by Jeffrey A. Baskies and John H. Pelzer

Higgs v. Warrick: Lessees of 99-year Leases Qualify for Homestead and Save Our Homes Tax Exemption Purposes

In a November 12, 2008, opinion, the Third District Court of Appeal affirmed a final summary judgment of the 16th Judicial Circuit Court for Monroe County. On June 4, 2009, the Florida Supreme Court declined to exercise jurisdiction notwithstanding certification of conflict by the Third District, ending the Monroe County property appraiser's fight to revalue the homestead of William L. Warrick as a result of the termination of his qualified personal residence trust (QPRT).[1] The ruling is very helpful to planners who work with clients who funded QPRTs and worry the clients may lose significant built-up tax benefits as a result of a change in owner upon the expiration of the QPRT term.

The 98-year Lease Technique

Many planners have advocated the use of a 98-year (or longer) lease as a way for grantors of QPRTs to retain homestead status and the F.S. §193.155, Save Our Homes (SOH) benefits.[2] The argument that a 98-year lease preserves homestead ad valorem tax treatment is grounded in F.S. §193.155(3), which states that property assessed under the SOH provisions shall be assessed to just value as of January 1 of the year following a change of ownership; however, a "change of ownership" is defined to *exclude* any transfer of legal title or beneficial title if "subsequent to the change or transfer, the same person is entitled to the homestead exemption as was previously entitled...."

The 98-year lease technique in conjunction with an expiring QPRT generally works as follows: The client enters into a 98-year lease prior to the expiration of the QPRT term and records that lease.[3] Based on the provisions of F.S. §196.041, the grantor of the QPRT remains the beneficial owner of the homestead even after the term ends, and, thus, maintains the SOH benefits. For purposes of minimizing any gift or estate tax exposure on the QPRT, the lease is typically made effective the day before (or near in time) to the expiration of the QPRT term. To preserve homestead status for the residence titled in the QPRT, it is essential that the lease be effective prior to the QPRT term ending, so there is never a change of owner triggering SOH revaluation.[4]

Thus, as a result of the lease, the same person (the grantor) has the requisite beneficial interest in the property to qualify for homestead and SOH benefits after the QPRT term ends as had a right to them before the QPRT termination. While legal title might pass to the children (or trusts for them) when the QPRT term ends, beneficial ownership of the homestead remains the same by virtue of the lease. Therefore, the termination of the QPRT and transfer of legal title should not be a change of ownership for ad valorem tax purposes because the same person (the grantor) has the beneficial rights both before and after the date for which the term of years of the QPRT expires, as is required by F.S. §193.155.

The decision in *Warrick* bolsters those arguments and supports the continued benefits of SOH by use of 98-year leases at the end of the QPRT term.

Facts of the Case

None of the facts of the case were in dispute. On April 27, 1995, Warrick created a QPRT and transferred his home on Sugarloaf Key in Monroe County to himself as trustee of the QPRT. For a retained term of 10 years, Warrick had the exclusive right to the rent-free use of the residence. During that retained term, Warrick claimed and was granted both a homestead exemption from ad valorem property taxes and SOH benefits.[5]

On April 27, 2005, Warrick's rent-free use of the home expired with the fixed term of the QPRT, and, pursuant to the terms of the trust agreement, his children became the beneficiaries of the trust.

Prior to the termination of the trust on April 27, 2005, however, Warrick individually entered into a lease with the QPRT. The lease provides for a 99-year term and provides for monthly rent (with certain revaluations to keep the rent at fair market value).

After the QPRT term ended, the property appraiser for Monroe County, Ervin A. Higgs, denied Warrick's request for a homestead exemption and treated the termination of the QPRT as a "change of ownership" for SOH purposes. Warrick then petitioned the value adjustment board (VAB) for consideration of his claim for continuing exemption and SOH benefits based upon his leasehold interest. The VAB heard arguments and ruled in Warrick's favor. The VAB found that the interest held by Warrick as a leaseholder of a 99-year lease constituted the requisite beneficial interest under F.S. §196.041 to qualify Warrick for homestead and SOH ad valorem

tax benefits.

Subsequently, the property appraiser filed suit in circuit court challenging the VAB's decision. The property appraiser then filed a motion for summary judgment, which the trial court denied. Further, in denying the motion, the trial court found that the property appraiser had no standing to make an argument that the statute (F.S. §196.041) allowing lessees under 98-year leases to claim homestead was unconstitutional, as the property appraiser had no standing to raise a constitutional challenge to the validity of any statute.[6]

The Primary Statutes at Issue and Arguments Presented

F.S. §196.031(1)(a) states, in relevant part:

> Every person who, on January 1, has the legal title or beneficial title in equity to real property in this state and who resides thereon and in good faith makes the same his or her permanent residence ... is entitled to an exemption from all taxation ... on the residence and contiguous real property, as defined in s. 6, Art. VII of the State Constitution.

F.S. §196.041(1) states, in relevant part:

> [L]essees owning the leasehold interest in a bona fide lease having an original term of 98 years or more in a residential parcel or in a condominium parcel . . . shall be deemed to have legal or beneficial and equitable title to said property.

Therefore, as stated in F.S. §196.041(1), a lessee under a bona fide 98-year lease is deemed to have legal or beneficial and equitable title to the homestead property subject to the lease. Further, as stated in F.S. §196.031(1)(a), every person who has legal or beneficial and equitable title to real property and resides thereon as his or her personal residence qualifies to receive a homestead exemption, and is treated for all homestead purposes (including SOH) as a fee simple owner.

The statutes create several benefits for the owner. These benefits include the lessee's entitlement to the annual homestead exemption provided in F.S. §196.031 and the annual assessment increase cap provided in F.S. §193.155.

In *Warrick*, the property appraiser did not argue that the statutes were unclear. Rather, the property appraiser argued that the above-cited provisions of §196.041(1) should be interpreted to apply only to condominiums and cooperative apartments. That argument was based upon the property appraiser's interpretation of the Florida Constitution, particularly the 1968 amendments.

Fortunately for Warrick, the Florida Supreme Court has consistently held that the doctrine of separation of powers precludes executive officers or agencies from challenging the constitutionality of validly enacted statutes they are directed to enforce.[7]

Warrick's counsel argued that the property appraiser's interpretation — that only condominium or cooperative apartment lessees are entitled to take advantage of the 98-year lease provision of F.S. §196.041(1) — was contrary to the plain meaning of that statute. The statute explicitly deals both with condominiums and cooperative apartments and with leases of a "residential parcel," such as the single-family home at issue in the *Warrick* case. The first sentence of F.S. §196.041(1), listing the persons who "shall be deemed to have legal or beneficial and equitable title" to a potential homestead property separately addresses a 98-year lease "in a residential parcel or in a condominium parcel as defined in Chapter 718." The second sentence of F.S. §196.041(1) addresses cooperative apartments separately, stating "[i]n addition, a tenant-stockholder or member of a cooperative apartment corporation" may also claim a homestead. Thus, F.S. §196.041(1) applies to the owners of a "residential parcel," a "condominium parcel," and a "cooperative apartment corporation." In his brief and arguments, the property appraiser apparently ignored the statute's reference to "a residential parcel" as well as the disjunctive "or" in the statute. The court agreed that the plain language supported Warrick's position.

Decision's Impact on 98-year Leases

It is unfortunate that the crux of the legal argument on appeal, and the heart of the legal argument in the summary judgment proceeding, related to the constitutional issue regarding the lack of standing of a property appraiser to challenge a statute. Therefore, the Third District Court of Appeal could have issued a simple per curiam affirmance of the Third District ruling, or it could have issued an opinion along those narrow lines of standing.

However, the court did not rule that way. Instead, the Third DCA went out of its way to write a decision that directly addresses the 98-year lease. The court found:

> On appeal the property appraiser contends that the VAB misinterpreted the applicable homestead exemption statutes. The homeowner, however, asserts that the trial court correctly entered summary judgment based upon the homestead statutes. *We agree with the homeowner.* The plain and ordinary meaning of sections 196.031 and 196.041 clearly provides that a 98-year-plus lessee of a residential parcel permanently occupied as a residence qualifies for a homestead exemption. Therefore, both the VAB and the trial court correctly determined that the homeowner should receive a homestead exemption. (Emphasis added.)

The court's focus on the substance of the 98-year lease argument was somewhat of a surprise for the attorneys involved. The lack of standing argument was the focus of the briefs and oral agreement, and it seemed like a virtually unbeatable defense based upon the position the property appraiser took in this case. Therefore, it was an unexpected and yet positive surprise that the Third District Court of Appeal specifically addressed the substantive issue of the 98-year lease and expressly held such leases qualify for homestead exemptions as defined in the relevant statutes.

Warrick is favorable for those who counsel and represent clients seeking homestead and SOH protection via 98-year leases. It now seems clear that holding an interest as lessee under a 98-year lease meets the standards of F.S. §§196.041 and 196.031 to create the requisite beneficial interest in real property to qualify for homestead and SOH protections. Thus, *Warrick* is authority that 98-year leases "work" to create and preserve homestead and SOH protections.

One Caveat

There is one caveat based upon the last paragraph of the court's opinion.

Because the Florida Supreme Court did not directly address the lack of applicability of *Prewitt*, it is possible that another property appraiser might challenge the technique again in the future.

In that paragraph the court states: "To the extent our ruling conflicts with *Prewitt Management Corp. v. Nikolits*, 795 So. 2d 1001 (Fla. 4th DCA 2001), we certify conflict." Of course, that language in the order was used as the basis for the property appraiser's unsuccessful effort to obtain review in the Florida Supreme Court. Reading *Prewitt*, the authors saw no area of conflict. *Prewitt* dealt with an S-corporation that owned a residence occupied by the owners of the S-Corporation, and whether that fact pattern was equivalent to ownership of a cooperative. At least at first blush, the cases don't seem to conflict. Warrick argued those points in his jurisdictional brief, and the Supreme Court declined to exercise jurisdiction. While the Supreme Court did not directly address the last paragraph of the opinion and did not directly address the purported conflict, the Supreme Court's decision to decline jurisdiction should indicate that it saw no conflict sufficient to warrant its intervention at that time.

As a result of this last paragraph, and because the Florida Supreme Court did not directly address the lack of applicability of *Prewitt*, it is possible that another property appraiser might challenge the technique again in the future. This caveat may even allow property appraisers outside of the Third District Court of Appeal to argue that the opinion is merely persuasive authority outside that district.[8] However, the authors believe there is no conflict with *Prewitt*.

Ultimately, in the context of resolving the homestead problems of clients with expiring QPRTs (and/or other clients desiring to implement homestead planning with 98-year leases), *Warrick* is a very important decision.❑

[1] *Higgs v. Warrick*, 994 So. 2d 492 (Fla. 3d D.C.A. Nov. 2008); *see generally* Richard S. Franklin and Roi E. Baugher III, *Protecting and Preserving the Save Our Homes Cap*, 77 FLA. B. J. 34 (October 2003); *see also* Steven M. Chamberlain, *Florida Homestead Transfers: The Advantages of Short-term Qualified Personal Residence Trusts*, 76 FLA. B. J. 51 (Nov. 2002); and Jeffrey A. Baskies, *Understanding Estate Planning with Qualified Personal Residence Trusts*, 73 FLA. B. J. 72 (Nov. 1999).

[2] FLA. STAT. §193.155 Homestead Assessments — provides in part: "Homestead property shall be assessed at just value as of January 1, 1994. Property receiving the homestead exemption after January 1, 1994, shall be assessed at just value as of January 1 of the year in which the property receives the exemption. (1) Beginning in 1995, or the year following the year the property receives homestead exemption, whichever is later, the property shall be reassessed annually on January 1. Any change resulting from such reassessment shall not exceed the lower of the following: (a) Three percent of the assessed value of the property for the prior year; or (b) The percentage change in the Consumer Price Index for All Urban Consumers, U.S. City Average, all items 1967=100, or successor reports for the preceding calendar year as initially reported by the United States Department of Labor, Bureau of Labor Statistics." *See also* Richard S. Franklin and Roi E, Baugher III, *Protecting and Preserving the Save Our Homes Cap* 77 FLA. B. J. 34 (Oct. 2003).

[3] FLA. STAT. §196.031 (emphasis added). Exemption of Homesteads — provides in part: "(1)(a) Every person who, on January 1, has the legal title or beneficial title in equity to real property in this state and who resides thereon and in good faith makes the same his or her permanent residence, or the permanent residence of another or others legally or naturally dependent upon such person, is entitled to an exemption from all taxation, except for assessments for special benefits, up to the assessed valuation of $25,000 on the residence and contiguous real property, as defined in s. 6, Art. VII of the State Constitution .... *Before such exemption may be granted, the deed or instrument shall be recorded in the official records of the county in which the property is located.* The property appraiser may request the applicant to provide additional ownership documents to establish title."

[4] Entering the lease presumptively constitutes a termination of the QPRT qualification/status. Some commentators have advocated a small GRAT (grantor retained annuity trust) payment might need to be made to the grantor for the period from the date of the lease to the date the QPRT term ends. Failure to do so might constitute a taxable gift, which argues for not terminating the QPRT status far in advance of the end of the term.

[5] *See Robbins v. Wellbaum*, 664 So. 2d 1 (Fla. 3d D.C.A. 1995). *See also Nolte v. White*, 784 So. 2d 493 (Fla. 4th D.C.A. 2001) (adopted the *Robbins* rationale), *rev. den.*, 805 So. 2d 808 (Fla. 2001). These cases essentially overrule a prior attorney general opinion (AGO 1994-50 (June 2, 1994)) that denied the homestead exemption to property held in a QPRT. In Information Bulletin DAV-96-003, the Florida Department of Revenue indicated that the *Robbins* decision left the area of law relating to this issue unsettled and that individuals seeking a homestead exemption through a QPRT should reapply for the exemption to preserve the issue.

[6] *See The Crossings at Fleming Island Comm. Dev. Dist. v. Echeverri*, 991 So. 2d 793 (Fla. 2008); *Fuchs v. Robbins*, 818 So. 2d 460 (Fla. 2002).

[7] *See State ex rel Atlantic Coastline R. Co. v. State Board of Equalizers*, 94 So. 681 (Fla. 1922). This history was recently recited at length by the Florida Supreme Court in *The Crossings at Flemming Island Community Development District v. Echeverri*, 991 So. 2d 793 (Fla. 2008). In *The Crossings*, the Florida Supreme Court re-affirmed its recent decision in *Fuchs v. Robbins*, 818 So. 2d 460 (Fla. 2002), which held that a property appraiser has no standing to challenge the constitutionality of property valuation statutes. The issue in *Crossings* was whether a property appraiser could avoid this prohibition if the procedural posture happened to make the property appraiser a defendant rather than a plaintiff. The *Crossings* court concluded that this happenstance did not alter the fundamental separation of powers limitation on the property appraiser's authority to challenge the constitutionality of a statute. The *Crossings* court dramatically likened the arguments of the property appraiser to secessionist doctrine of the pre-Civil War era, stating "that to allow a public official to refuse to obey a law would be 'the doctrine of nullification, pure and simple.'" *Crossings*, 991 So. 2d at *4, quoting, *Atlantic Coastline*, 94 So. at 683. The *Atlantic Coastline* court used even stronger words, noting that even "the most ardent followers of Mr. Calhoun never extended (the nullification doctrine) to give ministerial officers the right and power to nullify a legislative enactment." *Atlantic Coastline*, 94 So. at 683.

[8] *See Pardo v. State*, 596 So. 2d 665 (Fla. 1992).

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