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Steve Leimberg's Asset Protection Planning
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Subject: Jeff Baskies - Some “Dos” and “Don’ts” If You are Planning with Your Clients' Florida Homesteads in 2020

“It feels like the movie ‘Groundhog Day’ in the world of estate planning. Just like the summer and fall of 2012, practitioners today are facing a potential estate planning explosion (perhaps apocalypse) as clients are growing ever-more anxious regarding the potential (maybe probable) reduction of their gift, estate and GST exemptions.

As you know, the current $11.58 million gift tax exemption is scheduled to sunset on December 31, 2025, but clients are concerned the November election could lead to changes much sooner. As a result of this developing concern the transfer tax exemptions will decline dramatically and rapidly, there is a sense of urgency growing among many clients. This sense of urgency will likely create an uptick in the desire to estate plan with clients’ residences, including in some cases their Florida homestead residences.

However, there are unique risks involved when planning with Florida homestead properties, including: (i) potentially losing Florida’s unlimited homestead creditor protection; (ii) potentially losing the homestead ad valorem real property tax exemption (and the Save our Homes benefits); and (ii) potentially causing inclusion of the home in the estate of the client, due to the planning to try to retain the real property tax benefits.

If possible, it is still best to avoid planning with clients’ Florida homesteads. Too often in our practices, Florida advisors meet clients who previously transferred their homesteads as part of their estate plans and have lived to regret it and wished they had not. Indeed, Florida homestead jurisprudence is replete with cases involving regretted trust planning (many involving irrevocable trust planning, such as QPRTs).

Nevertheless, some of your clients (and some of ours) will insist on using their homesteads (often demanding it in lieu of planning with easier assets, like their marketable securities). Therefore, for those advisors considering estate planning with clients’ Florida homesteads, this newsletter offers some tips and pointers in the form of a few important ‘dos’ and ‘don’ts’ for your consideration.”

In September 2012, **Jeff Baskies** authored Asset Protection Planning Newsletter #209 "Please Don't Plan with Your Clients' Florida Homesteads." Now **Jeff Baskies** shares new commentary with members that focuses on planning with clients' Florida homestead properties in 2020.

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Here is his commentary:

EXECUTIVE SUMMARY:

"The more things change, the more they stay the same" is a quote attributed to French writer Jean-Babtiste Alphonse Karr, a year after the French Revolution. As apropos as the saying may have been in the winter of 1849, the saying remains apt today, particularly for estate planners.

After all, just like we did in the fall of 2012, estate planners today are facing a potential estate planning explosion (some may call it an apocalypse) as clients are growing ever-more anxious regarding the potential reduction of their gift, estate and GST exemptions.

As you know, the current $11.58 million transfer tax exemption is scheduled to sunset on December 31, 2025; however, clients are concerned the November 2020 election could lead to changes much sooner. In Newsletter #2804, Brad Dillon stoked those concerns with his article titled: "Yes, Democrats Could Enact Retroactive Tax Legislation Next Year with a Simple Majority Vote, So Plan Now or Forever Lose Your Exemptions!"

As result of this developing concern the transfer tax exemptions will decline dramatically and rapidly, there is a sense of urgency growing among many clients.

Of course, some clients have no issues transferring $23 million into trusts for (or even outright to) their descendants, but many clients are less

sanguine with such advice. Those clients are looking for alternative solutions to allow direct or indirect access to the gifted assets. Thus, SLATs, DAPTs, FAPTs and similar techniques are assuredly proliferating.

Further, while desirous of using their exemptions, many clients are looking for the simplest and most painless methods and mechanisms to do so, seeking solutions that do not reduce their sense of comfort regarding their net worth. As a result, there undoubtedly will be increased demand for estate planning with assets clients do not rely on to produce the income they need to live on, such as their vacation homes and even their primary residences. Those assets typically do not produce income and clients often do not "feel the pain" when transferring residences to irrevocable trusts.

However, for clients who live in Florida, planning with their homestead properties adds multiple levels of complexity and risk. Some of the unique risks involved when planning with Florida homesteads, include: (i) potentially losing Florida's unlimited homestead creditor protection; (ii) potentially losing the homestead ad valorem real property tax exemption (and associated "Save Our Homes" benefits); and (iii) potentially causing inclusion of the home in the estate of the client, due to the planning to try to retain the real property tax benefits.

As a result, the author continues to urge advisors both within Florida and beyond its borders that whenever possible please seek to avoid planning with your clients' Florida homesteads. Too often, it seems clients who have transferred their homesteads as part of their estate plans have ultimately regretted it and wished they had not done so. Florida homestead jurisprudence abounds with cases involving disputed transfers of homesteads to irrevocable trusts leading to results clients ultimately regretted (or would have regretted if still alive).

Nevertheless, odds are some of your clients (and some of ours) will insist on using their homestead properties in their planning. Therefore, for those advisors considering estate planning with clients' Florida homesteads, the newsletter will offer some tips and pointers and a few important "dos" and "don'ts" for your consideration.

Friends, my conclusion is unchanged: a Florida homestead should only be used in planning as a last-ditch measure, and even then, should only be used with great caution. If you can avoid it, please do not transfer your

clients' Florida homesteads as part of their estate planning. If you cannot avoid it, I hope this newsletter is helpful.

Florida Homestead Law and Planning with Homesteads

Florida homestead law derives 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.

A fundamental aspect in any homestead discussion involves distinguishing the 3 major categories of homestead law. As the Florida Supreme Court stated in the seminal case of Snyder v. Davis, there are essentially three

different kinds of homestead laws to distinguish: (i) creditor exemption/protection, (ii) real property tax exemption and (iii) devise restrictions. Whenever planning with a client's homestead, all three issues should be contemplated and accounted for.

Homestead Creditor Protection

As you know, Florida law protects an owner of a homestead from the claims of creditors. The protections are not limited in value (i.e. a $50 million property might be fully creditor-proof). However, there are certain limitations, such as the size/acreage of the property. The basic rules for creditor protection of homesteads are quoted above in subsection (a) of Article X, Section 4 of the Florida Constitution.

Section 4(b) of Article X of the Florida Constitution generally provides for the inurement of such creditor protection to the "heirs" of the homestead owner upon death. The inurement of the exemption is an often-litigated issue as it impacts post-death administration in a number of ways, including the availability (or unavailability) of the homestead property to be sold to satisfy pre-residuary bequests, debts and claims of the deceased, obligations of the Personal Representative ("PR") in administering the estate and expenses of administration (including the PR's fees and the PR's attorneys' fees).

Homestead Real Property Tax Exemption and Related Save Our Homes Cap

Florida provides ad valorem real estate property tax benefits to homestead owners. These tax benefits can quickly add up and may be vitally important for many clients. Certain clients save hundreds of thousands of dollars (or more) each year in property taxes thanks to the homestead and exemption and the related "Save Our Homes" ("SOH") cap on annual increases.

The homestead real property tax exemption and the SOH cap on property tax assessments are found in Section 6 of Article VII of the Florida Constitution. Under Section 6, 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; 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 the homestead/SOH cap. The homestead/SOH laws apply a cap of 3% (or CPI, if lower) on annual increases in property values for purposes of ad valorem real property taxes —regardless of market increases in value. Non-homestead property is subject to a 10% cap.

The significant gap between real fair market value and assessed/capped taxable value for property tax purposes for many clients creates a substantial incentive to maintain the homestead/SOH cap benefits. It was reported about a decade ago, that the homestead/SOH cap shields more than $400 billion in real property values from taxation.

An individual's homestead/SOH benefits can be really staggering. For example, we've encountered cases involving homestead/SOH benefits in excess of $100,000+ per year in property tax savings. Of course, in Florida (as in many other states) it is not uncommon to deal with clients owning residences with assessed values in excess of $20 million. When working with such clients, planners must be very careful to protect and preserve the homestead/SOH property tax benefits. Few clients will be understanding if their estate planning unwittingly causes them to lose the annual tax benefits.

Moreover, even clients with nominal homestead/SOH cap benefits today (but owning valuable homes) will typically also want their planning to ensure the availability of the homestead/SOH cap expecting and hoping for the long-term benefits of the 3% cap on their taxes in the future.

Estate planners must ensure transactions they are structuring do not change beneficial ownership of the homesteader (unwittingly) or do not cause loss of the exemption in the future (again unwittingly). Obviously, any practitioner working with a Florida client's homestead must proceed with caution and must consider the impact of homestead/SOH changes before transferring a homestead property as part of an estate planning technique.

Homestead Restrictions on Devise

Florida law restricts a homeowner's ability to devise a homestead on death and to alienate it during lifetime, via certain restrictions on devise provided in Article X, Section 4 of the Florida Constitution, and §732.401 and §732.4015, F.S.

As noted earlier, Article X, Section 4(c) (quoted above) provides the devise restriction as well as the limitation on lifetime alienation. Obviously, the provisions are designed to protect surviving spouses and minor children. However, these "protections" have created unsuspecting traps for the unwary practitioner. If a homestead is improperly devised or is not devisable, then §732.401 and §732.4015, F.S. apply and address what happens to the homestead, i.e. the spouse gets a life estate or 50% tenant in common interest (if properly and timely elected) and the descendants get a remainder or the balance of the tenant in common interest.

Most importantly, a devise in trust cannot satisfy the devise restrictions even if the trust affords the surviving spouse similar rights to a life estate. This rule applies even for clients who move to Florida after their estate plan was drafted and creates potentially horrible trap for the unwary. If you are preparing an estate plan for clients who have a vacation home in Florida (they may subsequently move to) or who may contemplate a move to Florida (which they share with you), then you must review the estate plan to ensure there are either proper waivers or proper devises in the estate plan.

COMMENT:

Some "Dos" and "Don'ts":

Because of the desire of so many clients to use the transfer tax exemptions but not give up income producing assets, there likely will be increasing pressure to fund irrevocable trusts with real estate, including Florida homesteads. Here are some "dos and don'ts".

Do Not Forget to Join the Spouse in the Conveyance of Homestead Property

If your client intends to validly convey her homestead property to an irrevocable trust, a SLAT for example, you need to be sure there is an effective deed to transfer the homestead.

If a client is married, the spouse must join in the conveyance even if the spouse is not on the deed/title. Improper transfers of homesteads (deeds without spousal joinder) are unfortunately more common than you might imagine.

For example, if the wife owns the homestead, the drafter of a new deed would see only the wife's name on the existing/old deed as grantee (the

husband's name would not be on the deed as a grantee, in this example, as he was not an owner). It would not be uncommon for the drafter of the new deed to assume that the grantor of the new deed ought to be the grantee on the prior deed (in many cases that may be a wise and natural assumption). However, in this example, with a homestead property, such assumption would be a mistake. If the drafter of the new deed was not aware of the homestead rules, the drafter would not know that the non-owner spouse must join in the new deed.

The consequences of a deed drafting mistake could be huge. Generally, improperly executed homestead deeds are void – although it is not as clear who has standing to challenge such deeds, due to the Lyons v. Lyons case. It may be necessary to have the spouse join in the new deed (and it is okay/appropriate to note that the spouse is only joining as joinder is required by the Florida Constitution) to ensure a valid transfer of title – and to avoid blowing up a gift tax plan.

Do Not Overlook the Creditor Protection Aspects of Florida Homesteads – Part 1

Many clients move to Florida just because of the liberal homestead exemption from creditors. Having an unlimited (in value) creditor protected homestead can be extremely important, so do not overlook the impact of your planning on the client's asset protection plan. Moreover, do not overlook how planning with the homestead might expose the property to other unforeseen creditors.

For example, suppose a client would like to use some of her exemption via an outright gift of her homestead to her two children. This estate planning technique seems simple enough, and it will allow application of gift tax exemption.

However, unless the children also live in the home with their mother, the "homestead" property is no longer protected. The homestead was previously exempt from the claims of the mother's creditors as well as the creditors of the children – as they did not own the home. However, after the simple deed in this example, the homestead is no longer protected from the children's creditors. If either child is sued (or both are), the homestead is available to be taken and sold to satisfy the judgment.

Do Plan to Retain the Homestead/SOH Benefits – Example of Married Clients

Here is a simple statement of near-universal truth: most clients wish to retain their homestead/SOH benefits at all costs.

Sometimes this is easier to do than others. For example, when planning with a SLAT, a transfer from one spouse (joined by the other on the deed) to a SLAT for the other spouse should not trigger a re-valuation for homestead/SOH purposes assuming the spouse/beneficiary of the SLAT has the requisite rights to use the property in the trust. For more on the "magic" trust drafting language see below.

In that case, one spouse is entitled to the homestead benefits before the transfer and the other spouse is entitled to the benefits after the transfer, so the deed should not void the homestead/SOH benefits.

Do Include the Homestead Ad Valorem Tax "Magic" Language in your Trusts

If you are creating an irrevocable trust (e.g. a SLAT) and intend the beneficiary (in this example, the grantor's spouse) will be eligible to continue the ad valorem homestead/SOH benefits, then you need to include special language in your trusts to do so.

Here is an example of a clause that might be used in such a trust (although there are many ways to draft proper "magic" language):

> A. Homestead. If any interest in Grantor's homestead residence is transferred to and held as a part of the principal of this trust, then Grantor's husband may live in such residence rent-free. Grantor's husband may use said residence as his primary residence, and Grantor intends that his beneficial interest and possessory rights to such residence shall comply with and satisfy the terms of Sections 196.041 and 196.031 of the Florida Statutes, such that said beneficial interest and possessory right constitute, in all respects, "equitable title to real estate" as that term is used in Section 6, Article VII of the Constitution of the State of Florida.

In this example, a transfer from the wife as owner of the homestead to the trust for her spouse (assume a typical SLAT) should not be deemed a homestead/SOH re-valuation event, at least so long as her husband is alive and remains a beneficiary of the trust and they live in the property.

Do Not Overlook Planning for What Happens on the Spouse's Death – in a SLAT

Following up on the example of the SLAT transfer above, even if the transfer from the wife to the SLAT for the husband is not a homestead/SOH re-valuation even, and if the husband is entitled to the homestead/SOH benefits post-gift, estate planners must next consider the impact of the husband's death.

What happens when the husband dies in this example?

As Florida is not a "domestic asset protection trust" jurisdiction and the creditors of the wife would have the ability to access the SLAT assets if the SLAT continued in trust for the wife's benefit after the husband's death, the SLAT would be includible in the wife's estate upon her death if the SLAT continued for her benefit. Thus, we can assume that upon the husband's death in our example, the trust would either pass outright or remain in trust for the children/descendants. That is the most likely result.

Generally, then, in this SLAT example, if the husband (in our example the beneficiary spouse) predeceases the wife (in our example, the gifting spouse), the death of the husband and the trust continuing for the children (or passing outright to them) would be a homestead/SOH re-valuation event.

Since you never know when the beneficiary spouse (the husband in this example) will die, it is only prudent to plan for that eventuality. Thus a 99-year lease should be considered in conjunction with this type of SLAT plan.

Moreover, knowing ahead a 99-year lease may be needed to save homestead/SOH benefits, the careful drafter should also ensure that the SLAT does not pass outright to the children and that the trusts for the descendants (after the husband's death, in our SLAT example) are structured as grantor trusts for income tax purposes to avoid creating taxable income on the rent payments.

Therefore, in this example of a wife-created SLAT for the benefit of the husband and the descendants, it is common to suggest coupling the SLAT with a 99-year lease, with the grantor/wife as tenant and the trustee as landlord. That way, the grantor/wife would be entitled to the homestead/SOH benefits under the 99-year lease if the husband should predecease her. Coupling the 99-year lease with the SLAT should create a

situation where the order of death should not matter – at least for retaining the homestead/SOH benefits.

The use of 99-year leases for homestead/SOH ad valorem tax purposes has been addressed in multiple other articles and presentations, thus the author will not re-address the details herein. However, the only published opinion to date on point is Higgs v. Warrick, which went all the way to the Florida Supreme court, and fortunately the taxpayer was on the winning side.

In our SLAT example, the transferor/client/wife is entitled to the homestead/SOH benefits on day 1 prior to the gift; the spouse/husband is entitled to the homestead/SOH benefits on day 2 (after the deed to the new SLAT – and due to the "magic language" in the SLAT). Thus, the deed to the SLAT should be an exempted transfer and not be a re-valuation event/trigger. Next, if the transferor/client/wife and trustee enter a 99-year lease on day 3 (and record it), the property should remain exempted for the lifetime of the client/transferor/wife and her spouse/husband, regardless of which one dies first.

Logically, this planning should work to preserve the homestead/SOH benefits since the homestead/SOH entitlement and benefits are just passing between and among the wife and the husband and each "change" should be an exempted transfer, avoiding a re-valuation.

Do Not Get Overly Cute with Your Leases

Some clients/transferors may prefer not to pay rent and thus not to enter a fair market value lease currently. They may ask to put the lease on the property only after the first death. Or they may ask to put the lease on the property but for no (or nominal) rent until the 1st death.

The author urges you not to get too cute with this planning. There is just no case law indicating what planning may be "too cute" for the property appraiser.

In our SLAT example, if the beneficiary spouse dies first, adding a lease only after the beneficiary spouse's death logically should not work to preserve the homestead/SOH benefits, because the beneficiary spouse's death would be a re-valuation event and recording a lease after the beneficiary spouse's death (even one minute after) would be too late. The built-up homestead/SOH benefits logically should be lost in that event.

Therefore, in our ongoing SLAT example, theoretically a 99-year lease could be entered between the transferor wife and the trustee of the SLAT after the initial transfer to the SLAT but before the husband dies. Theoretically, that should work. The wife was entitled to the homestead/SOH benefits pre-transfer to the SLAT, the husband was entitled to the homestead/SOH benefits while he was alive and title was in the SLAT, and because the wife entered a 99-year lease and recorded it before the husband died, if the husband dies first, the wife should be entitled to the homestead/SOH benefits for the balance of her lifetime.

However, it seems risky to hope the clients will subsequently enter and record a lease before the beneficiary spouse dies. An untimely death (by the husband beneficiary) before the 99-year lease would thus be a re-valuation event for homestead/SOH and a subsequent recording of a lease would be too late. Therefore, while such a plan might work, it seems too risky.

Some have also suggested a lease could be recorded after funding the SLAT but the lease might require no rent (or only a very nominal rent) rent until after the beneficiary spouse dies. This approach skates on the "too cute" border and runs the risk of being deemed illusory. Should that happen, the death of the beneficiary spouse may be a homestead/SOH re-valuation event.

Some advisors have shared the concept of recording a "springing" lease that comes into effect the day of (or the day before) the beneficiary spouse's death. Again, while there are arguments why this practice could work, there is still a risk the springing lease will be deemed illusory.

I am not aware of any property appraisers taking positions on these "cutting-edge" lease techniques; however, if any of you have had such experiences, please email me and share your stories.

Do Not Forget to Record the Leases

In the SLAT example above, the client/wife entering a 99-year lease at the formation of the SLAT should also record the lease currently with the transfer to the trust.

§196.031, F.S. states in part: "Before such exemption may be granted, the deed or instrument [e.g. the lease] shall be recorded in the official records of the county in which the property is located."

Recording the lease is a necessary part of the process.

Do Plan to Retain the Homestead/SOH Benefits – Example of Clients Without Spouses

Transfers to trusts by clients without spouses as beneficiaries may present unique challenges. Generally, a transfer to a "dynasty" type irrevocable trust for one's descendants would be a re-valuation event for homestead/SOH purposes.

You could say that preserving the homestead/SOH benefits on a transfer to a dynasty trust where there is no spouse as a beneficiary and you are relying on a 99-year lease presents genuine "chicken and egg" issues.

- If the lease is recorded effective immediately after the transfer to the trust, then is the transfer to the trust a homestead/SOH re-valuation event? Logically the answer is yes. For at least one second, title vested in someone else (the trustee) before the trustee and the client entered the lease. Theoretically, that could/should be a re-valuation event for homestead/SOH purposes.

- If the lease is entered into before the deed and then the deed is recorded simultaneously with the lease (perhaps the deed is made subject to the lease), arguably the lease was made effective before the deed, and there should be an argument for homestead/SOH benefits to continue. One question is: who are the parties to the lease? Before the transfer of title from the client to the trust, the client owns the property. So how can the client enter a lease with herself as tenant and as landlord? Wouldn't the lease be a nullity under the doctrine of merger (thus making the deed transfer a re-valuation event for homestead/SOH purposes)? A second question is: could the client enter into the lease with the trustee of the dynasty trust, prior to the deed (i.e. when the trustee doesn't yet have title to the property)?

Anecdotally, I've heard some estate planners and some property appraisers are comfortable entering into the lease at the same time as the deed and recording both simultaneously. Obviously, we have not polled every attorney or every property appraiser, but if this technique may be a part of your planning, you should check with the property appraiser before you leap.

To date, there have not been any cases or precedential rulings of any sort addressing the proper answer to this conundrum. Perhaps before entering such a transaction, the attorney/advisor can obtain an opinion giving approval from the property appraiser.

Do Consider the Potential Use of a Short-term QPRT – or a Revocable Trust - as a Step Toward the Dynasty Trust (and hopefully not a step transaction)

An idea to save the homestead/SOH benefits on a transfer to a dynasty trust may be the creation of a very short term QPRT (or maybe not a "qualified" PRT, but just a short term irrevocable trust) or even a revocable trust in between the client and the dynasty trust.

Intervening QPRT

If the client creates a QPRT, the client is entitled to continue the homestead/SOH benefits during the QPRT term. Florida Courts have rejected the notion that there must be a minimum term in a QPRT to retain the homestead/SOH benefits.

Thus, a client might consider transferring title to a very short term QPRT and entering a 99-year lease with the QPRT trustee and recording the lease prior to the QPRT term ending. That seems like it should work.

The transfer to a QPRT is not a homestead/SOH re-valuation event (there is case law on this point). And if the 99-year lease is entered into between the client and the QPRT trustee and recorded prior to the end of the QPRT term (even if that is only a few months, for example), then the transfer to an on-going irrevocable (grantor) dynasty trust for the children at the end of the QPRT term should not be a homestead/SOH event due to the recorded lease.

At the end of the very short QPRT term, title passes to a dynasty trust subject to the 99-year lease, GST exemption is applied, and the homestead/SOH planning and the gift/GST tax planning may both be achieved.

Intervening Revocable Trust

Another alternative would be transferring the title to a dynasty trust that is revocable at the outset (perhaps with a trustee who isn't the client) and

entering into and recording the 99-year lease between the client and the trustee before the dynasty trust becomes irrevocable.

Subsequently and after the deed to the trust and the 99-year lease are both recorded, the trust can become irrevocable, and the client's gift and GST exemptions may be applied.

Logically this should preserve the homestead/SOH benefits also, as the client would be contracting with a trust (not herself) and thus the lease should not be a nullity by the doctrine of merger.

Do Not Overlook the Risks of a Homestead/SOH Re-valuation Moment

However, not all trust transfers avoid re-valuation for homestead/SOH purposes. The author was recently made aware of a case involving a re-valuation by the Miami-Dade County property appraiser after a transfer of a homestead to an irrevocable trust for children, even though the trust immediately entered a 99-year lease with the transferor.

As retold to the author, the property appraiser used the transfer as cause to re-value the property in the year of the transfer and thus increase the property taxes dramatically. The transferor claimed the same party was entitled to homestead/SOH benefits before and after the transfer. But the property appraiser argued (and maybe was right) that for at least a moment in time the client did not have the right to use the property (for a moment it was in the trust prior to the new lease taking effect).

Further, according to the teller, this case created a great deal of consternation and litigation (and I'm sure also heartache) for all parties involved, including the drafter of the plan.

As noted above, the author has heard some property appraisers will not re-value if the transfer via deed to a trust was accompanied by a 99-year lease (in the fact pattern above), and both are recorded simultaneously, but I cannot confirm this technique will work. Using an intervening trust may be the safer and more reliable way to ensure the continuation of the homestead/SOH benefits.

Do Consider the Unique Estate Tax Inclusion Risks of 99-Year Leases

A unique problem of this type of homestead planning is getting comfortable with 99-year leases for estate tax purposes. Many practitioners believe that a lease requiring the payment of rent at full fair market value should

not cause estate inclusion. However, not all practitioners agree that entering a 99-year lease avoids estate inclusion.

On the one hand, an argument presented for inclusion is that because federal tax law relies on state law to define property interests, if the rights of a tenant under a 99-year lease are a sufficient retained interest in real property to be treated the same as property ownership for homestead/SOH purposes, then might the IRS argue the retained rights of a tenant under a 99-year lease are a sufficient retained interest in the transferred property to trigger Section 2036 of the Code? In other words, the IRS may argue the retained leasehold interest is akin to a retained fee interest or outright ownership and seek to include the property in the client's estate.

On the other hand, if there is a lease at fair market value, there should be a viable argument for no inclusion. At least one commentator asserted a sale for adequate and full consideration (even if the taxpayer remains whether paying rent or not) should not cause estate inclusion of the residence. [i]

Moreover, a number of cases and rulings indicate that although subject to close scrutiny, a gift of a residence coupled with a lease-back at fair market rent should not cause estate inclusion under Section 2036 of the Code. [ii] Also, in the context of expiring QPRTs, there have been a number of rulings supporting the proposition that the residence should not be included in the grantor's estate under Section 2036 of the Code so long as the grantor rents the property for full fair market rent. [iii]

However, most seem to agree Section 2036 of the Code does cause inclusion of the property in the client's estate if the lease is ever below fair market value. That presents a big concern. There are few appraisers comfortable quoting fair market rent and there are few cases testing what that means to the IRS. So, there is a substantial risk involved in entering into a 99-year lease that the IRS may/could seek to include the property under Section 2036 of the Code, arguing the lease may have been below market, if only for some period of time.

This risk is exacerbated for planners since such a dispute would come down to issues of fact (was the rent paid ever below fair market rent) - not legal issues. Inclusion could result not from an advisor's legal advice, but simply because a client failed to follow the advice, or failed to obtain an adequate appraisal of fair market rent (or didn't revalue fair market rent as may have been required by the lease or IRS).

To be blunt, ensuring a 99-year lease is always at fair market rent (or even just ensuring timely payment of the rent) presents issues clients may very easily mess up. Planners should be cautious in their advice and careful in their written directions to the clients, as subsequent IRS audits may lead the family to point fingers at the planner anyway.

One option to help reduce the inclusion risk is getting professional trustees involved; however, in our experience, using corporate trustees in cases with homesteads and 99-year leases appears to be rarely done. Moreover, even having a professional trustee does not ensure the lease is always at market value unless the client and the trust annually (or at least very frequently) incur the costs of re-appraising the property.

In the end, embarking on any planning with a Florida homestead and a 99-year lease has this added estate inclusion risk that even the best planners can't mitigate by the terms of their documents. Please draft a very clear letter of instructions to your clients detailing the steps necessary to ensure compliance with the lease and reminding/requiring the client to ensure the lease is always at fair market value.

Do Not Use "Triple Net Leases" Reflexively

While it may be theoretically possible to use a "triple net lease" in your planning, the practice seems quite risky. The benefit of the triple net lease is the client pays virtually all the expenses on the property directly and pays very little rent. Many clients like the "feel" of the triple net lease approach, as it is least disruptive to typical routines.

However, attempting to use a triple net lease in a residential rental adds risk. As a result, I do not dismiss the triple net lease technique out of hand, and I can see how maybe there are ways to utilize triple net leases that work, but please proceed with caution.

First, there are very few (or no) real market comparables for triple net leases in the residential context - in South Florida, at least. Thus, it is almost impossible to assure clients they won't cause estate inclusion as it is almost impossible to advise a client what the fair market rent would be in that circumstance.

Second, the less the client's economic situation changed (e.g. the client used to pay all the expenses directly from a personal account before the

gift/transfer and the client still pays the expenses directly from the same account after the transfer) the greater the risk of IRS inclusion.

To mitigate the inclusion risks, if you are preparing a 99-year lease, perhaps encourage the client to pay as much rent as reasonably possible, not the least possible; however, obviously, the client cannot pay far above market rent without risking an argument that a gift is being made. The rent is generally a tax-free "gift" to the trust. Alternatively, in drafting your lease, you may provide that if the tenant pays some of the expenses (which the trust/landlord should have paid), then a credit will be applied against the gross rental amount. This may be a safer approach than crafting a triple net lease.

Again, this discussion of net vs gross leases highlights unique risks posed when trying to plan with clients' homesteads. The analysis may become one not of legal issues but of factual ones. And these added "fact based" inclusion risks regarding the way clients handle the leases is a key reason why I suggest not planning with homesteads - if at all possible.

Do Not Forget to Plan for What Happens to the 99-year Lease Post-Death

If your client enters a 99-year lease with an irrevocable trust, you must ensure the rights and obligations under the lease are addressed in the client's estate plan.

One solution might be to specifically devise any rights and obligations in the lease to the same irrevocable trust that is the landlord on the lease. That should create a merger of the lease post-death. In that case, the trustee and the PR of the estate ought not have reason for a dispute.

Another solution, some have argued, is to have the lease end on the first to occur of the client's death or 99 years. Some respected planners have argued this type of lease works for homestead/SOH purposes. However, to my knowledge, this technique has not been tested by a court ruling or even a property appraiser's pronouncement. While there is logic to support such a lease qualifying to keep the homestead/SOH benefits, it seems a bit aggressive. A property appraiser could fairly argue that a lease that terminates on death is (by definition) not for a term of 98+ years and deny homestead/SOH benefits. Again, if you contemplate using such a lease it may be wise to seek pre-approval from the property appraiser's office.

In some cases, I've been made aware of, there was no planning at all for the lease post-death. Perhaps the clients and the planners assumed that post-death the fiduciaries and beneficiaries would agree to modify or terminate the lease. Third parties modify leases, so why can't the fiduciaries and beneficiaries? In many cases, expecting the family to "just figure it out" may be reasonable, but not all families are harmonious after the client's death. Anecdotally, the author has been alerted to at least one case where post-death litigation ensued over the enforcement of claims against the estate by the trustee of the irrevocable trust under a 99-year lease.

Do Alert your Clients that a 99-Year Lease Could Create Devise-restricted Homestead

At this time, it is unknown if the 99-year leasehold interest itself creates a devise-restricted homestead.

Geraci v. Sunstar, from the Second District Court of Appeal highlights this unique risk. The courts in Florida often jumble homestead issues together and look at one type of homestead issue (e.g. creditor protection cases or homestead/SOH cases) and use that logic to apply to other types of homestead issues (e.g. creditor protection and/or devise restriction cases). This happens all the time, and it has made homestead jurisprudence a bit of a jumbled mess, at times.

Nevertheless, it seems possible a court could decide an interest in a 99-year lease creates a devise-restricted interest in real property (a homestead issue). If that happens, it could create a title mess for any transfers made subject to such leases.

It seems logical that the Geraci decision should not apply to a 99-year lease between a client and an irrevocable trust where the client must pay fair market rent. Contrast a typical 99-year lease for homestead/SOH (with monthly rent payments) with Geraci which addressed a more typical 99-year leasehold (or land lease) interest which may be bought and sold like real property (comparable to a condominium), and after a one-time payment, there are typically not ongoing monthly lease payments. Therefore, the author feels the case can be made to distinguish Geraci.

Do Not Overlook the Creditor Protection Aspects of Florida Homesteads – Part 2

Depending on the nature of the transfer and the way in which the homestead/SOH benefits are supposed to be retained, there is a risk that a court will find that the property or the leasehold interest is not a protected homestead and will open the door to creditors.

Logically, if a client transfers a homestead to an irrevocable trust for her children that has spendthrift and discretionary provisions in it, the creditors of the client shouldn't be able to take the house (unless there was a fraudulent transfer – which seems unlikely as presumptively the property was protected homestead prior to the transfer) as the client doesn't own the house, an irrevocable trust does. And the creditors of the children shouldn't be able to touch the house as there is a spendthrift clause and discretionary distributions; although under Florida law there are certain exception creditors, such as spouses and children with support orders, who are favored over spendthrift clauses.

On the other hand, it seems possible that a court may find the 99-year lease really created a self-settled trust, and thus the client's creditors should be able to attach the homestead (or maybe just the leasehold interest). If a court ruled that the 99-year lease created a possessory type interest in the trust, and that the trust thus was a self-settled trust, one would hope that the property should be homestead protected for creditor purposes.

Also, the interest in the lease may not be protected. One could argue a lease for 99 years should be protected homestead (see Geraci). But if it is not a protected homestead interest, could a creditor take over the lease, throw the client out of the house and move in (or rent the home)? I'm not sure many creditors will want to move in and pay rent, but a sufficiently disgruntled creditor might enjoy throwing the client out of her homestead – even if the creditor had to pay rent or rent out the home, perhaps.

An issue to consider: None of our clients would find losing their homesteads very palatable if they knew that by simply not doing certain estate planning, their creditors couldn't have touched the house and they'd still be living there comfortably. This highlights probably the main reason why clients should find alternative assets to plan with. Why risk losing the creditor protection?

Conclusion

If the homestead is so well protected by Florida law (from creditors, from taxes, etc), I urge you to encourage your clients to find other ways craft their estate planning without messing with their homestead properties. Even if we planners convince ourselves that a plan/transaction will work, and even if the plan does work based on the current state of Florida homestead law, the client may still live to regret it.

If a client loses a homestead or even just the homestead/SOH benefits, the client will never forgive the planner. Further, if the property comes back into the client's estate when the client dies, then all of the planning was for naught – and the client's family may never forgive the planner. Either case could lead to nasty consequences for the planner.

Given such risks, I again urge you to proceed with great caution. If at all possible, please don't plan with your clients' Florida homesteads. But if you must transfer your clients' homesteads as part of your planning, I hope some of the "dos" and "don'ts" highlighted herein are helpful to you and assist you with your planning.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jeff Baskies

TECHNICAL EDITOR: DUNCAN OSBORNE

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CITES:

Snyder v. Davis, 699 So. 2d 999 (Fla. 1997); Lyons v. Lyons, 155 So. 3d 1179 (Fla 4th DCA 2014); Higgs v. Warrick, 994 So. 2d 492 (Fla 3d DCA Nov. 2008); Geraci v. Sunstar, 93 So. 3d 384 (Fla 2d DCA 2012).

CITATIONS:

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[i] Zaritsky, Howard, Tax Planning for Family Wealth Transfers: Analysis with Forms ¶11.08[1].

[ii] . Zaritsky, Howard, Tax Planning for Family Wealth Transfers: Analysis with Forms ¶11.08[2], citing to Estate of Barlow v. Comm'r, 55 TC 666 (1972), acq. 1972-2 CB1; Estate of DuPont v. Comm'r 63 TC 746 (1975) and others.

[iii] See IRS Private Letter Rulings 9827037; 9249014; 9425028; and 9433016; Choate, Natalie, The QPRT Manual, 3.7.01and 4.6.04.