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Succession Planning for the Family Lakehouse: I'll Take My Estate Plan with a Limited Liability Company on the Side

By Elizabeth Brown

Many New Englanders own second homes that serve as family vacation retreats, and these homes are often the central point of family traditions. These vacation homes may also comprise a significant portion of the family's wealth, so it's understandable that homeowners want to pass their properties and family traditions to future generations. But leaving the property outright to the next generation – if there is more than one child – is often not the best way to go.

Often, joint ownership can lead to family disputes regarding how the home is used, operated, and maintained. Some children may want to continue using the property, while others may want to cash out. When the parent owners attempt to pass joint ownership to the children, squabbles can break out just as they did during family game night, but with higher stakes and no parents around to mend the battle wounds!

Furthermore, if New Hampshire residents own vacation homes in a neighboring state such as Maine, Massachusetts, or Rhode Island, ownership of the real estate at death may subject the decedent's estate to estate taxes in states where the property is located, even if the individual does not have a federally-taxable estate. Sometimes, the neighboring state's estate tax can be avoided through the incorporation of a limited liability company into the New Hampshire estate plan.

Massachusetts generally taxes two types of individuals upon death. The Commonwealth will tax the estate of individuals who die residents of Massachusetts on all of their property, and will tax property with a situs in Massachusetts, owned by nonresident decedents. The Massachusetts estate tax threshold is $1 million. Massachusetts taxes a nonresident decedent by calculating the Massachusetts estate tax on the entire estate of the decedent, then assessing a tax equal to the proportionate share that the Massachusetts-situs property has to the entire estate. Therefore, even if the value of the Massachusetts-situs property is less than the threshold, it does not mean that the decedent avoids Massachusetts estate tax, where the decedent's entire estate exceeds the threshold.

New Hampshire, however, does not have a state level estate tax. Therefore, to the extent that a New Hampshire resident's Massachusetts property is converted from Massachusetts-situs property, such as real estate, to intangible property, such as stock, it will no longer have a situs in Massachusetts and will not contribute to a Massachusetts estate tax calculation. A note of caution, however, that this is not the case in Maine. Homeowners will need to analyze tax impact on a case-by-case basis.

Organizing an LLC is fairly simple. The organizational documents include a certificate of organization to file with the secretary of state, and an operating agreement. The LLC will also need its own taxpayer identification number.

The operating agreement can be simple or complex, but it should govern the management of the property. It can prevent disputes about who bears responsibility for expenses and maintenance, and can provide a mechanism for a child to cash in on their ownership to other children.

LLC operating agreement provisions for these types of entities often include:

1. Responsibilities for paying operating expenses
2. Procedures for transferring member units or interests
3. Duties and responsibilities for regular maintenance, budgeting, and approving property improvements
4. Developing property use schedules
5. Establishing rules for use

While there are some costs to creating an LLC – Massachusetts, for example, has annual filing requirements that carry a fee of $500 – these expenses may be small compared to the return on investment for avoiding the Massachusetts or Rhode Island estate tax.

Vacation homeownership through an LLC may also offer members personal liability protection from lawsuits, creditors, renters, etc. For instance, if there is an accident at the home that results in personal injury to a third party, LLC owners may be shielded from liability for that injury. Similarly, state laws may prevent creditors from becoming LLC owners or may prevent any asset within the LLC to be sold simply because the creditor has a judgment against an LLC owner. This is particularly important if an LLC owner becomes divorced, files for bankruptcy, or has a large judgment against him or her.

Another significant advantage is that real estate owned by the LLC will not be part of the owner's probate estate. This avoids the need to open ancillary probate in the state where the property is located. Additionally, most states (including New Hampshire) have adopted the Uniform Transfer On Death Security Registration Act (the Act), and the LLC membership interests can be passed along according to the terms of a beneficiary designation and are not controlled by the terms of the owner's will. This means that membership interests pass outside of the probate estate. Under the Act, individuals can also name multiple beneficiaries or contingent beneficiaries.

Vacation homeowners need to plan for what will happen to the property after death. Planning gives peace of mind that unnecessary estate taxes will be avoided, objectives will be met, and creates an opportunity to foster communication among the family regarding their interest and intent for the property. If you own a vacation property, speak with a qualified estate planning attorney to make sure your estate plan properly addresses your goals.

Elizabeth Brown, an attorney at Pierce Atwood, has more than 20 years of experience representing individuals and businesses in estate planning, business succession planning, business formations, commercial transactions, and corporate governance issues. She assists clients in preserving vacation homes by transferring such real estate to limited liabilities companies and ensures that ownership interests in business entities are incorporated into the client's estate plan. Elizabeth is a frequent speaker on topics including, estate planning, will and trust drafting, legal issues impacting small businesses, and business succession planning.