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Keeping the Cottage in the Family: Succession Planning for Vacation Homes

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I. Some options to keep the cottage in the family.

A. Immediate transfer. An owner can transfer title to a vacation home to children or others, either completely or with conditions attached. Transfer can be by gift, if gift taxes are not a concern, or if the children's resources allow it, by sale. Another alternative is a transfer on death deed, which will transfer the property at death without probate proceedings. Depending on the extent of the property, it may be divided and the parts transferred to different people. You can transfer title to your children (or others) but reserve a "life estate." Under a life estate, a property retains the right to use and manage the property up to the moment of death. A transfer can be made to children (or others) as individuals or through a trust or other entity or subject to a "cottage-in-common agreement" described below.

B. A vacation home trust. Under this option, the owners transfer title to the property to a trust. Typically the trust is revocable. This means that the owners can change their mind if they need to sell the property during their lifetimes. While the trust is in effect, the owners typically hold the powers of trustee. Upon the owners' deaths, the trust continues and children or others succeed the former owners as trustees. Provisions addressing governance, powers, eventual disposition of the property and other matters are addressed in the document creating the trust.

C. A cottage-in-common agreement. Wisconsin law sets the rules for co-tenants, including joint tenants, which apply in the absence of a written agreement. It is often desirable to avoid these default rules through the use of a written agreement governing property owned by two or more family members, typically adult siblings. It permits the co-owners to make provisions for shared use of the property, including governance, responsibility to pay for taxes, repairs and other expenses and to schedule use of the property. Co-owners usually have the right to compel division or sale of the property so they can get out of the common ownership, but this right can be restricted for as long as 30 years by a written agreement.

D. A cottage club or company. This option involves the creation of an entity to own vacation property. These are sometimes created in the form of a nonstock membership corporation (usually limiting membership to family members) or a limited liability company. Other alternatives that are sometimes suitable include business corporations, partnerships and limited liability partnerships.

II. Considerations in the form of vacation home family succession.

A. The family.

- 1. The owners.** Are the owners married? How old are the owners? Do they hope and expect to keep the cottage for the remainder of their lives? Do the owners have assets that could be used to establish a fund to assist in future vacation home taxes and other expenses?
- 2. The owners' descendants.** How many children do the owners have? Are all of the children interested in the cottage? Do they live nearby? Is one or more child especially qualified to manage a vacation home trust or similar entity? Are all of the children financially able to carry their weight? Are they married? How many grandchildren do the owners expect?
- 3. Family composition.** Are there issues of divorce, stepchildren, or blended families? How do the owners and their descendants get along with the in-laws?
- 4. Comfort with business formalities.** Some ownership arrangements involve ongoing business formalities like the filing of annual reports or tax returns.

B. Financial circumstances.

- 1. Owners.** Do the owners have sufficient assets not requiring sale? Could they endow a trust with funds to provide support a transition to full responsibility by the next generation or to subsidize property taxes and maintenance costs?
- 2. Children.** Are the children financially stable? Do they have sufficient assets to purchase the vacation home? Do they have adequate incomes to afford proper care of the vacation home?

- 3. Owners' long-term care.** Do the owners have sufficient assets (other than the vacation home) to cover potential long-term medical care? Might a sale of the vacation home be required to meet Medical Assistance eligibility requirements?

C. The property.

- 1. Condition.** Is the property in good shape, or is there significant deferred maintenance? Will significant capital improvements be required in the foreseeable future to maintain the property's value and utility?
- 2. Site.** Is the vacation home located on a small lot or a larger holding? Would a future division of the property to create separate ownership interests for more than one child be feasible?
- 3. Extent of transfer.** What property should be included? Boats, piers, home furnishings, books, equipment?

D. Taxes.

- 1. Capital gains.** The gain from the sale of property is taxable as determined from the property's purchase price and adjustments. Basis is "stepped up" to current value when it is transferred to a descendent upon the owner's death. These considerations affect the type and timing of transfers.
- 2. Estate taxes.** Federal law taxes at death the assets of the estate and certain prior transfers. Sometimes transfer of ownership to an entity can affect the valuation of the owners' interest. Especially for families with substantial assets, planning for a vacation home must be coordinated with broader estate planning matters.
- 3. Gift taxes.** Federal law taxes gifts above an inflation-adjusted minimum amount per person per year. In addition, there's a lifetime exclusion of a specified amount. Giving the vacation home to children would consume that minimum and eat into, if not consume, the lifetime exclusion. The effect of gift taxes is generally managed in an estate plan.
- 4. Generation-skipping-transfer tax.** A gift to a grandchild, or similar distance in kinship or age, is taxed at the highest federal estate tax rate.
- 5. Property taxes.** Can the children afford property taxes on the vacation property? Could the property qualify for programs or transactions that might provide some property tax relief? (Managed Forest Law? Conservation Easement?)

- E. Time frame.** What is a reasonable planning horizon? Should you try to establish a long-term ownership arrangement that can be used for more than a

generation? Or, is it better to provide a temporary solution and let the kids figure out a continuing plan in the future? When must a decision be made?

III. The trust and/or operating agreement.

- A. Number of documents.** Does the trust or corporate articles specify management in detail, or are those details placed in more easily amended operating agreements?
- B. Management style.** Is it better to delegate broad powers to one or more owners or to use a more democratic approach? How specifically should the plan address vacation home management problems and decisions such as: scheduling use, making assessments for taxes and expenses, handling repairs and maintenance, deciding to make capital improvements and providing insurance coverage?
- C. Limits on members.** How should the documents address a co-owner's determination to sell his or her interest? Should a special decision-making process govern major decisions, such as borrowing money, selling or leasing all or part of the property?

IV. Conclusion.

- A. Evaluate.** Think about the property that you have and how you want to preserve it. Understand your family, its desires, needs, and limitations.
- B. Schedule.** Determine the time frame in which a decision needs to be made.
- C. Do it!** Obtain the assistance to make the transfer work out for your family.