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FLORIDA HOMESTEAD

Florida Homestead Laws Present Malpractice Traps for the Unwary

Practitioners with Florida clients must become aware of the Homestead rules to ensure they avoid potential malpractice traps. This article is a must-read for non-Florida attorneys working with clients who change domicile to Florida.

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For practitioners who draft estate planning documents for clients who are moving to Florida (or who may already have moved), the most common "traps for the unwary" are Florida's Homestead laws. [1] Indeed, Homestead issues are probably the biggest trap even for the wary—including those of us who practice in Florida and specialize in Homestead issues.

This article analyzes some of the key problems created by the Homestead laws, including: the problems faced by life tenants, the problems in planning for disabled beneficiaries, the problems created by "mixed" or "blended" families, and the very common problem of estate plans created to use the Homestead as an asset to fund a credit shelter trust.

One of the most common "mistakes" involves cases where the Homestead was re-titled into one spouse's name (or the name of that spouse's revocable trust) with the expectation that upon that spouse's death, the Homestead would be an asset (perhaps the major asset) used to fund that client's credit shelter trust. But this common scenario is fraught with Homestead peril. Absent a valid nuptial agreement, the devise to the credit shelter trust is invalid (more below) and the disposition of the Homestead is determined by statute—typically vesting a life estate in the surviving spouse with a vested remainder in the then living descendants (even if they were not the intended remainder beneficiaries of the credit shelter trust or estate plan).

While I have posited in a prior publication [2] that the Homestead devise restrictions should perhaps be repealed—or at least tweaked—with any change far in the distance, it is imperative that non-Florida planners (who work with clients who are or who are becoming Florida residents) at least learn a few basics about the Florida Homestead.

If you don't currently feel comfortable with Florida Homestead issues, the good news is you are not alone. In a recent decision, Florida's Third District Court of Appeals held: [3]

> It has been said by those who labor in the area, that "the leading cause of cerebral herniation among probate lawyers, real estate lawyers, circuit court judges sitting in

probate, and appellate judges reviewing their work, is the study of the [']legal chameleon ['], also known as homestead." (citations omitted).

Background on Florida Homestead

There are a variety of statutes that affect Homestead (tax statutes, creditor exemption statutes, and probate statutes), but the fundamental law of Homestead comes from the Florida Constitution, the key provisions of which are in Article X, Section 4, as follows:

SECTION 4. Homestead; exemptions.—

(a) There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person:

(1) a homestead, if located outside a municipality, to the extent of one hundred sixty acres of contiguous land and improvements thereon, which shall not be reduced without the owner's consent by reason of subsequent inclusion in a municipality; or if located within a municipality, to the extent of one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner or the owner's family;

(2) personal property to the value of one thousand dollars.

(b) These exemptions shall inure to the surviving spouse or heirs of the owner.

(c) The homestead shall not be subject to devise if the owner is survived by spouse or minor child, except the homestead may be devised to the owner's spouse if there be no minor child. The owner of homestead real estate, joined by the spouse if married, may alienate the homestead by mortgage, sale or gift and, if married, may by deed transfer the title to an estate by the entirety with the spouse. If the owner or spouse is incompetent, the method of alienation or encumbrance shall be as provided by law.

As you can see, there are some creditors who are not barred by the Homestead provisions (section (a) above), like certain contractors. Further, there are size restrictions on Homesteads (the half-acre restriction in a municipality may cause problems for many wealthier clients). [4] Obviously, in planning for clients with Homesteads, you need to be aware of these provisions, and there are many cases that are pertinent, but this article will focus on planning for property that is assumed to qualify as "Homestead."

Also, a fundamental step in any Homestead discussion involves distinguishing the categories of Homestead being addressed. As the Florida Supreme Court stated in the seminal case of *Snyder v. Davis*, [5] there are essentially three kinds of Homestead we must distinguish.

Homestead creditor protection. The basic rules for protecting Homesteads from the claims of creditors are provided in Article X, Section 4 of the Florida Constitution, and Florida Statutes ("F.S.") Chapter 222. Sections 4(a) and 4(b) of Article X of the Constitution (quoted above) generally protect Homesteads from forced sale by creditors. There are certain restrictions (e.g., size of the property inside and outside a municipality), and there are certain exceptions (e.g., for property taxes of those who provide services improving or repairing the Homestead).

The creditor protection Homestead rules are very important for Florida resident clients, but they are not at issue for purposes of this article.

Homestead real property tax exemption and related Save Our Homes cap. The basic rules for

the Homestead ad valorem, real property tax exemption and the related "Save Our Homes" cap on property tax assessments are found in Section 6 of Article VII of the Florida Constitution and F.S. Chapter 196. [6] Therein, a property tax exemption is afforded for residents who own a Homestead, with additional exemptions for widows, seniors, disabled persons, and disabled veterans. These provisions are extremely important as Florida has no income tax, and thus property taxes are a primary source of revenue.

Essentially, Florida tax law favors residents with real property tax breaks, the most important of which is called the "Save Our Homes" cap ("SOH"). SOH applies a cap of 3% on annual increases in property values for purposes of ad valorem real property taxes—regardless of market increases in value. Over the past ten years, many Florida homeowners saw their property values double or triple while their assessed value for tax purposes crept along at 3% per year. The significant gap between real fair market value and assessed value has created a substantial incentive for these clients to maintain the SOH cap. Supposedly, at this time, the SOH cap shields nearly $350-$400 billion in real property values from taxation. [7]

Accordingly, while SOH is not the central point of this article, out-of-state planners need to be aware of this Homestead benefit before entering into estate planning with Florida clients. Any transaction which changes beneficial ownership of the Homestead can cause the client to lose the SOH benefits that have accrued—causing a revaluation for tax purposes and a potentially huge increase in property taxes every year thereafter.

While the intricacies of the SOH statutes are not really at issue for purposes of this article, obviously any practitioner working with a Florida client's Homestead must at least consider the impact of SOH. The "good news" is that the Florida legislature has been meeting in special sessions for almost a year exploring options to reform the property tax system. But the "bad news" is there seems to be no logical solution in sight.

Finally, practitioners should be aware there are significant penalties for clients who fraudulently claim the benefits of the Homestead exemption and the SOH protections. [8]

Homestead property restrictions on devise. At the heart of this article are the issues created by the Homestead restrictions on devise provided in Article X, Section 4 of the Florida Constitution and F.S. Sections 732.401 and 732.4015. As noted earlier, Article X, Section 4(c) provides that:

> (c) The homestead shall not be subject to devise if the owner is survived by spouse or minor child, except the homestead may be devised to the owner's spouse if there be no minor child. The owner of homestead real estate, joined by the spouse if married, may alienate the homestead by mortgage, sale or gift and, if married, may by deed transfer the title to an estate by the entirety with the spouse. If the owner or spouse is incompetent, the method of alienation or encumbrance shall be as provided by law.

This section delineates the key issues faced in trying to alienate an interest in Homestead property during life and upon death. Obviously, the provisions are designed to "protect" surviving spouses and minor children. As will be explored below, there are many instances now where these restrictions hinder typical and efficacious planning for the beneficiaries.

Some of the problems

The new Homestead trap for surviving spouses. As highlighted in an article by this author in the June 2007 issue of the *Florida Bar Journal,* [9] the Homestead protections for surviving spouses are trapping many unhappy widows in homes they no longer want and can no longer afford.

The problem for many surviving spouses can be summarized as follows. Under the principal and income act, the life estate created to protect surviving spouses causes them to pay for the income portion of

any mortgage, all the ad valorem property taxes, all the property insurance and virtually all the repairs, including special assessments and/or major repairs caused by hurricanes. While there are some exceptions for major improvements expected to be useful for longer than the spouse's life expectancy, even those are proportionately charged against the spouse.

If a surviving spouse wants to move to a new home or to an assisted living facility or nursing home, the law gives no relief to the spouse against all these charges. Currently, the only remedy is to rent the property and hope that the rent meets or exceeds the expenses. However, for many individuals, particularly after losing the SOH cap, the costs exceed the rental value. Florida law does not currently provide a means to sever the tenancies and does not permit a partition. [10]

At the same time that the expenses for life tenants have soared (indeed life tenants have borne 100% of the two worst fiscal crises faced in the state—skyrocketing property taxes and property insurance costs), the Florida real estate market has caused dramatic increases in the values of many homes which benefit the remainder beneficiaries exclusively. Especially in families where the remainder beneficiaries are hostile to the surviving spouse (e.g., stepchildren from a prior marriage who may not get along with the stepparent), there is no incentive for the remainder beneficiaries to cooperate with the life tenant since they benefit from a "free ride" as their asset (the remainder in the Homestead) is growing in value while all the expenses relating thereto are borne by someone else—indeed someone they may not even like.

Credit shelter planning. For many clients, the Homestead is a valuable component of their gross estate. And for many clients, the increasing federal estate tax exemption has created a premium on using the Homestead to fund the exemption of one or both of the spouses. The Constitutional restrictions on devise make it virtually impossible for Florida residents to avail themselves of the very common estate planning technique of funding a credit shelter trust with an interest in the home. This is a typical planning technique used in most other states to help protect the estate tax exemptions of both spouses in order to maximize the tax-free inheritance for the children. Yet, this simple and beneficial planning may not be possible under Florida law.

If the Homestead is to be used in credit shelter planning, there are a couple of options, but they must be thought-out in the planning process. First, by titling the property as tenants-by-the-entirety and then relying on the surviving spouse to disclaim the survivorship in one-half of the property, it is possible to fund a credit shelter trust.

Florida's disclaimer statute (F.S. 739.203(4)) provides in pertinent part: "A disclaimer of an interest in real property held as tenants by the entirety does not cause the disclaimed interest to be homestead property for purposes of descent and distribution under ss. 732.401 and 732.4015." The disclaimer statute clearly states that the disclaimer does not create a Homestead interest subject to the restrictions on devise. But of course this allows only half of the value of the home to be used in credit shelter planning, and it depends on a disclaimer after the client's death, which of course, involves a degree of trust and faith.

But what if the clients need or want to use more than half of the Homestead to fund a trust on the first death? Or what if there is a reluctance to rely on a disclaimer—such as in a second or third marriage situation with children from a prior marriage?

One planning option that may work is allowing the statutory life estate to apply. Despite the problems with life estates highlighted above, for some clients—particularly those in well-established marriages with children who get along—the prospect of a life estate/remainder is not perceived as a negative. Indeed, if the family members get along, it can be a positive as the surviving spouse will pay all the expenses for a property that is appreciating (hopefully) in value out of his/her estate. But, as noted above, if the spouse and children do not get along for any reason, this option is much less favorable than being able to fund a credit shelter trust, which might provide the spouse (or an independent trustee) with more direct control over the Homestead.

Another planning option that may work is the execution of a valid nuptial agreement. There are several problems with nuptial agreements. First, very few clients relish going home and telling their spouse they

need to discuss a post-nuptial agreement. Even in the context of estate planning, that can be uncomfortable. Second, Florida law does not make using nuptial agreements easy.

For example, some clients move to Florida and already have nuptial agreements. We can assume those agreements are perfectly valid where created. One problem is Florida law does not seem to recognize such agreements as a valid waiver of Homestead rights. The law on valid Homestead waivers requires an express and knowing waiver of Homestead.

Rutherford v. Gascon [11] held that any waiver of Homestead by a surviving spouse must be "knowing and intelligent," meaning the spouse must have been aware that but-for the agreement, Homestead title would vest in him or her by operation of law. Well, how could a client signing a prenuptial agreement in Massachusetts, New York, or any other state (with the intent to reside there) have expected that some day the client would move to Florida and need to expressly waive Homestead? As unreasonable as that sounds, Florida law seems to require that level of specificity to avoid the application of the Homestead laws.

Second, clients willing to sign valid post-nuptial waivers are faced with complex rules on the validity of post-nuptial agreements. For example, F.S. 732.702 provides that Homestead rights may be waived in a marital agreement if the statutory requirements are met, which includes the requirement for full financial disclosure provided in F.S. 732.702(2). Some clients are reluctant to meet this requirement. Moreover, Florida practitioners differ on their willingness to prepare/execute post-nuptial waivers of Homestead without separate representation for both spouses—adding significantly to the costs of the procedure.

Planning for an incapacitated spouse—Medicaid planning. The Homestead devise restrictions pose significant problems in Medicaid planning for married clients. In Medicaid planning, advisors often suggest transferring the Homestead to the community spouse (the "well" spouse living at home) to avoid having title vest in the institutionalized spouse in case the community spouse dies first. Homestead is an exempt asset for Medicaid purposes and generally won't affect Medicaid eligibility (unless the equity exceeds $500,000), whether the institutionalized spouse owns the whole house or just a life estate after the other spouse's death, but there may be ramifications for Medicaid recovery laws.

First, if the Homestead equity exceeds $500,000, over the next few years Florida law will cause the loss of Medicaid eligibility. Second, the Medicaid recovery rules will force/allow recovery on the institutionalized spouse's death. Taken together, these problems mean that the inability of the first spouse to leave the Homestead in a special needs trust for the survivor could significantly complicate traditional Medicaid planning, and the significance of this problem will increase over the next few years.

Special needs trust planning for a disabled minor child. Another difficult issue of Homestead planning is protecting a disabled minor child. For example, assume that a client has a disabled child and two nondisabled children (and at least one of them is a minor). Absent the Homestead rules, many clients would provide any funds for the disabled child (including, if applicable, an interest in the family home) in a special needs trust designed to supplement the public support the child receives but not to supplant those public benefits. In many cases, the public support—particularly qualification for health insurance coverage—is vital to the care and well-being of the minor.

But the Homestead devise restrictions abrogate the ability to plan for the disabled minor child. Instead, by law, the Homestead will pass to the children in equal shares or all to the disabled child if that's the only child. Ownership of the Homestead could well cause a loss of public benefits for that child for an extended period. Moreover, it also means that a client may not be able to fund a supplemental needs trust to help alleviate some of the extraordinary difficulties faced by the disabled child.

Trust planning for minor children. The overwhelming majority of all clients who plan for the passage of wealth to their minor children do not leave the funds in a guardianship. The guardianship process is a costly and often wasteful process which makes a judge the arbiter of how to use the funds for the client's children. Further, guardianships terminate at age 18 and vest the property in the children

outright. Ultimately, clients who take the time to create estate plans invariably opt out of guardianships of the property and prefer a trust plan that will last well beyond the 18th birthday of the child (most clients seem to prefer trusts for life).

Well, those clients may be shocked to discover that the beautiful estate planning documents they are creating will be completely ineffective to control the disposition of their Homestead. Imagine the confusion/upset when explaining to wealthy clients that their $10 million (or more) home will pass into a guardianship for their children and will be vested outright in the children on their 18th birthdays.

Obviously, the Florida statutes do not have to match the majority of estate plans—otherwise the entire intestacy statute might need to be updated—but for those clients who actually "bother" creating estate plans, it can be frustrating that we have a system of law that makes the planning inoperative.

Qualified personal residence trusts. Another complication created by the Homestead restrictions and SOH involves planning with qualified personal residence trusts ("QPRTs") for Florida residents. First, the practitioner must be aware that a lifetime alienation of an interest in a Homestead is not valid unless the spouse joins in the transfer. Thus, for example, a deed from a wife to her QPRT would be invalid unless also executed (joined in) by her spouse, and a failure to execute a valid will can imperil the gift and estate tax planning.

Second, there has not been a clear decision from a Florida court about the impact of a reversion. As most practitioners prefer to have clients retain a reversion in a QPRT in order to further diminish the gift tax value, the risk in Florida is that the reversion (coupled with the retained right of use) might cause the Homestead devise restrictions to apply to the property if the client dies before the end of the QPRT term.

If that happens, it is possible that the estate planning might be thwarted as the devise restrictions might limit the disposition of the home in a way contrary to the client's intent on funding the QPRT. While the author believes there are compelling arguments that the standard QPRT retained term interest coupled with a reversion should not cause the Homestead devise restrictions to apply if a client dies before the term ends, at this time the law on this matter seems unresolved.

QPRT planning has the added risk of potential loss of SOH at the end of the retained term. Case law confirms that the client retains the SOH benefits during the retained term of a QPRT, but the transfer of beneficial ownership (and maybe legal title) at the end of the retained term (even if the property stays in a "continuing trust" under the terms of the QPRT document) would normally trigger a revaluation for SOH purposes. [12]

For these situations, many practitioners are currently using a 99-year lease entered into prior to the end of the QPRT term to create an argument for retained SOH benefits. In several counties, this 99-year lease technique has been accepted as a viable way to retain beneficial ownership for the client; however, the law on this matter is far from settled. Indeed, the author currently has a case pending in Circuit Civil Court in Key West where the county property appraiser has argued the 99-year lease should not sustain SOH.

Conclusion

Practitioners with Florida clients must become aware of the Homestead rules to ensure they avoid potential malpractice traps. The most significant and likely trap is violating the rules on devise and causing an invalid devise which then vests a life estate and remainder in beneficiaries the client did not intend to benefit. A second potential trap lies in the area of inter vivos planning where practitioners must be mindful of the SOH cap. Most clients will not be happy if they lose the benefits of their SOH exemption. A third trap lies in QPRT planning without adequate Homestead forethought. There are issues to consider regarding successive trust interests in drafting, and the client must be advised of the potential future loss in the SOH cap upon the transfer of beneficial ownership at the end of the QPRT term (if the 99-year lease term is ultimately unsuccessful). These planning issues and risks must be

weighed against the federal transfer tax savings expected.

There are other Homestead malpractice traps as well, but understanding the basic SOH rules and the restrictions on devise will help practitioners go a long way toward avoiding the more obvious pitfalls.

PRACTICE NOTES

The Homestead restrictions on devise make it virtually impossible for Florida residents to avail themselves of the very common estate planning technique of funding a credit shelter trust with an interest in the home.

1

The issue of "unlicensed practice of law" by creating plans for someone living in a jurisdiction where the practitioner is not admitted is beyond the scope of this article. However, the author believes the majority or consensus view is that preparing documents under another state's laws is not the unlicensed practice of law in that state, *per se*, unless one goes to said state and actively solicits business. Nevertheless, there are many ethical and malpractice traps to consider in such planning.

2

See Baskies, "The New Homestead Trap: Surviving Spouses Are Trapped by Life Estates They No Longer Want or Can Afford," 81 Fla. B.J. 69 (June 2007).

3

Cutler v. Cutler, 32 FLW D583, 2007 WL 601866 (Fla. 3d DCA, 2/28/07).

4

See Nelson and Packman, "Florida's Unlimited Homestead Exemption Does Have Some Limits—Part 1," 77 Fla. B.J. 60 (Jan. 2003).

5

699 So.2d 999 (Fla., 1997).

6

See F.S. 196.031 and F.S. 196.041, in particular.

7

See Gerena-Morales, "Florida Snowbirds Challenge Fairness of Two-Tier Tax No Shield From Rising Bills for Seasonal Residents; Who Pays for Growth?," Wall Street Journal, p. A1 (5/22/06).

8

See F.S. 196.161(a) and F.S. 196.161(b), for example: "(b) In addition, upon determination by the property appraiser that for any year or years within the prior 10 years a person who was not entitled to a homestead exemption was granted a homestead exemption from ad valorem taxes, it shall be the duty of the property appraiser making such determination to serve upon the owner a notice of intent to record in the public records of the county a notice of tax lien against any property owned by that person in the county, and such property shall be identified in the notice of tax lien. Such property which is

situated in this state shall be subject to the taxes exempted thereby, plus a penalty of 50 percent of the unpaid taxes for each year and 15 percent interest per annum. However, if a homestead exemption is improperly granted as a result of a clerical mistake or an omission by the property appraiser, the person improperly receiving the exemption shall not be assessed penalty and interest. Before any such lien may be filed, the owner so notified must be given 30 days to pay the taxes, penalties, and interest."

9

See Baskies, *supra* note 2.

10

The author is currently pursuing options for legislative and/or constitutional reform to assist surviving spouses, and is examining the Homestead devise restrictions in his role as Chair of the "Homestead Law" Subcommittee of the Probate Law Committee of the Real Property, Probate and Trust Law Section of the Florida Bar.

11

679 So 2d 329 (Fla. 2d DCA, 1996).

12

See Robbins v. Welbaum, 664 So.2d 1 (Fla. 3d DCA, 1995); see also, Nolte v. White, 784 So.2d 493, 494 (Fla. 4th DCA, 2001), quoting Baskies, "Understanding Estate Planning with Qualified Personal Residence Trusts," 73 Fla. B.J. 72 (Nov. 1999).

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