

Succession Planning for Your Family Cottage

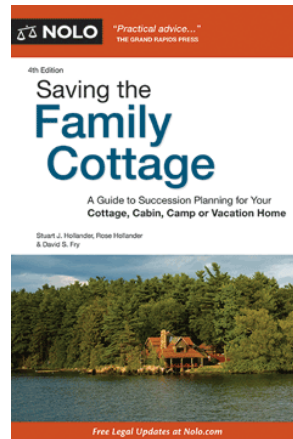
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Credits:

- Stuart J. Hollander, et. al., *Saving the Family Cottage*, 4th ed. (2013)



2015 Wisconsin Lakes Partnership Convention

April 23-25, 2015

Holiday Inn Convention Center, Stevens Point

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<http://www.uwsp.edu/cnr-ap/UWEXLakes/Pages/programs/convention/default.aspx>





Reinhart
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Attendee Survey

- How many grew up with a family cabin?
- How many currently own a lake home?
- How many are in the market for one?
- How many are leaders of Lake Associations?



Cottage Conflicts?

- A study of Canadian cottage owners found that of those owners who planned to give their cottages to family members, 11% said the cottage already caused a rift in the family and 22% believed it would lead to disagreement.
- Some gift, huh?



- Cottages are emotional places where you watch your kids grow up and create memories.
- Parents' goal: to provide future generations a place and setting for continuing shared family memories.
- We'd all like to think that our kids will remain sweet and innocent, but....



SERENITY NOW !
INSANITY LATER



OR WORSE.....



THEY COULD BECOME LAWYERS

Cottage Conflicts (cont.)

- What kind of conflict?
 - Inability to pay expenses
 - Not wanting to own the cottage
 - Inheritance trapped in the cottage
 - But they use it more?
 - To rent or not (does your lake association even allow?)
 - What color blinds should we have? Should we make improvements?
 - Should we hire improvements done, or do them ourselves?
 - Bankruptcy or Divorce





Cottage Conflicts (cont.)

- So, why is this important?
 - There are more than 5.2 million vacation homes in the US and about 600,000 in Canada
 - Florida has 483,000; California has 237,000; New York has 235,000; Michigan has 234,000
 - 16% of homes in Maine are cottages, 15% in Vermont and 10% in New Hampshire



Cottage Conflicts (cont.)

- One of every 20 housing units in the US is a cottage.
- Lawyers are cheaper on the front end. Litigation is expensive.

Estate Planning

- Surveys show that more than 50% of Americans don't even have wills





Estate Planning (cont.)

- Simple planning can avoid future complications
 - Some clients find that children would rather not inherit the cottage
 - Some clients appreciate the opportunity to structure the inheritance in a manner to help avoid future conflict
 - Planning is fluid and flexible; it's not perfect

Federal Gift/Estate Tax

- Definition:** A unified system of tax on the privilege of transferring wealth to the next generation, whether during life or at death
- Current Tax Rate:** 40%
- Concern:** Huge barrier to keeping business/wealth in the family

BASIC ESTATE PLANNING - TAXES

- Four Tools to Deal with the Federal Gift/Estate Tax
 1. Annual Exclusion (\$14,000 / donor per donee through 12/31/15)
 2. Exemption Amount \$5,430,000* / donor in 2015
 3. Charitable Deduction
 4. Unlimited Marital Deduction (really just a deferral mechanism)
- Generation-skipping Tax (no, you can't skip for free!)
- State Death Taxes

* indexed for inflation

Gift & Estate Tax Exemptions History

1976	\$60,000
1977 - 1981	\$120,667 - \$175,625
1982 - 1986	\$225,000 - \$500,000
1987 - 1997	\$600,000
1998 - 2001	\$625,000 - \$675,000
2002 - 2003	\$1,000,000
2004 - 2005	\$1,500,000
2006 - 2008	\$2,000,000
2009	\$3,500,000
2010	unlimited
2011	\$5,000,000*
2012	\$5,120,000
2013	\$5,250,000
2014	\$5,340,000
2015	\$5,430,000

* indexed for
inflation



Forms of Ownership

Joint Tenant: one of several persons owning property with right of survivorship, so that on the death of one, the others own the whole property (the legal theory is that each joint tenant owns 100% of the property, but they own it together)



Forms of Ownership

- Joint tenancy is created by expression of intent. If your deed says: "as joint tenants" or "as joint owners" or "jointly" "or the survivor" or "with right of survivorship" or any similar phrase, you are probably joint tenants. Wis. Stat. § 700.19
 - in Wisconsin – spouses own as "survivorship marital property"



Forms of Ownership

- Tenant in Common (Trouble is Coming): owner of an undivided fractional interest in property, with no right of survivorship in other interests of the same property
 - If your deed says "from A to B and C" or "from A to B and C as tenants in common" or "from A to B and C as tenants in common and not as joint tenants," you are tenants in common



Forms of Ownership

- Presumption is equal allocation between tenants in common unless the granting instrument states otherwise. Wis. Stat. § 700.20

The Rabbit Problem

# of Yrs	Generations							
	1	2	3	4	5	6	7	Alive
0	2	2						4
25	2	2	4					8
50		2	4	8				14
75			4	8	16			28
100				8	16	32		56
125					16	32	64	112

Assuming each owner has 2 children and lives for 75 years, in 50 years, a cottage could have 14 owners

Not included in the chart: Spouses & friends





General Rules of Tenancy In Common

- Each tenant in common has a right of partition
 - Wis. Stat. Chapter 842
 - *Delfino v. Vealencis*, 436 A.2d 27 (Conn. 1980)
 - Professor Thomas Mitchell, University of Wisconsin Law School - heirs property



General Rules of Tenancy In Common (cont.)

- Each tenant owns an "undivided interest"
 - No co-tenant has the right to exclude a co-owner (scheduling problems)
 - A co-tenant with a 1% interest has the same use rights as one with a 99% interest (cottage expenses are still allocated in proportion to ownership)



General Rules of Tenancy In Common (cont.)

- If by parking your boat at the dock you exclude your co-tenant's ability to use the dock, you may be liable for fair market rent for the dock space
- You have no legal basis for challenging your co-tenant's taste in decorations
- A co-tenant may grant a mortgage on his/her interest (and the lender may foreclose)



General Rules of Tenancy In Common (cont.)

- A tenant in common has a right to transfer his/her interest at any time
- A tenant in common does not owe rent to the other owners for using the cottage
 - If your brother-in-law loses his job and decides to camp out in one of the bedrooms at the cottage for the summer, you probably can't collect rent except in extreme situations

General Rules of Tenancy In Common (cont.)

- A tenant in common may rent out the cottage to third parties without consent of the other owners
- A tenant in common is not required to compensate another tenant for services associated with management of the cottage
 - A co-owner who lives closer to the cottage may end up with a disproportionate share of the burden




General Rules of Tenancy In Common (cont.)

- A tenant in common is not entitled to reimbursement for improvements or repairs to the cottage unless the repairs are necessary to preserve the cottage
- Paying a disproportionate share does not necessarily entitle the paying party to reimbursement (reimbursement may be limited to capital expenditures)



General Rules of Tenancy In Common (cont.)

- A tenant in common only has limited duties to the other tenants in common

- 
- Potential Solutions
 - TIC Agreements
 - Life Estates (used infrequently)
 - LLCs

Utilizing an LLC for Cottage Succession Planning

- Benefits
 - Shield cottage owners from liability
 - Ability to prevent an owner from filing an action for partition
 - Pass through taxation (profit and loss). Favorable tax treatment - cottage owners may ignore up to 14 days of rental income each year for federal tax purposes



Utilizing an LLC for Cottage Succession Planning (cont.)

- Ability to hold an endowment
- Ability to amend
- Perpetual existence
- FLEXIBILITY

Utilizing an LLC for Cottage Succession Planning (cont.)

- Transferring Property to the LLC
 - General
 - Structure transfer to avoid transfer taxes. Once the property is held by the LLC, future transfers of membership interests do not trigger transfer tax
 - Confirm that title insurance remains effective following transfer



Utilizing an LLC for Cottage Succession Planning (cont.)

- Update property/liability insurance
- Don't forget about boats, cars and cottage contents (transfer by bill of sale)

Utilizing an LLC for Cottage Succession Planning (cont.)

- Immediate vs. Springing LLCs
 - Immediate LLCs can be used to take advantage of the annual exclusion, or portion of Exemption Amount, by gifting membership units
 - Springing LLCs can take effect automatically when the owner dies

Annual Exclusion

- Still the best opportunity
 - 2015: \$14,000 per donor per donee
 - Not just for cash anymore!
- Think: Discounted assets with appreciation potential (minority interest; lack of marketability)
- Strategy: Combine in one transaction: end of 2015/beginning of 2016
- Example: Married couple with 2 children: gift \$112,000 without triggering gift tax or without using any gift tax exemption
$$(\$14,000 \times 2) \times 2 = \$56,000$$
$$(\$14,000 \times 2) \times 2 = \underline{\$56,000}$$
$$\$112,000$$
- Caveat: Must file gift tax return if taking discount OR applicable GST Exemption (ILIT)



HOWEVER . . .

- A transferor must be willing to gift up most or all benefit from and control over gifted property
- Transferor will have to pay gift tax once \$5,430,000 federal gift tax exemption is utilized



LLC Operating Agreement

- Common Issues Addressed by the LLC
 - Restrictions on Transfer
 - Automatically Permitted Transfers
 - Conditionally Permitted Transfers
 - Prohibited Transfers

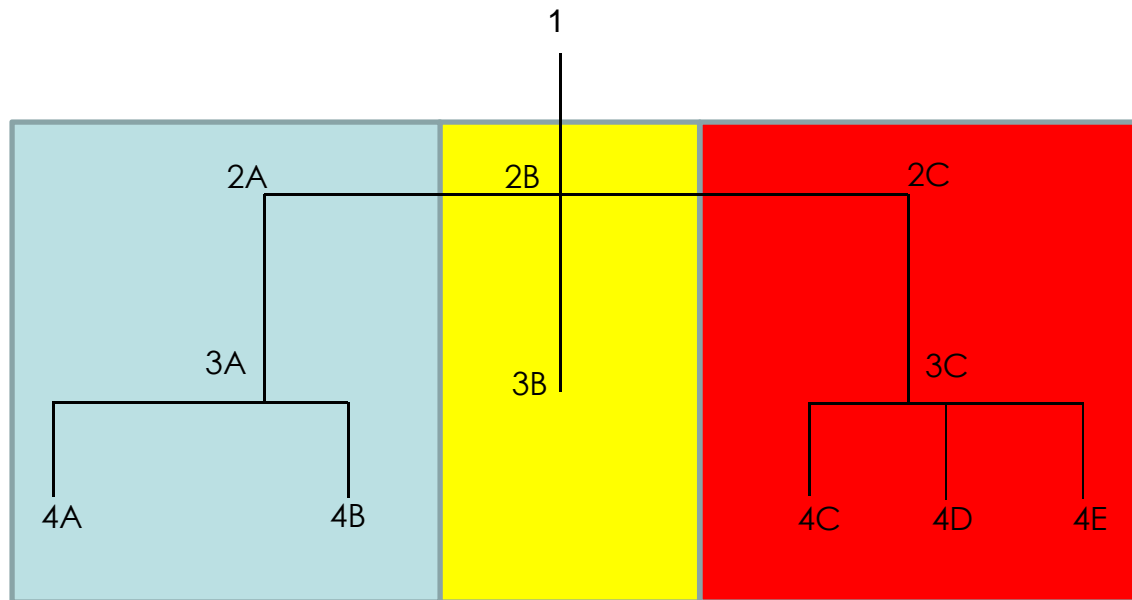


LLC Operating Agreement (cont.)

- Avoiding "Trapped" Members - put options allow an heir to sell the interest back to the LLC and can be structured with a discount to keep the interest affordable

Operating Agreement (cont.)

– The Branch System



Operating Agreement (cont.)

- Assessments
 - Suspend delinquent member's right to use cottage until his/her account is brought current. Within the branch system, each branch can begin to "police" itself
- Balance of Power among Branches
- Member vs. Manager Management



Utilizing an LLC for Cottage Succession Planning (cont.)

- Evaluating Decision Making Authority
 - Adopting annual budget
 - Amend the operating agreement
 - Approve capital improvements
 - Approve actions that would change the character of the cottage



Utilizing an LLC for Cottage Succession Planning (cont.)

- Approve actions that would assess the members for more than their share of the property taxes, property insurance and regular maintenance expense
- Mortgage the cottage
- Permit rental of the cottage
- Require contribution to endowment



Utilizing an LLC for Cottage Succession Planning (cont.)

- Select or replace any manager
- Sell the company or the cottage
- Writing checks, maintenance and scheduling

Utilizing an LLC for Cottage Succession Planning (cont.)

- Scheduling Use
 - Informal
 - Ad Hoc - schedule emerges through coordinated effort on an annual basis; depends on the goodwill of the participants
 - Customary Slots - "same time next year" schedule; works until somebody has a conflict



Utilizing an LLC for Cottage Succession Planning (cont.)

- Founder Control - current owners take their weeks and fit in the rest of the family
- Formal Systems: establish priorities; lottery; rooming house; or combination
- Renting the Cottage



SAMPLE PROVISIONS - INTENT

We, the Initial Members, are creating this Company to allow our children, their spouses, and their descendants, to share fairly in, access to use and support of, the Property. No mechanism to accomplish these goals is perfect and we, the Initial Members, rely on the good judgment of all our children and their families to carry out our, the Initial Members', intent. It is our hope that _____ LLC continues to unify our family by serving as a touchstone where our family returns to recreate, recharge, and create memories together.



SAMPLE PROVISION - USE

- Initial Managers maintain sole discretion
- Each child allocated equal number of weeks; holidays rotate
- A week or two reserved for maintenance
- A member or member's spouse must be present
- Members pay \$10/day (may require additional capital contribution)



SAMPLE PROVISION - DEFAULT

- Failure to make a required capital contribution triggers option to purchase in favor of other members, suspension of use and/or suspension of voting rights

SAMPLE PROVISION - SPOUSE

- Notwithstanding the above, the proposed transferee, if an individual, must provide proof of either a Prenuptial Agreement or a Marital Property Agreement with his or her current spouse that confirms treatment of all Units owned by the proposed transferee as the individual Property of the proposed transferee, to be awarded to him or her in the event of divorce, and solely transferable or devisable by him or her.



OTHER OPERATING AGREEMENT CONSIDERATIONS



THE OPTIONS
ARE ENDLESS

Questions?



Thank You!

Reinhart

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