Keeping It in the Family: Planning for the Vacation Home or the Family Farm

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November 6, 2019
A vacation home can be an important part of a family’s legacy

For this reason, as part of their estate plan, a family should consider:

- Defining their goals, including tax, asset protection and succession planning goals.
- Evaluating the available planning options based on those defined goals.
- Being mindful of the impact that any proposed planning option has on any tax benefits afforded by the home.
- Addressing any anticipated and customary issues associated with the vacation home, such as designation of management responsibilities, payment of expenses and requests for usage.
Consider the tax impact

The primary goal may be to create a structure that preserves the vacation home for future generations. Any proposed structure should be evaluated to determine its impact on the following taxes:

- Federal gift, estate and generation skipping transfer taxes,
- State estate taxes,
- Income and capital gains taxes, and
- State and local property taxes.
Three advanced planning options for transferring the vacation home to future generations include:

- Simple Gift to an Irrevocable Trust
- Installment Sale to Defective Grantor Trust
- Gift to a Qualified Personal Residence Trust

Other simpler options include outright transfers to the future generation as tenants in common or ownership of the home in a closely held entity with subsequent gifting.
Option 1: Simple Gift to an Irrevocable Trust

- You transfer the vacation home to an Irrevocable Gift Trust for the benefit of your descendants, using a portion of your exemption amount equal to the home’s fair market value.
- Any future appreciation of the home, and income earned by the trust following the transfer, would effectively be transferred to your descendants free of estate or gift tax.
- Because you would no longer own the home following its transfer, you should immediately begin paying rent for your use of the home, which will increase the value of the trust without gift tax consequences.
Option 2: Installment Sale to Defective Grantor Trust

- You sell the home to a trust that you create, as grantor.
- The trust purchases the stock using an installment note.
- The trust is structured as a grantor trust so that there are no income tax consequences of the sale or interest payments on the note.
- Generally, it is most beneficial to sell the home if it is likely to appreciate significantly.
Option 3: Gift to a Qualified Personal Residence Trust

- You transfer the home to a qualified personal residence trust (QPRT), retaining the right to use the vacation home for a specified period of time. At the end of the term, ownership of the home passes to trusts for your children.
- When you establish the QPRT, you are considered to have gifted only the remainder interest in the trust, which uses part of your exemption amount.
- After the end of the term, you should pay rent to the trusts for your children for your use of the home, which is an additional transfer of funds to your family without tax consequences.
- With a QPRT, you use less of your exemption amount to transfer the home; however, if you die during the initial term, the value of the home will then be included in your estate.
Avoid the customary disputes

Proper planning for the family vacation home can also allow a family to proactively accomplish the following:

- Delegate responsibility for management of the property.
- Arrange for the payment of expenses related to the property, both ordinary costs and expenses related to the improvement of the property.
- Establish each family member’s right to use the property and the rules related to such use.
- Protect the family from liability arising from the use of the home, and protect the home from liability related to personal liability of an individual family member.
- Address the ability of non-family members to use the property, including whether the home should be rented.
- Address the ability to sell the family home and conditions for any possible sale.
At times, the family vacation home may be more than a place where the family gathers; it may have other uses, such as agricultural and hunting. If so, other objectives to accomplish can include:

- Determining whether this use will be continued after the transfer and by whom
- Transferring the personal property and other assets related to the operations
- Maintaining any tax benefits and subsidies dependent on use of the land
- Preserving the ability to qualify for the special use estate tax valuation under Code Section 2032A and the deferral of estate tax under Code Section 6166
- Understanding the impact of the transfer on insurance and financing
Thank you!

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