TWIN CITIES ESTATE PLANNING COUNCIL
TUESDAY, MARCH 27, 2018

How to Keep the Cabin in the Family

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Background & Introduction

- Minnesota's cabin owners are aging
- Their wealth is decreasing
- Their health costs are rising
- A dramatic change in ownership of these properties is anticipated over the next decade
- Cabin succession planning can be complex
- Average length of cabin ownership is 34.6 years

Average Age of MN Cabin Owners	2017	2005	1999
	68	62	58

Source: 2016 Minnesota Lake Home and Cabin Property Ownership Study

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Overall Considerations

FOR CABIN SUCCESSION PLANNING

Be sure to consider the following:

- Has a family discussion taken place regarding a cabin transfer?
- Does the family get along with one another?
- What is the overall financial picture of the cabin owners? Of other family members/future owners?
- What is the owners' cost basis in the cabin?
- How will the owners pay for possible long-term care costs?

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Medical Assistance Considerations:

- Necessary information:
  - Complete asset information
  - Owners' cost basis in the cabin
  - Owners' income
  - Owners' health and likelihood of long-term care
  - Long-term care insurance specifics – if any
  - Other available benefits – Veteran's Benefits?
  - Other potential family support systems
- Transfer Cabin to Next Generation Now (pros and cons)
- Keep the Cabin and Transfer it at Death (pros and cons)
- Transfer the Cabin Reserving a Life Estate (pros and cons)

Information Needed to Facilitate Cabin Succession Planning

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Elements of Good Succession Planning:

- Accurate Property Valuation
- Estimate of Annual Expenses: Taxes, Maintenance and Upkeep
- How Major (and Minor) Decisions are Handled: now and future
- Usage Issues: calendars and policies
- The Rights and Responsibilities of Owners: now and future
- Buy-Out and Opt-Out Decisions
- Future Sale Considerations

Options for Transferring the Cabin

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Option 1: Do Nothing

- Advantages
  - Easy
  - Inexpensive
  - Avoids decision making during owner's lifetime
  - Flexible
  - Step-up in basis
- Disadvantages
  - Property vulnerable to long-term care costs
  - Possibility of partition of future owners do not agree
  - Post-death expenses may be prohibitive (probate, ownership transfers, partition, establishing a trust, etc.)

Option 2: Bequest in Will or Trust

- Advantages
  - Easy
  - Inexpensive
  - Owner(s) retain control during lifetime
  - Owner(s) may narrow distribution to those choosing to opt-in
  - Property receives step-up in basis
- Disadvantages
  - Property vulnerable to long-term care costs
  - Possibility of partition of future owners do not agree
  - Post-death expenses may include probate (with a will) and ownership transfer

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Option 3: Transfer on Death Deed

- Advantages
  - Easy
  - Inexpensive
  - Owner(s) retain control during lifetime
  - Owner(s) may narrow distribution to those choosing to opt-in
  - Property receives step-up in basis
  - Deed is revocable
  - Avoids probate
- Disadvantages
  - See "Do Nothing" list above
  - All TODD grantees and spouses must join in any sale, conveyance or mortgage
  - Does not solve other post-death issues

Option 4: Quit Claim Deed

- Advantages
  - Easy
  - Inexpensive
  - New owner(s)/children gain experience in co-owning and managing property while current owner(s) are still able to give advice
  - Owner(s) may narrow distribution to those choosing to opt-in
  - Avoids probate
- Disadvantages
  - Transfer is a taxable gift and a Federal gift tax return is required
  - May create Medical Assistance ineligibility
  - Transferee(s) receive owner(s)' cost basis in the property
  - Lack of structure or entity to manage cabin or resolve issues

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Option 5: Co-Tenancy Agreement

- Advantages
  - Same as for Transfer on Death Deed PLUS agreement in place to deal with management issues and succession
  - Can address potentially contentious issues
- Disadvantages
  - If the property transfer is during lifetime, see gift tax and medical assistance ineligibility analysis, in Option 4 (Quit Claim Deed)
  - Requires family members to agree on ownership and management issues (which is also an advantage!)

Option 6: Family Cabin Trust

- Advantages
  - Determines who are/will be co-owners of the cabin and who may receive other assets from the estate
  - Provides structure for future ownership
  - Amendable and revocable if funded during lifetime
- Disadvantages
  - Cost to establish
  - Possible ongoing costs to maintain
  - Family discussion required
  - Usually irrevocable upon parents'/owners' deaths
  - If cabin is transferred to the Cabin Trust during lifetime, taxable gift/gift tax return
  - Cost basis is transferred at time of transfer

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Option 7: Business Entity (LLC or FLP)

- Advantages
  - Perpetual existence
  - May allow for discount of asset for estate tax purposes
  - Can control transfer upon sale or death
  - Can limit liability to owner(s)
  - Easily funded
- Disadvantages
  - Cost to establish
  - LLC must operate as a business entity
  - Annual filings required
  - Possible tax issues
  - Property may lose homestead classification
  - Must comply with other jurisdictional laws

When is a Cabin Trust Appropriate?

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A Cabin Trust may be appropriate when . . .

- Cooperative family discussion has taken place
- No anticipation of Medical Assistance (at least not w/in 5+ years)
- Opting-in family members get along
- Other assets sufficient to offset opt-out by family member(s)
- Value of the property justifies ongoing management in trust
- Other assets available to seed the Cabin Trust for x years

A Cabin Trust may NOT be appropriate when . . .

- Anticipated future owners do not get along
- The parent(s)/current owner(s) insist on calling all the shots without input or buy-in from future owners
- The property value of the cabin is very low
- Medical assistance is anticipated in the near future
- Overall assets of the owner(s) are insufficient to either offer an opt-out provision for family members or to seed the cabin trust with funds for maintenance for x years
- Future owner(s) have legal, financial or personal issues that may jeopardize property ownership

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Drafting the Cabin Trust

OPTIONS AND CONSIDERATIONS

Decisions to make

Not one-size fits all!

- Testamentary Trust?
- Freestanding Cabin Trust?
- Sub-trust within a Revocable Living Trust?
- Who are settlors? Current owner(s) or future owner(s)?
- Funding now or at death of (second) settlor?
- Use DWTA Cabin Trust or another?

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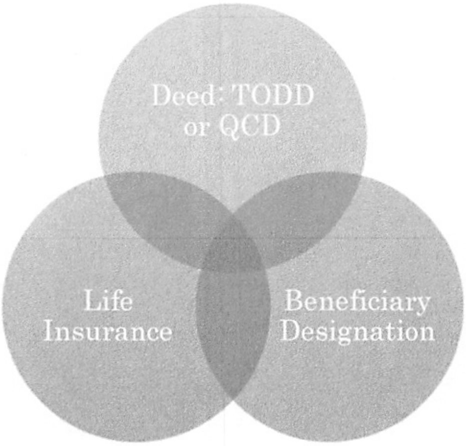
Essential Cabin Trust Funding Steps



- Lifetime funding or at death?
- Fund the trust with additional assets to provide for expenses for a number of years?
- Non-tax qualified assets with Cabin Trust as beneficiary

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FAMILY CABIN PLANNING DISCUSSION GUIDE

PURPOSE

This discussion guide is designed to help you explore the issues you may confront in managing vacation property as a group. Once you have the answers to the questions set out here (as well as any others you may choose to add), we will be much better prepared to recommend an ownership and management structure that can address the legal as well as the human dynamics of collective, family ownership.

BACKGROUND

There is truly something special about the "family cabin," or "grandpa's place in Minnesota/Wisconsin." This is the stuff of family history. It invariably is a place filled with wonderful memories, special times when you were all together, and those times when the cousins really got to know each other and the grandchildren held the focus of the gatherings. It was a place were you could almost believe the problems of every day life ceased to exist while you were together as a family. No wonder this is a special place that families go to great lengths to preserve.

Objectively, however, we know that one of the principal reasons the family "hideaway" works so very well is that it was grandma and grandpa's place. They called all the shots; made it known when the kids and grandkids were to come (and leave); who would be there; and what was expected (usually very little). While not spoken of very often, they also paid for the place, maintained it, paid taxes on it, and ensured that everything was in order from the boat to food in the cupboards.

Unfortunately, when grandma and grandpa are gone, the ownership and control of the family vacation home can be anything but blissful. It is at this time that divergent lifestyles, economic resources, geographic separation or simply the ages of the children can suddenly go from very natural differences between siblings to a dramatic source of tension or even open conflict. No estate asset (except perhaps photographic memorabilia) causes more family conflict than the vacation home. "Who gets to use it over the 4th of July; how do we divide up the taxes; when and by whom will the maintenance be done; how do you treat the distant brother fairly; what happens if someone gets divorced"; and on and on and on. None of these issues is insurmountable, but most are unique to each family and to the asset under consideration.

It is our hope that this questionnaire and the family discussions it will engender will give you and your advisors the information and insight you need to ensure that if you decide to keep the "family cabin," it will continue to be a place of celebration.

DISCUSSION QUESTIONS

(The term "cabin" has been used here for simplicity purposes, but the questions apply equally to a condo, ski place, family compound or family hobby farm.)

1. How much is the cabin worth today?

2. How much has the cabin appreciated in value over the last five to ten years?

3. How much do you expect it to appreciate in the next five to ten years?

4. Is it paid for; if not, what are the mortgage terms?

5. What are the taxes and annual maintenance expenses?

6. Are there other related expenses (such as slip fees, condo association dues, shared expenses with neighbors for things like access road maintenance, etc.)?

7. Are there other building sites on the land? If so, do you contemplate additional building (what type, cost, ownership and access to common areas is contemplated)?

8. Are there any potential legal problems associated with the land (boundary disputes, neighboring development, septic systems, water usage, zoning, shared access road, etc.)?

9. How would you divide expenses for operating the property?

10. How would "non-routine" decisions be made on maintenance (replace roof, resurface the access road, replace the dock, etc.) and improvements (adding air conditioning, winterizing, or expansion of existing structures)?

11. How much personal property goes with the cabin (boats, motors, furniture, dishes, linens, etc.); who would "own" it; how would it be maintained and as necessary, replaced; and could individual families keep their own things on-site?

12. Who would speak for the "group" relative to outsiders in business matters such as bill paying, ordering work done, resolving disputes, etc.?

13. How long would the spokesperson act for the "group," how would you pick a successor; what type and frequency of reporting to the group is expected of this spokesperson; and under what circumstances would the spokesperson be expected to step down?

14. Under what circumstances would the property be sold, and how should that group decision be made?

15. Under what circumstances would a family be "bought out" and how would the price be determined and the purchase be paid for by the remaining members?

16. What should happen in the event a sibling were to become divorced?

17. Are there other events that should trigger an involuntary buy-out (such as bankruptcy, insolvency, etc.)?

18. How should the interest of a deceased family member be treated? Can a family member pass an interest on to his or her spouse, only children, children, a trust for some or all of them? What happens when that spouse dies?

19. How will the use of the property be determined as between the families (i.e., use on holidays, dividing up the vacation year, etc.)?

20. During a specific family's time to use the property (see No. 19 above), do they have exclusive use of the land; are there to be any restrictions on guests; under what circumstances can others just "drop in?"

21. Is governance to be by majority rule or some other percentage? What items should be put to a vote of the group and what can be delegated to management? Who gets to vote?

22. Does it make sense to have a managing "partner" or "caretaker?" How should such a person be selected, re-elected and removed?

23. How should a family's interest be valued? Should there be any difference in value depending on why a family's interest is being sold (e.g., death, divorce, want out, etc.)?

24. How should a family's interest be paid for when there is a buy-out (e.g., cash immediately or a percentage as a down payment and X years to pay balance and at what interest rate, if any)?

25. Under what circumstances can a family's interest be sold to an outsider? Under what circumstances would the entire property be sold?

26. Should the property be held in an entity form such as a Corporation, Partnership, Limited Partnership, Limited Liability Company?

Cabin Trust vs. Minnesota Limited Liability Company (LLC) Analysis:

Topic	Revocable Cabin Trust	LLC
Ongoing legal formalities required	A cabin trust has many of the advantages of an LLC without the ongoing legal formalities.	Requires annual entity renewal; requires annual meetings with meeting minutes, corporate recordkeeping
Ability to change or amend the provisions	The trust becomes irrevocable at grantors' deaths or incapacity (but may include provisions for transfer to another trust). The trust may allow amendment by successor trustees or beneficiaries by majority or unanimous action.	LLC remains amendable after creators' death by a majority vote of its voting members.
Creditor protection	A trust can be a better protector against creditor claims against the beneficiaries, if the trust contains a spendthrift provision and to the degree the beneficiaries have not participated in funding the trust. In Minnesota, spendthrift protection for third-party trusts is particularly powerful. A beneficiary's interest in a discretionary trust may not be attached by any creditor, including in a spousal or child support proceeding.	An LLC does not provide as much creditor protection for the owners as a funded trust, especially in Minnesota. A creditor of an LLC member can attach the member's membership interest in the company, and once attaching a debtor's interest in an LLC, the creditor(s) step into the shoes of the debtor, and can use state law remedies to attempt to liquidate the interest.
Personal Liability protection	Naming the trust as a co-insured on your homeowner's policy and carrying an umbrella insurance policy add personal liability protection.	An LLC protects its member owners from personal liability for most LLC related obligations unless there has been a piercing of the corporate veil.
Funding for Expenses	If you want new/future owners to assume and fund expenses related to the ongoing needs of the property, a trust may be a better vehicle to achieve this.	In an LLC, you are able to set up a mechanism for the payment of annual expenses by means of a capital call system with a pre-defined enforcement mechanism.
Homestead Eligibility	Eligible	Not generally eligible
Protection of Trust Funding for Cabin Expenses	A trust may be a better protector of a pot of money	An LLC holding a pot of money for ongoing needs of

	provided for the ongoing needs of a cabin property, including maintenance, insurance, and property taxes because of the irrevocability of the trust instrument at the death or incapacity of the grantors.	a cabin property could be diverted by a vote of the beneficiaries after the creators' death.
Present Gifting of Ownership	Owners would transfer their interests to trust at inception but if trust is revocable, still own the trust assets. Beneficiaries would become beneficial owners of trust assets upon death of original grantors.	Easier to make gifts of small percentage interests in an LLC as part of an annual exclusion gifting program.
Management Control and Beneficial Ownership	Very possible to separate management responsibilities from beneficial interests. The trustee is responsible for all management decisions, while the beneficiaries are entitled to the use and enjoyment of the trust's assets. Trustees may be both.	Within an LLC, it may be more difficult to separate beneficial ownership with management control than a trust.
Decision Making	The revocable cabin trust allows for the flexibility of an Operating Agreement covering how major decisions are made, use agreements, etc., and the grantors may retain control of decision making while they have capacity to do so.	The ability to set up a management committee where each family group elects a representative to make cabin-related decisions can be valuable in large families.
Duration	The duration of a cabin trust is limited by the Rule Against Perpetuities found in Minn. Stat. § 501A.01	The duration of an LLC can be unlimited.
Income Tax Treatment	A revocable cabin trust is a grantor trust for income tax purposes so any transaction related to the cabin is reported/deductible by the grantor just as if the grantor owned the cabin outright. After death of grantor(s), trust generally becomes irrevocable and a taxable entity with a tax identification number and must file tax returns.	Tax issues for an LLC depend on how the company elects to be treated for tax purposes. An LLC may be treated as a sole proprietorship, partnership or a corporation. LLCs with more than one member may choose to be taxed as a partnership or a corporation. Either way, it must obtain federal and state tax identification numbers.

ADVANTAGES AND DISADVANTAGES OF TRANSFERRING PROPERTY

Some of the advantages, disadvantages and tax consequences of transferring real property to children during owner(s)' lifetime are:

ADVANTAGES

- Avoids probate on the property (can also be avoided by TODD)
- Homestead property occupied by relative of owner may qualify for homestead tax exemption for property tax purposes. (check w/ assessor)
- Property is protected from medical assistance claim after five years.

DISADVANTAGES

- If the gift exceeds $15,000 per person per year, a Federal gift tax return must be filed. No tax will be due on the transfer.
- The value of the gift is not the assessor's estimated market value but the "fair market value," which may be more.
- If you apply for medical assistance within five years of the gift, a period of ineligibility for medical assistance will be imposed beginning with the date you apply for and are otherwise eligible for medical assistance (**not** the date of transfer). Therefore, you and your children must be financially able to bear the risk of paying for up to five years of care because you would be ineligible for medical assistance.
- Your children would take your "cost basis" in the property When the property is sold, your children would pay capital gains tax on the difference between the sale price and your cost basis. Property retained in your estate gets a "step-up" in basis to the date-of-death value.
- You would not have a legal right to live in or use the property and would not be able to sell or borrow against property. (If you retained a life estate, medical assistance could make a claim against the property.)

CABIN PLANNING QUESTIONNAIRE

Date:__________

Family Information

Owner's Name_______________________________________Date of Birth:___________

Social Security No:______________________________ U.S. Citizen? Yes___No___

Co-Owner's Name_______________________________Date of Birth:________________

Social Security No:______________________________ U.S. Citizen? Yes___No___

Street Address_________________________________P.O. Box____County___________

City_______________________________ State_______ Zip________________

Phone: Home:________________ W:(owner) ____________W:(co-owner)___________

Email: (owner) __________________________(co-owner)________________________

Your Children

Name of Child Married Name Date of Birth Address

____

____

____

Has any child predeceased you? Should his/her children take in his/her place?

Your Cabin

What county is your cabin located in?____

Is your cabin located on a lake?________ What lake?__________________________

What is the physical address of the cabin?_______________________________________

____

Does your cabin have a "name" or what do you call it? (cabin, cottage, etc.) _________

Who presently owns your cabin? ___________________ *(Please provide a copy of your deed or Certificate of Title, Title Insurance Policy, and Plat map or Survey if available.)*

Does the property have any of these unique attributes: separate parcels, outlots, common areas, shared lake access, shared well or septic system, known boundary line or title problems, road access problems, easements, restrictions?___________________

____

Is your cabin year-round___or seasonal___? If seasonal, when is the season?________

Do all of your children wish to remain involved in the cabin? _______________________

Should a child have the right to "opt out" in exchange for cash or other assets of your estate upon your death(s)?____

Issues to be Addressed in Cabin Trust or Operating Agreement

General Management:

1. Who should serve as general manager/trustee?_____________________________
2. Who should serve as "treasurer"?____
3. Should the manager/trustee/treasurer be compensated?______________________
4. Should family units be allowed to vote on major decisions and expenditures?____

   Defined how or exceeding what value? $______________________________

   Should major decisions be unanimous _____ or by a majority ______?

Maintenance and Repair:

1. Does the family have a plan for handling repairs?____________________________
2. Are any family members unable or unwilling to perform their share of the upkeep of the cabin?____

    ____
3. If so, are they willing to hire this work to be done?___________________________

    ____
4. Should annual assessments or dues be paid? ____ If so, how much? $_________

Improvements:

1. Do you anticipate major remodeling or an addition?__________________________

    ____
2. Does the family agree or disagree on how rustic or modern the cabin should be in the future? ____
3. What kind of septic system does the cabin have?____________________________
4. Are the well and septic system up to code?_________________________________

Ongoing ownership of Cabin:

1. Should a child be able to "opt out" of cabin ownership after the initial opt-out period (if any)? ____ If so, how should they be compensated? (Fair market value, ____% of FMV etc.) ____
2. Can the owners agree to sell the property in the future? _______ If so, does it require a majority _______ or unanimous ________ vote? __________________
3. Upon the death of a child, should his/her interest pass to his/her children?_____ Should a spouse have any express rights under the agreement? ______________

On-site Personal Property:

1. What unique/expensive personal property is presently kept at the cabin (e.g. 4-wheeler, snowmobile) and who owns this property now?_______________

____

____

2. May members store personal property on the premises that is off-limits to other family members?____

Use and Reservation of Cabin:

1. How should use be determined? ____
2. Should certain reservation "slots" be more valuable than others (e.g. July 4th weekend)?____
3. Should "slots" be on a rotating basis or drawn by lot each year?_______________

   ____

4. If a family can't use a slot when eligible or chooses not to, does that family get priority the following year?____
5. Should a family member be permitted to rent or gift its slot to outsiders?

   ____

6. If no one is using the cabin, may the Trustee/Manager rent the property? _____

   ____

6\. Should fixed expenses (i.e. taxes, insurance and utilities) be divided equally or prorated according to use?____

7\. Should fixed expenses be payable (or estimated and payable) in advance of the cabin season?____

8\. In addition to fixed expenses, should there be a per diem usage charge? ______

If so, how much; per family group per day/week?____________________________

____

9. What Agreements should there be regarding decorating?_____________________

____

10. What rules should there be, if any, regarding pets, smoking, drinking, firearms, hunting, visitors, and unsupervised use of the cabin by teenage (or young adult) family members?____

____

____

Do you have other concerns or issues that have not been covered by this questionnaire?____

____

____

____

____

____

- All your children <u>and their spouses</u> must join in any deed, mortgage or other conveyance.

- If a child dies, probate proceedings will be required and ownership of property will pass to the child's spouse, children or other beneficiaries in accordance with the child's will or intestate law.

- If a child files bankruptcy, gets divorced or has judgments or tax liens filed against him/her, the property will be affected.