Cottage Succession Planning

How to Keep Your Cottage in the Family for Generations to Come

May 18, 2021

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The Legal Stuff

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- The trusted legal advisor for businesses and individuals.
- Full-service law firm with 40+ attorneys in more than 70 areas of legal practice.
- Offices in Lansing, Detroit, and Grand Rapids.
- Michigan's Member Firm of SCG Legal.

Topics to Cover Today:

- Property Tax and Co-Ownership Issues
- Family Goals and Objectives
- Cottage Succession Planning Solutions

Property Tax and Co-Ownership Issues

1994 Amendment to Michigan State Constitution

- Under the Michigan property tax system, property taxes remain "capped" (taxes are computed using "taxable value") until there is a "transfer of ownership"

Key is what constitutes "transfer of ownership"

- Throw out everything you ever knew about the verb "transfer" and the noun "ownership"
- Some events that are "transfers" are NOT "transfers of ownership" and
- Some events that are not "transfers" at all are "transfers of ownership"

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Michigan Compiled Laws, Section 211.27a

(6) Transfers of Ownership INCLUDE (but are not limited to) the following, unless new owner is a qualified family member:

- Conveyance by deed or land contract
- Conveyances to a trust
- Conveyances by distribution from a trust
- Inheritance from a will or trust
- Change of present beneficiary of trust
  - Perhaps the most misunderstood provision of the law on uncapping
- Transfers of ownership interest in a limited liability company, corporation, or other legal entity when, on a cumulative basis, more than 50% of the ownership has changed, EVEN WHERE THE NEW OWNER IS A “QUALIFIED FAMILY MEMBER”

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Michigan Compiled Laws, Section 211.27a

(7) Transfers of Ownership DO NOT include:

- Transfers to a spouse or jointly with a spouse
- Transfers to a "qualified family member"
- Transfers subject to a life lease retained by Grantor. When the lease terminates IF THE GRANTEE IS A "QUALIFIED FAMILY MEMBER"
- Transfers to a trust if the Settlor, Settlor's spouse or a "qualified family member" is the present beneficiary of the trust

Qualified Family Members Include:

- Transferor
- Spouse of the Transferor
- Transferor’s or Transferor’s Spouse’s:
  - Mother or Father
  - Brother or Sister
  - Son or Daughter, including adopted children
  - Grandson or Granddaughter

Note that this definition includes in-laws

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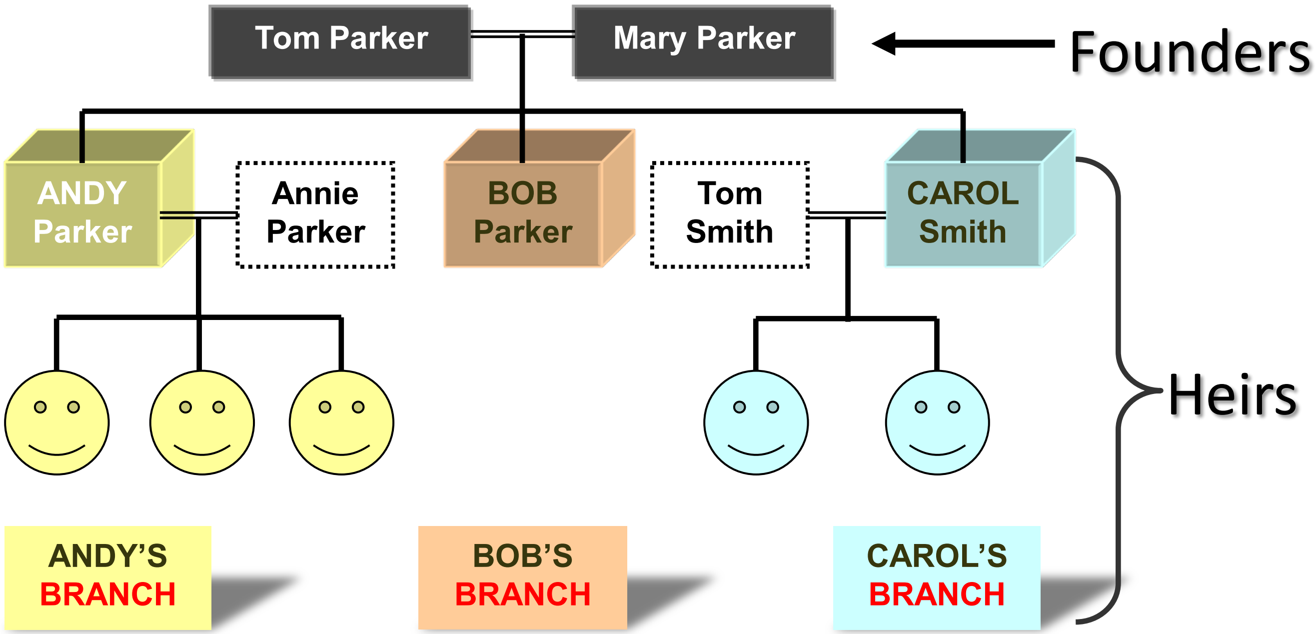
Overview of a Typical Plan

- Who should own it?
- Who should manage it?
- Who should pay for it?
- What if an owner wants/needs out?
- Who gets to use it?
- How should use be scheduled?

Cottage Lingo



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Title to the Cottage Without a Plan:

Founders:

- If husband and wife, most hold titles as joint tenants with rights of survivorship
- Title to the property automatically passes to the survivor on the death of the first co-owner regardless of any provision in a will or trust

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Title to the Cottage Without a Plan:

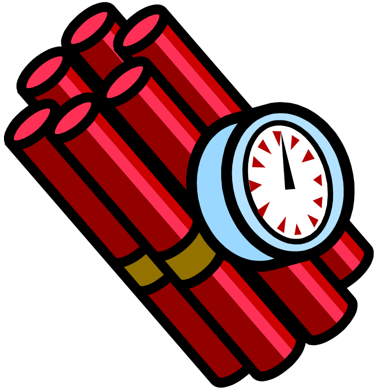
Heirs:

- Most children and cousins hold title to the cottage as tenants in common because they receive a share of a cottage:
  - As an inheritance
  - As a gift
  - As a distribution from a trust

Tenancy in Common Rules

1. Each tenant in common ("TIC") has a right to partition.
2. Each TIC may use the cottage at any time.
3. A TIC may transfer his interest to any person at any time – including his/her spouse.
4. A TIC does not owe rent to the other owners for using the cottage.

Tenancy in Common means…



Trouble is coming!

Family Goals and Objectives

Founders' Goals - Realistically

- Keep cottage in the family for generations so that it can serve as a gathering place for extended family
- Give children equal shares of the cottage
  - But avoid "trapping" an inheritance in the cottage
- Keep interests in the cottage out of hands of in-laws and creditors
- Reinforce family interests > any one individual's interests

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Heirs' Goals

- Protect cottage from a divorce
- Develop decision-making structure and control mechanisms
- Develop consequences for failure to abide by rules – financial and behavioral
- Develop fair, flexible scheduling system
- Have ability to sell interest back to family

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Cottage Succession Planning Solutions

1. Good: Co-Owner Agreements

- Tenants in common may be used if cottage will be sold soon
- Only those who sign the agreement are bound by its terms

2. Better: Avoid Tenancy in Common

- Having title to the cottage held by a:
  - Limited Liability Company (LLC)
  - Trust

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The Cottage Plan: Management

- If LLC: Management Committee
  - Operates in a similar fashion to a Board of Directors
- If Trust: Co-Trustees
- In either case, it is far better to have one representative from each branch of the family involved in decision making

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The Cottage Plan: Ownership of Beneficial Interest

Founders decide who may be an owner ("Member") or beneficiary

- Almost all cottage plans restrict participation to lineal descendants of Founders
  - This key clause keeps the cottage in the family
  - This clause prevents in-laws from becoming Members or Beneficiaries

The Cottage Plan: Ownership/Beneficial Interest Transfers

Put option – requires Company purchase of Members who want out

- Valuation
- Payment terms

Call option – forced buy-out of “difficult members”

- Delinquent payments
    - Valuation
    - Payment terms

The Cottage Plan: Finances

- Expenses typically allocated according to Members'/Beneficiaries' Sharing Ratio
- Many prepare annual budget and assess at beginning of year or season
- Endowment is one way of dealing with unequal financial resources among heirs

The Cottage Plan: Finances

What if a co-owner/beneficiary does not pay?

- Escalating sanctions
  - Impose late payment fees and interest
  - Immediate suspension of use by individual
  - Immediate suspension of use by individual's branch too
  - Immediate suspension of voting rights and/or management participation
- Triggers a call option
  - Allows forced buy-out of delinquent person

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Example 1 of Time Sharing Formula

	Branch A	**Branch B**	**Branch C**
Initial year	1st choice	2nd choice	3rd choice
2nd year	3rd choice	1st choice	2nd choice
3rd year	2nd choice	3rd choice	1st choice
repeats	1st choice	2nd choice	3rd choice

Example 2 Time Sharing Formula with Multiple Branches

	Branch A	Branch B	Branch C	Branch D	Branch E	Branch F
1st year	1st choice	2nd choice	3rd choice	4th choice	5th choice	6th choice
2nd year	6th choice	5th choice	4th choice	3rd choice	2nd choice	1st choice
3rd year	2nd choice	3rd choice	1st choice	6th choice	4th choice	5th choice
4th year	5th choice	4th choice	6th choice	1st choice	3rd choice	2nd choice
5th year	3rd choice	1st choice	2nd choice	5th choice	6th choice	4th choice
6th year	4th choice	6th choice	5th choice	2nd choice	1st choice	3rd choice
7th year	1st choice	2nd choice	3rd choice	4th choice	5th choice	6th choice
repeats	6th choice	5th choice	4th choice	3rd choice	2nd choice	1st choice

When to Create the Cottage LLC

During Founders' lifetimes?

- "Immediate" LLC
- Necessary if parents want to use exclusion gifts to minimize estate tax
  - Finish the gifting during the parents' lifetimes
- Also necessary if cottage is owned by siblings or cousins as tenants in common

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When to Create the Cottage LLC

Upon the Founders' deaths?

- The "Springing" LLC
- Must be integrated with Founders' estate plans
  - Add operating agreement for Cottage LLC to a Founder's revocable trust as an exhibit
  - Provide that the LLC is not formed until the death of the second Founder
- Allows parents to retain control for lifetimes, but establishes a plan so that children may share cottage in the future

Recap

- LLC or Trust offers best approach to cottage planning
- No single, “right” solution for every family
- Don’t strive for “perfection”
- Don’t expect miracles
- Don’t plan for “too many” generations
- A reasonable plan is better than no plan at all

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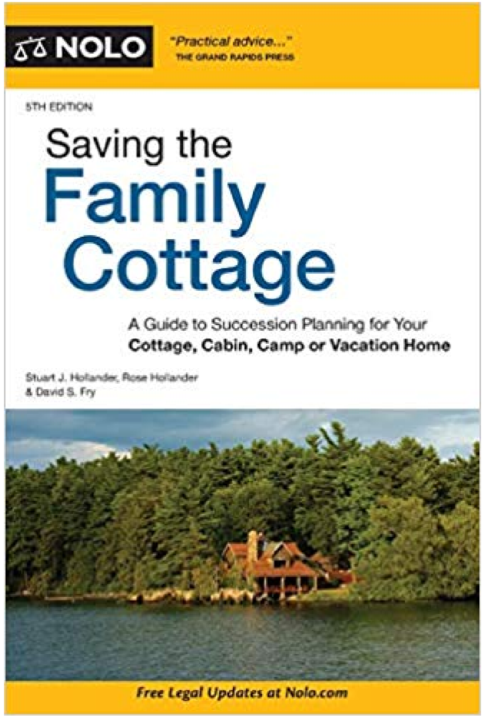
For More Information:



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Thank you for your time

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