

Keeping the Cottage, Vacation Home, or Family Farm in the Family

Many families have a goal of keeping a family cottage, vacation home, or farm in the family. Here are some concerns and discussion points to consider. The term cottage, vacation home and farm are used interchangeably herein.

Concerns

- Ownership passing to a spouse of a child due to death or divorce.
- Inability or unwillingness of an heir to meet financial obligations to the cottage.
- The effect that bankruptcy or creditor problems of an heir have on the cottage.
- An heir wants to cash out of the cottage.
- Conflicts among heirs over how the cottage is operated, maintained, or improved.
- Inability of the heirs, collectively, to afford to keep the cottage.

Discussion Issues

An easy way for the client/parent to deal with this issue is to leave the cottage to just one child. This might be easy because only one of the three children go there and have any interest in the property. However, if more than one family uses the cottage, there is the potential for problems. While it may not be desirable, you may give each family an opportunity to be the sole owner. Thus, at your death, each family picks a number at random. If Family One takes the cottage as the sole owner, the bidding is done. If not, then you move to Family Two. While this approach will vest the cottage in just one family, it may be better than setting up years of problems.

You may also create the opportunity for the family to have more than one choice. Thus, during life, you help the children buy their own cottage around the same lake. As an alternative, Child One receives the vacation home in the mountains and Child Two receives the farm.

a. Entity

Should the farm/cottage/vacation home be in an entity rather than joint ownership? In almost all cases, the answer is yes. The question will be what type of an entity: Partnership, Limited

Liability Company or Trust. Based on the decisions made below, your attorney can help you select the proper entity.

b. Original Ownership

Who can own a share of the cottage?

- i. Equal shares to all children.
- ii. Only children who want it get a share - the others get assets of like value.
- iii. Does ownership in the cottage by one child get offset with other assets for a child who does not own a share of the cottage?
- iv. Options to take all selected by random draw.

c. Transfer Ownership

When a child dies, who can be a permissible new owner?

- i. Spouse.
- ii. Grandchildren – second generation.
- iii. Interest reverts to the siblings – first generation.
- iv. Step grandchildren.
- v. Any of the above, but the shares must be held in a Trust with restrictions consistent with the goals of the family.

Are transfers during life allowed to family members or other outsiders? Should there be a right of first refusal as to insiders and outsiders?

d. Valuation of Shares

How is a share of the entity determined at death/transfer/buyout?

- i. Appraisal – this can be expensive.
- ii. Negotiation.
- iii. Sale to outsider with a right of first refusal to the family.
- iv. Auditor's value.
- v. Appraisal less an established family discount – i.e. all sales to a family member are at fair market value less a 30% discount.

e. Management and Control

Should you have voting rights and non-voting rights? For example, generation one children get a vote but generation two children do not get a vote until all generation number one children are deceased.

- i. Member Control – Should one family have one vote or should votes be determined by ownership percentage? Thus, if there are three children and one child owns two thirds because he bought out his sister, he would control 2/3 of the vote. You need to consider what it will look like in the third generation. One family line has six grandchildren and the other has two grandchildren. Does the vote stay 50/50 or is it 1/8 each?
- ii. Committee Control – Each family elects a member to represent the family.
- iii. Manager Control – One family member or an outsider is hired as a manager.
- iv. Bifurcated Control - For example, one member of the family is selected for all day-to-day control. These decisions might include: paying the bills; repairs and maintenance; management of schedule; communications; and contact with contractors and associations. However, big decisions need a majority or supermajority vote. Major decisions may include: changes to the operating agreements; whether to lease; mortgaging the property; selling the property; buying the next door lot; or changes to the schedule procedure.

f. Scheduling

- i. Lottery of weeks.
- ii. Floating schedule - assume a summer cabin with premium months of June, July, and August. Child One gets June, Child Two gets July, and Child Three gets August. Each year the order rotates. In lieu of months, you could use blocks of two weeks at a time.

g. Rental of cottage

- i. Yes/No?
- ii. Rent only to friends of families or rent to outsiders?

h. Funding of expenses

- i. Rental income used to pay cost - Any shortfall is made up by a family capital contribution.
- ii. Pay to use and then divide - each family pays a rent charge for their time of use. A family that uses the cabin more weeks pays for a greater share of the cost and the shortfall is divided equally.
- iii. Equal contribution - each family is assessed a fee for the shortfall.
- iv. Endowment - The first generation parents establish a Trust for the expenses of the cottage in perpetuity or for a term of years.

What happens if a family can't pay? Do they lose weeks, ownership percentages, or does it trigger a buyout of that family?

I hope this helps you with your retirement planning, estate planning, tax planning, and financial planning journey. Let me know if I can be of assistance. I welcome the opportunity to be a part of your team.

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