PLANNING FOR FAMILY CABINS

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I. Introduction.

Some homes serve as a magnet that pulls the family together. Others become the family battleground, literally and figuratively. Stories of family arguments over ownership of a vacation home abound. However, families continue to desire and invest in these properties.

There are a number of motivations behind the initial purchase of a recreational cabin. These include:

(a) The desire to create a sense of family, cultural identity, or other affinity. Vacation communities are often defined by race, religion, or other commonalities, including sexual orientation or even a passion for NASCAR racing. People gravitate toward these communities to vacation with others who share similar values or lifestyles.

(b) The opportunity to conspicuously display wealth. The grand homes of Newport, Rhode Island are early examples of this motivation.

(c) The opportunity to teach children to appreciate the benefits of nature. The 19th century Transcendentalist writers, including Henry David Thoreau, Ralph Waldo Emerson, and Walt Whitman, first documented their experiences in nature. Their philosophy was that a personal spiritual transformation could take place by getting away from the city to a restorative environment. In 1854, Henry David Thoreau recorded the experience of his retreat to Walden Pond in "Walden." Art Buchwald said this about his own summer home on Martha's Vineyard: "I think for most people summer houses have more meaning than homes in winter, because all the memories, usually, of summer places are happy ones. When you're in the city, you're just in the city, but here I have been happy."[1]

(d) The wish to get away from any reminders of routine daily living. The following quote from the New York Times encapsulates the desire to "get away from it all":

> Forget the Tuscan villa, the chateau in Provence and the pied-a-terre in Paris. They're so cliché, not to mention overpriced. Savvy second-home hunters are packing their passports, pouring through foreign classified ads and snapping up homes in far-flung countries from Argentina and Bulgaria to Nicaragua and Turkey.
>
> Even though these places may lack the glamour of Cannes and are sometimes harder to get to than Timbuktu, they are picturesque, not overrun by Americans and, in some cases, even fashionable. Best of all, there are still bargains to be found.[2]]

The sociological component of second home ownership is fascinating and important to a thorough understanding of the underlying issues that arise in families around this property, but it is a subject

[1] Joyce Wadler, *At Home With Art Buchwald: A Defiant Jester, Laughing Best*, N.Y. TIMES, July 27, 2006, at F1.

[2] Denny Lee, *A Second Home in Bulgaria?,* N.Y. TIMES, Oct. 28, 2005, at F1.

beyond the scope of this outline.[3] This outline focuses mainly on the equally important legal component of how families succeed in passing on ownership of a cabin from one generation to the next, with an emphasis on charitable planning, followed by a brief discussion of some unusual transfer issues—cabins on public land, and cabins in British Columbia. The more daunting task of ongoing management is also discussed below.

Few families successfully transfer ownership of a cabin or vacation property by accident. Families that do accomplish this Herculean feat do so only with a great deal of advanced multi-generational planning, often with mechanisms to adjust the plan as circumstances and needs change. In this chapter, the term "cabin" is used collectively to refer to vacation properties of all shapes, sizes, styles, and fair market values.

Cabins are frequently located in desirable areas where property values have appreciated at a rate far beyond a family's other assets. Often, a cabin may represent a large percentage of a family's financial holdings, posing complex estate tax and liquidity issues for the senior generation. For the junior generation, keeping a cabin in the family can create financial burdens. It can also bring the challenge of reaching a consensus among family members as to how to deal with this property, whether they want the property or not.

The legal mechanism for transferring the property is only the first of many challenges. Following the transfer, the next generation must determine how to maintain the property; how to pay taxes, insurance, and maintenance; and how to divide its use among the family members. The transfer itself is relatively easy compared to maintaining harmony among its owners following the transfer.

II. Creating a Master Plan.

Before a plan to transfer the family cabin can be implemented, it is helpful if the family can reach a consensus, in the form of a master plan, as to how that transfer will take place.[4] Creating structures and protocols for families can position them for long-term sustainable success. The family is a social unit that exists to protect its members unconditionally and tries to stay together at all costs. But the sometimes divergent interests within a family can be problematic if not thoughtfully structured and communicated. It is critical to attempt to develop a system of rules and protocols to help manage the competing interests of the individual and interrelated interests.

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[3] For an analysis of the sociological component, *see* Jeremy A. Blumenthal, *"To Be Human": A Psychological Perspective on Property Law*, 83 TIL. L. REV. 609 (Feb. 2009), *available at* http://ssrn.com/abstract=1334692; Ken Huggins, *Essay—Passing It On: The Inheritance, Ownership and Use of Summer Houses*, 5 MARQ. ELDER'S ADVISOR 85 (Fall 2003); Judith Huggins Balfe, *Passing It On: The Inheritance and Use of Summer Houses* (Professional Press (NC), 1999); and Judith Huggins Balfe, *Passing it On: The Inheritance of Summer Houses and Cultural Identity*, 26 THE AMERICAN SOCIOLOGIST 29 (Winter 1995).

[4] *See* James S. Sligar, *Estate Planning for Major Family Real Estate Holdings*, 133 TRUSTS & ESTATES 148 (Dec. 1994) for a comprehensive discussion of master plans; STEPHEN J. SMALL, PRESERVING FAMILY LANDS, BOOK I: ESSENTIAL TAX STRATEGIES FOR THE LANDOWNER (Landowner Planning Center 3d ed. 1998); STEPHEN J. SMALL, PRESERVING FAMILY LANDS, BOOK II: MORE PLANNING STRATEGIES FOR THE FUTURE (Landowner Planning Center 1997); STEPHEN J. SMALL, PRESERVING FAMILY LANDS, BOOK III: NEW TAX RULES AND STRATEGIES AND A CHECKLIST (Landowner Planning Center 2002).

The most successful transitions involve detailed and thoughtful advanced planning developed jointly by the senior and junior generations. The use of a mediator or other trained neutral third party can be invaluable in developing a master plan.[5]

A good facilitator can significantly increase the possibility of a successful outcome.[6] Family conflict is inevitable; a good facilitator can help families deal with conflict productively to mediate a mutually satisfactory understanding of the family's goals, missions and visions, with respect to the cabin and on a more global basis. Often, the presence of a mediator can provide objectivity and bring family members closer to a consensus when emotions might otherwise take center stage and derail the process.

Once the family members are informed of the various options (which may include setting aside portions for conservation purposes, selling portions to raise capital to support the remaining property, and transferring portions to succeeding generations), the first step in creating a master plan is to have the facilitator interview each family member.

The interview process is an opportunity for each family member to freely express their wishes and apprehensions with respect to the property. Not all family members have to participate in the interview process, but all should be given the opportunity. A trained non-family member serving in an intermediary capacity ideally allows the family members to focus on common interests rather than their differences. To do this successfully, the participants need to feel confident that the mediator is not aligned with the interests of any of the family participants or the estate planning attorney.[7]

Having met with as many family members as are willing to participate, the neutral third party would prepare a report summarizing their findings, identifying areas of consensus, if any, and pointing out areas where feelings and opinions diverge. This report can be shared by the family members, and used by the members of the senior generation and their attorney to begin to develop the master plan, incorporating the family's sense of direction, shared values, mission, and vision.

In some cases, the facilitator's report provides sufficient information so that family members can make meaningful decisions with respect to the property jointly. If the family is unable to reach an agreement, one or more family meetings guided by the facilitator could follow to resolve areas of dispute, further define areas of agreement, and continue building a consensus. The development of a master plan with the assistance of a trained neutral third party is especially useful when the senior generation has already ceded control of the property to the next generation and questions and issues concerning actual management have arisen.

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[5] *See* Olivia Boyce-Abel, *When to Use Facilitation or Mediation in Estate and Wealth Transfer Planning*, FAMILY OFFICE EXCHANGE, Vol. 9 No. 35 (1998), and Robert Solomon, *Helping Clients Deal With Some of the Emotional and Psychological Issues of Estate Planning*, 18 PROB. & PROP. 56 (Mar./Apr. 2004) (hereinafter "Solomon, *Helping Clients*"), for discussions concerning the role of a facilitator.

[6] Solomon, *Helping Clients*, *supra*, at 58.

[7] *Id.*

Often, the next step in developing a master plan is the creation of a mission statement to address the family's goals and values with respect to the cabin. Issues to address in the mission statement could include:

1. What is most important to the family about the cabin?
2. What does the family value most about how it uses the cabin?
3. What is the family's vision for the cabin?
4. How would the family like to see the ownership of the cabin affect the ways the various members interact?
5. What is the family's risk tolerance when it comes to owning recreational property?

Of course, the use of a facilitator in estate planning is not going to be accepted by all clients. It is understandably difficult to impress upon clients the value that could be added by employing a facilitator to guide this process. At a minimum, the lawyer could offer to distribute a survey to family members that they could respond to anonymously, in order to give the senior generation insight into the wishes and apprehensions of the next generation. As a result of the facilitator's work or the lawyer's survey, the senior generation may discover that some or all of the members of the younger generation honestly have no interest in retaining the cabin. They also may be able to determine the apprehensions of those who do want to retain the cabin and resolve those issues before the cabin becomes a battleground.

It may be the case that, rather than transferring all of the property to the next generation as part of the master plan, the property may need to be divided into separate portions, each to be dealt with differently. The different uses may include development, conservation, and residential use. Next, with the help of the estate planning attorney, the family can identify techniques to accomplish these objectives, which are described below.

III. Conservation and Preserving Open Space.

Frequently, families determine that certain portions of their land should be preserved as open space. They may also choose to restrict development or other uses on the donated property, the retained property, or both. Outlined below are a number of methods for transferring an easement or the real property to charity.

A. Conservation Easements.

One common way to restrict development is with a conservation easement.[8] A conservation easement is a permanent restriction on the use of privately owned land to promote conservation.

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[8] *See* Nancy A. McLaughlin, *Questionable Conservation Easement Donations*, 18 PROB. & PROP. 40 (Sept./Oct. 2004), for an analysis of the IRS's closer scrutiny of conservation easements and also an excellent list of further resources.

Granting a conservation easement typically reduces the value of the underlying real property for development purposes. For a family's purposes this can also have the effect of preserving a property's natural beauty and reducing gift and estate tax costs when the property is transferred between generations.

The Internal Revenue Code of 1986, as amended ("I.R.C."), permits income, and gift or estate, tax deductions for a grant of a conservation easement over certain real property.[9] The Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (the "Pension Protection Act") amended I.R.C. §170 to permit a deduction of up to 50% of a donor's contribution base for certain conservation easements rather than the previous deduction of up to 30% of a donor's contribution base otherwise allowed under I.R.C. §170(b)(1)(C), through the end of 2013.[10] Furthermore, it extends a taxpayer's ability to carry forward unused deductions for 15 years, rather than five years as under prior law.[11]

The Treasury Regulations set forth detailed requirements for deductibility of conservation easements, which are summarized below.[12]

1. Qualified Conservation Contributions.

I.R.C. §170(f)(3)(B)(iii) provides an exception to the split-interest rules, which would normally disallow a deduction for the gift of a partial interest, such as a conservation easement. To be eligible for the deduction, the transfer of a conservation easement must constitute a "qualified conservation contribution" as defined in I.R.C. §170(h)(1), by satisfying the following requirements:

(a) The property contributed must be a "qualified real property interest."[13]

(b) The property must be donated to a "qualified organization."[14]

(c) The gift must be "exclusively for conservation purposes."[15] The definition of conservation purposes is quite broad. The regulations provide that "conservation purposes" means: (i) the preservation of land areas for outdoor recreation by, or the education of, the general public, (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, (iii) the preservation of

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[9] I.R.C. §§170(h), 2055(f), 2522(d) (2008).

[10] I.R.C. §170(b)(1)(E).

[11] I.R.C. §170(d)(1)(A).

[12] Treas. Reg. §1.170A-14 (2009).

[13] I.R.C. §170(h)(2).

[14] I.R.C. §170(h)(3).

[15] I.R.C. §170(h)(4).

certain open space (including farmland and forestland), or (iv) the reservation of a historically important land or certified historical structure.[16]

(d) The conservation purposes must continue in perpetuity.[17]

Each of these requirements is further defined by the statute and regulations.

2. Qualified Real Property Interests.

There are three categories of qualified real property interests:

(a) The entire interest of a donor other than a qualified mineral interest;[18]

(b) A remainder interest;[19] and

(c) A perpetual conservation restriction.[20]

3. Qualified Organizations.

I.R.C. §170(h)(3) describes those organizations that are eligible to receive qualified conservation contributions, which include the following:

(a) Certain governmental units described in I.R.C. §170(b)(1)(A)(v);

(b) A publicly supported charity described in I.R.C. §170(b)(1)(A)(vi);

(c) A publicly supported charity described in I.R.C. §509(a)(2); and

(d) A supporting organization described in I.R.C. §509(a)(3), which is controlled by a governmental unit or a publicly supported charity.

A private foundation is not an eligible donee of a qualified conservation contribution.

Many parts of the country have local land trusts or land banks, which are nonprofit organizations established to protect and preserve valuable open space and environmentally sensitive land. *E.g.*, Northern Prairies Land Trust at www.northernprairies.org (for South Dakota), California Rangeland Trust at www.rangelandtrust.org and the San Juan Preservation Trust at www.sjpt.org in Washington, and Great Land Trust at www.greatlandtrust.org, Southeast Alaska Land Trust

[16] Treas. Reg. §1.170A-14(d).

[17] I.R.C. §170(h)(5)(A).

[18] I.R.C. §170(h)(2)(A).

[19] I.R.C. §170(h)(2)(B).

[20] I.R.C. §170(h)(2)(C).

www.souteastalaskalandtrust.org, just a few among many, in Alaska. A land trust or land bank can take title in fee simple, or to a remainder interest, and/or it can take title to a conservation easement over property.

In addition to being a qualified organization, an eligible donee must have a commitment to protecting the conservation purposes of the donation.[21] The requisite commitment is deemed present if the donee is organized or operated primarily or substantially for a conservation purpose specified in I.R.C. §170(h)(4)(A). The regulations further require that the donee have the resources to enforce the restrictions that are the subject of the contribution.[22] The donee is not required to set aside funds for the enforcement of the restriction. However, in practice, many organizations require the donor of a conservation easement to make a simultaneous cash contribution to help defray the cost of enforcement actions.

4. Exclusively for Permitted Conservation Purposes.

Under I.R.C. §170(h)(4)(A) and Treas. Reg. §1.170A-14(d)(1), a qualified conservation contribution must be made for one or more of the following permitted conservation purposes:

(a) Preservation of land areas for outdoor recreation by, or education of, the general public;[23]

(b) Protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem;[24]

(c) Preservation of open space, including farmland and forestland, for the scenic enjoyment of the general public or pursuant to a clearly delineated governmental conservation policy;[25] or

(d) Preservation of a historically important land area or a certified historic structure.[26]

The regulations require an undefined degree of public access to an easement, except when access restrictions are required to protect the conservation easement that gives rise to the deduction.[27] Visual access is sufficient for an open space easement for the scenic enjoyment of the general

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[21] Treas. Reg. §1.170A-14(c)(1).

[22] *Id.*

[23] I.R.C. §170(h)(4)(A)(i).

[24] I.R.C. §170(h)(4)(A)(ii).

[25] I.R.C. §170(h)(4)(A)(iii).

[26] I.R.C. §170(h)(4)(A)(iv).

[27] *See* Treas. Reg. §1.170A-14(d)(3)(iii).

public.[28]

In the family cabin context, an easement is typically granted to preserve a natural habitat and/or an open space for the scenic enjoyment of the public. Preservation for outdoor recreation is problematic because it requires the landowner to give access to the public, which private owners do not typically desire. (Note that many states, including Washington, provide recreational immunity for injuries caused by obvious dangers, for those who open up their land to members of the public to use their land for recreational purposes free of charge.[29])

There are few opportunities for easements for historical preservation in the family cabin context.

5. Transfer of Interest Subject to Debt.

If the property to which a conservation easement applies is encumbered by a mortgage, the mortgage must be subordinated to the easement restriction.[30]

6. Valuation.

(a) Before and After Method.

As a general rule, the value of an easement or other perpetual conservation restriction is equal to the difference between the fair market value of the encumbered property before and after the contribution.[31] If there is a substantial record of sales of comparable easements, however, the fair market value of the donated easement must be based on the sales prices of the comparable easements.[32] Because sales of conservation easements are not common, perpetual conservation restrictions are usually valued pursuant to the "before and after" method.

If the qualified real property interest is a remainder interest under I.R.C. §170(h)(2)(B), the value of the contribution is the fair market value of the remainder interest.[33] The valuation must take into account any pre-existing or contemporaneously recorded rights limiting the uses to which the property may be put for conservation purposes.

(b) Reserved Rights—Economic Benefit to Donor Must Be Taken into Account.

The regulations provide special rules for valuing a qualified conservation contribution. The rules are designed to take into account any economic benefit that may accrue to the donor or related parties as a consequence of the gift of the easement. Any interests retained by the donor must be

[28] Treas. Reg. §1.170A-14(d)(4)(ii)(B).

[29] RCW 4.24.200-.210.

[30] Treas. Reg. §1.170A-14(g)(2).

[31] Treas. Reg. §1.170A-14(h)(3)(i).

[32] *Id.*

[33] Treas. Reg. §1.170A-14(h)(2).

subject to legally enforceable restrictions that prevent the retained interests from being used for a purpose inconsistent with the perpetual conservation purpose.[34] In the case of a gift of a perpetual conservation restriction covering a portion of contiguous property owned by the donor or his family, the value of the contribution is the difference between the fair market value of the entire contiguous parcel before and after the granting of the restriction.[35]

A family may want to convey a conservation easement, yet retain certain development rights over the property. There are two ways of accomplishing this: (i) The "reservation method," or (ii) the "carve-out method." The rights retained by the donor may not interfere with the scenic quality of the land covered by the easement.

The reservation method permits the grantor to convey an easement over an entire parcel and reserve a right to develop a discrete number of lots (e.g., one single-family dwelling for every 40-acre parcel) on the property.

The carve-out method permits the grantor to carve out specific portions for development. The carve-out method allows the parcels not subject to the easement to be developed and often enhances the market value of these parcels because of their proximity to the parcels subject to the conservation easement. Both methods may be useful in the development of the family's master plan.

Where certain rights are retained, or adjacent property is retained, the easement may have the effect of increasing the value of any other property owned by the donor or a related person. This occurs because the donor recognizes incidental benefits as a result of the easement. Where the value of the property owned by the donor increases due to the donation of the easement, the value of the contribution is reduced by the amount of the increase in value of the other property, whether or not the property is contiguous.[36] A deduction may be completely disallowed if the economic benefit to the donor or related person exceeds the benefits that will inure to the general public.[37]

(c) "Qualified Appraiser" and "Qualified Appraisal."

The Pension Protection Act added I.R.C. §170(f)(11) to the Code, which provides statutory definitions of a "qualified appraiser" and a "qualified appraisal" for tax returns filed after August 17, 2006. I.R.S. Notice 2006-96, 2006-46 I.R.B. 902, provided transitional guidance on the new definitions under I.R.C. §170(f)(11) until the regulations are issued. Any charitable donation of real property valued in excess of $5,000 must be accompanied by a "qualified appraisal" prepared by a "qualified appraiser" to support the donation.[38]

For returns filed after August 17, 2006, appraisals of real property must be prepared by an appraiser

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34 Treas. Reg. §1.170A-14(g)(1).

35 Treas. Reg. §1.170A-14(h)(3)(i) (applying the definition of "family" found in I.R.C. §267(c)(4)).

36 Treas. Reg. §1.170A-14(h)(3)(i).

37 *Id.*

38 Treas. Reg. §1.170A-13(c).

licensed or certified for the type of property being appraised in the state in which the real property is located.[39]

(d) Penalties for Over-Valuation.

Penalties may apply to the amount of the tax that is underpaid because of a valuation overstatement.[40] (I.R.S. Notice 2006-96, 2006-46 I.R.B. 1, also provides guidance for substantial or gross valuation misstatements on appraisals under I.R.C. §6662.) The Pension Protection Act substantially increased the application of the penalties by reducing the thresholds for determining whether a substantial valuation misstatement has been made under I.R.C. §6662. The 20% penalty previously applied to overstatements of 200% or more; that threshold has been lowered to 150%. The 40% penalty previously applied to overstatements of 400% or more; that threshold has been lowered to 200%. The Pension Protection Act also created an appraiser penalty.[41] However, no penalty will be imposed on an appraiser who establishes that the appraised value was "more likely than not" the correct value.[42] The appraiser penalties apply to appraisals prepared in connection with returns filed after August 17, 2006. The accuracy-related penalties apply to returns filed after July 25, 2006.

(e) Exclusion of and Deduction of the Value of Certain Conservation Easement Property.

Even if a decedent did not specifically provide for a gift of a conservation easement, an executor or inheriting "family member" can grant a conservation easement on estate property.[43] The exclusion may apply to a portion of the value of certain property with respect to which a qualified conservation easement is granted, located within the U.S. or its possessions, and owned by the decedent or a member of the decedent's family for the three years prior to the decedent's death.[44]

Under I.R.C. §2031(c), a personal representative may elect to *exclude* from a decedent's estate the lesser of: (i) the applicable dollar exclusion limitation, or (ii) a percentage of the value of the land that is subject to the qualified conservation easement. The applicable percentage is 40%, reduced by 2% for each 1% by which the value of the qualified conservation easement is less than 30% of the value of the land.[45] Thus, up to 40% of the value of the land (but not improvements) may be excluded from the gross estate only if the qualified conservation easement is worth at least 30% of the value of the land. The maximum dollar exclusion is $500,000.[46]

[39] I.R.C. §170(f)(11)(E)(ii)(I).

[40] I.R.C. §6662.

[41] I.R.C. §6695A(b).

[42] I.R.C. §6695A(c).

[43] I.R.C. §2031(c).

[44] I.R.C. §2031(c)(8)(A)(ii).

[45] I.R.C. §2031(c)(2).

[46] I.R.C. §2031(c)(1)(B), (c)(3).

A number of other requirements must be met to take advantage of this exclusion.[47] One, which should be emphasized, is that an exclusion may not be taken to the extent the owner retains any development rights with respect to the property or to the extent the property is debt-financed.[48]

I.R.C. §2055(f) provides for an estate tax charitable deduction for a post-mortem grant of a qualified conservation easement to a qualified charity. Unlike the exclusion, there is no cap on the amount of the deduction. Furthermore, it is the estate's beneficiaries who may decide to take this deduction on a post-mortem basis.[49]

The deduction and the exclusion may be applied simultaneously to the same transfer. In the family cabin context, the result may be that the owners are able to continue using the property in the same manner as it had been used previously.

It is also possible, in the family cabin context, to place a conservation easement on the cabin property to preserve open space, which would allow for a current income tax deduction and a reduction in transfer taxes, without changing the way the family actually uses the property.

B. Direct Gifts to Charity.

In some cases, it may make sense for the family to directly contribute land that is environmentally sensitive to a charity that will hold and protect it. A direct gift eliminates the cost and complication of establishing a conservation easement. It also eliminates the complication of the ongoing operation of a charitable entity.

An outright gift will also entitle the donor or donors to either an income or a gift tax deduction for an inter vivos gift, I.R.C. §170(c), or an estate tax deduction at death, I.R.C. §2055(a). Unlike the charitable income tax deduction, there are no percentage limitations on the estate tax charitable deduction, and no related/unrelated use limitations. The fair market value of appreciated property contributed to a public charity is deductible up to 30% of the taxpayer's contribution base (the taxpayer's adjusted gross income without regard to net operating loss carrybacks).[50] Contributions in excess of the 30% limitation may be carried forward for five years.[51] The taxpayer may elect to increase the 30% limitation to 50% of the contribution base, but the deduction is then limited to the taxpayer's basis.[52] Typically, this election would be made if the taxpayer's basis in the property was very high or the deduction was so large that the taxpayer was not likely to use it in any case.[53] In general, contributions to public charities and private foundations are deductible without regard to the percentage limitations

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[47] *See* Robert H. Levin, *You're Not Too Late: Post-Mortem Donations of Conservation Easements*, Tax Notes Today (Oct. 26, 2000), for an in-depth discussion of postmortem granting of conservation easements.

[48] I.R.C. §2031(c)(4), (c)(5).

[49] I.R.C. §2031(c)(9).

[50] I.R.C. §170(b)(1)(C)(i), (b)(1)(B).

[51] I.R.C. §170(d)(1)(A), (b)(1)(C)(ii).

[52] I.R.C. §170(b)(1)(C)(iii), (e)(1).

[53] Frederick K. Hoops, Frederick H. Hoops III, Daniel S. Hoops, 1 *Family Estate Planning Guide* §11.8(d) (4th ed. 2005).

described above for estate and gift tax purposes.

The donation must be to a permissible donee, as defined in I.R.C. §170(a), which include governmental entities, public charities, and private foundations.

Where property is contiguous with public land, it may also be possible to donate the property to a government agency. However, there are limitations. For example, Congress determines the boundaries of national parks, and donations of real property are only permissible within those boundaries. Thus, even where land is contiguous with public land for National Park purposes, a land bank may be a more feasible donee.

Alternatively a family may give a personal residence or farm to a charity, subject to the reservation of a life estate. Where a home is involved, it must be a personal residence, but need not be the primary residence. A farm is defined as land that is used for the production of agricultural products, including crops or timber.[54] Farms qualify for gifts of remainder interests even if the production of agricultural products is being carried on by a tenant. For personal residences, the stock in a co-op will also qualify as long as the co-op unit is a personal residence. Reasonable surrounding grounds, determined by the customary lot size in the area, may also be included in the charitable gift. The gift of the remainder interest could take effect at the end of one or two lives, or a term of years.[55]

C. Part Gift/Part Sale Transactions.

Where a family cannot afford to give the property outright to charity, there are a number of part gift/part sale options available, which are discussed below. These arrangements are most useful with property that a family does not want to pass on to further generations or heirs, or where a family desires to downsize the amount of property to be retained for future generations. With any of these arrangements, the donor and the charitable recipient need to keep in mind the potential for generating unrelated business taxable income ("UBTI") due to property subject to acquisition indebtedness. (If property owned by the donor for less than five years is subject to debt that is less than five years old, a bargain sale may give rise to acquisition indebtedness.[56] A sale of property subject to acquisition indebtedness by the charity will result in UBTI. This result can be avoided if the charity waits 12 months to sell the property.[57] If a donor has owned the property for five years or more and the debt is five or more years old, the charity may avoid payment of unrelated business income tax if it sells the property within 10 years of receipt.[58] Any income earned by a charity subject to acquisition indebtedness will be treated as UBTI unless its use is substantially

[54] Treas. Reg. §1.170A-7(b)(4).

[55] Treas. Reg. §1.170A-7(b).

[56] I.R.C. §514(c)(2)(b).

[57] I.R.C. §514(B).

[58] I.R.C. §514(c)(2)(B).

related to the charity's exempt purpose.[59]

1. Bargain Sale.

A donor may enter into a purchase and sale agreement with a charity for an amount less than the fair market value. The difference between the actual sale price and the fair market value may be treated as a charitable deduction.[60] The donor must allocate their basis in the property pro rata to both portions, based on its fair market value, and report gain on the difference between the sale price and the basis allocated to the sold portion (but not the donated portion).[61]

2. Gift in Exchange for a Charitable Gift Annuity.

If appreciated property is used to fund the annuity, the taxable gain, calculated under the bargain sale rules, must be fully recognized by the donor in the year the annuity is created (unless the donor is the only annuitant).[62]

A charitable gift annuity is a contractual arrangement by which the donor transfers cash or other property in return for a specific charity's promise to pay annuity payments to one or more persons. The donor receives a charitable deduction equal to the amount transferred less the present value of the stream of annuity payments. The annuity could be for the life or lives of any two persons, although typically it would be for the life of the donor, the life of the partner, or both lives.

Like the donor of a charitable remainder trust, the donor of a charitable gift annuity receives an income tax charitable deduction for part of the value of the assets contributed. Unlike a charitable remainder trust, however, payments may be made to no more than two persons (consecutively or on a joint-and-survivor basis), and may not be made for a term of years. Furthermore, a charitable gift annuity is a contract involving a transfer of assets to a single charity, whereas a charitable remainder trust is a trust arrangement that may benefit multiple charities.

3. Gifts of a Remainder Interest in a Personal Residence.

A family may benefit from giving a residence to a charity, subject to the reservation of a life estate. The home involved must be a personal residence but need not be the primary residence. Reasonable surrounding grounds, determined by the customary lot size in the area, may also be included in the charitable gift. The gift of the remainder interest could take effect at the end of one or two lives, or a term of years.

While the gift of a remainder interest itself is made by means of a simple deed, there should also be a separate agreement regarding the rights and responsibilities of the charity and of the life tenant or tenants. This arrangement allows a donor to retain a measure of control and access to the

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[59] I.R.C. §514(b)(1)(A).

[60] I.R.C. §1011(b).

[61] *Id.*

[62] Treas. Reg. §1.1011-2(a)(4).

property for life, but this typically does not reduce the ongoing cost of owning the property.

Customarily, life tenants will be required to pay property taxes, utilities, liability and casualty insurance, maintenance expenses, and minor repairs. To avoid disputes during the occupancy period of the life tenant, the agreement should assign responsibility for the cost of capital improvements, and provide a procedure for reviewing subleases, a procedure for the sale or mortgage of the property, and criteria for the removal of tangible personal property and fixtures by the life tenant at the end of the term. A procedure for resolving disputes should also be agreed upon ahead of time between the tenant and the remaindermen, including the rights of recovery by one party from another, including reasonable attorneys' fees. There should also be a procedure for receiving notice of default on any debt secured by the property and an opportunity to take steps to cure a default and to bid for the property in a foreclosure sale. Finally, remaindermen should have a right of entry for inspection.

For lifetime gifts, the donor receives income and gift tax charitable deductions for the present value of the charity's remainder interest.[63] If the property is appreciated the donor does not recognize any capital gain. If the gift is made on a testamentary basis, the donor's estate is entitled to an estate tax charitable deduction for the present value of the charity's remainder interest.[64]

This arrangement is most useful with a residence that is not subject to a mortgage and for property not intended to be passed on to further generations or heirs. But, once the gift is made, it might be possible for another family member to re-acquire the remainder interest from the charity at a later date, the value of which would be subject to a discount valuation as a fractional interest.

A family may own an operating farm and wish to discontinue operation of the farm, after the current generation. But, they may wish to retain the appurtenant residence. These families may benefit from a fractional gift of a remainder interest in the farm.[65] (A farm is defined as land that is used for the production of agricultural products, including crops or timber, by either the owner or the tenant.[66])

The remainder interest in a home or farm typically has a duration of one or two lives (anything longer would produce a negligible charitable deduction), but there may also be a remainder interest following a term of years.[67]

D. Charitable Remainder Trusts.

Charitable remainder trusts ("CRTs") can be useful for the transfer of real property to charity when the donor is not able or willing to give up ownership without a retained financial benefit. The rules

[63] I.R.C. §§170(f)(3)(B)(i), 2522(c)(2).

[64] I.R.C. §2055(e)(2).

[65] Treas. Reg. §1.170A-7(b)(4).

[66] Treas. Reg. §1.170A-7(b).

[67] *Id*.

applicable to CRTs are extremely technical and complex.[68] But generally, the CRT is an irrevocable trust that makes distributions—at least annually—to one or more non-charitable beneficiaries for a term of not more than 20 years, or for the life or lives of the individual beneficiaries.[69] When the non-charitable interest or interests terminate, the remainder interest passes to one or more qualified charitable organizations.[70]

A CRT may be structured as either a charitable remainder annuity trust ("CRAT") or a charitable remainder unitrust ("CRUT"). A CRAT pays the non-charitable beneficiary a fixed dollar amount that is specified in the trust agreement, so the payout from a CRAT does not vary from year to year. A CRUT pays a fixed percentage (no less than 5% and no more than 50%[71]) of the value of the trust property. Thus distributions can fluctuate based on the increase or decrease in value of the trust. Because CRAT distributions cannot increase over time, CRATs are less frequently used.

A CRT is exempt from income tax unless it has UBTI.[72] (Until December 31, 2006, if a CRT had any UBTI in a year, all of its income that year would be subject to income tax.[73] Beginning January 1, 2007, §424 of the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, 120 Stat. 2922, amends I.R.C. §664(c) so that any UBTI in a CRT will simply be taxable, but will not disqualify the entire CRT for that tax year.) If no UBTI is generated, tax is paid by the annuity or unitrust recipient as distributions are received, according to the tier system set forth in I.R.C. §664(b). As a result, the trustee may transfer appreciated assets held more than one year, and liquidate and reinvest the proceeds, without immediate capital gain tax consequences.

In the year of funding, the grantor of an inter vivos CRUT may claim an income tax deduction for the present value of the remainder interest that will pass to charity, subject to certain restrictions.[74] One of those restrictions is that the actuarial value of the remainder eventually passing to charity must have an actuarial value of at least 10% of the value of the trust estate at the date the trust is funded in order to qualify as a charitable remainder trust.[75] A CRUT may have multiple recipients, either concurrently or serially. But additional recipients (and young recipients) reduce the likelihood that the trust will meet the 10% threshold.

Use of a CRUT for the sale of the property would generate cash flow and a charitable deduction for the donor. Furthermore, the charitable remainder beneficiary is not limited to charities with a conservation purpose, as with the outright gift of a conservation easement.

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[68] *See Charitable Remainder Trusts,* available at https://www.irs.gov/charities-non-profits/charitable-remainder-trusts (last updated July 28, 2023), for a thorough discussion of this topic with model forms.

[69] I.R.C. §664(d).

[70] I.R.C. §664(d)(1), (2).

[71] I.R.C. §664(d)(1)(A).

[72] I.R.C. §664(c).

[73] *Id.*

[74] I.R.C. §§170(f)(2), 2522(c)(2).

[75] I.R.C. §§664(d)(1)(D), (d)(2)(D).

One method for forming a CRUT funded with real estate is to design the trust so that no more than the net trust income is distributed until the occurrence of a triggering event—an event that is not discretionary or within the control of the trust or any person[76]—at which time the CRUT would begin paying out the full unitrust amount as of January 1 of the year following the year in which the event occurs.[77] This is sometimes referred to as a "net income with makeup charitable remainder trust" or "NIMCRUT." The sale of the real property could be the triggering event. After the triggering event, deficiencies from earlier years can be made up in later years when trust income exceeds the required set percentage amounts for such amounts. This allows payment of the unitrust amount to be deferred until after the year in which the sale takes place and allows for the possibility of a lack of liquidity in prior years.

At the end of the non-charitable term, the donor will give up ownership of the underlying real property.

The biggest challenge with this technique is impressing on the donor the importance of contributing the property prior to entering into the sale transaction. If the property is not transferred to the CRUT in time, the sale may be recharacterized as a sale subject to capital gains tax, followed by a contribution of the proceeds to the CRUT.

E. Gifts to Charitable Entities.

Rather than an outright gift to charity or a CRT, a family may wish to give property to an entity that it controls or participates in the management of. Two particularly useful recipients are the supporting organization and the private operating foundation.

1. Gifts to Private Operating Foundations.

A private operating foundation is a charitable entity that may be controlled by the family members and is exempt from income tax under I.R.C. §501(c)(3). The foundation would need to be established and operated to use the property exclusively for charitable or educational purposes that will confer a benefit upon the public and not the donors or their family members. Public uses include hiking and riding trails and open spaces that can be viewed by the public.

There are many compliance limitations that apply to private operating foundations and their donors. One is that the donor family will not be able to use or have access to the donated property in any manner that is more advantageous than the public's access to the property.

Contributions to a private operating foundation are treated as if made to a public charity.[78] In contrast, the deduction to a non-operating private foundation is limited to the *lesser* of (1) 20% of the taxpayer's contribution base, or (2) the excess of 30% of the taxpayer's contribution base over the amount of charitable contributions allowable to public charities, determined without regard to

[76] Treas. Reg. §1.664-3(a)(1)(i)(c), (a)(1)(i)(d)

[77] *See* Treas. Reg. §1.664-1(a)(7), (d)(1)(iii), (f)(4).

[78] I.R.C. §4942(j)(3); Treas. Reg. §53.4942(b)-1.

the 30% limitation.[79] Excess deductions may be carried forward for five years.

Private foundations of any sort are subject to strict regulation and scrutiny by the IRS. Unlike a private foundation, which is generally limited to passive grant making to public charities, a private operating foundation directly operates a charitable activity or program, and dedicates its funds to operating that program, such as a nature reserve. Specifically, the foundation could use the funds to perpetuate the preservation of environmentally sensitive land. The family of a private operating foundation donor may control the management of the foundation.

In spite of the many technical compliance requirements, in the appropriate situation the private operating foundation can provide a family with considerable flexibility in its charitable giving.

2. Gifts to Supporting Organizations.

A "supporting organization" is another form of family foundation, which is described under I.R.C. §509. Generally, the tax benefits of a supporting organization are more generous than those of a private foundation, but the donor does not retain as much management or control over the use of the funds.

The advantage of the supporting organization is that generally the tax benefits are more generous than those of a private foundation because it is treated as a public charity for purposes of calculating the donor's deduction. This comes at the expense of the donor's management or control over the use of the donated property. In return for the greater tax benefits of a supporting organization, the family of a supporting organization donor may participate in but not control the supporting organization.

A supporting organization must identify the charitable organizations or purposes it will support and must affiliate with an established public charity or charities.[80] While more costly to establish, a supporting organization offers significantly greater freedom from the technical compliance requirements of a private foundation, and is often the preferred charitable vehicle.

A supporting organization, which is affiliated with or controlled by a governmental unit or a publicly supported charitable organization, could also be the recipient of a contribution of real property.[81]

A supporting organization could be funded, in part, with a portion of the family's real property intended to be set aside for conservation purposes. The supporting organization could then support another charity, such as a state or local public park agency, land trust, historical society, or conservation organization, by donating the land to the supported charity and/or providing funds for the supported charity to conduct conservation programs on the land.

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[79] I.R.C. §170(b)(1)(C)(i), (e)(1)(B)(ii).

[80] I.R.C. §509(a)(3)(A); Treas. Reg. §1.509(a)-4(c)(1).

[81] I.R.C. §509(a)(2), (a)(3).

F. Taking Advantage of Current Use Restrictions for Property Tax Purposes.

Many taxing authorities have programs whereby a property owner may agree to keep property in its current use, typically as timber or agricultural land. In return, the landowner receives a reduction in property tax for as long as that restriction is maintained. These arrangements differ widely across the country.

IV. Sale and Development of Property.

As part of the master plan, the family may simply decide to sell some of the property to raise funds to maintain what is remaining and/or to reduce the ongoing costs of maintaining the property. More ambitious families may develop and then sell certain parcels. The proceeds can be set aside in a trust, or transferred with the cabin into any of the entities discussed below, for ongoing management of the cabin.

A. Sale of a Conservation Easement.

A landowner may not be able to afford to place a conservation restriction on his retained property. Or he may have little income against which a deduction may be taken. In some cases, the local government or a land bank may be willing to purchase a conservation easement on environmentally sensitive land. The value of the easement would be the value of the land without the easement less the value of the land with the easement. If the land is part of the seller's homestead, he could treat the transaction as a sale of his principal residence and shelter up to $500,000 in gain if married.[82] Otherwise, capital gain rates will apply to the proceeds. A landowner may also sell a conservation easement through a charitable remainder trust.[83]

B. Exchange of a Conservation Easement.

The sale of a conservation easement will generally trigger capital gain tax. Instead, a landowner may be able to defer that tax by using a like-kind exchange of a conservation easement, pursuant to I.R.C. §1031, for other land. For example, a family could exchange a scenic conservation easement for additional land without triggering tax.

Treas. Reg. §1.1031(k)-1 provides a detailed guide for exchange transactions. A deferred exchange occurs when an owner acquires qualifying replacement property in exchange for qualifying relinquished property. To qualify, the exchange (1) must involve like-kind properties; (2) must be an actual exchange and not merely a sale for money that is reinvested; and (3) must comply with specific time requirements.

Property is generally divided into four classifications for tax purposes: Property held for business use; property held for investment; property held for personal use; and property held for sale. Only

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[82] Treas. Reg. §1.121-1(b)(3).

[83] *See* Joan B. Di Cola, *Alternatives to Donating a Conservation Easement*, 31 ESTATE PLANNING 489, 491-494 (Oct. 2004).

property held for business use or for investment qualifies for exchange treatment under §1031.

In those instances in which property has more than one use (e.g., the duplex with one unit occupied by the owner, or a farm with a residence), the sale can be allocated between the two uses. Both business and investment property qualify for §1031 treatment, so a commercial property used in business (e.g., a building) can be exchanged for raw land held for future appreciation (investment).

The requirement of "like-kind" refers to the nature of the real estate as to its owner, rather than a comparison of physical characteristics of the property, or its prior or subsequent use. There are no holding periods under §1031. But, the length of time the property has been held by a taxpayer may help to show its particular use. In P.L.R. 200651030 (Dec. 22, 2006), the Service indicated that a holding period of two years was sufficient to show a qualified use.

The property can be located in any state (and the U.S. Virgin Islands). Foreign property will not qualify. Tax Cuts and Jobs Act ("TCJA") modifies IRC § 1031 for exchanges completed after December 31, 2017, limiting exchanges to real property. Previously, certain personal property held as a business asset could be included in the exchange.[84] The personal property included with any real property exchange (e.g., appliances, furnishings and equipment) under the new version of the law will be considered taxable "boot" in the exchange. A reasonable allocation of the transaction proceeds must be allocated to that property and the value reported on the income from the disposition of such property.

C. Option to Purchase.

To create flexibility without having to be too specific, a testator could use a right of first refusal or option to purchase the family cabin.

The right for first refusal might give one or more beneficiaries the right to purchase the cabin, which would otherwise be sold by the personal representative. The holder of the right of first refusal should be given a limited amount of time to exercise their right and other conditions so that the estate administration is not unduly prolonged or left without liquidity to pay taxes.

The following is a sample right of first refusal where the property would be sold if the right is not exercised:

> Right of First Refusal – Family Cabin. Any interest I may own at the time of my death in the family cabin, shall be sold by my personal representative to an independent third party at its fair market value at the time of my death, such value to be determined by a fair market appraisal made by an independent certified appraiser selected by the personal representative. Notwithstanding the forgoing, CALVIN followed by HOBBES, shall have a right of first refusal to purchase the family cabin from my estate at its fair market value. An election to purchase the family cabin must be made within ninety (90) days of my death, by delivering written notice of such election to the personal representative, and the sale

[84] Treas. Reg. § 1.1031(a)-2 dealing with product classes and general asset classes, IRS guidance, including Revenue Procedure 87-56, 1987-2 CB 674, and Chief Counsel Advice 200911006, are no longer relevant.

shall be completed within eight (8) months of my date of death. CALVIN and HOBBES may elect to purchase the family cabin jointly, as they shall agree, or if they choose not to purchase the family cabin jointly, they shall draw straws to determine who shall have the right to purchase the family cabin. If neither CALVIN nor HOBBES wishes to purchase the family cabin, or more than ninety (90) days from my date of death elapse without an election to purchase being delivered to the personal representative, this right of first refusal shall lapse, and sale of the family cabin to an independent third party shall proceed, and the proceeds shall pass pursuant to Section ____ below.

Alternatively, one or more beneficiaries could be given the option to purchase the cabin. If the option is not exercised, the house would continue to be held or distributed as provided under the testamentary document granting the option. Where there are two siblings, the senior generation could leave the cabin to the two of them the option to buy out the other at the highest bid. Or multiple beneficiaries could exercise the option to purchase so that a family member not interested in co-ownership can be bought out.

The following is a testamentary purchase option:

> Family Cabin – Option to Purchase. The family cabin shall be distributed to those of my children, HANZ, FRANZ, LISA and TODD, who are then living, and to those of my deceased children leaving descendants, per stirpes. Notwithstanding the foregoing, at the time family cabin becomes subject to distribution under the terms of this Section, each of the beneficiaries shall have the option to acquire the family cabin. The personal representative shall notify each beneficiary of this option in writing within thirty (30) days after the date of my death. If any of the beneficiaries express an interest in acquiring the family cabin, they shall notify the personal representative in writing within thirty (30) days after receipt of the notice. If one or more of the beneficiaries so notifies the personal representative that they are interested in acquiring the family cabin, the personal representative shall have the family cabin promptly appraised by a a fair market appraisal made by an independent certified appraiser selected by the personal representative. The personal representative shall promptly furnish the Settlor's children with copies of the appraisal. In valuing the family cabin for purposes of this purchase option, a discount of ten percent (10%) shall be allowed to reflect deemed expenses of sale.
>
> Upon receipt of notice of the appraised value of the family cabin, each beneficiary expressing interest in acquiring the family cabin shall have ten (10) days to notify the personal representative in writing that they elect both to receive their proportionate share of the family cabin in distribution of their final distributive share of the estate and to purchase from the estate the remaining (or pro rata) interest in the family cabin allocable to the other beneficiaries. If more than one beneficiary so elects to acquire the family cabin, they shall hold their interests as tenants in common and shall purchase pro rata interest of the family cabin allocable to the other beneficiaries.

V. Transferring the Cabin from the Senior Generation to the Junior Generation.

Once the portions to be set aside for preservation and sale or development (if any) have been identified, the linchpin of the master plan is transferring the cabin to succeeding generations. As

indicated above, there are a number of techniques for transferring the cabin to the next generation, some of which are discussed below.

A. Fractional Interest Gifts.

With any of the techniques discussed below, the donor could transfer a partial interest in the residence, either as a tenancy-in-common interest or as a unit of an LLC or family limited partnership holding the property, and retain a portion for personal use. As discussed above, this would potentially allow the donor to continue to use the residence without concern about estate tax exclusion. It could also reduce the gift and estate tax value through the application of various valuation discounts. The *Ludwick* case, discussed below, demonstrates that even based on convoluted, if not just incorrect, reasoning, the court was still willing to grant a 17% discount based on the cost of partition. However, anecdotally, by an informal poll conducted by the author, practitioners claim to be receiving discounts on fractional interests in real property or entities holding real property closer to 30% to 35% and often higher, based not simply on the cost of partition, but also on the lack of marketability and lack of control.

In *Ludwick v. Commissioner*,[85] the taxpayers, a married couple, owned a $7.25 million vacation residence on the Island of Hawaii. Each spouse created a separate qualified personal residence trust to which each spouse contributed a one-half interest in the home. In computing the value of the gifted remainder interest, the taxpayers claimed a 30% fractional interest discount from the value of one-half of the property. The Service determined that the maximum discount should have been 15%, so it determined that the taxpayers owed gift tax. When the matter got to the Tax Court, the Service took the position that a maximum discount of 11% should be applied. The court ultimately approved a 17% discount, determined as follows: The court found that a willing buyer of a one-half interest would expect that about 10% of the time, a partition of the property would be necessary. Any such partition action would likely take two years to complete. The court determined the present value of a one-half interest would be $3,037,500 where no partition action was necessary, and $2,663,388 in the 10% of cases where a partition action would be necessary. The weighted average of these two amounts suggests a buyer would have been willing to pay $3,000,089 for a one-half interest, and that is equivalent to a 17% discount.

B. Outright Gifts.

An outright gift to the younger generation (or to a trust for their benefit) will transfer the value of the property and all future appreciation, thereby reducing the taxable estate value of the senior generation. If the gift is given as undivided interests in real property, it may also be possible to apply minority and other discounts to further reduce the value of the gift for gift tax purposes.

Inter vivos gifts, which are tax exclusive, are usually preferable to gifts at death, which are tax inclusive. In other words, at death estate tax is assessed on both the value of a gift and the funds actually used to pay the tax. But during one’s life, gift tax is paid with funds not otherwise subject to gift tax. Against this benefit, though, it is necessary to consider that gifts at death are entitled

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[85] T.C.M. (CCH) 104 (2010).

to a full stepped-up tax basis to date-of-death fair market value.[86] Inter vivos gifts, on the other hand, only retain a carry-over basis equal to the basis in the hands of the donor, plus the amount of gift tax paid on the appreciation (unless gift tax is paid by the donees).[87] Thus, in a nontaxable estate, it may be best to hold onto property until death to take advantage of the stepped-up basis.

C. Qualified Personal Residence Trusts.

One estate planning technique that can be effective for transferring real estate between family members is the qualified personal residence trust or "QPRT." A QPRT permits a homeowner to make a gift of their personal residence (i.e., a primary residence or a vacation home, along with a reasonable amount of surrounding property) to a trust for the benefit of children or other beneficiaries at a reduced gift tax cost.[88] The "grantor" (i.e., the homeowner who transfers the residence to the QPRT) is permitted to reserve the right to live in the house for a specified number of years (referred to as a "reserved term of years"). The grantor selects the number of years. During the trust term, the grantor may use the residence rent-free. Upon expiration of the trust term, the residence is distributed to the remainder beneficiary or beneficiaries (usually the grantor's children), or held in further trust for their benefit.

The value of the gift is the fair market value of the residence at the time of transfer to the QPRT, decreased by the value of the reserved term of years (determined according to IRS tables).[89] Generally, a longer reserved term produces a correspondingly lower value of the gift for gift tax purposes. Furthermore, where a husband and wife form separate trusts with their respective interests (provided that they are the only owners), a fractional interest discount may also be applied to the value of the gift. The grantor will use a portion of his applicable credit when the transfer is made to the QPRT (or, if the applicable credit has been exhausted, the transfer would be subject to gift tax). At the end of the trust term, the residence passes to or for the benefit of the children with no further gift or estate tax consequences. As a result, all appreciation that occurs during the trust term is "shifted" to the children free of gift or estate tax.

When funding a QPRT, it may be necessary to subdivide the property to carve out the cabin, associated outbuildings, and an appropriate amount of surrounding real property to be transferred via the QPRT. (Treas. Reg. §25.2702-5(c)(2)(ii) provides that, in addition to the personal residence, a QPRT may be funded with "appurtenant structures used by the term holder for residential purposes and adjacent land not in excess of that which is reasonably appropriate for residential purposes (taking into account the residence's size and location).") There are a number of private letter rulings that give guidance as to what the IRS considers a reasonable amount of property to be transferred.[90] Other sources of guidance would be the minimum lot size under local

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[86] I.R.C. §1014(a).

[87] I.R.C. §1015.

[88] I.R.C. §2702; Treas. Reg. §25.2702-5(c).

[89] Treas. Reg. §25.2702-5.

[90] *See*, *e.g.*, P.L.R. 199918049 (Feb. 9, 1999); P.L.R. 200126026 (June 29, 2001); P.L.R. 200626043 (Feb. 23, 2006).

zoning regulations and the parcel sizes of comparable residences in the area.

A QPRT may also be funded with an interest in a foreign personal residence, so long as the non-U.S. jurisdiction recognizes trusts.[91]

1. Drawbacks to the QPRT.

There are the following drawbacks to the QPRT:

(a) If the grantor wishes to continue to occupy the residence at the end of the reserved term, the grantor must pay fair market rent to the remainder beneficiaries. If a home has appreciated considerably over the term of the QPRT, fair market rent may pose a financial burden. The rental payments would represent taxable income to the children. However, the amount of rent paid by the grantor would be removed from the (taxable) estate, which represents further overall tax savings for those parents interested in reducing potential estate tax liability.

(b) The tax advantages of a QPRT also depend on the grantor surviving the trust term. If the grantor fails to survive the term of years, the entire value of the trust's interest in the residence at the grantor's death will be included in the grantor's estate for estate tax purposes. Therefore, the estate and gift tax advantages will be lost, but the effect will generally be the same as if the QPRT had not been established.

(c) If a residence were transferred using a QPRT, it would not be entitled to the step-up in basis that would otherwise be available at the time of the transferor's death.[92] In some circumstances, it may be advantageous to transfer the residence at death (e.g., where the parents' estates are not expected to be taxable even if the residence is included or when the property is expected to be sold by the younger generation upon the death of the senior generation).

(d) A QPRT should not be used to make gifts to grandchildren because of the estate tax inclusion period. (The estate tax inclusion period is the period of time following a transfer during which the value of the transferred property would be included in the transferor's estate if the transferor dies. The transferor's GST exemption cannot be allocated to the value of the transferred property until the estate tax

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[91] John F. Meigs & Ryan R. Gager, *Using a U.S. Qualified Personal Residence Trust in Cross-Border Planning*, 35 ESTATE PLANNING 22, 26 (July 2008).

[92] I.R.C. §1014(a).

inclusion period terminates.[93]) The grantor's GST tax exemption cannot be allocated to the gift until the expiration of the term of years, and it must be allocated to the entire value of the gift at that time.[94]

(e) Generally, property subject to indebtedness should not be transferred to a QPRT. Future payments toward principal would be treated as additional gifts to the QPRT in the year paid (however, interest-only payments would not be treated as additional gifts).[95]

2. Additional Considerations.

When determining if a QPRT is appropriate for any client, balance the likely estate tax savings (i.e., the highest marginal estate tax rate applicable to the dollars in question, multiplied by the value of the residence that is being removed from the taxable estate) against the capital gains tax rate (generally, 15% under current law) that will be applied if the property is sold.

Note that capital gains tax applies to the difference between fair market value and basis (i.e., acquisition cost) of the property, and is paid at the time of sale of the property (when cash is available). In contrast, estate taxes are imposed on the entire fair market value of the property and are due nine months after death, regardless of whether the property has been sold by that time. These factors, plus the fact that the capital gains tax rate usually is lower than the estate tax rate, can make the QPRT an attractive estate planning technique.

It is also important to note that it is not entirely clear whether unrelated parties may establish QPRTs with cotenancy interests in a residence. The issue arises because: (i) the property must have its primary use as the grantor's residence, (ii) the grantor must have the exclusive right of occupancy, and (iii) the property may not be used other than as a residence when the grantor is not there.[96] Shared occupancy is permissible as long as it is at the sufferance of the grantor. There are no rulings concerning QPRTs established by cotenants who are not also spouses.[97] Therefore, the regulations suggest that the exclusive right of occupancy requirement precludes the establishment of QPRTs with cotenancy interests if the cotenants/donors are not also spouses.[98]

Where a cotenant with a non-spouse wishes to establish a QPRT, one approach to accomplish the exclusive occupancy requirement is to have that cotenant lease the property from the other

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[93] I.R.C. §2642(f)(3).

[94] I.R.C. §2642(f).

[95] *See* Meigs & Gager, *supra,* at 24 (*citing* Natalie B. Choate, *The QPRT Manual: The Estate Planner's Guide to Qualified Personal Residence Trusts* ¶2.7 (Ataxplan Publications 2004) (hereinafter "Natalie B. Choate, *The QPRT Manual*")).

[96] Treas. Reg. §25.2702-5(b)(2)(iii).

[97] *See* Natalie B. Choate, *The QPRT Manual, supra,* at ¶2.3.02.

[98] *See* John A. Hartog, *QPRTs for Co-Tenancy Interests—Do They Work?*, 6 CALIFORNIA TRUSTS AND ESTATES QUARTERLY 4 (Fall 2000).

cotenants during the QPRT term.[99]

D. Alternatives to the QPRT.

1. Reverse QPRT.

Instead of retaining a life interest, with a gift of the remainder interest, some families opt for the "Reverse QPRT." Under this arrangement, the grantor gives away the right to live in the home (rent-free) for a term of years, and retains the remainder interest. This was first approved by the Service in P.L.R. 200814011 (Apr. 4, 2008). (Since then, it has been approved in a number of additional rulings: P.L.R. 200901019 (Jan. 2, 2009); P.L.R. 200904022 (Jan. 23, 2009); P.L.R. 200904023 (Jan. 23, 2009); and P.L.R. 200920033 (May 15, 2009)). The favorable rulings were conditioned on the trust instrument being substantially similar to the specimen agreement in Rev. Proc. 2003-42 §4, and the residence qualifying as a personal residence under I.R.C. §25.2702-5(c)(2).

What benefit does this provide? Often, when a conventional QPRT terminates, the grantor is unable to pay fair market rent but wishes to remain in the home. The recipient of the remainder interest could transfer back to the grantor the right to live in the home for a term of years, and at the end, it would revert back to him. Like ordinary QPRTs, Reverse QPRTs must comply with I.R.C. §702, and the value of the retained interest would be determined using I.R.C. §7520. The value of the gift back to the grantor would simply be the right to reside in the home over the term of the QPRT.

2. Split-Interest Purchases.

Because of the disadvantages of a QPRT, clients may want to consider some of the alternatives that can be useful, albeit in limited circumstances. One is the split-interest purchase. A split-interest purchase involves the division of the total purchase price: One person contributes an amount equal to their life interest value or an interest for a term of years, while the other person contributes an amount equal to the value of the remainder interest following the termination of the term interest.

If the joint purchasers are applicable family members for purposes of I.R.C. §2702, the person acquiring the term interest is treated as acquiring the entire property and then transferring the remainder interest to the other purchaser, and the retained interest (generally a life estate) is valued at zero unless the retained interest constitutes a qualified interest.[100] One way around this might be to have a family member purchase a life interest and a GST trust purchase the remainder, preferably a trust that has been around for other purposes and was not established for this purpose.

3. Sale of a Remainder Interest.

Another QPRT alternative is the sale of a remainder interest, which may also be preferable to a

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[99] *See* Natalie B. Choate, *The QPRT Manual, supra,* at ¶2.3.02.

[100] I.R.C. §2702(c)(2).

QPRT because the seller can retain use of the residence for life, instead of a term of years, rent-free. It also avoids the concern that the grantor might not survive the QPRT term.

This technique is not without risk. Undervaluation of the remainder interest could cause the remainder interest to be brought back into a life tenant's estate under I.R.C. §2036. To withstand scrutiny, the purchasers of the remainder interest should use funds held for some time and not merely received as a gift just prior to the transaction. The sale of a remainder interest also needs to comply with the personal residence trust and qualified personal residence trust regulations set forth in Treas. Reg. §25.2702-5(a).[101]

If the residence is sold during the lifetime of the life tenant(s) and the proceeds are not reinvested in a replacement residence, or converted to a qualified annuity trust, the proceeds must be paid to the life tenant. One alternative would be to provide in the purchase and sale agreement of the remainder interest that the sale of the residence during the lifetime of the life tenant(s) is prohibited.

With a QPRT or life estate, the life estate or primary beneficiary of the trust must pay for maintenance, utilities, insurance, taxes and repairs; where the remainder interest has been sold, the payment for improvements by the life tenant is treated as an additional gift.

Mortgage interest is the responsibility of the life tenant. But, principal payments are considered additional gifts unless the debt is secured by property other than the residence prior to the sale of the remainder or transfer to the QPRT. Or the grantor could retain the obligation and enter into an indemnification agreement with the trust or remainder beneficiary in the event the lender attempts to realize on the security interest.

E. Other Types of Trusts.

1. Irrevocable Trusts.

An irrevocable trust (other than a QPRT) owning real estate, which removes the house from the grantor's estate, can serve as a vehicle for gift giving to younger generations during the senior generations' lifetime. The trust can name beneficiaries and grant others the power to expand the number of beneficiaries. The parents can give their children and grandchildren (or others) annual exclusion gifts and/or larger lifetime gifts that consume a portion of their applicable exclusion amount.

For many reasons, a trust may not be the preferred arrangement: duration may be limited by the applicable rule against perpetuities. Where a house is intended to be held in trust for future generations, the trust is often established with an endowment to cover future expenses. As the value of the property increases (which it often does in desirable vacation spots), the endowment may prove to be insufficient to cover expenses. Furthermore, trust terms are more difficult to amend—to adjust to unanticipated changes of circumstance or desires or to add beneficiaries who are not lineal descendants of the settlor—than a tenancy in common or LLC agreement. Similarly, ownership interests cannot be adjusted over time to account for unequal contributions of money or

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[101] *See* P.L.R. 200840038 (Oct. 3, 2008) for a roadmap of how to set up this arrangement.

labor. Finally, where a house is placed in an irrevocable trust by a parent and if the parent then chooses to remain in the home, they must pay fair market rent for that right or the value of the house will be included in their estate at death.[102] Note, however, that contrary to this generally accepted principal that the transferor must pay rent, in *Wineman Estate v. Commissioner*,[103] the decedent/mother transferred a 24% interest in her primary residence to her children, but continued to reside in the home without paying rent. The court held that the gifted interest was not included in her estate under I.R.C. §2036, even though she did not pay even a proportionate share of the rent for use of the property. The court based its decision on the fact that there was no implied understanding between the decedent and the children, she used only a fraction of the property, and she did not exclude the other owners from it. Nevertheless, the safest course is still to have the transferor pay rent.

Trusts also raise fiduciary duty issues. Typically, one generation would be the lifetime beneficiaries of the trust. They may also serve as trustees and make certain decisions that would benefit them individually over the interests of the remainder beneficiaries, violating the fiduciary duty of loyalty. These issues may be avoided by using other types of entities, discussed below.

The advantage of a trust for some families is that it is a familiar arrangement already because of other aspects of their estate planning.

The following drafting suggestions should be considered to avoid inclusion of the trust property in the estate of the grantor under I.R.C. §§2036-2038:[104]

(a) To avoid inclusion under I.R.C. §2036, the trust agreement should express the grantor's intent to relinquish possession and enjoyment of the property, the right to any income from the property, and the right to designate who will enjoy or possess the property or income from the property.

(b) Also to avoid inclusion under I.R.C. §2036, the trust agreement should state that neither its creation nor the distribution of any income from it shall be deemed to discharge or relieve the grantor from the obligation to support a dependent.

(c) To avoid inclusion under I.R.C. §2037, the trust agreement should not permit assets to revert to the grantor under any circumstances.

(d) To avoid inclusion under I.R.C. §2038, the trust agreement should be irrevocable and the grantor should not possess any power to

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[102] I.R.C. §2036.

[103] T.C.M. (CCH) 193 (2000).

[104] Adapted from Alexandra T. Breed & Rose A. Costello, *Camps, Compounds and Cottages: How to Keep Them in the Family, Tax Consequences for Family Compound Planning,* New Hampshire Bar Association 20th Annual Tax Forum (Nov. 15, 2002).

amend, revoke, or terminate the trust or any part of it.

2. Revocable Trusts.

The senior generation may consider using a revocable trust to transfer ownership of the cabin at a later date. A revocable trust offers the senior generation an opportunity to plan for the management of the cabin, without making those plans final because the grantor or grantors retain the right to revoke the trust.

Typically, the parents would serve as the initial trustees, and they would name their successors, should they become unable to serve, or simply choose to resign. Upon the death of the grantor or grantors, the trust would become irrevocable and could continue as an irrevocable trust for the next generation, or it could terminate and distribute its assets to named beneficiaries pursuant to its terms.

For a senior generation starting to plan for transfer of the cabin, but not willing to make those plans irrevocable, the revocable trust is a useful first step.

F. Family Limited Liability Companies.

Formation of a family LLC may provide a useful vehicle for transferring a cabin to younger generations. Consideration must be given to avoiding having the entity disregarded for lack of a business purpose. There are a number of legitimate business purposes that may support the use of an entity in the family LLC context, including facilitating the orderly management of the property and the actual operation of a business, such as rental of the cabin.

1. Transfer of Ownership.

The transfer of membership interests must occur within the framework of the federal gift tax law as annual exclusion gifts or gifts using part of the grantor's lifetime gift tax exemption amount.

Because of the discounts normally available for minority interests and lack of marketability associated with an LLC, such an entity can permit the transfer of assets at a lower gift tax cost than is generally available with respect to direct transfers. In other words, the LLC permits gift and estate tax savings because the LLC interests are valued at less than a pro rata portion of the underlying assets. Gift taxes are generally lower because of the discounted value of the gifted LLC interests, and the LLC interests held at the death of the older generation often are discounted as well, assuming the older generation has retained less than a majority interest.

The value of a percentage interest gift is established in a two-step process. The first step is to value the company property, i.e., the vacation home (and a bank account or other assets owned in the LLC). This is done by obtaining an appraisal from a competent real estate appraiser. The second step is to value the fractional membership interest that constitutes the gift. This requires a second appraisal by a person qualified to value fractional interests in business entities. The second appraisal takes into account the facts that the asset is a minority interest, it lacks control, and little, if any, market exists for such an interest. The result of the second appraisal is likely to be a discounted value of 20% or more from the proportionate share of the total value. Thus, the membership interests typically can be transferred on a very favorable gift tax basis.

2. LLC Management.

Management of an LLC may be by all of the members voting by percentage interests. Alternatively, one or more managers may govern an LLC. A manager form of LLC permits the transfer of ownership interests to other family members while maintaining control in one or only a few areas. Thus, Mom and Dad could name themselves as managers but transfer significant ownership interests to their children. As managers, Mom and Dad retain the right to manage the home, make repairs and improvements, and determine its use schedule, and they may give significant portions of the value of the home to the next generation.

In addition to the gift or estate tax benefits, gifts of LLC interests over time provide for the gradual and orderly transfer of responsibility and management. At the same time, the senior family members may retain significant control over management by naming themselves as managers of the LLC. The LLC agreement may also contain transfer restrictions to prevent a sale to an outside party without unanimous consent of the members.

Unlike trusts in most states, LLCs can have perpetual existence. The controlling documents are much easier to amend than a trust agreement. It is possible to alter LLC ownership, whereas it is not usually an option with trusts. But because the LLC operating agreement may be terminated if all of the members agree, there may be less long-term certainty than the senior generation would like.

3. Liability Protection.

An LLC can protect the underlying assets of the LLC from the claims of creditors in the event of a lawsuit, the bankruptcy of a member, a court judgment, or a tax lien, or from claims of a non-family-member spouse in the event of divorce. The LLC also offers the added advantage of limited liability for its members, even if all of the members are involved in management.

4. Estate Tax Considerations.

Families must consider the effect of I.R.C. §2036, which applies to the transfer of property, except in an arm's-length transaction, where the transferor retains the right to enjoyment or use of the property. In this case, the value of the property transferred would be included in the estate of the transferor, and the entity would be disregarded for estate tax purposes. Accordingly, it is important that family members pay rent to the LLC for the personal use of the cabin based on the applicable fair market rent, and accurate records be kept, to avoid having the LLC disregarded for estate tax purposes.

Where the senior generation retains management control of the LLC and the right to use the cabin, even where fair market rent is paid, the benefit will be closely scrutinized by the IRS.

Under all circumstances, LLC formalities should be followed. This includes timely completion of all required state and local filings and tax returns, holding regular meetings of the members and documenting the decisions made, and preparing resolutions authorizing significant transactions as required by the LLC agreement.

5. Income Tax Considerations.

(a) I.R.C. §121—Exclusion of Capital Gain Upon Sale.

The main disadvantage of the LLC is the loss of the exclusion of capital gain on sale of the property under I.R.C. §121, upon sale of the property. This exclusion is not available if the cabin is sold as an asset of an entity such as an LLC. (The Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, amended I.R.C. §121 (formerly providing a one-time exclusion of gain from sale of a principal residence by an individual who has attained age 55) and permits exclusion of up to $250,000 of gain by an individual or $500,000 by a married couple on the sale or exchange of a principal residence if the property was a principal residence for two of the last five years. For spouses, only one spouse must meet the ownership requirement, but both must meet the use requirement.[105] Any depreciation claimed with respect to the home after May 6, 1997, will reduce the gain eligible for the exclusion.[106] This portion of the gain is taxed at the maximum applicable long-term capital gain rate.)

(b) I.R.C. §280A: Vacation Home Income Tax Rules.

Finally, it is important to note that the vacation home income tax rules of I.R.C. §280A, which provide for the allocation of expenses attributable to a residence between personal and business use, may apply to LLCs holding a family cabin. The application of I.R.C. §280A is not likely to be significant enough to drive the use of a vacation home by a family. But, the consequences should be kept in mind when individuals are able to adjust their usage for income tax purposes.[107]

If a vacation home is rented for less than 15 days during the year, the rental income does not need to be reported, but no offsetting deductions may be taken either.[108] A vacation home is treated as a residence if personal use exceeds the greater of (i) 14 days, or (ii) 10% of the number of days the property is rented to non-family members at fair market rent.[109] In this case, the rental and personal portions of income and expenses are treated as follows:

(1) *Rental Portion*. Rental income may be offset by rent-related deductions. An owner may also claim a depreciation deduction. But, I.R.C. §280A(c)(5)(A) limits the deductions that may be taken currently to the amount of income. Excess losses may be carried forward.[110]

(2) *Personal Portion*. The expenses, mortgage interest and real

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[105] I.R.C. §121(b)(2)(A).

[106] I.R.C. §121(d)(6).

[107] *See* IRS Publication 527: Residential Rental Property (Including Rental of Vacation Homes) (2011) for further information on this topic.

[108] I.R.C. §280A(g).

[109] I.R.C. §280A(d)(1).

[110] I.R.C. §172(b).

estate taxes allocable to personal use are deductible. [111]

If the taxpayer does not rent out the residence at any time during a taxable year, that residence may be treated as a residence for such taxable year whether or not it is actually used by the taxpayer.[112] In other words, a taxpayer may have his actual residence, plus one additional residence for income tax purposes.

Even where the LLC members pay fair market rent for use of the cabin, unless the property is also rented to *non*-LLC members at fair market rent, no deductions may be taken on the partnership income tax return other than for taxes and interest. Prop. Reg. §1.280A-1(e)(5),[113], further limits the ability to take deductions to situations in which the LLC rents to a member as that member's principal residence, which is not likely to be the case with the vacation home.)

A vacation property can be treated primarily as a rental for a year in which personal use does not exceed: (i) 14 days, or (ii) 10% of the number of days the property is rented to non-family members at fair market rent. In this case, the owner's deductions are restricted by the passive loss rules of I.R.C. §469 and not by the vacation home rules described above.

For cabin owners who are able to limit or maximize the number of days the vacation property is used versus rented, there are some planning opportunities. If the cabin owner's adjusted gross income is less than $100,000, he may want to limit use in order to have the property qualify as a rental so that up to $25,000 of rental losses may be deducted against other income.[114] On the other hand, if the cabin owner's adjusted gross income is over $150,000, the $25,000 passive loss deduction is totally phased out.[115] In this case, the cabin owner would be better off having the vacation property qualify as a residence to preserve the mortgage interest and real estate tax deductions. Note also that losses may not be used to offset nonrental income.[116]

(c) <u>1031 Exchange of a Vacation Home</u>.

Like-kind exchanges are not permitted for personal use property.[117] A vacation home or family cabin that is not used as rental property will not qualify for an exchange. Under I.R.C. §280A, a use test is imposed to determine if property is used as a rental on a year-by-year basis. The property is used primarily for personal use if the owner's use exceeds 14 days or 10% of the total rental days, and the property is rented for at least one day during the year. If the owner does not use the property for more than 14 days or less than 10% of the rental days during the year, then the property

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[111] I.R.C. §280A(e).

[112] I.R.C. §163(h)(4)(A)(iii).

[113] 48 Fed. Reg. 33,320-21 (July 21, 1983).

[114] I.R.C. §469(i)(2).

[115] I.R.C. §469(i)(3).

[116] *<u>Ronald J. Lucero and Mary L. Lucero v. Commissioner</u>*, T.C. Memo. 2020-136 (Sept. 29, 2020).

[117] Rev. Rul. 59-229.

can qualify for §1031 treatment.

In Rev. Proc. 2008-16, 2008-10 I.R.B. 547 (Feb. 15, 2008), the IRS announced a safe harbor by which a taxpayer may defer taxes on a vacation home through a §1031 exchange after March 10, 2008.[118] The safe harbor provides that a vacation home can qualify for a §1031 exchange if the following conditions are met:

(1) With respect to the relinquished property:

(a) The taxpayer has owned it for at least 24 months prior to the exchange and in each of the two 12-month periods prior to the exchange the property was rented at fair value for 14 days or more, and

(b) The taxpayer's personal use of the property during the prior two 12-month periods did not exceed the greater of 14 days or 10% of the number of days that the property was rented at a fair rental rate.

(2) With respect to the replacement property:

(a) It is held for at least 24 months after the exchange, and

(b) The personal use and rental for the two subsequent 12-month periods meet the same 14 day/10% test that applies to the relinquished property given up.

Because it is a safe harbor, not following the rules does not preclude a qualifying exchange.

6. Using LLCs to Accomplish an Estate Freeze.

LLCs can be used to "freeze" the value of the property interests retained by the senior generation when other interests are transferred. This type of transaction transfers a property interest that is not likely to appreciate to the senior generation, while transferring an interest in the same property that is likely to appreciate to descendants, either simultaneously or shortly after the first transfer. (I.R.C. chapter 14 and the corresponding regulations impose detailed restrictions on how LLC interests may be structured to ensure that appropriate value is attributed to the senior family members' interests when they have transferred LLC interests to younger family members.[119]) A discussion of estate freezes is beyond the scope of this paper, but it is a useful planning tool to

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[118] *See* Bradley T. Borden & Alex Hamrick, *Like-Kind Exchanges of Personal-Use Residences*, 119 TAX NOTES 1253 (June 23, 2008), for a thorough discussion of this Revenue Procedure. See also *Reesink v. Comm'r*, T.C. Memo 2012-118 (April 23, 2012) where a former primary residence was eligible for exchange treatment and perhaps the most entertaining 1031 case of all time.

[119] Treas. Reg. §25.2701.

consider in connection with structuring an LLC that is intended to be used for gifting.

G. Sales to Family Members.

In addition to the transfer techniques discussed above, property can be sold by the senior generation to members of the next generation. Such a sale should eliminate, from the estate of the senior family member, any appreciation in value of the property. However, the selling-senior generation will receive the sales proceeds, which will be subject to capital gains tax. Eventually, the proceeds and their further appreciation will also be subject to estate tax if not spent or given away prior to death.

It is recommended that an appraisal be obtained to avoid having any portion of the transaction treated as a gift.

Sales can be structured as an outright gift for cash or as an installment sale under I.R.C. §453(b). But, I.R.C. §7872 imputes interest for loans with an interest rate less than the applicable federal rate ("AFR"). There is a risk that the IRS may assert that the difference between the AFR and the stated rate on the promissory note generates both income and gift tax consequences for the seller. The IRS will impute taxable income to the seller and impute a taxable gift received from the seller by the purchaser in the amount of this difference.[120]

1. Sale to a Defective Grantor Trust.

Another technique, the installment sale to an intentionally defective grantor trust ("IDIT"), involves the sale to an irrevocable grantor trust. The IDIT is a grantor trust under I.R.C. §§671-679, for income tax purposes, but it is irrevocable for transfer tax purposes. Therefore, the sale is not recognized for income tax purposes.

As a result, a grantor trust can be that the grantor can pay the trust's income tax, if any (such as income on leases to third parties). This essentially results in a nontaxable gift to the beneficiaries, reducing the grantor's gross estate without incurring gift tax. Under I.R.C. §2036(a)(1), any requirement under the trust instrument that the trustee reimburse the grantor for income taxes paid would cause the trust assets to be included in the grantor's gross estate.

The grantor typically makes a gift to the trust as initial "seed money" or equity so that the trust is not under-capitalized and the transaction is a real sale, and not a sham. The grantor subsequently sells interests in assets, such as the family home (or an entity holding the family home) to the trust in exchange for an interest-only promissory note with a balloon payment at the end of the term. The sale is income tax free, because the trust is "defective" for income tax purposes.

2. Sale in Exchange for a Self-Canceling Installment Note.

The self-canceling installment sale employs the use of a promissory note that, by its express terms,

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[120] *See* Benjamin N. Feder, *The Promissory Note Problem*, 142 TRUSTS & ESTATES 10, 11 (Jan. 2003).

expires upon the death of the payee.[121] As a result, the unpaid balance of the note is reduced to zero at the death of the payee prior to payment in full. Given the uncertainty of collecting all of the payments, the purchase price should reflect "full and adequate consideration," which includes a built-in premium to pay for the risk of not collecting the entire sum. While the IRS has accepted the use of self-canceling installment notes, there is minimal guidance on setting the amount of the risk premium.[122] Because the seller's life expectancy should exceed the payment period, the premium need not be excessively large. Usually, the seller's life expectancy is determined using particular tables. (The table used in this instance is Table I as required under Treas. Reg. §1.72-9.) However, if the seller's actual life expectancy is reduced for known reasons, the risk premium should be increased accordingly. Failure to do so may result in the IRS asserting that the sale is a disguised gift.

3. Sale in Exchange for a Private Annuity.

A private annuity is a contract that provides for specified payments to the named annuitant during the annuitant's lifetime. Typically, one party agrees to transfer property to an individual in return for the right to an annuity payment for life. A private annuity is similar to the self-canceling installment note, except that the payments never cease so long as the annuitant is alive, even if the annuitant outlives their life expectancy. The advantage of the private annuity is that the annuity amount can be determined from IRS valuation tables, eliminating the speculation as to the amount of the periodic payments to be made. However, under newly released regulations, the amount realized attributable to the annuity contract—the fair market value of the contract—is immediately subject to capital gains tax, making it a much less attractive tool.[123] Because a private annuity is essentially a sale in return for a promise to pay—unlike promissory notes used with installment sales—private annuities cannot be secured, putting the annuitant at risk that the buyer may default. Because of the disadvantages of the private annuity, the installment sale and self-canceling installment are likely to be more appealing alternatives to most families.

4. Gift with a Retained Interest.

Keep in mind that once ownership is relinquished during the donor's lifetime, if the donor continues to reside in the home it could be included in her estate at death under I.R.C. §2036 and Treas. Reg. §20.2036-1(c)(1)(i). To avoid this unfortunate result, the donor has a number of options.

The donor could retain a small ownership interest. This would not give the donor exclusive use of the residence, and other owners would have the same right of access and use. A use agreement, discussed in Section VI below, would provide useful evidence as to the arrangement among the

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[121] *See* Edward P. Wojnaroski, *Private Annuities and Self-Canceling Installment Notes,* 805-2d Tax Mgmt. (BNA).

[122] *Est. of Moss v. Comm'r*, 74 T.C. 1239 (1980), *acq. in result*, 1981-1 C.B. 2 & GCM 39,503 (May 7, 1986).

[123] *See Exchanges of Property for an Annuity*, 71 Fed. Reg. 61,441 (proposed Oct. 18, 2006), effective for annuities entered into on or after October 18, 2006. Payments received on contracts predating October 18, 2006, are grandfathered, as are arrangements completed before April 18, 2007, if unsecured, and the property is purchased by an individual and not resold within two years of purchase. Prop. Treas. Reg. §1.1001(j).

parties.

However, sometimes a complete lack of agreement, retention of all incidents of ownership, and every other action one would assume could cause estate inclusion under I.R.C. §2036 – doesn't. In *Estate of Stewart v. Commissioner,*[124] the decedent conveyed a 49% tenancy-in-common interest in New York City property. The decedent and her son resided on the first two floors of the property, and the remaining three floors were leased to an unrelated business. The deed was misplaced by the closing company and not recorded until five months after the decedent's death. The decedent's executors filed a gift tax return to report the gift to the son and included the decedent's 51% interest in the property on the estate tax return. The Service claimed that the entire value of the property was includible in the decedent's gross estate under § 2036(a)(1) because she continued to reside at the property and received all of the rental income from the commercial tenant. The court agreed, holding that the decedent's receipt of the rental income was sufficient to trigger inclusion in her gross estate of the full value of the property. (No mention is made of the impact of her retained occupancy of the property.)

The estate argued that there was an agreement between the decedent and her son to split the profits from the rents at some future point, but the court found the testimony on this point lacked credibility. The estate also argued that it should be entitled to deduct all of the property taxes related to the property even though they were paid by the son. The court held that because the taxes were not due until after the decedent's death, no deduction was permitted. On appeal, a divided Second Circuit vacated the Tax Court's decision and remanded the case for further findings of fact.

The Second Circuit held that the Tax Court was not erroneous in finding "an implied agreement that Decedent would enjoy for her life the substantial *economic* benefit of some part—indeed, perhaps all—of the rental portion of the Manhattan Property." Still, it needed to remand the case to determine "the extent to which Decedent enjoyed the substantial economic benefit of [the son's] 49% interest during her life. And, because the Tax Court did not consider 'all facts and circumstances surrounding the transfer and subsequent use of the property,' it is appropriate to vacate and remand so that the Tax Court may do so."

One has to assume that this case is an anomaly. But it is mentioned here to point out how far some donors are able to go, and also as a road map of what not to do.

H. Lease Back.

The donor could always lease back the residence from the donees. In addition, private letter rulings indicate that a reserved option to lease back property at the end of a QPRT does not create a problem under I.R.C. 2026.[125] A lease through a grantor trust is usually preferable to a lease among the individual owners. A grantor trust simplifies the negotiations between the donor and the donees, and the transaction between the donor and donees would be ignored for income tax

[124] 617 F.3d 148 (2d Cir. Aug. 9, 2010).

[125] P.L.R. 9626041 (Apr. 2, 1996).

purposes.[126] On the other hand, a lease directly between the donor and the donees would cause the rent to be taxable income to the donees.

VI. Ongoing Management of the Cabin.

A. Written Agreements.

Once the property has been transferred to the next generation using any of the methods described above, the family will need to put into place a mechanism to manage the property, resolve conflicts, and facilitate maintenance of the property.[127] This agreement may be in the form of a joint venture agreement, LLC operating agreement, trust agreement, contract, tenants in common agreement, or bylaws. For most families, an agreement where all members have consented to the terms tends to be more successful than an agreement imposed by the senior generation.

Exhibit A is a sample Tenants in Common Agreement that addresses many of the issues discussed below.

B. Issues to Be Addressed.

To assure the smooth operation of the vacation home for the extended family, the agreement needs to facilitate ongoing use and resolve issues that may arise.

The following is an outline of some of the issues that should be addressed in the agreement:[128]

1. How many slots per summer will there be and how long is each slot? Will slots overlap or run contiguously (e.g., Sunday morning to Saturday night)? How is the allocation of slots decided, and by whom? Are certain slots more valuable than others (e.g., Memorial Day, July 4th, and Labor Day weekends)? Are more valuable slots awarded on a rotating basis?

2. If there are more families than slots, how are slots to be assigned or rotated? How is "family unit" defined (e.g., a single person and a partner or friends, the traditional nuclear family, or a senior heir with children and grandchildren)?

3. What about early and late season slots? If one family unit can take one and no one else can (perhaps because they don't have school-age children), can they also be eligible for a prime slot? If someone cannot or chooses not to take a slot when eligible, do they get priority the following year?

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[126] Rev. Rul. 85-13, 1985-1 C.B. 184.

[127] See Louis H. Hamel, Jr., *Keeping a Vacation Home in the Family for Younger Generations*, 23 ESTATE PLANNING 123 (Mar./Apr. 1996), for an analysis of the managerial issues and suggested planning techniques.

[128] Adapted from Ken Huggins & Judith Huggins Balfe, HOW TO PASS IT ON: THE OWNERSHIP AND USE OF SUMMER HOUSES 44-55 (1999) (used with permission from Ken Huggins and the Estate of Judith Huggins Balfe).

4. Who opens and closes the house at the beginning and end of the season? How is this paid for if someone is hired? If family members perform the task, will their compensation be a longer slot, or one in a prime time?

5. As the next generation comes along, at what point (e.g., marriage, death of parents) do they get to have their own slot as opposed to sharing with their parents?

6. At what point will members of the older generation hand over their responsibilities and/or slot to the next generation?

7. Will there be a user's fee per slot to cover the taxes and maintenance? If not, how will each family be assessed their share? Who will serve as financial manager? Should this position be rotated?

8. How may ownership rights be transferred and how will the family deal with the financial crisis of an owner, such as divorce, bankruptcy, judgment, or other event resulting in a lien against the property?

9. What happens if one family unit, due to loss of job, severe illness, etc., is unable to pay their yearly user fee?

10. If there is to be a buy-out, will the rest of the family do this, or just one or two members? If this is to be an association or corporation with multiple shares, is a partial buy-out possible? How many shares could be bought? What would this mean in terms of use?

11. Should family members be allowed to withdraw and sell, and if allowed, how is value determined?

12. What plans could/should be made to make the house more accessible for a family member who is disabled, either through accident, disease, or old age? This is particularly important given the small size and age of many houses.

13. How will maintenance, repairs, and the replacement of improvements be handled? How will an expensive repair, such as a new roof, be paid for? Is it possible to remodel, expand, and add to the house? At what point might this be desirable? How, when, and where will these decisions be made? Who decides when appliances should be replaced and who picks them?

14. How and by whom is it to be decided when furnishings and furniture must be replaced and with what? (This can be among the stickiest of questions. People develop strong attachments to their favorite chair, couch, etc.) How will decorating decisions be made?

15. Who handles legal matters such as any changes in deeds, assessments, and taxes, particularly during the off-season? How should those handling these responsibilities be compensated? With slot time, if at all? Should these

positions be rotated? If so, how?

16. What is "sweat equity" worth and when does it go beyond normal duties? It is unlikely that any formula can be devised for normal duties. Will major jobs (e.g., house painting or re-roofing) be compensated? Will a log be kept of normal tasks and jobs each family unit has done?

17. May certain slots be rented by the whole family to outsiders so as to provide funds for taxes and maintenance? How will this happen? Who will serve as landlord? Can individual family units rent their slot? To whom? Who gets the rental fee? Can individual family units let non-family members use their slot or part of it as a gift? (This is sometimes done as a wedding present or donation to a charity auction.)

18. If elderly family members can no longer use their slots alone, with whom will they stay when they come? How will those members be compensated?

19. Will any property, e.g., a sailboat, be reserved for one family and off-limits for others?

20. What rules will there be regarding pets? What if certain members have animal allergies? Will the use of pesticides or other means of destroying pests be permitted, to which some have ethical or other objections? Similarly, will foods allowed in the house be restricted for religious reasons: non-vegetarian, Kosher, Hallal, non-alcoholic.

21. How will deer, rabbits, and other wild animals be dealt with if they enter onto the property?

22. Will environmental practices be required, such as recycling, the use of non-toxic or biodegradable cleaning products, and long-life (but dimmer) light bulbs? Will any special dispensations be made on grounds of gender, age, or fear of bugs? What about more expensive measures, such as replacing an outdated septic system? Keep in mind that many cabins are located in areas with fragile ecosystems that can be easily damaged.

23. What will be the formal status of in-laws, stepsiblings? In the event of the death of one of the natural heirs, can the surviving spouse assume their role, or will it pass to the offspring? If to the offspring, how old would they have to be?

24. What procedures are to be followed upon exiting the cabin for the next user? See attached *Exhibit B*, a form of Exit Checklist.

25. How can the rules be amended when conditions warrant?

26. What procedure will be used to resolve disputes?

C. Powers of Attorney.

When the senior generation has formulated a transition plan (regarding ownership and/or management) but has not completely implemented the plan, the senior generation may confirm that the agents under their durable powers of attorney will be permitted to do so. Some states require specific provisions in a power of attorney granting authority to make gifts of any type and others require specific provisions authorizing gifts of real property. While the senior generation may have designated particular members of the junior generation under a durable power of attorney, for purposes of maintaining family harmony, they may want to consider appointing multiple children to handle family cabin issues. Also, keep in mind that fiduciary duties may not be delegated under a power of attorney.

VII. Family Homeowners Associations.

If several residences have been built on the family property, or there is a possibility that several could be built, the family ought to consider the formation of a homeowners association to facilitate the ongoing management of the family property. A homeowners association is a formal legal entity created to maintain common areas and facilities and to enforce common covenants and restrictions.

A homeowners association is especially useful where the family intends to create or retain common facilities, such as a dock or swimming pool.

Generally, the procedure to create a homeowners association is to subdivide the property, and cause each lot to be subject to a set of common restrictions and covenants. The rules could:

1. Identify common open space and common use facilities;

2. Restrict or limit development of the affected parcels;

3. Provide guidelines for, or a mechanism to review, construction and development;

4. Establish penalties to encourage compliance; and

5. Restrict transfers or create rights of first refusal if an owner wishes to sell, or if an interest is subject to a bankruptcy or other type of lien.

A homeowners association can be formed as a partnership, LLC, or non-profit association. Typically, each lot owner is required to be a member and pay dues and special assessments. If organized as a non-profit entity, it can qualify for an income tax exemption for revenue received from its members under I.R.C. §501(c)(6) or §528.

The rules and regulations of the homeowners association could be established by the senior generation before transferring the property to the junior generation. Or, the junior generation could jointly develop its own association rules.

VIII. Vacation Homes on Public Land.

A. Federal Land.

1. Historical Background.

Cabins on national forest land have existed since the late 1800's, when national forests were reserves and were administered by the General Land Office in the U.S. Department of the Interior. The first lots for private cabins were authorized by the Forest Management Act of June 4, 1897, also known as the "Organic Act," to encourage public recreation. Beginning in 1915, thousands of permits were issued on national forests near large cities, such as the Mount Baker-Snoqualmie National Forest east of Seattle, the Angeles National Forest adjacent to Los Angeles, California, the Mount Hood National Forest east of Portland, Oregon, and the Black Hills National Forest in South Dakota. Currently there are approximately 14,000 recreation residence permits on National Forest lands, primarily in California, Idaho, Oregon and Washington.

Often National Forest leases have been referred to as "99-year leases." However, there has never actually been a 99-year Forest Service lease. In the early 1900's, some portions of private land were leased for summer homes and subdivisions for 99 years, and some of those leases still exist. Because they were located adjacent to National Forest land in the foothills and mountains, National Forest recreation residence tracts became associated with this type of lease.

2. Permits.

The Forest Service issues recreation residence permits for a maximum of 20 years.[129] Most of the permits involved high-value recreation land. In 1968, in recognition of other recreation needs, the Forest Service decided against establishing any additional new tracts. In 1976, this moratorium was expanded to include no development of new lots within existing tracts. Transfer of permits takes place now only by sale, gift, or inheritance.

The Forest Service Manual provides the rules concerning the issuance and administration of special use permits for recreational residences.[130] Special use permits are subject to a number of strictly construed regulations.

The Forest Service will issue especial use permits for a recreation residence in the name of one individual or to a husband and wife. Where more than one owner is intended (who aren't spouses), a revocable trust may be used, discussed below. The Forest Service will issue no more than one recreation residence special use permit to a single family (which includes a husband, wife, and dependent children). Special use permits will not be issued to commercial enterprises, nonprofit organizations, business associations, corporations, partnerships, or other similar enterprises,

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[129] Forest Service Term Special Use Permit for Recreational Residences Form 2700- 5a, available at https://www.fs.usda.gov/specialuses/documents/FS-2700-5a%20092020Final-RE.pdf.

[130] Forest Service Manual 2700 - Special Uses management, ch. 2700 - Special Uses Administration 2721.23a (eff. August 4, 2011). For recreation residence permits in Alaska, follow the additional requirements in section 1303(d) of the Alaska National Interest Lands Conservation Act. Administer recreation residence permits in accordance with the direction in FSM 2721.23a through 2721.23i and within the broad governing recreation residences and permitted uses set forth in FSM 2347.1 and Title 36, Code of Federal Regulations, section 251.50 (36 CFR 251.50).

except that a tract association may own a caretaker residence.

When a recreation residence is included in an estate, regardless of the testator's intent, a new permit may only be issued to one eligible heir, for the remainder of the original permit term, updated to reflect policy and procedural changes.

There is no guarantee that a new Term Special-Use Permit will be reissued at the end of the stated term. If a permit is not going to be renewed, the Forest Service will give 10 years' notice, and the permit holder will be required to remove all improvements from the lot and restore it to the original conditions at their expense.

A residence under this permit may be used for recreation only and not as a primary residence. In addition, a cabin must be used at least 15 days per year by the permit holder to ensure that the privilege granted by the permit is exercised and the continued use of public land is justified. Rental arrangements must be in writing and approved in advance by the Forest Service. Owners may rent their cabins for a maximum of 14 days per year, with written authorization from the Special Use Administrator.

A permit holder must give notice to the Forest Service Special Use Administrator using Forest Service Form 2700-3a to obtain prior approval of a transfer.[131] If a term permit is issued, the cabin owner will be permitted the remaining number of years on the current term. This allows for a common expiration date for all recreation residences located in the National Forest.

The special use permit does not provide exclusive use of National Forest lands to homeowners. The public is allowed free access for all lawful and proper purposes. Within tracts, the general public may access National Forest lands by walking across lots or parking in areas not under permit. The public does not have the right to use the lands within the permitted "lot boundary" for activities such as picnicking, camping, vehicle travel, or parking. Further information on the history of the Forest Service can be found at https://www.fs.usda.gov/learn/our-history.[132]

3. Trust Agreements.

Since 1995, the Forest Service has allowed recreation residence permits to be held by a revocable trust, but an individual must be named as the trust representative and holder of the term permit. This individual would agree to act in behalf of the trust and to be responsible for the conditions imposed on the trust under the term permit's provisions. This can be a person specifically named in the trust as having the responsibility of the recreation residence. To comply with the Forest Service's requirements for trusts, a Form 2700-3a and form of revocable trust issued by the Forest Service is required, which is Exhibit C, along with its instructions.[133]

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[131] Forest Service Form 2700-3a is available here: FS-2700-3a-20200910.docx (live.com).

[132] *See also* 16 U.S.C. §6214, Cabin User and Transfer Fees (effective Dec. 19, 2014); a summary of the fee structure is available here: https://www.nationalforesthomeowners.org/page/Permit_Fees.

[133] Available at http://www.fs.usda.gov/Internet/FSE_DOCUMENTS/stelprdb5133642.pdf.

B. State Programs.

Some states, including Idaho, Oregon and Washington, regulate cottage leases on state public lands, including forests and water systems.[134]

1. Washington and Oregon.

Washington does not have a recreational cabin program. However, under certain circumstances, Washington does provide for the lease of state lands for residential use.[135] Oregon also provides for recreational cabins on state forest land.[136]

2. Alaska.

The Bureau of Land Management of Alaska manages 72 million acres of public lands. Alaska no longer issues new cabin permits for recreational use, except under limited circumstances.[137] However, Alaska still provides for the building of new cabins on state public land limited to use for trapping purposes.[138] However, Alaska maintains several rustic cabins with primitive amenities, such as wood stoves, propane cook stoves, lanterns and outhouses, throughout the state on public lands, for private use. [139]

IX. Mexican Vacation Homes and *Fideicomisos*

A. Mexican Land Trusts: *Fideicomisos*.

Article 27 of Mexico's constitution requires that only Mexican citizens have the right to own real property in Mexico without restriction. Direct ownership of land by a non-Mexican citizen within 50 kilometers of the coast or within 100 kilometers of the United States, Belize, or Guatemala (together commonly referred to as the "Restricted Zone") is prohibited by the Mexican constitution.[140] A non-Mexican citizen may own land in the interior of Mexico directly provided

[134] *See*, *e.g.*, IDAHO CODE §58-304 (2008), Leases, and IDAHO ADMIN. CODE R. 20.03.13, Rules for Administration of Cottage Site Leases on State Lands.

[135] RCW ch. 79.13.

[136] OAR 141-125-0100(2)(c); OAR 141-125-0120(34).

[137] http://www.blm.gov/ak/st/en/res/pub_room/faqs.html (last visited Aug. 21, 2016).

[138] AS 38.95.080.

[139] More information can be obtained on Alaska public use cabins by contacting the Anchorage Field Office, http://www.blm.gov/ak/st/en/fo/ado/afo.html, or the Fairbanks District Office, http://www.blm.gov/ak/st/en/fo/fdo.html. Additional information on the use of cabins and related structures on Alaska National Wildlife Refuges can be found at 50 CFR 36.33 and http://alaskacenters.gov/upload/alaska-public-use-cabins.pdf.

[140] In May 2013, the Mexican Chamber of Deputies (the lower house of Mexico's Congress) approved a proposal to lift the ban on foreign ownership of real property in the Restricted Zone. The initiative failed as a result of the Congress's failure to continue with the amendment procedure, however. *The Fideicomiso will continue, amendment to Article 27 of the Mexican Constitution has been Rejected*, Yucatan Times (Feb. 9, 2014), *available at* http://www.theyucatantimes.com/2014/02/the-fideicomiso-will-continue-amendment-to-article-27-of-the-mexican-constitution-has-been-rejected/; *see also* Richard Fausset, *A line in the sand over opening Mexico's beaches to foreign*

(continued)

that they agree to certain restrictions, including their promise not to invoke the protection of their home country with regard to the Mexican real property (the "Calvo clause").

To circumvent the prohibition on foreign ownership of property in the Restricted Zone and encourage foreign investment, an individual may enter into a specific type of land trust agreement (called a "fideicomiso") with a bank authorized by the Mexican Secretary of Foreign Affairs ("SRE")[141] to hold title of property on behalf of non-Mexican nationals.[142] The bank takes title to the real property on behalf of the foreign buyer. As trustee, the bank has a fiduciary obligation to follow instructions given by the foreign owner/trust beneficiary. The trust beneficiary retains and enjoys all the rights of ownership while the bank holds title to the property: the foreigner is entitled to use, enjoy, and even sell the property that is held in trust to any eligible purchaser.

The fideicomiso must be registered with the SRE, recorded in a deed, and expire in 50 years or less, but the original term may be renewed as long as certain conditions are met. For example, the beneficiary, terms, and conditions of the trust remain the same and the renewal is made prior to the expiration of the fideicomiso.[143]

It is essential that the foreign purchaser understand the terms and conditions of the fideicomiso so that they may comply with all relevant requirements. Failure to comply could result in fines or even confiscation of the property.[144] For this reason, it is recommended that the beneficiary obtain a reliable translation of the fideicomiso. If the terms of the fideicomiso cause the trust to continue for longer than the current beneficiaries' lifetimes, it is important that remainder beneficiaries are aware of their duties and have a copy of the fideicomiso agreement and translation.

B. Use of a Mexican Will.

Mexico's testamentary formalities are different from those in each of the states, so it is likely that a will executed in the U.S. will not be valid in Mexico. Neither Mexico nor the United States has entered into the any of the major international testamentary successor treaties,[145] so Mexico is under no obligation to honor a will executed in the United States.

It is important to have a Mexican will to govern any property that is not passing as a result of the

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ownership, Los Angeles Times (Oct. 7, 2013), *available at* http://articles.latimes.com/2013/oct/07/world/la-fg-mexico-real-estate-20131007.

[141] In Spanish, this office is called the Secretaria de Relaciones Exteriores.

[142] For additional information on fideicomisos, go to Mexonline.com, *Buying Property in Mexico*, http://www.mexonline.com/propmex.htm (last viewed Apr. 24, 2015).

[143] Jorge A. Vargas, *Mexico's Foreign Investment Act of 1993*, 16 LOY. L.A. INT'L & COMP. L. REV. 907, 943-44 (1994).

[144] Angleynn Meya, *Reverse Migration: Americans in Mexico*, 18 PROB. & PROP. 57 (July/Aug. 2004).

[145] Hague Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of the Clauses of a Will; Convention on the Establishment of a Scheme of Registration of Wills (May 16, 1972); Washington Convention providing a Uniform Law on the Form of the International Will (Oct. 26, 1973) (the "Wills Convention of 1973"). The United States did sign the Wills Convention of 1973, but it did not ratify the convention.

fideicomiso or other non-probate device. For example, any tangible personal property located in the residence would not necessarily pass to the beneficiary of the residence without a Mexican will. Additionally, if the client inadvertently (or clandestinely) becomes a resident of Mexico, if the client did not have a Mexican will, their intangible property may pass under the Mexican intestacy laws even if the client had a will valid in another jurisdiction. A Mexican will could eliminate this ambiguity.

Of course, if a client has two wills, it is important to clearly delineate which assets and liabilities are covered by each will. The situs of assets, particularly intangible assets, can change based on the residence of the client. Moreover, assets in one country could trigger taxes and other expenses in the other country. For example, suppose a wealthy single client owned a property held in a fideicomiso worth $1 million and $2.34 million of additional property in Mexico. The client also had $7 million of property in the United States. The property in Mexico would trigger tax in the U.S. Should that tax be paid from the property in Mexico, the property in the United States, or some combination of the two? The analysis becomes more complex where the Mexican and U.S. beneficiaries differ. Regardless of the answer, planners should ensure that the Mexican and U.S. wills complement each other.

C. Tax Treatment of a *Fideicomiso*.

A recent revenue ruling held that a fideicomiso is not a trust for the purposes of the Internal Revenue Code.[146] The Service ruled that the trustee bank of a fideicomiso was merely an agent for holding and transfer of the real estate. The taxpayer remained liable for tax returns, taxes, and any other liabilities associated with the property. The Service analogized the Mexican fideicomiso to the Illinois land trust, and held that the taxpayer retained ownership for the purposes of the federal income tax.

X. Miscellaneous Planning Opportunities.

A. Life Insurance and Irrevocable Life Insurance Trusts.

In situations where it is available, life insurance can provide an effective means of creating a fund to support maintenance and other expenses associated with cabin ownership.[147]

The taxation of life insurance proceeds can be avoided under present law if a trust owns all incidents of ownership in a policy (e.g., the right to surrender, revoke, assign, pledge, or borrow against the policy or change the beneficiary).[148] A trust holding life insurance is commonly referred to as an irrevocable life insurance trust ("ILIT").

An ILIT is operated as follows: Each year, the grantor transfers money to the trust in an amount slightly greater than the amount sufficient to cover the annual premium on the policy. The

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[146] Rev. Rul. 2013-14, 2013-1 C.B. 1267.

[147] For a comprehensive analysis of life insurance trusts and their uses, see Howard M. Zaritsky & Stephan R. Leimberg, *Tax Planning With Life Insurance: Analysis With Forms* (WG&L).

[148] I.R.C. §101(a)(1).

beneficiaries are given withdrawal rights each year (the right to demand distribution of a stipulated amount of the trust corpus) for a limited period of time following the gifts to the trust, so that each transfer qualifies for the gift tax annual exclusion. This right is known as a "Crummey" right of withdrawal, and its purpose is to qualify the gift as a present interest so it will be eligible for the annual exclusion from gift tax. (In *Crummey v. Commissioner*,[149] the court held that by creating a window of time during which beneficiaries of certain trusts may exercise a demand power to withdraw funds that are added to the trust, the grantor makes the gifts subject to the withdrawal of present interests that qualify for the gift-tax annual exclusion under I.R.C. §2503(b).) Once the beneficiary's withdrawal right expires (assuming it goes unexercised), the funds may be accumulated in the trust. In the first year, the trustee uses the cash to purchase life insurance, typically on the life of the grantor. Thereafter, the trustee uses the cash to pay the annual premium. There are several additional technical requirements that must be observed in order for the proceeds to be excluded from estate taxation.

A potential insured can allocate a portion of their GST exemption to the trust each year when the gifts are made, and by these allocations, the entire trust corpus (including the insurance proceeds payable upon the insured's death) can be sheltered from the GST tax. Generally, the allocations of GST exemption are made with respect to a trust that is structured to remain in existence for the benefit of multiple generations of the donor's descendants. Because the GST exemption is allocated only to the cash transferred to the trust to pay the premiums – and the insurance proceeds usually exceed the total premiums by a substantial amount – the life insurance trust offers an opportunity to "leverage" all or a portion of the GST exemption.

The insurance trust, if established as part of a master plan to transfer ownership of a cabin, can provide that the policy proceeds will continue to be held in the trust and used to maintain the cabin and to cover related expenses.

B. Nonprofit Membership Corporation.

While the author has never seen this in practice, it has been suggested on good authority that it may be possible to rely on Rev. Rul. 67-8, 1967-1 C.B. 142, holding that a nonprofit membership corporation that was formed to bring the members of a particular family into closer association through social and historical activities is exempt under I.R.C. §501(c)(7), as a way to fund the operation of a family cabin. If significant social activities were involved between the members, 67-8 may allow a family to successfully fund a separate entity to support the operation of their vacation property. But note that Rev. Rul. 80-302, 1980-2 C.B. 182, denies exemption under I.R.C. §501(c)(3) to an organization doing genealogical research for one family.

XI. Conclusion.

The family cabin is an asset that often serves as a symbol of a family's history, emotions, and values. It is important to recognize that the cabin may also embody negative emotions for other family members. While some cabins are likely to be retained by succeeding generations, others

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[149] 397 F.2d 82 (9th Cir. 1968).

will be sold because the younger generation cannot get along with each other, have no emotional attachments to it, cannot agree on how to retain it, or simply cannot afford it. Understanding the attitudes toward the cabin held by various family members and building consensus is critical to assist the family in developing a master plan to transfer and to continue to happily own the cabin, if that is the goal.

EXHIBIT A
TENANTS IN COMMON AGREEMENT

THIS TENANTS IN COMMON AGREEMENT (the “Agreement”) is dated and effective this [_____] day of [_____], 20__. The parties (the “Parties”) to this Agreement are [_______] and [______], the undersigned individuals.

RECITALS

A. The Parties have acquired undivided interests in certain recreational property located in King County, Washington, which is more fully described in *Exhibit A* attached to and made a part of this Agreement (the “Property”). The Parties’ percentage ownership interests in the Property are set forth in *Exhibit B* attached to and made a part of this Agreement (collectively the “Ownership Interests” and individually an “Ownership Interest”).

B. The Parties have determined that it is in their mutual best interests to limit and establish procedures under which the Parties may dispose of or transfer their Ownership Interests in the Property, without prohibiting such dispositions or transfers, and to provide for the disposition of the Property upon the approval of less than all of the Parties.

C. It is the Parties’ hope that the property will be maintained for use by their respective descendants, but they also recognize that due to unforeseeable circumstances this may not be possible or appropriate.

D. The Parties desire to facilitate the convenient and orderly use and maintenance of the Property by providing for one (1) of the Parties to act as a Managing Owner of the Property (the “Managing Owner”). [**ALTERNATE**: The Parties desire to facilitate the convenient and orderly use and maintenance of the Property by the family groups who own the Property.]

E. The Parties further desire to facilitate the speedy and mutually satisfactory resolution of disputes that can be anticipated in any family, especially one that owns property together and the Parties hope that this understanding is kept in mind by their descendants when the inevitable dispute does occur.

NOW, THEREFORE, the Parties agree as follows:

I. Definitions.

The following terms shall have the following meanings as used in this Agreement:

A. Owner. The term “Owner” shall mean one or more individuals designated on *Exhibit B* as holding a specific Ownership Interest in the Property, or the successors in interest to such individuals, all of whom are descendants of Matriarch and Patriarch. [**ALTERNATE**: The term “Owner” means the individuals designated on *Exhibit B* as holding a specific Ownership Interest in the Property, or the successors in interest to such individuals.]

B. Permitted Owner. The term “Permitted Owner” shall mean descendants of

Matriarch and Patriarch [and spouses of the descendants of Matriarch and Patriarch].

1. In the case of two or more individuals holding a single specified Ownership Interest, such individuals shall collectively constitute the Owner, such that all rights of an Owner pursuant to this Agreement shall be jointly exercised by such individuals, and all obligations of an Owner shall be joint and several as between such individuals.

2. If a single specified Ownership Interest is owned by a trust, the beneficiaries of the trust may select the trustee as their Owner Representative.

3. If an Ownership Interest has been divided into a life estate and a remainder interest, the owner of the life estate shall be treated as the Owner under this Agreement as long as the life tenant is living and not incapacitated.

4. For purposes of this Agreement, a person shall be incapacitated if at least two (2) licensed physicians, each of whom has personally examined the person, signs a written certification that the examined individual is physically or mentally incapable of managing their affairs, whether or not there is an adjudication of incapacity. This certification need not indicate any cause for the incapacity. A certification of incapacity may be rescinded by written statement signed by at least two (2) licensed physicians, each of whom has personally examined the person, and at least one (1) of whom is board certified in the specialty most closely associated with the former incapacity.

C. <u>Initial Owners</u>. The initial Owners are the living children of Patriarch and Matriarch. At any time there may be no more than the initial number of Owners, so that the Managing Owner (as defined in Section VII below) may treat each living child of the Patriarch and Matriarch who is not incapacitated as the representative owner ("Owner Representative") for purposes of voting and scheduling for their immediate family.

D. <u>Appointment of Successor Owner Representative</u>. On the earlier of the incapacity or death of a child of Patriarch and Matriarch, and any other time as determined by mutual agreement of the child and their family, the immediate family of that child must notify the other Owners/Managing Member of its election of a successor Owner Representative for purposes of voting and scheduling pursuant to this Agreement within ninety (90) days of the prior Owner Representative's incapacity or death, and every three years thereafter. In default of such election, the successor Owner Representative shall be [the child's spouse, if living and not incapacitated, or, if none,] the child's oldest living adult descendant who is a descendant of Matriarch and Patriarch (or the legal guardian of any such descendant who is a minor).

E. Remaining Owners. The term "Remaining Owners" means all of the Owners other than a Selling Owner, as that term is defined below.

F. Selling Owner. The term "Selling Owner" means any Owner desiring to Transfer all or any portion of their Ownership Interest in the Property.

G. Transfer. The term "Transfer" means any voluntary or involuntary disposition, sale, assignment, gift, conveyance pursuant to foreclosure of a security interest (judicially, non-judicially, or otherwise), mortgage or other debt encumbrance or other transfer.

II. **Limitation on Disposition and Partition; Dissolution.**

A. Limitation on Disposition. An Owner may Transfer all or any portion of their respective Ownership Interest in the Property only as provided in this Agreement or with the written consent of all of the other Owners. Any attempt to Transfer any Ownership Interest without either such consent or compliance with the terms of this Agreement shall be void and of no effect.

B. Waiver of Partition. The Parties acknowledge that the provisions of this Agreement are intended and considered to provide for common use of the Property in a manner which minimizes the uncertainties and disputes regarding management, use and disposition which are inherent in tenancy-in-common ownership of property, and expressly waive any right to seek a partition of all or any portion of the Property, or for a sale of all or any portion of the Property, regardless of whether either of such remedies is specifically provided for by statute or otherwise. The Parties acknowledge that such right to seek a partition or sale is unnecessary to protect the interests of the Owners and would result in a great prejudice to all of the Remaining Owners. **ALTERNATE [**The Owners agree generally that any Owner shall have the right, while this Agreement remains in effect, to file a complaint or institute any proceeding at law or in equity to have the Property partitioned in accordance with and to the extent provided by applicable law. The Owners acknowledge and agree that partition of the Property may result in a forced sale by all of the Owners.**]**

C. Temporary Restriction on Disposition. No Owner may Transfer all or any portion of their respective Ownership Interest in the Property to Non Owner(s) until such Transferring Owner has reached the age of thirty (30) years without the consent of the other Owners.

D. [Dissolution of Marriage/Domestic Partnership. In the event of the dissolution of the marriage/domestic partnership of a couple who share an Ownership Interest in the Property, only one, but not both, of the members of that couple may continue to be Owners. The name of the continuing Owner shall be furnished in writing signed by both members of the couple to the Managing Owner. In the event the couple cannot agree on which of them shall continue as an Owner, and such disagreement continues until the judgment ordering the dissolution becomes final, then within ten (10) days thereafter the former

couple shall offer their Ownership Interest in the Property for sale to Remaining Owners as provided in Section IV.]

III. Transfers to Owners. Any Owner may at any time Transfer all or any portion of such Owner's Ownership Interest to any Permitted Owner or Permitted Owners, or to a trust for the benefit of such individual(s), subject only to the provisions of Section X.B. of this Agreement. Provided, however, in the event any Owner transfers all or any portion of their Ownership Interest to any other Owner or Owners, or to a descendant or descendants of an Owner, then they shall immediately notify all Remaining Owners in writing of the name of the new Owner, the effective date of the transfer, and the Ownership Interest transferred to the new Owner.

IV. Option to Purchase Ownership Interest.

A. Transfers Affected By This Section. The following provisions apply to all Transfers of Ownership Interest, except those defined at Section III immediately above.

1. In the event that any Owner at any time desires to Transfer all or any portion of such Owner's Ownership Interest in the Property, the Remaining Owners will have an option to purchase ("Purchase Option") all (but not less than all) of the Ownership Interest the Selling Owner desires to transfer, as provided in this Section IV.

2. In the event that any Owner's interest is transferred to a non-owner as the result of a divorce or bankruptcy, the Remaining Owners will have an option to purchase ("Purchase Option") all (but not less than all) of the Ownership Interest the Selling Owner desires to transfer, as provided in this Section IV.

B. Notice of Sale. Prior to providing notice of a bona fide offer to the Remaining Owners in accordance with the Right of First Refusal provisions of Section V, the Selling Owner will notify the Remaining Owners, in writing, advising them of such desire to sell all or any portion of the Ownership Interest. The Remaining Owners will have the Option to purchase such Ownership Interest by giving written notice to the Selling Owner within thirty (30) days after receipt of such notice, for the Sale Price set forth in Section IV.C. of this Agreement and under the terms and conditions set forth in Section IV.D. of this Agreement.

C. Sale Price. The "Sale Price" of an Ownership Interest shall mean ninety percent (90%) of the fair market value of the Property ("FMV") determined in accordance with the provisions of this Section IV multiplied by the Selling Owner's Ownership Interest.

1. Value Established by Owners. The Owners shall be entitled to establish the FMV by unanimous consent of all the Owners, and shall negotiate in good faith in an attempt to so establish such value. In the event the FMV is established by such unanimous consent, it will be

binding and conclusive upon all of the Owners and their respective personal representatives, successors and assigns for a period of one (1) year following the date such FMV is established.

2. Appraisal. In the event that no FMV has been established and is effective as provided in Section IV.C.1, any Owner shall be entitled to give notice to that effect, in which event the FMV shall be determined by valuation by an appraiser selected by unanimous consent of the Owners. In the event the Owners cannot agree on an appraiser, the valuation shall be by two (2) appraisers, one selected by the Selling Owner and one selected by the Remaining Owners. If the values determined by such appraisers differ by 5% or less based on the lower appraisal, the FMV shall be the average of the two appraised values. If the values differ by more than five percent (5%), each appraiser shall select a third appraiser, whose sole authority shall be to determine which of the two appraisals most closely reflects the FMV and such determination shall be final, conclusive and binding on all of the Owners. Each appraiser shall be licensed appraisers or brokers with not less than ten (10) years professional real estate experience in [_____] County, Washington. The cost of appraisers under this section shall be shared equally by the Selling Owner, on the one hand, and the Remaining Owners, on the other, irrespective of outcome. [**ALTERNATE**: Tax Assessed Value. In the event that no FMV has been established and is effective as provided in Section IV.C.1., any Owner shall be entitled to give notice to that effect, in which event the FMV shall be the tax assessed value as determined for the most recent tax year.]

D. Purchase Terms. At closing of the sale, not less than twenty percent (20%) of the Sale Price will be payable by the Remaining Owners in cash and the balance pursuant to one or more promissory notes to the Selling Owner providing for the balance of the Sale Price in equal monthly installments over a term of ten (10) years or less, the principal of which shall accrue interest at the then existing Applicable Federal Rate within the meaning of I.R.C. §1274(d). Upon request of a Selling Owner, such note or notes shall be secured by a trust deed, mortgage or other perfected security interest in the pro rata portion of the Seller's Ownership Interest in the Property that is being sold. The sale of the Selling Owner's Ownership Interest pursuant to this Section IV shall close on or before the twentieth (20th) business day following the date that the FMV has been determined.

E. Pro Rata Obligation By Remaining Owners. The Purchase Option of the Remaining Owners to purchase any Selling Owner's Ownership Interest, as provided by this Section IV shall be pro rata based upon the proportionate Ownership Interests held by the Remaining Owners. In the event any Remaining Owner fails to exercise this Option, the other Remaining Owners shall be entitled to exercise such Option pro rata based upon the proportionate Ownership Interests of such other Remaining Owners.

ALTERNATES: [Buy/Sell Option. Each Owner (the "Offeror") shall have the right, in its, their discretion, to irrevocably and unconditionally offer to the other Owners (the "Offeree"), in a writing delivered to the Offeree, to purchase all (but not less than all) of the Ownership Interest of the Offeree (the "Offer"). The Sale Price shall be no less than the amount determined in accordance with Section IV.C below.

1. Ver. 1.: Upon receipt of the Offer, the Offeree shall have fifteen (15) days to elect in writing (the "Election to Purchase"), delivered to the Offeror, to purchase all (but not less than all) of the Ownership Interest of the Offeror at the same price and on the same terms and conditions as the Offeror provided in the Offer. In the event that the Offeree delivers to the Offeror a timely Election to Purchase, the Offeror shall be required to sell its, their Ownership Interest to the Offeree under the terms and conditions of the Election to Purchase. If the Offeree does not deliver a timely Election to Purchase, the Offeree shall be required to sell its, their Ownership Interest to the Offeror under the terms and conditions of the Offer. In either case, the transfer of the Ownership Interest shall take place after not less than fifteen (15) business days or more than forty-five (45) calendar days from the expiration period of the Offer, or the date of delivery of the Election to Purchase received by the Offeror, as the case may be.

2. Ver. 2: Upon receipt of the Offer, the Offeree shall have fifteen (15) days to reject the Offer in writing. If the Offeree does not deliver a timely rejection of the Offer, the Offeree shall be required to sell all (but not less than all) of its, their Ownership Interest to the Offeror under the terms and conditions of the Offer. In such case, the transfer of the Ownership Interest shall take place after not less than fifteen (15) business days or more than forty-five (45) calendar days from the expiration period of the Offer.

At the closing of the purchase of the Ownership Interest, the selling Owner shall deliver a quit claim deed and such other written instruments of transfer as may be necessary or advisable to transfer such Ownership Interest to the purchasing Owner, all in a form reasonably satisfactory to the purchasing Owner, duly executed by the selling Owner, free and clear of any liens and adverse claims other than as set forth in the Offer.

V. Right of First Refusal in the Event that The Remaining Owners Have Not Exercised the Purchase Option.

A. Right of First Refusal. In the event that any Owner at any time intends to Transfer, for any consideration whatsoever, all or any portion of their Ownership Interest in the Property, and the Remaining Owners have not exercised the Purchase Option, the Remaining Owners will have the right of first refusal to purchase such interest, as provided in this Section V.A ("Right of First Refusal").

B. <u>Notice of Bona Fide Offer</u>. The provisions of this Section V.A will apply if and when the Selling Owner obtains a bona fide offer of purchase, in writing, setting forth in detail a description of what is being offered for sale and the price, terms and conditions of such offer to purchase ("Offer"). The Selling Owner will notify the Remaining Owners in writing advising them of the Offer and of the Selling Owner's intention to accept the Offer, and will furnish a copy of the offer to each of the Owners. The Remaining Owners will have the right, for a period of thirty (30) days after receipt of such notice, to purchase all, but not less than all, of the portion of the Selling Owner's Ownership Interest subject to the Offer ("Offered Interest") for the same price and upon the same terms and conditions as are set forth in the offer. Such thirty (30) day period shall not commence until the expiration of the period of thirty (30) days to exercise the Purchase Option, as provided for in Section IV.B.

C. <u>Pro Rata Exercise By Remaining Owners</u>. In the event more than one Remaining Owner wishes to exercise the Right of First Refusal, the rights of each of such Remaining Owners under this Section V. shall be limited to a pro rata amount of the Offered Interest, based upon the proportionate Ownership Interests held by those of the Remaining Owners wishing to exercise the Right of First Refusal.

D. <u>Failure to Exercise</u>. If the Remaining Owners fail to exercise the Right of First Refusal with respect to all of the Offered Interest within the specified 30-day period, then the Selling Owner may sell the Offered Interest subject to the Offer in accordance with its terms and conditions, provided such sale occurs within ninety (90) days after the end of such 30-day period. The failure of such sale to occur within such 90-day period shall require such Offered Interest to be again subject to the provisions of this Section V. Following such sale, the new owner shall be the deemed Owner for purposes of this Agreement.

VI. <u>Agreement to Transfer the Property for Full Consideration</u>.

One-hundred percent (100%) of the Ownership Interests in the Property may be sold or otherwise Transferred for consideration equal to its then fair market value upon the unanimous consent of the Owners, and the proceeds distributed to the Owners in proportion to their Ownership Interest. Upon the occurrence and notice of any such consent, each Owner agrees to execute any and all documents, instruments and agreements reasonably necessary to effectuate such approved disposition of the Property. The Parties agree that any Owner's breach of this Section VI by failing to execute any and all documents, instruments and agreements necessary to effectuate any such approved encumbrance or disposition would cause irreparable damage to the other Parties, and the recovery by the other Parties of money damages may not constitute an adequate remedy for such breach. Accordingly, the Parties agree that the agreements contained in this Section VI may be specifically enforced against any of them in addition to any other rights and remedies available to the other Parties on account of any such breach.

VII. Management of the Property.

A. Management by Majority Vote of Owners. Prior to the death of the last surviving child of Patriarch and Matriarch who is an initial Owner, all decisions affecting the management of the Property shall be made by a majority vote of the Owners, based on the affirmative vote of the Owner Representative for each Owner; provided that any decision to sell the Property; mortgage or otherwise pledge an interest in the Property as security for a loan; perform a substantial renovation of the Property (meaning a renovation costing, in total, more than one-half of the assessed value of the property); or demolish the Property, shall require the unanimous approval of the Owners by an affirmative vote of the Owner Representatives for each Owner. An "affirmative vote" shall be made at a meeting of the Owner Representatives (whether in person or by phone, email, or other electronic communication) held after 15 days' prior notice unless the Owners agree otherwise in advance.

B. Appointment and Succession of Managing Owners.

1. By entering into this Agreement, each Owner agrees to the appointment of [_____] as the initial Managing Owner of the Property. [**ALTERNATE**: Upon the death of the last surviving child of Patriarch and Matriarch who is an initial Owner, unless the remaining Owners agree otherwise, the Owners shall elect a Managing Owner of the Property, who shall manage the Property pursuant to the provisions of this Article.]

2. Unless the Owners unanimously agree otherwise, the Managing Owner shall be an Owner who is an adult descendant of Patriarch and Matriarch selected by the affirmative vote of a majority of the Owner Representatives.

3. The Managing Owner shall serve a 3-year term. To the extent practicable, the office of Managing Owner shall rotate among the Owners or groups of Owners consisting of at least one adult descendant of Patriarch and Matriarch so that each Owner or group of Owners will have an equal opportunity to select one of its members to serve as Managing Owner.

4. The Managing Owner may resign at any time and shall cease to be a Managing Owner upon their death or incapacity.

5. A Managing Owner may appoint a successor from among the Owners to finish out their term, in writing. If no successor Managing Owner has been so appointed, a successor may be designated upon the written approval of Owners holding two-thirds (2/3) of the Ownership Interests.

6. Each Owner agrees to execute any and all documents, instruments and

agreements reasonably necessary to effectuate a termination of the Managing Owner and designation of a successor Managing Owner of the Property.

C. Removal of Managing Owner. A Managing Owner may be terminated by written notice signed by a majority of the number of Owners, excluding the then Managing Owner.

D. Functions of Managing Owner.

1. Maintain the schedule of use for each calendar year.

2. Allocate maintenance projects as discussed in greater detail below.

3. Maintain the Property in its current condition, including maintenance of roof, plumbing, electrical, and HVAC systems; floor, wall and window coverings; lighting; appliances; and landscaping (capital improvements to be made only with authorization unless urgent or to protect the Property).

4. Maintain insurance (property and casualty) with specified coverage and limits (and additional insurance if the cabin is to be rented to non-owners or as otherwise determined by the Managing Owner in his reasonable discretion) at a minimum as follows:

   (a) Fire and extended coverage insurance on the improvements to the extent of 90% of replacement.

   (b) Liability insurance in amounts of not less than $500,000 with respect to injuries or death of one person, $500,000 with respect of any one accident, and $500,000 with respect of property damage.

5. Pay taxes, encumbrances, and other specified charges.

6. Lease the Property, with specific authorization, to tenants.

7. Take reasonable compensation and reimbursement for reasonable expenses.

8. Keep records regarding expenses, assessments and budgeting as indicated in greater detail below.

9. Vote on each matter submitted to a vote of the ___________ Homeowner's Association as instructed by Owners holding a majority of the Ownership Interests in the Property, or if a majority vote cannot be obtained then the Managing Owner shall vote as he/she deems appropriate and reasonable under the circumstances.

10. Notify third-party cleaning services and third-party snowplow services

if an Owner's family will not be using the Property for a particular use period.

11. Retain third-party management services as deemed appropriate by the Managing Owner.

E. Maintenance Projects. The Managing Owner may assign reasonable projects to be accomplished by each Owner to maintain the Property (i.e. painting, yard work, minor repair, etc.). The performance of these projects by Owners will help keep the annual assessments to a minimum. If an Owner does not fulfill their project goals, the Managing Owner shall have the right to hire outside firms or individuals to do that work and include the expense in that Owner's assessment the next year.

F. Budget and Accounting. The Managing Owner shall by April 1 of each year prepare and distribute to the Owners a line item budget estimating the funds needed for general maintenance, of the Property, its repairs, necessary capital expenditures, payments of taxes, insurance, utilities, fees, etc., for the subsequent twelve (12) calendar months plus the maintenance of a reasonable reserve fund for the payment of capital expenditures reasonably expected over the subsequent sixty (60) months. This reserve fund shall initially be in the amount of Ten Thousand Dollars ($10,000) plus the cost of the anticipated expenditures set out in *Exhibit C* ("Anticipated Expenditures"). The budget distributed by Managing Owner shall be accompanied by a statement of income, expenses and disbursements for the previous calendar year. If no objections to the budget are received by the Managing Owner within 30 days of the distribution of the budget to the Owners, the budget shall be deemed approved. If any objections are received that cannot be resolved within 60 days of the distribution of the budget to the Owners, the approved budget shall be the budget from the previous year plus 10%.

G. Assessments. Based upon the budget and projected income, the Managing Owner shall by April 1 of each year, assess to each Owner a percentage equal to each Owner's Ownership Interest of the anticipated additional needed funds to cover all expenses for the current calendar year, said payment to be due on May 1 of that year. In the event of failure of the Managing Owner to make an assessment in a year or determine that no assessment is necessary, the assessment for that year shall be the same as the previous year plus ten percent (10%). Each Owner shall decide among their immediate family how the assessment is to be satisfied.

H. Obligation of Owners to Managing Owner:

1. All other Owners shall, at all times, provide reasonable assistance to the Managing Owner with respect to the Managing Owner's functions.

2. Notwithstanding any prior assessments made by the Managing Owner, upon reasonable notice to the Owners by the Managing Owner, each Owner shall provide sufficient funds to the Managing Owner to allow

the Managing Owner to make, on a timely basis, all payments reasonably required for the operation and maintenance of the Property, and to maintain a contingency reserve balance of cash on hand in an amount determined by the Managing Owner to be reasonable and appropriate under the circumstances, which amount shall in no case be less than Ten Thousand Dollars ($10,000), provided that capital expenditures shall be paid for out of the reserve to the extent of funds therein The Managing Owner shall incur no liability with respect to other Owners or non-Owners relating to the performance of his/her functions as Managing Owner.

3. If an Owner fails to meet its full assessment by May 1 of a given year, such Owner shall incur a late payment fee of ten percent (10%) of the amount of the assessment and interest on the amount of the assessment plus the late payment fee at the rate of eight percent (8%) per annum until paid, unless the Managing Owner decides otherwise.

4. If an Owner fails to pay his/her full assessment within ____ days of the date of the assessment, that Owner forfeits all rights to the use of the Property for the rest of that calendar year, unless the Managing Owner decides otherwise. If such forfeiture is enforced by the Managing Owner, the other Owners may obtain the forfeited rights of the nonpaying Owner by contributing the funds not paid by the nonpaying Owner; provided, however, the interest and late fee shall be waived.

5. Notwithstanding the foregoing, if there is a bona fide dispute regarding the amount due no interest shall accrue, use rights shall not be forfeited as otherwise provided above, until such dispute is settled pursuant to the dispute resolution provisions provided for herein, or by mutual agreement of the Owners.

6. Notify the Managing Owner or third-party cleaning services and third-party snowplow services if an Owner's family will not be using the Property for a particular use period.

I. Limitations on Managing Owner. The following limitations on the Managing Owner shall apply:

1. Any sale or borrowing against the Property must be unanimously approved in writing by the Owners, or

2. Any improvement of the Property requiring the expenditure of One Thousand Dollars ($1,000) or more may be made only upon the unanimous, written consent of all Owners, unless, in the reasonable discretion of the Managing Owner, such expenditures are required to protect the Property in an emergency; provided, however, if the Owners have approved a budget that includes such expense, then it need only be approved if the expense represents a change to that

previously-approved budget.

3. An expenditure of less than One Thousand Dollars ($1,000), which the Managing Owner determines is necessary and reasonable may be made by any Owner without the consent of the other Owners.

4. Owners shall vote on all other nonroutine events, including but not limited to renting the Property to a non-Owner, the use of the Property by a non-owner, and amending the rules or operating agreement.

5. Owners have the right to call a meeting to review the decisions of the Managing Owner and generally to provide a safeguard against arbitrary management.

VIII. Allocation of Use of Property.

A. Allocation. By entering into this Agreement, each Owner hereby agrees that, with respect to any calendar year, each Owner shall have the right to the occupancy and other use of the Property for one or more periods cumulatively equal to, but not in excess of, such Owner's Percentage Interest multiplied by the number of days in such year. Each Owner agrees to negotiate in good faith with all other Owners to allocate use by one or more Owners at various times during each calendar year so that use fairly and equitably takes into account each Owner's Percentage Interest and the days during each year during which use is feasible and desirable. In the event the Owners are unable, in the judgment of the Managing Owner, to so allocate use of the Property, the Managing Owner shall make such allocation, and all Owners shall be bound thereby. Except with the consent of all Owners, such use must consist of personal use by the Owner or by the Owner's spouse or family. [**ALTERNATE**: The Property shall be used for recreational and residential purposes and for no other purposes, including without limitation, business commercial purposes, or storage purposes.]

1. There shall be fifty-two (52) use periods in each calendar year, each period being of equal duration and referred to herein as a "Use Period." The term of each Use Period shall consist of seven consecutive days, commencing at 4:00 pm on Wednesday of each week and ending at 4:00 pm on Wednesday of the following week.

2. Each Owner shall be entitled to one Use Period out each three (3) consecutive Use Periods, beginning with the first Use Period of each calendar year.

3. Each Owner shall be entitled to two (2) Use Periods in each calendar year each of which contains one of the following holidays: New Year's Eve/Day, President's Day, Memorial Day, July 4th, Labor Day, Thanksgiving Day, [insert applicable school and religious holidays, opening day of hunting, fishing, boating season]. No Owner shall be entitled to consecutive Use Periods encompassing Christmas Day and

New Year's Day/Eve without the prior consent of the remaining parties.

4. At the conclusion of the occupancy of each Owner, such party shall be responsible for fully and thoroughly cleaning the Property in preparation for occupancy by the next Owner.

5. If all of the Use Period of an Owner is not used during any calendar year or years, the unused portion may be accrued, up to a maximum period of six (6) months, and used in subsequent calendar years provided the unanimous consent of all Owners is obtained for the specific use of same.

6. If all Owners consent, an Owner may occupy the Property for a period in excess of the Use Period at a previously agreed rental. The agreed rental shall be determined by considering all of the following factors: market value rent; property expenses; benefits to the co-tenancy resulting from occupancy such as security, maintenance and repairs which would discount the market value rent.

7. Owners may exchange Use Periods.

8. On or before [_____] of each calendar year, the Managing Owner shall distribute to the other Owners a list of Use Periods for the subsequent calendar year. Within Fifteen (15) days thereafter, the Owners shall meet in person or by teleconference to select Use Periods for the subsequent calendar year, which shall be done by each Owner drawing lots to determine who among them shall select first, and such Owner so determined to select first shall select one Use Period, and then the next Owner in the order so determined shall select one Use Period, and so on, until each Use Period has been selected.

9. Use of the Property by an Owner may include invited guests and spouses if accompanied by an Owner.

B. Use Restrictions.

1. The Property shall be used for recreational and residential purposes and for no other purposes, including without limitation, business/commercial or storage purposes.

2. At the conclusion of the occupancy of each Owner or Owner's permitted guest(s), such Owner or their designee shall be responsible for fully and thoroughly cleaning the Property in preparation for occupancy by the next Owner, and completing an Exit Checklist, by initialing and dating to indicate completion of each item on the checklist, a copy of which is attached as *Exhibit D*.

3. Use of the Property by an Owner may include spouses as well as

invited guests (but guests must be accompanied by an Owner unless the other Owners consent in advance).

4. A surviving spouse of an Owner may use and occupy the Property only if accompanied by the successor to such Owner's Ownership Interest.

5. No Owner shall permit smoking or the use of illegal substances on the Property.

6. No owner shall permit pets in the residence on the Property, with the exception of necessary trained companion animals.

7. No Owner shall make any alterations, changes or additions to the real property and its improvements, including, without limitation, bulldozing or paving roads, cutting trees, drilling wells, or constructing new improvements or making additions to existing improvements, except as otherwise permitted by the terms of this Agreement.

8. If damage to or destruction of the Property, caused by an Owner, its guests, invitees or licensees, whether through negligence or otherwise, such Owner shall be solely liable to the other Owners for the cost of repair and restoration of the Property to its pre-existing condition to the extent the same is not covered by insurance. Any repair or improvement to the Property shall be completed in accordance with all laws, ordinances, rules and requirements for such repairs and improvements, and no such repair or improvement shall negatively affect the fair market value of the Property.

9. Each Owner will each be allocated a closet, designated kitchen storage and basement storage. Items that one Owner does not wish to share with the other Owners shall be stored in one of those three places when such Owner is not in residence.

10. The Property is subject to the [_____] Master Design recorded [_____], under recording number [_____] in [_____] County and is subject to the covenants, conditions and restrictions of the [_____] Homeowner's Association. The Property shall at all times be owned, occupied and maintained pursuant to such Final Master Design, CC&R's, and any other rules, regulations and declarations issued thereunder and amendments thereto.

IX. <u>Dispute Resolution.</u>

The Owners have entered into this Agreement in good faith and in the belief that it is mutually advantageous to them. It is with that same spirit of cooperation that they pledge to attempt to resolve any dispute amicably without the necessity of litigation.

A. <u>Procedure for Initiating Dispute Resolution</u>. The Owner(s) seeking to initiate

the Procedure (the "Initiating Owner" whether one or more) shall give written notice to the other Owner(s), describing in general terms the nature of the Dispute, the Initiating Owner's claim for relief, and identifying one or more individuals with authority to settle the Dispute on such Owner's behalf. The Owner(s) receiving such notice (the "Responding Owner" whether one or more) shall have five (5) business days within which to designate by written notice to the Initiating Owner one or more individuals with authority to settle the Dispute on such Owner's behalf. The individuals so designated shall be known as the "Authorized Individuals." The Initiating Owner and the Responding Owner shall collectively be referred to as the "Disputing Owners" or, individually, as the "Disputing Owner."

B. Mediation. The parties agree that if any dispute arises between them relating to this Agreement (the "Dispute"), they will first use the mediation procedures specified in this Article (the "Procedure") prior to commencing additional proceedings as defined below.

1. In the mediation, each Disputing Owner shall be represented by an Authorized Individual and may be represented by counsel. In addition, each Disputing Owner may, with permission of the mediator, bring such additional Persons as needed to respond to questions, contribute information, and participate in the negotiations. The Disputing Owners agree to sign a document that provides that the mediator shall be governed by the provisions of Washington law and such other rules as the mediator shall prescribe. The Disputing Owners commit to participate in the proceedings in good faith with the intention of resolving the Dispute if at all possible.

2. The Disputing Owners agree to participate in good faith in the mediation procedure to its conclusion. The mediation shall be terminated (i) by the execution of a settlement agreement by the Disputing Owners, (ii) by a declaration of the mediator that the mediation is terminated, or (iii) by a written declaration of a Disputing Owner to the effect that the mediation process is terminated at the conclusion of one full day's mediation session. Even if the mediation is terminated without a resolution of the Dispute, the Disputing Owners agree not to commence any Additional Proceedings prior to the expiration of five (5) days following the mediation. Notwithstanding the foregoing, any Disputing Owners may commence Additional Proceedings within such five day period if the Dispute could be barred by an applicable statute of limitations.

3. Provided that [designated mediator] is available and is willing to serve as the mediator, [designated mediator] shall serve as the mediator of the Dispute. Otherwise, the Authorized Individuals shall have thirty (30) business days from the date of the Responding Owner's written response to the Initiating Owner to select a mutually agreeable mediator. In consultation with the mediator selected, the Authorized

Individuals shall promptly designate a mutually convenient time and place for the mediation, and unless circumstances require otherwise, such time to be not later than forty-five (45) days after selection of the mediator.

C. Arbitrationf the Disputing Owners are not successful in resolving the Dispute through mediation, then the Disputing Owners agree that the Dispute shall be settled by arbitration in Seattle, Washington in accordance with the provisions of the [insert appropriate procedural rules to be relied upon/rules of the American Arbitration Association then in effect] ("Additional Proceedings"), and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction.

X. General Provisions.

A. Entire Agreement; Amendment. This Agreement contains the entire agreement of the Parties with respect to any matter covered or mentioned in this Agreement, and no prior agreements or understandings pertaining to any such matter shall be effective for any purpose. No provision of this Agreement may be amended or modified except by a written agreement fully executed by the Parties. However, each Party to this Agreement agrees that in the case of a Transfer of any Ownership Interest where the transferee is subject to the provisions of this Agreement, such transferee shall be treated for all purposes as a party to this Agreement, as if such transferee were one of the Parties.

B. Successor in Interest. The covenants and conditions contained in this Agreement shall apply to, bind and inure to the benefit of the heirs, successors, executors, administrators, and assigns of the Parties. Before any Transfer of any Ownership Interest is made or will be deemed effective, a Selling Owner agrees that the transferee, if not already a Party to this Agreement, shall acknowledge all of the terms and provisions of this Agreement as they have been amended and shall agree to be bound thereto by executing a counterpart to this Agreement. Notwithstanding compliance with the terms of this Agreement regarding Transfers, or obtaining the written consent of all Owners to a Transfer, any party acquiring any Ownership Interest, in a Transfer or otherwise, shall hold such interest subject to all of the restrictions, terms and conditions set forth in this Agreement, to the same extent and effect as if such party were one of the Parties to this Agreement. The Parties acknowledge that the covenants and agreements contained in this Agreement constitute covenants running with the Property, touch and concern the Property and do not constitute personal rights, which covenants shall be binding upon any successor Owners of the Property or the Ownership Interests. Assuming the requirements of this Paragraph are satisfied, the new owner shall be the deemed Owner for purposes of this Agreement.

C. Recordation. This Agreement shall not be recorded or otherwise made a matter of public record, except as required by law. Upon written request of the Managing Owner or Owners holding two-thirds (2/3) of the Ownership

Interests, a memorandum or other appropriate notice of this Agreement shall be executed and recorded or otherwise made a matter of public record so as to give notice of the existence of this Agreement to potential transferees of an interest in the Property.

D. Power of Attorney. Each Owner shall execute a durable power of attorney designating a person or persons to serve as attorney-in-fact, in the event of their incapacity, for purposes of carrying out their responsibilities provided for in this Agreement.

E. Tenancy In Common. It is mutually understood and agreed that the Parties are at all times acting and performing as tenants in common, and nothing in this Agreement is intended nor shall be construed to create a partnership relationship among the Parties.

F. Governing Law. Except for matters required by law to be governed by the law of the jurisdiction in which the Property is located, this Agreement shall be governed by the laws of the State of Washington.

G. Notices. All notices and other communications required or permitted to be given by any party to the other under this Agreement shall be in writing and shall be delivered by (1) email, (2) hand delivery or (3) by U.S. registered or certified mail, postage prepaid, return receipt requested, in any case, addressed to the appropriate party at its address set forth in Exhibit B, or at such other address as such party shall have last designated by notice to the other. Notices, demands, consents, approvals, and other communications shall be deemed given when delivered or three (3) days after mailing.

H. Counterparts. This Agreement may be executed in multiple counterparts, each of which shall be considered an original and all of which, when taken together, shall be considered a single agreement.

EXECUTED as of the day and year first above written.

"Owner" and "Managing Owner"

____

[

"Owner"

____

[______]

Insert:
Notary blocks for each Owner
Spousal Consents if this is separate property of married parties to the Agreement
Exhibit A (legal description of property)
Exhibit B (Table of Ownership Interests and Owner Contact Information)
Exhibit C (Anticipated Expenditures)
Exhibit D (Exit Checklist)

EXHIBIT B

EXIT CHECKLIST

Kitchen

□ Remove all perishable items from refrigerator.
□ Clean sinks, countertops, and backsplashes.
□ Clean range top and wipe out inside of oven.
□ Clean appliances, including the inside of toaster oven and coffee maker.
□ Clean inside of refrigerator and microwave oven.
□ Wash floor.
□ Empty dishwasher, and organize cupboards.
□ Restock auto dish detergent, liquid dish soap, coffee filters, and trash bags.
□ Clean appliances, counters, cabinets, table, and chairs.

Living Room

□ Sweep floors, wash or vacuum as necessary.
□ Dust window sills and ledges, furniture, blinds, picture frames, knick-knacks, ceiling fans, and lamps.
□ Vacuum carpets or wash floor.
□ Check furniture under seat cushions.
□ Check sofa bed for dirty linens.
□ Empty wastebaskets.

Bedrooms

□ Change sheets and pillowcases.
□ Vacuum floor and under beds.
□ Check for personal belongings left in drawers and closets.
□ Dust furniture and clean mirrors.
□ Check windows for fingerprints.
□ Make sure light bulbs are not burnt out.

Bathrooms

□ Clean toilets, showers, bathtubs, vanity, sinks, and backsplashes and mirrors.
□ Empty wastebasket.
□ Replenish liquid hand soap.
□ Wash all linens and shower mat.

Other areas

□ Be sure washer and dryer are empty; clean out lint trap.
□ Check light bulbs, change if necessary.
□ Change furnace filter once a month.
□ Wipe off patio set and clean barbecue grill.

EXHIBIT C

FOREST SERVICE MODEL REVOCABLE TRUST AND INSTRUCTIONS

The following is an example of a single asset trust that the Forest

Service may accept if not modified. It is not intended to be a template to anyone or intended for use by any parties without the review of their own legal counsel. The Forest Service will not assume any liability for use of this example in any form.

REVOCABLE TRUST

This Trust Agreement is entered into this [_____]_day of [_____], 2023, between [_____] as the Trustors, and [_____] as the Trustees. This Trust shall be known as the [Trustor name] Recreation Residence Trust. This trust is established solely for the non-commercial personal benefit of the Trustors.

1. Trustors are currently the special use permit holders of a Special Use Permit issued by the United States Department of Agriculture Forest Service for a recreation residence tract, [_____], Lot [_____], [_____] Ranger District, in the Okanogan-Wenatchee National Forest..

2. Trustors are the owner of the recreation residence located thereon and hereby transfer and deliver to the Trustees the recreation residence. Trustee shall manage the recreation residence in accordance with the terms of the Special Use Permit, and regulations of the Forest Service. Trustee shall ensure that unauthorized commercial activity or use of any form, whether or not a net profit is obtained, is prohibited. Additional assets may be conveyed to the trust at any time by Trustors or any other person by will, deed, or otherwise. Such property when received and accepted by the Trustees shall become part of the trust estate and be subject to the terms and provisions of this Agreement and any and all such additional assets shall be used or accumulated or held for the payments of fees, assessments, maintenance, repairs, improvements etc. relating to the continued occupancy or use of the recreation residence.

3. The Trustee shall maintain the recreation residence for the recreational use and enjoyment of Trustors. At such time when Trustors cease to seasonally occupy or use the recreation residence, Trustee shall select a qualified individual or husband and wife beneficiary to be the successor-users of the recreation residence until the death of the Trustor(s) and shall notify the Forest Service in writing of the new qualified user.

4. Within one year following the death of the Trustor, or second Trustor if there are two, and provided this trust has not been revoked, this trust shall terminate and the recreation residence shall be distributed out of trust to the qualified individual or husband and wife beneficiary designated in paragraph 6 below, or sold to a third party. The remainder of the trust estate, if any, shall be managed as provided in paragraph 6 below.

5. This trust may be revoked by the Trustors by an instrument in writing signed by the Trustors and delivered to the Trustee(s). This trust may be amended only as to paragraph 6 below, concerning the disposition of the trust.

6. Upon the death of the Trustor, or second Trustor if there are two, the recreation residence shall be distributed to [_____]. The remainder of the trust assets, if any, shall be administered as follows: [_____]

____

7. Trustors grant to Trustee(s) discretion and complete power to administer the Trust estate as fiduciary. In addition to those powers now or subsequently conferred by law, the grant of such power is circumscribed only by the stated purposes of this trust and the conditions under which the Federal government has granted the permit to use the subject recreational residence. The common law and statutory powers of trustees shall be those provided by law in the state where the recreation residence is located. [Some states will need an express statement that the trustee can retain non-income producing/depreciating assets.]

8. Any Trustee shall have the right to renounce their duties and to resign the trusteeship at any time. Such resignation shall be in writing and filed with the Trustor, any co-trustee and all beneficiaries then entitled to distribution in paragraph 6 and to successor trustees. The resignation shall be effective 30 days after such written notice has been personally delivered or mailed by United States mail, return receipt requested, to such person or persons entitled thereto. If a trustee resigns, or if for any reason a trustee becomes unwilling or unable to act, then [_____] shall become the successor Trustee.

9. Notification of the Forest Service is required if there are any changes to the trust, the status of the trust, trust property, or any change in the status of the trustee.

____

XXXXXXX XXXXXXXX

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

I certify that I know or have satisfactory evidence that [_____] and [_____] are the persons who appeared before me, and said persons acknowledged that they signed this instrument and acknowledged it to be their free and voluntary act for the uses and purposes mentioned in the instrument.

DATED: ________________, 2023.

____

(Signature)

____

(Please print name legibly)
NOTARY PUBLIC in and for the State of Washington
My appointment expires: ___________________

INFORMATION ABOUT THE TRUST

Review of Trust by the Forest Service. The Forest Service must review the **entire** Trust to ensure the interests of the United States are protected. If the property is a single asset (Recreation Residence) trust, the other private/sensitive assets, distributions, etc., will not have to be provided to the Forest Service.

Property Transferred to the Trust The trust must demonstrate that the recreation residence (personal property) was transferred to the trust. There must be a statement in the trust stating that the Holder(s) is/ are transferring ownership of the recreation residence to the trust. Many times the recreation residence will be listed as a trust asset in Schedule A of the trust.

Successor Trustee Provisions should be made so that the Forest Service is notified of the death of the trustor/trustee, or of any change of trustees. The permit terminates under its own terms when the permit holder dies or changes. The new owner or trustee is responsible for contacting the Forest Service and making application for a new permit. A successor trustee shall not be a corporation, such as a bank, because Forest Service policy does not provide for issuing authorizations to a corporate entity, even as a trustee.

Discharge or Resignation of a Trustee. Upon either of these occurrences, the Forest Service must be notified and the new trustee must make application to the Forest Service for a new permit.

Trustee Powers:

Occupancy of Residence-In the case of the recreation residence, occupancy is limited by the terms of the authorization.

Discretionary Dissolution of Trust-Upon dissolution of the Trust, the special use permit will terminate under its own terms. The Forest Service must be notified and an application for a permit submitted to the Forest Service by the owner of the improvement.

Distribution of Trust Assets-By Forest Service policy, a permit for a recreation residence can only be held by an individual, husband & wife, or in trust. The distribution of the trust, as it pertains to the recreation residence, cannot have the recreation residence divided among more than one person, unless it is a husband & wife.

Charity-If a trust provides for distribution of the recreation residence to a charity, this would be inconsistent with Forest Service policy in that only an individual or husband and wife could hold a permit for a recreation residence.

Permit Holder-A permit holder or Trust can only own one recreation residence on National Forest System lands.

Fee Payment and Upkeep-Trust should provide for the payment of the fee to the Forest Service and for upkeep of the recreation residence while it is in the trust prior to distribution.

Status of the Recreation Residence-The recreation residence is personal property, not real property as the underlying land is owned by the United States.

Permit-The use of National Forest System lands is allowed through a special use permit, not lease.

Trustee-The trustee(s) are subject to the terms of the permit, including liability and indemnification, when the permit is vested in their name as trustee. Many trusts do have provisions for their continuation up to 21 years after the death of the Trustors/Grantors. The Forest Service should not place a permit in the name of the Trustee of a trust that provides for long term continuation after the death of the last of the Trustors/Grantors.