Planning For the Succession of the Family Vacation Home

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During this unprecedented time, vacation and travel have changed dramatically. While most plans have been cancelled or postponed, many families have taken this "opportunity" to spend more time at their vacation homes. Some families and individuals are permanently taking up residence at what was once only an occasional vacation spot. Working from home has changed how and where we operate, as have the various new laws and policies in effect.

For this reason, many are thinking about plans for their vacation residence. During life, parents can generally broker and manage the use of the vacation home among their children and extended family with ease – or at least with a sense of clear control and geniality. But what about when mom and dad are gone?

Although siblings may be both responsible and agreeable, even the closest family relationships may be strained by the stress, complications, and disagreements that frequently arise from managing a vacation home together. When individuals with separate family sizes, goals, and interests own a vacation home together, the logistics of maintaining, using, and possibly renting the home become quite cumbersome. Parents risk unintentionally putting strain on interfamily relationships by neglecting to plan for a vacation home. Fortunately, there are ways to plan ahead and avoid the possible perils of co-ownership.

Outright Gift

The simplest way to transfer a vacation home would be by means of an outright gift, either during life or at death. Note that the transfer may be subject to gift or estate taxes, but if the home is transferred following the death of the owner, the home will receive a full step-up in basis for income tax purposes. This option is ideal for clients with children who have already agreed that they would like to share the vacation home and will work cooperatively to use and maintain the home.

Sale To Family Members

Some homeowners may choose to sell the vacation home to one or more family members during lifetime. Although the vacation home will be removed from the homeowner's taxable estate for estate tax purposes, the sale will be subject to capital gains tax, and any proceeds will be includable in the seller's estate unless the funds are otherwise removed from the estate.

If the younger generation has sufficient liquidity, the sale may be accomplished by means of a simple cash sale. Alternatively, the sale could be structured as an installment sale or as an exchange of the home for a private annuity. Your Vorys attorney can advise you in greater detail with respect to the advantages and disadvantages to each of these approaches.

Qualified Personal Residence Trust

A Qualified Personal Residence Trust (QPRT) offers a mechanism for minimizing transfer taxes associated with a gift of a vacation home. The homeowner transfers the home to a QPRT pursuant to which the homeowner retains a beneficial interest in the home for a fixed term of years. At the end of the fixed term, the home is distributed outright to the beneficiaries or retained in trust for their benefit.

The QPRT reduces the value of the taxable gift. Instead of making a gift of the full fair market value of the home, the value of the gift is reduced by the value of the homeowner's retained interest (according to IRS tables). Further, any appreciation realized during the years in which the grantor retains a beneficial interest passes to the beneficiaries free of tax.

With respect to any transfer of the vacation home during lifetime – by outright gift, by sale, or by means of a gift to a QPRT – such transfers are irrevocable, and the grantor gives up the absolute right to use and enjoy the home. However, if the beneficiaries or purchasers agree, the original homeowner could continue using the home by paying the new owners fair rental value for use of the home. The rent payment would not be subject to gift tax (b8t would be income to the recipient) and could serve as an additional opportunity for reducing the homeowner's taxable estate.

Irrevocable Trust

During the homeowners' lifetime, upon the homeowners' death, or following the fixed term of a QPRT, the homeowner may direct that the vacation home should be retained in trust for the benefit of the succeeding generation or generations. The grantor may also transfer cash to the trust to provide for long-term upkeep of the home and payment of associated expenses, such as real property taxes.

The grantor-homeowner can control how the home will be enjoyed and maintained by including trust terms that provide specific direction to the trustee. Alternatively, the grantor may wish to build in more flexibility and give the trustee significant discretion to manage and administer the home fairly among the beneficiaries.

The grantor should carefully consider the appropriate person or persons who will serve as trustee. The grantor may choose a neutral third party who is willing and able to oversee the management of the trust assets. On the other hand, the grantor may choose one or more beneficiaries. Where two or more beneficiaries will serve as co-trustees, they may be required to act by majority, supermajority, or unanimous agreement.

Creation of Family Limited Liability Company

Another option involves the creation of a family limited liability company (LLC). The homeowner creates the LLC during their lifetime and may transfer the vacation home to the LLC upon creation or upon the homeowner's death. At the death of the homeowner, each child will inherit an equal number of units in the LLC.

The primary benefit of LLC ownership is that the LLC can be governed by an operating agreement and/or bylaws that address all issues related to the maintenance and enjoyment of the vacation home, as well as how any unforeseen disputes should be resolved. The homeowner may choose to create such governing documents during life, alleviating the difficulty that could arise if the LLC owners (i.e., their children) must determine the terms after their deaths. However, unlike with respect to the terms of an irrevocable trust, once the second generation of owners inherits ownership of the LLC, the members may amend the governing documents as desired.

To preserve the family vacation home – and family harmony – for future generations, parents should undertake careful succession planning. Contact your Vorys attorney to discuss your goals and to learn more about the advantages, disadvantages, and tax consequences of each of your options in greater detail.

To expand our capabilities in assisting clients with a Florida residence, Vorys attorney Bailey R. Drexler has recently been licensed to practice law in the State of Florida, in addition to our long-time Florida practitioner, David A. Swift.