have fond memories of and sentimental attachment to the vacation home. But without careful planning, this sentimental attachment can lead to family disharmony around the future ownership of the home. This article briefly addresses what an attorney should consider when planning for a client's vacation home to avoid legal drawbacks and significant family drama.

Many of the estate planning considerations for a vacation home are really not too nuanced. Just as an attorney would with any other asset, it is important to find out a client's values, concerns, and overall goals with regard to the vacation home. Does the client want to transfer the vacation home to their children when the client dies? Or would the client instead desire the vacation home be sold and its proceeds split among their children? It is equally important to find out whether the client's children actually

want to be the next owners. There might not be any interest. And even with proper planning, transferring the vacation home to children may not be the best course of action given the fact that siblings may not always be the best joint owners. If there is no interest in transferring the vacation home to a client's children, the best estate plan would allow the fiduciary to easily sell the vacation home after the client's death. If the children want to own the vacation home, careful thought must be given to a variety of factors and a flexible plan must be implemented to account for changing family dynamics. Attorneys will do well to understand a client's values, concerns, and overall goals, so they can properly advise their client as to the vacation home.

After taking stock of these items, the next major consideration is how the vacation home will be owned. Without careful planning, the typical ownership structure is outright ownership. In such a case, a client's children will take title to the vacation home

as either tenants in common or as joint tenants with rights of survivorship. Tenancy in common creates several risks, namely each child having the ability to sell their interest to an unrelated individual or entity (unless an agreement to the contrary is in place), and the potential for a partition action in the event a dispute among children arises. In a joint tenancy, a client must understand that title to the vacation home will eventually vest in only one child's family, to the exclusion of other family members.

Regardless of the type of tenancy, a co-ownership agreement should be implemented to set forth rights, duties, and responsibilities of each child. Although it may be introduced post-transfer, this agreement should be implemented upon a client's transfer of the vacation home to the children. A fiduciary who is granted the power of sale in a client's will may be able to leverage this power (i.e. threaten to sell the vacation home) to persuade children to sign such an agreement. Key terms to be addressed in such an agreement are:



- Who may occupy the vacation home and when (including guests or short-term tenants);
- How necessary expenses, repairs, maintenance, and improvements will be handled and paid for;
- How transferability of interests will be restricted; and
- How disagreements will be resolved.

While this mode of transfer is prevalent, it is not without its drawbacks. For example, holding title in the children's individual names exposes the vacation home to liability with regard to a child's creditors or (potentially) divorcing spouse. Additionally, the children could be subject to personal liability to third parties for the action or inaction of the other children. Furthermore, unless agreed otherwise, unanimity among the children would be required to sell or transfer the home, which could give rise to a 'hold-out' child. In light of these drawbacks, careful consideration should be given in determining if this method of transfer is appropriate.

Because of the various risks with outright ownership by the children, perhaps the more efficient form of ownership is a trust. During a client's lifetime, they can manage and control the vacation home as trustee. After the client's death, the successor trustee can transfer the vacation home according to the terms of the trust without having to build consensus among several beneficiaries. There are often some beneficiaries who want to keep the vacation home and some who just want a cash buyout. The trust can create the ability to accommodate both of these desires. Family dynamics often change as well. After years negotiating with other relatives for time at the vacation home (taking into account seasons and weather, holidays, and limited time off for vacation), a child's desire for ownership may wane. It is important to have trust provisions that could accommodate this potential change. In addition to this, a well-drafted trust will address several other key terms, including:

- Who makes decisions;
- How management duties are passed down to successor trustees;
- How costs related to the vacation home are covered, and if additional funds are necessary;
- Transfers of interests through generations; and
- Spendthrift provisions protecting against creditors and divorced spouses.

Some potential drawbacks of using a trust include irrevocability and fiduciary duties. If a

trust is (or when a trust becomes) irrevocable, the terms will be difficult to amend, so it will become inflexible. Also, trustees risk breaching fiduciary duties to beneficiaries if they fail to act impartially. Nevertheless, trusts remain reliable vehicles for vacation home transfers and are often more beneficial than direct transfers to children.

A third alternative for vacation home transfers is through the use of a business entity. When utilizing this vehicle, clients must consider what business entity is best — limited liability companies are the most flexible entities but family partnerships are sometimes preferred. Regardless of the legal form, these companies must be properly structured and meet all state law requirements. Clients should also limit management of the entity so the most competent and responsible people can exercise authority over the vacation home without pushback from the owners. In some instances, a disinterested third party is best suited to manage the entity. Clients should take time to implement an operating or partnership agreement that addresses key items such as:

- If ownership of the entity should be divided into voting and non-voting interests;
- Management structure (e.g., a board of managers with one manager from each child's family);
- Funding issues, such as capital calls;
- How children can exit the entity if they want or are unable to respond to capital calls; and
- How transferability of interest in the entity will be restricted.

Using a business entity might also allow for ownership changes inside the entity without customary drawbacks. For example, changes in the entity's ownership might avoid triggering real estate transfer or conveyance taxes or fees, or even property tax revaluations, since the same entity will own the vacation home after the ownership change. Also, for vacation homes that are in planned communities and governed by association rules, changes in the entity's ownership without transfer of the real estate could shield the entity from future rules or restrictions that might restrict use of the vacation home. These benefits may be reduced or even eliminated under the Corporate Transparency Act, which takes effect January 1, 2022. Under applicable regulations, the ownership changes contemplated here may

be required to be disclosed. Nevertheless, these benefits should not be overlooked and may create significant value for a client.

While business entities provide several benefits — not the least of which is protection from personal liability — there are potential drawbacks. Despite a client's careful planning, operating agreements may be amended (or even terminated) by children, which may thwart or undo a client's intentions. Entities can also have substantial initial formation costs (state filing fees as well as attorney fees) and ongoing operating costs (annual filing or registration fees as well as annual tax preparation and filing fees) in addition to the other costs regularly associated with property ownership. Despite these drawbacks, if executed properly, this method of transfer can be an effective tool to help clients protect the vacation home.

For clients with vacation homes, the strategies mentioned here should be considered and tailored to fit each client's specific needs and to ensure their goals are properly implemented. Vacation homes are valuable assets and, if not properly owned and managed, can lead to family dissension. Attorneys play an integral role in structuring a plan that protects the vacation home, helps the family avoid conflict, and furthers the family's legacy.



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