

All in the Family: Estate Planning for the Vacation Home

Vacation. It is a word that has become almost synonymous with the summer. And whether your destination is a beach house, a lake cottage, or a mountain cabin, there are common threads of leisure, fun, and memories tied to a vacation home.

Many people have a vacation getaway on the Outer Banks, at Lake Gaston, in the mountains, or elsewhere that is enjoyed by the whole family. Once frequented by young families, the vacation dwelling is now a multigenerational meeting place where grandparents, adult children and their spouses, and grandchildren relax and play.

For nostalgic reasons, many people want to keep their vacation home in the family for future generations. But, passing a vacation home on, without a succession plan, can quickly negate the positive memories. Consider these examples of unintended consequences by failing to plan:

- Sally, Ben and Michael, siblings, inherit a vacation cottage outright. Michael's one-third interest is awarded to his unpopular ex-spouse, Cathy, after a bitter divorce.
- Liz and Amy, sisters, inherit a vacation home outright. Liz has lost her job, cannot afford to share in the maintenance, and wants to cash out. Amy can't afford to buy Liz out, so Liz petitions the court for "partition" – a forced sale of the property.
- Peter and John, brothers, inherit a mountain cabin outright. Peter is sued. His creditor obtains a judgment and levies on Peter's interest in the cabin, forcing a sale of the property.
- Susan and Joe, siblings, inherit a beach house outright. Susan and Joe's wife, Rachel, have never gotten along. They argue over updating the kitchen and adding furniture, over whose family gets the house on July 4, and they even argue over the cable television package. Eventually the discord results in litigation.
- Ann, Kevin and James, siblings, inherit a lake cabin outright. None of them are as successful as their physician parents, and collectively they cannot afford to maintain the cabin.

These undesirable outcomes are the result of inheriting property outright as "tenants in common." Real estate left directly to multiple family members in a will, trust, or by intestacy, results, by default, in a tenancy in common ownership unless otherwise specified. This form of ownership is governed by real property law, which has changed little over the centuries and provides nominal flexibility for the challenges faced by multiple-property owners.

Among the reasons to avoid creating tenancy in common ownership is each owner's right of partition. Partition is the right under real property law to petition the court for a forced sale of

the property, if an owner desires to cash out and the other joint owners do not buy him/her out. Further, tenants in common have concurrent rights to use the real property. If one owner holds a 70% interest in the property, and the two remaining owners hold a 20% and 10% interest, respectively, this does not mean that the 70% interest holder is entitled to exclusive use of the property 70% percent of the time. Nevertheless, he/she is responsible for 70% of the maintenance expenses. And one owner's disproportionate payment of expenses does not necessarily entitle that owner to reimbursement from the other owners.

In addition, consider what one tenant in common can do without the consent of the other owners: renovate the real property; mortgage his/her interest in the property; transfer his/her interest in the property, or rent the property to third parties.

The pitfalls of a tenancy in common ownership can be avoided by transferring the real property to a trust, limited liability company, partnership, or some other entity. When owned by an entity, use of the property is governed by contract law rather than real property law – providing far greater flexibility. A trust, a partnership agreement, or LLC operating agreement can:

- Protect the ownership interest of a family member by addressing how the interest is treated in the event of death or divorce (preventing a non-family member from acquiring an ownership interest).
- Address the inability of one or more owners to afford maintenance of the property, by creating an endowment for expenses, or providing a “right of first refusal” for owners to buy out the interest of others who wish to cash out.
- Establish consequences for failure to contribute to maintenance and upkeep of the property (for example, the loss of right to use the property).
- Establish how decisions are made regarding capital improvements, maintenance, etc. (using “majority vote” or another dispute resolution method).
- Provide a list of rules for cottage usage along with “majority vote” or another standard for changing the rules. The agreement can even provide that a deadlock be decided by a neutral mediator.
- Prevent a forced sale of the property if an heir wants to cash out, by establishing the terms of the buyout by other owners who wish to keep the property.
- Depending on its structure, there can also be positive tax and asset protection consequences resulting from the vacation home succession plan.

The governing trust or agreement can be as unique as the family for which it is created. Don't leave the future enjoyment of your vacation home to chance – take time to create a plan that ensures family harmony and fun for future generations.