

Counseling Clients About Their Vacation Homes

Residential real estate is the largest asset class in the United States. Beyond its primary function of providing shelter, housing provides a store of wealth and increases individual economic growth. A residence—particularly a vacation property—can also have sentimental value to a family.

Second homes are traditionally associated with wealthy Americans, but research shows that vacation homes are no longer just a luxury for the rich. This means that more of your clients than you think may benefit from a discussion regarding planning for multiple homes. The finances and feelings tied up in a vacation home can present unique estate planning challenges when a client is making plans to pass the home to the next generation. Family dynamics, ownership structure, taxes, and more need to be considered in the transition.

Vacation Homes: A Source of Wealth—but Not Just for the Wealthy

Andrew Carnegie famously said that 90 percent of millionaires got their wealth from investing in real estate. Those who are already millionaires are increasingly investing in second homes. Having more than one home is now the norm for wealthy Americans. But it is not only wealthy Americans buying second homes.

According to a recent survey, 4 out of 10 Americans now own vacation homes.¹ The National Association of Home Builders puts the national stock of second homes at 7.15 million, accounting for around 5 percent of all housing.²

Investing in a vacation home can be surprisingly affordable. Most survey respondents reported paying less than \$200,000. And the return on investment can be impressive.

Vacation Home Estate Planning Strategies

While real estate often accounts for a large share of a client's net worth, their second home may also be where family gatherings take place. Estate planning becomes more challenging in situations where a treasured family asset changes hands. This can be doubly true when the "treasure" is both tangible and intangible.

The first step in formulating an estate planning strategy for a vacation home is to determine the client's goals. The following questions can help guide your discussion:

- **Are they ready to pass the vacation home to their loved ones now, while they are alive, or are they planning to transfer it when they die?** Their preference may depend on how much time they still spend at the property and whether they think their loved ones are ready to take on the responsibility and expense of managing it.

¹ Andrew Lisa, *40% of People Have Vacation Homes: Where You Can Find One for Your Budget*, GoBankingRates (June 16, 2023), <https://www.gobankingrates.com/investing/real-estate/where-to-find-vacation-home-in-your-budget>.

² Na Zhao, *The Nation's Stock of Second Homes*, Nat'l Ass'n of Home Builders (May 13, 2022), <https://eyeonhousing.org/2022/05/the-nations-stock-of-second-homes>.

- **What is their preferred method for transferring the vacation home?** Some options include selling it to a loved one, gifting it to them, passing it down through their will, using a transfer-on-death deed, or placing the home in a trust. Each of these methods comes with different tax savings and liabilities.
- **Who will have an interest in the property?** The more family members who have a right to use the home, the more detailed the planning should be. Without a structure that addresses issues like who is responsible for paying for upkeep, taxes, and insurance, and without defining property usage rules, co-ownership rights and responsibilities could become unclear, leading to conflicts.
- **Do they want to set any limits on what can be done with the vacation home?** The client, for example, should consider whether the vacation home can be used as a rental, if family members have the right to sell the vacation home or their interest in it to people outside the family, and conditions for one family member buying out another's interest.

Once you define your client's goals for the vacation property, you can help them come up with appropriate planning strategies. During your discussion, address the following additional considerations:

- If the property is mortgaged, they may need permission from the lender to transfer it.
- A trust can allow the client to maintain control by enabling the client to set rules about how the property is to be used and maintained. They can also transfer money into the trust to pay for ongoing expenses. The trust can be designed so that the client retains the right to use the vacation home until death, at which point it passes to their loved ones.
- Clients can also establish a life estate that allows the vacation home to be transferred at their death while allowing them to continue using it until they die.
- A business entity such as a limited liability company (LLC) or family limited partnership (FLP) could be created to own the home and potentially provide some asset protection.
- Clients need to consult with a tax professional to ensure that federal gift, estate, and generation-skipping transfer taxes; income and capital gain taxes; state-level estate and inheritance taxes; and state and local property taxes applicable to transferring and owning the property are properly considered in the vacation home succession plan.
- Vacation homes in another state or country pose additional estate planning challenges and will likely necessitate local counsel or advisors.
- If there are children who are not interested in owning the vacation home, the client may want to consider how they will equalize their children's inheritances if treating everyone equally is an estate planning priority.

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It might seem like a simple decision to keep a vacation home in the family. But estate planning is rarely straightforward. Deciding how to handle a property that has served as a past gathering place—and hopefully a future one—can prove to be especially complicated.

Whether a vacation home has been in a client's family for generations or just a few years, it needs to be thoughtfully addressed in their estate plan. For advice on counseling clients about vacation home legacy strategies, reach out to schedule a time for a conversation.



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