



Insights: Publications

Estate Planning for Real Estate: Vacation Home Edition

September 11, 2024

Written by

As summer draws to a close, you may find yourself reminiscing about your vacations taken earlier this season. Those vacations may have involved traveling to your second home with your family. If you own a vacation home, now is the time to revisit how you have planned for its succession.

Considerations

Vacation homes can be the source of endless memories with your family for generations to come. Planning for the succession of your vacation home is important and involves many considerations. You may consider whether all your children will use the home or if some live too far away to enjoy it and would prefer to sell it. If all children will use the home, will their desired dates of occupancy cause disagreements? Additionally, will all children be responsible and capable of paying for the taxes, maintenance, and upkeep of the home? Situations may arise as time goes on or family dynamics change. You can plan now to address these issues, allowing you to achieve your goal of leaving your vacation home to your family to continue making cherished memories.

Proper Planning

1. Transfer to your Revocable Trust

A primary residence is often placed in a Revocable Trust as a means to control disposition and to avoid probate. If your real property is titled solely in your name at death, your Executor will need to open a probate estate to distribute the property. This applies to vacation homes, too. For example, if a decedent was an Illinois resident who owned a vacation home in their name in another state, probate must be opened in that state too. Probate can be expensive and time consuming, and inadequate planning for multiple properties can lead to multiple probate proceedings. Titling your vacation home in your Revocable Trust generally avoids the need to open a probate estate to distribute it because the Trustee will distribute the home to your beneficiaries designated under your trust agreement. This ultimately saves your family time and money.

Under the terms of your Revocable Trust, you can include long-term planning provisions to financially support your family's use and enjoyment of the home. Funds can be set aside in a sub-trust created under your Revocable Trust. This sub-trust can be responsible for the real estate taxes, maintenance, and upkeep of the home, thereby removing that burden from the beneficiaries. You can also provide your wishes for how and when the home can be sold. Since your Revocable Trust can be amended at any time during your lifetime, you can modify these terms as needed.

2. Establish a Limited Liability Company ("LLC")

Establishing an LLC for your vacation home can be a useful estate planning tool. The LLC will be governed by an Operating Agreement which can incorporate a broad range of considerations for the home. Among other items, the Operating Agreement will name the Manager(s) and set forth the managerial authorities and duties relating to the vacation home. It can also specify how the home can be leased or sold and can include provisions that allow for the right of first refusal with pricing methodology if a majority of your children want to sell but do not agree unanimously. For some families, it may make sense to prepare a calendar each year to lay out each child's preferred dates of use. This can ensure that the use of the home over holidays and school breaks, etc. are rotated among family members from year to year. The provisions of the Operating Agreement can be amended as appropriate, but setting forth the operating procedures eases concern and provides clear direction for how the home will be maintained upon your death. Over time, your interest in the LLC can be given or assigned to your children resulting in your children taking full ownership.

Sometimes families decide to leverage their vacation home as a source of income. An LLC also offers personal liability protection for the owner of the vacation home. If your vacation home is used as a rental property for a portion of the year, having it held in an LLC provides protection for you individually in the event that a renter is involved in an accident at the home. LLCs are state governed entities and the requirements for establishing an LLC and maintaining good standing vary from state to state. If you live in a state that has a state estate tax, or the home is located in a state that has a state estate tax, the state estate tax consequences of transferring the home to the LLC should be considered. Your Kilpatrick attorney can guide you through establishing an LLC, creating an Operating Agreement, and discussing any estate tax consequences.

3. Set Up a Qualified Personal Residence Trust ("QPRT")

QPRTs are Irrevocable Trusts that can be established for your vacation home and your primary personal residence. A QPRT is established by gifting the home to the trust which contains a stated term. During the stated term set forth in the QPRT, you reserve the right to use the home as a beneficiary of the trust. After the conclusion of the stated term, the home passes to your beneficiaries. If you choose to reside in the home once that stated term is complete, you would do so on a rental basis by paying a fair market rent to the QPRT.

A QPRT can provide estate and gift tax benefits if you survive the stated term. If you survive the stated term, the value of the home is removed from your total estate at death. For gift tax purposes, the amount of the gift is less than the amount that would otherwise be reported if you made an outright gift of the home because the amount of the gift is the current fair market value of the home, reduced by the value of the stated term set forth in the QPRT (the value of the stated term is determined by using IRS tables). If you die during the stated term, the entire value of the home is included in your estate for estate tax purposes, but you can reclaim the exemption applied to the gift. If the home is sold during the stated term and all of the proceeds are used to purchase another home within two years, the QPRT will continue. If all of the proceeds are not used to purchase a new home, the QPRT must pay an annuity to you for the remaining stated term (the amount of the annuity is determined by using IRS tables). Your Kilpatrick attorney can help you determine if a QPRT is appropriate for your estate plan.

As you say goodbye to the summer season, take a moment to consider how you want your vacation home to be enjoyed for generations to come. If you have not yet incorporated your vacation home into your estate plans, or if you want to revisit your current plan to ensure that you are fully prepared, contact Kilpatrick's [Private Client Group](#).