How to Manage and Maintain a Family Legacy

Grandpa's

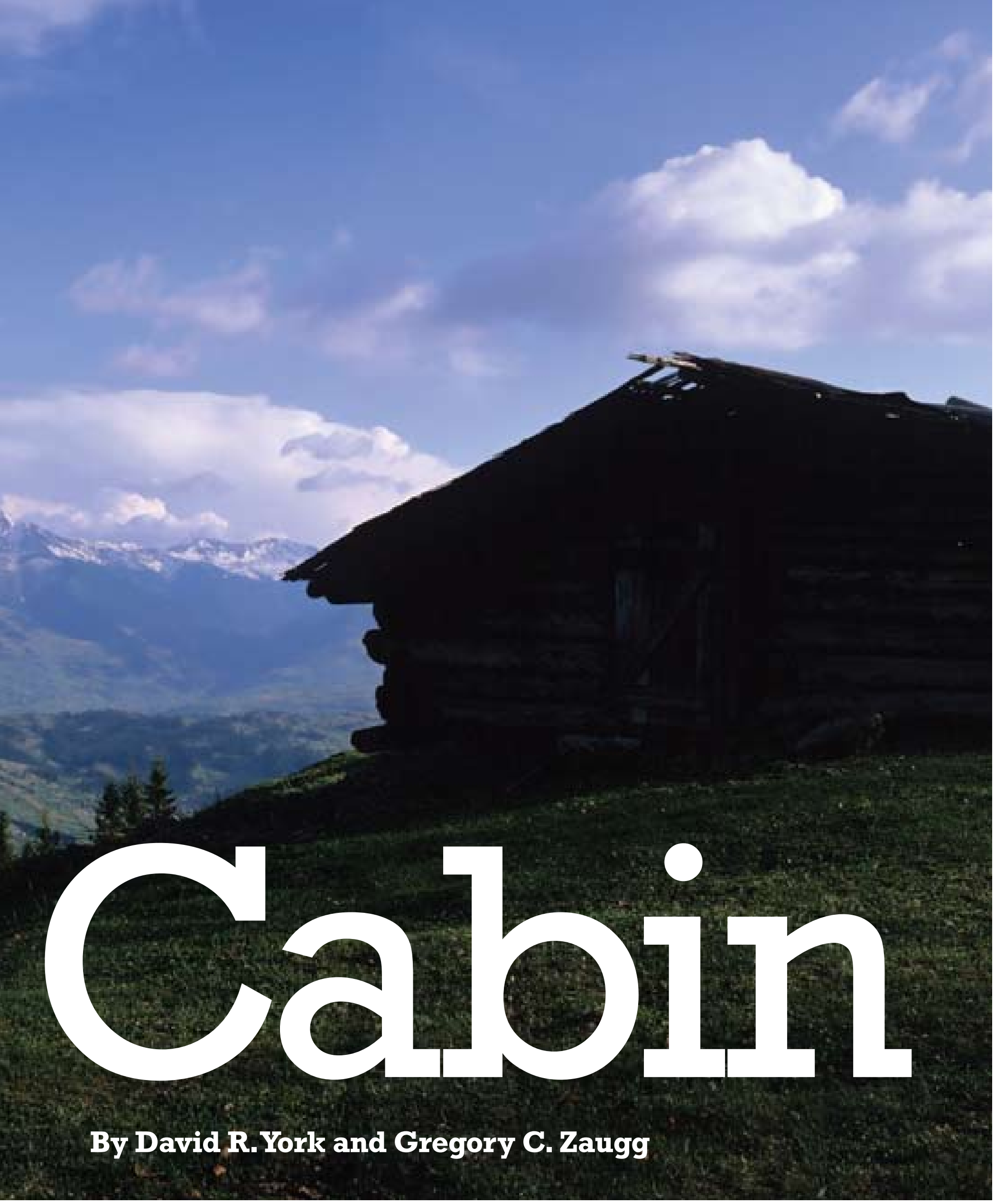
For many families, recreational properties like cabins, beach houses or condominiums provide countless opportunities for bonding and relaxation. Everyone has fond memories like the time little Billy got chased by a raccoon or the night the cousins snuck out for a moonlight hike and got lost. Little wonder that parents want the family recreational property to be kept in the family for future generations. Although accomplishing this desire can be difficult, careful planning can often avert a number of pitfalls.

Titling Options

For parents who want to eventually transfer the family recreational property to their children, but are not ready to make those plans irrevocable, the revocable trust is a great option. Upon the death of the settlor of the trust (the person who established it), the trust becomes irrevocable. It can be designed to hold the recreational property for the use and enjoyment of the settlor's posterity. An advantage of holding recreational property in a revocable trust is that the settlor can amend or revoke the trust at any time during his or her life. In addition, upon the death of the settlor, the tax basis of the property increases to its value on the date of death, which may save capital gain taxes if the property is later sold. The trust can hold the property and also protect it from the claims of the children's creditors.

Irrevocable trusts can also be used to transfer recreational property to the next generation. As the term suggests, once the irrevocable trust is executed, it cannot be revoked or modified. If the transfer to the irrevocable trust is properly structured to be deemed a completed gift by the settlor to the beneficiaries, the value of the recreational property and all future appreciation will be out of the settlor's estate, thus not subject to federal estate tax upon the death of the settlor. However, gift tax issues will need to be considered. Another option is to sell the property to the trust in exchange for a promissory note. This option allows the senior generation to "freeze" the value of the recreational property in their estate, and therefore can be beneficial for recreational properties that are anticipated to increase in value. Also, property that is gifted or sold to an irrevocable trust will typically retain the same tax basis it had in the hands of the donor or seller, plus the amount of any gift tax paid.

Family limited liability companies (LLCs) provide a flexible means to transfer recreational property to the next generation. Because ownership and management of an LLC can be separate,



Cabin

By David R. York and Gregory C. Zaugg

the senior generation can manage the LLC until their deaths, allowing them to oversee the property. The ownership interests can be gifted or sold to the younger generation during the life of the senior generation, or transferred upon the death of the senior generation, or a combination of the three. Gifts of ownership interests are subject to federal gift tax laws. However, by using the senior generation's gift tax annual exclusion amount (currently $12,000 per donee) and lifetime exclusion amount (currently $1 million) one can avoid paying any gift tax. Additionally, the value of the LLC membership interests may be able to be discounted based on minority ownership and lack of marketability. This can reduce the value of any interest retained by the senior generation, thus reducing the value of their estate for estate tax purposes.

The LLC operating agreement can be structured to prevent the transfer of ownership interests outside of the family unless there is the unanimous consent of the members. The LLC operating agreement can also contain a buy-sell agreement that governs the transfer of membership interests. That way, if some of the children want to continue owning the property and others don't, the terms of the LLC operating agreement govern how members can sell interests to each other.

Management and Maintenance Agreements

Once the recreational property has been transferred to the younger generation, the family will want to put into place a mechanism to manage the property, resolve conflicts and facilitate maintenance of the property. This agreement can be incorporated into the LLC operating agreement or the trust agreement. The agreement may also be in the form of a contract or bylaws. In order to maintain the smooth operation of the recreational property for the younger generation, the agreement needs to facilitate ongoing use and maintenance. The agreement should address several points:

- >> The resolution of problems that may arise among owners;
- >> Who will pay the ordinary and capital expenses of the property;
- >> Scheduling the use of the property;
- >> Whether the property should be rented out;
- >> Whether family members may bring guests to the property; and
- >> Whether nonfamily members may use the property.

The senior generation may want to give other assets to the trust or LLC that can be used to pay the ordinary and capital expenses of the property. The design and implementation of the management and maintenance agreement can often prove to be the most difficult aspect of the transition from the senior generation to the younger generation.

Jointly Owned Property

Shared ownership of property among nonfamily members is becoming more and more popular. Instead of owning an interest in a timeshare that may be difficult to use or trade, many individuals are purchasing fractional interests in property with friends or others. These arrangements can allow individuals to own an interest in property they might not otherwise be able to afford or to more accurately reflect the amount of time they would actually use it. It is especially important with joint ownership of property among nonfamily members that an agreement be put into place with appropriate buy-sell provisions. An LLC is a great mechanism for owning such property.

With a proper legal structure and thoughtful planning, a family or joint-owned cabin or other recreational property can provide for years of positive family memories.

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