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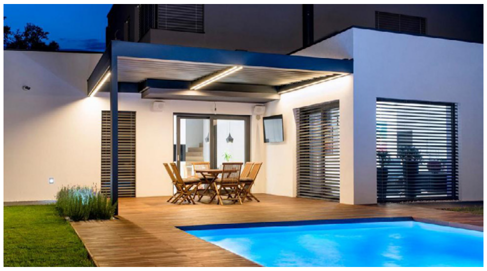
TRANSFERRING A VACATION HOME INVESTMENT CAN BE TRICKY

Selling allows heirs to invest the proceeds, especially if they don't want the property.



By: Jeff Brown - October 11, 2017

A second home is often meant to reduce vacation costs, strengthen family ties and, if all goes well, provide a profitable investment.

And many parents hope to pass the vacation place to their children, imagining generations toasting grandma and grandpa at family gatherings.

But there's more to the process than simply noting your wishes in a will. Taxes should be considered, as well as the heirs' investing prowess, needs and priorities.

"The most common way to transfer a primary home to heirs is through probate," says Nick Maggard, elder law attorney at Maggard Elder Law in Florence, Kentucky.

Simply executing a will does not in itself eliminate the expenses and other issues involved in probate, Maggard says, advising the use of a trust set up by a lawyer, or putting an heir on the deed.

"This often becomes the most common mistake people make because the probate process is often riddled with delays and fees. In my area, probate fees are routinely 3 percent to 5 percent of the gross estate," he says. "This means a probate estate valued at $400,000 can equal up to $20,000 in fees. Furthermore, probate is a public proceeding so it makes a person's estate easier to attack should there be any disgruntled heirs or other creditors."

Lee Miller, regional director of Wealth Management at Glenmede, a New York City-based wealth management firm, says many property owners don't think through the implications of leaving heirs an investment, especially a large one.

"Among the most common mistakes people make when planning for the inheritance of a vacation home is to assume that children want the property and have the financial resources to afford its upkeep," Miller says.

Among the hazards, Miller says: Heirs may not be in a position to handle the property.

"Leaving your house to your children sounds like a gift, but in terms of financial expenses, inheriting a vacation property one cannot afford can end up being more of a burden," she says.

For many homeowners, the biggest issue is whether to pass on the property as is or to sell it and pass on the proceeds, making it easier for heirs to invest as it suits them.

Selling also simplifies matters if the property or proceeds are to be shared by two or more heirs, especially if they don't all have the same financial savvy, don't see eye to eye or don't have the same sentimental feelings.

But a sale before death can have unwelcome tax consequences.

Profit on a second home, for instance, is typically taxed as a long-term capital gain after the original owner sells. Leave the property to an heir instead and it will receive the same "step-up in cost basis" that applies to stocks, funds or other inherited assets. That means profits when the heirs sell will be the sales price minus the value when the property was inherited, not the larger profit based on the lower value from when the parents first bought the place.

"If I'm meeting with a client that has a lot of appreciation built up in their primary home, vacation home, or investment properties, then I want to ensure the heirs receive a step-up basis, which is why I usually recommend a living trust or life estate deed," Maggard says.

Also, estate planning documents can contain instructions for resolving a dispute – by providing for one heir to buy out another, for instance, Maggard says.

Jeralyn Seiling, managing director and wealth strategist for Merrill Lynch, says the parents should generally rely on a financial advisor and attorney to find the best path, but that many conclude the simplest approach is an outright gift to the heirs while the parents are alive, then filing a gift tax return. This gets into the tricky relationship between gift and estate taxes, and usually takes a pro to figure out.

Expenses and delay are just one of many difficulties involved in passing on property.

To avoid squabbles, the property owner should also prepare a "governance system," Miller says. "Who gets to use it when? How are decisions about maintenance made?"

Generally, she says, a mortgage will have to be paid off upon the owner's death, so the plan should provide funds unless it's clear the heirs can pay the debt or get a new loan.

"An outright gift requires the least amount of paperwork and simply involves transferring title to your children by executing a deed," Seiling says. "You will be required to file a gift tax return to claim the use of a portion of your federal estate and gift exemption amount."

Another option for high-value properties is a qualified personal residence trust, but it must be set up by a lawyer and the requirements can be tricky.

An even more formal option is to transfer the property to a limited liability company set up for the purpose, assigning management responsibilities and heirs' rights to use the home.

Nick Maggard of Maggard Elder Law does his best to provide each client with an estate plan that is uniquely their own and keeps the client's interest as his number one priority. Nick is focused on preserving client memories and legacies, all while protecting their wealth.

To contact Nick call 859-372-6674
or visit www.maggardelderlaw.com.