Leimberg Information Services, Inc.

Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2893

Date:08-Jul-21

Subject: Alan Gassman & Chris Denicolo - The Florida Community Property Trust: Rethinking Client Trust Logistics with a New Powerful Catalyst

"Effective July 1, 2021, Florida has enacted a Community Property Trust Act that allows for married couples to "opt-in" to community property treatment for assets held in a trust that meets certain requirements. As described below, community property can have considerable income tax planning benefits on the death of the first spouse due to Internal Revenue Code Section 1014(b)(6), which provides for all community property assets (including the surviving spouse's interest in community property) to receive a full step-up in basis upon the death of the first dying spouse. Hats off to the Judiciary Committee of the Real Property, Probate and Trust Law Section of the Florida Bar and countless others for working with State Senator Berman and State Representative Diamond to design, draft, and implement what we believe to be the best Community Property Trust legislation in the Country."

Alan S. Gassman, Esquire and **Christopher J. Denicolo, Esquire** provide members with commentary that examines the planning implications of Florida's Community Property Trust Act. Members should take special note of their exclusive **LISI** Webinar titled **Florida (and Other) Community Property Trusts: The Right Solution For Many, But Not For All** that will air on Friday, July 9th at 1:00PM ET - 2:30PM ET.

Alan S. Gassman, J.D., LL.M., is a partner in the law firm of **Gassman, Crotty & Denicolo, P.A.** and practices in Clearwater, Florida. He is a frequent contributor to LISI and has published numerous articles in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, and Interactive Legal. Mr. Gassman is also co-author of *Gassman and Markham on Florida and Federal Creditor Protection* and several other books on tax and estate planning. His email is alan@gassmanpa.com.

Christopher Denicolo, J.D., LL.M., is a partner at the Clearwater, Florida law firm of **Gassman, Crotty & Denicolo P.A.**, where he practices in the areas of estate tax and trust planning, taxation, physician representation, and corporate and business law. He is Board Certified in Wills, Trusts and Estates by the Florida Bar. He has co-authored several handbooks that have been featured in Bloomberg BNA Tax & Accounting, Steve Leimberg's Estate Planning and Asset Protection Planning Newsletters and the Florida Bar Journal. Mr. Denicolo is also the author of the Federal Income Taxation of the Business Entity Chapter of the Florida Bar's Florida Small Business Practice, Seventh Edition. Mr. Denicolo received his B.A. and B.S. degrees from Florida State University, his J.D. from Stetson University College of Law, and his LL.M. (Estate Planning) from the University of Miami. His email address is christopher@gassmanpa.com.

Here is their commentary:

EXECUTIVE SUMMARY:

Effective July 1, 2021, Florida has enacted a Community Property Trust Act that allows for married couples to "opt-in" to community property treatment for assets held in a trust that meets certain requirements. As described below, community property can have considerable income tax planning benefits on the death of the first spouse due to Internal Revenue Code Section 1014(b)(6), which provides for all community property assets (including the surviving spouse's interest in community property) to receive a full step-up in basis upon the death of the first dying spouse. Hats off to the Judiciary Committee of the Real Property, Probate and Trust Law Section of the Florida Bar and countless others for working with State Senator Berman and State Representative Diamond to design, draft, and implement what we believe to be the best Community Property Trust legislation in the Country.

FACTS:

Community Property: An Overview

Some of the key information regarding this community property overview has been derived from an excellent article written by Steve R. Akers as part

of his ACTEC 2013 Fall Meeting Musings, which can be found at https://www.naepcjournal.org/journal/issue16d.pdf**.**

What is Community Property?

There are two primary types of legal regimes concerning the ownership of property by legally married couples - community property law states and common law states (also known as separate property states). Under a community property system, all property of the spouses is considered to be either "community" or "separate" property. All property acquired during the marriage is generally presumed to be community property unless clear and convincing evidence demonstrates that the property is the separate property of one spouse only. For example, property received by one spouse as a gift or inheritance as his or her "sole and separate property" generally becomes the sole and separate property of that spouse. (See, Steve R. Akers, ACTEC 2013 Fall Meeting Musings, November 2013, pg. 3).

In the United States, there have historically been eight community property states and two territories that have applied community property law:

- Arizona
- California
- Idaho
- New Mexico
- Louisiana
- Texas
- Nevada
- Washington (state)
- Guam
- Puerto Rico

The laws in these states generally evolved from Spanish law, except that Louisiana's community property law came from France.

It is worth noting that in Louisiana, married couples who have assets characterized as community property can modify or terminate community property characterization only upon joint petition and a finding by a court that this serves their best interests. (La. Civ. Code Ann. art. 2329) In the other community property states, couples can simply enter into matrimonial

agreements during marriage (without petitioning a court) that modify or terminate (“transmute”) their community property characterization of assets, and may be required to record such agreements to transmute real estate.

Wisconsin became the ninth member of the “community property state” club in 1986 when it became the first state to adopt the Uniform Marital Property Act, which is a community property system developed by the National Conference of Commissioner on Uniform State Laws. In 1998, Alaska also enacted the Uniform Marital Property Act on an elective basis so that couples who reside in Alaska have the choice of having the community property law apply or not apply.

While the nine community property states discussed above are all considered “community property states,” it should be noted that there are differences among the laws of the community property states. Exhibit 25.18.1-1 of the IRS Manual details many of these differences.[i]

As noted by Steve Akers, Oklahoma and Oregon had opt-in community property systems briefly, but quickly repealed them less than a year after enactment of the Revenue Act of 1948. This was shortly after Abraham Lincoln invented the internet and Jonathan G. Blattmachr considered an installment sale to a Defective Grantor Trust. (Steve R. Akers, ACTEC 2013 Fall Meeting Musings, November 2013, pg. 3.)

Alaska adopted an innovative "opt-in" Community Property Trust law in 1998, which is described below, and Tennessee, South Dakota, and Kentucky also adopted "opt-in" community property systems in 2010, 2016, and 2020. The Kentucky and Tennessee statutes are very similar.

Alaska's Community Property Act, which was enacted in 1998 under the leadership of Jonathan G. Blattmachr, provides that non-Alaskans can hold assets in Alaska Community Property Trusts, with the expectation that all assets of the trust will receive a step-up in basis upon the death of the first spouse.[ii]

Likewise, the Tennessee Community Property Trust law that was enacted in 2010 allows for non-Tennessee residents to hold assets in Community Property Trusts. Under the Tennessee Community Property Trust law, the obligation of one spouse incurred before or during the marriage can be satisfied only from that spouse's one-half of the trust. On a spouse's death,

half of the value of the trust reflects the deceased spouse's share and the other half reflects the surviving spouse's share. These provisions are similar to Florida's new rules, which are discussed below.

In March of 2020, Kentucky followed suit and enacted their own Community Property Trust legislation that allows non-resident married couples to place assets in Community Property Trusts.

While the Alaska, Tennessee, and Kentucky Acts seek to provide non-residents with the ability to "opt-in" to the advantages of community property, commentators have pointed out concerns about whether the trusts will be afforded such tax treatment, and that creating such trusts can potentially forfeit valuable creditor protection benefits.

Effective July 1, 2021, Florida has joined the ranks of the "opt-in" Community Property Trust jurisdictions by enacting the Florida Community Property Trust Act, which is described in more detail below.

Joint Revocable Trusts in Community Property

Joint revocable trusts have been a popular trust instrument in community property states, and in the “opt-in” community property jurisdictions described above. Community property contributed to a joint revocable trust will be treated as community property for federal tax purposes under 1014(b)(6) as long as it is considered community property under state law.[iii]

The language of Section 1014(b)(6) is as follows:

> …property which represents the **surviving spouse’s one-half share** of community property held by the decedent and the surviving spouse under the **community property laws of any State**, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent’s gross estate” (emphasis added).

Assigning community property to a revocable trust is unlikely to change its character. For example, in *Katz v. US*, 382 F.2d 723 (9th Cir. 1967), the assignment of a husband and wife's community property to the husband's

revocable trust did not convert the property to the separate property of the husband because the community property presumption was not defeated.[iv]

The obvious allure of Community Property Trusts is the ability to receive a full step-up in basis on the death of the first dying spouse under Internal Revenue Code Section 1014(b)(6), which provides that assets owned as community property will receive a new income tax basis equal to their fair market value on the death of the first dying spouse. This “step-up” in basis applies to the full extent of community property assets, and not just to the first dying spouse’s interest in community property, regardless of whether only one-half of the value of the community property assets are included in the first dying spouse’s gross estate for federal estate tax purposes.

In other words, the surviving spouse will receive a step-up in basis for his or her interest in community property *even though* his or her interest is <u>not</u> subject to the federal estate tax system on the first dying spouse’s death. This is an incredible loophole provided by the Internal Revenue Code, since for federal estate tax purposes, the first dying spouse’s gross estate typically will include his or her separate property and his or her one-half interest in the community property.

Conversely, assets owned jointly by spouses in a manner other than as community property (such as tenants by the entirety, joint tenants with right of survivorship, or tenants in common), where the full value of such assets is included in the estate of the first dying spouse for federal estate tax purposes (such as under a JEST Trust system, as described below), will receive a step-up in income tax basis only to the extent of the first dying spouse’s interest on his or her death (i.e., 50% of assets held in this fashion).

Nevertheless, the IRS has not confirmed whether a step-up in basis applicable to community property under Internal Revenue Code Section 1014(b)(6) will apply to property held under an elective Community Property Trust system.   IRS Publication 555 entitled "Community Property" specifically provides that it "does not address the federal tax treatment of income or property subject to the ‘community property' election under Alaska, Tennessee, and South Dakota state laws." This language creates some doubt as to whether the IRS will respect an "opt-in" Community Property Trust for the purposes of affording a full step-up in basis to the assets of the trust on the death of the first dying spouse. Further,

commentators have expressed concerns about whether the full fair market value basis step-up will be recognized by the IRS, while pointing out that such trusts will often expose assets to creditors that would otherwise had not had the ability to reach such assets.[v]

Survivorship Rights in Community Property

Generally, the first dying spouse's interest in community property (and such spouse's interest in separate property) can pass upon his or her death as he or she designates by will or trust while the surviving spouse's interest in community property will become the sole and exclusive property of the surviving spouse.

Sixteen states,[vi] including Florida, have adopted the Uniform Disposition of Community Property Rights at Death Act (UDCPRDA), which provides that community property acquired in a community property jurisdiction which is brought into a UDCPRDA state will remain community property for purposes of testamentary dispositions.[vii] Individuals who move from a community property state to one of the states that does not recognize community property may wish to establish a Community Property Trust before moving to own community property if desired.

The 1967 Third District Court of Appeals case of *Quintana v. Ordono* supported the above proposition. The case involved a husband and wife who moved from Cuba in 1960, which is a community property country, to Florida, a common law state. The husband purchased stock in United States companies and later sold the stock for a promissory note worth $810,000 while still living in Cuba. The couple moved to Florida, and then the husband died, leaving a will that provided for the note to pass to his children. The wife filed suit in Florida claiming that the note was community property and therefore she should own one-half of the note.[viii] The court held that the law of the couple's domicile at the time of the acquisition of the property is what defines the property interests, so because the stock was acquired as community property in Cuba, the wife had one-half ownership of the promissory note.[ix]

Some states have legislation that allows community property to be held with right of survivorship and the IRS recognized in Revenue Ruling 87–98 that community property could be treated as such for tax purposes even though it is held with right of survivorship.[x] For example, community

property can be held by spouses where the first dying spouse's community property interest passes to the surviving spouse on the first spouse's death by operation of law. Property ownership in this manner nevertheless will be treated as community property for step-up in basis purposes under Section 1014(b)(6).

Creditor Rights in Community Property

Creditor rights vary based on the state where the community property is located. Most of the community property states allow the creditor of one spouse to reach all community property.[xi]

The general categories of these states is as follows:

1. "Creditors Can Take It All" States

All states, except Texas, allow collection of some post-marital obligations from 100% of community property. Some states (California, Idaho, and Louisiana) allow creditors to collect all debts of either spouse from 100% of community property. Other states (New Mexico and Nevada) only allow this with respect to post-marital obligations.[xii]

In California, Idaho, and Louisiana, creditors of the debtor spouse can reach all community property if the debt is incurred during the marriage. Idaho and Louisiana courts have held similarly that community property can be reached to satisfy separate debts.

Nevada has a statute that was enacted in 1873 which provides that the non-debtor spouse's interest in community property is not accessible to satisfy the debtor spouse's premarital obligations.[xiii]

New Mexico law requires the creditor to first seek payment from the separate property of the debtor spouse before being able to attempt to attach the debtor spouse's one-half ownership in the community property.[xiv]

2. "Community Debt" States

Some states (Arizona, Washington and Wisconsin) characterize post-marital debts as either community debt or separate debt. Community debt is debt that has been incurred to benefit the marriage or family.

Community debts may be satisfied from all community property. Separate ("non-community") debt may only be satisfied from the debtor spouse's half of community property or from the debtor spouse's contribution to community property. In these states, the presumption is that debts are community debts.[xv]

In Arizona, all debts incurred during the marriage are presumed to be community debt unless clear evidence is presented to show that the debt is separate. Thus, Arizona law allows creditors to reach the debtor spouse's interest in community property for payment for debt incurred prior to the marriage.[xvi]

Washington statutes permit community debt to be satisfied from the community property of both spouses, and the separate property of the debtor spouse.

Wisconsin courts divide the debts incurred after the marriage into (1) family purpose obligations; or (2) non-family purpose obligations. Debt incurred for family purpose obligations can be satisfied through the debtor spouse's separate property and all marital property, including community property. Non-family purpose obligations can be repaid by the debtor spouse's separate property and the debtor spouse's one-half interest in the couple's community property.[xvii]

Texas law provides for different rules as to a creditor's ability to access community property, depending on whether the debt results from a contract or tort claim, and whether the debt was incurred before or during the marriage.[xviii]

Under the Tennessee Community Property Act, the obligation of one spouse incurred before or during the marriage can be satisfied only from that spouse's one-half of the trust. On a spouse's death, half of the value of the trust reflects the deceased spouse's share and the other half reflects the surviving spouse's share. Similarly, Florida's Community Property Trust Act provides that the debts and obligations of one spouse may be satisfied from that spouse's one-half share of the trust, regardless of whether the debt or obligation is incurred before or during the marriage. As such, the Florida Community Property Trust may not be attractive to spouses who prioritize creditor protection planning due to assets owned as tenants by the entireties generally being protected from the debts and

obligations of only one spouse. A joint debt or obligation of both spouses may be satisfied from the assets of the trust, which is similar to the treatment of joint debts and obligations vis-à-vis tenants by the entireties assets.

Gifts of Community Property

Gifts of community property made by one spouse are automatically considered to have been made one-half by each spouse, so that “gift splitting” by the filing of a gift tax return by the non-donor spouse is not required for community property transfers.[xix] Akers instructs the reader to "not make a gift of community property to a trust in which a spouse is a beneficiary if the desire is to exclude the trust assets from the gross estates of the spouses. The beneficiary spouse will be treated as making the gift of one-half of the assets with a retained beneficial interest subject to 2036(a)(1).”[xx]

Estate Tax Implications

For estate tax purposes, the gross estate of a deceased spouse will typically consist of his or her separate property and his or her half of the community property. Because of this, most well-advised couples who reside in community property states will either transmute out of community property treatment when appropriate or consider holding the community property in a Joint Trust that breaks up into two separate parts when one spouse dies. Part one consists of the half ownership of the assets that continues in the name and under the control of the surviving spouse. The other half of the assets will typically pass into a Credit Shelter Trust, with an overflow provision into a Marital Deduction Q-TIP Trust for the surviving spouse and descendants. More detail on the estate tax implications of community property is provided below.

Gift Tax on Funding

Planners should be aware that the funding of a Community Property Trust may be considered to be a taxable gift by one spouse to the other, depending upon how much in assets each spouse transfers to the trust, and what legal rights each spouse will have over the trust.[xxi]

Steve Akers describes the issue masterfully in his ACTEC 2013 Fall Meeting Musings:

> Completed gift issues can arise even though the joint trust is revocable.
>
> In community property states, if the assets will pass to or for the benefit of the surviving spouse at a spouse's death and if spouses must act jointly to revoke the trust, there may be a completed gift upon creating the trust because the trust could be revoked only with the consent of a person who has a substantial adverse interest (reg.§ 25.2522-2(e)), and that causes a completed gift under the gift tax regulations. The older spouse may be treated as making a gift to the younger spouse that would not qualify for the marital deduction (because it would be a terminable interest without a mandatory income interest). Typically, joint trusts with community property provide that either spouse may unilaterally revoke the trust as to all community property held in the trust (i.e., both halves of community property). (The community property would be subject to the same ownership and management rights, but the trust layer would have been removed.)
>
> The Uniform Trust Code states that for revocable trusts holding community property, "the trust may be revoked by either spouse acting alone but may be amended only by the joint action of both spouses." (§602(b)).
>
> In common law property states, joint trusts often state that the contributions are treated as if made one-half by each spouse, that on revocation one-half of the trust assets would pass to each spouse, and that if a distribution is made to one spouse, an equal distribution is made to the other spouse.[xxii]

Creating a Florida Community Property Trust

Florida's Community Property Trust Act (the "Act") introduces Florida Statutes Sections 736.1501 through 736.1512, and is very similar to the Alaska, Tennessee, South Dakota and Kentucky Acts. The Act provides that "Community Property" means the property, and the appreciation of and

income from the property, owned by a qualified trustee of a Community Property Trust during the marriage of the settlor spouses.

A Community Property Trust is a trust that complies with Florida Statute Section 736.1503 and is created on or after July 1, 2021. Therefore, it appears that a pre-existing trust cannot be converted into a Community Property Trust, but trust assets existing on or before July 1, 2021, can be "decanted" or transferred into a new Community Property Trust.

A “qualified trustee” is defined under Florida Statute Section 736.1502 to be either (a) a natural person who is a resident of [Florida], or (b) a company authorized to act as a trustee in [Florida].

736.1502 defines "settlor spouses" to mean a married couple who establish a Community Property Trust pursuant to the statute.

In order for a married couple to form and maintain a Florida Community Property Trust, the Act requires that one or both settlor spouses transfer property to a trust that meets the following four requirements:

1. Expressly declares that the trust is a Community Property Trust "within the meaning of this [statute]"

2. Has at least one trustee who is a qualified trustee "provided that both spouses or either spouse also may be a trustee."

3. Is signed by both settlor spouses consistent with the formalities required for the execution of a trust [under this chapter].[xxiii]

4. Contains substantially the following language in capital letters at the beginning of the Community Property Trust Agreement:

THE CONSEQUENCES OF THIS COMMUNITY PROPERTY TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND UPON THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD BE SIGNED ONLY AFTER CAREFUL

CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK COMPETENT AND INDEPENDENT LEGAL ADVICE."

Florida Statute Section 736.1504 provides that the trust agreement that establishes the Community Property Trust may include agreement by the settlor spouses upon the following:

a. The rights and obligations in the property transferred to the trust, notwithstanding when and where the property is acquired or located.

b. The management and control of the property transferred into the trust.

c. The disposition of the property transferred into the trust on dissolution, death, or the occurrence or nonoccurrence of another event, but subject to both of the following limitations:

Limitation 1 - Under Florida Statute Section 736.1507, upon "the death of a spouse, one-half of the aggregate value of the property held in a Community Property Trust …is not subject to testamentary disposition by the decedent spouse or distribution under the laws of succession…the other one-half…reflects the share of the decedent spouse and is subject to testamentary disposition or distribution under the laws of succession of the state."

Limitation 2 - Florida Statute 736.1508 states that, upon dissolution of the marriage of the couple, the Community Property Trust will terminate, and the trustee will distribute one-half of the trust assets to each spouse.

It is important to note that Florida Statute Section 736.1508 appears to intend to provide that the married couple can contractually agree to share the assets of the Community Property Trust other than equally in the event of the dissolution of marriage, but does not seem clear to the authors.

The authors are not sure whether the spouses can have a prenuptial or postnuptial agreement that would require the equal ownership of assets received from the Community Property Trust to be adjusted after receipt, such as upon the event of a divorce filing, after the literal language of the statute has been satisfied by facilitating an equal distribution.

d. Whether the trust is revocable or irrevocable. The presumption is that the trust is revocable unless stated otherwise.
There are advantages of having an irrevocable Community Property Trust. This includes the reduction of risk that one or more individuals may unduly influence the married couple to change the trust and to lose access to the assets thereof.

e. Any other matter that affects the property transferred to the trust "and does not violate public policy or general law…or result in the property not being treated as community property under the laws of any jurisdiction."

The statute further provides that in the event of the death of a settlor spouse, the surviving spouse may amend the trust with reference to the disposition of the surviving spouse's one-half share of the trust "regardless of whether the agreement provides that the Community Property Trust is irrevocable," or regardless of what the trust agreement says to the contrary. This (and Limitation 1 described above) underscores the principle that the surviving spouse’s one-half of the Community Property Trust is the surviving spouse’s property that vests in the surviving spouse upon the first dying spouse’s death. Moreover, this prevents distributions from being made to descendants, charities, or others from a Community Property Trust, and causes loss of flexibility, but enhances the protection of the married couple themselves.

Many married couples enter into joint trusts based upon the premise that the surviving spouse would be required to have the assets remain under the trust and be usable only for the health, education, maintenance, and support of the surviving spouse and common descendants in order to preserve the assets for the common descendants or other family or charities that may be favored by the first dying spouse. This is apparently

not possible under a Florida Community Property Trust, at least to the extent of the surviving spouse's interest in the Community Property Trust.

Furthermore, during the joint lifetimes of the spouses, they "shall be deemed to be the only qualified beneficiaries of a Community Property Trust until the death of one of the settlor spouses regardless of whether the trust is revocable or irrevocable." After the death of one of the settlor spouses, the surviving spouse shall be deemed to be the only qualified beneficiary as to his or her share of the Community Property Trust. This is important because qualified beneficiaries have certain rights under Florida law, such as the right to receive trust accountings, and the right to access information regarding the trust instrument and the trust's activities.

"Qualified beneficiary" is defined under Florida Statute Section 736.0103 as "a living beneficiary who, on the date the beneficiary's qualification is determined:

> a. Is a distributee or permissible distributee of trust income or principal;
>
> b. Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in paragraph (a) terminated on that date without causing the trust to terminate; or
>
> c. Would be a distributee or permissible distributee of trust income or principal if the trust terminated in accordance with its terms on that date."

Despite the advantages of a Florida Community Property Trust, a married couple transferring assets to a Community Property Trust will cause assets that would otherwise be protected from creditors to be accessible to them, such as if and when the married couple may transfer tenants by the entireties assets, annuities, life insurance, 529 Plans, and wage accounts to a Community Property Trust.

Some couples may have the Community Property Trust own the majority interest in an LLC that will have other members. The statutes are silent as to whether a charging order will be the sole remedy of the judgment creditor who has the right to receive one-half of the Community Property

Trust assets by reason of being owed by one spouse, or all of such assets by reason of being owed by the other spouse, although it seems that the protection provided by Florida's charging order law will apply if an interest in a multiple member LLC is owned by a Florida Community Property Trust.[xxiv] The safest approach would be to have voting-member interests owned by the minority member so that the creditor can only reach an LLC member interest that would not be able to vote to authorize or require a liquidation or distribution from the LLC, but a Community Property Trust that does not control the voting rights of an entity that it owns part of may result in less than a full fair market value basis if the IRS argues that there should be a significant discount in value.

Furthermore, Florida Statute Section 736.151 entitled "Homestead Property" provides that "property that is transferred to or acquired subject to a Community Property Trust may continue to qualify or may initially qualify as…homestead…provided that the property would qualify as…homestead with title as held in one or both of the settlor spouse's individual names, and the "settlor spouses shall be deemed to have beneficial title in equity to the homestead property held subject to a Community Property Trust for all purposes, including for purposes Section 196.031."

Under the Florida Constitution, the first dying spouse can only devise Florida homestead property to the surviving spouse. The 2014 case of *Stone v. Stone* addressed this shortcoming and the court allowed a deed from a spouse to constitute a waiver of homestead rights so that the first dying spouse's interest could be devised as the first dying spouse wished.[xxv] Since the *Stone* case, Florida Statute 732.7025 was enacted to provide a safe harbor method of having a spousal waiver of homestead by deed. There is no language regarding the waiver of homestead rights included in the Florida Community Property Trust Act, so a spouse wishing to do so must rely on Florida Statute 732.7025, or must execute an agreement to waive homestead rights.

Florida Statute 196.031 provides for the property tax treatment of homestead, which allows for a reduction of up to $50,000 in the assessed value of a Florida homestead for county property tax purposes, and also a limitation in the annual increase on a homestead property's assessed value to the lesser of 3% or the increase in the Consumer Price Index over the prior year.

Perhaps more importantly, the statute provides comfort that the homestead creditor protection benefits afforded by Florida law will apply despite the property being titled under a trust and not directly in the spouses' names. It would seem that this principle would be extended to cause homestead creditor protection to apply where the homestead property is owned by a Floridian's revocable trust that is not a Community Property Trust. Many practitioners have believed homestead creditor protection would apply in such event, but *In re Bosonetto,* a 2001 Middle District of Florida Bankruptcy Court case held that the homestead creditor protection does not apply to homestead property owned by a revocable trust.[xxvi] In *Bosonetto*, Judge Proctor of the Middle District of Florida Bankruptcy Court ruled that a homestead that was considered to be owned under a revocable trust is not protected from creditors. It was interesting that Judge Proctor also ruled that Mrs. Bosonetto's homestead, which was titled in her personal name, was

considered to be owned by her revocable trust because the revocable trust had a provision which basically said that "this trust owns any of my real estate."

Since that case, there have been three District Court of Appeals cases and two Bankruptcy Court cases that declined to follow the *Bosonetto* decision and found that homesteads owned under a revocable trust are protected from creditors, but the question of whether a Florida homestead loses its protection from creditors upon transfer to a revocable trust has not been heard by the Florida Supreme Court. This new statute, which specifically provides that a homestead owned by a revocable trust is protected from creditors, may be read to indicate that the Florida Legislature believes that property owned by a revocable trust would not be protected, but for having to pass this section of the statute to clarify that a Community Property Trust can own homestead property without abrogating the creditor protection afforded by the Florida Constitution.

In addition, if this is only statutory protection because the Florida Constitution may not apply as asserted by Judge Proctor, then the Florida fraudulent transfer statute would still apply to a transfer of homestead by a debtor to a Community Property Trust. The now famous *Havaco of America, Ltd. V. Hill* established that the Florida homestead creditor protection trumps the Florida fraudulent transfer statute and would apply to the transfer of a statutorily exempt asset where the creditor protection of homestead emanates from the Florida Constitution. Married couples with potential creditor issues should therefore be advised that a transfer to a Community Property Trust may be reversed by a creditor who existed or was expected to exist at the time of the transfer.

Married couples may wish to serve as trustees of their Community Property Trust but also have confidentiality as to the ownership of their homes. It will therefore be possible, and many times advisable, to have the Community Property Trust be the sole beneficiary of a land trust which has another person or entity as its trustee so that the deed on the public record will show the name of an individual or LLC other than the home owners. In our experience, the county property appraisers in most, if not all counties, will permit the homestead exemption to be enjoyed while not revealing the names of the actual homesteading beneficial owners on the property appraiser website. Some property appraisers require the name of the beneficial owners to be included in one cell on their website, but that cell will only display a certain number of letters. For example, if the website can only display twenty characters, and the trust is beneficially owned for John and Molly Smith, the property appraiser may put "Hillary S. Jones, Esq. as Agent for her clients

John and Molly Smith. If the property appraiser only lists the first 20 characters then the property appraiser website will only show “Hillary S. Jones, Esq. a.”

Built in Protection

Under Florida Statute Section 736.1512 entitled "Unenforceable trusts," a Community Property Trust executed during marriage is not enforceable if it was:

(a) unconscionable or

(b) not executed voluntarily by the spouse against whom enforcement is sought

(c) before execution, the spouse against whom enforcement was sought:

(1) was not given a fair and reasonable disclosure of the:property, and financial obligations of the other spouse,

(2) did not voluntarily sign a written waiver expressing waiving the right to disclosure of the property and financial obligations of the other spouse, or

(3) did not have notice of the property or financial obligations of the other spouse.

The above safeguard puts lawyers and other planners in a position where they must assure that each spouse is given fair and reasonable disclosure of the property and financial obligations of the other spouse.

Finally, 736.1512(3) provides that "a Community Property Trust may not be deemed unenforceable because the settlor spouses did not have separate legal representation when executing the trust.” Nevertheless, it would be most prudent to recommend that each spouse should have separate independent legal counsel, or at least waive the opportunity to have separate independent legal counsel. It also is appropriate for the spouses to provide each other with a full and fair disclosure of their respective assets and to observe other formalities applicable to the execution of marital agreements.

COMMENT:

Advantages of the Florida Community Property Trust

The two reasons that Florida's Community Property Trust Act may be preferred over other “opt-in” community property jurisdictions are:

(1) The creditors of one spouse can only reach such spouse's one-half of the assets held in a Florida Community Property Trust (and generally not the other spouse's one-half of the trust assets). In all other states with Community Property Trust laws (except Tennessee and Kentucky), creditors of one spouse can reach all assets held in a Community Property Trust.

(2) More individuals will know a lawyer or potential trustee in Florida because Florida has a significantly larger population than Alaska, South Dakota, Tennessee, and Kentucky.

Another advantage of the Florida Community Property Trust Act is that any person residing in the State of Florida can serve as the trustee or a co-trustee under a Florida Community Property Trust.

Before the enactment of the Florida Community Property Trust Act on July 1, 2021, married couples who wanted to enter into a Community Property Trust had to have a trust company duly registered with Alaska, South Dakota, Kentucky or Tennessee, or an individual residing in one of those states, serve as trustee of the trust. Florida's Community Property Trust Act works the same way by permitting any Floridian or a qualified company to act as a trustee of a Florida Community Property Trust, which broadens the universe of potential trustees of a Community Property Trust established by Floridians.

Specifically, Florida has approximately 1.5 times the population of the states of Alaska, South Dakota, Kentucky and Tennessee combined, and Florida married couples can serve as trustees for themselves.

As of 2021, the most populated states in the United States are (with the population numbers estimated):

California (39,512,223 people)
Texas (28,995,881 people)
Florida (21,477,737 people)
New York (19,453,561 people)

Illinois (12,671,821 people)

Furthermore, a great many individuals who reside in the Northeast or the Midwest have close friends, relatives, or advisors in Florida that can serve as trustee of a Community Property Trust.

For most married couples, the benefit of having a Community Property Trust is that all assets under a Community Property Trust will receive a fair market value date of death basis for federal income tax purposes if the Community Property Act works, which is an issue described below. Other purposes include the avoidance of probate and guardianship, and having a trust agreement that can receive distributions under beneficiary designations if the surviving spouse does not survive. Most married couples will make IRAs, pensions and life insurance payable to a surviving spouse or a trust for a surviving spouse that will be separate from a Florida Community Property Trust, as described below.

For example, Harry and Sally Katz-Deli live in New York and are in their 70s. They have $3,000,000 worth of publicly traded stock for which they paid approximately $500,000. Neither of them has a “Billy” Crystal ball with respect to who will survive the other.

If they sell the stock now, they will have a $2,500,000 capital gain and may have to pay a 23.8% combined federal income tax and net investment income tax, not to mention a 9.65% New York state tax and 3.876% New York City tax.

The federal income and net investment income tax would be $595,000, and the New York state and local capital gains tax would be $338,150, if they are in the highest brackets.

If the stock is held entirely in the name of the first dying spouse, then all of the stock may receive a new income tax basis equal to its fair market value upon the death of such spouse, unless the deceased spouse received the assets as a gift from the surviving spouse within one year or less of the first death and the surviving spouse inherits it back. This increase in basis is known as a "step-up in basis." Nevertheless, in most situations, it is difficult or impossible to determine which spouse will die first. Further, Internal Revenue Code Section 1014(e) would prevent a step-up in basis to the

extent that the stock given to the first dying spouse came from the surviving spouse for no consideration and the stock passes to or for the benefit of the surviving spouse as a result of the first dying spouse's death.

Section 1014(e) reads as follows:

> (e) Appreciated property acquired by decedent by gift within 1 year of death
>
> (1) In general
>
> In the case of a decedent dying after December 31, 1981, if—
>
> (A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and
>
> (B) such property is acquired from the decedent by (or passes from the decedent to) the donor of such property (or the spouse of such donor),
>
> the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent.

If the stock is held in joint names (such as tenants by the entireties or joint tenants with right of survivorship), and one spouse dies while the stock is worth $3,000,000, then, immediately after the death of the first dying spouse, the surviving spouse will have the ability to sell the one-half of the stock inherited on the death of the first dying spouse for $1,500,000, and would pay no state or federal tax. However, if the surviving spouse sells his or her one-half of the stock that was held in joint names, such spouse would pay $297,500 in federal income and net investment income tax and $169,075 in New York state and local income tax (one-half of the tax described above, if all of the stock was sold before the death of the first dying spouse).

Instead of holding the stock jointly or placing it into the name of the spouse who may be expected to die first, Harry and Sally can establish a Florida Community Property Trust and have it drafted by the estate planning

lawyer for their daughter, who lives in Boca Raton, Florida, and their daughter can serve as trustee.

On the first death, the surviving spouse can have a $3,000,000 basis in the stock and pay no state, federal, or Medicare tax on the sale.

Important Notice for Assets Owned Jointly Before 1978 – The *Gallenstein* Rule

Under the case of *Commissioner v. Gallenstein,* a joint asset or account funded by one spouse after 1955 and before 1977 can receive a full step-up in basis on the death of the donor spouse. It may be best not to transfer such pre-1977 joint assets to a Community Property Trust if the donor spouse has a significantly shorter life expectancy than the other spouse.

While the estate tax exemption of $11,700,000 per decedent has made estate tax planning less of a concern for most taxpayers, many factors have caused a great number of married couples to have the need for, and an interest in, estate tax planning. The scheduled reduction in the estate tax exemption to one-half of its otherwise inflation-adjusted amount in 2026 (which is expected to be approximately $6,500,000), and Bernie Sanders' proposed plan that would reduce the estate tax exemption to $3,500,000 and the gift tax exemption to $1,000,000, stand to affect more taxpayers. These potential legislative changes, along with significant increases in net worth that have occurred as the result of the recent stock market growth and rising real estate prices, are incentivizing many married couples to learn about and engage in estate tax planning.

One challenge for many couples is how to lock up as much in assets as possible under a credit shelter trust on the first death, when the surviving spouse may have significant estate tax challenges, but the first dying spouse has only approximately half of the assets that can be used to fund a credit shelter trust and the value of such assets are far less than the exemption amount.

Many planners believe that it is fine to leave all assets to the surviving spouse and not make full use of the estate tax exemption of the first dying spouse by maximizing the funding of credit shelter trusts because the

surviving spouse will receive the unused estate tax exemption of the first dying spouse under the portability rules if the first dying spouse's estate files an estate tax return in the proper manner. These advisors may not be taking into consideration that one or more of the following issues may arise:

(1) The surviving spouse may remarry and then the new spouse may die, resulting in the portability allowance of the surviving spouse being reduced to whatever is available from the subsequent dying spouse;

(2) The portability allowance is not indexed to grow with inflation or with the growth of assets as would apply under a credit shelter trust; and

(3) The portability allowance does not provide for the surviving spouse to “port” out of the first dying spouse’s unused GST exemption.

For example, let us assume that Harry and Sally have $7,000,000 in personally owned investment assets, a $1,000,000 home, and $3,000,000 in IRAs.

They also receive approximately $150,000 per year in pension income, and their assets are expected to grow at approximately 7.25% a year after taxes and expenses.

They have a 20-year life expectancy, despite eating a lot of deli food, including corned beef, pastrami, matzo ball soup, potato knishes, and egg creams almost every day.

In 20 years, their net-worth will be approximately $28,382,069.37 so they would like to not only avoid capital gains tax for the surviving spouse but also place as much as possible into a credit shelter trust on the first death.[xxvii]

If Harry and Sally each presently have approximately $4,000,000 worth of assets in a separate revocable trust, or $8,000,000 worth of assets in a joint trust that only has half of the assets locked up under a credit shelter trust on the first death, then there can be a significantly higher estate tax on the second death.

Harry and Sally may therefore consider a JEST ("Joint Exempt Step-up Trust") in lieu of a Community Property Trust for their income tax basis and estate tax planning.

But Is the JEST Trust Superior to the Community Property Trust?- Take a Serious Look at This Planning Tool

The Joint Exempt Step-Up Trust, or the "JEST", is a joint revocable trust established by a married couple. Under a JEST, the first dying spouse has the testamentary power to appoint all of the trust assets to creditors of his or her estate, which causes all assets of the trust to be included in his or her estate for federal tax purposes so that they may receive a new income tax basis under Code Section 1014, and be considered to be the assets of the first dying spouse for purposes of funding a credit shelter trust.[xxviii]

Three Private Letter Rulings (PLRs) and a Technical Advisory Memorandum (TAM) published in 1999 and 2000 support this proposition, although there is some risk that the IRS might not follow these non-precedential pronouncements and take the position that the transfer of assets considered as owned by the surviving spouse to a credit shelter trust might be characterized as a gift by the surviving spouse.[xxix] One of these Private Letter Rulings was applied where each spouse had a separate Revocable Trust, and each spouse had a Power of Appointment over the assets of the Revocable Trust of the other spouse. This technique can work as well as a JEST, but is often considered to be confusing by clients and many advisors. This risk is ameliorated by the design of the JEST, which contains provisions that cause the assets that were contributed to the trust by the surviving spouse to be held in a separate credit shelter trust of which the surviving spouse is not a beneficiary unless or until such spouse is added by a committee of independent trust protectors serving in a non-fiduciary capacity.

Further, the JEST can be drafted so that the separate credit shelter trust might be deemed as funded by the surviving spouse if considered to be an incomplete gift for gift tax purposes by giving the surviving spouse a power to direct how assets may pass among the spouses' common descendants

or otherwise upon death, and requiring the surviving spouse's consent to any distribution from such separate credit shelter trust.

The same PLRs and TAM that concluded that a credit shelter trust could be funded with assets considered as owned by the surviving spouse also concluded that those assets would not receive a new income tax basis, based upon the assertion that the arrangement constitutes a gift by the surviving spouse to the first dying spouse immediately before death, that is then inherited by the surviving spouse, thus triggering the Internal Revenue Code Section 1014(e) one-year rule.

The PLRs and TAM, however, failed to point out that Section 1014(e) applies when an asset is gifted to a decedent who devises it back to the donor upon death, and not a situation where the assets are left to an irrevocable trust that may benefit the donor.

A properly drafted JEST may therefore contain provisions that would make it unlikely or potentially even impossible for the surviving spouse to benefit from the credit shelter trust that is funded with the assets considered to have been held by the surviving spouse. Section 1014(e) should not be implicated if the surviving spouse cannot benefit from assets that he or she is considered to have contributed to the trust, therefore allowing for a step-up in basis as to such assets on the first dying spouse's death. This is why a JEST Trust will typically provide that the surviving spouse will not be a beneficiary of the credit shelter trust established and funded with the assets of the surviving spouse on the first dying spouse’s death unless or until any and all other trusts for the surviving spouse have been completely spent, and Trust Protectors acting in a non-fiduciary capacity, or the holder of a power of appointment without a fiduciary duty to exercise it, may add the surviving spouse to the Trust. This would typically occur much more than three years after the trust assets may be sold with an assumed full step-up in income tax basis.

As a practical matter, assets held under a JEST trust might be sold to avoid capital gains taxes shortly after the death of the first spouse, and the surviving spouse would not be added to or considered to be a beneficiary of the JEST credit shelter trust unless or until it is clear that the income tax return for the tax year of the sale would not be audited, or that the audit would not be complete.

The JEST is clearly more complicated than the Community Property Trust from the point of view of the drafter, but should allow for the funding of a credit shelter trust from all assets of the JEST.

Non-Tax Considerations of Joint Trust Vehicles

Notwithstanding the allure and advantages of the use of Community Property Trusts and JESTs, many married couples will prefer to have a simple joint trust that may be treated as a tenancy by the entireties vehicle or a simple “joint with full or limited” right of survivorship vehicle. From a fundamental perspective, a joint trust can function essentially as a marital agreement between the spouses that defines the rights, obligations, and restrictions on disposition associated with the assets of the trust. Advisors need to be very careful to explain the options that a married couple has with respect to this.

Many couples will decide to have their most appreciated assets held under Community Property Trusts or JESTs, with less appreciated assets being held under tenancy by the entireties trusts (or as tenants by the entireties outright) to provide creditor protection so that a creditor owed money by only one spouse cannot reach the trust assets.

While nothing in the Florida common law or statutory law prevents trust assets from being held as tenants by the entireties by a married couple, a recent opinion issued by the Middle District of Florida Bankruptcy Court specifically states that “[t]he issue is whether a revocable living trust can own property as tenants by the entireties to exempt it from creditors' claims in bankruptcy cases. The answer is no because the trust cannot meet the unities required for tenants by the entireties ownership.”[xxx] In reaching its decision, the Middle District of Florida Bankruptcy Court cited the 1941 Florida Supreme Court case of *Hunt v. Covington*:

> No persons except the husband and wife have a present interest in an estate by the entireties.... It is not subject to partition; it is not subject to devise by will; neither is it subject to the laws of descent and distribution. It is, therefore, an estate over which the husband and wife have absolute disposition and as to which each, in the fiction of law, holds the entire estate as one person.[xxxi]

The authors disagree with the Bankruptcy Court Judge's conclusion, and do not believe that the Court considered the fact that a married couple could own the beneficial ownership interest of a trust as tenants by the entireties. As a result of the *Givans* case, many advisors will probably place a significant portion of a married couple's assets into a limited liability company owned as tenants by the entireties that may be "payable on the second death" under the Operating Agreement to a joint trust or to separate trusts upon the death of the first dying spouse. A separate LISI Newsletter will be published in the next week on these decisions.

Will a Community Property Trust Work?

There is a question as to whether an elective community property arrangement like the Florida Community Property Trust will be recognized by the IRS as a legitimate community property arrangement to qualify all trust assets for a fair market value date of death basis step-up under Internal Revenue Code Section 1014(b)(6) on the death of the first dying spouse. The IRS has not formally commented on the efficacy of Community Property Trust arrangements, although well respected commentators have concluded that it "should qualify." With the warning that this tax treatment is "not absolutely certain,"[xxxii] Jonathan Blattmachr, Howard Zaritsky and Mark Ascher in "Tax Planning with Consensual Community Property: Alaska's New Community Property Law" provide extensive discussion of the *Harmon* case and statutory law that exists in this area.

Since Blattmachr, Zaritsky, and Ascher published their article in 1998, the IRS updated its Publication 555 on community property to specifically provide that "[t]his publication does not address the federal tax treatment of income or property subject to the 'community property' election." It is unknown whether the IRS will take a closer look at whether an "opt-in" Community Property Trust will be afforded a step-up in basis to all trust assets in light of the advent of elective Community Property Trust systems, and that Florida has implemented an elective Community Property Trust regime which will open this planning tool to many more married couples who may have family, friends, or advisors in Florida who can serve as trustees so as to avoid paying trust company fees for a Community Property Trust.

Commentators who urge caution point to the 1944 U.S. Supreme Court decision of *Commissioner v. Harmon*[xxxiii], which involved a married couple who opted into community property treatment under an Oklahoma law that was passed to allow married couples living there to elect whether to have community property characterization apply to their assets.

Before 1948, married couples could not file joint federal income returns, so each spouse would file a separate return and the spouse with more income would be in a higher tax bracket. Married couples living in community property states were nevertheless able to divide their income from community property equally on income tax returns, giving them an advantage over married couples living outside of community property states.

The U.S. Supreme Court held in *Harmon* that the act of electing into the community property regime constituted an "assignment of income" and quoted the 1930 United States Supreme Court case of *Lucas v. Earl*. *Lucas v. Earl* is one of the most famous United States Supreme Court tax cases, and provides that a taxpayer cannot avoid taxation on income by assigning in advance of receipt.[xxxiv]

While some read this case to indicate that it may not be possible to elect into community property status to receive tax advantages, the *Harmon* decision is somewhat vague and seems to base its conclusion on the fact that the Oklahoma statute "permits voluntary action which effects a transfer of rights of the husband and wife, and that the situation is governed by *Lucas v. Earl* and other decisions of like import."[xxxv] In essence, the majority opinion distinguished community property treatment applicable by operation of law upon marriage from community property treatment that applies "by contract" such as where an election is made by the married couple.

In contrast, Howard Zaritsky has noted that "I think the JEST is a great technique for what it is seeking to do. It is a way to minimize the problems of 1014(e)."[xxxvi]

In a well-written dissent to the *Harmon* decision, Justice Douglas's decision noted that the federal income tax law discriminates in favor of community

property states and claimed that the Court's distinction between "consensual" and "legal" community property systems had no practical basis and could not be consistently maintained for federal tax purposes.[xxxvii] Justice Douglas went on to opine that "[t]he only apparent basis for such discrimination is that the community property systems in the eight states are traditional; that those eight states have a well settled policy; that Oklahoma merely gives its citizens a choice to get under or stay out of its community property system, Yet how can we say that the state which allows husband and wife to revoke or alter its community property system by contract has a more 'settled' policy towards community property than a state which gives husband and wife the choice to invoke its community property system or to keep their marital property on a common law basis? The truth is that there is a wide range of choice in each. But the fact that there is a choice should not be deemed fatal when Oklahoma's case comes before the Court..."[xxxviii]

The 1958 United States District Court decision of *McCollum v. United States* seems to support the proposition that the 1014(b)(6) step-up in basis will apply to community property created as a result of an election made by the spouses. In *McCollum*, a married couple elected under the then-applicable 1943 Oklahoma law to treat their assets as community property, and in 1945 Oklahoma changed its law to require that all of a married couple's assets had to be considered to be community property.[28] Mr. McCollum died after the community property status became mandatory and Mrs. McCollum took a full step-up in basis for the full value of the community property that existed on Mr. McCollum's date of death. The court allowed the full step-up in basis.

The *McCollum* decision seems consistent with the notion that Section 1014(b)(6) applies to elective community property as well as mandatory community property. Although Oklahoma had a mandatory community property system, by the time the decision was reached, and because the property at issue was acquired before the change of law in 1945, the property would not have been community property under the 1945 Oklahoma community property law, except by reason of the fact that the McCollum's had previously designated it as community property under the elective system.

Internal Revenue Code Section 1014 was enacted in 1948, only four (4) years after the Supreme Court decision in *Harmon*, and it is therefore possible that Congress recognized the issue by enacting Section 1014(b)(6). This is evidenced by the fact that Congress made no mention in the statutory language and provided no legislative history that would distinguish between elective and mandatory community property systems that existed when the statute was updated. Section 1014(b)(6) is very clear that the step-up in basis applies to the surviving spouse's share of community property "held by the decedent and the surviving spouse under the community property laws of any State, or possession of the United States or any foreign country…" (emphasis added), without distinction for elective community property laws or without regard to unique characteristics that a State might have with respect to its community property laws (such as creditor protection features).

A 1977 Revenue Ruling discusses the differences between separate property and community property income, and references the *Harmon* case vis-a-vis the issue of whether income generated by separate property has become community property by agreement between the spouses.[xxxix] "To the extent that the agreement affects the income from separate property and not the separate property itself, the Service will not permit the spouses to split that income for Federal income tax purposes where they file separate income tax returns. See *Commissioner v. Harmon*, 323 U.S. 44 (1944), 1944 C.B. 166." The Ruling acknowledges that property converted from separate property to community property is community property for federal tax purposes, and makes no mention as to whether the Service will distinguish between elective and mandatory community property systems.

Blattmachr, Zaritsky, and Ascher conclude as follows on the step-up in basis tax issues:

> Because the Alaska Community Property law's treatment under Section 1014(b) remains untested, a couple seeking a full step-up in basis when the first spouse dies should preferably place all of their assets in the name of the spouse who is expected to die first. Unfortunately, crystal balls are scarce. Moreover, no change in basis occurs when a donor gives property to the decedent within a year of death and then acquires it directly or indirectly.[xl]

There are no known cases or audits, so the risk of this being an issue as a practical matter may be quite small. Nevertheless, the issue will have a larger profile on the IRS's radar now that Florida and its citizenry will be entering into this arena.

For those looking for reassurance, in a June 29th Florida Bar Real Property, Probate, and Trust Law Section presentation entitled “An Examination of the New Florida Community Property Trust Act”, Travis Hayes and Robert Lancaster stated that “The IRS is silent on the federal tax treatment of property subject to the community property election... silence doesn’t mean ineffective... as it stands to date, Alaska established these in 1998, Tennessee in 2010, and there are no known cases where the IRS has challenged these opt-in Community Property Trusts. And you know, I know from my personal discussions with trustees in those jurisdictions, that they’ve not had any situation where they did not get the basis adjustment either.”

An additional concern with respect to Florida's Community Property Trust Act is whether it is possible to have community property when the assets are not 100% accessible to the creditors of one spouse. Because Alaska and South Dakota allow creditors of one spouse to access 100% of the assets held in a Community Property Trust, assets held in Community Property Trusts in those states are treated more like traditional community property than with a Tennessee, Kentucky, or Florida Community Property Trust. Few articles have been written on this subject, and no definitive authority on this issue exists, but it is a possible argument that the IRS could use to support the proposition that Florida's "elective community property" statute does not result in the assets held under the trust being "real community property." Therefore, in the abundance of caution, it may be safer to use an Alaska or South Dakota Community Property Trust for purposes of receiving the Section 1014(b)(6) double stepped-up basis, although the authors do not believe that any such IRS argument would have any merit due to Section 1014(b)(6) not making any distinction between the types of community property laws of the States.

Conclusion

In conclusion, the Florida Community Property Trust Act should be well understood by estate and tax planning professionals based in Florida, or

who have Floridian clients or clients with Florida ties, as a potential tool that will benefit married couples who have substantially appreciated assets and would like to avoid federal income tax by being able to sell the assets after the death of the first dying spouse. In addition, estate and tax planners throughout the United States should be somewhat familiar with the various Community Property Trust acts in order to determine which state will be most appropriate for clients for whom the Community Property Trust would be a good fit.

Given that all five states have statutes which are probably effective to provide a full step-up in basis upon the first dying spouse's death, the main criteria may be what family members or advisors or trust companies would be preferable trustees. A secondary consideration might be whether all assets held under a Community Property Trust are accessible to creditors, such as using a state (Florida, Kentucky, or Tennessee) that does not expose 100% of the Community Property Trust assets to creditors, versus using a state (Alaska or South Dakota) that exposes all of the Community Property Trust assets to creditors.

Perhaps more importantly, the new Act will cause advisors to discuss basis step-up and logistical planning with clients. A great many Florida lawyers suggest that their clients use predominantly one type of arrangement, such as where each spouse has a separate revocable trust, or the spouses share a joint trust that does not provide a full step-up on the first death. Many lawyers still favor joint ownership of assets without using revocable trusts. Well informed clients with similar circumstances will commonly choose different systems based upon their orientation, appreciation of tax planning strategies, and their perception of cost considerations and complexity.

Perhaps most importantly, The Florida Community Property Trust Act is a reminder that "one size will not fit all" and that married Floridians and other clients should have tailor-made estate plans to better protect and benefit themselves and their families while effectuating their wishes.

Married Couples Trust Decision Chart

	JEST (Joint Exempt Step-Up Trust)	**Tenants by the Entireties Trust**	**Joint Trust – Not TBE, JEST, or CPT**	**Florida Community Property Trust**	**Tennessee Community Property Trust**	**South Dakota Community Property Trust**	**Alaska Community Property Trust**	**Kentucky Community Property Trust**
Step-Up in Basis After First Death	Probably Yes	Only Half of a Step-Up	Depends Upon Drafting and Logistics	Probably Yes	Probably Yes	Probably Yes	Probably Yes	Probably Yes
Creditors of One Spouse Can Reach Trust Assets	Yes – the Debtor Spouse's Share	Protected from Either Spouse's Creditors	Depends Upon Trust Drafting	One-Half of Trust Assets Exposed to One Spouse's Creditors	One-Half of Trust Assets Exposed to One Spouse's Creditors	All of Trust Assets Exposed to One Spouse's Creditors	All of Trust Assets Exposed to One Spouse's Creditors	One-Half of Trust Assets Exposed to One Spouse's Creditors
Can Create Credit Shelter Trust With More Than Half of the Trust Assets	Yes, All Trust Assets May Go Into Credit Shelter Trusts	Up to Half, But Only by Disclaimer or Surviving Spouse Will Not Have a Power of Appointment	Depends Upon Drafting – Be Careful!	Only as to One-Half	Only as to One-Half	Only as to One-Half	Only as to One-Half	Only as to One-Half
May Share Upon Divorce as Set Forth in Pre- or Post-Nuptial Agreement	Yes	Probably Not	Yes	Yes – Spouses can agree on the dissolution of property Fla Stat. 736.1508	Yes – Spouses can agree on the dissolution of property	Yes – Spouses can agree on the dissolution of property	Yes – Spouses can agree on the dissolution of property	Yes – Spouses can agree on the dissolution of property
May Be Converted from Former Joint or Individual Trust	Yes	Yes	N/A	No – Must Be Created On or After July 1, 2021 as a new Florida Community Property Trust	N/A	Yes	Yes	Yes
Complicated to Draft?	Yes	Simpler than JEST	Will Depend Upon Specifics	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed
Requires a "Qualified" Trustee	No	No	No	Yes	Requires a Tennessee Trustee	Requires a South Dakota Trustee	Requires an Alaska Trustee	Requires a Kentucky Trustee

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
Florida	**(1)** Expressly declares that the trust is a community property trust within the meaning of this part **(2)** Has at least one trustee who is a qualified trustee, provided that both spouses or either spouse also may be a trustee **(3)** Is signed by both settlor spouses consistent with the formalities required for the execution of a trust under this chapter. **(4)** Contains substantially the following language in capital letters at the beginning of the community property trust agreement: THE CONSEQUENCES OF THIS COMMUNITY PROPERTY TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT	(1)An obligation incurred by only one spouse before or during the marriage may be satisfied from that spouse's one-half share of a community property trust. (2) An obligation incurred by both spouses during the marriage may be satisfied from a community property trust of the settlor spouses.	All property owned by a community property trust is community property under the laws of the state during the marriage of the settlor spouses.	**36.1511 Application of Internal Revenue Code; community property classified by another jurisdiction**.--For purposes of the application of s. 1014(b)(6) of the Internal Revenue Code of 1986, 26 U.S.C. s. 1014(b)(6), as of January 1, 2021, a community property trust is considered a trust established under the community property laws of the state. Community property, as classified by a jurisdiction other than this state, which is transferred to a community property trust

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
	NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND UPON THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD BE SIGNED ONLY AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK COMPETENT AND INDEPENDENT LEGAL ADVICE.			retains its character as community property while in the trust. If the trust is revoked and property is transferred on revocation of the trust, the community property as classified by a jurisdiction other than the state retains its character as community property to the extent otherwise provided by ss. 732.216-732.228.
South Dakota	An arrangement is a South Dakota special spousal trust if 1) one or both spouses in a marriage transfer property to a trust, 2) the trust expressly declares that some or all the property transferred is South Dakota special spousal property as provided in this chapter, 3) and at least one trustee is a qualified person. A South Dakota special spousal trust is enforceable without consideration. Both spouses, or either spouse, may be a trustee. The trust must be signed by both spouses. The trust may be revocable or irrevocable. For purposes of this section, a qualified person is any person who meets the requirements of §§ 55-3-41 and 55-3-39, but without regard to whether that person is the transferor. 4) A South Dakota special spousal trust shall contain the following language in capital letters at the beginning of the trust: THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND AT THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK INDEPENDENT LEGAL ADVICE.	Notwithstanding anything contained in § 55-17-9 to the contrary: (1) A provision of a revocable South Dakota special spousal property trust does not adversely affect the interest of a creditor unless the creditor has actual knowledge of the trust when the obligation to the creditor is incurred. The interest of a creditor in an irrevocable South Dakota special spousal property trust may be subject to the rights and liabilities of a creditor with respect to transfers under chapter 55-16 as provided in § 55-17-6; (2) A spouse shall act in good faith with respect to the other spouse in matters involving South Dakota special spousal property. The obligation under and effect of this section may not be varied by a South Dakota special spousal property trust.	The trustee of a South Dakota special spousal trust shall maintain records that identify which property held by the trust is South Dakota special spousal property and which property held by the trust is not South Dakota special spousal property.	For purposes of the application of § 1014(b)(6) of the Internal Revenue Code of 1986, 26 U.S.C. § 1014(b)(6), as of January 1, 2016, a South Dakota special spousal trust is considered a trust established under the community property laws of South Dakota. For purposes of this chapter, the term, special spousal property, means community property for those purposes. Community property as classified by a jurisdiction other than South Dakota transferred to a South Dakota special spousal trust retains its character as community property while in the trust. If the trust is revoked and property is transferred on revocation of the trust, the community property as classified by a jurisdiction other than South Dakota retains its character as community property to the extent otherwise provided by South Dakota law.
Alaska	(a) A community property agreement must be contained in a written document signed by both spouses and classify some or all of the property of the spouses as	(j) An obligation incurred by only one spouse before or during marriage may be satisfied only from the	(h) The trustee of a community property trust shall maintain	N/A

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
	community property. It is enforceable without consideration. (b) A community property agreement must contain the following language in capital letters at the beginning of the agreement: THE CONSEQUENCES OF THIS AGREEMENT MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE. (c) A community property agreement may not adversely affect the right of a child to support.	property of that spouse that is not community property and from that spouse's interest in community property. This subsection does not apply to an obligation described in (b) of this section. (k) An obligation incurred during marriage by both spouses may be satisfied from property of each spouse that is not community property and from the community property.	records that identify which property held by the trust is community property and which property held by the trust is not community property.	
Tennessee	An arrangement is a community property trust if one or both spouses transfer property to a trust, that: (1) Expressly declares that the trust is a Tennessee community property trust; (2) Has at least one (1) trustee who is a qualified trustee whose powers include, or are limited to, maintaining records for the trust on an exclusive or a nonexclusive basis and preparing or arranging for the preparation of, on an exclusive or a nonexclusive basis, any income tax returns that must be filed by the trust. Both spouses or either spouse may be a trustee; (3) Is signed by both spouses; and (4) Contains the following language in capital letters at the beginning of the trust: THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY	(a) An obligation incurred by only one spouse before or during marriage may be satisfied from that spouse's one-half (1/2) share of a community property trust. (b) An obligation incurred by both spouses during marriage may be satisfied from a community property trust of the spouses.	(c) All property owned by a community property trust will be community property during marriage.	N/A

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
	QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.			
Kentucky	Any arrangement between spouses involving community property shall be considered a community property trust if one (1) or both spouses transfer property to a trust that: (a) Expressly declares that the trust is a Kentucky community property trust that meets the requirements of Sections 1 to 3 of this Act; (b) Has at least one (1) trustee who is a qualified trustee whose powers include or are limited to maintaining records for the trust, on an exclusive or a nonexclusive basis, and preparing or arranging for the preparation of, on an exclusive or a nonexclusive basis, any income tax returns that must be filed by the trust. Both spouses or either spouse may be a trustee; (c) Is signed by both spouses; and (d) Contains the following language in capital letters at the beginning of the trust: THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING BUT NOT LIMITED TO YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.	(1) An obligation incurred by only one (1) spouse before or during marriage may be satisfied from that spouse's one-half (1/2) share of a community property trust. (2) An obligation incurred by both spouses during marriage may be satisfied from a community property trust of the spouses	All property owned by a community property trust shall be considered community property during marriage and the right to manage and control property that is transferred to a community property trust shall be determined by the terms of the trust.	N/A

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

Alan Gassman

Chris Denicolo

CITE AS:

LISI Estate Planning Newsletter #2893 (July 8, 2021) at www.leimbergservices.com Copyright 2021 Leimberg Information Services, Inc. (LISI). Reproduction in Any Form or Forwarding to Any Person Prohibited Without Express Permission. This newsletter is designed to provide accurate and authoritative information regarding the subject matter covered. It is provided with the understanding that LISI is not engaged in rendering legal, accounting, or other professional advice or services. If such advice is required, the services of a competent professional should be sought. Statements of fact or opinion are the responsibility of the authors and do not represent an opinion on the part of the officers or staff of LISI.

CITATIONS:

---

[i] https://www.irs.gov/irm/part25/irm_25-018-001.

[ii] Jonathan G. Blattmachr, Howard M. Zaritsky, and Mark L. Ascher, Tax Planning with Consensual Community Property: Alaska's New Community Property Law, 33 Real Prop. Prob. & TR. J. 615 (1998) Page 631.

[iii] Rev. Rul. 66-283, 1966-2 C.B. 297 (IRS RRU 1966). "For purposes of section 1014(b)(6) of the Code, *H* and *W* are considered as continuing to own the property transferred by them to the revocable trust as their

community property.”

[iv] Steve R. Akers, ACTEC 2013 Fall Meeting Musings, November 2013, pg. 8.

[v] *Id.*

[vi] **Error! Main Document Only.**These 16 states are as follows: Alaska, Arkansas, Colorado, Connecticut, Florida, Hawaii, Kentucky, Michigan, Minnesota, Montana, New York, North Carolina, Oregon, Utah, Virginia, and Wyoming. North Dakota legislators have recently introduced a bill that would make them the 17th state to adopt the Uniform Disposition of Community Property Rights at Death Act.

[vii] *See* David Westfall & George P. Mair, *Estate Planning Law and Taxation*, 2000/2001 Financial Professional’s Edition (4th Ed.) Page 4-13. “[T]he fact that the application of the Alaska Community Property Act is elective makes it doubtful that the act will have the effect of creating community property for federal tax purposes.” *See also* William Roberts, *A Cautionary Tale Community Property Trusts*, Tennessee Bar Association (Sept. 6, 2011)

[viii] Quintana v. Ordono, 195 So. 2d 577, 578 (Fla. Dist. Ct. App. 1967)

[ix] *Id.*

[x] Rev. Rul. 87-98, 1987-2 C.B. 206 (IRS RRU 1987). “If property held in a common law estate is community property under state law, it is community property for purposes of section 1014(b)(6) of the Code, regardless of the form in which title was taken.”

[xi] Bloomberg Tax & Accounting, Community Property: General Consideration (Portfolio 802)

[xii] https://www.irs.gov/irm/part25/irm_25-018-004

[xiii] Nev. Rev. Stat. tit. 11, § 123.050.

[xiv] N.M. Stat. Ann. § 40-3-10.A.

[xv] https://www.irs.gov/irm/part25/irm_25-018-004

[xvi] *Id.*

[xvii] Bloomberg Tax & Accounting, Community Property: General Consideration (Portfolio 802)

[xviii] For an excellent discussion of creditor's rights with respect to Texas community property, see Thomas M. Featherston, Jr, *Creditors' Rights in and to the Marital Estate: What Property is Liable for which Debts?¸*2013 Advanced Estate Planning and Probate Course, State Bar of Texas, June 26, 2013.

[xix] *Id.*

[xx] *Id.* at page 9.

[xxi] Karen Boxx. "The Use of Joint Revocable Trusts for Married Couples". June 2016.

[xxii] *Id.*

[xxiii] "Revocable Trust Execution Requirements: A Notary is Not Needed" By Jeff Baskies and Mary Karr. The Real Property, Probate & Trust Law Section of the Florida Bar. April 29, 2020.

[xxiv] Florida's Charging Order Statute, Section 605.0503, provides the following "[A] charging order is the sole and exclusive remedy by which a judgment creditor of a member or member's transferee may satisfy a judgment from the judgment debtor's interest in a limited liability company or rights to distributions from the limited liability company."

Section 605.0503(6) further provides that: "In the case of a limited liability company that has more than one member, the remedy of foreclosure on a judgment debtor's interest in the limited liability company or against rights to distribution from the limited liability company is not available to a judgment creditor attempting to satisfy the judgment and may not be ordered by a court."

[xxv] Stone v. Stone, 157 So. 3d 295, 305 (Fla. Dist. Ct. App. 2014)

[xxvi] In re Bosonetto, 271 B.R. 403 (Bankr. M.D. Fla. 2001)

[xxvii] Under the Portability rules, the portion of the first dying spouse's $11,700,000 estate tax exemption (or whatever the exemption amount will be at that time) can be used by the surviving spouse, but the portability allowance (1) does not go up with inflation; (2) will be lost if the surviving spouse remarries someone who then dies before the surviving spouse and leaves no portability allowance; and (3) does not provide the same creditor protection for the surviving spouse as having a credit shelter trust funded.

[xxviii] *Id.*

[xxix] Alan Gassman, Christopher Denicolo and Kacie Hohnadell. "JEST Offers Serious Estate Planning Plus for Spouses – Part 1". Estate Planning Magazine. September 9, 2013., Susan L. Racey, "Joint Revocable Trusts", 20 OHPRLF 77 (2008).

[xxx] *In re Givans*, 623 B.R. 635 (Bankr. M.D. Fla. 2020)

[xxxi] Hunt v. Covington, 145 Fla. 706, 708, 200 So. 76, 77 (Fla. 1941).

[xxxii] Jonathan G. Blattmachr, Howard M. Zaritsky, and Mark L. Ascher, Tax Planning with Consensual Community Property: Alaska's New Community Property Law, 33 Real Prop. Prob. & TR. J. 615 (1998) Page 631.

[xxxiii] *Commr. of Internal Revenue v. Harmon*, 323 U.S. 44 (1944)

[xxxiv] *Id.* at 46. "Under Lucas v. Earl an assignment of income to be earned or to accrue in the future, even though authorized by state law and irrevocable in character, is ineffective to render the income immune from taxation as that of the assignor. On the other hand, in those states which, by inheritance of Spanish law, have always had a legal community property system, which vests in each spouse one half of the community income as it accrues, each is entitled to return one half of the income as the basis of federal income tax"

[xxxv] Jonathan G. Blattmachr, Howard M. Zaritsky, and Mark L. Ascher, Tax Planning with Consensual Community Property: Alaska's New Community Property Law, 33 Real Prop. Prob. & TR. J. 615 (1998) Pg. 626.

[xxxvi] 49th Annual Heckerling Institute on Estate Planning, Gassman, Crotty & Denicolo, The Thursday Report, January 15, 2015. "On the First Day of Heckerling..."

https://gassmanlaw.com/thursday-reports/thursday-report-1-15-15-first-day-heckerling/

[xxxvii] *Commr. of Internal Revenue v. Harmon*, 323 U.S. 55-56 (1944) (J. Douglas dissenting)

The *Harmon* Court distinguished between "Consensual community property," which arises out of contract and "legal community property," which arises by incident of marriage through the inveterate policy of the state.

[xxxviii] *Id.* at 55–56. (J. Douglas dissenting).

[xxxix] Rev. Rul. 77-359, 1977-2 C.B. 24 (IRS RRU 1977). "Accordingly, where a husband and wife residing in the State of Washington agree in writing that all presently owned property and all property to be acquired thereafter, both real and personal, will be community property, such agreement changes the status of presently owned separate property and subsequently acquired separate property to community property.

[xl] Jonathan G. Blattmachr, Howard M. Zaritsky, and Mark L. Ascher, Tax Planning with Consensual Community Property: Alaska's New Community Property Law. Pg. 633.