

Saving the Beach House

Given that summer is here, the summer beach house seemed an appropriate topic for this edition of Practical Planning. A beach house or other vacation property can represent a significant portion of a family's wealth. If bought many decades ago, it has likely appreciated in value many times over. Children may have grown up spending their summers on the beach and they have strong emotional ties to it. Yet, a beach house has considerable expenses associated with it, including taxes, insurance and repairs. What will happen when the parents are gone? Will each child be willing and able to share it equally?

Understandably, parents want to treat their children equally. To keep things simple, they usually just leave the beach house outright to their children. We often hear, "They will work it out, don't worry." What many families do not understand, though, is that a beach house is a legal quagmire. Every owner has a legal right to seek partition of the real estate. A partition suit asks a judge to either physically divide the property or to sell the property and divide the proceeds. With a beach house, a judge will usually order a sale and divide the proceeds. When parents give the beach house to the children outright, they risk a partition sale.

Why might a partition sale occur? A child could get a divorce, the ex-spouse receive a share of the beach house in the divorce decree, and seek a partition sale. A child could incur debt for a business or lifestyle, default on the loan obligations and/or file bankruptcy, have his share of the beach house lien, and the creditor or a bankruptcy trustee ask for a partition sale. Even more common, a child could move away for work or love and seldom visit the beach house. He may be unable or unwilling to share in the beach house expenses. The other children may not wish to buy out that his share. Eventually, the faraway child files suit seeking a partition sale. The child justifies the sale as simply claiming a fair share of his parent's estate.

Even if a partition sale does not occur, the beach house may cause a major rift in the family. Sometimes a child cannot afford to share in the beach house expenses. The other children rightfully think it unfair that they have to bear the burden of carrying the beach house. The resentment can grow over the years and lead to a permanent rift between them.

How do you avoid this predicament? You could give the beach house to one child. But how do you choose which one? Should you base the decision on ability to bear the expenses, the frequency of use of the beach house, or the amount of assistance provided to the parents? Most parents prefer not to choose among their children because they correctly believe it will cause long-term resentment in the family.

There is a better way. This solution can preserve family relationships, treat all children equally and avoid a partition suit. It involves transferring the beach house while you are alive or after your death to a limited liability company (LLC). In the LLC operating agreement, the children waive their partition rights. The agreement clarifies the method for sharing expenses. The agreement can allow the family to restrict use, impose a fine, reduce the ownership share, or buy out a child who no longer is able or willing to share in the property's expenses. It can give a child who has moved away, the option of requiring the family to buy out his share. Such buy out options are usually for less than fair market value and allow payment over a series of years. The agreement will restrict who can become an owner of the beach house so the family does not have to worry about creditors or ex-spouses. The family could avoid the problem of multiplying heirs (and hence owners) by allowing voting and transfer of shares by family instead of individually. The agreement can give the children the right to maintain and improve the beach house and compel contributions for such improvements. The family could control the use of the beach house through the agreement so that one child (or the child's guest) does not monopolize the use of the beach house. The agreement can also provide compensation to a child who lives near the beach house and bears a disproportionate burden of maintaining and renting the house.

At Cipparone & Zaccaro, P.C., we help families create LLCs to manage and transfer beach houses and other vacation properties. We also have experience with partition suits so we know what is at stake. Give us a call if you need help creating a wise a succession plan for your beach house.

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