



By Mark B. Peterson
& Shanna L. Strowbridge



Mark Peterson is a shareholder and a member of our business law practice area. He assists companies and their owners with a wide variety of business matters, including corporate governance, contracts, stock and asset transactions, real estate/leasing, and litigation. He is also a second-generation cabin owner and has counseled clients relating to the management and transition of family-owned properties. Mark can be reached at 612.877.5428 or at PetersonM@moss-barnett.com.



Shanna Strowbridge is a member of our real estate and business law practice areas. She assists clients with the acquisition, financing, leasing, and sale of real estate. Additionally, she assists corporate clients with mergers and acquisitions and contract negotiation and provides advice on financing arrangements, business structuring, and management matters. Shanna can be reached at 612.877.5259 or StrowbridgeS@moss-barnett.com.

SUCCESSION PLANNING FOR FAMILY-OWNED CABINS

“Going to the lake” is a summertime ritual enjoyed by many Minnesota families. Memories of idyllic time spent with the family at the cabin, however, often give way to conflicts, especially as parents age and ownership, use, and upkeep of the cabin turn over to the next generation, which may involve multiple siblings (and in-laws). The changed dynamic and inherent complication of the differing expectations of multiple and multi-generational co-owners can create many problems for families as to how the cabin will be used in the future and how expenses and upkeep will be shared. The more common issues faced by families include:

- Not all family members live in proximity to the cabin or share the same ability or interest in continuing to own or use it.
- Not all family members have the financial resources to maintain the cabin.
- Family members may not get along and have no interest in cooperating regarding the use and responsibilities of a shared cabin.
- Sharing the cabin interest with spouses of family members and the complications arising in the event of divorce or death.
- Concerns over joint and several liability regarding the acts of others.

Shared ownership is fraught with challenges that can turn the cabin from a family retreat to a sibling battleground. In order to preserve family harmony and continued enjoyment of the family cabin, it is important for families to carefully plan how the cabin will pass to, and continue to be enjoyed by, the next generation(s).

The Need to Plan

It is important to have a clear succession plan in place for a cabin, such as having a trust or entity established to own the property (which allows it to pass to named beneficiaries or members) or even placing title to the cabin into joint tenancy (which provides a right of survivorship and transfer of property to the other co-owners at death). When

there is no succession plan and the cabin owner dies without having designated in his or her will one or more individuals to receive title to the cabin upon that owner’s death, then all of the deceased’s heirs will receive equal shares of ownership in the cabin property as “tenants-in-common.” This means that they will each own an undivided and indistinguishable interest in the entire property which results in no owner having a clear right to use, sell, or pledge his or her portion of the property to the exclusion or without the consent of the other owners. It also results in all owners being equally responsible for the expenses relating to the property and all owners being equally liable for events at the property, but without creating any fiduciary duty responsibilities among the owners.

Another risk is that the “tenants-in-common” are continually subject to potential claims of the other owners’ creditors and the potential transfer of interests to an owner’s spouse as a consequence of divorce or death. Considering that jointly owning property requires all the parties to agree on decisions relating to the property, it is easy to see how problems can occur and tensions rise. If emotions are running high, people often have difficulty separating those emotions from the real issue at hand. When an impasse occurs, the results can be outright conflict. The only legal remedy for a tenancy-in-common ownership dispute is a partition action, which involves the court forcing a buyout of the disgruntled owner or a forced sale of the property to a third party with an apportionment of the proceeds. Involving the judicial system leads to an expensive and time-consuming mess, and hurt feelings are inevitable.

Cabin Co-Ownership Agreements. The simplest way to preserve goodwill and harmony among co-owners of a family cabin is to prepare, in advance, a written agreement to cover the various issues that may arise during the course of owning the cabin. It is easier to have an agreement worked out in advance, when family members are amenable to it and when there are few frictions that can make reaching an agreement difficult.

SUCCESSION PLANNING FOR FAMILY-OWNED CABINS CONTINUES ON PAGE 3

A co-ownership agreement should address at least the following topics:

A. How will decisions be made among the owners? A cabin may need an addition or remodeling, and it is certain to need repair and maintenance. Does everyone get an equal vote in making these decisions? In the case of siblings who own a cabin together, do their spouses get a vote? What about subsequent generations?

B. How will the cabin be funded and expenses paid? As a cabin passes to the next generation, so will the obligations to cover the expenses, such as maintenance, property taxes, insurance costs, and debt service payments. The agreement must answer the question of how expenses will be paid and what happens if a co-owner cannot or will not contribute money. The agreement also should address whether and how the owners who contribute “sweat equity” will get credit for their labor.

C. Scheduling Use of the Cabin. It is important to establish a system to ensure that use can be shared and scheduling decisions can be made easily. Depending on the number of co-owners and the relationship among them, it may be necessary to allocate certain days that each co-owner receives. Even if a complete calendar is not necessary, many co-owners plan in advance to alternate use for certain hardships.

D. Establishing General Rules and Regulations. Preparing a set of rules in advance is one of the most effective ways that co-owners can establish expectations and make sure that those expectations will be met. Such rules can cover everything from use of watercraft by minors to restocking the refrigerator. Such rules should be revisited and updated regularly as circumstances and situations dictate.

E. Expectations for Sharing of Chores. Anyone who owns recreational property knows well that such properties require a lot of upkeep. Thus, the agreement should address the sharing of labor for such tasks as putting in the dock and boats and “closing up” the cabin at the end of the season.

F. Transfer of Ownership. There are many situations in which one owner may need or want to sell his or her share of the cabin, and it is vital to lay out a plan for the transfer of future ownership. Such agreement also should address other events that would automatically trigger a transfer of an owner's interest, including incapacity, divorce, or even the failure to contribute to expenses. It is also appropriate to determine whether a deceased co-owner's share will be transferred to his or her heirs or sold or offered under a right of first refusal to the surviving owners.

G. Purchase Price of an Owner's Interest. The agreement should establish how the purchase price for a co-owner's share will

be determined. The price could be based on an agreed-upon formula or on a fair market appraisal. Provisions for financing the purchase of a departing owner's share also can be established, such as cash at closing, use of a promissory note for an established period, or purchasing life insurance to make cash available to purchase a deceased owner's share. Of course, the agreement also can establish the terms of selling the cabin if the owners are forced to sell or if they agree that they no longer want to own the cabin.

H. Dispute Resolution. There is always the possibility that a dispute will come up that parties cannot solve according to a prior agreement. If the owners are unable to work things out through a simple discussion, it is helpful to have an agreement for dispute resolution. By establishing a process for resolving disputes, the parties are one step closer to reaching an amicable solution quickly.

Setting up a cabin co-ownership agreement gives those involved an opportunity to consider the most legally appropriate way to own and use the cabin and protect it as a long-term asset for their family. The agreement can stand on its own as a written contract or can be included in the provisions of a more formal arrangement, such as a specifically created trust or through the formation of a limited liability company.

Limited Liability Company. Depending on the owners' individual situations and goals, it may be worthwhile to transfer ownership of the cabin to a limited liability company (“LLC”), in which the co-owners are “Members” and all contribute their individual ownership interests to the entity, which will become the property owner.

The Operating Agreement or Member Control Agreement of the LLC can address the transfer of ownership and purchase price issues addressed above. Other matters typically covered in the Operating Agreement or Member Control Agreement are how decisions are made about improvements, how operating funds will be contributed, and what happens when a member cannot afford to make contributions. Utilizing an LLC to own the cabin allows for a majority of members to decide how to resolve issues. In contrast, when family members own the cabin individually, they are not required to resolve issues and can force a sale. An LLC also offers its members limited liability. This means that if there is an accident that causes property damage or personal injury to a third party, the family members typically cannot be sued personally in their capacity as owners. Finally, an LLC can last forever. Title to the property is held in the name of the LLC, which allows members to leave or be added, subject to the terms of the Operating Agreement. Continuity of title in the name of the LLC avoids having to update title records as owners come and go.



However, despite the increasing use of LLCs as a cabin ownership tool, many insurance carriers struggle with the concept of using an LLC and may charge higher premiums for the “business” operation.

Cabin Trust. Another option when multiple generations are involved is to use a trust. A trust is a vehicle for holding title to the cabin and transferring it between generations without the requirement of probate, and the trust agreement can set forth the terms governing use of the cabin. Using a trust to hold title to a cabin has the advantages of keeping the terms of the agreement private, and allows a long-term savings that avoids costs, delays, and attorneys’ fees associated with probate.

Estate tax planning is still a valid issue for many families, and potential changes in federal estate tax may make it an issue for many more. A common estate tax-minimization technique to use with cabins is the qualified personal residence trust (“QPRT”). With this technique, an owner creates a QPRT, then gifts the cabin to the trust. The owner retains the use of the property for a set term of years, after which the property then passes directly to the beneficiaries (usually the owner’s children). The owner who retains only a partial interest in the property

is treated as making a gift of less than the full value of the property. At the end of the term, however, the full value of the property passes to the beneficiaries without being included in the owner’s estate. This allows many families to pass a family cabin to the next generation for a significantly reduced transfer tax cost.

A QPRT can be a good tax planning device. However, it does not solve the management problems associated with family cabins. In addition, if the owner does not survive the term of the trust, the tax planning goals will not be realized. Perhaps most importantly, if the owner does survive the term, he or she has to lease back the property to be able to continue to use it. Thus, although a powerful tax planning tool, an owner must carefully decide whether a QPRT is appropriate for a family cabin.

Conclusion

Family-owned cabins can be a great bonding experience or can tear a family apart. Proper planning can minimize the strife and preserve the original and paramount goal of owning a cabin—having it available as a relaxing family retreat.

