



Should You Hold Your Family Vacation Home in an LLC?

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Most ordinary folks do not hold their primary residence in a limited-liability company (LLC), so why consider doing so for one's vacation home? As it turns out, there are some pretty good reasons why the LLC structure is a good one for vacation homes.

Asset Protection. One important benefit of creating an LLC for the home is personal liability protection. Say you rent out the property for some of the time and the renter suffers an accident and sues you for damages. If the property is in an LLC, your exposure is limited to the assets of the LLC, not your total assets. You could purchase general liability and umbrella insurance, but both come with limits, whereas an LLC provides permanent and unlimited protection.

Property Management. Every LLC needs to have an operating agreement, which is a blueprint for how the home is to be managed. Such an agreement is especially important if the home is owned by several family members. A good operating agreement will spell out who can use the property and when, how much each must contribute to upkeep, how decisions are to be made, and what happens if one member wants to sell their share, and so forth. You can just

imagine how many disputes might be avoided by having such rules well specified.

Property Accounting. As a separate legal entity, the LLC also needs to have proper accounting of income and expenses. With good accounting, the operating agreement can clearly specify how income and expenses are to be allocated across owners (e.g., based on usage) or any other criteria chosen, and hold members accountable.

Flexibility in Intra-Family Ownership Transfers. Once the deed of the home is listed in the name of the LLC, the deed does not need to change until the property is sold to a third party. This is because LLC membership interests represent personal property and so the transfer of these interests does not involve conveyance of real property. As a result, such transfers won't result in any transfer fees and taxes associated with changing the deed, nor affect title insurance. Moreover, an LLC operating agreement can include transfer restrictions to prevent family members from transferring their interests to someone inside or outside of the family without the approval of the other members.

Other transfer issues that can be addressed in an operating agreement include requiring an appraisal to value the interests, and rules regard-



ing who gets right of first refusal to buy out the interests of a member who wishes to sell.

Estate and Gift Planning. In some states, probate can be a lengthy and costly process. Probate is a court process to determine ownership claims on the property transferred via a will. If the vacation home is located in a state that is not the decedents primary residence (and is not already in some form of trust), the estate executor may be required to go through probate in that state. If the home is in an LLC, this potentially lengthy and expensive process is avoided.

In addition, an LLC can help reduce estate taxes. In a typical scenario with an LLC structure, parents transfer the home to the next generation by gifting them membership interests over a period of years using the annual exclusion for taxable gifts. (This is the amount – currently \$15,000 per person - that one can give to any single individual annually without potential tax consequences down the road.) Because the gifted interests represent only a portion of the underlying real estate,

and because there are often restrictions on transferring the interests, reasonable discounts in the valuation of the interests are justified, thereby reducing the value of the gift. (In other words, you might be able to gift \$20,000 in membership interests annually and still fall under the annual exemption.)

Are there any disadvantages to creating an LLC? Apart from the costs of establishing the LLC and creating the operating agreement, LLCs are easy to maintain as most LLCs that own personal property do not require any type of federal or state income tax return. Most states do, however, require one to register their LLC with the state annually. In Massachusetts, this annual fee is currently \$500.

Bottom Line:

Holding your family vacation home in an LLC structure can go a long way in reducing potential conflict down the road. That’s worth a lot to many families.