

# **Multi-Generational Ownership and Planning for Family Owned Properties**



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## **I. The Role of Land Trusts and Conservation Transactions in Planning for Multi-Generational Properties**

Many families who live in Maine full time or seasonally have acquired, by purchase, inheritance or gift, vacation homes, farms and properties that run the gamut from modest cabins with no heat source other than a wood stove, to large multi-acre tracts with multiple year-round homes. The properties may be deep in the north woods, may front on a river, lake or the ocean, or be island property. One thing that many of these properties have in common is an owner or owners who would like to see the property preserved and protected for their descendants or extended family to enjoy for years to come. For that reason, conservation easements, bargain sales and other conservation tools may play a crucial role in the planning process for multi-generational ownership of family properties.

Where the members of a family have an emotional stake in preserving family lands in their current undeveloped state, the family may be very open to working with a land trust on the gift of a conservation easement or a gift or bargain sale of all or portions of the property. The benefits of such transactions to the property owners include the preservation of the property in its natural state, the concomitant reduction in property values, the availability of current income tax deductions and, for larger estates, the reduction in asset values for estate tax purposes. The types of family properties in Maine most likely to benefit from such conservation planning include coastal islands, largely undeveloped tracts of coastal and lakefront property, large tracts of forest land, and farm properties. The primary impetus for such conservation planning is usually the protection of the land from future development but the real estate, income and estate tax benefits often make the transactions more attractive from the owner's point of view. In some cases, a sale to a land trust of part of a family property for fair market value or at a bargain sale may provide the funds necessary to pay estate taxes that will be due on the appraised value of the remaining balance of the property.

In dealing with properties that are or will be owned by extended families, land trusts should be prepared for several years of family planning and discussions. It is often not an easy task to arrive at a consensus of family members as to how to proceed. The issues that need to be addressed include:

1. What areas of the property will be preserved in a natural state;
2. Will existing structures be permitted to be expanded and by how much;
3. Will new structures be permitted, and if so, how many and where will they be located;
4. What will be required in terms of building materials and screening;
5. Will there be an obligation to keep fields open;
6. What will be the limits on timber harvesting;

7. Will future subdivision of the property be permitted, and if so, into how many parcels; and
8. Will public access be permitted, and if so, under what limitations.

Because of the complexity of these issues, and the potential for disagreements within the family, it is often advisable for the land trust to make an arrangement with the family that one member of the family will serve as the primary contact point between the family and the land trust. If the interests of family members diverge in the planning process, however, it may be necessary for the various individuals or groups within the family to obtain separate independent legal advice and, in those cases, the land trust may have to negotiate the terms of a proposed conservation easement or other conservation transaction with multiple parties. If a land trust is dealing with a family member who is more than 60 years of age and may be dependent on others, and who may have a confidential or fiduciary relationship with a representative of the land trust, the land trust should be mindful of Maine's Improvident Transfer Act, 33 MRS § 1021, which requires that such persons retain separate counsel in connection with the transaction.

There are numerous large parcels of land on the Maine coast, on Maine's lakes, and in Maine's primary farming areas that will be passed on to a new generation in the coming years. The current owners of these properties face complex issues involving family dynamics, estate planning, property and income tax planning, and land conservation. The Maine land trust community can play an important role in this ownership transition by providing expert advice on issues relating not only to land conservation and appropriate levels of development, but also on potential ownership structures for multi-generational stewardship of the property. There will be additional significant opportunities for land conservation if Maine land trusts have the patience and the skills to work closely with Maine families in planning for the transition to multi-generational ownership and conservation of family properties.

As advisors to these owners and their families, we're often asked to craft a way to accomplish their goals of preserving and protecting the property. Although the details of how we might ultimately craft a plan for preserving and protecting the family property are as varied as the families themselves, there are a few basic design models that most often serve as the foundation of the plan.

To enable us to determine which of the basic design models is most appropriate for any given family circumstance we need to clearly understand the family's goals and objectives. Our first opportunity to understand those goals and objectives is typically in a conversation with the current owner(s). Although the owner(s) usually have the ability to be objective in describing their vision for the future of the family property, they understandably lack the experience needed to have fully thought through the various issues inherently involved in evaluating whether it is practical to accomplish their articulated goals.

There is an adage among estate planning lawyers: “You don’t really know someone until you share an inheritance with them.” Although adult children may enjoy getting together with their parents on key holidays or for a week or more during the summer, they may not share their parents’ vision of having them co-own the family property with their siblings. The power of the hidden undercurrent of sibling relationships can scuttle the best of parents’ plans. Dynamics of adult relationships between or among siblings are often formed decades earlier, and those relationships are sometimes less than healthy when the surface layers are peeled away. It may be impossible for the professional advisor to discern the true feelings of extended family members about their siblings, their siblings’ spouses and their nieces/nephews. Family members may only be willing to say what they think their parents want to hear . . . for all the reasons that some children want to please their parents, both in childhood and in adulthood.

Real estate ownership can be expensive after accounting for the costs of maintenance, repairs, capital improvements, utilities, security, insurance and property taxes. Unless the founding generation has the capacity and willingness to provide a substantial sum of money to endow the costs of long-term ownership, the capacity and willingness of the descendants who will be the future owners/users of the property needs to be explored. The financial equation may be easy when all children are financially well equipped to contribute to the long-term ownership. But, taking on the financial burden of co-owning the family property may be at the bottom of the list of priorities when one sibling is struggling to stay current on his monthly mortgage payments, and another is laying awake at night worrying about how to pay college costs for her three children and simultaneously fund her own retirement account.

Descendants’ physical proximity to the family property will often be an important factor in the success of a plan for long-term ownership. The child who lives in Portland is likely to be far more inclined to want to see her parents preserve the family property on Moosehead Lake than the child who lives in Dallas and enjoys the convenience of taking his own children to Padre Island for vacations.

An essential part of the conversation that is sure to influence how family members respond to the idea of implementing a plan for the long-term ownership of the family property is whether each person’s interest in the family property may be viewed as an economic interest, or whether the ownership will be structured for the benefit of the extended family as a whole with no individual having the opportunity to “cash-out” and receive his/her fair share of the value of the property. In fact, this may be the most influential element that shapes each family member’s response to the discussion of preserving the family property. Some family members may think of the property as a sacrosanct family gathering spot and be indignant at the thought of other individual family members viewing the property as a financial asset. Although some members may be willing to give co-ownership a try, they may feel quite strongly about ensuring that a structure be implemented that will permit them to sell their interest for full value in the event they want to do so at some point in the future. Family members may want to realize the economic value of the asset for any number of

reasons - - they no longer live close enough to Maine to justify the time and expense required to use the property, they don't get along with their siblings or their siblings' spouses, or they need or want the money to sustain another aspect of their lives . . . whether to buy a vacation home of their own, to pay for their own children's education, to alleviate their own debt load, or simply because they no longer want to contribute toward the annual costs of co-owning the property. If discussions with the family reveal the importance of permitting a family member to cash-out his/her interest in the property, the design of the ownership structure needs to permit that to happen. If a decision is made to give a family member the right to exchange his/her interest for cash, then the ownership arrangement will need to require that the others buy the interest of the selling family member. How will the sale and purchase price be determined? Is it a pro rata portion of an appraised value determined at that time? In other words, if there are three sibling owners and one wants out and the property appraises at \$900,000, are the other two siblings required to ante up \$300,000 to purchase the interest of their selling sibling? Or will there be some discount applied to the pro rata ownership interest being purchased? Is the amount payable in a lump sum or over a period of years? If the purchase price is payable over a period of years, will interest accrue? What if one of the other owners doesn't have the financial ability to buy or doesn't want to buy? Does one sibling's desire to cash-out force an outright sale of the property? The answer to the underlying question of whether family members should be entitled to convert their interest for economic value will influence the decision of what planning option is best suited for ownership of the property.

There are many issues that need to be considered as part of any common ownership plan. In addition to those already mentioned above, here's a sampling of other issues:

1. What will be the gift, estate and generation-skipping transfer tax consequences of the transfer?
2. Will the senior generation be entitled to continue to use the property if a decision is made to transfer ownership of the property during the senior generation's lifetime?
3. How will expenses of ownership be handled and managed?
4. What happens if someone doesn't contribute his/her share of the annual expenses of ownership? Do they lose their right to use the property? What penalties and/or interest accrue on their unpaid contribution obligation?
5. Who is in charge of scheduling the use of the property?
6. Do senior generation members have priority of use over junior generation members?
7. Can a spouse (in-law) own an interest in the property? If so, what happens in the event of divorce?
8. How old do kids have to be to use the property without a parent on site?

9. Can members contribute sweat equity (e.g., fixing the broken porch railing, painting the house, removing or installing the dock, etc.) in lieu of a financial contribution? If so, how is their time and labor valued? A related question is whether members are entitled to payment for work done on the property.
10. If one family is using the property during their scheduled week of use in mid-July, can another family member stop in to use the property (e.g., the lake front) during the day? Or, is assigned usage exclusive?

## **II. Threshold decision – preferred choice of entity**

A threshold decision to be made for long-term ownership of the family property is whether the property should be owned via an entity, and if so, what type. The most common form of shared ownership of properties is as tenants-in-common, with each individual owning an undivided equal interest in the property. Decisions are made by the owners as needed. A jointly owned bank account often serves as the source of funds for property related expenses, and the individual owners add money to the joint account as needed to pay the bills. Sometimes the relationship is formalized by a tenant-in-common agreement that spells out rights and responsibilities of the owners. Tenant-in-common ownership permits any single owner to file a partition suit, which, except in rare circumstances where the property can be physically divided in an equitable manner, results in a sale of the property and a division of the proceeds of sale. Tenant-in-common ownership offers no creditor or divorce protection, and provides no restrictions on the transfer of ownership interests during lifetime or death.

Once a decision is made to own the property in a form other than as tenants-in-common, there are two primary entity options available for consideration - - trusts and limited liability companies.

Trusts separate legal ownership from the beneficial enjoyment of the trust property. Legal ownership of the trust property is in the trustees. The trust is created for the benefit of the beneficiaries, one or more of who will often, but need not, be the trustee or one of multiple trustees. Trusts in Maine can have perpetual existence. Trusts can be an effective option for holding a family property for a single generation or for multiple generations and are likely to be the preferred entity when the goal is not to have family members view their beneficial interest in the property as an economic interest with cash value. Trusts are also likely to be the preferred entity when the transfer of the property to the next generation doesn't occur until the death of the senior generation. Although trusts at one time were relatively inflexible once created, trust law has evolved in recent years to permit the amendment of irrevocable trusts in ways that make them fairly flexible planning tools.

Although a trust may be designed to deny the beneficiaries the opportunity to convert their beneficial interest into an economic interest, a trust may also be designed to permit the

beneficiaries/trustees to sell the real estate at any time, terminate the trust, and distribute the proceeds of sale outright to the beneficiaries. Or, if preferred, the proceeds of sale may be held in continued trust for the long-term education, health, maintenance and support of the beneficiaries. In some cases it may be more appropriate, for estate tax planning purposes or because none of the beneficiaries have the necessary sophistication or experience to make such decisions, to give an independent trustee (a non-family member) the authority to sell the property, terminate the trust, or distribute the trust assets. It may be desirable to have multiple trustees govern the trust, with each branch of the family represented in the governance of the trust and entitled to elect and remove one of the trustees.

Irrevocable trusts can be designed to permit beneficiaries to transfer their beneficial interest to a permitted class of transferees that is defined as narrowly or as broadly as desired. Transfers of beneficial interests can take place either during a beneficiary's lifetime or upon the beneficiary's death via the beneficiary's exercise of a lifetime or testamentary power of appointment. A lifetime power of appointment could be exercised with or without compensation to the beneficiary.

Trusts can provide creditor protection for the beneficiaries of the trust. A trust, although irrevocable, may be designed to permit an independent trustee or "trust protector" to amend the trust, adding significant flexibility to a structure that might otherwise be considered overly restrictive. In other words, irrevocable doesn't have to mean that the trust can't be changed; but, it does mean that the donor can't change the trust provisions.

A donor who wishes to continue to use property that has been transferred to an irrevocable trust must pay fair market rent for his/her use of the property to avoid having the value of the property included in the donor's taxable estate at death.

A limited liability company (LLC) is the other commonly used choice of ownership for family properties. An LLC can be a flexible way to own property over a long period of time and through multiple generations. Management of the LLC may be by the members, or management may be structured with one or more managers, who may or may not be members of the LLC. Classes of membership interests can be created, some of which have voting rights and some of which do not. An LLC operating agreement typically contains detailed provisions governing the members' ability to transfer their interest to another person, the LLC's right or obligation to buy a membership interest in the event of the death of a member, the method of valuing a member's interest and the terms for payment of a purchased interest. Like irrevocable trusts, an LLC can provide an effective means of providing creditor protection for the LLC's members. A member's creditor will not be able to reach the property owned by the LLC. An LLC initially created and owned by the senior generation may permit the senior generation to make gifts of LLC interests over the course of years, using annual exclusion gifts (currently \$13,000 a year per donee).

### **III. Secondary decision – How to convey**

Once a decision is made as to the preferred method of ownership or choice of entity, there are various options for how to best convey the property to the chosen method of ownership. The most common options for conveying the family property are:

1. **Outright transfers during the donor's lifetime.** The donor can use all or part of his/her current \$5,120,000 gift/estate exemption (or \$10,240,000 for both spouses) for the gift/conveyance of the real estate. An outright lifetime transfer will transfer the donor's cost basis in the property.
2. **Lifetime transfers via annual exclusion gifts.** The donor can make transfers of fractional interests over time using the \$13,000 annual gift tax exclusion, which permits gifts of \$13,000 each calendar year to an unlimited number of donees. A married couple may gift \$26,000 a year to each donee. In other words, a husband and wife with 3 children and 4 grandchildren may gift \$182,000 of property a year using annual exclusion gifts, before factoring in any valuation discount that might apply to the gifted fractional interest.
3. **Qualified personal residence trust (QPRT).** A QPRT is an irrevocable trust that permits a gift of a personal residence (which can be a vacation home), with a reasonable amount of surrounding land, for the benefit of children or other beneficiaries at a reduced gift tax cost. The reduced tax cost takes into account the present value of a future gift. The donor may continue to live in the property rent-free for the QPRT term and may reserve the right to rent the property for fair market rent at the end of the QPRT term. Because of the rules governing the creation of trusts that benefit multiple generations, a QPRT is often not the preferred vehicle to use if the goal is to create a trust that will benefit grandchildren or subsequent generations. If the donor dies during the QPRT term, the value of the property will be included in the donor's taxable estate. It is therefore important to select a term of years for the QPRT that is within the donor's life expectancy. Or, an effective strategy may be to create two or three ladder QPRT terms to hedge against the risk of the donor's premature death. Like an outright lifetime transfer, a transfer to a QPRT will transfer the donor's cost basis in the property. Each person may have two personal residences for purposes of the QPRT rules. Therefore a husband and wife may create QPRTs for as many as four different personal residences. When the QPRT term ends, the property may be held in continued trust or the property may be transferred to an LLC or other entity.



4. **Inter vivos (during life) transfers to irrevocable trusts other than QPRTs.** Like outright gifts and QPRTs, inter vivos irrevocable trusts are an effective way to transfer all future appreciation to succeeding generations free of gift and estate tax. Like outright gifts and QPRTs, an inter vivos irrevocable trust will transfer the donor's cost basis in the property.
5. **Testamentary trusts (irrevocable trusts created at the donor's death).** A testamentary trust will result in a step-up in the income tax cost basis for the property to reduce or perhaps entirely eliminate capital gain if the property is eventually sold. Whether this is a benefit to the family will depend on the donor's cost basis in the property, the current value of the property, the likelihood of future appreciation in the value of the property, and the size of the donor's overall taxable estate - - in other words, if the property is still owned by the donor at death, will it be subject to estate tax? If the property is likely to appreciate substantially in value during the donor's lifetime, and if the donor will have an estate of sufficient size to be subject to estate tax, then a lifetime gift (either outright, via annual exclusion gifts, or via a QPRT) may be the better tax option. If a person is given a "pick your poison" choice of which of two taxes to pay, it is typically preferable to subject the property to the possibility of capital gain tax at some distant time in the future than to the certainty of the estate tax at death.

No matter what vehicle is used for ownership of the family property, the goal should be to ensure that the property and the ownership structure is viewed as a benefit to the family, and not a burden. There should be sufficient flexibility to ensure that if a given percentage of the family members no longer share a desire to co-own the property, there is a reasonably straight forward way to terminate the ownership structure and permit the property to be sold, with family members having the first right to purchase the property before it is offered for sale to non-family members.

#### **IV. Decision Making Procedures**

One of the most important issues that a family must resolve as part of establishing a trust or an LLC for managing a family property is designing the future decision making process for the family. There are a number of considerations that must be taken into account. The decision making process should be relatively stream-lined so that decisions can be made quickly and efficiently. It should be representative of the different family groups without being too cumbersome; and perhaps most importantly, it should include a mechanism for tactfully isolating a difficult family member who, consciously or unconsciously, attempts to work out family grievances by making it difficult to resolve relatively minor issues involving the family property.

One structure that seems to be quite successful in this regard is to divide the ownership or beneficial interests in the property into separate classes, often representing different branches of the family, and to provide that each class may elect one member or trustee to a board that has final authority over day to day operating and management decisions. If there is a difficult family member who tends to create problems, that person will usually not be elected to the board or, if they are elected to the board by their class, they can be outvoted by the board members representing the other classes. While it is desirable to vest decision making authority over day to day management matters in a small governing board, it is also common to require a super-majority of the ownership or beneficial interests for major decisions such as whether or not to encumber the property with debt, whether to construct new buildings or facilities or whether to sell the property.

## **V. Allocation of Costs**

Another issue that families face in managing commonly held properties is how to allocate the ongoing operating and maintenance costs. In most situations, it becomes necessary to allocate costs partly on the basis of actual use of the property and partly on the basis of ownership or beneficial interest. It is generally not fair to allocate costs entirely on the basis of ownership or beneficial interest because some owners will make frequent use of the property while others will use the property only infrequently. On the other hand, it may not be feasible to allocate costs entirely on the basis of use. The economics of family property ownership often dictate that if the user charges get too high, some family members will decide not to use the property as frequently. That may create a vicious circle where the usage of the property keeps going down and the user charges keep going up. Some balance between allocating costs to the users and the owners or beneficiaries is usually necessary in order to keep the property occupied for sufficient periods of time for the user charges to cover most of the operating costs.

To the extent that property costs are allocated based on usage, it is often necessary to vary the user charges based on the desirability of the times that the property is being used. For Maine seasonal properties, it is quite common to designate a primary season from July 1 through Labor Day, a secondary season for June and the rest of September, and an off-season from October through May. Charging users different amounts for each of these seasons may result in increased occupancy and reduced overall charges. Another issue that must be addressed is whether the costs of the property are allocated on a per day basis for the entire property or whether the costs are allocated on the basis of “person-days.” There are any number of variations between these two approaches that can be worked out by the family based on the nature of the property and the established patterns of family use.

## **VI. Allocation and Use of Time**

Another issue that must be addressed is how the time at the property will be allocated or divided up among family members. The first question that must be answered is whether the property is going to be used by numerous members of the family at the same time, or whether the time is going to be divided among family members so that each member has exclusive use of all or a portion of the property for a specified period of time. Under the exclusive use model, it is then up to each user whether or not to invite other members of the family to use the property during their allocated time, and if so, which family members will be invited and whether or not they will be asked to contribute to the user charges.

Another issue is how the “prime” time will be allocated. In some families, certain weeks of the season are allocated to the same family members each year, while in other families there is a periodic rotation of time from year to year. This type of schedule rotation may be desirable for properties that have relatively short peak seasons, or conversely, those that typically have long stretches of undesirable weather, black flies or mosquitoes. Other issues that come up include whether priority for use of the property should be based on seniority, extent of ownership interests, or on the importance of family events such as reunions, weddings or honeymoons.

A final issue regarding allocation of time at the property is who has authority to make final decisions. In some families it will be the trustees, directors or managers of the property while in others it may be a person who is specifically designated for that role. One successful model is to have the board appoint a well respected family member, who is also a good communicator, to play that role.

## **VII. Separate Entities for Specific Resources and Activities**

Another issue that must be addressed with larger family compounds is whether all of the costs of the property should be allocated in the same manner or whether the costs of separate facilities on the property should be allocated in different ways. In larger, multi-generational family compounds, it is quite common to have separate associations or corporate entities that own or manage particular facilities such as a tennis court, pool, boat house or dock. In those situations, it is quite common for the costs of those facilities to be allocated among the members on a different basis than costs for taxes, caretaking, maintenance, and other shared services.

## **VIII. “Stranger Danger”**

One consideration that is often involved in planning for multi-generational family properties is the degree to which non-family members will be permitted to participate in the ownership, management and use of the property. This issue has been characterized by one family we have worked with as to the matter of “stranger danger.” The basic question is

whether and how to discourage or prevent people from outside the family from gaining an ownership interest in the entity. This issue arises if the interest of a family member is transferred to someone outside the family voluntarily by sale or gift, or involuntarily, as a result of a creditor's lien, bankruptcy or divorce judgment.

The most common way of dealing with this issue is to create a group of "permitted transferees" such as the parents, children, grandchildren, siblings, nieces and nephews of the existing owners, and then to grant family members first refusal rights in the event of a sale or transfer to anyone other than a permitted transferee. In the case of involuntary transfers, the organizational documents may include a provision requiring a non-family transferee to offer the interest in the property to the remaining owners, or to the ownership entity itself, based on the appraised value of the property, often with an appropriate minority discount. Examples of such provisions are included in the Appendix.

Another issue that sometimes comes up in the context of "stranger danger" is whether or not in-laws are permitted to hold ownership interests in the property, particularly in the aftermath of a divorce or, if a member of the family dies, and the family member's widow or widower remarries. Different families have different views as to how important it is to include or exclude in-laws from the ownership structure, and first refusal and buy-out provisions can be tailored to each family's situation.

The problem of "stranger danger" also becomes an issue in situations where there are a number of separately owned houses as part of a larger family compound. In that situation it is quite common for all of the properties within the family compound to be subject to mutual first refusal agreements that provide that before a house can be sold outside of the family, it must be offered to the other owners in the compound at the same price and on the same terms as the proposed purchase by a person outside the family. If the prospective purchaser is a well liked long-term friend of the family, it is common for the members of the family to waive their first refusal rights to allow the sale to go forward.

## **IX. Division of the Property**

With larger properties, a generational change often results in a need to physically divide the property among the descendants of the original owners. In these situations, it is usually necessary for the family to engage a soils scientist, a land planner and an appraiser to help design a division of the property that preserves the core family holdings, that is fair to the various members of the family, and that permits the family members who don't choose to be involved with the property to sell their interests either inside or outside the family. The issue of "stranger danger" is often involved in these discussions and a critical consideration is whether there are parts of the property that can be split off without jeopardizing the privacy and enjoyment of the remaining family members who wish to stay involved with the property. In situations where the property is physically divided among members of the family, it is quite common for the parties to enter into mutual first refusal agreements

providing that the separate parcels must be offered to the remaining owners before they are sold outside the family. In these situations, it is also somewhat common to provide that rights to use common facilities such as pools, docks and boathouse are not automatically transferred to non-family members who may purchase a portion of the property.

#### **X. Intra-Family Subsidies Involved in Multi-Generational Ownership of Seasonal Properties**

Although it is rarely discussed openly, one of the underlying issues involved in joint family ownership of seasonal property is whether or not the property should be considered a financial asset of the individual owners. With the rapid escalation of shorefront values in Maine over the last 30 years, coastal and lakefront properties have become extremely valuable. Along with the increases in property values have come substantial increases in property taxes. For some family members their share in a commonly held family property may represent a significant percentage of their net worth while for more affluent members of the same family, the property may not be considered as a financial asset at all, but rather as part of the glue that holds the extended family together. In discussions concerning buyout provisions and allocation of costs, there is often an undercurrent that the less affluent members of a family find it difficult to understand why they should be expected to subsidize the seasonal properties of their more affluent cousins. The flip-side of this undercurrent is that the more affluent members of the family may feel that the suddenly valuable summer property was never intended to be considered a financial asset and that they should not have to buy out the shares of family members who can no longer afford to participate.

#### **XI. Partition Actions**

In some situations, rather than holding the family together as originally intended, common ownership of family properties creates rifts within a family that cannot be resolved through negotiation and agreement. In those situations where the members of the family own the property as tenants-in-common, the only remedy may be the filing of a partition action in Superior Court. If the property can be divided in a manner that is fair to the contending parties, the Court will issue an order of partition dividing the property among the owners. If there is no fair way to divide the property, however, the Court will typically order that the property be sold and that the proceeds of the sale be divided among the owners. In some situations, it becomes necessary for a family member who wants to sell his or her interest to the rest of the family to bring a partition action in order to persuade the remaining members of the family to put a fair value on their interest in the property and buy them out. In planning for common ownership of family properties, it is important to try to anticipate such problems and to establish clear procedures for reaching a resolution that does not lead to a major breakdown in family relationships.

## **XII. Conclusion**

For members of many families, the family property will be the source of fond lifetime memories that they would like to see subsequent generations have the opportunity to experience. For others, the property will be symbolic of a time in their lives they hope to forget. While some family properties will be enjoyed by multiple generations over decades, others will be sold for a multitude of individual reasons, but most commonly because subsequent generations don't share the founders' emotional attachment to the property, or because the members of a subsequent generation don't get along with each other, can't agree on how to manage the property, want to create new memories and traditions elsewhere, or simply can't afford to keep the property. As advisors, it is our job to help our clients identify and articulate their goals, give them objective and experienced advice about the best way to accomplish their goals, and ensure that whatever ownership option is used, the design enables subsequent generations to experience the family property as a benefit and not a burden.

Issues and Considerations	Ownership Vehicle		
	Tenants-in-Common	Trust	LLC
1. Ownership entity can be structured to avoid estate taxes on individual interests	No	Yes	No
2. Individual interests retain their economic value and can be sold for value	Yes	Within limitations	Yes
3. Individual interests are protected from creditors	No	Yes	Yes
4. Individual interests can be protected from divorce judgments	Maybe	Yes	Yes
5. Individual family members are protected from personal liability	No	Yes	Yes
6. Property is managed by elected or appointed board	No, unless there is a TIC agreement	Yes	Yes
7. Elected or appointed board can assess maintenance and operating costs to individual members	No, unless there is a TIC agreement	Yes	Yes
8. Original owners may change the method of ownership	Yes	No, but Trust can be amended by an independent trustee or trust protector	Yes
9. Ability to restrict transfer of ownership interests outside of family	No, unless there is a TIC agreement	Yes	Yes
10. Property is subject to division or sale in a partition action	Yes	No	No
11. Interests may be transferred during owners' lifetime using annual gift tax exclusion	Yes	Yes	Yes
12. Interests may be transferred during owners lifetime using a qualified personal residence trust (QPRT)	Yes	Yes	Yes

<b>Issues and Considerations</b>	<b>Ownership Vehicle</b>	<b>Issues and Considerations</b>	<b>Ownership Vehicle</b>
	<b>Tenants-in-Common</b>	<b>Trust</b>	<b>LLC</b>
13. Interests may be transferred during owners' lifetime to an irrevocable trust	Yes	N/A	Yes
14. Interests may be disposed of by will to a testamentary trust	Yes	N/A	Yes
15. Interests may be transferred for value	Yes	Yes, if properly structured	Yes
16. Decision making requires unanimity among family members	Yes, unless there is a separate TIC agreement	No, the trust instrument may permit decisions to be made by a majority of trustees	No, the LLC agreement may permit decisions to be made by a majority of a board of managers
17. There is a mechanism for allocating costs and assessing family members	No, unless there is a separate TIC agreement	Yes	Yes
18. There is a mechanism for allocating time at the property	No, unless there is a separate TIC agreement	Yes	Yes
19. There are procedures for restricting ownership to members of the family	No, unless there is a separate TIC or first refusal agreement	Yes	Yes



## **Appendix**

Following is an example of selected trust or limited liability company provisions designed to provide flexibility for the protection and preservation and use of a family property in Maine. The sample trust provisions can be adapted for use in a limited liability company:

### **I. Sample statement of purpose**

The purpose of holding the family property in this trust is to permit it to be preserved and enjoyed by our descendants for generations to come. However, we do not intend by this agreement to force our beneficiaries to maintain the property against their wishes and therefore have designed this trust with flexibility to try to provide our beneficiaries with a benefit, but not a burden that they do not wish to bear.

We recognize and acknowledge that the equitable sharing of the use and the burden of the family property may be a delicate undertaking. It would be completely contrary to all our reasons for creating this trust to have the shared use of the property be the source of intrafamily dissension. To assist in accomplishing the purposes of the trust, we ask all our beneficiaries to be unselfish and cooperative; to treat the other beneficiaries as each would, in turn, like to be treated by them; and to remember that one of the purposes of retaining and preserving the property within and for the benefit of the family, is to bring the family closer together.

We are empowering our Trustee to make many decisions to ensure the efficient operation of this trust and the fulfillment of the trust's purposes. Consistent with that objective, all determinations and exercise of discretion by our Trustee under this Article shall be final, conclusive and binding on all beneficiaries and shall not be subject to challenge by any beneficiary.

### **II. Sample provision for assessments from beneficiaries**

It is expected that there will be, from time to time, insufficient income and cash assets of the trust to cover the expenses of operating, maintaining and owning the property. Consequently, each beneficiary will be expected to contribute his or her share of the expenses as assessed by our Trustee.

In addition to the conventional powers given to our Trustee in this trust, our Trustee shall have the power to calculate, allocate and collect reasonable assessments at times and in amounts deemed by our Trustee, in its sole discretion, to be necessary or appropriate for the expenses of operation, maintenance and ownership of the property. Those expenses shall include, but not be limited to, property taxes, insurance, utilities, maintenance, repairs, capital improvements and reasonable reserves for the payment of those expenses. Our Trustee shall not be expected nor obligated to incur any personal expenses in the discharge of

the Trustee's duties. In order to permit our Trustee to fulfill its responsibilities under this Trust, we intend our Trustee to have broad powers to assess and collect the funds required to operate, maintain and own the property. In order to fulfill its responsibilities, our Trustee shall have the authority, in its sole discretion, to issue any of the assessments described in this Section.

Our Trustee shall formulate an annual budget projecting the expenses of operation, maintenance and ownership of the property. The budget shall be prepared and provided to the beneficiaries annually. The budget may include the funding of reserves for current or future anticipated capital improvements. Our Trustee shall have the power to employ a property manager for the property, and the annual budget may include the costs and expenses of a property manager.

In the efficient fulfillment of its responsibilities, our Trustee shall have the authority to appoint one or more persons to various positions of responsibility. For example, our Trustee may appoint one or more persons to the position of Treasurer, who shall issue assessments and fees consistent with the Trustee's decisions, keep track of paid and unpaid assessments and fees, issue checks, and carry out such other responsibilities as may be delegated by the Trustees.

**(a) Assessments Based on Pro Rata Beneficial Interest**

Our Trustee may issue written notice of assessments to the beneficiaries in proportion to their ownership of beneficial interests in the trust. The notice of assessment from our Trustee shall indicate the due date of the beneficiary's payment of the assessment, which due date shall not be less than thirty (30) days from the date of the notice.

**(b) Assessments Based on Individual Use and Responsibility**

Our Trustee may issue written notice of assessments to one or more beneficiaries, in such amounts and at such frequencies as our Trustee determines to be equitable, necessary or appropriate for the operation, maintenance and ownership of the property, with such assessments determined based upon individual usage of the property. For example, if expenses of maintenance or repair are incurred by the Trustee as a result of the use of the property by certain beneficiaries, our Trustee shall have the authority to assess the particular responsible beneficiaries for the full cost of the expenses of maintenance or repair. The notice of assessment from our Trustee shall indicate the due date of the beneficiary's payment of the assessment, which due date shall not be less than thirty (30) days from the date of the notice.

**(c) Assessment of Fee for Use and Occupancy**

Our Trustee may establish and assess a fee for use and occupancy of the property. Such a fee may, in our Trustee's discretion, be imposed for use and occupancy of the property on a daily, weekly or other basis. Such a fee, if imposed by our Trustee, shall be due and payable as determined by our

Trustee. We encourage our Trustee to use the assessment of a fee for use and occupancy under this subsection (c) as the primary means of obtaining the funds required to operate, maintain and own the property. Use and occupancy fees are likely to be the most equitable way to distribute the costs of operation, maintenance and ownership without penalty to the beneficiaries who do not use the property, or who use it infrequently. We recognize however, that use and occupancy charges alone may not be sufficient and that the assessment of other fees may be necessary and appropriate, and we have therefore provided our Trustee with broad discretion to raise the needed funds of operation, maintenance and ownership in any of the ways deemed most appropriate by our Trustee.

### **III. Sample termination and sale provision**

The common trust created under this Article shall terminate as provided in this Section.

#### **(a) Termination by Agreement**

The common trust created under this Article shall terminate upon written approval of beneficiaries owning seventy-five percent (75%) of the beneficial interests in the trust and the consent of a special Independent Trustee appointed pursuant to Section 5.

In the event of such approval and consent, the property shall be sold as provided in subsection (b) and our Trustee shall distribute the net proceeds of sale and all other trust property to the beneficiaries in proportion to their beneficial interests, outright and free of the trust.

#### **(b) Provisions for Sale of the property**

If the property is to be sold as provided in subsection (a), the provisions of this subsection (b) shall govern the sale.

##### **(1) Independent Appraisal**

Our Trustee shall obtain an appraisal of the fair market value of the property, as determined by an independent appraiser selected by our Trustee. A complete copy of the written appraisal report of the independent appraiser shall be provided to all beneficiaries.

##### **(2) Offers by Beneficiaries**

Before the property is offered for sale to any person who is not a beneficiary, all beneficiaries shall be given an opportunity to submit an offer to purchase the property for cash, for an amount equal to the appraised value minus ten percent (10%), with the closing to take place within forty-five (45) days from the date of

our Trustee's acceptance of the beneficiary's offer. The process for submitting written offers by the beneficiaries shall be established by our Trustee in a manner that is objective and free of bias or the opportunity for one beneficiary to have an unfair advantage over another beneficiary. Any such process shall give the beneficiaries not less than thirty (30) days, from the date the beneficiaries are provided with a copy of the written appraisal report, to submit their offer to our Trustee. If any beneficiary who is serving as a Trustee intends to bid on the purchase of the property, then that Trustee shall take no part in the selection of the independent appraiser and shall take no part in the design of the bid process or the receipt of bids from beneficiaries. If more than one beneficiary submits a bid that satisfies the criteria of this subsection (b)(2) (a "qualifying bid") our Trustee shall notify all beneficiaries who submitted a qualifying bid of the names of those beneficiaries who submitted a qualifying bid and of the Trustee's intent to convey the property to all such beneficiaries as tenants in common. Each beneficiary shall have fifteen (15) days from the date of the beneficiary's receipt of such notice from our Trustee to inform our Trustee if the beneficiary does not intend to purchase the property as a tenant in common with the other beneficiaries who submitted a qualifying bid. No less than fifteen (15) days before closing our Trustee shall notify the beneficiaries of the names of those beneficiaries to whom the Trustee intends to convey the property.

If all of the beneficiaries who submitted a qualifying bid inform our Trustee that they do not intend to purchase the property as a tenant in common with the other beneficiaries who submitted a qualifying bid, then all beneficiaries shall be given an opportunity to submit an offer to purchase the property for cash, for an amount equal to or greater than the appraised value, with the closing to take place within forty-five (45) days from the date of our Trustee's acceptance of the beneficiary's offer. The process for submitting written offers by the beneficiaries shall be established by our Trustee in a manner that is objective and free of bias or the opportunity for one beneficiary to have an unfair advantage over another beneficiary. Any such process shall give the beneficiaries not less than thirty (30) days, from the date the beneficiaries are provided with a copy of the written appraisal report, to submit their offer to our Trustee. If any beneficiary who is serving as a Trustee intends to bid on the purchase of the property, then that Trustee shall take no part in

the design of the bid process or the receipt of bids from beneficiaries. If more than one qualifying bid is received by our Trustee, our Trustee shall accept the highest price bid submitted by the beneficiaries. If two or more qualifying bids are received at the same purchase price, our Trustee shall sell to either or any of such beneficiaries, at our Trustee's election.

**(3) Offers by Persons who are not Beneficiaries**

If no beneficiary submits an offer to purchase the property pursuant to the procedure set forth in subsection (b)(2), then our Trustee, with or without the assistance of a licensed real estate broker, shall market the property for sale to persons who are not beneficiaries. Any sale shall be for cash at closing and shall be for a price not less than the appraised value as determined under subsection (b)(1).

**IV. Sample First Refusal Provision**

No member, or executor, administrator, trustee, assignee or other representative of a deceased member, shall pledge, sell, assign or otherwise dispose of any interest in this Company to any firm, corporation, association, entity or person, except the spouse, parents, children, grandchildren, siblings, nieces, nephews, grandnieces or grandnephews of said member (hereinafter a "Permitted Transferee"), without first offering said interest for sale to any other members of the same class, in proportion to the interests then held by them, at a price equal to a firm offer in writing for said interest. Any interests not purchased in response to such offer shall next be offered to any members of said class who have indicated in writing a desire to purchase said interests, in proportion to the interests held by said members. Any interests which may still be unpurchased shall be offered to the members owning interests of other classes, in proportion to interests then held by them, and any interests not purchased by said members shall then be offered to the company. Any interests which may still be unpurchased may then be sold to the person making the firm offer in writing in accordance with the terms of that offer. In all cases, the members or the company, as the case may be, shall have the right to purchase any interests offered to them or it for sale at any time within thirty (30) days after receipt of written notice of said offer.

**V. Sample Involuntary Transfer Provision**

If any interests in this Company are transferred by order of any court or by operation of law to any person other than a Permitted Transferee or the Company (such as but not limited to a member's trustee in bankruptcy or a purchaser at any creditor's or court sale, (hereinafter an "Outside Member"), the remaining members and the Company may exercise an option to purchase the interests so transferred on the following terms:

Within sixty (60) days of gaining the right to acquire or becoming the owner of any interest in the Company, the Outside Member shall notify the manager of the Company that the Outside Member has gained the right to acquire or has taken ownership of interests in the Company and that the other member(s) and the Company have an option to purchase those interests in accordance with this section. Within thirty (30) days of receipt of such notice from the Outside Member, the manager of the Company shall mail a notice to all of the other members and to the Company, advising them that they have ninety (90) days from the date of mailing of notice by the Manager to exercise their option to purchase some or all of the interests owned by the Outside Member under the terms of this section.

Within thirty (30) days of the expiration of the ninety (90) day notice period (hereinafter the "Exercise Period"), any of the other member(s) and/or the Company who wish to exercise the option to purchase all or a portion of such interests shall give notice of such exercise in writing to the Manager of the Company and the Outside Member by certified U.S. mail, return receipt requested or by other delivery service that provides similar written proof of delivery. Within thirty (30) days of the expiration of the Exercise Period, the other Members and/or the Company who have exercised the option to purchase interests and the Outside Member shall each appoint an appraiser to determine the appraised value of the interests in the Company held by the Outside Member. If the two appraisers agree upon the appraised value of the interests in the Company, they shall jointly render a single written report stating that value within thirty (30) days of the appointment of the last appraiser to be appointed. If the two appraisers cannot agree upon the appraised value of the interests in the Company, they shall each render a separate written report within thirty (30) days of the appointment of the last appraiser to be appointed and, within ten (10) days of delivery of the last appraisal delivered by such appraisers, shall appoint a third appraiser, who shall determine the appraised value of the interests in the Company, and shall render a written opinion of value within thirty (30) days of appointment. Each side shall pay the fees and other costs of its appraiser, and the fees and other costs of the third appraiser shall be divided equally between the two sides. In determining the appraised value of the interests in the Company, each appraiser shall consider any appropriate discounts for minority interest and/or lack of marketability. The appraised value of the interests contained in the joint written report of the first two appraisers or the written report of the third appraiser, as the case may be, shall be the appraised value of the interests in the Company; provided, however, that if the appraised value of the interests in the Company contained in the appraisal report of the third appraiser is more than the higher of the first two appraisals, the higher of the first two appraisals shall govern; and provided, further, that if the appraised value of the interests in the Company contained in the appraisal report of the third appraiser is less than the lower of the first two appraisals, the lower of the first two appraisals shall govern. The valuation date for the appraisals shall be the date that the Outside Member gained the legal right to ownership of the interests. Once the appraised value of the interests in the Company has been determined, the Outside Member shall sell the interests in the Company subject to the purchase option to those of the remaining members and/or the Company who have exercised the option to purchase as follows:

First priority shall be given to the exercising members of the same class as the interests of the Outside Member in proportion to the relative interests then owned by them; second priority shall be given to the exercising Members owning interests in other classes in the Company in proportion to the interests of other classes then owned by them; and third priority shall be given to the Company, but only if the Company has also exercised its option to purchase. In all cases, the interests shall be purchased by the exercising Members and/or the Company within thirty (30) days after receipt of written notice from the Outside Member of the right to purchase those interests.

If any portion of the interests of the Outside Member remains unpurchased after full compliance with the procedures of this section, the Manager of the Company, within thirty (30) days after receiving an accurate and complete sworn affidavit of compliance with the procedures of this section from the Outside Member, shall issue a certificate to the Outside Member for any interests that remains unpurchased. Until such a certificate has been issued, the Outside Member shall not have voting rights with respect to interests in the Company that are subject to the foregoing procedures.