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Estate Planning for Vacation Homes Is a New Practice Niche

By William C. Smith

Estate planning lawyers have an opportunity to draw quality business by showing potential clients how to save one of the things that is nearest and dearest to their hearts – their vacation homes.

For tens of thousands – possibly millions – of upper-middle-class and wealthy citizens, the family property has served as a summer oasis since child-

hood, imbuing the land with the power of nostalgia and deep family roots.

But as any summer homeowner knows, this pleasant façade may obscure family discord over the control, funding and future of family properties – simmering disputes that often erupt into full-scale warfare when death forces the property to be transferred from one generation to another.

It is a phenomenon that Winthrop, Maine, general

practitioner Howard Lake calls “the curse of common ownership.”

And this curse “multiplies logarithmically” with the number of heirs, says attorney Richard McKittrick of Camden, Maine.

“If Mom and Dad own the property, the problems are minimal,” he says. “When it’s passed on to the kids, the issues are magnified. Once you get cousins and second cousins in there, it’s all but unworkable.”

As anyone who has lived in a vacation community knows, even congenial families can be torn asunder when the fate of the beloved cottage is suddenly on the line. One faction wants to sell, one wants to develop, another wants to preserve the land in its present state forever.

This phenomenon presents lawyers with excellent marketing and practice opportunities.

Vacation home planning

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is a growing and vastly underutilized practice niche, according to Stephen Small, a Boston lawyer who devotes his entire tax and estate practice to saving family property. He believes that the need for this type of work will increase dramatically in the coming years due to the interplay of two factors:

• **Demographics.**

Landowners in the U.S. are getting older, and thus more likely to sell or pass on their property. Small recently heard from a colleague in Montana that a third of the state's total area – about 30 million acres – will change hands in the next 20 years, since the average age of its landowners is over 60. Senior citizens also have a lock on undeveloped land back east, says Small. The average age of a New England woodland owner is well over 60, and owners of forest land in the Southeast average 64 years of age.

• **Skyrocketing land values.**

Land values have soared in recent years – and with a federal estate tax rate of up to 50 percent, it may be impossible to simply pass on this property by will.

"The land may have become so valuable that it may have to be sold to pay the estate tax," says Small, who previously worked for the IRS where he drafted the regulations on conservation easements.

McKittrick believes that smaller practices have an advantage in this growing field since they usually provide more personal attention to family dynamics than their big-firm colleagues.

He says lawyers should look at family land planning as a distinct practice that is bound to grow as a "staggering amount of wealth" in land is inherited by the baby boomers, thus generating legal work for years to come.

"This work is not going away," he says. "It may involve decades of interpretation [of legal documents], and interplay between family owners, land trusts, and future owners. Whatever you do will be around for a long time."

Furthermore, clients who hire a lawyer to save the summer cottage are likely to bring all of their estate planning work to that lawyer.

Family Warfare

The key to avoiding all-out warfare is to create the estate plan before there is a crisis such as mortal illness or death, says Olivia Boyce-Abel, a family-lands mediator based in Santa Cruz, Calif.

Boyce-Abel should know – the absence of a clear estate plan turned her idyllic family retreat into a nasty legal battleground.

In the 1920s, her grandfather bought 3,000 undeveloped acres on the Carolina coast which included a beautiful barrier island. When the grandfather died, he passed the land on to his wife, son and daugh-

ter (Boyce-Abel's mother), and when the grandmother died, her share went to her grandchildren.

That's when the land war began.

Boyce-Abel's mother and uncle first fought over how to divide the grandmother's one-third interest among six grandchildren. The two then clashed over the land's future, with her mother treasuring it as "a home for all of God's creatures" and her uncle dreaming of a profitable "Hilton Head-type" golf resort.

With the majority of owners in or near retirement, vacation properties across the country are poised to change hands.

After the uncle died, his wife sued to partition the prime oceanfront property, now worth \$30 million. Boyce-Abel's mother was terminally ill with cancer, and she realized that her dream of preserving the land's natural beauty was also slipping away. Facing \$5.5 million in inheritance taxes on her portion of the property, her children would have no choice but to sell the land after her death.

Enter Stephen Small, the Boston estate planning lawyer whom Boyce-Abel credits with saving her mother's share of the land.

Five days before her death, the mother deeded her 1,000 acres to a charitable trust foundation, which

named Boyce-Abel as one of its "environmentally-oriented trustees." This move prompted two siblings to file a lawsuit challenging the will and the property transfer. The case ultimately settled on terms that protected the mother's former land, says Boyce-Abel, but not before "my once peaceful life was taken over by faxes, continuous conversations with lawyers, court hearings and motions."

While the issues encountered by Boyce-Abel's family are extreme, they are similar to those faced by millions of families that own anything from palatial estates to single-room cabins.

McKittrick ticks off the major flashpoints for family fights over summer homes:

- Cost-sharing for taxes, insurance and upkeep.
- Scheduling conflicts during peak holiday seasons.
- Ill will toward in-laws.
- Disputes over future development.

But as McKittrick points out, the barriers to sound planning often run far deeper, involving age-old family disputes that stem from sibling rivalry, perceived slights and a host of other grudge matches unrelated to the property.

These families may need professional help to reach consensus on a plan for their property, says McKittrick. Lawyers can sometimes fill this role, but many lack the expertise or

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time needed to deal with feuding families. An attorney's ethical duty to an individual client also disqualifies them from serving as a neutral mediator, McKittrick notes.

Sorting Through Tangled Family Disputes

Many lawyers went into tax and estate work because they wanted to avoid the messy emotional elements of family law or litigation.

Experts in the field suggest that these lawyers may want to team up with professional mediators who thrive in the volatile world of family passions. This allows the lawyer to concentrate on the law, while still offering clients the support services they need to sort out the longstanding issues that stand in the way of a rational estate plan.

Boyce-Abel is one such mediator. After her own family's 23-year legal battle she founded Family Lands Consulting in Santa Cruz, Calif., a mediation firm dedicated to helping families resolve property disputes through consensus rather than court battles. Boyce-Abel has worked with estate lawyers throughout the U.S., helping their clients' families to agree on a coherent strategy for the succession and maintenance of family lands.

She says that lawyers can either hire a mediator to take on this part of the work or learn the key elements of family mediation themselves.

Either way, the issues must be dealt with tactfully because families are often uncomfortable even discussing these subjects.

"While families enjoy sitting around the fireplace reflecting on their family ancestry, there is tangible strain when families try to address inheritance, estate planning, and wealth transference issues," she says. These subjects are "culturally verboten and carry unwanted emotional

families engage in a more "open and forthright" discussion about land transfer issues when the "heirs are in their thirties and forties, and their parents are still in good health."

If a lawyer chooses to bring in a mediator to handle this portion of the job, the mediator turns the case back to the lawyer when it comes time to prepare the necessary legal instruments.

McKittrick has a similar relationship with land-use

or allowing some additional development. Once family members agree on their common goals for the property, the family lawyer drafts the necessary wills, trusts, or other legal instruments to implement these objectives.

Putting It All on Paper

With the emotional complications being sorted out by an independent mediator, the lawyer is more likely to be able to develop a rational legal plan for managing the family property.

According to Lake, many parents, in an attempt at evenhandedness, simply pass on the land to their children as tenants in common. Under this arrangement each child has equal control over the entire property. When grandchildren are involved, this arrangement can be even more cumbersome. For example, two children may have a one third interest each and two grandchildren each have a one sixth interest. If the property is sold, the money is divided accordingly, but while the property is still in the family, no one has control.

But that's not the worst of it, says Lake. Under this arrangement, any owner may file a partition suit, forcing the family either to break up the land or to pay fair market value for their unhappy relative's share of the property.

To avoid this "awkward and expensive" outcome, Lake often advises landowners to set up a

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baggage," such as the mortality of loved ones.

Many parents adopt the attitude that "we'll just leave [the land] to the kids and let them fight it out," she says. "Well, that's exactly what happens, and land is a lot more emotional for [the children] than shares of Exxon stock."

This type of laissez-faire attitude often means that momentous decisions about family lands are made when the family is at "crisis point," says Boyce-Abel. If the issue isn't dealt with in advance, the discussion inevitably is forced by the illness or death of a loved one. And this is the worst time for a family to deal with emotionally-charged issues.

Boyce-Abel suggests that

specialist Jerry Bley of Readfield, Maine, whom he calls in whenever his clients' families can't agree on a long-term plan for their lands.

"Tensions around family lands usually have little to do with the land itself," Bley finds. "Rather, they sprout from the endless variety of conflicts that can be found in today's families."

With written questionnaires and interviews, Bley usually finds that despite their emotional squabbles, family members can reach a "broad consensus" on goals for their commonly held property. These "guiding principles" might include reducing taxes, ensuring continued access for all family members, preserving natural resources,

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family trust to own and manage their vacation properties. Trust provisions may formalize the family's agreements on financial issues, decision-making authority, "buy-out" procedures, vacation scheduling, and other potentially controversial subjects.

Boyce-Abel has also found that trusts, partnerships and corporate ownership devises can codify a family's land management and transfer objectives.

For example, governance provisions might require yearly meetings in which family members – acting as trustees, partners, or shareholders – deal with property management issues and approve annual budgets. Families can also allocate the cost-sharing of summer homes on a "pay to play" system based on actual usage of the property. Some families have even formalized their agreement on vacation schedules, she recalls, even down to a week-by-week, 12:01 a.m. Monday to midnight Sunday reservation system.

Death and Taxes

To Small, author of *Preserving Family Lands*, the biggest threat to a family's enjoyment of its summer home is not Uncle Louie's demand to have the place every July 4th weekend, but Uncle Sam's demand for estate taxes.

"If you don't get the property through estate tax, then there will be no holiday reservations to fight over." Small warns.

"The place will be gone.

However, there are several strategies to reduce or avoid this potentially ruinous tax burden, according to Small and other estate planning lawyers.

Deeding the property over to the kids during the parents' lifetime takes it out of the parents' estate. However, Small warns that this option is "not as simple or painless as it sounds," since the transfer is still subject to the federal gift tax. Furthermore, if the parents retain the right to use and enjoy the place, the IRS will include it in their estate at death, deeming the conveyance to be meaningless tax dodge.

Still, it makes sense for some owners to pass on land in their lifetime, especially those who can structure the transfer to take advantage of the \$10,000 annual exclusion for gifts to any individual, or the \$650,000 lifetime exclusion from gift and estate taxes.

Mark Blaskey, the estate planning chair at Philadelphia's Cozen & O'Connor, says that many summer homeowners can slash property transfer taxes through a "qualified personal residence trust," or QPRT. Under Section 2702 of the Tax Code, landowners remain in possession of the property during the fixed term of the irrevocable trust, after which the place passes to the beneficiaries (typically, the children).

Although gift taxes must be paid when the trust is settled, a QPRT greatly reduces

the government's take. First, the taxable value of the gift is discounted because the recipient is not getting immediate possession, but rather the promise of future ownership. Second, the gift's value is reduced even further to account for the risk that the donor will die before the end of the trust period, which would cause the property to return to the estate.

The longer the trust term, the greater the tax discount, notes Ronald Gormey of Boston's Hutchins Wheeler & Dittmar.

Saving Nature and Dollars

A landowner can also protect the environment while slashing taxes by giving up development rights through a conservation easement.

"For the family that cares about its land, [a conservation easement] is the first tool in the toolbox," says Small. It allows owners to protect their land's natural beauty while lowering its taxable value.

Taxpayers who donate conservation easements to nonprofit groups have long been able to claim a charitable income tax deduction, based on the reduced fair market value of the restricted property. The property's lower value should also reduce the local property tax bill, says Small.

In the Taxpayer Relief Act of 1997, Congress gave another tax benefit to those who give up their right to develop open land. Section 2031(c) of the Internal Revenue Code allows a further

estate tax exclusion for the gift of a "qualified conservation easement" to a government body or conservation organization. With a conservation easement, the landowner still owns the property, but has given the easement holder the right to prohibit future development on the land.

Under Section 2031(c), the executor may exclude from the taxable estate up to 40% of the property's fair market value. The exclusion is being phased in annually in \$100,000 increments, to be capped at \$500,000 in the year 2002. The decedent or a family member must have owned the property for three years before the decedent's death.

"Conservation purposes" is statutorily defined as the protection of natural habitat, open spaces that benefit the public, or historically significant lands or buildings," says Small. "The more significant the land is, the more it adds to the public good, the more likely you will qualify for [favorable tax treatment]."

But conservation easements are not for families who are not firmly committed to preserving their land's natural features.

"You have to be very comfortable [with the development restrictions] because easements are permanent," says Neil Head, of West Chester, Pa.

Blaskey also preaches caution. Easements are sometimes touted as a "tax gimmick," he says, but limits on development are real and enforceable. **LWUSA**